November 18, 2008

Address by Davíd Oddsson, Chairman of the Board of Governors of the Central Bank of Iceland, at a breakfast meeting of the Iceland Chamber of Commerce, November 18, 2008

I would like to thank the Chamber of Commerce for inviting me to speak here today. I have spoken at this forum before, actually, and at this time of the year, but the season of the year is probably the only aspect of today's situation that resembles the other occasions on which I have spoken here. The memory of October 2008 will remain with us for a long time to come: the winds changed in the Icelandic economy, and vulnerabilities that had been lurking beneath the surface combined and intensified to produce an economic perfect storm. October is seldom harvest time, but it was surely harvest time this October. And the harvest was a pitiful one – mouldy and withered – but for the most part, we reaped what we sowed. You will notice what I say: *for the most part, we reaped what we sowed*, because the soil and the climate – factors generally beyond a planter's control – couldn't mitigate the damage caused by the imprudence of the planters. And now the harvest is in the barn, and many are angry. That should come as no surprise, for it is abundantly clear that, as always in a bad year, the failed harvest will mean difficulties for most, and extremely hard times for some. This is why so many people are irritated and angry, and even those who are calmer and more disciplined are resentful and chagrined.

But there are still others who are grabbing the opportunity to exploit that anger and resentment in the service of their own interests and their own acrimony. And they've managed quite well until now; there's no denying it. After all, the tools needed to do it are still in existence and still in the right hands. But hopefully that game will end, and end soon, for Abraham Lincoln was right when he said, "You can fool some of the people all of the time, and all of the people some of the time, but you cannot fool all of the people all of the time."

There is robust demand for culprits at the moment, but very meagre supply. And oddly enough, the fundamental principle of market activity seems to have failed, for in this case, strong demand and weak supply have not raised the trading price on culprits to any marked degree. But I am reasonably certain that, over the past several weeks, the Central Bank of Iceland and its leaders have been at the top of the most-wanted list. Actually, it is difficult not to be amazed that this should persist for such a long time, given how farfetched it is. And the most fascinating thing is that among the people behind this campaign are those who bear the most responsibility for the situation now facing us.

Amid all of the tempestuous happenings that have dominated the scene recently, something that happened in 1998 appears to have been forgotten: by statutory amendment, banking supervisory activities were transferred out of the Central Bank, thus removing virtually all of the Central Bank's legal authority and responsibility to monitor the inner workings of the banking system. What remains are issues such as prudential rules on liquidity and foreign exchange exposure, collateral loans, and other tasks of this type, which are of little significance in the current circumstances. The conferral of all permits and licences for financial institutions was transferred from the Central Bank to the new Financial Supervisory Authority. The authorised activities of the Financial Supervisory Authority, which had been quite extensive beforehand, were expanded, and budgetary allocations to it have grown substantially over the past several years. The Financial Supervisory Authority has broad-based authority and numerous measures that it can employ in order to obtain information from the banking system and thereby fulfil its own mandate. It has measures it can use to force changes in conduct, and it has the authority to investigate every drawer, shelf, and filing cabinet in banking institutions in order to ascertain that operations are being conducted as required. The Central Bank no longer has these tools at its disposal because its role has changed. As a result, it cannot send supervisors or investigators into the banks at will, as the Financial Supervisory Authority can. It cannot determine whether rules on lending to the banks' owners or to related parties are followed, or whether the presentation of collateral – i.e., for loans to buy securities – is carried out in an appropriate manner or not. The Central Bank cannot prevent the banks from opening branches abroad and collecting deposits there. These things had all been changed. It may be that separating the Financial Supervisory Authority from the Central Bank was a mistake, but that is another story. It was done, and therefore it is senseless to behave as though the Central Bank still has the obligations and the authority in its hands, and to behave as though it is appropriate to lambast the Bank for not carrying out the monitoring that was part of its sphere of activity a decade ago. Most of those who take part in instigating the attacks on the Central Bank should know better, but they have purposely looked beyond these fundamental points. This is a dirty game that would not have succeeded if ownership of the Icelandic media had been structured in a sensible manner.

After the Financial Supervisory Authority was separated from the Central Bank, the Bank's main task by law was to attempt to control inflation by wielding the only instrument at its disposal, the policy interest rate. In addition, the Bank was to ensure that the nation's payment systems functioned, and it has been successful in doing so even after the collapse of nearly the entire banking system. Keeping payment systems functional over the past several weeks has been no simple matter. But the battle against inflation is the principal objective, and the policy interest rate is virtually the only tool that can be used to achieve that objective. If other forces in the economy participate actively in the fight against inflation, the interest rate channel is quite effective and can be used with moderation, which is exactly how it works best. But if other forces pull against the Central Bank, the Bank has no choice but to wield the policy rate more decisively – perhaps even harshly – and the unpleasant side effects will be magnified. This is the situation that has reigned in recent years as a result of expansionary fiscal policy and enormous lending growth in the banking system. The banks boasted openly about helping customers to avoid the Central Bank's policy rate, by granting foreign-denominated loans to borrowers with little or no income in the currencies underlying the loans. These things pressed inflation upwards and adversely affected those who suffer when inflation rises. It is often said that monetary policy needs to be re-examined, as it is generally worded, but this wish list item is seldom accompanied by any sensible explanation of what is meant. No one is willing to say outright that we should stop trying to control inflation, although some want to "pass it through," as it were. The writers of the wish list simply say monetary policy should be re-examined, and leave it at that. A statement like this is just hazy enough to provide a convenient buzz word to people who don't know exactly what they are talking about. But in spite of this lack of clarity, the Central Bank has elected to receive all of these suggestions with a positive attitude, and it has encouraged a review of monetary policy as soon as possible. Actually, the fact is that monetary policy is examined on a regular basis, including reviews by foreign experts two or three times a year. For example, OECD and the International Monetary Fund have examined our monetary policy in depth on frequent occasions and have concluded that, in the main, the Central Bank has been on the right track in its formulation and implementation of monetary policy. They have also said, however, that a co-ordinated effort to support the Central Bank has been lacking, and that this dichotomy has produced poorer results. Therefore, I rather assume that, if a review of monetary policy were conducted – and the Central Bank is emphatically *not* opposed to such a review – it is quite likely that foreign experts would come to this same conclusion once again.

But even after the supervision of banking activities was removed from the Central Bank, the task of monitoring and promoting financial stability remained, although the Bank was not provided with effective means for doing so. In that context, the Bank is to express its opinion, as appropriate, about the private sector, the government, and the banking institutions themselves. It can make comments and issue recommendations of various sorts, but it cannot take coercive action because all such measures were transferred to the Financial Supervisory Authority. Thus it is appropriate to ask, with respect to the financial stability function, whether the Central Bank did not err quite notably. Did the Bank carry out this function well or poorly? Did it not realise what sort of situation had developed, or what was in the offing? And it is no wonder that questions should be raised, for it has repeatedly been implied that the collapse of the banking system this October took everyone by surprise. Some have even maintained that the collapse was unnecessary – a home-grown problem – because all that was needed was an expedited emergency loan of 80 billion krónur to Glitnir, and then everything would have been just fine. This is so preposterous that it hardly merits a response, but I hope nonetheless that there will be an opportunity to expand more fully on that topic at a later time. However, the other part of this implication – that the banking crisis came like a bolt out of the blue and destroyed everything in its wake – is worth closer scrutiny here and now, as is the assertion that the Financial Supervisory Authority, the Central Bank, and the Government of Iceland did not know, or were not told, what was on the horizon. The failed banks maintained recently that their financial position was actually quite tolerable but that the authorities' intervention felled them, and this incoherent twaddle is presented as the truth.

Central banks all over the world – including those that have lost control of banking supervisory activities because of the once-fashionable idea that the monitoring of the banking system should be separated from other activities – issue reports on financial stability for their respective countries at least once a year. Of course, these reports and others like them are read with varying attention and interest, and they are doubtless read least, and least carefully, when banking systems and the financial environment in general appear staunch and healthy.

It is inconceivable that any central bank, no matter how uneasy about its financial environment, would say in such a report that all indicators suggested that its banks – one or more, not to mention *all* of them – were headed straight for insolvency. Such a forecast could easily prove to be a self-fulfilling prophecy, with the forecast itself acting as the catalyst. Financial stability reports must take this into account, and readers must read them with this in mind. The Central Bank of Iceland's most recent financial stability report, which was published in May, begins with this heading: "Current conditions test the banks' resilience". If you bear in mind what I just said about what central banks can allow themselves to say publicly, this heading – which should speak clearly to anyone who is accustomed to reading such reports – indicates that the Central Bank was concerned about the banks' position and developments in the banking system at the time the report was published. Nonetheless, the Bank also said in this report that, on the whole, the financial system was still sound but that contingency measures were needed. Even though central bankers in Iceland and abroad generally express themselves with care and may be vague at times, it is a blatant misstatement to assert that the Central Bank of Iceland had not long ago become aware of the situation and warned about it. The Bank issued repeated warnings in the public arena and was even more vehement in private discussions. Because of the furore that has ensued, and the veritable flood of incorrect statements, I cannot do otherwise than mention a few examples, which include statements made publicly and statements made to the authorities behind closed doors and far in advance of the bank failures.

More than one-and-a-half years ago, I made this statement at the annual meeting of the Central Bank of Iceland. This was in March 2007: "What remains, however, is of course that people are now more aware of the widespread risks that the future may hold in store. Global market conditions can change suddenly. The level of access to credit, which in recent times has been exceptionally favourable for Icelandic and other banks, may change suddenly if unexpected conditions arise. It is important to be prepared for such a contingency." And elsewhere in the same address: "Rapid and sweeping changes in the financial sector put a great strain on regulatory agencies, which may face an uphill struggle to keep up with the swift pace of developments. The same may undoubtedly be said about the Central Bank. After all, useful and supportive as these institutions may be, they neither can nor should play a leading role. That role can only be performed by the financial companies themselves. Because they rely so heavily on open access to credit markets, it is crucial for them to enjoy the confidence of their creditors. In this respect like many others, credibility is a fragile thing and a very high price can be paid for losing it." And in yet another part of the same speech: "Global liquidity has been exceptionally abundant in recent years, and has been widely tapped on good terms. The benefits of resourcefulness and bold, quick action can be realised to the full in such circumstances. It is impossible to rule out that such a climate will persist for a long while, but this is by no means certain. And when a change does take place, it may be caused by unexpected circumstances and strike quickly. It is then that caution and prudence prove most effective."

And now, respected members of the Chamber of Commerce and honoured guests, let us move a little closer in time. One year ago, on November 6, 2007, I said at a breakfast meeting of the Icelandic Chamber of Commerce: "Another phenomenon we see is that newly coined terms soon become cloaked in a sort of semi-divinity - like the term 'international expansion,' which no one dares oppose lest he be accused of being an anachronism, devoid of a sense of ‘vision,’ as it is now called, and of not knowing when the time is ripe for action.

Upon closer scrutiny, the term ‘international expansion’ seems to be nothing more than investment abroad – together with utilisation of knowledge and talent, of course. In that sense, the construction of the aluminium smelter in Reydarfjördur can be called Alcoa's international expansion into Iceland, though no one has bothered to call it that. But it is: it is investment combined with the utilisation of knowledge of the aluminium industry. That expansion is promising in many ways, of course, and some aspects of it have already generated substantial returns, not least because people took advantage of favourable conditions and external circumstances. For a while, cheap capital was readily available, and some were bold enough to grab the opportunity. But the flip side of expansion, and the side that cannot be ignored, is that Iceland is becoming uncomfortably beleaguered by foreign debt. At a time when the Icelandic government has rapidly reduced its debt and the Central Bank's foreign and domestic assets have increased dramatically, other foreign commitments have increased so much that the first two pale into insignificance in comparison. All can still go well, but we are surely at the outer limits of what we can sustain for the long term.

The term ‘expansion’ is so thoroughly bathed in radiance that even when people seem to be invading companies that are owned by the public, the invasion is called expansion. And companies whose primary obligation, by law and by the nature of their operations, is to provide the public with specific services at the lowest price possible, suddenly find themselves participating in foreign risk ventures without there having been any rational discussion of the matter beforehand - and all in the name of ‘international expansion.’ In matters such as this, we must proceed with the utmost caution.

We Icelanders have been successful in our endeavours in the recent past, and we have had the wit to be careful when necessary, but it would be imbecilic to believe that we can loosen our belts - that is, if we want to continue being successful. One of the ways in which we must remain vigilant is to refuse to allow inflation to gain a foothold in our economy. All attempts to dodge this responsibility will harm the Icelandic people, with unforeseeable consequences. We must not increase our foreign debt beyond its current limits - on the contrary, it is right and necessary that we reduce our foreign debt and achieve a more favourable balance with abroad. Plans for international expansion must therefore be carried out within sensible limits. The immoderate zeal that is so intoxicating may not be allowed to steer our course for the future. We know that, in many ways, our upward climb rests on a bed of clouds. To some extent, this is inevitable, and it is normal that items like intangible assets should be prominent in good times; but when the sky darkens and the clouds become heavy, the rain can start at a moment's notice, and little may be left of those assets when the air clears. So we must take care in this as well as in other things.”

I think there were too few who thought it wise to heed these warnings. Indeed, it was recollected recently that scholars had thought my concerns about the accumulation of debt in the economy unnecessary at the very least. I would like to conclude these references to public warnings with some words that I spoke this past March, at the Central Bank’s annual meeting. I had just mentioned that many considered the problems we were facing to be imaginary; they thought the situation was actually good and that any problems would correct themselves without intervention. “There is the danger that those who placed their trust in such a beneficent outcome used their time far less well than they should have from August 2007 onward. The CEO of one of the largest banks in the world said, ‘While the band plays, we dance.’ He was forced to resign shortly thereafter, when the bank demonstrated a shocking operating loss, but with a fat fund in his pockets as a reward for his foresight and progressive thinking. For similar reasons, many will have more difficulty waiting for better times. Of course, it is far from inconceivable that strong gusts of wind could come from any direction, dispersing pitch-black storm clouds in a moment’s time, bringing leveraged buyouts of heavily indebted companies under the aegis of credit institutions offering minimum terms and slick collateral, and bright, sunny morning would smile on markets in Iceland and elsewhere. But even though this is not inconceivable, and though history shows that the market is living proof of the most improbable outcomes, the likelihood is that the probability of winning the wait-and-hope game is measurably poorer than that accompanying the purchase of a Lotto ticket. Therefore, it is appropriate to assume that the situation will not right itself very much in the short term, and if it does right itself to any measurable degree, it will hardly return to its prior state. If people haven't prepared themselves already, there is no reason to wait. We must seek all possible ways to strengthen the liquidity position of companies – particularly financial companies – and at the same time we must re-examine market models. In athletic terms, one could say that this means that now is the time to consolidate our defences and be content with a goal if opportunities emerge in spite of all odds. Though exaggerated pessimism is obviously unnecessary, it is as bad or worse to paint the situation in rosy colours for the benefit of ourselves and the public and imply that there is some sort of magical solution to the problem that faces us. As the saying goes, ‘Lying to others is a wicked bent; lying to oneself breeds a lethal event.’”

These are examples of stern words of warning issued by the Central Bank in public fora over a period of one-and-a-half years, in addition to repeated admonitions over the fact that the banks should extend foreign-denominated loans to households and businesses without income in the borrowed currencies. Granted, this enabled many borrowers to sidestep the Central Bank's attempts to control inflation. But this circumvention required that the Central Bank's policy rate be raised higher and remain high for a longer period than would otherwise have been the case. Little heed was paid to the Bank's warnings, and so no action was taken. And still I ask whether it wouldn't have been different if the nation's media had not been fettered as they have been for such a long time. These warnings and the information underlying them were presented in non-public fora as well: at meetings of the Supervisory Board of the Central Bank, at meetings with the senior staff members of the Financial Supervisory Authority, and in discussions with bank executives and governmental leaders. On those occasions, it was possible to communicate in much stronger terms than could be done in public. The Board of Governors of the Central Bank met numerous times with governmental ministers and other officials – including both of the chairmen of the political parties making up the present government – in order to express their deep concern. The reactions of the latter were far from unnatural. In most cases, after having met with the Board of Governors, they met with senior executives at the commercial banks, who assured them that the Central Bank's concerns were, at the very least, grossly exaggerated, and that the banks' funding was in place for all of 2008 and virtually guaranteed through 2009.

In early February 2008, representatives from the Central Bank went to London to meet with highly placed executives from a number of the largest banks that do business with Iceland and Icelandic companies, as well as with credit rating agencies located in London. Although the Central Bank had long been concerned about the banking system, its representatives were alarmed by the views of those present at the meetings in London. When they arrived back in Iceland, they requested a meeting with political party leaders, governmental ministers, and other officials. That request was granted. At the meeting, the entire text of a report on the London trip was read. The report, which was in manuscript form, is quite long. I would like to quote two parts of it, wherein the names of individuals and companies are omitted with one exception, where the name is necessary to clarify the context. The first part of the report states as follows: "It is obvious that concerns about Iceland are centred on concerns about the nation's banks, whose domination of the Icelandic financial system are so complete that, if they should slip and fall, others will fall with them. After [ ] general overview of the state of economic affairs and the changes that have taken place, and the matters that particularly involve the government and the Central Bank's tasks, there was considerable discussion of the banks on their part. The final question was then this: What will happen if the Icelandic banks cannot (or cannot to any significant extent) access the markets in the next 12 months or so? The Central Bank representatives' answer was substantively this: that if this were to happen, Iceland's commercial banks would be in an extremely tight spot, but it should be pointed out that under those circumstances the entire international banking system must also be in such a vulnerable state that it would be possible to speak of a banking crisis, if not a global crisis. But this question by [ ], as uncomfortable as it appeared, became more and more comprehensible to the Central Bank representatives over the course of their stay in London."

I would like to remind you that this is a description of conditions and discussions that took place over seven months ago. The latter quote, from the concluding section of the London report, is as follows: "Based on these discussions, and on comments made by people who are so well informed – although these comments were presented with varying degrees of clarity – it can be concluded that the Icelandic banking system is in danger, not least because of the poorly organised and careless way in which it has expanded in recent years, trusting that credit would always be easy to come by. Markets will be more or less closed to Icelandic banks for at least the next 12 months, although some believe 24 months is more likely. Of course, it is necessary to emphasise strongly the uncertainty entailed in such assertions. But that conclusion is based on the assumption that when the markets finally open, large, powerful, and well-known banks will gain access first, followed by their smaller counterparts. The Icelandic banks will be near the end of the queue. And the 'model' that involves including Icelandic bonds in 'structured securities,' which made them a desirable product, is gone for good.

It would surely not help Kaupthing in any way to move its headquarters out of Iceland, which some considered a viable alternative, but under the current conditions it would considerably lighten the load on other banks and would be positive for the Icelandic financial system, because in that case the Central Bank and the government would be deemed capable of saving the remaining banks from collapse if need be. The situation that the Central Bank representatives were now becoming fully aware of – and the fact that it was well known in the market, prompting investors to take short positions in the Icelandic banks in the belief that the markets would be closed to them for a long time – was considered one of the main explanations for the Icelandic banks' high CDS spreads. The fact that the Central Bank and the Icelandic government were neither large enough nor strong enough to save the banks, even though they were most willing to do so, compounded the problem. Some believed the only thing that could make a dent in these high retroactive terms was if the Central Bank of Iceland could negotiate credit facility agreements with foreign central banks so as to ensure that the Bank could contribute to the rescue of the Icelandic banking system. The conclusion is this: It is clear that the Icelandic banks [ ] have placed themselves and, what is worse, the Icelandic financial system in jeopardy, and perhaps in a position beyond remedy, with their conduct over the past several years. It is dangerous to take no action in the hope that the markets will open up unexpectedly and make the problem simply vanish. It is necessary to begin unwinding the situation immediately so that it will not be impossible to untangle it later. The possibility that market conditions and access to liquidity will improve much sooner than is now thought likely cannot be ruled out. There are no indications of this at present, however, and if people allow themselves to cling to that hope, it will be too late to respond once it becomes obvious that their wishes are not going to come true."

When one hears all of these statements, which have been made both publicly and in private, to all of the people involved in this situation, it is astounding that the Central Bank should be censured so strongly on the grounds that it sat on its hands, was blissfully unaware of what was going on, and was therefore unable to warn others. These examples – and many, many others that I could share with you if time allowed – show that the Central Bank was acutely aware, perhaps more aware than others, of the situation, and that it recommended emphatically that something be done. "Get rid of the Central Bank governors" is shouted on the town square, mimicked by those who find the Central Bank governors a convenient target, and echoed by the propaganda machine – a propaganda machine that has been abused blatantly in recent years, as prize-winning television commentator Egill Helgason put it last Sunday.

Perhaps it would be good if the Governors of the Central Bank would turn to other tasks than those currently occupying them, but that is another matter. What is most striking is that those who cry out against the Central Bank had little to say when the Bank tried with all its might to warn everyone of the hazards ahead. "All of this has to be investigated," is what they are saying now, and no stone must be left unturned. But nothing is being investigated and, worse still, no information is being provided to the public. The Central Bank urgently requests that its role in the run-up to the bank collapse be investigated in full, that the investigation be carried out as soon as possible by the most competent foreign experts available. The Central Bank has nothing to fear from such an investigation. If closer scrutiny reveals that the Bank has failed, it will not be necessary to dismiss any governors, at least not the man now standing before you, for he will leave immediately and without any backlash. I reiterate that the Central Bank not only considers it desirable that its role in this affair be investigated, it demands outright that such an investigation be conducted because of the accusations that have been levelled at it, even by responsible parties. It will be interesting to see if others have a cleaner record than the Central Bank does.

But at this turning point, in the midst of all the talk of investigations and leaving no stone unturned, why is no information forthcoming about why the banks collapsed? Why do the people of Iceland, who will ultimately have to pay the bill for this – and it's no small bill, either – why do the people receive no cogent information, even though everything is supposedly on the table in front of the parties working on matters related to the failed banks, and it should all be as clear as day? The Kaupthing issue involving the cancellation of bank executives' liability was several weeks old before it was disclosed. It was not until indignant employees leaked the information that the matter became public knowledge. And since that time, there has been no information on how the affair will be followed up. Suggestions to the effect that the police should be called in at once have not met with any support. Is confidentiality in banking affairs being touted here? Confidentiality in banking no longer applies to these matters. The anger that is seething just below the surface of our society and can be aimed in various directions is seething largely because the public have received so little information about what is happening. Why are they not being told that a single party owed one trillion Icelandic krónur to the domestic banking system? And that includes only the three commercial banks; it does not include savings banks, pension funds, or other debt, nor does it include that same party's foreign debt. Since the separation of the Financial Supervisory Authority and the Central Bank, the Bank cannot gather information about such things. It may not know them. But others know it; there is no doubt about that. That a single party should owe the Icelandic banking system one trillion krónur is difficult to apprehend – so difficult that one is tempted to ignore it. But we must not turn away from this fact. In other words, one party owed Iceland's three banks one trillion Icelandic krónur or more. This is more than the equity of all three of the old banks combined. The bank directors who loaned their share of that amount must have known that the total was because they considered not only the credit they themselves extended; they examined documents on collateral before granting their largest loans, or they could be expected to do so. And the supervisory authorities must have known it as well, and it must have required quite a stretch of the imagination to conclude that this same party was unconnected to himself where these loans were concerned. How in the world could this happen? What sort of stranglehold did this party have on the banks and the whole system? One thing is abundantly clear: if the banks' foreign customers had been aware of this, all transactions with the Icelandic banking system would have ceased, and the banks would have collapsed as a result. Is it possible that some public discourse would have taken place – about this matter and others – if all of the free media (which is a contradiction in terms in this context) had not been controlled by the owners of the banks? And it has been disclosed that the new banks are continuing in the same vein as their predecessors did: they are not forcing debtors who owe more than a trillion krónur to the banking system to declare bankruptcy, although they do so quickly and efficiently when the debtors are Mr. Smith and Mrs. Jones, even though the Smiths and the Joneses are now the banks' owners once again. It seems that people haven't learned anything, or else they are just as afraid as before. I repeat: the Central Bank of Iceland strongly encourages an investigation of its role in the banking collapse, which many people would like to exaggerate. That investigation will be simple, and the staff of the Central Bank have nothing to fear. But in spite of the organised outcry against this organisation – the only organisation in Iceland to issue a storm warning a year and a half before the downpour began – it is ironic to contemplate the fact that the Central Bank of Iceland should probably place dead last on the list of those in greatest need of investigation. It is critical to reveal the actual position of the failed banks. The investigation procedure that has been disclosed so far is entirely inadequate and unacceptable. It is almost funny to see the histrionics involved in the propaganda campaign that has been waged by those most responsible for the banking scandal. Attempts have been made to convince the public that statements made in an interview with me on *Kastljósid* (*The Spotlight*), when I tried for the first time to explain what was going on in comprehensible language, prompted the British government to use its anti-terrorist legislation against Iceland and freeze Landsbanki's assets. This assertion has been repeated again and again, like the refrain in a ballad – most recently in a flagrant incident on Channel 2 just yesterday – but the remarkable thing is that the British government has never made this statement. It hasn't said a single word about it, even though Gordon Brown and Alistair Darling are known to be great fans of *Kastljósid* and watch it almost every evening! They have explained, however, why they resorted to this drastic measure. Not all of the discussions concerning that matter have been published, and this makes it easier to serve up pre-digested accusations and feed them to a credulous public through media that have been abused blatantly for years, as the television commentator put it. I have no concerns about this because other discussions will doubtless be published when the matter is investigated. I know what was said, and I know what actually prompted the British government to take that action.

Respected colleagues:
It is inevitable that I take some time to address these matters because of the undeserved attacks on the Central Bank since the collapse of the banks. I would have needed even more time to do the subject justice, but I will do so at another place and time. However, we are looking to the future as well, especially in view of the forecast that the Central Bank staff published in the last *Monetary Bulletin*. It has been said that the forecast is a gloomy one, and who should wonder? Darkness fell at noon in the Icelandic banking sector this October, and as the saying goes, darkness is dark.

Economic forecasts have not proven terribly reliable in the past few years, but the Central Bank's forecasts have not been farther from the mark than those made by others under volatile conditions. But if it has been difficult to produce accurate forecasts in the recent past, it is all but impossible now, for uncertainties have taken over the leading role while the factors that can be projected with some reliability have been relegated to supporting roles. However, closer scrutiny of the underlying data indicates that, given the scale and scope of the shock, the future is relatively bright. How can I say this, when it is obvious that unemployment and domestic liabilities will skyrocket? Net foreign liabilities were not projected to rise substantially, but now it has been decided to add considerably to the nation's debt burden without any statutory authorisation, assuming that Parliament approves the measures that have been announced. This had not been decided when the forecast was prepared, but presumably it would have made a gloomy forecast even darker and added to the burden on the nation. *Monetary Bulletin* projects that output growth will turn negative for a while, and that unemployment will rise and even approach the levels in the euro zone, that Shangri-La envisioned by all those swept along with the tide of the current herd mentality. How, then, can I say, in spite of everything, that this gloomy report can include a ray of hope? I say it because, notwithstanding the enormous shock to our economy, the Bank's forecast suggests that we can emerge relatively quickly from the worst of the problem. In this issue of *Monetary Bulletin* is a chart illustrating GDP growth following episodes of economic distress, including a comparison among a number of countries that have experienced such crises. In many ways, Iceland is better situated and better able to rise from a crisis of this type than were the comparison countries shown on that chart, most or all of which have less developed economies than Iceland does. And Iceland has demonstrated its responsiveness and adaptability on numerous occasions. Counteracting this, however, is a negative factor that did not exist in the crises in the comparison chart and should not be underestimated: in the current situation, there is a strong economic headwind that affects the entire globe and could slow down our own recovery. For example, output growth is turning negative in the euro zone for the first time, and conditions there are clearly deteriorating. But this need not discourage us, for forecasts show clearly – and our own feelings support this – that we are fully capable of taking up arms and fighting our battle quickly and well once we dedicate ourselves to it. Of course, we are not speaking of a few weeks or months, but rather one or two years.

When the bulk of our banking system collapsed in the space of a few days in October and the British placed a fellow NATO member on a list together with the most notorious terrorists on the planet – a list that included not only Landsbanki but also the Republic of Iceland – it was no wonder that foreign exchange activity between Iceland and other nations should be utterly paralysed. Many were irritated because it took a few days for the Central Bank to re-establish minimum foreign exchange service, although this was a minor miracle under the circumstances. And since then, the transport of goods to and from Iceland has been restored with few difficulties, given the scope of the problem. The Central Bank has acted as an intermediary in transactions that the commercial banks carried out previously, and this has put enormous strain on the Bank and its employees. While this arrangement cannot and must not endure for long, it is worth remembering that the Central Bank was able to do it because it had had the tenacity and fortitude to oppose tossing its foreign exchange reserves into the banking inferno. If it had relented under pressure, it would be impossible to criticise anyone for denouncing the Bank and throwing food at the building in which it operates. But because of this, the Central Bank has been able to guarantee, and will continue to guarantee, smooth imports even while export revenues are only trickling into the country, even though there are no longer any technical reasons for delays in transfers of funds. Within a few days, all those who want it will be able to purchase foreign currency for all types of goods transactions or travel, although restrictions on financial transactions will be lifted in stages. Exporters are being truly myopic and are hurting themselves and others with their delays in bringing foreign currency back into the country. They need not fear that they will be unable to obtain all the currency they need when they need it. As regards goods transactions, the flow of foreign exchange will be positive in the years to come, and it is unnecessary to assume that foreign investors will engage in a mass exodus from Iceland when the króna is re-floated, even though the exchange rate might be disadvantageous to them at first. Inflation will fall quickly in the next year, and interest rates will do likewise.

Ladies and gentlemen:
In closing, I wish to emphasise that it is vital to inform the people who must pay the bill – tell them honestly how the banks stood before they collapsed and what sort of conduct was going on at the time. Only then can informed discussion begin. Perhaps it will begin in the heat of anger, which is understandable and must be tolerated, but those who are mere noisemakers will quickly lose control of the facts, which is the most important thing that can happen as we rebuild our economy.

It has been asserted that the Nordic countries have demanded unexpectedly that we shoulder, above and beyond statutory obligations, a debt of more than 600 billion krónur for IceSave accounts; otherwise, they will not grant us a loan requiring a substantially smaller contribution from each individual nation. I do not want to gainsay this statement, although I have not seen anything in writing to support it. Our friends from the Faeroe Islands, at least, have not placed any such stringent conditions on their assistance. It has been said that true friends are the unobtrusive angels who lift us when our own wings have failed us. The Faeroese are such angels, and I thank them and bless them.