



Lifting capital controls in Iceland

Már Guðmundsson, Governor

Central Bank of Iceland

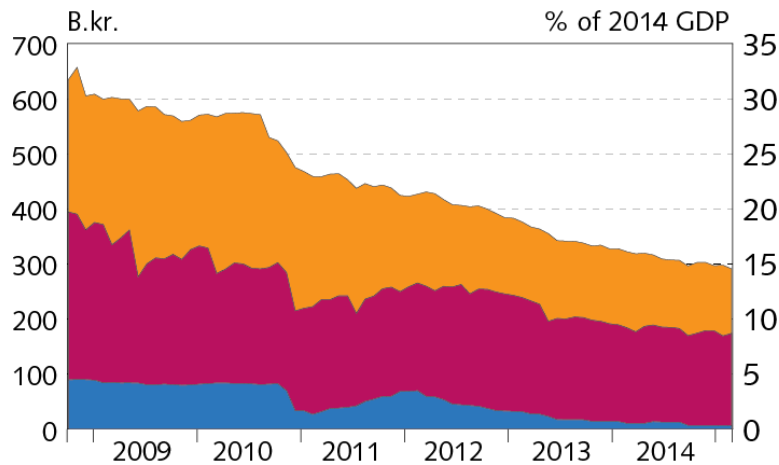
Seminar at EFTA Surveillance Authority

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Balance of payments problem



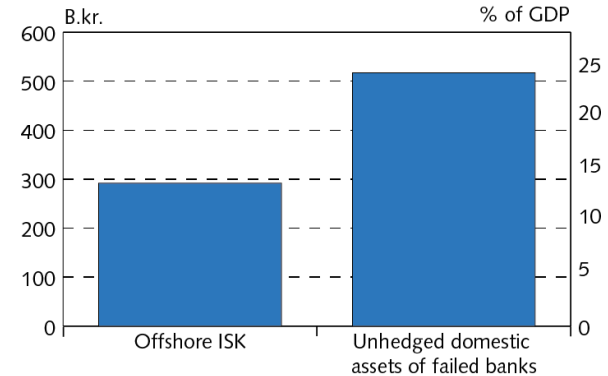
Short-term ISK assets held by non-residents
October 2008 - February 2015



- HFF bonds
- Treasury bonds and bills
- Deposits

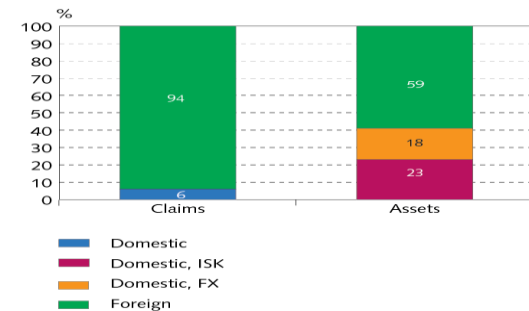
Sources: Statistics Iceland, Central Bank of Iceland.

The balance of payments problem



Source: Claims lists and financial information from Glitnir, Kaupping and LBI; Statistics Iceland, Central Bank of Iceland.

Estimated domestic/foreign breakdown of assets and claims of DMBs in winding-up proceedings
Book value of assets 31.12.2014



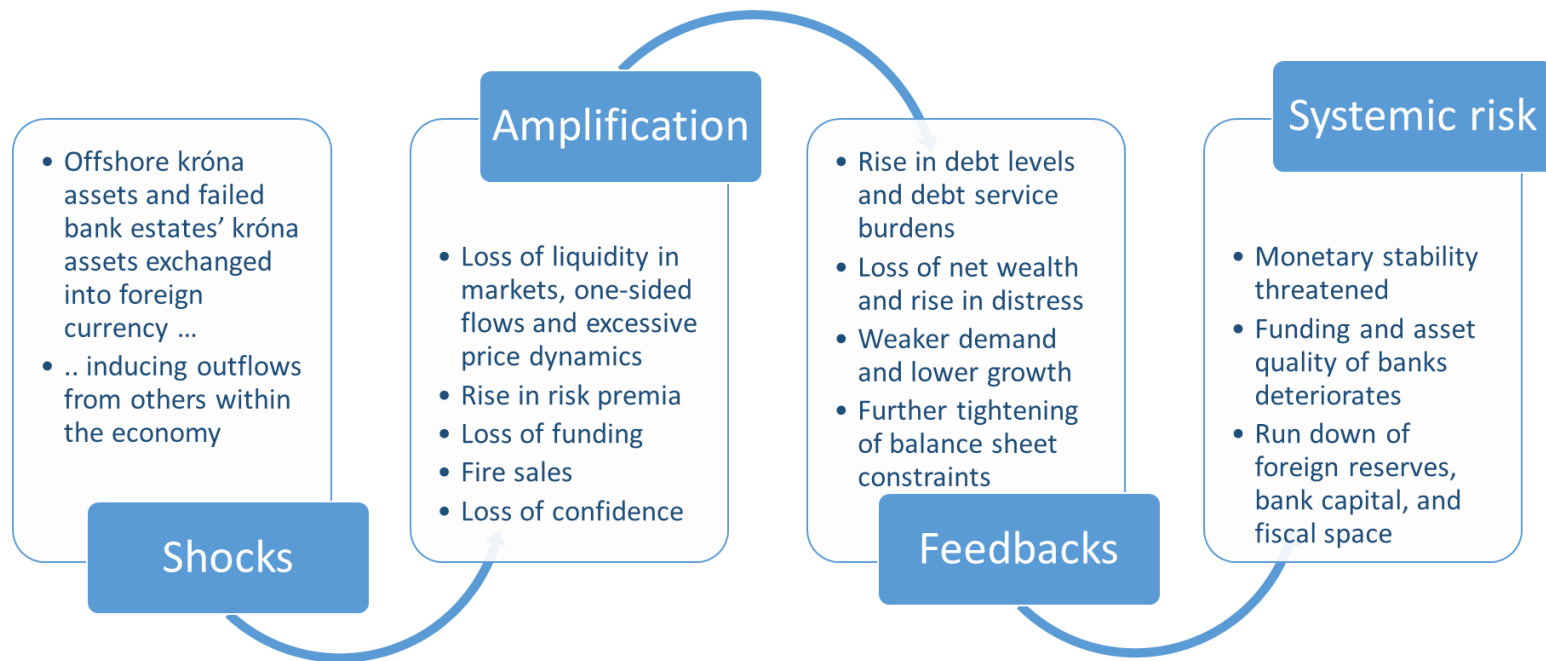
Sources: Claims lists and financial information from Glitnir, Kaupthing, and LBI; Central Bank of Iceland.

Balance of payments problem



- Lack of market access
- Hump in the country's debt repayment profile due to Landsbankinn's debt to the old bank
- Accumulated need for rebalancing of domestic balance sheets and other potential outflows from domestic residents

Systemic risk



Principles



- Solve the balance of payments problem without endangering financial stability
- Long-term sustainability
- Minimise risk for the sovereign (debt level, credit ratings, and FX reserves)
- The exchange rate of the króna should reflect the real economy and not private sector legacy problems
- Consistency with the Constitution and international obligations – minimise legal risk
- Simplicity, finality, flexibility, equal treatment, and transparency

Three-phased solution



1. Old banks' estates
 2. Stock of offshore krónur
 3. Households, businesses, pension funds, and others in the onshore market
- First two phases in a controlled process; i.e., no negative effect on the exchange rate allowed
 - Create optimal conditions for general liberalisation of capital controls, where confidence is key



Old banks' estates

- Stability tax (effective rate 31.5%) or unwinding based on stability conditions (stability contribution, repayment of official support, and lengthened maturity of new banks' financing) and an exemption from the CB
- Finalised without any entity paying the tax => the process was faster, and legal and reputational risks less
- The use of stability contributions must be consistent with economic and financial stability

Offshore krónur



- FX auction in June: 1,688 offers accepted or 98.4% of offers, for a total of 83 b.kr.
- The remaining stock amounts to just under 240 b.kr., or 10% of GDP
- Pricing range decided based on analysis of FX reserve level and BoP prospects
- Segmentation of offshore and onshore secured for the next steps in liberalisation

General liberalisation of capital controls



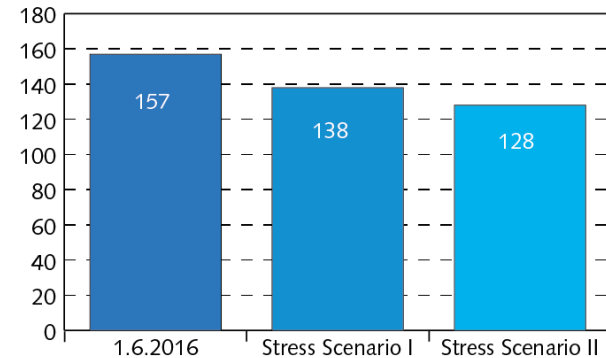
- First step (now):
 - Outward FDI
 - Outward portfolio subject to ceiling of 30 m.kr. (EUR 230 thousand) per legal entity
- Second step (1 Jan 2017):
 - Portfolio ceiling raised to 100 m.kr. (EUR 780 thousand) per entity
 - Direct deposit transfers allowed (subject to above ceiling)
- Interim: CB authorised to liberalise further if conditions allow
- Final: assessment made early next year

Stress scenarios



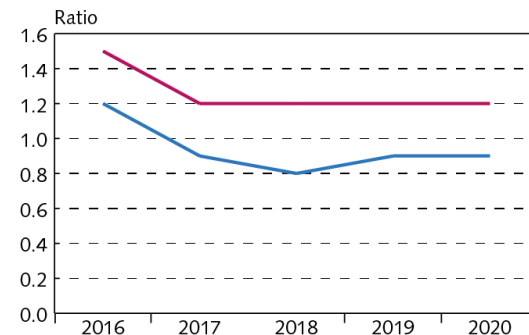
- Two scenarios: 10% and 15% outflows of free liquid assets
- Banks can withstand both
- FX reserves still adequate even if the total effect comes through them

Commercial banks' liquidity ratio



Source: Central Bank of Iceland.

Ratio of foreign exchange reserves to RAM¹



— Scenario 1: Significant outflow

— Scenario 2: Moderate outflow

1. RAM is a reserve adequacy metric developed by the IMF.

Source: Central Bank of Iceland.

Prudential regulations or tools after capital controls



	Regulation or tool	Status
a)	LCR and NSFR in FX	Implemented
b)	Restrictions on deposit-taking in foreign branches	a) restricts – future issue
c)	Limits on FX imbalances	In progress – depends on d)
d)	Restrictions on FX lending to unhedged borrowers	Before Parliament
e)	Capital flow management tool for capital inflows	Implemented

Capital flow management measure to mitigate risks



Risks

- Risks associated with capital flows depend in particular on their relative size and composition, as well as domestic financial markets' and balance sheets' resilience to their associated volatility: these risks must be considered against the well-known benefits of cross-border capital flows

Policy

- Iceland's experience is a vivid example: it should be recognised that conventional macroeconomic and financial stability policies may need to be complemented with capital flow management measures (CFM) so as to prevent institutions from becoming overburdened – indeed, this has already been implemented in the form of a reserve requirement in Iceland

