Iceland suspends trading in bank shares as financial crisis hits Scandinavia hard

Jordan Shilton
7 October 2008

Iceland's Financial Services Authority yesterday suspended all trading in the shares of all financial instruments issued by its major banks--Exista , Glitnir, Kaupthing, Landsbanki, Straumur-Burdaras and SPRON.

The move was made due to concerns that shares were massively overvalued and would collapse.

At a midnight press conference Sunday, Prime Minister Geir Haarde stated that the banks had collectively agreed to "sell their foreign assets and decrease their activity abroad" to facilitate a rescue plan by the government. There is talk of a merger between Kaupthing and Landsbanki and a requested loan from the European Central Bank.

After a weekend of frantic discussions between Iceland's business, political and trade union leaders Haarde also announced that the trade unions are to be asked to repatriate some of the funds in pension funds in an effort to shore up the krona. Reports indicate that the unions have also been asked to sign up to wage restraints, under conditions of 14 percent inflation.

The package came just days after the announcement that Glitnir, the country's third largest bank, was to be nationalised. The central bank (Sedlabanki) announced that it was purchasing a 75 percent stake in Glitnir for €600 million. The valuation of Glitnir at €800 million cut the value of the bank by more than half from its level at the end of the previous week.

Announcing the deal, Sedlabanki Chairman David Oddsson said, "Without this intervention Glitnir would have ceased to exist within the next few weeks. It's as simple as that."

The collapse of one of Iceland's largest banks has been a concern for a number of months. While Iceland has enjoyed an unprecedented period of economic growth since 2003, the economy has been in freefall from the beginning of this year. In the second quarter alone, Iceland's economy contracted by 3.7 percent. The Icelandic krona (ISK) has fallen by 38 percent against the US dollar this year. Following the announcement that Glitnir would be nationalised, the ISK fell almost 3 percent against the euro to its lowest level ever. With the sharp fall in the currency, it has become increasingly difficult for the Icelandic banks to fund their debts, a particular problem for Glitnir, where half of its debt of approximately €15.5 billion is due to be repaid in the coming three years.

Inflation in Iceland has been rampant and Sedlabanki has increased interest rates to 15.5 percent. In this environment, the central banks of three other Scandinavian countries--Denmark, Norway and Sweden--were compelled to make available €1.5 billion to the Icelandic government in May. This was to guard against fears that the government would have insufficient funds to back one of Iceland's major banks should it collapse. In 2007, total bank assets had grown to over 900 percent of GDP.

The effects of the nationalisation will be felt beyond Iceland. With a population of barely 310,000, the only way for banks to expand was to seek foreign markets. Glitnir joined Kaupthing and Landsbanki in expanding its operation dramatically throughout Scandinavia and in to Britain. The UK retail industry has benefited from a large amount of investment from Icelandic banks, which could now threaten some firms as they find it increasingly difficult to obtain credit. Gavin George of Ernst & Young revealed the extent to which UK firms were reliant on funds from Icelandic banks: "The tentacles of Iceland stretch far and deep along the UK high street. Icelandic banks have backed UK retailers to the tune of £2 billion (€2.53 billion)--and that is just direct investments, not funding that they have lent via a consortium."

The announcement by another Icelandic investment firm Stodir that it was filing for temporary protection from its debtors on the same day is significant in this regard.

Stodir owned a 32 percent stake in Glitnir and is controlled by Jon Asgeir Johanneson, who is also the CEO of Baugur, a company which owns a number of retail outlets in the UK. Despite Baugur's insistence that it had no exposure to the Icelandic economy and that it would continue with "business as usual," the impact on its operations could be severe.

In addition to Britain, Icelandic banks expanded heavily in Scandinavia. In Norway, the bank was forced to reassure customers that their savings would not be affected and that services would continue. The Norwegian economy is itself facing a growing number of problems resulting from the global crisis. It is believed that the oil fund, which invests some of the country's oil wealth to be spent in the future, has lost value as world markets have crashed. It was estimated that the oil fund held shares to the value of 168 million Norwegian kronor (approximately €20 million) in failed US bank Washington Mutual when it collapsed. Nordea bank also reported that the fund could have large debt obligations in Washington Mutual. At the start of 2008 it held seven different obligations totalling well in excess of $1 billion (€700 million).

While the Norwegian central bank held interest rates steady at 5.75 percent last week, the rate for inter-bank lending has continued to rise well above that figure. In response, Norges Bank has entered into a currency exchange agreement with the US Federal Reserve amounting to $5 billion. The central banks in both neighbouring Sweden and Denmark have entered similar deals.

Announcing the measure, Norges Bank stated, "There is now an unusually high degree of uncertainty linked to the turbulence in financial markets. The crisis in financial markets has deepened. In Norway there are also clear signs that economic growth is slowing."

The announcement of the Icelandic government's takeover of Glitnir came on the same day as three other European banks failed--Bradford & Bingley in Britain, Hypo Real Estate in Germany, and Fortis in Belgium. Big losses resulted on stock markets across the Nordic region.

Sweden saw large falls particularly in banking shares, amid fears that the full impact of the crisis in Europe may only just have started. Swedbank and Carnegie were the two worst hit, but shares in Nordea and Handelsbanken were also down significantly. Swedbank is one of the banks under the most pressure, since its market value has dropped by more than half since the beginning of 2008.

The Riksbank, Sweden's central bank, was compelled to announce that it had increased the limit of its currency swap with the US Federal Reserve from $10 billion to $30 billion. This would allow it to make dollars available to any Swedish banks suffering from a shortage of funds, although it maintained that it did not consider any bank to be at immediate risk.

Earlier in September, two auctions of treasury bills had been issued by the Riksbank in a bid to free up the markets. But the outlook remains gloomy. Many of Sweden's largest companies are seeing production fall dramatically, with Volvo laying off 8 percent of its workforce. Scandinavian Airlines is in severe trouble, with rumours that it may be taken over or face collapse.

The IMF has warned Sweden of the dangers of its investments in the Baltic, where both Estonia and Latvia are in recession. It stated that the problems in the Baltic could threaten to "cause a credit crunch in Sweden itself." It singled out Swedbank and SEB as particularly exposed.

Vast losses have also hit Finland. In the days following the collapse of Lehman brothers, shares on the OMX stock market in Helsinki fell rapidly, resulting in a loss of €14 billion in total investments. An estimated €2 billion in Finnish household wealth was wiped out.

As Iceland announced its emergency package, Denmark stated that it would guarantee all bank deposits.

In July, Denmark's National Bank was forced to bail out Roskilde bank following higher than expected write-downs on its loans amounting to €500 million. On September 22 it was announced that EBH bank would be taken over by the national bank following a sharp fall in its share prices. It has also been forced to facilitate the merger of two troubled banks, Lokalbanken and Forstaedernes. So far this year, excluding the failed Roskilde bank, Danish banks have written off almost 2 billion kroner (DKK, €270 million) in bad loans.

The Danish economy has contracted in the early part of 2008 and house prices are believed to have fallen by as much as 20 percent. The level of household debt in Denmark was pushed during the years of economic boom to a staggering 260 percent of GDP, the highest level anywhere in the world.