

SEÐLABANKI ÍSLANDS

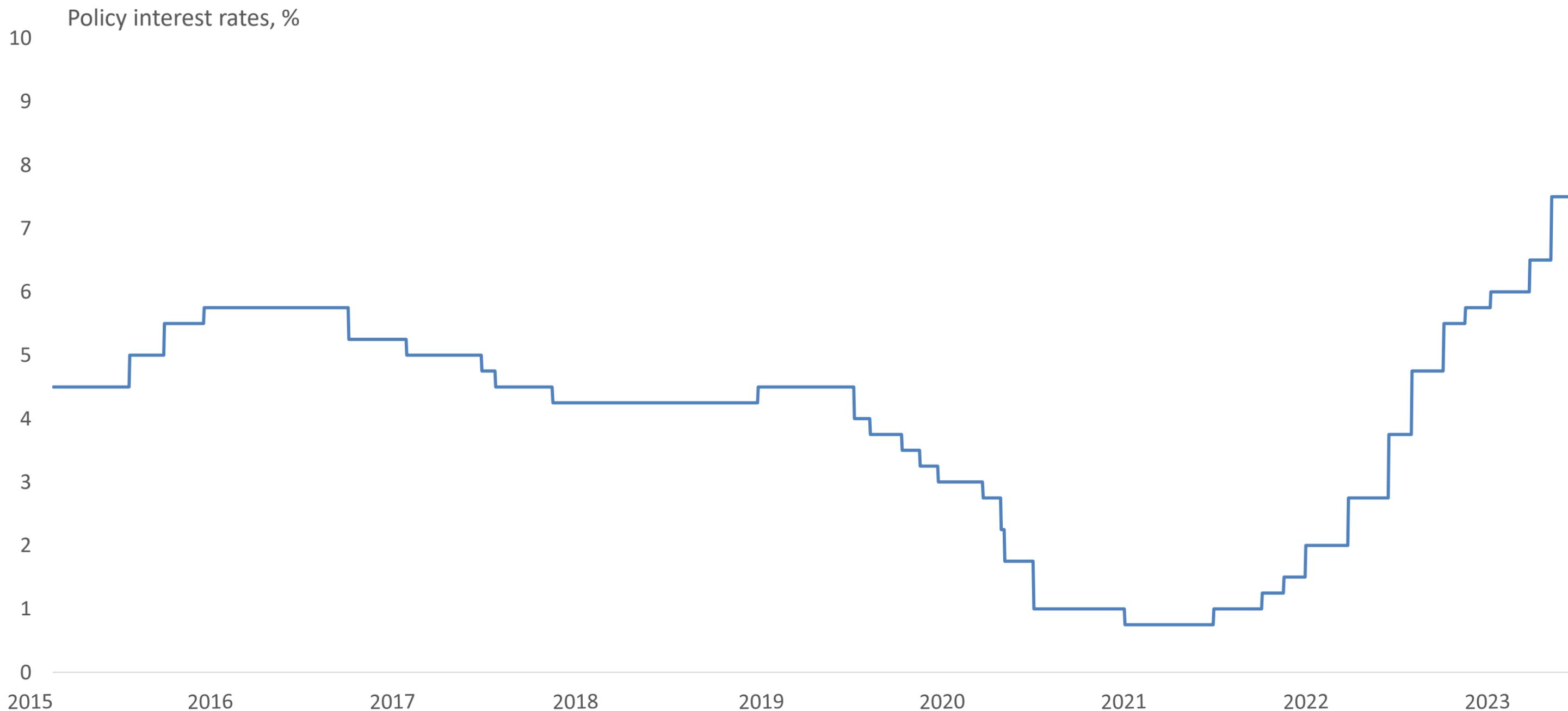
# Banking: Troubles on the horizon or idiosyncratic shocks?

Ásgeir Jónsson Governor of Central Bank of Iceland



29<sup>th</sup> Dubrovnik Economic Conference  
May 2023

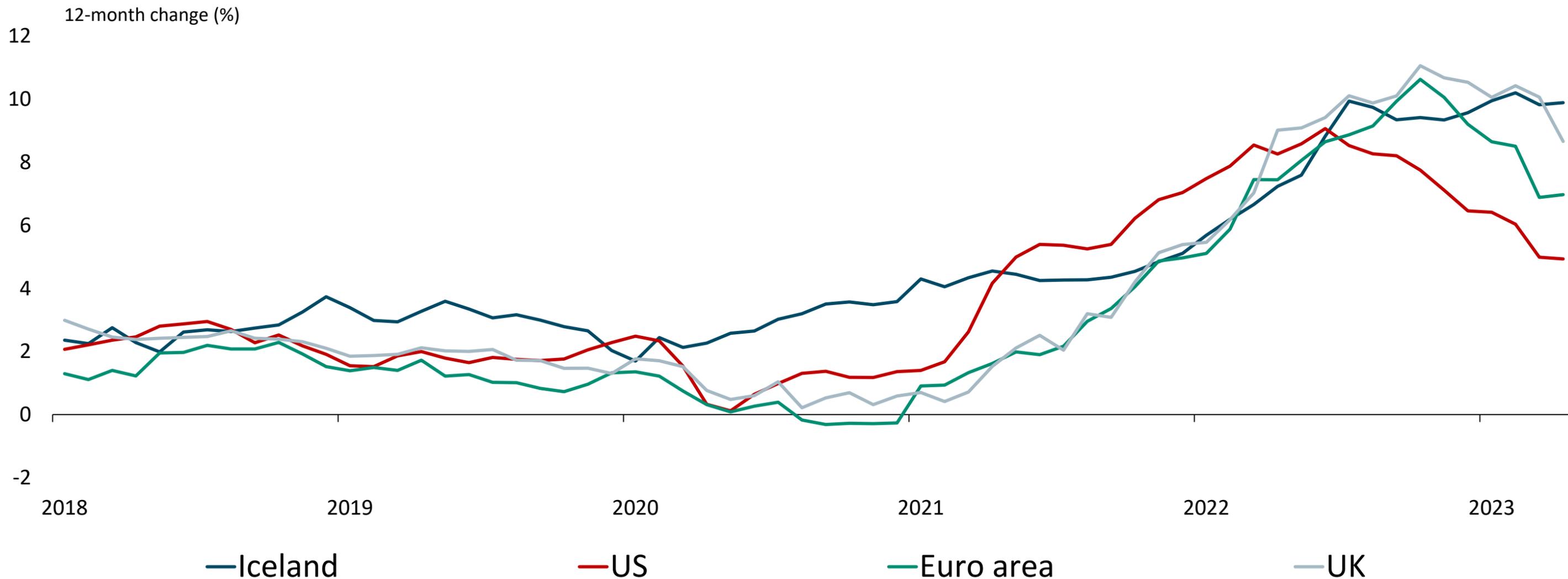
# Central Bank of Iceland has raised its policy rate to 8.75% ...



# ... to respond to increasingly broad based inflation

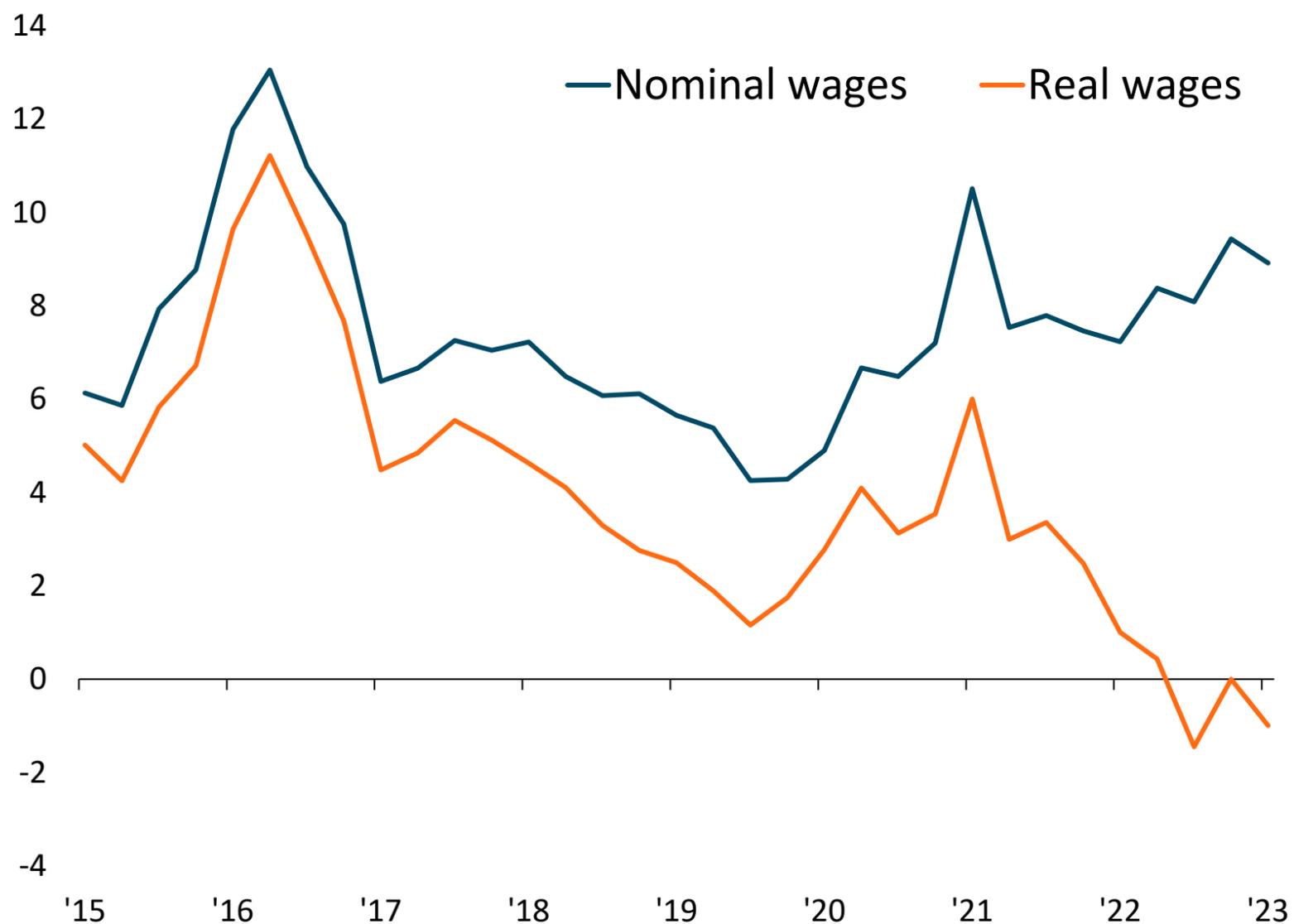
## Global inflation

January 2018 - April 2023

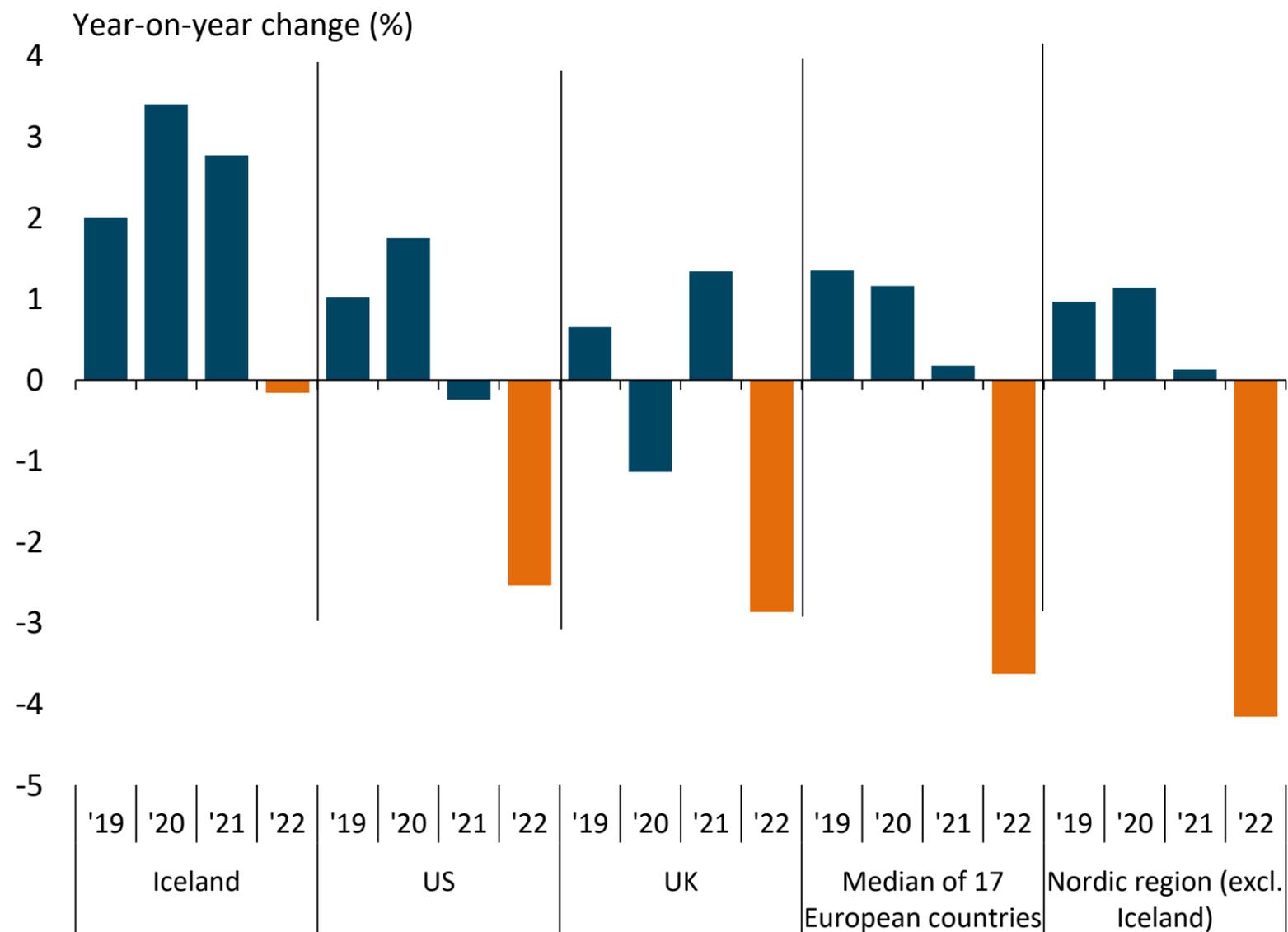


# Real wages have remained largely unchanged

Wages in Iceland, year-on-year change

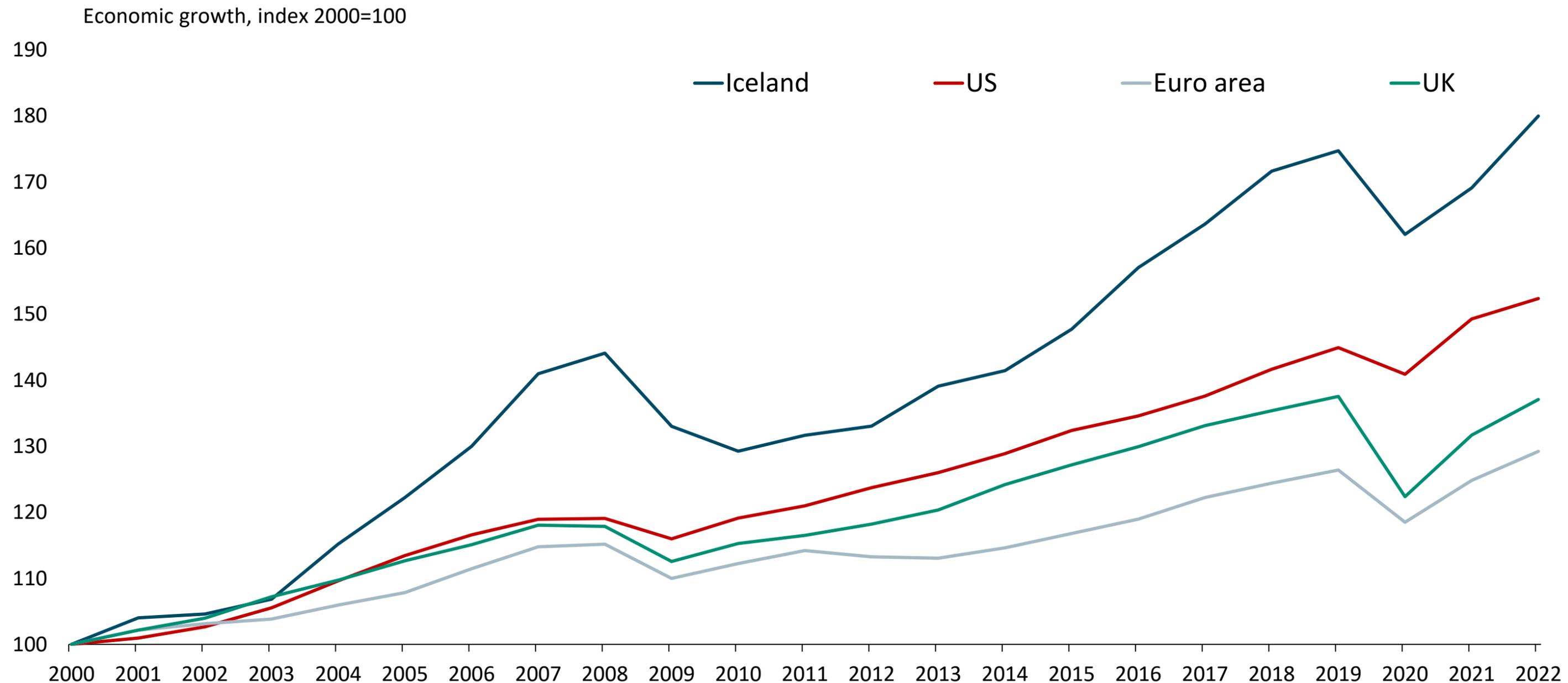


Real wages in developed countries 2019-2022<sup>1</sup>



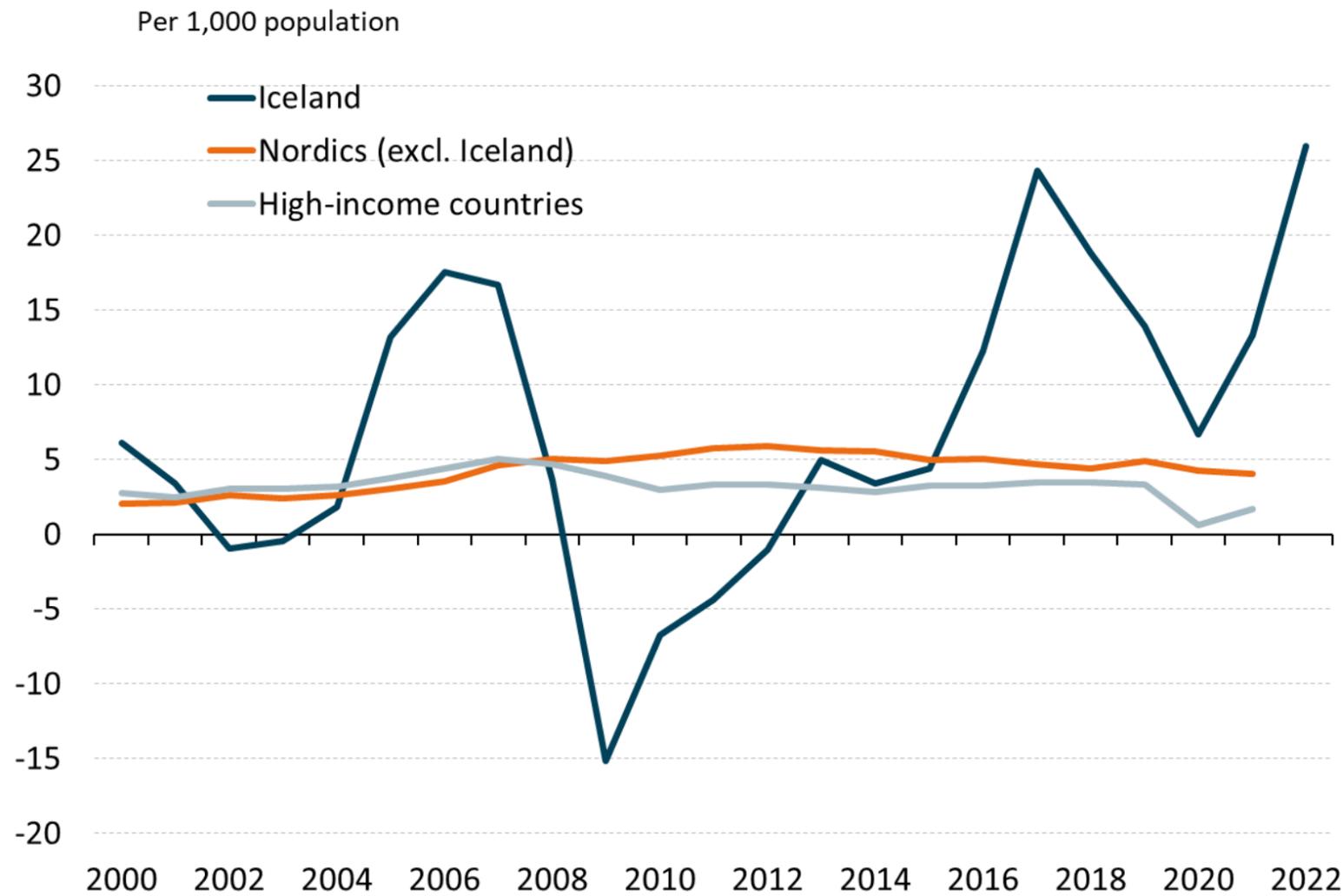
1. Average hourly earnings in manufacturing, deflated with the CPI. The Nordic region (excl. Iceland) shows a simple average for Denmark, Finland, Norway, and Sweden. The 17-country median excludes the Nordic countries and the UK.  
Sources: OECD, Central Bank of Iceland.

# Iceland has been on a higher growth trend than most other developed countries

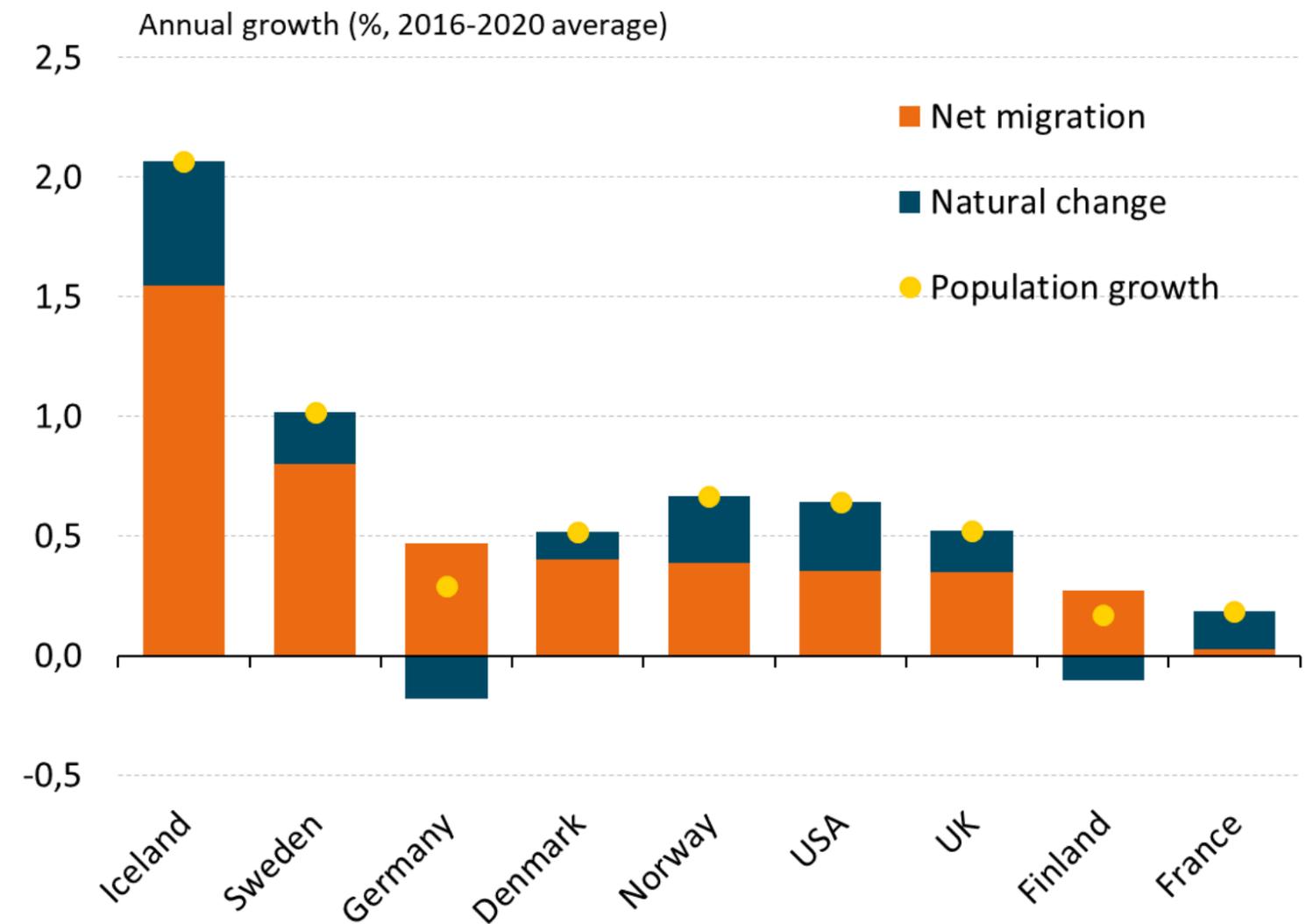


# High net migration, thriving tourism industry and demographics have led to increased demand for housing

Net migration rate 2000-2022<sup>1</sup>



Population growth and net migration<sup>2</sup>



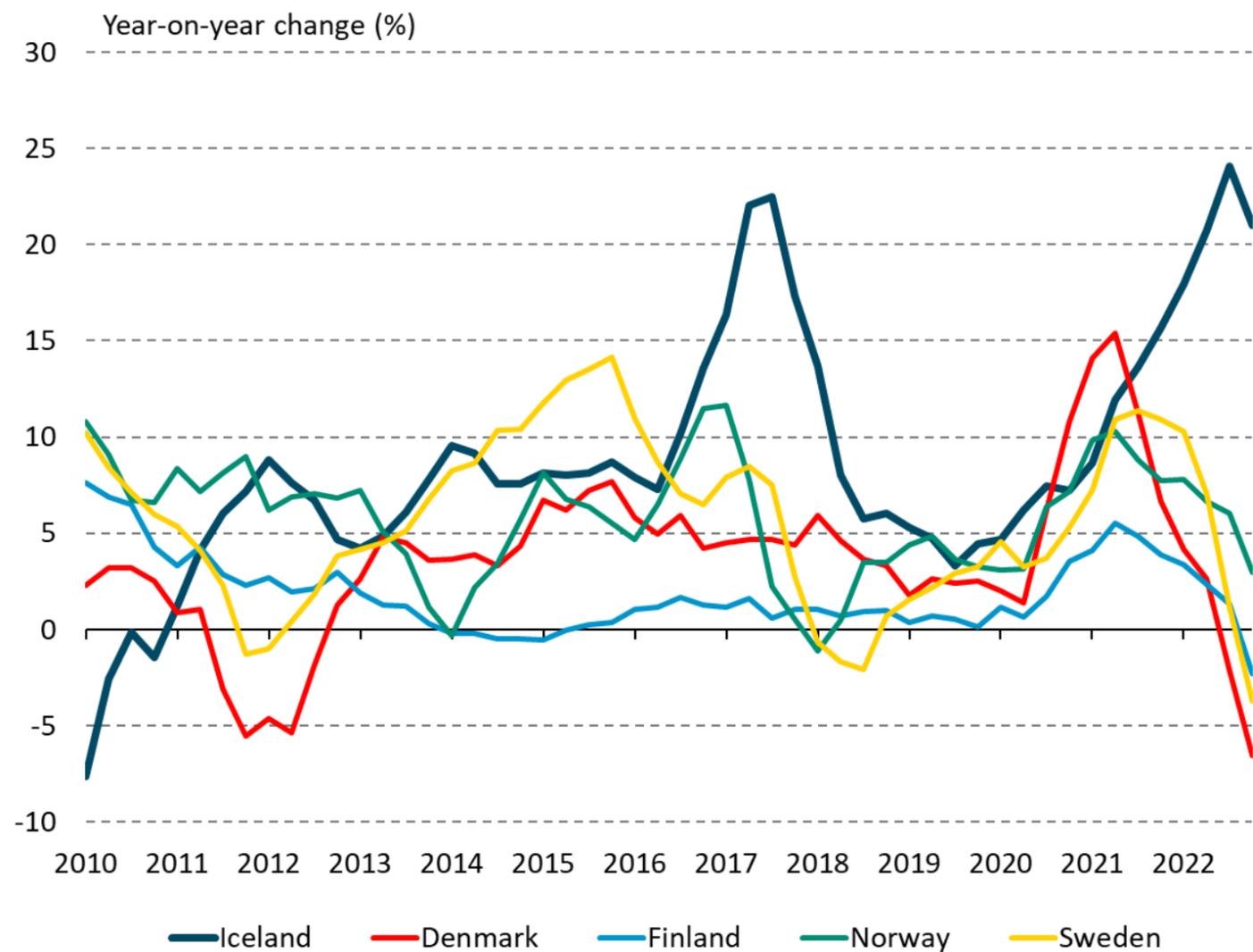
1. Nordics (excl. Iceland) includes Denmark, Finland, Norway and Sweden. High-income countries defined by United Nations as countries with GNI per capita of \$13,205 or more. 2. Natural change calculated as a residual and therefore also includes an adjustment factor.

Source: United Nations.

# House prices rose sharply in Iceland after the pandemic and are still rising faster than in other Nordic countries

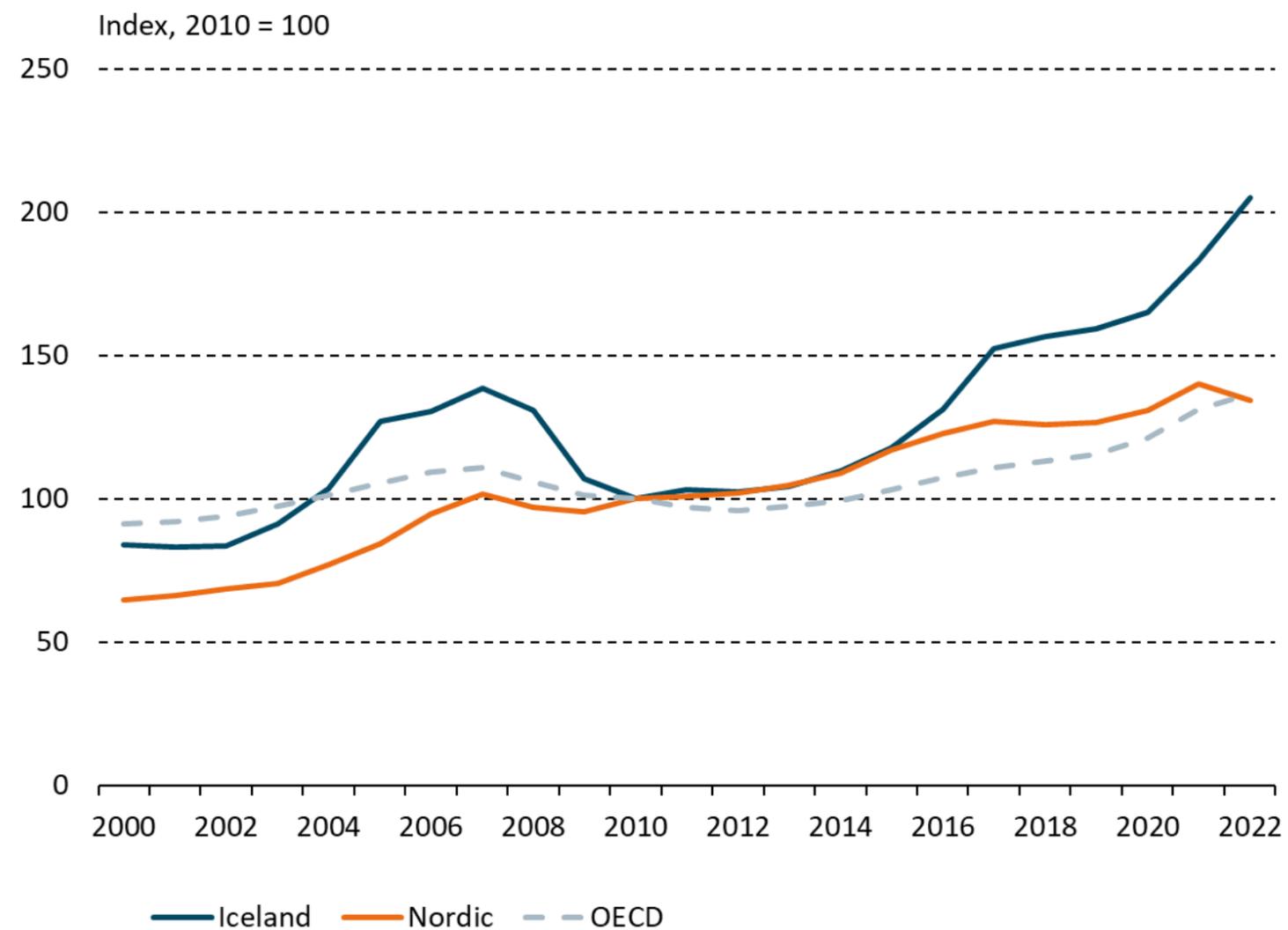
House prices in the Nordic countries

Q1/2010 - Q1/2023

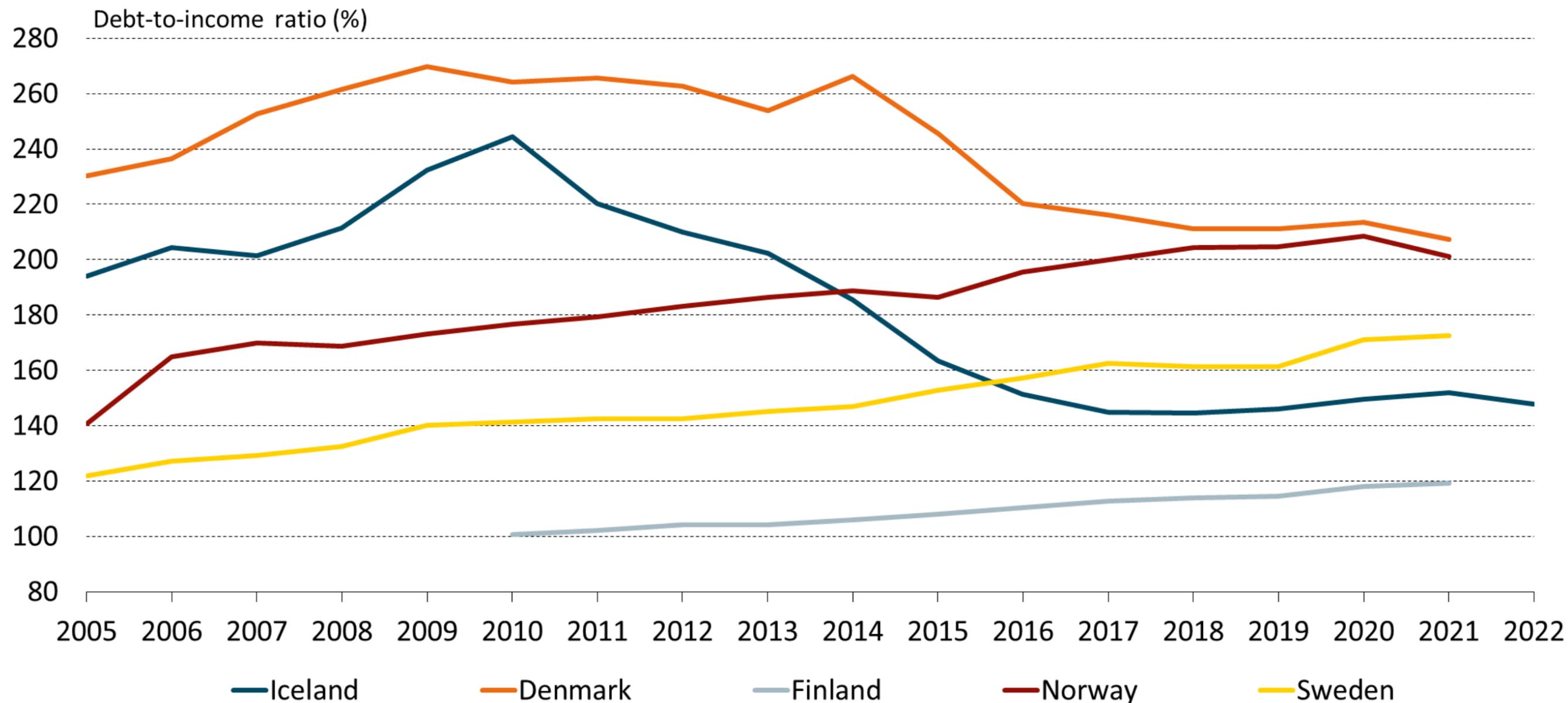


Real house prices

2000-2022



# Tight borrower based measures have slowed down the rise in house prices and kept a lid on leverage





# Framework for financial resilience

# How do you create resilience in a small open economy?

1. Institutionally integrate responsibility for monetary policy, financial stability and supervision in a clear and transparent way – and divide decision making authority through policy committees with outside participation

The Financial Supervisory Authority was merged with the Central Bank in 2020; there is now a single institution responsible for both price stability and financial stability. Enabled the Bank to respond decisively and in a consistent manner in all of its policy areas to the effects of the pandemic

2. Mitigate the influence of the balance of payments on the domestic economy
  - a) Maintain adequate international reserves – manage the foreign exchange market through limited but strategic interventions
  - b) Limit the ability of domestic entities to accumulate short-term external debt
  - c) Limit the scope for FX futures to be used as vehicles for speculative carry-trade

# How do you create resilience in a small open economy?

## 3. Manage leverage ratios and constrain credit growth

- a) Maintain high capital ratios of banks - in excess of 20% - in addition to 2,5% countercyclical capital buffers
- b) Employ borrower-based measures; capping both leverage and debt service burden
- c) Limit foreign-denominated currency lending to non-export companies

## 4. Limit risk-seeking in the financial sector

- a) Impose caps on bonuses
- b) Additional capital requirements due to loans to holding companies that are categorized as riskier



Thank you