

# SEÐLABANKI ÍSLANDS

## Motivations of Foreign Exchange Market Intervention in Iceland

Foreign Exchange Market Interventions: Conventional or Unconventional Policy

Van Leer Jerusalem Institute, 7 and 8 December 2017



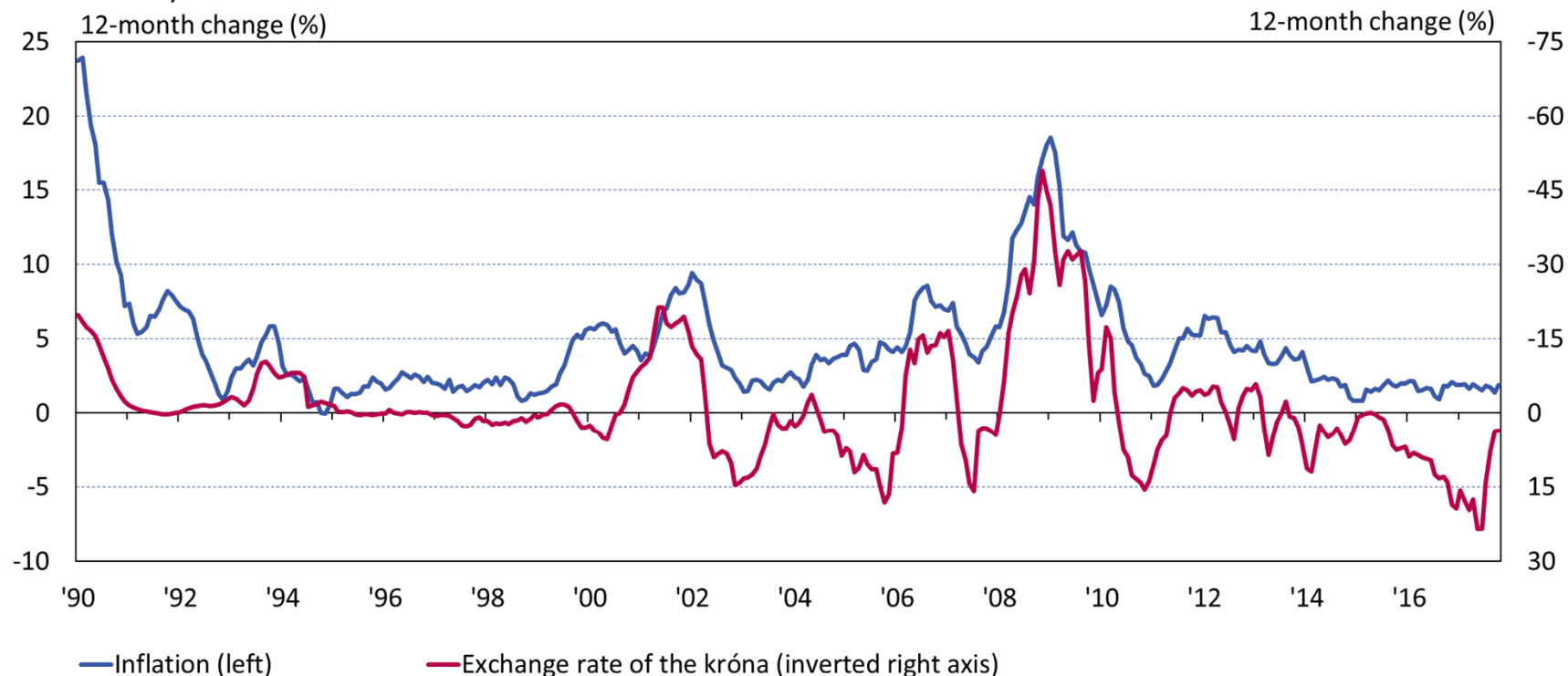
Arnór Sighvatsson

Deputy Governor, Central Bank of Iceland

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

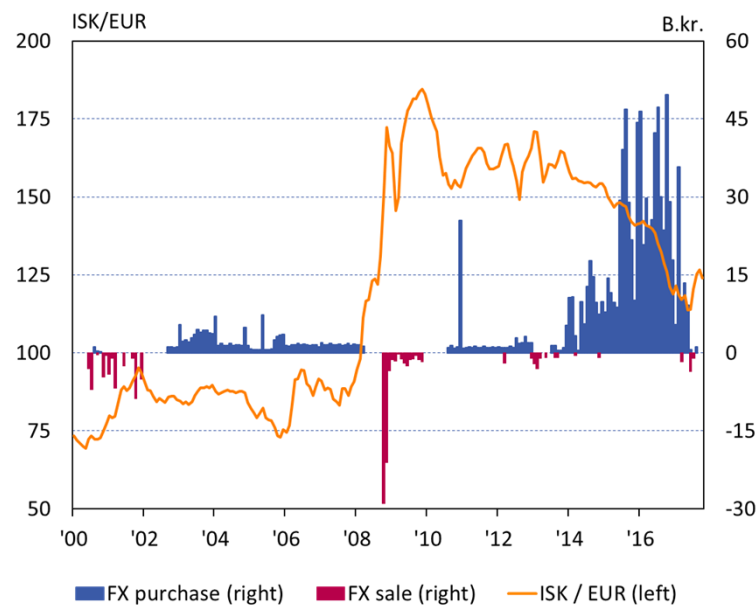
Inflation and exchange rate of the króna

January 1990 - October 2017

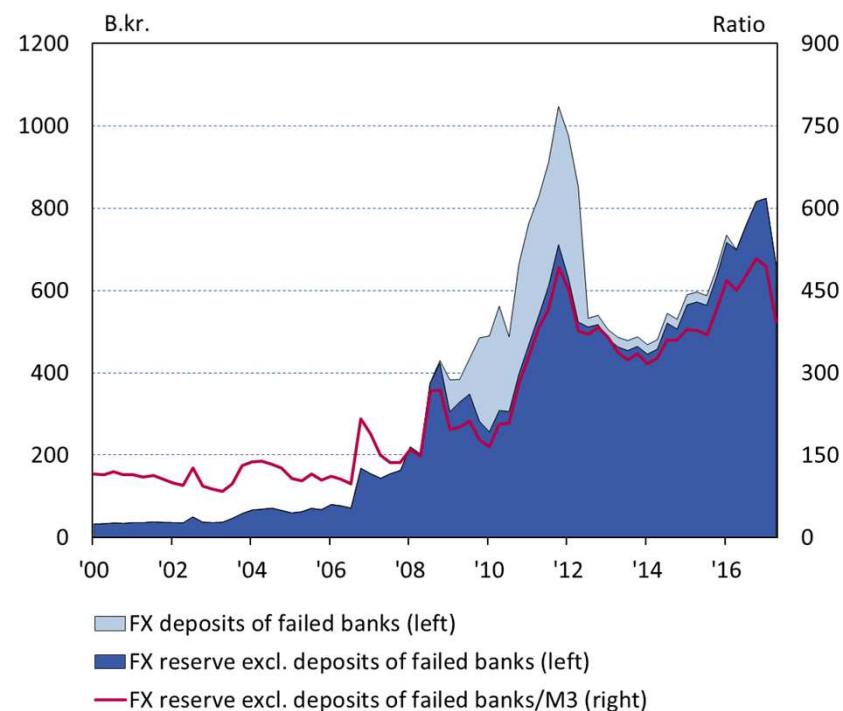


## II. Building reserves has been one of two publicly stated objectives of CBI FX purchases

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



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

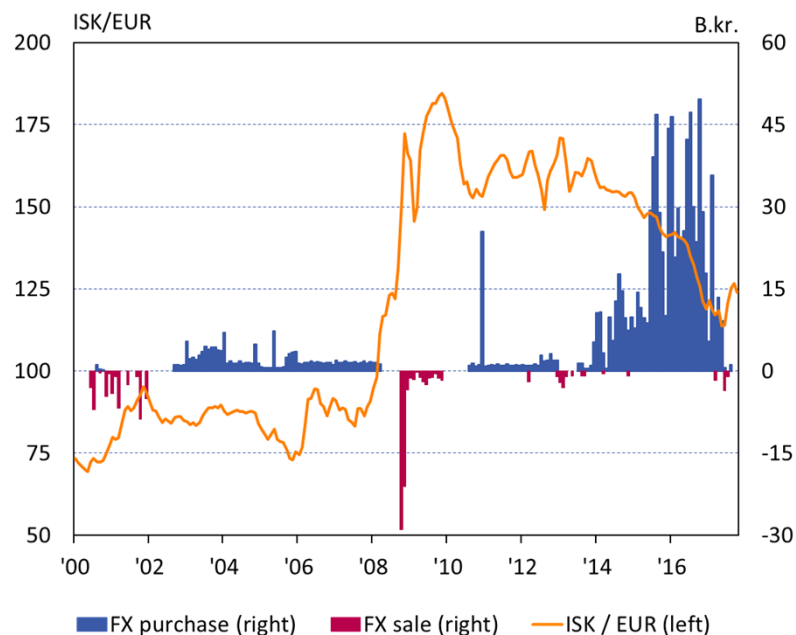


1. 2017 values and equilibrium real exchange rate estimate are from the Central Bank baseline forecast (MB 2017/4). IMF Article IV estimation range includes IMF's equilibrium real exchange rate estimates based on the current account approach and the REER approach in the last three Article IV publications.

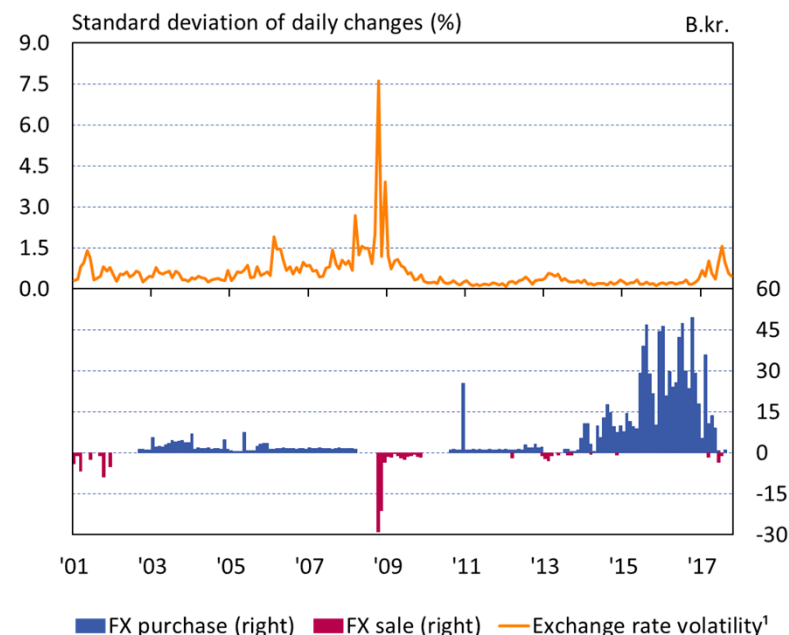
Sources: International Monetary Fund, Central Bank of Iceland.

# 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



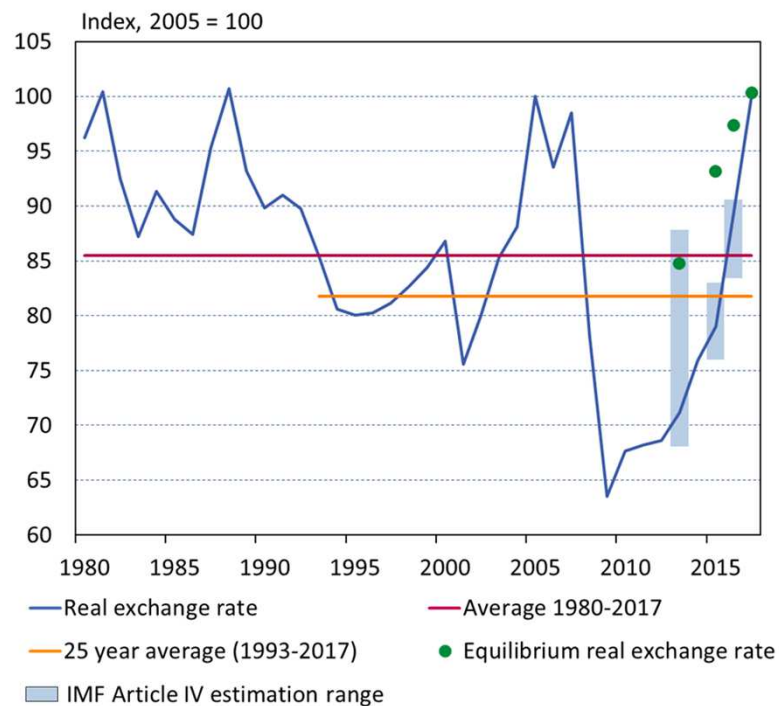
Exchange rate volatility and Central Bank transactions in the foreign exchange market  
January 2001 - October 2017



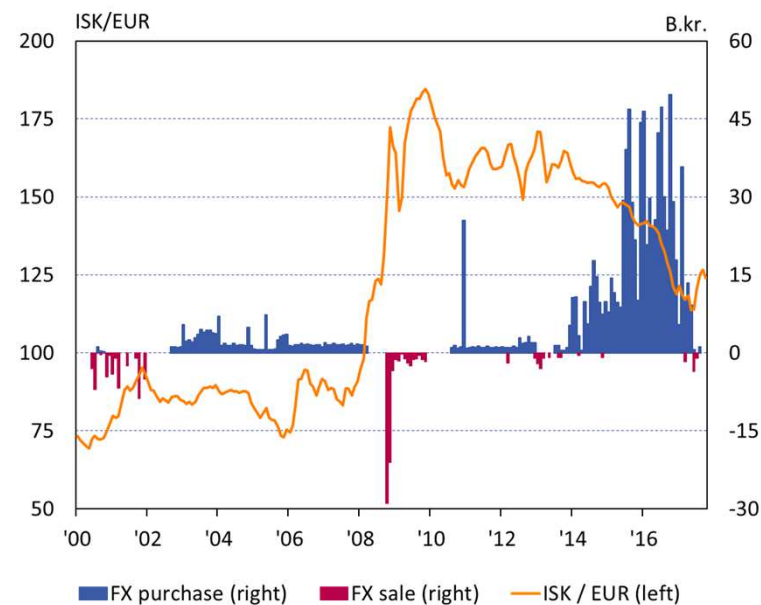
1. Exchange rate of the króna in terms of the trade-weighted exchange rate index.  
Source: Central Bank of Iceland.

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

Real exchange rate 1980-2017<sup>1</sup>



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

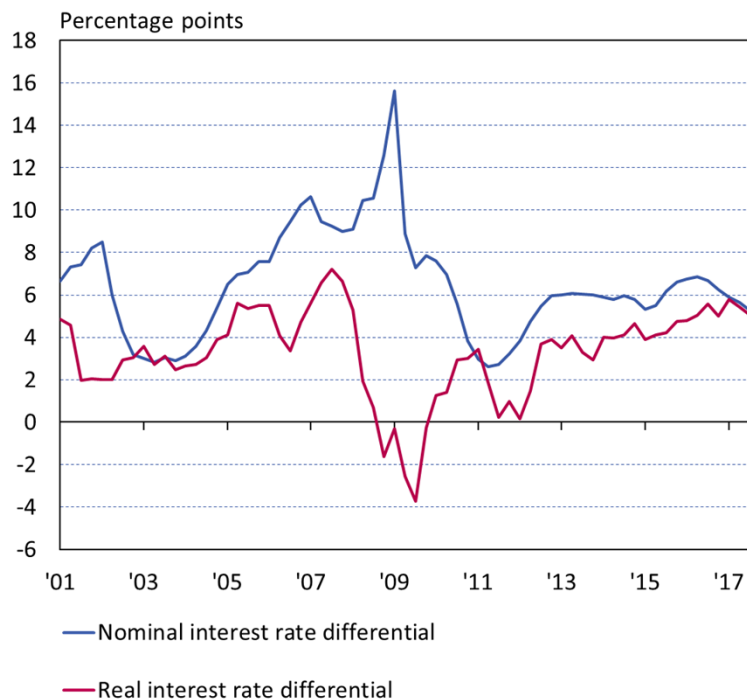


1. 2017 values and equilibrium real exchange rate estimate are from the Central Bank baseline forecast (MB 2017/4). IMF Article IV estimation range includes IMF's equilibrium real exchange rate estimates based on the current account approach and the REER approach in the last three Article IV publications.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

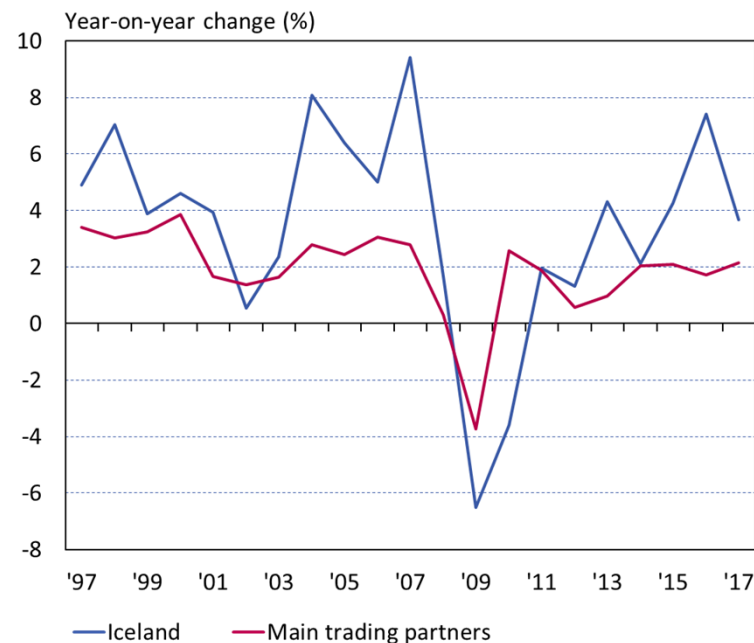
# V. Wide short-term interest rate differentials makes building reserves through interventions costly

Short-term interest rate differential with the euro area<sup>1</sup>

Q1/2001 - Q3/2017



GDP growth in Iceland and trading partners 1997-2017



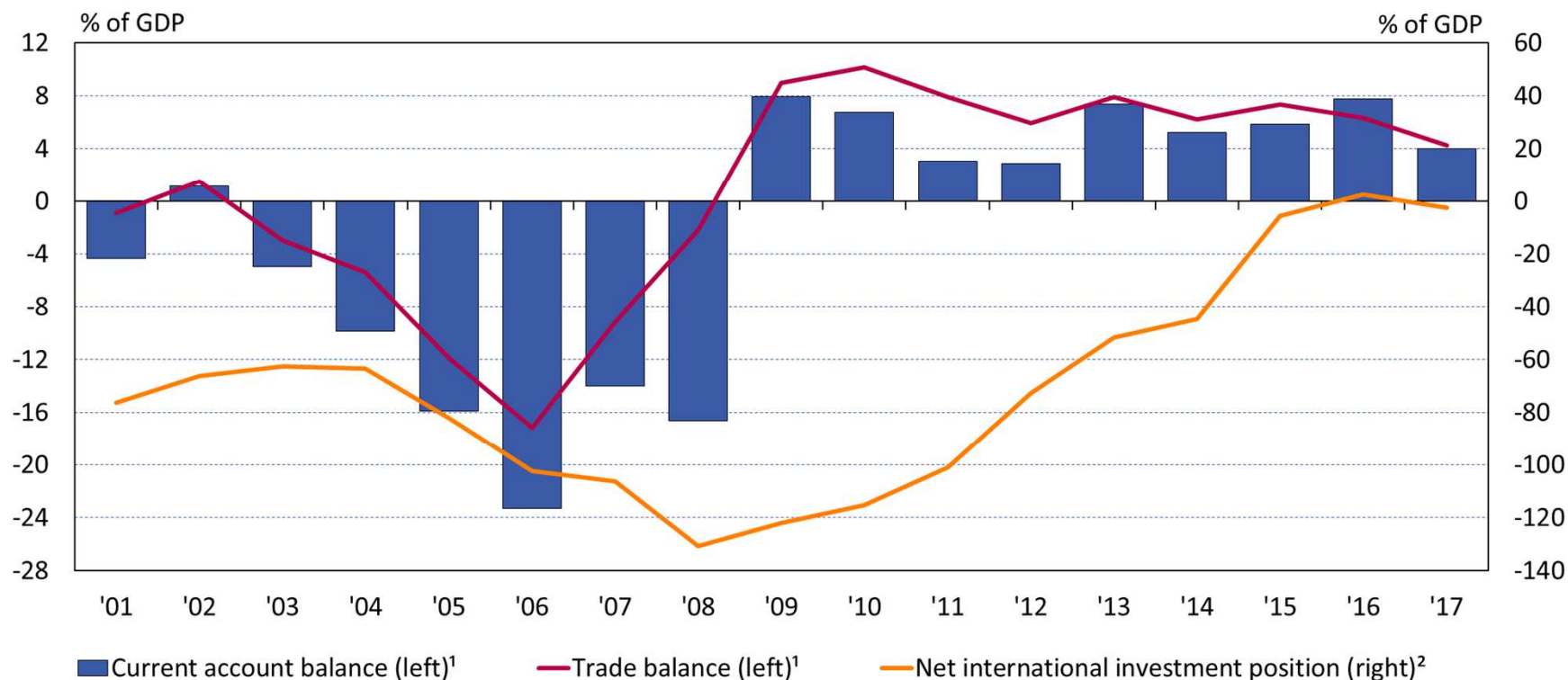
1. The difference between 3-month interbank rates.

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

Additional slide

# The financial crisis forced 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 is based on the underlying NIIP, that is adjusted for the effects of settlement of the DMBs in winding-up proceedings. NIIP data for 2017 is Q2 data. Sources: Statistics Iceland, Central Bank of Iceland.