

Iceland

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IN A NUTSHELL

- Population increase due to migration is putting a strain on the housing market. The population grew by 3.1%, the highest since 1734.
- Inflation has been persistent and the Central Bank has increased the key interest rates to 8.75%. Households with variable interest rates and high LTV are likely to convert these loans to index-linked annuities with maturities up to 40 years.
- Supply of new housing units is not keeping up with demand due to the population growth.

MACROECONOMIC OVERVIEW

The economy experienced robust growth. According to Statistics Iceland, GDP increased by 6.4% to ISK 3,766 bn.¹ Per capita growth was estimated to be 3.7%. The principal growth driver was increasing private consumption and exports. Statistics Iceland estimates that the GDP in 2023 will grow by 3.8%.

Unemployment between the ages of 16 to 74 was estimated to be 3.7%.

Inflation was persistent as in many other developed economies. The consumer price index rose by 9.6% and 7.5% excluding housing cost. Inflation has been persistent in the first half of 2023 and reached 9.9% in April 2023.² Due to the high inflation the Central Bank of Iceland increased its key interest rates by 8.00 pps from its lowest value to 8.75% in the second quarter of 2023. At year-end 2022 the key interest rate was 6.0%.

A strong rebound in tourism has also contributed to the recovery of the Icelandic economy, overnight stays increased by 77% from 2021 to 2022. Tourism has continued to grow in the first half of 2023.³

One of the challenges Iceland is facing is that population growth has not been higher since 1734. The population grew in 2022 was 3.1% and population increased by 11,510. The total population was 387,758 on 1 January 2023. This rapid population growth, which is driven by net immigration, puts further strain on the housing market.

LOOKING AHEAD

The ongoing conflict in Ukraine has probably affected Iceland proportionally less than other European countries as most of the energy produced in Iceland is from renewables. Heating and electricity use come from sources of hydro power stations and geothermal power. However, higher oil prices affected the economy

and contributed to inflationary pressure to some extent, the sectors most affected were fisheries and the aviation sector.

Inflation, which is broad based, is expected to subside, albeit slowly. Domestic demand is expected to remain elevated throughout 2023 despite higher policy rates. The continued rebound in the tourism sector coupled with population growth and rising wages will maintain a positive output gap throughout the remainder of the year. A possible downside to this scenario could be a drop in tourism.

HOUSING MARKETS

During the pandemic, the Central Bank of Iceland cut interest rates to the lowest level in history, 0.75% pps. In 2021 the Central Bank of Iceland started to increase the key interest rates to the current level of 8.75% in Q2 2023. This has affected the mortgage markets and interest rates on new loans.

House prices continued to increase in 2022, they went up 17.4% in the Capital Region of Reykjavik or 7.1% in real terms compared to the previous year. In comparison prices went up by 18.4% in nominal terms and 12.7% in real terms in 2021. At the beginning of 2023 prices continued to increase in nominal terms, although lagging inflation, and increased by 8.6% from April 2022 to April 2023 in the Reykjavik Capital Region.

Housing completion was 2,886 by year-end 2022 (preliminary data).⁴

The number of transactions fell by 25% from 2021. Compared to these figures the market in 2020 and 2021 was robust with a record number of transactions in 2021. The number of transactions in 2022, was estimated to be 12,422 according to the Housing & Construction Authorities.

MORTGAGE MARKETS

Outstanding residential mortgages were ISK 2,408 bn by year-end an increase of 9.1%, 63.9% of GDP and a decrease of 4.1 pps from 2021.

In June 2022, the Central Bank introduced new rules on maximum LTV ratios and on maximum Debt Service-to-Income ratios for mortgage loans to consumers. The maximum LTV ratio for first-time buyers was lowered from 90% to 85%. For other loans the LTV is 80%. The maximum debt service cannot exceed over 35% of disposable income, or in the case of first-time-buyers, 40%.⁵ The objective of this strategy was to cool the housing markets contribution to inflation.

Nominal mortgage rates increased substantially in 2022 from 3.7% on average in 2021 to 5.8% on average in 2022. At year-end 2022 the average mortgage rate in December was 7.5%. Indexed mortgage rates decreased on average

¹ <https://stative.is/publications/news-archive/national-accounts/national-accounts-2022-provisional-estimates/>

² <https://stative.is/publications/news-archive/prices/consumer-price-index-in-april-2023/>

³ <https://stative.is/publications/news-archive/tourism/tourism-short-term-indicators-in-may-2023/>

⁴ <https://fasteignaskra.is/gogn/fasteignagattin/fjoldatolur-ur-fasteignaskra/fjoldi-ibuda-eftir-byggingarari/>

⁵ <https://www.cb.is/publications/news/news/2022/06/15/Rules-on-maximum-LTV-and-DSTI-ratios/>

<https://www.stjornartidindi.is/Advert.aspx?RecordID=c9a53dc2-7afc-4066-8e0f-3968b8c976d5>

<https://www.stjornartidindi.is/Advert.aspx?RecordID=045933fe-d5d8-4b69-a416-010b92000550>

from 2.4% in 2021 to 2.3%. At year-end 2022 the average mortgage was 2.9% in December 2022. In 2023 mortgage rates continued to rise. The average LTV ratio was 53.4% a decrease of 5.7 pps.

At year-end 2022 the share of indexed linked mortgages was 42.2% of these 17.8% of the total were subject to variable rates. The share of non-indexed mortgages was at the same time 56.8%. Around 27.5% was subject to variable rates. In the beginning of 2023 household demand for indexed linked mortgages increased. Indexed linked mortgage rates are usually annuities and are therefore backloading in terms of payment structure.

The ratio of house price index to wage index was 131.97 at year-end 2022 but was 126.34 a year earlier.⁶

Households in arrears on mortgage payments are the lowest portion since 2004 or just over 1.1% arrears among tenants increased slightly between 2021 and 2022 or from 5.3% to 7.5%.

The state and the local authorities continued to provide financial support (i.stofnstyrkir) for the construction and purchase of affordable rental apartments, with the objective to lower rental prices in the general rental housing market. The help-to-buy programme will continue in 2023.

According to the European Banking Authority the exposure to real estate activities and construction was 20.5% as percentage of total of exposures to non-financial corporations.⁷

MORTGAGE FUNDING

Covered bond issuance is relatively new and developing in Iceland and demand for the bonds has been limited due to few buyers.

In 2022 the domestic systemically important banks issued ISK 49 bn in króna-denominated covered bonds. According to the Financial Stability report of the Central Bank of Iceland the stock of outstanding covered bonds denominated in ISK contracted by ISK 5 bn in 2022.

Other funding sources come mostly from deposits and from direct lending from pension funds. The principal buyers of covered bonds are pension funds and insurance companies.

GREEN FUNDING

Over several years the Icelandic banks have been providing green funding; for example for cars fuelled by electricity, methane or hydrogen.

Icelandic housing is almost entirely heated with renewable energy, e.g. geothermal heating or electricity generated with hydro or geothermal power plants. In addition, all housing is well insulated and with double glazing.

Foreign funding partners of the Icelandic banks are encouraging green lending and want the balance sheet of banks to be categorized like that. The banks have therefore issued green bonds denominated both in ISK and euros.

It is becoming more common that construction companies incorporate green standards and sustainability targets in the construction of new residential housing.

	ICELAND 2021	ICELAND 2022	EU 27 2022
MACROECONOMIC VARIABLES			
Real GDP growth (%) (1)	4.3	6.4	3.5
Unemployment Rate (LSF), annual average (%) (1)	6.1	3.8	6.2
HICP inflation (%) (1)	3.7	5.7	9.2
HOUSING MARKET			
Owner occupation rate (%) (1)	73.6	n/a	69.1
Gross Fixed Investment in Housing (annual change)(1)	-4.4	-6.3	1.5
Building Permits (2015=100) (2)	#N/A	#N/A	125.8
House Price Index - country (2015=100) (2)	177.6	214.8	164.6*
House Price Index - capital (2015=100) (2)	171.4	212.5	163.8*
Nominal house price growth (%) (2)	12.5	21.0	10.6*
MORTGAGE MARKET			
Outstanding Residential Loans (mn EUR) (2)	14,952	15,897	6,743,197
Outstanding Residential Loans per capita over 18 (EUR) (2)	51,471	54,327	18,433
Outstanding Residential Loans to disposable income ratio (%) (2)	n/a	n/a	71.5
Gross residential lending, annual growth (%) (2)	n/a	n/a	-6.5
Typical mortgage rate, annual average (%) (2)	2.4	2.3	3.1

* Please note that this value is the simple average of the available values in 2022.

Sources:

(1) Eurostat Data

(2) European Mortgage Federation – Hyostat 2023, Statistical Tables

⁶ Financial Stability Report

⁷ Statistical Annex EBA.

ICELAND FACT TABLE

Which entities can issue mortgage loans in your country?	Deposit taking corporations (banks) and Pension Funds, the Housing and Construction Authority.
What is the market share of new mortgage issuances between these entities?	In the year 2022 the market share of deposit taking banks was 95% and the pensions fund's share was 4% the remaining 1% was lent by the government's housing authority and building authority (HMS).
Which entities hold what proportion of outstanding mortgage loans in your country?	At year-end 2022 the deposit taking banks held 67% of the total outstanding mortgages to households, the pension funds 18% and IL – Fund (in winding-up, precursor to the HMS) 15%.
What is the typical LTV ratio on residential mortgage loans in your country?	About 55% on new mortgages and about 65% for first time buyers. The maximum LTV at year-end 2022 was 80%, but up to 85% for first time buyers (limit to price). This limit was lowered on 15 June 2022 from 85% to 80% and 90% to 85% respectively.
How is the distinction made between loans for residential and non-residential purposes in your country?	A residential mortgage is a loan to an individual which is backed by real estate or is made for the purpose of buying a residential asset. The Central Bank currently makes a distinction between those loans in its accounts. Banks and pension funds require a pledge in the underlying property for a new mortgage.
What is/are the most common mortgage product(s) in your country?	Mortgage for 25 to 40 years with 3 to 5 year reset period on interest rates (29.4% of outstanding mortgages at end of 2022, about 45% of new mortgages in 2021). Mortgages with fixed payments are more common than with fixed installments. The relative popularity of indexed vs. non-indexed mortgages varies depending on the level of interest and inflation. Most mortgages have flexible rates with reset periods up to five years.
What is the typical/average maturity for a mortgage in your country?	25 to 40 years
What is/are the most common ways to fund mortgage lending in your country?	Covered bonds and deposits in the case of banks. Members funding in terms of pension funds.
What is the level of costs associated with house purchase in your country (taxes and other transaction costs)?	Stamp duty – 0.8% of the official property valuation (fasteignamat) for individuals and 1.6% for rental companies/legal entities.
What is the level (if any) of government subsidies for house purchases in your country?	The government has introduced a help to buy programme and pays interest expense benefits to low income households. First time buyers pay half of the stamp duty.