

Economic and monetary chronicle

November 2007

On November 1, the Board of Governors of the Central Bank of Iceland decided to raise the Bank's policy interest rate by 0.45 percentage points to 13.75%.

On November 20, rating agency Standard & Poor's announced that it had changed the outlook for the Republic of Iceland's sovereign credit rating from stable to negative. The agency affirmed its foreign currency sovereign credit ratings of A+ for long-term obligations and A-1 for short-term obligations. The local currency sovereign ratings are AA for long-term obligations and A-1+ for short-term obligations.

December 2007

On December 6, the supplementary budget for 2007 was approved by Parliament. Estimated tax revenues increased by 20% from the original budget, and estimated fiscal performance improved from 9 b.kr. to 83 b.kr.

On December 12, the Norwegian Ministry of Finance approved the merger of Glitnir Bank ASA and BNbank. The merged entity has also been authorised to acquire all shares in Glitnir Factoring ASA and Glitnir Securities ASA, as well as a 70% share in Glitnir Property Holding AS, with the subsidiary Glitnir Property Group AS.

On December 13, the fiscal budget for 2008 was approved by Parliament, with revenues amounting to 473 b.kr., expenditures amounting to 434 b.kr., and a surplus of 39 b.kr. The increase in revenues over and above the 2007 budget was estimated at 0.3% and the increase in expenditures at 11½%. On the same day, Parliament approved a temporary reduction in oil charges, from 45 kr./l. to 41 kr./l., and an indefinite extension of the temporary reduction in the fee schedule for special per-kilometre fees for diesel vehicles.

January 2008

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

On January 28, Moody's Investors Service issued a special comment on Iceland entitled, "Iceland's Aaa ratings are at a crossroads". The report did not announce any change in ratings on the Republic of Iceland.

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

On January 31, international rating agency Fitch Ratings affirmed Kaupthing Bank's credit rating and revised its outlook from negative to stable. The outlook for the rating had been negative since December 6. Kaupthing's rating is A for long-term obligations and F1 for short-term obligations. The individual rating is B/C, the support rating is 2, and the support rating floor is BBB.

February 2008

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

On February 17, new wage settlements 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 wage settlements remain in effect until November 30, 2010, and are identical in their fundamentals. The negotiating parties have estimated that total costs incurred by employers will rise by just under 11% during the term of the settlement, or by an average of 3½% annually. There are three main pillars in the settlements: a "safety net" for wage developments, an increase in the lowest wage rates, and a review clause in 2009. No general wage rise is included until the final year; instead, workers are guaranteed specified wage developments during the first two years. The settlement also provided for the establishment of a Worker Rehabilitation Fund, whose function is to provide assistance and services to employees who are injured or have long-term illnesses. Further provisions include an increase in vacation days and in days of leave due to children's illnesses. The assumptions underlying the settlements are two. First, real wages in the private sector, according to the Statistics Iceland wage index, must not drop between January and December 2008. The other assumption concerns maximum inflation levels. At the beginning of February 2009, the review committee will meet in order to discuss an extension of the agreement based on the underlying assumptions. If they have held, the agreement will be extended until November 30, 2010; if not, the parties will attempt to reach a consensus on their response to the changes. If they cannot reach a consensus, the agreement will expire at the end of February 2009.

In connection with the signing of the private sector wage settlements on February 17, the Government pledged to raise the tax-free income threshold in excess of price levels, reduce income-linked cutbacks of child allowances and asset-linked reductions of mortgage interest allowances, lower the corporate income tax rate from 18% to 15% beginning with the income year 2008, raise unemployment benefits in line with the rise in the lowest wage rates, and contribute one-third to the Rehabilitation Fund beginning in 2009, against matching contributions from employers and pension funds. Other pledges include raising rent subsidy allowances, increasing the number of loans pledged for subsidised residential rental housing, and increasing the amount allocated to continuing education and adult education. The Ministry of Finance

estimates that the cost to the Treasury as a result of these measures will total approximately 35 b.kr. over the term of the settlement.

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

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

On February 28, international credit rating agency Moody's Investor Service announced a downgrade of Kaupthing Bank, Landsbanki Íslands, and Glitnir Bank. The banks' credit ratings for long-term obligations in local and foreign currencies were downgraded from Aa3 to A1 for Kaupthing and from Aa3 to A2 for Glitnir and Landsbanki, and all three banks' financial strength ratings were lowered from C to C-. The ratings for short-term obligations in local and foreign currencies remain unchanged at P-1. The outlook on all of the ratings is stable.

March 2008

On March 5, Moody's Investor Service announced that it had changed its outlook for the Republic of Iceland's Aaa Government bond ratings and the country ceiling on foreign currency bank deposits from stable to negative. The outlook remains stable for the Aaa/P-1 long- and short-term country ceilings for bonds and notes, as well as for the Aaa local currency bank deposit ceiling.

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

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

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

On March 20, Standard & Poor's announced that it had placed Glitnir Bank hf. on credit watch with negative implications. The bank's rat-

ings for long- and short-term obligations are now A- and A-2, respectively.

On March 25, the Board of Governors of the Central Bank of Iceland decided to raise the Bank's policy interest rate by 1.25 percentage points to 15%. Also announced were amendments to internal Central Bank rules that were drafted with the aim of facilitating financial market activity, especially transactions with Icelandic krónur.

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

April 2008

On April 1, Fitch Ratings announced that it had revised the outlook for the Republic of Iceland's long-term foreign and local currency issuer default ratings from stable to negative. The long-term foreign and local currency issuer default ratings were affirmed at A+ and AA+, respectively, and the F1 rating for short-term obligations and the country ceiling of AA- were likewise affirmed.

On April 1, Fitch Ratings announced that it had placed Glitnir Bank, Kaupthing Bank and Landsbanki Íslands ratings for long- and short-term obligations and financial strength on ratings watch negative.

On April 1, Standard & Poor's announced that it had placed the Republic of Iceland's long-term ratings on credit watch with negative implications.