

The underlying external position of the economy at the end of the third quarter of 2015

The Central Bank of Iceland has published on its website the preliminary statistics for the balance of payments in the third quarter of 2015, and for the international investment position (IIP) at the end of the quarter.

For further information, the Central Bank also publishes an assessment of the underlying IIP, which takes account of the effects of the winding-up of the deposit institutions in winding-up proceedings based on the position during the quarter and book value of assets according to the winding-up boards' accounts.¹ Until the courts have evaluated the composition agreements of the deposit institutions in winding-up proceedings, there will be some uncertainty about how the settlement of the estates ultimately affects the IIP. Whether the entities concerned conclude composition agreements and pay a stability contribution or instead pay a stability tax, it is clear that their winding-up will have a considerable impact, which will show as a reduction in Iceland's external liabilities and therefore a more favourable IIP than calculations indicate.²

The international investment position was negative by 7,495 b.kr., or 348% of GDP, at the end of the third quarter of 2015. The position excluding the deposit institutions in winding-up proceedings was positive, however, by just under 22 b.kr., or 1% of GDP. Based on the position during the quarter and the book value of assets, the winding-up of the failed deposit institutions is estimated to have a negative effect on the net position in the amount of 781 b.kr., or 36% of estimated GDP. In comparison, it was estimated that the effect would be negative in the amount of 800 b.kr., or 38% of GDP, in the second quarter.

¹ The assessment is based on the assumption that all of the assets of the deposit institutions in winding-up proceedings will be distributed equally to all creditors. Furthermore, creditors are classified as domestic or foreign based on the underlying ownership of recognised claims according to the estates' claims registers. It should be noted that both the market value of the assets of the deposit institutions in winding-up proceedings and the proportional distribution of claims as domestic and foreign are somewhat uncertain. Factors such as the exchange rate used for settlement, the netting of debt, and the resolution of disputes on specific claims will ultimately determine the status of the estates and thereby the effect of their settlement on the IIP. The underlying IIP does not reflect the position that will develop if the estates pay a stability tax or stability contribution in accordance with the stability conditions set by the authorities.

² The Central Bank of Iceland report entitled "Settlement of the failed financial institutions on the basis of stability conditions: impact on balance of payments and financial stability", published on the Bank's website on 27 October 2015, describes the projected developments in the net IIP with consideration given to the failed banks' estates' most recent draft composition agreements.

The underlying IIP is therefore estimated to be negative by 760 b.kr., or 35.2% of estimated GDP, at the end of the third quarter of 2015. In comparison, the underlying external position at the end of Q2/2015, based on a re-estimation of the net IIP, was estimated to be negative by 715 b.kr., or 33,8% of GDP. Therefore, the underlying position deteriorated during the quarter by 45 b.kr., or nearly 2.1% of GDP, owing mainly to price level and exchange rate movements.³ However, the calculated impact of winding up the failed deposit institutions was more positive than in the second quarter by nearly 18 b.kr. Quarter-on-quarter changes in the book value of assets stem mainly from exchange rate movements, settlement of assets, and increases in the valuation of the domestic commercial banks.

Table 1. Underlying international investment position as of end-Q3/2015 (% of GDP)

	<u>2015, III</u>		
<i>% of GDP</i>	Foreign assets	Foreign liabilities	International investment position
- total	244.7	592.4	- 347.7
- excl. DMBs in winding-up proceedings	175.0	174.0	1.0
- based on calculated settlement of DMBs in winding-up proceedings ¹	178.5	213.7	- 35.2

1. The estimate of the calculated settlement does not take account of the payment of a stability tax or stability contribution.

Further information can be obtained from Steinn Friðriksson, Financial Stability Department, Central Bank of Iceland, at tel +354 569-9600.

³ For more detailed information on developments in the IIP excluding the impact of the deposit institutions in winding-up proceedings, see Central Bank press release no. 24/2015 on the balance of payments and external position in Q3/2015.