



MINISTRY OF FINANCE
AND ECONOMIC AFFAIRS

Icelandic Economic and Fiscal Situation

August 2017

Key points

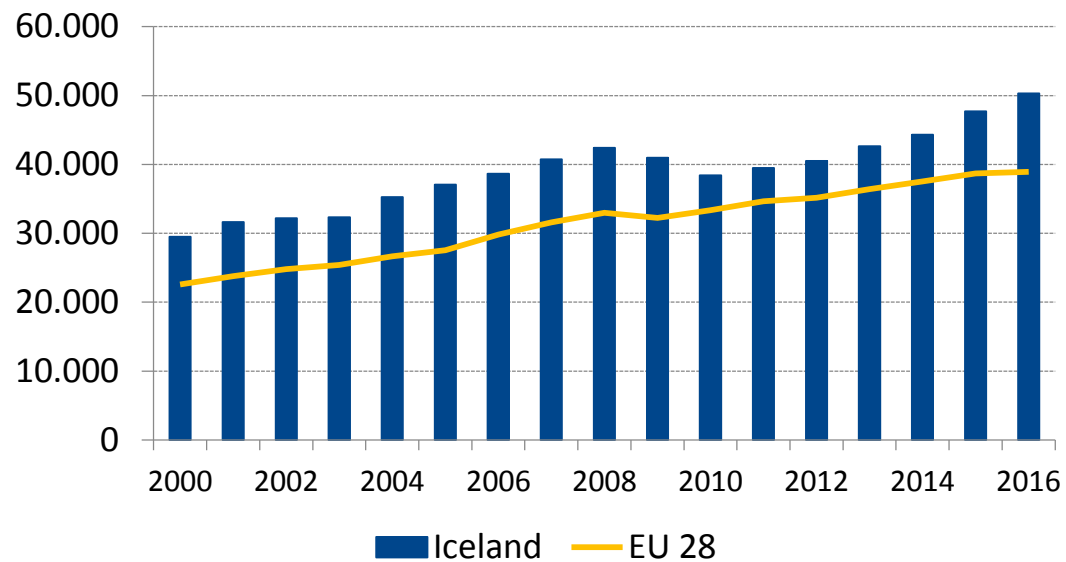
- The economy has continued its strong rebound (GDP growth exceeded 7 % in 2016)
- Two major contributors – terms of trade and tourism
- Solid internal and external balance
- Inflation under the 2½% target for over three years - inflation expectations also at the target
- Responsible fiscal consolidation 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



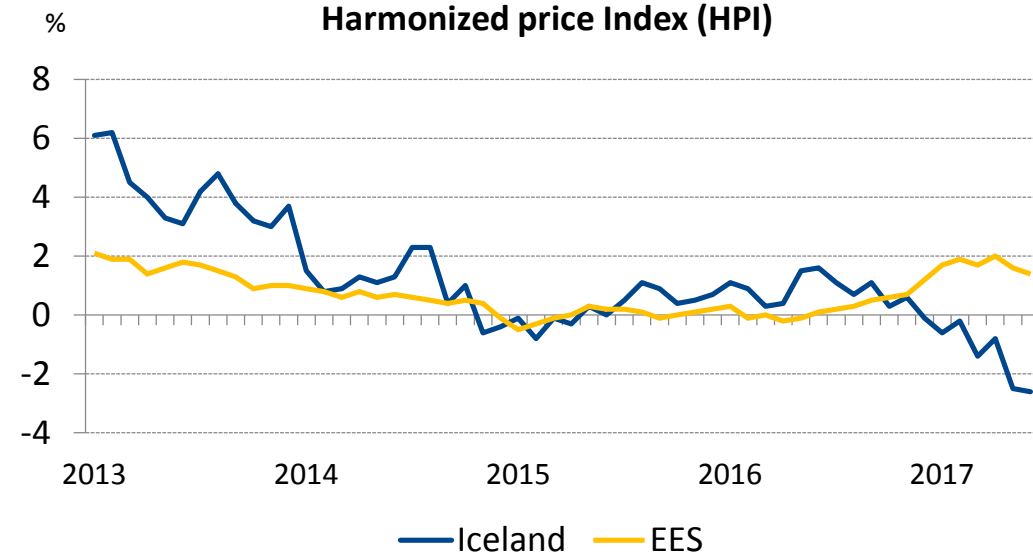
Strong growth

- GDP growth (2016) 7.2%
- Unemployment (May) 5.3%
- Inflation, CPI in July 2017: 1.8%,
HPI in June 2017: -2.6
- Positive current account balance
- 1,8 million foreign visitors to Iceland in 2016

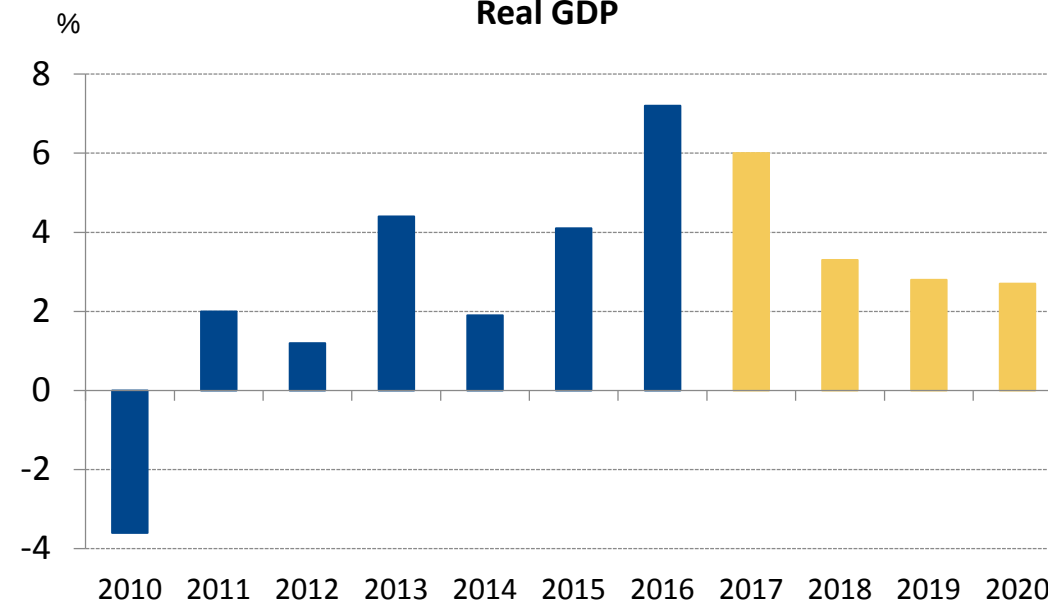
GDP per capita, USD PPP



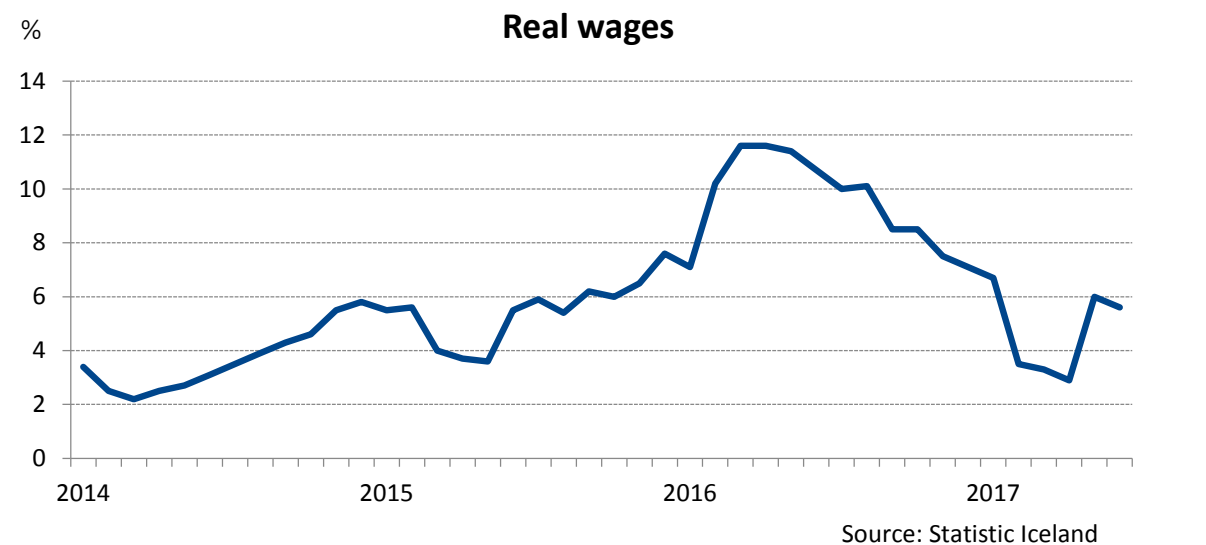
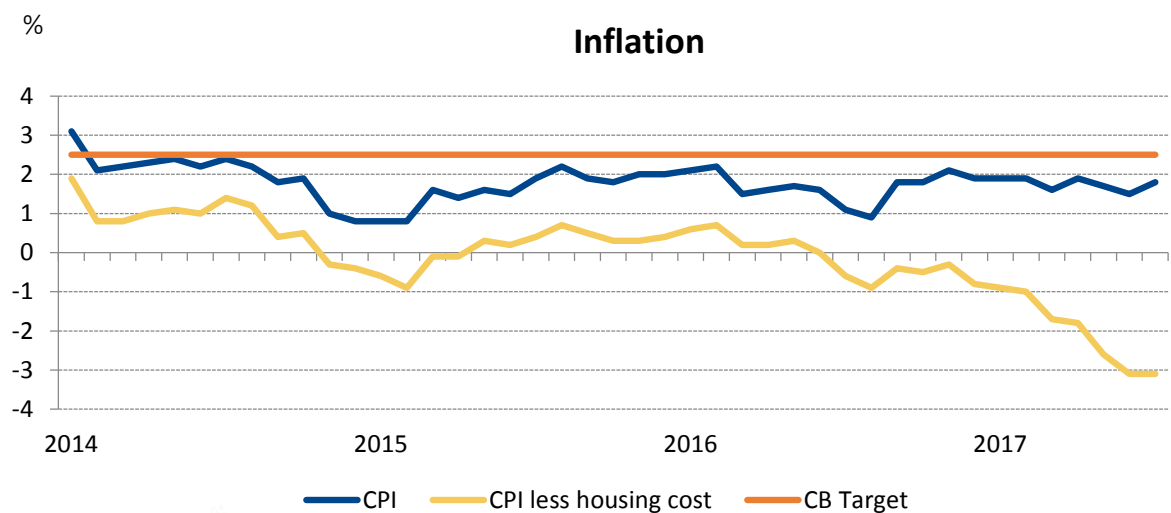
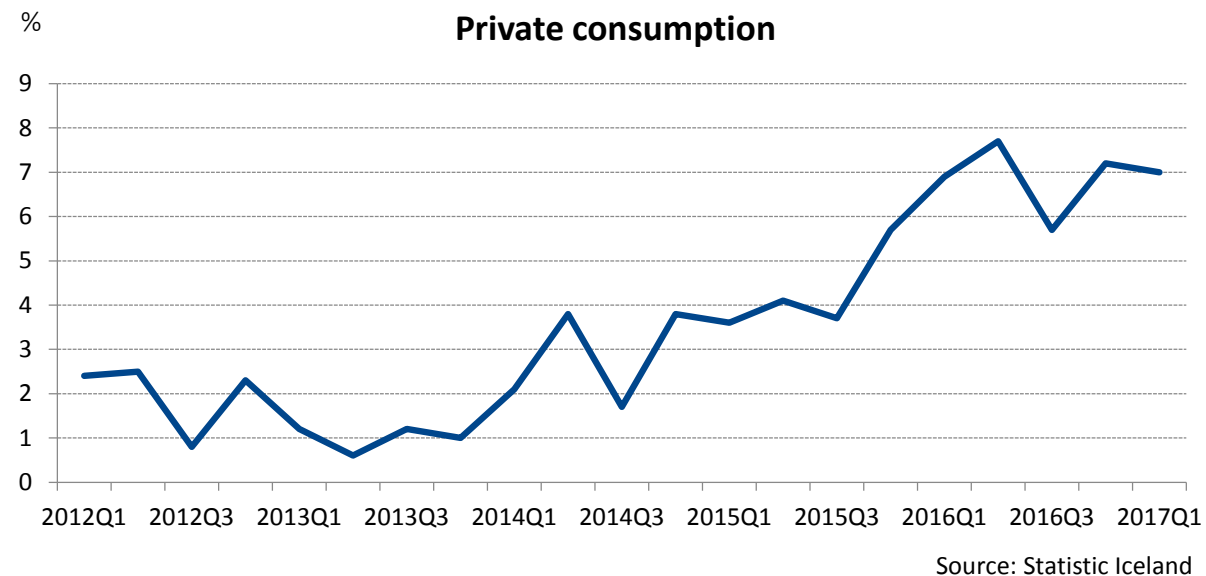
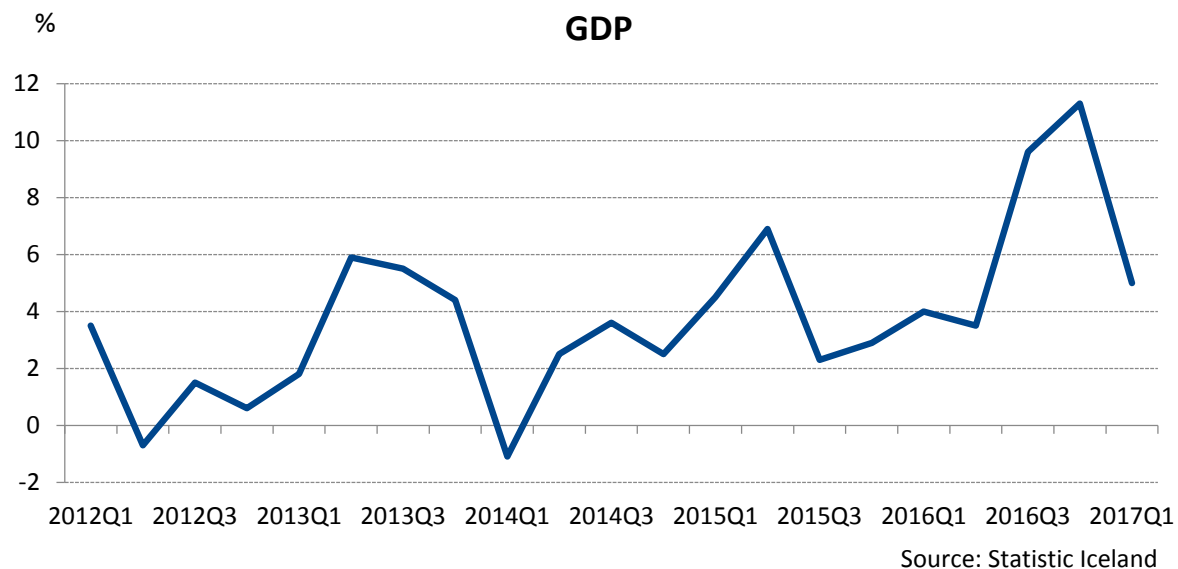
Harmonized price Index (HPI)



Real GDP

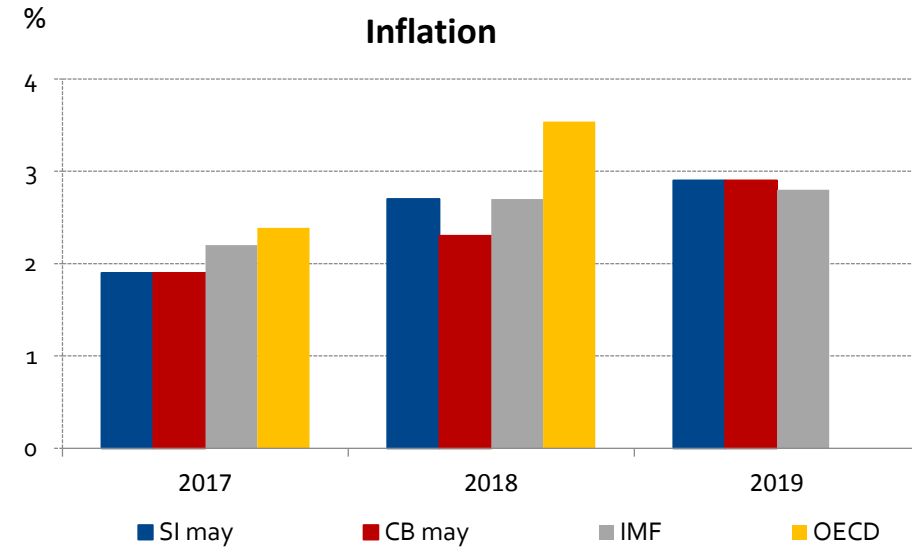


Recent developments, year over year

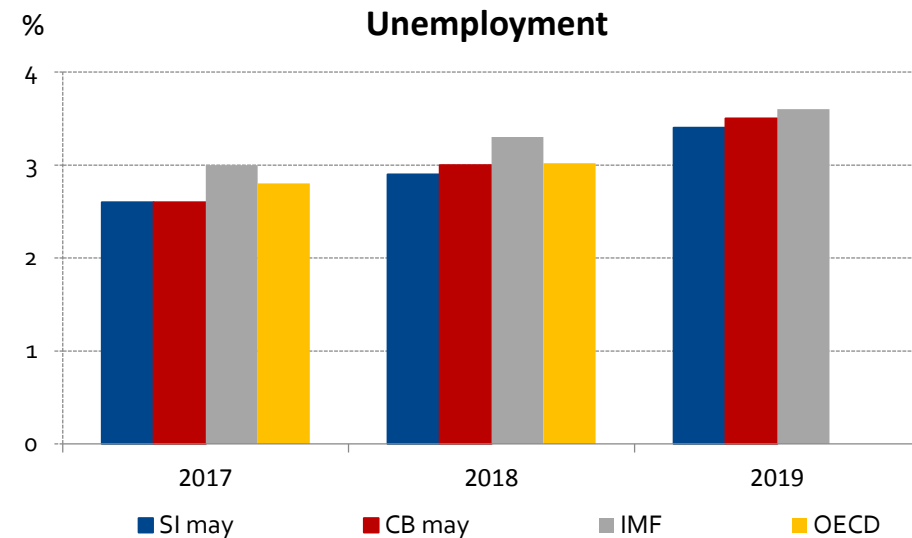
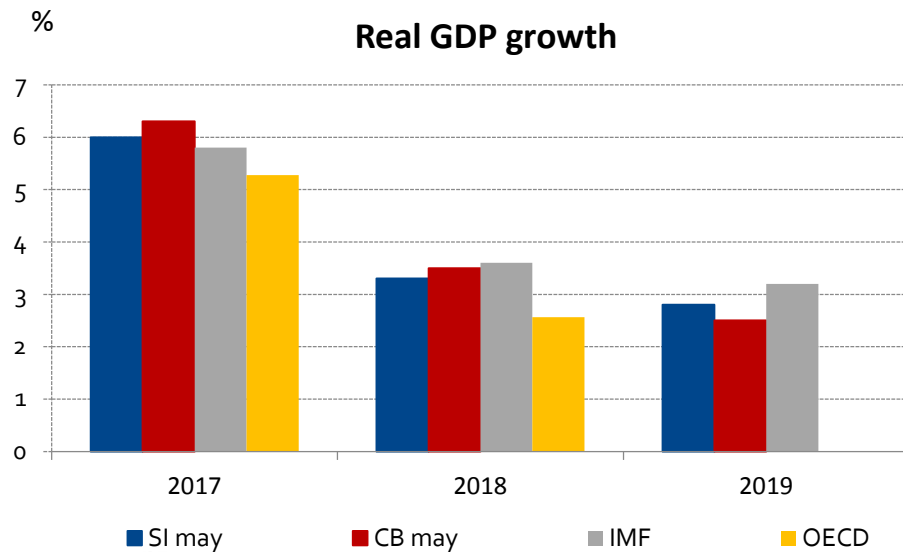


Forecasts

- IMF and OECD published new forecasts for Iceland in June 2017
- Statistic Iceland assumes the real GDP growth to be 6.0% in 2017 and 3.3% next year
- Inflation is expected to exceed the inflation target in 2018 but inflation is expected to stay low



Source: Statistic Iceland, Central Bank, IMF, OECD

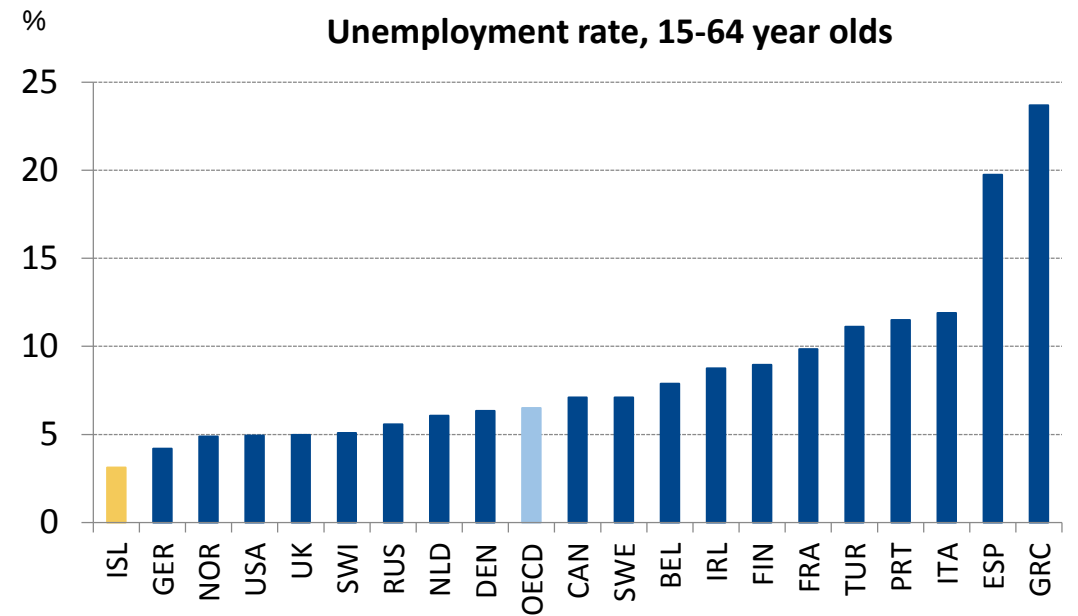
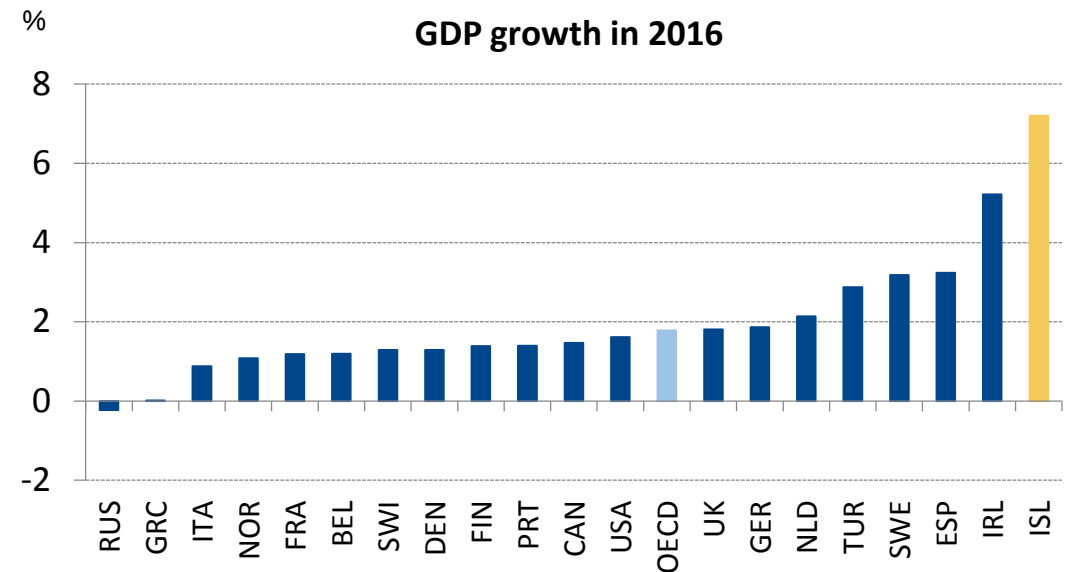
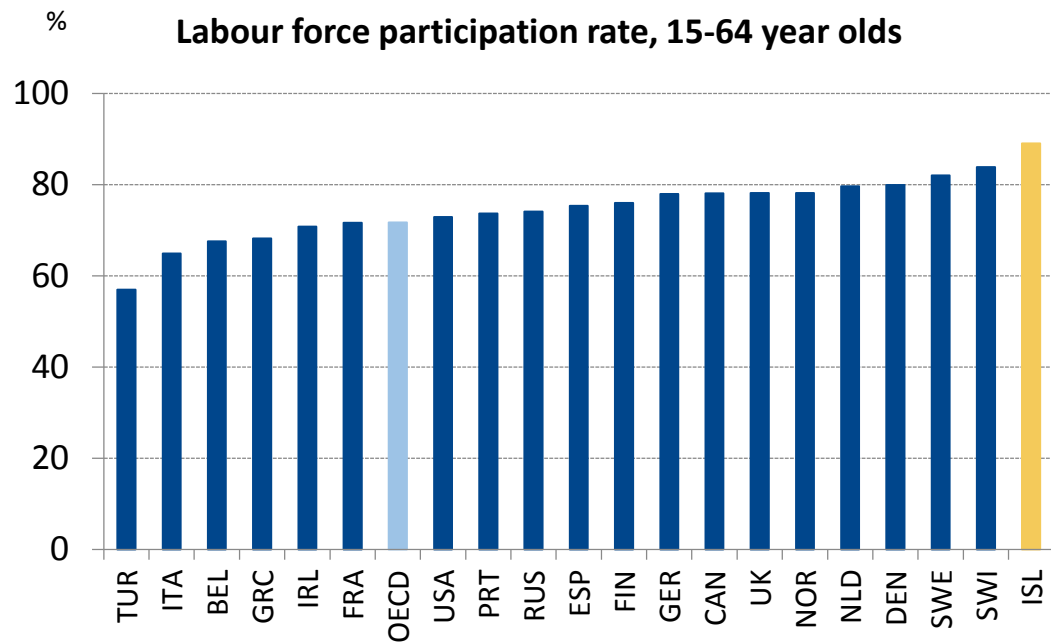


Source: Statistic Iceland, Central Bank, IMF, OECD



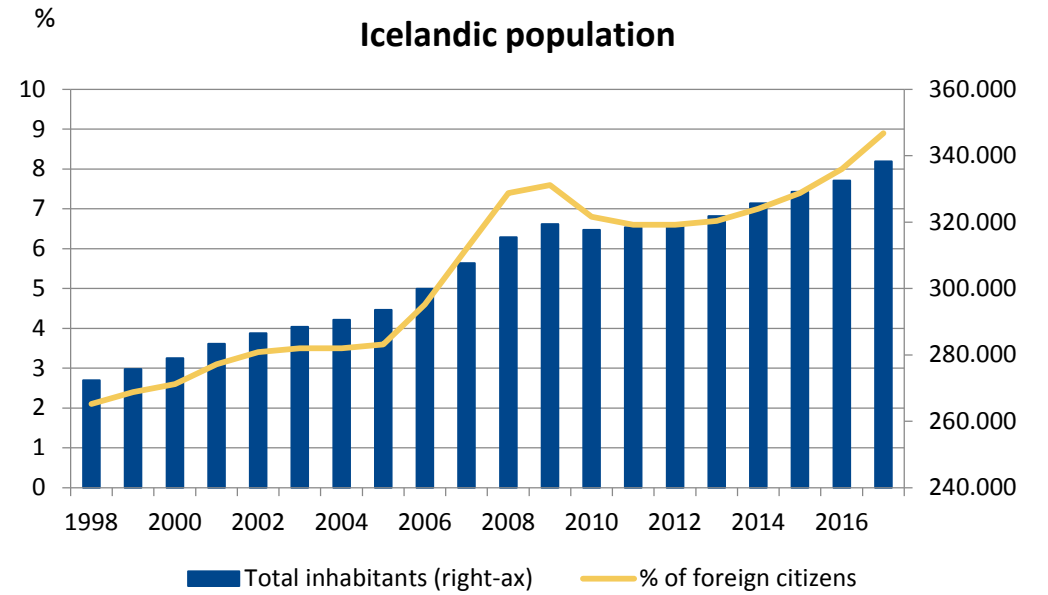
International comparison

- 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

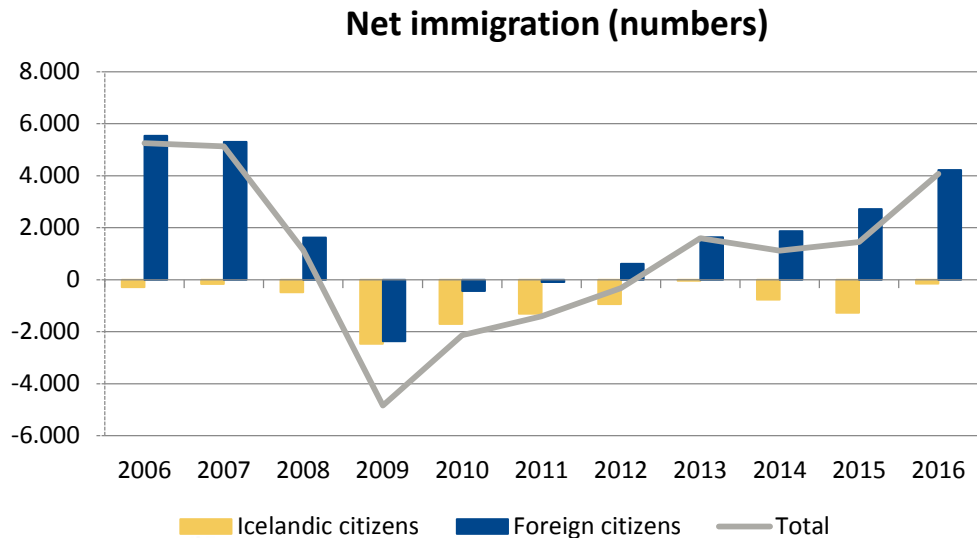


Population

- 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 1st quarter of 2017, 1,790 foreign citizens immigrated to Iceland and 620 emigrated

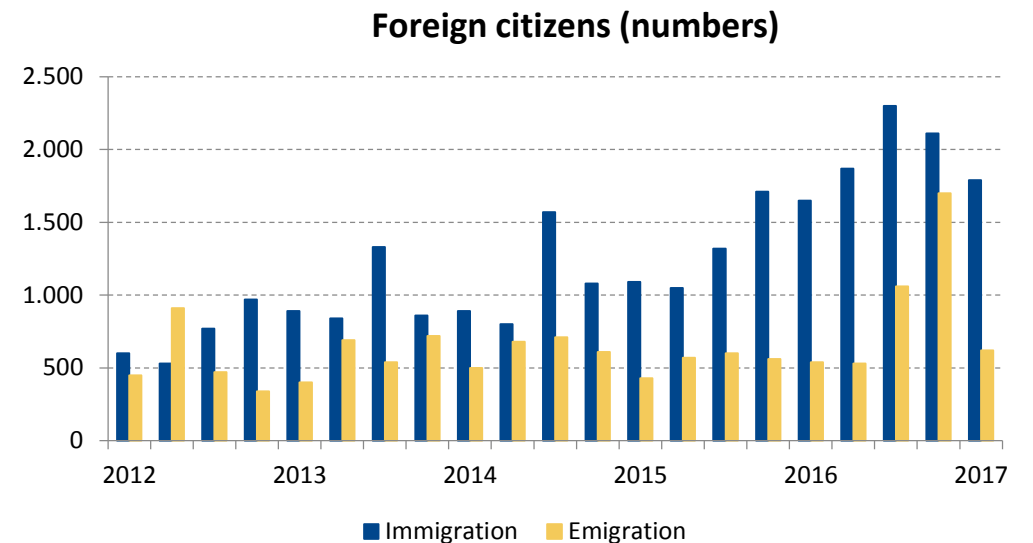


Source: Statistic Iceland



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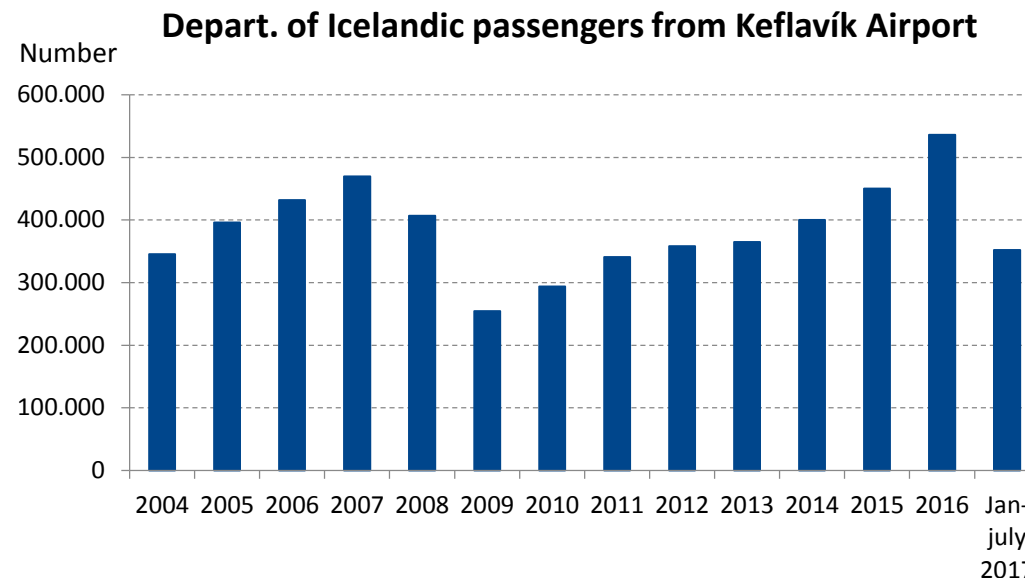
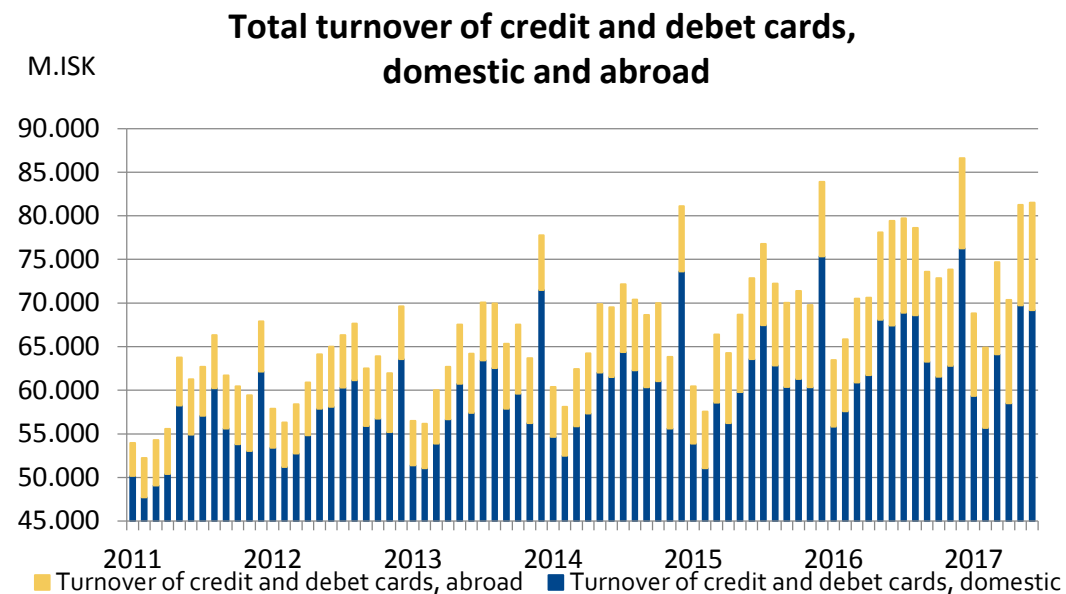
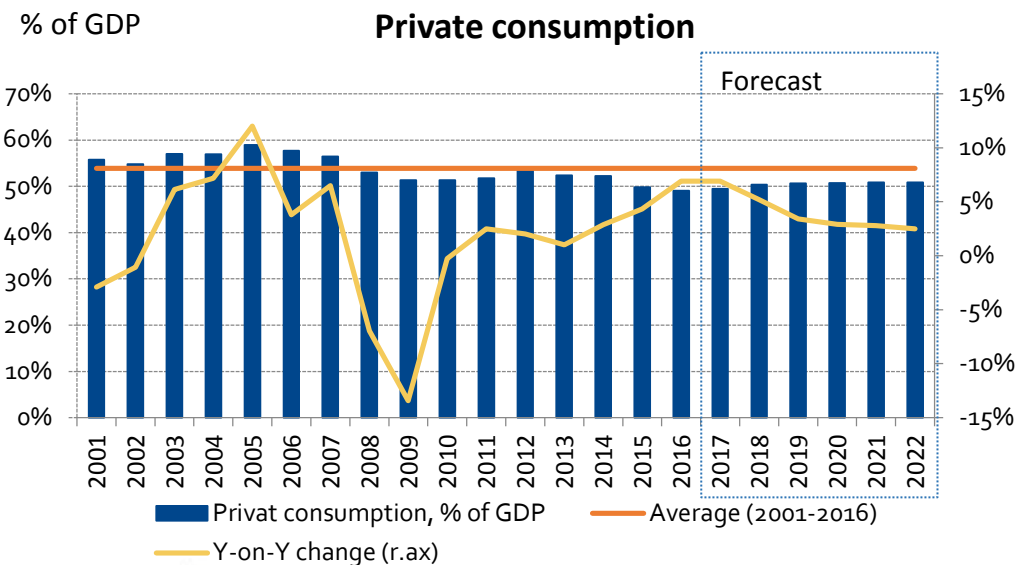
Source: Statistic Iceland



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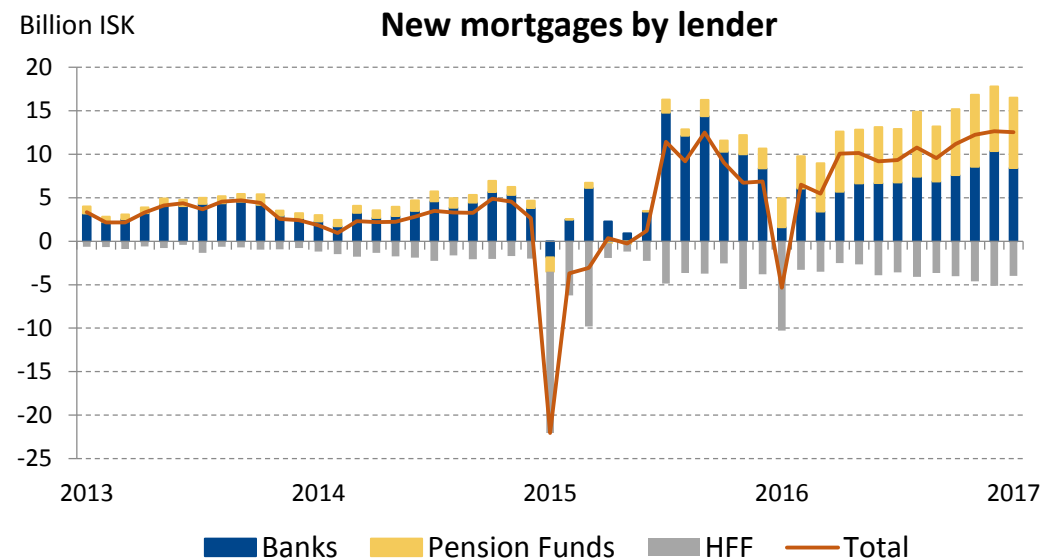
Private consumption

- 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 so far in 2017

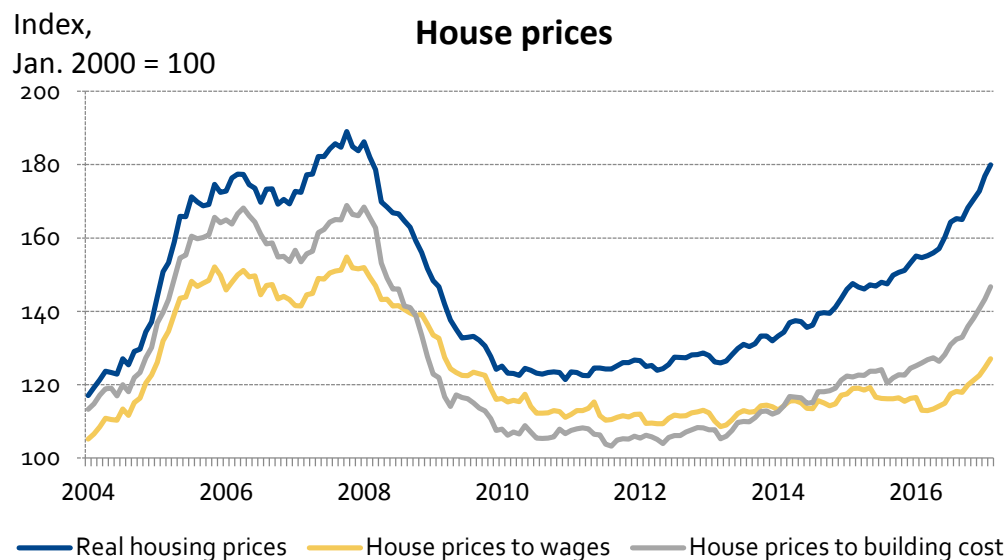


Housing market

- Turnover in the real estate market has risen, and residential housing prices have increased far in excess of the general price level.
- Prices have risen sharply in the recent term because new construction has been unable to keep pace with demand stemming from population growth and the tourism boom.
- Prices are now high in historical context and appear to have risen in excess of wage growth in the past few months.



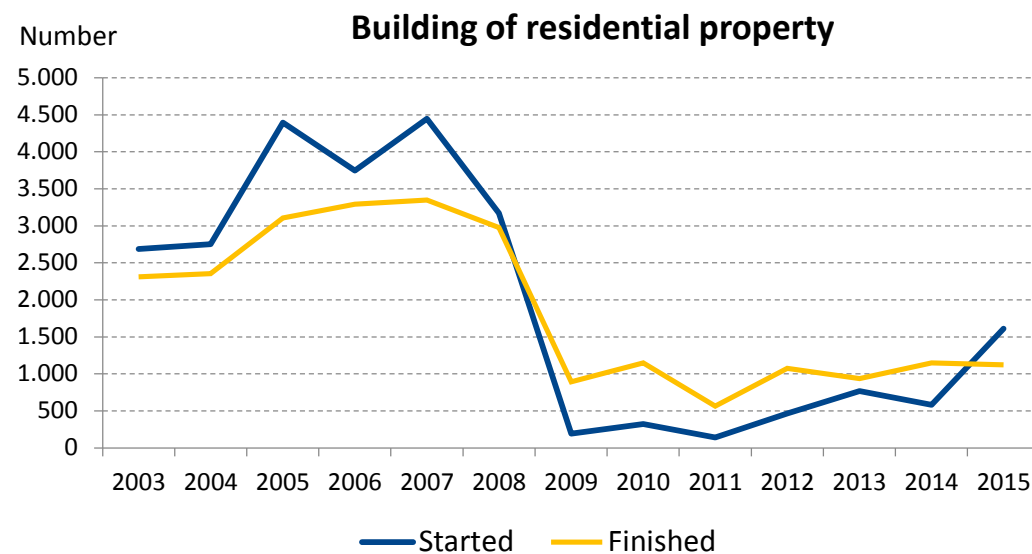
Source: Central Bank



Source: Central Bank



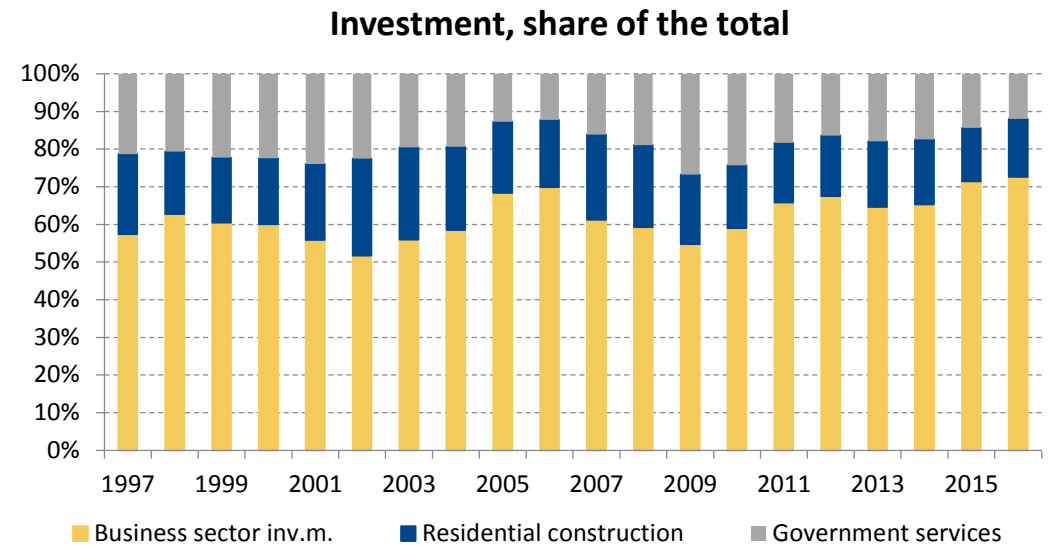
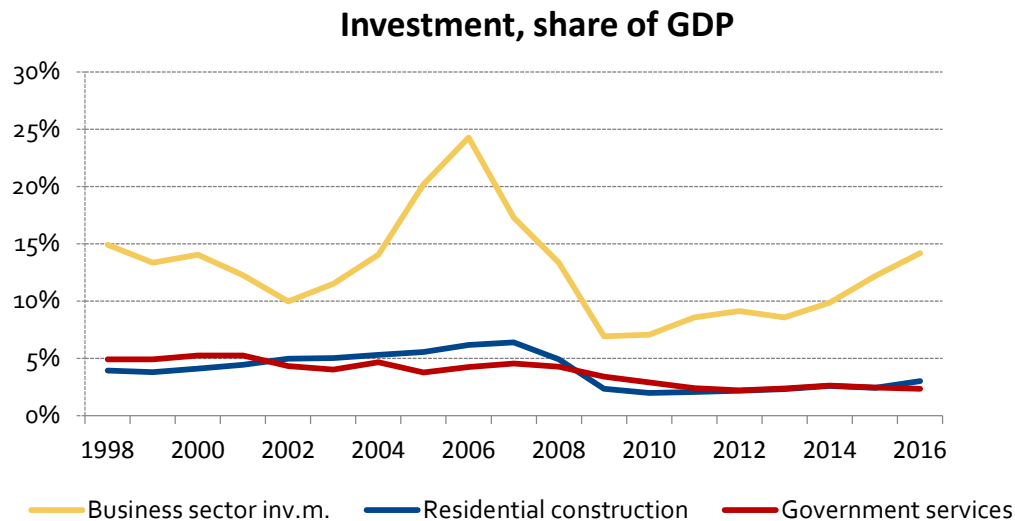
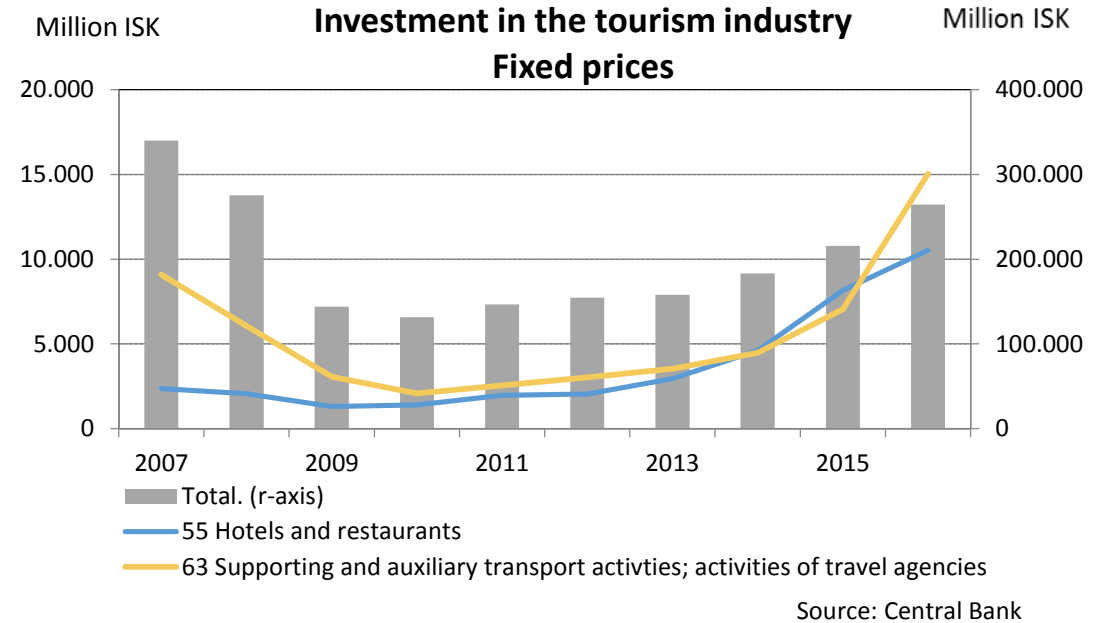
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Source: Federation of Icelandic Industries

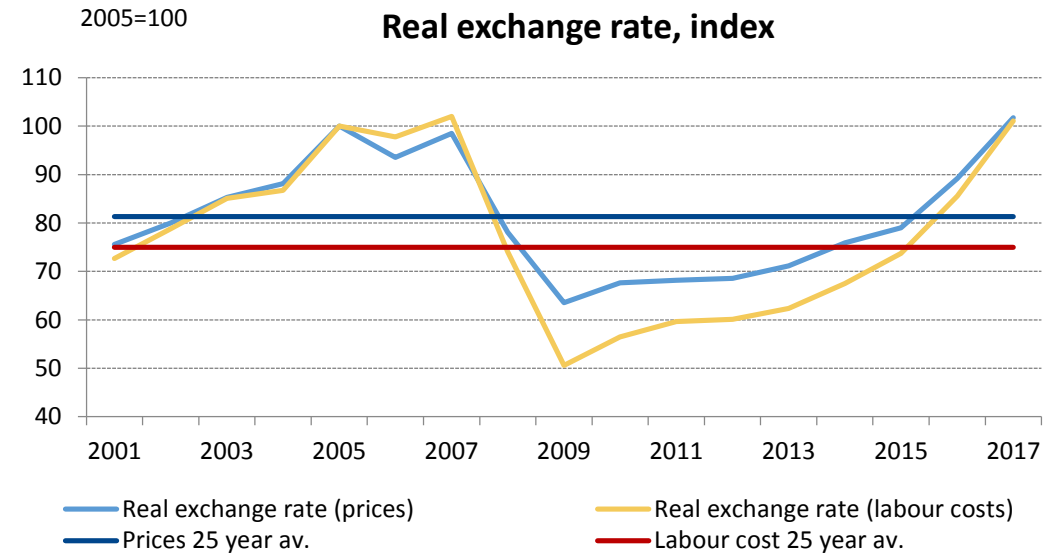
Investment

- 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 past, 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.

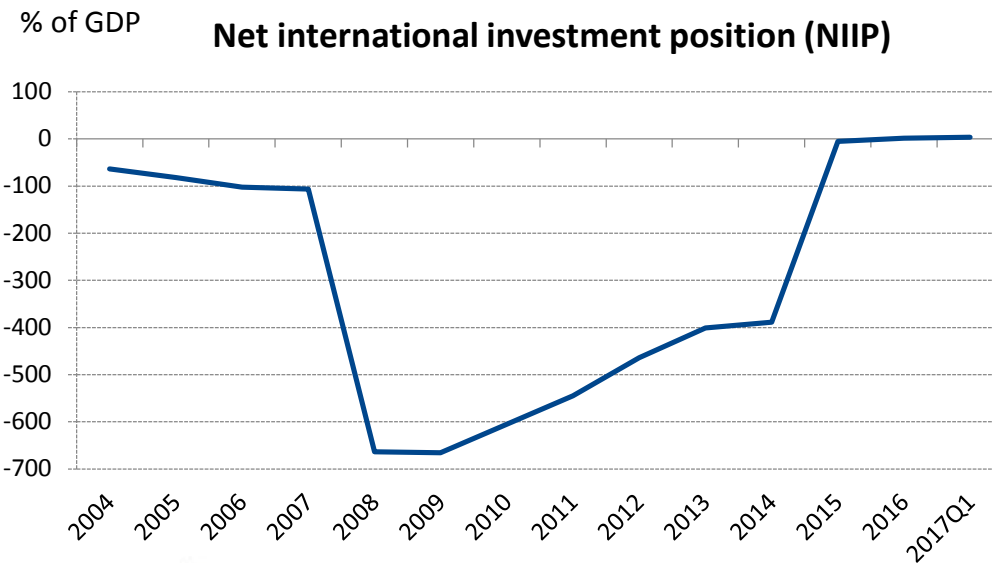


External position

- The real exchange rate in terms of relative consumer prices has risen sharply from the autumn 2009. The increase has continued so far in 2017, with the real exchange rate about a fifth above its twenty-five year average in Q1.
- The rise is due for the most part to the nominal appreciation of the króna
- Iceland's net international investment position (NIIP) has improved substantially in the recent term and is now positive by 1.1% of GDP.

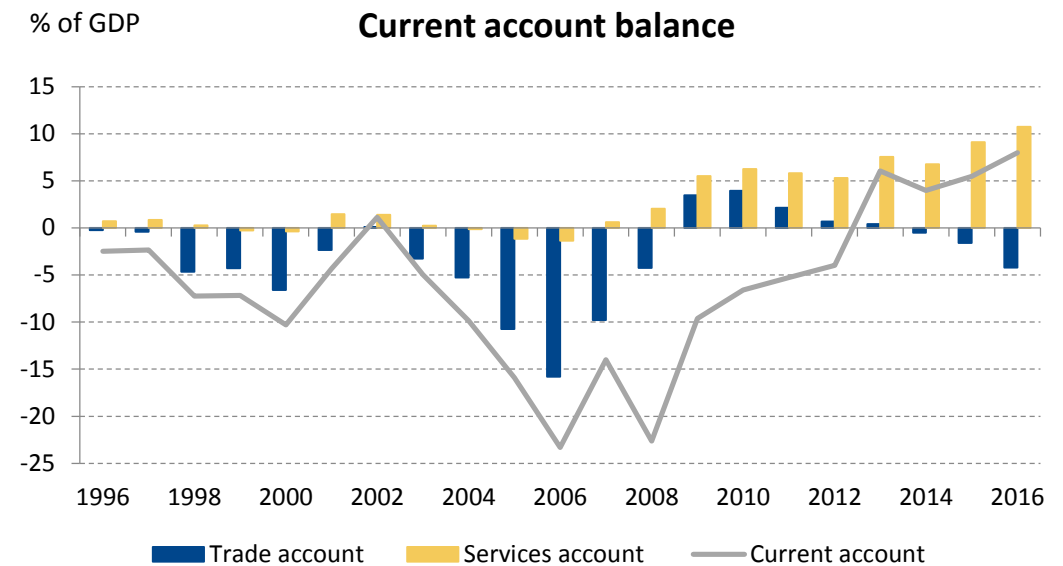


Source: Central Bank



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Source: Central Bank

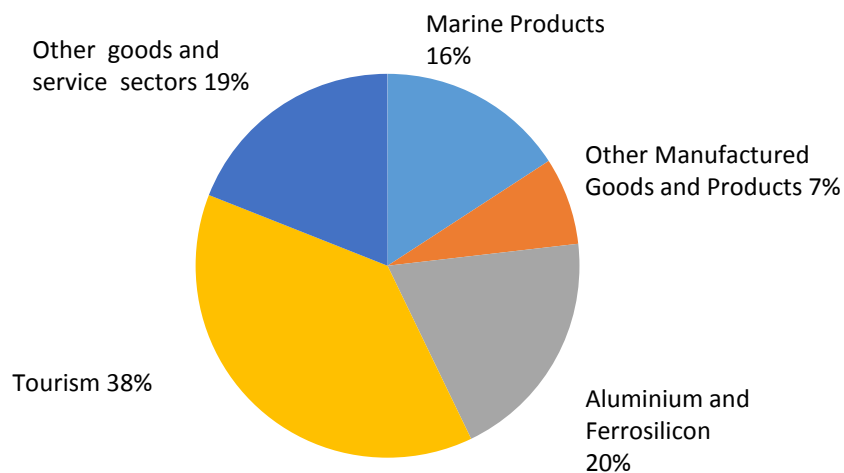


Source: Central Bank

Trade

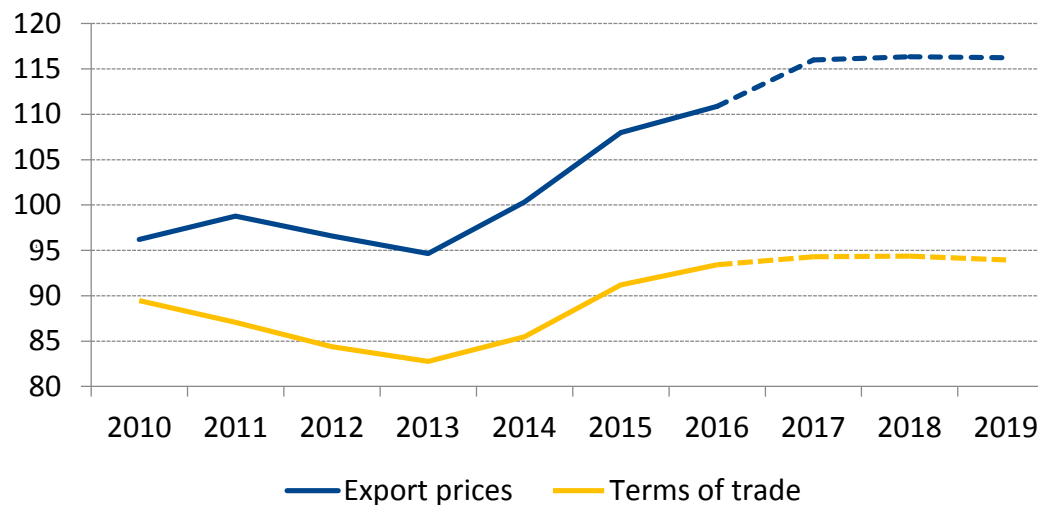
- Terms of trade have improved markedly, and exports have grown rapidly
- The rise in the exchange rate is due largely to growth in tourism, considerably better terms of trade, and a substantial improvement in Iceland's external position.
- Exports of goods and services combined rose by over 11% in 2016
- The surplus of balance of trade in goods and services in 2016 was 158,836 million ISK

Total export of goods and services by type 2017, q1



2005 = 100

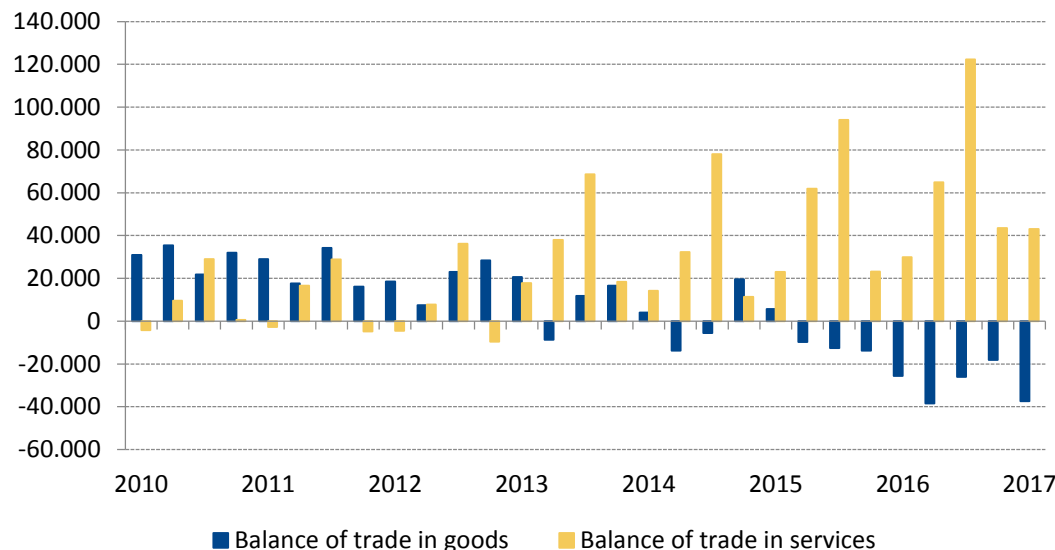
Export prices and terms of trade



Source: Central Bank

Millions, ISK

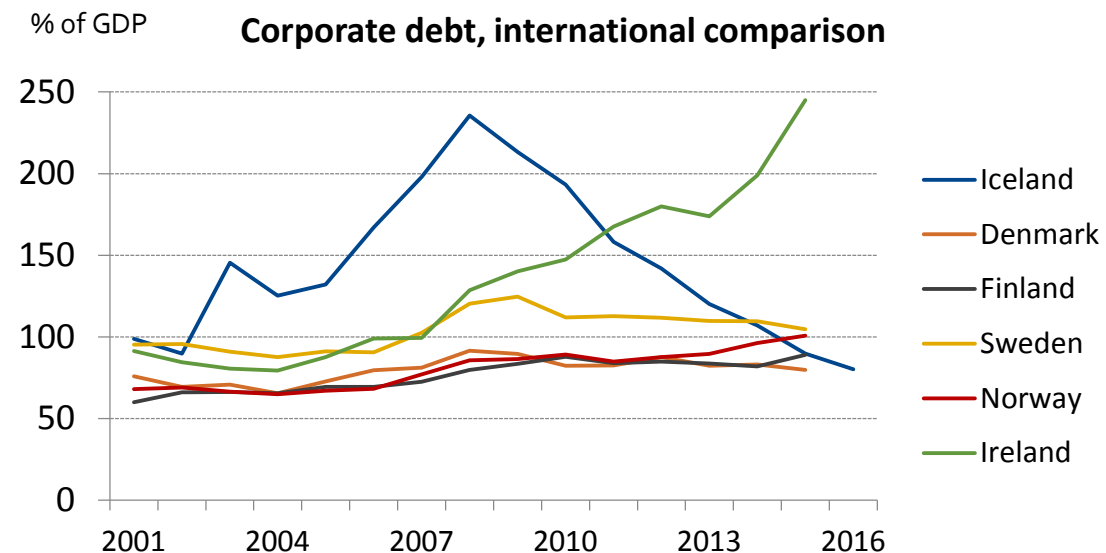
Balance of trade, quarterly figures



Debt levels

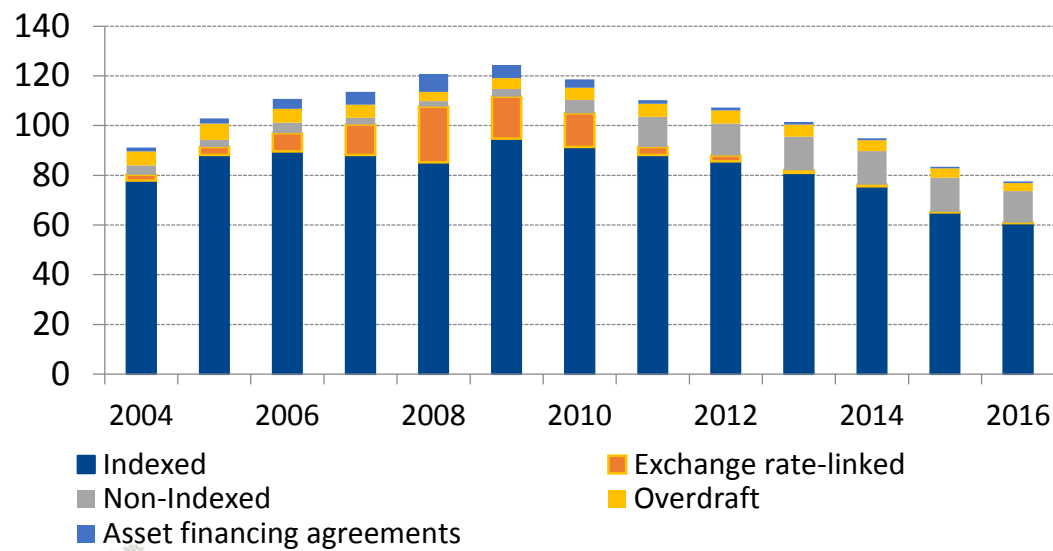
- Total household debt continues to decrease, debt has not grown in line with increases in housing prices
- Household debt was reduced by 33 b.kr. in 2016 in connection with the Government's debt relief measures
- Loans to tourism companies account for around 14% of the commercial banks' total corporate lending.

Corporate debt, international comparison



Source: Central Bank

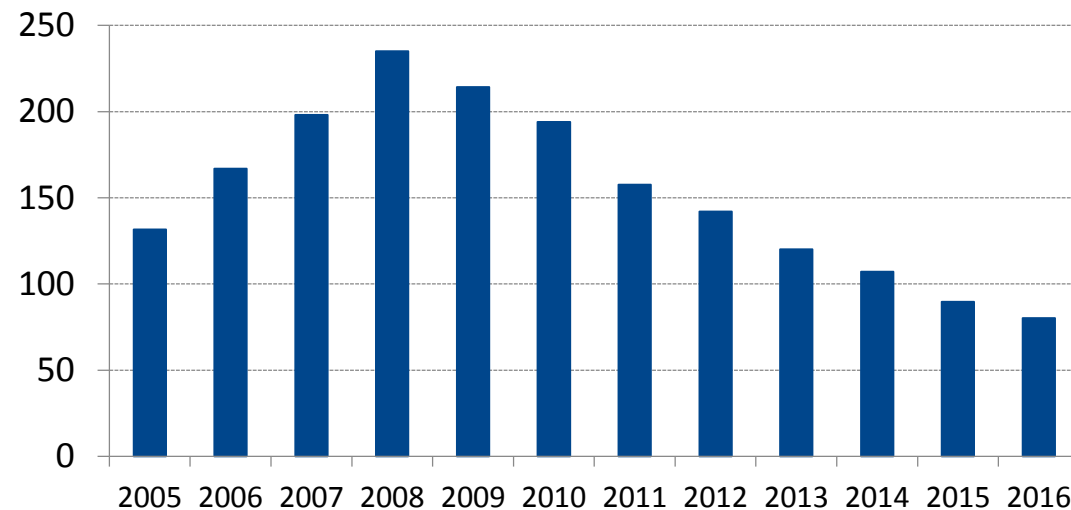
Total household debt



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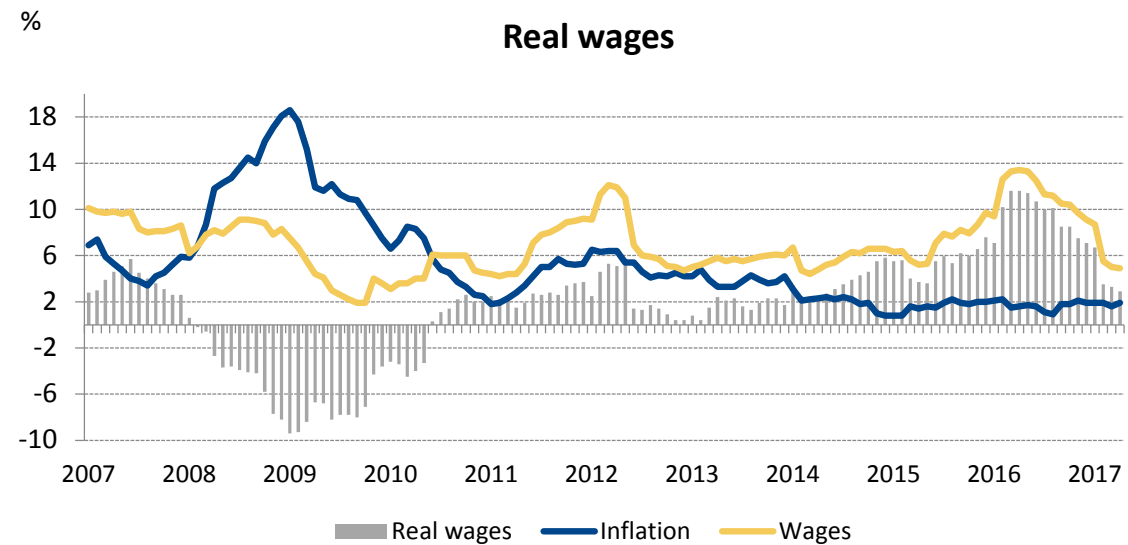
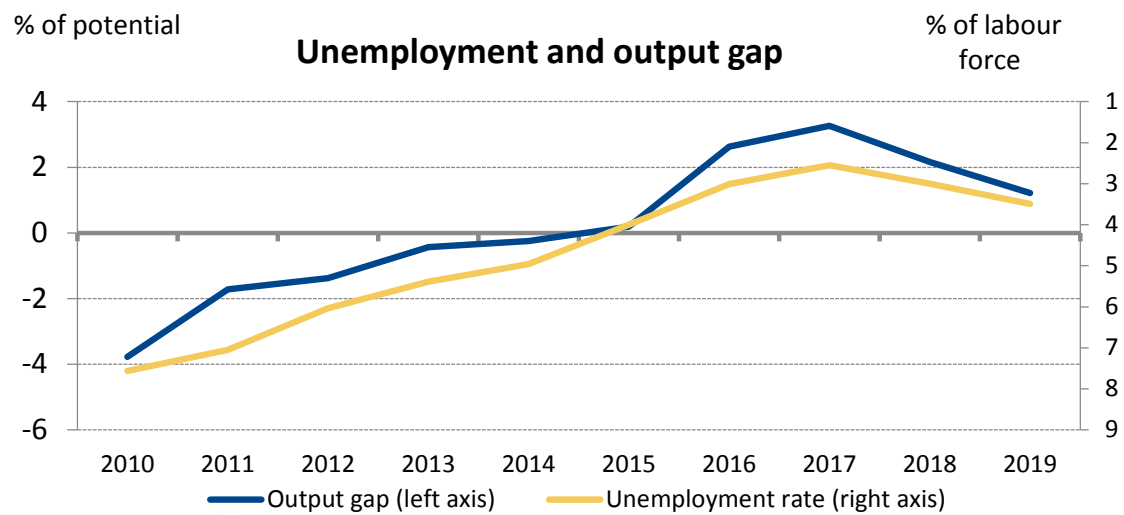
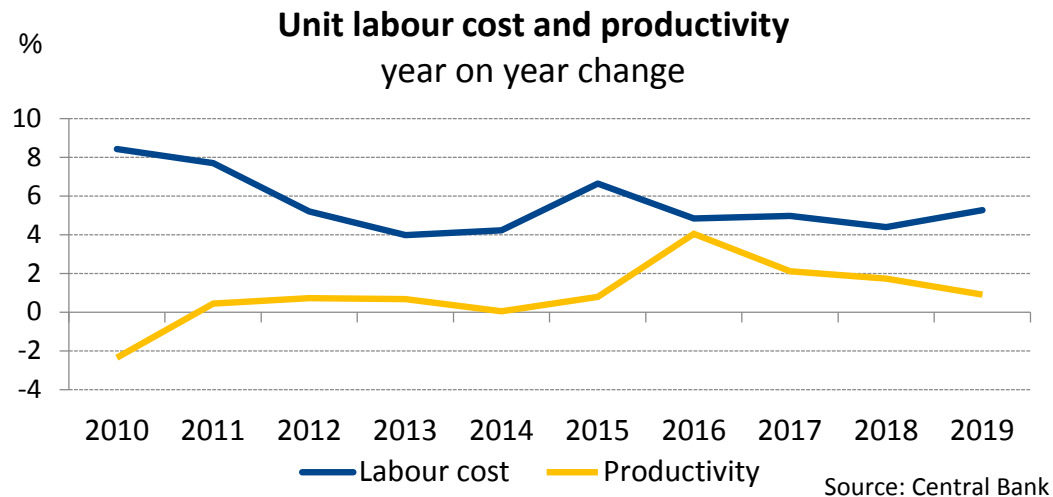
Source: Central Bank

Corporate debt



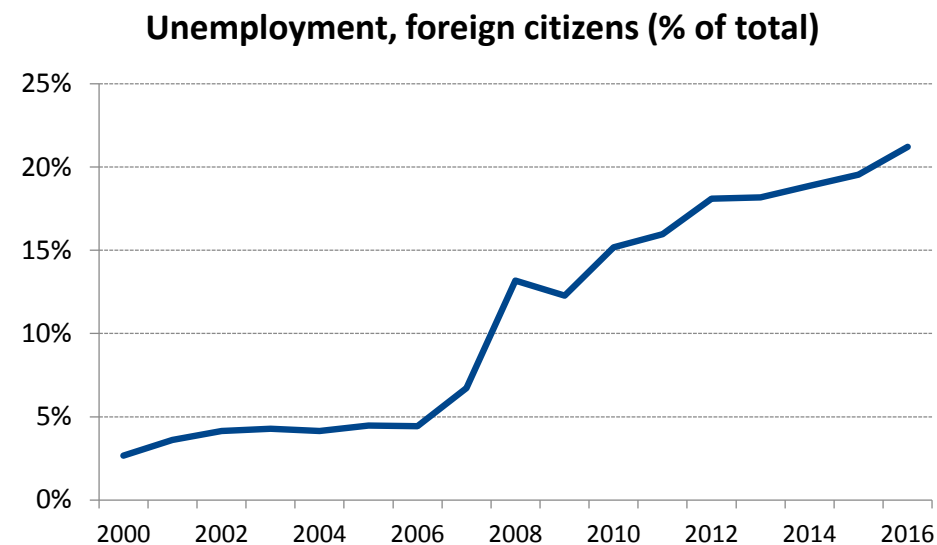
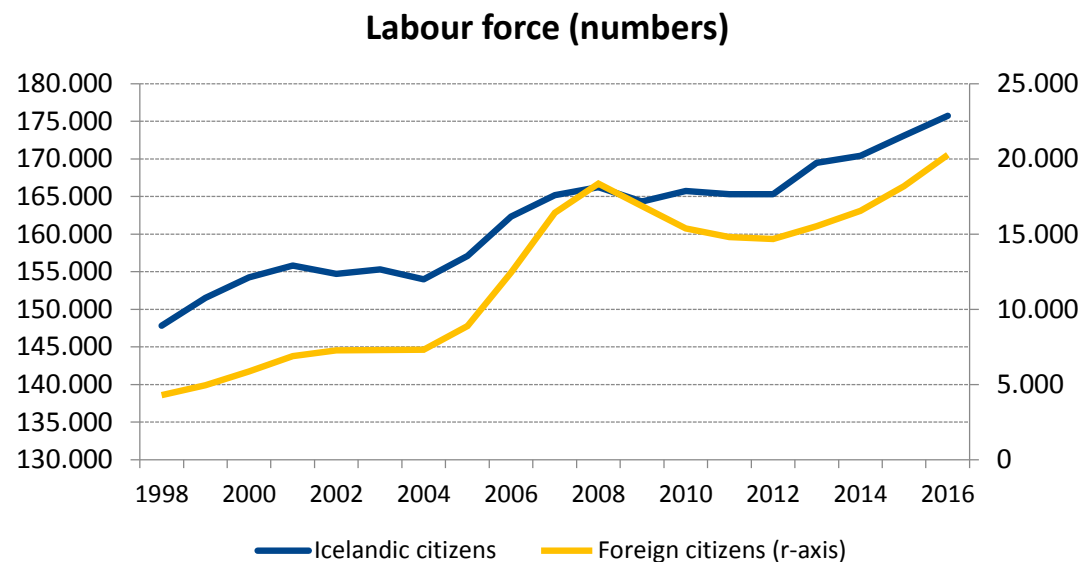
Source: Central Bank

Labour market – foreign labour



Labour market – foreign labour

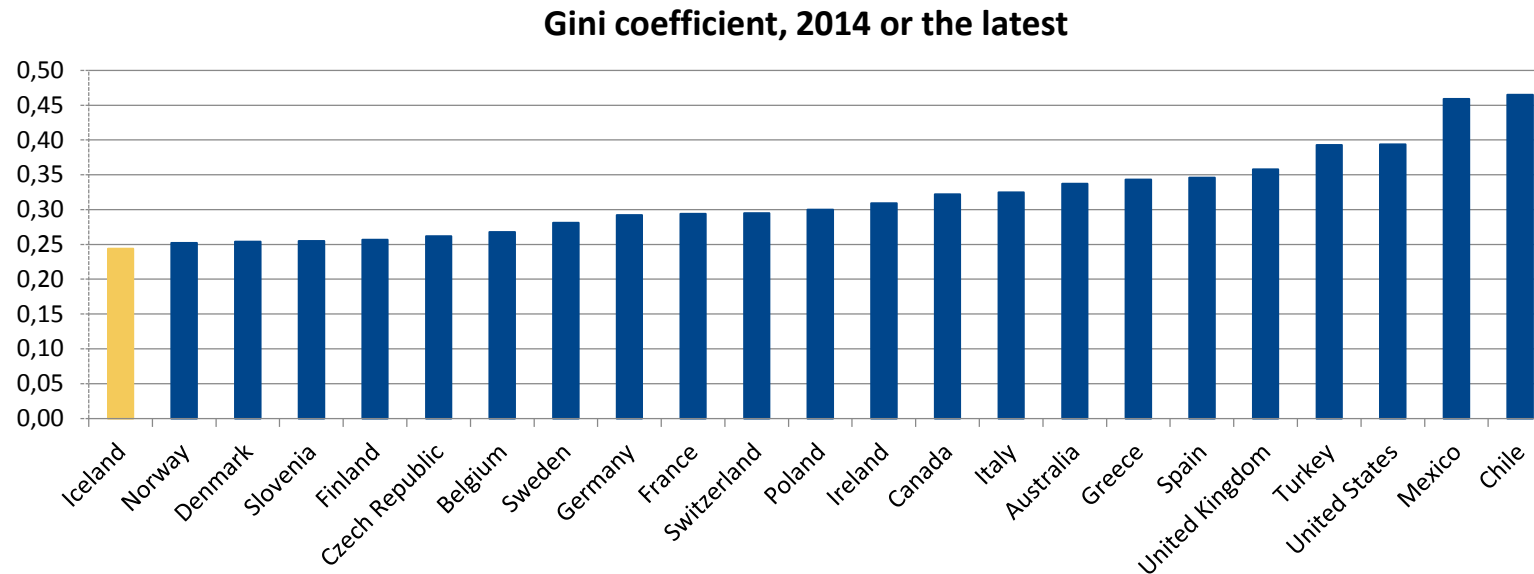
- From the year 1996, the highest numbers of foreign immigrants to Iceland were Polish citizens, with the exception of 2004, when Portuguese citizens were most numerous.
- At the end of 2016 there were 20.273 foreigners in the workforce, 10,3% of the labour market



Gini coefficient in selected OECD countries

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.

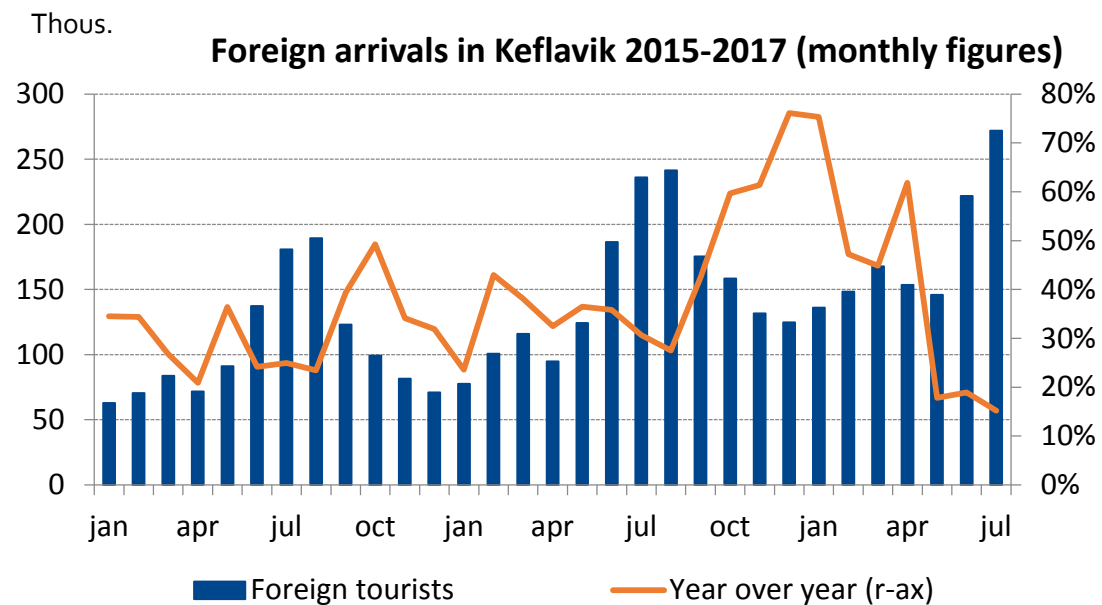
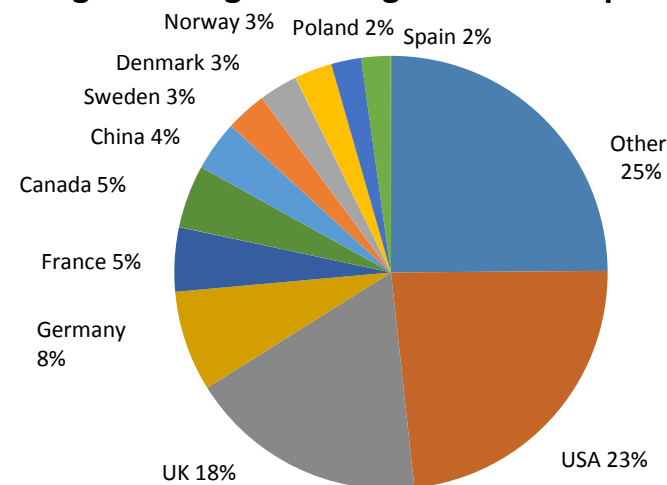
With a Gini coefficient of 0.24, Iceland's income inequality after government taxes and transfers is the lowest among OECD countries.



Tourism

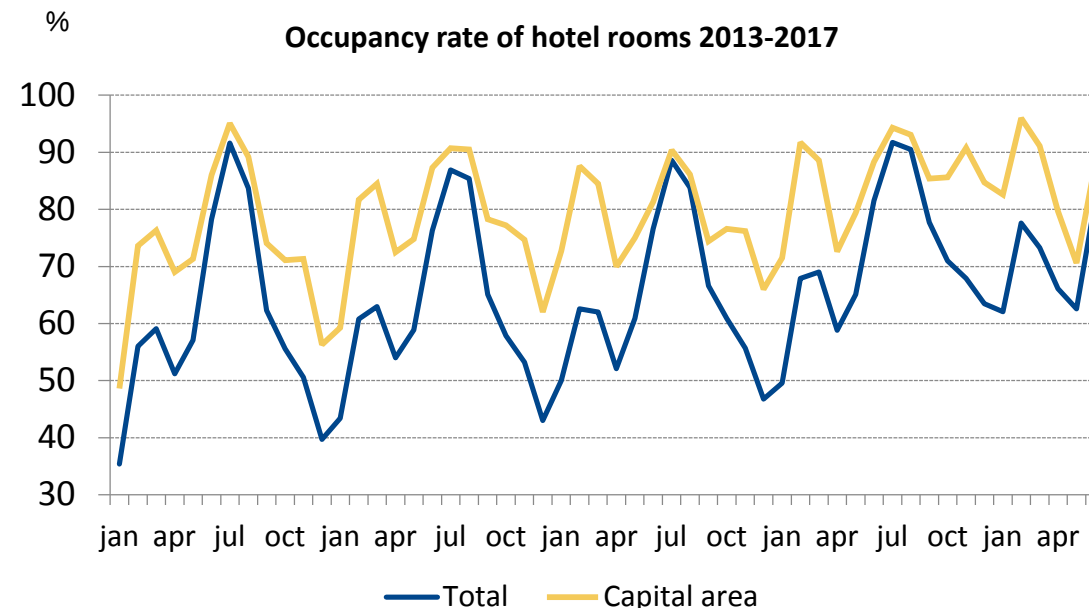
- The total number of foreign visitors to Iceland was around 1,8 million in 2016
- That is a 39% increase from 2015
- In the first 5 months of 2017 the increase is 46,5%
- Higher growth in the winter months than summer
- The appreciation of Krona might shorten the dwelling time and cause less spending

Foreign Passengers through Keflavik Airport 2016

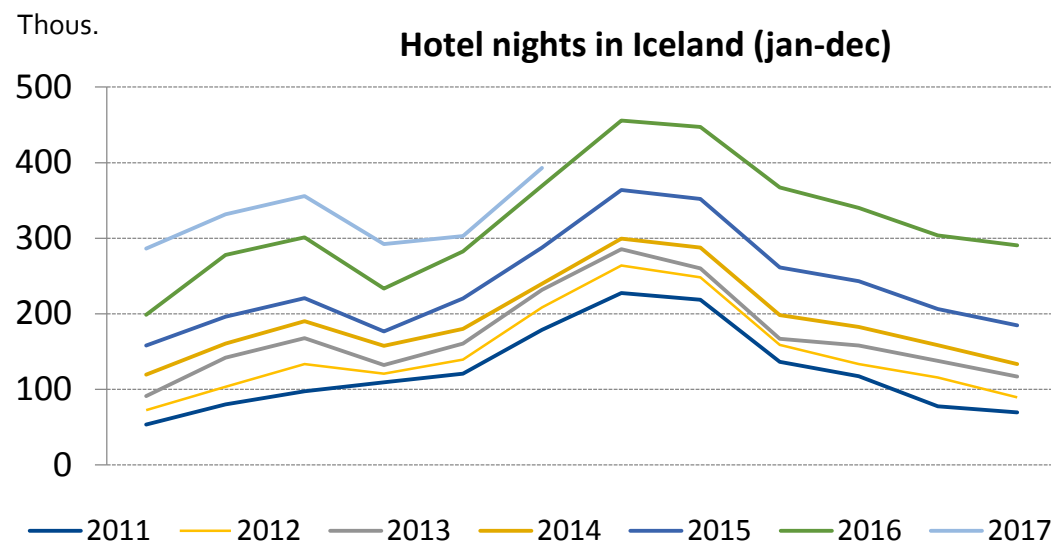


Tourism

- Overnight stays in hotels increased by 6% in June, year on year.
- In the first six months of 2017 the overnight stays increased by 18%
- The occupancy rate stays high, especially in the capital area

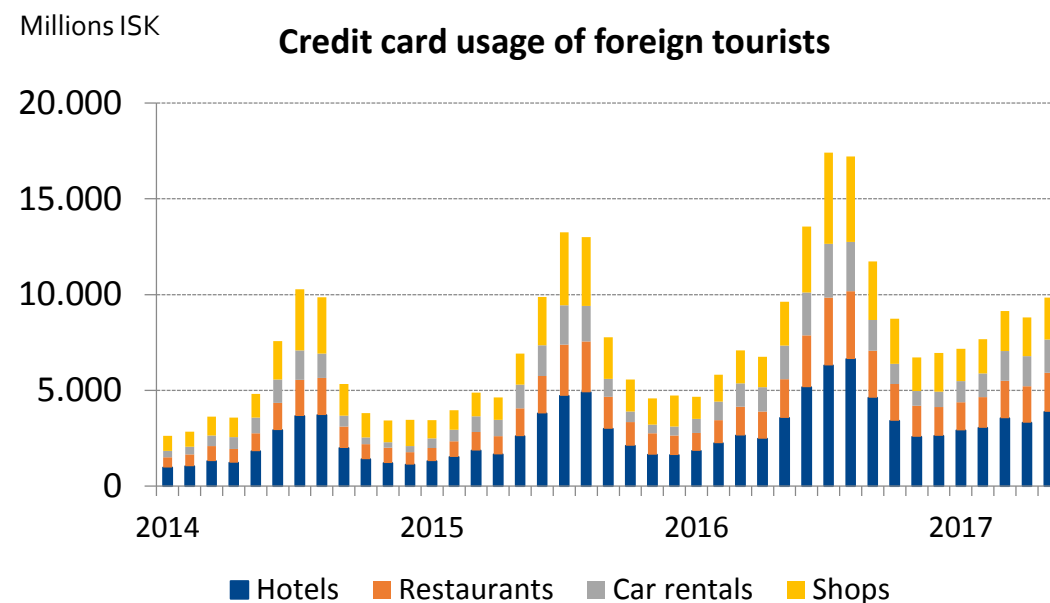


Source: Statistic Iceland



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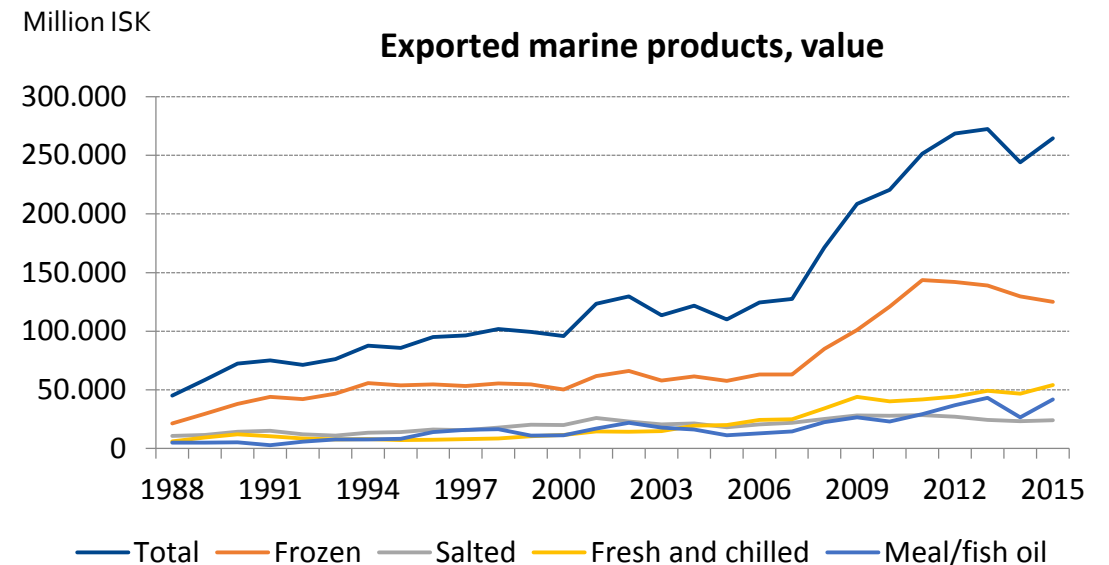
Source: Statistic Iceland



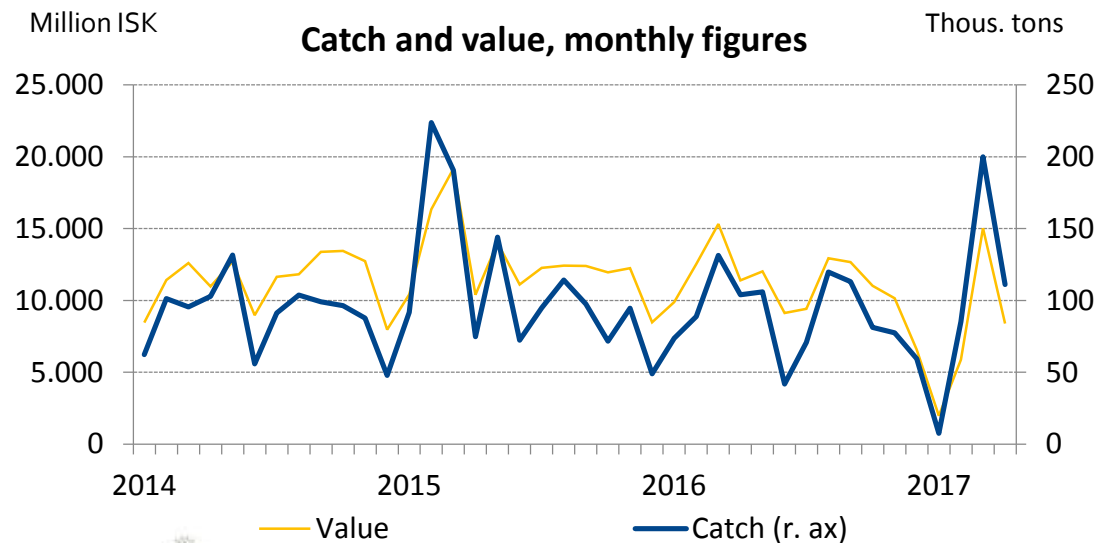
Source: Center for Retail Studies

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.

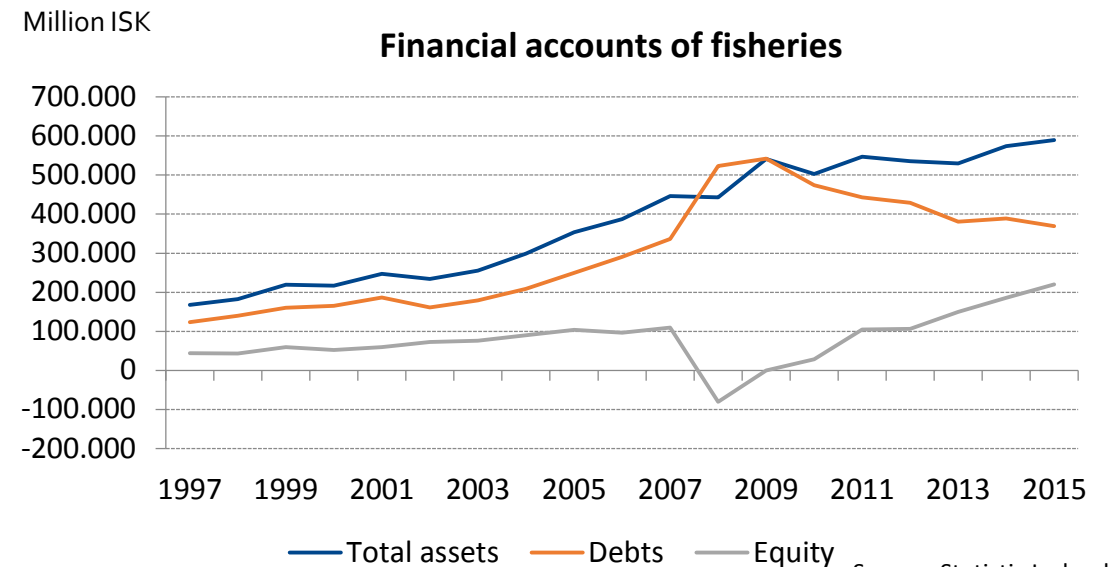


Source: Statistic Iceland



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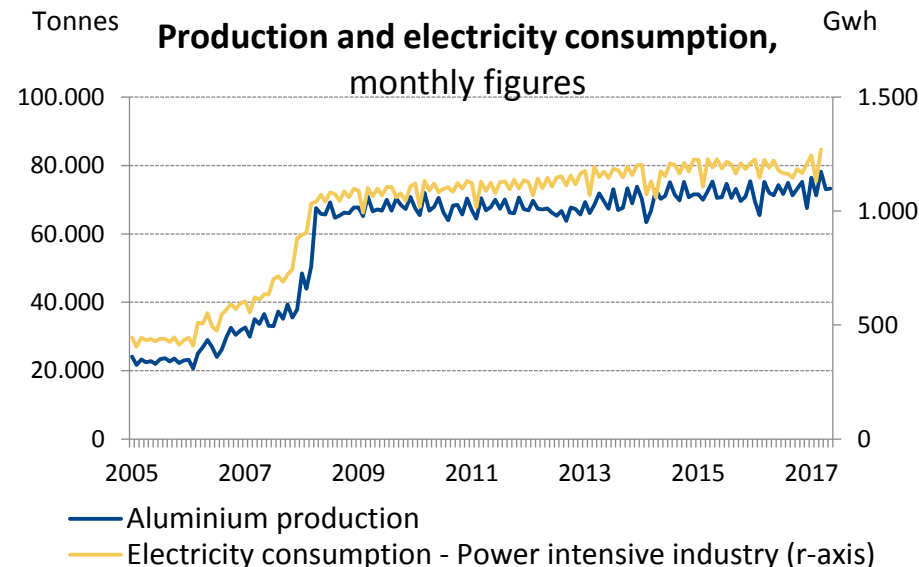
Source: Statistic Iceland



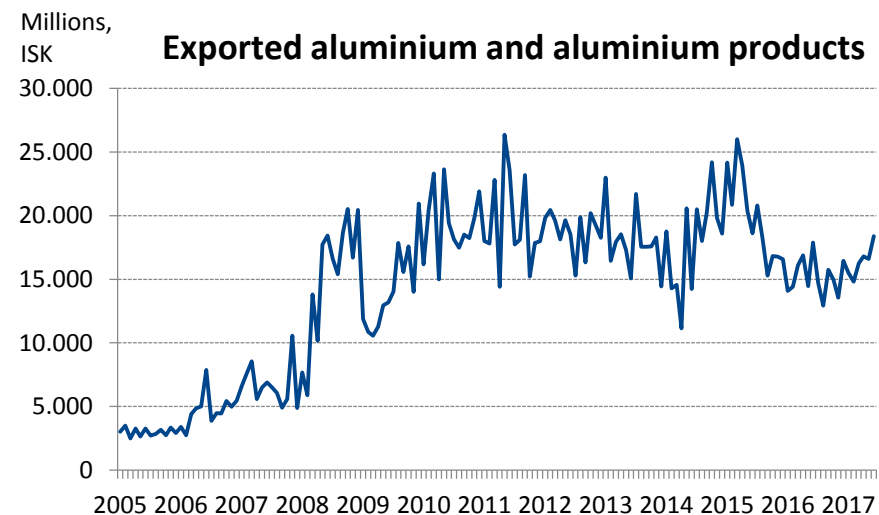
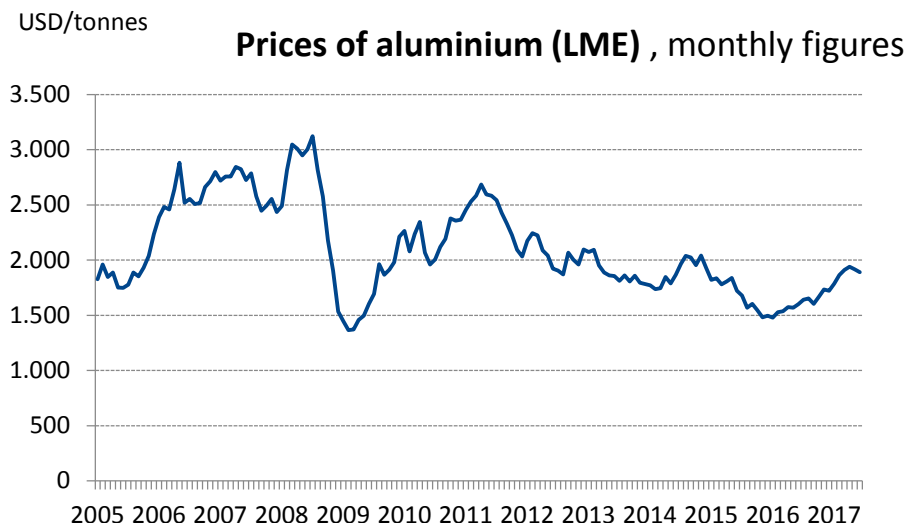
Source: Statistic Iceland

Aluminium sector

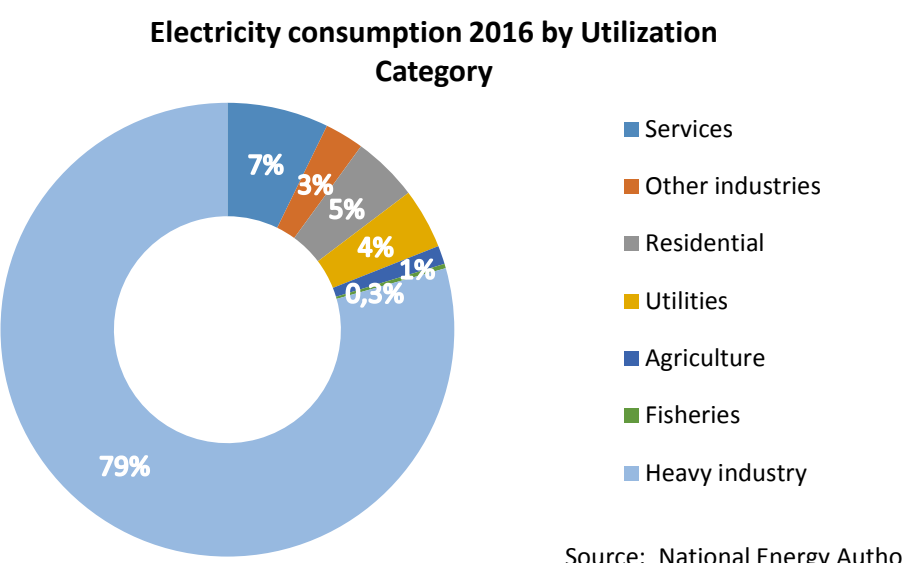
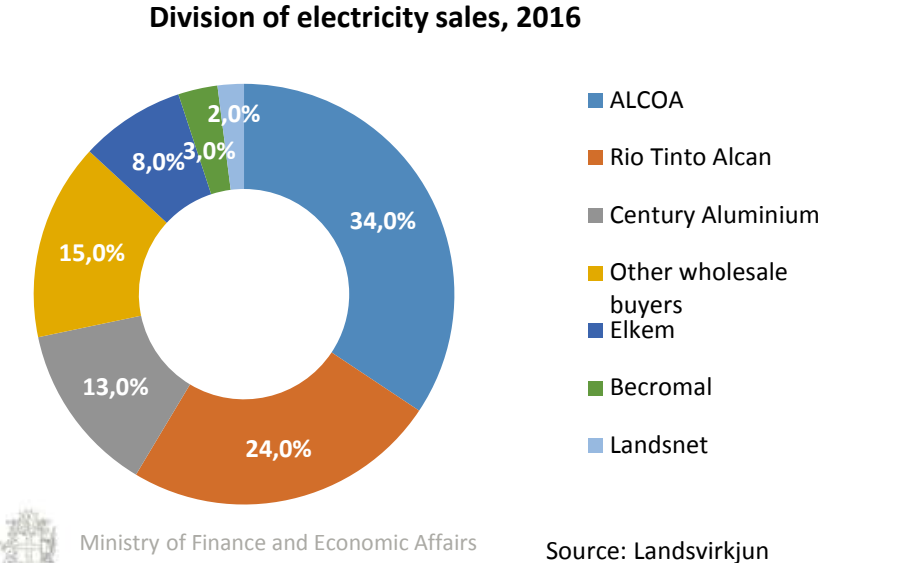
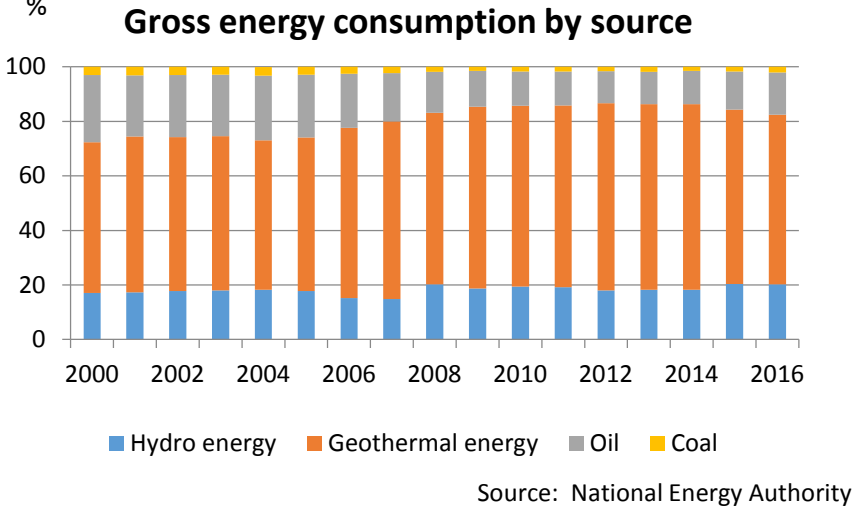
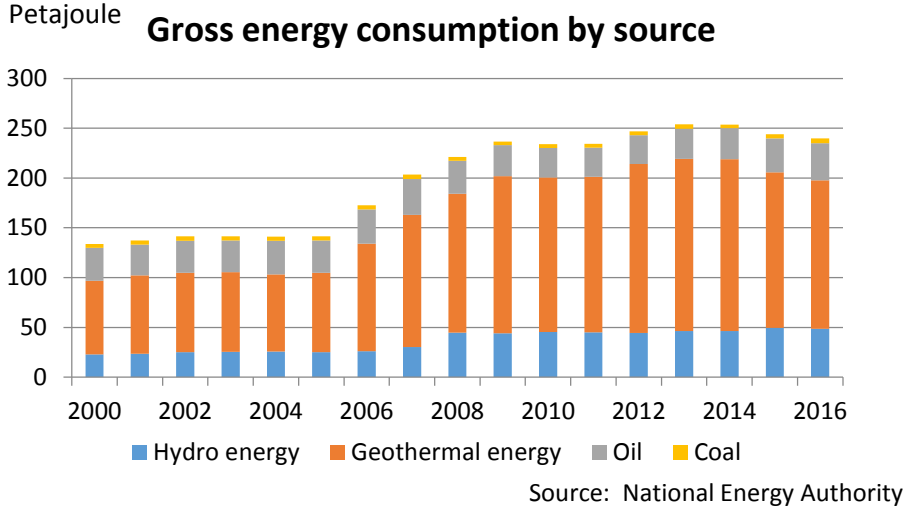
- Aluminium exports account for 20% of total exports of goods and services
- There are three aluminium smelters in Iceland, Alcoa (East Iceland), Century Aluminium (West Iceland) and Rio Tinto Alcan (South Coast Iceland)
- Production of aluminium started in Iceland in 1969 in Straumsvík (South Coast). During the first year, the production capacity was 33 thousand tonnes
- The capacity today for all three smelter is around 850 thousand tonnes per year



Source: Statistic Iceland

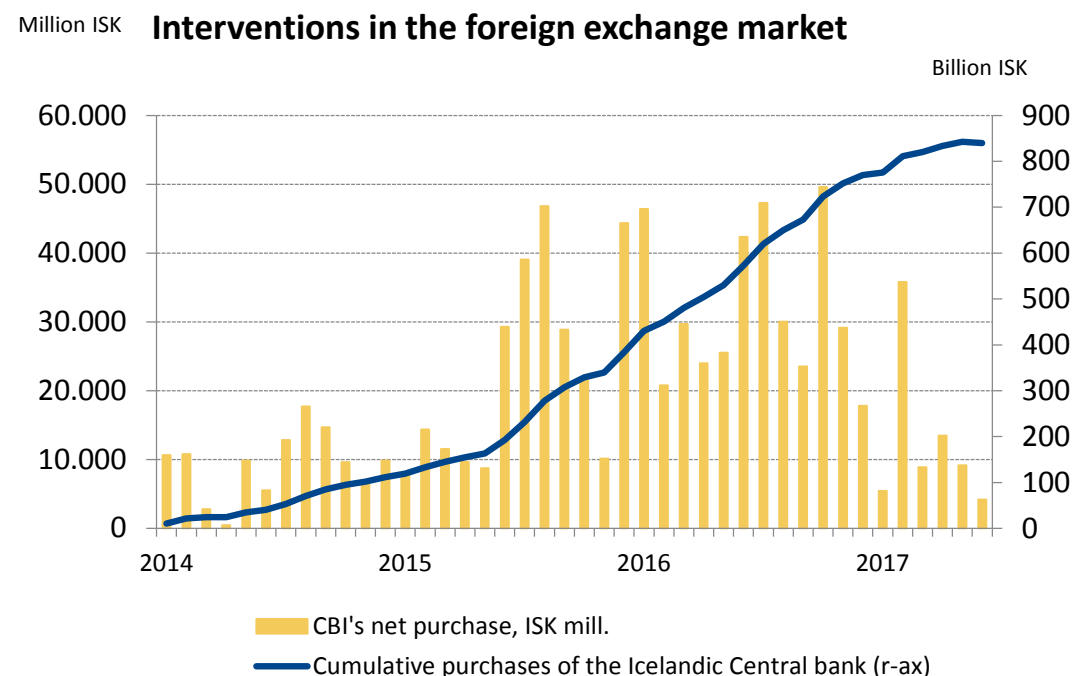
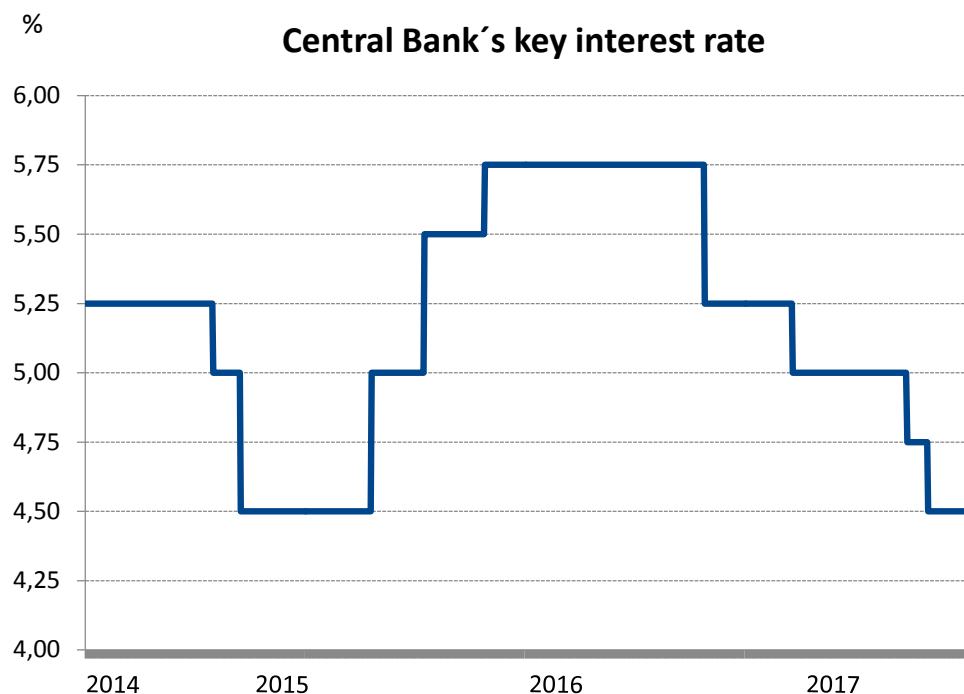


Energy consumption – 80% renewable



Monetary policy

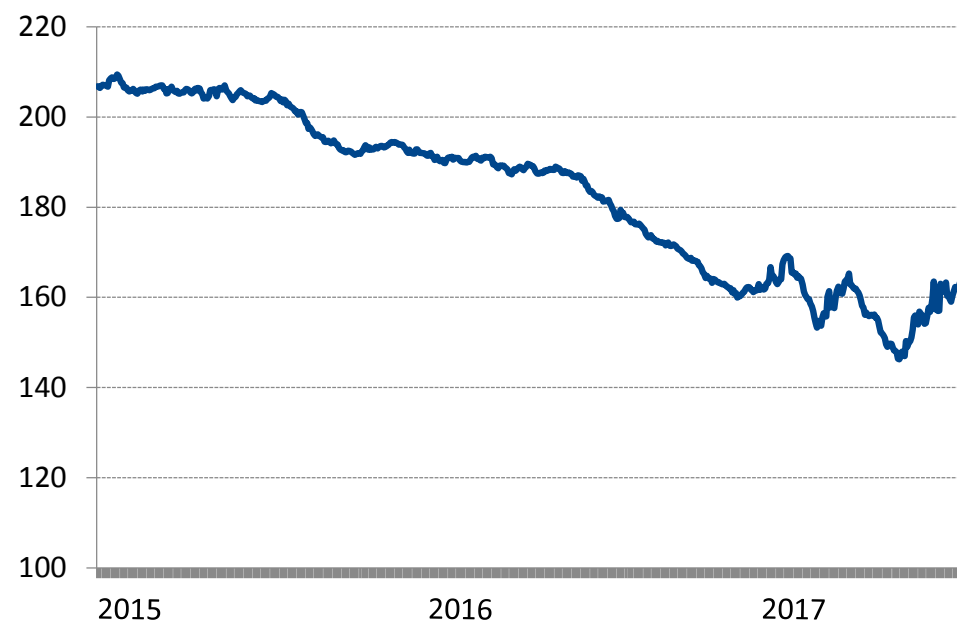
- The Monetary Policy Committee of the Central Bank of Iceland lowered the Bank's interest rates by 0.25 percentage points in June.
- The Bank's key interest rate – the rate on seven-day term deposits, are now 4,5%.
- The Central Bank has scaled down its intervention in the foreign exchange market in 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.



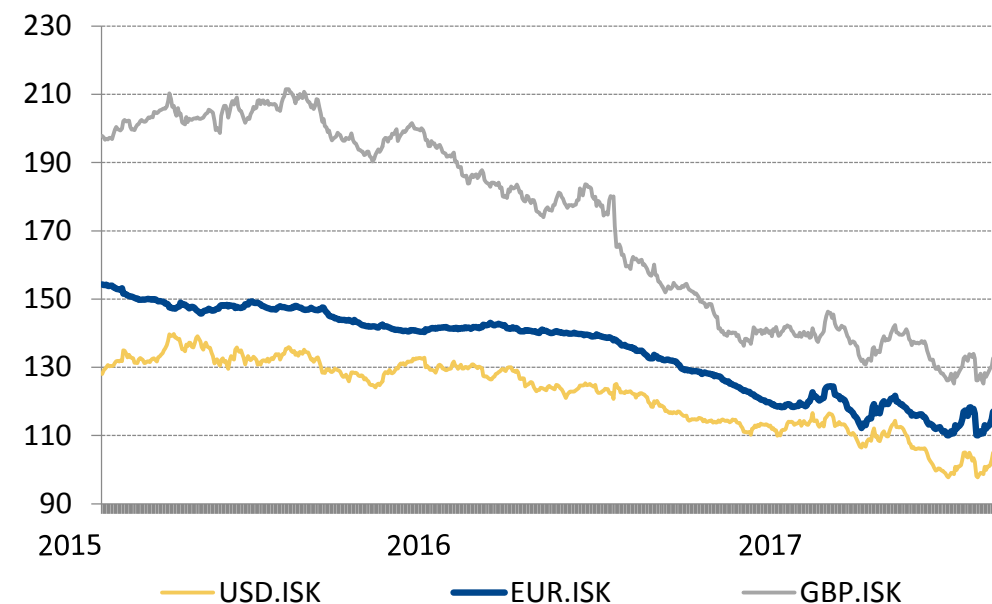
Exchange rate

- The króna appreciated 18% in 2016
- The króna continued to appreciate in the first quarter of 2017 but the strengthening of the króna has reversed and the exchange rate index in August is now similar as it was in the beginning of 2017

Exchange rate Index (narrow trade index)

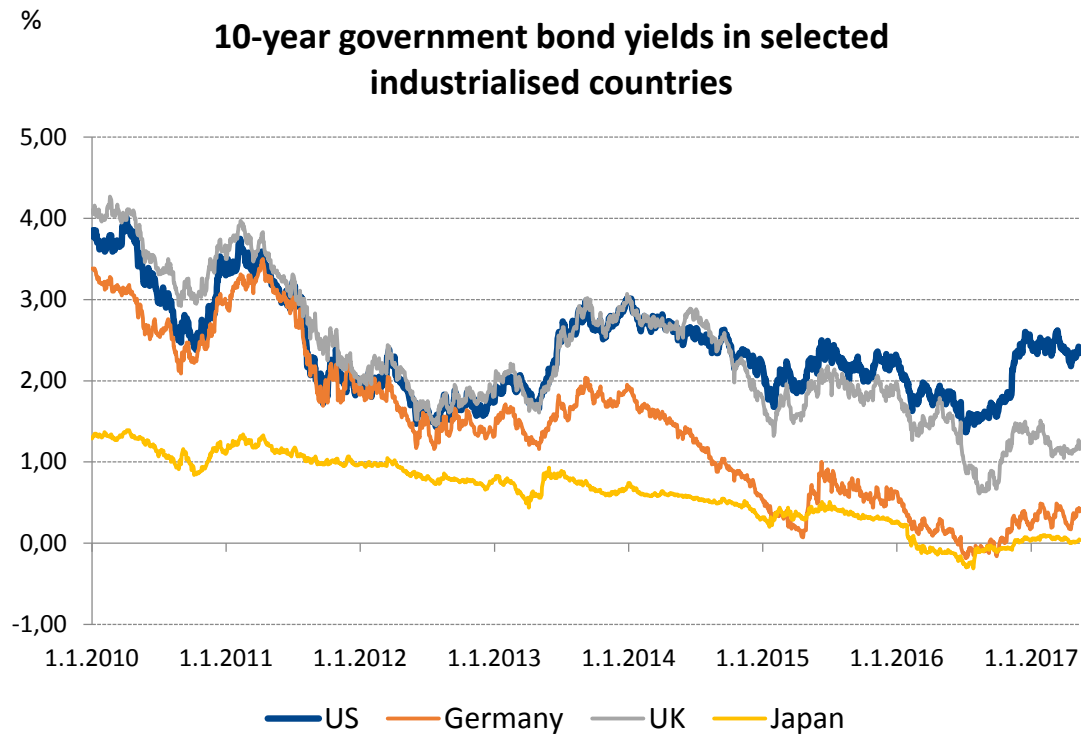


Exchange rate

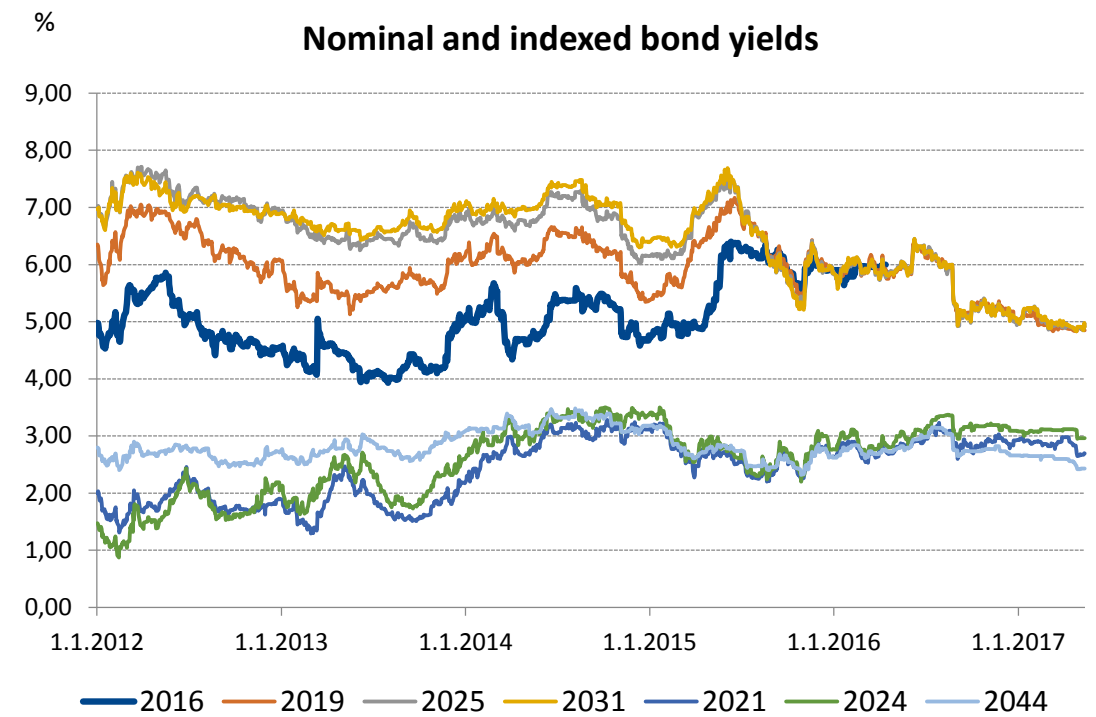


Interest rates

- The spread between long-term interest rates in the US and the UK has grown wider
- 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

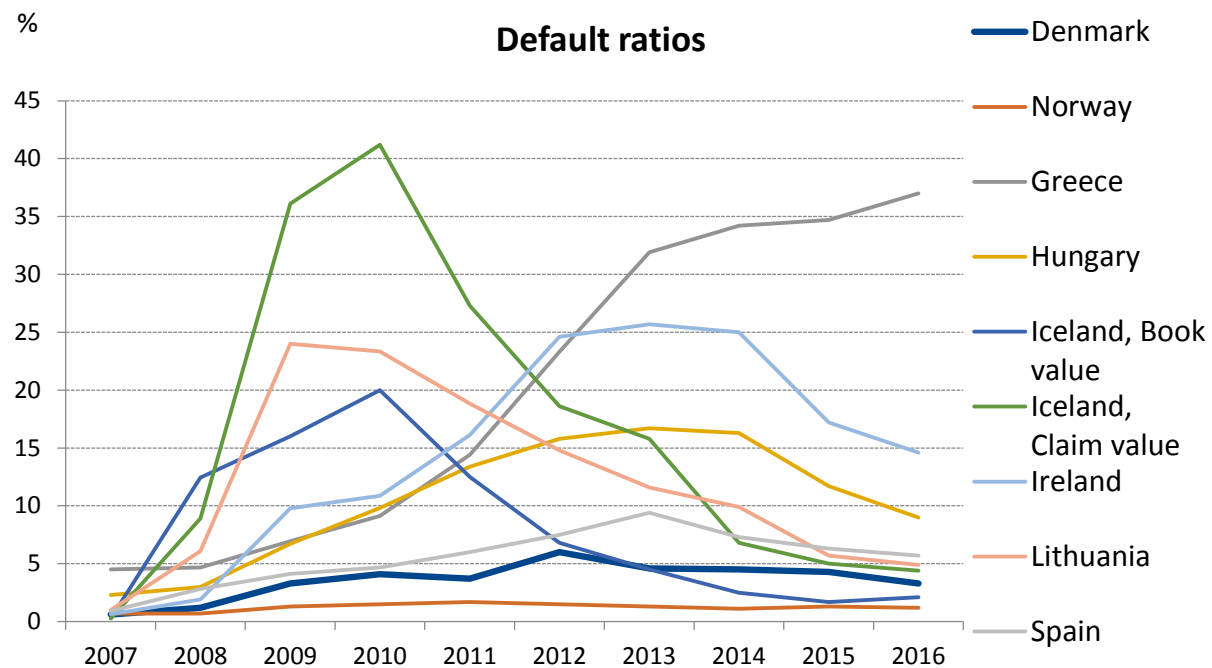


Source: Central Bank

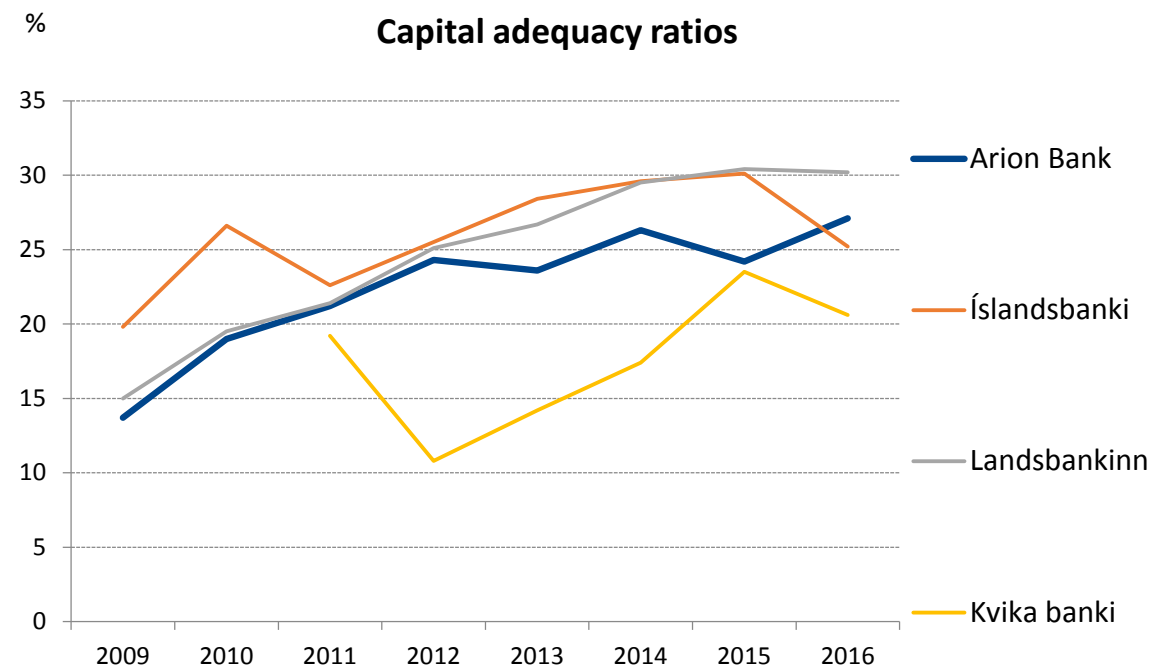


Commercial banks

- 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



Source: Central Bank

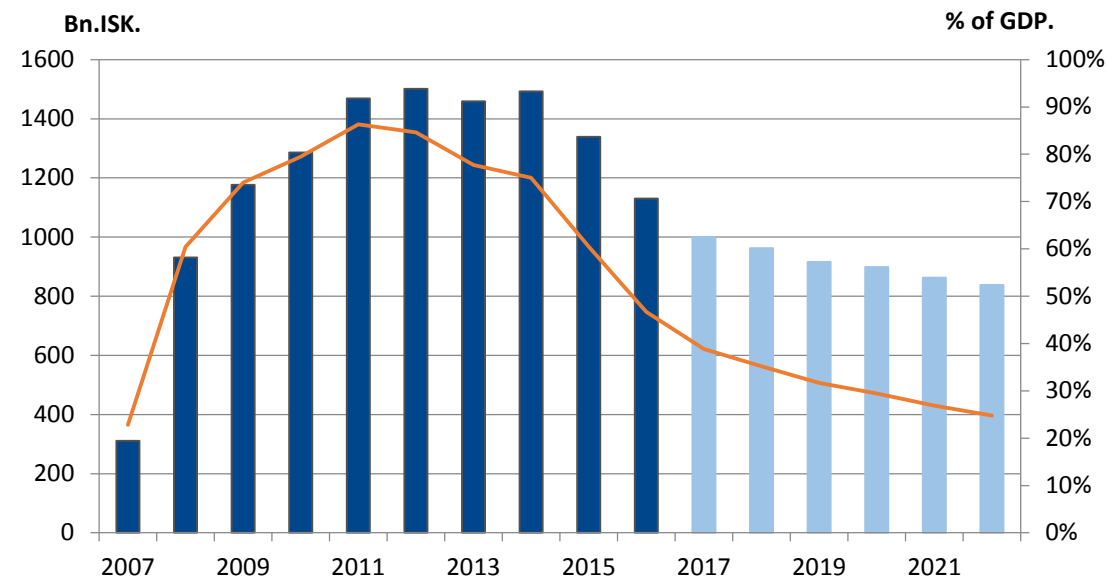


Source: Central Bank



Debt Management 2017-2022

- Proceeds from stability contributions used to pay down debt
 - The budget 2017 assumes that 105 bn. ISK will be used to pay down debt
 - Plans are subject to the sale of 87% share in Arion bank takes place this
- Treasury ISK deposits in Central bank reduced
 - Deposit levels reduced to 40 bn. ISK last fall when active liquidity management implemented
- Irregular revenues – dividends, proceeds from asset disposal
 - During the period, irregular income of 140 bn. ISK is assumed to be used to retire debt
- Central Bank bond fully repaid in 2017
- Outstanding amounts of RIKH 18 og RIKB 19 reduced by switch auctions and buy-backs
- Gross central government debt ratio peaked in 86% of GDP in 2011, the ratio was down to 47% at end of 2016
- GDP growth and debt repayments are the contributing factors in lowered debt levels
- At the end of forecast period 2022 total debt is expected at 838 bn. ISK – 25% of VLF



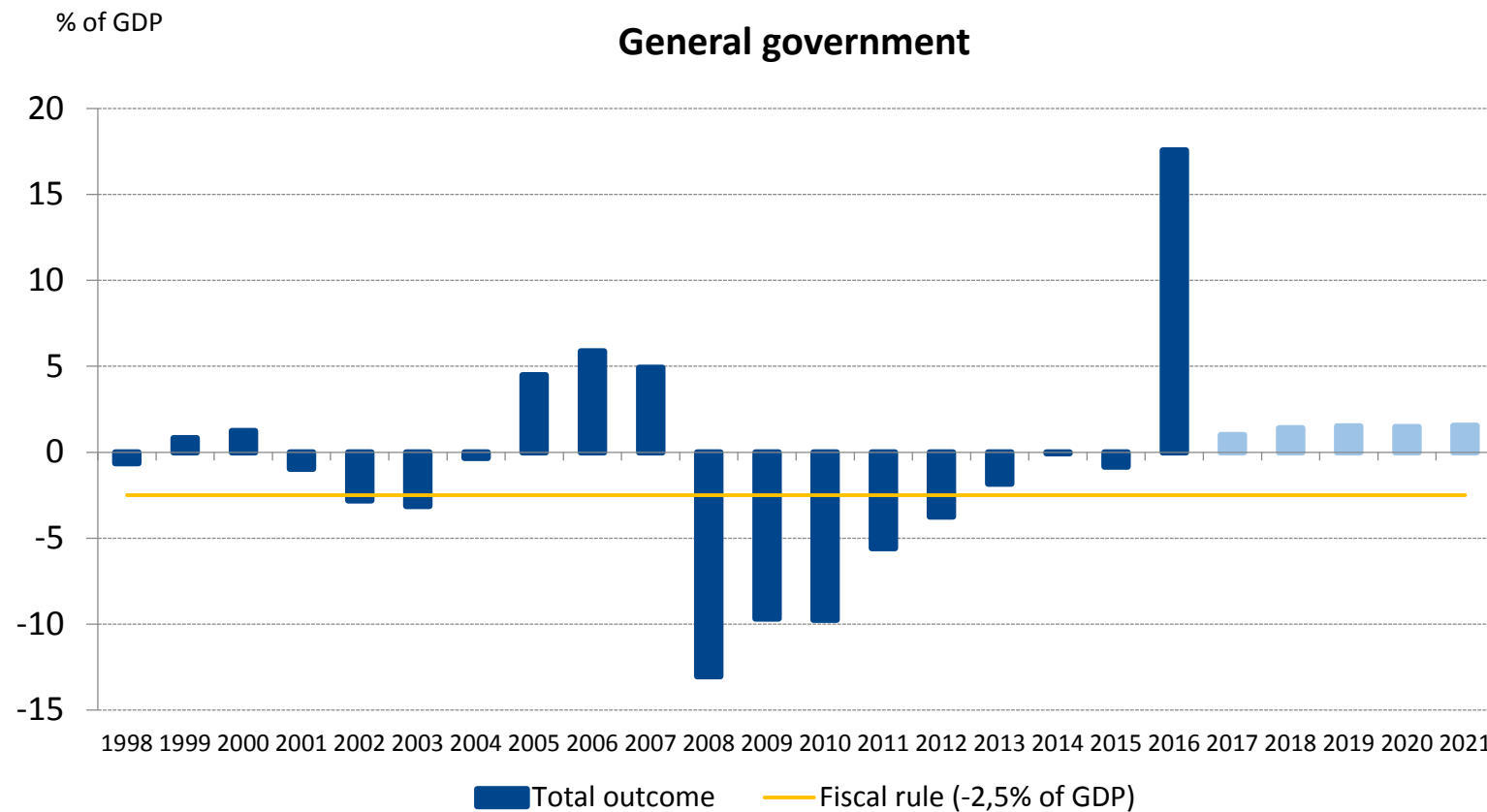
ACT ON PUBLIC FINANCES - STRENGTHENS THE FISCAL FRAMEWORK

- New Act on Public Finances came into force 1. January 2016. The architecture involves i.a. three main documents:
 - Five-year Fiscal Policy Statement, a parliamentary resolution submitted every five years. When new Government takes office, it has to publish a new policy statement and strategy for the next 5 years, as soon as possible
 - Fiscal Strategy for the next five years, a parliamentary resolution submitted every year.
 - Budget Bill (submitted every year)
-
- The Policy Statement and the Strategy reflects the Government's objectives and emphasis concerning the economic policy effect of public finances, tax policy, and prioritization of spending.
 - The five year Fiscal Policy Statement for this Government was approved in April 2016.
 - The Fiscal Strategy was approved in May 2016.



Total outcome – General government

- Stability contributions and other irregular income **included**



Fiscal strategy plan 2017-2022

Central Government balance

- **Excluding** irregular items such as revenues from stability contributions

