

Impact of 2008 financial crisis on iceland banking sector

[Finance](#), [Banks](#)



The global financial crisis, which was brewing for a while, really started to show its effects in the middle more towards the end of 2007 and into 2008. The much more adverse effects started to show through in 2008 and therefore the recession is remembered and cited with the year 2008. In 2008 the world economy faced its most perilous crisis since the great depression of The contagion, which began in 2007 when sky-high home prices in the United States finally turned decisively downward, spread quickly, first to the entire U. S. financial sector and then to financial markets overseas. (Joel Havemann 2008). Around the world stock markets started falling, large financial institutions collapsed or been bought out, and governments in even the wealthiest nations have had to come up with rescue packages to bail out their financial systems. (Anup Shah, 2003). This chaos originated when the mortgage dealers of US started putting unfavorable terms for the borrower in their contracts; which ranged from initial low interest rates to later higher rates or prepayment penalties that prohibited refinancing of the mortgage. The lenders further sold the mortgage to government institutes thus in this way having access to more finance to lend. The insurance industry than got involved in the game by trading in credit default swaps; that is in return for a fee the insurer would assume that the losses caused by mortgage holder defaults, the insurance soon turned into speculation with financial institutes paying for they did not owned. As early as 2003, Warren Buffett, the renowned American investor and CEO of Berkshire Hathaway, called them “ financial weapons of mass destruction.” About \$900 billion in credit was insured by these derivatives in 2001, but the total soared to an astounding \$62 trillion by the beginning of 2008.

Till the time the property price were soaring everything was good but the slump in prices which had begun from 2006 took a giant leap downward in 2008 the housing bubble burst, more and more mortgage holders defaulted on their loans. What ensued was a crisis in confidence: a classic case of what happens in a market economy when the players—from giant companies to individual investors—do not trust one another or the institutions that they have built.

What started as profit earning venture become a global economic disaster. It wasn't long before the upheaval took over US and then the storm blown across the whole world, recession took over money matters and the whole world froze monetarily. On the one hand many people were concerned that those responsible for the financial problems are the ones being bailed out, while on the other hand, a global financial meltdown affected the livelihoods of almost everyone in an increasingly inter-connected world. The problem could have been avoided, if ideologues supporting the current economics models weren't so vocal, influential and inconsiderate of others' viewpoints and concerns (Anup Shah, 2003).

The small country of Iceland was taken over with a huge force by this unprecedented storm of financial crisis of 2008; majorly due to the large size of the banking sector in comparison to the overall economy. The collapse of major banks jolted the currency, economy and people of Iceland. The reasons and impacts are a lesson that countries across the world use as an example. Banks that are considered a safe place to deposit and earn money as the major reason of collapse. It left a scar on the economic front of Iceland

and the irrecoverable impacts. The Icelandic Government has taken measures and is working hard to resolve the situation, both independently and in cooperation with other parties. Iceland is cooperating with its Nordic and European partners and is currently consulting with the IMF on measures toward further stabilization of the Icelandic economy.

1. 2-Title of the research

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1. 3-Introduction to research

When the resources that are available to organization are managed efficiently and to the best of its abilities then at such level the performance of organization is deemed to be up to the mark or standards. There are certain financial indicators designed by financial analysts that help in determining whether the performance of the firm is reaching the success level or not. Out of those indicators there are two prime indicators that are put forward by Hristos et al (2006) that has been primarily used in this research to evaluate the performance of the bank and its governance specifically. Return on equity (ROE) and Return on Assets (ROA) determine the first indicator while the second indicator consists of different market ratios, Tobin Q along with single share profits. It has been highlighted by Kosmidou (2006) that Net interest margin (NIM) is one of those ratios that are considered by many analysts as an important indicator to determine the financial position of the firms.

The financial crisis in Iceland came as a major collapse of the country's financial system in October 2008. It happened in the wake of a build-up of what has been described as the world's largest bubble economy, in relation to the size of the national economy. Given the enormity of these developments the consequences for level of living were expected to be very serious indeed. Iceland's crisis that set in after the spectacular collapse of the country's banking system in October 2008 was indeed a deep and difficult crisis. It came in the wake of a build-up of what has been described as the largest bubble economy in history, in relation to the size of the national economy. The financial collapse was accordingly also of historical proportions, given the size of the three main banks that were at the centre of the whole saga. The fall of the stock market index from its height was steeper and faster than the collapse on Wall Street in 1929-32 and the debt accumulation associated to the bubble was exceptionally large (Ólafsson 2011). The crisis was at the same time a banking crisis, a currency crisis (the value of the Icelandic Krona came down by about a half), an economic recession and a crisis of politics and societal trust. So it was a very serious setback for the economy and society. The government that came to power in February 2009, after protests in the streets of Reykjavik drove the previous government from power, pledged its goal of being a Nordic welfare government, which would aim to shelter the lower and middle-income groups against the worst consequences of the crisis. In a way these were big promises since the governmental finances were in ruins, with the budget deficit being almost 14% at the end of 2008. The government went into a standby program with the IMF that ended in the autumn of 2011, with most

of the goals relating to resurrection of the financial system and containment of public finances having been achieved. The IMF declared Iceland as a graduate with flying colours. Growth of 3-4% expected in 2011 and some growth for the next years, while the extent of government debt seems set to be reduced from 2013 onwards. The government had also declared that it aimed to save the welfare state against cuts as far as possible. In effect that meant less expenditure cuts for welfare issues than for other fields. That has in effect been the case. The public budget situation was mended with a mixed way of expenditure cuts and tax increases, in similar proportions, with taxes raised particularly on high income groups (Stefan Olafssen, 2011).