

Domestic foreign exchange market and foreign exchange reserves 2015

In 2015, the króna appreciated by 7.9%, foreign exchange market turnover grew 85%, and the Central Bank's share of market turnover was 55%. The Bank's foreign exchange reserves increased by 123 b.kr. during the year, to an end-2015 balance of 653 b.kr. The increase in the reserves was due predominantly to the Bank's net foreign currency purchases, which totalled 272 b.kr. during the year; however, it was offset by the Treasury's buyback of its own foreign-denominated bonds and prepayment of the outstanding balance of the loan from the International Monetary Fund.

The foreign exchange market in 2015

During the year, the Central Bank continued to follow the strategy of increased foreign exchange market intervention as set forth by the Monetary Policy Committee in May 2013.¹ All of the Bank's intervention transactions took the same form; i.e., currency purchases from market makers. In all, the Bank bought more than twice as much currency in 2015 as in 2014.

The Bank's net foreign currency purchases in the interbank market in 2015 totalled 272.4 b.kr., or 12.5% of estimated GDP for the year, a year-on-year increase of roughly 140%. In 2014, foreign currency purchases totalled 5.6% of year-2014 GDP. Foreign exchange market turnover rose by 85% year-on-year in 2015, totalling 492.7 b.kr. The Bank's transactions accounted for 55% of total turnover in 2015, as opposed to 43% in 2014.

The objectives of the Bank's intervention during the run-up to capital account liberalisation are, on the one hand, to expand the foreign exchange reserves and increase the portion not financed with foreign debt and, on the other, to limit exchange rate volatility. Low inflation and foreign currency inflows made it possible to undertake such substantial purchases, as the exchange rate rose by 7.9% during the year in spite of the Bank's currency purchases. The Bank's transactions mitigated short-term exchange rate volatility and prevented the króna

¹ Monetary Policy Committee announcement of 15 May 2013.

from strengthening still further. In 2015, the listed EURISK exchange rate peaked in January at 154.3 and bottomed out at 140.3 in December. The spread between the highest and lowest EURISK values was 9.9%, as opposed to 4.9% in 2014. The annualised daily volatility of the króna vis-à-vis the euro was 3.1%.

In addition to intervening in the foreign exchange market, the Central Bank continued its regular currency purchase programme with no change from the prior year.² Under the programme, the Bank bought EUR 6 million per week according to a preannounced schedule. These regular transactions totalled 46.2 b.kr. in 2015, about 17% of the Bank's total purchases.

The Central Bank bought the most currency over the summer months. Purchases made in June, July, and August totalled 115 b.kr., or 42% of the total for the year. In August alone, the Bank bought currency for about 47 b.kr. Foreign investors had some impact on the foreign exchange market in the year with new investment in Treasury bonds. Formally reported new investments in Treasury bonds totalled 50 b.kr., the equivalent of 20% of the Central Bank's foreign currency purchases during the year.

Foreign exchange reserves³

The Central Bank's foreign exchange reserves increased by 123 b.kr. (USD 951 million) in 2015, totalling 653 b.kr. (USD 5,042 million) by the year-end. At the end of the year, the Central Bank's foreign exchange reserves totalled 33% of GDP and 35% of broad money holdings (M3), and they covered nine months' worth of goods and services imports.

The main transactions increasing the foreign exchange reserves during the year were the Central Bank's net interbank market purchases, which totalled 272 b.kr. (EUR 1,872 million). Foreign-denominated recoveries made by the Central Bank of Iceland Asset Management Company (ESÍ) expanded the reserves by 22 b.kr. in 2015. Arion Bank and Íslandsbanki paid down subordinated loans from the Treasury, in the amount of 20 b.kr. each, and Íslandsbanki paid off a currency swap agreement, expanding the reserves by 11 b.kr.

The principal transactions reducing the reserves during the year were the Treasury's buyback of its own foreign-denominated bonds, in the amount of 67 b.kr. (USD 497 million), and the Central Bank's prepayment of the outstanding balance of the loan from the

² Press release no. 23/2014

³ Figures for 2015 are preliminary.

International Monetary Fund (IMF), equivalent to 42 b.kr. (SDR 237 million). The Treasury's prepayments of foreign debt totalled 36 b.kr.: 28 b.kr. (EUR 192 million) on bonds in connection with the Avens transaction and 8 b.kr. (PLN 204 million) on the bilateral loan from Poland. In addition, foreign exchange transactions for final settlement of deposit insurance in connection with the Icesave accounts totalled 30 b.kr.

At the end of 2015, the foreign exchange reserves net of the Central Bank and central government's foreign-denominated debt were positive by 313 b.kr. In comparison, the net reserves thus calculated amounted to 57 b.kr. at year-end 2014 and therefore grew by 256 b.kr. in 2015. In addition to the foreign exchange reserves, the Central Bank and the Treasury own foreign-denominated assets in the amount of 66 b.kr. The Central Bank's foreign exchange balance – i.e., the difference between the Bank's total foreign-denominated assets and total foreign-denominated liabilities – was 370 b.kr., an increase of 230 b.kr. in 2015.

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Foreign exchange market and foreign exchange reserves

		2012	2013	2014	2015
ISK exchange rate (change from beginning to end of year)	%	-6.6	10.7	1.7	7.9
Daily exchange rate volatility, annualised	%	5.4	6.3	3.2	3.1
FX market turnover	<i>b.kr.</i>	167	166	267	493
— portion due to Central Bank	%	13.8	11.5	42.8	55.3
FX market purchases, Central Bank	<i>b.kr.</i>	20	10	113	272
FX market sales, Central Bank	<i>b.kr.</i>	3	9	1	0
Net purchases, Central Bank	<i>b.kr.</i>	17	1	111	272
Foreign exchange reserves, in USD millions	<i>USD m</i>	4,182	4,228	4,178	5,042
Foreign exchange reserves, in ISK billions	<i>b.kr.</i>	540	487	530	653
Foreign exchange reserves net of CB and Treasury foreign debt	<i>b.kr.</i>	-29	-28	57	313
Central Bank foreign exchange balance: foreign assets net of foreign liabilities	<i>b.kr.</i>	112	61	138	370
Foreign exchange reserves, as % of GDP	%	33	29	28	33
Foreign exchange reserves, equivalent months of imports ⁴	<i>Months</i>	13	11	7	9

⁴ It should be noted that, from 2014 onwards, these figures include imports of both goods and services, whereas they previously included only goods imports. This explains why the 2014 figure is lower than the 2013 figure even though the reserves are larger.