INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

Press Release No. 09/375
FOR IMMEDIATE RELEASE
October 28, 2009

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes First Review Under Stand-By Arrangement with Iceland, Extends Arrangement, and Approves US$167.5 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the first review of Iceland's economic performance under a program supported by a Stand-By Arrangement (SBA). At the request of Iceland's authorities, the Board also extended the SBA by six months to May 31, 2011 to compensate for delays in program implementation and review, and approved the rephasing of the undisbursed amount over the remainder of the arrangement. The completion of the first review enables the immediate disbursement of SDR 105 million (about US$167.5 million), bringing total disbursements under the program to SDR 665 million (about US$1,061.1 million).

In completing the review, the Board approved waivers for the nonobservance of performance criteria related to the central government net financial balance and net international reserves. It also approved waivers for the nonobservance of the structural performance criterion concerning a capital injection into three new banks, and of the continuous performance criterion concerning the imposing or intensification on restrictions on the making of payments and transfers for current international transactions.

The SBA was approved on November 19, 2008 (see Press Release No. 08/296) for SDR 1.4 billion (about US$2.2 billion). The arrangement entails exceptional access to IMF resources, amounting to 1,190 percent of Iceland's quota.

Following the Executive Board's discussion on Iceland, Mr. Murilo Portugal, Deputy Managing Director and Acting Chair, stated:

"Iceland's First Review Under the Stand-By Arrangement was completed after being delayed due to several factors, including the change in government, the time required to reach agreement on a policy program with the new authorities, and ongoing negotiations with creditors, which complicated securing from some participating countries the financing needed for the program.

"Iceland's financial crisis has taken a very heavy toll on the economy, even if the decline in output has been less than expected. But there are positive signs now: inflation has come down sharply; the program's main objective, stabilizing the krona, has been met, as have been the financial sector restructuring and fiscal consolidation objectives; and external financing has been secured. With determined and timely policy implementation, the economy could begin to turn the corner in the middle of 2010 and a recovery should follow in the medium term.

"Iceland has emerged from the crisis with high external and public sector debt, higher than understood at the program outset. However, the stronger policies envisioned in the revised program, including more rapid fiscal adjustment, more gradual capital control liberalization, and an enhanced focus on private sector debt restructuring, should suffice to keep debt on a robust and sustainable downward path.

"The focus of monetary policy continues to be on preserving currency stability, within a flexible exchange rate regime, in light of the balance sheet exposures of the private sector. Against this backdrop, progress with financial sector restructuring and fiscal consolidation should improve confidence and open up room for cautious interest rate reductions. Capital controls remain an essential feature of the monetary policy framework, given the scale of potential capital outflows, and in line with the authorities' published plan, should be removed gradually as confidence returns and as balance of payments developments permit.

"The authorities' strengthened medium-term fiscal consolidation plan will help improve debt dynamics and limit financing risks. It will be important to identify remaining measures needed to achieve medium-term targets, in consultation with social partners. In light of Iceland's higher public debt, a full medium-term public debt management strategy needs to be articulated in time for the next fiscal year.

"Resuscitating the financial sector has proven to be a complex challenge, but important milestones have been reached with the recapitalization of New Kaupthing and Islandsbanki. It is important now to conclude the Landsbanki discussions and to finalize the program of savings bank recapitalization. Creditors must be treated fairly and equitably, in line with applicable law, but it also remains imperative for the government not to further absorb losses from the private sector.

"Facilitating voluntary private sector debt restructuring is a key complement to financial sector restructuring efforts and will play an important role in reviving the economy. In light of binding fiscal constraints, the focus should be on targeted voluntary private work-outs, underpinned by measures to strengthen the insolvency regime," Mr. Portugal stated.