



MINISTRY OF FINANCE
AND ECONOMIC AFFAIRS

Icelandic Economic Situation

September 2018

Key points

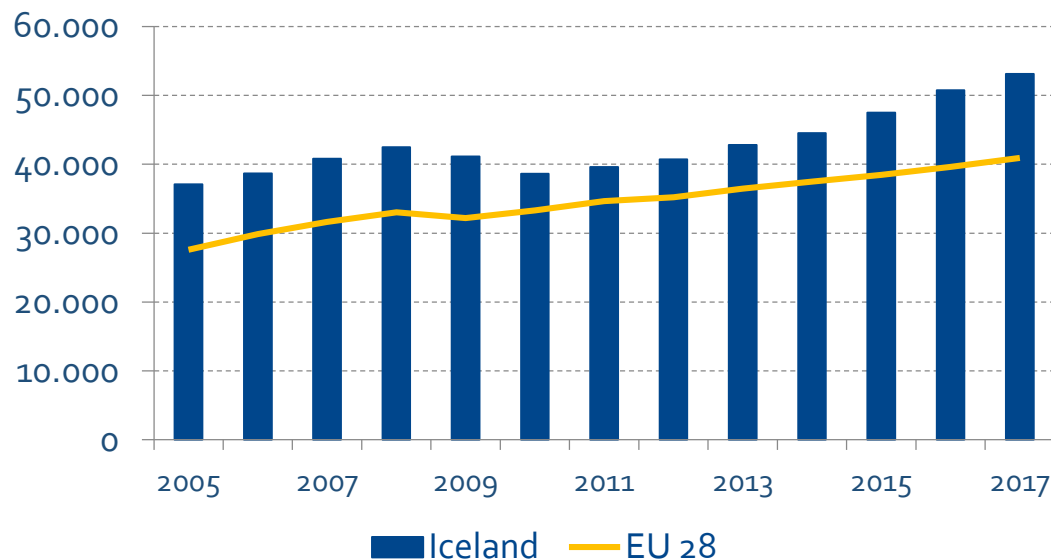
- Expecting soft landing of economic growth
- Major contributor is private consumption but investment, export and public consumption contribute to the growth as well
- Solid internal and external balance
- Inflation three times above the 2½% target since January 2014
- Responsible fiscal consolidation 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



Growth is slowing down

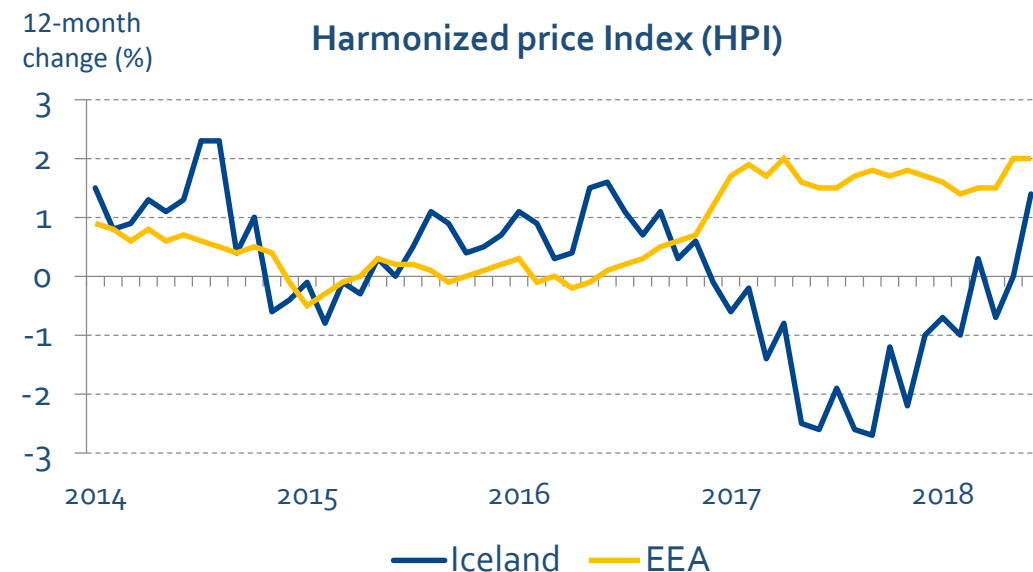
- GDP growth (2017) 3.6%
- Unemployment (July 2018) 2.5%
- Inflation, CPI in August 2018: 2.6%.
HPI in June 2018: 1.4%
- Positive current account balance
- 2.2 millions foreign visitors to Iceland in 2017

GDP per capita, USD PPP

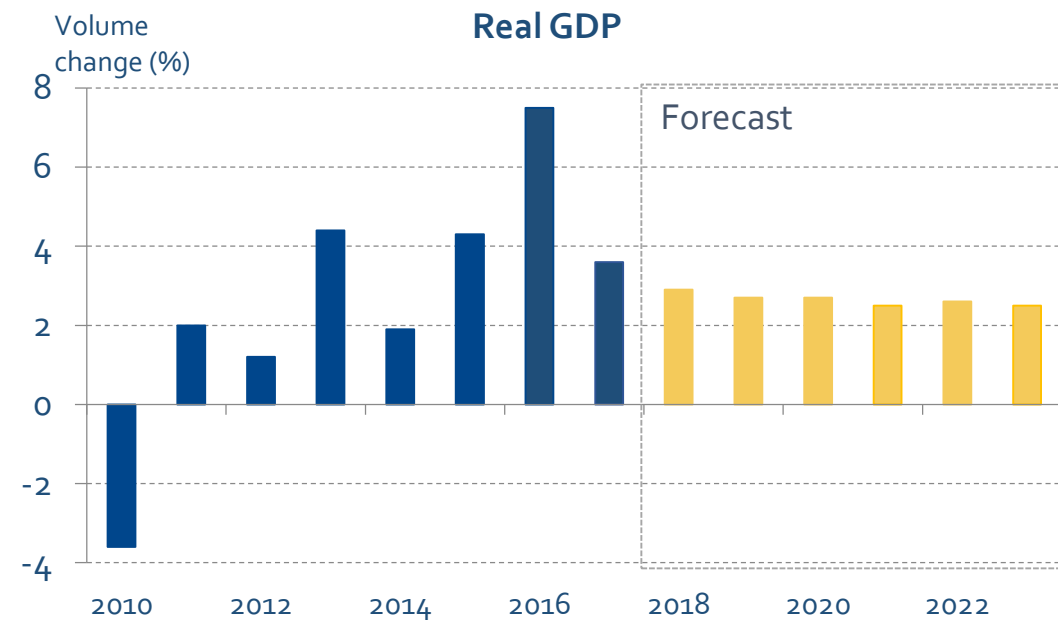


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Source: OECD

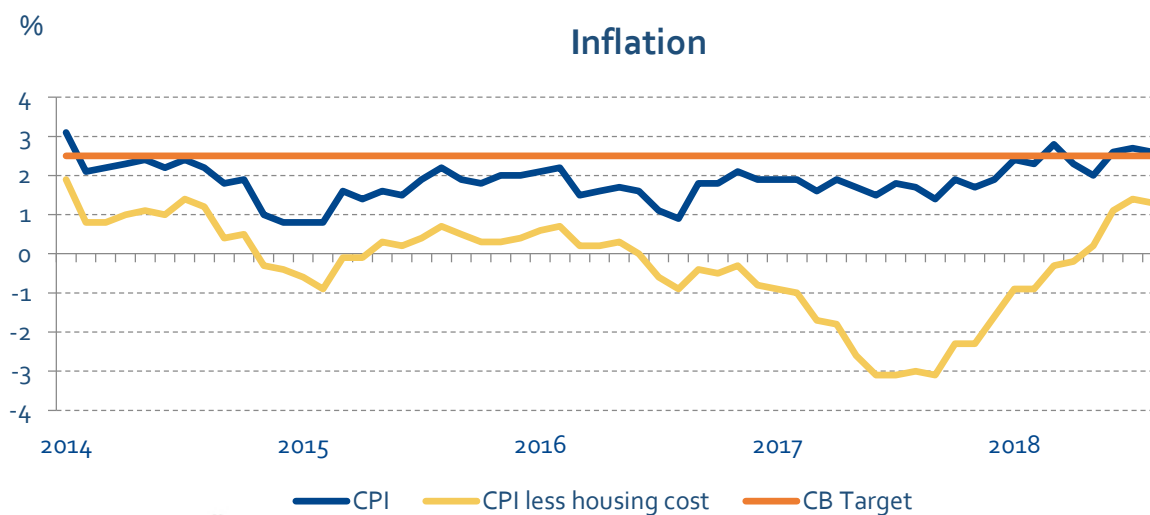
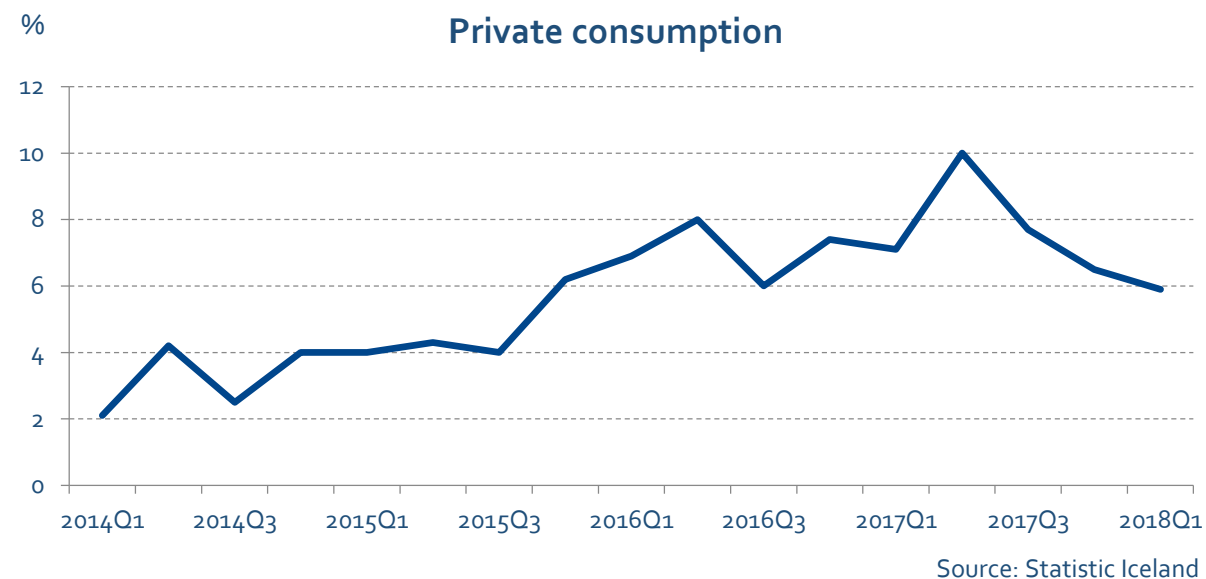
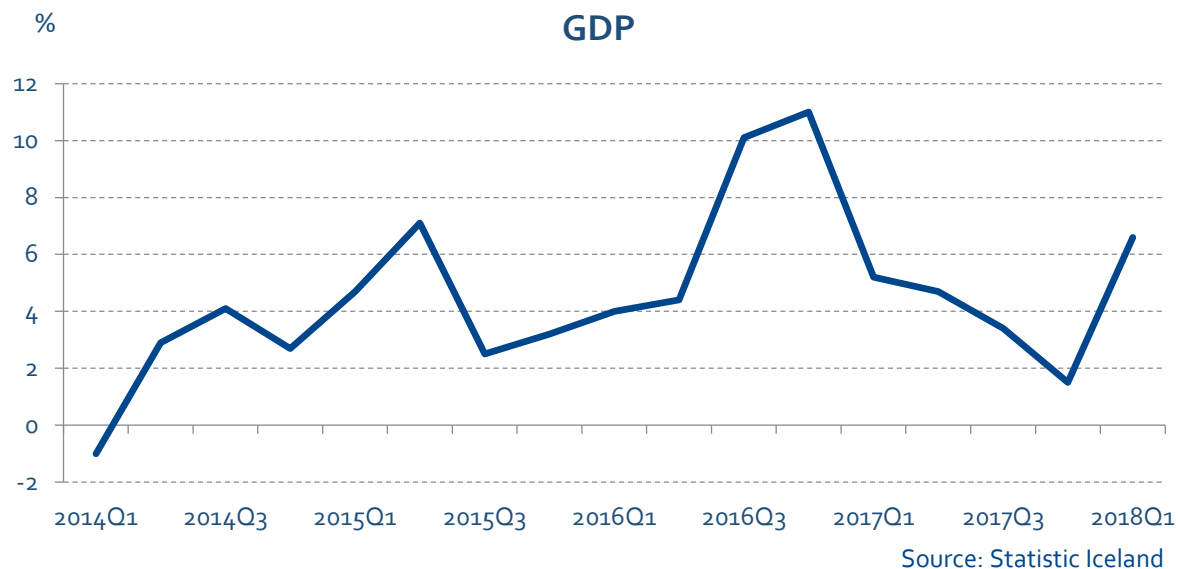


Source: Statistic Iceland



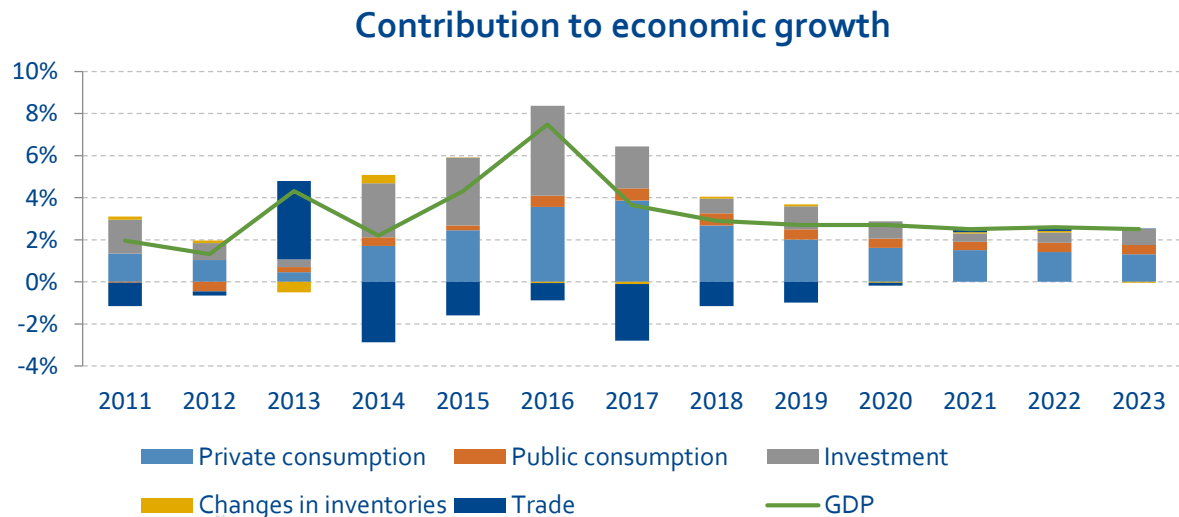
Source: Statistic Iceland

Recent developments, year over year



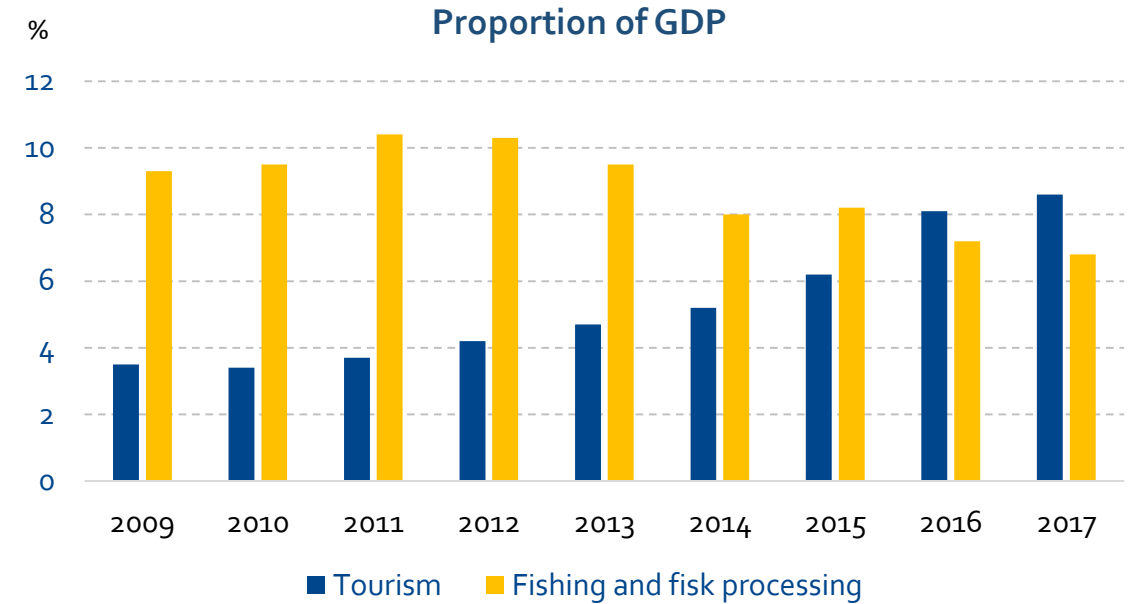
Combination of GDP

- Private consumption is expected to be the driving force for economic growth in the coming years, as well as investment and public consumption
- The share of tourism in GDP has grown year by year since 2010
- The share of tourism in 2016 exceeded the share of fishing and fish processing in GDP. However, the fishing sector has not decreased, but GDP has increased due to the increase in tourism

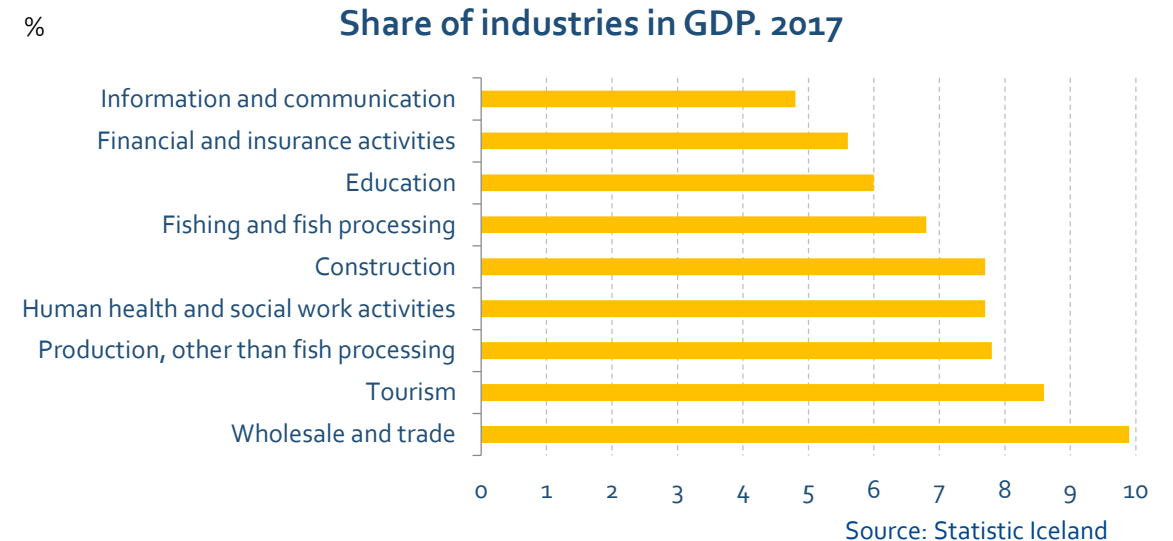


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Source: Statistic Iceland



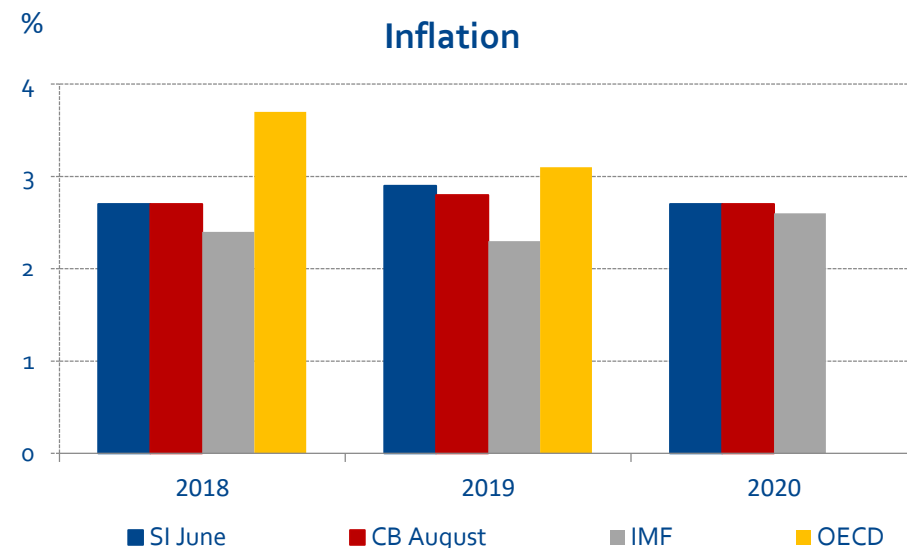
Source: Statistic Iceland



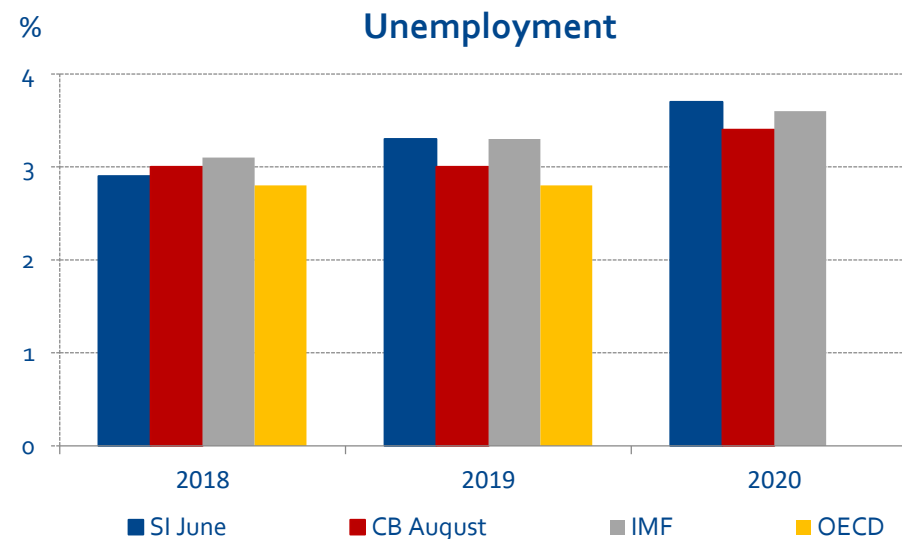
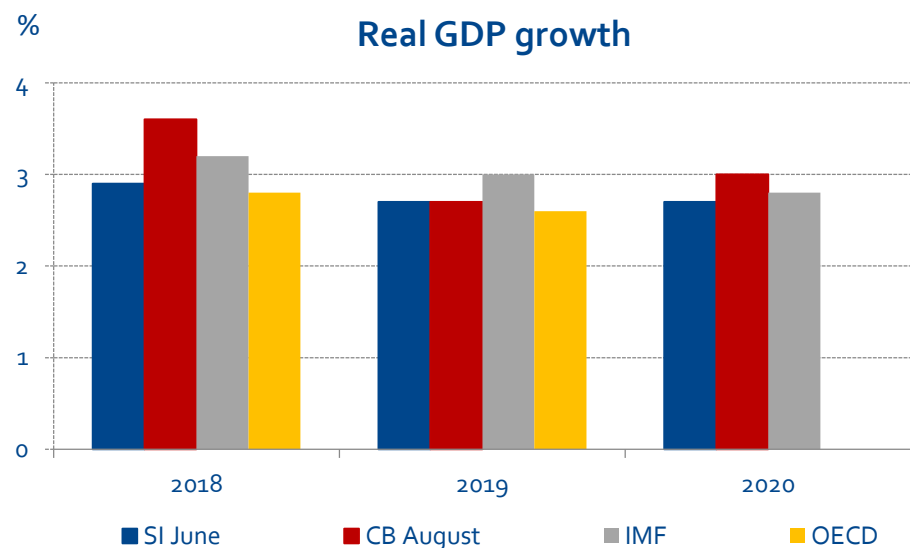
Source: Statistic Iceland

Forecasts

- The Central Bank forecasts GDP growth of 3.6% in 2018, up 0.3 pp, from its May forecast
- Statistics Iceland projects GDP growth of 2.9% in 2018 and 2.7% in 2019
- IMF and OECD published new forecasts for Iceland in the spring 2018
- Inflation is expected to exceed the inflation target in 2018 except in the IMF forecast



Source: Statistic Iceland, Central Bank, IMF, OECD



Source: Statistic Iceland, Central Bank, IMF, OECD



Key economic indicators – forecast published 1. June 2018

Volume change on previous year, %

	2018	2019	2020	2021	2022	2023
Private consumption	5,3	3,9	3,1	2,9	2,7	2,5
Public consumption	2,5	2,1	1,9	1,7	1,9	1,9
Gross fixed capital formation	3,2	4,9	3,6	1,7	2,2	3,5
Business investment	-1,9	3,1	1,7	-0,1	3,6	3,9
Housing investment	20,9	12,4	8,2	5,4	4,8	3,6
Public investment	14,7	3,6	5,8	4,3	-7,5	1,6
National expenditure	4,2	3,8	2,9	2,4	2,4	2,5
Exports of goods and services	3,4	2,7	2,6	2,6	2,6	2,4
Imports of goods and services	6,4	5,1	3	2,4	2,3	2,5
Gross domestic product	2,9	2,7	2,7	2,5	2,6	2,5

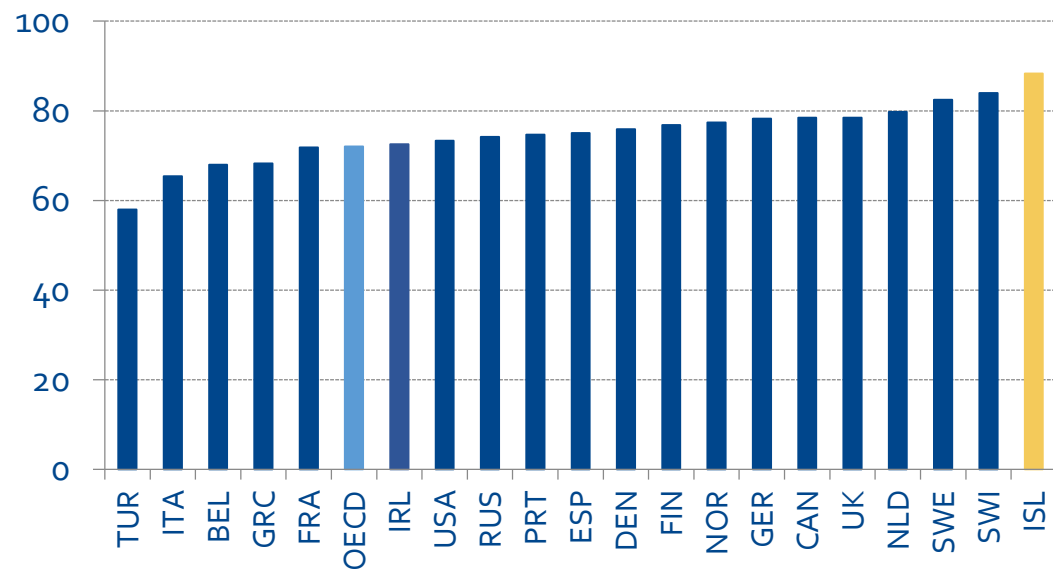
Source: Statistic Iceland



International comparison

- GDP growth in Iceland has been slowing in 2017, but it is still well above the average in the OECD countries
- Iceland has the highest participation rate in the labour market, both among men and women
- Unemployment rate was around 3% in 2017

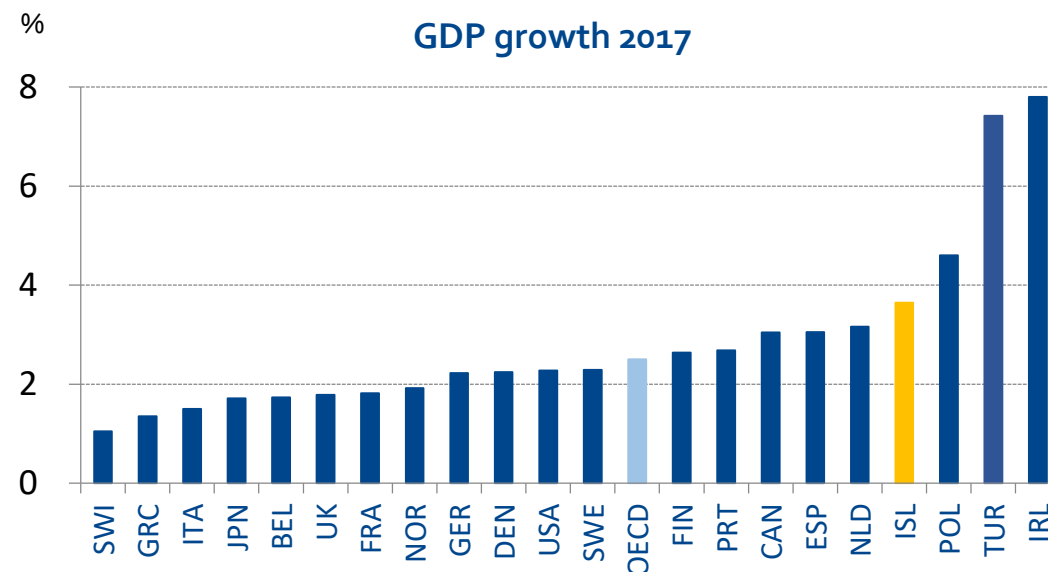
% Labour force participation rate 2017, 15-64 year olds



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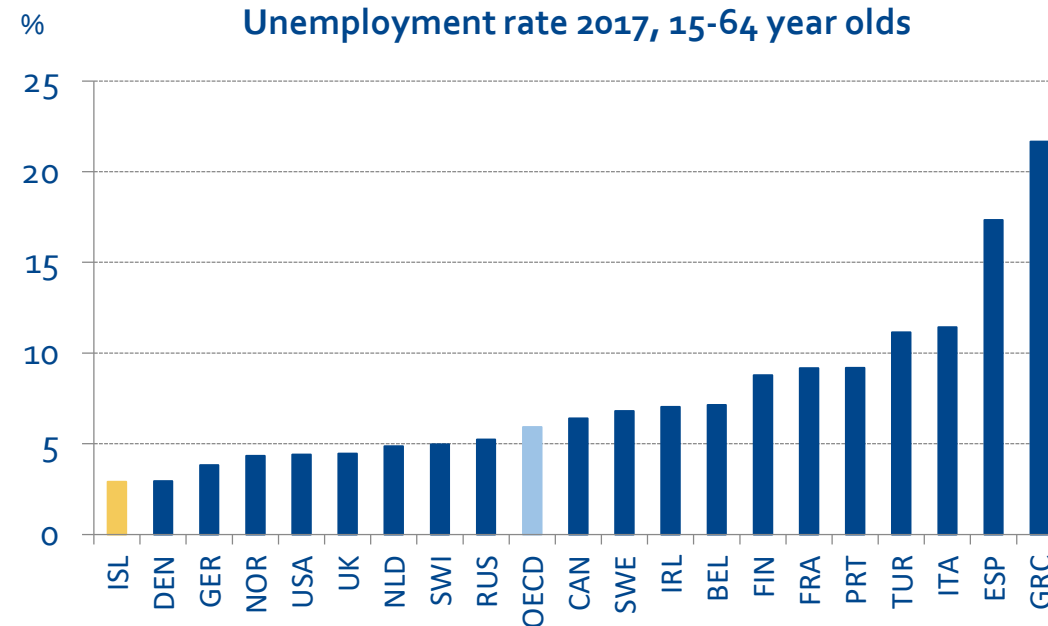
Source: OECD

GDP growth 2017



Source: OECD

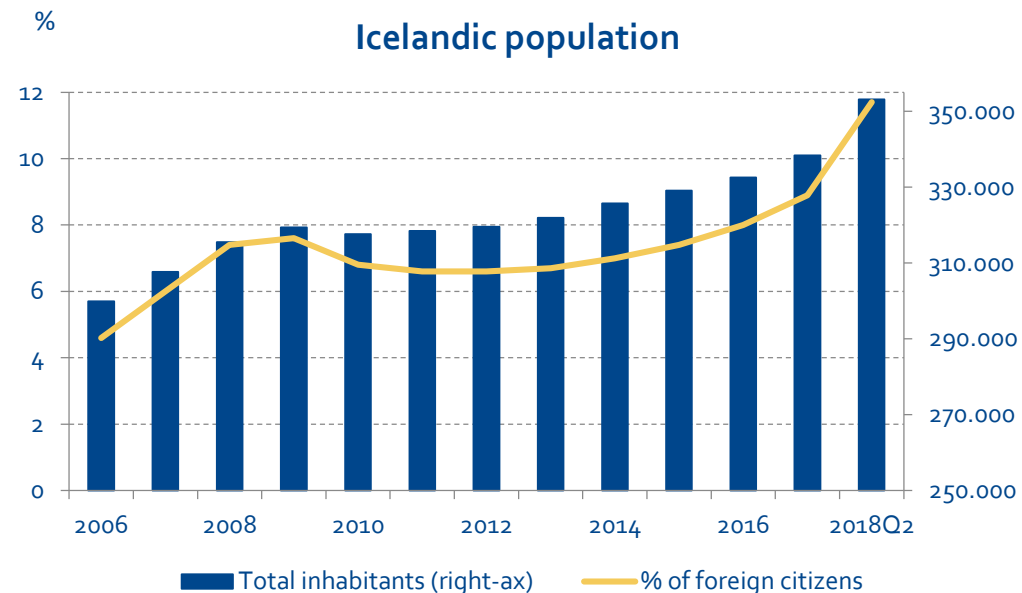
% Unemployment rate 2017, 15-64 year olds



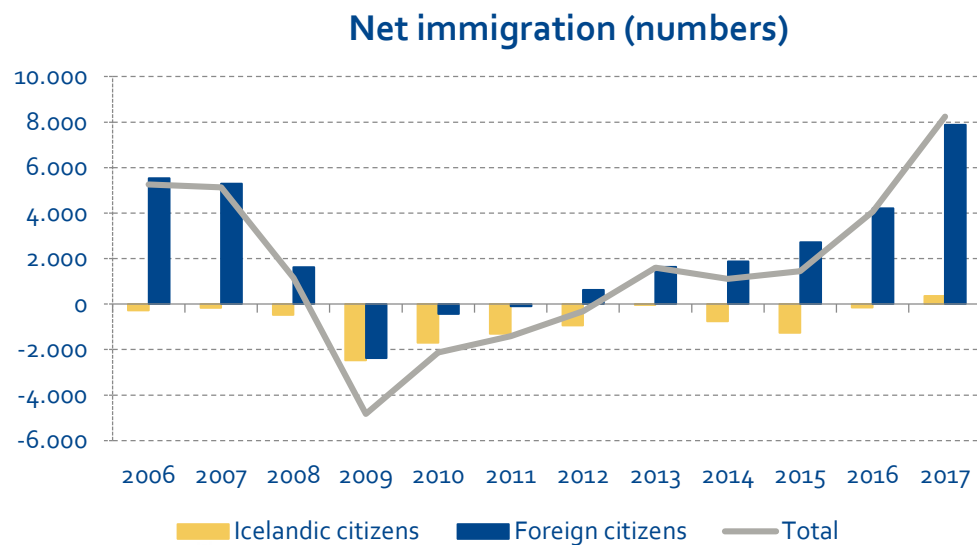
Source: OECD

Population

- Total population 2nd quarter 2018: 353,070
- Life expectancy (2017): Men: 80.6, women: 83.9
- In the 2nd quarter of 2018 there are 41,280 foreign citizens in Iceland, 11,7% of the total population
- In the 2nd quarter of 2018, 3,150 foreign citizens immigrated to Iceland and 1,410 emigrated

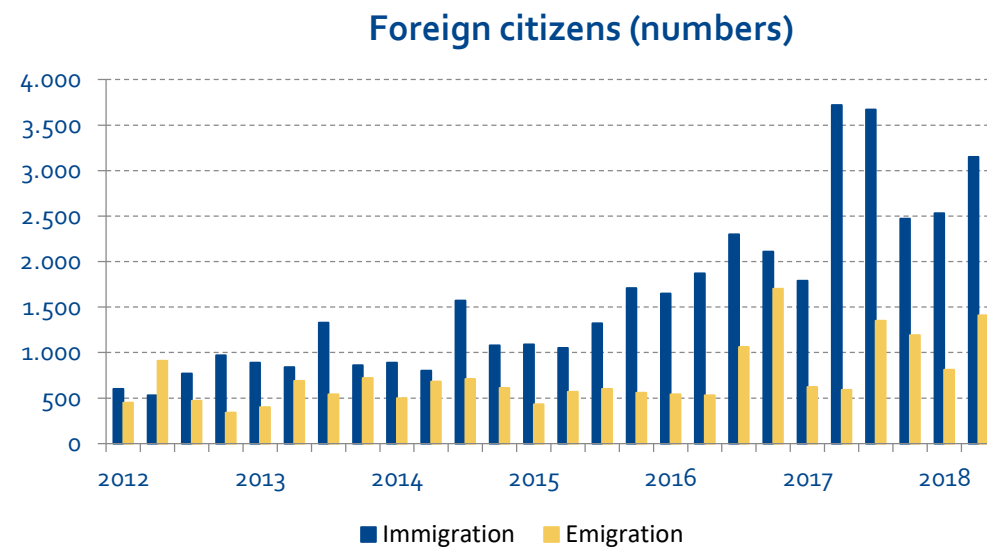


Source: Statistic Iceland



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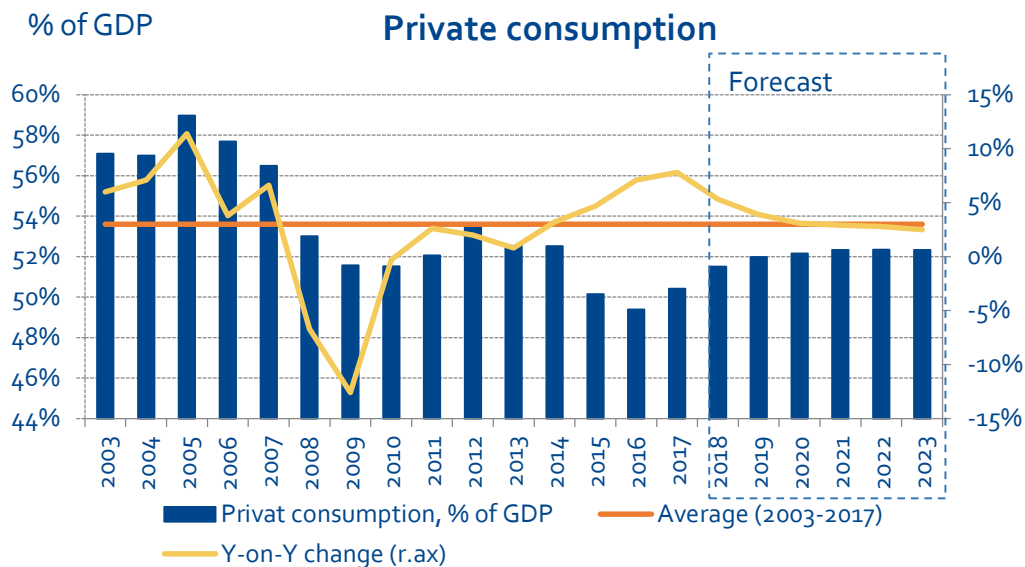
Source: Statistic Iceland



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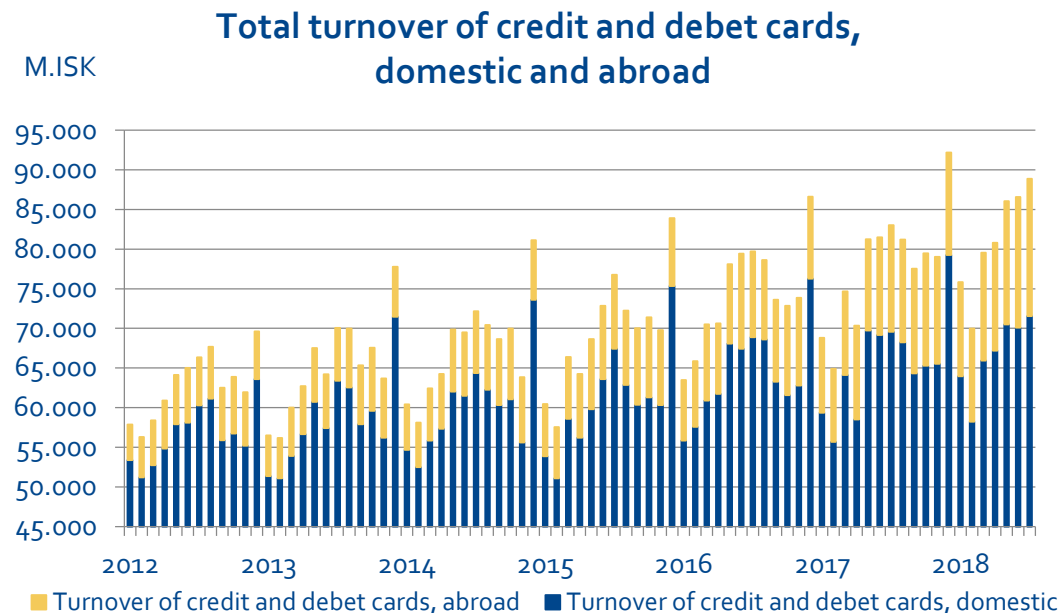
Private consumption

- 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



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Source: Statistic Iceland



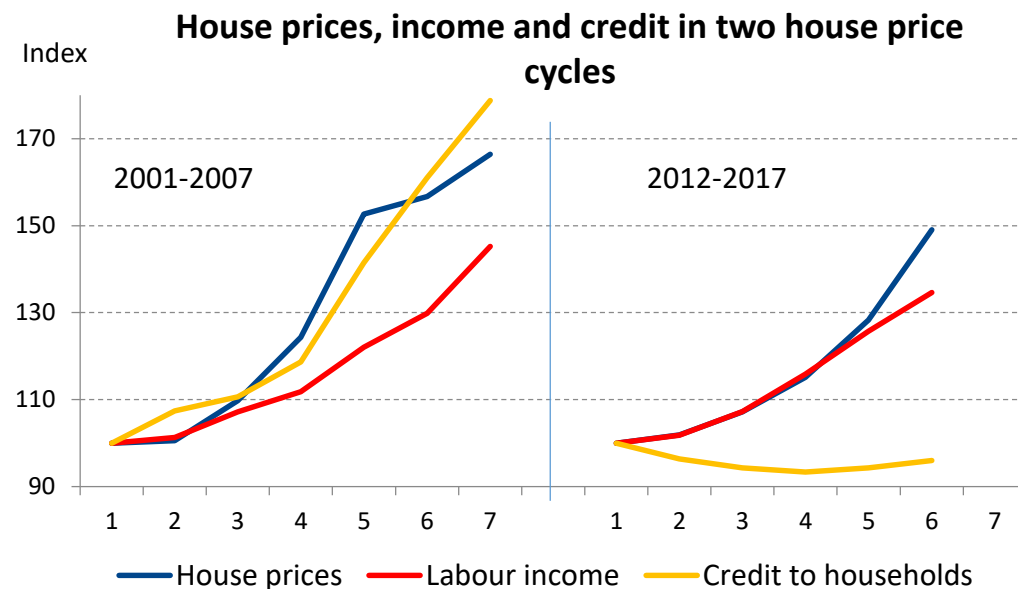
Source: Central Bank



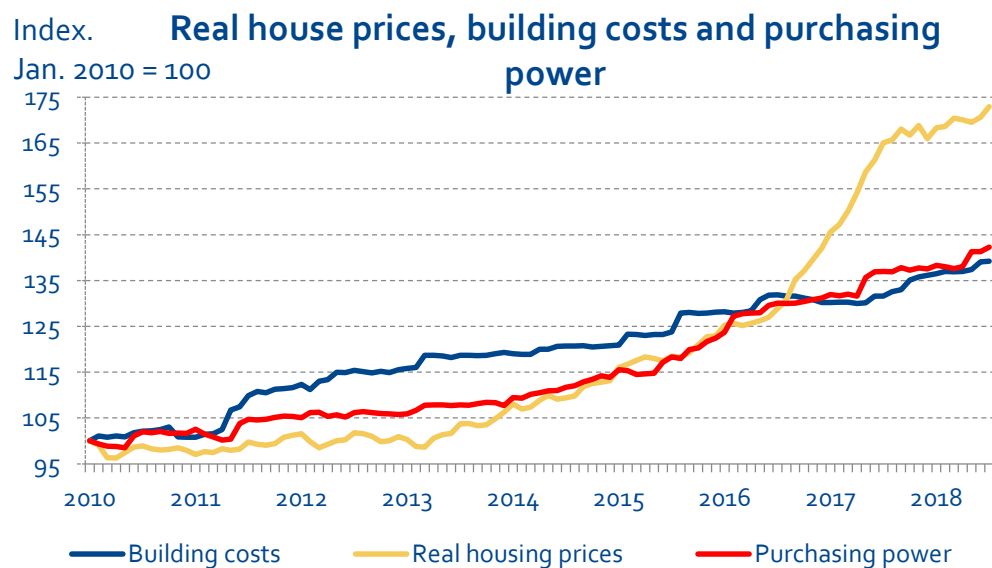
Source: Icelandic Tourist Board

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

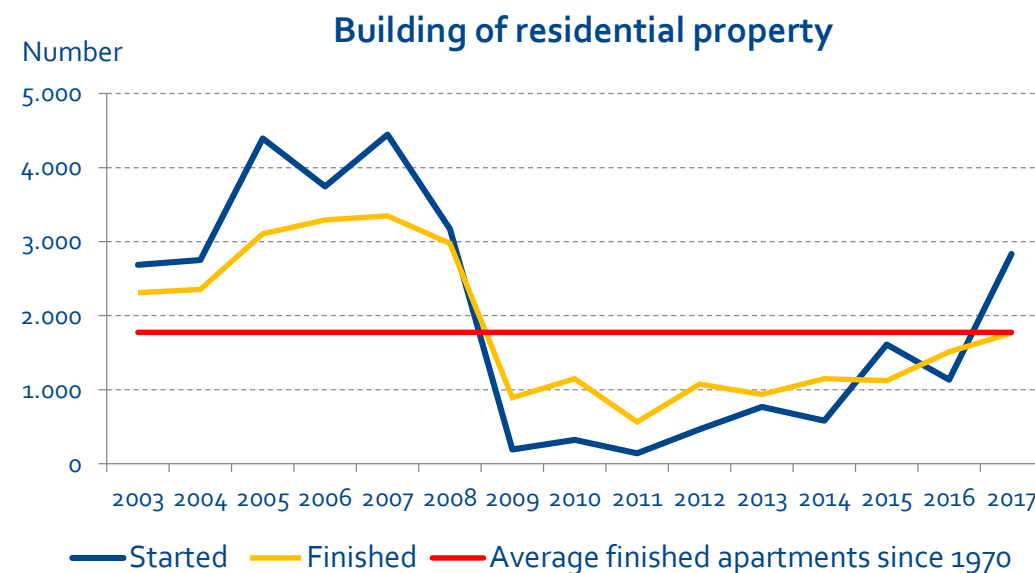


Source: Central Bank



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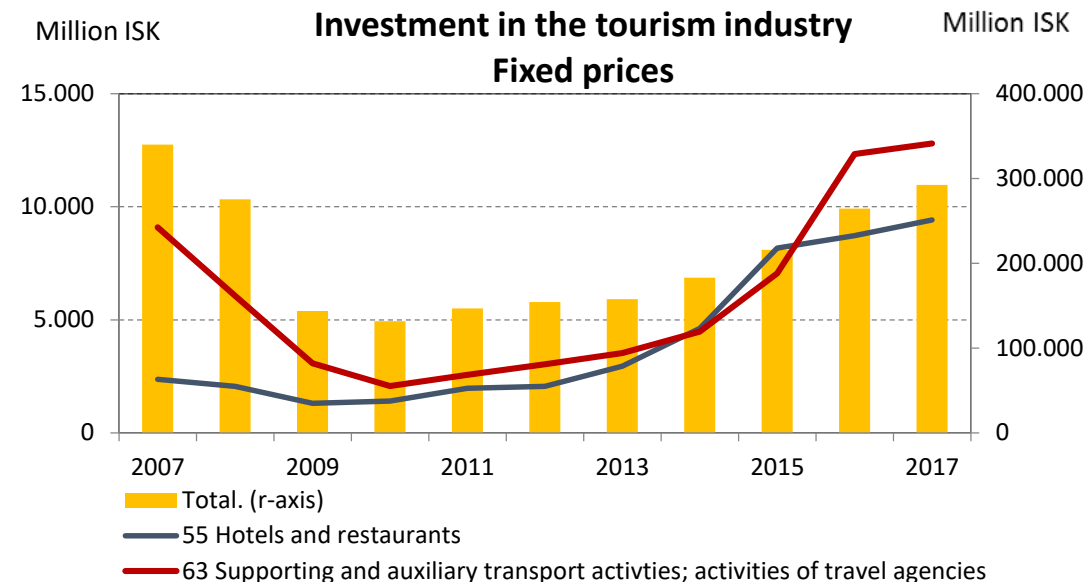
Source: Central Bank



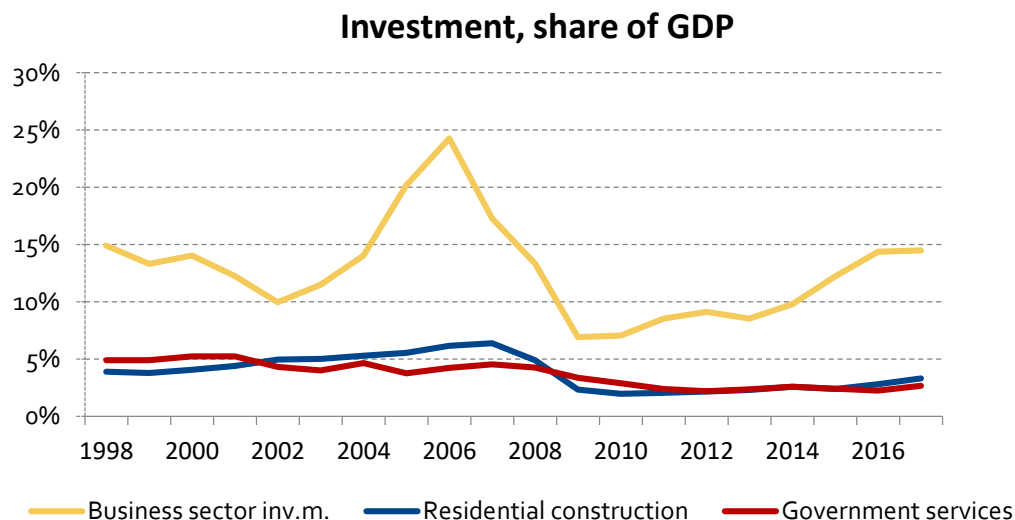
Source: Federation of Icelandic Industries

Investment

- Business sector investment has risen as a share of GDP in the last 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

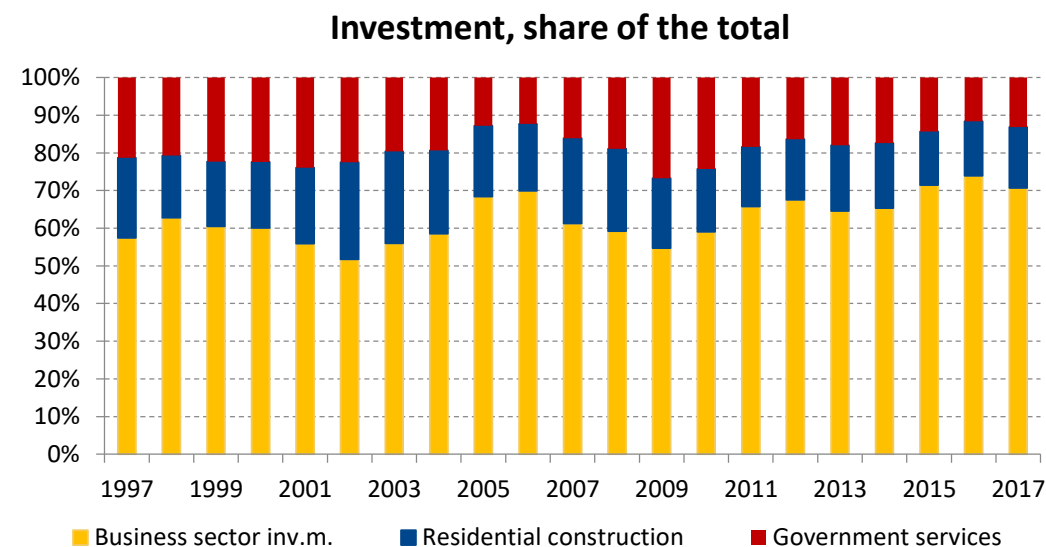


Source: Statistic Iceland



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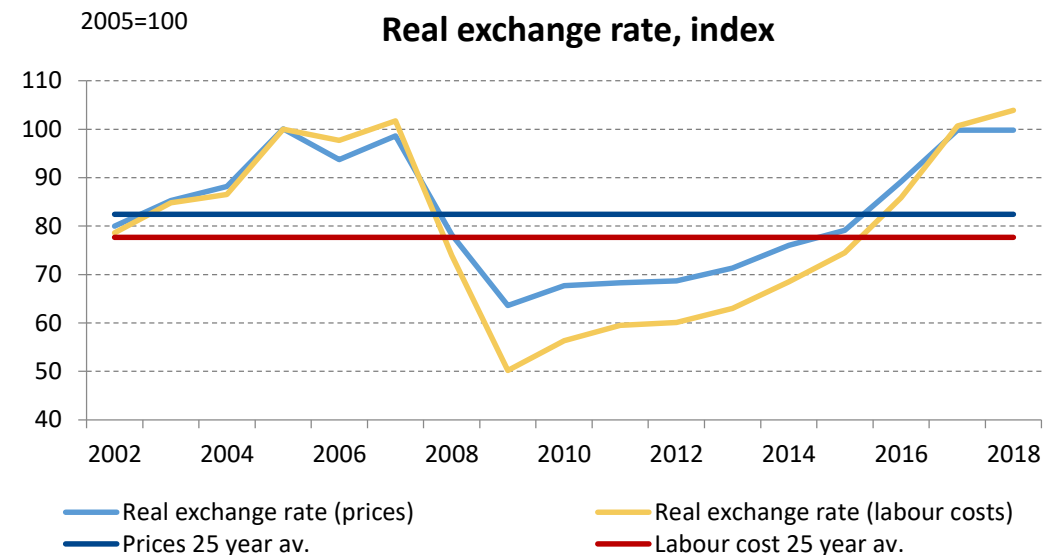
Source: Statistic Iceland



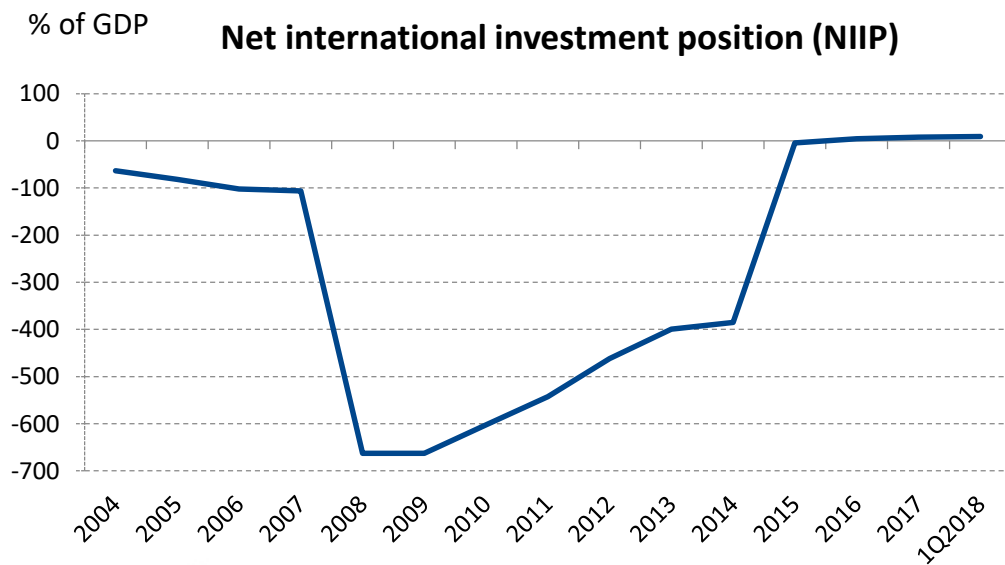
Source: Statistic Iceland

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 (3,65% of GDP in 2017), largely thanks to the development in tourism
- Iceland's net international investment position (NIIP) has improved substantially and currently stands at 9% of GDP

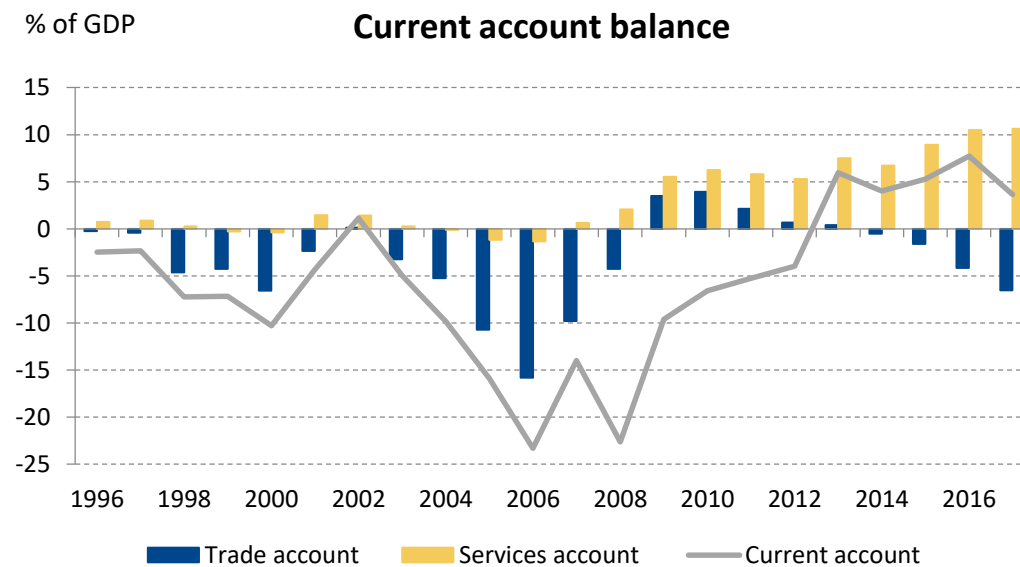


Source: Central Bank



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Source: Central Bank



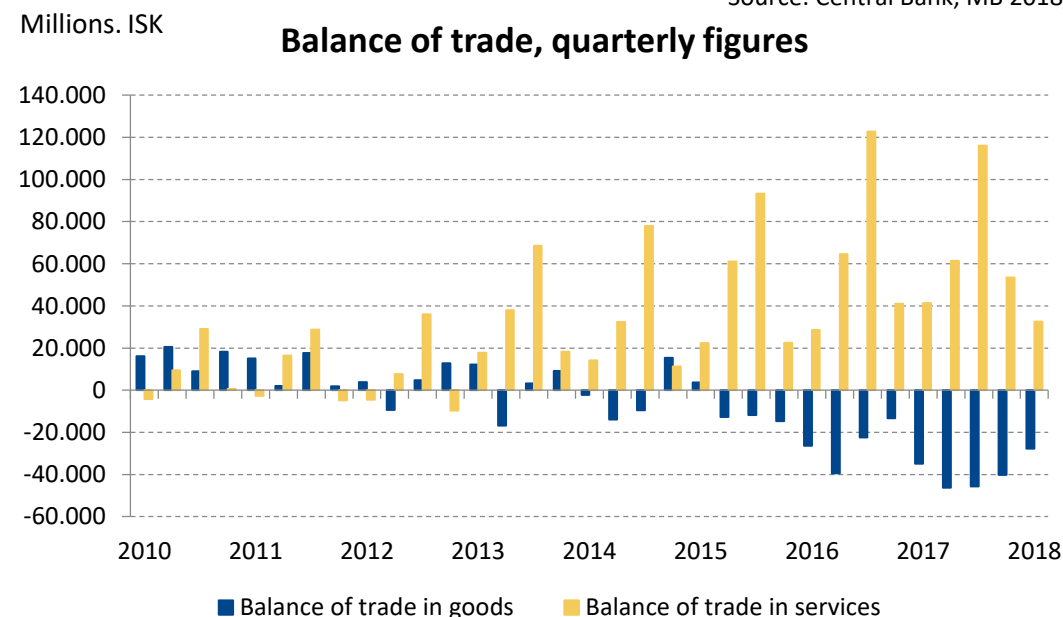
Source: Central Bank

Trade and terms of trade

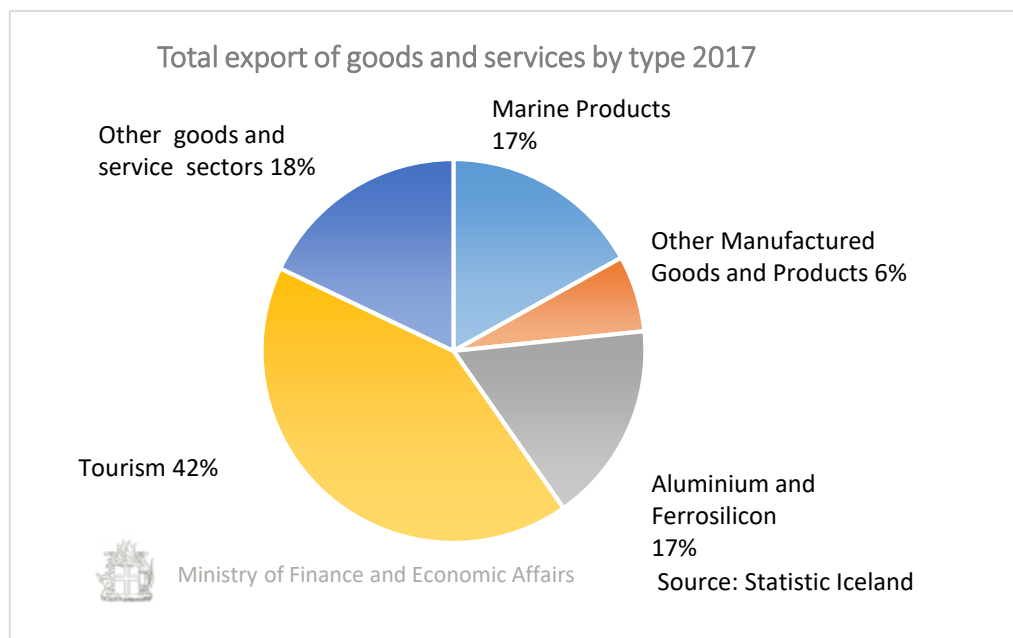
- Terms of trade have improved markedly, and exports have grown rapidly
- The rise in the exchange rate is due largely to growth in tourism, considerably better terms of trade, and a substantial improvement in Iceland's external position
- The share of tourism in total exports of goods and services in 2017 was 42%
- The balance of trade surplus in 2017 amounted to 4.1% of GDP



Source: Central Bank, MB 2018/2

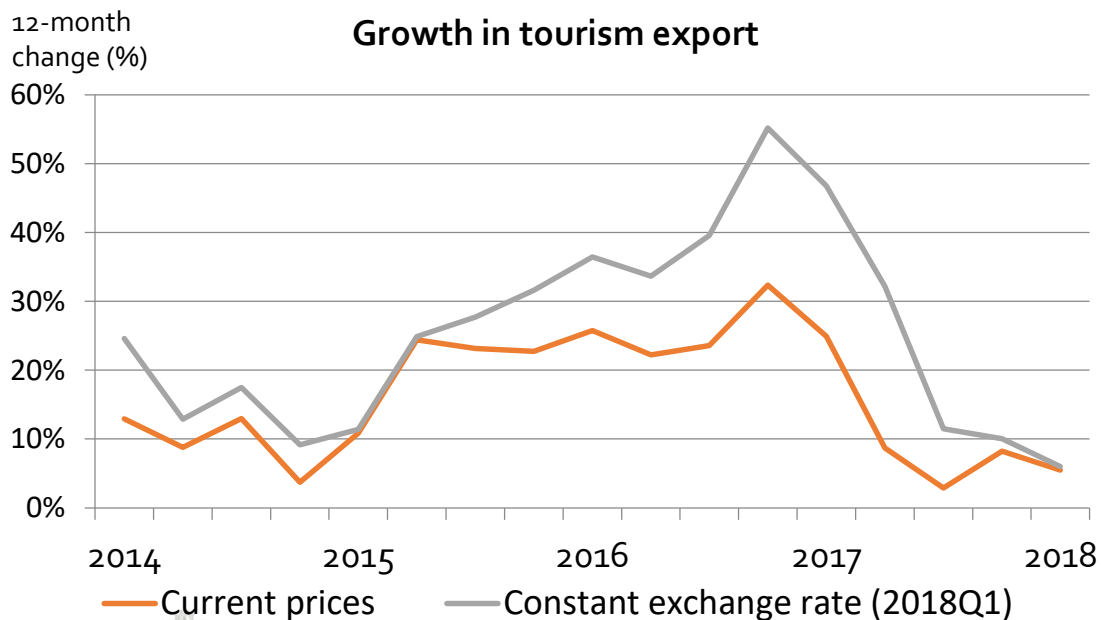


Source: Statistic Iceland



Trade

- Income from foreign tourists in Iceland and abroad amounted to 95 b.kr. in the first quarter of 2018, increasing by 5.5% in current prices 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 82% in the first quarter of 2018

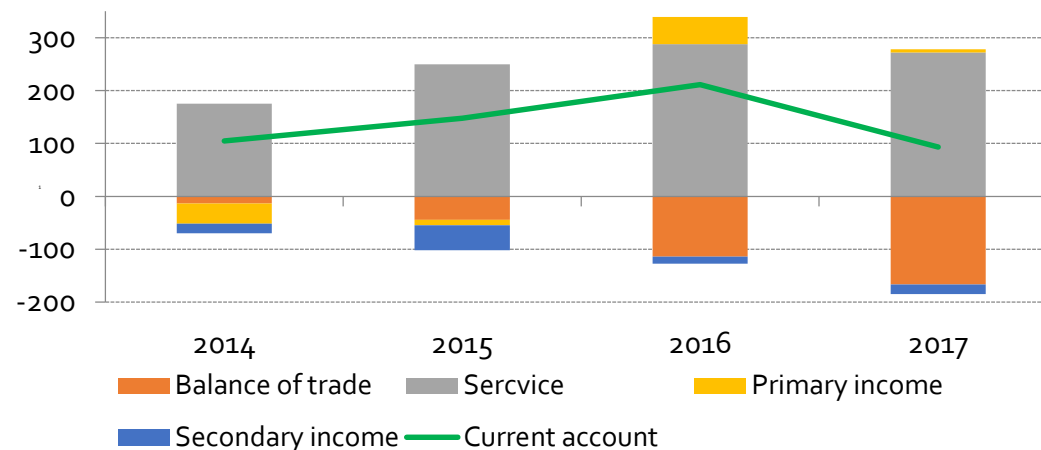


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Source: Statistic Iceland

Billions ISK

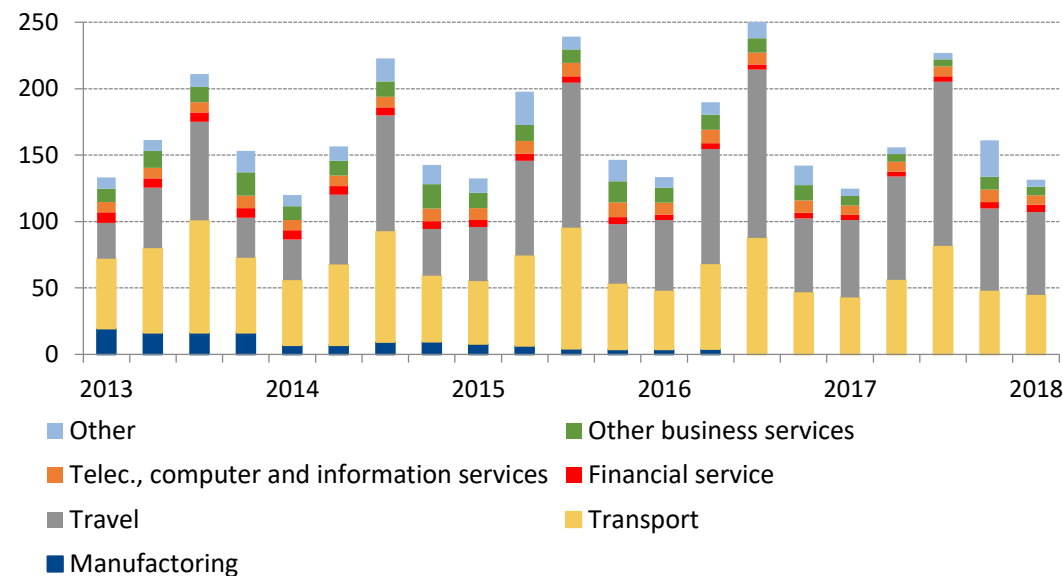
Current account balance and components
constant exchange rate (2017Q4)



Source: Central Bank

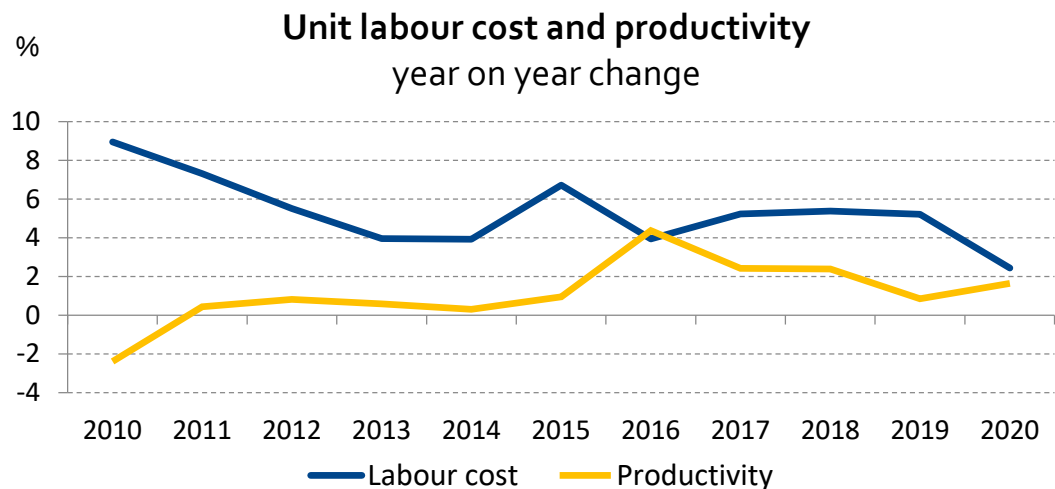
Billions ISK

Service export, constant exchange rate (2018Q1)

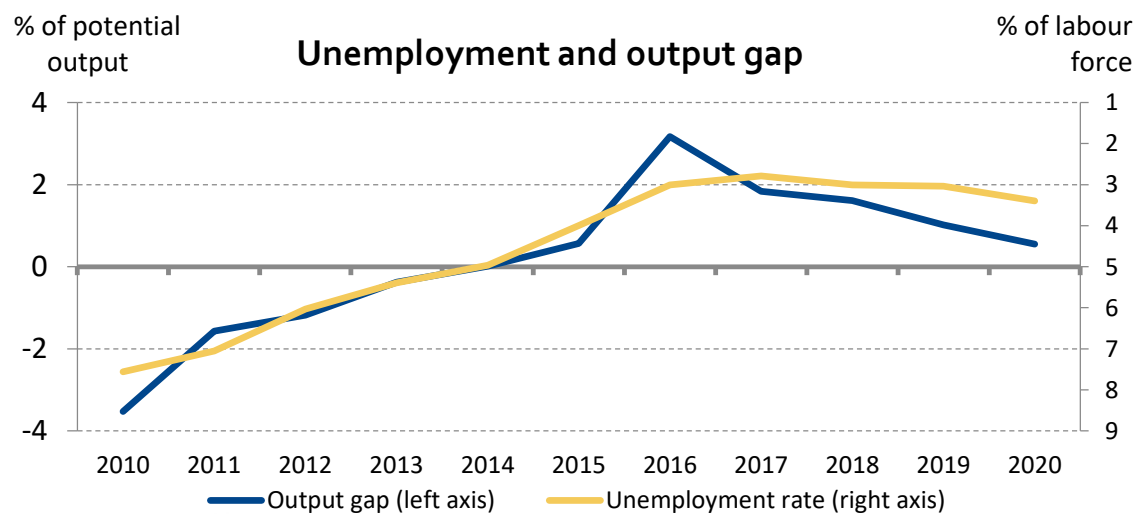


Source: Statistic Iceland

Labour market

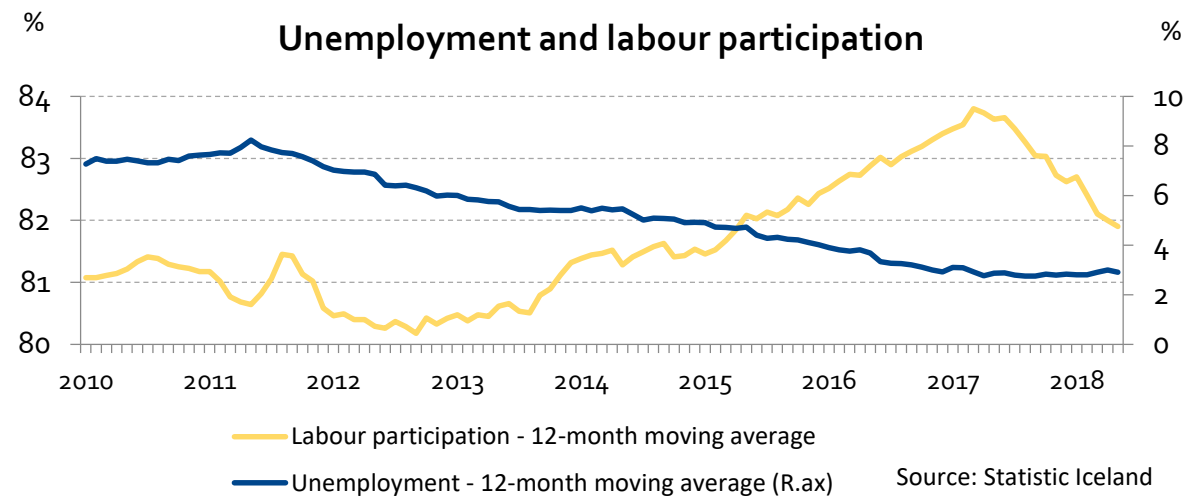


Source: Central Bank, MB 2018/3

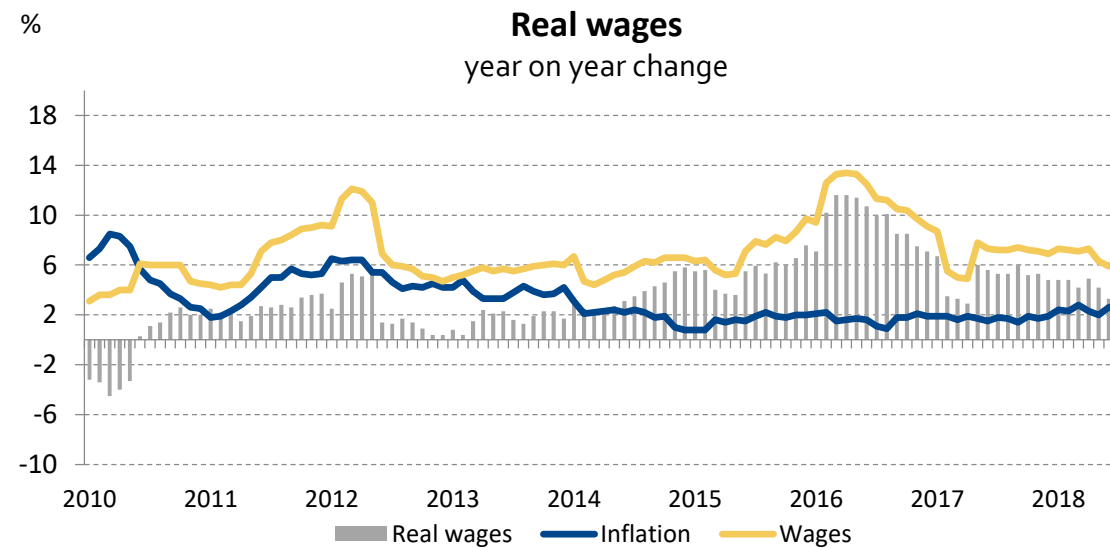


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Source: Central Bank, MB 2018/3



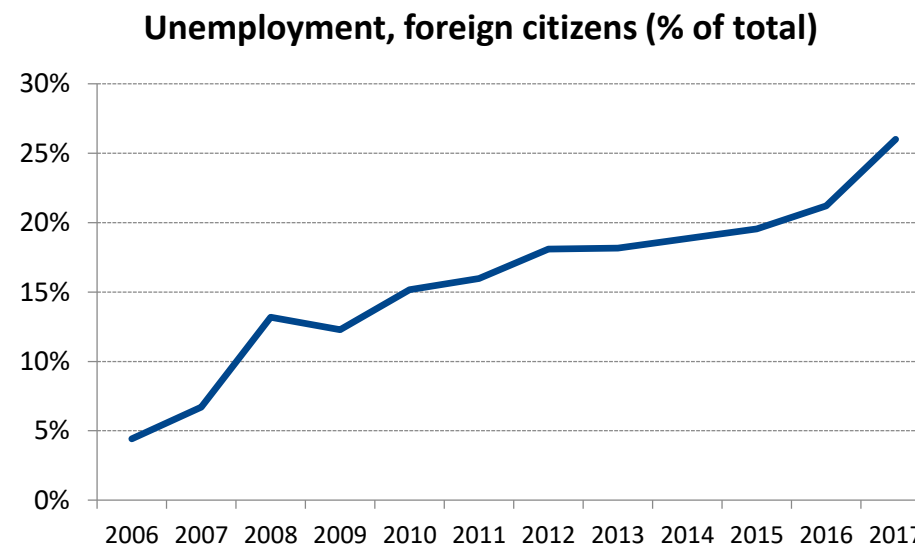
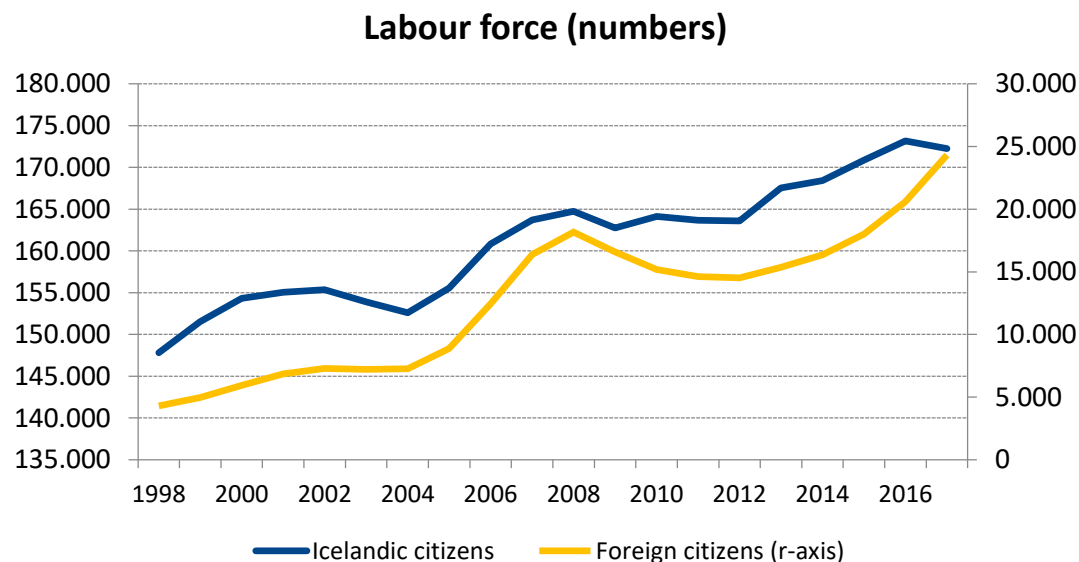
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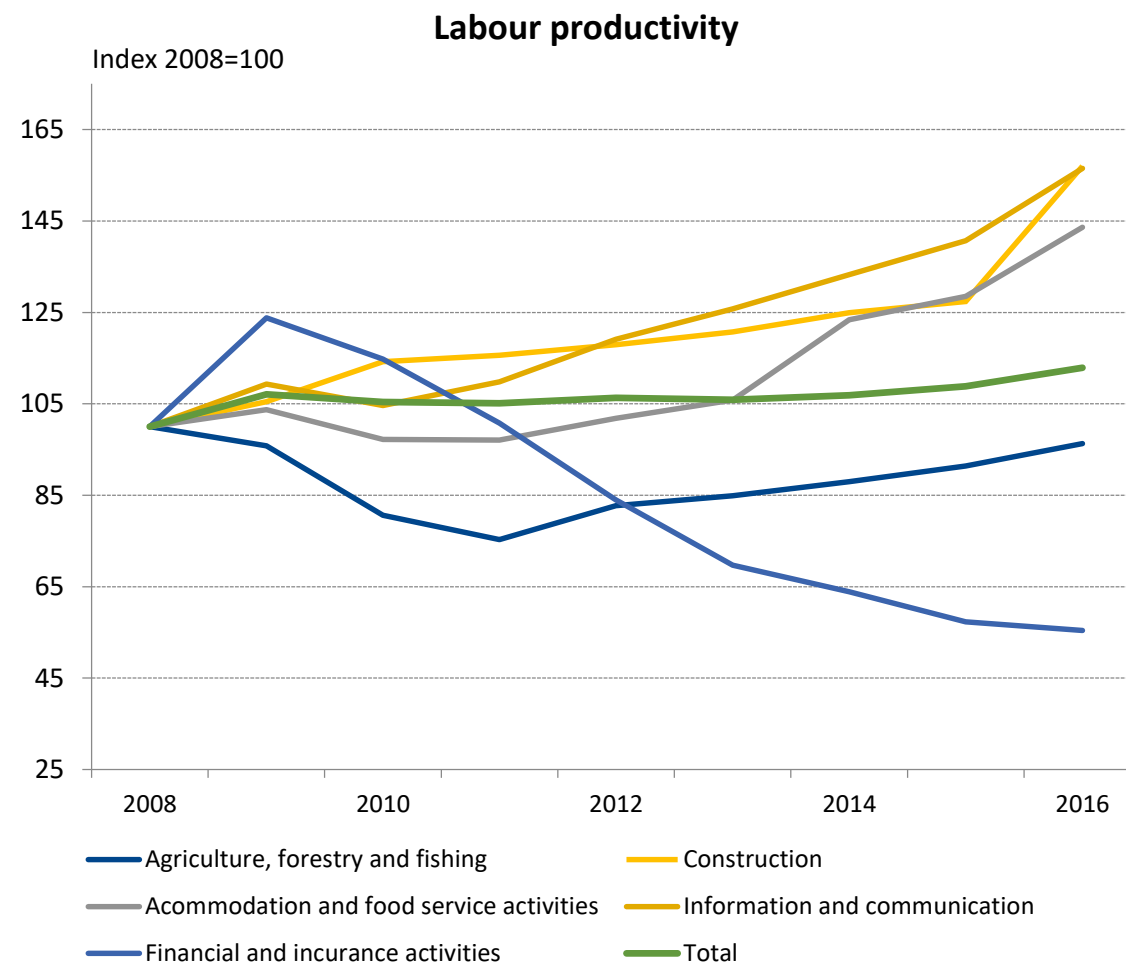
Labour market – foreign labour

- 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 2017 there were 24,340 foreigners in the workforce, 12.4% of the labour market
- The ratio of foreign citizens of total unemployment was 26% at the end of 2017



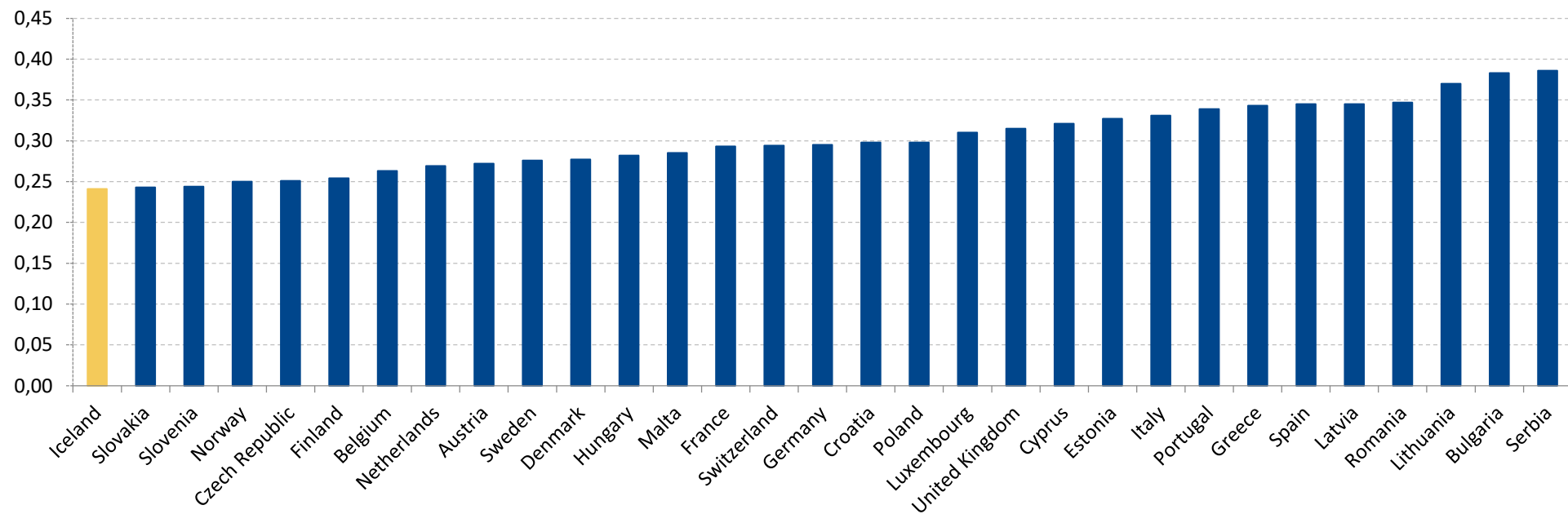
Labour productivity

- From 2014 overall productivity increases have been accelerating
- Increasing productivity have mainly been in construction, tourism and in the information and communications sector
- However, labour productivity is still somewhat lower than in the other Nordic countries



Gini coefficient in Europe 2016

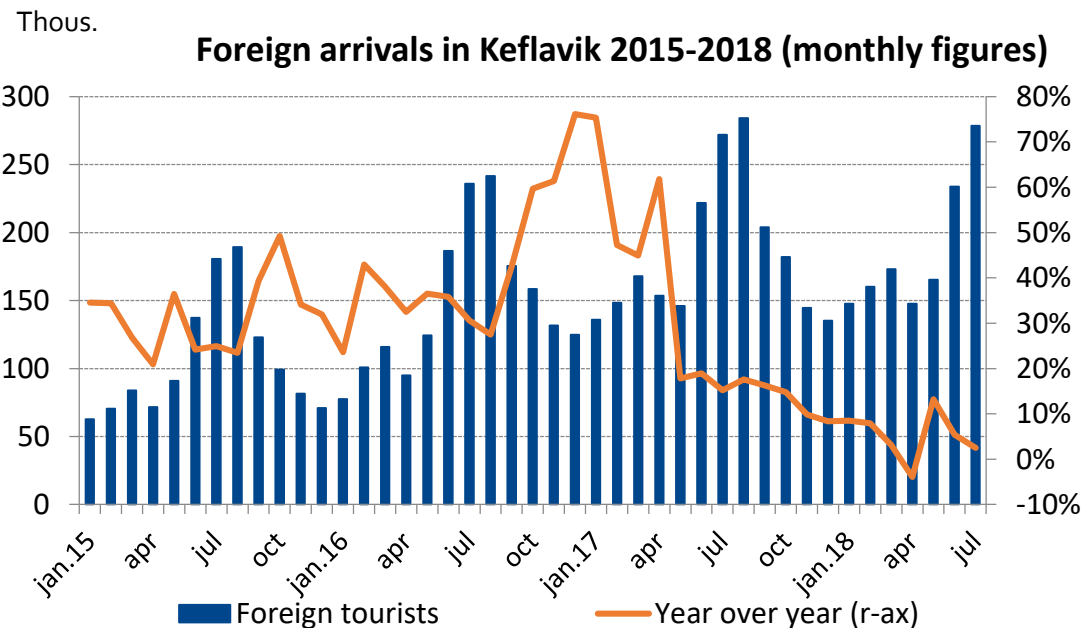
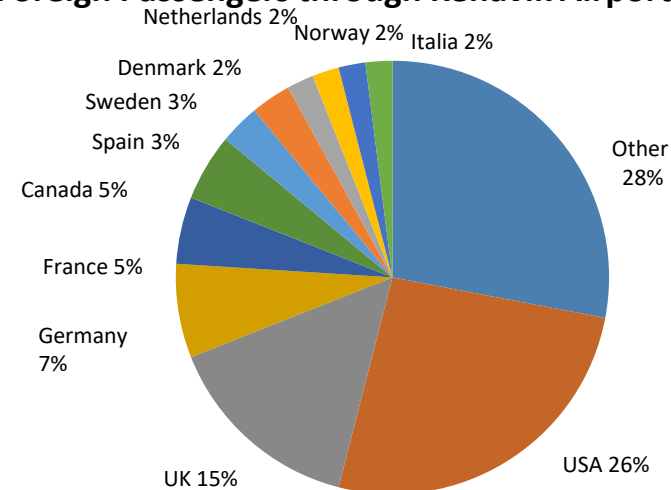
- The Gini coefficient is based on the comparison of cumulative proportions of the population against cumulative proportions of income they receive, and it ranges between 0 in the case of perfect equality and 1 in the case of perfect inequality
- With a Gini coefficient of 0.24, Iceland's income inequality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



Tourism

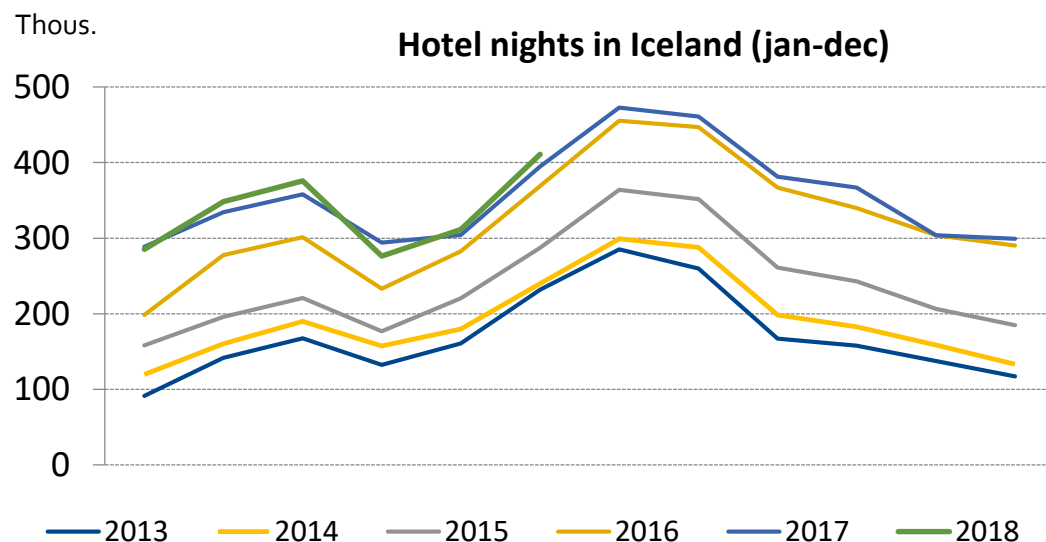
- The total number of foreign visitors to Iceland was around 2.2 million in 2017, that is 24% increase from 2016
- Of foreign passengers traveling through Keflavik Airport Americans and Britons are the largest group, or 41% of all passengers in 2017
- The appreciation of Krona might shorten the dwelling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

Foreign Passengers through Keflavik Airport 2017



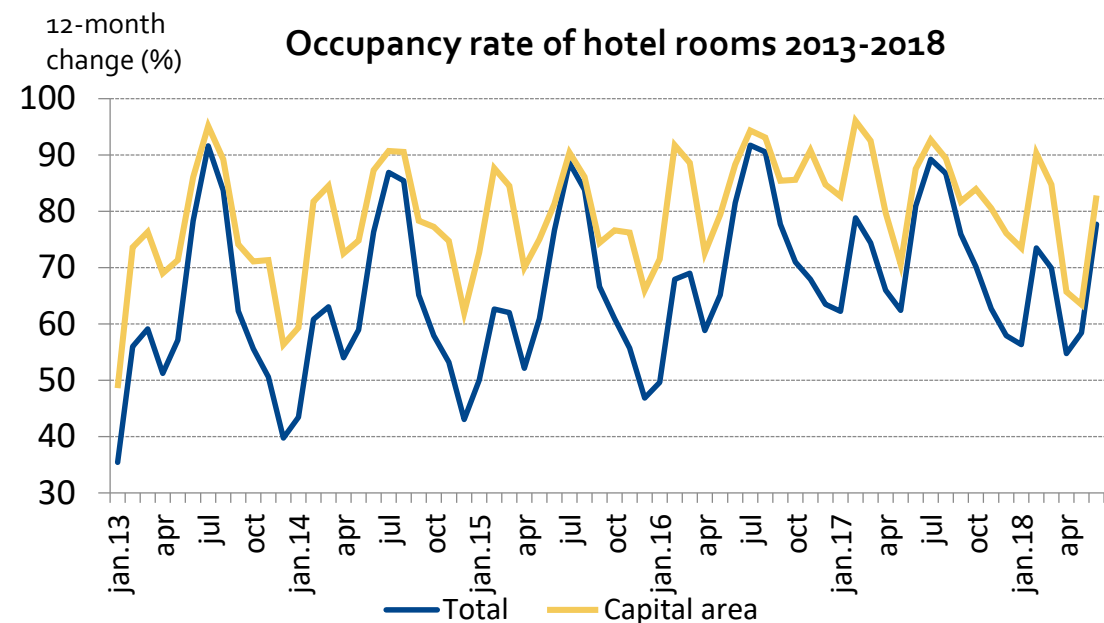
Tourism

- Overnight stays in hotels increased by 4% in June, year on year and by 10% between 2016 and 2017
- The occupancy rate of hotel rooms in June in the capital area was 82.8%, a decrease of 4.7 percentage points from June last year when it was 87.5%. At the same time, the supply of accommodation in the capital area has increased by 5.5% measured in a number of rooms

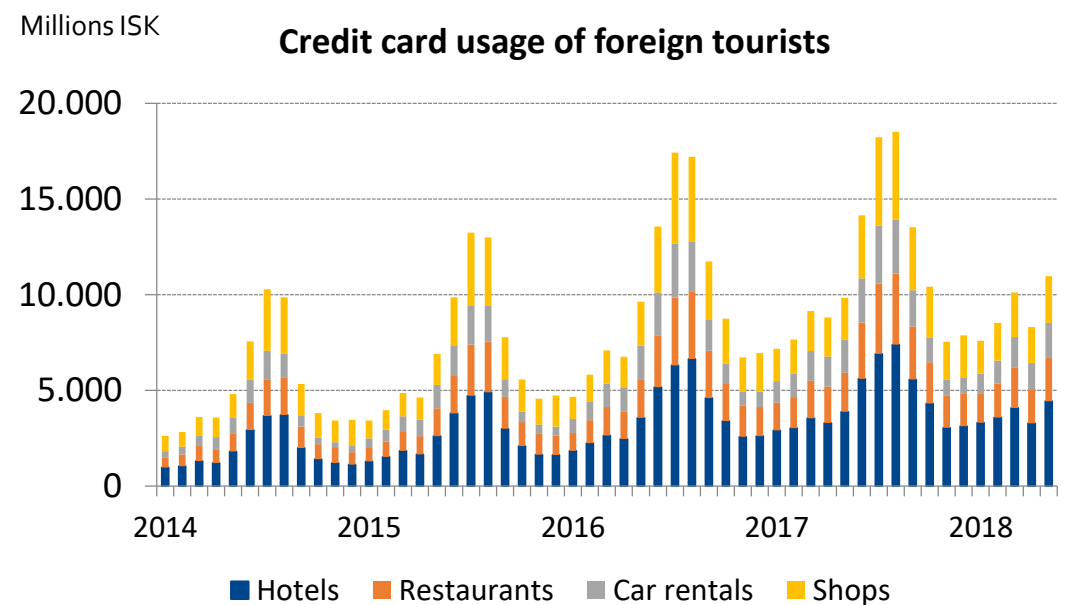


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Source: Statistic Iceland



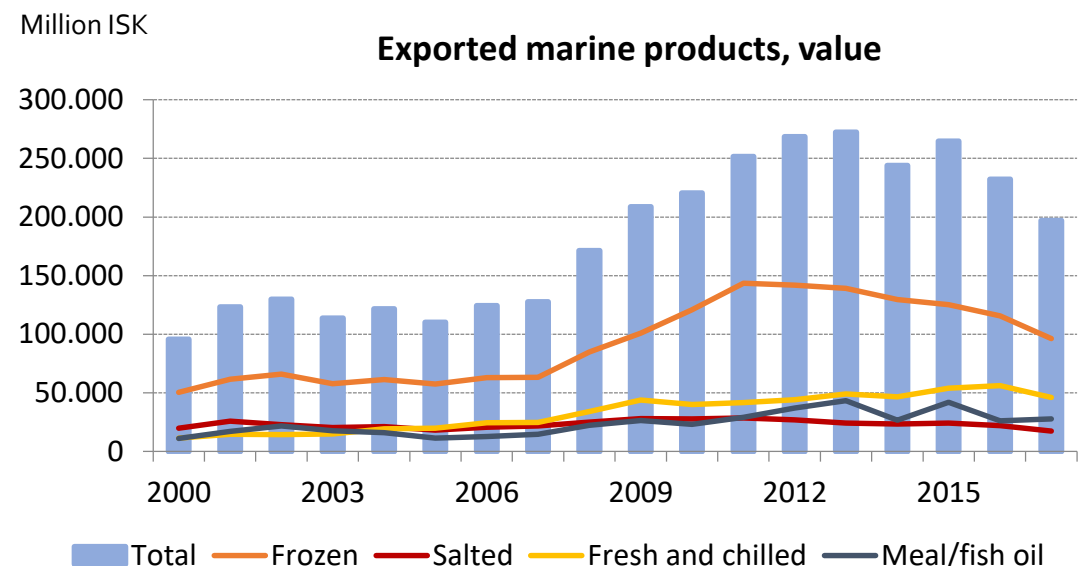
Source: Statistic Iceland



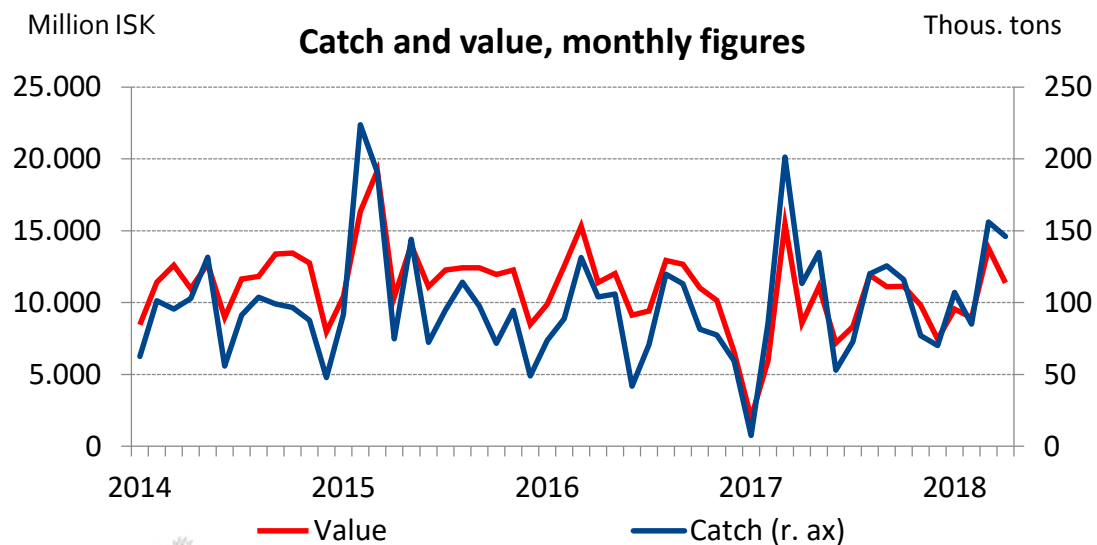
Source: Center for Retail Studies

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

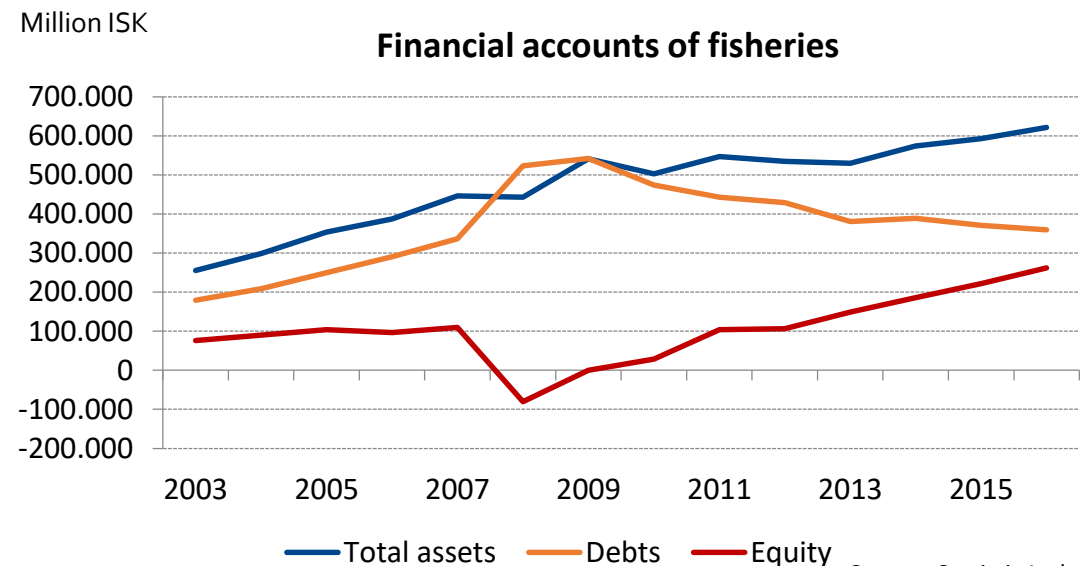


Source: Statistic Iceland



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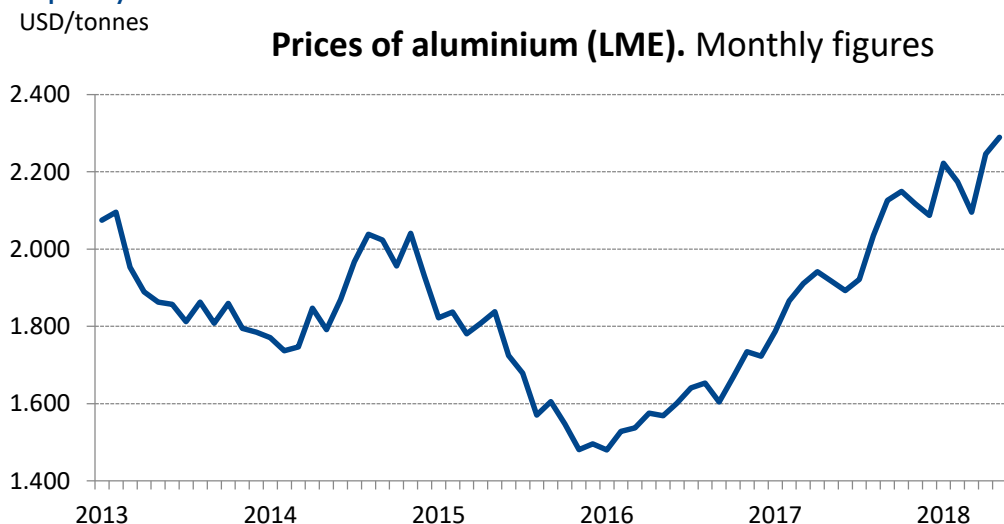
Source: Statistic Iceland



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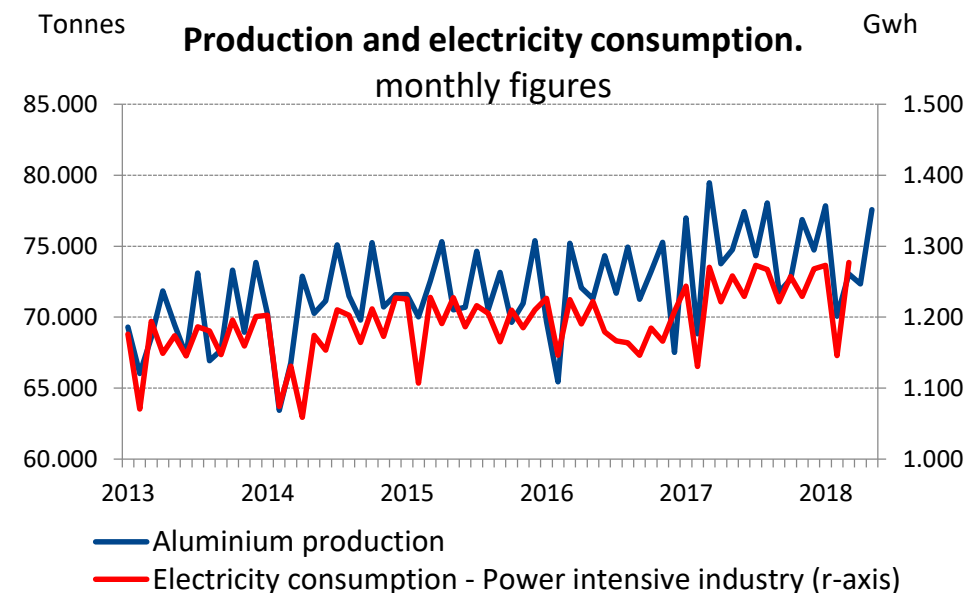
Aluminium sector

- Aluminium exports account for 17% of total exports of goods and services in 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

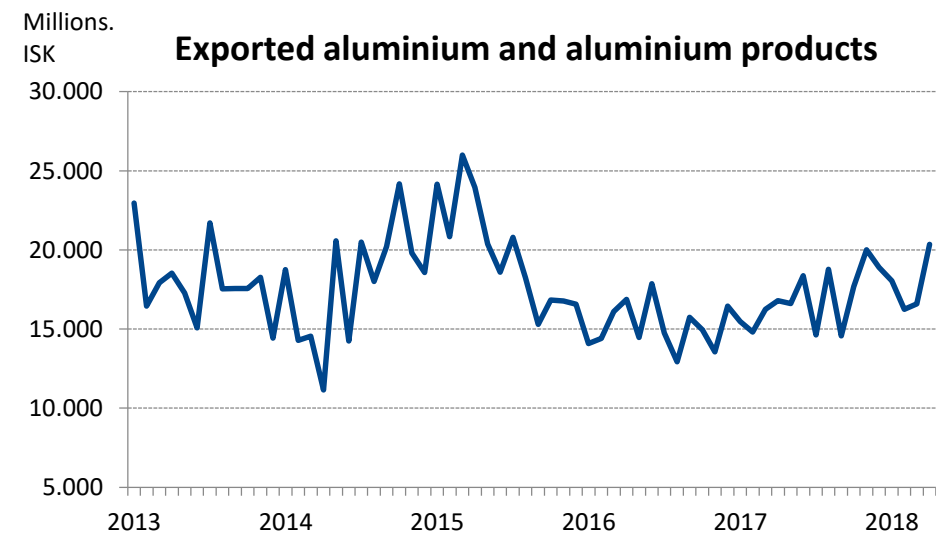


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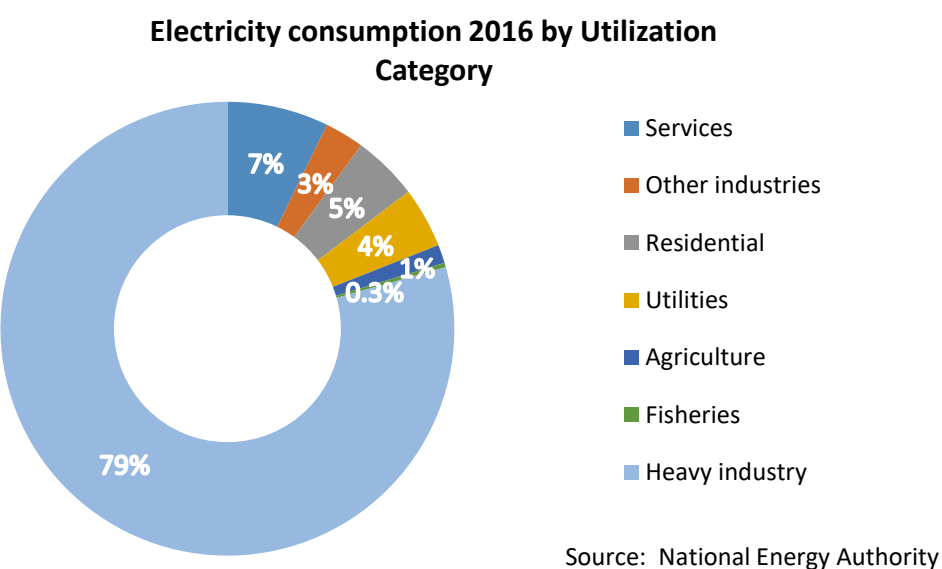
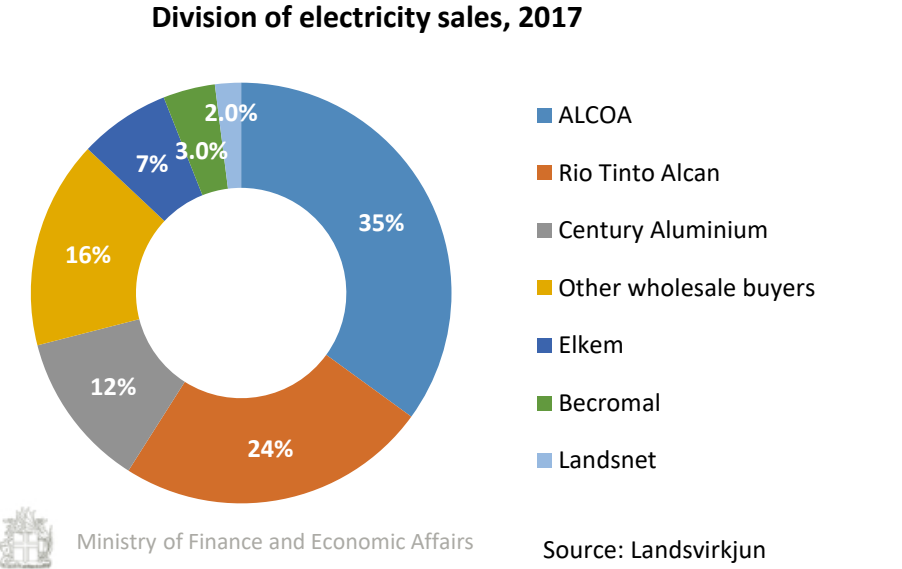
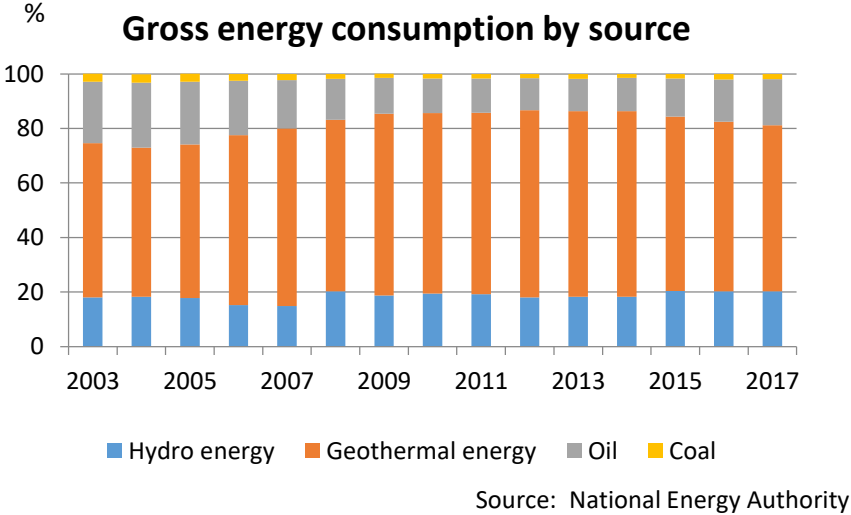
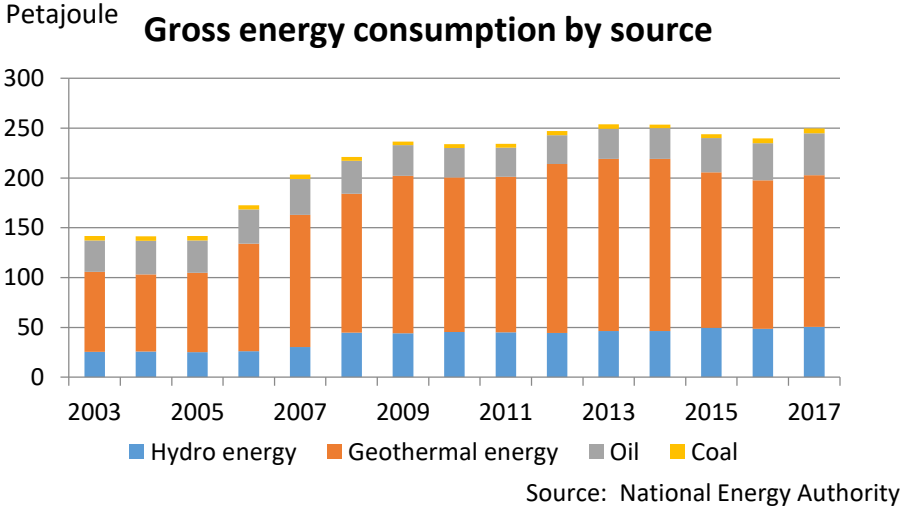


Source: Statistic Iceland



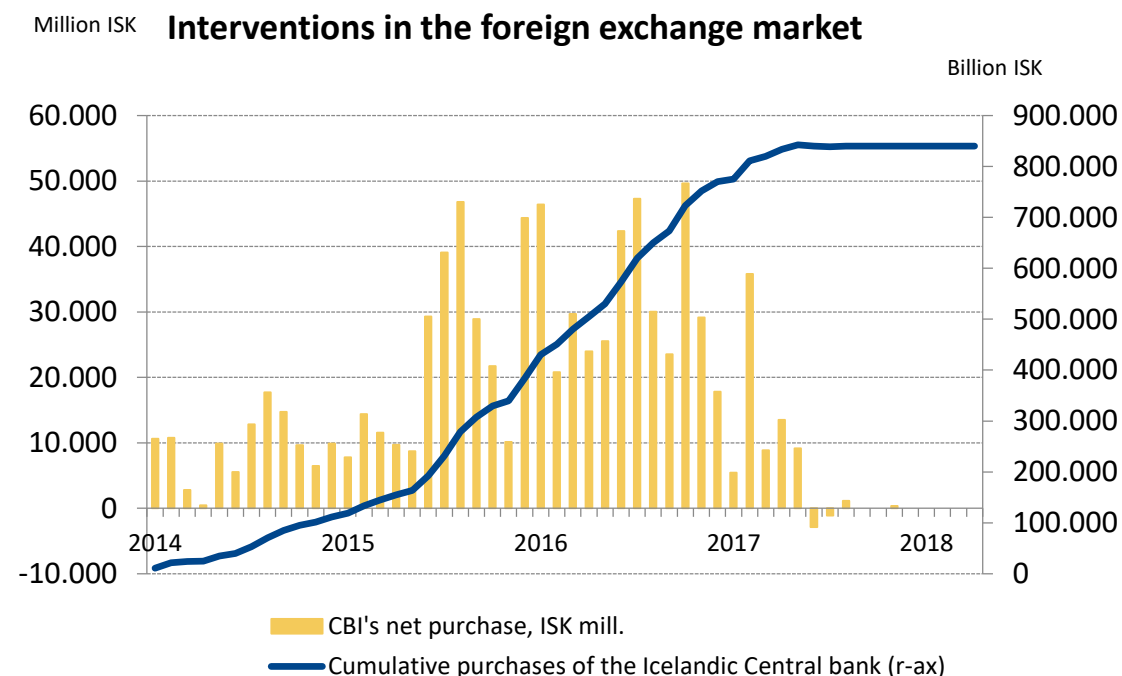
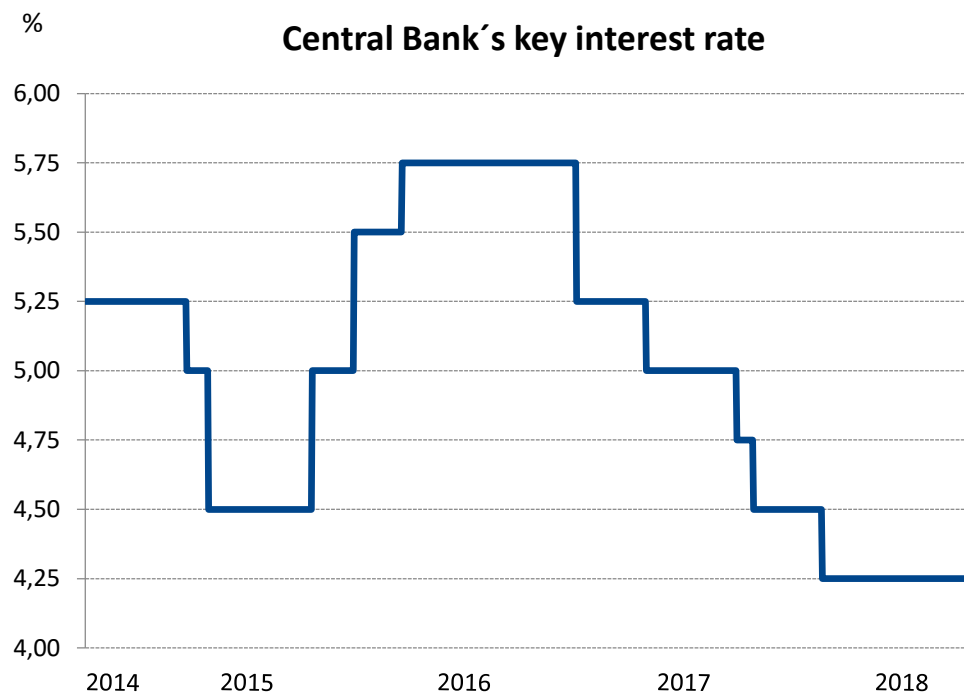
Source: Statistic Iceland

Energy consumption – 80% renewable



Monetary policy

- The Monetary Policy Committee (MPC) of the Central Bank of Iceland decided on 29th of August 2018 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



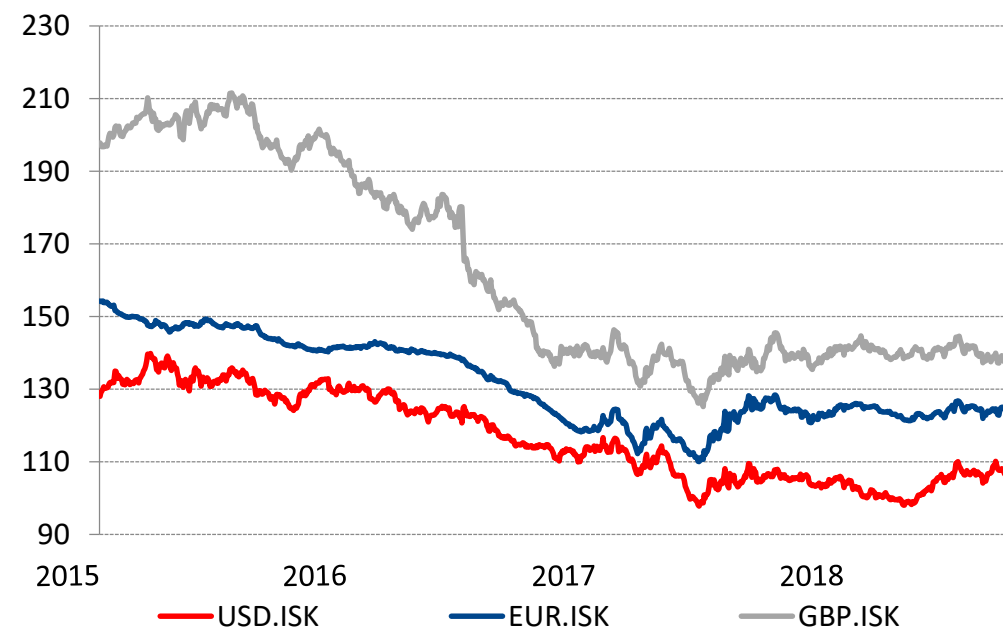
Exchange rate

- The króna appreciated steadily in the wake of capital controls alongside a large inflow of capital, but from the middle of 2017 there has been a reversal.
- In August the exchange rate of the Icelandic króna was similar to the beginning of the year 2018

Exchange rate Index (narrow trade index)

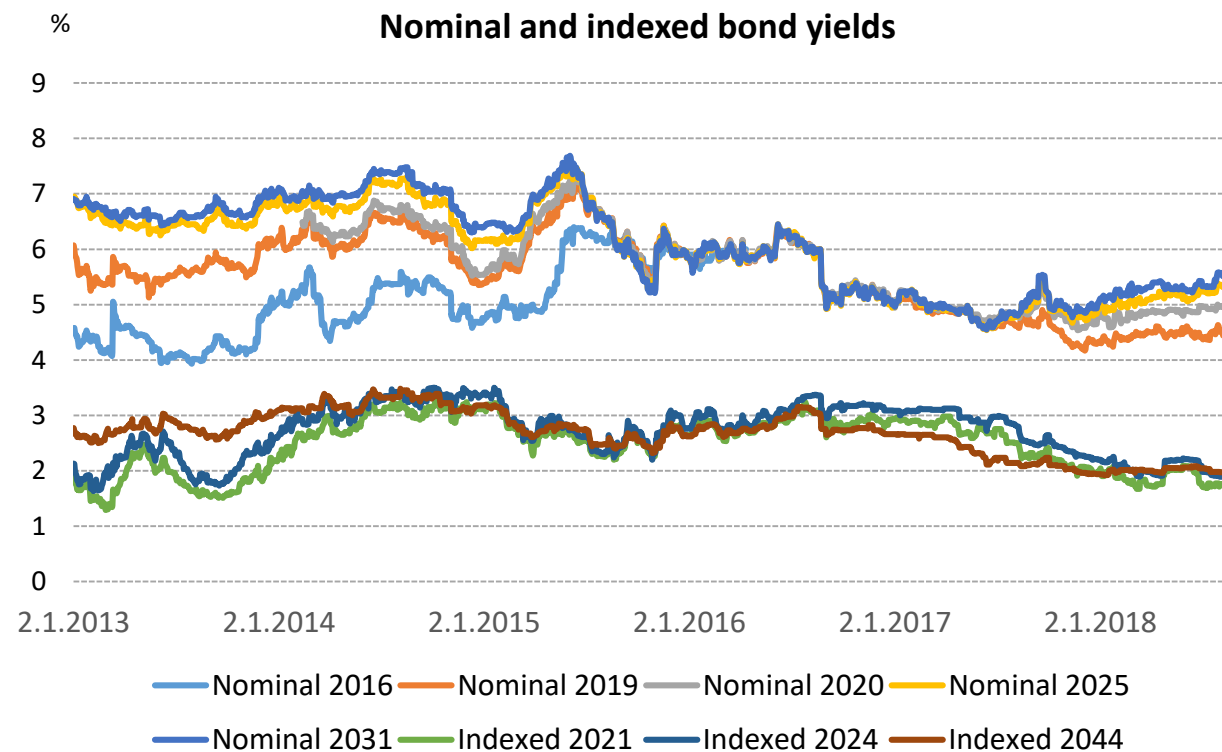
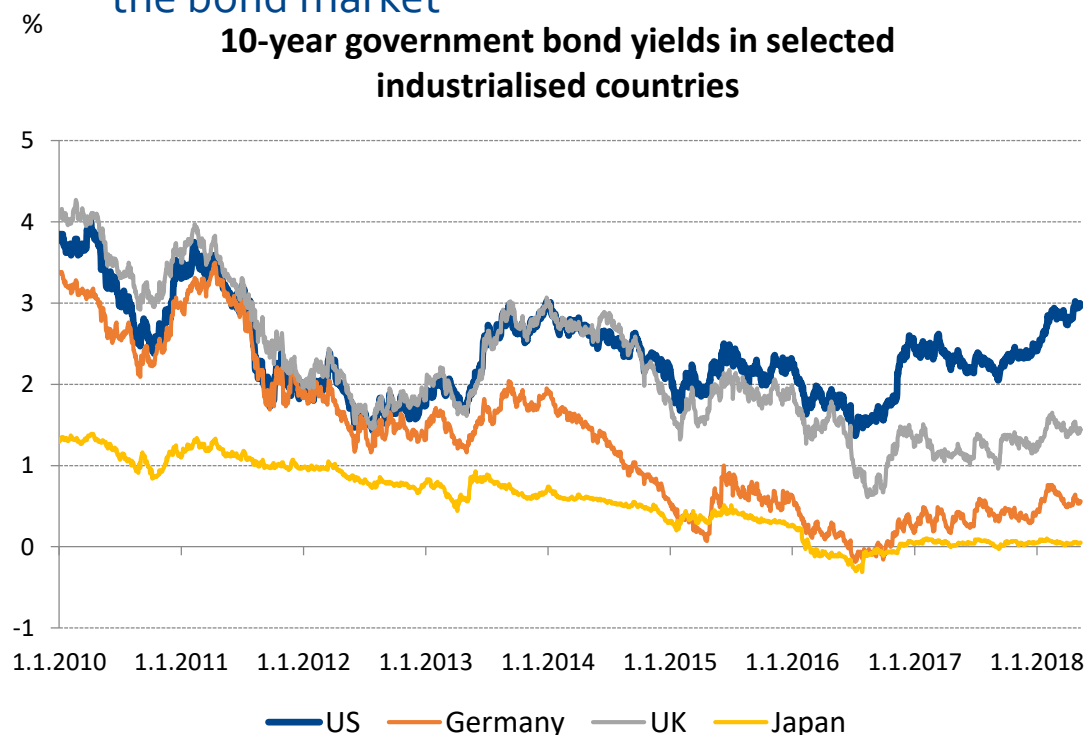


Exchange rate of foreign currencies against the króna



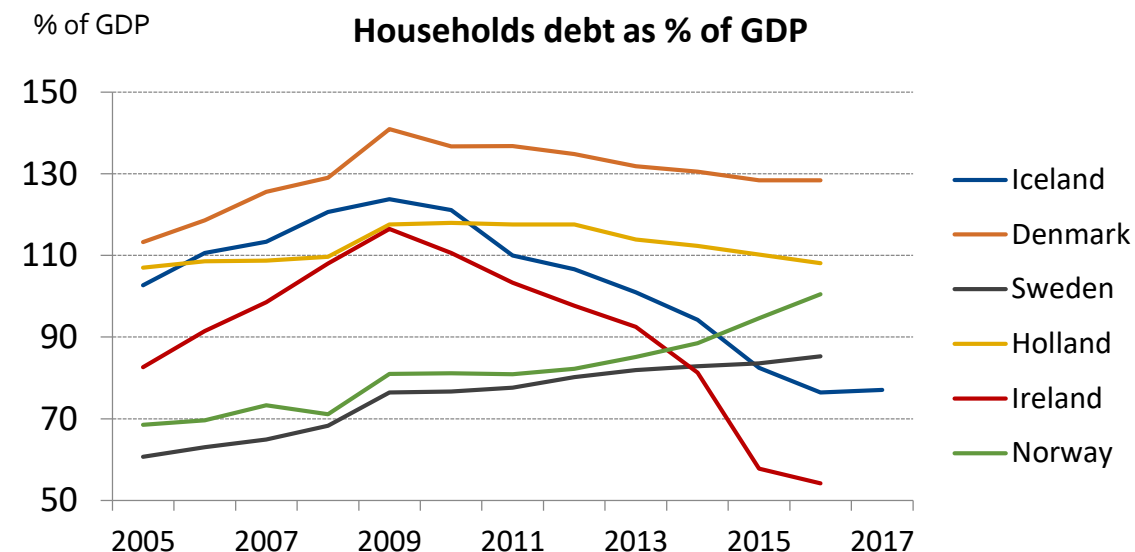
Interest rates

- Long-term interest rates have risen in US and the interest rate differential vis-à-vis other advanced countries has widened
- Yields on indexed Treasury and Housing Financing Fund (HFF) bonds have been fallen since the second half of 2016
- Nominal Treasury bond yields began to rise late in 2017, followed by a rise in the breakeven inflation rate in the bond market

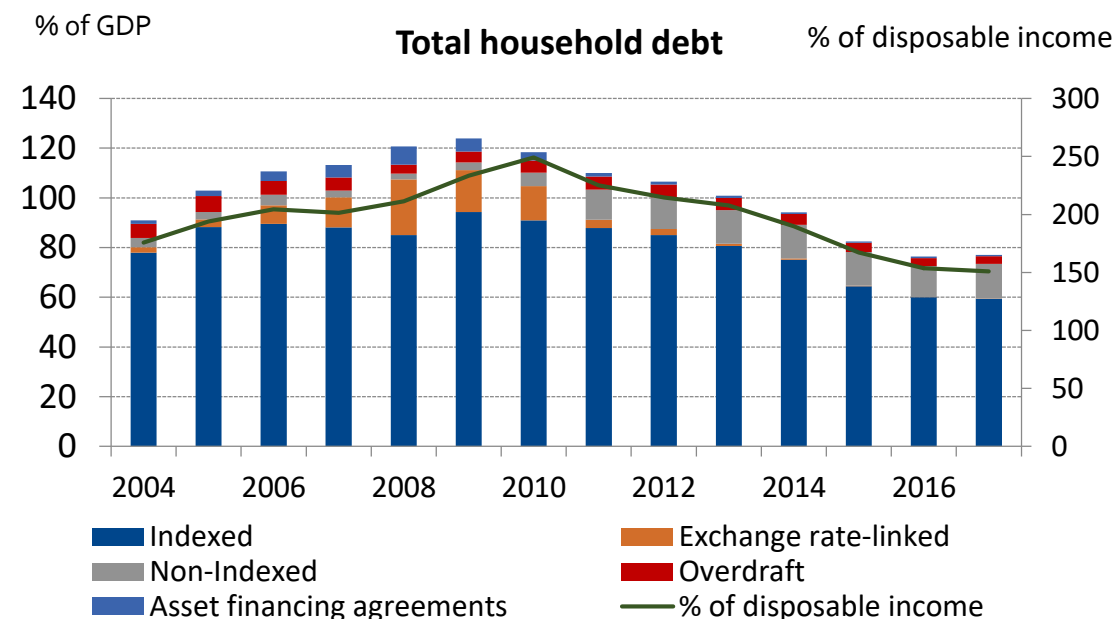


Households' debt levels

- Total household debt as a percentage of GDP has declined steadily from 2009 until the second half of 2016.
- Household debt has not grown in line with the rise in property prices
- The share of non-indexed mortgages from new lending by DMBs has increased again
- Household debt as a ratio of disposable income has declined considerably from 2010 and the ratio amounted to 150% at the end of 2017



Source: Central Bank

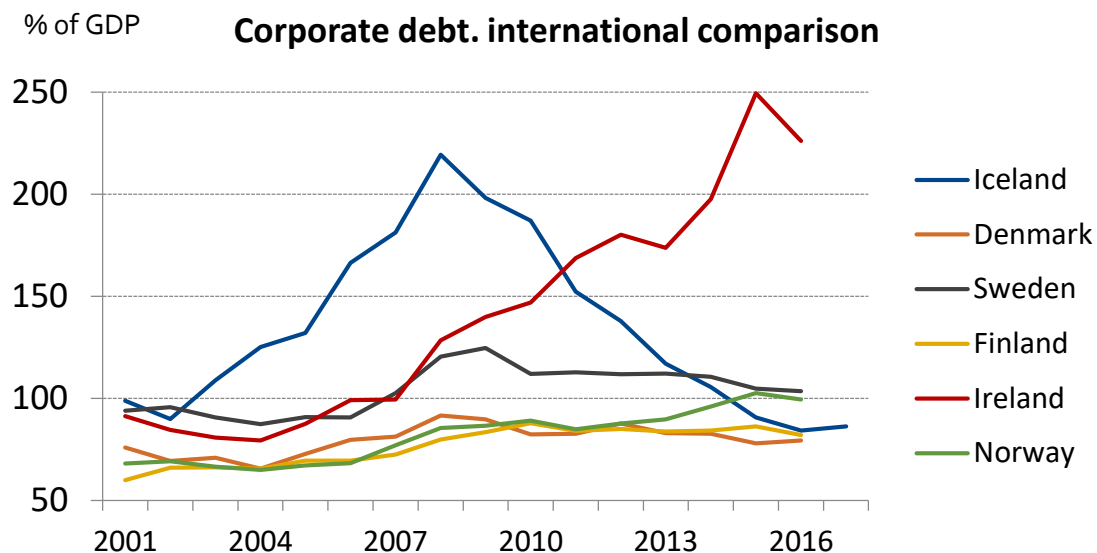


Source: Central Bank

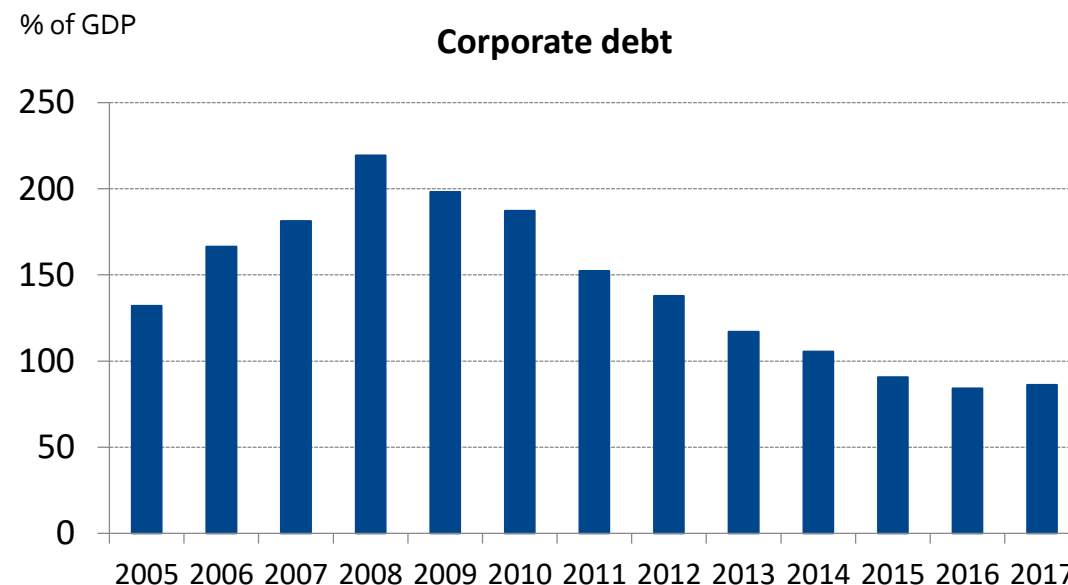


Corporate debt levels

- Corporate debt has decreased steadily from 2009 to 2016 but in 2017 the corporate debt increased by 4.7% in real terms
- At the end of 2017, lending to tourism companies amounted to 9% of total lending by the major commercial banks
- The financial position of companies in 2016 is strong according to Statistics Iceland's data on business performance
- Number of companies in the default register have decreased in recent years



Source: Central Bank

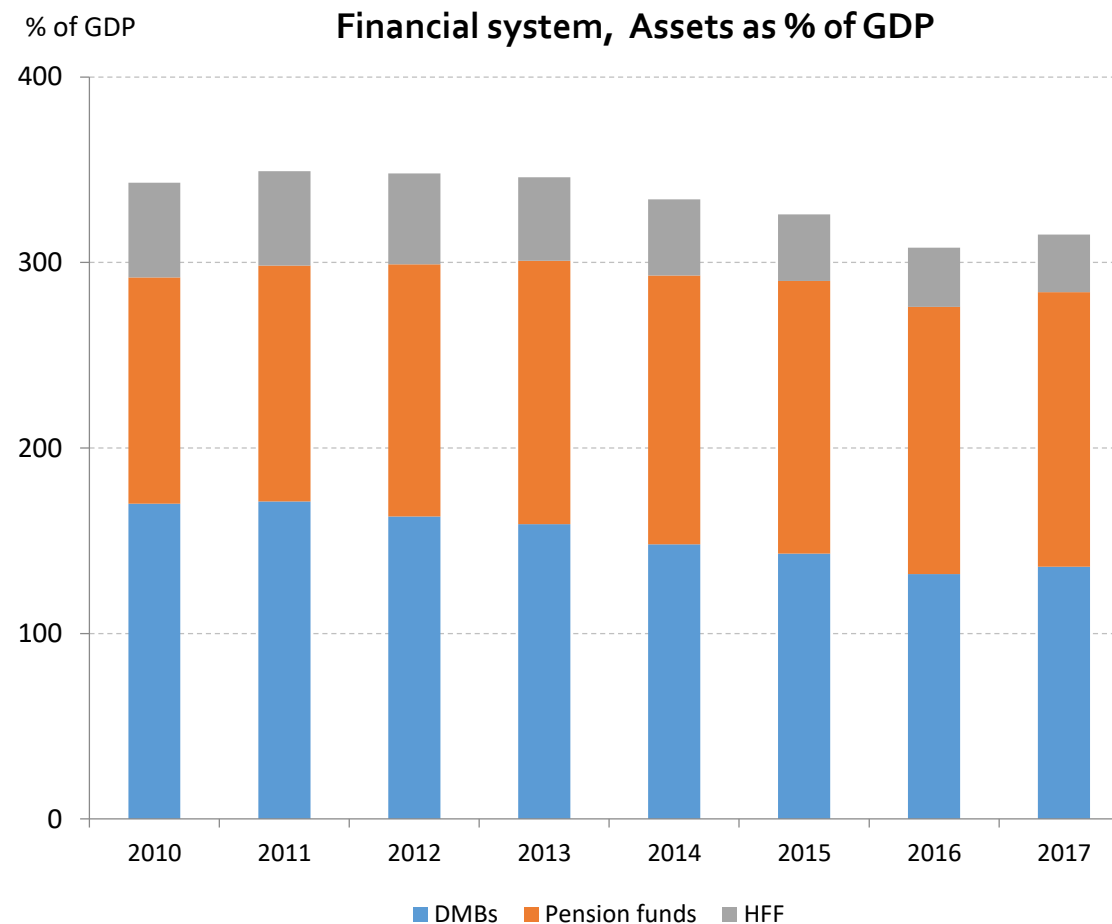


Source: Central Bank



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
- The Treasury has sold its 13% stake in Arion Bank on the basis of purchase rights to the holding
- The five-year Fiscal Strategy Plan for 2018 - 2023 assumes 158 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%

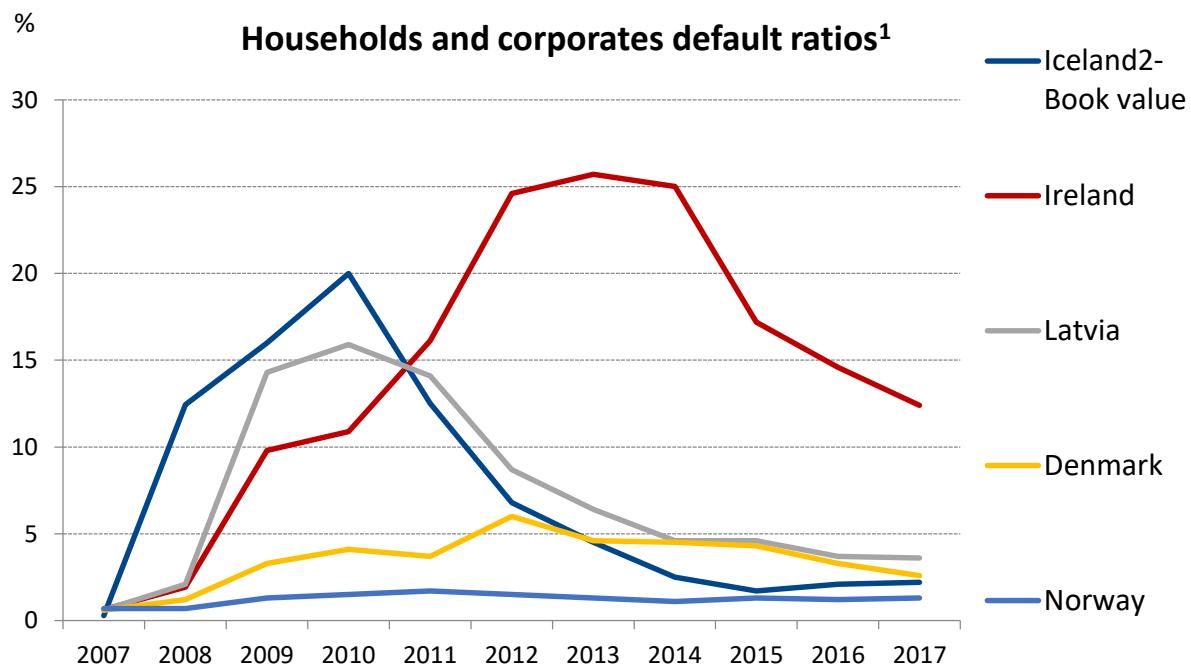


Source: Central Bank

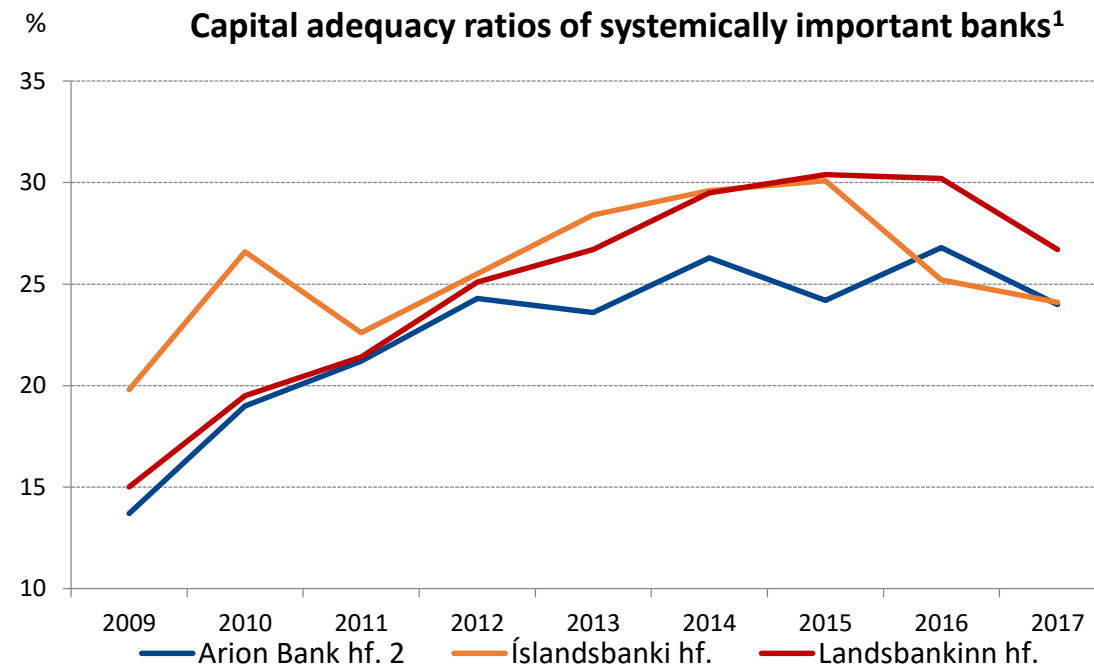


Commercial banks

- 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



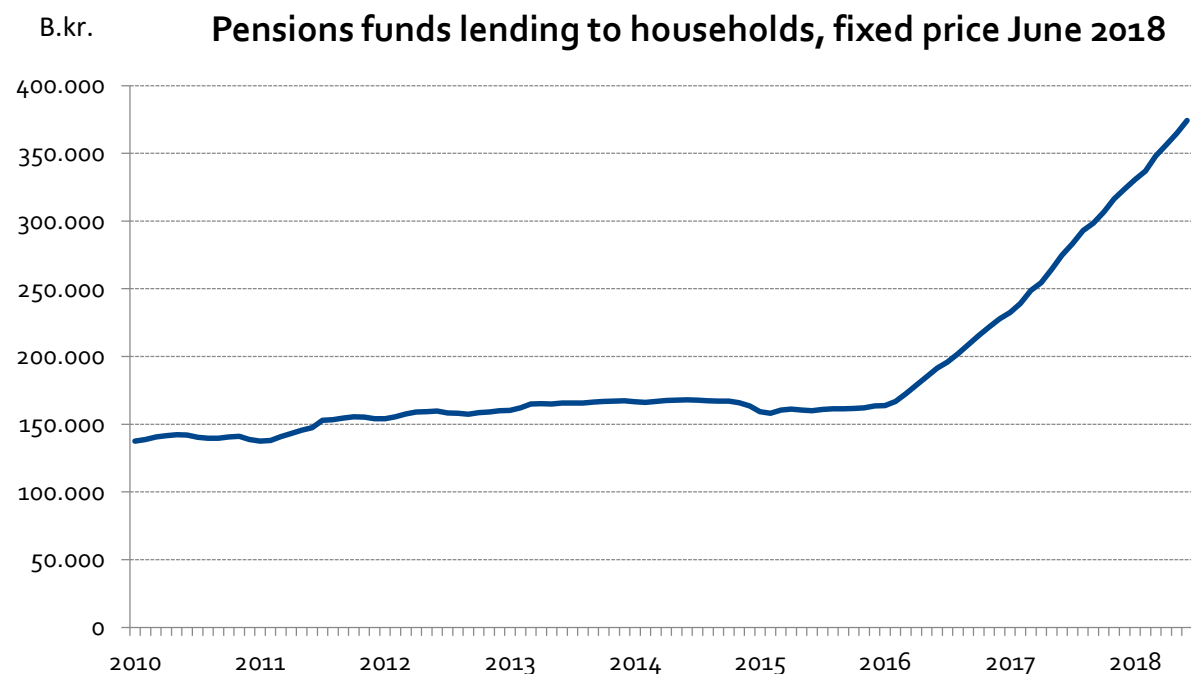
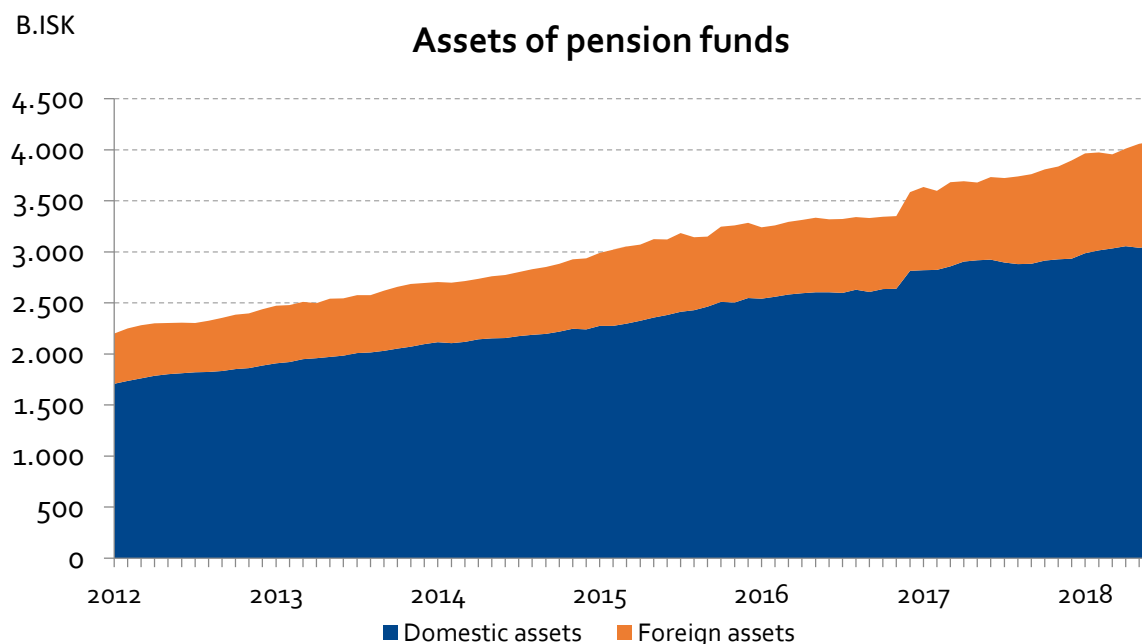
1. Banks' non-performing loans as a percentage of gross loan portfolio w/o write-downs. 2017-Q3 figures for Denmark, Ireland and Greece and 2017-Q2 figures for Norway. 2. 2007: Figures estimated from the annual accounts of the failed banks. 2008: Central Bank estimates.



1. Capital base as % of risk-weighted assets. 2. A dividend of 25 b.kr. that was paid in 2018 has been taken into account for Arion Bank's end-2017 capital ratio.

Pension funds

- 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
- Pensions funds lending have grown enormously since 2016, and their ratio of total lending to households now stands at 18%, but at the beginning of the year 2016 it was 10%
- Pension funds' and third-pillar savings custodians' foreign investment amounted to 119 bn ISK in 2017, or 4,7% of GDP





MINISTRY OF FINANCE
AND ECONOMIC AFFAIRS

Thank you for your attention

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