

Progress of the Plan for Removal of Capital Controls

This report is published by the Minister of Finance and Economic Affairs as provided for in Paragraph 2 of the Temporary Provision I in Act No. 87/1992 on Foreign Exchange, which reads as follows:

The Minister shall make public a report on the progress of plans to remove restrictions on cross-border capital movements and foreign currency trading at six-month intervals until such restrictions are finally removed. The report referred to in the first sentence shall be published for the first time within six months of the entry into force of this act.

Former reports are available at the website of the Ministry of Finance and Economic Affairs.¹

A working group on the revision of the Foreign Exchange Act is under way

A working group on the revision of the Foreign Exchange Act had its first meeting on October 9, 2019. The group was assigned with submitting a draft bill to the Minister of Finance and Economic Affairs for a new comprehensive foreign exchange legislation and, as appropriate, necessary amendments to other acts no later than June 2020. The task also involves revising the Foreign Exchange Act, no. 87/1992, the Act on the Treatment of Króna-Denominated Assets Subject to Special Restrictions, no. 37/2016, and rules set on both sides of the Act. The outbreak of the COVID-19 pandemic resulted in delays in the work of the group. Its deadline for submitting a draft bill to the Minister has therefore been extended from June to November 2020.

A lower offshore króna position

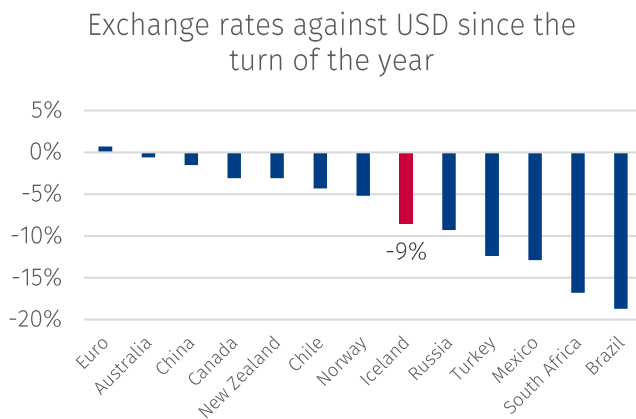
Aside from amendments to confidentiality provisions to the Act on the Treatment of Króna-Denominated Assets due to the merger of the Central Bank of Iceland and the Financial Supervisory Authority, the legal framework of offshore króna assets is unchanged from the previous report from October 2019. The offshore króna asset position has decreased, amounting to 50 bn. ISK in May (1.7% of GDP) compared to 62 bn. ISK in September 2019.

¹ <https://www.government.is/topics/economic-affairs-and-public-finances/progress-of-plans-to-remove-capital-controls/>

Offshore króna assets	Market value (bn. ISK)
Treasury bonds and bills and other gov't guaranteed bonds	7.3
Deposits and Central Bank CDs	37.8
Other securities and unit shares	5.4
Total amount	50.4

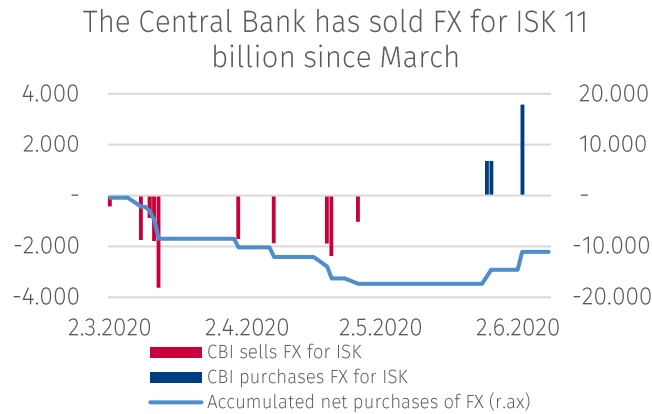
Source: The Central Bank of Iceland

The króna has depreciated 9% against the US dollar since the turn of the year. The majority of the depreciation materialised since March, after the first case of COVID-19 was diagnosed in end-February and major economies announced extensive travel restrictions and other measures to limit the spread of COVID-19. It is in line with the depreciation of many other currencies against the dollar as investors have fled to safe assets and currencies that are traditionally in high-demand in times of great uncertainty



Source: Macrobond

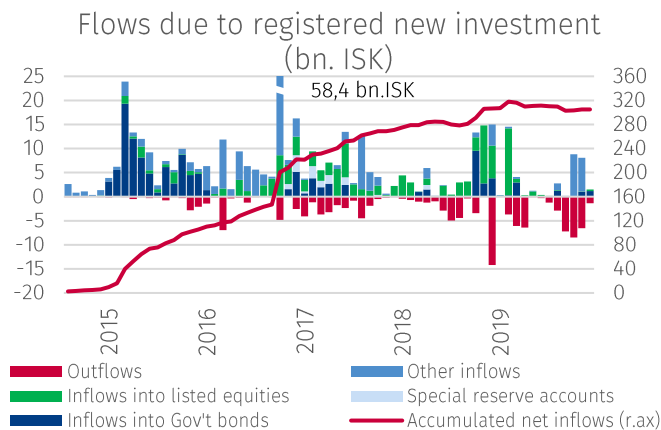
The Central Bank’s interventions in the foreign exchange market increased along with increased volatility in the market. The Bank’s first intervention this year was on March 2, the first business day after the first infection was detected in Iceland, when it purchased ISK 430 million for foreign currency. In March and April, the bank intervened 10 times in the market and purchased over ISK 17 billion for foreign currency. Towards the end of May, however, the króna appreciated and the bank intervened three times in with purchases of foreign currency for ISK 6 billion. Foreign exchange outflows through the domestic pension funds have also declined significantly following their decision in March of delaying foreign investment.



Source: The Central Bank of Iceland

Government bonds mostly held by domestic residents

Net inflow of foreign capital for registered new investment in Iceland has slowed significantly. Since October 2019, the inflow amounted to ISK 23 billion compared to outflow of billion 28 ISK. On net, the outflow thus amounted to ISK 5 billion (0.2% of GDP). In comparison, net inflows of foreign capital for registered new investment amounted to ISK 31 billion for the eight months leading up to October 2019. Significant other inflows in March and April relate to a non-resident investor's acquisition of a stake in a domestic real estate company. Foreign investors now hold 13% of outstanding treasury bonds issued in ISK, which is low both historically and internationally.



Source: Central Bank of Iceland

Remaining restrictions

Restrictions on the following transactions remain in place:

1. Cross-border transfers of domestic currency due to transactions with offshore króna assets that are subject to special restrictions;
2. Foreign exchange transactions carried out between residents and non-residents without the intermediation of financial institution, if domestic currency is a constituent of the transaction;
3. Derivatives transactions involving domestic currency against foreign currency and undertaken for non-hedging purposes or for hedging purposes in relation to issuance of ISK debt abroad, sometimes referred to as glacier bonds.