28 November 2008

New foreign exchange regulation

The Central Bank of Iceland guidelines from early October on temporary modifications in currency outflow have been revoked. The guidelines were adopted in the wake of the failure of three commercial banks and the ensuing market disturbances.

Thereafter, the Central Bank began trading foreign currency from its foreign exchange reserves through daily auctions designed to facilitate foreign exchange business that had been obstructed due to difficulties in payment intermediation and other causes. The revocation of the guidelines means that there are no longer restrictions on current account related transactions.

Last week the Executive Board of the International Monetary Fund approved a Stand-By Arrangement for Iceland. The economic program entails continuing restrictions on movement of capital between Iceland and other countries and the subsequent lifting of those restrictions as soon as an sufficient stability has returned to the foreign exchange market. Parliament has passed a legislative bill from the Minister of Business Affairs, amending the Foreign Exchange Act of 1992. This new Act authorises the Central Bank, upon consultation with the Minister, to adopt rules restricting cross-border movement of capital. This authorisation has now been utilised, and the Central Bank will issue on its website Rules on Foreign Exchange based on the authority contained in the new Act.

(See: Rules on foreign exchange, No. 1082, November 28, 2008)

The aim of the Rules is to maintain restrictions on capital outflows that could have a negative impact on the reconstruction of the foreign exchange market. The Rules stipulate that those who acquire foreign currency must submit it to a domestic financial institution; however, such foreign currency may be deposited to a foreign currency account in such an institution. Restrictions are placed on movement of capital by parties intending to exchange Icelandic krónur for foreign currency.

Furthermore, the Rules prohibit trading between domestic and foreign parties in domestic securities and other króna-denominated financial instruments. Foreign parties are prohibited from purchasing króna-denominated securities through the intermediation of domestic parties, unless they already own króna denominated assets that can be used for this purpose. Furthermore, foreign parties are prohibited from issuing securities in Iceland. Domestic parties are also prohibited from investing in foreign securities. Foreign borrowings, provision of guarantees to foreign parties, and derivatives transactions unrelated to trading of goods and services are restricted or prohibited, as are loans granted by domestic parties to foreign parties.

It should be noted that an auction of Treasury notes will be held during the first week of December. Foreign parties owning Treasury notes on the maturity date, December 12, 2008, may reinvest the proceeds in new Treasury notes.

It is emphasised that all current account restrictions on foreign exchange transactions have been abolished. The restrictions now adopted on the basis of the newly passed legislation include foreign exchange transactions related to movement of capital between Iceland and other countries. These restrictions are an necessary part of the measures intended to restore stability in the foreign exchange market. They will be lifted as soon as circumstances allow.

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