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June 12, 2023

**Statement by Ms. Medearis and Mr. Sturm on Iceland
(Preliminary)
Executive Board Meeting
June 14, 2023**

We thank staff for the clear report and the informative Financial Sector Stability Assessment. We also thank Mr. Vasiliauskas, Ms. Marcussen, and Ms. Ogmundsdottir for their helpful Buff statement. We commend the authorities on Iceland's robust economic recovery from the COVID-19 pandemic, including through the resurgence of the tourism sector and a full recovery in the labor market. **We broadly agree with staff's appraisal and recommendations and offer the following comments for emphasis.**

Staff make a strong case for a more contractionary fiscal stance to rebuild buffers. We concur with staff's recommendation to move up the reinstatement of the fiscal rules one year to 2025, and we encourage the authorities to frontload the ongoing fiscal consolidation. While we are encouraged by the authorities' intention to ensure the orderly, timely, and effective resolution of the debts issued by Housing Finance Fund, a timely conclusion of these efforts to clarify the government's obligations would be important to reassure markets and limit perceptions of fiscal risks. We note that continued monetary and fiscal tightening could help strengthen Iceland's external position.

We welcome the Central Bank of Iceland's (CBI) early and rapid monetary policy tightening. We encourage the authorities to maintain a sufficiently restrictive monetary policy stance to bring inflation back down to target. We welcome that the CBI has reduced its activity in the foreign exchange market. *Could staff expand on their suggestion that the authorities could consider insights from the Integrated Policy Framework to address destabilizing premia in shallow foreign exchange markets, including for example how high UIP premia or bid-ask spreads actually are? Given the importance of country specific circumstances in considering generalized IPF recommendations, could staff explain whether they anticipate future analysis and work to refine recommendations to country context in Iceland, including to tailor advice to CBI on its presence in the foreign exchange market?* Such analysis could also hopefully suggest further steps the authorities could take to deepen

the market, so FXI does not need to be relied upon so heavily to prevent disorderly market conditions.

We welcome the completion of the FSSA for Iceland and we positively note the authorities' appreciation for staff's work. We encourage the authorities to remain vigilant against risks in the commercial and residential real estate sectors. We concur with staff's recommendation that stronger governance and supervision of pension funds is warranted given their systemic importance in the Icelandic financial system. We welcome the authorities' ongoing efforts to safeguard financial integrity through Iceland's AML/CFT regime, but we agree with staff's recommendation that steps should be taken to improve beneficial ownership information maintained by the Icelandic Register of Enterprises. It is crucial that bank supervisors have adequate resources to implement their new responsibilities across the financial sector, including to support the AML/CFT regime. Finally, we appreciate the FSSA's inclusion of climate-related financial risk and support the authorities' incorporation of these risks within macroprudential surveillance.

Structural reforms remain essential for the authorities to sustain momentum to diversify and green the Icelandic economy as well as to make further strides to boost productivity. We appreciated staff's analysis in Annex IX on options to increase both the sustainability and fiscal contributions of the tourism sector. We welcome staff's recommendations for a revised "GDP Bonus" clause in Icelandic wage agreements presented in Annex VII. We emphasize the key role that well-structured wage agreements reflecting real productivity growth can play in reducing the risk of sustained inflationary pressures.