

# Iceland's International Sector

Macroeconomic Perspective and Key Focus Points

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In the fall of 2012, McKinsey published a report on Iceland's economy, focusing on productive capacity



Iceland's path towards sustainable economic growth depends on the ability to **increase the productive capacity** of the economy through a **broader portfolio of competitive exporting industries**

# To assess Iceland's growth potential, the economy was divided into three sectors

■ Focus of today

## Definition

## Key challenge

### Domestic service sector

Industries that mostly provide **non-tradable goods and services** for the domestic market

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*Increase productivity to enable reallocation of labor to export sectors*



### Resource-based sector

Industries that require **domestic natural resources** as an input for their production

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*Focus on capturing and maximizing value from limited natural resources*



### International sector

Business that produce **tradable goods and services** that are largely independent of local natural resources

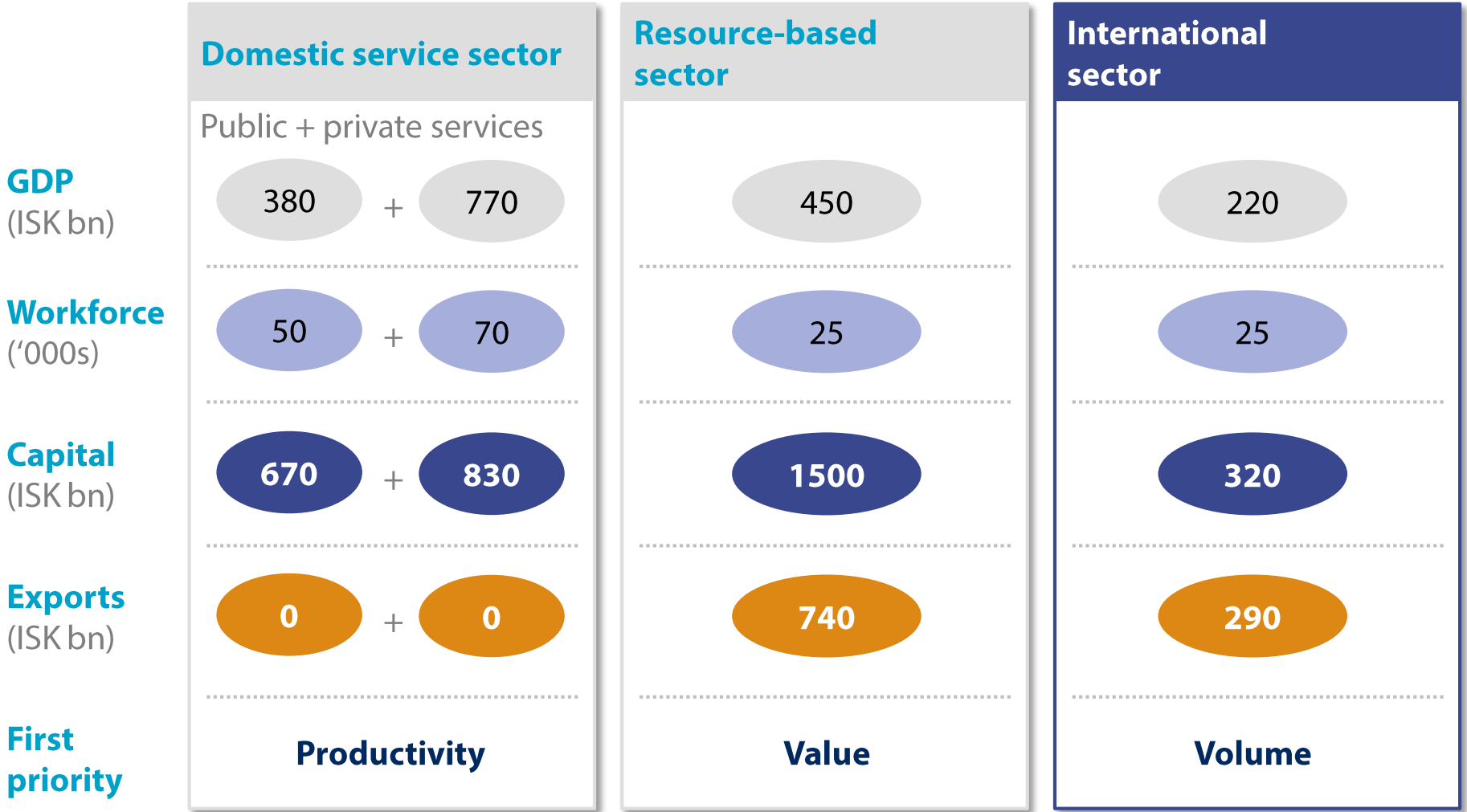
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*Enable growth and renewal through a globally competitive business environment*

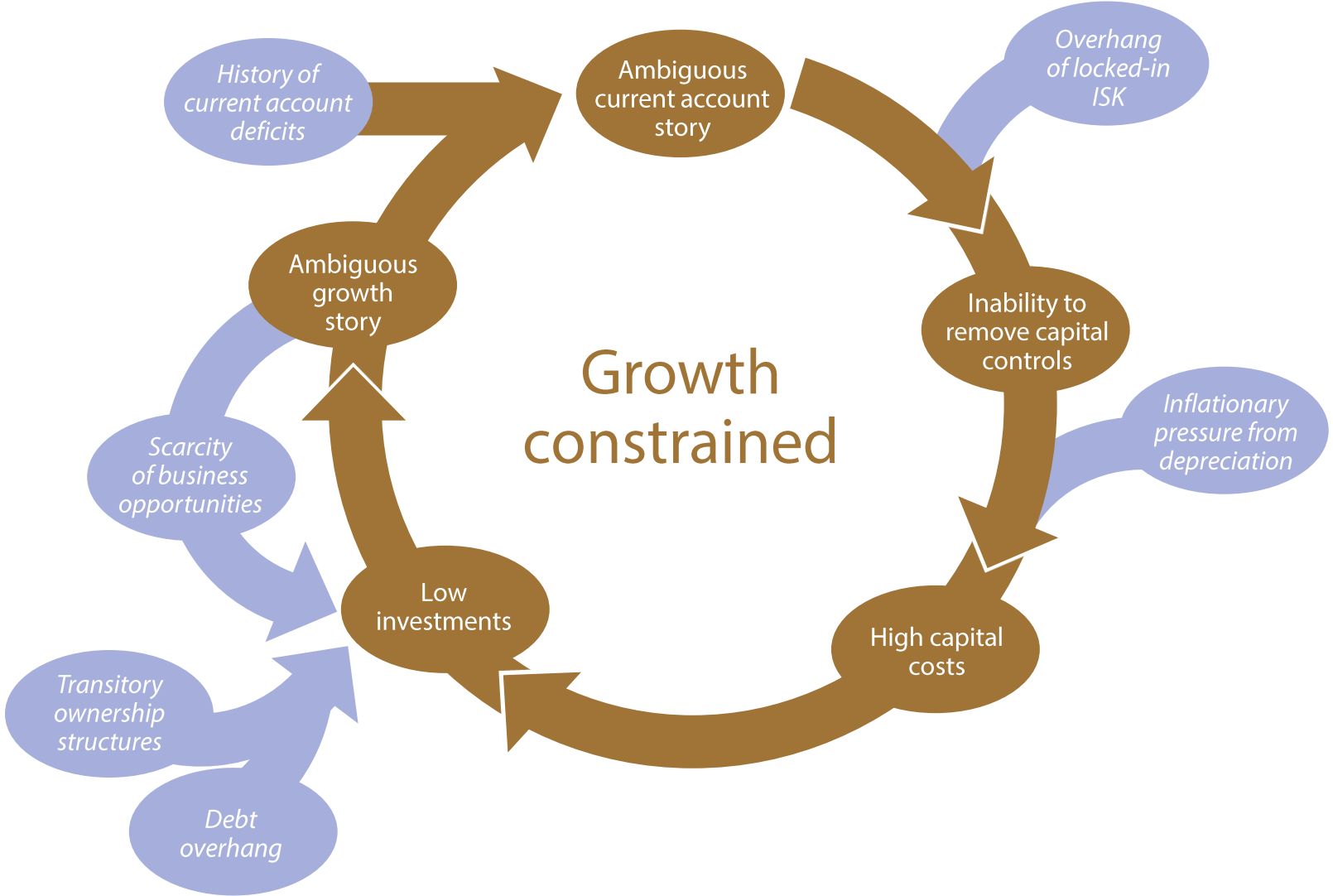


# These three sectors are fundamentally different in both size and objectives

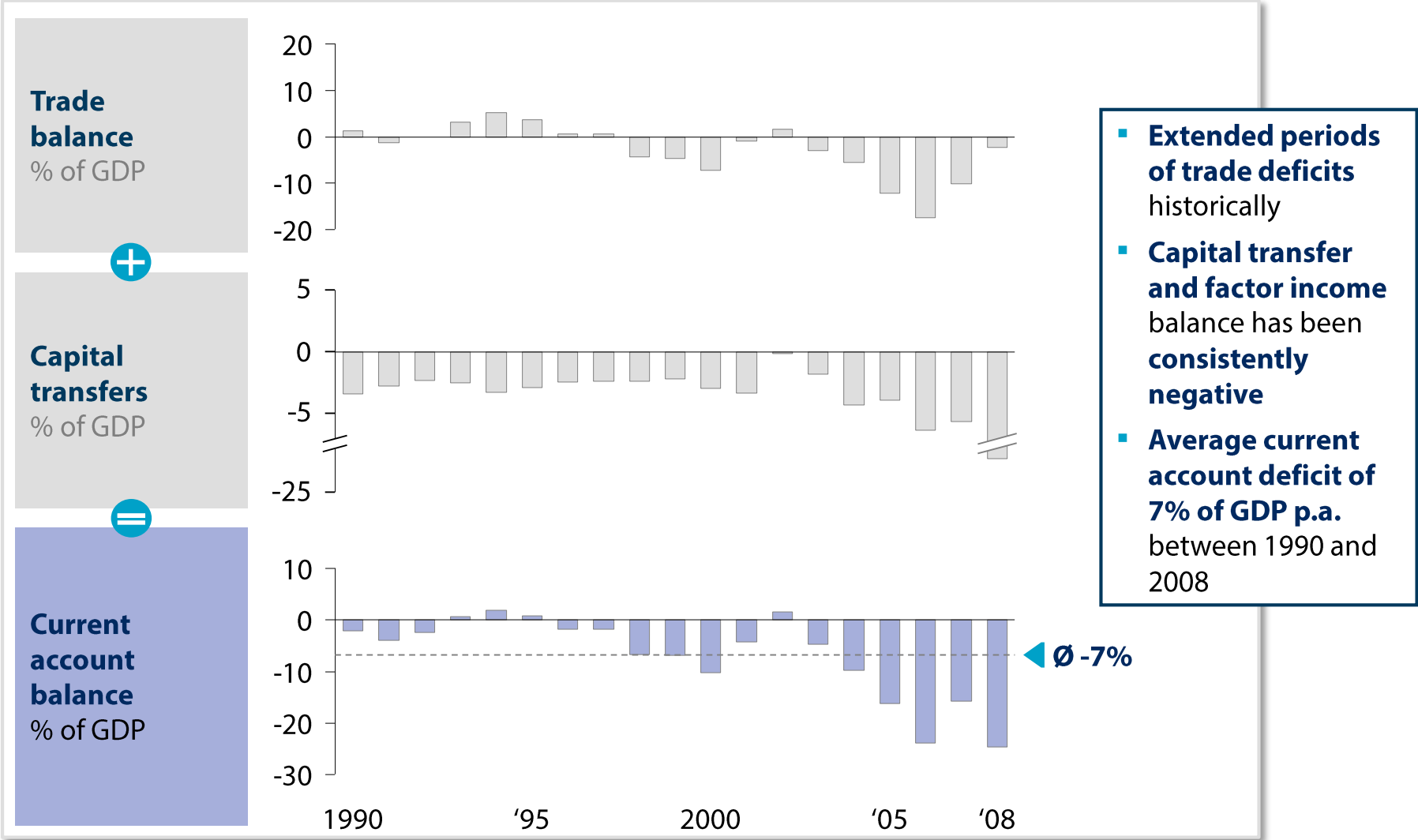
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# Without credible export growth prospects, a vicious circle will hamper overall economic growth



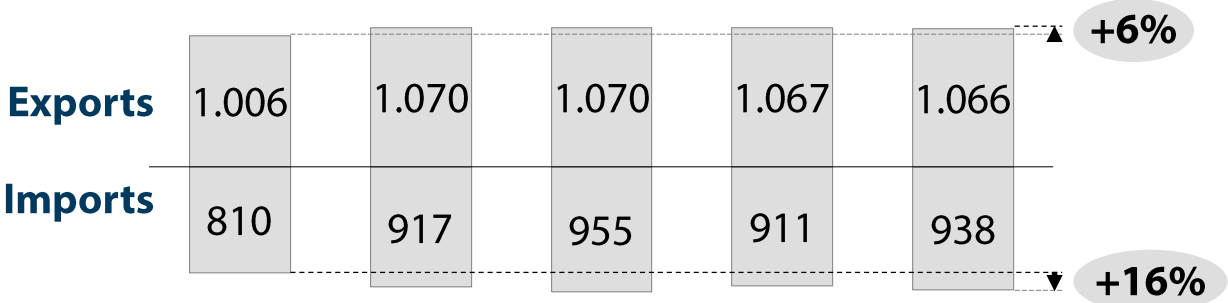
# Historically, Iceland has had a strong tendency to run a current account deficit



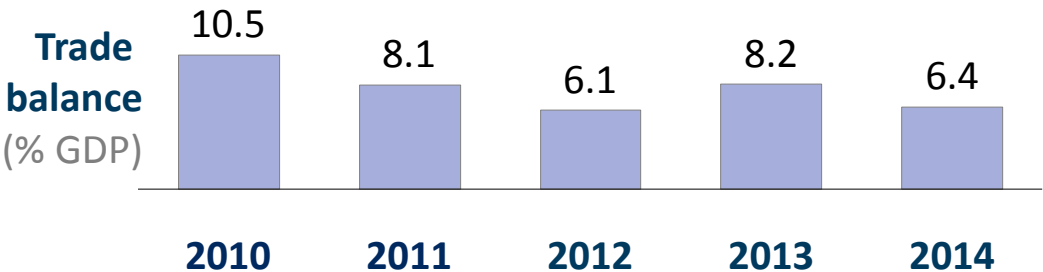
# Weak currency has supported a positive trade balance since the recession, but imports are gaining momentum

## Imports are gaining momentum ...

Trade balance components, ISK billions, constant 2014 prices

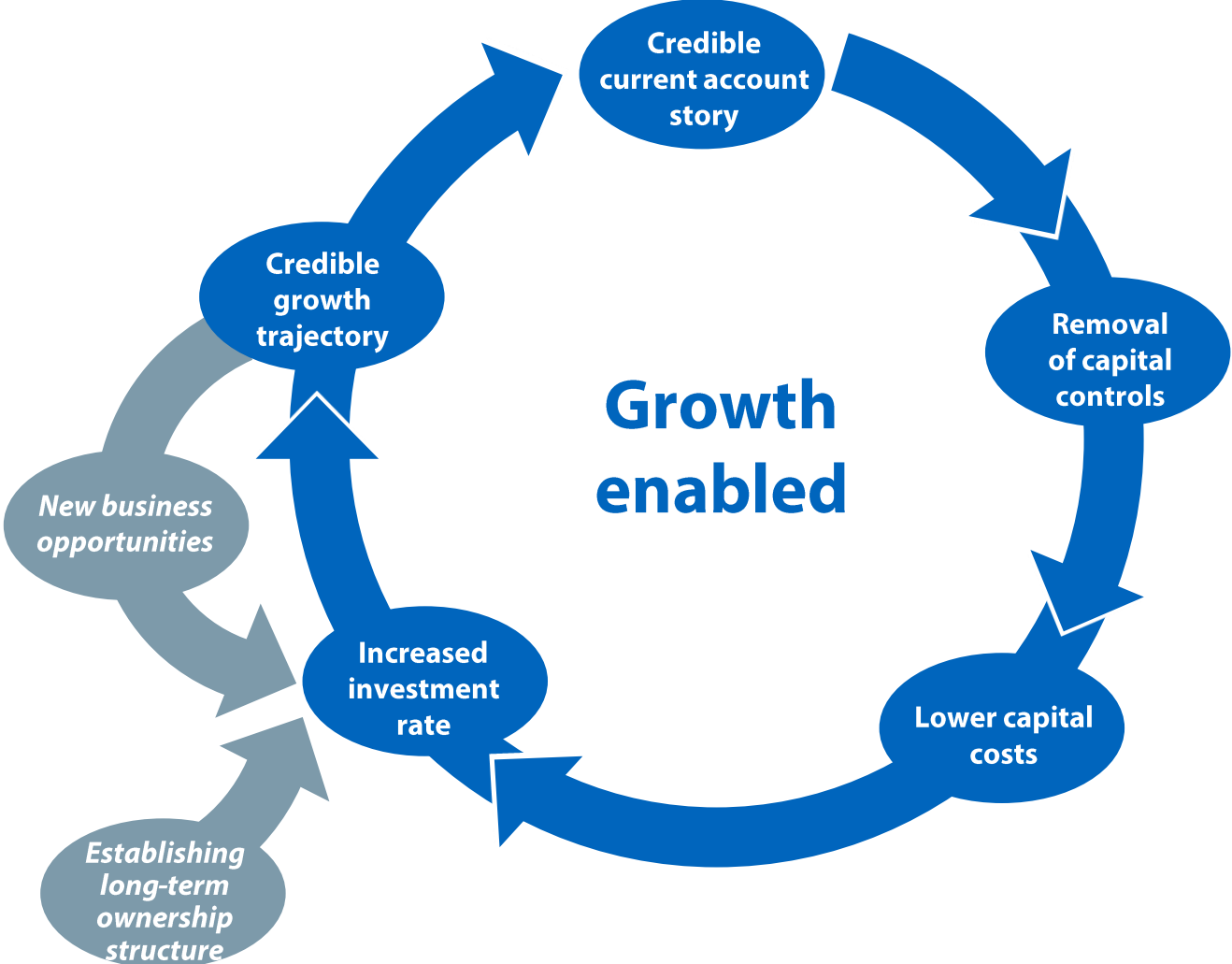


## ... putting negative pressure on the trade balance



- Following the collapse of the ISK trade balance **converted from deficit to surplus**
- This was driven to a large extent by significant **reduction in imports** (measured in foreign currency)
- As import momentum picks up, **it is critical that exports grow in parallel** to continue on a sustainable growth track

A turnaround in this development would enable *virtuous circle* based on trust in long-term economic balance

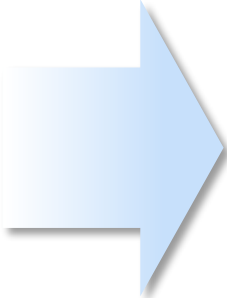




Key message: If Iceland wants to follow a strong, sustainable growth path, exports need to grow dramatically



GDP growth per capita p.a.



In exports within 20 years

# The scarcity of natural resources means that half of these new exports needs to come from the international sector

**Scenario**

**Key assumptions**

**Limited resource growth**

- Tourism growth slows down and average spending is unchanged
- Power generation grows but energy prices remain low
- Fishing is unchanged

**Moderate resource growth**

- Moderate growth in tourism volume and average spending
- Power generation increases and energy prices rise modestly
- Modest value increases in fishing

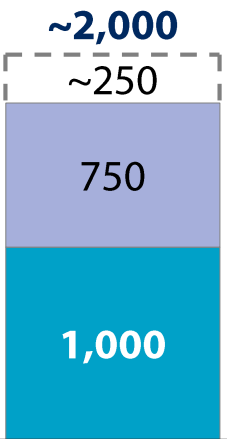
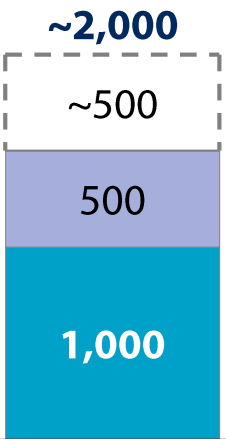
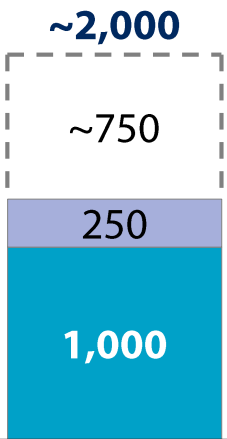
**High resource growth**

- Tourism grows fast and spending increases
- Power generation increases significantly and average prices spike
- Fishing value increases

**Resulting exports**

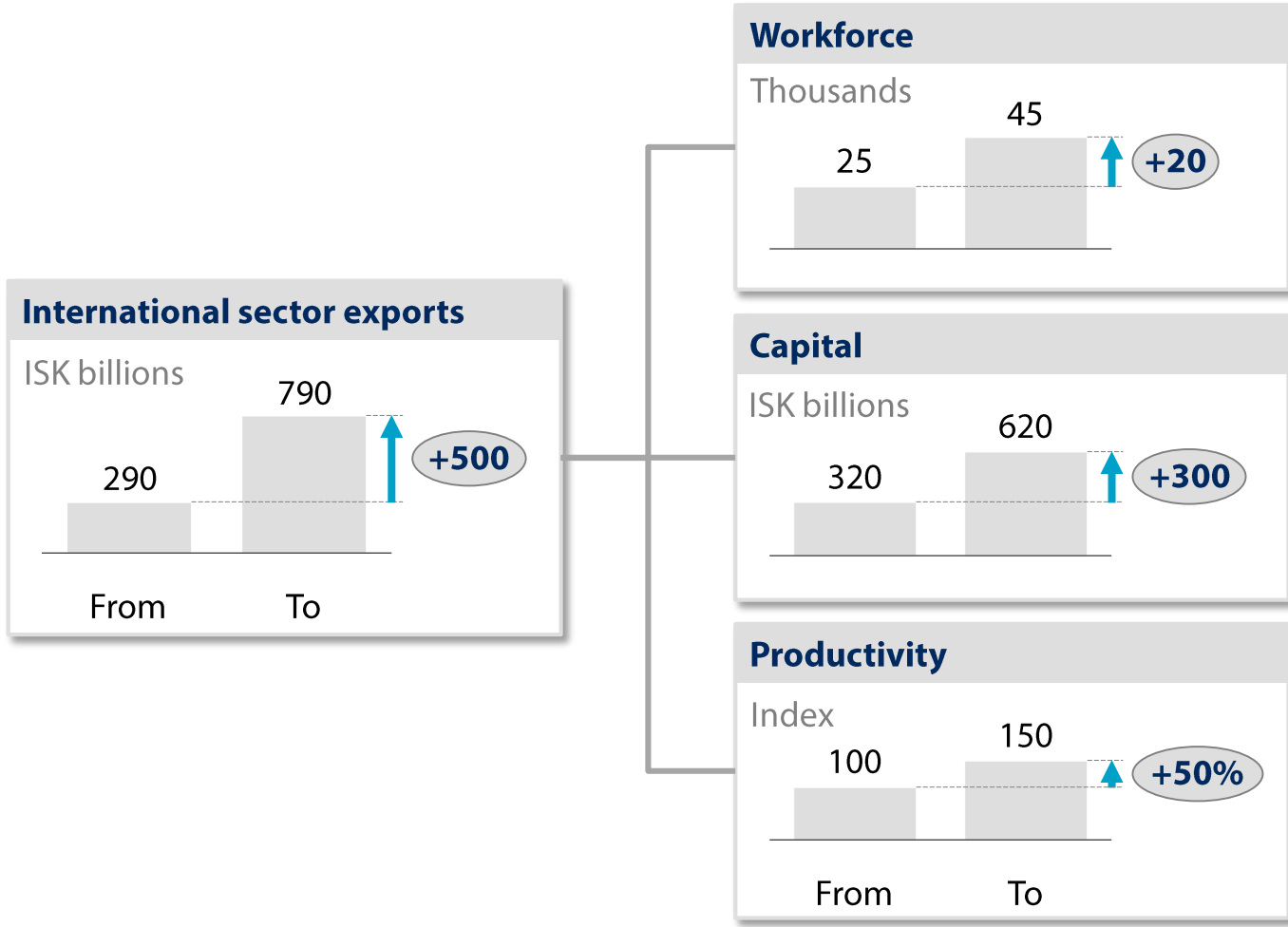
ISK billions (2033)

- [-] New international sector exports
- [■] New resource sector exports
- [■] Current exports



# This implies a major increase for the international sector in workforce, investment and productivity

Exports growth decomposition, assumes moderate growth scenario for resource sector<sup>1</sup>



<sup>1</sup> The decomposition of exports growth is based on the Cobb-Douglas production function, where exports are the product of capital input, labor input and total factor productivity, with the output elasticity of capital input assumed to be 0.33

# To put the size of this challenge in perspective

An increase of 20,000 employees in the international sector is equivalent to...

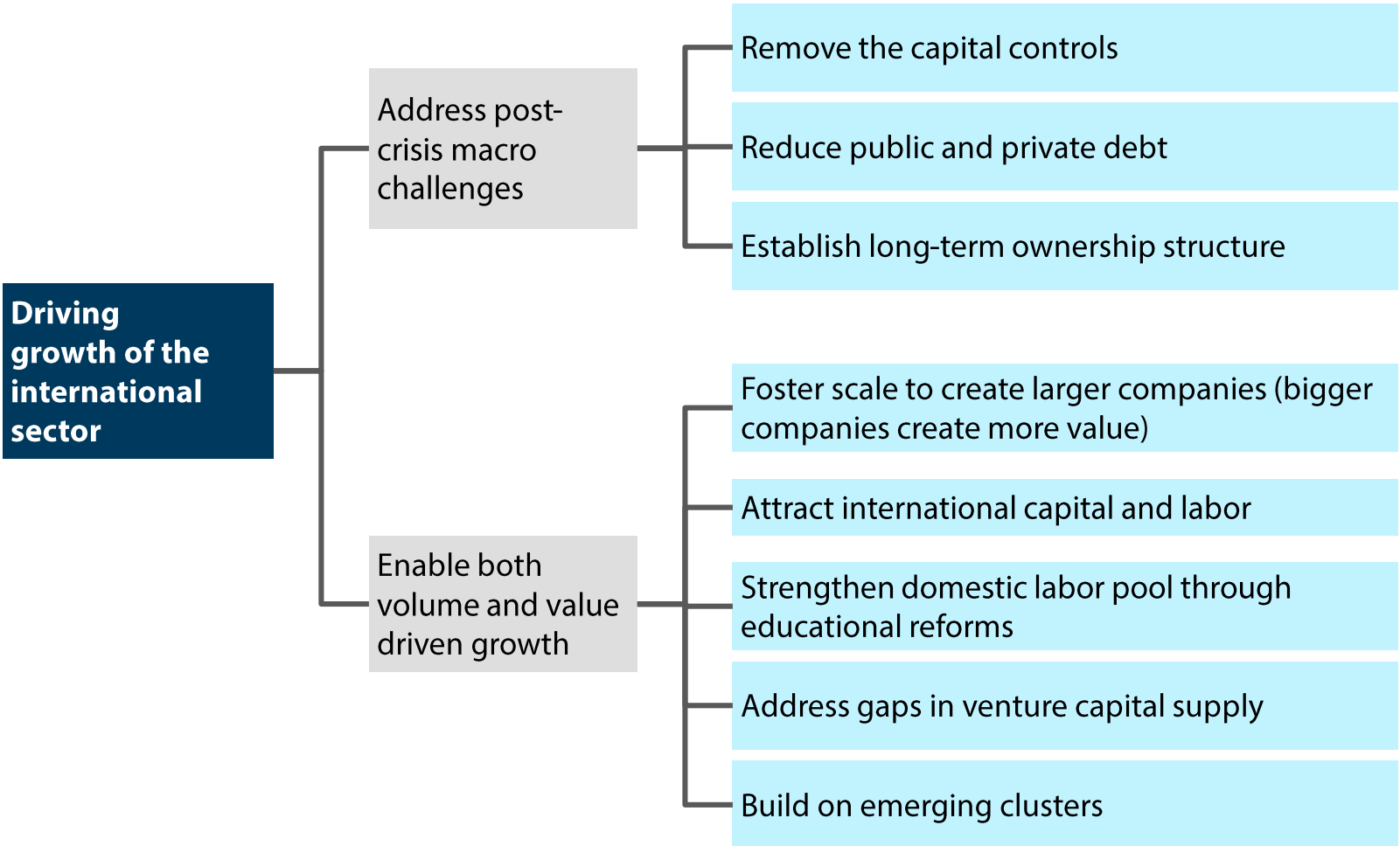
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50 × 

80 × 

320 × 

# The McKinsey report gives a good overview of the situation and challenges in the international sector





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