



MINISTRY OF FINANCE
AND ECONOMIC AFFAIRS

Icelandic Economic Situation

January 2018

Key points

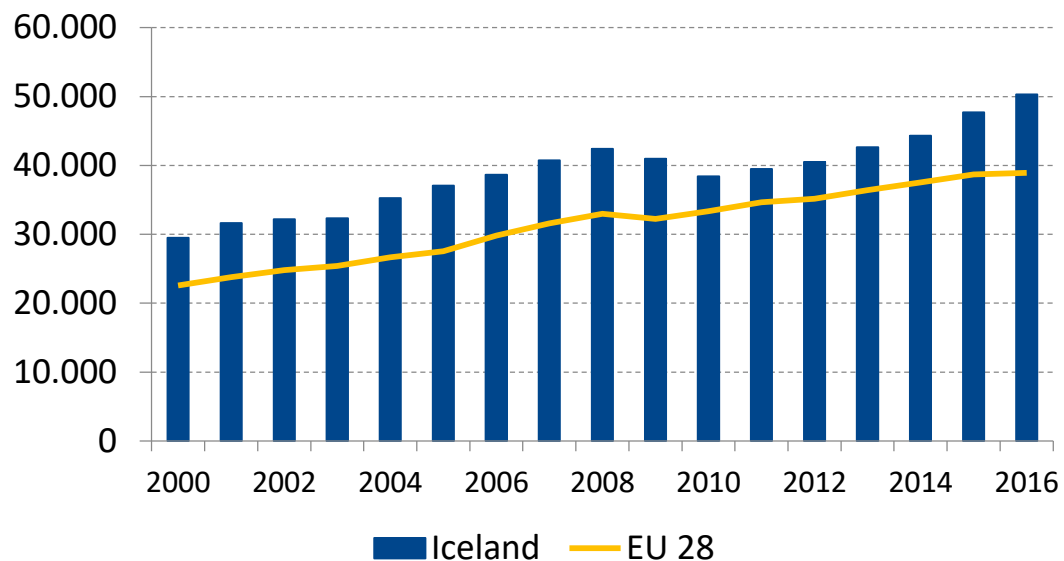
- Robust economic growth
- Two major contributors – terms of trade and tourism
- Solid internal and external balance
- Inflation under the 2½% target for almost four years - inflation expectations also at the target
- Responsible fiscal consolidation and fiscal framework
- Steep decline in debt ratio
- Credit ratings rising - Return to an A-rating category in Sept 2016
- Well capitalized banking system - capital ratios remain above 25%
- Successful removal of capital controls
- Continued favorable economic prospects



Strong growth

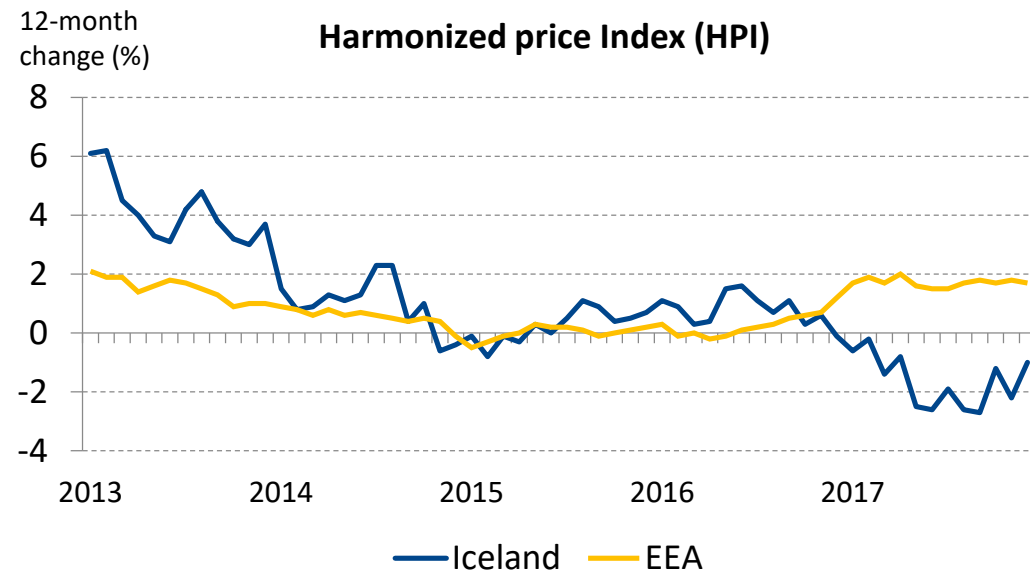
- GDP growth (2016) 7.4%
- Unemployment (November 2017) 1.7%
- Inflation, CPI in December 2017: 1.9%.
HPI in December 2017: -1.0
- Positive current account balance
- 2.2 millions foreign visitors to Iceland in 2017

GDP per capita, USD PPP

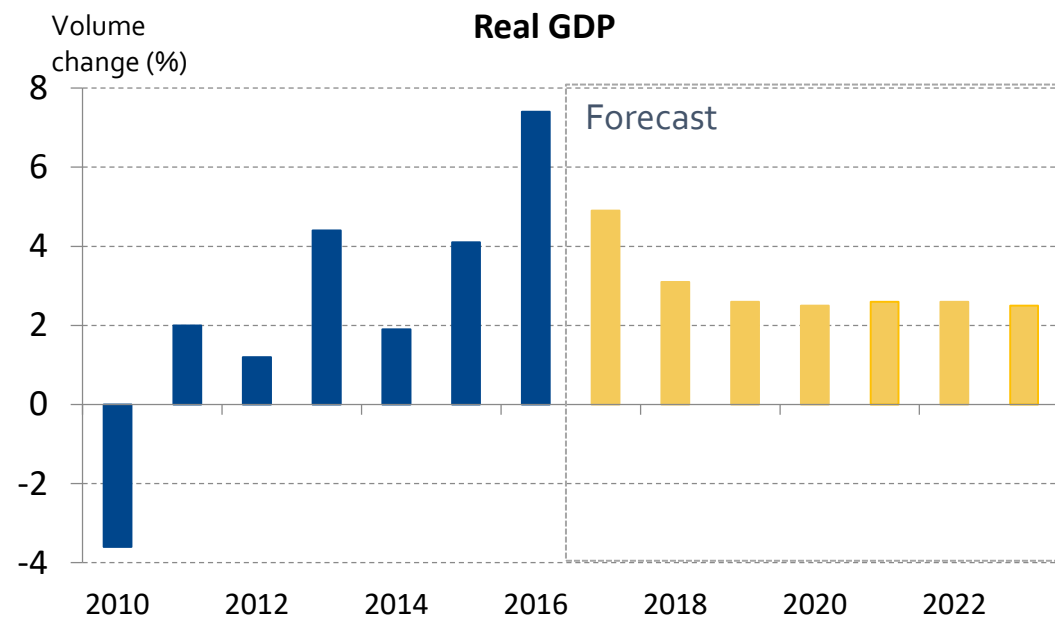


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Source: OECD

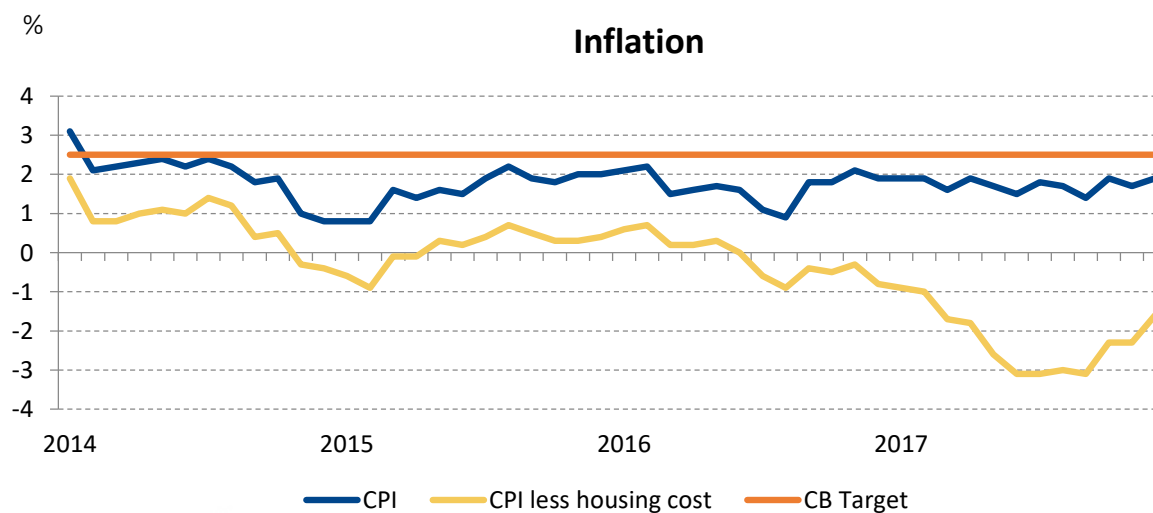
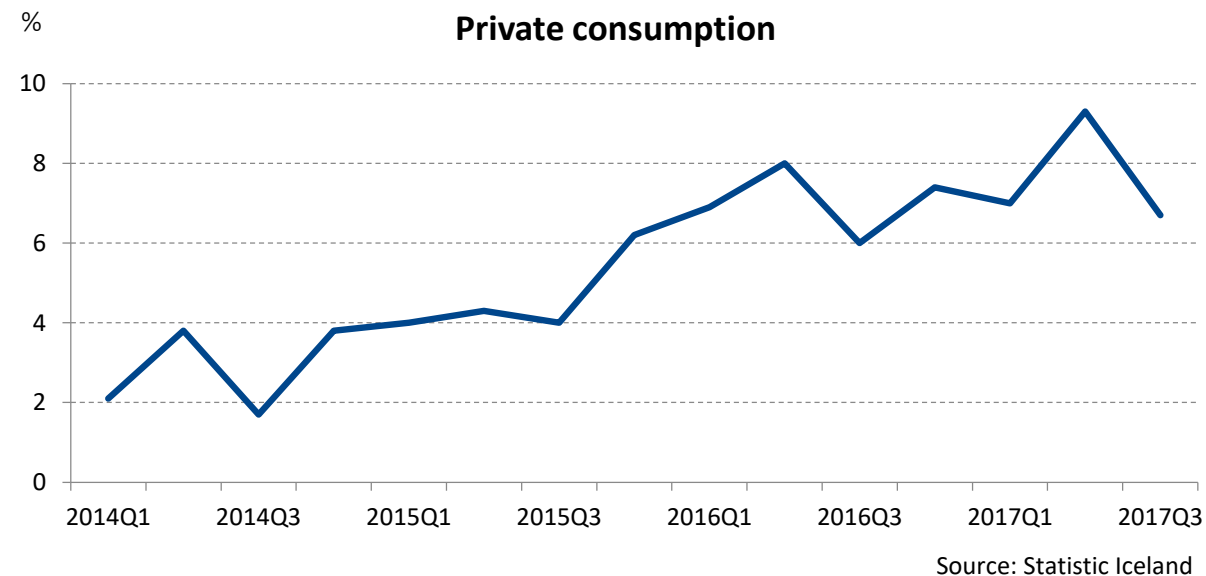
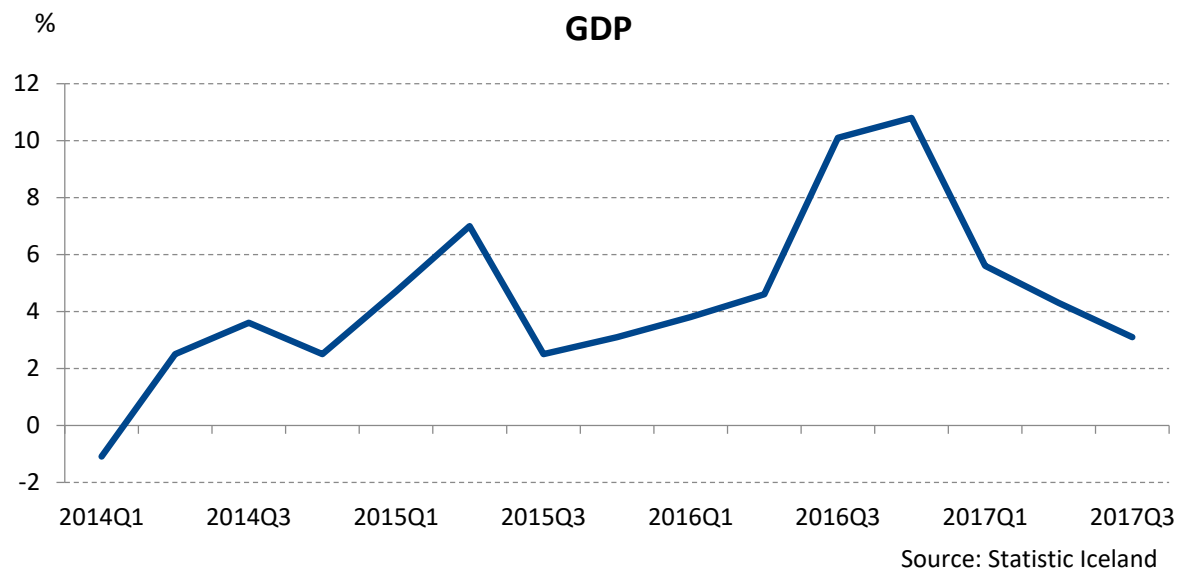


Source: Statistic Iceland



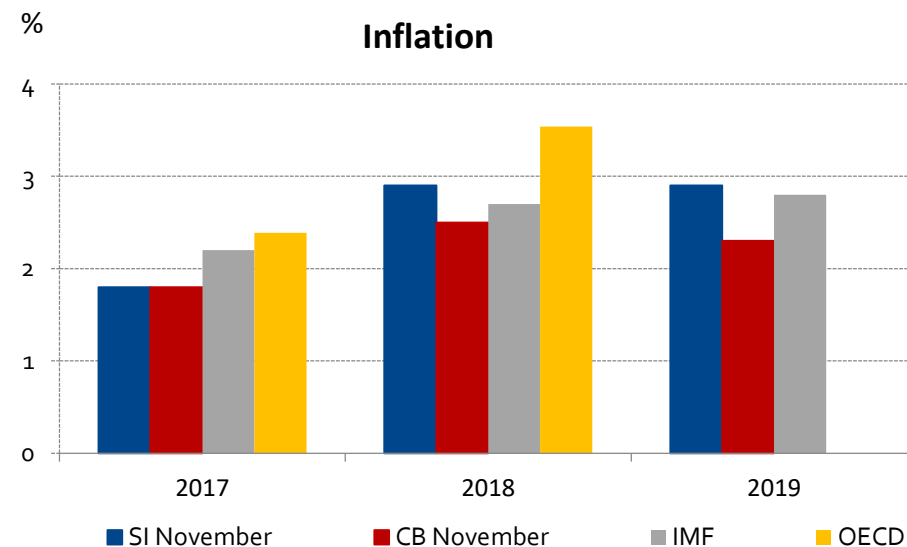
Source: Statistic Iceland

Recent developments, year over year

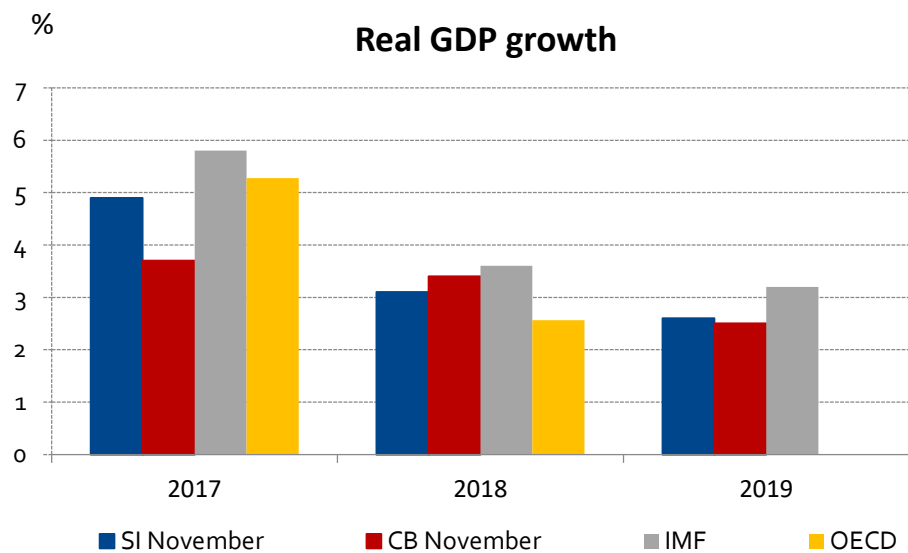


Forecasts

- The Central Bank forecasts GDP growth of 3.7% in 2017, down 1.5 pp, from its August forecast
- Statistics Iceland projects GDP growth of 4.9% in 2017 and 3.1% in 2018
- IMF and OECD published new forecasts for Iceland in June 2017
- Inflation is expected to exceed the inflation target in 2018

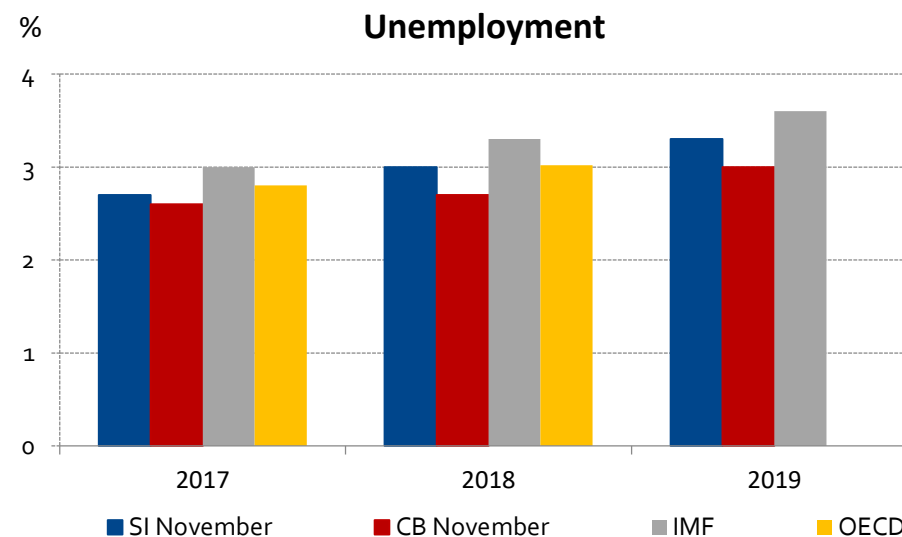


Source: Statistic Iceland. Central Bank. IMF. OECD



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Source: Statistic Iceland. Central Bank. IMF. OECD



Source: Statistic Iceland. Central Bank. IMF. OECD

Key economic indicators - forecast

Volume change on previous year, %

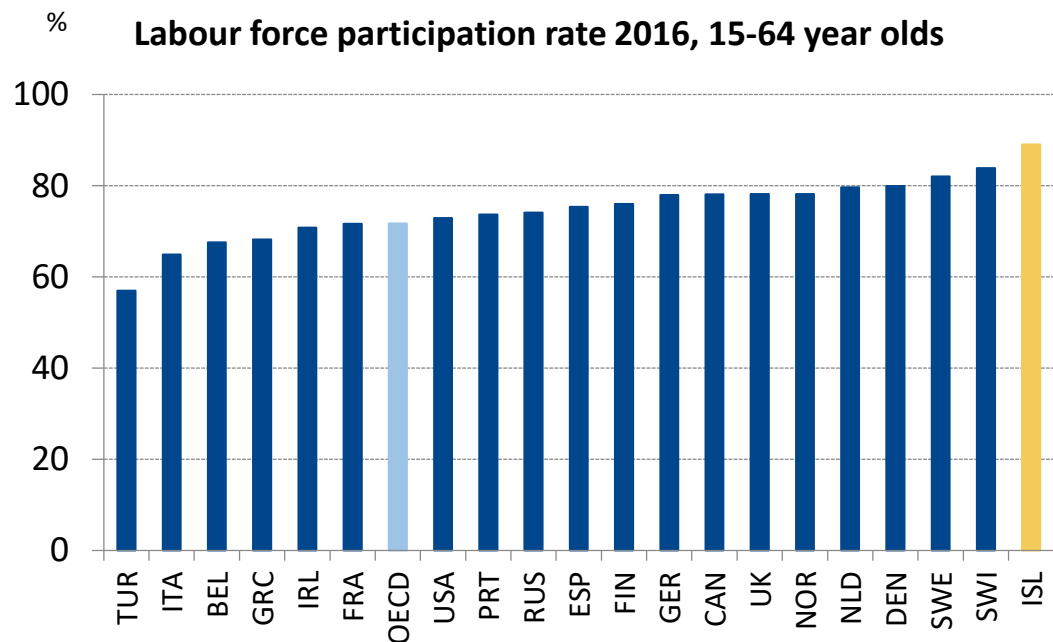
	2017	2018	2019	2020	2021	2022	2023
Private consumption	7.8	5.3	3.6	3.1	2.9	2.6	2.5
Public consumption	2.2	1.3	1.3	1.7	1.8	1.8	1.8
Gross fixed capital formation	8.8	3.1	2.9	2.1	3.6	3.8	3.9
Business investment	5.6	-0.9	-0.7	0.1	3.0	3.6	4.2
Housing investment	26.0	19.0	13.2	7.4	5.1	4.7	3.9
Public investment	9.9	6.4	6.6	3.9	3.7	3.4	2.3
National expenditure	6.9	3.9	3.0	2.6	2.8	2.7	2.6
Exports of goods and services	7.7	4.3	3.3	3.1	2.6	2.5	2.5
Imports of goods and services	12.5	6.2	4.2	3.4	3.0	2.7	2.8
Gross domestic product	4.9	3.1	2.6	2.5	2.6	2.6	2.5

Source: Statistic Iceland



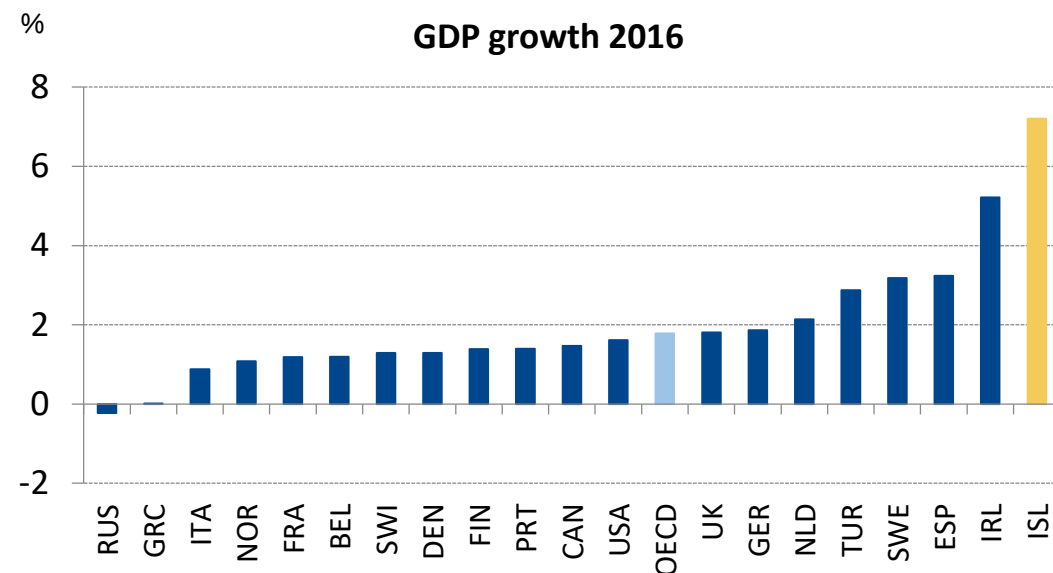
International comparison

- In 2016 Iceland was the fastest growing economy among the OECD countries
- Iceland has the highest participation rate in the labour market, both among men and women
- Unemployment rate was around 3% in 2016 and is expected to stay low

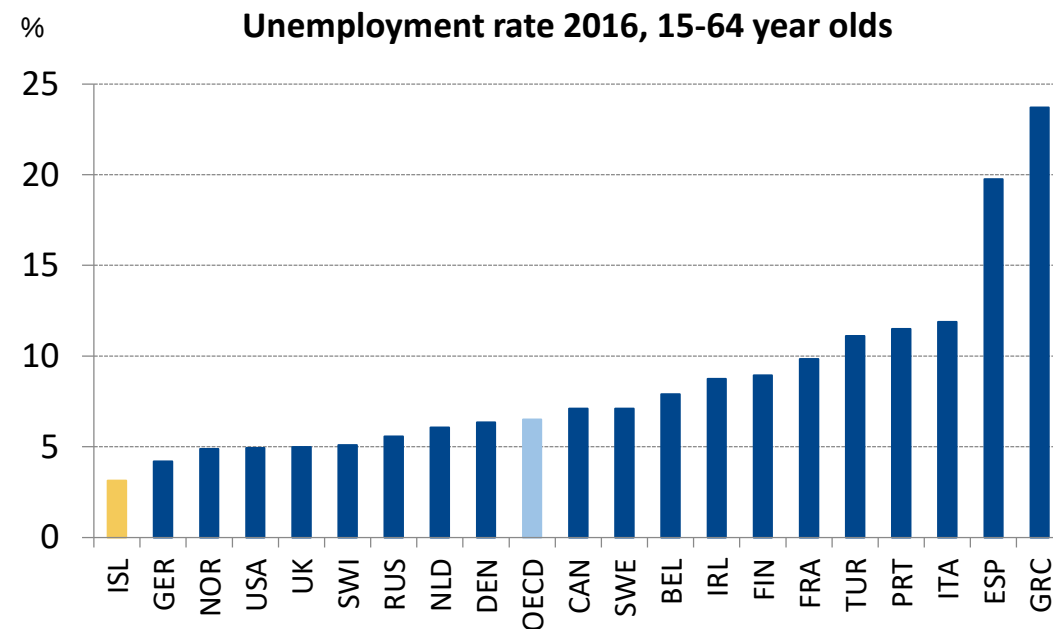


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Source: OECD



Source: OECD

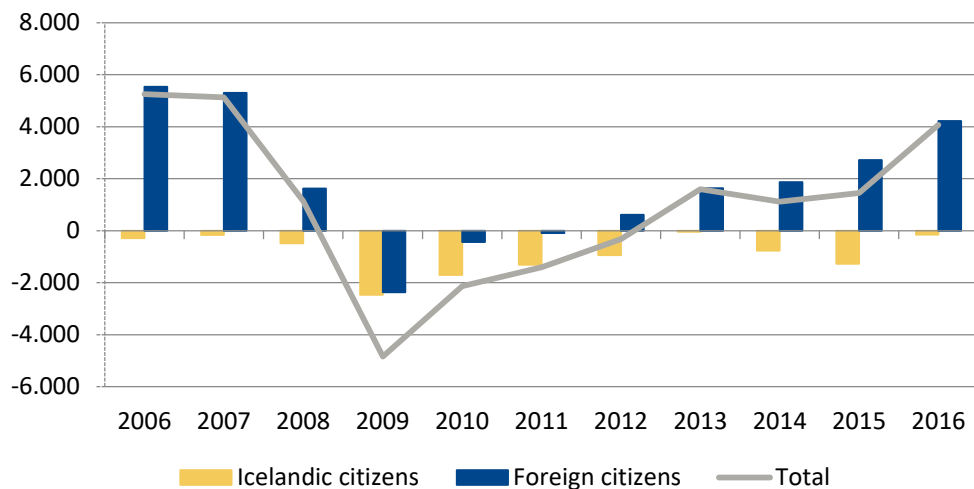


Source: OECD

Population

- Total population January 1. 2017: 338.349
- Life expectancy (2016): Men: 80.7, women: 83.7
- In 2017 there are 30.275 foreign citizens in Iceland, thereof 13.795 from Poland
- In 2016, 2.873 people with Polish citizenship immigrated to Iceland. Polish citizens were also the largest group of foreign nationals to emigrate from Iceland in 2016, or 1.117.
- In the 3rd quarter of 2017, 3.670 foreign citizens immigrated to Iceland and 1.350 emigrated

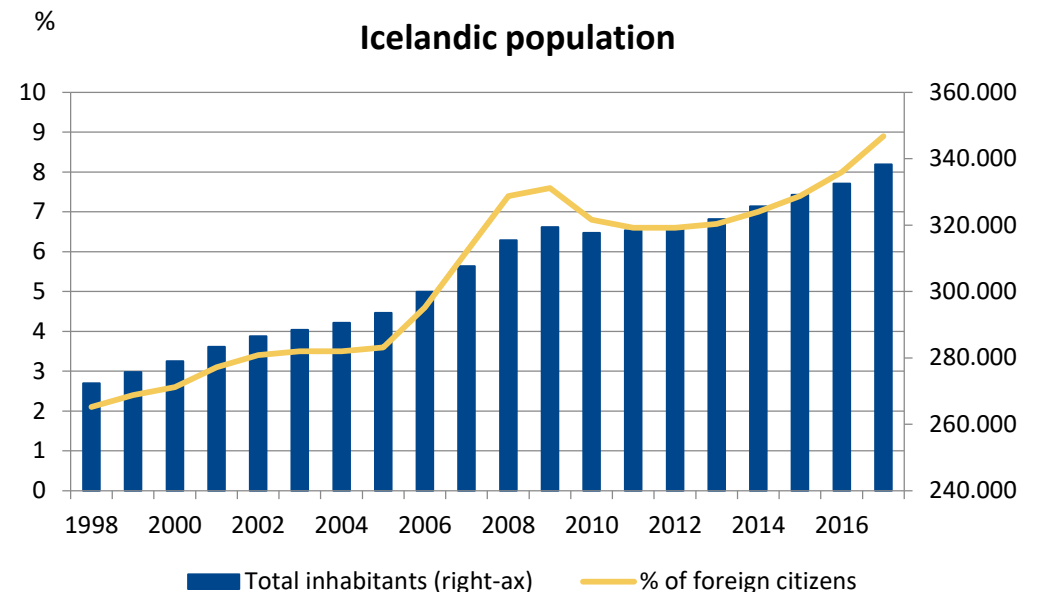
Net immigration (numbers)



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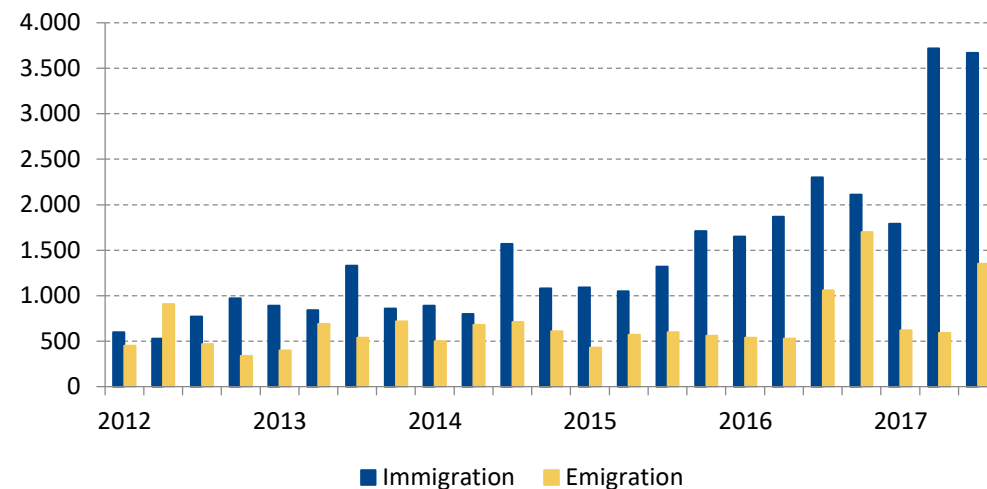
Source: Statistic Iceland

Icelandic population



Source: Statistic Iceland

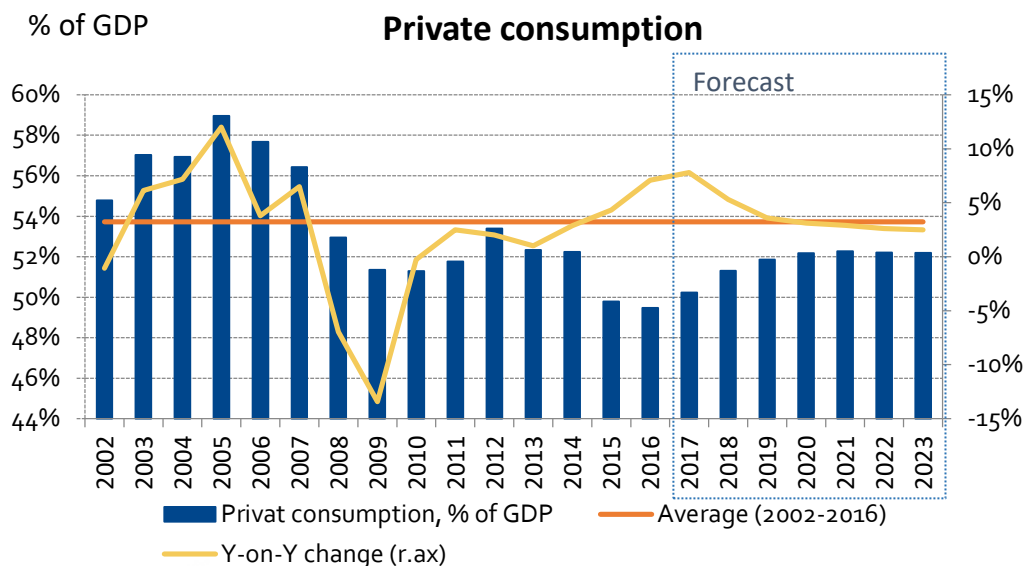
Foreign citizens (numbers)



Source: Statistic Iceland

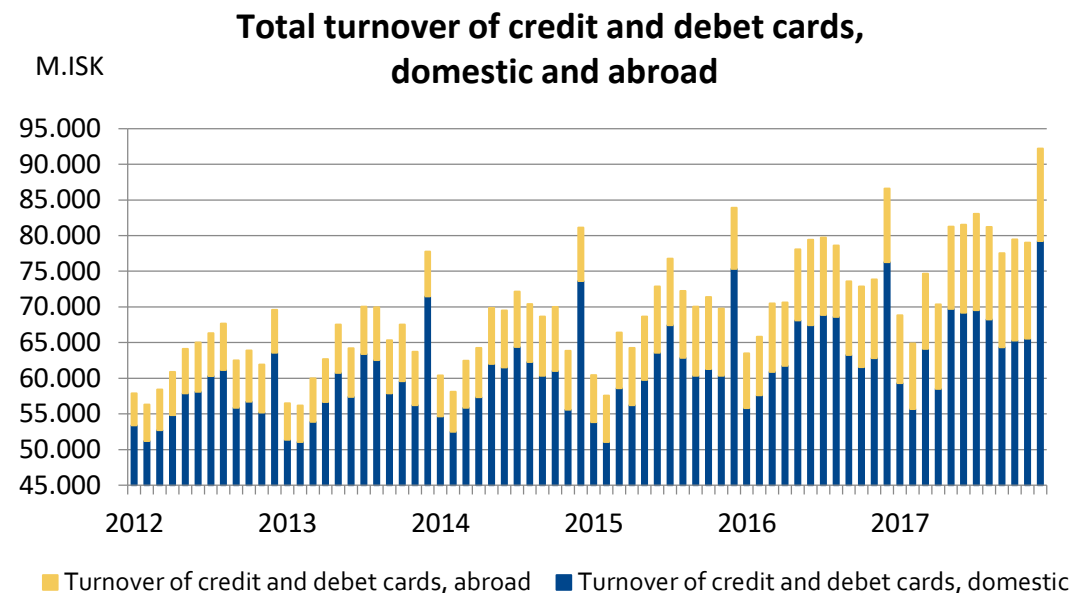
Private consumption

- Substantial private consumption growth since 2013
- As a share of GDP private consumption is still well below its long term average
- Number of Icelanders traveling abroad has increased, especially since 2015
- Robust growth in domestic debit- and credit card usage so far in 2017

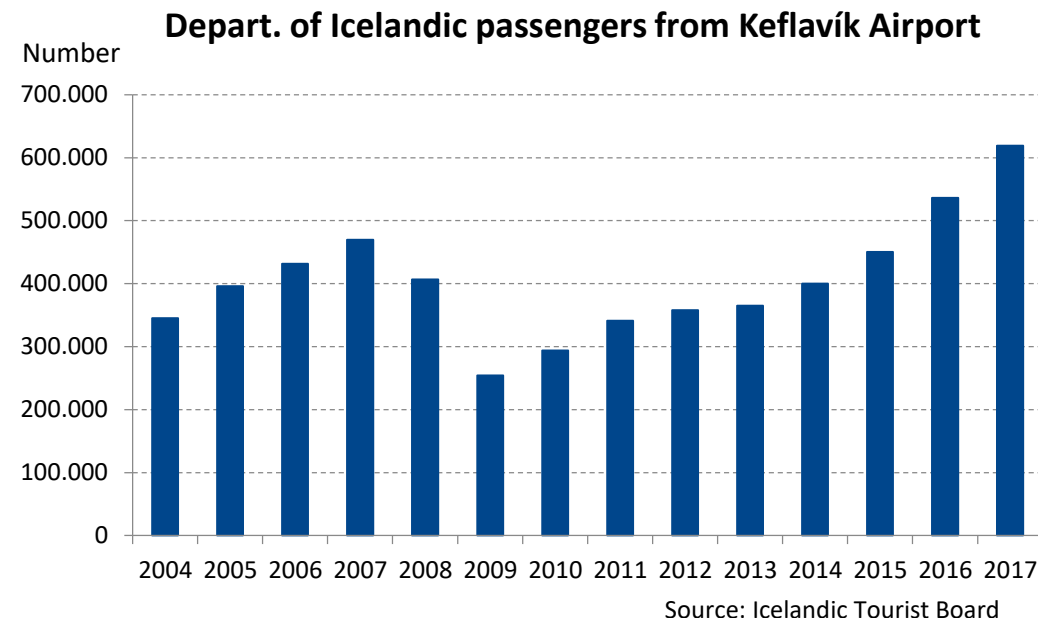


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Source: Statistic Iceland

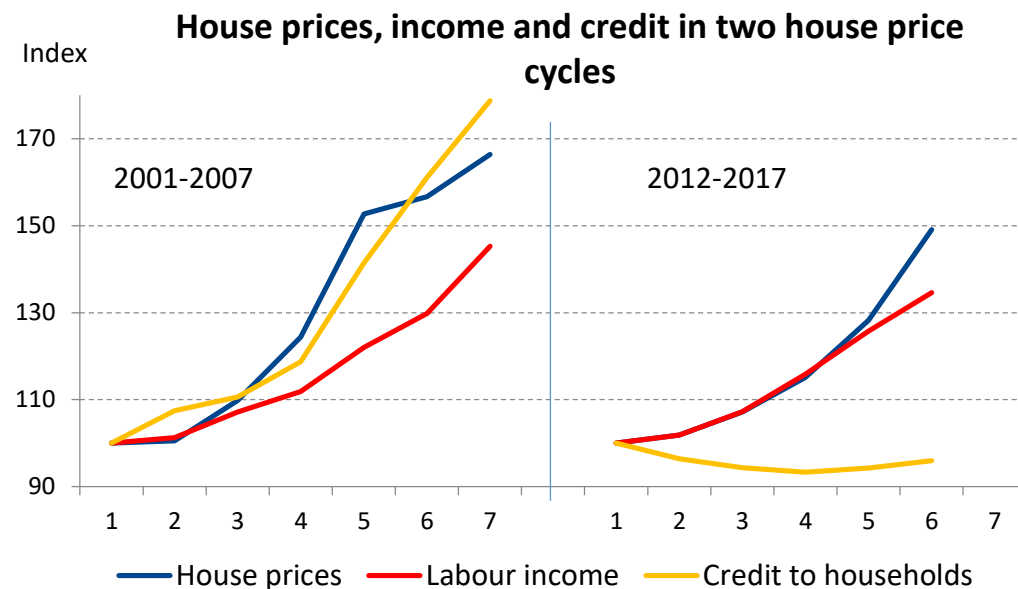


Source: Central Bank

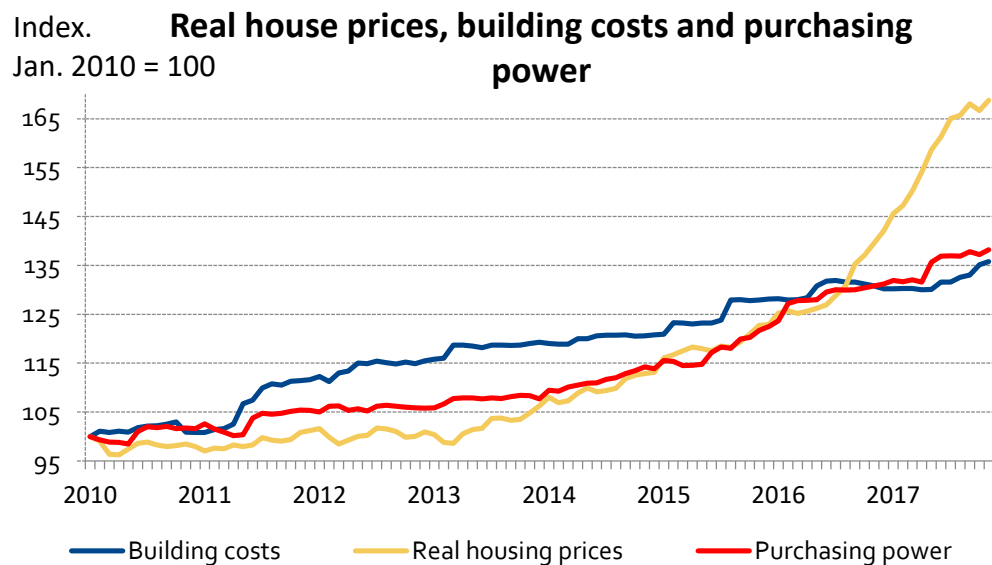


Housing market

- Turnover in the real estate market has risen, and residential housing prices have increased far in excess of the price level
- Factors contributing to price increases are substantial wage growth, low investment since the GFC and population growth
- Despite rising house prices, household credit growth has been moderate

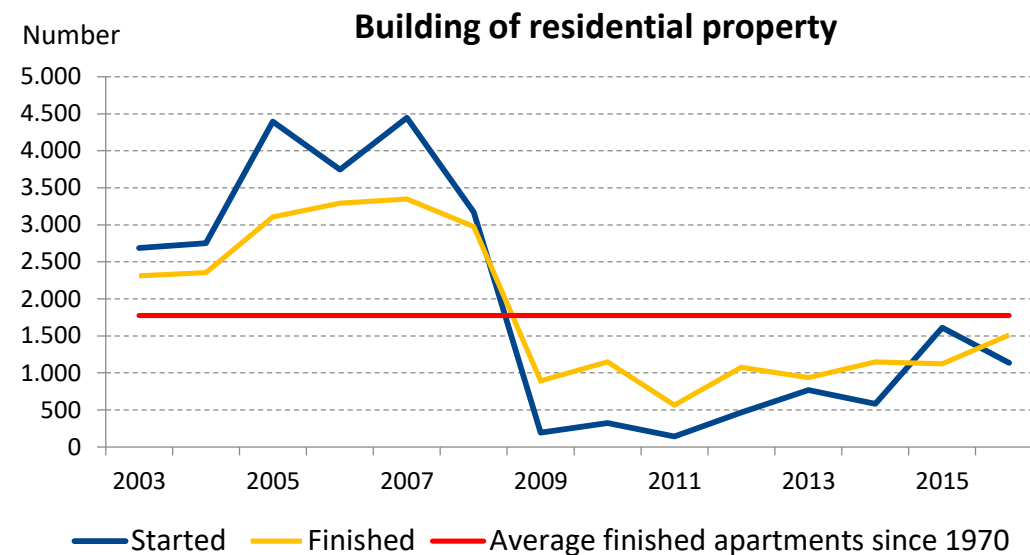


Source: Central Bank



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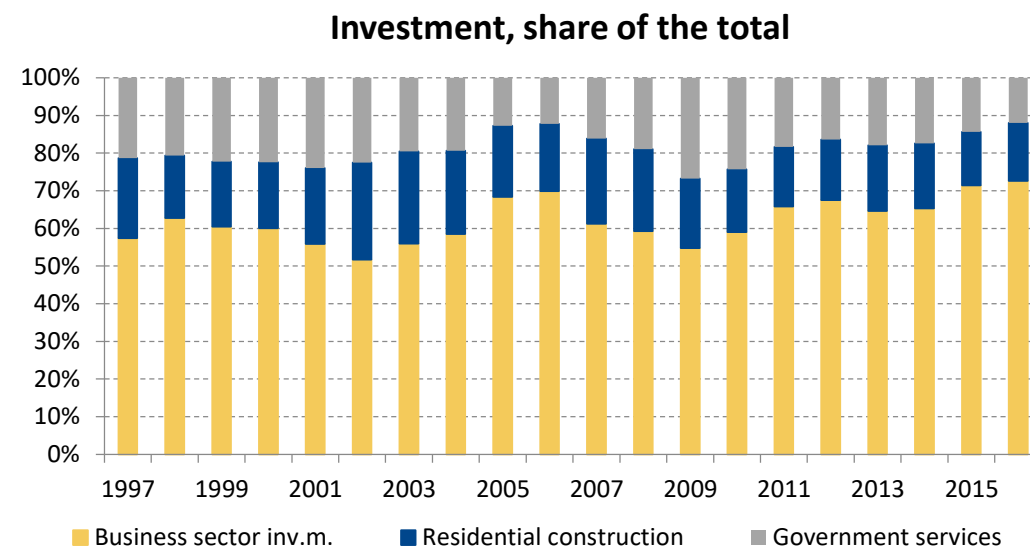
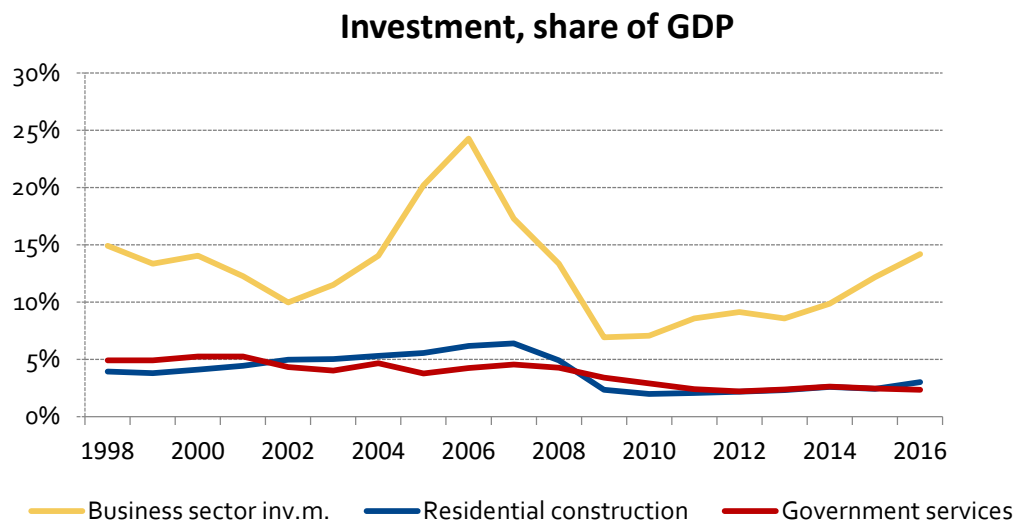
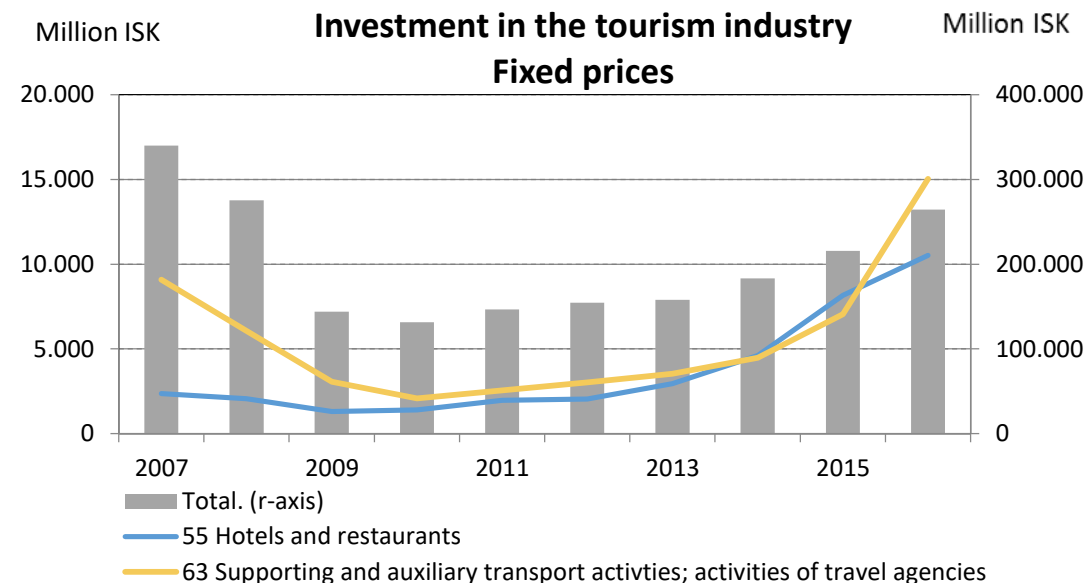
Source: Central Bank



Source: Federation of Icelandic Industries

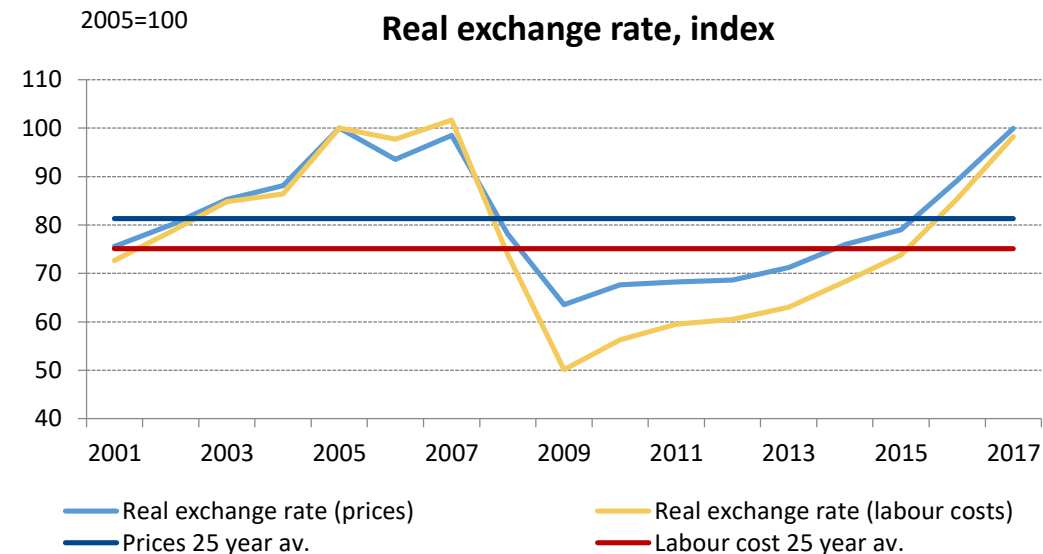
Investment

- Business sector investment has risen as a share of GDP in the last two years
- Lending to tourism companies has increased markedly in the recent years in line with increased investment in the sector
- At the end of 2016, lending to the tourism industry accounted for 8.5% of loans granted to the private sector

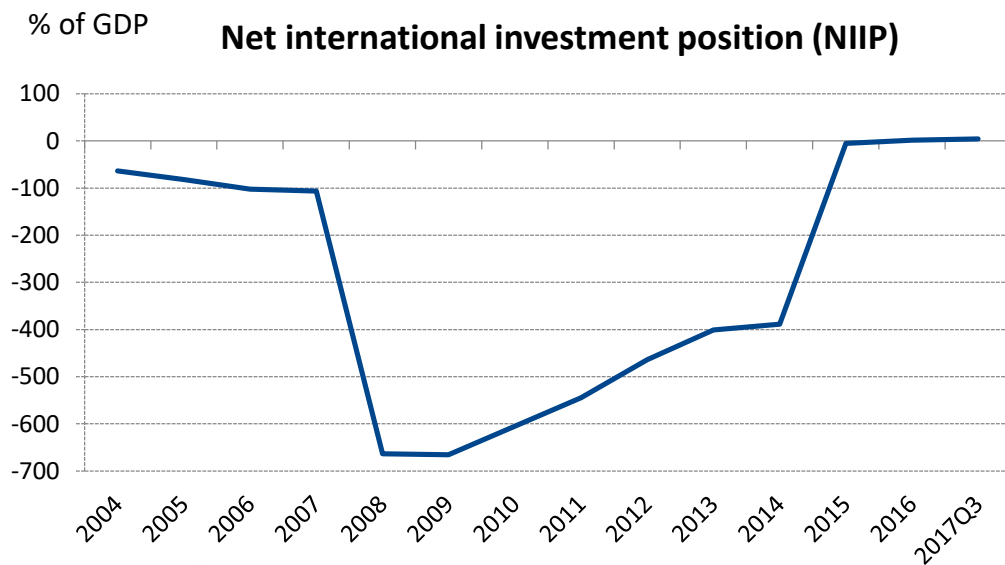


External position

- The real exchange rate in terms of relative consumer prices has risen sharply from the autumn 2009
- However, there is still vast surplus on the current account (8% of GDP in 2016), largely thanks to the development in tourism
- Iceland's net international investment position (NIIP) has improved substantially and currently stands at 4.4% of GDP

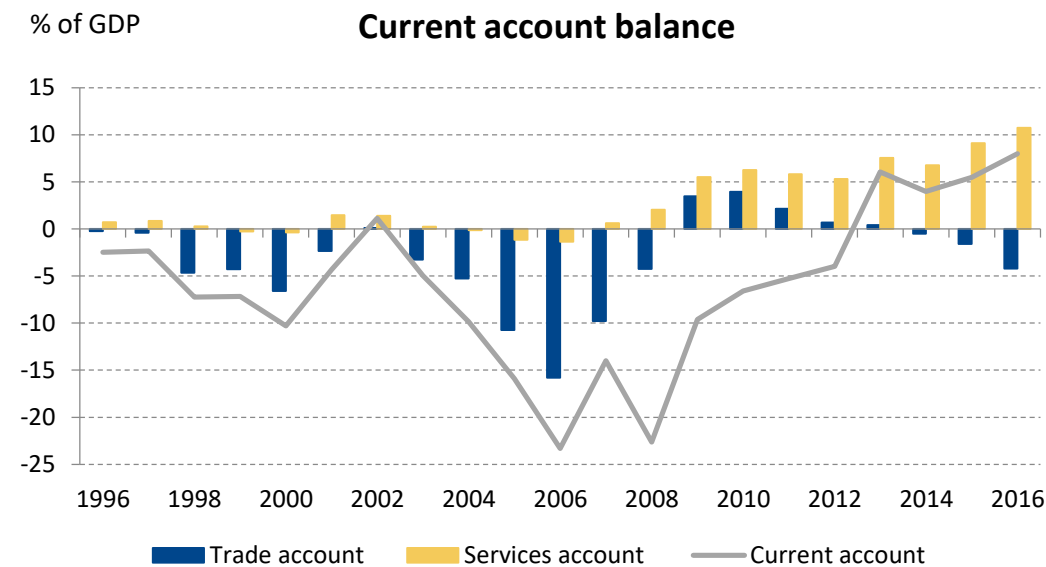


Source: Central Bank



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Source: Central Bank

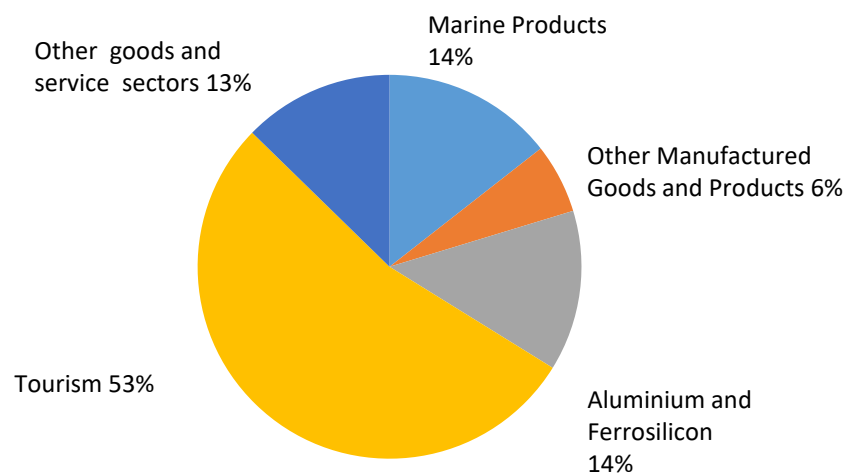


Source: Central Bank

Trade and terms of trade

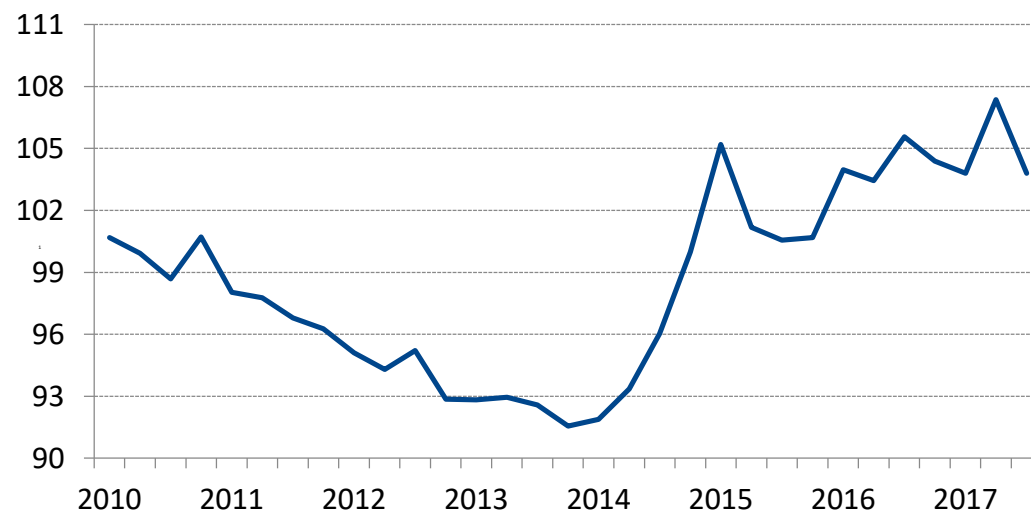
- Terms of trade have improved markedly, and exports have grown rapidly
- The rise in the exchange rate is due largely to growth in tourism, considerably better terms of trade, and a substantial improvement in Iceland's external position
- Exports of goods and services combined rose by over 11% in 2016
- The balance of trade surplus in 2016 amounted to 6.3% of GDP

Total export of goods and services by type 2017, q3



Index
2010 = 100

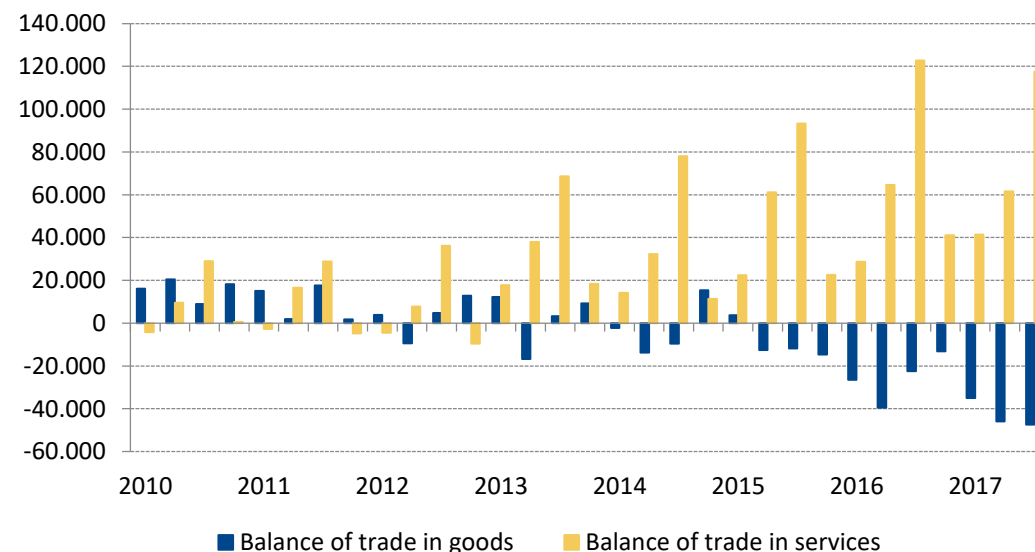
Terms of trade



Source: Central Bank

Millions. ISK

Balance of trade, quarterly figures



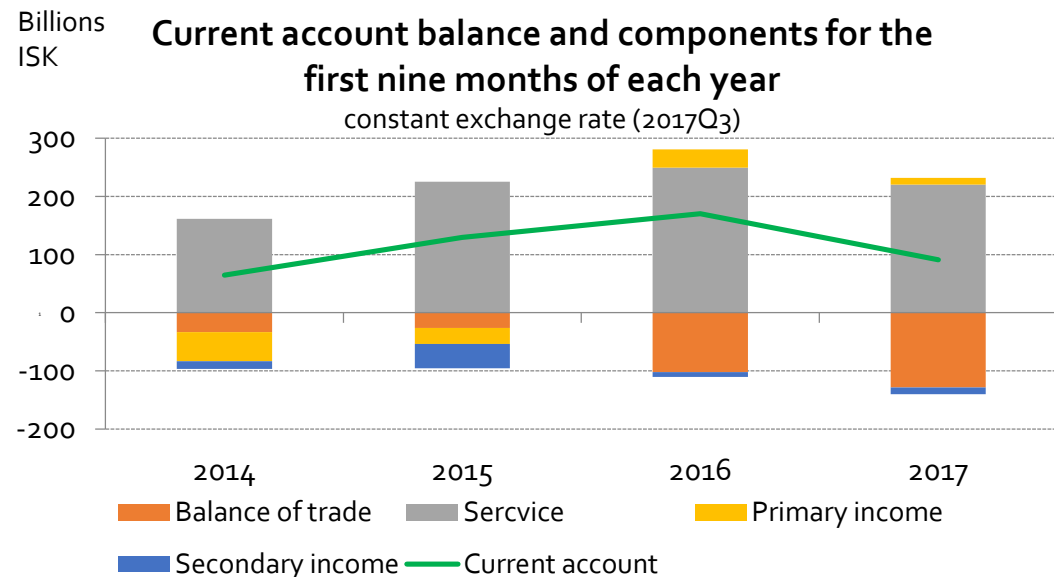
Trade

- Income from foreign tourists in Iceland and abroad amounted to 190 b.kr. in the third quarter of 2017, increasing by 3.2% from the same period the year before
- The service balance maintains the surplus on the current account
- The share of travel and transportation services in services exports was 90% in the third quarter of 2017, of which the share of tourism was 54%

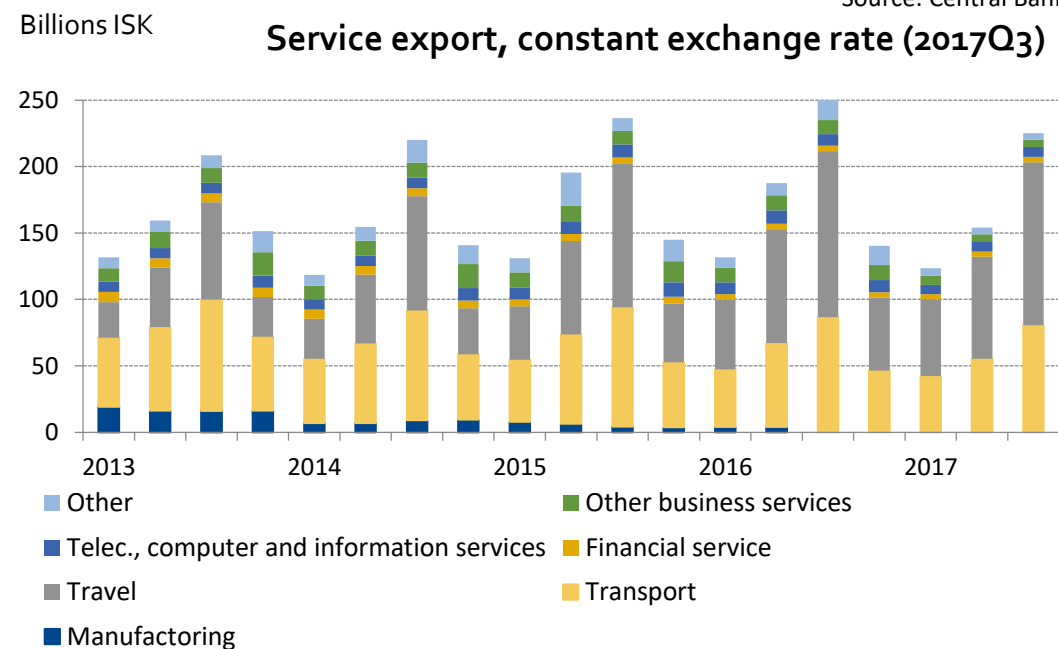


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Source: Statistic Iceland



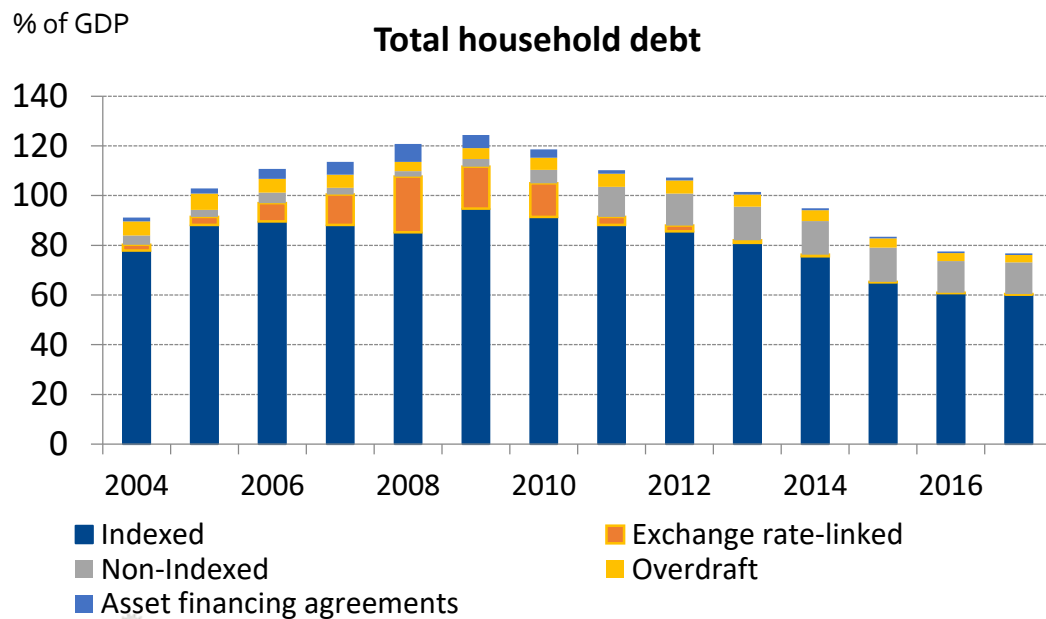
Source: Central Bank



Source: Statistic Iceland

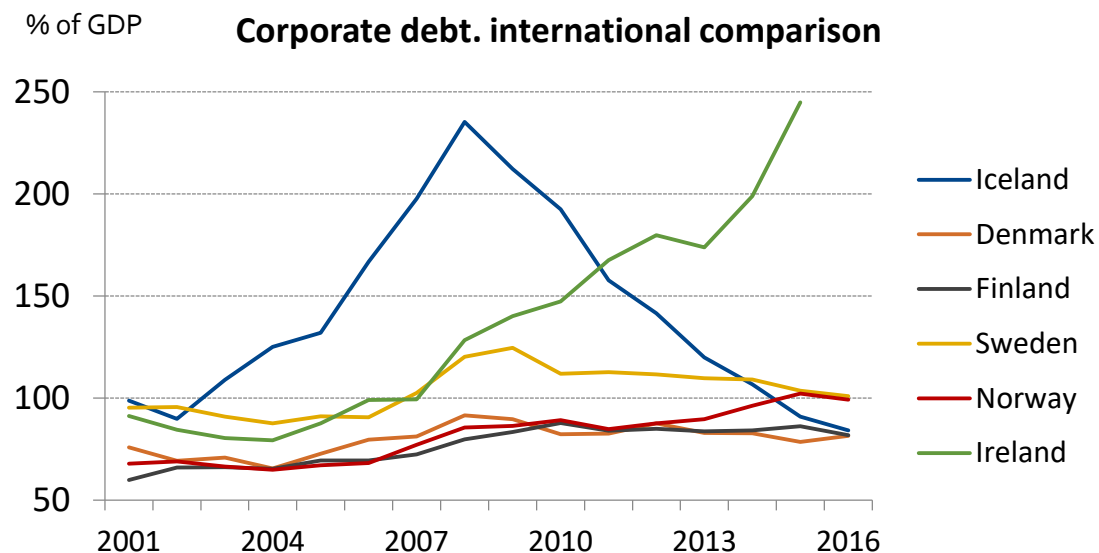
Debt levels

- Household debt has decreased as a result of the Government's debt relief measure and a change in credit appetite
- Framework on LTV, DSTI and restrictions foreign currency lending has been put in place
- NPLs have decreased and their share of the loan portfolio is low

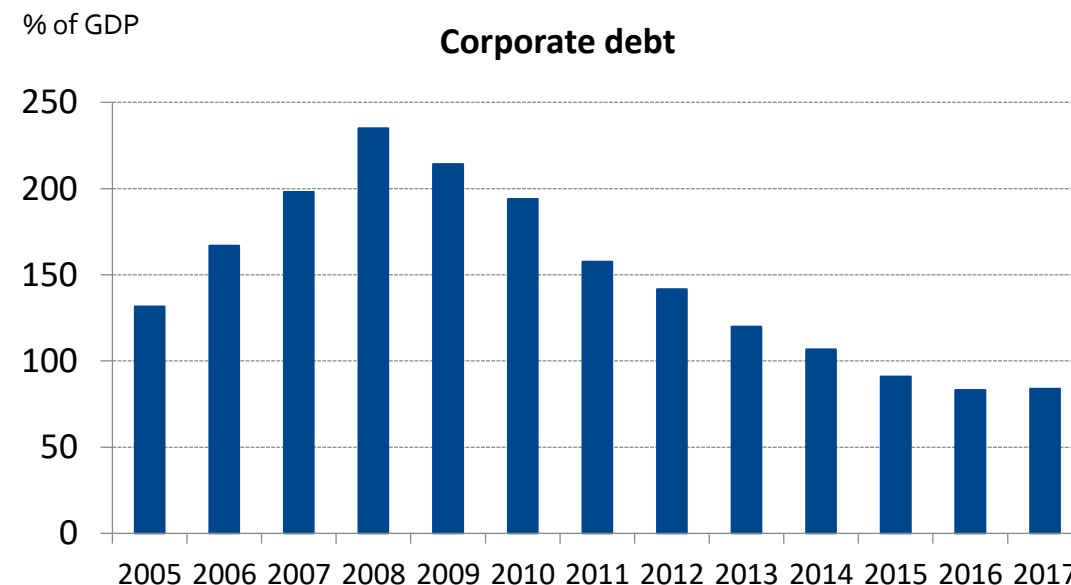


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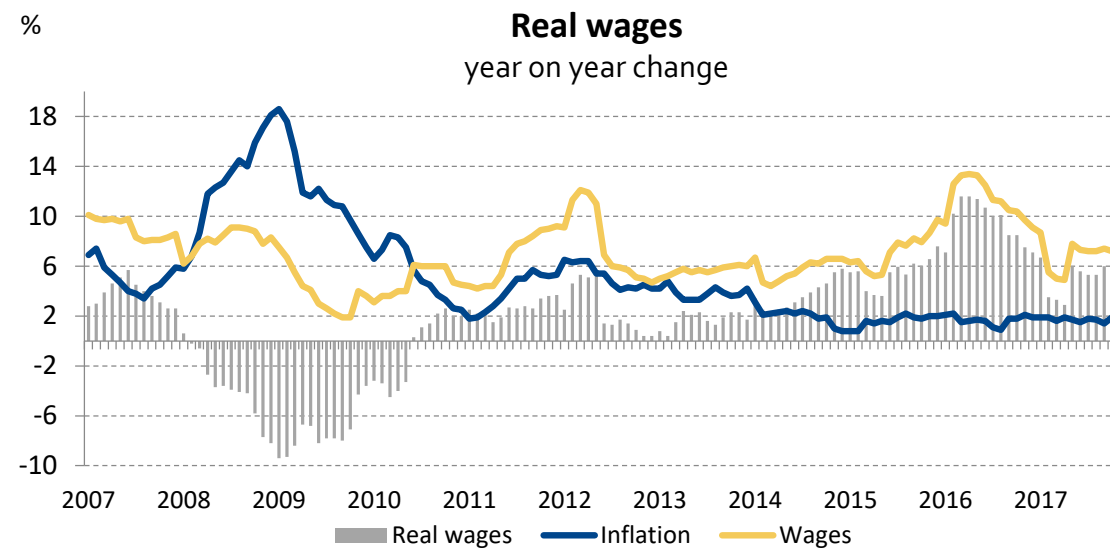
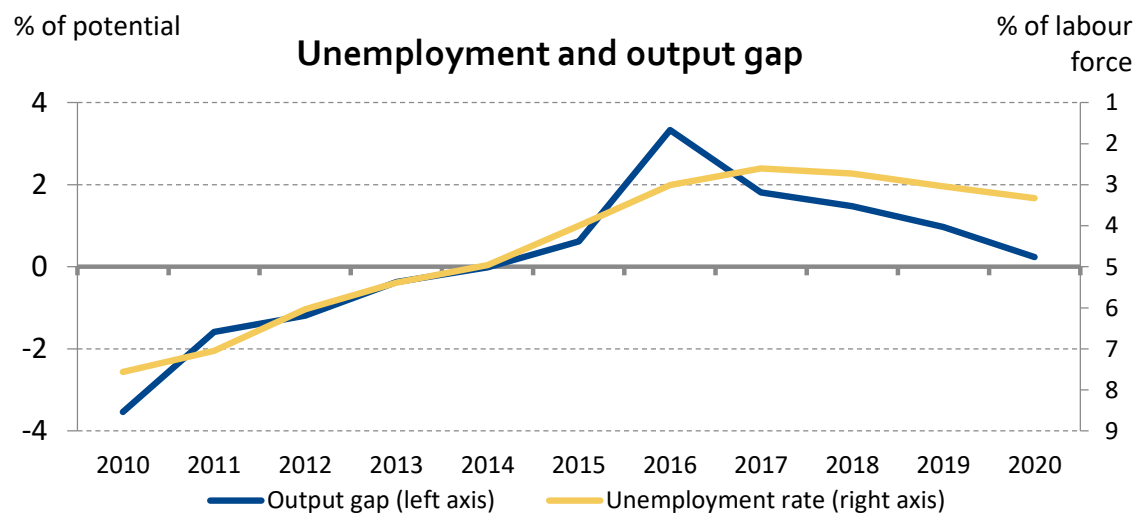
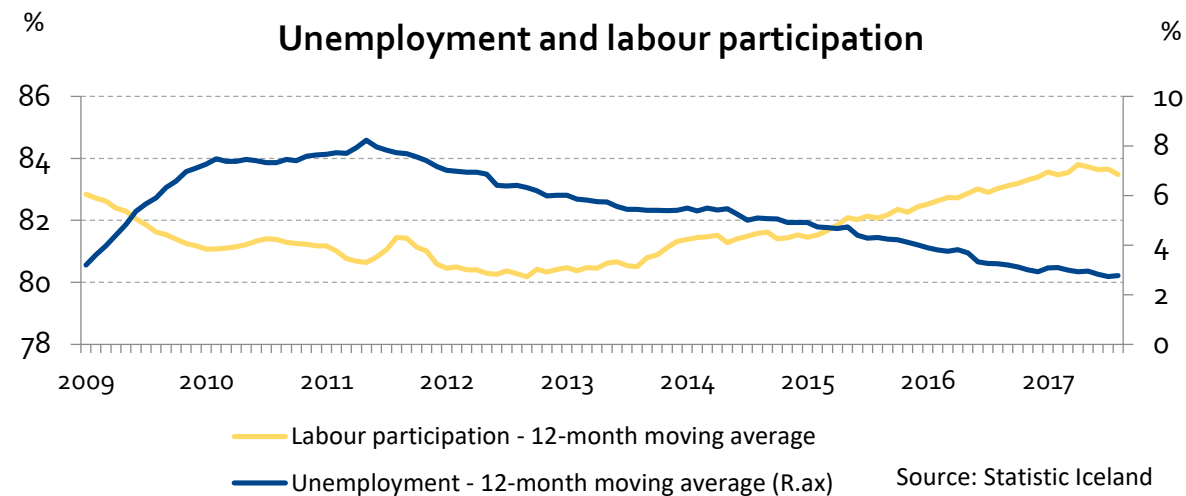
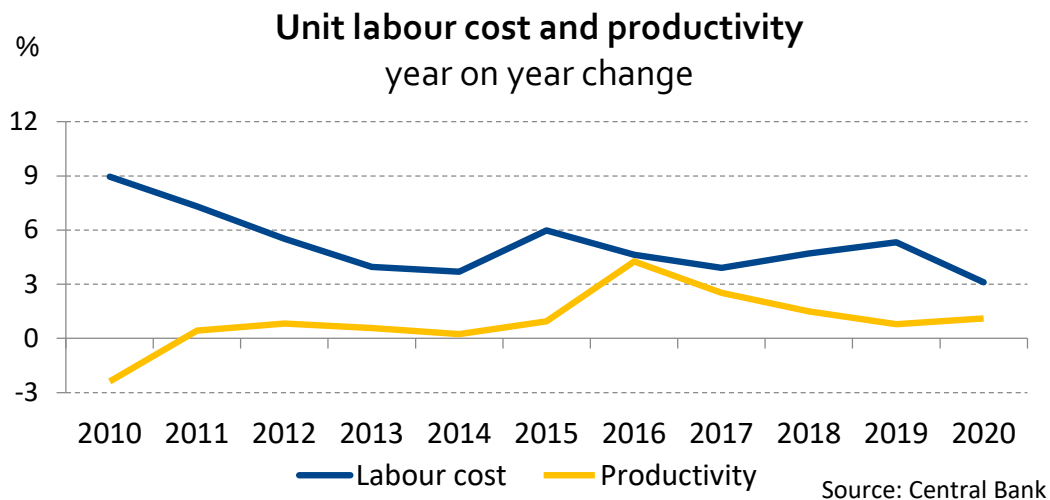


Source: Central Bank



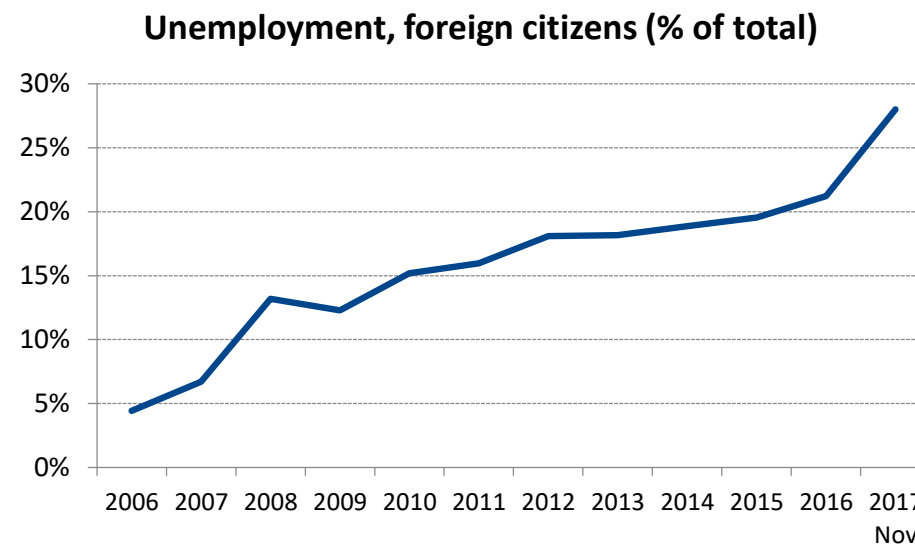
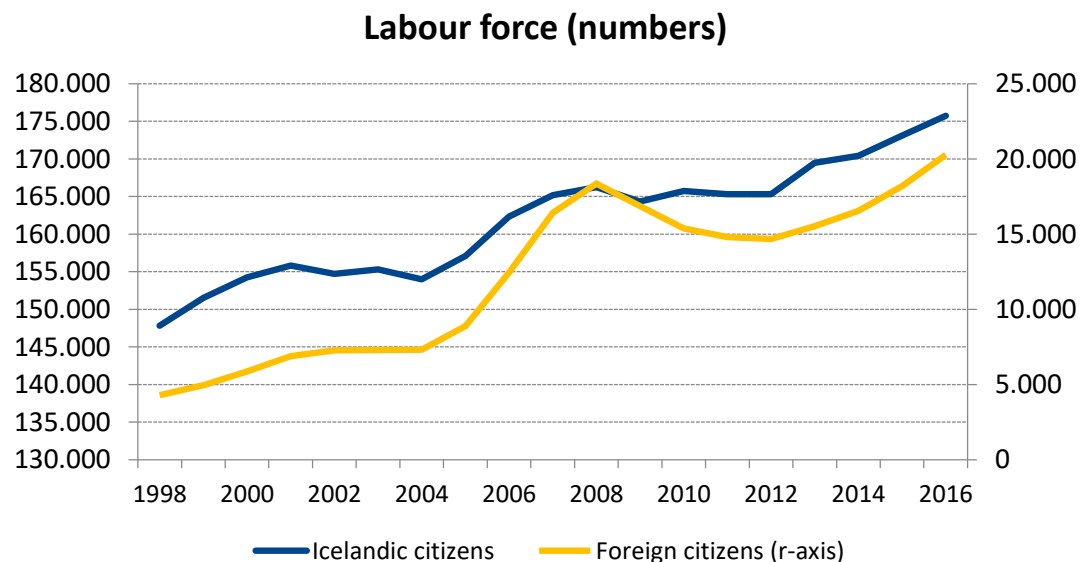
Source: Central Bank

Labour market



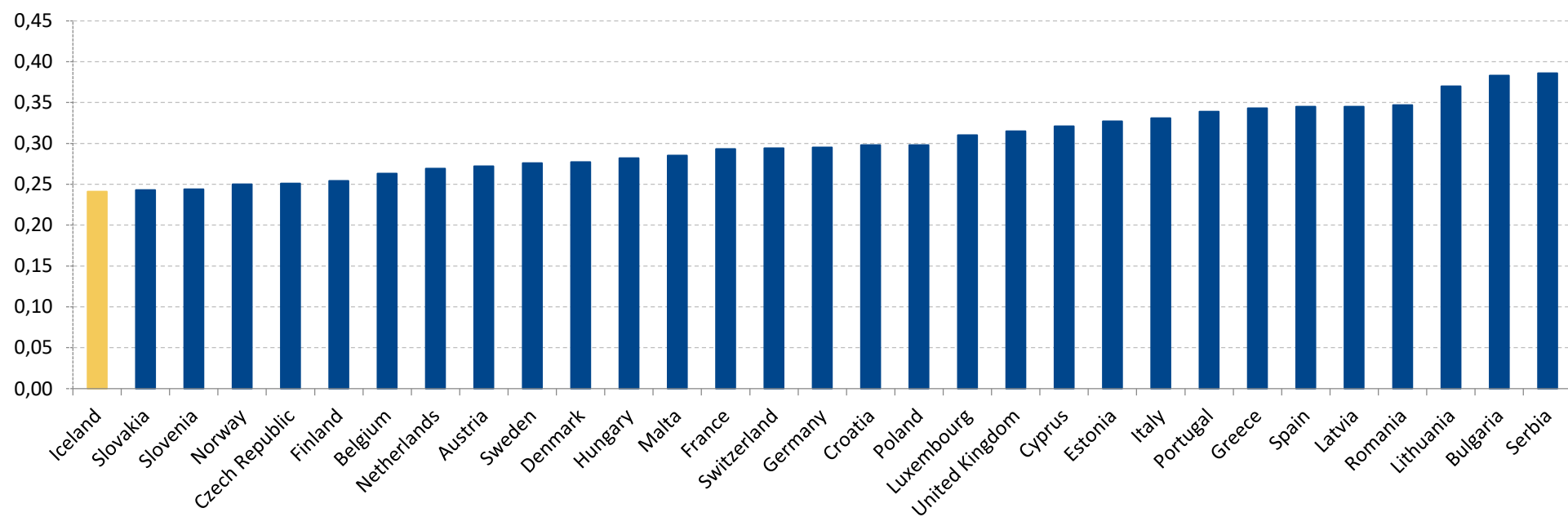
Labour market – foreign labour

- From the year 1996, the highest numbers of foreign immigrants to Iceland were Polish citizens, with the exception of 2004, when Portuguese citizens were most numerous
- At the end of 2016 there were 20.273 foreigners in the workforce, 10.3% of the labour market
- At the end of November 2017 the ratio of foreign citizens of total unemployment was 28%



Gini coefficient in Europe 2016

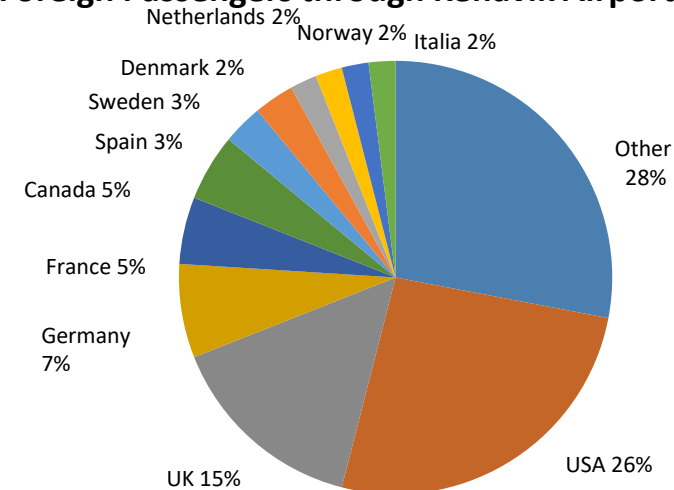
- The Gini coefficient is based on the comparison of cumulative proportions of the population against cumulative proportions of income they receive, and it ranges between 0 in the case of perfect equality and 1 in the case of perfect inequality
- With a Gini coefficient of 0.24, Iceland's income inequality after government taxes and transfers is the lowest among the countries in Europe



Tourism

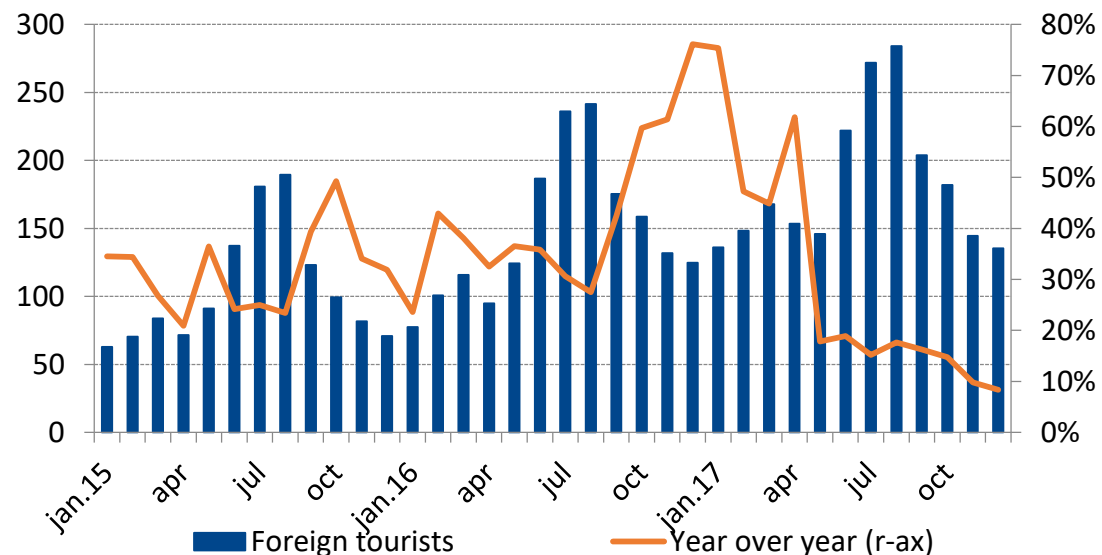
- The total number of foreign visitors to Iceland was around 2.2 million in 2017, that is 24% increase from 2016
- Of foreign passengers traveling through Keflavik Airport Americans and Britons are the largest group, or 41% of all passengers
- The appreciation of Krona might shorten the dwelling time and cause less spending

Foreign Passengers through Keflavik Airport 2017



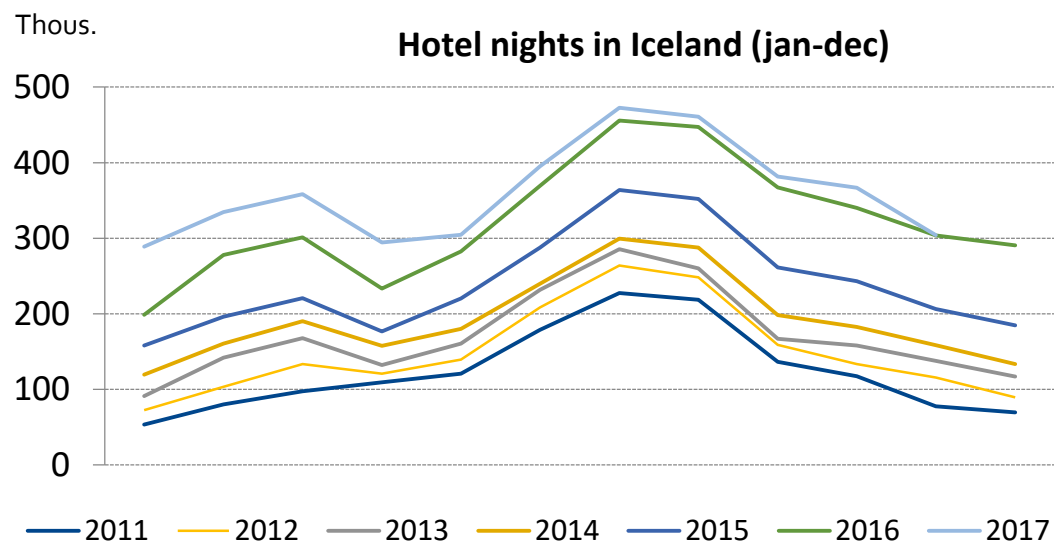
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Foreign arrivals in Keflavik 2015-2017 (monthly figures)



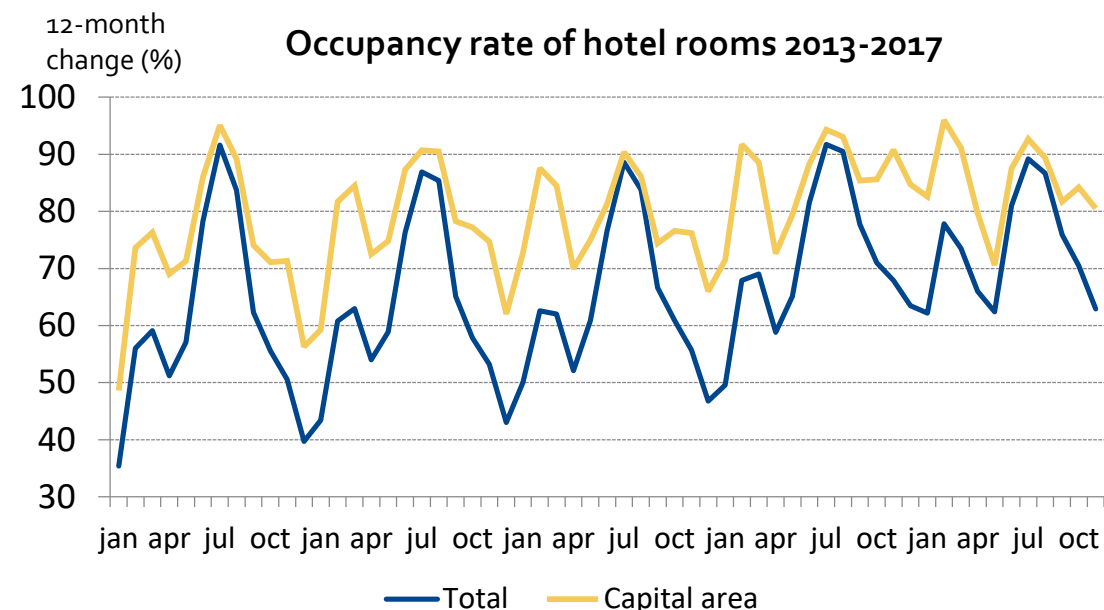
Tourism

- Overnight stays in hotels remained unchanged in November, year on year
- In the first 11 months of 2017 the overnight stays increased by 11%
- The occupancy rate stays high, especially in the capital area
- The credit card usage of foreign tourists and number of overnight stays in hotels has increased, year after year

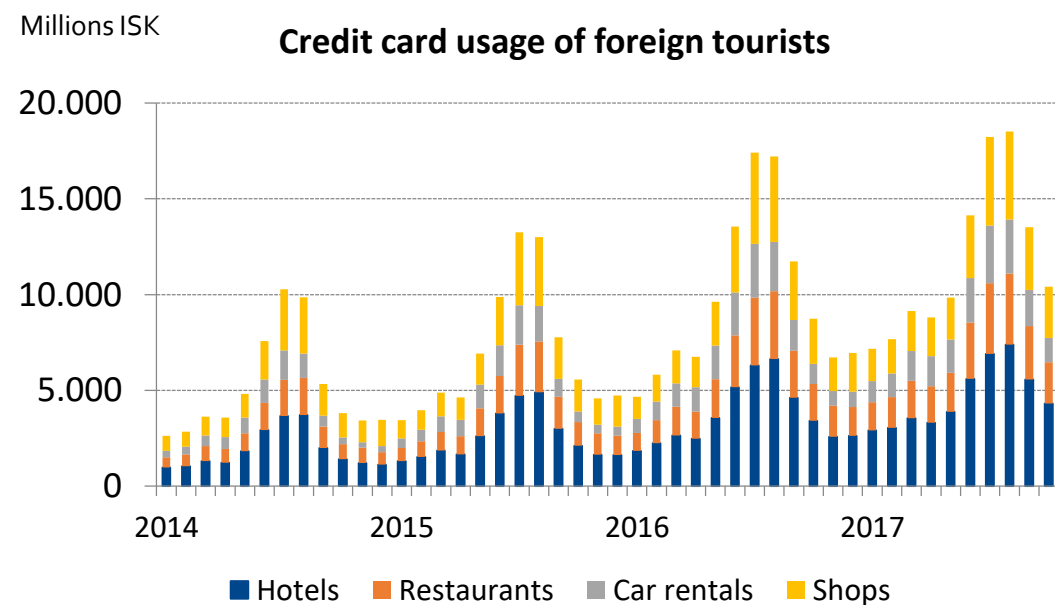


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Source: Statistic Iceland



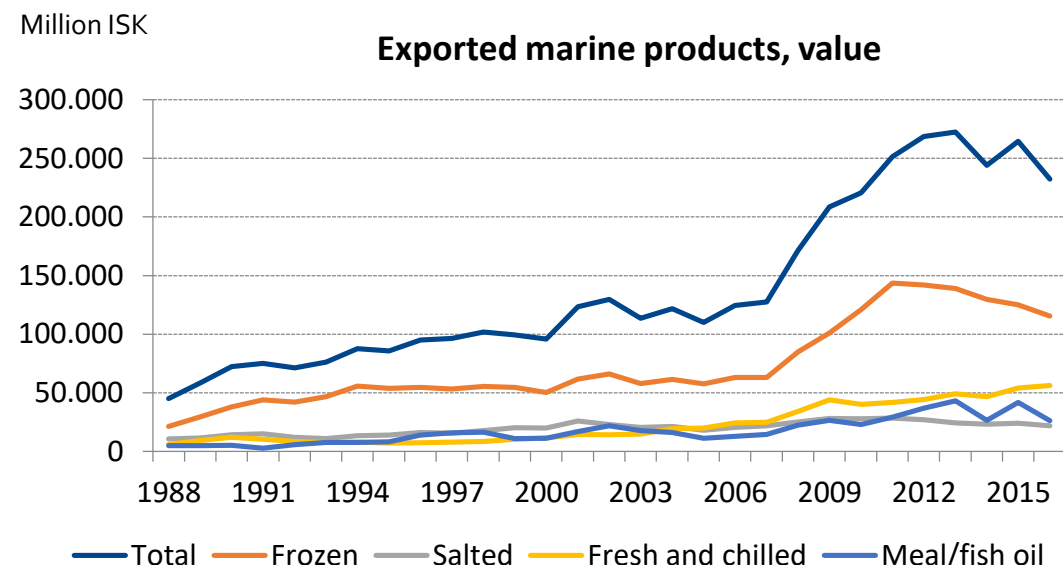
Source: Statistic Iceland



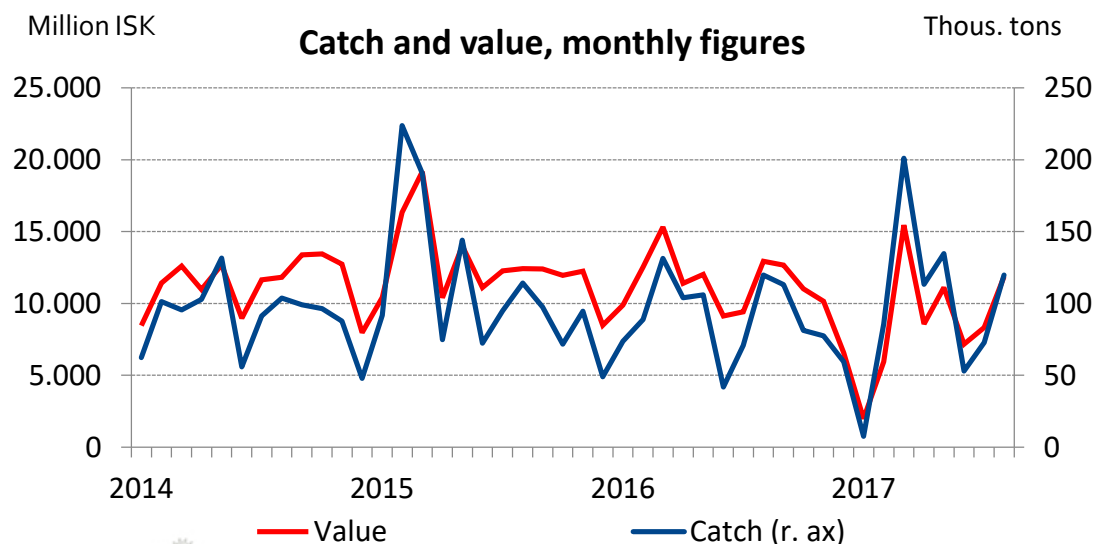
Source: Center for Retail Studies

Fishing sector

- Marine products have historically been the country's leading export items
- The fishing industry is one of the main pillars of the Icelandic economy
- Iceland maintains a 200 nautical miles exclusive fishing zone, 7 times the area of Iceland itself
- A catch limitation system is the cornerstone of the Icelandic fisheries management system. The system is intended to limit the total catch and to prevent more fishing from the fish stocks than the authorities allow at any given time

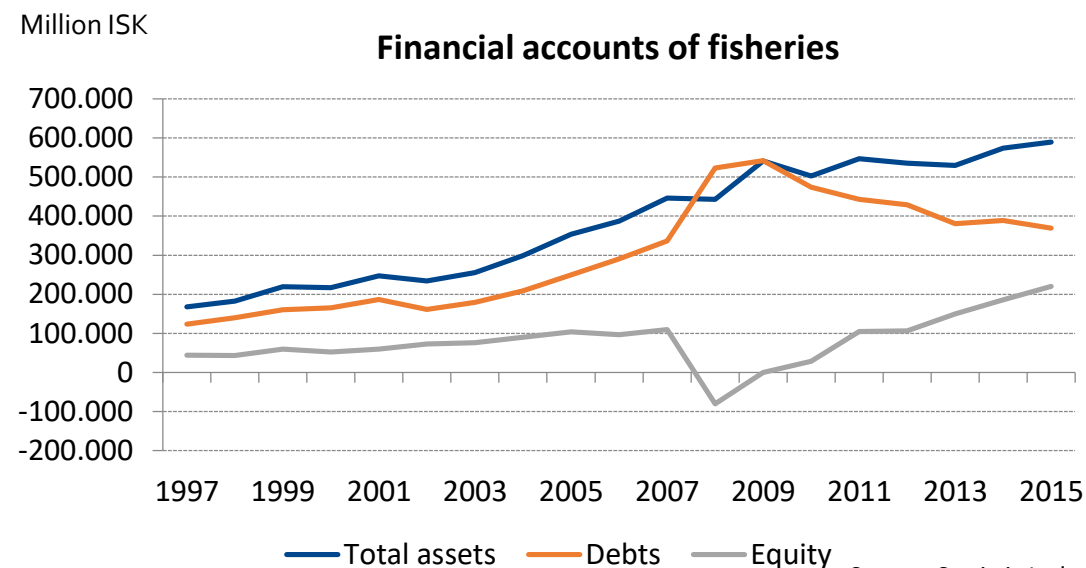


Source: Statistic Iceland



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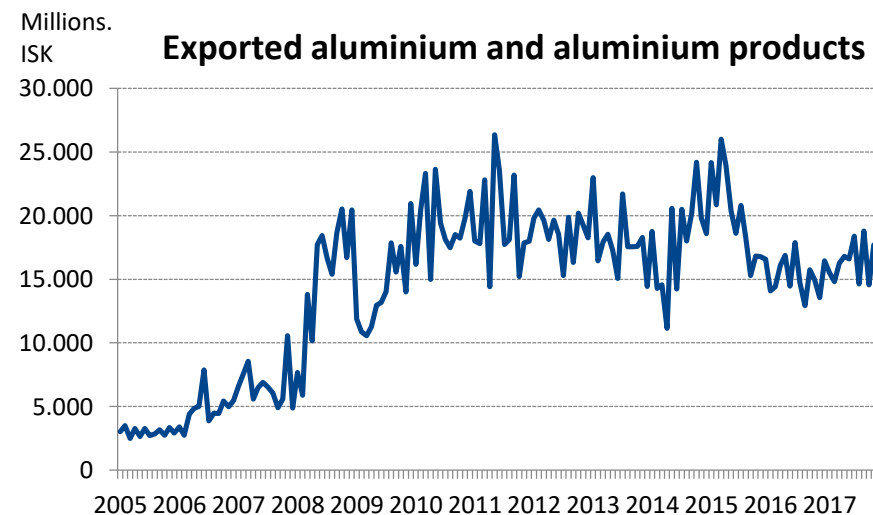
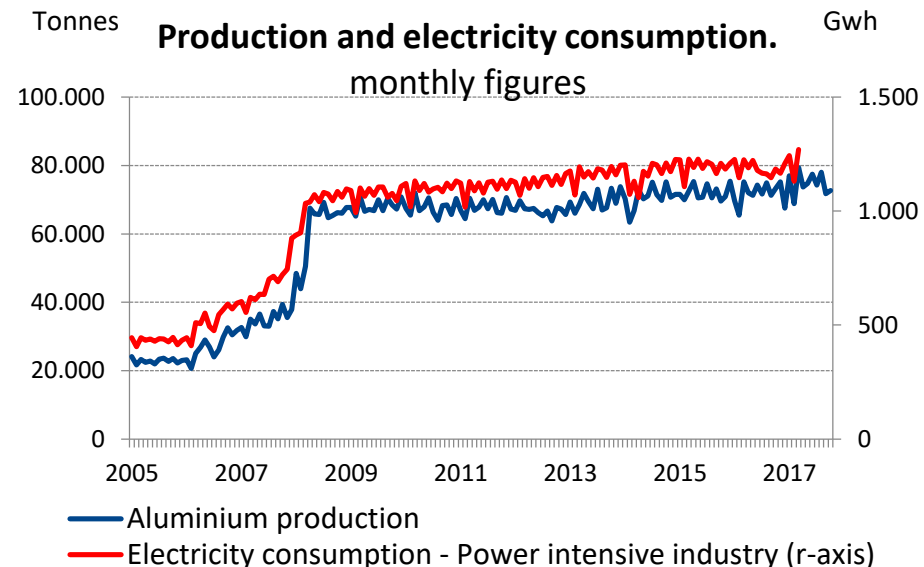
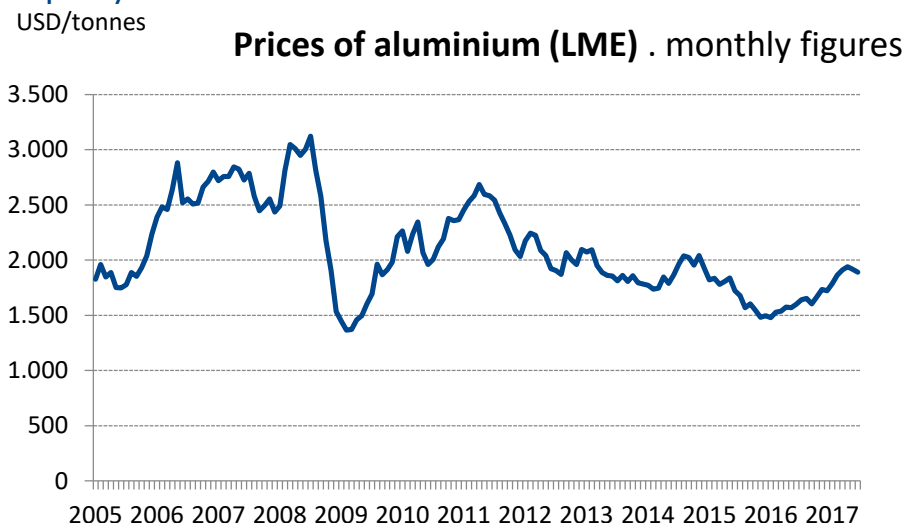
Source: Statistic Iceland



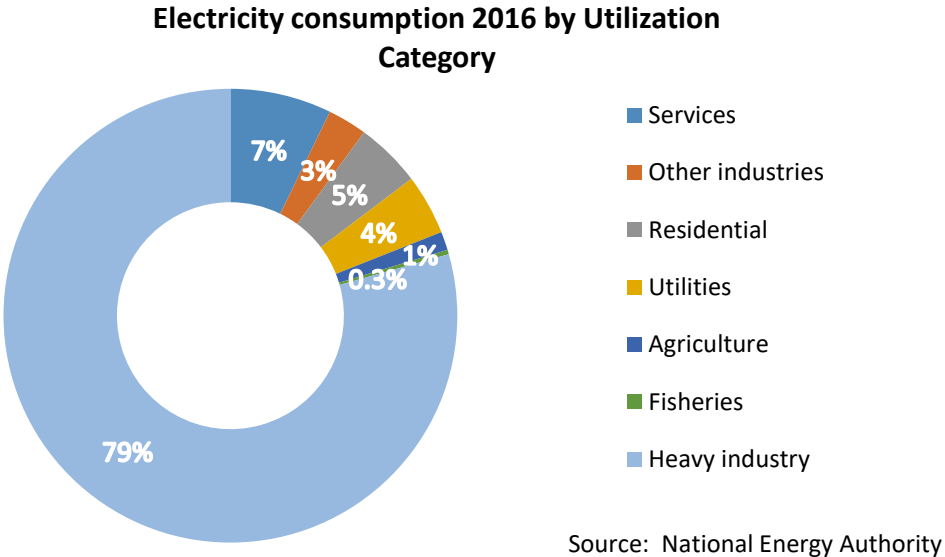
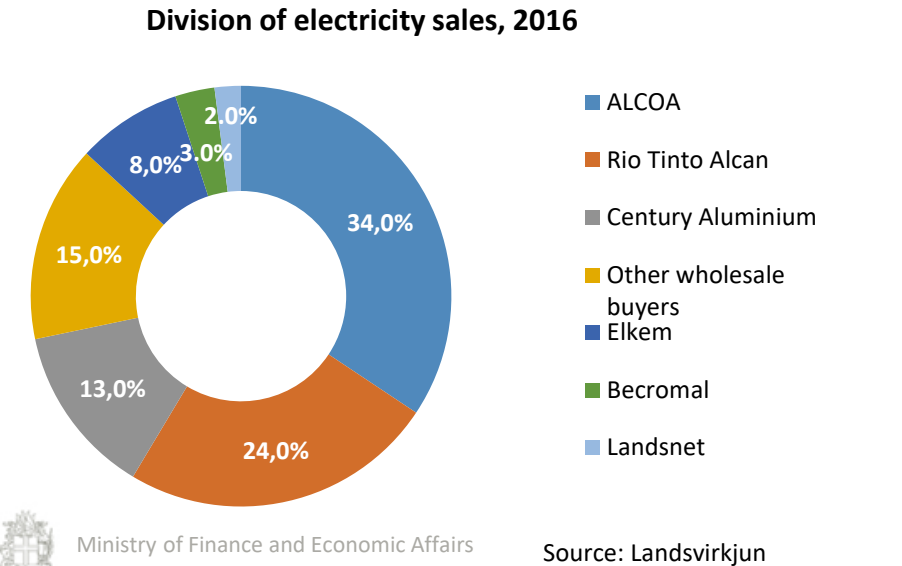
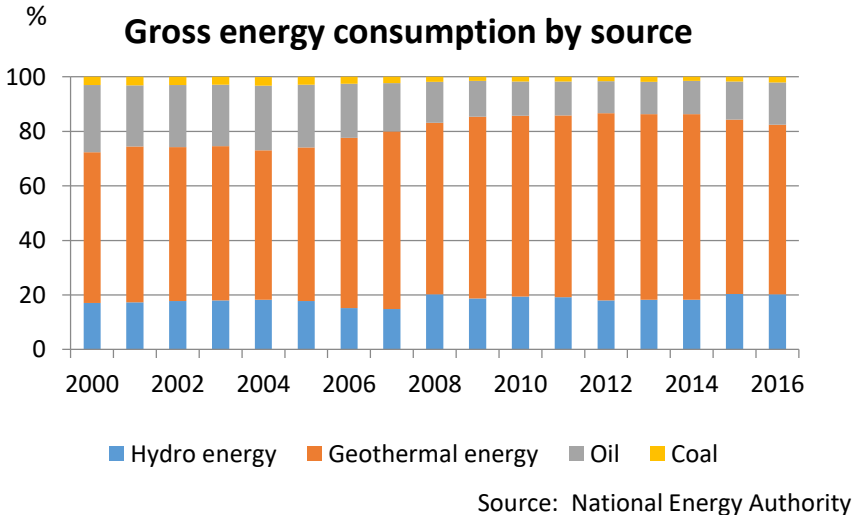
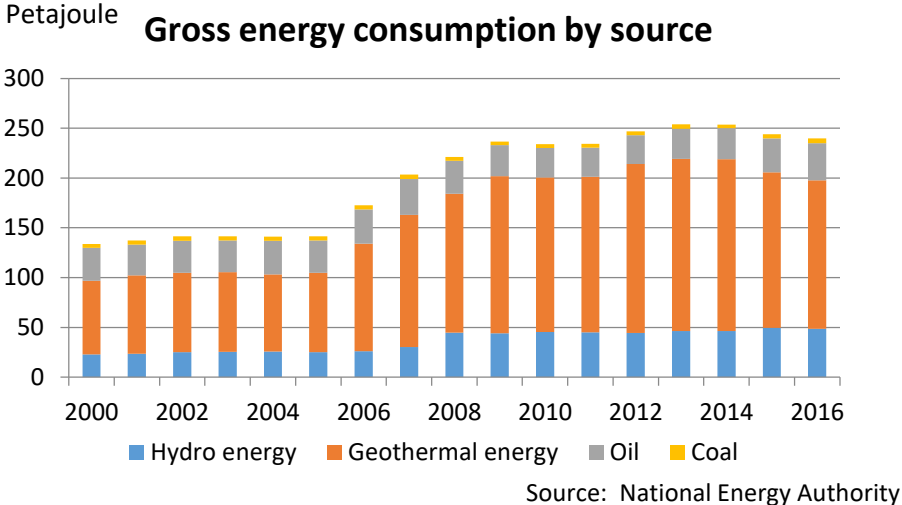
Source: Statistic Iceland

Aluminium sector

- Aluminium exports account for 14% of total exports of goods and services in the third quarter of 2017
- There are three aluminium smelters in Iceland, Alcoa (East Iceland), Century Aluminium (West Iceland) and Rio Tinto Alcan (South Coast Iceland)
- Production of aluminium started in Iceland in 1969 in Straumsvík (South Coast). During the first year, the production capacity was 33 thous. tonnes
- The capacity today for all three smelter is around 850 thous. tonnes per year

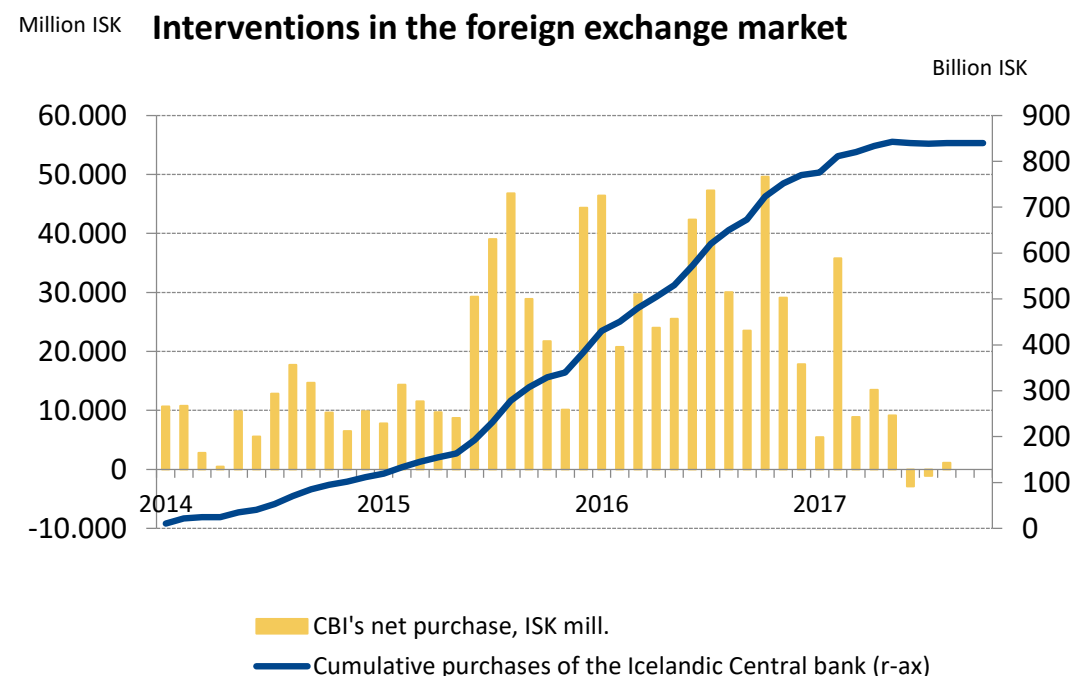
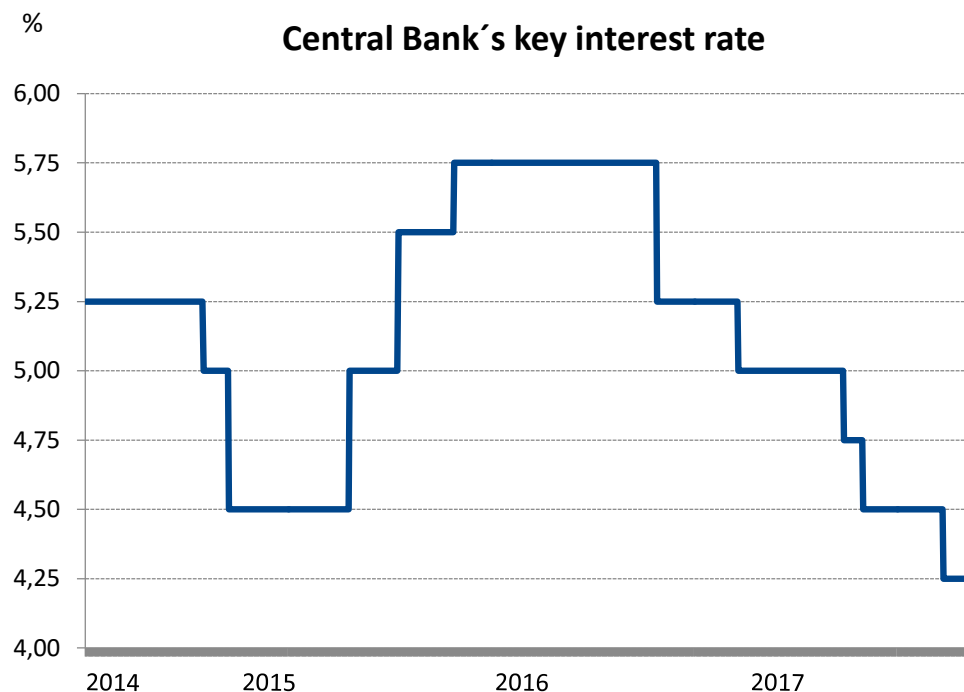


Energy consumption – 80% renewable



Monetary policy

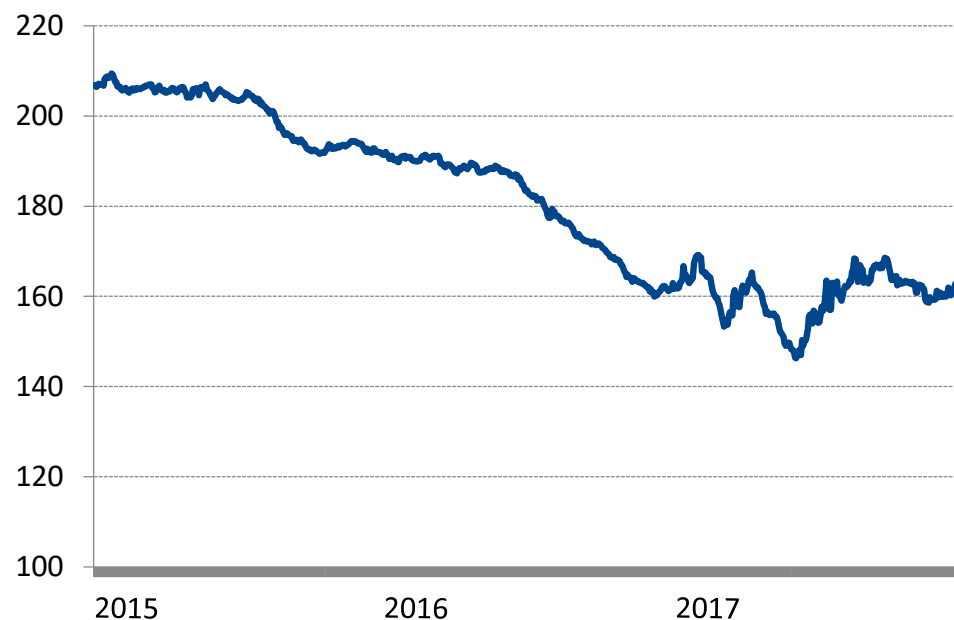
- The Monetary Policy Committee (MPC) of the Central Bank of Iceland decided on 13th of December to keep the Bank's interest rates unchanged.
- The Bank's key interest rate – the rate on seven-day term deposits, are 4.25%.
- The Central Bank has scaled down its intervention in the foreign exchange market in view of its strong foreign exchange reserves, as the appreciation of the króna is considered to reflect economic fundamentals. As before, the Bank will intervene in the market in order to mitigate volatility when it considers such intervention warranted



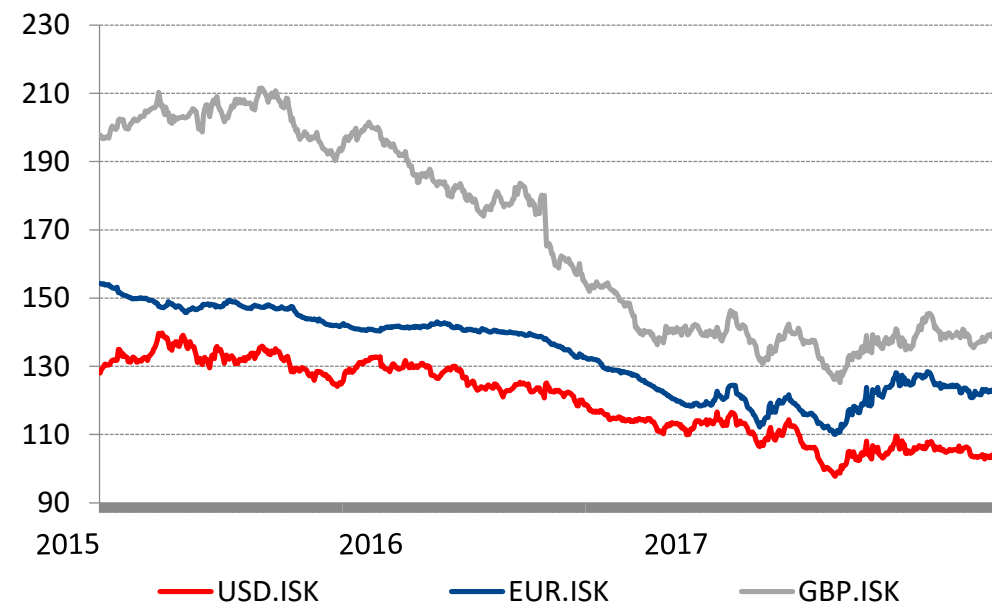
Exchange rate

- The króna appreciated 18% in 2016
- The króna appreciated steadily in the wake of capital controls alongside a large inflow of capital, but from the middle of 2017 there has been a reversal and the rate is similar to the beginning of the year

Exchange rate Index (narrow trade index)

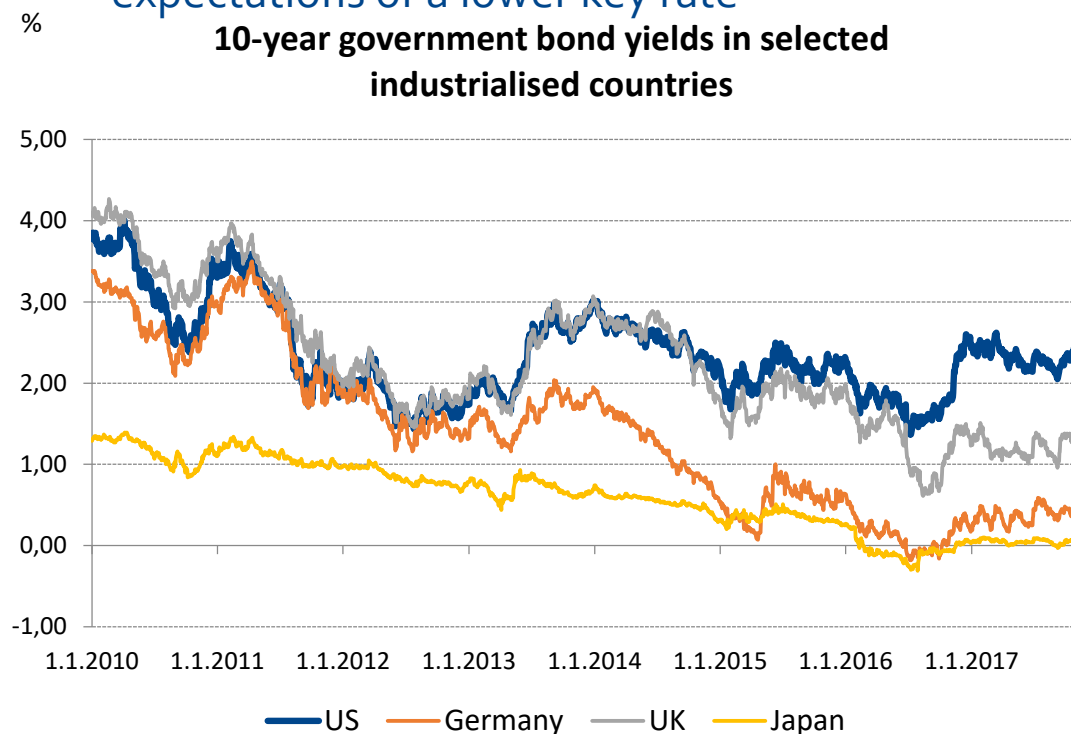


Exchange rate

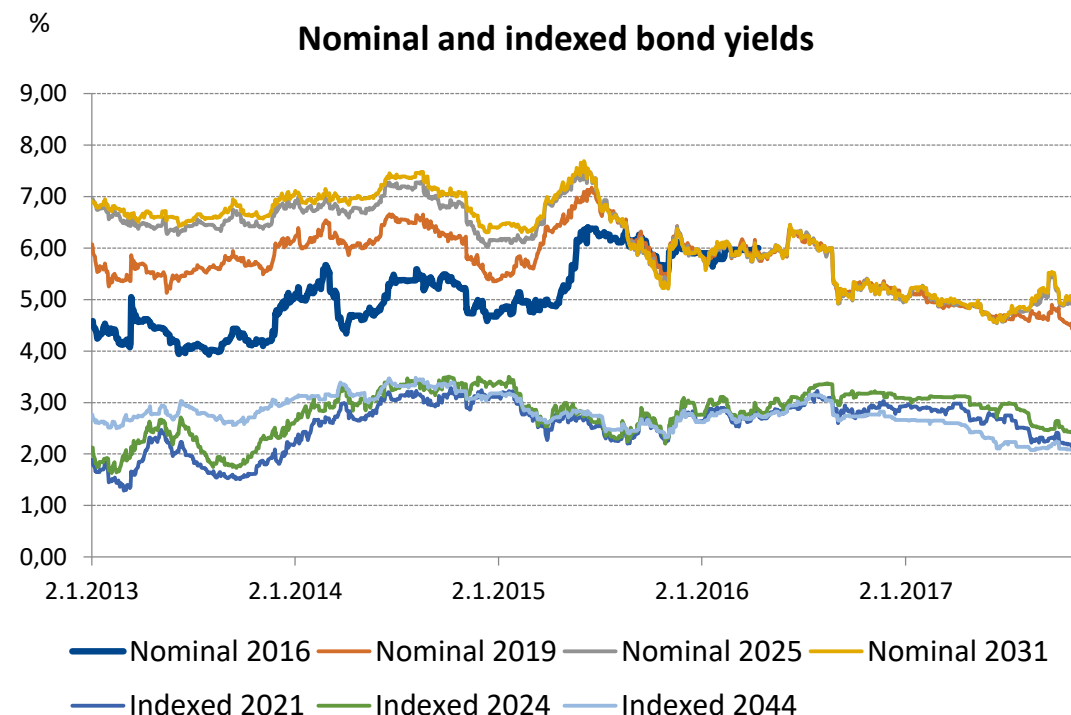


Interest rates

- Recently the long-term interest rates have risen in US and UK, while in Germany and Japan they are virtually unchanged
- The yields on indexed and nominal bonds have fallen
- The decline in bond yields appear to reflect market agents' reduced inflation expectations and their expectations of a lower key rate



Source: Central Bank

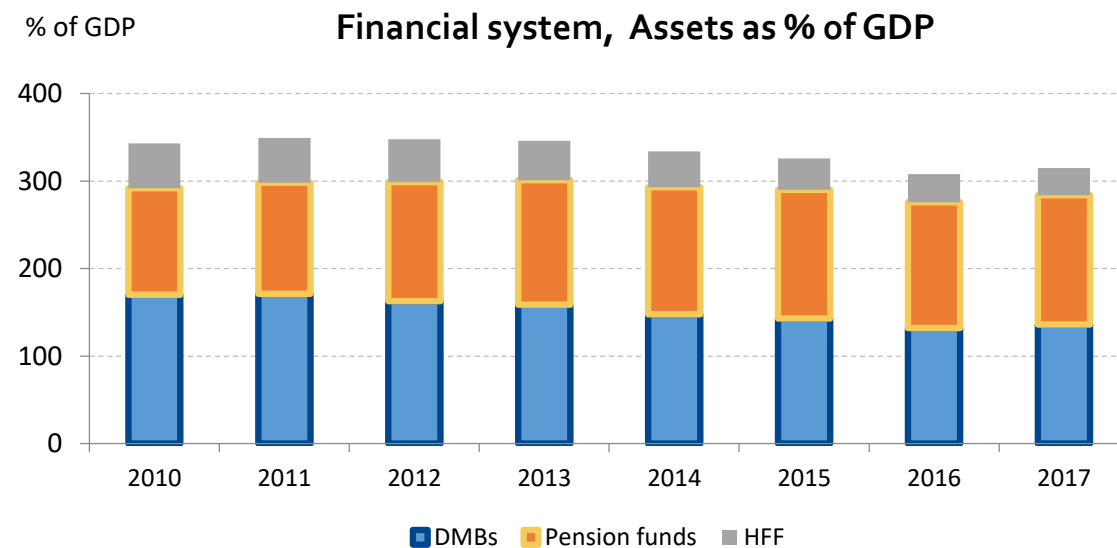
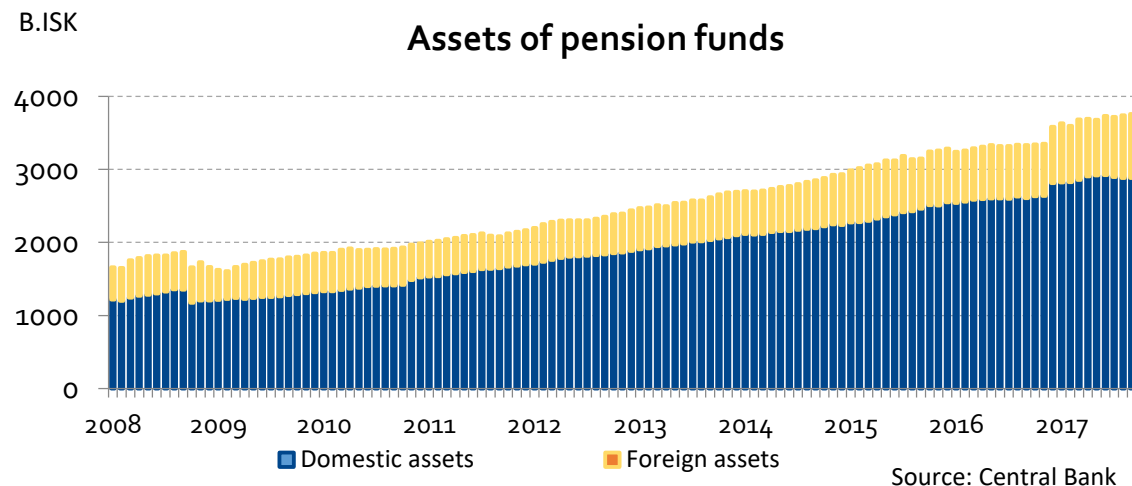


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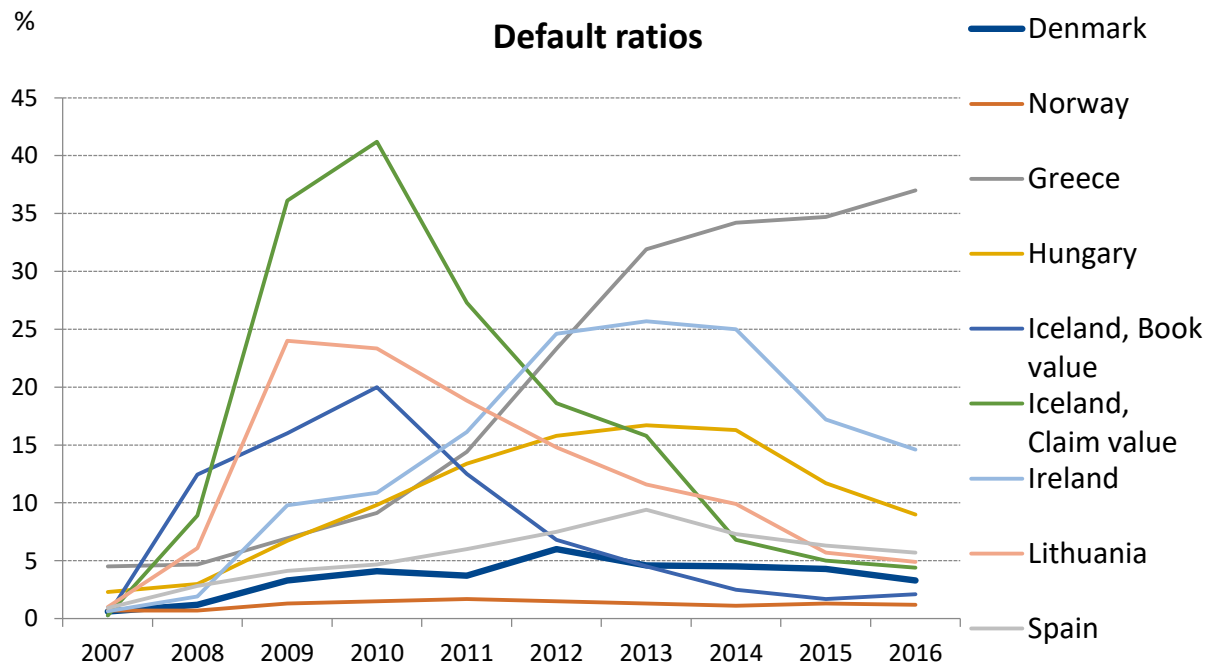
The financial system

- The three largest commercial banks are considered resilient with strong capital and liquidity positions
- Profitability, outside of irregular items, has been low
- Two of the largest banks are majority owned by the state, while it holds 13% in the third one
- The five year fiscal statement for 2017 - 2022 assumes 140 bn ISK in dividends
- The successful IPO of Arion bank is considered essential to re-establishing trust in the system
- The state's current ownership policy of financial institutions is to sell the 13% share in Arion and all holdings in Íslandsbanki while reducing the share in Landsbanki to 35 to 40%
- Within capital controls the size of the pension funds in the domestic financial market grew. They own around 50% of stocks and are majority holders of gov't debt

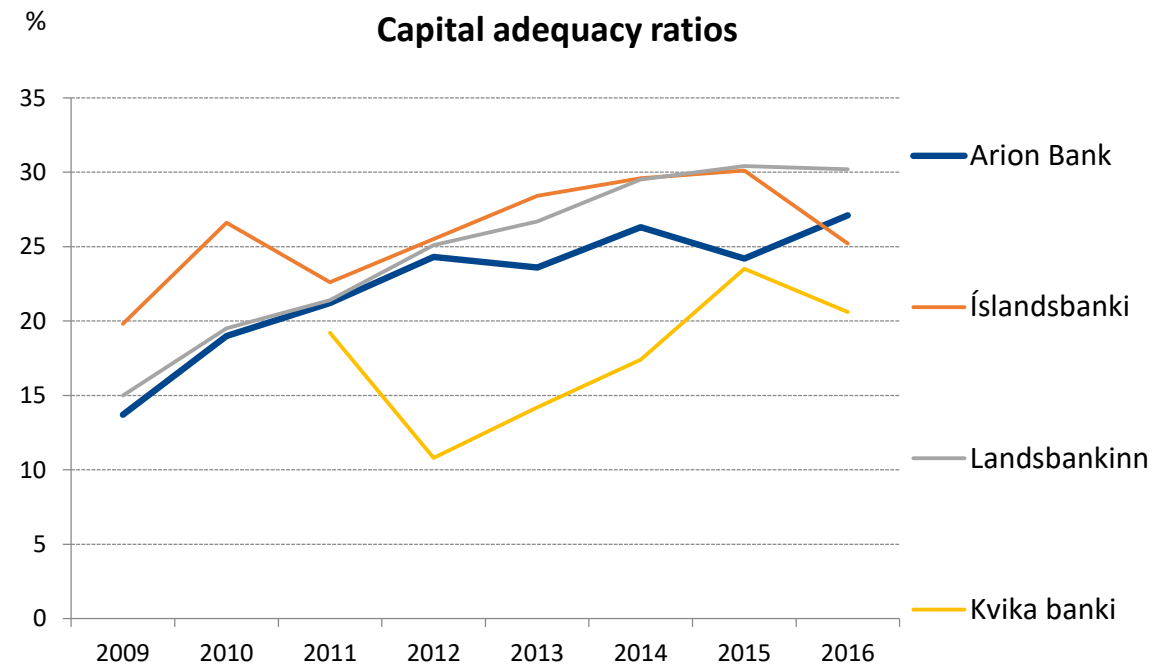


Commercial banks

- Default ratios for households and business in Iceland have declined
- Capital position is strong and both capital and leverage ratios are high for the commercial banks in Iceland



Source: Central Bank



Source: Central Bank





MINISTRY OF FINANCE
AND ECONOMIC AFFAIRS

Thank you for your attention

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