



Annual Report 2011

ANNUAL REPORT 2011

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Supervisory Board and senior officers of the Central Bank of Iceland (photo taken 23 February 2012). From left: Jón Þ. Sigur­geirsson Secretary of the Supervisory Board, Már Guðmundsson Governor, Friðrik Már Baldursson, Ingibjörg Ingvadóttir, Rag­nar Arnalds Deputy Chairman, Lára V. Júlíusdóttir Chairman of the Supervisory Board, Ragnar Árnason, Hildur Traustadóttir, Björn Herbert Guðbjörnsson, Arnór Sighvatsson Deputy Governor and Þórarinn G. Pétursson Chief Economist.

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The Central Bank of Iceland

Kalkofnsvegur 1, 150 Reykjavík, Iceland

Tel: (+354) 569 9600, fax: (+354) 569 9605

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I Objectives and policy

As is stated in the Act on the Central Bank of Iceland (Act no. 36/2001, with subsequent amendments), the Bank's principal objective is to promote price stability. By agreement with the Minister of Economic Affairs, the Bank is authorised to declare a numerical inflation target. The inflation target is defined in a joint declaration issued by the Icelandic Government and the Central Bank of Iceland on 27 March 2001 as a 2½% rise in the price of goods and services over the previous 12 months (as measured by the consumer price index).¹ The Central Bank Act grants the Bank full independence to implement monetary policy so as to achieve this objective; however, it also states that the Bank shall contribute to the implementation of the Government's economic policy unless it considers that policy inconsistent with its own objective of promoting price stability. Moreover, the Act states that the Bank shall 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. The Act also clarifies provisions on accountability, transparency of monetary policy, and the Bank's activities in general.²

Because of the extraordinary circumstances that developed after the banks' collapse in the fall of 2008, exchange rate stability (in part through the support of capital account restrictions) became one of the key factors in the monetary policy devised jointly by the Government, the Central Bank, and the International Monetary Fund (IMF). The capital account liberalisation process is currently underway, and the inflation target has attained greater importance in monetary policy as the effects of the financial crisis diminish.

Monetary policy

Monetary policy implementation is based on the Central Bank's inflation forecast, prepared over a horizon of three years. The forecast is published in the Bank's *Monetary Bulletin*, which was issued four times in 2011. *Monetary Bulletin* includes an in-depth analysis of economic and monetary developments and prospects as well as the Bank's forecast.

The most recent amendment to the Central Bank Act, in 2009, provided for a five-member Monetary Policy Committee whose task is to take decisions on the application of monetary policy instruments. In this context, the Bank's monetary policy instruments are its interest rate decisions, transactions with credit institutions other than loans of last resort, decisions on reserve requirements, and foreign exchange market transactions. The Committee has adopted rules of procedure that have been approved by the Bank's Supervisory Board.³ The

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. The Bank's tasks and activities are further described in various sections of the present report.

3. The Rules of Procedure for the Monetary Policy Committee can be found on the Central Bank website.

Governor is the chair of the Monetary Policy Committee, which also includes the Deputy Governor, a senior Central Bank executive in the field of monetary policy formation (currently the Chief Economist), and two other economic and monetary experts appointed by the Minister of Economic Affairs.

In 2011 there were eight interest rate decision dates, four of which were also publication dates for *Monetary Bulletin*. Interest rate decision dates are announced in advance; however, the Committee is authorised to change the announced dates or schedule additional ones.

Financial stability

The Central Bank attempts to maintain a constant, clear overview of the position of credit institutions and financial markets, and in its twice-yearly *Financial Stability* report, it publishes a detailed analysis of factors relating to financial stability. In addition, the Central Bank promotes an efficient and secure financial system by ensuring that Icelandic payment and settlement systems operate in line with internationally recognised standards.

As authorised by law, the Central Bank has set rules on minimum liquidity of credit undertakings and on their foreign exchange balance. The Bank carries out transactions with credit institutions, both receiving deposits from them and granting them loans. 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.

Foreign exchange reserves, foreign borrowing, and currency issues

The Central Bank invests the nation's foreign exchange reserves. The reserves are intended to enhance security in transactions between Iceland – particularly the State and parties with a State guarantee – and other countries, and they are handled in accordance with special rules set by the Governor and confirmed by the Supervisory Board, covering topics such as investment and security. The Central Bank is authorised to borrow funds in order to reinforce the foreign exchange reserves and to participate in international co-operation, in part for this purpose. The Bank is also authorised by law to act as an advisor to the Government on matters pertaining to foreign exchange, including foreign borrowings.

II Monetary policy

According to the Act on the Central Bank of Iceland, the Central Bank's principal objective is to promote price stability. This objective is further described in the joint declaration issued by the Bank and the Icelandic Government on 27 March 2001 as an inflation target of 2½%. The Central Bank shall also promote the economic policy of the Government as long as it is not inconsistent with the price stability objective.

Interest rate, exchange rate, and inflation developments

At the beginning of 2011, the deposit rate (current account rate) was 3.5% and the maximum bid rate for 28-day certificates of deposit (CDs) was 4.25%.¹ At that time, the Bank's collateralised lending rate was 4.5%. The Central Bank of Iceland Monetary Policy Committee lowered interest rates in February 2011 and kept them unchanged until August. Rates were raised twice in the latter half of the year, however, by 0.25 percentage points on both occasions. Following the MPC's December 2011 interest rate decision, the current account rate was 3.75%, the maximum rate on 28-day CDs was 4.5%, and the collateralised lending rate was 4.75% (see Chart II-1).

The two rate hikes were implemented because of the marked deterioration of the inflation outlook, which raised Committee members' concerns that higher inflation expectations and a weak currency could cause inflation to become entrenched, particularly as economic recovery gained momentum.

The Bank's real interest rates fell, however, in spite of the nominal rate hikes. As of end-December 2011, the real policy rate measured about -1% in terms of twelve-month inflation and -½% in terms of the average of various measures of inflation and inflation expectations, more than 2 percentage points lower than at the beginning of the year. The relaxed monetary stance has therefore supported the economic recovery. In terms of the trade-weighted exchange rate index (TWI), the króna depreciated by about 4.3% over the course of the year, by some 3.2% against the euro and 6.2% against the US dollar (see Chart II-2).

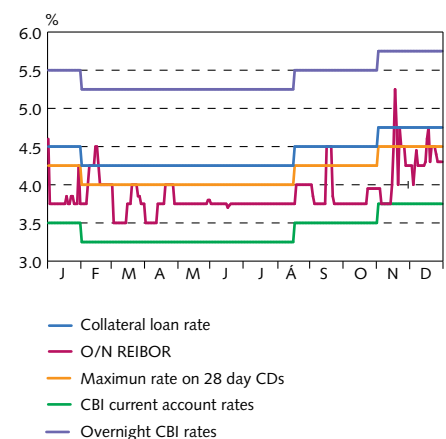
In spite of the slack in the economy, inflation rose during the year, driven mainly by rising house prices, increased inflationary pressures following contractual pay increases, and elevated global oil and commodity prices, together with a weak króna. At the beginning of 2011, twelve-month inflation measured 2.5% in terms of the CPI, and underlying twelve-month inflation (inflation excluding the effects of consumption taxes, volatile items such as food and petrol, public services, and mortgage interest) was 1% (see Chart II-3). Inflation rose rapidly early in the year, peaking at 5.7% in September and then tapering off to 5.3% by year-end. On the other hand, underlying inflation continued to rise, reaching 5% in December 2011.

Table II-1 Central Bank of Iceland interest rates 2011 (%)

Date	Current account	28-day CDs (max)	7-day collateral	Over-night lending rate
7 Dec.	3.75	4.50	4.75	5.75
2 Nov.	3.75	4.50	4.75	5.75
21 Sep.	3.50	4.25	4.50	5.50
17 Aug.	3.50	4.25	4.50	5.50
15 June	3.25	4.00	4.25	5.25
20 April	3.25	4.00	4.25	5.25
16 March	3.25	4.00	4.25	5.25
2 Feb.	3.25	4.00	4.25	5.25

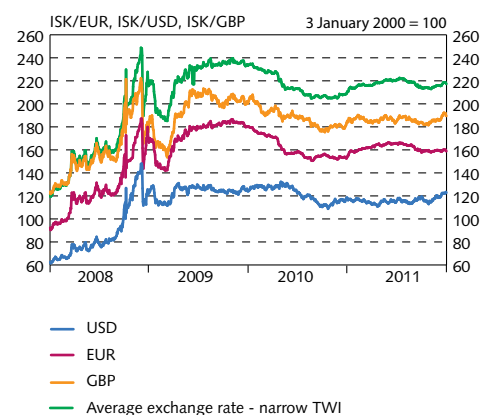
Source: Central Bank of Iceland.

Chart II-1
Central Bank of Iceland interest rates and short-term market rate
Daily data 1 January - 30 December 2011



Source: Central Bank of Iceland.

Chart II-2
Exchange rate of the króna
Daily data 3 January 2008 - 30 December 2011



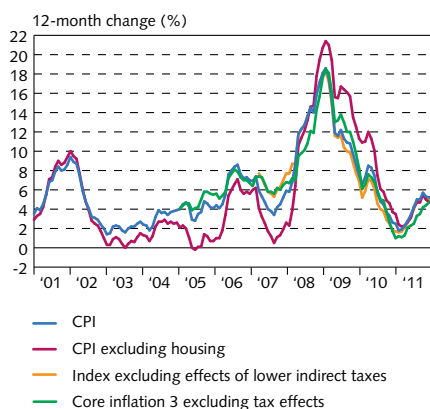
Source: Central Bank of Iceland.

1. Since early 2009, these rates have been the most effective measure of the monetary stance because banking system lending has been very limited.

Chart II-3

Inflation: various measurements

January 2001 - December 2011



Monetary policy decisions and the rationale behind them

In Iceland, the Central Bank is obliged by law to publish reports on its monetary policy; on monetary, exchange rate, and foreign exchange developments; and on its measures in these areas. In its quarterly *Monetary Bulletin*, the Bank reports on the economic and monetary outlook. *Monetary Bulletin* is an English translation of *Peningamál*.

The Act on the Central Bank of Iceland requires that the Bank's Monetary Policy Committee make public the minutes of its meetings and that it explain its decisions and the rationale behind them. The MPC publishes the minutes of its meetings two weeks after each interest rate decision is announced. The minutes contain the Committee's assessment of the status and outlook in economic and monetary matters and the members' reasons for their votes.

The Act also stipulates that, twice yearly, the Monetary Policy Committee shall submit to Parliament a report on its activities and that the contents of the report shall be discussed in the Parliamentary committee of the Speaker's choosing.

To pursue forward-looking monetary policy, a central bank needs models for assessing the economic outlook, especially inflation. A considerable share of the research done at the Central Bank of Iceland is devoted to this task. At the beginning of 2006, the Bank's economists began using a quarterly macroeconomic model (QMM) that illustrates the main channels for monetary policy transmission. While the QMM is constantly under development, also in progress is the development of a new dynamic stochastic general equilibrium (DSGE) model, which is more suitable for economic policy simulations and will be used alongside the QMM. One means of enhancing transparency is to publish the QMM and its database on the Bank's website.

The Monetary Policy Committee and its decisions

According to the amended Central Bank Act, which entered into force on 27 February 2009, a monetary policy committee shall take decisions on the application of the Bank's monetary policy instruments, which include decisions on interest rates, specified transactions with credit institutions, determination of reserve requirements, and foreign exchange market transactions intended to influence the exchange rate of the króna.

By law, the Monetary Policy Committee is chaired by the Governor of the Central Bank. In 2011, Committee members were Governor Már Guðmundsson, Deputy Governor Arnór Sighvatsson, Chief Economist Þórarinn G. Pétursson, Professor Anne Sibert of Birkbeck College in the UK, and Professor Gylfi Zoëga of the University of Iceland.

Interest rate decisions 2011

The Central Bank Act requires that the Monetary Policy Committee meet at least eight times each year. Eight meetings were held during the year. The Committee's decisions were as follows:²

2. The members' arguments are presented in the minutes of the meetings.

2 February: The Governor proposed that the Bank's interest rates be lowered by 0.25 percentage points. All Committee members voted in favour of the Governor's proposal, although Gylfi Zoëga would have preferred a rate cut of an additional 0.25 percentage points. He decided to vote in favour of the Governor's proposal, however, due to the small difference between the two.

16 March: The Governor recommended that the Bank's interest rates be held unchanged. Anne Sibert, Arnór Sighvatsson, and Þórarinn G. Pétursson voted in favour of the Governor's proposal, although Þórarinn G. Pétursson would have preferred to lower rates by 0.25 percentage points. He decided to vote in favour of the Governor's proposal, however, due to the small difference between the two. Gylfi Zoëga voted against the Governor's proposal, voting instead in favour of a rate cut of 0.25 percentage points.

20 April: The Governor recommended that the Bank's interest rates be held unchanged. Arnór Sighvatsson, Gylfi Zoëga, and Þórarinn G. Pétursson voted in favour of the Governor's proposal, while Anne Sibert voted against it, voting instead in favour of a rate increase of 0.25 percentage points.

15 June: The Governor recommended that the Bank's interest rates be held unchanged. All members voted in favour of the proposal, although Anne Sibert would have preferred a rate hike of 0.25 percentage points. She decided to vote in favour of the Governor's proposal, however, due to the small difference between the two.

17 August: The Governor proposed that the Bank's interest rates be raised by 0.25 percentage points. Arnór Sighvatsson and Þórarinn G. Pétursson voted in favour of the Governor's proposal, while Gylfi Zoëga voted against it, voting instead in favour of unchanged interest rates. Anne Sibert was not in attendance.

21 September: The Governor recommended that the Bank's interest rates be held unchanged. Anne Sibert, Arnór Sighvatsson, and Gylfi Zoëga voted in favour of the Governor's proposal, while Þórarinn G. Pétursson voted against it, voting instead in favour of a rate increase of 0.25 percentage points.

2 November: The Governor proposed that the Bank's interest rates be raised by 0.25 percentage points. Anne Sibert, Arnór Sighvatsson, and Þórarinn G. Pétursson voted in favour of the Governor's proposal, while Gylfi Zoëga voted against it, voting instead in favour of unchanged interest rates.

7 December: The Governor recommended that the Bank's interest rates be held unchanged. All Committee members voted in favour of the proposal.



III The financial system

One of the Central Bank of Iceland's legally mandated roles is to promote a safe, effective financial system. In other words, the Bank must promote financial stability. Financial stability means that the financial system is equipped to withstand shocks to the economy and financial markets, to mediate credit and payments, and to mitigate risks appropriately. A healthy financial system is a prerequisite for positive economic developments and effective monetary policy.

Organisational changes

During the year, the Financial Stability Department was split into two departments: Financial Stability and Payment Systems. The role of the Payment Systems Department is to contribute to the safety and efficiency of systemically important payment systems, issue and administer banknotes and coin, and operate the Bank's vaults. One Central Bank subsidiary, Greiðsluveitan ehf., operates under the auspices of the department.

The Financial Stability Department's main tasks centre on analysis of financial system risk and participation in the formulation of precautionary rules for the financial system. The department has also placed increased emphasis on analysing household and corporate balance sheets.

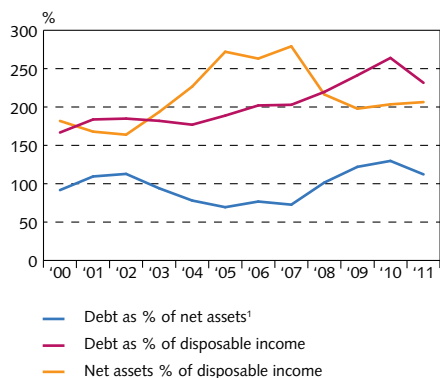
Financial Stability

The Financial Stability Department participates in policy-making concerning both financial system structure and the objectives, tools, and structure of financial stability in Iceland. It interacts closely with the institutions involved with domestic financial stability, particularly the Financial Supervisory Authority, and participates in broad-based international cooperation.

New cooperation agreement with the Financial Supervisory Authority

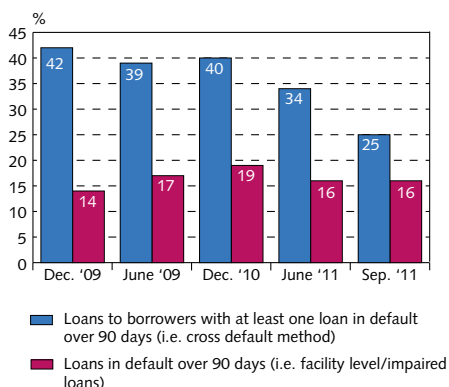
A new cooperation agreement between the Central Bank of Iceland and the Financial Supervisory Authority took effect at the beginning of 2011. The agreement emphasises explicit definition of the responsibilities of each institution and the division of tasks between them. It also aims to ensure that coordinated contingency plans are in place and that the regulatory environment's effectiveness in promoting financial system stability is assessed on a regular basis. Among the principal new provisions of the agreement are financial stability meetings and the operation of joint risk assessment groups. Systemic risk in the Icelandic financial system is assessed at financial stability meetings. The agenda of the meetings includes macroeconomic factors, risk in the operations of individual financial institutions, the interplay of risk factors (both within the financial system and between it and the real economy), the status of payment systems, the regulatory framework for financial activities, and improvements to contingency plans. Prior to the meetings, each of the two institutions summarises the status

Chart III-1
Financial position of households



1. Including real estate, motor vehicles, bank balance, and various securities but excluding pension assets.
Sources: Statistic Iceland, Central Bank of Iceland.

Chart III-2
Default ratios by the three largest commercial banks¹



1. Book value, parent companies.
Source: Financial Supervisory Authority.

of the risk factors within its purview. Joint risk assessment groups are appointed to handle functions where the roles of the two institutions overlap. Four such joint risk assessment groups are currently functioning: a funding risk group, an exchange rate risk group, a payment and settlement risk group, and a macroprudential group focusing on the interplay of risks in the operations of individual financial institutions and risks in the system as a whole. The new cooperation agreement also provides for plans to improve the acquisition and reciprocal communication of information between the two institutions, including plans for a joint access-controlled database. In the Central Bank's opinion, the cooperation agreement is extremely important and is as broad in scope as is possible under the current legislative framework governing the two institutions.

Precautionary rules

New Central Bank of Iceland Rules on Foreign Exchange Balance for credit institutions took effect at the beginning of 2011. One of the most important amendments to the Rules is that the permissible open foreign exchange position in individual currencies has been reduced from 20% to 15% of the relevant financial institution's risk-weighted asset base, and the permissible total foreign exchange balance has been lowered from 30% to 15%. Due to the circumstances that developed after Iceland's banks failed, however, temporary provisions were added so as to allow the Bank to authorise financial institutions to maintain a separate positive or negative foreign exchange balance temporarily. When applying for such authorisation, financial institutions must present a dated timetable showing how they intend to bring their foreign exchange balance back within the limits provided for in the Rules. Exemptions will not be granted beyond 1 January 2013.

The Central Bank Rules on Liquidity Ratio date from 2006. According to the rules, credit institutions' liquid assets and liabilities are classified by periods and assigned weights according to risk. The rules state that credit institutions must have liquid assets in excess of the next three months' liabilities. They entail a certain stress test where a discount is applied to various equity items, but where it is assumed, on the one hand, that all obligations must be paid upon maturity, and on the other, that a portion of other obligations, such as deposits, must be paid at short notice or immediately. In 2011, the Central Bank, in collaboration with the Financial Supervisory Authority and the largest commercial banks, initiated a review of the liquidity rules with reference to the new international liquidity rules that will take effect in the next few years (Basel III).

Work remains to be done to address the flaws in the structure and tools used to preserve financial stability. Capital account liberalisation could entail considerable movement of liquid assets, as well as exchange rate volatility. In light of experience, the Bank intends, concurrent with liberalisation, to develop precautionary rules to combat risk in the banks' foreign balance sheets.

Developments during the year

The Central Bank published two Financial Stability reports in 2011, in June and December. The reports stated that, in spite of positive devel-

opments in the domestic economy, there were clouds on the horizon and the outlook more uncertain than usual. According to the reports, instability in the global economy, particularly to include the banking and sovereign debt crisis in the euro area, will probably have very little direct impact on Iceland in the near term, in part because of the capital controls and because resident entities are relatively independent of foreign market funding at present. If the European crisis persists, however, Iceland could be indirectly affected by declining demand for Icelandic exports and deteriorating terms of trade.

Since November 2008, Iceland's financial companies have operated under the aegis of capital controls and blanket deposit guarantees. The banks' capital ratios are high, and financial firms are reasonably well prepared to face shocks. Their liability ratios are within acceptable limits, and their liquidity is sound. Their default ratios are high, however, although they have declined during the year as debt restructuring measures have progressed. For the long term, the banks will need to access credit markets and lengthen the maturity profile of their domestic funding in preparation for a more open financial environment. The first signs of this were seen during the year with the issue of covered bonds.

Private sector indebtedness declined in the wake of restructuring and debt cancellation but remains substantial. The number of individuals and firms on the default register did not rise in the latter half of the year, after increasing constantly since the crash. Bankruptcy and unsuccessful distraint measures against individuals increased year-on-year in the first half of 2011, but the latter half of the year saw an abrupt turnaround. Among firms, however, bankruptcy and unsuccessful distraint measures rose markedly during the year and were high in historical terms. This trend is a natural accompaniment to the inevitable reshuffling that entails restructuring of viable firms and failure of those that cannot survive.

Payment Systems

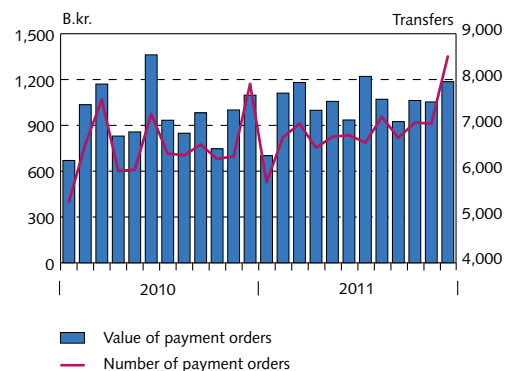
Payment and settlement systems

The tasks of the payment systems unit within the Payment Systems Department centre on policy-making in the area of payment intermediation, formulation of rules on payment and settlement systems, assessment of efficiency and safety, and oversight of systemically important payment and settlement systems in Iceland.

The cashier's unit handles banknotes and coin on behalf of the Bank, including distribution to vaults in regional Iceland and banking institutions in the greater Reykjavík area.

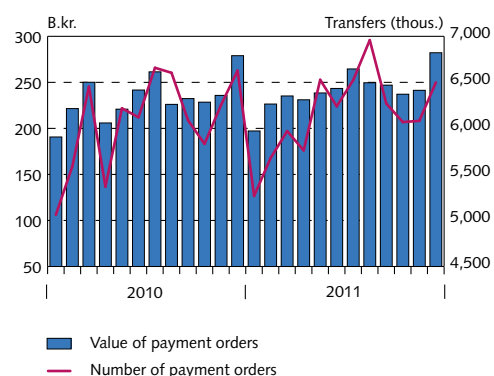
The Central Bank of Iceland sold its holding in the Icelandic Banks' Data Centre (RB) at the beginning of 2011 and simultaneously acquired Greiðsluveitan ehf. (previously Fjölgreiðslumiðlun hf.) in full. Concurrent with this, RB was converted to a limited liability company. Until this time, RB's operations had been based on a cooperation agreement and had been viewed as a part of the owners' infrastructure. The change was made in order to separate ownership and control of important infrastructure from users in a competitive market and to streamline information technology functions. Greiðsluveitan now

Chart III-3
RTGS system turnover
2010-2011



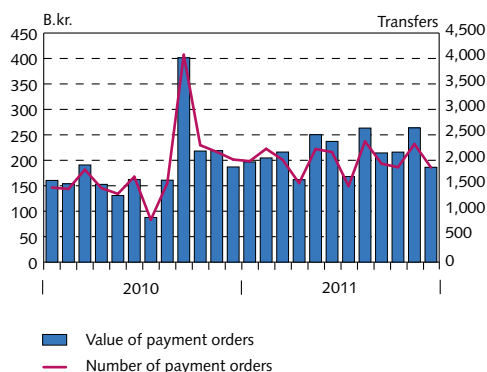
Source: Greiðsluveitan ehf.

Chart III-4
Netting system turnover
2010-2011



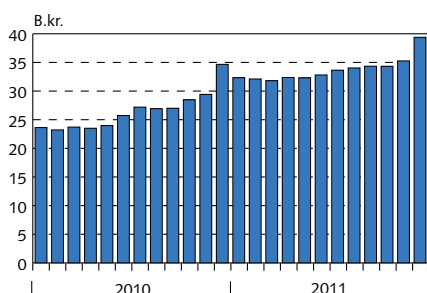
Source: Greiðsluveitan ehf.

Chart III-5
Securities settlement system turnover
2010-2011



Source: Icelandic Securities Depository.

Chart III-6
Notes and coin in circulation
2010-2011



Source: Central Bank of Iceland.

handles the operational aspects of important payment intermediation systems. The Central Bank's main objective and policy with the operation of Greiðsluveitan is to ensure secure, efficient, and economical payment intermediation services.

Real-Time Gross Settlement (RTGS) system

Direct participants in the Real-Time Gross Settlement (RTGS) system as of 31 December 2011 were Arion Bank hf., Byr hf., Clearstream Bank s.a., the Housing Financing Fund, Íslandsbanki hf., MP Bank hf., NBI hf., and Straumur IB hf., as well as the Central Bank of Iceland. In addition, the RTGS system carries out the final monetary settlement of securities transactions from the Icelandic Securities Depository securities settlement system and the Greiðsluveitan netting system.

Total turnover in the RTGS system rose by 8.4% year-on-year in 2011, to 12,502 b.kr. (outgoing payments) and over 82,000 payment orders. Turnover had contracted in the two previous years, by just over 12% in 2010 and by 84% in 2009.

Netting system

As of year-end 2011, direct participants in the netting system were Arion Bank hf., Byr hf., the Housing Financing Fund, Íslandsbanki hf., MP Bank hf., NBI hf., and the Central Bank of Iceland. Total netting system turnover increased by 3.7% year-on-year in 2011, to 2,894 b.kr. The number of transactions rose by 1% from 2010, to just under 73 million.

Icelandic Securities Depository securities settlement system

As of 31 December 2011, settlement institutions in the securities settlement system were Arion Bank hf., Byr hf., Clearstream Banking s.a., Íslandsbanki hf., MP Bank hf., NBI hf., and Saga Capital hf.

Settled transactions in 2011 were 23,995, with a total value of 2,579 b.kr. Off-exchange trading increased slightly, from 50,820 transactions in 2010 to 51,882 in 2011.

Payment instruments

Payment cards

In 2011, the Central Bank prepared a report on card netting systems and arrangements for settlement. The report can be found on the bank's website. Afterward, a comparable appraisal of the debit card market was undertaken. It will be published in 2012 and will also be posted on the Bank's website.

In 2011, the total number of payment card transactions rose by 2%, to 115 million. Card transactions amounted to a total of 730 b.kr., a 7.5% increase year-on-year. Debit card transactions amounted to 385 b.kr., or 52.7% of the total, while credit card transactions amounted to 345 b.kr., or 47.3% of the total.

Cheques

Use of cheques in the domestic market has contracted steadily in recent years. In 2011, turnover in chequing transactions declined by

14.9%, and the total amount of issued cheques was 55.7 b.kr. A total of 104,000 cheques were cashed, some 38.5% fewer than in the previous year.

Banknotes and coin in circulation

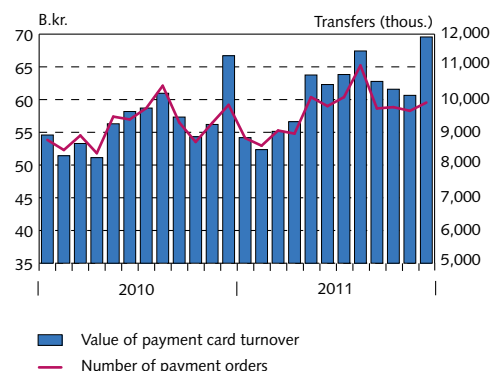
Cash in circulation outside deposit institutions and the Central Bank totalled 39.4 b.kr. as of year-end 2011. The increase measured 13.6%, as opposed to a 34.8% increase the year before. This was the third year in a row to see a rise in cash in circulation. For a long period, cash in circulation amounted to less than 1% of GDP. After the banks collapsed in October 2008, however, use of cash rose substantially. At year-end 2011, cash in circulation was 2.4% of GDP, an increase of 0.1 percentage points year-on-year.

The Central Bank of Iceland has the exclusive right to issue Icelandic currency. The Central Bank Act requires, among other things, that the Bank always have a sufficient supply of banknotes and coin. The Central Bank gives high priority to maintaining the credibility of Icelandic banknotes, by processing them regularly and incorporating security features into them, among other things. The aim of the security features is to facilitate the detection of counterfeit banknotes. Note sorting includes counting, identification of forgeries, and sorting of notes into fit and unfit. In 2011 the note sorting department received 13.1 million notes from commercial banks and savings banks. 4.3 million notes were destroyed. Counterfeiting is very rare in Iceland.

The banknotes currently in use in Iceland were first circulated between 1981 and 1995. Since then, there have been considerable advances in banknote design. In 2003-2005, 500 kr., 1000 kr., and 5000 kr. banknotes were updated, with new security features and minor changes in appearance. 2000 kr. banknotes were first circulated in 1995. Distribution of 2000 kr. banknotes was never as extensive as was hoped, in part because it was not used in bank automats (ATMs) from the outset. A large proportion of banknotes in Iceland are circulated through ATMs, and a banknote that is not available in ATMs is less widely distributed than others. At present, 2000 kr. notes can be obtained in one of every 10 ATMs.

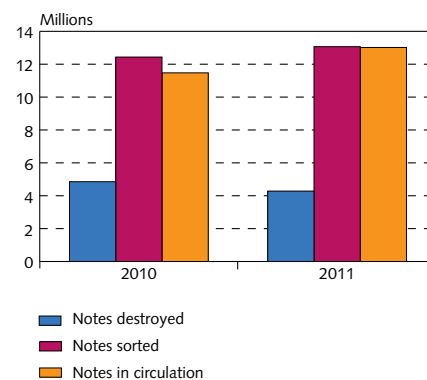
At year-end 2011, some 700 m.kr. worth of 2000 kr. banknotes were in circulation in Iceland. This is approximately 1.7% of the total value of cash in circulation and roughly proportional to the amount of notes that have been printed. It is assumed that the Bank will not have more 2000 kr. notes printed but will allow them to diminish in number over time. They will not be recalled, however. They will remain legal tender and will circulate in the economy for as long as they continue to exist.

Chart III-7
Payment card turnover
2010-2011



Source: Central Bank of Iceland.

Chart III-8
Notes sorting and number of notes
in circulation at end of year



Source: Central Bank of Iceland.



IV Foreign reserves

The foreign exchange reserves limit risk and mitigate the effects of external risks related to changes in access to foreign credit and fluctuations in capital flows to and from Iceland. They enable the Bank to help the Treasury meet its need for foreign currency and fulfil its foreign debt obligations. The reserves create in the market the confidence that Iceland is able to service its foreign debt. They can also be used to support monetary policy. The size of the reserves is determined with reference to the scope of external trade, the exchange rate and monetary regime, rules on capital movements and foreign exchange transactions, and Iceland's foreign liabilities. At any given time, the necessary size of the reserves is determined by the balance of payments outlook. International obligations and cooperation, such as that with the International Monetary Fund (IMF), may also affect the minimum size of the reserves.

Important changes in the reserves

Since 2008, the Central Bank has emphasised fortifying its foreign exchange reserves. Through loans from the IMF, bilateral loans from neighbouring countries, and market issuance, the Bank's net foreign exchange reserves have roughly tripled since mid-2008.

In 2011, the Treasury drew the full amount of its loan from the IMF, bringing the total amount to SDR 1,400 million by the end of the year. In addition, the Central Bank and the Treasury received the last tranche of loan facilities from Denmark, Sweden, Finland, and Norges Bank, in connection with the Stand-By Arrangement with the IMF. The Nordic loans amount to 1,775 million euros.

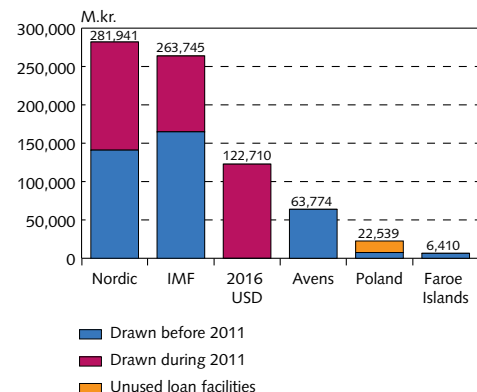
The Central Bank of Iceland's foreign exchange reserves amounted to 1,049 b.kr. as of year-end 2011, as opposed to 665 b.kr. at the end of 2010, an increase of 384 b.kr. during the intervening year. The expansion of the reserves is due primarily to the SDR 525 million loan facility from the IMF, the facilities from the Nordic countries (887.5 million euros), and an increase in foreign-denominated deposits held by parties other than the Treasury (approximately 70 b.kr.). The main outflows from the reserves are due to buybacks of Treasury bonds (346 million euros), full payment of a Treasury foreign loan (291 million euros), and the final payment of a Treasury loan amounting to 75 million euros.

Maintenance of the reserves

The Bank attempts to ensure that the reserves are maintained and invested in a secure manner. It has exercised particular caution in the recent term because of instability in the global financial markets.

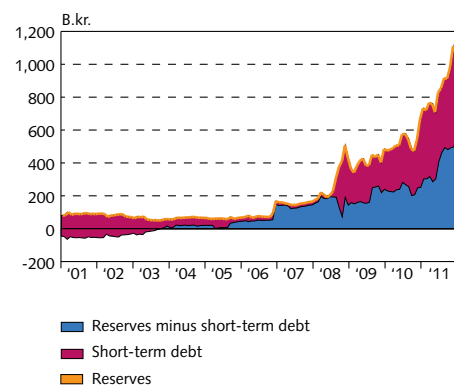
The vast majority of the Bank's foreign exchange reserves are invested in foreign securities and deposits with foreign central banks and the Bank for International Settlements (BIS). At year-end 2011, the share of deposits was unusually large, for two reasons: first of all, the resolution committees of the failed banks deposit foreign currency

Chart IV-1
Loans fortifying foreign reserves
from November 2008



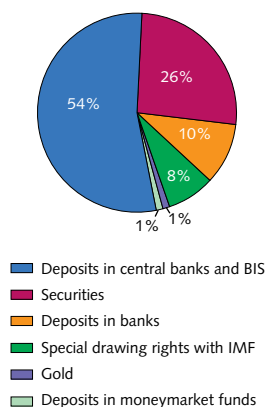
Source: Central Bank of Iceland.

Chart IV-2
Distribution of reserves



Source: Central Bank of Iceland.

Chart IV-3
Distribution of reserves %



Source: Central Bank of Iceland.

with the Central Bank, which invests it with foreign central banks and the BIS; and second, towards the end of the year, the Bank drew on a large portion of the loan from the Nordic countries.

The chart in the margin shows the year-end 2011 distribution of the foreign exchange reserves, which amounted to 1,049 b.kr., or 6,605 million euros.

At that time, the Bank had access to loan facilities from the BIS in the form of repurchase agreements amounting to 400 million US dollars, or 49 b.kr. Unused loan facilities from Poland totalled 420 million Polish zlotys at the end of the year. Because of its strong foreign liquidity position, the Bank did not draw on this loan facility in 2011.

Financial risk

In order to reduce financial risk, the Governor sets rules on the maintenance of the foreign exchange reserves, including stipulations concerning decision-making and the external framework of the financial risk that the Bank is willing to take. These rules were thoroughly reviewed in 2011 and will be implemented in amended form in 2012.

The size of the reserves and the requirements concerning the share of liquid reserves at any given time place limitations on investment and steering. It is critical that reserve assets be both sound and sufficiently liquid so that the Bank can use them to achieve its objectives and carry out its tasks. Steering the foreign exchange reserves aims at minimising the Bank's risk-adjusted cost of reserve maintenance and managing the Bank's balance sheet in an efficient, economical manner. The stringent requirements concerning liquidity and the ability to respond to external events may affect the Bank's ability to seek out maximum returns at any given time.

The currency composition of the foreign exchange reserves is adjusted with the aim of minimising fluctuations in foreign-denominated assets net of foreign-denominated liabilities. The currency composition of this net holding, or the Central Bank's foreign exchange balance, is reviewed regularly and confirmed in the rules of procedure governing the foreign exchange reserves. The Bank uses derivatives, among other instruments, to manage the currency composition of the reserves.

Table IV-1 Yield on foreign bonds in 2011

	GBP	USD	EUR	PLN
Bond yields	4.73%	3.17%	3.25%	7.26%
Reference index	5.70%	3.40%	3.26%	7.26%
Returns in excess of reference	-0.97%	-0.23%	-0.01%	0.00%

V Treasury debt management

Agreement on Treasury debt management

The Central Bank of Iceland administers domestic and foreign borrowings and debt management for the Treasury as the representative of the Ministry of Finance. An agreement between the Bank and the Ministry provides for division of tasks and decision-making authority. The Central Bank is entrusted with overseeing the Treasury's foreign borrowings and administering auctions, buybacks, and redemption of Treasury securities, as well as preparing primary dealer agreements and administering securities lending to primary dealers. The Central Bank of Iceland carries out risk management and debt management according to Treasury portfolio management benchmark set by the Ministry of Finance. The Bank is also responsible for regular disclosure of information on Government debt affairs to the market and the Ministry of Finance and maintains the websites www.bonds.is and www.lanamal.is. The above-mentioned agreement entrusts the Bank with communications and disclosure of information on the Icelandic economy to foreign credit rating agencies and credit institutions, in addition to tasks related to Government guarantees and relending, such as administration of Government guarantees and the assessment of the Treasury's risk due to such guarantees. The Bank submits statements on Government guarantees to the Ministry, handles processing of guarantees, and collects the pertinent fees. The Central Bank also issues bonds for relending.

Domestic debt management

In December 2010, the Central Bank, on behalf of the Treasury, published its Government Debt Management Prospect for 2011. According to the Prospect, Treasury bonds were to be issued for a total of 120 b.kr. in 2010 in order to fund the Treasury's operational deficit and the debt maturing during the year. In addition, the outstanding amount of Treasury bills was to be reduced by about 12 b.kr. In 2011, Treasury bond series RIKB 11 0722 matured in the amount of 53 b.kr. Net Treasury bond issuance was therefore estimated at 67 b.kr.

The issuance of new 10- and 20-year bond series was announced in the Prospect. The arrangements for Treasury bill issuance were changed in 2011. Instead of four-month bills, it was decided to issue six-month bills each month, with an expansion option three months before maturity. The purpose of the change was to meet the needs of investors that are building up funds with short-term securities more effectively.

During the year, it was decided to publish a quarterly Prospect at the end of each quarter. The quarterly Prospect discusses Treasury issuance in the upcoming quarter in detail, and it provides for more flexibility in bond issuance, so as to meet market demand at any given time.

The Government's Medium-Term Debt Management Strategy for 2011-2014 was published at the beginning of the year. The strategy

sets forth the authorities' plans for credit financing during the specified period. Its principal objective is to ensure that, over the medium to long term, the Treasury's financing needs and financial obligations are met at the lowest possible cost that is consistent with a prudent degree of risk.

On 25 March 2011, changes in Treasury issuance were announced concurrent with the capital account liberalisation strategy. It was decided to issue a new indexed Treasury bond series maturing in 2030 and offer owners of foreign currency the option of purchasing it. For that reason, it was decided to reduce issuance of Treasury bills and bonds by an amount equal to the sale value of the new bond series. Sales of the new bond totalled 46 b.kr. in 2011, including 32 b.kr. due to a Treasury bond exchange with the Housing Financing Fund.

Total Treasury bond issuance in 2011 amounted to 126 b.kr., including 13 b.kr. sold through foreign currency auctions.

Interest expense

Interest expense is one of the Treasury's largest expenditure items. In 2011, net Treasury interest expense was changed in the amount of 64 b.kr. for the year, as opposed to 68 b.kr. in 2010. Interest in Treasury bond auctions fell year-on-year in 2011. The weighted average rate on accepted bids in auctions of nominal Treasury bonds was 5.28% in 2011, as opposed to 6.09% in 2010. The weighted average rates on indexed bonds were 2.78% and 3.41%, respectively, in 2011 and 2010. Market interest rates are an important factor in determining the interest burden on borrowed funds. Market terms are particularly important when long bonds are issued. To illustrate, a 0.81% year-on-year decline in the weighted interest rates in nominal bond auctions saves the Treasury about 913 m.kr. in annual interest expense on a 113 b.kr. bond issue. If the average duration of nominal bonds is 6.2 years, an 81-point drop in interest rates translates to savings of almost 5.7 b.kr.

The weighted average interest rate (flat rate) in Treasury bill auctions was 3.09% in 2011, and inflation was 5.3%. In 2010, the weighted average of accepted bids was 5.75%. The drop in interest rates in the 2011 auctions has therefore generated considerable savings for the Treasury. For example, the 2.66% decline in average rates has reduced the Treasury's interest expense by 1.3 b.kr. on Treasury bill issuance of 50 b.kr.

Foreign debt management

The Treasury's foreign debt totalled 449 b.kr. at year-end 2011. This debt can be divided into two categories: bilateral loans and foreign market loans. In September 2011, one syndicated loan matured in the amount of 75 million euros, or 11 b.kr. The loan, taken in autumn 2008, originally amounted to 300 million euros, but the Treasury repaid 225 million euros in December 2010. A bond originally in the amount of 1,000 million euros matured in December 2011. The Treasury had dramatically reduced its refinancing risk through secondary market buybacks and auctions, reducing the amount due upon maturity to 281 million euros.

Table V-1 Treasury foreign debt (amounts in ISK millions)

<i>Bilateral loans</i>							
	<i>Loan facility</i>		<i>Utilised credit line</i>	<i>Unutilised credit line</i>	<i>Loan facility ISK</i>	<i>Utilised credit line ISK</i>	<i>Unutilised credit line ISK</i>
	<i>Currency</i>	<i>Amount</i>					
Denmark	EUR	480	480	0	76,454	76,454	0
Finland	EUR	320	320	0	50,970	50,970	0
Sweden	EUR	495	495	0	78,844	78,844	0
Poland	PLN	630	204	426	22,539	7,303	15,236
Faeroe Islands	DKK	300	300	0	6,429	6,429	0
<i>Total</i>					235,235	219,999	15,236

The bilateral loans, from the treasuries of Denmark, the Faeroe Islands, Finland, Poland, and Sweden, were granted in order to strengthen the Central Bank of Iceland's foreign exchange reserves. The total amount of the loan facilities is 235 b.kr. At the end of 2011, the last tranche of the Nordic loans was drawn, in the amount of 117 b.kr., as the drawdown period expired at the end of the year. The loans are to be repaid over a seven-year period, beginning in 2014. As the table shows, the Treasury had undrawn loan facilities in the amount of 15 b.kr. at year-end 2011 because the drawdown period for the bilateral loan from Poland was extended by one year.

The loans from the IMF in the amount of 272 b.kr. (SDR 1,400 million) are part of the Stand-By Arrangement between the Fund and the Icelandic authorities and are disbursed directly to the Central Bank of Iceland. The same applies to the loan facility from Norway, which amounts to 76 b.kr. (480 million euros). The loans are used to expand the Bank's foreign exchange reserves and are not part of Treasury liabilities.

EMTN Programme and issuance in USA

The framework agreement establishing the Euro Medium-Term Note (EMTN) Programme was first signed in 2001. The agreement is administered by Citibank and provides for both public and private issues. It was most recently renewed in the summer of 2008, and the ceiling now amounts to 5 billion euros. As the table shows, four bond issues totalling 223 b.kr. are currently outstanding under the programme.

Table V-2 Treasury foreign debt (amounts in ISK millions)

<i>Marketable bonds</i>						
	<i>Maturity</i>	<i>Currency</i>	<i>Original amount</i>	<i>Buyback/ instalment</i>	<i>End-2011 balance</i>	<i>End-2011 balance in ISK</i>
Eurobond (MTN)	2012	EUR	250	86	164	26,194
Eurobond (MTN)	2014	USD	200	0	200	24,600
Bonds("the children's loan")	2016	GBP	30	2	28	5,374
Eurobond (MTN)	2016	USD	1,000	0	1,000	123,000
Eurobond (MTN)	2025	EUR	402	91	311	49,536
<i>Total</i>						228,704

The debt management objective set at the beginning of 2011 was to tap foreign credit markets, in part to build confidence externally. The objective was met with the Treasury's June 2011 issuance in the United States of a bond in the amount of 1 billion US dollars. The bond was issued for five years and bears fixed 4.99% interest. The terms were equivalent to a 3.20% premium on interbank market rates. Investors were keenly interested, with demand totalling 2 billion dollars. Most of the buyers were institutional investors from the US and Europe.

If foreign market terms are acceptable, the Treasury will undertake another bond issue in 2012 in order to allocate the proceeds towards the bilateral Nordic loans, which are scheduled for repayment in 2014-2017.

Government guarantees and relending

Government guarantees are provided for in Act no. 121/1997. The Treasury may not undertake a guarantee unless authorised by law. Because of the risk to the Treasury, collateral must be provided that is deemed satisfactory by the State Guarantee Fund, which is authorised by law to supervise Government guarantees, keep track of the operations of entities that have received Government guarantees, and maintain a register of obligations backed by Government guarantees.

The bulk of Government guarantees are due to the Treasury's holdings in the Housing Financing Fund and Landsvirkjun. These parties' borrowings are not handled through the State Guarantee Fund in the same way as those of parties outside the public sector that request Government guarantees for specified loans. However, parties that enjoy Government guarantees due to Government ownership are required to obtain the Minister of Finance's approval of the terms and conditions for loans they intend to take abroad.

Sovereign credit rating of the Republic of Iceland

The main agencies that assign the Treasury a credit rating are Standard & Poor's, Moody's Investors Service, and Fitch Ratings. The Central Bank of Iceland communicates regularly with these agencies on behalf of the Government. Rating agencies have significant influence on lending terms in the global credit markets, and an entity's credit rating is, among other things, an indicator of the terms it will enjoy as a borrower. Iceland's sovereign credit rating suffered greatly from the banks' failure in 2008.

At year-end 2011, Moody's rating was Baa3 for long-term foreign and domestic obligations, and P-3 for short-term obligations. The outlook was negative. The ratings fall under the investment-grade category. Iceland's sovereign credit rating remained unchanged during the year, although Moody's implied in February that a rejection of the Icesave agreement would probably lead to a downgrade. Other factors led the agency to a different conclusion, however, concerning the potential impact of the Icesave referendum.

Iceland's year-end sovereign credit ratings from Standard & Poor's were BBB- for long-term obligations in foreign and local currency, respectively, and A-3 for short-term obligations in foreign and local

currency. The ratings from Standard & Poor's are investment-grade. The ratings were placed on CreditWatch negative status in April, in the wake of the Icesave referendum. In May, S&P affirmed unchanged ratings with the exception of that for domestic long-term obligations, which was downgraded from BBB to BBB-. In November the outlook on the ratings was changed from negative to stable. The agency cited improvements in the Icelandic economy as the main grounds for the change.

At year-end 2011, Iceland's sovereign ratings from Fitch were BB+ and BBB+ for long-term obligations in foreign and local currency. The rating for short-term obligations in foreign currency was B. The foreign-currency ratings were therefore speculative-grade. In its opinion published after the Icesave referendum in April, Fitch stated that the results could delay an upgrade to investment-grade ratings. In May the outlook on the ratings was changed from negative to stable. According to Fitch's announcement on that occasion, the agency's decision represented a reassessment of the effects of the rejection of the Icesave agreement in the 9 April referendum. It was Iceland's first positive rating with the rating agency since 2006.





VI 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.

International Monetary Fund

The Central Bank represents Iceland at the International Monetary Fund (IMF). The Stand-By Arrangement between the Fund and the Icelandic authorities concluded during the year, and IMF missions met with the authorities to discuss the progress made under the programme. In addition, the authorities received technical assistance from the IMF in such areas as budget preparation, liquidity management, tax policy, and statistics.

Three reviews of the economic programme under the Stand-By Arrangement were approved by the Executive Board of the Fund during the year: the fourth review on 10 January, the fifth on 3 June, and the sixth and last on 26 August. By the end of the programme, the entire loan facility, approximately 2.1 billion US dollars (by year-end the principal totalled 263.8 b.kr.) had been disbursed to the Icelandic authorities. The funds disbursed are held at the Central Bank of Iceland. Repayment begins in 2012 and will be complete in 2016.

By the end of the year, a total of 295.8 b.kr. had been drawn on the loan facilities granted concurrent with the Stand-By Arrangement by the Faeroe Islands, Poland, and the Nordic countries. All reports related to the economic programme and the IMF Stand-By Arrangement are published on the Central Bank website.

Iceland cooperates with the Nordic and Baltic countries through the Nordic-Baltic Constituency at the IMF, and they jointly elect an Executive Director as one of the Fund's 24 Executive Board members. In 2011, the Constituency's permanent representative on the IMF Executive Board in Washington was Benny Andersen from Denmark.

Meetings of the IMF's Board of Governors and Monetary and Financial Committee (IMFC) are held in Washington, the spring meetings usually in April and the Annual Meeting in September or October. In connection with the meetings, the Central Bank of Iceland publishes on its website the Nordic-Baltic Constituency Office's reports to the IMF on the main activities of the Fund and its Executive Board. The joint Nordic-Baltic speeches presented to the IMFC and the IMF Annual Meeting are also published.

The Annual Meeting of the IMF was held on 23 September and the meeting of the IMFC the day after. Már Guðmundsson, Governor of the Central Bank of Iceland and Iceland's representative to the Board of Governors of the IMF, attended the meetings. The Nordic-Baltic Constituency's speech for the Annual Meeting was delivered by Stefan Ingves, Governor of Sveriges Riksbank. The Constituency's representative on the IMFC was Danmarks Nationalbank Governor Nils Bernstein.

The Icelandic authorities and the IMF held a well-attended conference at the Harpa concert hall and conference centre on 27 October. The conference, which featured a panel of renowned scholars and lecturers, focused on the lessons learnt from the crisis and the challenges facing the Icelandic economy.

In January, Parliament passed Act no. 5/2011, formally ratifying the amendments to the IMF Articles of Association that were approved by the Fund's Board of Governors in 2008. The amendments focus on changes to senior management and member countries' quotas. Further amendments to the Articles of Association were approved by the Board of Governors in 2010, including a doubling of quotas in order to meet increased need for the Fund's assistance around the world. As a result, Iceland's quota will increase from SDR 117.6 million to SDR 321.8 million. In January 2012, Parliament authorised the Government to approve the amendments to the Articles of Association and the increase in Iceland's quota.

The Bank for International Settlements (BIS)

The Central Bank is a shareholder in the Bank for International Settlements (BIS) in Basel, Switzerland, which is an important consultative forum for central banks, as well as an information and research institution in the field of monetary policy and financial stability. The Governor and other Central Bank staff members participate regularly in work carried out by BIS.

Organisation for Economic Co-operation and Development (OECD)

During the year, Central Bank representatives participated in the work of various OECD committees and groups, including the Economic Policy Committee, Working Party 1, the Committee on Financial Markets, and an expert committee on government debt management. OECD experts come to Iceland on a regular basis to keep abreast of economic developments, and they issue frequent reports setting forth the Organisation's opinion of economic affairs in the country.

Co-operation with other central banks

During the year, the Central Bank of Iceland engaged in a variety of tasks in co-operation with other central banks. The central banks in the Nordic region have long enjoyed close collaboration. The Bank also works regularly with the European Central Bank and, increasingly, with other central banks in Europe.

Other financial institutions

The Central Bank cooperates with a large number of foreign financial institutions in connection with the management of its foreign exchange reserves, Treasury foreign debt, and other topics related to its operations.

VII Special projects

Central Bank of Iceland Holding Company ehf. (ESÍ)

After Iceland's banks collapsed in the autumn of 2008, the Central Bank acquired sizeable claims against domestic financial institutions. The claims were backed by collateral of various types. Some of them were transferred to the Treasury at year-end 2008, and the Central Bank advised the Government on their treatment.

At the end of 2009, these assets were transferred to a separate subsidiary of the Central Bank, a holding company called the Central Bank of Iceland Holding Company ehf. (ESÍ). Another Central Bank subsidiary, Sölvhóll ehf., is an operating company whose role is to maximise the value of the assets in the holding company (ESÍ) and divest them when market conditions permit, subject to the approval of the ESÍ Board of Directors. This arrangement provides the Bank with an effective means of separating the operations and assets related to the crash from its conventional activities.

From the beginning, the Board of Directors of ESÍ and Sölvhóll have comprised the following members: Már Guðmundsson, Chair; Sigríður Logadóttir, and Sturla Pálsson.

In 2011, agreements were reached with the majority of the winding-up committees handling the estates against which ESÍ has claims. Thereafter, ESÍ assumed direct ownership of the collateral concerned, in addition to general claims against the estates. During the year, ESÍ took over Hilda hf., which became a subsidiary of ESÍ. At year-end 2011, ESÍ's balance sheet totalled 340,3 b.kr., or 21% of the Central Bank's total balance sheet. ESÍ's assets had declined by 56 b.kr. since year-end 2010, or just under 14,1%, primarily because debt to the Central Bank was paid down as a result of asset recovery. The company's pre-tax profit totalled 3 b.kr.

Capital Controls Surveillance Unit

The Central Bank of Iceland's Capital Controls Surveillance Unit (CCSU) was formally established as a separate department within the Bank in September 2009. The CCSU's main tasks in 2011 were to carry out general monitoring of the Foreign Exchange Act and the Rules on Foreign Exchange, investigate alleged violations of the Rules, process and take decisions on applications for exemptions from the Act and the Rules, review and revise the Rules, and provide instructions and information to individuals and legal entities. It should be noted that the Rules on Foreign Exchange, no. 370/2010, were incorporated into law on 29 September 2011, with the passage of Act no. 127/2011 Amending the Foreign Exchange Act, the Customs Act, and the Act on the Central Bank of Iceland.

In 2011, the Central Bank referred 12 cases to the criminal authorities due to suspicions of major violations of the Foreign Exchange Act and the Rules on Foreign Exchange. Of these, one was returned to the CCSU for further review and five had been reported to the Financial Supervisory Authority in 2009. Another 13 cases were investigated

within the CCSU. The number of new cases derived from monitoring the Foreign Exchange Act has decreased notably.

The CCSU received 971 requests for exemptions from the Foreign Exchange Act and the Rules on Foreign Exchange in 2011. During the year, 946 requests were processed: 688 were approved, 112 rejected, 23 approved in part, and 123 were withdrawn or concluded through issuance of guidelines or in another manner. During the year, the Central Bank received 159 notifications of new investment (cf. Article 13(m) of the Foreign Exchange Act) in the total amount of 19.8 b.kr.

Application for EU membership

The Central Bank carried out analysis and other preparatory work in connection with the EU accession negotiations. Particular topics included currency issues and other matters related to Section 17 of the negotiations, which focuses on EU legislation in the areas of economic and monetary policy. The Governor chairs the negotiating committee on currency issues in the EU accession discussions and is a member of the main negotiating committee.

National Festival Fund

The year 2010 was the last year of allocations from the National Festival Fund. From that time, the Fund will continue to operate for two years in connection with the payment of previously allocated grants. Thereafter, the board will dispose of any remaining capital in accordance with the Fund's objectives. When its accounts have been settled, the Fund's operations will be discontinued.



VIII Accounts and organisation

Central Bank accounting principles

According to Article 32 of the Act on the Central Bank of Iceland, no. 36/2001, with subsequent amendments, the preparation of the Bank's annual accounts "shall comply with laws, rules and good account practice. The Minister shall set detailed rules on the accounting principles and preparation of the annual accounts." The current rules were set in 2005. The financial statements for 2011 are based on the same principles as in 2010; however, minor changes have been made in the presentation of individual items. These changes are explained in the notes to the financial statements, 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 profit of 14,398 m.kr. in 2011, compared with a loss of 13,499 m.kr. in the previous year. Excluding exchange rate gain and loss, the Central Bank recorded a profit of 11,539 m.kr. in 2011, compared with a loss of 5,697 m.kr. the year before. The table illustrates the changes in the principal items of the Bank's profit and loss account. The transfer to the Treasury for 2011 was 3,464 m.kr. Exchange rate gains for the year totalled 7,471 m.kr.

As the table shows, the Bank's earnings increased by 27,897 m.kr. from the previous year. Net interest income rose by 20,771 m.kr., due primarily to an increase in interest income from indexed securities and other domestic assets in the amount of 14,600 m.kr. and a decline in interest paid on current accounts in the amount of 13,960 m.kr. Other operating income rose by 266 m.kr., due in large part to increased service income, owing to payment intermediation activities undertaken by the Bank's subsidiary. Exchange rate gains on foreign exchange transactions rose by 1,385 m.kr. year-on-year, due in part to relaxation of the capital controls. The revaluation of gold was 881 m.kr. as compared with 2,565 m.kr. in 2010. Operating expenses rose by 1,123 m.kr. year-on-year, due principally to an increase in the Bank subsidiary's expenses related to management of assets and liquid assets. In addition, there were expenses for coin mintage and bank-note printing in 2011 but not in 2010. Salaries and related expenses rose by 283 m.kr., owing primarily to contractual pay hikes and increases in staffing. The Bank's assets totalled 1,581 b.kr. at year-end 2011, as opposed to 1,278 b.kr. at the end of 2010. Foreign assets rose by 323 b.kr. during the year. The real increase in the reserves was financed with borrowed funds and deposits, including loans from the IMF and Norway, which totalled 265 b.kr. and 76 b.kr., respectively, at year-end exchange rates. The loans from the Nordic countries are disbursed both to the Treasury, which deposits the funds to its accounts with the Central Bank, thus expanding the foreign exchange reserves, and to the Central Bank itself. Foreign deposits from the Treasury, financial institutions, and financial firms in winding-up proceedings rose by 272 b.kr. year-on-year.

Table VIII-1 Profit and loss account highlights

(Figures in ISK millions)	2011	2010	Change
Performance for the year	14,398	(13,499)	27,897
Changes specify as follows:			
Net interest income	33,531	12,760	20,771
Other revenues	5,086	4,870	266
Operating expenses	(3,171)	(2,047)	1,123
Loan impairment	(23,907)	(21,280)	2,627
Transfer to the Treasury	(3,464)	0	3,464
Exchange rate difference	7,471	(6,933)	14,404
Income tax	(1,148)	(869)	279

Table VIII-2 Balance sheet highlights

(Figures in ISK millions) 2011 2010 Change

Equity:	83,777	69,379	14,398
<i>Changes specify as follows:</i>			
Assets:			
Gold	12,249	10,426	1,822
Foreign assets	1,044,516	721,060	323,456
FX balance with the IMF	3,525	3,322	203
Domestic financial assets	502,332	535,896	(33,563)
Fixed and liquid assets	4,891	4,997	(107)
Other assets	13,198	1,920	11,278
Liabilities:			
Banknotes and coin	43,205	38,269	4,935
Foreign debt	341,604	193,238	148,366
Counterpart to IMF	21,141	19,971	1,170
Deposits of financial institutions	61,997	98,017	(36,020)
Other deposits	919,729	673,176	246,553
Domestic financial liabilities	85,914	182,791	(96,877)
Other liabilities	19,880	2,780	17,100
Unpaid transfer to Treasury	3,464	0	3,464
Equity	83,777	69,379	14,398

At year-end 2011, the Bank's foreign assets constituted 67% of its total assets. At year-end 2010, the Bank's foreign assets accounted for 50% of total assets. The Central Bank's accounts are presented later in this report, together with detailed explanatory notes on individual items.

Supervisory Board

The Central Bank Act, no. 36/2001, stipulates that there shall be seven members of the Supervisory Board. During the year, members of the Supervisory Board were Chairman Lára V. Júlíusdóttir, Ragnar Arnalds, Björn Herbert Guðbjörnsson, Hildur Traustadóttir, Ragnar Árnason, Katrín Olga Jóhannesdóttir, and Daniel Gros.

Governor and Deputy Governor

During the year, Már Guðmundsson served as Governor of the Central Bank. He was appointed for a term of five years beginning on 20 August 2009. Arnór Sighvatsson served as Deputy Governor. He was appointed to a four-year term beginning on 1 July 2009.

Central Bank organisation

The Bank's activities take place in six main departments. The General Secretariat 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 General Secretariat also handles regular communications with international credit rating agencies, the International Monetary Fund, and foreign financial institutions (apart from financial transactions). The General Secretariat's legal staff provide the Governors and the various departments of the Bank with legal advice on matters related to the Bank's role and operations. They participate in the preparation of legislation and other regulatory instruments, prepare legal opinions and prepare contractual agreements on behalf of the Bank, and finalise legal instruments and contracts. The Library and Collection Department is a part of the General Secretariat. It carries out library operations, as well as overseeing the Central Bank and National Museum numismatic collection.

The Capital Controls Surveillance Unit (CCSU) is a new department answering directly to the Governor. The CCSU's function is to ensure compliance with regulatory instruments on foreign exchange. The unit also participates in amending rules, publishing guidelines, and interpretation of such instruments. In addition, the CCSU processes requests for exemptions to the Rules on Foreign Exchange and is authorised to investigate alleged violations of the Foreign Exchange Act and the Rules on Foreign Exchange.

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 Department also oversees communications with the foreign financial institutions with which the Central Bank and the Treasury interact.

The Finance Department oversees the financial information for the Bank and its subsidiaries, as well as overseeing the bookkeeping for the Norwegian National Festival Gift Fund and the Greenland Fund, which is administered by the Bank. The department administers domestic and foreign loans for the Treasury and the Central Bank. Furthermore, it administers the Bank's SWIFT system, as well as overseeing domestic and cross-border payments for the Bank, the Treasury, and State enterprises. The department also oversees custody of securities and settlement of securities transactions. The Finance Department's activities comprise two operational units: Accounting and Bank Office.

During the year, the Financial Stability Department was split into two departments: Financial Stability and Payment Systems. The role of the Payment Systems Department is to contribute to the safety and efficacy of important payment systems, issue and administer banknotes and coin, and operate the Bank's vaults. One Central Bank subsidiary, Greiðsluveitan ehf., operates under the auspices of the department.

The Financial Stability Department's main tasks centre on analysis of financial system risk and participation in the formulation of precautionary rules for the financial system. The department has also placed increased emphasis on analysing the position of households and businesses. 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 affairs, including the macroeconomic elements of financial stability. The Department oversees the issuance of various Bank publications, including *Hagvísar/Economic Indicators*, *Peningamál/Monetary Bulletin*, *Working Papers*, *Economic Affairs*, and *Economy of Iceland*. The Department comprises two units: the Analysis and Publications Unit and the Research and Forecasting Unit.

The Operations Department 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.

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 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 its publications and on the Statistics pages of its website. All statistical data are also available in English. The Statistics and IT Department is divided into five units: Financial Institutions, Balance of Payments, Markets, Software, and Service.

Human resources

The Bank's staff numbered 145 at the beginning of 2011. By year-end, there were 148 members of staff. During the year, 22 employees were hired and 19 left the Bank. Nine summer staff members were employed by the Bank in 2011. The gender ratio of the Bank's staff remained relatively even in 2011: there were 69 male employees and 76 female employees at the beginning of the year and 73 males and 75 females at the year-end. Of the Bank's 10 departmental directors, five are men and five are women. As of year-end 2011, employees of the Bank's subsidiaries were 13, including 10 employed by Greiðsluveitan ehf. and three by Sölvhóll ehf.

Four of the 19 employees who left the bank during the year retired: Ingvar A. Sigfússon, Operations, after 38 years of service; Ísólfur Sigurðsson, Finance Department, after 35 years; Garðar Halldórs-son, Operations, after 30 years; Þórey Þórarinsdóttir, after 39 years.

Several changes were made to the Bank's organisational chart during the year. The former Financial Stability Department was abolished and two new departments – Financial Stability and Payment Systems – established in its place. Tryggvi Pálsson, Director of the former Financial Stability Department, left the Bank's employ during the year. Sigríður Benediktsdóttir, assistant to the chair of the Economics Department at Yale University, was hired to replace him. She joined the Bank's staff on 1 January 2012. Harpa Jónsdóttir was engaged as Deputy Director and served as acting Director after Tryggvi's departure. Guðmundur Kr. Tómasson, former Deputy Director of the Financial Stability Department, was engaged as Director of the Payment Systems Department. The name of the Operations Department was changed to the Operations and Human Resources Department during the year. In another change to the organisational chart, Information Technology staff were transferred from the Statistics and IT Department to Operations and Human Resources. Ásta H. Bragadóttir was hired to replace Ingvar A. Sigfússon, Director of Operations, who retired. The International and Market Operations Department was divided into three units during the year, and three unit supervisors were hired. Gerður Ísberg, Deputy Director of the International and Market Operations Department, was engaged as head of Market Operations. She will continue to serve as Deputy Director of the department. Freyr Hermannsson was engaged as head of Foreign Transactions and Björgvin Sighvatsson as head of Government Debt Management. Salome R. Birgisdóttir was engaged as head of Back Office in the Finance Department.

Former Governor Eiríkur Guðnason passed away in 2011. Eiríkur had worked for the Bank for four decades, including serving as Chief Economist, Deputy Governor, and Governor, when he left the Bank's employ in 2009. He maintained active and cordial relations with Bank staff after that time and delivered a memorable speech at the celebra-

tory dinner held on the Bank's 50th anniversary of operations in April 2011.

Wage agreements

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

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 31 December 2011

Supervisory Board

Principal members

Lára V. Júlíusdóttir, Chairman
 Ragnar Arnalds, Deputy Chairman
 Björn Herbert Guðbjörnsson
 Hildur Traustadóttir
 Ragnar Árnason
 Katrín Olga Jóhannesdóttir
 Daniel Gros

Alternates

Margrét Kristmannsdóttir
 Anna Ólafsdóttir Björnsson
 Sigrún Elsa Smáradóttir
 Guðrún Ágústa Guðmundsdóttir
 Birgir Þór Runólfsson
 Ingibjörg Ingvadóttir
 Friðrik Már Baldursson

Governor

Már Guðmundsson

Deputy Governor

Arnór Sighvatsson

Principal officers:

Capital Controls Surveillance Unit	Ingibjörg Guðbjartsdóttir, Director
Economics Department	Þórarinn G. Pétursson, Chief Economist
Finance Department	Kristín Hannesdóttir, Director
Financial Stability Department	Harpa Jónsdóttir, Deputy Director
General Secretariat	Jón Þ. Sigurgeirsson, Director
International and Market Operations Department	Sigurður Sturla Pálsson, Director
Legal Services	Sigríður Logadóttir, Chief Attorney
Operations and Human Resources	Ásta H. Bragadóttir, Director
Payment Systems Department	Guðmundur Kr. Tómasson, Director
Statistics and IT Department	Tómas Örn Kristinsson, Director

Subsidiaries

Greiðsluveitan ehf.:	Logi Ragnarsson, Director
Sölvhöll ehf. (ESÍ):	Haukur C. Benediktsson, Director



CONSOLIDATED
ANNUAL ACCOUNTS 2011

Independent Auditor's Report

To the Supervisory Board and the Governors of the Central Bank of Iceland

We have audited the consolidated annual accounts of the Central Bank of Iceland for the year 2011. The consolidated annual accounts include confirmation by the senior management of the Central Bank of Iceland, a profit and loss account, a balance sheet, a statement of cash flows, information on accounting principles, and other explanatory notes.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these Consolidated Annual Accounts in accordance with generally accepted accounting principles in Iceland and the Icelandic Annual Accounts Act. This responsibility includes designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of Consolidated Annual Accounts that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these Consolidated Annual Accounts based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the Consolidated Annual Accounts are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Consolidated Annual Accounts. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the Annual Accounts, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the Annual Accounts in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the Consolidated Annual 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 consolidated annual accounts give a true and fair view of the results of operations of the Central Bank of Iceland for the year 2011, the financial position as at 31 December 2011, and cash flows for the year then ended, in accordance with the Annual Accounts Act and the Rules on the Central Bank of Iceland's Accounting and Annual Accounts.

Kópavogur, 22 March 2012

Deloitte ehf.

Benóni Torfi Eggertsson
State Authorised
Public Accountant

Jón Rafn Ragnarsson
State Authorised
Public Accountant

Confirmation by the management of the Central Bank of Iceland

The Supervisory Board and Governor of the Central Bank of Iceland hereby confirm the Bank's annual financial statements for the year 2011 with their signatures.

Reykjavík, 22 March 2012

Confirmation by the Supervisory Board

Lára V. Júlíusdóttir

Chairman

*Ragnar Arnalds
Hildur Traustadóttir
Katrín Olga Jóhannesdóttir*

*Björn Herbert Guðbjörnsson
Ragnar Árnason
Ingibjörg Ingvadóttir*

Confirmation by the Governor

Már Guðmundsson

Confirmation by the Minister of Economic Affairs

With reference to the statements by the auditor, the Supervisory Board, and the Governor of the Central Bank, I hereby ratify these financial statements.

Reykjavík, 29 March 2012

Steingrímur J. Sigfússon

Profit and Loss Account for the Year 2011

	Notes	2011	2010
Interest income			
From domestic assets		49,694,764	37,958,088
From foreign assets		11,658,597	11,125,305
	1	<u>61,353,362</u>	<u>49,083,393</u>
Interest expense			
From domestic liabilities		17,061,232	27,783,299
From foreign liabilities		10,761,361	8,540,466
	2	<u>27,822,593</u>	<u>36,323,765</u>
Net interest income		33,530,769	12,759,628
Other operating revenues			
Service revenues	3	1,201,897	380,656
Service expenses	4	(299,542)	(249,087)
Revenues from shareholdings	5	60,697	137,185
Revaluation of foreign securities and loans	6	1,155,346	975,851
Revaluation of gold	7	881,405	2,564,501
Exchange rate gains on foreign exchange transactions ..	8	2,086,187	727,842
Gains on system sales			186,760
Revaluation of Greiðsluveitan	9		146,625
		<u>5,085,990</u>	<u>4,870,333</u>
Net operating revenues		38,616,758	17,629,961
Other operating expenses			
Salaries and related expenses	10	1,599,320	1,316,123
Other operating expenses	11	1,196,870	642,847
Expense due to banknotes and coin	12	218,560	9,886
Depreciation of property and equipment	27	155,981	78,642
Impairment of claims	13	23,906,948	21,279,537
		<u>27,077,680</u>	<u>23,327,035</u>
Profit (loss) for the year excluding exchange rate		11,539,079	(5,697,074)
Income tax 20%	15	(1,148,005)	(868,785)
Profit (loss) w/o contribution to Treasury		10,391,074	(6,565,859)
Contribution to the Treasury	16	(3,463,692)	
Exchange rate difference	14	7,470,603	(6,933,007)
Net Profit (loss) for the year		<u>14,397,984</u>	<u>(13,498,866)</u>

Amounts are in ISK thousands

Balance Sheet 31 December 2011

Assets	Note	2011	2010
Gold	17	12,248,658	10,426,358
Foreign assets	18-21	1,044,515,699	721,059,761
FX balance with the IMF	22	3,525,215	3,321,985
Domestic financial assets	23-26	502,332,405	527,298,685
Real estate and liquid assets	27	4,890,746	4,997,336
Income tax credit	28	5,062,286	1,200,000
Other assets	29	8,135,768	9,317,391
		<u>1,580,710,777</u>	<u>1,277,621,517</u>
Liabilities and equity			
Banknotes and coin	31	43,204,646	38,269,478
Foreign debt	32, 33	341,603,677	193,237,741
Counterpart to IMF	22	21,140,864	19,970,893
Deposits of financial institutions	34	61,997,455	98,017,286
Other deposits	35	919,729,302	673,176,272
Domestic financial liabilities	36	85,914,469	182,791,137
Income tax obligation	28	5,348	9,070
Pension obligations	37	321,113	322,222
Other liabilities	38	19,553,069	2,448,259
Unpaid contribution to Treasury	16	3,463,692	
		<u>1,496,933,635</u>	<u>1,208,242,358</u>
Capital		57,501,000	57,501,000
Revaluation reserve and liquid assets		4,501,922	4,554,388
Other equity	39	21,774,221	7,323,770
		<u>83,777,143</u>	<u>69,379,158</u>
		<u>1,580,710,777</u>	<u>1,277,621,517</u>
Assets and liabilities not included in the balance sheet ..	40		
Subsidiaries	30		
Risk management	41-48		

Statement of Cash Flows 2011

OPERATING ACTIVITIES:	2011	2010
Profit (loss) for the year	14,397,984	(13,498,866)
<i>Operating items not involving cash:</i>		
Depreciation of property and equipment	155,981	78,642
Exchange rate differences on assets and liabilities	24,736,899	(27,868,907)
Exchange rate differences on cash position	(32,207,501)	28,512,530
Various valuation changes, assets and liabilities	(34,912,945)	(16,956,535)
Loan impairment	23,906,948	21,279,538
Capital shares written off	(3,866,007)	(1,199,586)
<i>Change in operating assets and liabilities</i>	25,994,898	3,756,863
	<u>18,206,257</u>	<u>(5,896,322)</u>
INVESTMENT ACTIVITIES:		
Collateralised and overnight loans (increase)	41,819,956	(30,892,332)
Foreign-denominated loans to domestic parties		(1,470,518)
Purchased property and equipment	(53,026)	(25,886)
Sold liquid assets (equipment)	4,000	
Equity sold	4,964,132	
Purchased government bonds	(18,518,856)	
Securities purchased	(57,785,246)	(59,848,119)
Securities sold	66,305,337	
Instalments on securities, etc.	70,393,197	86.332.795
Securities purchased in foreign reserves	(178,191,076)	(99.051.514)
Securities sold in foreign reserves	136,324,418	77.485.490
Share capital increase and subsidiaries' share capital increase		(188.240)
Investment tax, subsidiaries	226,057	(1.424.573)
	<u>68,300,957</u>	<u>(29.082.897)</u>
FINANCING ACTIVITIES:		
Banknotes and coin in circulation, increase	4,935,168	9.311.800
Loan from IMF	96,303,980	38.930.335
Loans taken from Nordic central banks	38,121,600	25.009.110
Other loans taken	(58,373)	6,739,897
Certificates of deposit, increase (decrease)	13,063,339	28,483,775
Treasury time deposits (decrease)	(98,854,554)	(6,500,000)
Contributed capital	(11,000,011)	(32,643,000)
Foreign-denominated deposits, increase (decrease)	245,224,831	107,480,036
Increase (decrease) in deposits, DMBs	(27,085,115)	(30,197,579)
Increase (decrease) in deposits, other	(63,233,952)	5,591,544
Increase (decrease) in deposits, central government	11,627,680	102,164,719
	<u>210,275,886</u>	<u>254,370,637</u>
CHANGES IN CASH POSITION:		
Foreign bank deposits, increase	293,971,035	220,718,909
Exchange rate differences on bank deposits	32,207,501	(28,512,530)
Foreign deposit balance at beginning of year	433,260,412	241,054,034
Foreign cash balance at year-end	<u>759,438,947</u>	<u>433,260,412</u>

Amounts are in ISK thousands

Summary of main accounting principles

Basis for accounting methods

- The annual financial statements have been prepared in accordance with the Annual Accounts Act, no. 3/2006, the Act on Financial Undertakings, no. 161/2002, and the Rules on the Central Bank of Iceland's Accounting and Annual Accounts, no. 1088/2005.

Estimates and decisions

- In preparing the Annual Accounts, management must, in accordance with the Annual Accounts Act, take decisions, make estimates and draw conclusions that affect assets and liabilities on the financial reporting date, and provide information in the explanatory notes concerning income and expenses. These accounting estimates and conclusions are based on experience and various other factors that are considered appropriate and constitute grounds for the decisions taken on the book value of assets and liabilities where such value cannot be determined otherwise.
- Changes in accounting estimates are recognised in the period in which they take place.

Group

- The consolidated Annual Accounts include those of the parent company and its subsidiaries. Subsidiaries are companies controlled by the group. Control exists when the parent has the power to take decisions on the finances and operations of the subsidiary.

The group accounts are prepared using the cost method, and in instances where ownership of a subsidiary is less than 100%, the minority interest is identified and operating performance. Where the minority interest is an insignificant amount, it is not shown separately in the accounts.

In acquisitions of subsidiaries, their assets and liabilities are estimated at fair value on the date of purchase. If the purchase price is higher than the net asset after such valuation, the difference is recognised as goodwill. Subsidiaries' operating results during the year are included in the consolidated profit and loss account.

Among the objectives of consolidated financial reporting is to publish only income, expenses, assets, and liabilities vis-à-vis external parties; therefore, internal transactions are netted out in preparing the financial statements. If appropriate, adjustments are made to the subsidiaries' accounts in order to harmonise them with the consolidated accounting methods.

Shares in subsidiaries

- Subsidiaries are firms controlled by the parent company. Control exists when the parent has the power to take decisions on the finances and operations of the subsidiary. Shares in subsidiaries are accounted for using the equity method, and shares in associates are recognised at cost, after adjusting for the share in operations and impairment of individual investments. Subsidiaries' losses in excess of the ownership share are only charged if the company has guaranteed or undertaken obligations on their behalf.

Foreign currencies

- Assets and liabilities in foreign currency are entered in Icelandic currency using the mid-exchange rate at year-end 2011. Revenues and expenses in foreign currency are converted using the exchange rate on the transaction date.

	Average exchange rate for the year		Year-end exchange rate	
	2011	2010	2011	2010
Euro (EUR).....	161.42	161.89	158.84	153.80
US dollar (USD).....	116.07	122.04	122.71	115.26
Pound sterling (GBP).....	186.00	188.55	189.43	178.47
Canadian dollar (CAD).....	117.31	118.46	120.21	115.26
Danish krone (DKK).....	21.67	21.74	21.37	20.64
Norwegian krone (NOK).....	20.70	20.21	20.40	19.67
Swedish krona (SEK).....	17.88	16.96	17.79	17.16
Swiss franc (CHF).....	131.20	117.24	130.66	122.91
Japanese yen (JPY).....	1.46	1.39	1.59	1.41
Polish złoty (PLN).....	39.25	40.54	35.78	38.85

- Indexed assets and liabilities are entered with accrued indexation as of year-end 2011, using the index value of January 2012, which reflects year-end 2011 price levels. Indexation is recognised in the profit and loss account, with interest.
- Securities in the Bank's foreign exchange reserves are entered at market price in US dollars, and valuation changes are entered in the profit and loss account. Valuation changes are the difference between market value and book value of securities, and the premium or discount on the date of purchase is distributed over the lifetime of the securities on a straight-line basis, providing an effective interest rate.
- Revenues are entered when earned, irrespective of whether collection has taken place. Expenses are also entered when incurred, irrespective of whether they have been paid. Furthermore, valuation changes in securities are entered in the profit and loss account, irrespective of whether the securities have been redeemed.
- Banknotes and coin in circulation are recognised at nominal value. The amount is obtained by deducting the value of banknotes and coin received by the Central Bank of Iceland from manufacturers, both the value of notes and coin in the vaults and the value of notes and coins the Bank has destroyed. The change is expensed in the profit and loss account.
- Seigniorage is expensed when the costs are incurred.
- Income tax is calculated and recognised in the annual accounts. Its calculation is based on earnings before taxes, adjusted for permanent differences between taxable earnings and earnings according to the annual accounts. The income tax rate is 20%.
- Income tax payable is income tax that is estimated to become due and payable in the next year due to taxable profit for the year, plus an adjustment of income tax payable for previous years.
- Deferred tax derives from the difference between balance sheet items in the tax settlement, on the one hand, and the annual accounts, on the other. The difference stems from the fact that the company's income tax base is obtained by means other than those used in the preparation of the financial statements.

Indexed assets and liabilities

Securities

Entry of revenues and expenses

Banknotes and coin

Taxation

Property and equipment

- The income tax credit balance is assessed on the accounting date and is only recognised to the extent that it is likely to be used to offset taxable profit in the future.
- Property and equipment were capitalised in 2005 based on the appraised value at the end of that year. Assets are listed among property and equipment when it is likely that the economic benefits of the asset concerned will be useful to the group and when it is possible to estimate the cost due to the asset in a reliable manner. Property and equipment are recognised using either the cost-price method or the revaluation method. According to the cost-price method, property and equipment are entered at original cost price less accumulated depreciation and impairment. The cost price of property and equipment consists of the purchase price and all direct costs relating to putting the asset into revenue-generating condition. The revaluation method uses fair value on the date the property and equipment are revalued, less depreciation and impairment.
- Depreciation is calculated as a fixed annual percentage of the cost price/revaluation price based on the holding period during the year with consideration given to expected scrap value.
- Profit or loss due to the sale of assets is the difference between the sale price and the book value of the asset on the date of sale.

Gold

- Gold in the Bank's foreign exchange reserves is entered at market price in US dollars, and valuation changes are entered in the profit and loss account.

Obligations

- Obligations are written up in the balance sheet if it is considered likely that the company will be faced with financial expense in the future due to a specified event or transaction and it is possible to assess the monetary amount in a reliable manner.

Derivatives

- Derivatives are entered depending on whether they are listed in the foreign exchange reserves (that is, vis-à-vis a foreign party) or whether they are highly liquid and settled and entered in foreign currency, or whether they are vis-à-vis domestic parties or those involving domestic currency.
- The value of derivatives is entered as a net amount; that is, assets less liabilities.
- Forward foreign exchange agreements (FX forwards) are entered based on the forward principal, which is multiplied by the difference between the settlement exchange rate and the spot exchange rate on the date of the transaction. The difference between the exchange rate on the date of the transaction and the contract exchange rate is recognised through profit and loss.
- Forward foreign exchange swap agreements (FX swaps) are recognised as a spot transaction, on the one hand, and as a forward transaction, on the other. The spot transaction is entered as an FX spot transaction, and the forward transaction is entered as an FX forward transaction.
- Gains on FX forwards and swaps are entered as exchange rate gains on foreign exchange transactions.

Notes to the financial statements for the year 2011

Interest income

1. Interest income specifies as follows (in ISK thousands):

	2011	2010
<i>Interest income on domestic assets:</i>		
Interest income on overnight loans	34,780	131,905
Interest income on collateralised loans	367,580	1,497,751
Interest income on marketable securities	1,399,936	3,035,864
Interest income on indexed securities	27,216,384	21,732,489
Interest income on other domestic assets	20,676,085	11,560,078
	<u>49,694,764</u>	<u>37,958,088</u>
<i>Interest income on foreign assets:</i>		
Interest income on bank accounts	3,638,320	1,402,235
Interest income on securities	6,469,776	9,693,957
Interest income on other foreign assets	1,550,501	29,113
	<u>11,658,597</u>	<u>11,125,305</u>

- Interest income on overnight loans declined from 132 m.kr. in 2010 to 35 m.kr. in 2011, or by 74%. In 2011, 90 overnight loans were granted, in the amount of 135 b.kr. In 2010, 288 overnight loans were granted, in the amount of 378 b.kr. The average interest rate in 2011 was 5.42%, as compared with 9.15% in 2010.
- Interest income on collateralised loans declined by 75% during the year, primarily due to lower principal. No collateralised loans were outstanding at year-end 2011. The average interest rate in 2011 was 7.77%, as compared with 4.44% in 2010. In 2011, 49 collateralised loans were granted, in the amount of 298 b.kr. In 2010, 115 collateralised loans were granted, in the amount of 676 b.kr.
- Interest income on marketable securities declined from 3.0 b.kr. to 1.4 b.kr., or by 54%. This is due to the purchase and sale of marketable securities in 2010.
- Interest income on indexed securities rose by 5.5 b.kr. between years. Indexation due to indexed securities is recognised as interest income. The Consumer Price Index rose by 4.0% in 2011, and indexation income increased by 14 b.kr. In 2010, the CPI rose by 5.4% and indexation income by 7.8 b.kr.
- Interest income on foreign bank accounts rose by 160%, or by 2.2 b.kr. Bank deposits rose by 60% year-on-year, due primarily to expansion of the foreign exchange reserves with borrowings and foreign-currency deposits from the Government, the financial institutions, and financial institutions in winding-up proceedings.
- Interest income on foreign securities declined by 33%, or by 3.2 b.kr. This is due to lower interest on the securities. The average interest rate on foreign securities was 3.47% in 2011, as opposed to 5.42% in 2010.

- Interest income on other foreign assets rose by 1.5 b.kr. The increase is due to interest income on derivatives used by the Bank to steer its foreign exchange balance and to hedge against other items in its balance sheet.

Interest expense

2. Interest expense specifies as follows (in ISK thousands):

	2011	2010
<i>Interest expense on domestic liabilities:</i>		
Interest expense on certificates of deposit	3,653,120	5,066,426
Interest expense on current accounts	2,946,225	8,550,151
Interest expense on Treasury current accounts	4,628,446	12,984,895
Interest expense on foreign-currency accounts	3,340,578	1,181,827
Interest expense on other domestic liabilities	2,492,862	
	<u>17,061,232</u>	<u>27,783,299</u>
<i>Interest expense on foreign liabilities:</i>		
Interest expense on the balance with the IMF	1,311,568	310,084
Interest expense due to Treasury foreign borrowing	2,367,076	5,131,075
Interest expense on foreign borrowings	7,082,717	3,099,307
	<u>10,761,361</u>	<u>8,540,466</u>

- Interest expense on certificates of deposit declined by 1.4 b.kr., or 28%. The average balance of certificates of deposit was 86.9 b.kr. in 2011, as opposed to 66.6 b.kr. in 2010. The average interest rate in 2011 was 4.0%, as compared with 7.3% in 2010.
- Interest expense on current accounts declined by 5.6 b.kr., or 66%. The balance of current accounts declined by 47 b.kr. between years, or 51%. The average interest rate on current accounts fell from 6.3% to 3.4%.
- Interest expense on Treasury current accounts declined by 8.4 b.kr., or 64%. The balance of Treasury current accounts declined by 13.5 b.kr. between years, or 10.3%. The average interest rate fell from 6.3% to 3.4%.
- Interest expense on foreign-currency accounts rose by 2.2 b.kr. The increase is due primarily to the year-on-year rise in foreign-denominated deposits owned by the Government, the financial institutions, and financial institutions in winding-up proceedings.
- Interest expense on the balance with the IMF rose by 1 b.kr. This is because the full amount of the IMF loan facility has been drawn.
- Interest expense due to Treasury foreign borrowing declined by 2.8 b.kr., or 54%. This is due to retirement of debt during the year.

Service revenues

3. Service revenues specify as follows (in ISK thousands):

	2011	2010
Revenues from payment intermediation	993,040	219,932
Revenues from foreign exchange brokerage	3,333	3,469
Revenues from service to the Treas. for market transact.	102,011	97,000
Other service revenues	103,513	60,255
	<u>1,201,897</u>	<u>380,656</u>

- Service revenues rose by 821 m.kr. from the prior year. This is due mainly to payment intermediation revenues generated by the Bank's subsidiary. At year-end 2010, the Central Bank of Iceland acquired Greiðsluveitan ehf. (see Note no. 30).

Service expenses

4. Service expense specifies as follows (in ISK thousands):

	2011	2010
Expenses due to payment intermediation	47,900	51,782
Expenses due to foreign currency auctions	55,696	
Borrowing expense	47,475	65,900
Other service expenses	148,470	131,405
	<u>299,542</u>	<u>249,087</u>

- Expenses due to foreign currency auctions in connection with the capital account liberalisation strategy were incurred during the year.

Income from equity holdings

5. Income from equity holdings specifies as follows (in ISK thousands):

	2011	2010
Dividends from BIS	57,947	137,185
Other dividends	2,750	
	<u>60,697</u>	<u>137,185</u>

Revaluation of foreign securities

6. Revaluation of foreign securities specifies as follows (in ISK thousands):

	2011	2010
Foreign securities, change in fair value	1,155,346	975,851
	<u>1,155,346</u>	<u>975,851</u>

<i>Nominal value of foreign securities, by currency:</i>	2011	2010
EUR.....	874,392,477	928,865,744
GBP.....	92,368,918	55,457,947
PLN.....	204,129,000	204,129,000
USD.....	744,418,155	290,970,306

Revaluation of gold

7. The increase in the Bank's gold reserves, at constant exchange rates, totalled 881 m.kr. in 2011, as opposed to 2.6 b.kr. in 2010. The market price of gold was 1,564.91 US dollars per ounce at year-end 2011, as compared with 1,420.78 US dollars per ounce at the beginning of the year.

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Exchange rate gains on foreign exchange transactions

8. Exchange rate gains on foreign exchange transactions totalled 2.1 b.kr. in 2011, as opposed to 728 m.kr. in 2010.
- This is due primarily to realised gains on derivative transactions in foreign currencies, which are carried out at foreign financial institutions. The Bank uses derivative instruments to steer its foreign exchange balance and to hedge against other items in its balance sheet.

	2011	2010
Exchange rate gains on foreign exchange transactions (in ISK thousands):.....	2,086,187	727,842
	<u>2,086,187</u>	<u>727,842</u>

Revaluation of Greiðsluveitan

9. The revaluation of the holding in Greiðsluveitan totalled 147 m.kr. in 2010. The revaluation took place concurrent with the Bank's acquisition of Fjölgreiðslumiðlun hf. in full and the simultaneous change of the company's name to Greiðsluveitan ehf.

Salaries and related expenses

10. Salaries and related expenses specify as follows (in ISK thousands):

	2011	2010
Salaries.....	1,244,301	1,046,445
Pension fund.....	170,534	132,784
Other salary-related expenses.....	140,143	113,033
Contribution to pension obligations.....	44,342	23,861
	<u>1,599,320</u>	<u>1,316,123</u>
Number of full-time position equivalents at year-end.....	161	147

- There is no bonus system in place for Central Bank employees, neither for managers nor for other members of staff.
- In 2011, total remuneration to the Governor and the Supervisory Board amounted to 28 m.kr. The Governor is not remunerated for participation in boards and committees jointly operated by institutions in the financial market or to which the Central Bank of Iceland appoints a representative by law. Total remuneration to the Governor and the Supervisory Board in 2011 specify as follows (in ISK millions):

	2011	2010
<i>Governor</i>		
Már Guðmundsson	16.5	18.7
<i>Supervisory Board:</i>		
Lára V. Júlíusdóttir	2.8	3.0
Other Supervisory Board members and alternates	8.7	9.5
	<u>28.0</u>	<u>31.2</u>

Other operating expense

11. Other operating expense specifies as follows (in ISK thousands):

	2011	2010
Outsourced services	382,287	330,897
Operation of property and liquid assets	547,396	187,901
Sundry operational items	267,188	124,049
	<u>1,196,870</u>	<u>642,847</u>

- Other operating expense increased by 554 m.kr. year-on-year. The increase is due in particular to increased expense related to the operation of payment systems owned by Central Bank subsidiaries.

Expense due to banknotes and coin

12. Expense due to banknotes and coin specifies as follows (in ISK thousands):

	2011	2010
Banknote printing	150,309	
Minting of coins	55,859	
Distribution costs	2,624	2,895
Equipment	9,768	6,991
	<u>218,560</u>	<u>9,886</u>

Impairment of claims

13. Expensed claim impairment amounted to 23.9 b.kr. in 2011, as opposed to 21.3 b.kr. in the prior year.

	2011	2010
Permanently lost	1,548,974	7,869,694
Precautionary write-off	22,357,974	13,409,844
	<u>23,906,948</u>	<u>21,279,537</u>

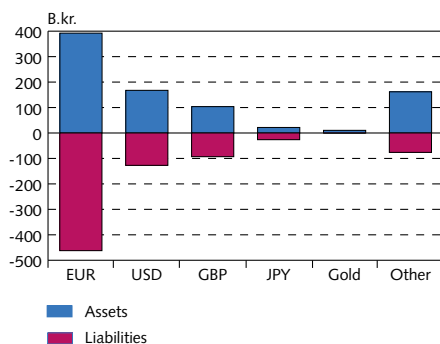
14. Exchange rate difference specifies as follows (in ISK thousands):

	2011	2010
Gold	940,895	(801,992)
International Monetary Fund	1,540,782	1,438,917
Foreign bank deposits	29,683,850	(28,512,530)
Foreign securities	11,661,611	(32,263,674)
Foreign current liabilities	(10,006,467)	14,262,579
Foreign loans, FX accounts	(26,350,067)	38,943,693
	<u>7,470,603</u>	<u>(6,933,007)</u>

Changes in major currencies versus the Icelandic króna were as follows:

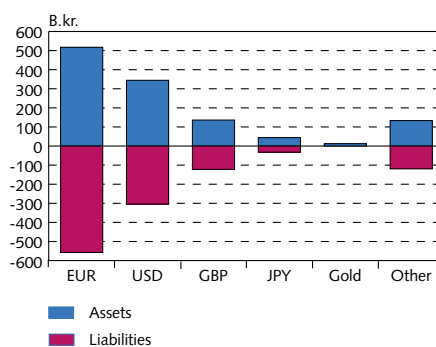
%	2011	2010
USD	6.7	-7.9
EUR	3.3	-14.5
GBP	6.1	-11.5
NOK	3.7	-9.2
DKK	3.5	-14.6
SEK	3.7	-2.1
JPY	11.5	4.6
CAD	4.3	-3.2
XDR	5.9	-9.1

Total assets and liabilities in currency
2010



Source: Central Bank of Iceland.

Total assets and liabilities in currency
2011



Source: Central Bank of Iceland.

Income tax

15. The Central Bank of Iceland is exempt from income tax pursuant to Article 4 of the Income Tax Act, no. 90/2003. The Bank's subsidiaries are taxable entities pursuant to the Income Tax Act, however. Their income tax is expensed in the consolidated accounts and specifies as follows (in ISK thousands):

	2011	2010
Sölvhóll ehf.	(1,715)	(1,462)
Central Bank of Iceland Holding Company ehf.	(1,108,467)	(867,323)
Greiðsluveitan ehf.	(37,823)	
	<u>(1,148,005)</u>	<u>(868,785)</u>

- Income tax payable in 2012 amounts to 5,014 m.kr.

Effective income tax for 2011 specifies as follows (in ISK thousands):

	Amount	%
Profit from subsidiaries	4,289,565	
Tax rate	(857,913)	-20
Non-deductible expense	(11)	0
Share in subsidiaries' losses not recognised as income	(403,797)	-9.4
Change in write-down of income tax	113,716	2.7
Income tax according to profit and loss	<u>(1,148,005)</u>	<u>-26.8</u>

Contribution to the Treasury

16. The contribution to the Treasury, pursuant to Article 34 of the Act on the Central Bank of Iceland, no. 36/2001, is calculated as 2/3 of the profit on its net profit (excluding exchange rate loss or gain) during the year if equity (excluding revaluation) exceeds 2.25% of outstanding loans and domestic securities holdings in the credit system at the end of the year; otherwise, the contribution shall equal 1/3. Because the Bank's equity was below this limit at year-end 2010, payment should have been calculated as 1/3 of profits; however, the Bank incurred a loss in 2010, and there will be no contribution to the Treasury for the year.

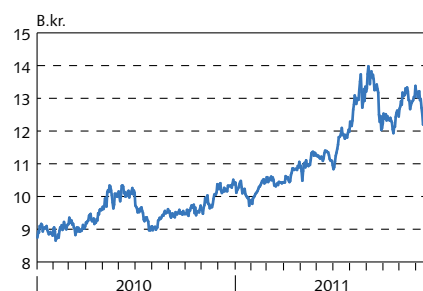
- The Bank's equity at year-end 2011 was below this limit; therefore, it is assumed that the contribution to the Treasury will amount to 1/3 of the profit excluding calculated exchange rate differences.

	2011	2010
Profit for the year excluding exchange rate difference and contribution to the Treasury	10,391,074	(6,565,859)
Contribution to the Treasury	(3,463,692)	
Profit / (Loss) for the year excl. exchange rate difference	<u>6,927,382</u>	<u>(6,565,859)</u>
Exchange rate difference	7,470,603	(6,933,007)
	<u>14,397,984</u>	<u>(13,498,866)</u>

Gold

17. The Bank's holdings in gold amounted to 63,785.1 ounces at year-end 2011. The gold is entered at market value as of year-end 2011, when the ounce was valued at USD 1,564.91, the equivalent of 192,030 kr. Thus the Bank's holdings in gold were valued at 12.2 b.kr. as of year-end 2011.

Development of gold prices



Source: Central Bank of Iceland.

Changes in gold holdings specify as follows (in ISK thousands):

	2011	2010
Balance at beginning of year	10,426,358	8,663,849
Revaluation	881,405	2,564,501
Exchange rate difference	940,895	(801,992)
Balance at year-end	<u>12,248,658</u>	<u>10,426,358</u>

18. Foreign assets specify as follows (in ISK thousands):

	2011	2010
Foreign bank deposits	672,143,912	420,181,891
Foreign securities	272,072,067	217,821,305
Special drawing rights with the IMF	87,295,035	13,078,521
Foreign assets not held in reserves	13,004,685	69,978,044
	<u>1,044,515,699</u>	<u>721,059,761</u>

19. Foreign bank deposits specify as follows (in ISK thousands):

	2011	2010
Balance in foreign central banks	565,575,529	320,494,767
Balance in other foreign banks	106,568,383	99,687,124
	<u>672,143,912</u>	<u>420,181,891</u>
Deposits available for disbursement	417,687,204	196,758,961
Term deposits, available within 3 months	254,456,708	223,422,930
	<u>672,143,912</u>	<u>420,181,891</u>

20. Changes in foreign securities during the year specify as follows (in ISK thousands):

	2011	2010
Balance at beginning of year	217,821,305	231,573,927
Purchases during the year	178,191,076	99,051,514
Sold and collected during the year	(136,324,418)	(78,209,704)
Revaluation	722,494	(2,330,758)
Exchange rate difference	11,661,611	(32,263,674)
	<u>272,072,067</u>	<u>217,821,305</u>

21. Foreign assets not held in reserves

Foreign assets not held in reserves specify as follows (in ISK thousands):

	2011	2010
Shareholdings in the Bank for International Settlements..	184,486	184,486
Other assets not held in reserves.....	12,820,199	69,793,558
	<u>13,004,685</u>	<u>69,978,044</u>

- Shareholdings in the Bank for International Settlements (BIS) are entered at cost price. At year-end 2011, the number of shares was 1,070 and the value of each share was SDR 5,000. The bank's shares are entered under Other foreign assets not held in reserves. The book value as of year-end 2011 was 184.5 m.kr., and the nominal value was 252 m.kr. (SDR 1.3 million). Payment has been remitted for 25% of each SDR 5,000 share, or SDR 1,250 for each share. The Bank is obliged to remit the remaining 75% upon demand.

International Monetary Fund (IMF)

22. Iceland's quota with the International Monetary Fund (IMF) totalled SDR 117.6 million at year-end 2011. One-fourth (¼) of the quota was paid for with gold and Icelandic krónur. The Bank's foreign exchange balance with the Fund totalled SDR 18.7 million, which is the difference between the quota and the Fund's ISK deposits with the Bank; cf. the table below. The Bank's borrowings in the form of Fund allocations in SDR totalled SDR 112.2 million. The Bank has also drawn the full amount of the loan facilities from the Fund, in the amount of SDR 1,400 million.

<i>Assets (m.kr.):</i>	SDR	ISK
Central Bank of Iceland quota	117.6	22,154.7
IMF deposit with Central Bank of Iceland	(98.9)	(18,631.8)
Central Bank's FX balance with IMF	18.7	3,525.2
Central Bank's deposit balance with IMF	463.4	87,295.0
	<u>482.1</u>	<u>90,820.2</u>
<i>Liabilities (m.kr.):</i>		
Counterpart to IMF allocations	112.2	21,140.9
IMF current account with Central Bank of Iceland	0.0	1.6
Loan from IMF	1,406.5	264,963.6
	<u>1,518.7</u>	<u>286,113.6</u>

Domestic financial assets

23. Counterparties to domestic financial assets specify as follows (in ISK thousands):

	2011	2010
Financial institutions	202,367,435	227,771,824
Treasury	194,641,368	173,392,552
Financial institutions in winding-up proceedings	53,682,450	101,951,118
Other parties	51,641,152	24,183,192
	<u>502,332,405</u>	<u>527,298,686</u>

24. Domestic financial assets at financial institutions specify as follows (in ISK thousands):

	2011	2010
Collateralised loans		40,824,956
Overnight loans		995,000
Derivatives	4,311,854	313,582
Deposits	7,278,487	304,272
Housing Financing Fund bonds	8,827,629	8,015,606
Housing Authority bonds	125,915	156,197
Loans	181,823,550	177,162,211
	<u>202,367,435</u>	<u>227,771,824</u>

25. Domestic financial assets with the Treasury specify as follows (in ISK thousands):

	2011	2010
Bonds	173,073,569	164,388,389
Treasury bonds	20,419,596	2,867,986
Treasury bills	898,961	
Treasury securities denominated in foreign currency	249,242	6,136,176
	<u>194,641,368</u>	<u>173,392,552</u>

Changes in Treasury bond specify as follows (in ISK thousands):

	2011	2010	2009	2008
Balance at beginning of year	164,388,389	161,141,868	270,005,388	
Principal	146,651,654	146,651,654	270,005,388	
Purchases during the year				270,005,388
Indexation	25,358,795	16,726,965	23,303,301	
Accrued interest	1,063,120	1,009,770	1,833,179	
Payment			(134,000,000)	
Balance at year-end	<u>173,073,569</u>	<u>164,388,389</u>	<u>161,141,868</u>	<u>270,005,388</u>

26. Loans due and payable amount to 53.7 b.kr. at year-end 2011, as compared with 102 b.kr. at year-end 2010.

<i>Loans due and payable specify as follows (in ISK thousands):</i>	2011	2010	2009	2008
Balance at beginning of year	101,951,118	490,614,019	333,491,781	
Due and payable during the year			117,269,848	678,496,781
Collateralised loans purchased from the Treasury			134,000,000	
Book value of collater. loans sold to the Treasury				(95,102,000)
Appropriation of assets	(34,497,885)	(264,931,242)		
Impairment of claims	(3,515,636)	(16,516,643)	(22,073,493)	(249,903,000)
Instalments and exchange rate differential	(10,255,147)	(107,215,016)	(72,074,117)	
Balance at year-end	<u>53,682,450</u>	<u>101,951,118</u>	<u>490,614,019</u>	<u>333,491,781</u>

Real estate and liquid assets

27. Real estate and liquid assets are recognised using either the cost-price method or the revaluation method.

- Tangible operational assets as of year-end 2011 specify as follows (amounts in ISK thousands):

	<i>Land</i>	<i>Real estate</i>	<i>Liquid assets</i>	<i>Libraries and collections</i>	<i>Total</i>
<i>Cost price and valuation</i>					
Cost price at beginning of year 2010...		90,976	103,191	8,126	202,293
Valuation at beginning of year 2010...	24,000	4,575,331	173,055	237,000	5,009,385
Total at beginning of year 2010	24,000	4,666,307	276,246	245,126	5,211,679
Transferred due to merger			671,108		671,108
Capitalised during the year			25,886		25,886
Sold (cost price)			(13,214)		(13,214)
Sales and disp. dur. the year (valuation)			(140,329)		(140,329)
Cost price at beginning of year 2011...		90,976	786,972	8,126	886,074
Valuation at beginning of year 2011...	24,000	4,575,331	32,726	237,000	4,869,057
Total at beginning of year 2011	24,000	4,666,307	819,698	245,126	5,755,130
Capitalised during the year			53,026		53,026
Sales and disp. dur. the year (cost price)			(5,050)		(5,050)
Cost price at year-end 2011		90,976	834,948	8,126	934,050
Valuation at year-end 2011	24,000	4,575,331	32,726	237,000	4,869,057
Total at year-end 2011	24,000	4,666,307	867,674	245,126	5,803,107
<i>Depreciation</i>					
Cost price at beginning of year 2010...		2,572	52,223		54,795
Valuation at beginning of year 2010 ...		243,554	158,976		402,530
Total at beginning of year 2010		245,126	211,199		457,325
Transferred due to merger			375,370		375,370
Depreciation for the year at cost price ..		951	25,224		26,175
Deprec. for the year at valuation price		48,944	3,523		52,467
Sold (cost price)			(13,214)		(13,214)
Sales and disp dur. the year (valuation)			(140,329)		(140,329)
Cost price at beginning of year 2011 ..		3,523	439,603		443,126
Valuation at beginning of year 2011 ...		292,498	22,170		314,668
Total at beginning of year 2011		296,021	461,773		757,794
Depreciation for the year at cost price ..		951	102,563		103,514
Deprec. for the year at valuation price	48,944	3,523		52,467	
Sales and disp. dur. the year (cost price)			(1,414)		(1,414)
Cost price at year-end 2011		4,474	540,752		545,226
Valuation at year-end 2011		341,442	25,692		367,135
Total at year-end 2011		345,917	566,445		912,361
<i>Book value</i>					
Book value at beginning of year 2010..	24,000	4,420,181	65,046	245,126	4,754,354
Book value at beginning of year 2011 ..	24,000	2,470,286	357,924	245,126	4,997,336
Book value at end of year 2011	24,000	4,320,390	301,229	245,126	4,890,746
Annual depreciation rates	0%	1-3%	10-33%	0%	

28. Deferred tax

<i>Deferred tax specifies as follows (in ISK thousands):</i>	<i>Credit balance</i>	<i>Liability</i>	<i>Total</i>
Balance at beginning of 2010			
Change due to reduction in income tax rate		(41)	(41)
Transferred due to consolidation		(8,656)	(8,656)
Calculated income tax for year 2010	(867,323)	(1,423)	(868,746)
Income tax for payment in 2011	2,067,323	1,051	2,068,374
Balance at beginning of 2011	1,200,000	(9,070)	1,190,930
Calculated income tax for year 2011	(1,108,467)	(39,538)	(1,148,005)
Income tax for payment in 2012	4,970,753	43,259	5,014,012
Year-end balance 2011	5,062,286	(5,348)	5,056,938

The income tax credit/(liability) is allocated as follows to individual balance sheet items:

	2011	2010
Property and equipment	(4,041)	(8,213)
Indirect write-down of financial assets	6,103,230	1,556,515
Deferred exchange rate difference	(480,506)	(67,283)
Write-down of credit due to uncertainty	(561,745)	(290,089)
	5,056,938	1,191,930

29. Other assets specify as follows (in ISK thousands):

	2011	2010
Equities	2,476,970	6,828,136
Investment tax withheld	1,568,645	1,768,894
Appropriated assets	1,457,739	
Unsettled transactions	1,980,882	
Other assets	651,442	720,362
	8,135,678	9,317,392

30. Subsidiaries

<i>Name of subsidiary</i>	<i>Location</i>	<i>Ownership share</i>	<i>Nominal value</i>	<i>Primary activities</i>
Sölvhóll ehf.	Iceland	100%	1,000,000	Operating company
Central Bank of Iceland Holding Comp. ehf.	Iceland	100%	1,000,000	Holding company
Greiðsluveitan ehf.	Iceland	100%	20,000,000	Payment system operations
Hilda hf.	Iceland	100%	1,000,000,000	Holding company

Greiðsluveitan ehf.

- On 15 November 2010, the owners of the Icelandic Banks' Data Centre (RB) and Fjölgreiðslumiðlun hf. (FGM) signed a framework agreement concerning a new structure for core and support systems pertaining to domestic payment intermediation. Among other things, the framework agreement stipulated that RB's operational form would change from a collaborative forum to a limited liability company, that the Central Bank would sell its stake in RB

and acquire FGM in full, and that ownership of the part of RB's software solutions most closely connected with payment intermediation would be transferred to FGM.

- These changes were formally confirmed on 15 December 2010 with the signing of an agreement between the owners of RB and FGM (banks, savings banks, payment card companies, and the Central Bank). With Decision no. 2/2011, dated 28 January 2011, the Competition Authority approved the merger of the Central Bank and Greiðsluveitan (the Bank's takeover of Greiðsluveitan's operations is the equivalent of a merger in the sense of the Competition Act). The name of the company has now been changed to Greiðsluveitan, and the operational form has been changed from a public limited company (hf.) to a private limited company (ehf.), as the Central Bank of Iceland is the sole owner.
- Greiðsluveitan ehf. now owns and is responsible for the operation of the following six payment intermediation systems: the RTGS system, the netting system, the RÁS system, the payables pool, Birtingur, and the SWIFT Alliance system. The Icelandic Banks' Data Centre is involved with the technical operations of these systems in the same manner as before the change. In addition, the owner of the company has entrusted it with the task of administering specified technical and operational aspects of the RTGS system, which handles all payment orders in amounts of 10 m.kr. and over.

Central Bank of Iceland Holding Company ehf (ESÍ) and Sölvhóll ehf.

- Until 2008, the Bank had not sustained any losses due to credit risk. In the wake of the banking collapse of 2008-2009, however, it has become clear that the Bank has sustained some losses due to unsecured collateral for collateral loans that were deemed sound at the time the loans were granted. In view of this, the Treasury, as the owner of the Bank, purchased securities with a book value of 345 b.kr. at year-end 2008 and paid for them with an indexed five-year debt instrument in the amount of 270 b.kr. At the same time, 75 b.kr. were written off. At year-end 2009, it was decided that the Central Bank would buy back the assets in question and then sell them to a separate subsidiary owned by the Bank and bearing the name Central Bank of Iceland Holding Company ehf. (ESÍ). Another Central Bank subsidiary, Sölvhóll ehf., is an operating company whose role will be to maximise the value of the assets in the holding company (ESÍ) and divest them when market conditions permit, subject to the approval of the ESÍ board. This arrangement provides the Bank with an effective means of separating the operations and assets related to the crash from its conventional activities. During the year, ESÍ took over Hilda hf., which became a subsidiary of ESÍ.

Banknotes and coin

31. Banknotes and coin in circulation (in ISK thousands):

<i>Banknotes:</i>	2011	2010
5.000 krónur	35,558,500	31,402,500
2.000 krónur	699,000	618,000
1.000 krónur	3,366,500	2,896,500
500 krónur.....	1,095,500	994,500
Total	<u>40,719,500</u>	<u>35,911,500</u>
 <i>Coin:</i>		
100 krónur.....	1,435,600	1,359,600
50 krónur	436,390	412,390
10 krónur	413,720	392,920
5 krónur.....	100,934	97,934
1 króna.....	98,502	95,134
Total	<u>2,485,146</u>	<u>2,357,978</u>
 Total in circulation	<u><u>43,204,646</u></u>	<u><u>38,269,478</u></u>

Foreign debt

32. Foreign liabilities specify as follows (in ISK thousands):

	2011	2010
Loan from IMF	264,963,639	156,321,881
Loan from Norges Bank	76,251,962	36,915,859
Other liabilities.....	388,076	
	<u>341,603,677</u>	<u>193,237,741</u>

- Disbursements from the IMF in connection with the Stand-By Arrangement are eight in number: the first tranche totalled SDR 560 million, the next four tranches are SDR 105 million each; and the last three tranches are SDR 140 million each. The total IMF loan facility in connection with the Stand-By Arrangement amounts to SDR 1,400 million. At year-end 2011, the loan facility had been drawn for the full amount (SDR 1,400 million, or 265 b.kr.).
- On 21 December 2009, the first tranche of the loan from the Nordic countries was disbursed to Iceland in connection with the Stand-By Arrangement. The second tranche was disbursed on 28 June 2010 and the third in December 2011. The Central Bank of Iceland has borrowed 480 million euros (76.2 b.kr. at the end-2011 exchange rate) from Norges Bank.

33. Instalments on long-term foreign debt are itemised as follows (in ISK thousands):

	<i>Loan from IMF</i>	<i>Loan from Norges Bank</i>	<i>Other liabilities</i>	<i>Total</i>
Instalments 2012.....	107,465,313	15,774,455	388,076	123,627,844
Instalments 2013.....	13,226,500			13,226,500
Instalments 2014.....	47,120,351			47,120,351
Instalments 2015.....	64,479,188			64,479,188
Instalments 2016.....	32,240,539	7,887,228		40,127,766
Instalments later.....	431,749	52,590,279		53,022,028
Total long-term debt.....	264,963,639	76,251,962	388,076	341,603,677

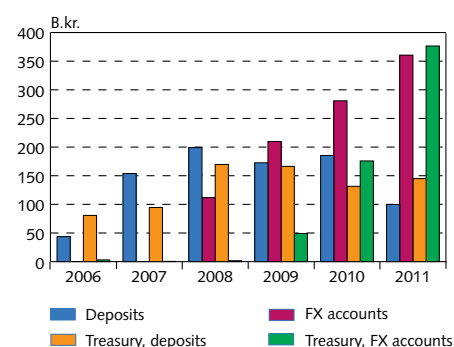
Deposits of financial institutions

34. Deposits of financial institutions specify as follows (in ISK thousands):

	2011	2010
Current accounts of deposit money banks.....	31,285,903	55,659,624
Current accounts of other financial institutions.....	13,898,245	36,915,985
Foreign exchange accounts.....	16,813,307	5,441,677
	61,997,455	98,017,286

- Credit institutions that are participants in the Central Bank RTGS system submit collateral for payments through the system. That collateral takes the form of securities. The collateral amount corresponds to the credit institutions' authorised intraday overdraft limit in the RTGS system.
- At year-end 2011, RTGS system collateral securities had a total market value of 17.75 b.kr.
- Credit institutions submit collateral to be held in custody at the Central Bank of Iceland in return for their collateralised loans in accordance with Rules no. 997/2004.

Development in deposits and FX accounts



Source: Central Bank of Iceland.

35. Deposits of other entities specify as follows (in ISK thousands):

	2011	2010
Treasury.....	143,851,334	130,050,348
Government institutions.....	1,111,222	1,426,680
Treasury, FX accounts.....	376,465,573	175,842,255
Domestic deposits of foreign parties.....	36,656,090	67,004,033
Term FX dep. of fin. institut. in winding-up proceedings	178,257,760	252,978,772
FX accounts of fin. institut. in winding-up proceedings ..	157,556,798	23,089,771
Domestic deposits of other parties.....	25,830,526	22,784,413
	919,729,302	673,176,272

- Deposits of other parties held at the Bank increased by 37%, to 919.8 b.kr. at year-end 2011, as opposed to 673.2 b.kr. at year-end 2010.
- The increase in the Treasury's foreign exchange accounts is due primarily to the June 2011 bond issue in the amount of USD 1 billion.
- On 30 December 2011, the last payments of the Nordic loan facilities were disbursed to Iceland, in the amount of 887.5 million euros, which was added to the Central Bank's foreign exchange reserves. Of this amount, the Treasury borrowed 645.7 million euros and deposited them to its foreign exchange accounts with the Bank.
- Deposits held by financial institutions in winding-up proceedings increased by 22%, to 335.9 b.kr. at year-end 2011, as opposed to 276 b.kr. at year-end 2010.

Domestic financial liabilities

36. Domestic financial liabilities specify as follows (in ISK thousands):

	2011	2010
Certificates of deposit	78,526,106	65,462,767
Foreign-denominated Treasury bonds	7,388,362	106,328,359
Treasury bonds issued in ISK	11,000,011	11,000,011
	85,914,469	182,791,137

- The Central Bank of Iceland issues short-term securities – so-called certificates of deposit – in accordance with the Rules on Central Bank Facilities for Financial Undertakings, currently no. 533, dated 26 June 2009.
- The Bank took a long-term loan from the Treasury in late 2006 in order to expand its foreign exchange reserves. The Treasury sold bonds abroad and relaned the proceeds, in the amount of 1 billion euros, to the Bank. The nominal interest rate on the loan is 3.75%, and the bonds sold at an effective rate of 3.88%. The loan matured on 1 December 2011.
- The Bank also borrowed funds from the Treasury in late 2010 in order to expand its foreign exchange reserves. The Treasury borrowed 205 million euros from the Polish government. The book value of the debt, including accrued interest, was 7,4 b.kr. at year-end 2011.
- The Bank also borrowed funds from the Treasury in late 2008 in order to expand its foreign exchange reserves. The Treasury borrowed funds from Bayerische Landesbank in the amount of 300 million euros. The loan was taken in late September 2008, with interest payable at the end of March and September, until it matured at the end of September 2011. The loan to the Central Bank is in Icelandic krónur. The loan bore the same interest as deposit money banks' current accounts. Borrowing costs were borne by the Treasury.

Pension obligations

37. According to actuarial assessments, the Central Bank of Iceland's obligations due to pension payments to former governors and their spouses and the director of the National Economic Institute, of which the Bank bore half the operational expense, totalled 321.1 m.kr. as of year-end 2011. Payments related to these obligations totalled 45.5 m.kr. in 2011 and reduce the previously entered obligation. Increases in the Bank's obligations, after adjusting for payments, totalled 44.3 m.kr. in 2011 and are expensed.

Changes during the year specify as follows (in ISK thousands):

	2011	2010
Pension obligations at beginning of year	322,222	349,569
Paid due to retirement	(45,451)	(51,207)
Increase during the year	44,342	23,860
Pension obligations at year-end	<u>321,113</u>	<u>322,222</u>

Other liabilities

38. Other liabilities specify as follows (in ISK thousands):

	2011	2010
Unrealised gains on foreign exchange transactions	11,041,286	
Treasury share in foreign exchange transactions	1,026,634	
Unpaid tax	5,014,012	2,091,729
Other liabilities	2,471,137	356,530
	<u>19,553,068</u>	<u>2,448,259</u>

- A portion of the gain on foreign exchange transactions is due to transactions carried out during the year as an element in the capital account liberalisation strategy. Exchange rate gains from foreign exchange transactions in which the Bank has sold foreign currency and bought it back are recognised as profit. On the other hand, a precautionary entry is made in the same amount, offsetting the profit deriving from foreign currency sold by the Bank during the year 2011 but for which payment is not forthcoming until 2012. The profit will be used in foreign currency auctions in 2012.

Itemisation of equity and developments in the Bank's profit

39. In the past five years, the Bank's equity has changed as follows (in ISK millions):

	2011	2010	2009	2008	2007
Equity at beginning of year (excl. revaluation).....	64,825	78,271	77,387	86,012	43,236
Capital contribution.....					44,000
Net profit (loss) bef. contribution and exch. rate diff.	11,539	(5,697)	(2,523)	(227,509)	7,013
Collateralised loans reclaimed from the Treasury.....				174,903	
Contribution to the Treasury.....	(3,464)				(2,338)
Depreciation of revalued assets.....	52	52	384		
Exchange rate difference for the year.....	7,471	(6,933)	3,023	43,980	(5,899)
Calculated income tax of subsidiaries.....	(1,148)	(869)			
Equity at year-end (without revaluation).....	79,275	64,825	78,271	77,386	86,012
Revaluation of assets at beginning of year.....	4,555	4,607	4,991	4,991	4,991
Depreciation of revalued assets.....	(52)	(52)	(384)		
Equity at year-end.....	<u>83,777</u>	<u>69,379</u>	<u>82,878</u>	<u>82,377</u>	<u>91,003</u>
<i>Stock figures/ratios at year-end (in ISK billions):</i>					
Total assets.....	1,580.7	1,277.6	1,178.1	1,187.4	476.8
Equity (w/o asset revaluation).....	79.3	64.8	77.9	77.4	86.0
Equity / total assets.....	5.0%	5.1%	6.6%	6.5%	18.0%

Guarantees and off-balance sheet commitments

40. The Central Bank of Iceland is obliged to pay for a subscription for capital shares to the Bank for International Settlements upon request. 25% of the subscription has already been paid. The 75% share could be due for payment and totals 785 m.kr.

- At year-end 2011, the Bank had access to loan facilities from the BIS in the form of repurchase agreements amounting to 400 million US dollars, or 49 b.kr. Because of its strong liquidity position, the Bank did not draw on this loan facility in 2011.

Risk management

41. The Central Bank of Iceland is a public institution that, by law, has a specific role focusing primarily on monetary policy, via its interest rate decisions and the investment of the nation's foreign exchange reserves. Risk in its operations is therefore of a different type than in the operation of other financial institutions, although the same terminology is used. The Central Bank of Iceland's financial risk entails claims risk, liquidity risk, and market risk. Claims risk is the risk of loss due to counterparties' or issuers' inability to fulfil their financial obligations, in whole or in part, at the designated time. Claims risk comprises issuer risk, counterparty risk, and settlement risk. Liquidity risk is the risk that the Central Bank will be unable to fulfil its tasks and commitments due to insufficient assets, inability to sell assets in time, or inability to sell assets except at significant discounts. Market risk is defined as the risk of loss or reduction of financial assets due to changes in market value. Market risk comprises exchange rate risk, interest rate risk, claims risk, and

gold price risk. The following is a discussion of these risks. In addition, the Bank operates under operational risk, which is the risk of human error or the failure of internal processes and systems. Operational risk is managed by the Bank's employees on a day-to-day basis, and every effort is made to implement monitoring and procedures that minimise this risk.

Interest rate risk

42. Interest rate risk is the risk of loss due to changes in market interest rates. The Bank's investment strategy aims at enabling the Bank to be able to fulfil its tasks and commitments at all times. As a consequence, the Bank attempts to invest in foreign assets that are liquid and issued by reliable parties. However, returns are also considered. Interest rate risk in foreign currencies is reduced by using assets to offset liabilities. In 2011, the Bank did not use interest rate derivatives to manage its foreign-currency interest rate risk. The Monetary Policy Committee decides the interest rates on domestic assets such as collateralised loans, certificates of deposit, deposit money banks' current account balances, and Treasury deposits. Returns on domestic securities vis-à-vis the Treasury take the form of fixed indexed interest. Returns on domestic marketable securities are determined by movements in market interest rates.

Exchange rate risk

43. Exchange rate risk is the risk of loss due to changes in the exchange rate of foreign currencies vis-à-vis the Icelandic króna. The Bank uses derivatives to manage its exchange rate risk. The Bank's assets and liabilities subject to exchange rate risk specify as follows at year-end 2011, as compared with year-end 2010 (all figures in ISK millions):

Currencies in financial assets and liabilities 2010

	Euro	Dollar	Pound	Yen	Other currencies	Gold	Total
Assets:							
Gold						10,426	10,426
Foreign assets	349,104	119,228	96,288	3,070	153,369		721,060
FX balance with the IMF	1,177	1,358	301	486			3,322
Domestic financial assets	42,126	47,008	6,976	18,173	9,085		123,369
Other assets	1,920						1,920
	<u>394,328</u>	<u>167,594</u>	<u>103,564</u>	<u>21,729</u>	<u>162,455</u>	<u>10,426</u>	<u>860,097</u>
Liabilities:							
Foreign debt	92,322	63,889	14,160	22,865			193,237
Counterpart to IMF	7,078	8,162	1,809	2,921			19,971
Deposits of financial institutions	910	1,755	634	198	1,946		5,442
Other deposits	263,144	53,304	76,511	357	58,594		451,910
Domestic financial liabilities	98,339				7,989		106,328
Other liabilities	475				61		537
	<u>462,270</u>	<u>127,110</u>	<u>93,114</u>	<u>26,342</u>	<u>76,178</u>		<u>785,013</u>
Net ISK assets	<u>(69,861)</u>	<u>40,484</u>	<u>10,450</u>	<u>(4,612)</u>	<u>86,277</u>	<u>10,426</u>	<u>73,164</u>

Currencies in financial assets and liabilities 2011

	<i>Euro</i>	<i>Dollar</i>	<i>Pound</i>	<i>Yen</i>	<i>Other currencies</i>	<i>Gold</i>	<i>Total</i>
<i>Assets:</i>							
Gold						12,249	12,249
Foreign assets	478,652	290,676	124,810	15,682	134,695		1,044,515
FX balance with the IMF	1,257	1,515	393	360			3,525
Domestic financial assets	38,047	52,313	11,228	28,111	20,260		149,960
	<u>517,956</u>	<u>344,504</u>	<u>136,432</u>	<u>44,153</u>	<u>154,955</u>	<u>12,249</u>	<u>1,210,249</u>
<i>Liabilities:</i>							
Foreign debt	171,322	113,729	29,573	26,979			341,604
Counterpart to IMF	7,540	9,088	2,360	2,153			21,141
Deposits of financial institutions	293	10,583	3,654	572	1,711		16,813
Other deposits	359,284	161,417	81,546	393	109,639		712,280
Domestic financial liabilities					7,388		7,388
Other liabilities	45	19	520		7		592
	<u>538,485</u>	<u>294,836</u>	<u>117,654</u>	<u>30,098</u>	<u>118,745</u>		<u>1,099,818</u>
Net ISK assets	<u>(20,529)</u>	<u>49,668</u>	<u>18,778</u>	<u>14,055</u>	<u>36,210</u>	<u>12,249</u>	<u>110,432</u>

Credit risk

44. Issuer risk is the risk that issuers of securities in the Bank's portfolio will be unable to fulfil their financial obligations, in whole or in part, at the designated time. Below is a list of foreign securities in the Bank's portfolio, itemised by credit rating, country of issuance, and type of issuer.

45. Foreign bonds, by credit rating:

<i>Rating</i>	<i>2011</i>	<i>2010</i>
AAA	89%	77%
AA+	4%	11%
AA	4%	2%
AA-	1%	3%
A+	0%	0%
A	0%	4%
A-	3%	2%
BBB+	0%	0%
BBB	0%	0%
BBB-	0%	0%
Below BBB-	0%	0%
	<u>100%</u>	<u>100%</u>

46. Foreign bonds, by country of issuance:

	2011	2010
Germany	24.5%	38.9%
United States	22.4%	14.8%
Holland	16.2%	3.3%
International institutions	8.8%	6.4%
France	8.7%	13.2%
United Kingdom	5.6%	5.1%
Finland	3.3%	2.4%
Poland	2.8%	3.7%
Austria	2.1%	1.5%
Denmark	1.9%	0.6%
Norway	1.6%	0.2%
Canada	1.1%	1.1%
Sweden	0.5%	1.8%
Australia	0.5%	0.4%
Italy	0.0%	4.2%
Spain	0.0%	2.1%
	<u>100%</u>	<u>100%</u>

47. Counterparty risk due to deposits in banks headquartered abroad:

Rating		2011	2010
S&P	A-2	4.0%	7.4%
	P-1	94.2%	92.6%
	A-2	1.8%	0.0%
Moody's	P-1	97.9%	100.0%
	Not rated by Moody's	2.1%	0.0%

Liquidity risk

48. Liquidity risk is the risk that the Central Bank will be unable to fulfil its tasks and commitments due to insufficient assets, inability to sell assets in time, or inability to sell assets except at significant discounts. The vast majority of the Bank's foreign exchange reserves are invested in highly liquid securities, deposits in central banks, and deposits with the BIS. The following table specifies assets and liabilities by maturity. The table shows the difference based on foreign and domestic maturities. Figures are in ISK millions.

Outstanding balances of assets and liabilities in domestic and foreign currency 2010:

	<i>Payable on</i>	<i>Within</i>	<i>3 to 12</i>	<i>1 to 5</i>	<i>Over</i>		
	<i>Matured</i>	<i>demand</i>	<i>3 months</i>	<i>months</i>	<i>years</i>	<i>5 years</i>	<i>Total</i>
<i>Assets in foreign currency</i>							
Gold		28	10,399				10,426
Foreign assets	69,794	226,009	425,257				721,059
FX balance with the IMF		3,322					3,322
Domestic financial assets					123,369		123,369
Other assets		184		1,736			1,920
<i>Assets in domestic currency</i>							
Domestic financial assets	101,951	2,462	41,820		247,529	10,168	403,930
Property equipm. and liquid assets		4,997					4,997
Other assets					8,597		8,597
	<u>171,745</u>	<u>237,002</u>	<u>477,476</u>	<u>1,736</u>	<u>379,495</u>	<u>10,168</u>	<u>1,277,621</u>
<i>Loans in foreign currency</i>							
Foreign debt						193,238	193,238
Counterpart to IMF		19,971					19,971
Deposits of financial institutions		5,442					5,442
Other deposits		198,932	252,979				451,911
Domestic financial liabilities				106,328			106,328
Other liabilities				537			537
<i>Loans in domestic currency</i>							
Banknotes and coin		38,269					38,269
Deposits of financial institutions		92,576					92,576
Other deposits		221,265					221,265
Domestic financial liabilities			65,463	11,000			76,463
Income tax liabilities				9			9
Pension obligations				50	200	72	322
Other liabilities				1,910			1,910
	<u>0</u>	<u>576,455</u>	<u>318,442</u>	<u>119,835</u>	<u>200</u>	<u>193,310</u>	<u>1,208,242</u>
Foreign maturity gap	<u>69,794</u>	<u>5,198</u>	<u>182,677</u>	<u>(105,129)</u>	<u>123,369</u>	<u>(193,237)</u>	<u>82,669</u>
Domestic maturity gap	<u>101,951</u>	<u>(344,651)</u>	<u>(23,643)</u>	<u>(12,969)</u>	<u>255,926</u>	<u>10,096</u>	<u>(13,290)</u>
Total balance	<u>171,745</u>	<u>(339,453)</u>	<u>159,034</u>	<u>(118,098)</u>	<u>379,295</u>	<u>(183,141)</u>	<u>69,379</u>

Outstanding balances of assets and liabilities in domestic and foreign currency 2011:

	<i>Matured</i>	<i>Payable on demand</i>	<i>Within 3 months</i>	<i>3 to 12 months</i>	<i>1 to 5 years</i>	<i>Over 5 years</i>	<i>Total</i>
<i>Assets in foreign currency</i>							
Gold		32	12,216				12,249
Foreign assets		504,982	526,713		12,820		1,044,515
FX balance with the IMF		3,525					3,525
Domestic financial assets				4,312	145,399	249	149,960
<i>Assets in domestic currency</i>							
Domestic financial assets	53,682	105		4,387	225,594	68,605	352,372
Property equipm. and liquid assets		4,891					4,891
Other assets		4,946		1,646	6,606		13,198
	<u>53,682</u>	<u>518,481</u>	<u>538,930</u>	<u>10,344</u>	<u>390,419</u>	<u>68,854</u>	<u>1,580,711</u>
<i>Loans in domestic currency</i>							
Foreign debt				52,906	235,288	53,410	341,604
Counterpart to IMF		21,141					21,141
Deposits of financial institutions		16,813					16,813
Other deposits		534,022	178,258				712,280
Domestic financial liabilities						7,388	7,388
Other liabilities			592				592
<i>Loans in domestic currency</i>							
Banknotes and coin		43,205					43,205
Deposits of financial institutions		45,184					45,184
Other deposits		207,451					207,451
Domestic financial liabilities				78,526		7,388	85,914
Income tax liabilities					5		5
Pension obligations				50	50	221	321
Other liabilities		330	17,189	4,905			23,017
	<u>0</u>	<u>868,145</u>	<u>196,039</u>	<u>207,109</u>	<u>165,009</u>	<u>60,632</u>	<u>1,496,934</u>
Foreign maturity gap	<u>0</u>	<u>(63,437)</u>	<u>360,672</u>	<u>(119,316)</u>	<u>(37,481)</u>	<u>(52,773)</u>	<u>87,666</u>
Domestic maturity gap	<u>53,682</u>	<u>(286,227)</u>	<u>(17,781)</u>	<u>(77,449)</u>	<u>262,891</u>	<u>60,995</u>	<u>(3,889)</u>
Total balance	<u>53,682</u>	<u>(349,663)</u>	<u>342,890</u>	<u>(196,765)</u>	<u>225,410</u>	<u>8,222</u>	<u>83,777</u>

Appendices to the consolidated annual accounts

Central Bank of Iceland

Profit and Loss Account for the Year 2011

	2011	2010
Interest income		
From domestic assets	23,292,763	20,015,090
From foreign assets	12,237,257	11,125,305
	<u>35,530,021</u>	<u>31,140,395</u>
Interest expense		
From domestic liabilities	16,693,371	26,659,277
From foreign liabilities	10,761,361	10,065,391
	<u>27,454,732</u>	<u>36,724,668</u>
Net interest income / (interest expense)	8,075,289	(5,584,273)
Other operating revenues		
Service revenues	356,980	401,733
Service expenses	(169,758)	(135,518)
Income from equity holdings	57,947	137,185
Revaluation of foreign securities and loans	1,439,064	975,851
Revaluation of gold	881,405	2,564,501
Exchange rate gains on foreign exchange transactions	2,086,187	727,842
Gains on system sales		375,000
Revaluation of Greiðsluveitan		146,625
Profit or loss of subsidiaries	3,179,209	1,058,704
	<u>7,831,034</u>	<u>6,251,923</u>
Net operating revenues	15,906,322	667,649
Other operating expense		
Salaries and related expenses	1,436,022	1,278,019
Other operating expenses	686,968	596,802
Expense due to banknotes and coin	218,560	9,885
Depreciation of property and equipment	79,321	78,642
Impairment of claims		4,762,894
	<u>2,420,871</u>	<u>6,726,242</u>
Profit (loss) w/o contribution to Treasury	13,485,451	(6,058,593)
Contribution to the Treasury	(3,463,692)	
Exchange rate difference	4,376,225	(7,440,271)
Profit (loss) for the year	<u>14,397,984</u>	<u>(13,498,866)</u>

Balance Sheet 31 December 2011

	2011	2010
Assets		
Gold	12,248,658	10,426,358
Foreign assets	1,031,695,499	652,771,319
FX balance with the IMF	3,525,215	3,321,895
Domestic financial assets	528,712,438	607,325,712
Property and equipment	4,647,324	4,701,598
Other assets	4,945,955	1,920,362
	<u>1,585,775,089</u>	<u>1,280,467,244</u>
Liabilities and Equity		
Banknotes and coin	43,204,646	38,269,478
Foreign debt	341,603,677	193,237,741
Counterpart to IMF	21,140,864	19,970,516
Deposits of financial institutions	61,997,455	98,017,286
Other deposits	931,459,622	678,379,317
Domestic financial liabilities	85,914,469	182,791,137
Pension obligations	321,113	322,222
Other liabilities	12,892,429	100,389
Unpaid contribution to Treasury	3,463,692	
	<u>1,501,997,966</u>	<u>1,211,088,086</u>
Capital	57,501,000	57,501,000
Revaluation reserve	4,501,922	4,554,388
Other equity	21,774,201	7,323,770
	<u>83,777,123</u>	<u>69,379,158</u>

Amounts are in ISK thousands

Central Bank of Iceland Holding Company ehf.

Profit and Loss Account for the Year 2011

	2011	2010
Interest income	22,215,559	18,007,056
Interest expense	(10,138,503)	(11,491,631)
Net interest income	12,077,056	6,515,424
Valuation changes in securities	13,102,198	11,830,483
Impairment of claims	(23,906,948)	(16,516,643)
Service expenses	(274,789)	(226,047)
	(11,079,538)	(4,912,207)
Profit without exchange rate difference	997,517	1,603,217
Exchange rate difference	3,094,377	504,621
Profit before tax	4,091,895	2,107,838
Income tax	(1,108,467)	(867,323)
Profit for the year	2,983,428	1,240,515

Balance Sheet as of 31 December 2011

	2011	2010
Assets		
Non-current assets		
Equity shareholdings	2,476,970	6,828,136
Bonds and other long-term assets	230,830,525	226,180,749
Collateralised claims against fin. institutions in winding-up proceedings	24,529,771	69,104,021
Other claims against fin. institutions in winding-up proceedings	31,667,662	25,162,880
Mortgages foreclosed	1,457,739	0
Deferred income tax asset	5,062,286	1,200,000
	<u>295,554,919</u>	<u>328,475,786</u>
Current assets		
Next year's instalments on bonds and long-term claims	13,038,812	13,607,418
Marketable securities	8,669,495	8,035,956
Other current receivables	3,942,751	40,975,355
Cash and cash equivalents	18,618,639	5,203,123
	<u>44,269,697</u>	<u>67,821,852</u>
	<u>340,294,650</u>	<u>396,297,638</u>
Liabilities and equity		
Non-current liabilities		
Debt to parent company	329,282,708	391,416,448
	<u>329,282,708</u>	<u>391,416,448</u>
Current liabilities		
Current tax liabilities	4,970,753	2,067,323
Other liabilities	1,816,247	1,572,352
	<u>6,786,999</u>	<u>3,639,675</u>
	<u>336,069,707</u>	<u>395,056,122</u>
Share capital		
Share capital	1,000	1,000
Statutory reserves	250	250
Retained earnings	4,223,693	1,240,265
	<u>4,224,943</u>	<u>1,241,515</u>
	<u>340,294,650</u>	<u>396,297,638</u>

Amounts are in ISK thousands

Sölvhóll ehf.

Profit and Loss Account for the Year 2011

	2011	2010
Operating revenues	128,713	149,524
Salaries and reletad expenses	(48,031)	(32,984)
Office and administrative expenses	(70,657)	(108,907)
Other operating expenses	(1,714)	(380)
Operating profit	8,311	7,254
Financial income	629	637
Financial expenses	(364)	
Profit before tax	8,576	7,890
Income tax	(1,715)	(1,462)
Profit for the year	6,861	6,429

Balance Sheet as of 31 December 2011

	2011	2010
Assets		
Current assets		
Current receivables	90	41,631
Cash and cash equivalents	61,726	7,344
	<u>61,816</u>	<u>48,975</u>
Liabilities and equity		
Non-current liabilities		
Deferred income tax liability		414
	<u>0</u>	<u>414</u>
Current liabilities		
Current tax liabilities	2,129	1,048
Other current liabilities	45,398	40,085
	<u>47,527</u>	<u>41,132</u>
	<u>47,527</u>	<u>41,546</u>
Share capital	1,000	1,000
Statutory reserves	250	250
Retained earnings	13,039	6,179
	<u>14,289</u>	<u>7,429</u>
	<u>61,816</u>	<u>48,975</u>

Amounts are in ISK thousands

Greiðsluveitan ehf.

Profit and Loss Account for the Year 2011

	2011	2010
Operating revenues		
RÁS system	421,010	413,301
The netting system	277,597	291,121
Other systems	159,610	
	858,217	704,421
Operating expenses		
System operating expenses	371,724	263,438
Salaries and related expenses	115,267	112,149
Other operating expenses	62,816	52,883
Property and equipment	114,308	86,216
	664,115	514,686
Profit before financial expenses	194,102	189,736
Financial income	11,852	9,438
Financial expenses	(16,860)	(37,975)
Profit before tax	189,095	161,199
Income tax	(37,823)	(29,881)
Profit for the year	151,272	131,317

Balance Sheet as of 31 December 2011

	2011	2010
Assets		
Non-current assets		
Property and equipment	394,014	483,978
	<u>394,014</u>	<u>483,978</u>
Current assets		
Trade receivables	177,727	91,335
Other current receivables	33,687	3,700
Cash and cash equivalents	412,818	304,272
	<u>624,232</u>	<u>399,307</u>
	<u><u>1,018,246</u></u>	<u><u>883,285</u></u>
Liabilities and equity		
Non-current liabilities		
Subordinated loans	176,271	60,000
Deferred tax liabilities	5,348	8,656
	<u>181,619</u>	<u>68,656</u>
Current liabilities		
Accounts payable	71,440	37,696
Current maturities of long-term liabilities	84,475	285,536
Current tax liabilities	41,130	23,358
Other current liabilities	40,485	20,215
	<u>237,530</u>	<u>366,805</u>
	<u>419,149</u>	<u>435,460</u>
Share capital		
Share capital	20,000	20,000
Share premium	108,240	108,240
Statutory reserves	5,000	5,000
Retained earnings	465,857	314,585
	<u>599,097</u>	<u>447,825</u>
	<u><u>1,018,246</u></u>	<u><u>883,285</u></u>

Amounts are in ISK thousands

APPENDICES

Press releases from the Central Bank of Iceland 2011

Nr.	1	3 January 2011	Financial institutions' FX imbalances reduced
–	2	4 January 2011	Central Bank of Iceland hires new Director of Operations and Human Resources
–	3	6 January 2011	Financial Supervisory Authority and Central Bank of Iceland conclude improved cooperation agreement
–	4	13 January 2011	The role of central banks in financial supervision
–	5	28 January 2011	Central Bank of Iceland payment intermediation
–	6	31 January 2011	Central Bank of Iceland Monetary Policy Committee's interest rate decisions: minor changes in timing of announcements
–	7	2 February 2011	Statement of the MPC 2 February 2011
–	8	2 March 2011	Balance of payments in the fourth quarter of 2010 and the external position
–	9	16 March 2011	Statement of the Monetary Policy Committee 16 March 2011
–	10	15 April 2011	Treasury to prepay foreign-denominated bonds
–	11	20 April 2011	Statement of the Monetary Policy committee 20 April 2011
–	12	6 May 2011	Treasury prepays bonds for 346 million euros (57 b.kr.)
–	13	23 May 2011	Central Bank of Iceland offers to buy Icelandic krónur
–	14	1 June 2011	Balance of payments in the first quarter of 2011 and the external position
–	15	7 June 2011	Results of foreign currency auction
–	16	15 June 2011	Statement of the Monetary Policy Committee 15 June 2011
–	17	16 June 2011	Central Bank of Iceland offers to purchase euros
–	18	28 June 2011	Results of foreign currency auction
–	19	6 July 2011	Central Bank of Iceland offers to purchase Icelandic krónur
–	20	12 July 2011	Results of foreign currency auction
–	21	28 July 2011	ESÍ sells stakes in Sjóvá-Almennar tryggingar
–	22	2 August 2011	Central Bank of Iceland offers to purchase euros
–	23	16 August 2011	Results of foreign currency auction
–	24	17 August 2011	Statement of the Monetary Policy Committee 17 August 2011
–	25	1 September 2011	Balance of payments in the second quarter of 2011 and the external position
–	26	21 September 2011	Statement of the Monetary Policy Committee 21 September 2011
–	27	2 November 2011	Statement of the Monetary Policy Committee 2 November 2011
–	28	18 November 2011	The Investment Programme – a step in capital account liberalisation
–	29	1 December 2011	Balance of payments in the third quarter of 2011 and the external position
–	30	7 December 2011	Statement of the Monetary Policy Committee 7 December 2011
–	31	14 December 2011	Capital controls in accordance with EEA Agreement

Publications by the Central Bank of Iceland 2011

In English:

Annual Report 2010.

Financial Stability 2011, two issues.

Monetary Bulletin 2011, four issues.

Economic Indicators, nine issues.

Economic Affairs, February 2011.

Central Bank of Iceland Working Papers No. 53, Exchange rate policy in small rich economies, by Francis Breedon, Thórarinn G. Pétursson and Andrew K. Rose (June 2011).

Central Bank of Iceland Working Papers No. 54, Price setting in turbulent times: Survey evidence from Icelandic firms, by Thorvardur Tjörvi Ólafsson, Ásgerdur Pétursdóttir and Karen Á. Vignisdóttir (July 2011).

Central Bank of Iceland Working Papers No. 55, Evidence of Nominal Wage Rigidity and Wage Setting from Icelandic Microdata, by Jósef Sigurdsson and Rannveig Sigurdardóttir (August 2011).

Central Bank of Iceland Working Papers No. 56, Unemployment Dynamics and Cyclical Fluctuations in the Icelandic Labour Market, by Jósef Sigurdsson (December 2011).

In Icelandic:

Ársskýrsla 2010.

Fjármálastöðugleiki 2011, two issues.

Peningamál 2011, four issues.

Hagvísar 2011, nine issues.

Efnahagsmál, January 2011.

Efnahagsmál, February 2011.

Sérrit 5: Hlutverk seðlabanka í fjármálaeftirliti, janúar 2011.

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

Speeches and articles 2011

Below is a list of speeches given by the Governor and other senior Central Bank officers in 2011. The list contains only those speeches that are available in English. In many instances, the text can be found on the Central Bank website. Speeches and lectures were given in Reykjavík unless otherwise specified.

Governor Már Guðmundsson:

Monetary policy. A speech given at a breakfast meeting of the Iceland Chamber of Commerce, 4.11.2011.

The fault-lines in cross-border banking: Lessons from the Icelandic case. Keynote address at the Banking Law Symposium 2011, OECD, Paris. 4.10.2011.

Prospects and policy challenges during the recovery. British Icelandic Chamber of Commerce, London, 29.9.2011.

Fault lines in cross-border banking. Speech delivered at Les Rencontres Économiques, Aix-en-Provence in France, 9.7.2011.

The role of network risk and common exposures in the Icelandic banking crisis: Analysis and reflection on the reform agenda. Geneva, 10.6.2011.

The collapse of Iceland's cross-border banks: Some lessons for deposit insurance and resolution policies. IADI Research Conference, BIS, Basel, 9.6.2011.

Shocks, adjustment, recession and recovery in Iceland. Center for European Policy Studies, Brussels, 16.5.2011.

The Financial Crisis in Iceland: Reflections on causes, consequences and lessons to be learnt. Bank of England, 11.5.2011.

Speech at the 50th Annual General Meeting of the Central Bank of Iceland, 7.4.2011.

Lessons from the Iceland Crisis. Maastricht University, Brussels, 21.3.2011.

Speech at an IMF hosted conference on Macro and Growth Policies in the Wake of the Crisis. Washington, 8.3.2011.

Deputy Governor Arnór Sighvatsson:

The logic behind the capital account liberalisation strategy. Speech given at a meeting of the Iceland Chamber of Commerce, 15.12.2011.

Chief Economist Þórarinn G. Pétursson:

Iceland: From boom to bust and back again. Presentation for a group of experts from international financial institutions, 3.10.2011.

Other speeches and articles:

Article by Jón Þ. Sigurgeirsson, Why Iceland is not Greece. How Reykjavík kept state signature intact. Published in OMFIF (Official Monetary and Financial Institutions Forum), December 2011.

In addition, Central Bank staff and senior management have given a number of presentations and written a number of articles related to the Bank's operations. Among these are presentations for various financial institutions and student groups.

Economic and monetary chronicle 2011

January 2011

On 1 January, the asset and income thresholds according to the rules on State-subsidised residential housing were raised by 2.46%. The asset limit for rent subsidy allowances was raised by the same percentage. The increases accord with the rise in consumer prices from the beginning of 2010 to the beginning of 2011.

On 4 January, the Minister of Welfare instructed the municipalities to increase financial assistance to individuals to equal the amount of unemployment benefits.

On 5 January, an agreement between the Government and the Icelandic Pension Funds' Association was announced. The agreement stipulates as follows: i) general increases in pension payments within the year 2011 will not reduce State payments through income linkage; ii) during the same period, the pension funds will not use income linkage to reduce payments, even though disability assessments are denied; iii) the tax-free threshold for pensioners will increase in three stages over the period 2013-2015, in accordance with the increase in the tax-free threshold for disability benefits.

On 6 January, the Central Bank and the Financial Supervisory Authority announced the conclusion of a new co-operation agreement. The aim of the agreement is to promote a sound, effective, and safe financial system in Iceland, including payment and settlement systems. Among other new provisions, senior management and relevant experts from both institutions are to meet regularly, at least twice a year, so as to assess systemic risk in the financial system, including macroeconomic risk factors, risks in financial institutions' operations, the interplay of risk factors, the status of payment systems, the need for amendment of regulatory instruments, and improvements in contingency exercises.

On 7 January, the Government agreed to extend the incentive programme called "Back to Work," which was established in collaboration with the Icelandic Federation of Labour, the Confederation of Icelandic Employers, the Federation of Icelandic Industries, and others. The authorisation for reimbursement of value-added tax on labour costs for work done on residential housing will be extended until year-end 2011 and will remain in effect for the same length of time as the authorised income tax deduction.

On 10 January, the Executive Committee of the International Monetary Fund (IMF) approved the fourth review of Iceland's economic programme. The approval by the Executive Board released the fifth tranche of the IMF loan facility, in the amount of SDR 105 million (just under 19 b.kr.). Iceland is also authorised to draw further funds on the loan facilities from the Nordic countries and Poland.

On 28 January, the Financial Supervisory Authority decided that the holding company Eignarhaldsfélag NBI ehf. is eligible to own qualify-

ing holdings large enough that Landsvaki hf. and SP-Fjármögnun hf. will be considered its subsidiaries.

On 28 January, it was announced that the Competition Authority had approved the Central Bank's sale of its stake in the Icelandic Banks' Data Centre, concurrent with its takeover of Fjölgreiðslumiðlun hf., which will henceforth be called Greiðsluveitan. Before this change was implemented, Fjölgreiðslumiðlun operated the netting system and the joint payment channel for payment card transactions. Henceforth, it will also operate the RTGS system, the SWIFT-Alliance system for cross-border payments, the collections system for electronic claims and remittance slips (payables pool), and the system that handles the posting of electronic documents to online banking accounts (the check-free system). In its approval of the change, the Competition Authority makes reference to its ruling on the card companies' violation in 2008 and sets requirements for Greiðsluveitan's conduct in the market.

On 31 January, the Financial Supervisory Authority concluded that NBI hf. was eligible to own and administer up to a 33% qualifying holding in Borgun hf.

On 31 January, the Central Bank announced a minor change in the announcement of decisions by the Monetary Policy Committee. Beginning with the Committee's 2 February decision, the MPC statement announcing and explaining the decision would be published at 9:00 on the interest rate decision date instead of 11:00, as had previously been done. The change was made primarily to allow market agents to assess the Committee's decision before markets open. This arrangement allows members of the media, financial analysts, and other interested parties to acquaint themselves with the MPC statement prior to the press conference.

February 2011

On 2 February, the Monetary Policy Committee of the Central Bank of Iceland decided to lower the Bank's interest rates by 0.25 percentage points. The current account rate was reduced to 3.25%, the maximum rate on 28-day certificates of deposit (CDs) to 4.0%, the seven-day collateralised lending rate to 4.25%, and the overnight lending rate to 5.25%.

On 2 February, Parliament passed Act no. 9/2011, amending the Act on Responsible Utilisation of Fish Stocks. The amendment authorises the Minister of Fisheries to impose per diem fines in order to enforce submittal of catch reports.

On 2 February, the Minister of Finance publicised the Government's debt management strategy for 2011-2014 and its plans for borrowing. The plans aim to reduce total Treasury debt from 83% of GDP at end-2010 to 70% of GDP at end-2014, and to reduce net debt from 43% of GDP to 35% of GDP over the same period. Annual repayments on domestic Treasury bonds shall be less than 6% of GDP, balances on the

Treasury's current accounts shall equal at least 80 b.kr. at all times, and Treasury debt shall be 60-80% domestic and non-indexed, 20-40% indexed, and 0-20% foreign.

On 3 February, Parliament passed Act no. 12/2011, which increased the number of judges in the judicial system. Three new Supreme Court judges and five new District Court judges will be appointed because of the strain on the judicial system in the wake of the financial crisis.

On 7 February, the Minister of Welfare presented a report on consumption criteria for Icelandic households, prepared by a group of experts. Three types of consumption criteria were presented: i) typical criteria, which represent modest consumption; that is, the median expenses of Icelandic households; ii) short-term criteria based on the same assumptions, but assuming a temporary reduction in consumption and postponement of expenditure items; and iii) basic criteria, which indicate the minimum a household needs to support itself.

On 16 February, Parliament passed the so-called Icesave Act, no. 13/2011, which authorises the Government to guarantee repayment by the Depositors' and Investors' Guarantee Fund to the British and Dutch governments for the compensation paid for Icesave deposits.

On 18 February, the Ministry of Agriculture and Fisheries announced that the capelin quota for the year had been increased to 390,000 tonnes. The original quota was 200,000 tonnes.

On 20 February, the President of Iceland refused to sign Act no. 13/2011, the so-called Icesave Act, which confirmed the agreements providing for a State guarantee of the Depositors' and Investors' Guarantee Fund repayment to the British and Dutch governments. In so doing, the President referred the matter to the electorate for a national referendum, which was subsequently scheduled for 9 April.

On 23 February, the Financial Supervisory Authority revoked the operating licenses of the old financial institutions Byr Savings Bank, Frjálsi Investment Bank hf., and Reykjavík Savings Bank (SPRON) hf., in the wake of a ruling winding up these institutions pursuant to Chapter XII of the Act on Financial Undertakings, no. 161/2002.

On 23 February, rating agency Moody's Investors Service issued a special opinion on the results of the Icesave referendum. The opinion stated that if the Icesave agreements were approved in the referendum, the outlook for Iceland's sovereign credit rating would probably be changed from negative to stable. On the other hand, if the agreements were rejected in the referendum, the rating would probably be downgraded to non-investment grade.

On 23 February, Parliament passed Act no. 14/2011 in order to reinforce the Competition Act, no. 44/2005. Provisions include authorising the Competition Authority to take action against conditions or

conduct that prevents, restricts, or is detrimental to competition and is contrary to the public interest. The Competition Authority is now authorised to initiate legal proceedings before the courts in order to revoke rulings by the Competition Appeals Committee.

On 25 February, the Financial Supervisory Authority concluded that the holding company Eignarhaldsfélag NBI ehf. was eligible to own a large enough qualifying holding in Rose Invest hf., a UCITS management company, that Rose Invest would be considered a subsidiary of the holding company.

March 2011

On 1 March, Parliament passed amendments to the Electricity Act. Among other changes, the amended Act expands the requirements for connecting to distribution systems. It also stipulates that Landsnet shall be directly owned by the State and/or the municipalities beginning on 1 January 2015. Furthermore, price lists shall be structured so that they can support average operating expenses plus a profit equivalent to taxes and cost of capital. The Act also requires a licence to operate a market for energy distribution.

On 3 March, Parliament approved amendments to the Act on Landsvirkjun, no. 42/1983, so as to comply with ESA guidelines and to ensure that State guarantees for Landsvirkjun are in compliance with the EEA Agreement provisions on State aid. According to the amendment, the State guarantee is not unlimited; that is, the Act on Bankruptcy, Etc., no. 21/1991, can apply to the company, the amendment covers only credit obligations, and a suitable guarantee fee must be paid for the State guarantee.

On 3 March, Parliament passed an amendment to the Act on State Guarantees, no. 121/1997. According to the amendment, instead of the general State guarantee fee (0.25%) pursuant to Article 6, Paragraph 2 of the Act, Landsvirkjun and others specified in Article 6, Paragraph 1 of the Act on State Guarantees shall pay a guarantee fee that fully corresponds to the concession enjoyed by the company on the basis of the State guarantee, in the form of credit terms more beneficial than those generally available in the market without such a guarantee. With Act no. 144/2010 amending the Act on the Establishment of the Partnership Orkuveita Reykjavíkur, no. 139/2001, with subsequent amendments, Parliament approved the same type of changes as regards owner liability for Orkuveita Reykjavíkur's credit obligations.

On 5 March, the Minister of Finance concluded an agreement with Landsbanki Íslands concerning the latter's takeover of SpKef Savings Bank. This was done in consultation with Icelandic State Financial Investments and with the approval of the Financial Supervisory Authority. On 5 February, SpKef's capital was assessed as negative in the amount of 11 b.kr. In all, the savings bank was deemed in need of 19.4 b.kr. in order to fulfil the FME's minimum capital adequacy requirements. The savings bank had been in liquidity difficulties as well. The agreement

with Landsbanki limits the Treasury's expense in relation to deposit insurance. The additional economic capital was estimated at 8.2 b.kr.

On 16 March, the Central Bank of Iceland Monetary Policy Committee decided to hold the Bank's interest rates unchanged. The current account rate therefore remained 3.25%, the maximum rate on 28-day certificates of deposit (CDs) was 4.0%, the seven-day collateralised lending rate was 4.25%, and the overnight lending rate was 5.25%.

On 16 March, Parliament authorised the Government to confirm various decisions of the EEA Committee on amendments to the following annexes to the EEA Agreement: Annex IX (on financial reporting standards, Parliamentary Document 1056; and electronic payment intermediation, Parliamentary Document 1057); Annex XIII (on maritime insurance, Parliamentary Document 1058); Annex XIX (on consumer protection, Parliamentary Document 1055); Annex XX (on environmental affairs, Parliamentary Document 1054); and Annex XXII (on company law, Parliamentary Document 1060).

On 16 March, Parliament passed Act no. 24/2011, amending the Act on Withholding of Public Levies, the Value-Added Tax Act, and the Act on Withholding of Investment Tax. Provisions were added to all of these Acts, authorising freezing of assets if the risk is considered to exist that the taxable party could avoid payment of public levies by transferring assets to another party. A comparable provision was added to the Income Tax Act in 2010.

On 17 March, an agreement was reached among major fishing nations apart from Russia, concerning fishing of the ocean perch stock around the Reykjanes peninsula. The agreement was reached after many years of discussions. The objective is that fishing will be carried out as advised and that Iceland's share will be 31%.

On 22 March, the Prime Minister issued a code of conduct for Government ministers. The code includes provisions on connections and conflicts of interest, finances and wage payments, conduct and demeanour, interactions between ministers and ministerial employees, and disclosure of information to the public.

On 22 March, Parliament authorised the Government to confirm two decisions of the EEA Committee on amendments to Annex XX to the EEA Agreement (on environmental issues, Parliamentary Documents 1090 and 1091).

On 25 March, it was announced that the Financial Supervisory Authority's advisory committee on board member eligibility had evaluated 47 insurance and financial company board members, including eight board members from holding companies. The conclusion was that the expertise, understanding, and attitudes of the board members as regards the main topics related to their sphere of activity were adequate in 35 instances and inadequate in 12 instances.

On 25 March, the Central Bank of Iceland published its capital account liberalisation strategy report. The report discusses the experience gained from the Central Bank's previous strategy and the conditions that must be met in order for it to be possible to lift the controls. In addition, two main phases of the strategy are described, as are smaller increments in the first phase. The report concludes that the conditions required to begin careful removal of some controls already exist, while major steps cannot be taken until the Treasury has demonstrated, through borrowing, that it is able to refinance its foreign loans.

On 28 March, Parliament agreed to add a temporary provision to the Housing Affairs Act, no. 44/1998, authorising the Housing Financing Fund (HFF), upon fulfilment of specified conditions, to write individual mortgage loans down to 110% of the value of the underlying residential property. The amendment is in accordance with the 3 December 2010 agreement between the Government, on the one hand, and credit institutions and pension funds, on the other. The cost of the HFF write-down is estimated at 21.8 b.kr.

April 2011

On 8 April, the Financial Supervisory Authority revoked the operating licences of Askar Capital hf., Sparisjóðabanki Íslands hf. – Icebank, and VBS Investment Bank hf.

On 9 April, a national referendum was held concerning Act no. 13/2011, which authorised the Minister of Finance to guarantee the Depositors' and Investors' Guarantee Fund's reimbursement of costs incurred by the UK and Dutch governments for minimum deposit insurance in British and Dutch branches of Landsbanki and to pay the outstanding balance, with interest, of those obligations. The President of Iceland had referred the matter for referendum on 20 February. Voter turnout was 75%, and the authorisation was rejected with 59.77% of valid votes. 40.23% voted in favour of the authorisation.

On 11 April, the Financial Supervisory Authority approved the transfer of a specified operational unit of EA Investment Company hf. (previously MP Bank hf.) to MP Bank hf. (previously nb.is-Savings Bank hf.) and granted the new bank a commercial banking licence. At the same time, the company's savings bank licence was revoked. In addition, the Financial Supervisory Authority concluded that Titan Investment Company ehf. was eligible to own a qualifying holding of up to 20% in the new MP Bank hf.

On 13 April, rating agency Standard & Poor's placed the Republic of Iceland on CreditWatch negative status.

On 15 April, the Central Bank of Iceland, on behalf of the Treasury, offered to purchase, at par, foreign-denominated Treasury bonds maturing in 2011 and 2012. The offer extended to two bond series in the original amount of 1,250 million euros. The measure was an element in Treasury liquidity and debt management, as well as the manage-

ment of the Bank's foreign exchange reserves. The offer remained in effect until 5 May 2011.

On 20 April, the Competition Authority imposed per diem fines on the Central Bank of Iceland in order to force the delivery of information on lending by individual banks and savings banks, which the Central Bank considered confidential. The fines would amount to 1.5 m.kr. per day until the documents were submitted. The fines were recalled after the credit institutions concerned authorised the Central Bank to deliver the requested information.

On 20 April, rating agency Moody's Investors Service affirmed the Republic of Iceland's Baa3 ratings for long-term obligations in local and foreign currency in the wake of the rejection of the Icesave agreement in the 9 April referendum. The outlook on the ratings was negative. The agency had previously indicated that rejection of the agreement would probably lead to a rating downgrade. In its press release of 21 April, Moody's attributed the unchanged rating to the positive outlook for payments from the Landsbanki estate, Iceland's performance under the IMF-led economic programme, and support from the Nordic countries in the wake of the referendum.

On 20 April, the Central Bank of Iceland Monetary Policy Committee decided to hold the Bank's interest rates unchanged. The current account rate therefore remained 3.25%, the maximum rate on 28-day certificates of deposit (CDs) was 4.0%, the seven-day collateralised lending rate was 4.25%, and the overnight lending rate was 5.25%.

May 2011

On 2 May, the Icelandic authorities delivered to the EFTA Surveillance Authority a letter from the Minister of Economic Affairs, rejecting the assertion that Iceland had violated the EU Directive on deposit guarantees and demanding that the case be dismissed. It was pointed out that the Landsbanki estate would cover the vast majority of the deposit claims, payouts were scheduled to begin in the near future, and the actions taken by the British and Dutch authorities had delayed settlement.

On 5 May, 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 main provisions of the agreements are: A general percentage increase in wages above a specified monthly wage threshold, a rise of a specific sum in wage scales below that threshold, an increase in minimum wages, and a bonus due to delays in contract negotiation. Similar agreements were then concluded in both private and public sectors. The agreements remain in effect until 31 January 2014 if the premises hold. They would have expired on 1 February 2012 if various contract-related pledges had not been formalised before 22 June 2011. The premises that must be met upon review of the agreements in 2012 are that real wages must have risen between December 2010

and December 2011, price levels must have remained stable, and the króna must have appreciated markedly between the effective date of the agreement and year-end 2011. Upon the latter review, in 2013, real wages must have risen between December 2011 and December 2012, twelve-month inflation must be below 2.5% in December 2012, and the trade-weighted exchange rate index must be below 190 at that time. According to the agreements, wages above 282,353 kr. per month will rise by 4.25% on 1 June 2011; wages above 314,286 kr. will rise by 3.5% on 1 February 2012; and wages above 338,462 kr. will rise by 3.25% on 1 February 2013. Wage scales below these thresholds rise by 12,000 kr. on 1 June 2011 and by 11,000 on 1 February 2012 and 2013. The minimum pay for full-time employment shall be at least 204,000 kr. per month by the end of the contract period, an increase of 23.6%. Employers' costs rise very little due to the increase in minimum pay, as few workers are employed on those terms. One-time payments due to contract delays amount to 75,000 kr.: 50,000 kr. paid upon approval of the contract and 25,000 kr. in connection with vacation and December bonuses in 2011. The gross increase in expense incurred by employers affected by the contract will be about 13% over the lifetime of the agreement, or an average of 4.3% per year. Employers' net costs will increase less, however, as the payroll tax will decline in line with falling inflation, according to a Government announcement.

At the time the agreements were signed, the Government stated that the personal deduction would be indexed, benefits from the general and unemployment insurance funds would rise in line with wages, income linkage of child benefits and mortgage interest allowances reviewed, and the payroll tax reduced in line with declining expenditures related to unemployment. Other pledges included easing the corporate tax environment, improving corporate governance practises, and strengthening employees' position in the event of bankruptcy. The parties to the agreement declared that it was their objective to increase the investment ratio to 20% or more by the end of the contract period. This corresponds to an investment level of at least 350 b.kr. per year. A campaign to help unemployed people back to school was promised, with 2 b.kr. to be shifted from unemployment benefits to educational measures. The Government pledged to work towards the harmonisation of pension rights without curtailing public sector employees' accrued rights, with the aim of presenting the matter before Parliament before the end of the legislative session. Finally, it pledged to show stakeholders proposals for amendments to the Fisheries Management Act before presenting them to Parliament.

On 6 May, the Central Bank announced the approval of plans to purchase, at par, foreign Treasury bonds in the amount of 346 million euros (57 b.kr.). The bonds mature in 2011 and 2012. The transaction was carried out following a tender among investors in Treasury bonds, which was announced on 15 April. The tender centred on two bond series in the combined total amount of 1,250 million euros (204 b.kr.) nominal value. Prior to the purchase, approximately 800 million euros (130 b.kr.) were outstanding.

On 16 May, Fitch Ratings changed the outlook on Iceland's sovereign credit rating from negative to stable.

On 17 May, rating agency Standard & Poor's affirmed Iceland's sovereign credit rating for obligations in foreign currency. The rating for long-term obligations in domestic currency was downgraded to BBB-.

On 23 May, the Central Bank offered to purchase Icelandic krónur against cash payment in foreign currency. The auction was an element in the removal of restrictions on movement of capital as set forth in the Central Bank's capital account liberalisation strategy, published on 25 March 2011. The Bank offered to purchase 15 b.kr. in return for payment in euros. The objective of these initial measures in Phase I of the capital account liberalisation strategy was to enable investors to sell their króna assets in an orderly manner if they so choose.

June 2011

On 3 June, the Executive Board of the International Monetary Fund (IMF) approved the fifth review of Iceland's economic programme. It was also decided at that time to merge the two last reviews. The approval by the Executive Board released the sixth tranche of the IMF loan facility, in the amount of SDR 140 million (just under 26 b.kr.).

On 7 June, an auction was held of Icelandic krónur in return for payment in foreign currency. The auction was announced on 23 May. All accepted bids in the auction were based on the exchange rate at which they were submitted. Bids were submitted for 61.13 b.kr., and bids amounting to 13.4 b.kr. were accepted. The average accepted price was 218.89 kr. per euro, and the minimum price of accepted offers was 215.00 kr. per euro.

On 9 June, the Treasury concluded agreements for a bond issue in the amount of 1 billion US dollars, or 114 b.kr. The bonds bear fixed interest and are issued for five years at a yield of 4.993%. The terms are equivalent to a 3.20% premium on interbank market rates. Investors were keenly interested, with demand totalling 2 billion dollars.

On 10 June, Parliament passed Act no. 64/2011 Amending the Act on Greenhouse Gas Emissions, no. 65/2007. The amendment incorporates the European Union's system for emissions allocations into Icelandic law.

On 10 June, Parliament passed Act no. 78/2011, amending the Act on Financial Undertakings, no. 161/2002. The amendments strengthen creditors' and winding-up committees' right to dispose of assets, as well as strengthening creditors' rights in other countries vis-à-vis cancellation, setting eligibility requirements for participation in winding-up committees, confirming the Financial Supervisory Authority's right to supervise winding-up committees and resolution committees, and requiring winding-up committees and resolution committees to notify creditors of all major actions.

On 10 June, Parliament approved Resolution no. 42/139 providing for the appointment of a committee to investigate the collapse of the savings banks.

On 11 June, Parliament passed Act no. 70/2011, amending the Fisheries Management Act. The Act expands authorisations for inshore fishing and allocates supplemental quotas for several species versus payment. The deduction due to regional catch quotas and inshore fishing is to be applied in part to all catch quotas rather than to quotas for the species in question, and inshore fishing requirements for multi-vessel fisheries are tightened. The regional quota is increased, the fishing fee is raised from 9.5% to 13% of the calculated margin, and 15% of it reverts to the municipalities.

On 11 June, Parliament passed Act no. 73/2011, legalising points made in the Government's statement concerning the wage settlements in May.

On 11 June, Parliament passed Act no. 81/2011, extending the Central Bank of Iceland's temporary authorisation to restrict or stop specified types of capital movements and related foreign exchange transactions until 30 September 2011.

On 14 June, the Financial Supervisory Authority announced that it had approved the merger of Avant hf. and SP fjármögnun hf. with Landsbanki hf. under the name of Landsbanki.

On 15 June, the Central Bank of Iceland Monetary Policy Committee decided to hold the Bank's interest rates unchanged. The current account rate therefore remained 3.25%, the maximum rate on 28-day certificates of deposit (CDs) was 4.0%, the seven-day collateralised lending rate was 4.25%, and the overnight lending rate was 5.25%.

On 16 June, the Central Bank of Iceland offered to purchase euros against payment in Treasury bonds. The auction was held in connection with the capital account liberalisation strategy. The aim was to recoup the foreign currency that the Central Bank of Iceland used to purchase offshore krónur in the previous auction and sell krónur to buyers prepared to hold them for at least five years. The Central Bank offered to purchase 64 million euros against payment in Treasury series RIKS 30 0701.

On 23 June, Registers Iceland announced the revision of the property valuation to be used to levy property taxes in 2012. The total nationwide property valuation rose by 6.8%, to 4,400 b.kr. The total valuation of residential housing rose by 9%.

On 24 June, the Financial Supervisory Authority announced that it had revoked SpKef's operating licence due to a ruling on the winding-up of the savings bank.

On 28 June, the foreign currency auction announced on 16 June took place. Bids totalling 71.8 million euros were submitted, and bids amounting to 61.74 million euros were accepted. The auction was structured with a single-price format, so that all accepted offers were made available to primary dealers at the same price, which was set at 210.00 kr. per euro. Purchasers receive indexed Treasury bonds in the RIKS 30 0701 series as payment for the foreign currency.

July 2011

On 4 July, the Financial Supervisory Authority announced that its board had approved rules on financial institutions' bonus payment systems, as was stipulated in the amendments to the Act on Financial Undertakings. The annual bonus may not exceed 25% of the annual salary without the bonus, and payment of a portion of the bonus must be deferred for at least 3 years. Payment of non-performance-linked bonuses is prohibited.

On 5 July, the Minister of Fisheries announced quota allocations for the 2011/2012 fishing year. The cod quota was increased by 17,000 tonnes, the haddock quota was reduced by 5,000 tonnes, and the perch quota was increased by 12,000 tonnes. Overall, quotas were increased by 32,500 tonnes in the species for which quotas were issued.

On 6 July, the Central Bank offered to purchase Icelandic krónur against cash payment in foreign currency. The auction was an element in the liberalisation of restrictions on movement of capital. The Bank offered to purchase 15 b.kr. in return for payment in euros.

On 12 July, the Central Bank announced the results of the auction of foreign currency against payment in Icelandic krónur, which was announced on 6 July. Bids were submitted for 52.2 b.kr., and bids amounting to 14.9 b.kr. were accepted. The average accepted price was 216.33 kr. per euro, and the minimum price of accepted offers was 215.00 kr. per euro. Offers above the minimum price were accepted in full, and those equal to the auction price were accepted pro rata, at a percentage of 44.0%.

On 13 July, an agreement between Byr and Íslandsbanki was announced, according to which Íslandsbanki would contribute new share capital to Byr and purchase the Byr shares held by the Byr winding-up committee and the Ministry of Finance. The two firms would then merge under the name of Íslandsbanki, subject to the approval of the Competition Authority and the FME.

On 14 July, the Parliamentary Ombudsman notified the Central Bank of Iceland that the Icelandic Homes' Coalition (HH) considered the Bank's Rules on Indexation of Savings and Loans, no. 492/2001, to lack statutory authority. According to Article 13 of the Act on Interest and Price Indexation, no. 38/2001, indexation should be applied to loan payments, not to principal, as the Rules stipulated. Consequently, HH considered the financial institutions' collection of indexed claims

unauthorised. In its response of 30 August, the Central Bank pointed out that the Rules were set on the basis of instructions in the Act and that, in practise, payments were always the same, irrespective of whether the wording of the Act or the Rules was followed. Therefore, there could be no violation of the rule of legality.

On 15 July, the Minister of Fisheries issued a regulation based on the newly passed legislation and raised the fishing fee for cod equivalents by 6.44 kr., to 9.46 kr. The Treasury's estimated revenues from the fee rise from 2.7 b.kr. to 4.5 b.kr. per year. The increase is due both to increased fishing quotas and an increase in the fishing fee.

On 21 July, the Financial Supervisory Authority announced that it had revoked the operating licences of Glitnir Bank hf. and Kaupthing Bank hf.

On 26 July, the national accounts for 2010 were published. Treasury expenditures in excess of revenues totalled 123 b.kr., as opposed to 139 b.kr. in 2009. Revenues net of interest rose by 13½% due to an increase in tax revenues. Expenditures rose by 4% year-on-year and were 7½% over budget. Excluding interest, pension obligations, lost claims, and other expenditures related to the economic crisis of 2008, expenditures declined by 3% in nominal terms and almost 8% in real terms; therefore, the budget held by that measure.

On 28 July, it was announced that the Central Bank of Iceland Holding Company ehf. had finalised the sale of a 52.4% share in the insurance firm Sjóvá-Almennar hf., in accordance with a purchase agreement dated 18 January 2011. The purchaser is SF1 slhf., a firm operating under the oversight of Stefnir hf. The transaction has been approved by the Competition Authority and the Financial Supervisory Authority.

August 2011

On 2 August, the Central Bank of Iceland offered to purchase up to 72 million euros against payment in Treasury bonds. The auction was an element in the removal of restrictions on movement of capital as set forth in the Central Bank's capital account liberalisation strategy, published on 25 March 2011. The aim was to recoup the foreign currency that the Central Bank of Iceland used to purchase krónur in the previous auction and sell krónur to buyers prepared to hold them for at least five years.

On 4 August, it was announced that the EFTA Court had ruled that the Icelandic authorities were prohibited from requiring that employees sent temporarily to Iceland should enjoy the rights enjoyed by Icelanders in the Icelandic labour market if they exceed the rights set forth in the EU directive on minimum protection for such employees.

On 16 August, the Central Bank of Iceland publicised the results of the foreign currency auction of 72 million euros, announced on 2 August. Bids were submitted for a total of 3.4 million euros, and all offers were

accepted in full. The auction was structured with a single-price format, so that all accepted offers were made available to primary dealers at the same price, which was set at 210.00 kr. per euro. Purchasers received indexed Treasury bonds as payment for the foreign currency.

On 17 August, the Monetary Policy Committee of the Central Bank of Iceland decided to raise the Bank's interest rates by 0.25 percentage points. Interest rates were raised to the following amounts: interest on deposit institutions' current accounts, to 3.5%; the maximum rate on 28-day certificates of deposit (CDs), to 4.25%; seven-day collateralised loans, to 4.5%; and overnight loans, to 5.5%.

On 26 August, the Executive Board of the International Monetary Fund (IMF) approved the sixth and last review of Iceland's economic programme. The approval by the Executive Board released the last tranche of the IMF loan facility, in the amount of SDR 280 million (51 b.kr.). The total loan facility from the Fund amounts to SDR 1.4 billion, or 257 b.kr. In addition, the Nordic countries and Poland loaned Iceland about 150 b.kr. in connection with the IMF programme and authorised borrowings in the amount of 160 b.kr.

On 31 August, it was announced that MP Bank had negotiated the purchase of Saga Investment Bank's corporate finance department.

On 31 August, the Financial Supervisory Authority granted Straumur IB hf. a licence to operate as a credit institution according to the Act on Financial Undertakings.

September 2011

On 1 September, Arion Bank introduced non-indexed 25- or 40-year mortgage loans. The loans bear 6.45% interest up to a loan-to-value ratio of 60%, with fixed interest for the first five years. Supplemental loans up to an LTV of 80% bear 7.55% interest. Interest will be reviewed after five years in line with market interest rates. Customers can then continue, change the form of their loan, or retire the debt without a prepayment penalty. Other banking institutions followed soon thereafter, offering similar non-indexed loans.

On 2 September, Parliament passed Act no. 103/2011, amending the Unemployment Insurance Act and the Act on the Legal Status of Employees upon Transfer of Ownership of an Undertaking. The act extends until year-end 2011 a temporary provision which lengthens the payment period for income-linked benefits in proportion to the entitlement for 100% job loss against utilised benefits. In addition, parties that assume control of an undertaking are required to take on obligations vis-à-vis employees according to existing contracts. The changes were related to the Government's involvement in the wage settlements in May.

On 8 September, the Minister of Fisheries announced an initial capelin quota of 181,000 tonnes for the coming fishing season.

On 16 September, Parliament passed Act no. 119/2011, amending the Act on Financial Undertakings, no. 161/2002, with subsequent amendments (equity, large exposures, securitisation, etc.). The primary purposes of the Act were to incorporate into Icelandic law the provisions of Directive no. 2009/111/EC and to make minor amendments to other provisions of the Act, such as Article 52, Paragraph 4, concerning eligibility for participation in the board of directors of a financial undertaking.

On 17 September, Parliament passed the Payment Services Act, no. 120/2011, which incorporates into Icelandic law the European Payment Services Directive, no. 2007/64/EC and sets comprehensive legislation on payment services. The aim of the Directive is to create a comprehensive, harmonised, modern regulatory framework for payment services within the European Economic Area. The Act contains, among other things, detailed provisions on the rights and responsibilities of users and providers of payment services.

On 17 September, Parliament passed Act no. 122/2011, amending the Mandatory Insurance of Pension Rights and on Activities of Pension Funds. The amendment tightened the eligibility requirements for managing directors and board members and expanded the authorisation for third-pillar pension savings withdrawals.

On 17 September, Parliament passed Act no. 123/2011, amending the Mandatory Insurance of Pension Rights and on Activities of Pension Funds. The pension funds are authorised to own and operate residential housing, establish companies for the operation of residential housing, or negotiate with private entities for the provision of such services.

On 17 September, Parliament passed Act no. 127/2011, amending the Foreign Exchange Act, the Customs Act, and the Central Bank Act, and enshrined in law the Rules on Foreign Exchange set by the Central Bank. It is assumed that the capital controls will remain in effect until year-end 2013. The validity period of related provisions in the Customs Act and the Central Bank Act was extended for the same period.

On 17 September, Parliament passed the Act on Mutual Funds, Investment Funds, and Institutional Investment Funds, no. 128/2011. Investment funds are thereby included in older legislation that now covers all funds for collective investment. In addition, the Act implements the provisions of Directive 2007/16/EC, amending the Directive on undertakings for collective investment in transferable securities (UCITS). Other principal amendments include narrowing the authorisations for investment, tightening the requirements for operation of funds, and expanding the requirements for disclosure of information to customers.

On 17 September, Parliament passed Act no. 134/2011, amending the Housing Act, no. 44/1998, with subsequent amendments. The Act authorises the Housing Financing Fund to offer nominal mortgage loans,

whereas previous provisions stipulated that HFF bonds should be indexed to the consumer price index. The amendment also stipulates that interest on indexed HFF bonds shall be fixed for the entire duration of the loan, while interest on nominal HFF bonds may be variable.

On 17 September, Parliament passed the Local Government Act, no. 138/2011. The main new provisions concerning municipal finances are that budgets and annual financial statements must be submitted earlier and that deviations from budgets require an annex to the budget. The combined expenditures of municipalities and their institutions may not exceed regular revenues for each three years, and combined debt and obligations may not exceed 150% of regular revenues. Municipalities are given a 10-year grace period to adapt to the provisions of the Act.

On 21 September, the Central Bank of Iceland Monetary Policy Committee decided to hold the Bank's interest rates unchanged. The current account rate therefore remained 3.5%, the maximum rate on 28-day certificates of deposit (CDs) was 4.25%, the seven-day collateralised lending rate was 4.5%, and the overnight lending rate was 5.5%.

On 26 September, the Financial Supervisory Authority ruled that Íslandsbanki hf. was eligible to own a large enough qualifying holding in Byr hf. for Byr to be considered its subsidiary.

On 28 September, the Financial Supervisory Authority announced that it had revoked the collections permit held by SPRON Factoring hf. and the operating licence of Vextir hf. – verðbréfamiðlun, as well as a portion of the operating licence of old Landsbanki, as a ruling had been handed down on the winding-up of the bank.

October 2011

On 4 October, the Financial Supervisory Authority announced that it had granted Íslandsbanki hf. a licence to issue covered bonds. On 5 December, Arion Bank hf. received the same type of licence.

On 11 October, an agreement was reached at a meeting of coastal nations concerning blue whiting fishing in 2012. The total allowable catch will be 391,000 tonnes, a considerable increase year-on-year, and the Icelandic quota will be 63,477 tonnes.

On 14 October, the relevant coastal nations concluded an agreement on fishing from the Norwegian summer-spawning herring stock in 2012. The total allowable catch will be 833,000 tonnes, and the Icelandic quota will be 123,000 tonnes.

On 20 October, Parliament passed Act no. 146/2011. This Act amends Chapter XII of the Act on Financial Undertakings, no. 161/2002, so as to legalise a special venue provision concerning rescission cases involving Icelandic financial institutions undergoing winding-up proceedings, and to extend the deadline for initiation of rescission cases involving financial institutions.

On 20 October, the Financial Supervisory Authority announced that it had revoked Saga Investment Bank hf.'s licence to operate as a credit institution effective 3 October, as the company did not meet the statutory capital requirements.

On 28 October, the Supreme Court handed down judgments in 11 cases that had been appealed at the district court level. The cases centred on whether specified claims against the old banks should be considered deposits and whether they should be considered priority claims with reference to the Emergency Act, no. 125/2008. The priority of deposit claims was deemed to stand. On that occasion, the Prime Minister's Office published a statement to the effect that the provisions of the Emergency Act giving priority to deposit claims against the old banks were deemed valid by the Court.

November 2011

On 1 November, it was announced that MP Bank had purchased Júpi-ter rekstrarfélag hf. Júpi-ter specialises in asset management. It operates four mutual funds and one institutional investment fund.

On 2 November, the Monetary Policy Committee of the Central Bank of Iceland decided to raise the Bank's interest rates by 0.25 percentage points. Interest rates were raised to the following amounts: interest on deposit institutions' current accounts, to 3.75%; the maximum rate on 28-day certificates of deposit (CDs), to 4.5%; seven-day collateralised loans, to 4.75%; and overnight loans, to 5.75%.

On 7 November, the Ministry of Fisheries announced the Minister's decision to raise the total allowable catch of Icelandic summer-spawning herring by 40,000 tonnes for the 2011/2012 fishing year.

On 10 November, the boards of Auður Capital hf. and Tindar verðbréf hf. agreed to merge the two firms' operations under the name Auður Capital. Tindar verðbréf had been licensed by the Financial Supervisory Authority to operate as a securities undertaking and to offer its customers securities brokerage and corporate finance services, whereas Auður Capital had not offered securities brokerage services prior to the merge.

On 11 November, the Minister of Finance signed an agreement with the municipality of Reykjanesbaer concerning the State's purchase of land and energy resources owned by Reykjanesbaer, subject to Parliamentary approval. The acquisition was authorised in the budgetary supplement on 17 November.

On 15 and 16 November, rating agency Moody's Investors Service published a statement on Iceland's sovereign credit ratings. The ratings were kept unchanged at Baa3 for long-term obligations and P-3 for short-term obligations.

On 17 November, the supplementary budget for 2011 was approved

by Parliament. Estimated revenues rose by 8 b.kr. and expenditure authorisations by 17.4 b.kr., due primarily to transfers and increased expenses for Government operations, whereas interest expense declined due to falling interest rates. The budget supplement also authorised the sale of the Government's holding in Byr hf.

On 18 November, the Central Bank of Iceland announced a new step in capital account liberalisation under the title "Investment Programme". The Investment Programme is an element in the Bank's capital account liberalisation strategy of 25 March 2011. It authorises investors interested in investing in Iceland with foreign currency to purchase Icelandic krónur for a portion of their foreign currency via Central Bank auctions. The investor concerned must purchase at least the same amount of krónur through a conventional transaction with a financial institution, and the investment is subject to a long-term commitment period.

On 23 November, rating agency Standard & Poor's affirmed Iceland's sovereign credit rating of BBB-/A-3 for long- and short-term obligations in foreign and local currency. The outlook on the rating was changed from negative to stable.

On 25 November, it was announced that the Government had sold its holding in Byr hf. to Íslandsbanki with the consent of the Financial Supervisory Authority, the Competition Authority, and the EFTA Surveillance Authority. The purchase price was 740 m.kr. for an 11.8% stake.

December 2011

On 7 December, the National Budget for 2012 was approved by Parliament. Total revenues according to the 2012 budget are estimated at 523 b.kr., an increase of 9% over the 2011 budget supplement; total expenditures are estimated at 544 b.kr., an increase of 3%; and the deficit is estimated at 35 b.kr., as opposed to 57 b.kr. according to the 2011 budget supplement.

On 7 December, the Central Bank of Iceland Monetary Policy Committee decided to hold the Bank's interest rates unchanged. The current account rate therefore remained 3.75%, the maximum rate on 28-day certificates of deposit (CDs) was 4.5%, the seven-day collateralised lending rate was 4.75%, and the overnight lending rate was 5.75%.

On 14 December, the EFTA Court confirmed that capital controls like those in effect in Iceland are in compliance with the EEA Agreement. The ruling was a guideline opinion requested by the District Court of Reykjavík in connection with a case then under consideration by the Court.

On 14 December, the EFTA Surveillance Authority announced that it had been decided to refer the so-called Icesave case concerning Iceland's alleged violation of the EU Deposit Insurance Directive to the EFTA Court.

On 17 December, Parliament passed Act no. 156/2011, amending the Mandatory Insurance of Pension Rights and on Activities of Pension Funds. New provisions include these: a) extending by one year the pension funds' authorisation to maintain a difference of up to 15% between asset items and future pension obligations without amendment to the Articles of Association; b) requiring pension funds to pay into a vocational re-education fund; c) imposing a tax of 0.0814% on pension fund assets for supplemental housing benefits in 2011-2012; and d) postponing the implementation of a prohibition on simultaneous participation in numerous pension fund boards.

On 17 December, Parliament passed Act no. 164/2011, which sets forth various fiscal measures. It was decided, among other things, to reduce the payroll tax by 0.91% of the tax base beginning in 2012, to raise the share of the childbirth benefits fund from 1.08% to 1.28% of the base payroll tax, and raise payments to the guarantee fund by 0.05% of the same base. The personal income tax deduction was increased by 5.2%, the threshold between tax brackets #1 and #2 was increased by 15%, and the threshold between tax brackets #2 and #3 was increased by 8.4%. The national tax percentage did not change, but the average local tax rate and the tax withholding percentage rose by 0.03% of the tax base. Parish fees rose by 0.5%, the wealth tax levy was extended by two years, and the deduction from the tax base for premiums to acquire supplemental pension rights was reduced from 4% to 2% of income for the period 2012-2014. In addition, the fuel tax, the alcoholic beverage tax, and the carbon tax were increased. The imposition of a special tax on financial institutions was extended through 2013, as were various other tax provisions related to financial shocks.

On 17 December, Parliament passed the Financial Administration Tax Act, no. 165/2011. The Act provides for a tax on financial institutions and entities engaged in insurance operations. The tax base for the tax will be these entities' total wage and salary payments, and the tax rate was set at 5.45%. The Act is an element in special revenue generation measures in the 2012 National Budget, and revenues deriving from the new tax are estimated at 2.25 b.kr. in 2012. Concurrent with this, a special 6% income tax was levied on these companies' profits in excess of 1 b.kr.

On 17 December, Parliament passed Act no. 175/2011, amending the Act on Landsvirkjun, no. 42/1983, the Act on the Establishment of the Partnership Orkuveita Reykjavíkur, no. 139/2001, the Electricity Act, no. 65/2003, and Act no. 19/2011, amending the Electricity Act, no. 65/2003, with subsequent amendments. The amendment to the Act on Landsvirkjun is intended to eliminate all uncertainty about which financial obligations shall enjoy owner guarantees. A comparable amendment was made to the Act on the Establishment of the Partnership Orkuveita Reykjavíkur. In addition, Article 8 of the Electricity Act was amended so that, instead of stipulating that firms engaged in electricity transmission shall be directly owned by the Icelandic Gov-

ernment and/or Icelandic municipalities, they shall be majority-owned by them and/or firms owned by them.

On 17 December, Parliament passed Act no. 178/2011, amending various laws concerning social security. Among other provisions, social security benefits were increased by 3.5% starting in 2012, and the benefit period for those becoming unemployed after the end of February 2008 was extended by one year, until end-2012.

On 17 December, Parliament extended by one year the main provisions of Act no. 107/2009 on measures to assist individuals, households, and businesses due to extraordinary circumstances in the financial market. These provisions are now valid until year-end 2012.

On 21 December, the Ministry of Finance announced the key figures for tax withholding in 2012. The average local tax rate will be 14.44%, an increase of 0.03% year-on-year. Tax withholding percentages increase by this amount (0.03%), to 37.34% for income up to 230,000 kr. per month; 40.24% for income between 230,000 and 704,000 kr. per month; and 46.24% on income above 704,000 kr. per month. The tax-free threshold will be 130,000 kr. per month, an increase of 5.2%; the lower threshold for tax bracket #2 rises by 9.8% to 230,000 kr.; and the lower threshold for tax bracket #3 rises by 3.5% to 704,000 kr.

On 31 December, the temporary provision in the Act on Unemployment Insurance authorising payment of partial benefits against reduced employment expired. A corresponding provision for self-employed individuals expired at the same time.

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Table 1 Selected Central Bank interest rates¹

	Bank's current accounts	Non-indexed certificates of deposit, 90-day	Required deposits, nominal terms	O/N loans discount rates	Yield on collateral loan auctions	Collateral loans (nominal rate)	Yield on certificates of deposit, 7-day	28-day certificates of deposit (max. rate) ²
21 February 2005	6.75	8.25	7.75	10.75	8.75	.	.	.
29 March 2005	7.25	8.50	8.00	10.75	9.00	.	.	.
7 June 2005	8.00	9.35	8.75	11.00	9.50	.	9.35	.
4 October 2005	8.75	10.10	9.50	11.75	10.25	.	10.10	.
11 December 2005	9.00	10.35	9.75	12.00	10.50	.	10.35	.
1 February 2006	9.25	10.25	10.00	12.25	10.75	.	10.60	.
1 April 2006	10.00	11.00	10.75	13.00	11.50	.	11.35	.
21 May 2006	10.75	11.75	11.50	13.75	12.25	.	12.10	.
11 June 2006	11.50	.	12.00	14.25	13.00	.	12.85	.
21 August 2006	12.00	.	12.25	14.50	13.50	.	13.35	.
21 September 2006	12.50	.	12.75	15.00	14.00	.	13.85	.
21 December 2006	12.75	.	13.00	15.25	14.25	.	14.10	.
20 June 2007	12.75	.	13.00	15.25	14.25	.	14.10	.
21 July 2007	12.75	.	13.00	15.25	.	13.30	13.20	.
1 November 2007	13.25	.	13.25	15.25	.	13.75	13.65	.
25 March 2008	14.50	.	14.50	16.50	.	15.00	14.75	.
10 April 2008	15.00	.	15.00	16.50	.	15.50	15.25	.
15 October 2008	11.50	.	11.50	14.00	.	12.00	11.75	.
28 October 2008	17.50	.	17.50	20.00	.	18.00	17.75	.
18 December 2008	15.00	.	15.00	22.00	.	18.00	15.25	.
19 March 2009	14.00	.	14.00	21.00	.	17.00	14.25	.
8 April 2009	12.50	.	12.50	19.50	.	15.50	12.75	.
7 May 2009	9.50	.	9.50	17.00	.	13.00	9.75	.
4 June 2009	9.50	.	9.50	16.00	.	12.00	9.75	.
24 September 2009	9.50	.	9.50	14.50	.	12.00	9.75	9.5–10 ¹
5 November 2009	9.00	.	9.00	13.00	.	11.00	.	9.5–10.25 ¹
10 December 2009	8.50	.	8.50	11.50	.	10.00	.	9.75
27 January 2010	8.00	.	8.00	11.00	.	9.50	.	9.25
17 March 2010	7.50	.	7.50	10.50	.	9.00	.	8.75
5 May 2010	7.00	.	7.00	10.00	.	8.50	.	8.25
23 June 2010	6.50	.	6.50	9.50	.	8.00	.	7.75
18 August 2010	5.50	.	5.50	8.50	.	7.00	.	6.75
22 September 2010	4.75	.	4.75	7.75	.	6.25	.	6.00
3 November 2010	4.00	.	4.00	7.00	.	5.50	.	5.25
8 December 2010	3.50	.	3.50	5.50	.	4.50	.	4.25
2 February 2011	3.25	.	3.25	5.25	.	4.25	.	4.00
17 August 2011	3.50	.	3.50	5.50	.	4.50	.	4.25
2 November 2011	3.75	.	3.75	5.75	.	4.75	.	4.50
<i>Time-weighted average</i>								
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	.
2009	11.04	.	11.04	17.16	.	13.68	.	.
2010	6.31	.	6.28	9.25	.	7.78	.	7.53
2011	3.41	.	3.41	5.41	.	4.41	.	4.16

1. Rates on published day, except for current accounts and required deposits, which change on 1, 11 or 21 of each month. 2. Shows minimum and maximum rates on 28-day certificate of deposits.

Table 2 Exchange rate indices

	Official exchange rate ¹ 31 Dec. 1991 = 100	Narrow trade index ² 31 Dec. 1991 = 100	Average exchange rate index ³ 31 Dec. 1994 = 100			Real exchange rate ⁴ 2000 = 100				
			Based on		Based on		Based on		Based on	
			Average	Based on import weights	Based on export weights	Index	%-change ⁵	Index	%-change ⁵	
1996	116.2	.	99.0	100.0	98.1	91.3	0.3	88.9	1.1	
1997	114.7	.	97.7	98.3	97.2	92.2	1.0	90.4	1.6	
1998	112.8	.	96.2	96.7	95.7	93.8	1.8	92.8	2.7	
1999	112.6	108.8	96.0	96.5	95.6	96.3	2.6	96.8	4.3	
2000	112.7	107.7	96.1	96.3	95.7	100.0	3.9	100.0	3.3	
2001	135.4	128.7	115.4	115.1	115.3	87.3	-12.7	86.7	-13.3	
2002	131.4	125.7	112.0	111.7	112.0	91.7	5.1	90.8	4.7	
2003	123.5	120.2	105.3	104.8	105.4	96.0	4.7	95.9	5.6	
2004	121.0	118.9	103.1	102.4	103.5	98.0	2.0	93.1	-2.9	
2005	108.6	106.9	92.6	91.9	93.0	111.4	13.7	104.8	12.6	
2006	121.3	119.5	103.4	102.6	104.0	104.2	-6.4	102.2	-2.5	
2007	118.3	117.6	100.9	99.9	101.5	108.6	4.2	110.6	8.2	
2008	166.4	166.8	141.9	140.9	142.4	85.5	-21.2	85.7	-22.5	
2009	216.1	223.3	190.9	189.9	191.3	70.0	-18.2	63.8	-25.5	
2010	.	216.3	185.0	184.4	185.0	74.5	6.4	72.1	13.0	
2011	.	216.8	183.5	183.0	183.3	75.2	1.0	73.4	3.7	

1. The index shows the average exchange rate of foreign currencies against the Icelandic króna for each period. From 6 September 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 has been recalculated so that, 2 January 2009, it was assigned a value equivalent to that of the now-discontinued Exchange Rate Index. 3. 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. 4. Based on quarterly information on prices (consumer prices), wages, employment and output in main trading partner countries. 5. Year-on-year.

Table 3 Notes and coin in circulation by denomination

	2007		2008		2009		2010		2011	
	ISK thousands	%	ISK thousands	%	ISK thousands	%	ISK thousands	%	ISK thousands	%
<i>Notes:</i>										
5,000 kr.	9,597,500	70.3	18,000,000	80.8	22,445,000	84.1	31,402,500	87.4	35,558,500	87.3
2,000 kr.	398,000	2.9	617,000	2.8	504,000	1.9	618,000	1.7	699,000	1.7
1,000 kr.	2,669,000	19.5	2,696,500	12.1	2,776,000	10.4	2,896,500	8.1	3,366,500	8.3
500 kr.	989,500	7.2	952,750	4.3	957,000	3.6	994,500	2.8	1,095,500	2.7
Total	13,654,000	100.0	22,266,250	100.0	26,682,00	100.0	35,911,500	100.0	40,719,500	100.0
<i>Coin:</i>										
100 kr.	1,188,600	57.1	1,256,600	57.9	1,318,600	57.9	1,359,600	57.7	1,435,600	57.8
50 kr.	374,890	18.0	373,640	17.2	392,390	17.2	412,390	17.5	436,390	17.6
10 kr.	342,370	16.5	359,520	16.6	377,620	16.6	392,920	16.7	413,720	16.6
5 kr.	89,434	4.3	92,434	4.3	95,434	4.2	97,934	4.2	100,934	4.1
1 kr.	86,132	4.1	87,994	4.1	91,634	4.0	95,134	4.0	98,502	4.0
Total	2,081,426	100.0	2,170,188	100.0	2,275,678	100.0	2,357,978	100.0	2,485,146	100.0

Table 4 Summary of the accounts of deposit money banks¹

<i>M.kr. at year-end</i>	2005	2006	2007	2008	2009	2010	2011
<i>Assets:</i>							
Domestic assets, total	2,445,068	3,314,826	4,977,887	3,553,638	2,669,001	2,479,284	2,595,370
Cash and cash balances with Central Bank	36,906	47,359	163,798	206,586	132,705	117,516	121,320
Receivables on domestic institutions	105,362	196,396	209,168	131,224	104,875	28,210	15,856
Domestic credit	2,205,912	2,969,617	3,827,402	2,194,381	2,100,844	2,068,280	2,201,439
Lending ²	1,701,808	2,407,176	3,148,054	1,933,727	1,652,721	1,676,648	1,754,985
Redeemed liabilities	468	276	134	894	2,090	2,016	566
Overdrafts	171,976	198,986	214,527	139,331	145,122	149,462	154,396
Bills	5,648	4,762	11,248	35,973	1,772	840	422
Unindexed bonds	201,797	329,420	517,150	198,815	250,696	331,278	532,763
Indexed bonds	658,406	780,351	844,956	534,939	511,864	531,305	680,452
Foreign currency-linked bonds	659,988	1,077,672	1,518,618	1,302,065	974,854	866,281	470,882
Foreign currency-linked overdrafts	3,526	15,710	41,421	59,169	31,684	31,909	26,139
Provisions	...	...	...	-337,458	-265,360	-236,442	-110,635
Leasing contracts	18,909	28,380	38,126	30,374	26,291	27,637	66,443
Debt instruments	256,788	275,620	388,628	187,816	410,690	353,616	346,010
Treasury bills	5,248	2,770	3,401	1,764	2,647	731	-
Equities	223,158	255,670	252,593	42,464	11,142	10,379	34,001
Derivatives	...	...	266,126	90,461	14,078	1,508	1,245
Share in associates	28,892	21,125	23,352	11,487	12,868	8,324	14,321
Share in affiliated undertakings	67,996	80,329	188,610	213,816	106,606	92,566	117,218
Other assets	...	...	299,431	705,683	197,025	162,880	123,971
Foreign assets, total ³	1,488,256	3,031,477	4,721,174	630,592	287,161	284,134	356,383
Foreign credit and equities	723,831	1,284,133	2,867,835	399,904	136,662	133,893	181,887
Foreign lending	500,953	817,046	1,996,874	329,293	92,502	87,229	96,994
Marketable bonds and bills	71,165	227,456	576,504	28,786	40,134	43,350	81,594
Equities	151,713	239,631	294,457	41,825	4,026	3,314	3,299
Foreign receivables	...	...	788,952	25,131	73,403	93,292	109,399
Derivatives	...	...	134,180	1,524	962	23	315
Share in associates	1,168	1,714	76,560	-	-	1,367	-
Share in affiliated undertakings	205,190	329,305	560,542	138,744	25,523	2,528	1,706
Other assets	558,067	1,416,326	293,106	65,289	50,612	53,030	63,076
Assets, total	3,933,324	6,346,303	9,699,061	4,184,230	2,956,162	2,763,418	2,951,753
<i>Liabilities:</i>							
Domestic liabilities, total	1,137,043	1,545,990	2,552,524	3,083,620	2,334,955	2,140,694	2,313,454
Central Bank facilities	77,766	120,388	281,360	358,916	12,997	41,844	-
Deposits of residents, total	647,001	774,714	1,217,856	1,604,159	1,580,825	1,412,306	1,509,028
Current accounts	161,435	184,425	351,059	492,711	450,351	422,025	427,684
Current accounts in foreign currency	850	15,651	47,310	29,540	37,837	40,969	30,241
Money market rate accounts	...	...	173,076	109,537	190,901	127,070	114,486
Sight deposits	66,296	80,031	111,144	372,798	360,044	341,679	322,026
Indexed deposits	145,513	148,061	114,572	255,554	227,133	213,420	224,094
Holiday pay accounts	...	...	6,809	7,492	6,745	6,733	7,471
Supplementary pension deposits	28,448	31,713	36,850	62,302	74,057	80,769	86,981
Other time deposits	179,540	243,310	250,592	106,928	95,966	93,446	118,664
Foreign currency accounts	64,920	71,523	126,444	167,298	137,792	86,195	177,382
Deposits from credit institutions	...	...	110,570	171,038	172,741	144,117	66,109
Bond issue	146,243	252,498	409,489	87,238	19,643	7,557	128,780
Subordinated loans	30,392	30,668	39,991	31,066	33,208	48,846	55,356
Direct borrowing	130,997	188,684	234,257	552,492	434,162	404,194	465,659
Derivatives	...	...	51,154	5,520	2,251	1,267	5,362
Other liabilities	104,644	179,038	207,847	273,191	79,128	80,563	83,161
Foreign liabilities, total ³	2,391,125	4,234,096	6,224,485	731,539	311,467	207,607	153,901
Deposits from foreign credit institutions	...	...	388,858	203,429	180,259	160,489	107,841
Deposits from foreign parties, other than credit institutions	52,069	364,595	1,297,271	103,706	80,729	45,850	44,367

Table 4 Summary of the accounts of deposit money banks (cont.)¹

M.kr. at year-end	2005	2006	2007	2008	2009	2010	2011
Derivatives	...	...	125,841	11,564	-	807	1,692
Bond issue	1,842,123	2,814,959	2,496,270	-	-	-	-
Subordinated loans	151,125	360,588	418,388	17,046	-	-	-
Direct borrowing	345,808	693,954	1,493,533	395,787	50,340	-	-
Other foreign liabilities	...	...	4,325	8	140	462	-
Total equity and minority interest	405,156	566,217	922,051	369,070	309,740	415,117	484,399
Total liabilities and equity	3,933,324	6,346,303	9,699,061	4,184,230	2,956,162	2,763,418	2,951,753

1. The latest data is preliminary. The data only represents DMBs that are operating at each time. 2. In these figures, the loans of Arion Bank hf., Íslandsbanki hf., and NBI hf. are assessed at purchase value; that is, the price at which these parties purchased the loan portfolio from Kaupthing Bank hf., Glitnir Bank hf., and Landsbanki Íslands hf. The purchase value is the amount that is expected to be collected on the loans. The value of the loan portfolio therefore does not reflect customers' debt position. The loan portfolios are revalued on a regular basis, and could lead to an increase or decrease in the value of specific loans. 3. Foreign party means that the counterpart is non-resident, according to Act on foreign exchange (No 87/1992).

Table 5 Summary of the accounts of the banking system¹

M.kr. at year-end	2005	2006	2007	2008	2009	2010	2011
Foreign assets, total ²	1,555,761	3,199,547	4,884,759	1,060,082	772,292	950,570	1,404,048
Foreign credit and equities	766,533	1,405,600	3,006,157	619,363	375,267	358,529	457,305
Other foreign assets	789,228	1,793,948	1,878,602	440,720	397,025	592,041	946,743
Foreign liabilities, total ²	2,392,759	4,235,969	6,226,198	973,521	515,456	487,820	552,914
Foreign bond issue	1,842,123	2,814,959	2,496,270	-	-	-	-
Other foreign liabilities	550,636	1,421,010	3,729,928	973,521	515,456	487,820	552,914
Domestic assets, total	2,539,857	3,468,598	4,855,562	3,571,505	3,195,101	2,927,099	2,906,272
Domestic credit	2,295,586	3,118,026	3,877,504	2,480,809	2,269,375	2,241,808	2,286,723
Treasury and Government institutions	18,380	24,855	6,610	273,890	168,440	173,383	194,140
Municipalities	10,600	11,828	11,645	11,019	11,067	18,857	16,931
Non-bank financial companies	212,173	281,719	131,126	34,618	24,385	25,370	26,140
Companies	872,519	1,137,030	1,316,380	1,245,311	1,162,071	1,128,607	1,062,837
Households	544,418	707,531	836,672	593,789	517,183	532,708	633,671
Holding companies	443,509	719,829	928,020	425,824	226,200	231,157	189,706
Other	193,986	235,233	647,051	233,815	425,390	368,168	273,932
Provisions	...	...	...	-337,458	-265,360	-236,442	-110,635
Derivatives	...	...	266,126	90,461	14,078	1,508	1,245
Share in associates	28,892	21,125	23,352	11,487	12,868	8,324	14,321
Share in affiliated undertakings	67,996	80,329	188,610	213,816	106,606	92,566	117,218
Other domestic assets	147,383	249,118	499,970	774,932	792,175	582,892	486,765
Broad money and bonds (M4)	803,746	1,037,629	1,640,954	1,713,390	1,628,236	1,456,524	1,584,824
Domestic bond issue	146,243	252,498	409,489	87,238	19,643	7,557	11,068
Broad money (M3)	657,503	785,131	1,231,465	1,626,153	1,608,593	1,448,967	1,573,756
Time deposits	353,501	423,084	583,079	543,454	596,845	523,433	553,816
Money and sight deposits (M2)	304,002	362,047	648,385	1,082,699	1,011,747	925,533	1,019,941
Sight deposit	131,216	150,498	237,588	540,097	497,835	427,874	499,407
Money supply (M1)	172,786	211,549	410,797	542,602	513,912	497,659	520,533
Demand deposits	162,286	200,077	398,369	522,250	488,187	462,994	481,143
Notes and coin in circulation	10,500	11,472	12,429	20,352	25,725	34,666	39,391
Other domestic borrowing	130,997	199,480	4,148	402,633	396,621	394,882	460,951

1. The latest data are preliminary. The data only represent DMBs operating at the time in question. 2. The loans of Arion Bank hf., Íslandsbanki hf., and NBI hf. are assessed at purchase value; that is, the price at which these parties purchased the loan portfolio from Kaupthing Bank hf., Glitnir Bank hf., and Landsbanki Íslands hf. The loan portfolios are revalued on a regular basis, and such revaluation could lead to an increase or decrease in the value of specific loans. Changes in the loan portfolios of these parties could therefore be due either to revaluation of the loans or to actual movement of funds. The Central Bank has now harmonised data on the loans and write-downs of the three banks established in October 2008. This harmonisation leads to an increase in the principal of these three parties' loans in comparison with previous data, together with a contribution to their provisioning accounts.

Table 6 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>
1 June 1979	28.0	1 January 1992	7.0
17 April 1985	18.0	1 November 1992	6.0
1 March 1987	13.0	1 December 1992	5.0
1 August 1988	12.0	1 November 1993	4.0 (2.5) ²
1 March 1989	11.0	21 May 1998	4.0 (1.5) ²
1 May 1990	10.0	21 March 2003	3.0 (1.0) ²
1 June 1990	7.0	21 December 2003	2.0 (0.0) ³
31 October 1991	6.0		

1. Percentage of bank total deposits as of 1 June 1979, of domestic disposable funds as of 1 March 1989, and of all disposable funds as of 21 May 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 7 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>
1 January 2011	5.55	4.70	3.70
1 February	5.50	4.70	3.67
1 March	5.25	4.70	3.50
1 April	5.25	4.70	3.50
1 May	5.25	4.70	3.50
1 June	5.25	4.30	3.50
1 July	5.25	4.30	3.50
1 August	5.25	4.30	3.50
1 September	5.25	4.30	3.50
1 October	5.25	4.30	3.50
1 November	5.40	3.90	3.60
1 December	5.25	3.90	3.50
Average 2010	7.78	4.79	5.20
Average 2011	5.31	4.40	3.54

Table 8 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>	
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	21.6	4.5	24.7	7.1	25.8	8.1	16.4
2009	20.2	10.6	15.7	6.5	21.2	11.6	8.6
2010	15.4	12.5	11.5	8.7	15.1	12.2	2.6
2011	13.8	8.2	11.1	5.6	11.4	5.9	5.2

1. Weighted average of DMBs' interest rates on general non-indexed bonds from 1995 to 2009. Two payment dates per year are assumed. Simple average of interest rates in 2010 and 2011. 2. Weighted average of DMBs' interest rates on new indexed loans. Simple average of interest rates in 2010 and 2011. 3. Between January values.

Table 9 Balance Sheet of the Central Bank of Iceland¹

M.kr.	End of year					
	2005	2006	2007	2008	2009	2010
Assets:	162,294	321,842	476,859	1,187,460	1,178,082	1,328,240
<i>Foreign assets</i>	67,506	168,070	163,585	429,491	485,131	666,436
Foreign deposit	21,049	41,650	19,338	207,257	222,894	420,098
Gold	2,074	2,934	3,305	6,653	8,664	10,426
Foreign securities	42,702	121,467	138,322	211,855	231,574	217,821
Foreign assets apart from reserves	-	-	787	211	190	1,690
Special drawing rights with the IMF	3	8	11	53	18,161	13,079
IMF reserve position	1,678	2,010	1,823	3,462	3,649	3,322
<i>Domestic assets</i>	94,789	153,772	313,273	757,969	692,952	661,804
<i>Deposit money banks</i>	77,772	119,863	258,165	466,540	28,869	90,037
Other claims	-	-	-	231,024	6,722	-
Collateral	77,772	119,863	258,165	72,352	9,249	40,825
Overnight loans	-	-	-	37,982	1,700	995
Other claims in foreign currency	-	-	-	125,181	11,197	48,217
<i>Other financial institutions</i>	11,902	28,547	50,102	16,423	3,133	3,004
Listed securities	1,832	1,473	1,447	2,757	3,133	3,004
Collateral	10,070	27,074	44,554	13,666	-	-
Overnight loans	-	-	4,102	-	-	-
<i>Central government</i>	-	-	-	270,005	165,398	170,525
Listed securities	-	-	-	-	-	-
Bonds receivable	-	-	-	270,005	165,398	170,525
<i>Other sectors</i>	189	499	131	117	490,665	391,617
<i>Real estate and other assets</i>	4,527	4,479	4,520	4,470	4,420	4,370
<i>Other assets</i>	399	385	356	413	467	2,252
Liabilities and capital:	162,294	321,808	476,859	1,187,460	1,178,082	1,328,240
<i>Foreign liabilities</i>	1,634	1,873	1,712	241,982	203,989	280,213
Short-term	150	95	100	134,403	36,752	67,004
Long-term	-	-	-	104,521	145,266	193,238
IMF SDR allocation	1,484	1,779	1,613	3,058	21,970	19,971
IMF deposits	-	-	-	-	1	-
<i>Domestic liabilities</i>	124,291	271,633	384,143	863,100	891,215	978,648
<i>Notes and coin</i>	13,202	14,513	15,735	24,436	28,958	38,269
<i>Deposit money banks</i>	34,250	45,006	152,112	378,743	152,664	170,537
Sight deposits	31,956	43,228	152,112	90,618	87,607	55,660
Time deposits	-	-	-	-	6,657	-
Certificates of deposit	2,294	1,777	-	167,600	29,702	60,957
Other claims	-	-	-	16,519	9,409	47,903
Sight deposits in foreign currency	-	-	-	104,005	19,290	6,017
Insurance accounts	-	-	-	-	-	-
<i>Other financial institutions</i>	145	131	1,425	22,008	245,418	316,915
Sight deposits	145	131	1,425	4,415	35,412	36,916
Time deposits	-	-	-	-	669	-
Certificates of deposit	-	-	-	9,827	-	4,505
Sight deposits in foreign currency	-	-	-	7,766	56,196	22,515
Time deposits in foreign currency	-	-	-	-	153,142	252,979
<i>Central Government</i>	75,916	211,036	211,177	403,246	446,668	424,648
Treasury current account	33,573	80,110	93,971	168,723	166,050	130,050
Government institutions	371	605	536	895	282	1,427
Treasury's sight deposits in foreign currency	9,113	97,235	89,855	2,376	49,129	175,842
Treasury's time deposits in foreign currency	-	-	-	169,404	179,998	106,328
Time deposits	32,859	33,085	26,815	61,849	51,210	11,000
<i>Other liabilities</i>	778	948	3,694	34,666	17,507	28,279
Capital and reserves	36,370	48,336	91,003	82,378	82,878	69,379

1. Based on the Central Bank of Iceland annual accounts.

<i>End of month 2011</i>											
<i>January</i>	<i>February</i>	<i>March</i>	<i>April</i>	<i>May</i>	<i>June</i>	<i>July</i>	<i>August</i>	<i>Sep.</i>	<i>Oct.</i>	<i>Nov.</i>	<i>Dec.</i>
1,302,140	1,298,669	1,309,678	1,305,829	1,251,704	1,372,755	1,396,612	1,445,903	1,451,172	1,518,310	1,627,523	1,585,775
736,479	723,071	765,346	760,403	710,491	829,137	859,738	918,227	913,405	984,510	1,112,210	1,047,469
472,840	457,688	495,612	491,644	435,449	552,152	561,866	571,757	554,900	613,951	736,917	672,144
9,869	10,438	10,421	11,057	11,250	10,955	12,040	13,203	12,233	12,444	13,380	12,249
235,352	237,820	242,350	240,844	247,682	249,967	243,563	242,020	253,941	267,748	270,358	272,072
1,703	1,349	1,367	1,343	1,469	1,465	1,575	1,588	1,694	1,696	1,842	184
13,329	12,371	12,216	12,152	11,204	11,171	37,226	86,246	87,187	85,296	86,232	87,295
3,385	3,405	3,379	3,361	3,436	3,426	3,469	3,413	3,450	3,375	3,480	3,525
565,662	575,597	544,333	545,425	541,213	543,619	536,874	527,676	537,767	533,800	515,314	538,306
29,855	37,302	2,495	143	1,310	6,443	2,385	2,134	3,871	10,863	2,989	4,312
-	-	-	-	-	-	-	-	-	-	-	-
27,968	35,202	-	-	-	4,999	-	-	-	10,442	-	-
995	995	1,897	-	-	-	-	-	-	-	-	-
892	1,105	598	143	1,310	1,444	2,385	2,134	3,871	421	2,989	4,312
2,990	2,951	3,029	2,771	2,539	3,069	3,200	3,158	3,140	3,006	3,007	3,122
2,990	2,951	3,029	2,771	2,539	3,069	3,080	3,040	3,019	3,006	3,007	3,122
-	-	-	-	-	-	119	119	121	-	-	-
-	-	-	-	-	-	-	-	-	-	-	-
170,130	172,166	173,092	174,142	167,204	170,424	170,576	171,098	171,900	172,261	173,214	191,905
-	-	-	-	-	-	-	-	-	-	-	18,582
170,130	172,166	173,092	174,142	167,204	170,424	170,576	171,098	171,900	172,261	173,214	173,323
357,986	358,476	361,015	363,668	365,458	359,018	356,012	346,584	342,003	342,968	331,402	334,320
4,370	4,370	4,370	4,370	4,370	4,333	4,370	4,370	4,370	4,370	4,370	4,320
331	331	331	331	331	331	331	331	12,482	331	331	327
1,302,140	1,298,669	1,309,678	1,305,829	1,251,704	1,372,755	1,396,612	1,445,903	1,451,172	1,518,310	1,627,523	1,585,775
280,697	274,753	282,582	290,438	294,111	285,007	327,100	372,950	365,594	356,250	363,129	399,401
62,557	55,618	45,451	53,147	52,942	44,215	57,430	56,028	47,374	43,421	42,525	36,656
197,787	198,667	216,826	217,091	220,544	220,220	248,837	296,440	297,514	292,574	299,718	341,604
20,353	20,468	20,305	20,200	20,625	20,573	20,834	20,482	20,706	20,255	20,885	21,141
-	-	-	-	-	-	-	-	-	-	-	-
949,576	952,220	957,823	945,395	884,098	1,009,468	985,254	987,909	1,000,120	1,075,529	1,175,212	1,102,597
36,529	36,287	35,946	36,533	36,639	37,689	38,620	38,689	39,012	38,889	39,561	43,205
124,703	121,236	102,080	108,593	100,828	121,386	145,455	140,724	168,078	178,522	121,823	118,114
39,284	50,082	39,993	45,788	27,276	34,216	51,307	28,723	32,354	27,175	28,928	31,286
-	-	-	2,000	-	-	-	-	-	-	-	-
81,414	65,585	57,216	54,933	66,334	78,339	87,487	99,823	113,102	100,933	84,366	70,015
-	-	-	-	-	-	-	-	-	-	-	-
4,005	5,569	4,870	5,873	7,218	8,831	6,661	12,177	22,623	50,414	8,529	16,813
-	-	-	-	-	-	-	-	-	-	-	-
326,239	293,629	330,238	312,254	302,703	308,769	312,326	307,194	323,462	354,306	516,263	358,224
34,459	27,397	32,656	23,736	22,228	12,893	15,315	13,071	16,349	13,177	15,358	13,898
-	-	-	-	-	-	-	-	-	-	-	-
5,158	5,110	2,703	3,606	5,210	7,109	7,260	7,311	7,009	8,062	9,515	8,511
85,212	51,519	47,367	32,336	20,624	21,954	15,505	15,024	34,293	11,436	198,228	157,557
201,409	209,604	247,512	252,577	254,642	266,812	274,246	271,788	265,810	321,632	293,163	178,258
429,061	467,747	455,995	450,691	398,030	501,387	445,303	456,182	424,956	450,890	458,988	528,816
123,769	151,662	143,699	133,838	146,980	136,587	79,520	94,615	94,798	125,483	128,025	143,851
1,567	1,506	1,592	1,897	1,917	1,897	2,173	2,211	2,275	2,048	1,059	1,111
182,620	191,920	186,760	188,511	182,089	295,595	296,326	292,643	274,094	269,614	276,246	376,466
110,073	111,598	113,062	115,533	56,102	56,335	56,281	55,679	53,790	53,745	53,659	7,388
11,033	11,061	10,883	10,912	10,943	10,972	11,003	11,034	-	-	-	-
33,045	33,321	33,564	37,323	45,898	40,238	43,549	45,120	44,612	52,922	38,578	54,238
71,868	71,696	69,274	69,996	73,494	78,280	84,258	85,044	85,458	86,531	89,183	83,777

