



STRESS TEST

FINANCIAL STABILITY

2025



The Central Bank of Iceland is required by law to promote price stability, financial stability, and sound and secure financial activities. The Bank shall also undertake such tasks as are consistent with its role as a central bank, including promoting a safe and effective financial system, which entails, among other things, ensuring that the banks are resilient enough to maintain the supply of credit and support the economy during times of stress. In its annual system-wide stress test, the Central Bank assesses potential developments in risks in the banks' operations under a severe but plausible adverse scenario. The Bank ensures internal consistency in the scenario by using its macroeconomic model to estimate developments in economic variables during a shock. The results of the stress test also provide input for the assessment of systemic risk and the possible application of macroprudential tools, including changes in the banks' capital requirements.

The purposes of the report are as follows:

- to foster informed discussion of stress tests and their importance in the assessment of the financial system's resilience to severe shocks;
- to explain the Central Bank's priorities in this area;
- to explain how the Bank develops methodologies and models for scenario design and stress test execution.

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(+354) 569 9600, sedlabanki@sedlabanki.is, www.sedlabanki.is

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Contents

Stress Test in a nutshell	4
Stress Test 2025	5
Summary	5
The purpose of system-wide stress testing	5
Scenarios	5
The stress scenario for 2025	6
Results	7
Growth in deposits and lending	8
Net interest income	8
Loan losses	9
Operations	9
Capital	10
Risk-weighted assets	10
Capital ratio and capital requirements	10
Comparison with the baseline scenario	11
Conclusions	12
Boxes	
Icelandic banks and the 2025 EBA stress test	13
Credit growth and feedback loops	17
Appendix	
Definitions	19

Stress Test in a nutshell



The Central Bank of Iceland's stress test indicates that the three systemically important banks O-SII are resilient enough to maintain the supply of credit and support the economy during a severe shock. The shock described in the stress test is based on hypothetical but severe events centring on heightened geopolitical tensions and an escalation of war. These events lead to a contraction in GDP, a rise in unemployment, and a steep decline in asset prices.



The Central Bank estimates that in the scenario presented, the O-SIIs' loan losses would equal 145 b.kr., or 3.3% of the claim value of the loan portfolio at the time the test began. Loan losses are offset by the D-SIBs' strong core operations, so that their after-tax losses total 13 b.kr. in the most difficult year of the stress scenario.



The ratio of common equity Tier 1 (CET1) capital to the risk base declines by 1.3 percentage points from the beginning of the scenario to the trough. Overall capital requirements and CET1 capital requirements are satisfied in all years of the horizon. Based on the results of the stress test, it is unlikely that the O-SIIs would have to significantly curtail the supply of credit in response to the shock. In other words, it is considered unlikely that the banks would have to cut back on lending to strengthen their capital ratios, which would cause an even deeper economic contraction.



For the first time, the assumptions underlying the Central Bank's stress scenario are comparable to those used by the European Banking Authority (EBA) in its stress test of 64 European banking conglomerates. A comparison reveals that Icelandic banks' capital and leverage ratios decline only modestly in comparison with those of the European banks. This is due, among other things, to the Icelandic banks' higher leverage ratio and their relatively limited market risk. The results are positive, but it should be borne in mind that the Icelandic economy is smaller and is exposed to various risks.

Stress Test 2025

Summary

The objectives of the Central Bank of Iceland's stress test which covers the years 2025 to 2027 are to assess the impact of a severe shock on the three systemically important banks (O-SII) and determine whether they are resilient enough to maintain the supply of credit and support the economy during times of stress. At the end of 2024, these banks held some 93% of deposit institutions' total assets.¹

At the starting point of the current stress test, the banks had ample capital in terms of their capital ratio, common equity Tier 1 (CET1) ratio, and leverage ratio. Their lending was secured by strong collateral, partly because Central Bank rules on loan-to-value (LTV) ratios have put limitations households' real estate debt in recent years.² The Central Bank estimates that in the scenario presented, loan losses would equal 145 b.kr., or 3.3% of the year-end 2024 claim value of the loan portfolio. The O-SIIs' core operations are profitable in the stress scenario, however, offsetting the loan losses. The three banks' combined operating losses after tax equal only 13 b.kr. in the first year, and the ratio of CET1 capital to risk-weighted assets declines by 1.3 percentage points. Overall capital and CET1 requirements are satisfied in all years of the stress scenario, and on the whole, it is not expected that the banks' responses to the shock will reduce the credit supply to any significant degree.

In the stress test, it is not assumed that there will be any management action that could entail, for instance, amendments to lending terms and conditions, changes to the proportional composition of loans and funding, or issuance of capital instruments other than those needed to refinance previous issues. Nor is it assumed that the Government will intervene in the economy with targeted measures.

The purpose of system-wide stress testing

Each year the Central Bank of Iceland conducts a system-wide stress test in which it tests and compares risks in the O-SIIs' operations. The results provide input for the assessment of systemic risk and for the possible application of macroprudential tools. With the stress testing model and other economic models, it is also possible to assess the interplay between the banking system and the rest of the economy, as is done in Box 2. A reduction in the O-SIIs' capital ratio in the stress test could provide the foundation for changes in capital requirements. The Financial Stability Committee's (FSN) criteria for the countercyclical capital buffer (CCyB) state that the neutral CCyB value is determined in part by how financial institutions' capital ratios develop in the Bank's stress tests.³

Scenarios

Geopolitical risk, including that stemming from war in Europe and trade disputes, is considered one of the key risks currently facing the Icelandic economy. It is also in the cross-hairs in neighbouring countries and was selected as the basis for the stress scenario in the European Banking Authority's (EBA) 2025 stress test.⁴ The economic variables in the EBA stress test cover most Western countries, although not Iceland, and for each country the scenario is tailored to the economy concerned. The Central Bank's 2025 stress test is based on an analysis of the EBA scenario and an estimate of likely economic developments in Iceland, which could align with a comprehensive analysis using the Bank's macroeconomic model.⁵

1. The Central Bank's stress test is described more fully in Kaloinen, E. *et al.* (2017), *The Central Bank of Iceland's approach to stress testing the Icelandic banking system*. Central Bank of Iceland Working Paper no. 75.

2. See the Rules on Maximum Loan-to-Value Ratios for Mortgage Loans to Consumers, no. 550/2023.

3. See the *Criteria for the determination of the countercyclical capital buffer*, published on the Central Bank's website in December 2024.

4. All key information about the EBA stress test can be found [here](#).

5. Icelandic banks do not participate in the EBA stress test, and the scenario does not include macroeconomic variables for developments in the Icelandic economy.

In addition to the assessment of risk and a potential decline in capital ratios, the 2025 stress test gives supervisory bodies, test participants, and other analysts the opportunity to compare the Icelandic banking system with that in Europe. Such a comparison is subject to various limitations, however, as is discussed further in Box 1.

Developments in key risk indicators in the stress scenario are also compared with the baseline scenario, which builds on the Bank's assumptions about medium-term economic developments according to the baseline forecast in *Monetary Bulletin* 2024/4. Developments in interest rates are not included in the published baseline forecast, however. As a result, developments in short-term interest rates are based on the average of the three large commercial banks' late-2024 forecasts, and five-year interest rates are extrapolated from the Treasury bond yield curve as of 30 December 2024.

The stress scenario for 2025

The origins of the shock in the 2025 stress scenario lie outside Iceland. Heightened geopolitical tensions cause international business relationships to rupture and isolationism to grow by leaps and bounds. Everywhere the effects are severe and lasting. Sectors that rely on global supply chains are hit first, causing unemployment to rise, and the global economy contracts as a result. In addition, war escalates, pushing

energy prices higher, followed by commodity prices. Both lead to a rise in prices and interest rates. Increased defence spending, interest rate hikes, and weaker GDP growth cause the public debt situation to deteriorate in European countries. Cyberattacks on European banks increase in tandem with elevated tension in international relations, so that banks' creditworthiness deteriorates and risk premia on their bond issues rise over and above those of companies in other sectors.

Tourist visits to Iceland decline because of elevated unemployment in key trading partner countries. Visitor numbers total 2.1 million in 2025 and then contract by an average of 2.1% per year, as compared with 2.3 million arrivals in 2024. Other export sectors suffer as well from higher tariffs and a downturn in demand. The overall effect is that exports shrink by an average of 5.3% per year over the horizon of the scenario. This is similar to 2019, when the tourism industry suffered a downturn (Chart 1).

The effects can also be seen in a decline in business investment. Investment in export sectors has been strong in recent years – for instance, in data centres, pharmaceuticals, and land-based aquaculture. Investors can be expected to respond quickly to changed conditions and scale down their investments in these industries, with the result that business investment shrinks by 17.8% in 2025 and 2026 combined.

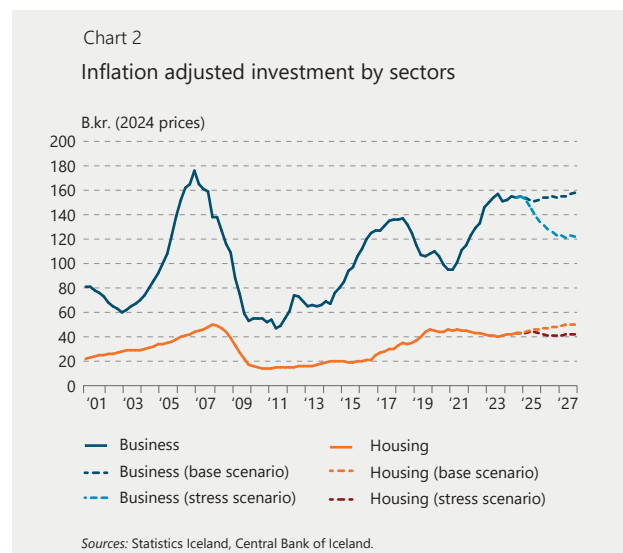
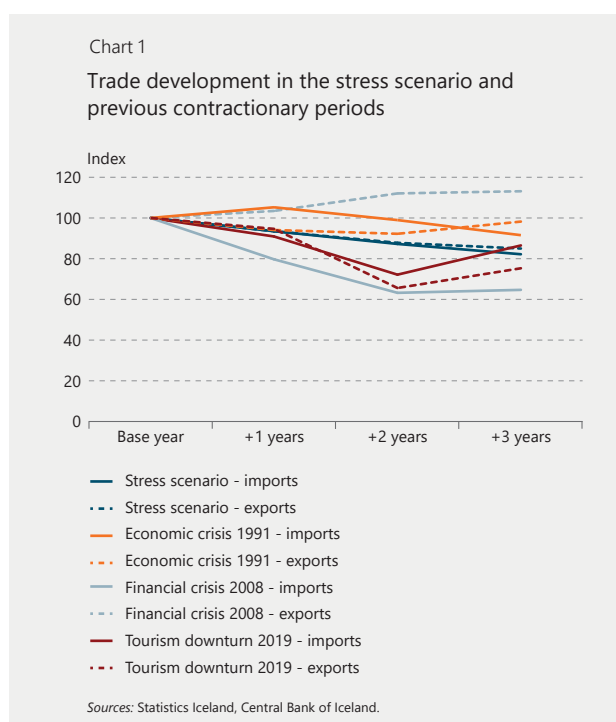


Chart 2 shows how investment develops in a crisis and gives a comparison with historical data and the assumptions in the baseline scenario. It shows that business investment – and the blow it sustains – is decisive for investment as a whole.

This causes unemployment to rise to a peak of 7.7%, on average, in 2026. It also causes a sizeable eco-

conomic contraction measuring 3.3% in 2025 and 2.4% in 2026. Public investment is assumed to be unchanged relative to the baseline scenario, although tax revenues fall and various expenditures rise, such as those relating to unemployment.

The nominal exchange rate of the króna is relatively stable for the first year, but the real exchange rises by nearly 1 percentage point in 2025. The real exchange rate then falls in 2026 and 2027, by just over 6% per year. The economic contraction leads to a slack in output and declining inflation, although inflation is slightly above the baseline forecast in 2025, at 4.2%. It averages 2.9% in 2026 and 1.1% in 2027. Short-term interest rates decline markedly as a result. They fall by 1½ percentage points in the first year of the scenario and 4½ percentage points in the second year, to an average of 0.8% in 2027. Long-term interest rates

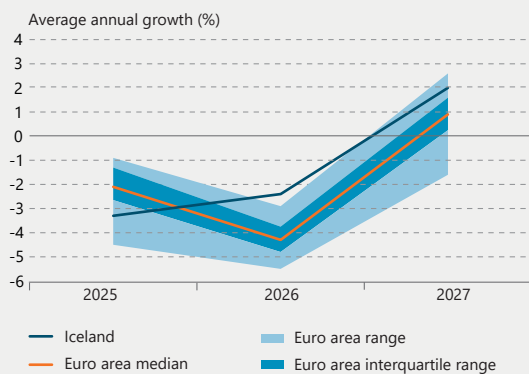
decline as well: five-year nominal rates fall 2.7 percentage points in the first year of the scenario and reach an average of 3.6% in 2027. Based on these two maturities, the nominal yield curve is even more inverted at first but then rights itself later in the horizon, finally sloping upwards by year-end 2026.

In the scenario, key asset markets are strongly affected. Chief among them is the commercial real estate market, where prices fall by about 25.5% in nominal terms and 28.7% in real terms between end-2024 and end-2025. At the same time, house prices fall by 20.2% in nominal terms and 23.6% in real terms. It is assumed as well that the price gap between new and older residential properties closes, so that the price of homes still on contractors' and construction companies' books falls by nearly 5 percentage points more. Share prices fall by 35.6% between end-2024 and end-2025, owing both to contagion from foreign equity markets and to the importance of world trade for the largest companies on the stock exchange.

Because of war, the price of oil and aluminium rises permanently by nearly 50% in the first year of the scenario. The rise in aluminium prices generates increased revenue for the Icelandic economy, but oil prices push production costs higher. Marine product export prices decline by a combined 12.2% in the first two years of the scenario, however, because of tariffs and trade barriers.

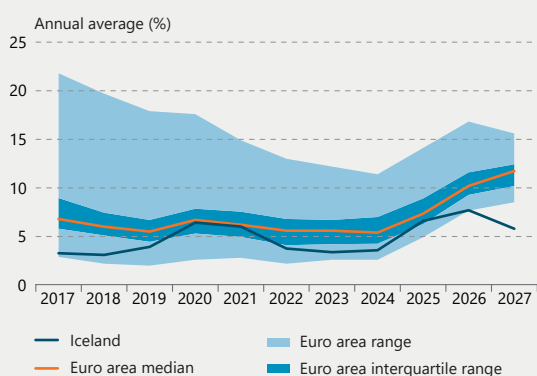
The O-SII' access to financing is not assumed to deteriorate, but spreads on corporate bond issues and bank funding are expected to widen, to 150 basis points on CPI-indexed domestic market funding and 200 basis points on non-indexed funding. Premia on the banks' foreign funding are 600 basis points above reference interest rates, while the spread on comparable Icelandic Treasury bonds issued in foreign currencies is 175 points.

Chart 3
Stressed GDP growth compared to EBA scenario



Sources: European Banking Authority, Central Bank of Iceland.

Chart 4
Stressed unemployment rate compared to EBA scenario



Sources: European Banking Authority (EBA), Organisation for Economic Co-operation and Development (OECD), Statistics Iceland, Central Bank of Iceland.

Results

The stress test is carried out in cooperation with the O-SIIs. The scenario is presented to the banks, and they are invited to estimate how their operations and balance sheets will develop during the shock. Concurrently, the same type of analysis is done within the Central Bank, and discussions are then held between it and the banks being tested. The results published here, which are estimated by the Central Bank, give an indication of how the O-SIIs' operations, balance sheets, and capital ratios could develop in the stress scenario.

Growth in deposits and lending

In the scenarios, developments in deposits and lending are estimated using vector autoregression (VAR) models based on total deposits in the banking system, loans to companies, loans to households, and selected economic variables relevant to the scenario.⁶ The banks' deposits and lending are allowed to develop in accordance with the estimates from the VAR models, which are conditional upon developments in economic variables in each of the two scenarios. A more detailed discussion of the estimate can be found in Box 2.

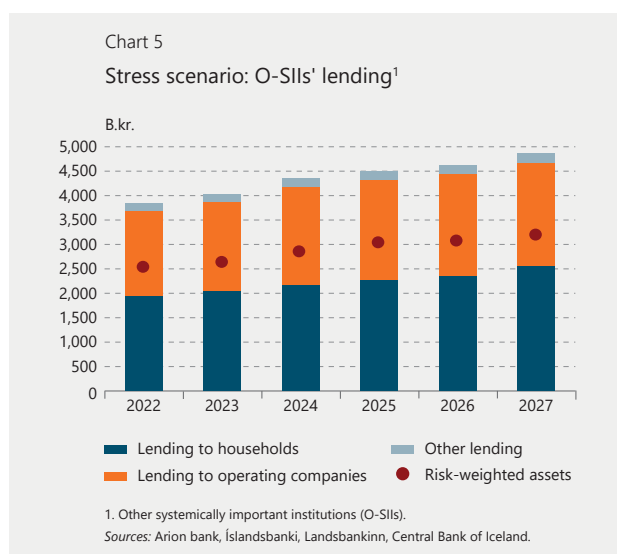


Chart 5 shows estimated developments in the O-SIIs' combined lending under the stress scenario. Lending growth averages 3.7% per year in the stress scenario, based on the results of the aforementioned model plus price and exchange rate movements, which change the nominal value of the loans on the banks' books. Corporate lending growth is modest at first but then picks up towards the end of the horizon. Household lending growth is more stable.

Lending growth has advantages and disadvantages during a shock: it has a positive effect on the banks' operations, provided that borrowers pay on time, because it increases interest income, but on the other hand, it causes the banks' risk-weighted assets to grow, thereby lowering their capital ratio. Credit growth in the stress scenario is far weaker than in the past five years, when it has averaged 8.9% per year.

Deposits grow by an average of 3.6% per year, which is enough to maintain an unchanged deposit-to-liabilities ratio of 65%. Deposits are generally

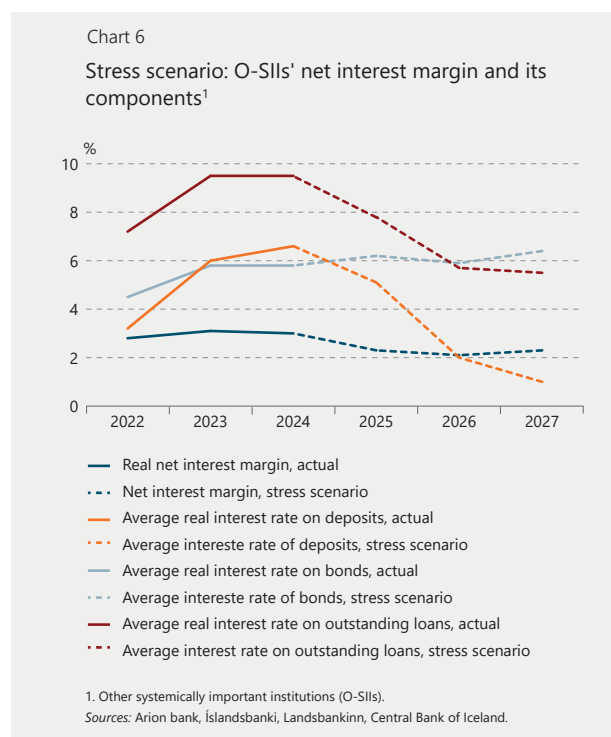
a favourable source of funding for banks, but if that funding becomes more elusive, it will negatively affect the interest rate differential on total assets.

Net interest income

In the scenario, short-term interest rates decline steadily, with the result that deposits become a less expensive source of funding for the banks. Long-term rates fall even more quickly, but not all households and businesses are equally quick to refinance their debt on better terms, so that interest income from loans does not fall as fast as long-term market rates do. Furthermore, a large share of loans are price-indexed, and indexation causes interest income to rise.

It is assumed that risk premia on bonds will be considerably higher in the stress scenario, making the banks' market funding more costly. Foreign interest rates rise as well, and some of the banks' funding is obtained abroad. Since the last stress test, the banks have extended the duration of their funding, so that higher interest rates affect average bond rates with a longer time lag.

On the whole, the banks' net interest margin narrows, from an average of 3.2% in 2024 to a low of 2.1% in year 2 of the stress scenario. After that time, they begin to widen once more. The interaction between muted lending growth and narrower interest rate spreads causes net interest income to shrink from 155 b.kr. to 128 b.kr., or 17.6%, in year 1 of the scenario.



6. The data are price- and exchange rate-adjusted.

Interest income bottoms out at 121 b.kr. in year 2 and then starts to grow again.

Loan losses

When a loan has been in arrears for 90 days or longer, or if for other reasons it is deemed unlikely that the borrower will repay it on time, the loan is moved to stage 3 according to the IFRS-9 financial reporting standard. Then impairment is expensed in an amount corresponding to the loss the bank estimates that it would sustain if the loan were settled. If the collateral securing the loan declines in value, as is assumed in the stress scenario, it can be expected that loss given default (LGD) will rise and the bank will have to recognise increased impairment as a result.

The banks also recognise impairment on loans that are performing and classified under IFRS-9 stage 1. This impairment is based on expectations of future default according to the banks' forecasting models and expectations about the value of the underlying collateral. In the stress scenario, the probability of default rises overall, and it is also assumed that collateral values decline. As a result, the banks must make entries to their impairment accounts.

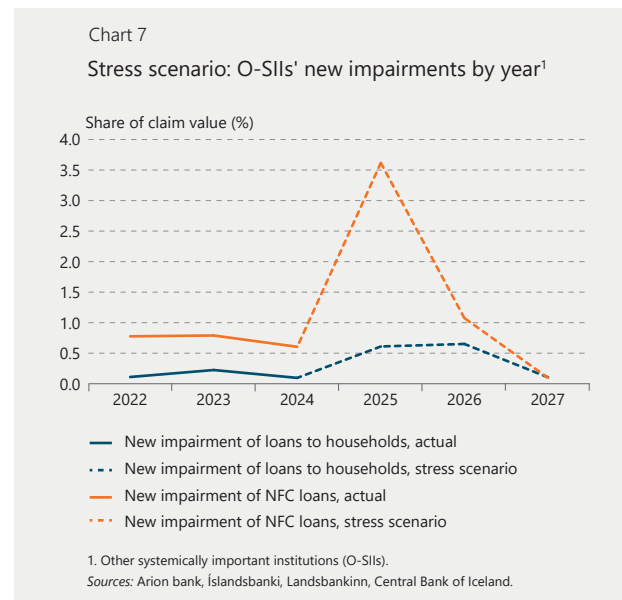
Finally, there is special impairment for loans that are performing but have deteriorated creditworthiness; i.e., loans in IFRS-9 stage 2. In this case, the banks enter increased impairment, but they are required to assess the probability of default based on the entire duration of the loan, not just the following year, as is the case with stage 1 loans. In shocks comparable to those described in the scenario, it can be assumed that more individuals' and companies' creditworthiness will deteriorate and that more loans will be moved from stage 1 to stage 2, requiring increased impairment.

The loan losses that materialise in the stress scenario are therefore multifaceted, but the objective is to ensure that impairment entries are made promptly and that they equal the losses that materialise later.

Two assumptions are given that simplify the estimation of developments in loan losses: first of all, that a loan transferred at some point to stage 3 will not be transferred back to stage 1 or 2, and second, that no loans will be written off. In the stress scenario, impairment is equivalent to loan losses.

Arrears are most pronounced among companies in construction and tourism in the scenario. Impairment of loans to individuals is considerably less because the loan portfolios consist largely of residential mortgages, which have substantial collateral value.

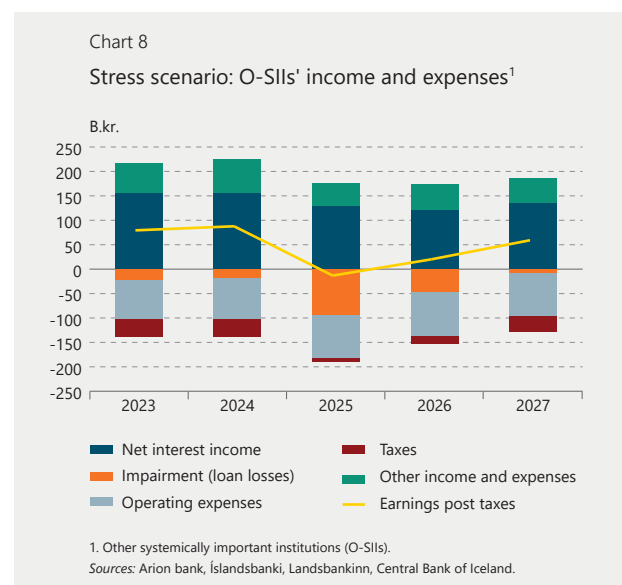
In the first year of the stress test, the three banks' combined loan losses total 93 b.kr.: loans to companies account for 74 b.kr. (3.6% of the claim value of corporate loans), loans to individuals 14 b.kr. (0.6% of claim value) and others 5 b.kr. Losses continue in year 2 of the scenario, bringing the two-year total to 145 b.kr., or 3.3% of the claim value of the portfolio as it stood at the beginning of the scenario.



Operations

In addition to interest income and loan losses, the banks' operating performance depends, among other things, on operating expenses, net commissions and fees, and net income from financial activities.

Operating expenses rise marginally in the stress scenario, as inflation is low and wage growth limited.



Year-2024 operating expenses came to 83 b.kr. for the three banks combined. According to the stress scenario, they total 87 b.kr. in year 1, 88 b.kr. in year 2, and 89 b.kr. in year 3. The Central Bank's estimate of operating expenses assumes that cost-cutting measures will not be tightened beyond the current level.

Net income from fees and commissions rises slightly because of inflation and increased activity, while net income from financial activities turns from positive to negative. The latter totalled 16 b.kr. in 2024, due to changes in the fair value of equities and bonds. It was a favourable year for securities owners, with share prices rising and many bond yields falling, thereby pushing bond prices upwards. Share prices plunge 35.6% in the first year of the stress scenario, while Treasury bond yields fall, causing prices to rise. As a result, net income from financial activities is negative by 20 b.kr. overall in the first year of the stress scenario but then turns positive with a marginal rise in asset prices.

As long as the banks generate operating losses, they pay no income tax, but in year 1 of the stress scenario the special tax on financial institutions amounts to 10 b.kr. for the three banks combined. The banks' after-tax losses come to 13 b.kr. in year 1, followed by operating profits of 20 b.kr. in year 2 and 59 b.kr. in year 3. This is far less than their profits in recent years, as the scenario assumes much lower interest rates.

Capital

CET1 capital grows or shrinks in tandem with profits or losses, as the stress test assumes that no dividends will be paid beyond those approved at 2025 annual general meetings and paid out in H1/2025. CET1 capital totalled 676 b.kr. at the beginning of the scenario. It falls to 662 b.kr. in year 1 and then increases again as operating results turn positive. The capital base consists of CET1, plus additional Tier 1 capital (AT1) and Tier 2 (T2) capital. Many of the financial instruments issued by the banks and classified as AT1 and T2 capital are inflation-indexed or denominated in foreign currencies, so that their nominal value in Icelandic krónur increases when inflation rises or the exchange rate falls. This offsets the decline in CET1 capital in the capital base. Because inflation is relatively low in the stress scenario and the depreciation of the króna is modest, the capital base shrinks slightly less than CET1 capital, or from 791 b.kr. to 781 b.kr., and then starts growing again when the operating performance turns positive.

Risk-weighted assets

The numerator in the capital ratio – the risk base – is composed of risk-weighted assets (primarily loans) but also includes calculated amounts based on market risk and operating risk.

Risk-weighted loans are calculated as the mathematical product of the loans' book value and their risk weights. Because the banks use the standardised approach, the risk weights are relatively high compared with those of large foreign banks that use the internal ratings-based (IRB) approach. On the other hand, risk weights under the standardised approach generally do not rise as much during crises as those used under the IRB approach.

In the stress test, average risk weights on corporate loans rise marginally because of increased arrears and a deterioration in companies' creditworthiness. The average risk weight on residential mortgages rises marginally because of an increase in the share of loans with an LTV ratio over 80%, which are assigned higher risk weights. The risk base due to operational and market risk declines slightly because of reduced operating revenues and a loss on financial assets.

When all of these effects are considered together, the risk base grows from 3,430 b.kr. to 3,603 b.kr., or 5.1%, in year 1 of the stress scenario. In comparison, the risk base grew by 8.1% between 2023 and 2024, when total assets increased far more because of inflation and lending growth. In the latter years of the stress scenario, the total risk base grows by an average of 2.1% per year.

Capital ratio and capital requirements

In this stress test, two capital ratios are examined: the ratio of the capital base to the risk base, which was required to be at least 19.9% for the three banks on average as of late 2024, and the ratio of CET1 capital to the risk base, which was subject to a minimum of 15.5%.

At the beginning of the scenario, the banks' average capital ratio was 3.2 percentage points above the requirement. It falls during the stress scenario by an average of 1.4 percentage points in year 1, to an average of 1.8 percentage points above the requirement. All three banks satisfied the requirement. The bank that was closest to it was 0.3 percentage points above the requirement and the one farthest from it was 2.7

percentage points above it. Thereafter, the ratios grow stronger, and by the end of year 3 the banks' capital ratios are an average of 3.1 percentage points above the requirement.

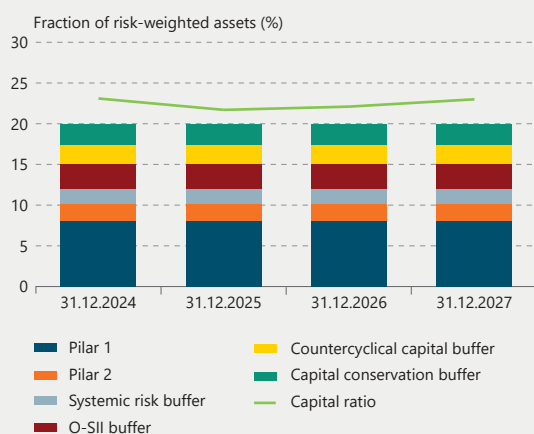
At the beginning of the scenario, the ratio of CET1 capital to the risk base was an average of 4.2 percentage points above the requirement. These ratios fall by an average of 1.3 percentage points in year 1, to an average of 2.9 percentage points above the requirement. All of the banks' capital ratios exceed the requirement at that time. The bank that was closest to it was 1.5 percentage points above the requirement and the one farthest from it was 4.5 percentage points above it. Thereafter, the ratios grow stronger, and by

the end of year 3 the banks' capital ratios are an average of 4.2 percentage points above the requirement.

The banks all have benchmarks for management buffers, which are precautionary buffers of capital that they maintain over and above requirements. The scenario analysis reveals that if the overall requirement is unchanged, the capital ratio would in one instance fall below the management buffer at the end of year 1. It can be considered likely that the banks would activate their emergency plans and take mitigating action. Because all of the banks are above the overall requirement in all years of the scenario, it is likely that they would take moderate measures that could entail, for instance, increased monitoring of loan portfolios, a halt on dividend payments, some limitations on new lending, and issuance of capital instruments.

Chart 9

Stress scenario: O-SIIs' capital ratio and requirements¹

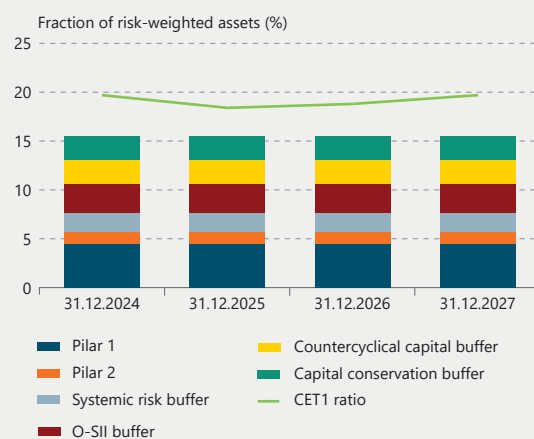


1. Other systemically important institutions (O-SIIs).

Sources: Arion bank, Islandsbanki, Landsbankinn, Central Bank of Iceland.

Chart 10

Stress scenario: O-SIIs' CET1 ratio and requirements¹

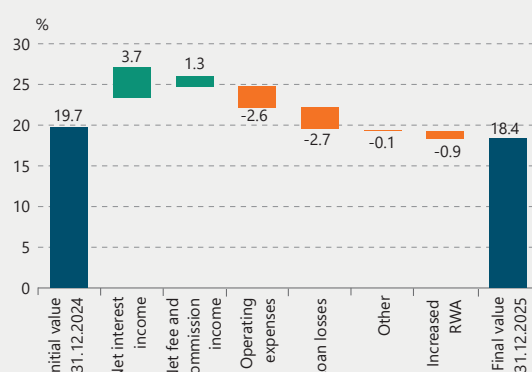


1. Other systemically important institutions (O-SIIs).

Sources: Arion bank, Islandsbanki, Landsbankinn, Central Bank of Iceland.

Chart 11

Disaggregated development of O-SIIs' CET1 ratio¹



1. Other systemically important institutions (O-SIIs).

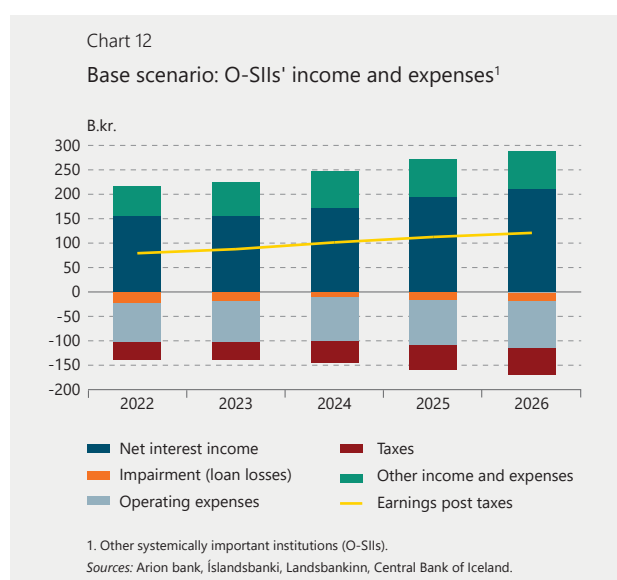
Sources: Arion bank, Islandsbanki, Landsbankinn, Central Bank of Iceland.

Chart 11 shows a breakdown of developments in the CET1 ratio from year-end 2024 to the trough late in year 1 of the scenario. The first three items (net interest income, net commission and fee income, and operating expenses) have the most impact on the banks' core operations and, in combination, result in a higher CET1 ratio. Loan losses reduce the ratio by 2.7 percentage points, and the expansion of the risk base, which is due to credit growth and marginally higher risk weights, lowers it by an additional 0.9 percentage points. The credit growth that materialises is based not only on supply but also on demand for credit. If it does not materialise or does so only to a limited degree – due to weak demand, for instance – the CET1 ratio can be expected to fall less.

Comparison with the baseline scenario

Under the baseline scenario, net interest income should continue to grow and loan losses should remain limited. According to that scenario, the O-SIIs' combined year-2025 profits could be expected to total 101 b.kr. The calculated loss under the stress scenario therefore causes a reversal in the amount of 115 b.kr. For all three years combined, the reversal totals 269 b.kr.

The O-SIIs' strong profitability under the baseline scenario gives them the latitude to choose between increased dividend payments and increased growth. The banks plan to change the composition of their capital by issuing subordinated debt to offset special dividend payments. As a result, their CET1 ratio can be expected to fall even more than is assumed in the stress scenario in the next few years, while their capital ratio will be broadly unchanged.



Conclusions

The results of the stress test show that Iceland's systemically important banks are highly resilient and can support the economy even in the event of shocks to the economy. Their strong capital position and core operations give them scope to maintain lending growth even in the face of an economic contraction, a drop in asset prices, and significant arrears, thereby enabling them to support the economy during a downturn.

It should be noted that no management measures are assumed in the stress test. However, the O-SIIs would doubtless take a range of actions to support lenders – for instance, by amending loan terms and conditions – and would protect shareholders' interests

if a shock like that envisioned in the stress scenario should materialise. These measures would probably prevent arrears in some cases and would mitigate the impact of the shock on the banks' balance sheets.

The high and stable risk weights applied by the O-SIIs under the standardised approach result in substantial CET1 capital. This is one reason why the ratio of CET1 to the risk base falls by only 1.3 percentage points from the starting value to the trough in the adverse scenario. In comparison, this ratio falls by an average of 3.7 percentage points in the EBA's stress test of European banks, which was based on an adverse scenario of similar severity. Participants in the EBA test generally use far lower and more risk-sensitive risk weights than the Icelandic banks do, and their ratio of CET1 capital to total assets is therefore lower.⁷

Furthermore, there are various other factors distinguishing the European banks from those in Iceland; for instance, the former are exposed to greater risk in asset markets. The European banks' losses on financial assets, totalling 183 billion euros, emerged in full in year 1 of the EBA scenario, making those losses the second-largest risk factor after loan losses, which totalled 394 billion euros for all years of the scenario. The Icelandic banks' losses on financial assets totalled 20 b.kr. in year 1 of the Central Bank scenario, whereas the largest risk factor, loan losses, totalled 145 b.kr. over the entire three-year scenario. Thus the Icelandic banks' losses on financial assets are far smaller in proportional terms. These results support the conclusion that the Icelandic banks' business models rely more on conventional lending activity than those of the large European banks. Further discussion of the differences between EBA and Central Bank of Iceland stress tests can be found in Box 1.

The capital requirements in the stress test are assumed to be unchanged at end-2024 levels. In the stress test, a shock to the real economy coincides with a financial shock characterised by steep declines in asset prices and losses in the banking system. In such a scenario, it would be possible to respond by easing the CCyB. The results of the stress test indicate that if such action is deemed necessary to maintain the banks' willingness to lend, a 1.5 percentage point reduction in the buffer would suffice to cover the decline in capital ratios.

7. The EBA stress test is based on full adaptation to the amended CRR in the assessment of the risk base, while the Central Bank's test is based on the pre-amendment version of the CRR, as the new version has not yet taken effect in Iceland.

Icelandic banks and the 2025 EBA stress test

The scenario in the Central Bank of Iceland's 2025 stress test is similar to that used by the European Banking Authority (EBA) as regards economic developments. Both tests assume elevated geopolitical stress stemming from war, widespread tariffs and their potential long-term impact. It is interesting to examine the assumptions and methodologies used to evaluate the status of Europe's banks in the EBA stress test and compare them to those used by the Central Bank, as Icelandic banks do not participate in the European stress test.

Differing stress tests

The Central Bank of Iceland conducts stress tests annually, and in processing the results it uses data from the systemically important banks, based on the Central Bank's assumptions about developments in macroeconomic variables, adjusted for their impact on the Bank's macroeconomic model. The stress test results shed light on the Icelandic banks' resilience and are part of the Central Bank's assessment of their capital requirement, including Pillar 2-G and capital buffers. The EBA conducts stress tests every other year. The results of this year's EBA stress test were published on 1 August 2025.¹ Icelandic banks do not participate in the EBA stress test due to proportionality. This year the EBA tested banks' resilience and risk tolerance, including an assessment with respect to recent amendments to the Capital Requirements Regulation (CRR).² The assessment provides insight into whether the banks have enough capital to withstand shocks and continue intermediating credit to businesses and households during a period of stress, thereby preserving financial stability. The results of the EBA stress test provide transparency in the market, as the outcome for each individual bank is published, as is the impact of a potential shock on each bank's position.

The European Systemic Risk Board (ESRB) designs the baseline and adverse scenarios for the test in cooperation with supervisory bodies, central banks, and financial supervisors in Europe. The baseline scenario is based on each national bank's year-end 2024 macroeconomic forecast, while the adverse scenario is designed by an ESRB working group. The adverse scenario reflects a combined macro-financial shock featuring a steep contraction in the

economy and escalating global trade tensions, including a rise in protectionist tariffs and a surge in energy and commodity prices. The assumptions in the adverse scenario are adapted to each country and therefore vary as regards factors such as asset prices and macroeconomic variables. This adaptation depends on the position of the economy in each country, including differences in the weight of external trade, the characteristics of the labour market, imbalances in the real estate market, and the impact of previous shocks on the country concerned. National financial supervisors are responsible for applying the joint assumptions in the test vis-à-vis all of the banks participating in the test, and for ensuring that the assumptions are communicated in the test results. Using a common methodology for assessing the impact of the shock on each country and placing restrictions on the banks' responses generates a result that can be used to compare the banks' position under the hypothetical conditions affecting the entire European market under the stress scenario.

This year the test included 64 banking conglomerates that collectively hold over 75% of European banking system assets. The methodology for the EBA's 2025 stress test was modified to capture the impact of amendments to the CRR, which took effect in Europe on 1 January 2025. The modifications entail new minimum criteria for the assessment of credit, operational, and market risks, irrespective of whether the banks use the standardised or internal ratings-based (IRB) approach to calculate their capital requirement. Furthermore, the test takes account of the decision to postpone the application of the fundamental review of the trading book (FRTB).³ The methodology also incorporates lessons learned from the last stress test. It now assumes harmonised expected developments in interest income, and it places upper and lower limits on profits from market transactions and income from commissions and fees. These modifications are part of the adaptation of stress test execution to the amended CRR. Information on balance sheets and profit and loss accounts as of end-2024 is provided in accordance with the new and previous versions of the CRR. For the sake of consistency with previous tests, cap-

1. [Results of the EBA's 2025 stress test.](#)

2. Further information can be found on the [EBA website](#) and the [Central Bank of Iceland website](#).

3. Some European banks use the IRB rather than the standardised approach when using models to calculate their capital requirement from their risk base. Further information can be found on the [EBA website](#). Icelandic banks use the standardised approach for such calculations.

ital requirements are also published based on the criteria in the previous stress test, as European banks have eight years to phase in the CRR amendments. The impact of the amendments is greatest for banks that assess their risk base using the IRB approach. These banks need to adapt the calculation of their risk base to the criteria in the standardised approach, which increases in stages over the eight-year transition period ending in 2033. The minimum criterion will equal 72.5% of the risk base according to the standardised approach in 2033. This adjustment in calculation therefore increases the risk base, therefore lowering the capital ratio of banks that use the IRB approach.⁴ All of Iceland's banks use the standardised approach.

In conducting their respective stress tests, the EBA and the Central Bank of Iceland gather data from each bank on the impact of a shock. Predefined assumptions concerning developments in specific variables – such as interest rates – or restrictions on how the shock could affect a bank within specified criteria could affect the results. The EBA stress test assumes balance sheet stability – i.e., it assumes that banks can change neither the size nor the composition of their balance sheets over the period, nor may they take management action in response to the shock described in the stress scenario. The Central Bank's stress test is similar, in that it does not assume changes in balance sheet composition, nor does it assume any management measures; however, it does assume credit growth and provides for price and exchange rate movements. Such premises are laid down so as to enhance realism and comparability. The results of the Central Bank stress test are published collectively, for the banking market as a whole, whereas the EBA publishes results for individual banks.

EBA stress test 2025 — scenario

The adverse scenario in the EBA's 2025 stress test assumes heightened geopolitical polarisation and international tension. It assumes both armed conflict and shocks relating to a tariff-driven downturn in world trade, plus the impact on supply of and demand for goods. This leads to a recession in the European and global economies. Asset prices fall steeply and GDP contracts sharply during the stress test horizon. Unlike the last EBA stress test, which examined the long-term impact of high inflation, the scenario in this test provides for lower and less persistent inflation. The focus of the stress test reflects the enormous uncertainty currently prevailing in global affairs and the potential economic repercussions for European countries.

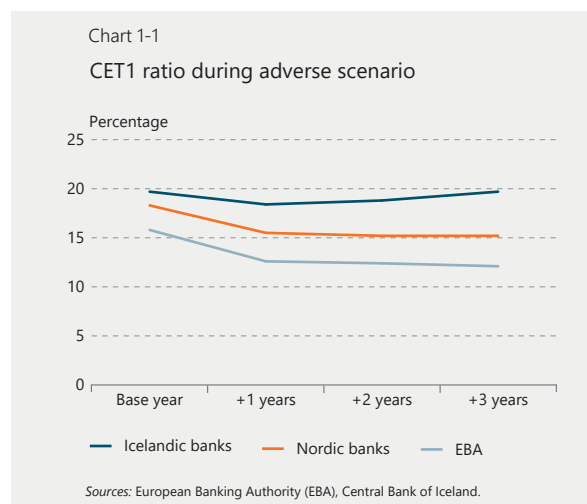
4. Further information can be found on page 19 of the [EU-wide stress test results](#).

The key changes in macroeconomic variables for European countries as a whole are a 6.3% cumulative real contraction in GDP in 2025-2027 and a rise in unemployment by 5.8% over the same period. The shock is more severe than that accompanying the 2008 financial crisis and those occurring more recently. Inflation rises over and above the baseline scenario by 2.6 percentage points in 2025 and 1.5 percentage points in 2026 but falls short of the baseline by 0.2 percentage points in 2027. Long-term eurozone interest rates are as much as 1.5 percentage points above the baseline scenario by the middle of the horizon.

The main difference in the results of the stress tests carried out by the EBA and the Central Bank lie in how differently macroeconomic variables affect the outcome, even though the underlying shocks are the same in both cases.⁵ For example, the cumulative contraction in GDP measures 3.7% in Iceland but 6.3% in the EU. Unemployment averages 11.6% over the stress test horizon in Europe but 7.7% in Iceland. Over the entire horizon, house prices fall by 15.7% in Europe but by 20% in Iceland, and commercial property prices drop 30% in Europe, as opposed to 25% in Iceland. The EBA stress test takes into account the effects of the amended CRR on risk base calculation, whereas the Central Bank's stress test does not, as the amendments have not yet been implemented in Iceland.

Conclusions

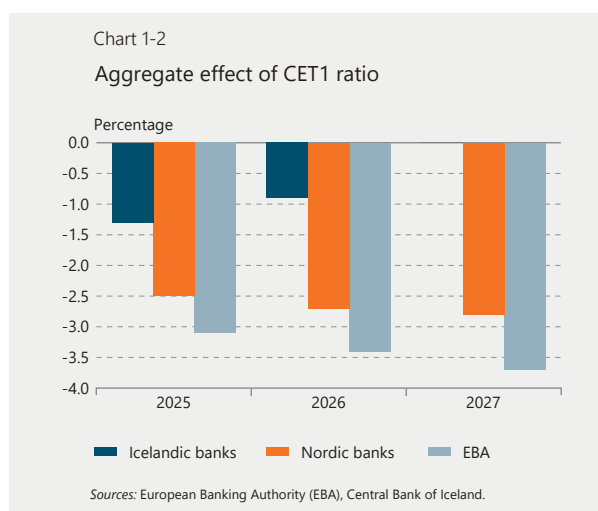
The EBA stress test results show that Europe's largest banks are well able to withstand a severe shock entailing a steep contraction, elevated geopolitical fragmentation, and tariff-related tensions. The CET1 ratio of banks participating in the EBA test decline by 3.7 percentage points over the



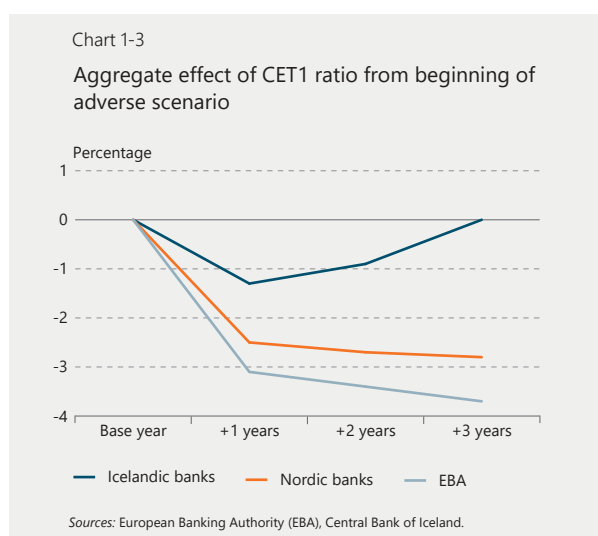
5. The macroeconomic variables in the Central Bank of Iceland's stress test can be found [here](#).

stress test horizon. After measuring 15.8% at the end of 2024, the ratio falls to 12.1% by the end of the horizon in 2027, as can be seen in chart 1-1.

Comparing the results for Nordic banks participating in the EBA test against the overall test results shows that the Nordic banks develop broadly as their European counterparts do, but the cumulative effect of the fall in the CET1 ratio over the stress test horizon is less pronounced for the Nordic banks, as can be seen in chart 1-2.



Comparing the Central Bank of Iceland's test results against the EBA results suggests that the Icelandic banks' CET1 are less sensitive to a shock comparable to that used in the EBA stress test. Furthermore, the Icelandic banks' ratios recover quickly and return to their previous level, while those of the European and Nordic banks do not.



At the beginning of the EBA test, the European banks' profits are stronger and their capital position more robust than in recent years. The impact of the stress scenario varies

by sector, owing to rising energy and commodity prices, as well as higher trade tariffs. Because of the European banks' solid income base, other risk factors in the stress test have less effect. Net interest income shrinks because of higher interest rates and higher risk premia on instruments issued to refinance the banks' bonds, but a large share of the loan portfolio is refinanced during the period, which offsets the decline as the horizon advances. Other income, such as commissions and fees, develops favourably, increasing over the horizon. The banks' strong income base at the beginning of the stress scenario therefore shores up their resilience. Furthermore, operational efficiency in the European banks' operations over the past several years leads to a decline in their cost-to-income ratios.

The EBA stress test breaks down the impact of the shock by sector so as to determine where the strongest effects emerge for the various banks, as their loan portfolios differ as much as the banks themselves do. As a result, the banks are affected to differing degrees by the shocks in the stress test, which makes the exercise more realistic than it would be otherwise. Loan losses vary by sector, as the effects of changes in tariffs hit some industries harder than others. The tariffs are particularly harmful to sectors that rely heavily on global supply chains; i.e., retail trade, manufacturing, and agriculture. Half of the loan losses come from real estate firms, however. Loans to the real estate sector comprise 19.5% of corporate lending and cause 15.5% impairment in corporate loans under the stress scenario. The risk base increases by 9.6% over the horizon of the test, mainly because of elevated credit risk due to the methodology changes resulting from amendments to the CRR.

European banks have a 12% CET1 ratio at the end of the stress scenario, which is an improvement relative to previous stress tests.⁶ The Central Bank stress test results show that Icelandic banks are quite resilient based on assumptions comparable to those used in the EBA stress test, and their CET1 ratio is 19.7% at both the beginning and the end of the Bank's stress scenario. In terms of their leverage ratio, the Icelandic banks have considerably more capital. Loan losses automatically have less impact on capital ratios for banks like those in Iceland, which calculate their risk base using risk weights according to the standardised approach rather than the IRB approach.⁷ For the European banks participating in the EBA stress test,

6. The results of the EBA stress test can be found [here](#).

7. The European banks' leverage ratio was 5.75% at the beginning of the shock and falls to 4.92% by the end. The Icelandic banks' ratio is higher at the outset, or 12.6%, and falls to 12.0% by the end.

deviation in CET1 capital totals 3.7 percentage points for the entire period, and if the leverage used by the European and Nordic banks in the EBA test is applied to the Icelandic banks, the cumulative deviation is 1.5 percentage points.⁸

Icelandic banks appear to have a solid income base and high-quality assets. As a result, they appear well equipped to withstand a shock comparable to that suffered by the European banks in the EBA stress test.

8. The EBA stress test is based on full adaptation to the amended CRR in the assessment of the risk base, while the Central Bank's test is based on the pre-amendment version of the CRR, as the new version has not yet taken effect in Iceland.

Credit growth and feedback loops

Introduction

When the Central Bank of Iceland conducts its stress test, growth in lending and deposits is estimated using a special statistical model. The results obtained with the model are conditional upon the economic variables included in the stress test scenarios, so that spirals between the banks' responses and the real economy should not occur if it is assumed that deposits and lending develop in accordance with the model.

One important exception is made in carrying out the stress test, as a floor of 0% is set for real credit growth; i.e., real growth in lending cannot be negative in the scenario. There are two main reasons for this. First of all, there is a decline in risk-weighted assets (i.e., the risk base) when the banks cut back on lending or sell loan portfolios, as the risk base is the numerator in the formula for calculating the capital ratio. The purpose of the stress test is to determine whether the banks are resilient enough to withstand shocks. The capital ratio is a key measure of that resilience. Increasing the capital ratio by reducing the risk base is therefore classified among management actions, which are not permitted during the execution of the stress test. This is done to avoid underestimating the impact of the stress test. Second, a structural change taking place during the 2008 financial crisis caused a six- to seven-year contraction in lending; therefore, the data on which the model is based probably do not accurately reflect the short-term relationship between lending and other macroeconomic variables.

This Box begins with a brief description of the model for growth in deposits and lending. It then uses an impulse response analysis to explore the implications of deviating from the model's forecasted values, and it closes with a discussion of what the analysis can tell us about spirals between the banks' responses and the real economy in the shock entailed in this year's stress test.

Assessment of developments in deposits and lending

The statistical model is a vector autoregression (VAR) model based on quarterly data from 2004 through 2024. It is estimated using Bayesian methodology, as it contains a relatively large number of variables but few observations. The variables in the model are key macroeconomic variables in the stress test scenarios, including GDP, exports,

and unemployment, as well as households' and businesses deposits and loans in the banking system and the banking system's aggregate capital.¹

The model is intended to reflect developments in deposits and lending, which are determined by interactions between supply and demand in the relevant domestic markets. If an economic downturn causes private sector demand for credit to weaken, lending could contract even if the banks are willing to issue loans. Conversely, if such a downturn causes the credit supply to shrink, lending could contract even if private sector borrowers seek out loans. If both supply and demand weaken, lending can contract sharply.

Assessment of spirals between the banks and the real economy

In the baseline scenario of this year's stress test, the conditional forecast obtained from the model suggests that both household and corporate credit growth will be positive in all years of the horizon. In the adverse scenario, the forecast from the model indicates that household lending will grow in all years but that corporate lending will contract. The floor for corporate credit growth is binding for all years. The impact of the floor varies from year to year. The forecasted value for year 1 is -1% real growth in lending, while in years 2 and 3 it is -4%. The credit growth on which the stress test results are based is therefore 4 percentage points above the level indicated by the model in the latter two years of the scenario. It can therefore be expected that the impact of manipulating the lending variable in this way comes largely to the fore in years 2 and 3 of the stress scenario.

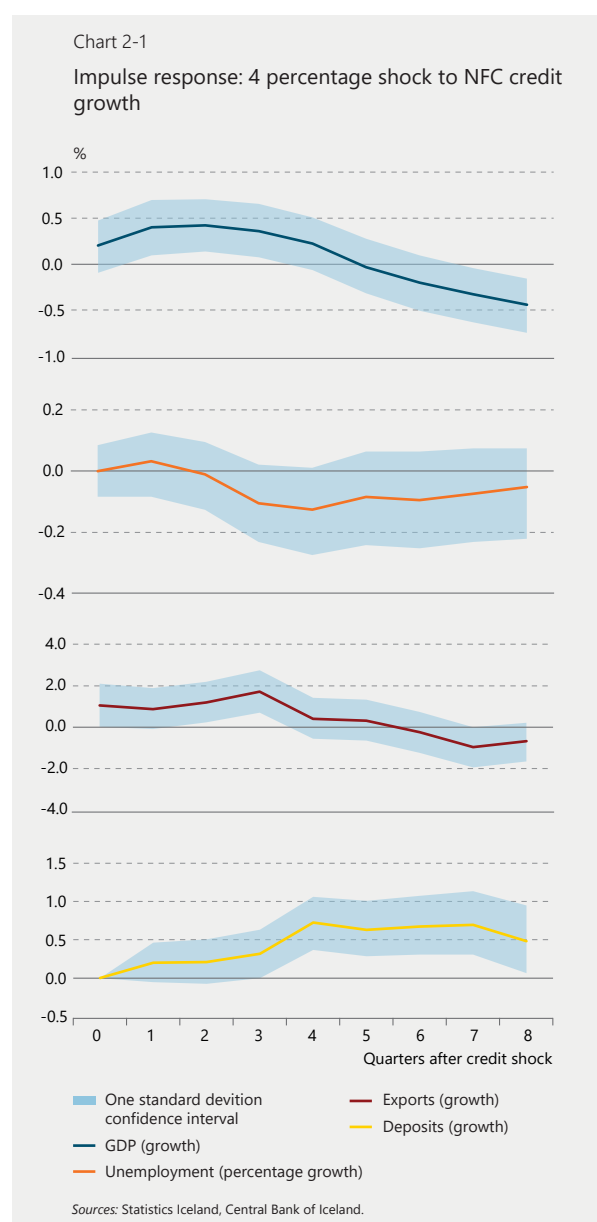
In order to determine the scope of the impact on the economy, the VAR model's impulse response functions are assessed vis-à-vis an unexpected change in corporate lending. It is assumed that there will be a 4 percentage point spike in lending growth, in line with the intervention in the model's forecast in years 2 and 3.

Chart 2-1 shows the estimated response of four variables that give a general view of the economy during this lending shock. The result is that an unexpected 4 percentage point jump in lending growth has a positive impact on GDP, and that after one to three quarters the effect is statistically significant, measuring 0.4 percentage points.

1. The economic variables are expressed at real value, and data on loans and deposits are price- and exchange rate-adjusted.

There is no immediate impact on unemployment, but three quarters after the jump in lending, unemployment is 0.1 percentage points lower than it would have been otherwise, although this is not statistically significant. Exports increase as well after the lending shock, and the impact is greatest after three quarters, when exports are 2 percentage points stronger than they would have been otherwise.

The impact on deposits is examined as well. It can be expected that, all else being equal, increased lending to companies will result in stronger deposit growth. According to the impulse response function, a 4 percentage point increase in corporate lending leads to a 0.2 percentage point increase in deposits one quarter later. This increase grows to 0.8 percentage points just over a year after the shock.



The analysis shows that the short-term impact of a credit shock is positive overall for the economy, which is consistent with economic intuition. The impact is relatively mild, however, and does not suggest that it will have a significant effect on the stress test results. The confidence intervals shown in Chart 2-1 indicate that statistical significance is weak in many instances. The model is relatively simple, and lending is only one of many factors that could affect developments in other variables. The effects of the response analysis are therefore expected to be moderate. Further development of the model will primarily entail adaptations to structural changes in historical data on credit growth and use of side constraints for contemporaneous relationships between variables.

When does negative spiral formation occur?

The analysis suggests that the premise of the stress test – to interpret a contraction in lending as a management measure and to prohibit such responses within the scenarios – causes the shock itself, as manifested in developments in macroeconomic variables, to be slightly milder than it would be otherwise. On the other hand, if the banks do reduce lending beyond the 4% contraction, the mathematical signs are reversed, and the shock becomes more severe than it would otherwise have been.

The results highlight how harmful fear-driven responses to shocks can be, not only to overall economic interests but also to the interests of the banks themselves. By suddenly cutting back on lending and making a concerted effort to minimise all risk, the banks could exacerbate economic shocks and make the situation worse. In the end, this will be detrimental to the quality and liquidity value of their own asset portfolios.

In this year's stress test, the banks' capital ratios are all above the overall capital requirement and the maximum distributable amount (MDA). Furthermore, the banks have various ways to strengthen their balance sheets, including working with lenders by amending loan terms and conditions, streamlining funding, and so forth. The banks' experience of adopting these measures during the pandemic was positive; therefore, in a shock like that in the stress test, they are likely to take such measures again rather than cutting lending severely or selling loan portfolios. The banks' strong capital position and high-quality assets therefore prevent negative spiral formation between their responses and the real economy in this year's stress test.

Appendix

Definitions

Additional Tier 1 capital (AT1):

Only capital instruments with an unlimited duration are eligible for designation as additional Tier 1 capital.

Bill:

A debt instrument with a short maturity, generally less than one year.

Bond:

A written instrument acknowledging the issuer's unilateral and unconditional obligation to remit a specified monetary payment.

Book value of a loan:

The nominal value or outstanding balance of a loan once haircuts or loan loss provisions have been deducted.

Calculated return on equity:

The profit for a given period as a percentage of average equity over the same period.

Capital base:

The sum of two tiers of capital, Tier 1 which consists of common equity Tier 1 capital additional Tier 1 capital as well as Tier 2 capital after adjusting for deductions according to the CRR; cf. the Act on Financial Undertakings, no. 161/2002. Deductions include the current year's losses; approved dividend allocations and, if applicable, foreseeable dividend allocations; goodwill and other intangible assets; calculated tax credits; the book value of own shares held by the financial undertaking in question; and other items.

Capital buffers:

Additional capital requirements that financial undertakings must satisfy in accordance with the Act on Financial Undertakings, no. 161/2002. The countercyclical capital buffer, the buffer for domestic systemically important banks (D-SIB buffer), and the systemic risk buffer are determined through Central Bank rules upon prior approval by the Financial Stability Committee. The capital conservation buffer applies to certain financial undertakings according to Act no. 161/2002.

Capital ratio:

The ratio of the capital base to risk-weighted assets (risk base).

Cash:

Physical currency; i.e., banknotes and coin issued by a central bank.

Claim value of a loan:

The nominal value or outstanding balance of a loan.

Commercial bank:

A credit institution that has been granted a licence to operate as a commercial bank according to the Act on Financial Undertakings, no. 161/2002.

Common Equity Tier 1 (CET1):

Common Equity Tier 1 capital consists primarily of paid-in share capital or initial capital, stock or initial capital surpluses, retained earnings, and reserve funds.

Credit institution:

A financial undertaking (commercial bank, savings bank, or credit undertaking) that accepts deposits or other repayable funds from the public and grants loans on its own account.

Cross-default non-performing loans:

This refers to non-performing loans according to the cross-default method, according to which all of a borrower's loans are considered non-performing if one loan is frozen or in arrears by 90 days or more, or if the borrower is deemed unlikely to pay their obligations when due.

Current account balance:

The sum of the goods, services, and income account balances.

Deposit institution:

A financial undertaking (commercial bank or savings bank) authorised to accept deposits.

Disposable income:

Expected permanent income net of direct taxes and levies in accordance with the Act on Mortgage Lending to Consumers, no. 118/2016.

Domestic systemically important banks (D-SIB):

Banks that, due to their size or the nature of their activities, could have a significant impact on the stability of the financial system and the general economy, in the opinion

of the Central Bank of Iceland Financial Stability Committee. Currently, Arion Bank hf., Íslandsbanki hf., and Landsbankinn hf. are classified as D-SIBs in Iceland.

European Supervisory Bodies:

European Banking Authority (EBA), European Insurance and Occupational Pensions Authority (EIOPA), European Securities and Markets Authority (ESMA), and European Systemic Risk Board (ESRB); cf. the Act on the European System of Financial Supervision, no. 24/2017.

Equity:

Assets net of liabilities.

Facility-level non-performing loans:

According to the facility-level non-performing loan ratio, a customer's loan is classified as non-performing if it is in arrears by 90 days or more.

Financial system:

Deposit institutions; miscellaneous credit undertakings (including the ÍL Fund); investment firms; pension funds; insurance companies; mutual, investment, and institutional investment funds; alternative investment funds; and State credit funds.

Financial technology (fintech):

Any type of innovation in financial services that is based on technology and can give rise to new business models, software, processes, or products in the area of payment services, and could affect the financial market, financial services, and the way in which financial services are provided.

Foreign exchange balance:

The Central Bank of Iceland has set the Rules on Foreign Exchange Balance, no. 784/2018. According to the rules, neither the overall foreign exchange balance nor the open position in individual currencies may be positive or negative by more than 10% of a systemically important bank's capital base. For other credit institution, the ratio is set at 15% of the capital base.

Foreign exchange imbalance:

A foreign exchange imbalance (or mismatch) is the difference between assets and liabilities in foreign currencies.

Funding rules:

Funding rules according to the CRR (cf. the Act on Financial Undertakings, no. 161/2002) stipulate that credit institutions shall maintain a minimum net stable funding ratio (NSFR)

of 100% in all currencies combined. The rules are based on international criteria developed by the BCBS. The rules on funding ratios are intended to restrict the degree to which the credit institutions can rely on unstable short-term funding to finance long-term foreign-denominated lending.

Holding company:

A company whose sole objective is to acquire stakes in other companies, administer them, and pay dividends from them without participating directly or indirectly, albeit with reservations concerning their rights as shareholders.

Indexation imbalance:

An indexation imbalance or mismatch is the difference between indexed assets and indexed liabilities.

Interest burden:

Interest payments as a percentage of disposable income.

Interest premium:

A premium on a base interest rate such as the interbank rate.

International reserves:

Foreign assets that are managed by monetary authorities and considered accessible if necessary.

Key interest rate (policy rate):

The interest rate that is used by the Central Bank in its transactions with credit institutions and is the most important determinant of developments in short-term market interest rates. The rate that has the strongest effect on short-term market rates and is therefore considered the Central Bank's key rate may change from time to time.

Large exposure:

A financial institution's exposure to a given customer or group of related customers is considered a large exposure if it equals or exceeds 10% of the Tier 1 capital.

Leverage ratio:

The leverage ratio is calculated as the relevant institution's Tier 1 capital divided by its total exposure measure, or non-risk-weighted assets.

Liquidity ratio (liquidity coverage ratio):

The ratio of high-quality liquid assets to potential outflows over a 30-day period under stressed conditions according to the Rules on Credit Institutions' Liquidity Ratios, no. 1520/2022; cf. Commission Delegated Regulation (EU) 2015/61.

Liquidity rules:

Rules no. 1520/2022 implement Commission Delegated Regulation (EU) 2015/61 on liquidity coverage requirements for credit institutions, which is based on international criteria developed by the BCBS. Credit institutions must maintain a 100% liquidity coverage ratio (LCR) in all currencies combined and must monitor ratios in significant currencies; i.e., individual currencies in which total obligations equal or exceed 5% of the institution's total liabilities. Furthermore, credit institutions shall satisfy a minimum 50% liquidity ratio in Icelandic krónur. They must also satisfy at least 80% of their liquidity ratio in euros if euro-denominated liabilities constitute 10% or more of their total liabilities.

Loan-to-value (LTV) ratio:

A debt as a percentage of the value of the underlying asset (for instance, mortgage debt as a percentage of the value of the underlying real estate); cf. Rules no. 217/2024.

Maximum distributable amount (MDA):

Restriction on dividends, share buybacks, bonuses and other distributions if banks draw down their capital buffers.

Real exchange rate:

Relative developments in prices or unit labour costs in the home country, on the one hand, and in trading partner countries, on the other, from a specified base year and measured in the same currency. The real exchange rate is generally expressed as an index.

Risk-weighted assets:

Assets adjusted using risk weights according to the CRR; cf. the Act on Financial Undertakings, no. 161/2002.

Risk-weighted assets (risk base):

The sum of the weighted risks of financial undertakings (e.g., credit risk, market risk, operational risk, etc.), according to Regulation (EU) no. 575/2013 (the Capital Requirements Regulation, CRR); cf. the Act on Financial Undertakings, no. 161/2002.

Terms of trade:

The price of goods and services imports as a percentage of the price of goods and services exports.

Tier 2:

Tier 2 capital includes capital instruments that absorb losses when an undertaking has reached the point of non-viability (PoNV); i.e., subordinated bonds with a limited duration.

Trade-weighted exchange rate index (TWI):

The index measuring the average exchange rate in terms of average imports and exports based on the narrow trade basket.

Yield:

The annualised return that an investor requires on funds invested.

Yield curve:

A curve that plots financial market yields at set points in time.

