

# Fifth OECD forum on African public debt management and bond markets



Session II, Panel 1: The role of (bond) exchanges in (a) encouraging the free cross-border flow of capital and (b) managing large foreign flows into local debt markets

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# Overview

- **Focus on two recent policy topics:**
- **Panel I. The role of (bond) exchanges in:**
  - encouraging the free cross-border flow of capital and
  - managing large foreign inflows into local debt markets
- Panel II. The role of exchanges in (developing) regional markets

# Foreign investors

- Efforts to promote foreign involvement in the local bond market (2000-2008)
  - Bonds transformed from fiscal to electronic format (1999)
  - New stock exchange platform linked to OMX/Nasdaq (2001)
  - The domestic securities registry linked to Clearstream (2004-5)
  - Measures to enhance liquidity in local bonds
    - Benchmark size bond series
    - Market makers
    - Bond lending to market makers
  - Instruments tailored to meet foreign investor needs
    - From structures to plain vanilla bonds
  - Increased transparency and improved access by foreign investors to information on the local bond market

# Foreign investors

- The foreign investors call for
  - A trading platform (exchange) that provides
    - Transparent pricing mechanism
    - A secure settlement mechanism
  - A certain level of liquidity
  - Yield

# Foreign investors

- Foreign investors enter the ISK market
  - Foreign holding of ISK increased from 0 – 40% of GDP (ISK 600bn.) from 2004-8
  - Held as deposits, swaps and/or local bond (treasury and housing bonds)
  - Allot of issuance of ISK by foreign accounts fuelling the carry trade
    - High interest rate differential due to a economic boom
    - Strong credit ratings of Icelandic banks

- The crisis
  - Holders of ISK become concerned about Icelandic banks
    - Credit risk becomes FX risk
  - Shallow ISK government bond market pushes investor out of ISK
    - Short rates suppressed due to flight to quality
    - Pressure on the ISK exchange rate
    - CBI issues certificates of deposit
  - Market failure
    - FX and MM market in Q1 2008
    - Bond market in Oct. 2008
  - IMF program and capital controls

# Resolution

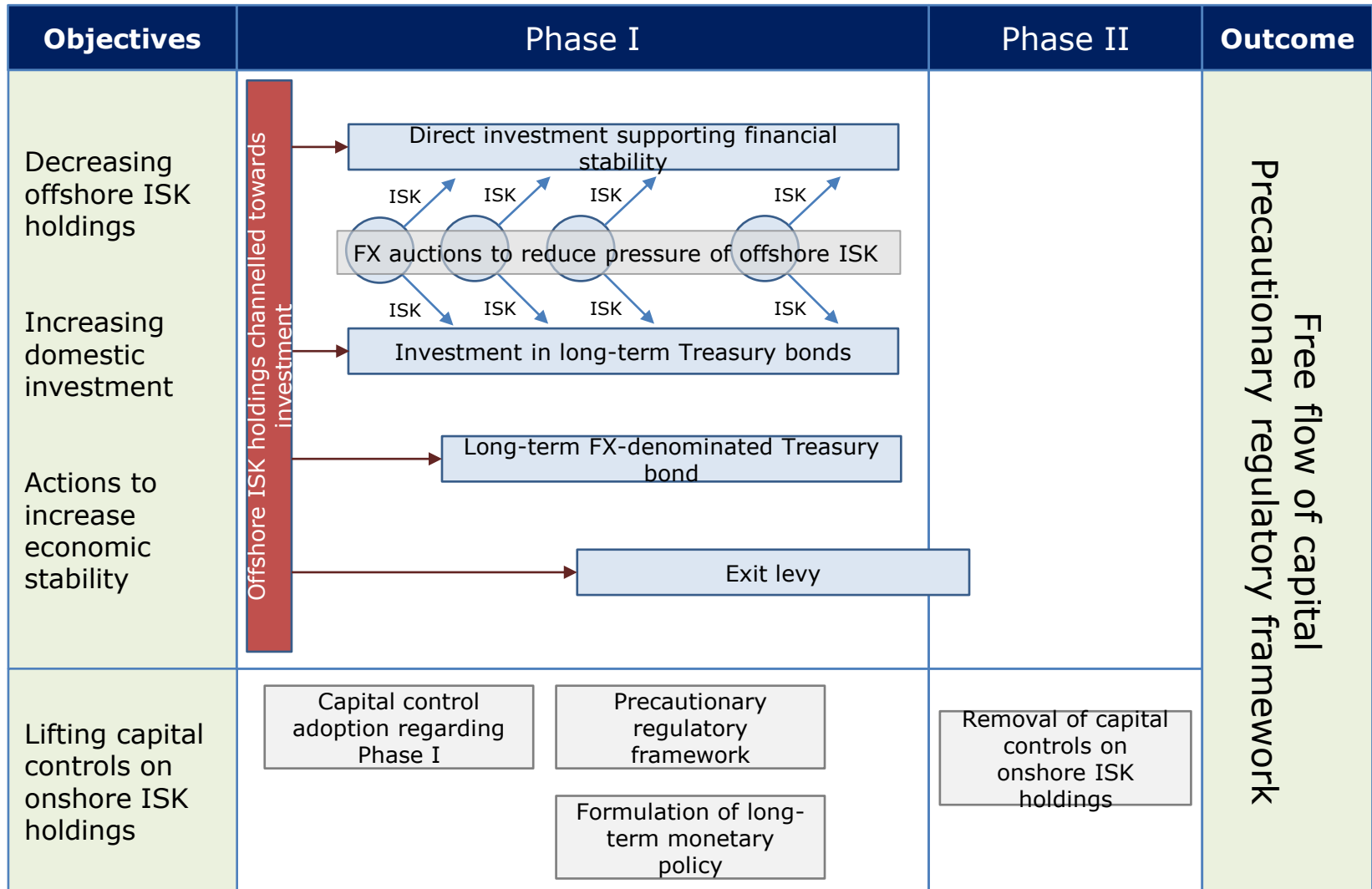
- Crisis resolution
  - IMF program
    - \$5bn. of loan facilities
    - Capital Controls
    - Monetary tightening
      - policy rate raised to 18%
  - Reopening of local bond market (Nov. 2008)
    - Re-introduction of CP's
    - Increased focus on extending duration
- Foreign holding of ISK assets (treasuries and deposits) now approx. 30% of GDP is locked in behind the capital controls

# Strategy for liberalizing the capital account

- The Central Bank published its report on a revised Capital Account Liberalization Strategy on 25 March 2011
- The strategy is divided into two phases, each segmented into various smaller steps of gradual sequencing as preconditions are in place
- In Phase I the aim is to alleviate potential pressure on the exchange rate by reducing offshore ISK holdings and boost domestic investment to increase economic stability
- Phase II will commence once sufficient economic stability has been reached and the Treasury has demonstrated its ability to borrow in foreign markets. This phase entails removal of controls on onshore ISK holdings
- Initially the focus will be on steps that do not place a strain on foreign exchange reserves, i.e. auctions where unstable króna holdings are directed into the hands of longer-term investors.



# The strategy at a glance





Thank you