Iceland

The economy started rising in 2021, after a 6.8% contraction in GDP in 2020 the economy rose by 4.4% in 2021. GDP forecasts indicate that the growth will be 6.2% in 2022, driven by rebound tourism and increased private consumption. Unemployment has gone considerably down, was at 4.4% at year end in 2021 and has continued to decline. Inflation on the other hand is on the rise and was at 5.1% year-on-year in year-end 2021 but has risen considerably in 2022.

The commercial banking sector consists of four universal banks and five small savings banks that operate in the rural areas. Of the four commercial banks, three are defined as systemically important parties subject to supervision by the Financial Stability Council in Iceland.

The banking sector currently has around 2,400 employees working in 70 branches around Iceland. Commercial banks and savings banks have closed a considerable number of service points and reduced staff since 2012 with increased emphasis on electronic self-service solutions. Electronic payments, services and signatures have been on the rise over the past years and temporarily reduced services in branches during the pandemic have accelerated the process with online services and interactions surpassing traditional ones.

Since October 2015, ownership of two of the three major banks has been primarily in the hands of the Icelandic government. The government has taken steps in deleveraging its holdings in the financial system. One bank is 98.2% government owned, the Minister of Finance and Economic Affairs has begun the process of selling the governments holding in the second bank. An initial public offering was held in June 2021 and 35% of the governments share was sold. All shares in the bank were listed on the stock exchange in Reykjavík thereafter. An additional 22.5% was sold to professional investors and eligible counterparties in March 2022. The third bank is listed on the stock exchanges in Reykjavík and Stockholm and the sole investment bank is listed on the stock exchange in Reykjavík.

Total assets of DMB’s amount to ISK 4,700 billion, the equivalent to around 145% of GDP in 2021. The asset base is predominately domestic: total domestic assets are ISK 4,272 billion or 91% of total assets. Total domestic loans in the banking sector amount to ISK 3,464 billion. The banks are predominantly funded by domestic deposits which amount to ISK 2,378 billion.

DMB lending grew by 9% at year-end in 2021. Lending to households increased significantly over the course of 2021. Twelve-month growth was around 22% at year-end. It stems almost entirely from increased mortgage lending, as the housing market has been lively, fuelled by a significant drop in mortgage interest rates and a modestly leveraged household sector. Corporate lending remained broadly flat in 2021. The growth rate had slowed in 2019 and 2020, alongside declining economic activity and higher returns required by banks on corporate loans. Lending to corporates has picked up in 2022.

The Icelandic banks are all contributing to sustainability in Iceland. All have high ESG ratings and are moving towards sustainable financing. The banks have a broad spectrum of green products e.g. green bonds, green mortgage lending, green car financing and green deposits. This subject will continue to be a focus point for the financial sector in the coming years.

The Icelandic banks are all involved in projects to increase public awareness on the importance of financial literacy. The Icelandic Financial Services Association runs a joint project called Fjármálavit. The project is based on visits from employees from the Icelandic banks to grammar schools where they talk about money and savings. Fjármálavit participates in the European Money Week.

The overall performance of the three systemically important banks had deteriorated in recent years. The banks' return on equity was positive by 4.6% in 2020, roughly the same as in 2019. The reduction in returns in both 2019 and 2020 is due in large part to negative returns on discontinued operations and Covid-19 related provisions for loan impairment. In 2021 the return on equity rose to 11.9%, due to increased activity and reversal in loan impairments.

The commercial banks in Iceland were well prepared for the operating difficulties brought on by the COVID-19 pandemic thanks to a strong capital and liquidity position, which is well above the levels required. Although new challenging market conditions have risen in the last year the economy has started to rise and the banks are showing improvements in ROE.

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