

# The Icelandic Economy

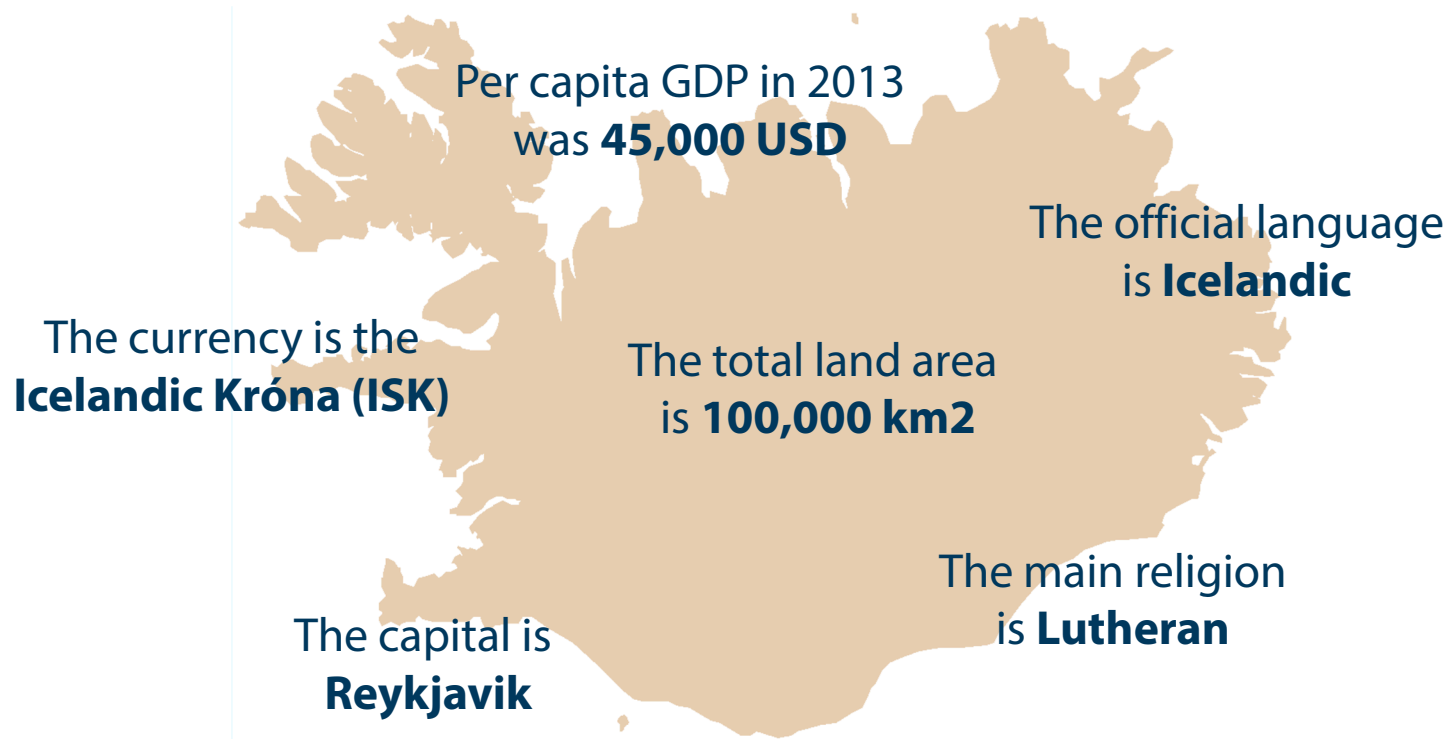
Current State, Recent Developments and Future Outlook



Iceland Chamber  
of Commerce



# Key Facts



## Did you know?

- The number of tourists visiting Iceland in 2014 is expected to be triple the country's population
- Iceland's parliament, Alþingi, was established in 930 AD, making it the world's oldest extant parliamentary institution in the world
- Iceland is one of the least densely populated countries in the world, with only 3.2 inhabitants per km<sup>2</sup>
- Vigdís Finnbogadóttir, the 4th president of Iceland, was the first democratically elected female head of state

# Foreword

In 2008 the Icelandic economy underwent dramatic changes concomitant to the collapse of its financial sector. At the same time, foreign parties interested in Iceland experienced difficulties accessing in English a holistic overview of events and the status of the economy following the crisis.

To remedy this, in October 2008 the Iceland Chamber of Commerce (ICoC) published the first edition of this report. Our aim is to provide an objective overview of the current economic, business and political landscape in Iceland, recent events and developments, and future economic prospects.

Since its first publication, the report has been regularly revised and updated. Considerable changes have been made to the current edition, with more focus on the current economic landscape, on-going challenges and future prospects, with less focus on past events.

This report is divided into three sections. The first section is primarily a fact-based overview of Iceland's current economic landscape. The second section is a more descriptive review of recent developments. Lastly, the third section portrays potential future scenarios and longer term growth prospects.

More detailed information on the financial crisis and its immediate consequences can be found in earlier editions. The current and previous editions of this report, in addition to a presentation based on its contents, can be accessed on the ICoC's webpage.

It is our hope that the report will be useful to those looking to gain an insight into the functioning of the Icelandic economy and an overview of its current state of affairs.



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of Commerce

# Acknowledgements

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# Current State

Recent  
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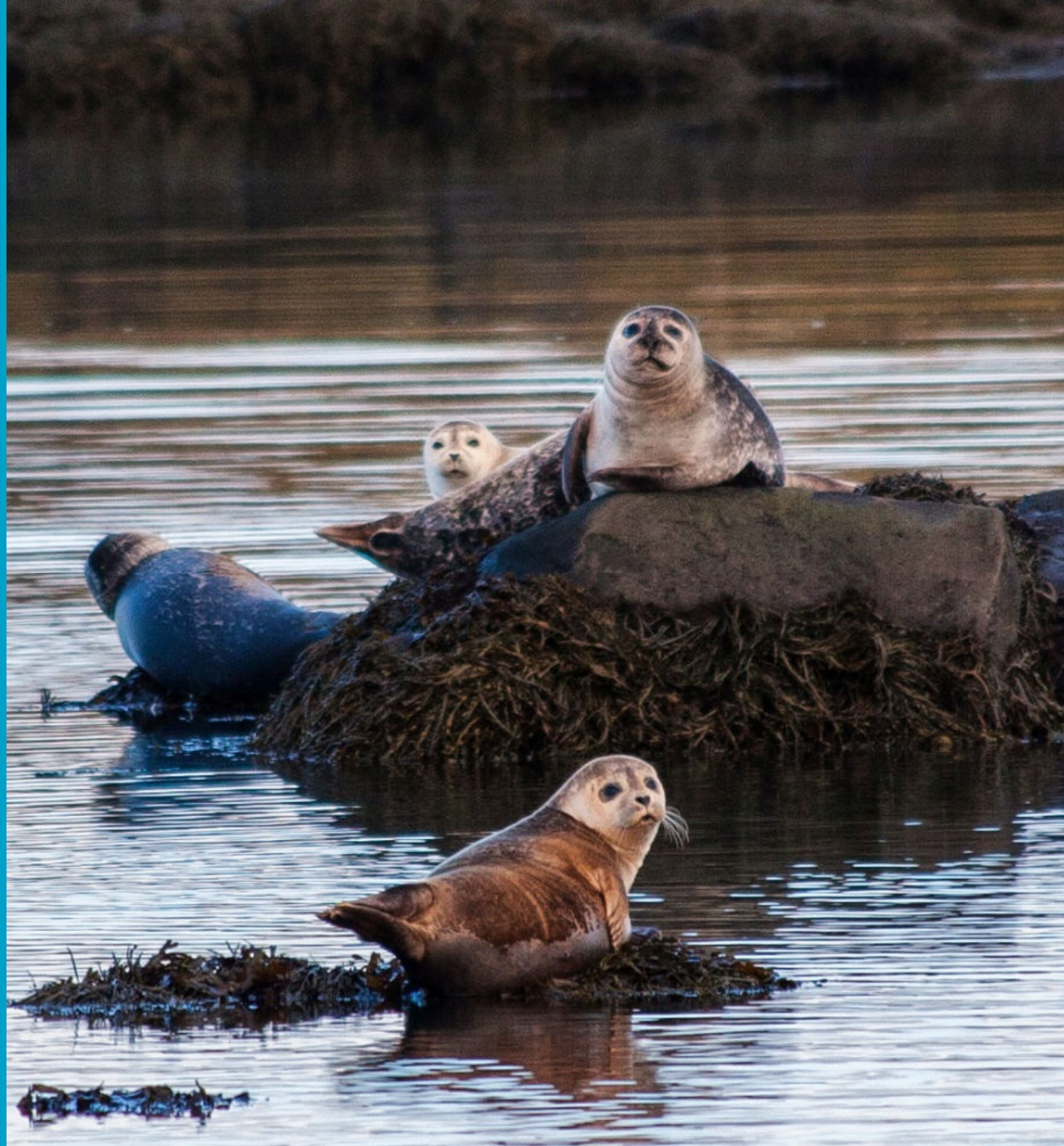




Figure 1.1

# Iceland has a high standards of living and has largely recovered from the recession

Country rankings, GDP per capita (PPP adjusted)

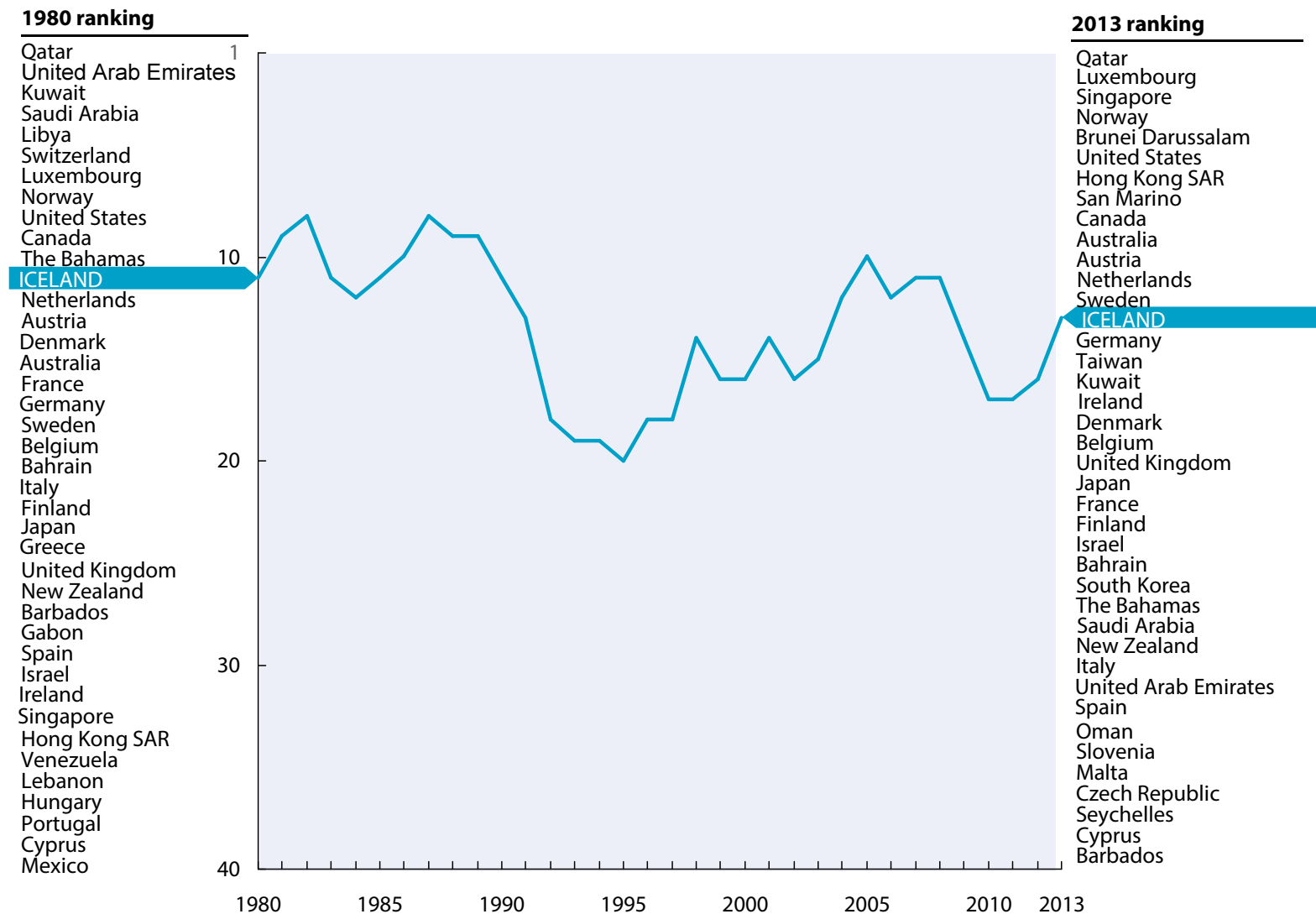


Figure 1.2

# Iceland ranks highly in numerous competitive indices

Competitiveness rankings (Iceland's rank and total number of countries in index)

Iceland's ranking # of countries ranked

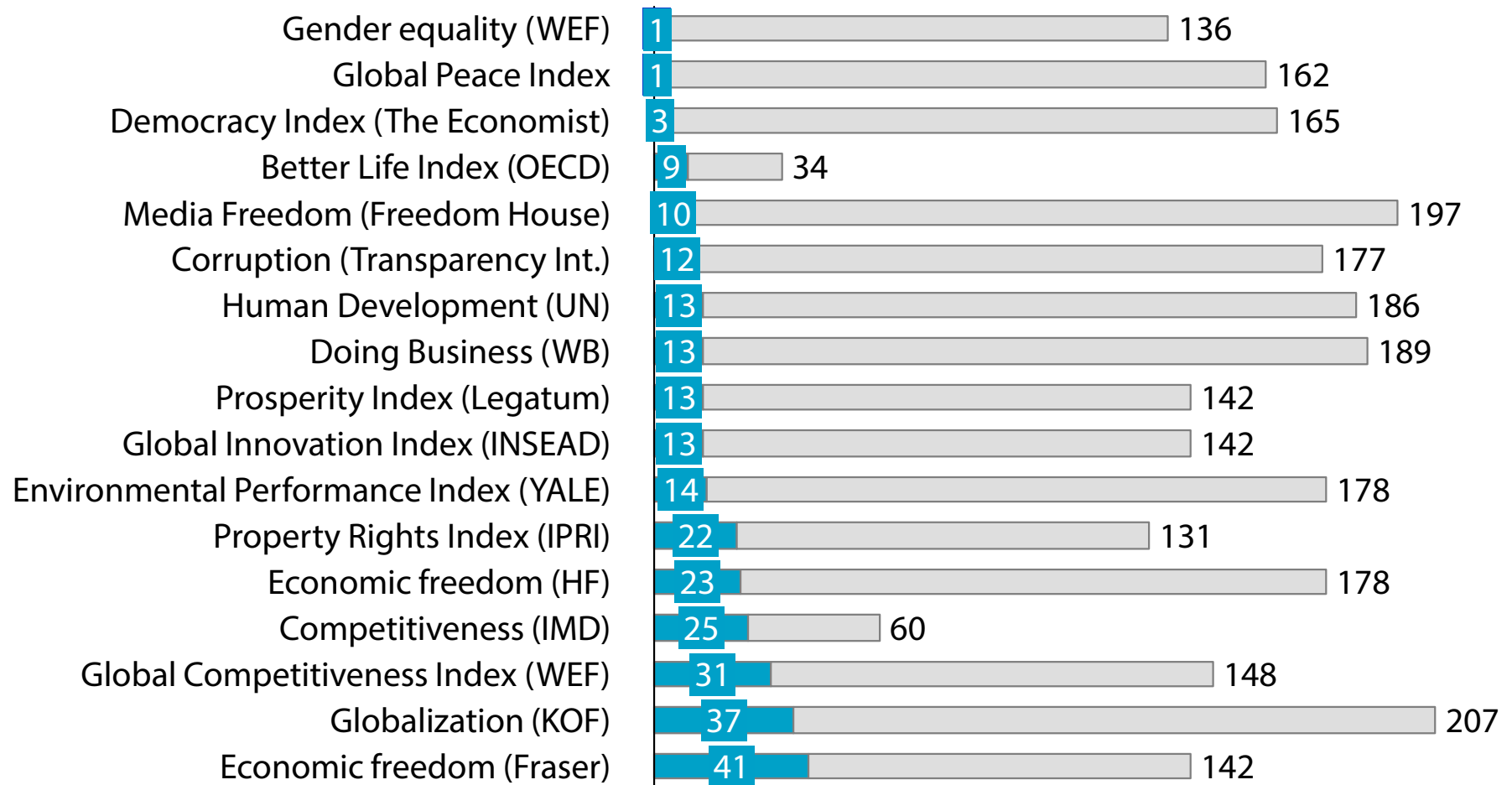


Figure 1.3

# The economy shrank following the financial crisis but is now experiencing robust growth

Real GDP growth per capita (percent)

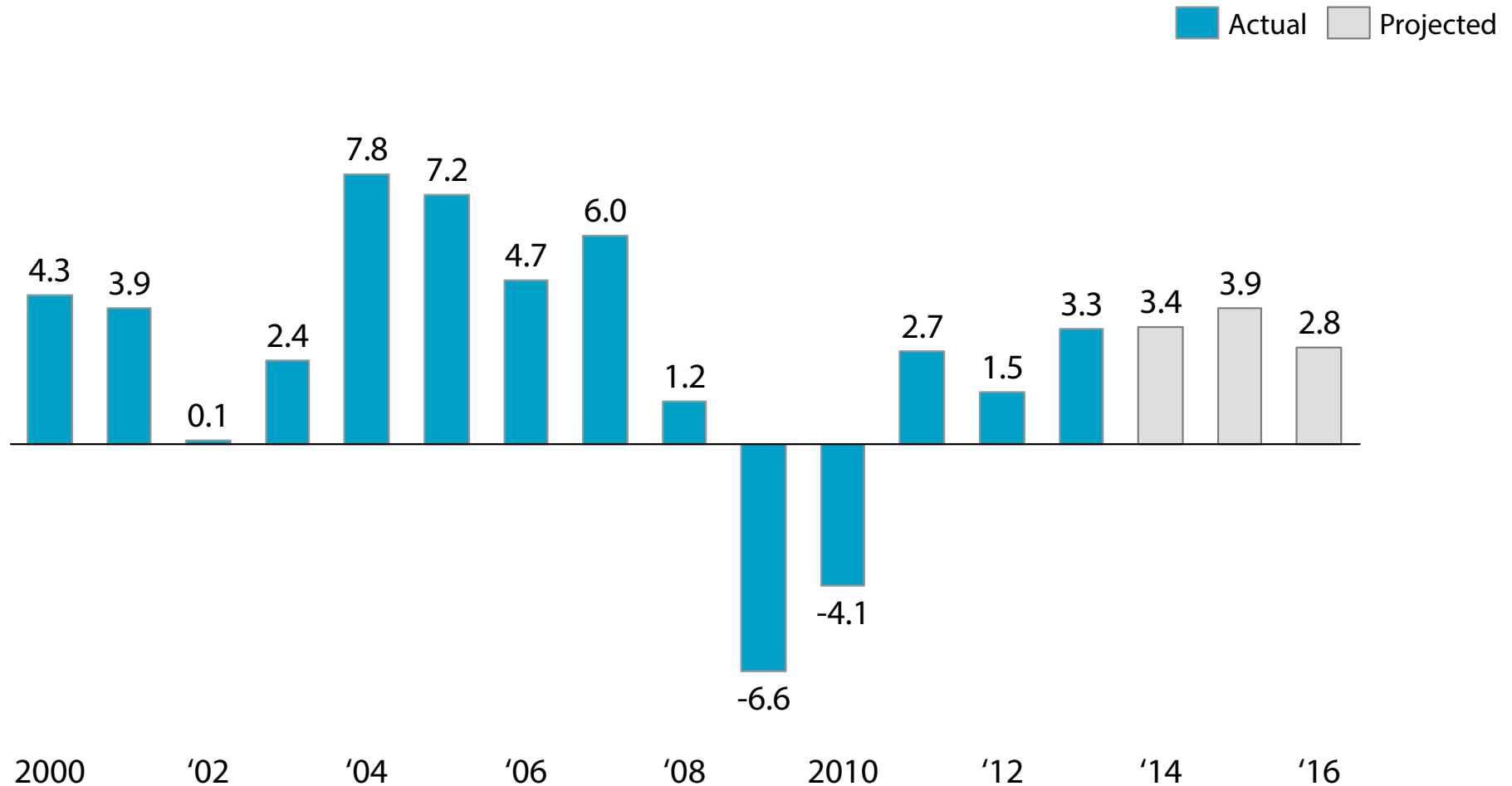
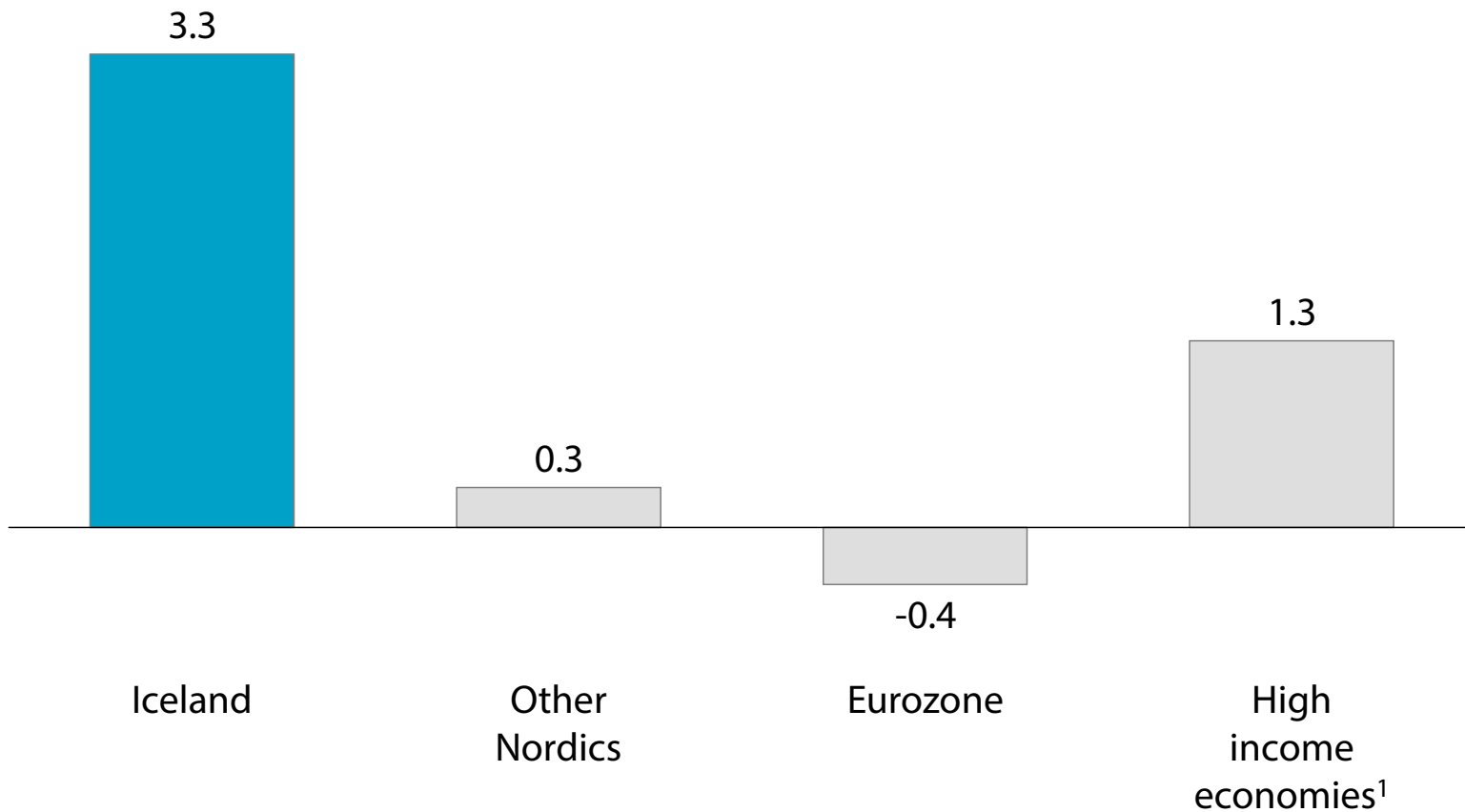




Figure 1.4

# Iceland experienced strong economic growth in global comparison in 2013

GDP growth in 2013 (percent)



1 A high-income economy is defined by the World Bank as a country with a gross national income per capita above US\$12,746 in 2013

Figure 1.5

# Unemployment has decreased after a sharp rise in 2009 and is approaching structural unemployment levels

Unemployment rate (percent)

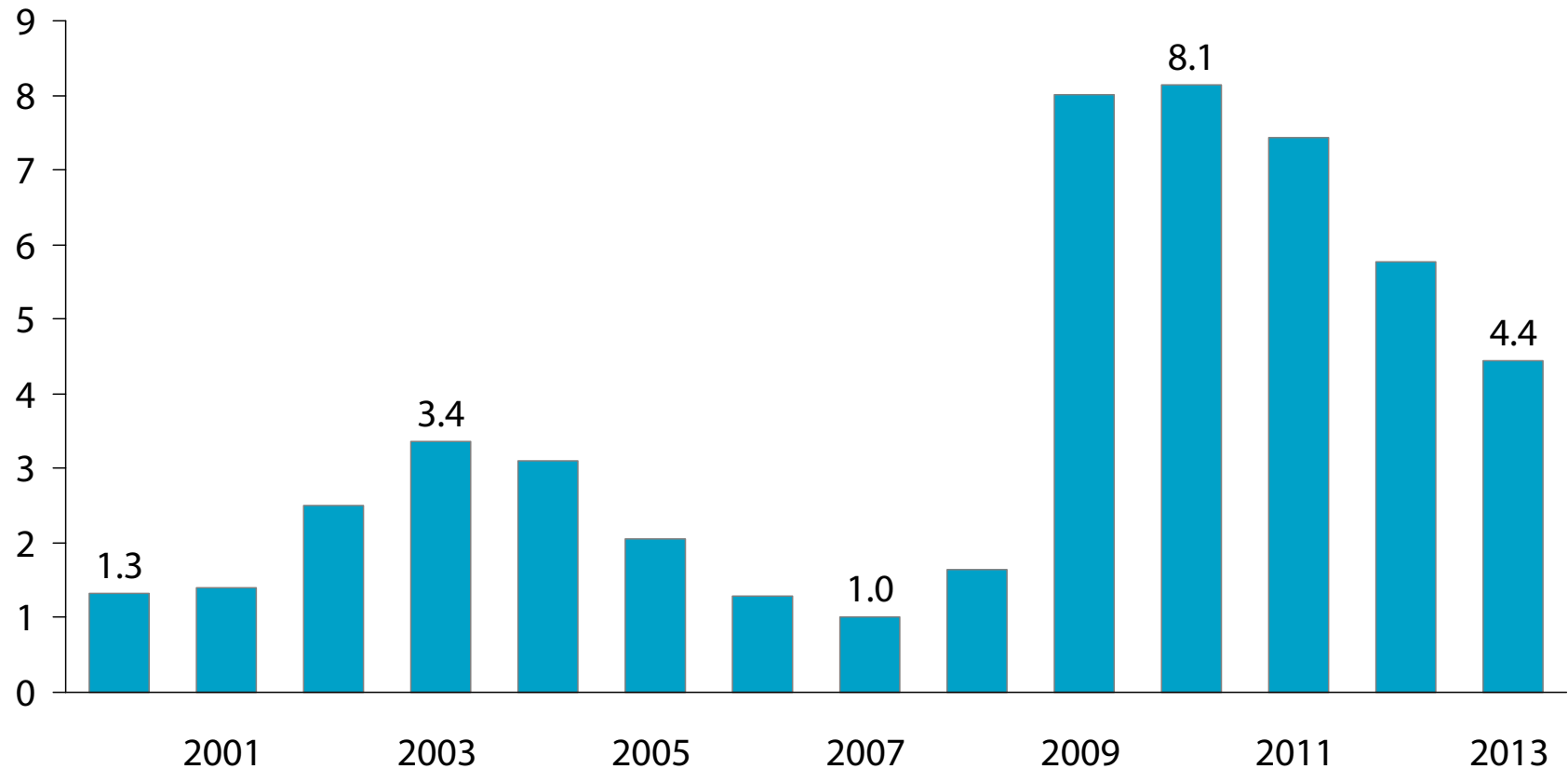


Figure 1.6

# Private debt has gradually declined, especially corporate debt, and is now close to pre-crisis levels

Corporate and household debt (percent of GDP)

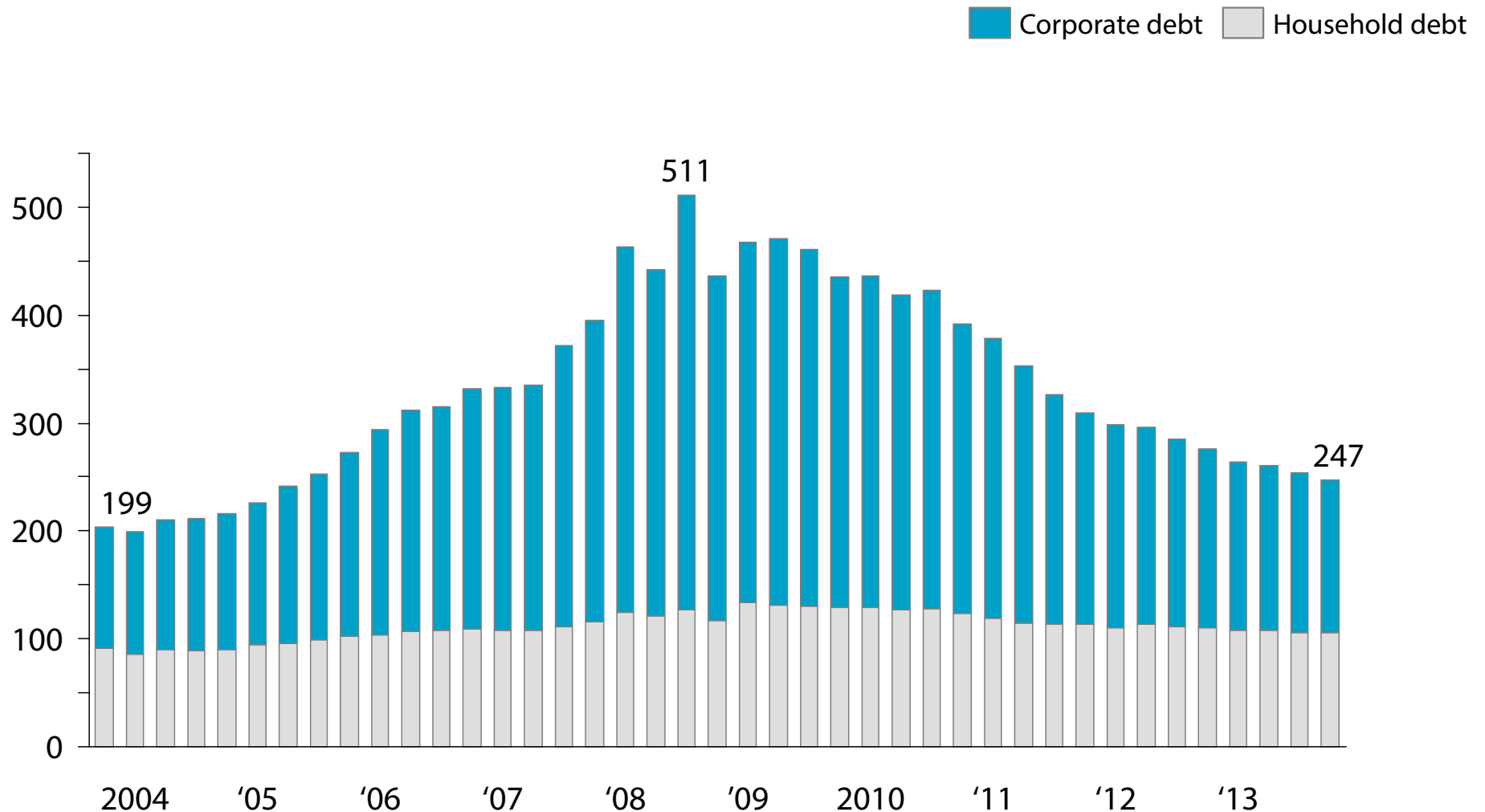
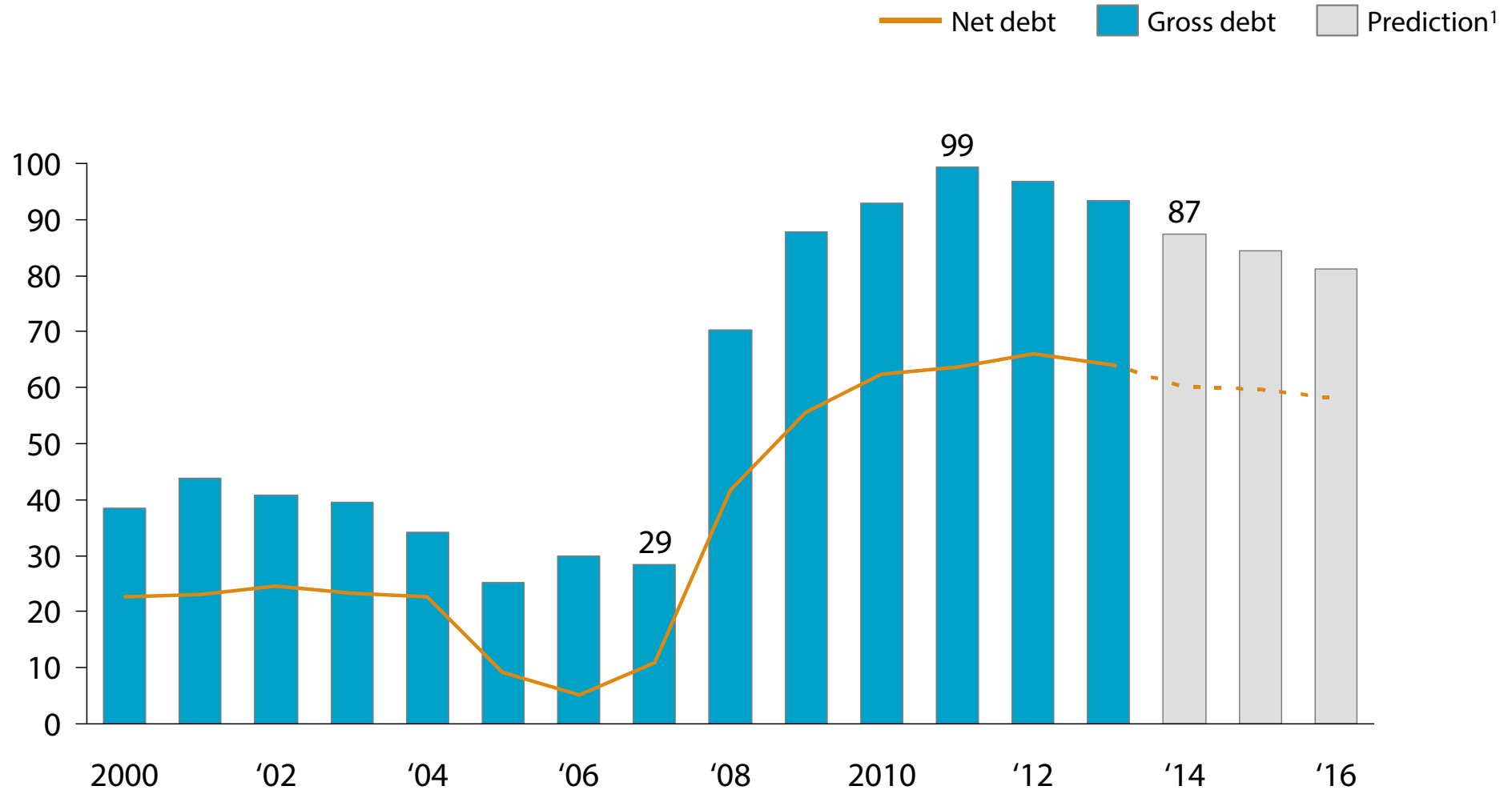




Figure 1.7

# Public debt more than tripled following the financial crisis in 2008, but has gradually declined in the last two years

General government debt (percent of GDP)



<sup>1</sup> Central Bank of Iceland's prediction

Figure 1.8

# Inflation rose following a devaluation of the krona but is now within the Central Bank's target

Annual inflation rate (percent)

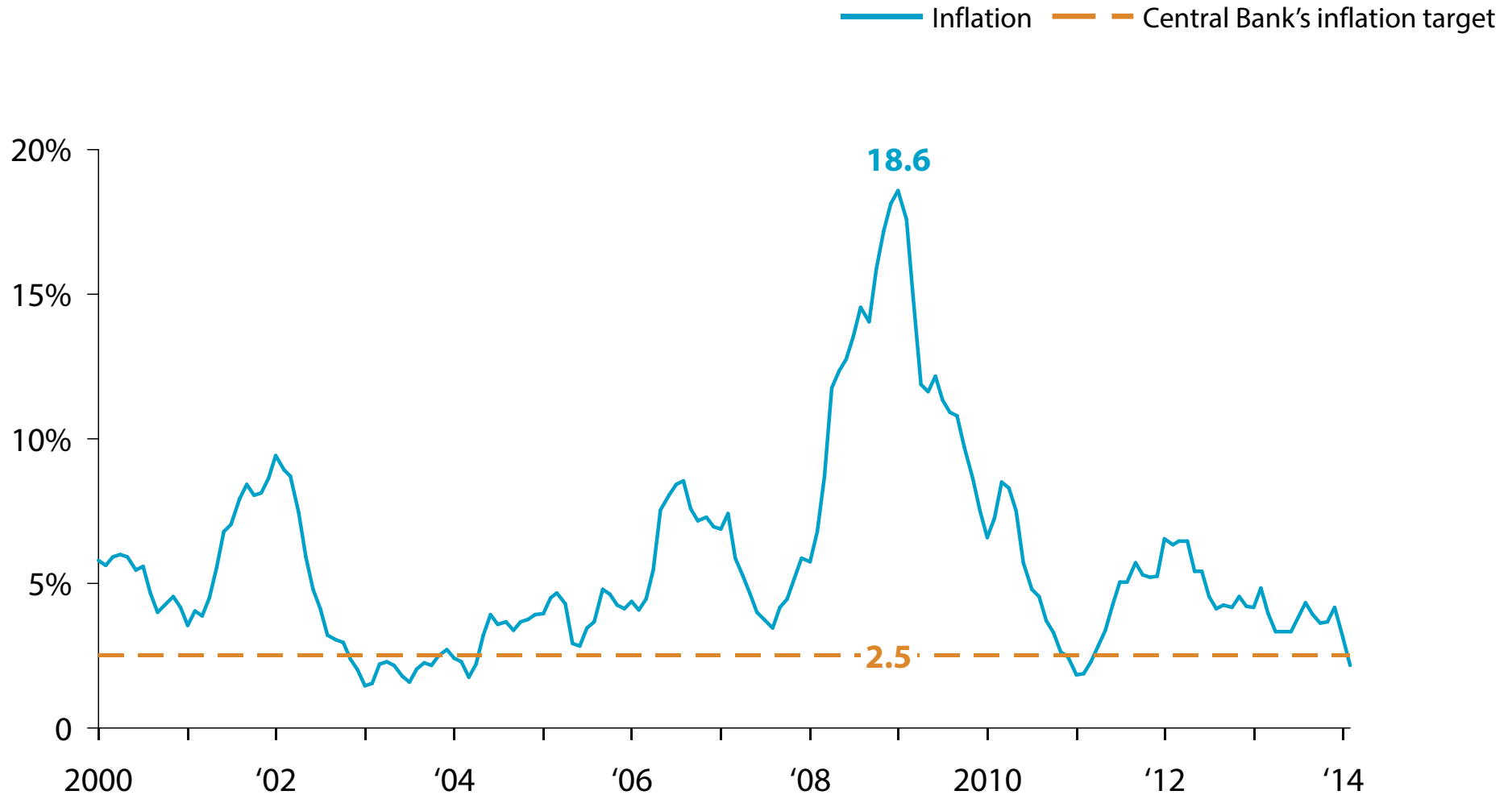


Figure 1.9

# The Icelandic krona devaluated dramatically during the financial crisis and has remained relatively weak

Exchange rate index (ERI). A higher index value indicates a weaker Icelandic krona

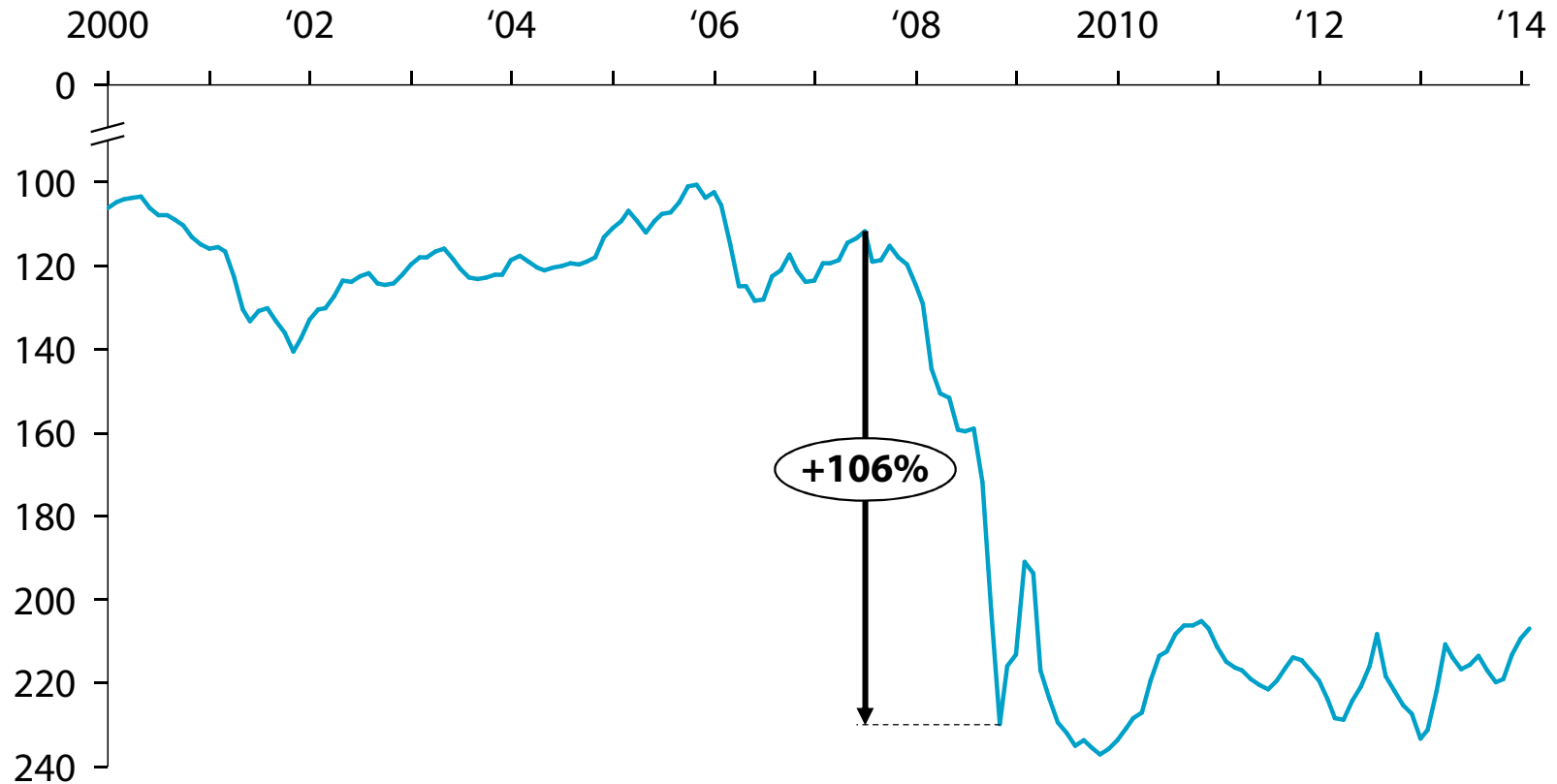
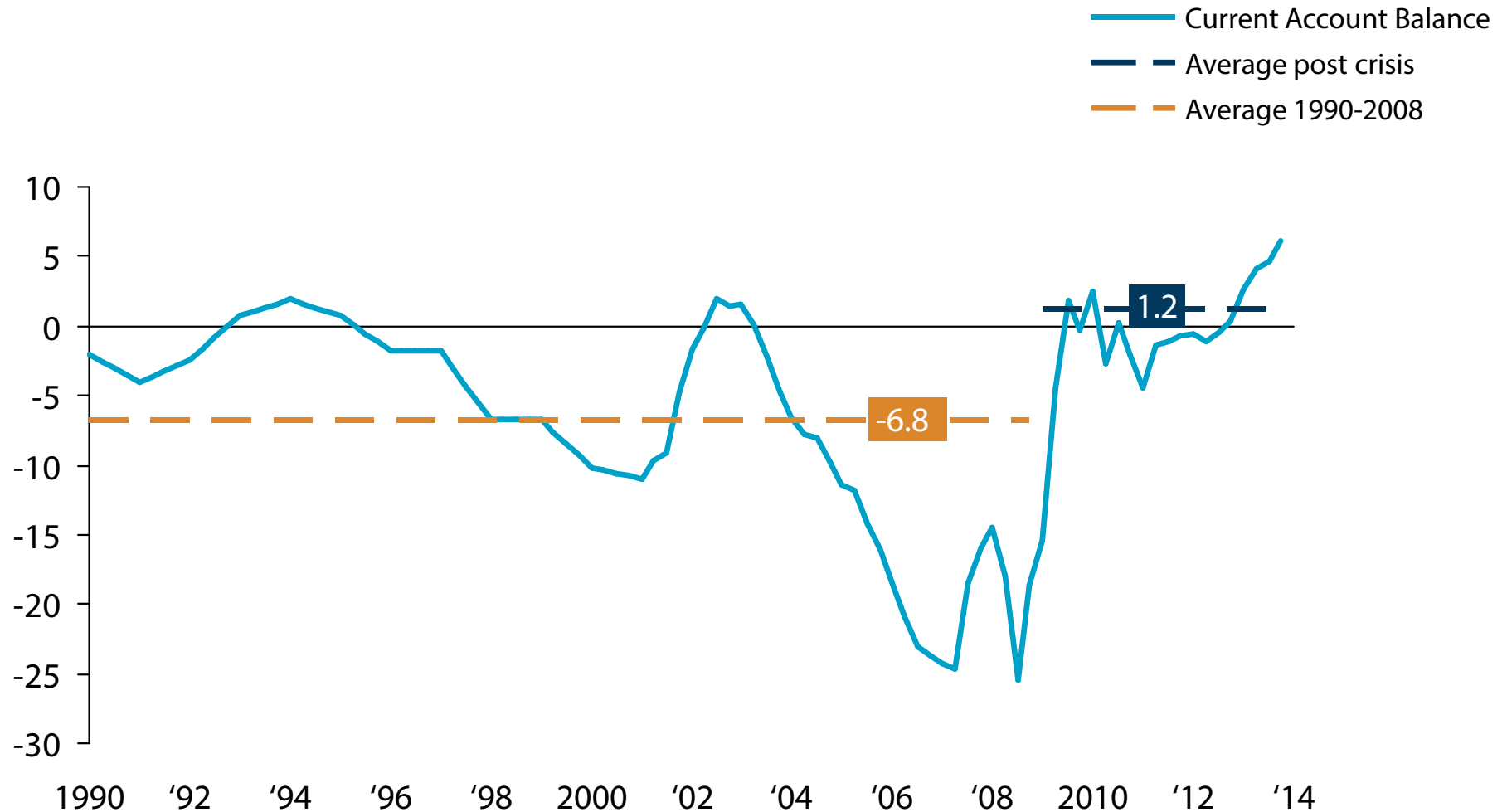




Figure 1.10

# The devaluation of the krona converted a persistent current account deficit into a surplus

Current account balance<sup>1</sup> (percent of GDP)



<sup>1</sup> Seasonally adjusted, trailing 12 month average

Figure 1.11

# A persistent current account deficit in the years leading up to the crisis resulted in a vast amount of obligations

Iceland's net international investment position (percent of GDP)

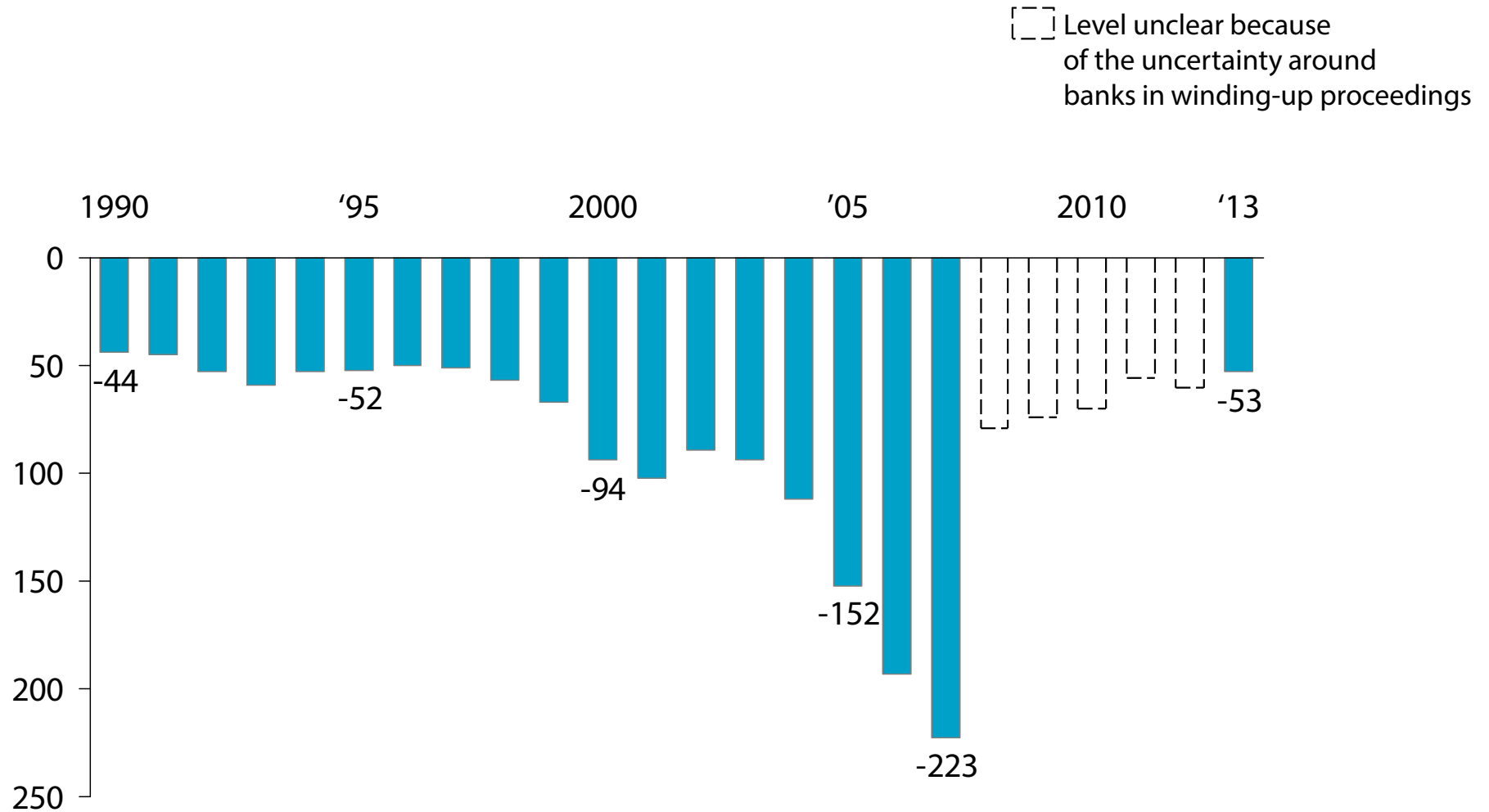
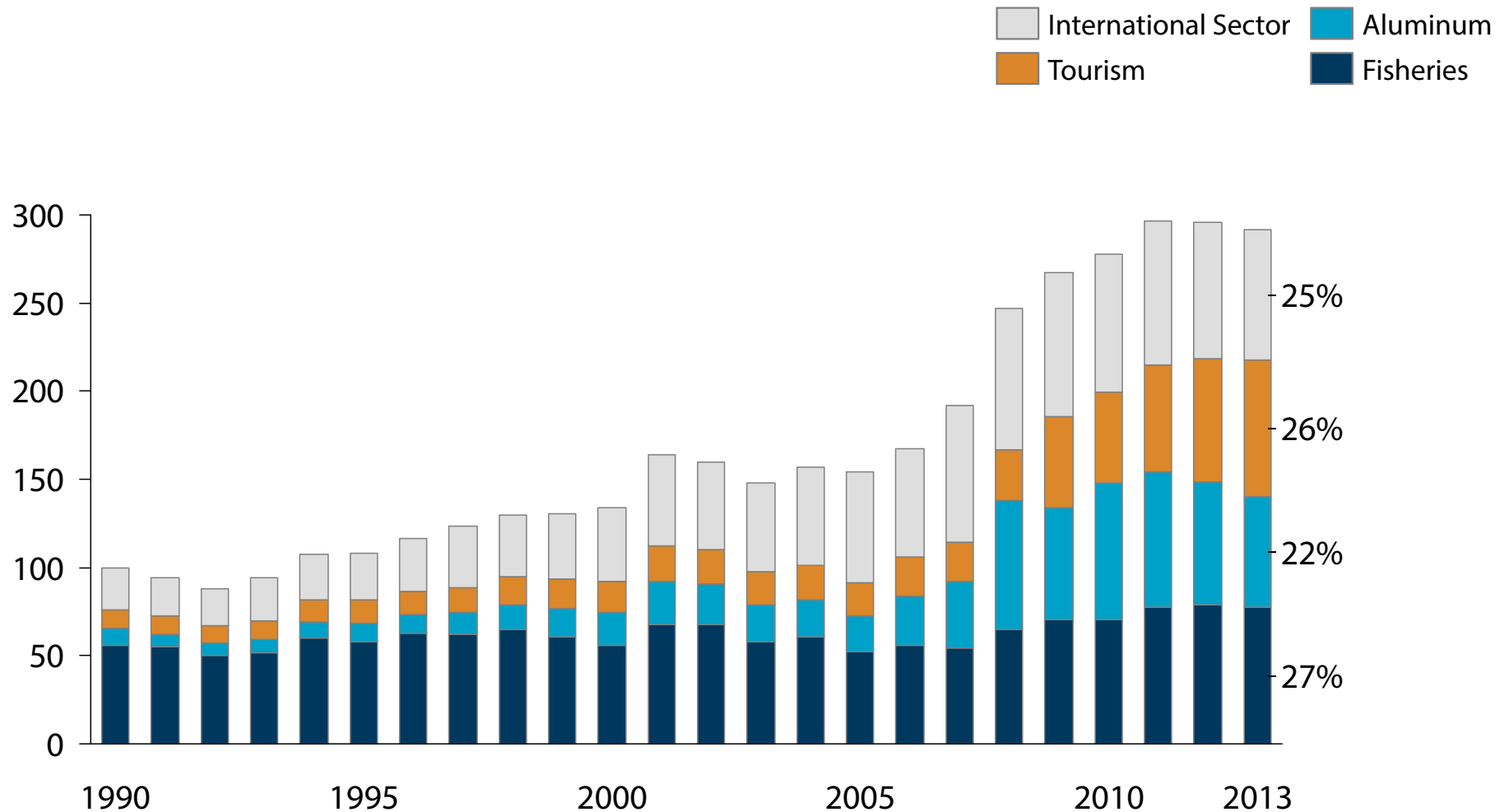


Figure 1.12

# Iceland has historically been dependent on fishing but three other export foundations have recently emerged

Iceland's exports, index (1996 = 100), inflation adjusted





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Figure 2.1

A new centre-right wing government was formed in May 2013, replacing a centre-left wing government



Figure 2.2

# Iceland's application to the EU was halted in 2013, but a proposal to withdraw the application was not approved

Iceland's negotiations with the European Union

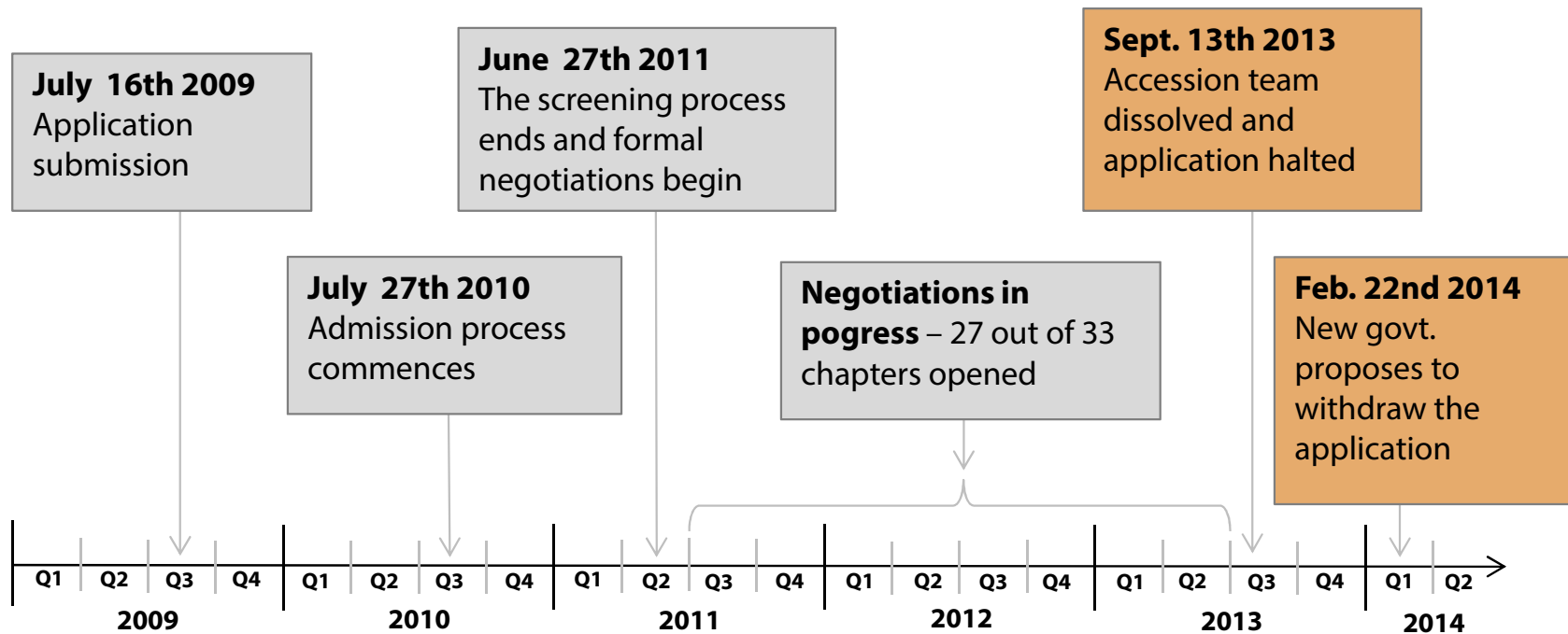
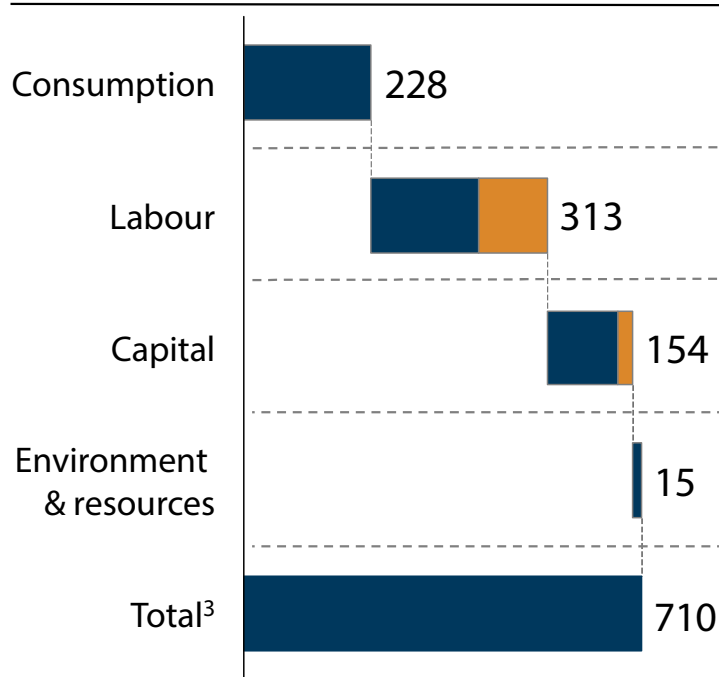


Figure 2.3

# The current government aims to reduce consumption taxes and is imposing a new tax on financial institutions

■ Government<sup>1</sup> ■ Municipalities<sup>2</sup>

## Public sector tax revenues (bn. ISK)



## Current govt. actions/proposals

- Reduce tariffs and excise duties
- Combine sales/VAT-tax brackets
- Few changes, some emphasis on less progressive income taxes
- New bank tax on outstanding debt to raise 30 bn. ISK p.a.
- Resource fee on fisheries reduced

1 Central Government 2014 draft budget

2 2012 data for Municipalities

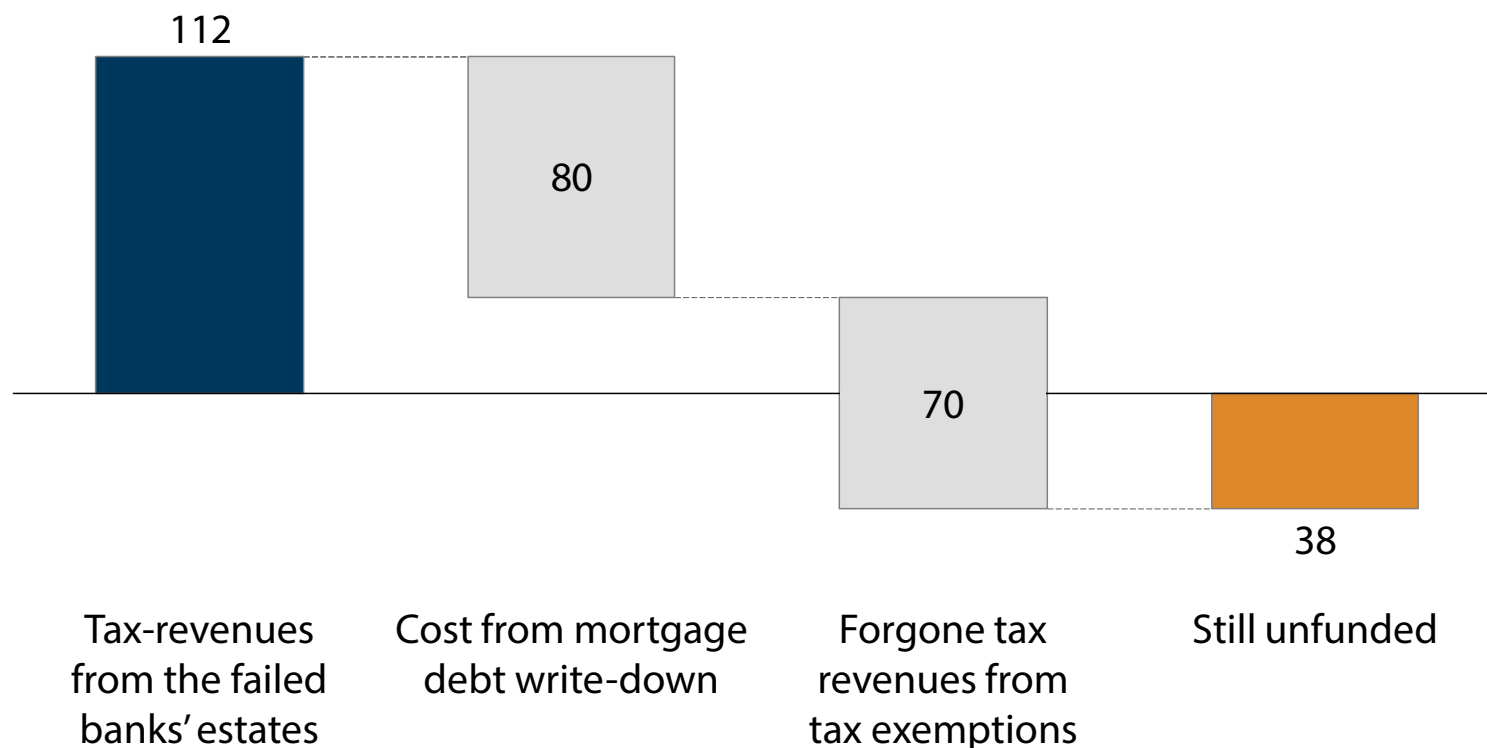
3 On top of this the general government gets 53bn. ISK in other revenues, mostly from public services, capital gains and dividend payments



Figure 2.4

# The government unveiled its mortgage debt relief plan – most of it funded by a tax on the failed banks' estates

Breakdown of the government's mortgage debt-relief financing, bn. ISK



1 Cost and revenue will realise incrementally over the next four years

Figure 2.5

# The capital controls were imposed to prevent an outflow of capital that could destabilise the economy

Key parties inside and outside of the capital controls

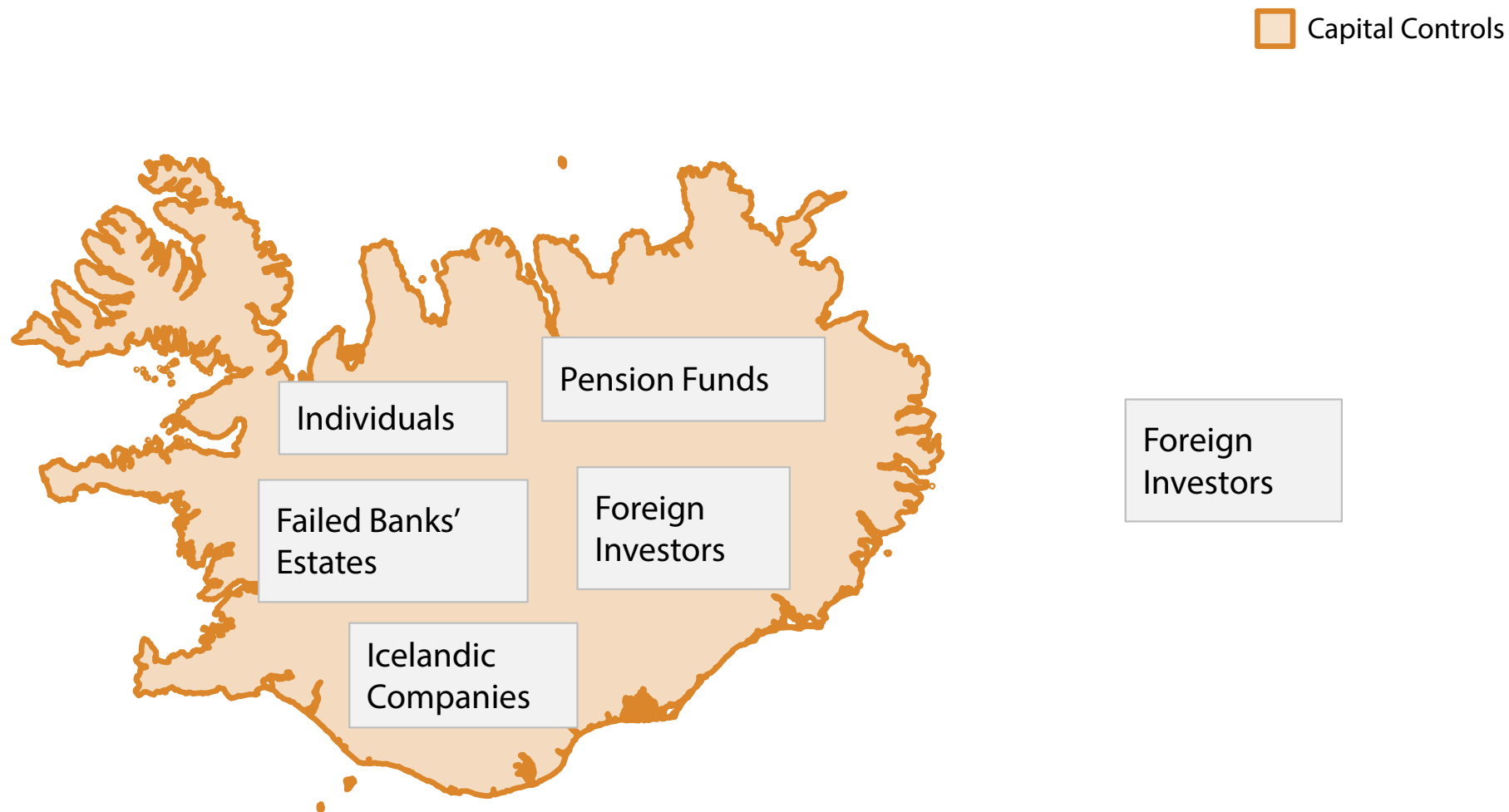


Figure 2.6

# The Icelandic krona was one of the most volatile currencies in the developed world before the controls

Exchange rate fluctuations against the Euro (standard deviation of weekly changes)

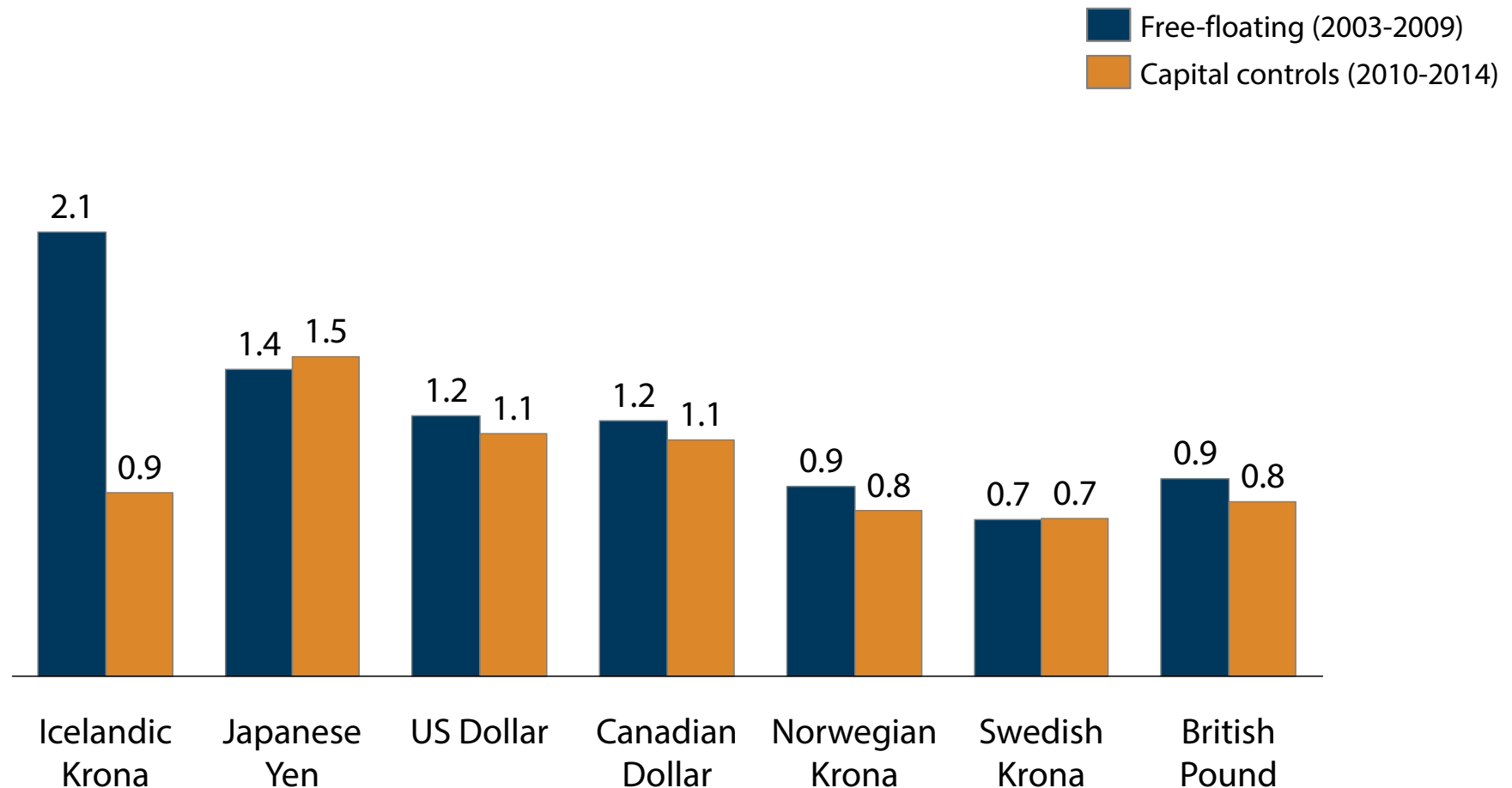


Figure 2.7

# The adverse effects of the capital controls are most visible in the international sector, which has stagnated recently

Iceland's exports originating from the international sector, bn. ISK (inflation adjusted)

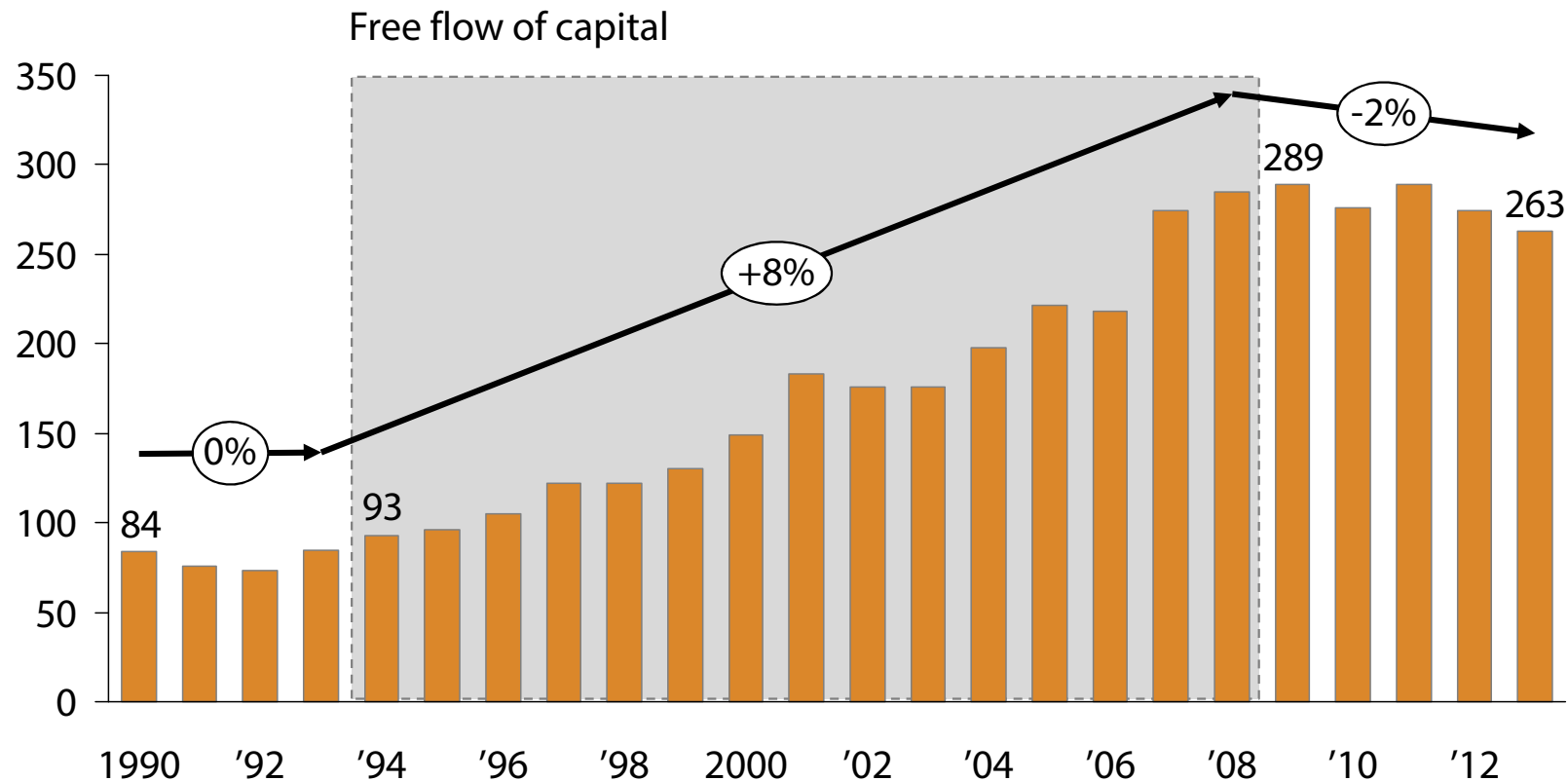


Figure 2.8

# Iceland's shortage of foreign currency combined with the risk of capital flight makes it difficult to lift the controls

Iceland's Currency Needs, bn. ISK / % of GDP

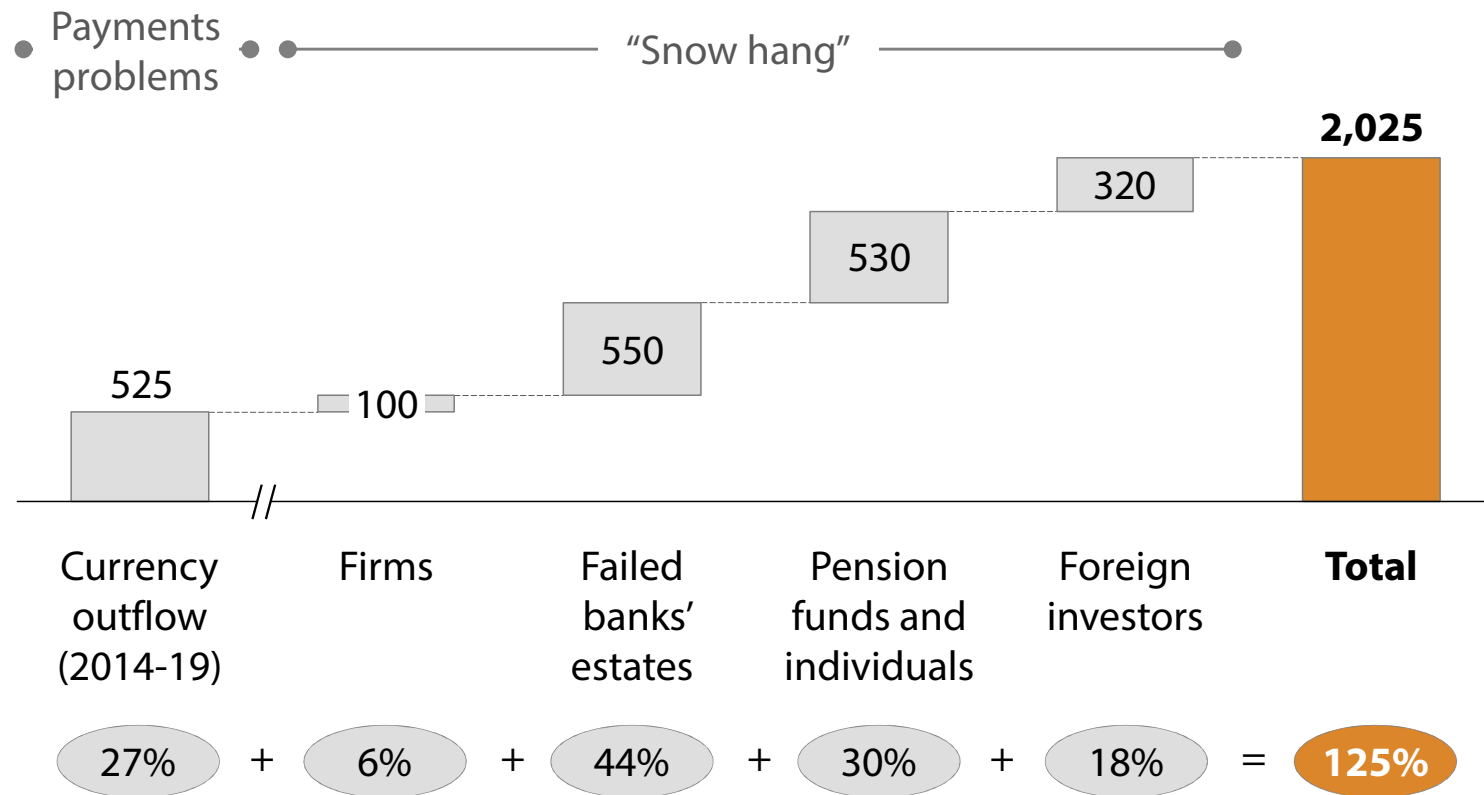
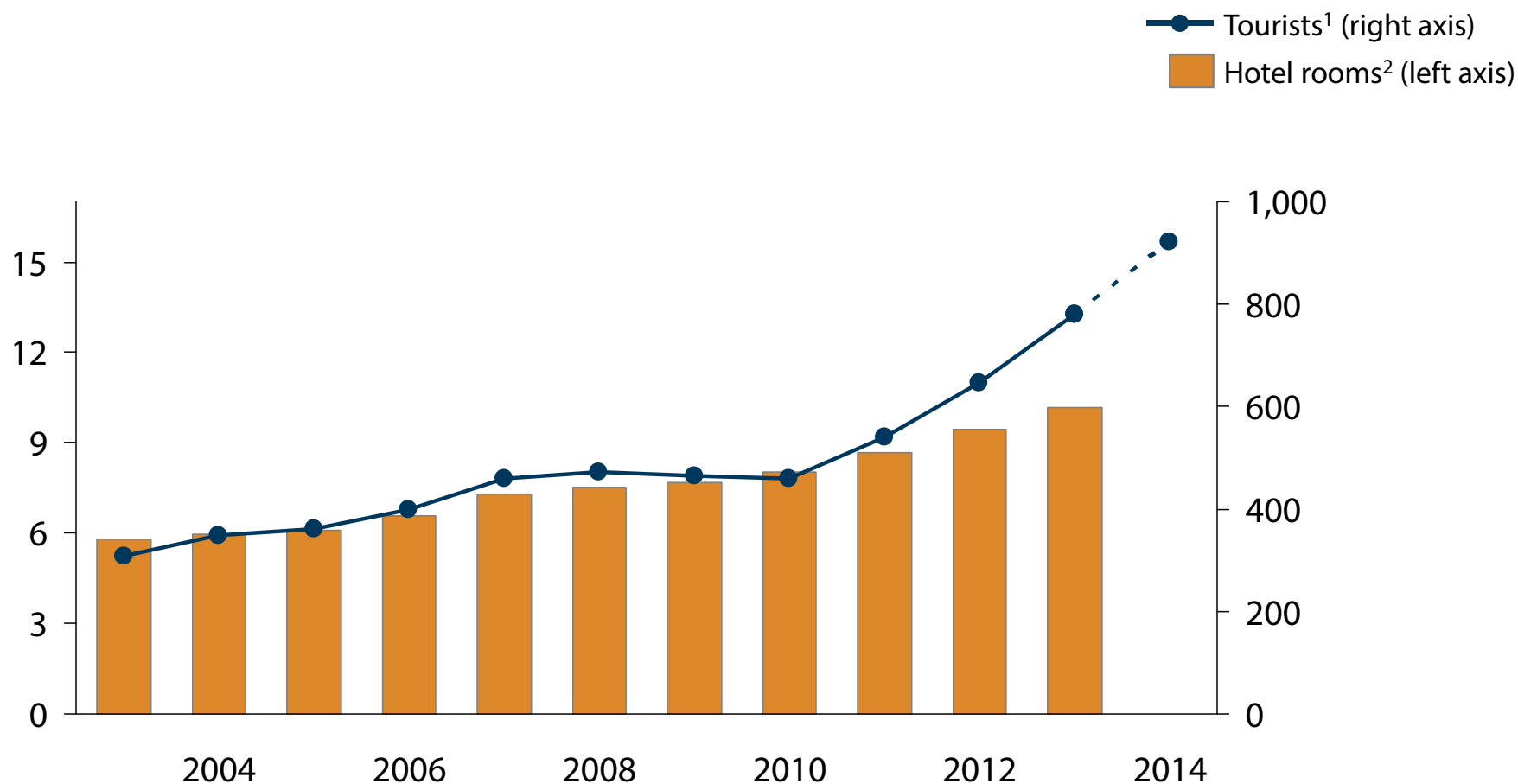




Figure 2.9

# The supply of hotel rooms has not kept up with tourism demand, but new infrastructure is under construction

Number of tourists and hotel rooms (thousands)



<sup>1</sup> The figure for 2014 is an estimate by the Economic Research department of Landsbanki

<sup>2</sup> Yearly average

Figure 2.10

# The Icelandic tourism industry has suffered from high seasonality, but recently the it has been reduced

Number of foreign visitors, thousands

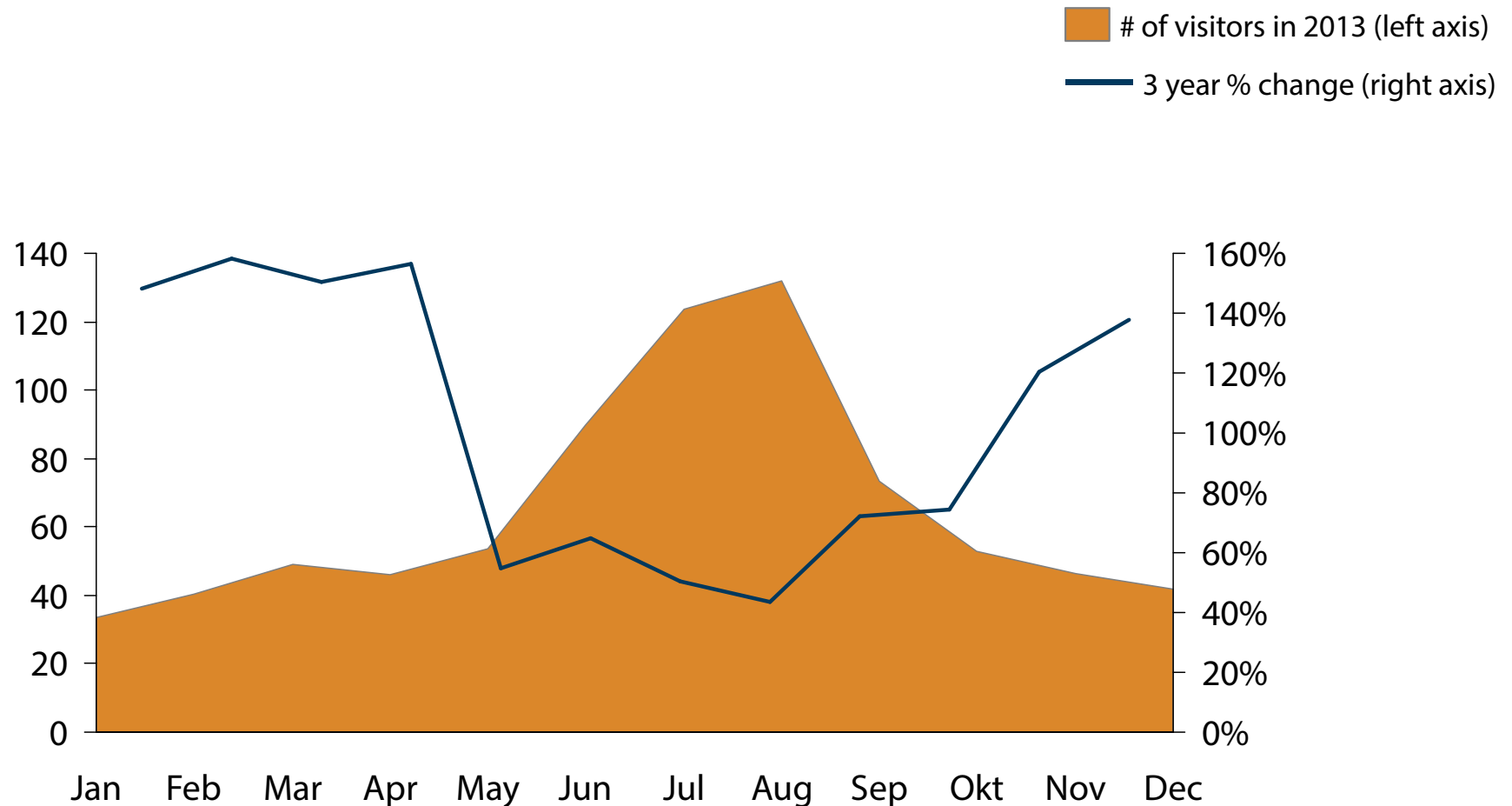
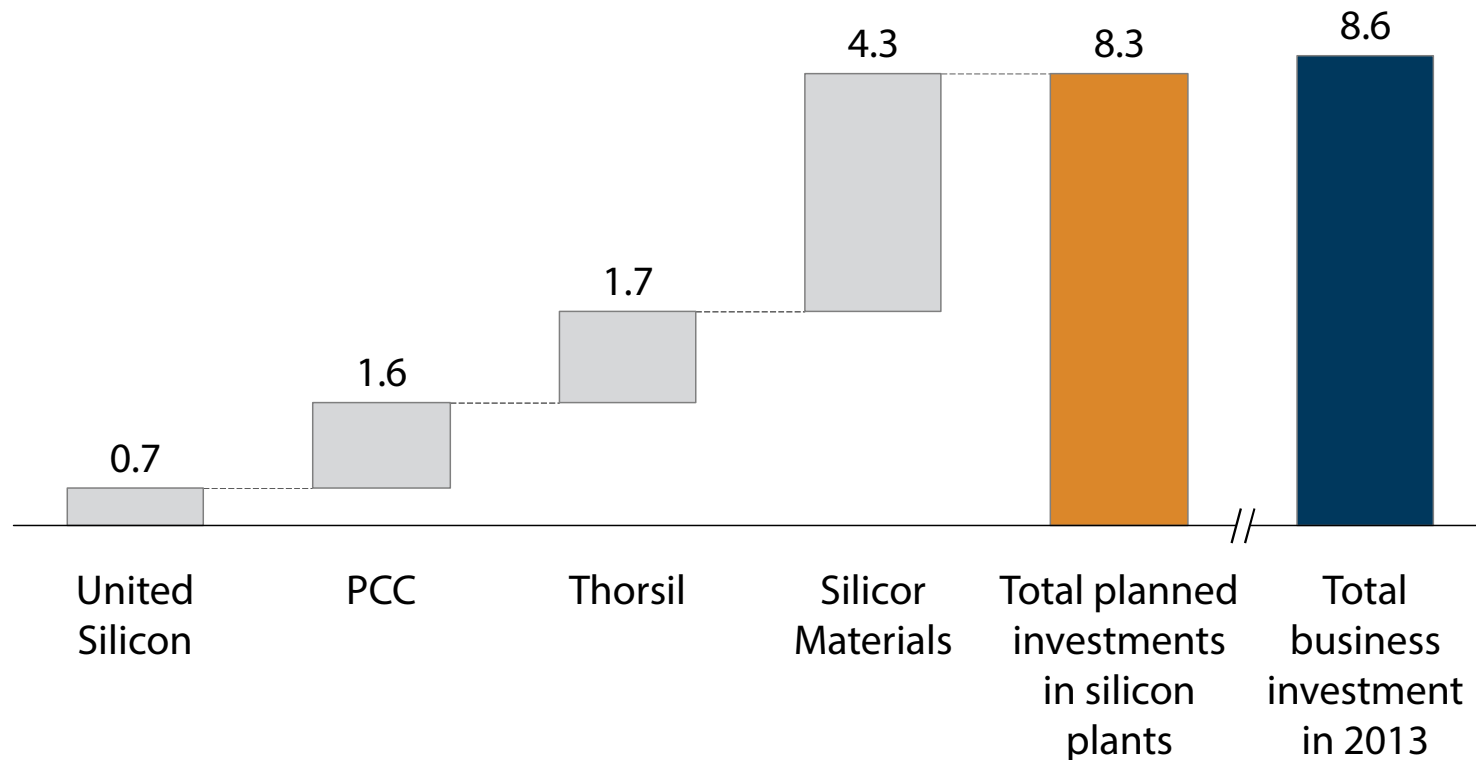


Figure 2.11

# Four silicon plant construction project agreements have been signed, resulting in significant new investments

Signed silicon plant investment projects (percent of GDP<sup>1</sup>)



<sup>1</sup> United Silicon, PCC and Thorsil have signed both investment agreements with the government and power purchase agreements with Landsvirkjun. Silcor Materials has signed a terms of a contract agreement with the government but has not yet signed a power purchase agreement with a power provider.

Figure 2.12

# Favourable climate in addition to affordable energy makes Iceland an attractive location for data centers

Potential increase in profitability by storing data in Iceland (illustrative)

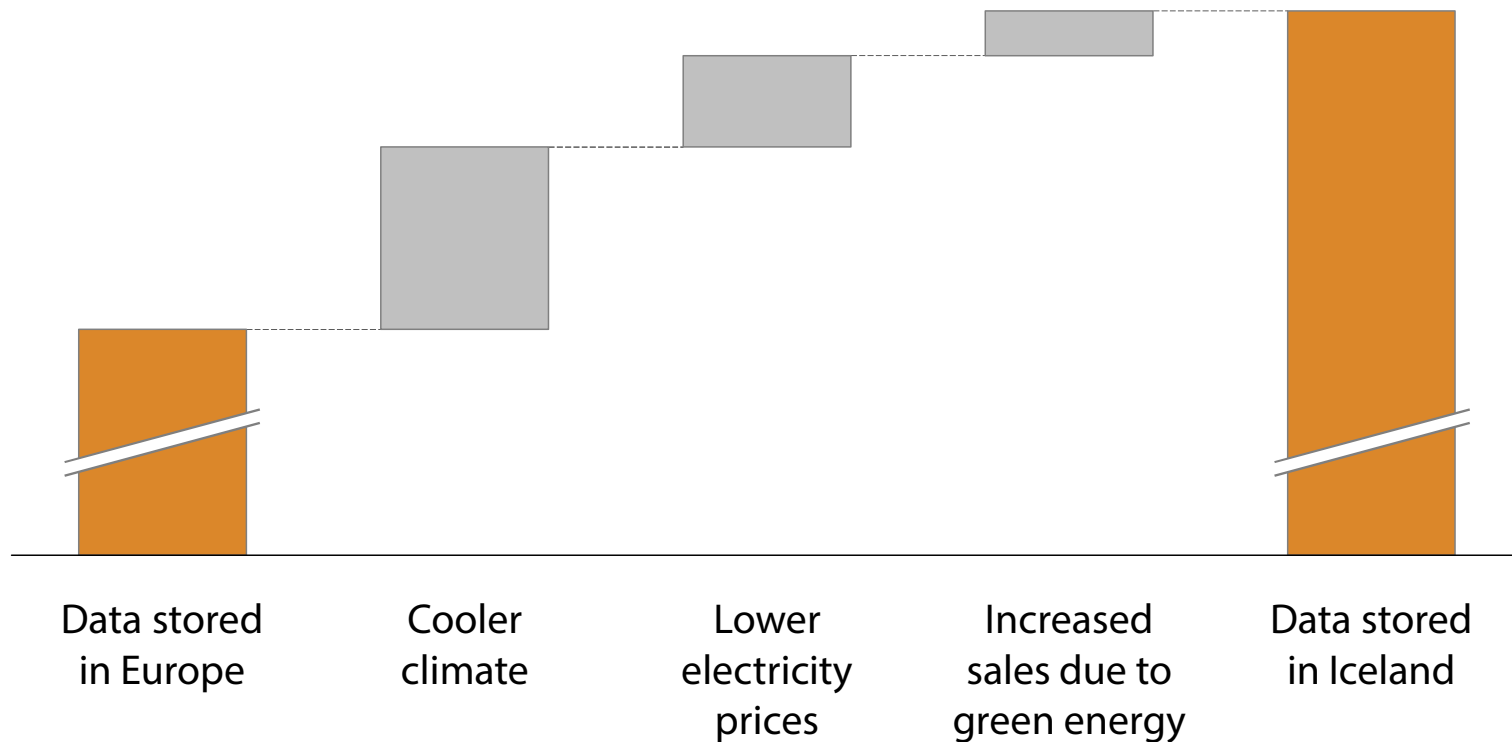


Figure 2.13

# A proposed interconnector from Iceland to the UK would be one of the longest in Europe, if constructed

Interconnectors in northern Europe, length and capacity

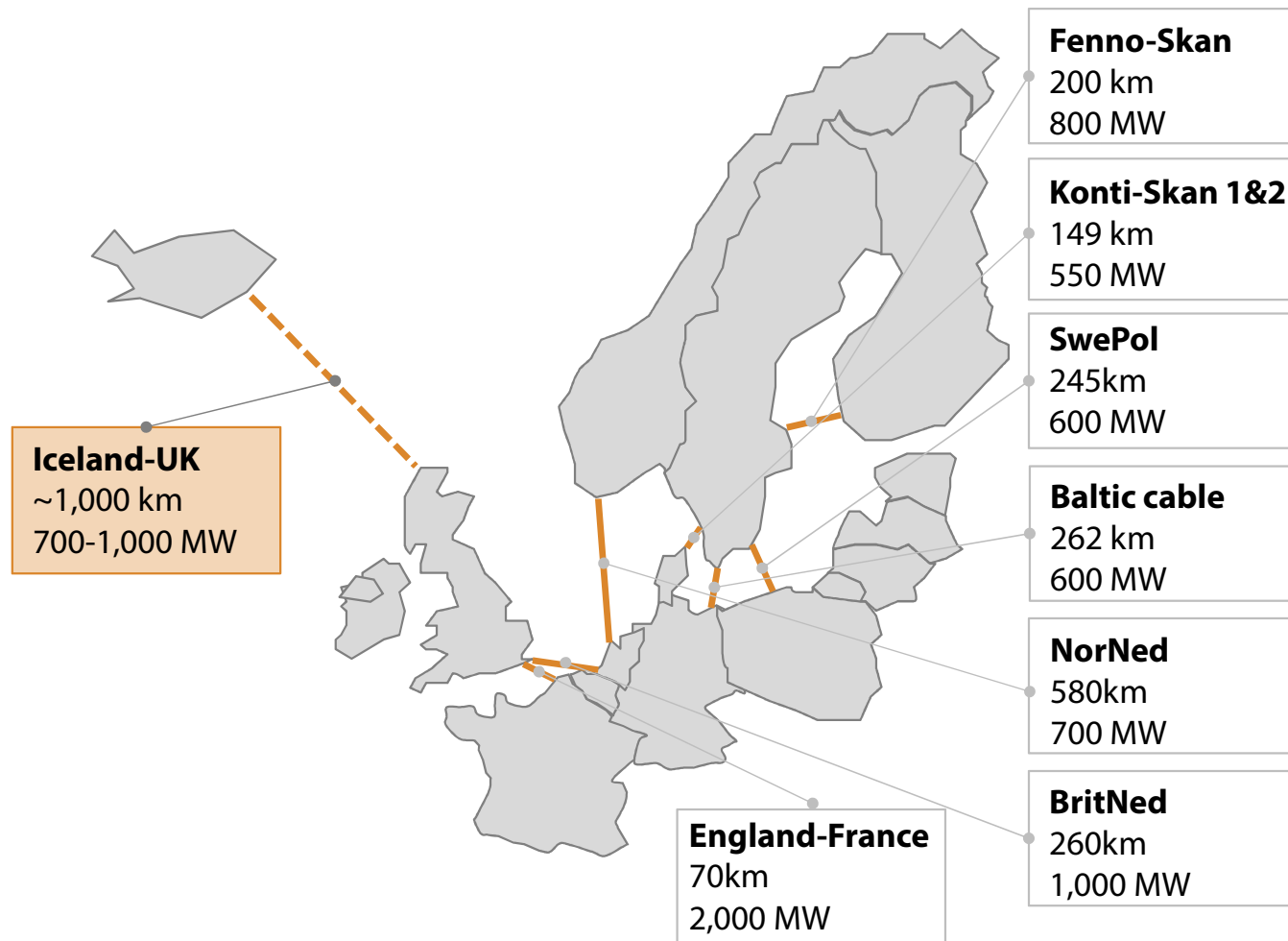




Figure 2.14

# Iceland shares a ridge with Norway near Jan Mayen which has the potential to yield a large amount of oil and gas

Dreki area is the part of the ridge that falls within Iceland's jurisdiction

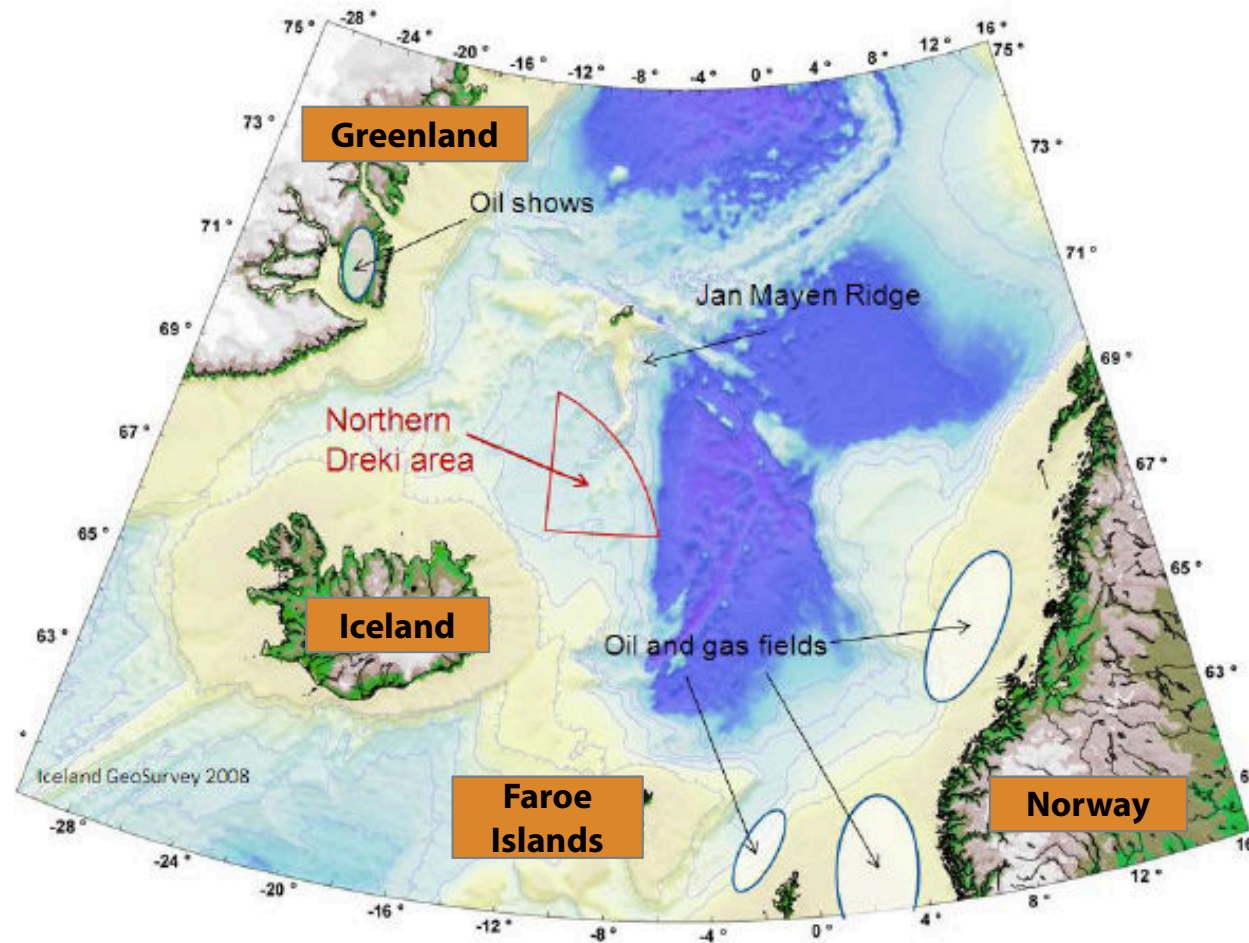


Figure 2.15

# Iceland's "Big Three" banks are all in inactive ownership, either through the government or estates

Ownership of the three largest domestic banks (percent)



Figure 2.16

# Iceland has remained at the bottom of the investment grade credit ratings, but the outlook is now stable

Iceland's credit ratings (sovereign debt)

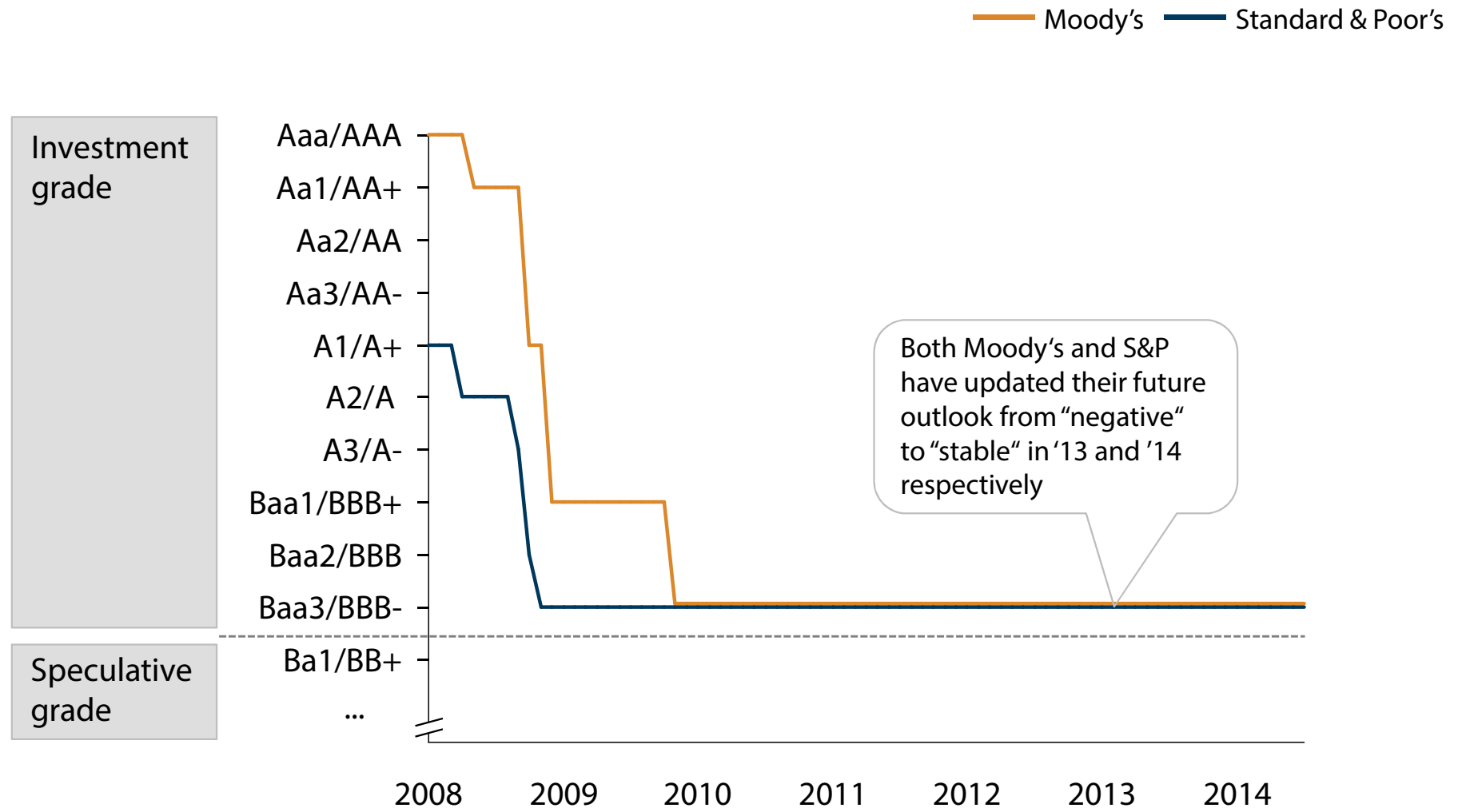


Figure 2.17

# Iceland's risk premium has gradually declined since the financial crisis, improving access to capital

Credit default swap prices (Icelandic sovereign debt, monthly averages, basis points)

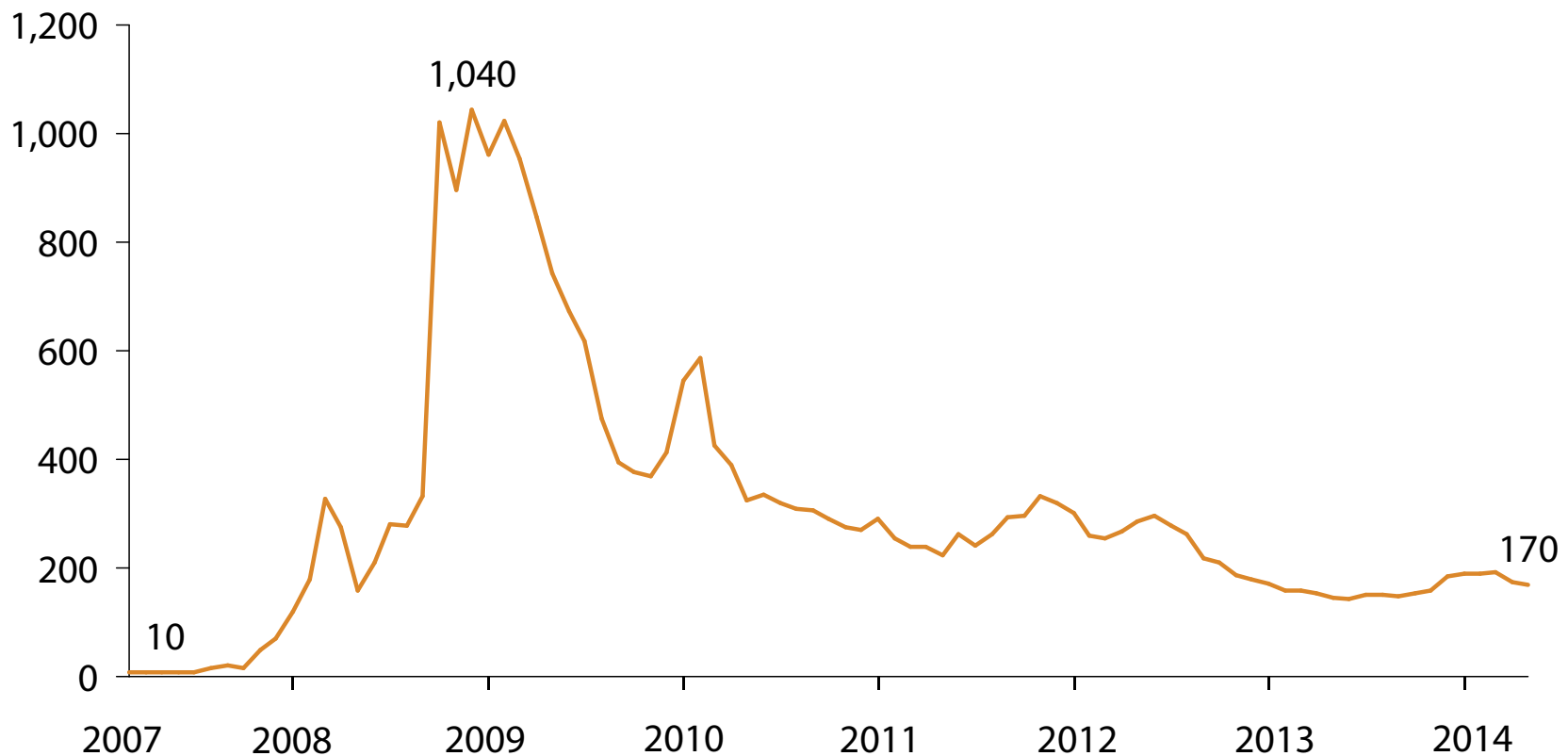
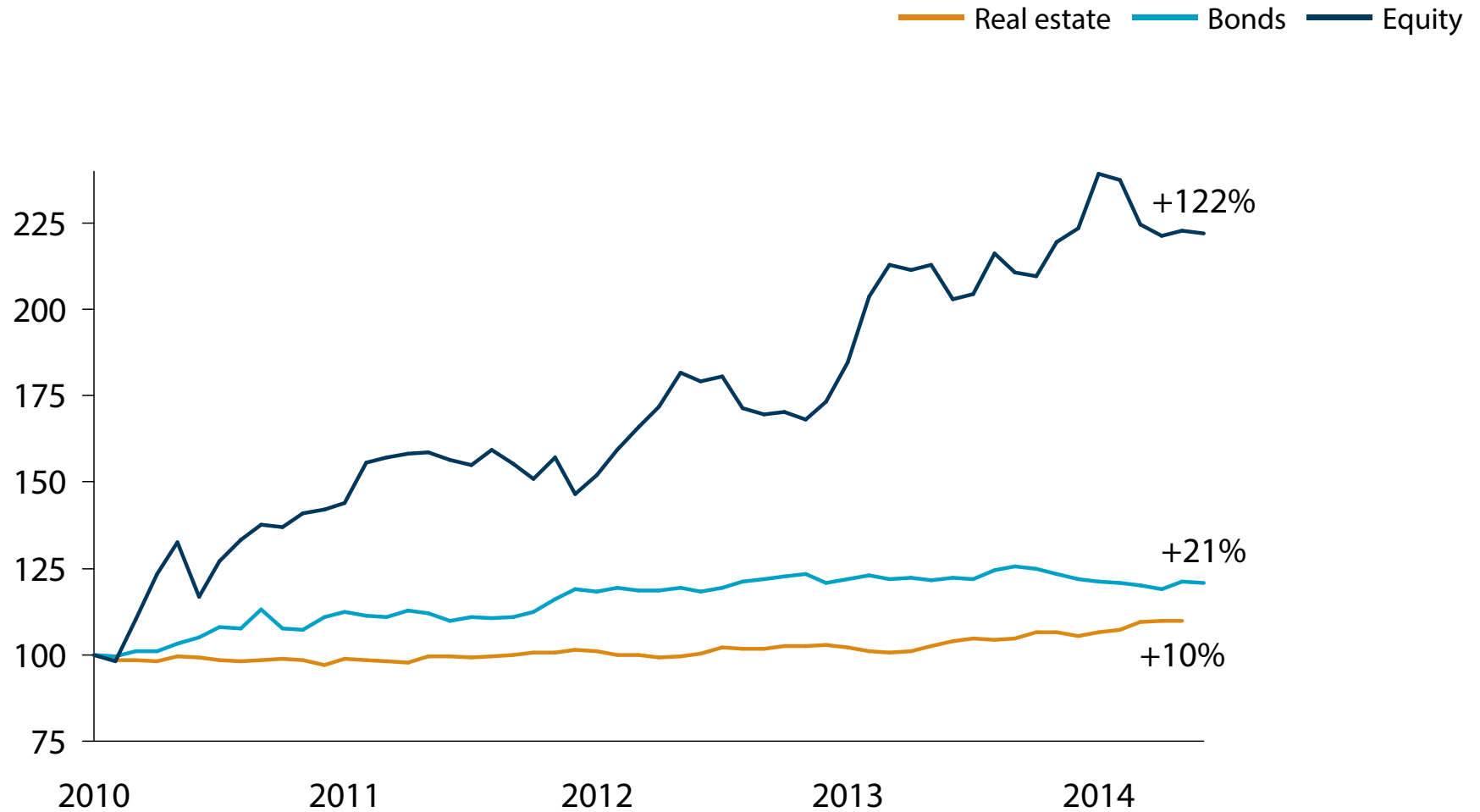


Figure 2.18

# Domestic assets have appreciated in value over the last few years

Asset value, inflation adjusted (BOY 2010 = 100)





**Current State**

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Figure 3.1

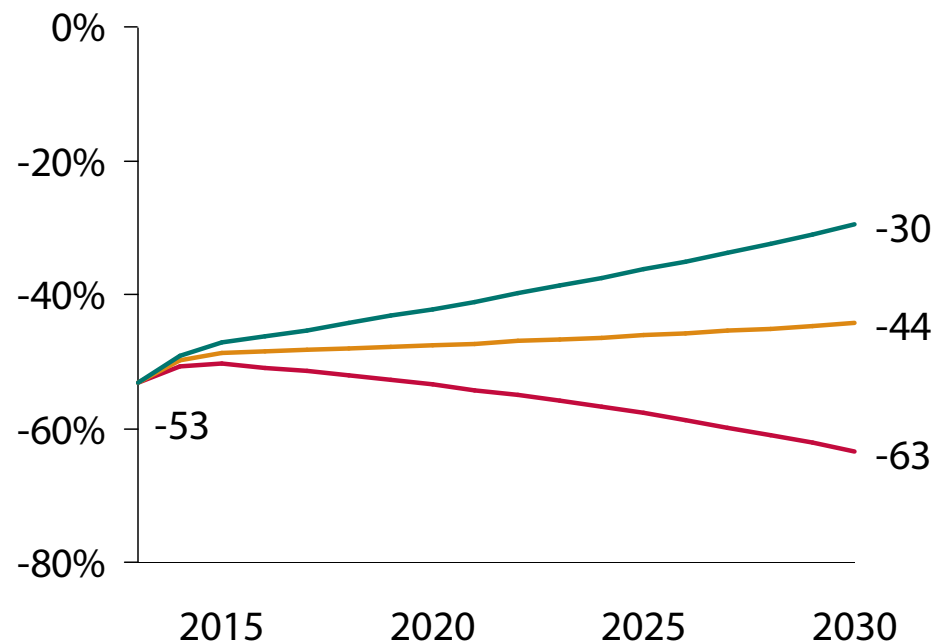
# Iceland's net external obligations will be determined by access to foreign credit and GDP growth in the long term

Iceland's Net International Investment Position (% of GDP)

- Unfavourable rate (7.5%)
- Unchanged rate (5.0%)
- Favourable rate (2.5%)

## Average growth

OECD projections (2.0% p.a.)



## Strong growth

Growth Forum Target (3.5% p.a.)

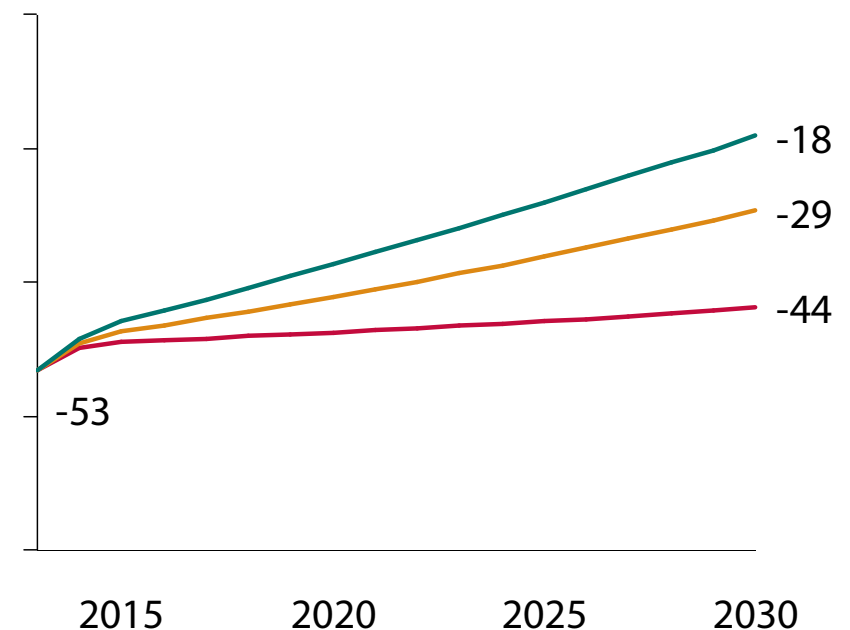


Figure 3.2

# Iceland has a strong labour market compared to peers, but investment and productivity levels are lagging

Iceland's GDP composition (2010)

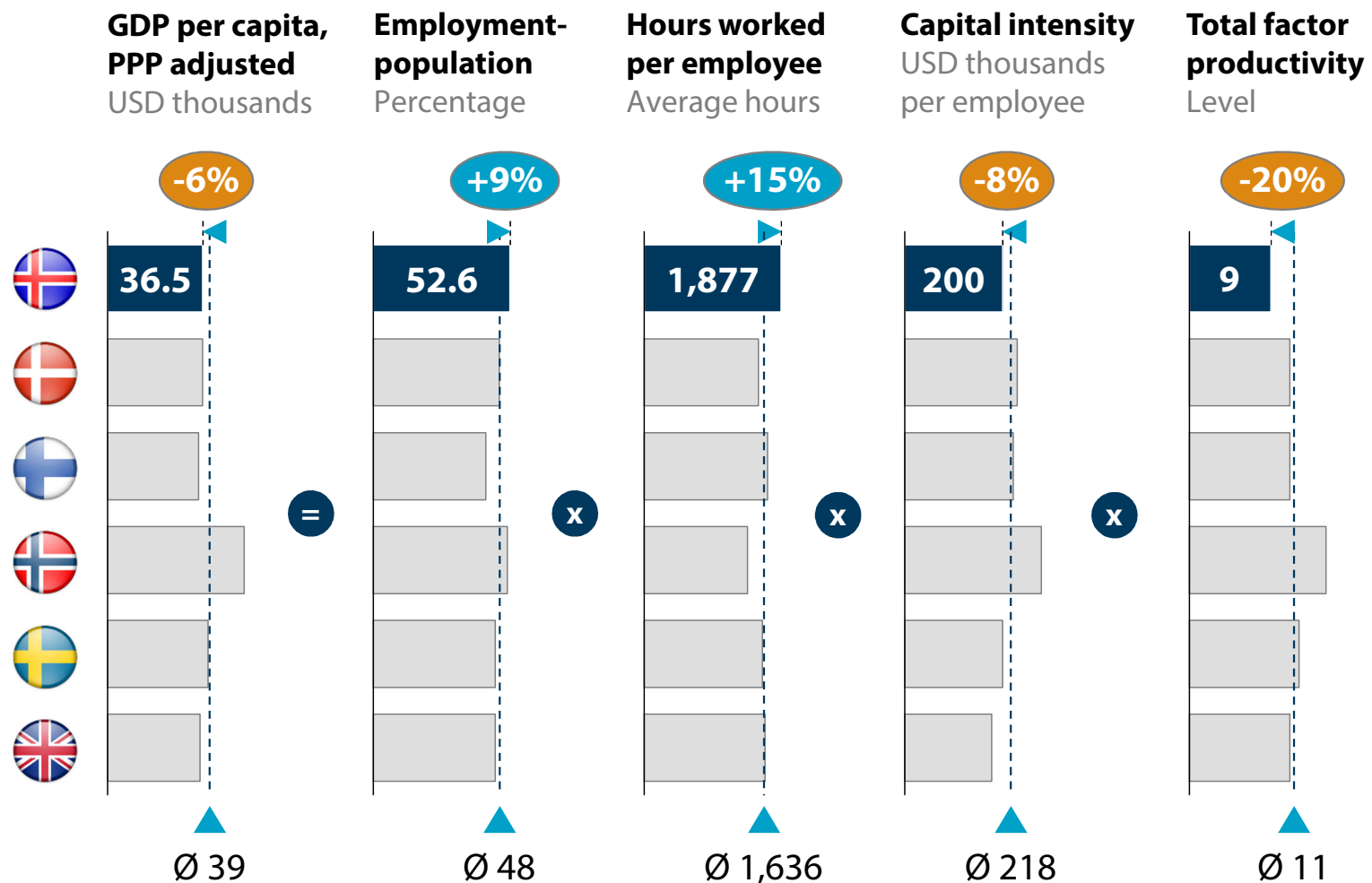
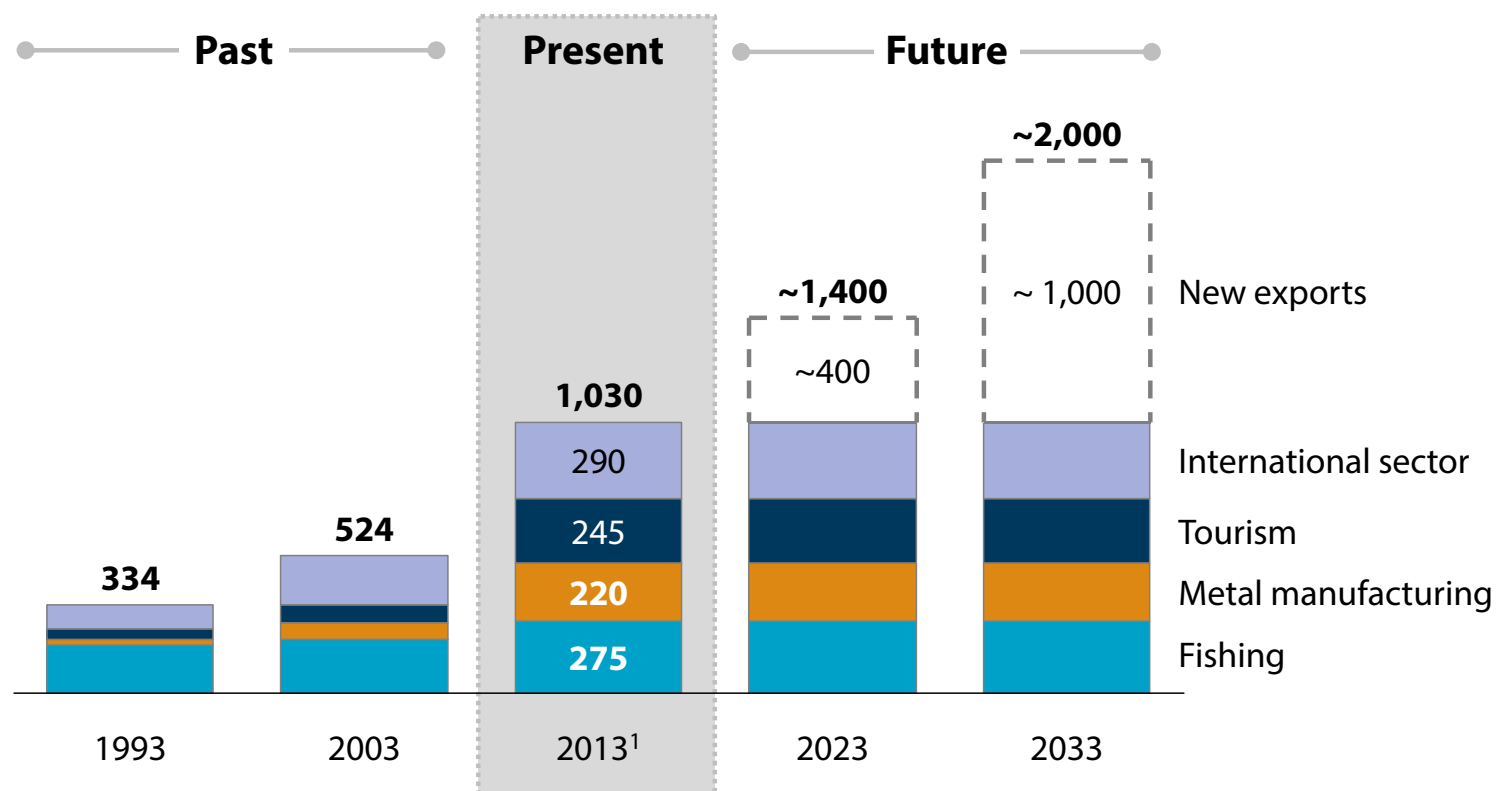




Figure 3.3

# Exports need to increase by one trillion ISK in the next 20 years to support a GDP per capita growth of 2.6% p.a.

Iceland's exports, ISK billions (2013 prices)



1 As only Q1-Q3 export values are available, Q4 is estimated using an average of seasonality factors for 2010-12

Figure 3.4

McKinsey & Company divided the economy into three distinct segments, with different challenges for each

Domestic service sector	Resource-based sector	International sector
Definition		
Industries that mostly provide <b>non-tradable goods and services</b> for the domestic market	Industries that require <b>domestic natural resources</b> as an input for their production	Businesses that produce <b>tradable goods and services</b> independently of local natural resources
Key focus		
<i>Increase productivity to enable reallocation of labor to export sectors</i>	<i>Focus on capturing and maximizing value from limited natural resources</i>	<i>Enable growth and renewal through a globally competitive business environment</i>

Figure 3.5

# The Iceland Growth Forum presented approx. 40 reform proposals to support a sustainable growth trajectory



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UM AUKNA HAGSÆLD  
Iceland Growth Forum





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