



Iceland's Economic Recovery Programme

Supported by the IMF

The Icelandic government has undertaken difficult austerity measures to rigorously implement the economic programme supported by the International Monetary Fund (IMF). According to IMF estimates from December 2009, positive growth should return to the Icelandic economy by the second half of 2010, sustained by Iceland's strong economic fundamentals.

- Iceland's economic programme with the IMF was established in October 2008 in the aftermath of the collapse of Iceland's three large international commercial banks, Glitnir, Kaupthing and Landsbanki. The combined liabilities of the failed banks exceeded 10 times the country's GDP.
- An emergency legislation was passed by the Icelandic parliament on 6 October 2008 to secure the continuation of domestic banking services and payment systems abroad after the collapse of the banks. The three banks were put into receivership and their boards replaced by Resolution Committees.
- Iceland's economic programme with the IMF focuses on four main objectives:
 1. Stabilizing the exchange rate and rebuilding confidence in monetary policy.
 2. Revising fiscal policy and maintaining a manageable level of public sector debt.
 3. Restructuring the financial sector and its regulatory framework.
 4. Facilitating household and corporate debt restructuring.
- IMF's Stand-by Arrangement is \$2.1 billion and an additional \$2.75 billion from the other Nordic countries, Poland and the Faroe Islands.

Monetary Policy

- Radical changes were introduced at the Icelandic Central Bank with a new legislation in February 2009.
- Subsequently a new governor, deputy governor and five-person Monetary Policy Committee were appointed to the Central Bank of Iceland.
- The short-term focus of the bank's monetary policy has been shifted from inflation targeting to currency stability.
- The government imposed capital controls in November 2008 in order to stabilize the Icelandic Krona. The Central Bank began sequenced removal of these controls in October 2009.

Fiscal Policy

- The government has committed to commencing fiscal consolidation in 2010, to reaching a primary surplus by 2011 and to achieving an overall surplus by 2013. In 2009, the general government budget deficit was just over 14% of GDP.
- The government and social partners signed a "stability pact" in June 2009. The 2010 budget is in line with this agreement, with a balance of expenditure cuts and tax increases, including capital income, excise duties and VAT rates. A new three-tier personal income tax system replaced the

previous one-tier system.

- The fiscal framework will be strengthened through the adoption of a 4-year fiscal consolidation plan.

Financial Sector Restructuring

- The Financial Services Authority of Iceland (FME) established three new banks by carving out the old banks' domestic operations, after their collapse.
- The Resolution Committees of the failed banks, Kaupthing and Glitnir, on behalf of their creditors, have decided to recapitalize and become majority owners of the new Arion Bank and the new Íslandsbanki, respectively. The Icelandic state will remain the majority owner of Landsbanki, with the Resolution Committee taking a 20% stake.
- All three new banks have been recapitalized with strong capital ratios.
- The FME is governed by a new board and a new managing director.
- Extensive reforms of financial market regulations are being carried out. This has been done in accordance with international best practise with a clear aim of building up a solid sustainable financial system.
- The legislative reforms include stricter rules on internal auditing responsibility and qualifications, increased responsibilities for boards and management, strict regulation of bonus pay, golden

handshakes and golden parachutes, revision of the deposit insurance scheme and transparency of ownership in limited companies.

Debt Restructuring

- Due to the lowered exchange rate of the Icelandic krona, Icelandic households and companies have experienced a great increase in their debt through the widespread inflation indexing of mortgages and use of loans in foreign currencies.
- Major debt restructuring is ongoing for individuals and firms. A generalized payment smoothing mechanism is in place for individuals. Loans may be extended for up to three years, after which any remaining amount will be written off.
- Financial institutions and the state have developed special out-of-court debt restructuring frameworks for severely distressed households. Corporate debt restructuring is being managed primarily as a voluntary process within the banking system.
- The government increased the interest payment rebate for 2009 and 2010, and access was granted to previously sheltered private pension funds.
- A review of the bankruptcy code has been undertaken to ensure that bottlenecks do not delay proper restructuring and economic recovery.

Iceland, with a population of around 317,000, is a constitutional republic with a parliamentary government. Iceland joined the United Nations in 1946, became a founding member of the OECD in 1948, of NATO in 1949 and joined EFTA in 1970. With Iceland's accession to the European Economic Area in 1994, Iceland gained access to EU's internal market. The foundations of the Icelandic economy, with a GDP of \$11.4 billion (IMF 2009 est.) are fisheries, industry, tourism, pharmaceuticals and services.