Iceland

The economy has experienced rapid growth post-pandemic, with a 5% increase in 2023 and an average of 6.4% between 2021 and 2023. Inflation has been higher and more persistent compared to most European countries. The Central Bank of Iceland (CBI) has maintained a high policy rate to slow the economy and reduce inflation to acceptable levels. Inflation is now declining, and the CBI has already initiated a reduction in the policy rate. The economy shows signs of cooling, and the CBI forecasts much lower growth in the coming years compared to recent periods. Unemployment is also expected to rise from 3.4% in the previous year to 5% by 2025.

Iceland's commercial banking sector comprises four universal banks and five smaller savings banks operating primarily in rural areas. Three of the four major banks are classified as systemically important and are subject to supervision by Iceland's Financial Stability Council. Together, these three banks control approximately 96% of the loan market share in the banking sector.

The banking sector employs about 2,500 individuals across 69 branches in Iceland. Both commercial and savings banks have closed numerous service points and reduced staffing since 2012, increasingly focusing on electronic self-service options. The demand for electronic payments, services, and digital signatures has grown in recent years, with the pandemic further accelerating this shift. Despite these changes, the number of bank branches per 100,000 inhabitants in Iceland remains significantly higher than in other Nordic countries.

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. Landsbankinn is 98.2% government owned but the Minister of Finance and Economic Affairs has begun the process of selling the governments holding in the Islandsbanki and is planning the sale of the rest of the 42,5% shares in the bank. 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.

As of 2023, total assets of deposit money banks (DMBs) stood at ISK 5.5 billion, equivalent to approximately 126% of GDP. The three largest banks hold about 93% of these assets. The total loan volume is around ISK 4.2 billion, and total deposits are about ISK 2.9 billion.

DMB lending increased by 5.6% at the end of 2023, a slower pace than the growth rates seen in 2021 (10.8%) and 2022 (22.8%). Although the economy has been cooling following a prolonged period of high policy rates, the delinquency rate for households has not shown signs of increasing and remains lower than it was in the years leading up to the pandemic.

All of Iceland's banks are contributing to the nation's sustainability efforts, each earning high ESG (Environmental, Social, and Governance) ratings and moving toward sustainable financing. The banks offer a range of green financial products, including green bonds, green mortgages, green car loans, and green deposits. Sustainability will remain a key focus for the financial sector in the coming years.

In terms of public engagement, Icelandic banks are involved in initiatives to promote financial literacy. The Icelandic Financial Services Association runs a program called Fjármálavit, in which bank employees visit grammar schools to teach students about money management and savings. Fjármálavit also participates in European Money Week.

Icelandic banks were well-prepared to handle the operational challenges brought by the COVID-19 pandemic, thanks to their strong capital and liquidity positions, which exceeded regulatory requirements. The banking sector's performance post-pandemic has been better than in the years before. Return on equity has ranged from 9.6% to 11.9% since 2021, compared to 0.5% in 2020 and between 5.6% and 6.9% in the two years leading up to the pandemic.

The three largest banks are well-prepared to face future challenges. The CBI's annual stress test shows that these banks are highly resilient to external shocks. They also have some of the highest leverage ratios in Europe, partly due to strict capital adequacy ratio regulations. However, this has placed constraints on their return on equity, which has historically been lower than the European average and the banking systems of other small European countries.

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