

SEÐLABANKI ÍSLANDS

Motivations for Foreign Exchange Market Intervention in Iceland

Foreign Exchange Market Intervention: Conventional or Unconventional Policy

Van Leer Jerusalem Institute, 7 and 8 December 2017



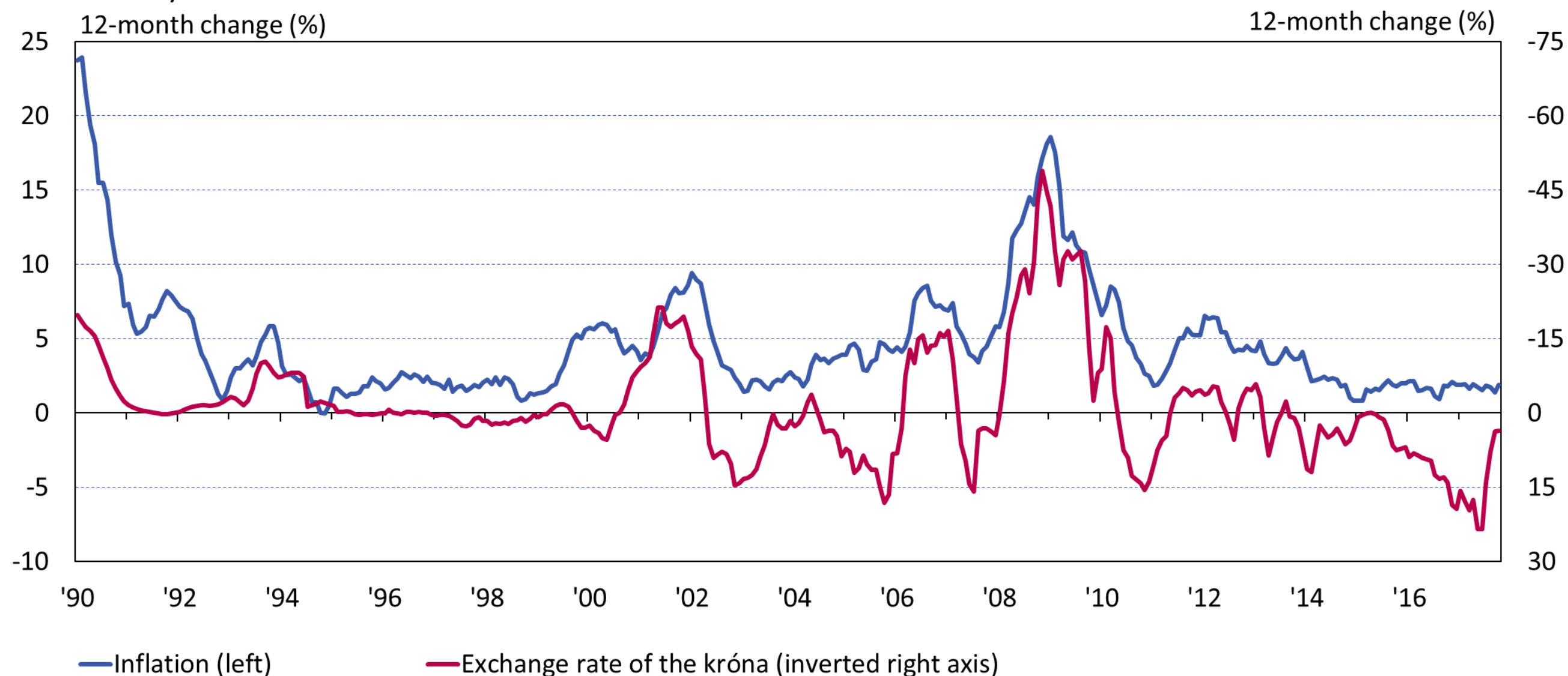
Arnór Sighvatsson

Deputy Governor, Central Bank of Iceland

I. Given strong pass-through, intervention can be an important auxiliary tool for monetary policy

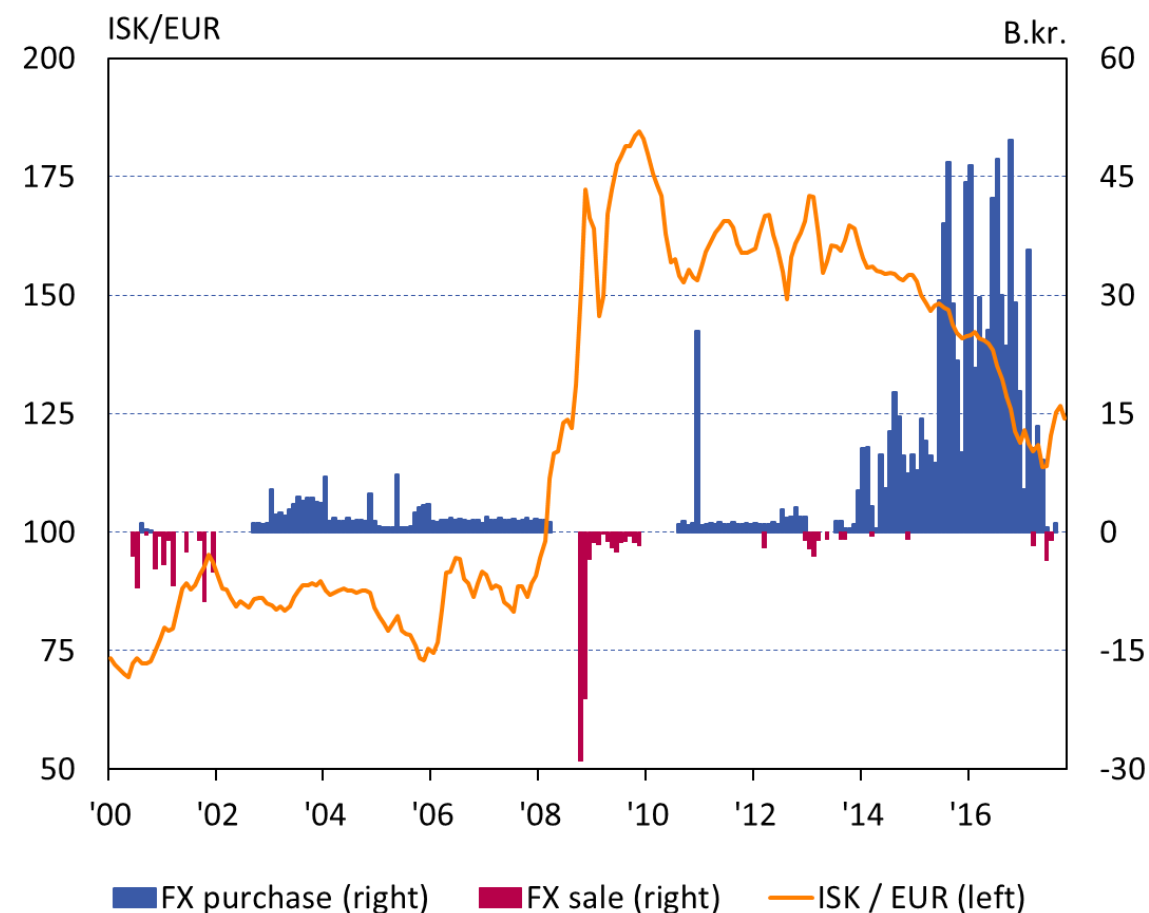
Inflation and exchange rate of the króna

January 1990 - October 2017

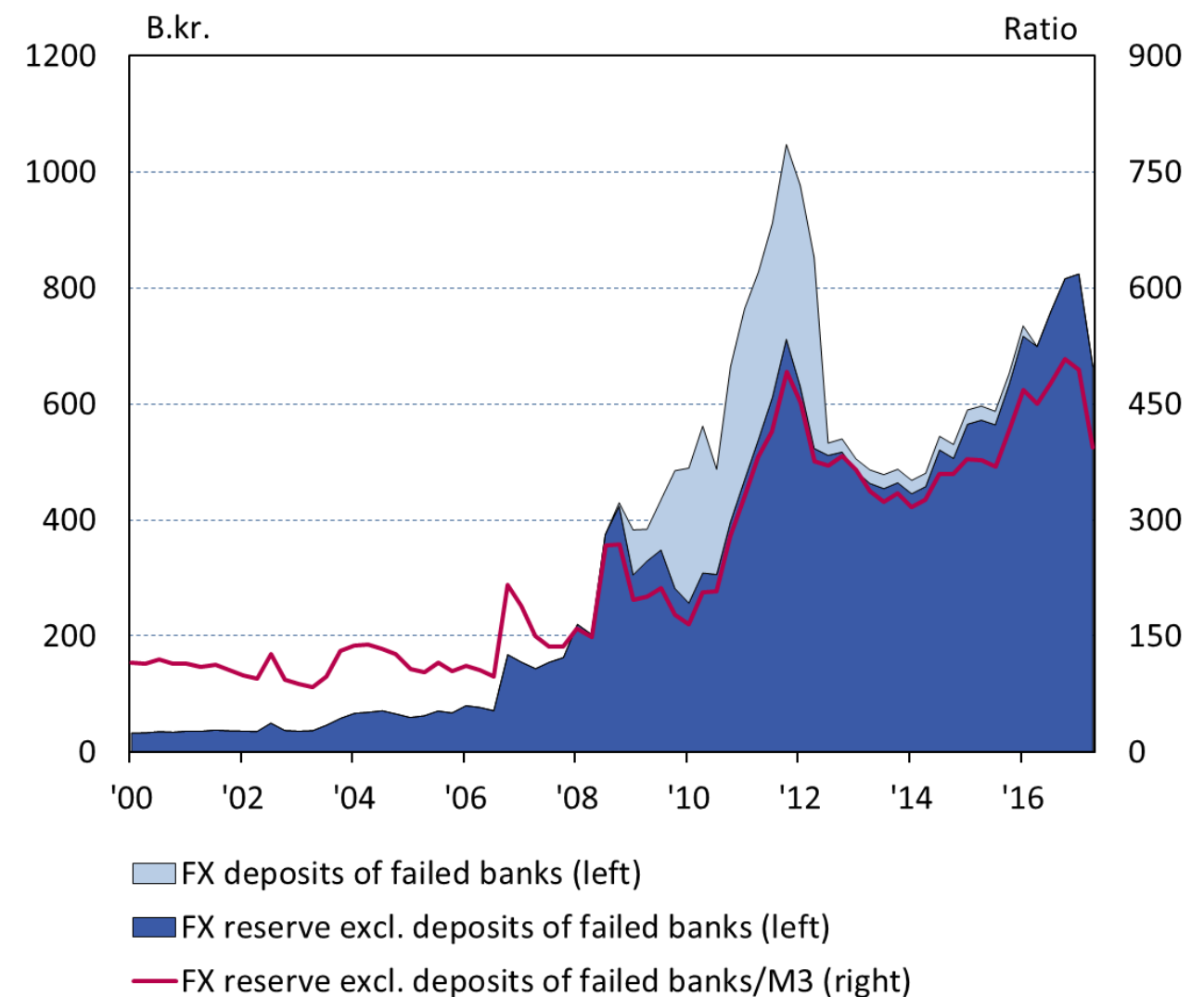


II. Building reserves has been one of two publicly stated objectives of CBI FX purchases

EUR/ISK exchange rate and Central Bank transactions in the foreign exchange market
January 2000 - October 2017



The Central Bank of Iceland FX reserves
Q1/2000 - Q2/2017

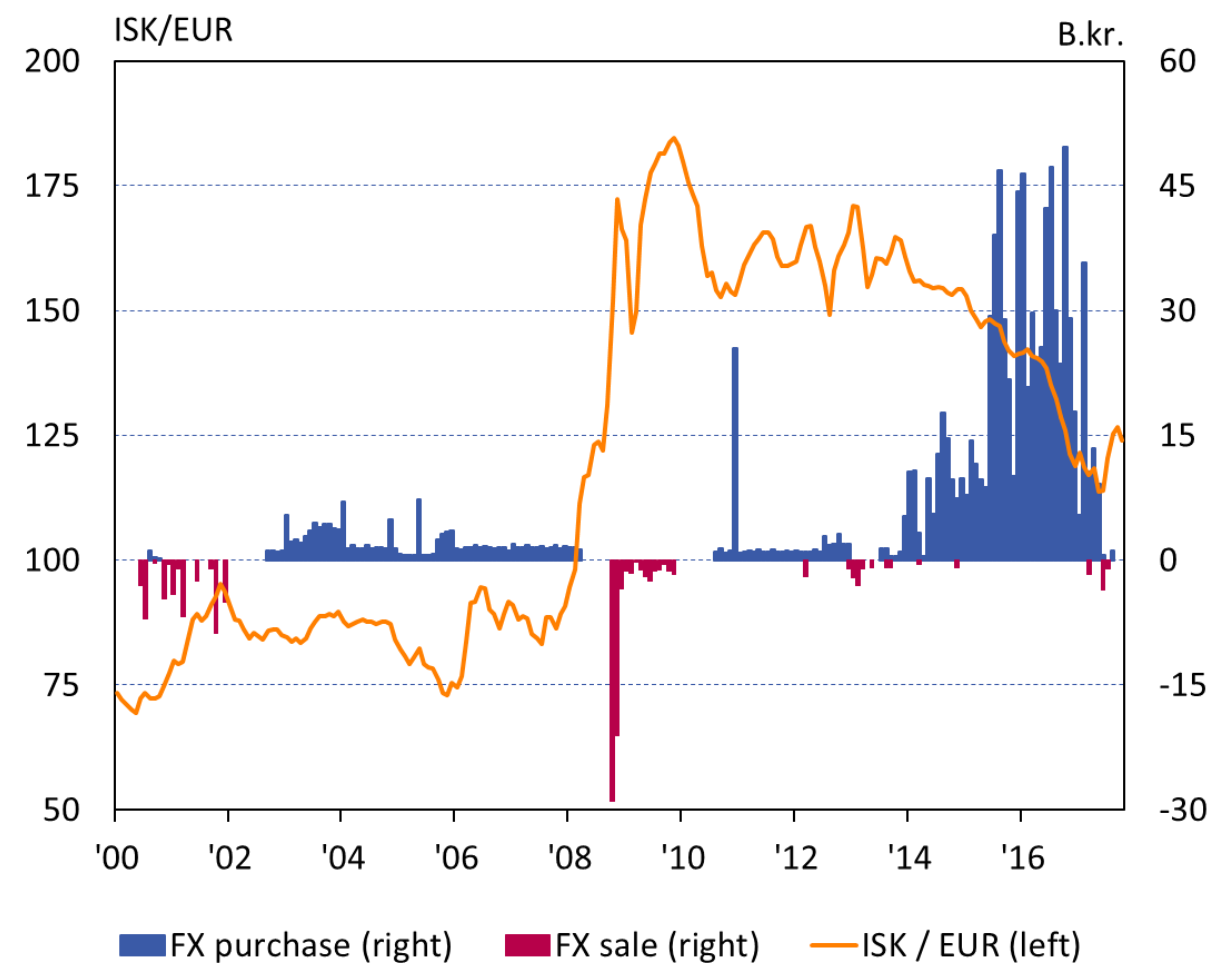


1. 2017 values and equilibrium real exchange rate estimates are from the Central Bank baseline forecast (MB 2017/4). IMF Article IV estimation range includes the IMF's equilibrium real exchange rate estimates based on the current account approach and the REER approach in the last three Article IV publications.

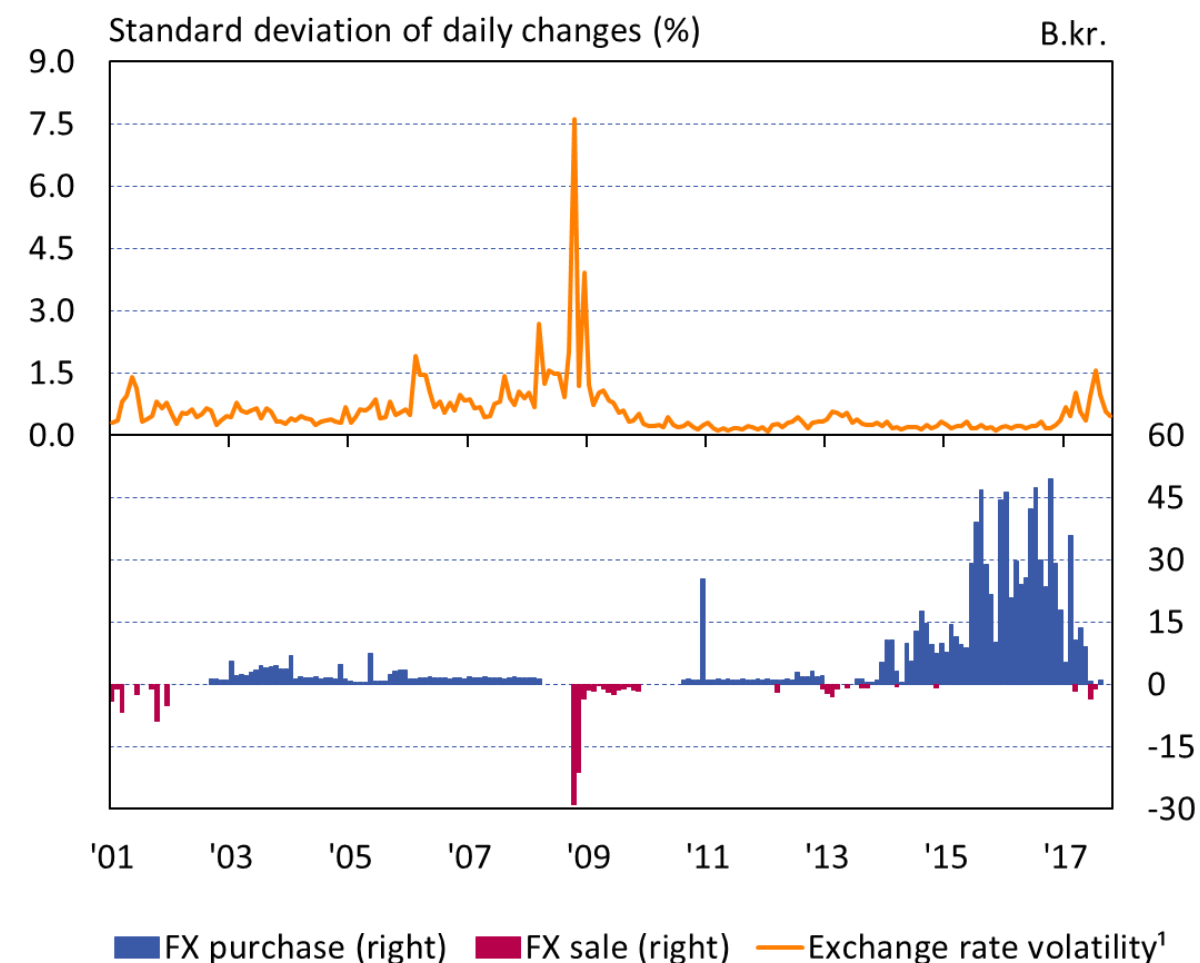
Sources: International Monetary Fund, Central Bank of Iceland.

III. Reducing short-term volatility is also a publicly stated objective of FX intervention

EUR/ISK exchange rate and Central Bank transactions in the foreign exchange market
January 2000 - October 2017



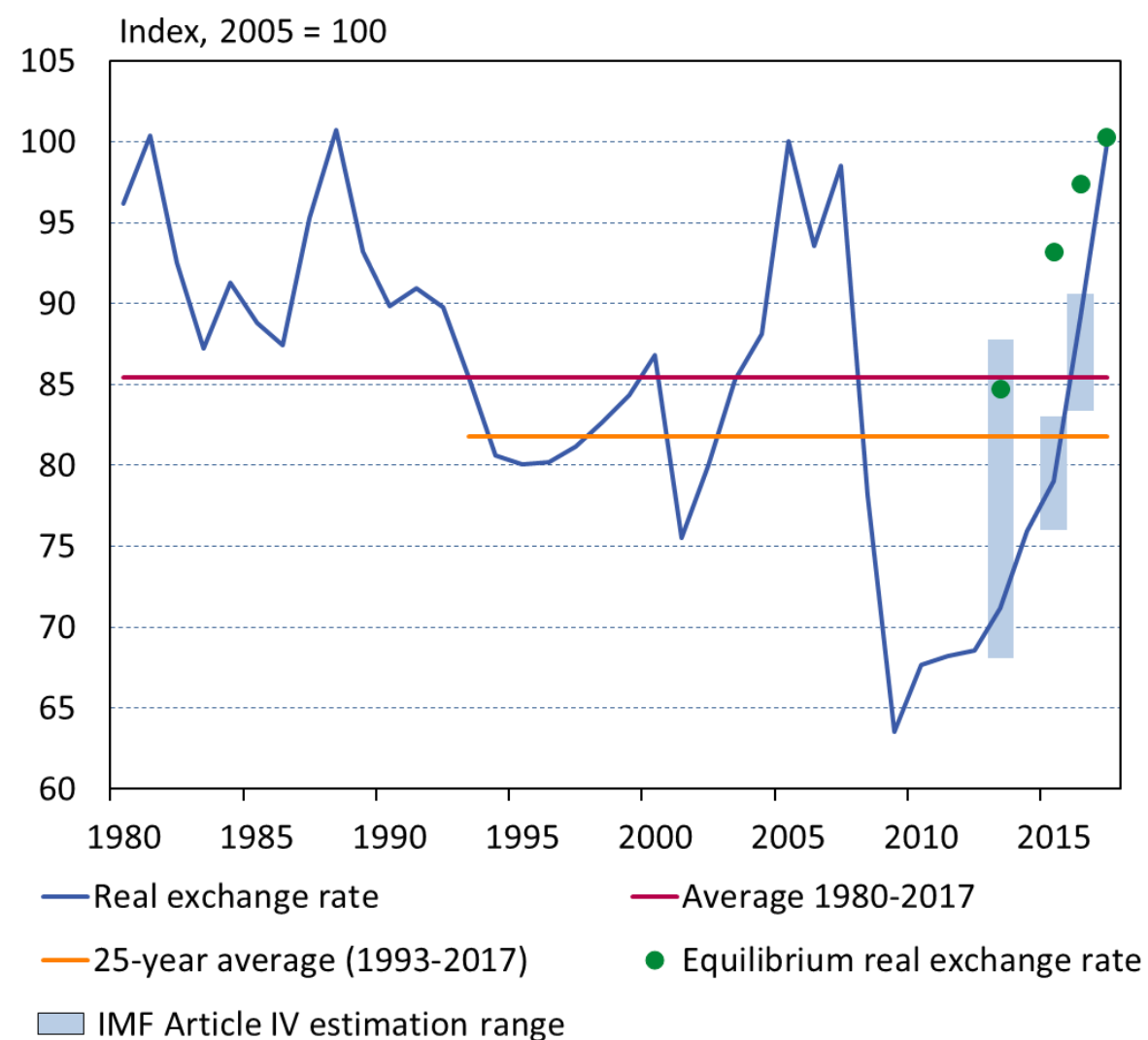
Exchange rate volatility and Central Bank transactions in the foreign exchange market
January 2001 - October 2017



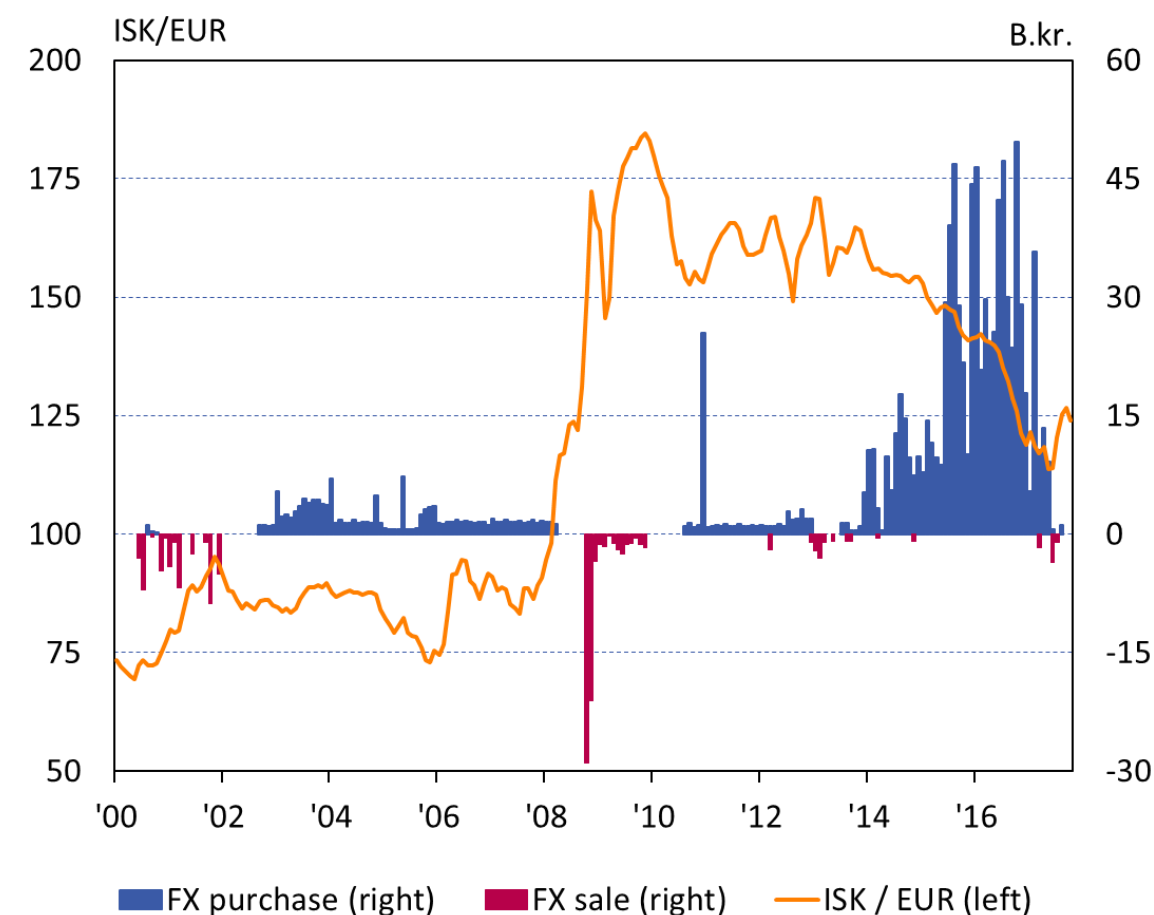
1. Exchange rate of the króna in terms of the trade-weighted exchange rate index.
Source: Central Bank of Iceland.

IV. Preventing misalignment has been a secondary motivation for CBI FX intervention

Real exchange rate 1980-2017¹



EUR/ISK exchange rate and Central Bank transactions in the foreign exchange market
January 2000 - October 2017

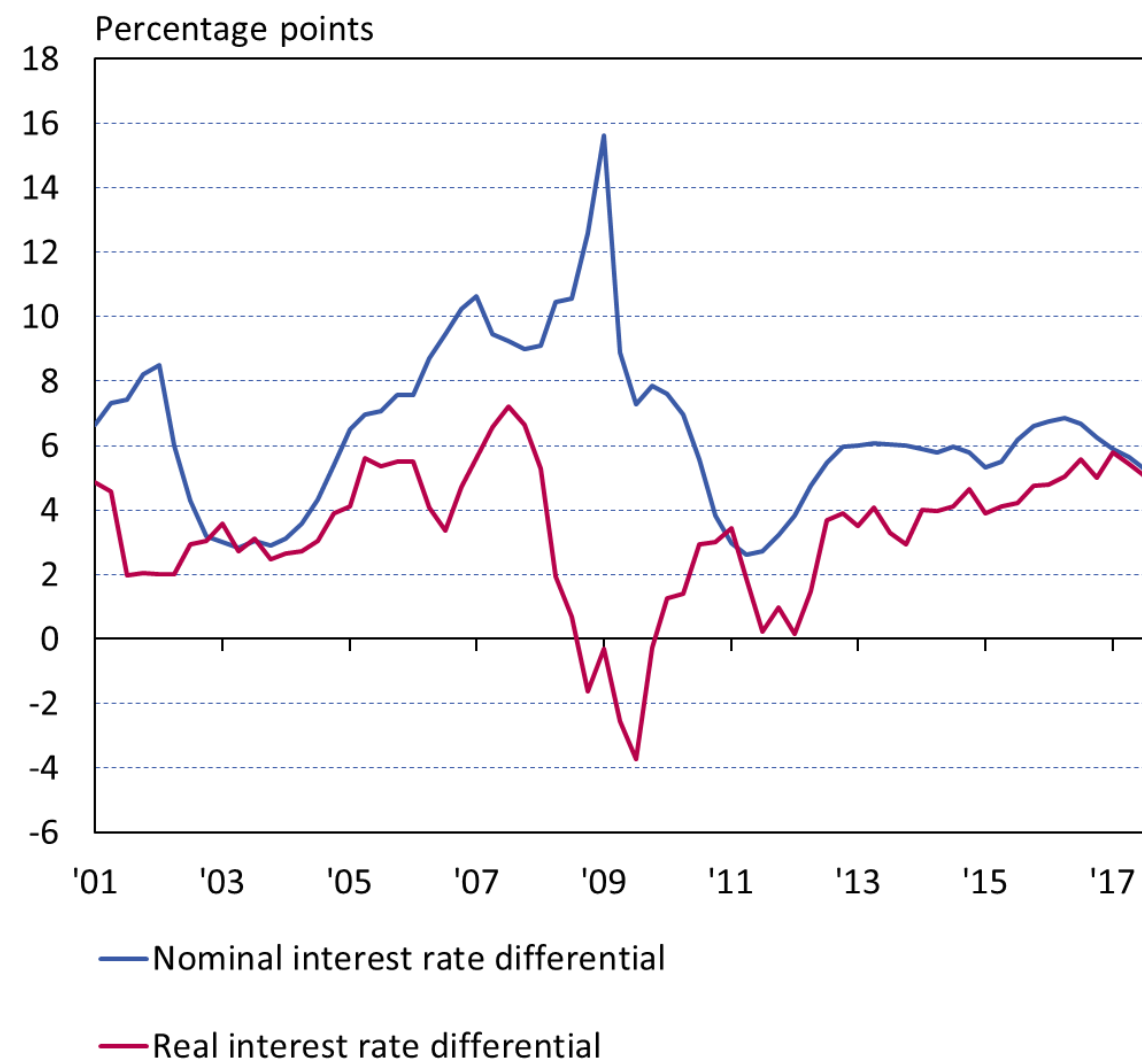


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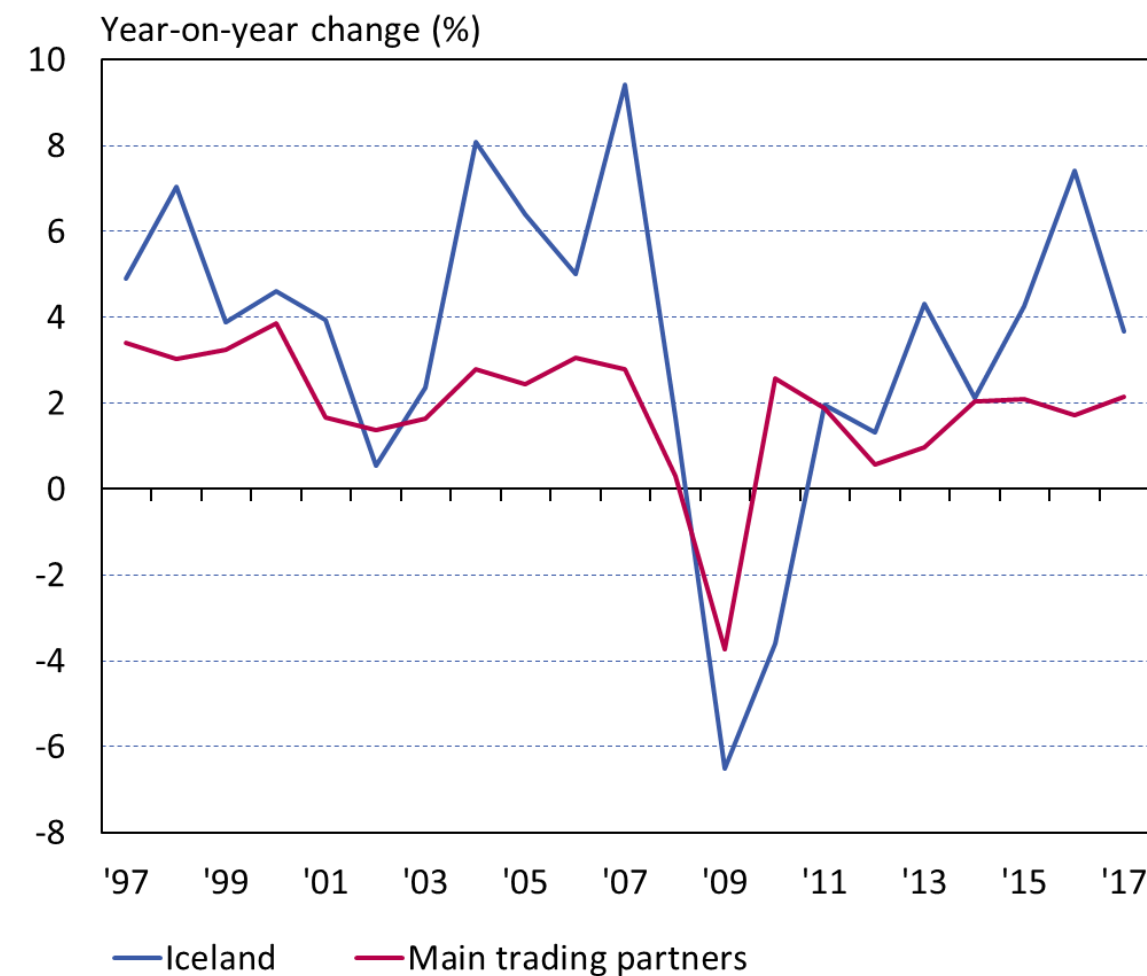
Sources: International Monetary Fund, Central Bank of Iceland.

V. Wide short-term interest rate differentials make building reserves through intervention costly

Short-term interest rate differential with the euro area¹
Q1/2001 - Q3/2017



GDP growth in Iceland and trading partners 1997-2017



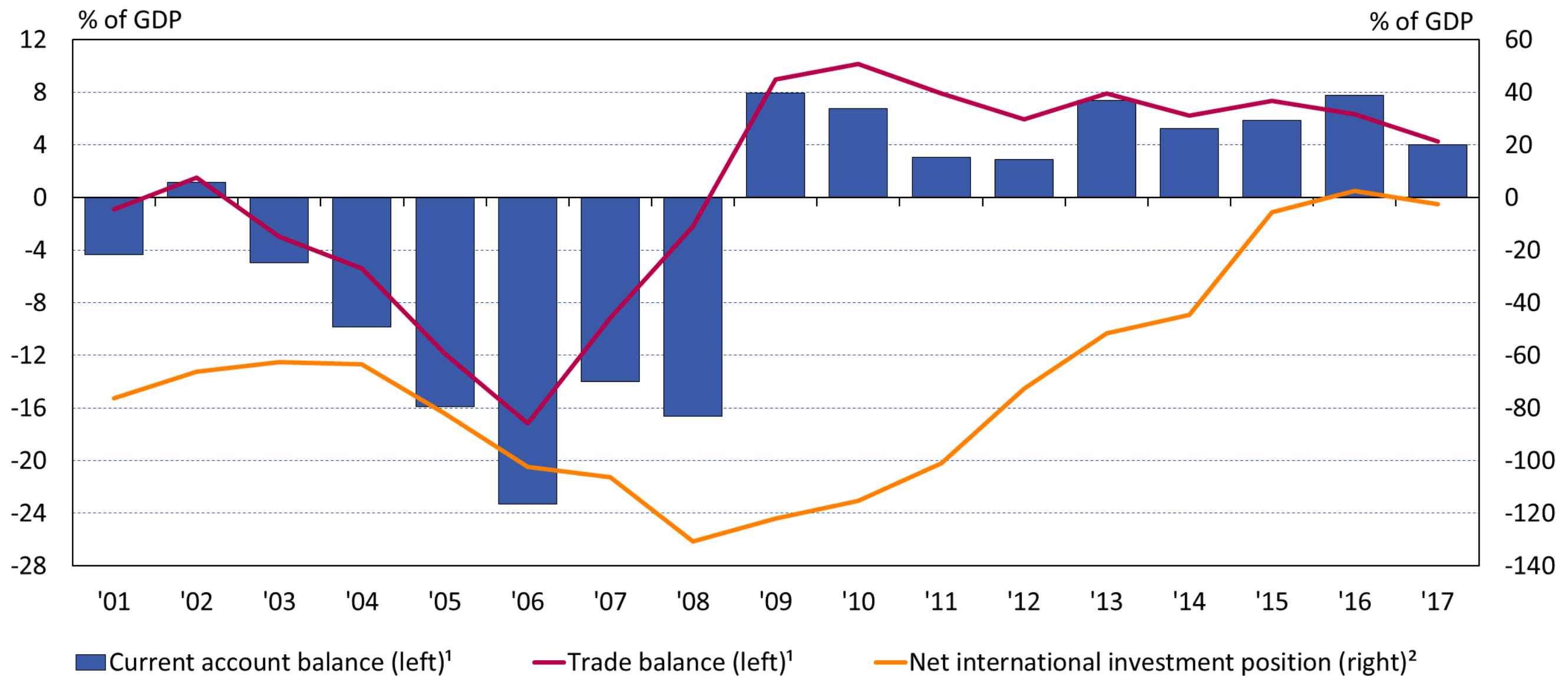
1. The difference between 3-month interbank rates.

Sources: Statistics Iceland, Thomson Reuters, Central Bank of Iceland.

Additional slide

The financial crisis forced a sharp current account reversal

Current account and net external position 2001-2017



1. Central Bank of Iceland baseline forecast 2017. Excluding the effects of DMBs in winding-up proceedings in 2008-2015 and the effects of pharmaceuticals company Actavis on the balance on income in 2009-2012. Also adjusted for the failed DMBs' financial intermediation services indirectly measured (FISIM). 2. In 2008-2015, the data are based on the underlying NIIP; i.e., adjusted for the effects of settlement of the DMBs in winding-up proceedings. NIIP data for 2017 are Q2 data. Sources: Statistics Iceland, Central Bank of Iceland.