ICELAND CHAMBER
OF COMMERCE

Iceland's External Debt and the Capital Controls

A Consolidated Overview

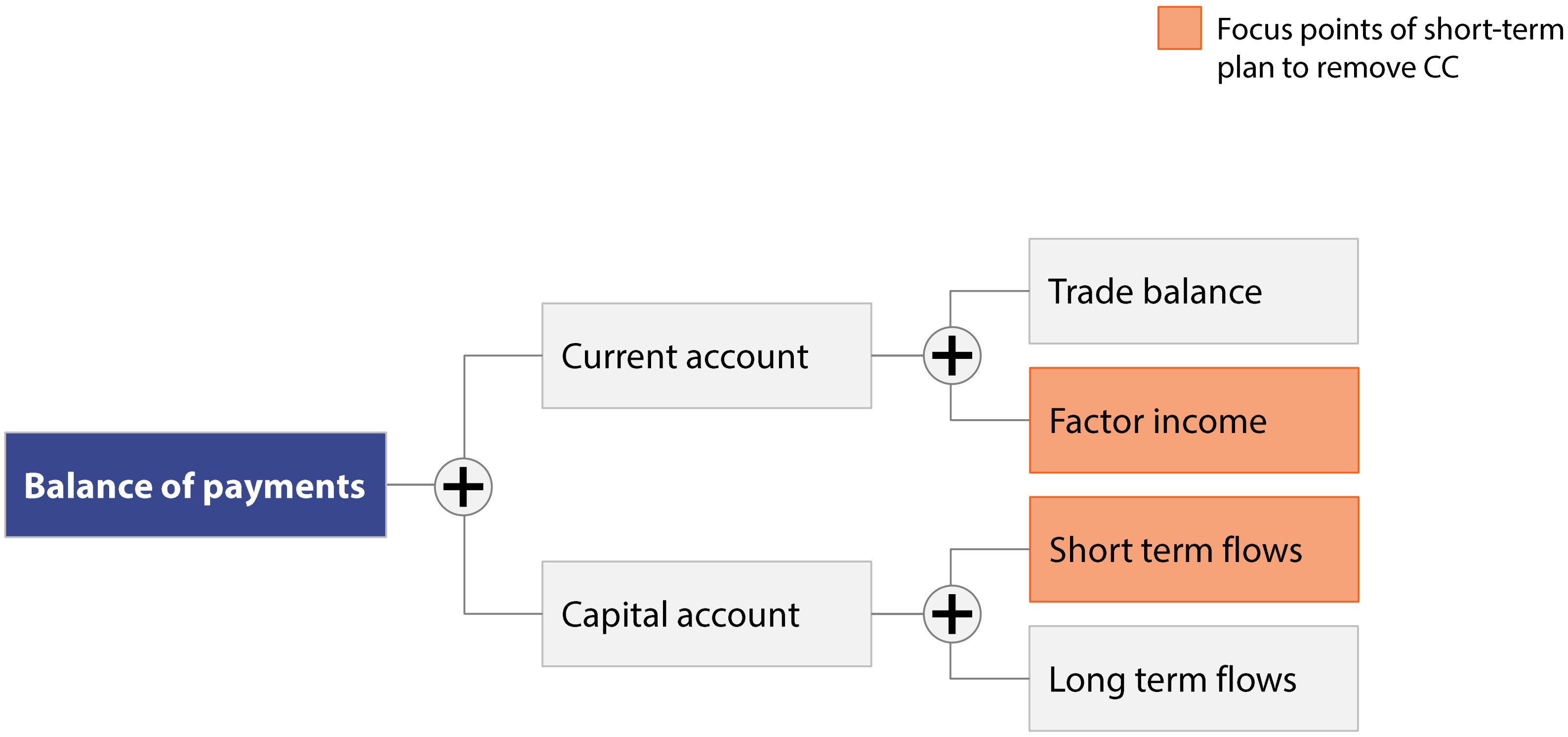
22 April 2014

Executive Summary

- **Iceland's net external debt is higher than in neighbouring countries and closer to the PIIGS countries**[1], which faced external debt challenges in the Eurozone crisis
- The negative external debt position results in interest payments on foreign loans that **completely negate Iceland's positive trade balance** in the foreseeable future
- Additionally, **Iceland is facing a *BoP*[2] *problem***, caused by a current account deficit and steep payment schedule on foreign liabilities
- In order to remove the capital controls (CC), Iceland needs to gain access to sufficient foreign currency to:
  1. Close the gap caused by the **BoP problem**
  2. Finance expected **short term capital outflows** when lifting the controls
- Iceland's future outlook depends on the economy's ability to sustain an **export-driven GDP growth** and obtain a sustainable **refinancing rate** on current liabilities
- Thus, the key challenges for Iceland today are:
  1. Reaching a broad alignment on a **long-term national growth strategy**
  2. Formulate a holistic **short-term plan for lifting the CC** which supports this strategy

1 Portugal, Italy, Ireland, Greece and Spain
2 Balance of Payments

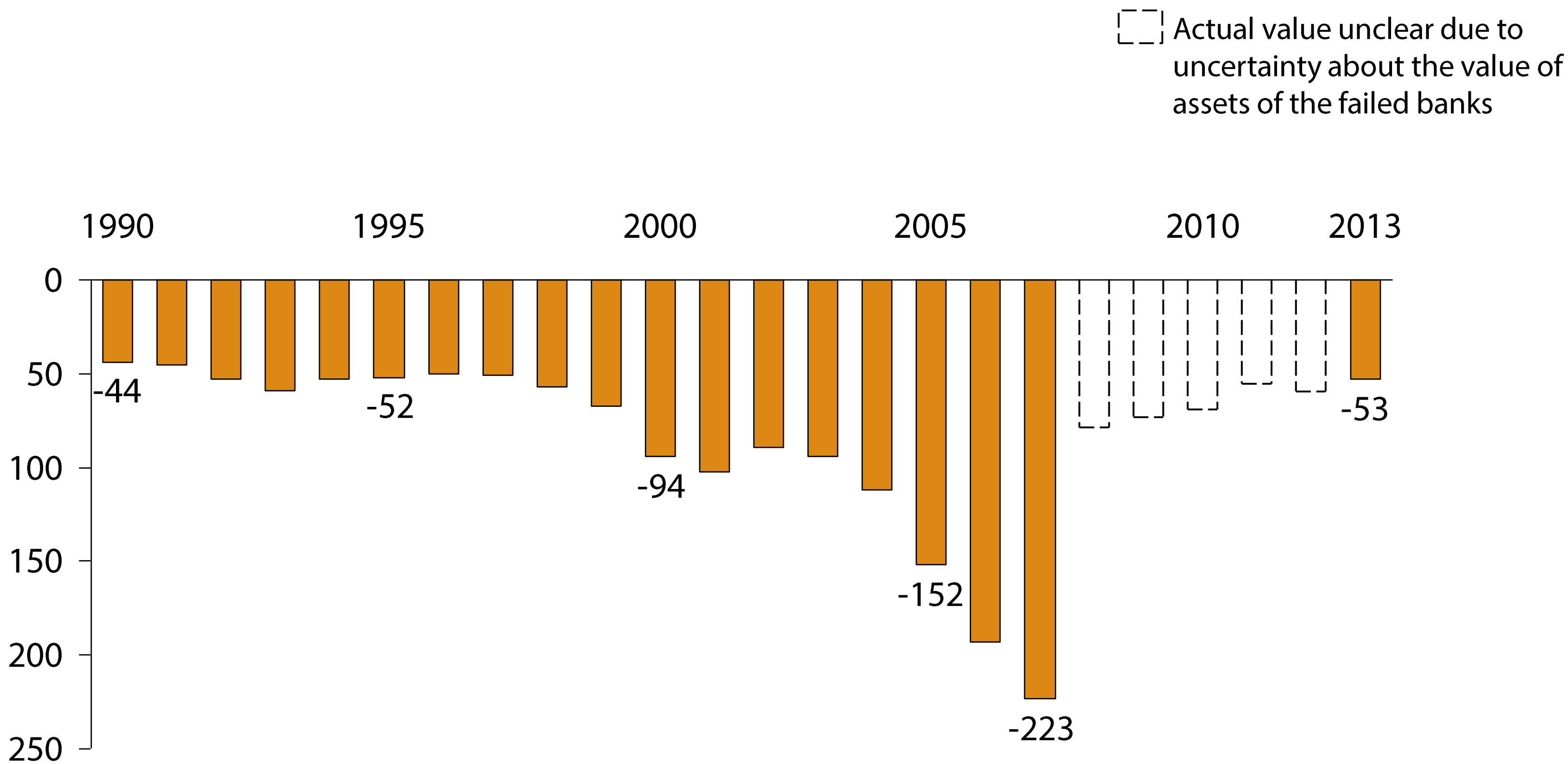
Iceland's challenge is caused by negative pressure on both the current and capital accounts



Source: Iceland Chamber of Commerce

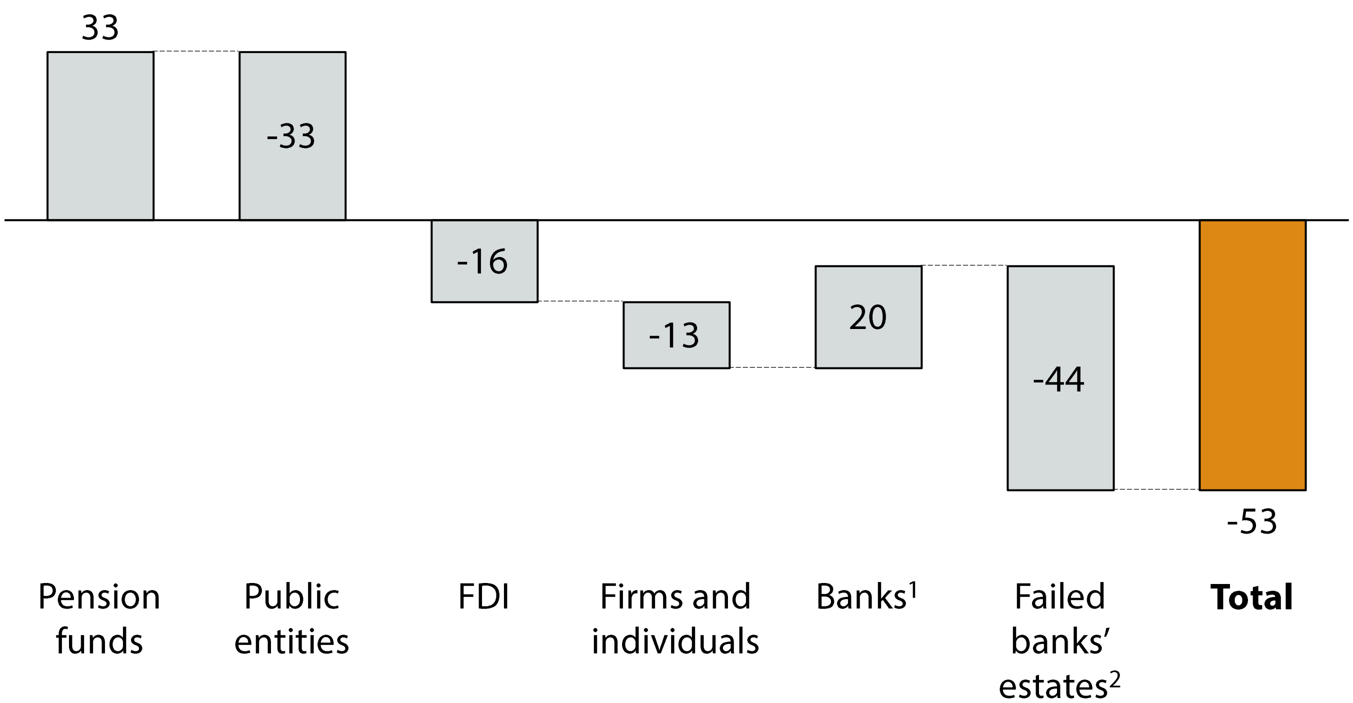
Iceland has historically been a net external borrower, with obligations accumulating dramatically before the crisis

Iceland's Net International Investment Position (NIIP)[1], % of GDP



The largest current contribution to Iceland's net external obligations comes from the failed banks' estates

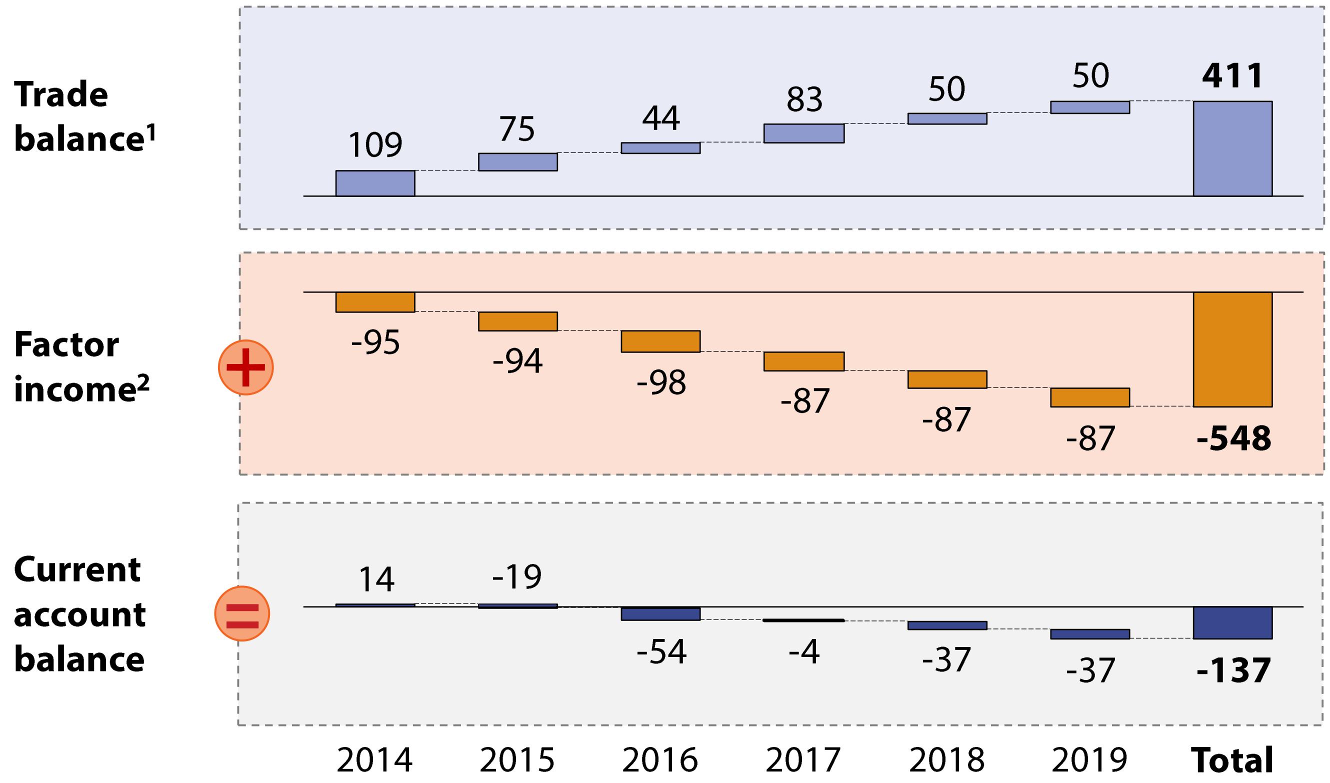
Iceland's NIIP, % of GDP



1 Without liabilities to failed estates, which would reduce the NIIP of the banks by 29% of GDP
2 Central Bank's estimated effect of a settlement

The external obligation position results in interest payments that negate the trade surplus

ISK billions



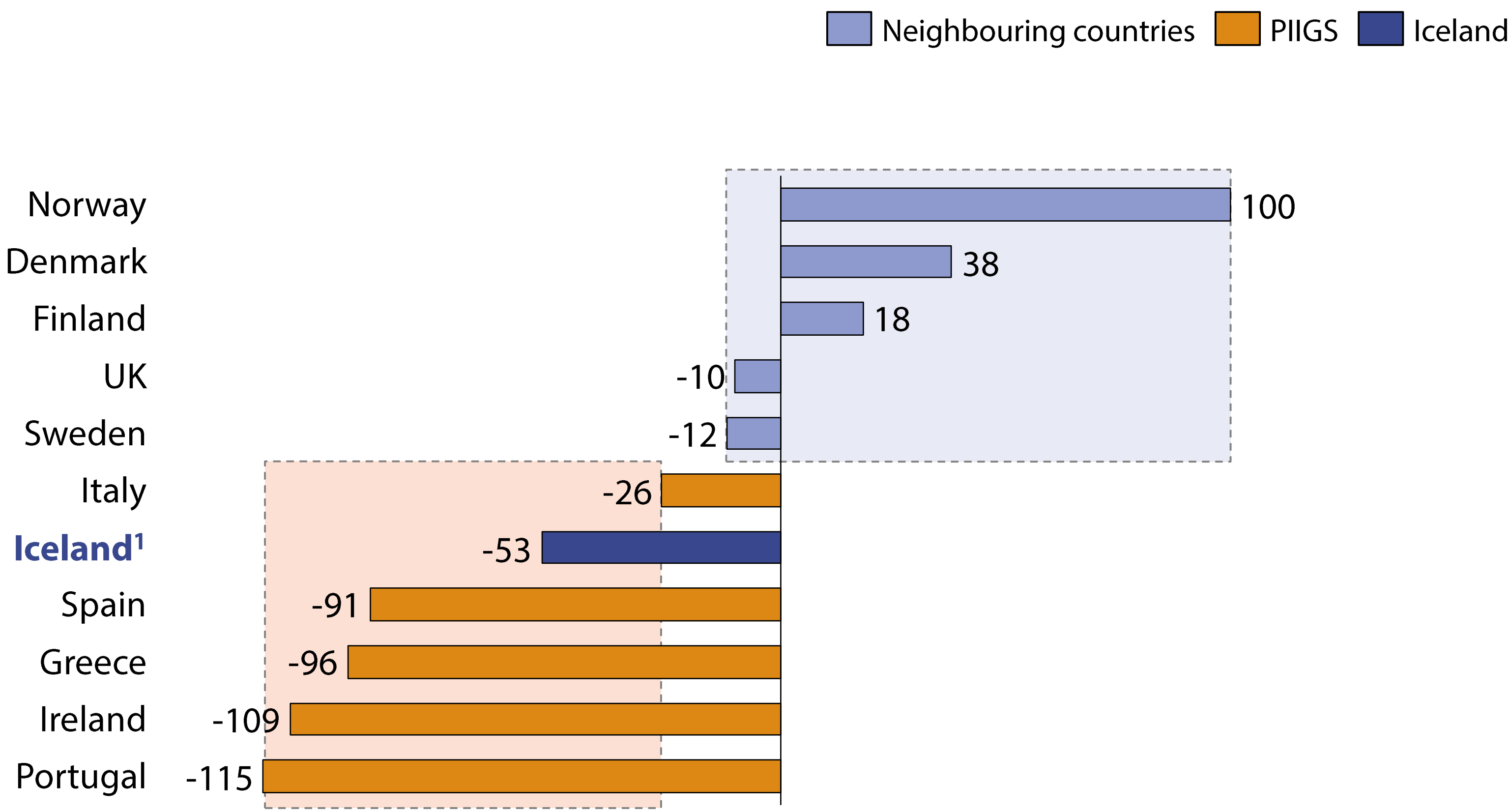
1 Central Bank's projections until 2016. After 2016, an unchanged trade balance is assumed, adjusted for the difference in FDI between years

2 Includes the Central Bank's estimate of factor income effects of a settlement of the failed banks' estates. The effect amounts to 2.5% of GDP, approx. 45 bn. ISK in 2014. Does not include the projected effects of a proposed tax on the failed banks' estates

Sources: Central Bank of Iceland (Monetary Bulletin 2014/1, Special Publication No. 9); Iceland Chamber of Commerce estimate

Iceland is closer to the PIIGS countries than its neighbours when it comes to net external obligations

NIIP, % of GDP (2012)

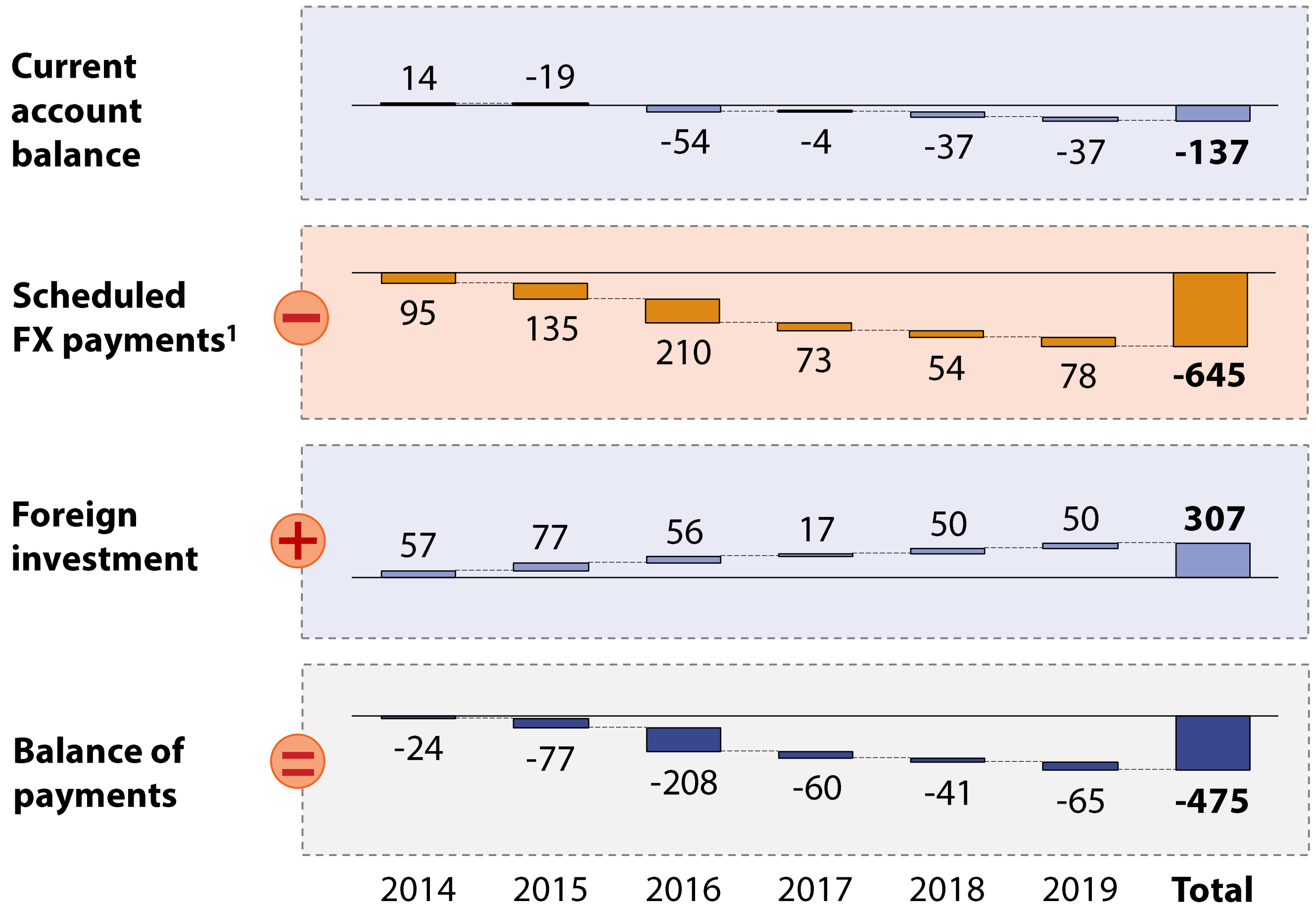


1 Figure for 2013. Includes the Central Bank's estimated effect of a settlement of the failed estates

Sources: IMF; Eurostat; Central Bank of Iceland; Statistics Norway; Iceland Chamber of Commerce

Iceland has a BoP deficit of 475 bn. ISK over the next few years which needs to be refinanced

ISK billions

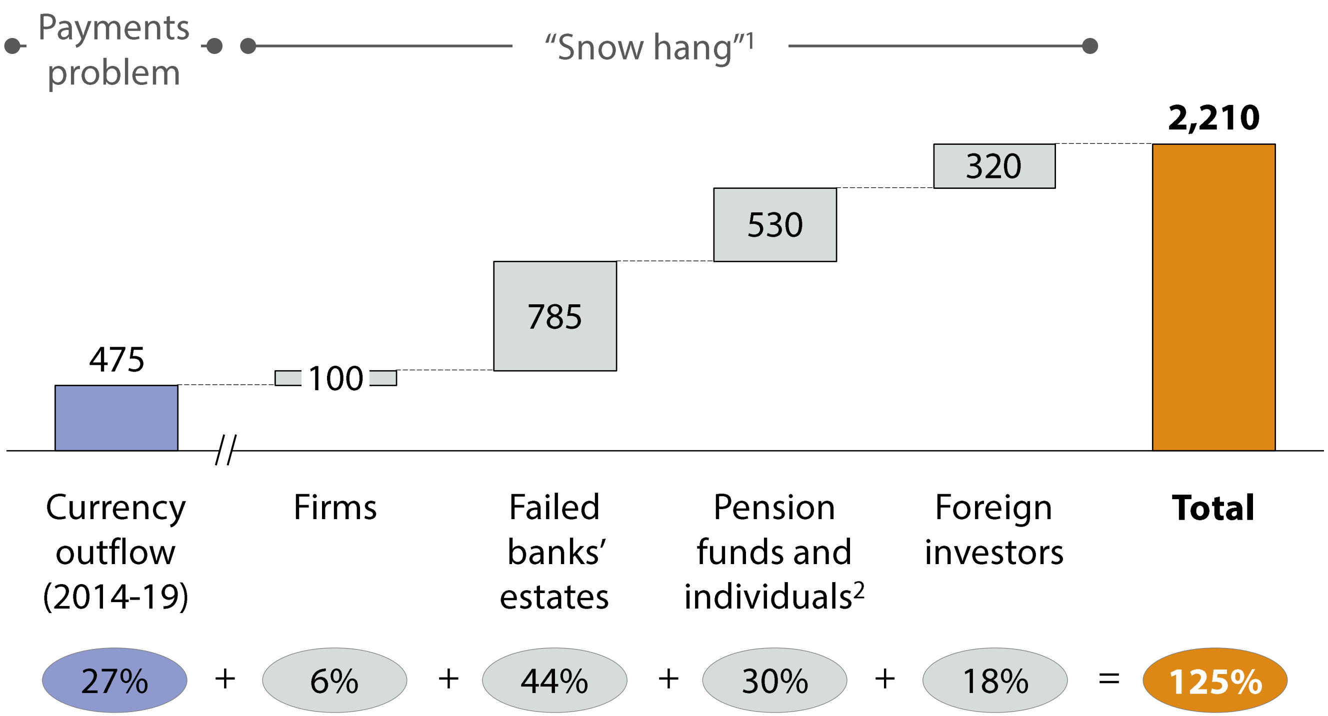


1 Excludes Landsbanki bonds to LBI. Includes all other obligations, e.g. scheduled repayments of Central Bank's reserve loans

Sources: Central Bank of Iceland (Monetary Bulletin 2014/1, Financial Stability 2014/1); Iceland Chamber of Commerce estimate

Additionally, 1,500 bn. ISK may be needed in order to lift the capital controls

Iceland's Currency Need (ISK billions / % of GDP)



1 Key assumptions behind the size estimate for the respective parts is covered in further detail in the opinion piece
2 There of 470 bn. ISK from pension funds and 60 bn. ISK from individuals

According to OECD's growth projections, this refinancing need can lead to an unsustainable interest burden

Iceland's NIIP (% of GDP)