

Icelandic Competitiveness and Economic Outlook

The Icelandic American Chamber of Commerce

April 17th 2021

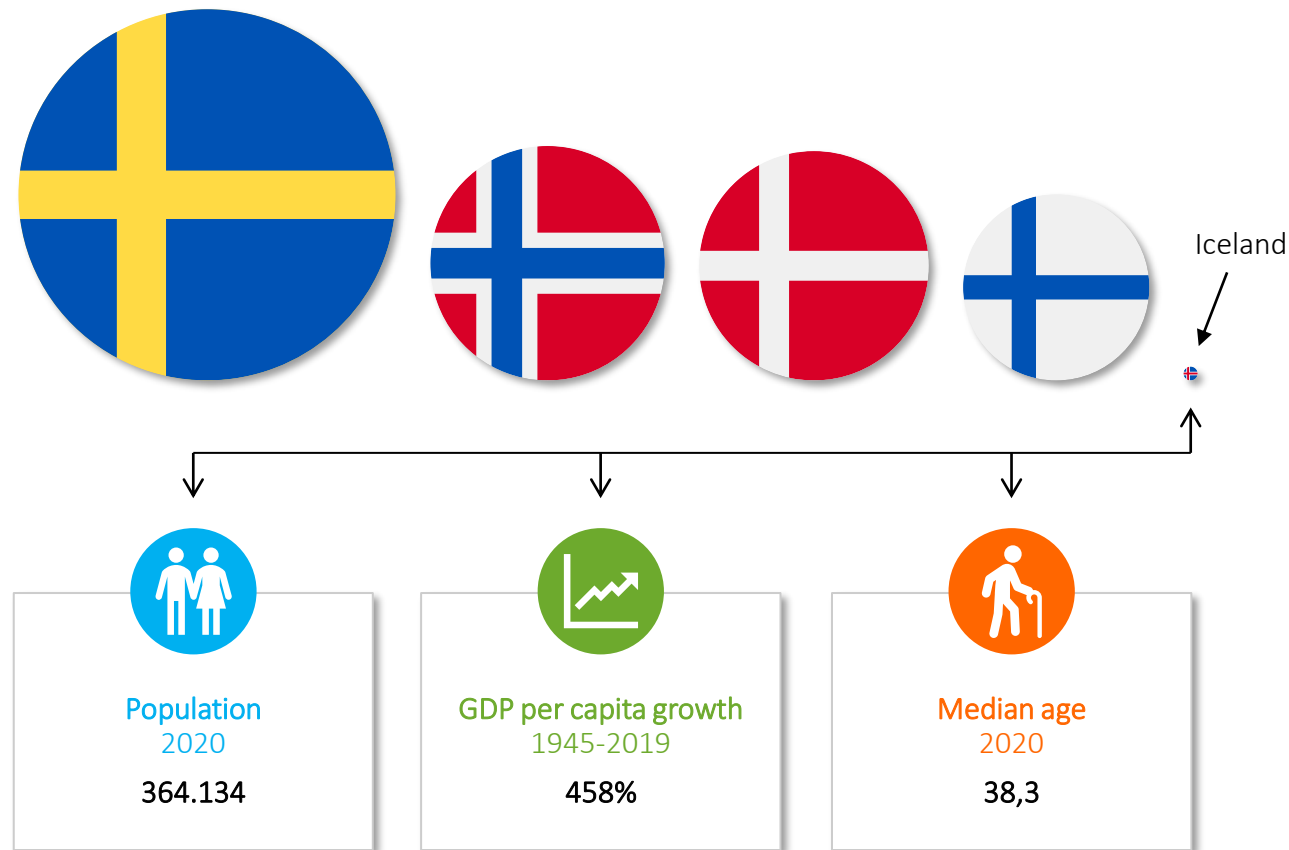
Halldór Benjamín Þorbergsson, Director General



Iceland is a Small Open Economy. The size of the Icelandic economy is about 0.5% of that of Germany, rendering the Icelandic economy the smallest among OECD countries. However, in terms of GDP per capita, Iceland ranks 7th within the OECD.

The relative size of Nordic economies

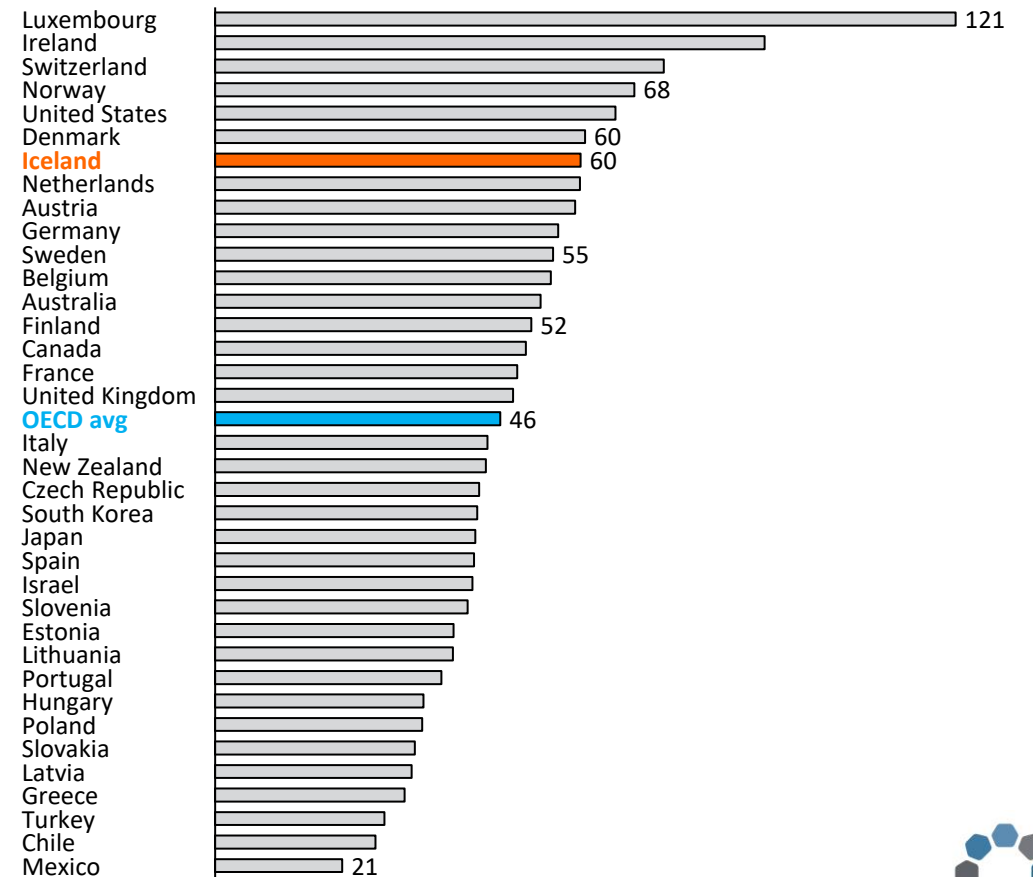
GDP 2019



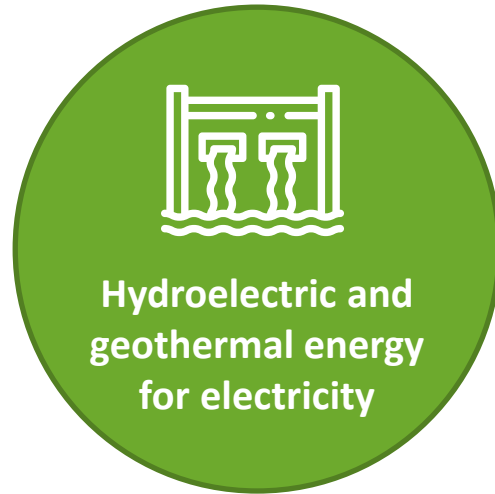
Source: OECD, Statistics Iceland

GDP per capita in 2019

Thousands USD PPP



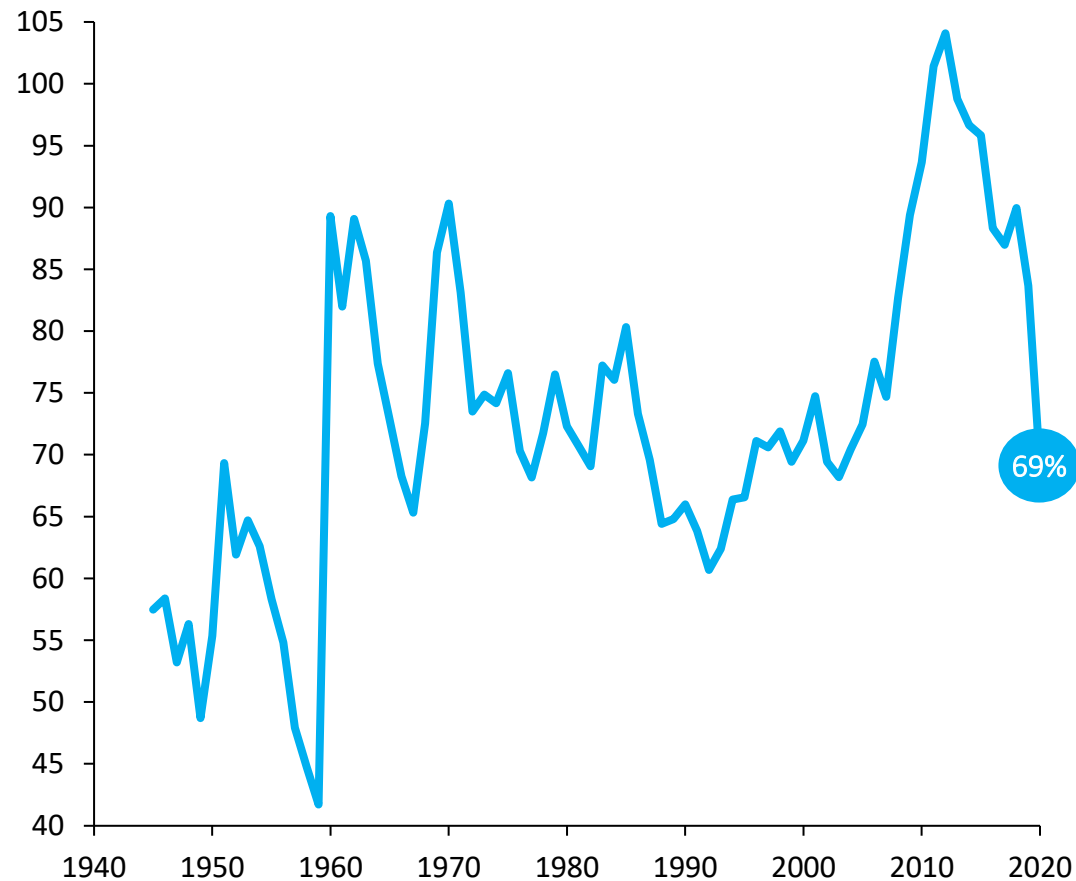
High Standard of Living and Prosperity Based on Sustainability. Iceland is endowed with great sources of green energy and natural resources. Their successful and effective use are the foundation of Iceland's economy.



Heavily Reliant on Foreign Trade. Since many products and services are not produced domestically they need to be imported. A strong export sector is essential to fund these imports. International trade thus plays a fundamental role in Iceland's economy.

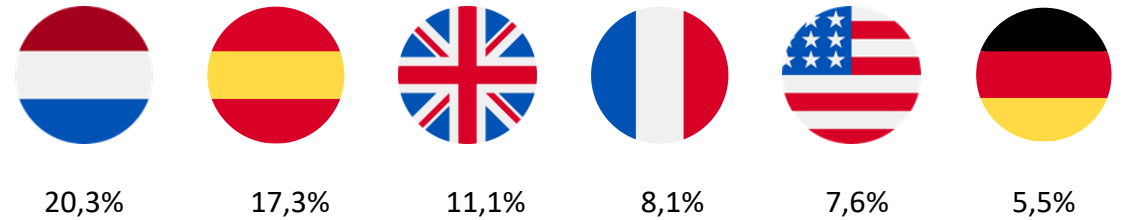
Trade % GDP

Exports and imports as a share of GDP



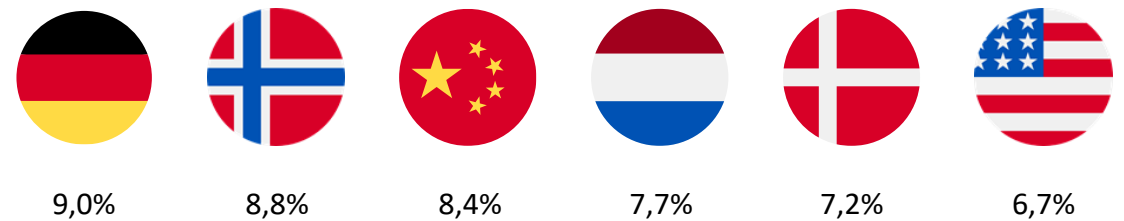
Where did Icelandic export goods go in 2020?

% of total exports



Where did Icelandic imports goods come from in 2020?

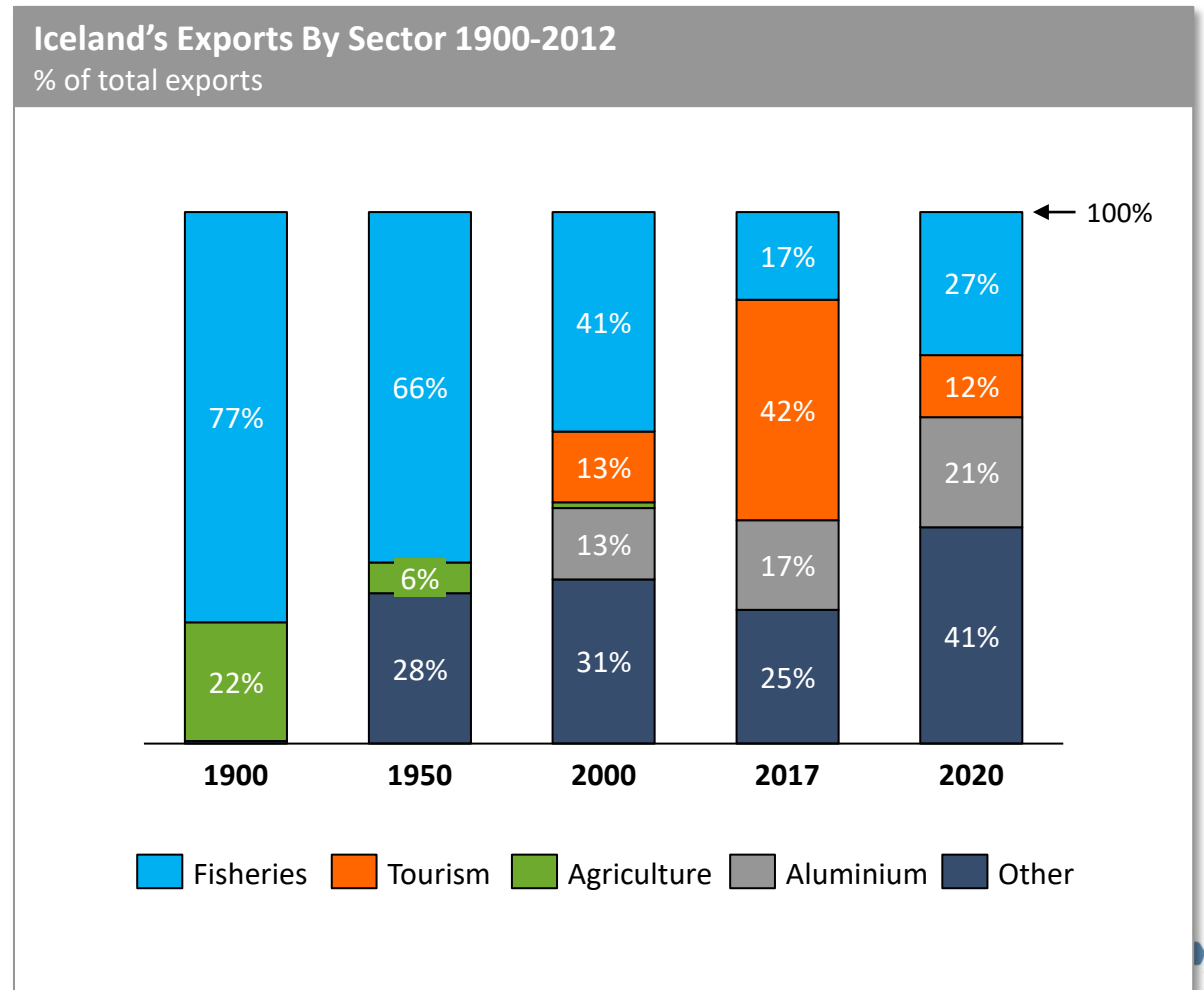
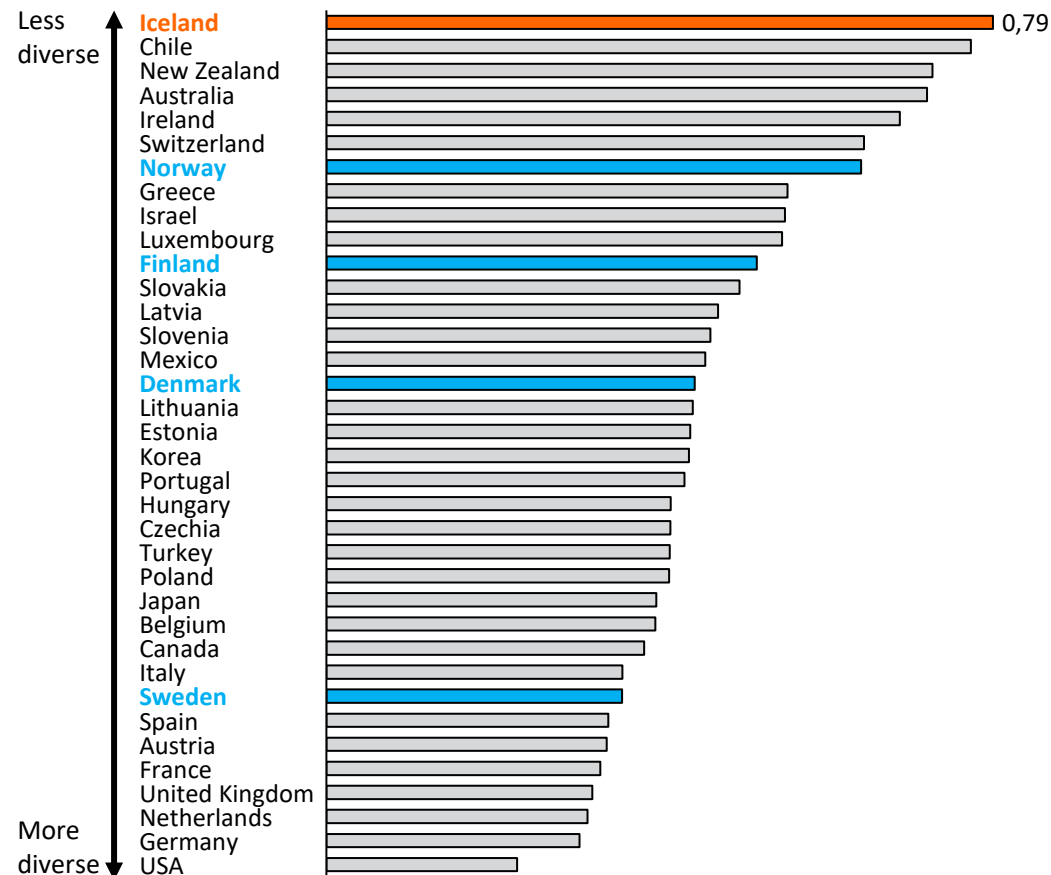
% of total imports



Iceland Lacks Diversification in Exports. However, diversification has increased in the past 100 years with the addition of the tourism and aluminium sectors. The IP industry and pharmaceuticals show promise for future growth. However, Iceland remains the least diversified within OECD.

Diversification of Exports

(0-1) A value closer to 1 indicates greater divergence from world pattern



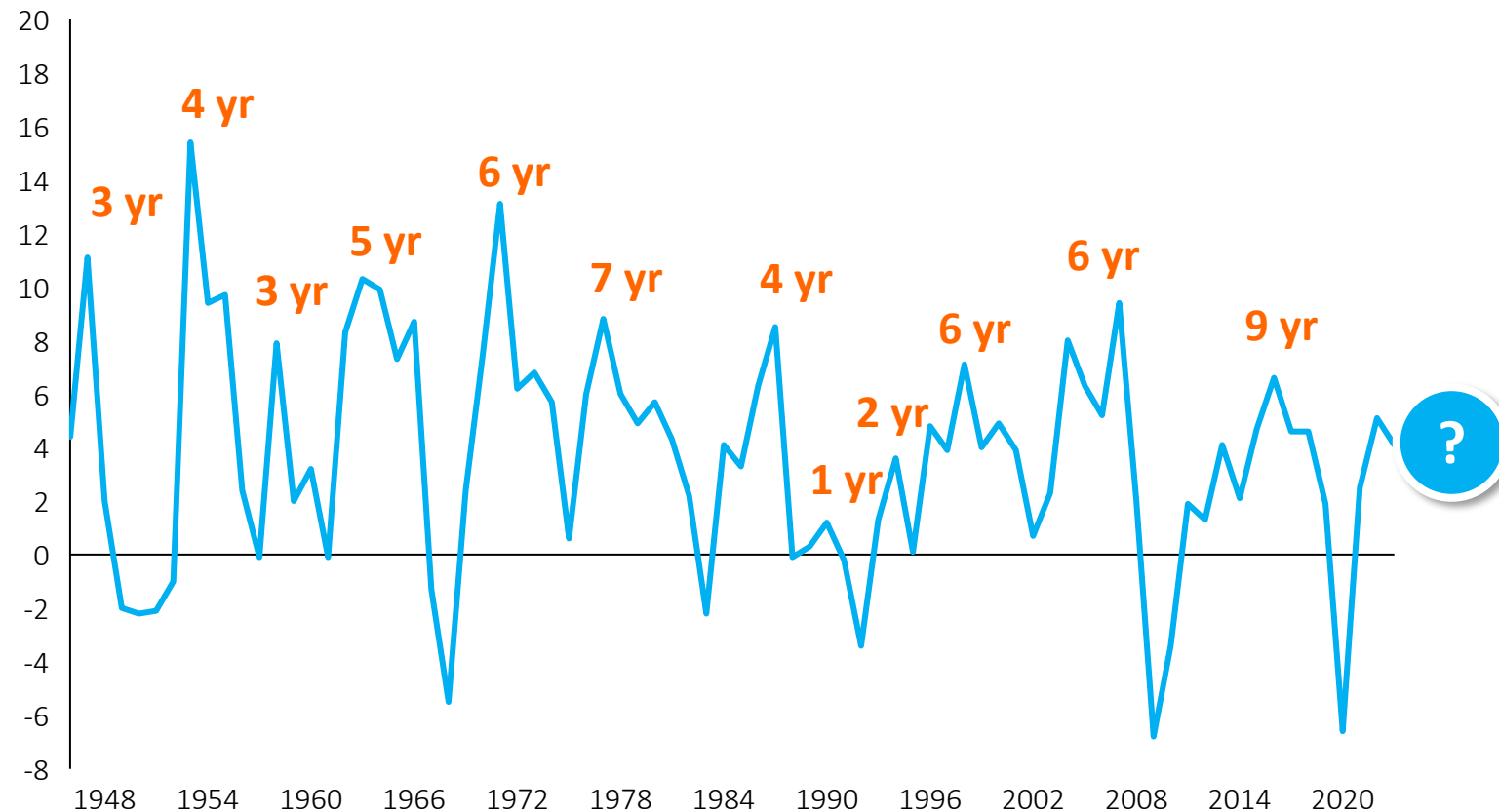
Source: UNCTAD, Statistics Iceland, National Economic Institute



Significant Business Cycle Fluctuations. As a small open economy, Iceland tends to be more volatile than other larger economies. The latest period of economic growth is one of the longest in Icelandic history, a total of 9 years, halted by the pandemic. The economy contracted by 6,6% in 2020, but is expected to grow by 4% on average in the next 3 years.

GDP growth from 1946

% real change in GDP



Periods of continuous growth¹

1946-1948	3 yr
1953-1956	4 yr
1958-1969	3 yr
1962-1966	5 yr
1969-1974	6 yr
1976-1982	7 yr
1984-1987	4 yr
1990	1 yr
1993-1994	2 yr
1996-2001	6 yr
2003-2008	6 yr
2011-2019	9 yr

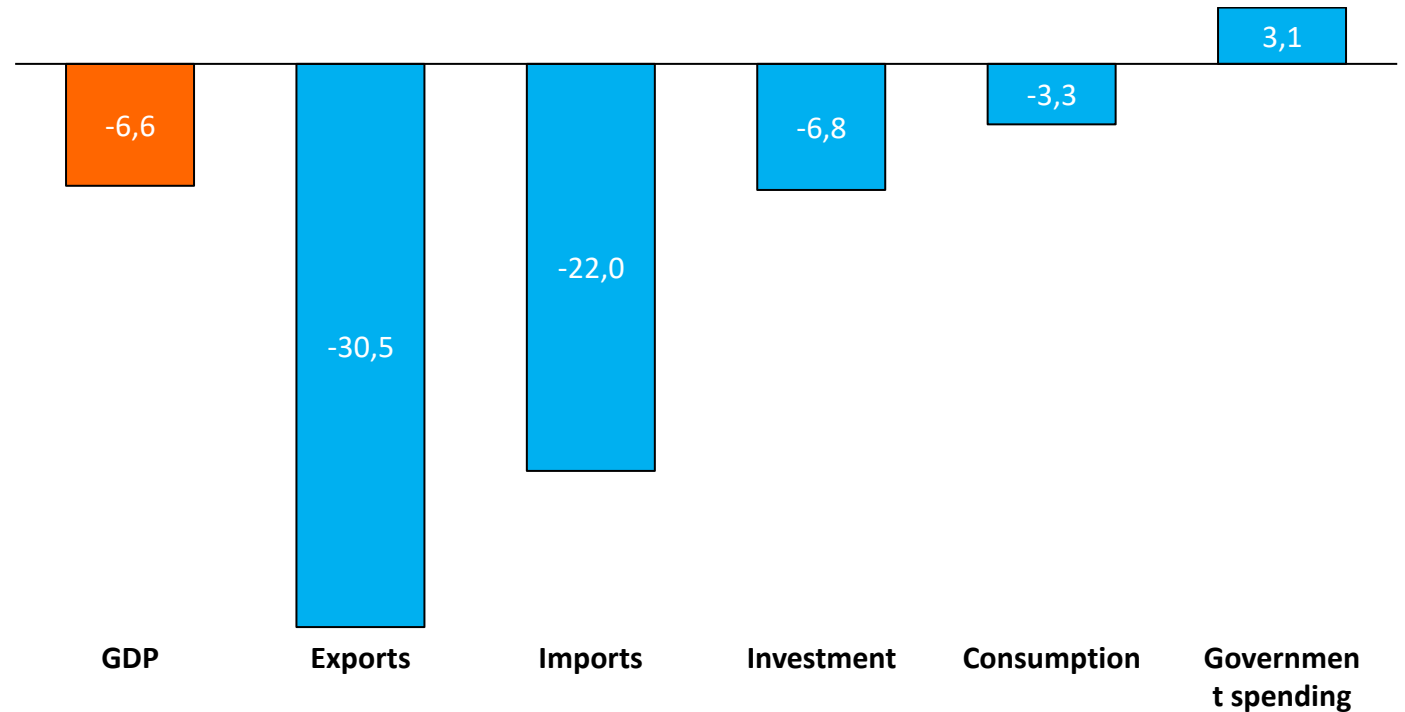
Unprecedented Times Socially and Economically. The second quarter of 2020 brought the largest quarterly GDP contraction ever measured in Iceland. The economic impact of social distancing was most notable in foreign trade. GDP contracted by 6,6% in 2020, substantially less than the -8% which had been expected.



- Travel limitations severely restricted both imported and exported services, while domestic social distancing measures had a large impact on the demand for goods and services.
- Private consumption decreased by 3%, less than expected due to increased domestic demand, with obvious effects from decreased mobility and business closings.
- An increased level of uncertainty is likely to at least partly explain the severe contraction in business investment.

GDP and components

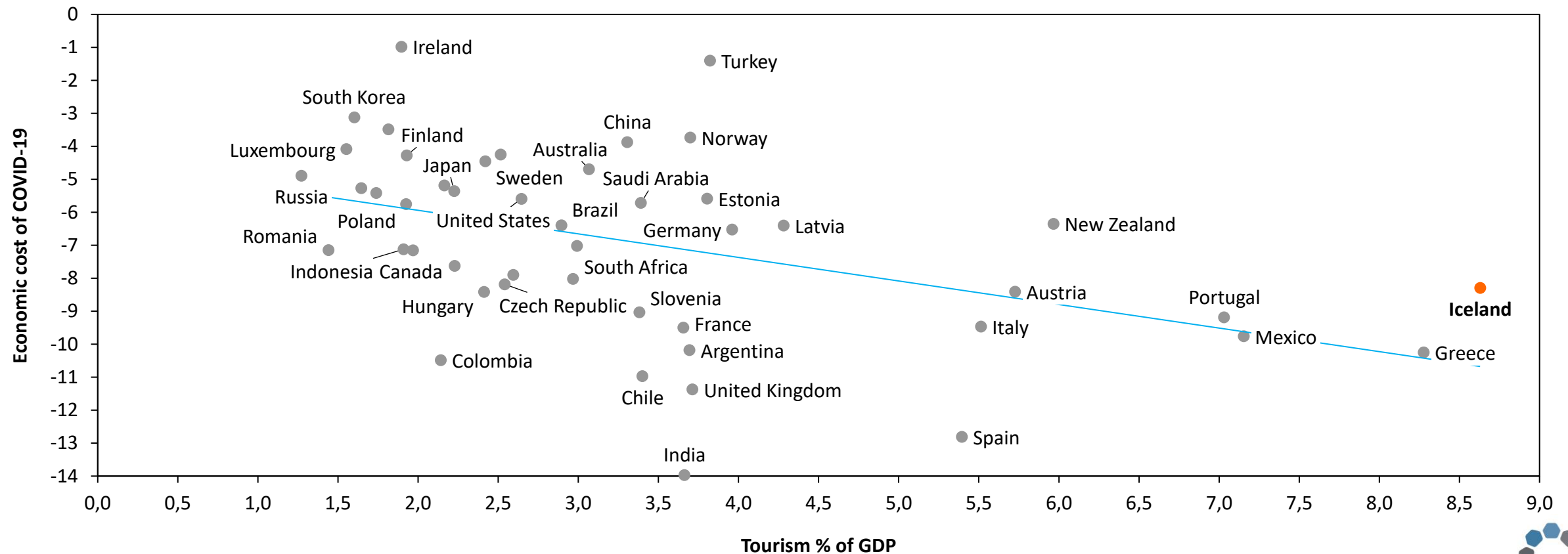
Real yearly change (%)



Iceland severely hit by COVID-19 due to the importance of tourism. Tourism grew fast after the GFC and made up 42% of Icelandic exports in 2017. However, following COVID-19 tourism's share of exports shrank to 12%. Yet, the economic impact of COVID-19 is still less than might be expected with regards to reliance on tourism.

Tourism and the economic cost of COVID-19

Economic cost defined as the difference in actual in GDP growth and 2020 GDP IMF forecast prior to the pandemic.

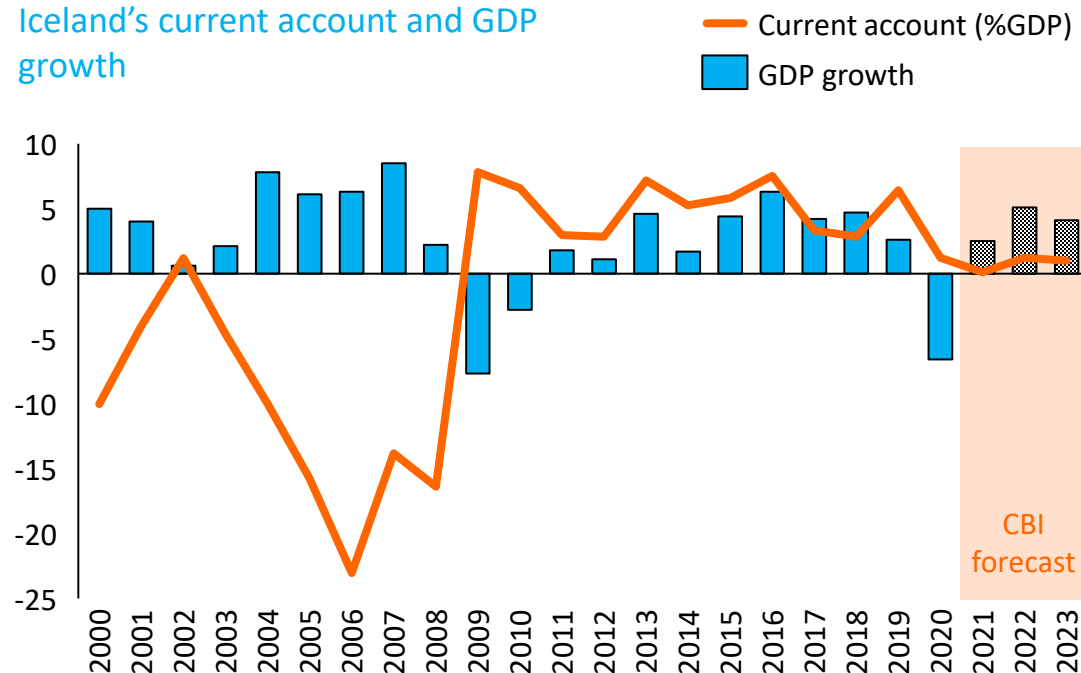


Based on average quarterly growth Q1-Q4, YoY, in 2020, where available. Tourism share of GDP in 2018.
 Source: IMF, World Travel & Tourism Council, UNCTAD, Statistics Iceland, National Economic Institute, Staff calculations



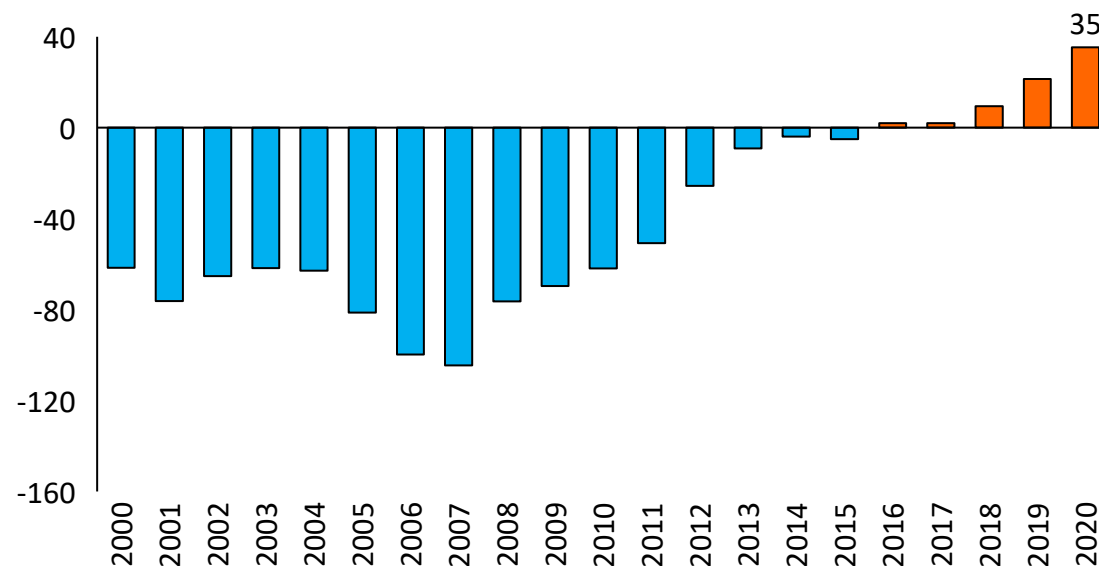
Strong Growth in Recent Years a Result of a Healthier Economy. Iceland exhibited a current account surplus in 2020, for the 12th year in a row. This is in contrast of most recorded history which has been characterized by persistent deficits, reflecting stronger fundamentals. NIIP has also turned positive. This has helped make room for effective COVID response.

Iceland's current account and GDP growth



Iceland's net international investment position (NIIP)

End of period, % GDP



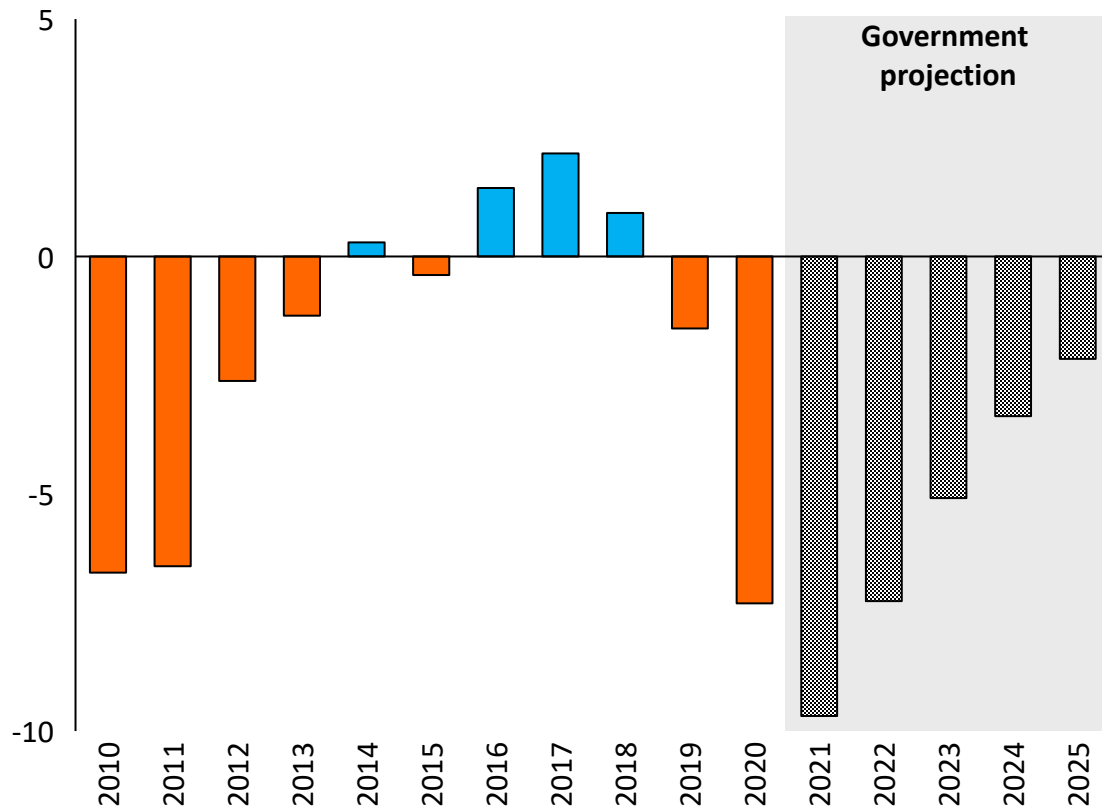
Net foreign assets

Following the restructuring of the banking system in the aftermath of the financial crisis, and years of current account surplus the NIIP turned positive. Iceland has gone from being a net borrower to a net lender to the rest of the world.

Iceland Has in Recent Years Been Among the Few Developed Countries with a Positive Government Balance. Rapid economic growth has strengthened government finances and lowered debt. Policy responses due to the pandemic have had a severe impact on fiscal balances and debt expected to increase at least until 2025.

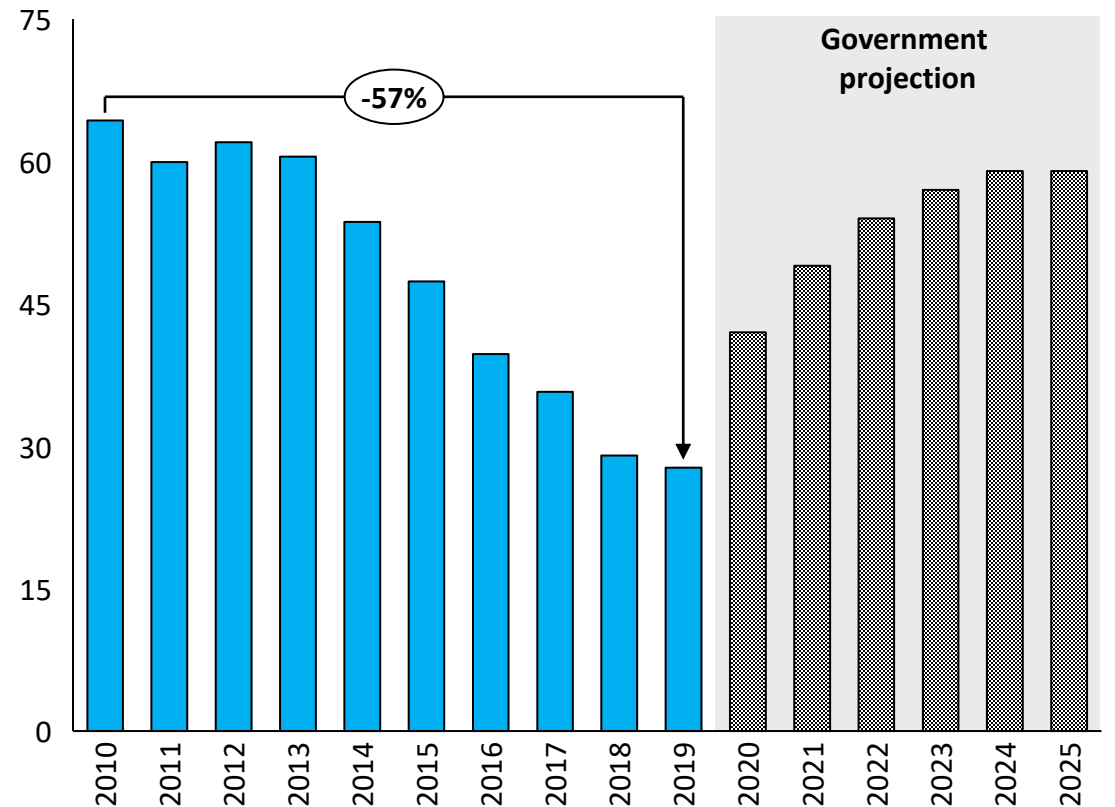
Government balance¹

% GDP



Government debt

% GDP



Source: IMF, Statistics Iceland & Central Bank of Iceland

1: Excluding the stability contribution of fallen financial institutions and the special contribution to LSR in 2016

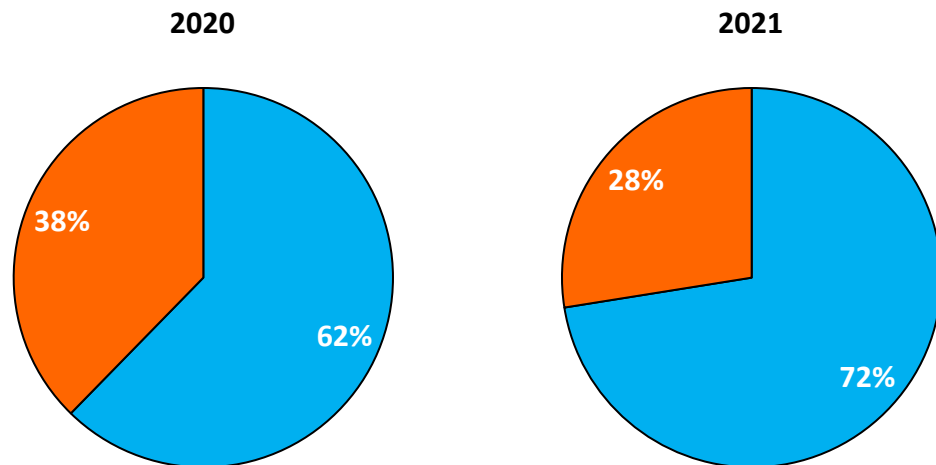


Automatic Stabilizers The Key Players of The COVID Response . Instead of raising taxes the government has allowed the basic features of public finances to carry out their intended purpose, where income has decreased while expenses increase. When looking at direct counter measures households have benefited the most from the government’s response.

Effects of COVID-19 response on government balance

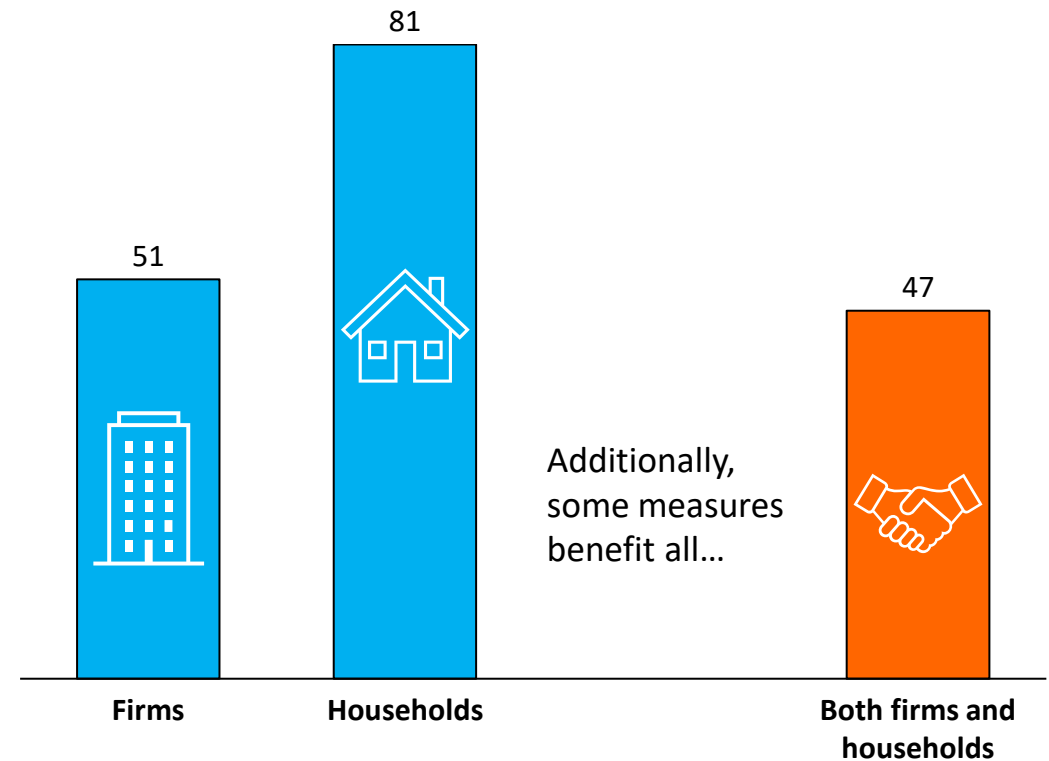
Share of change in government balance from pre-COVID-19 budget

■ Revaluation & automatic stabilisers ■ Counter measures

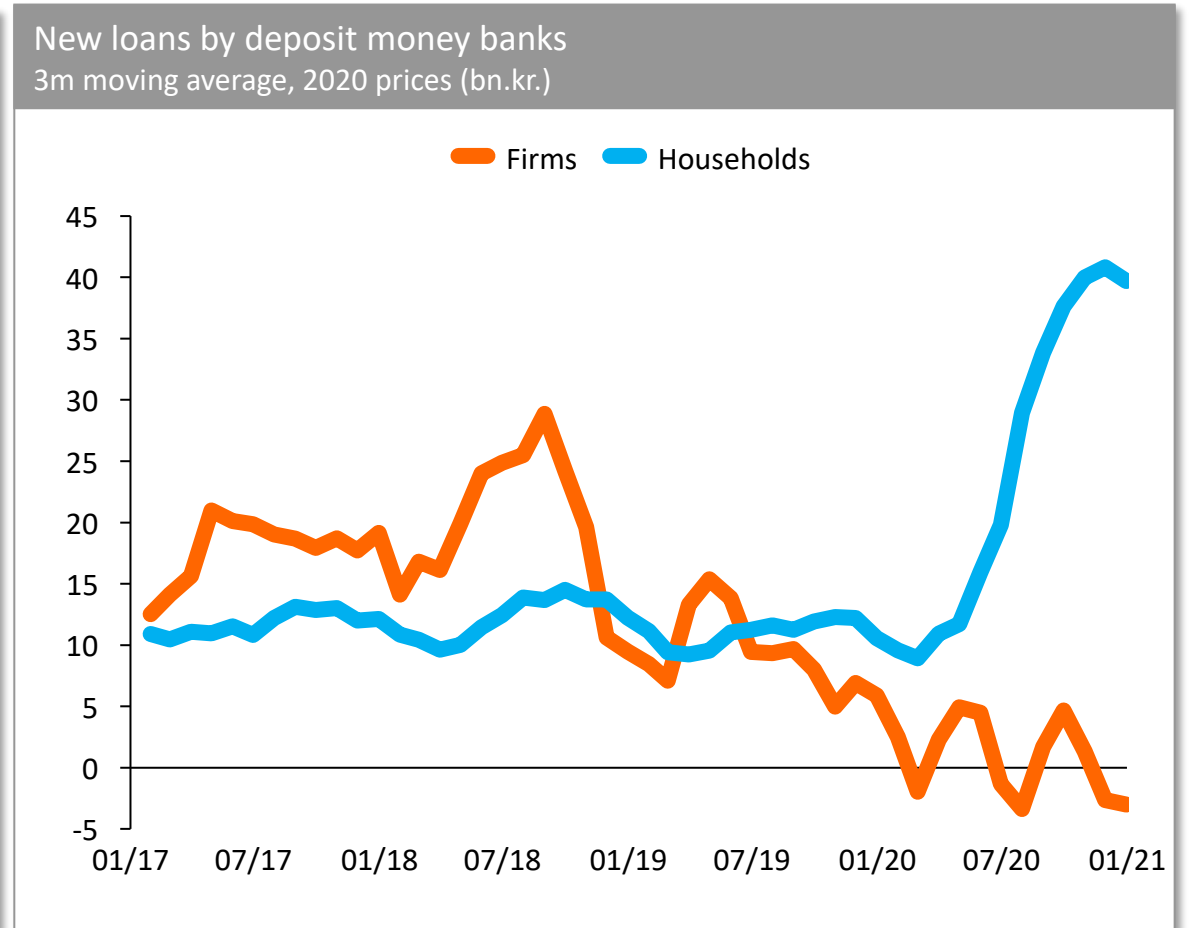
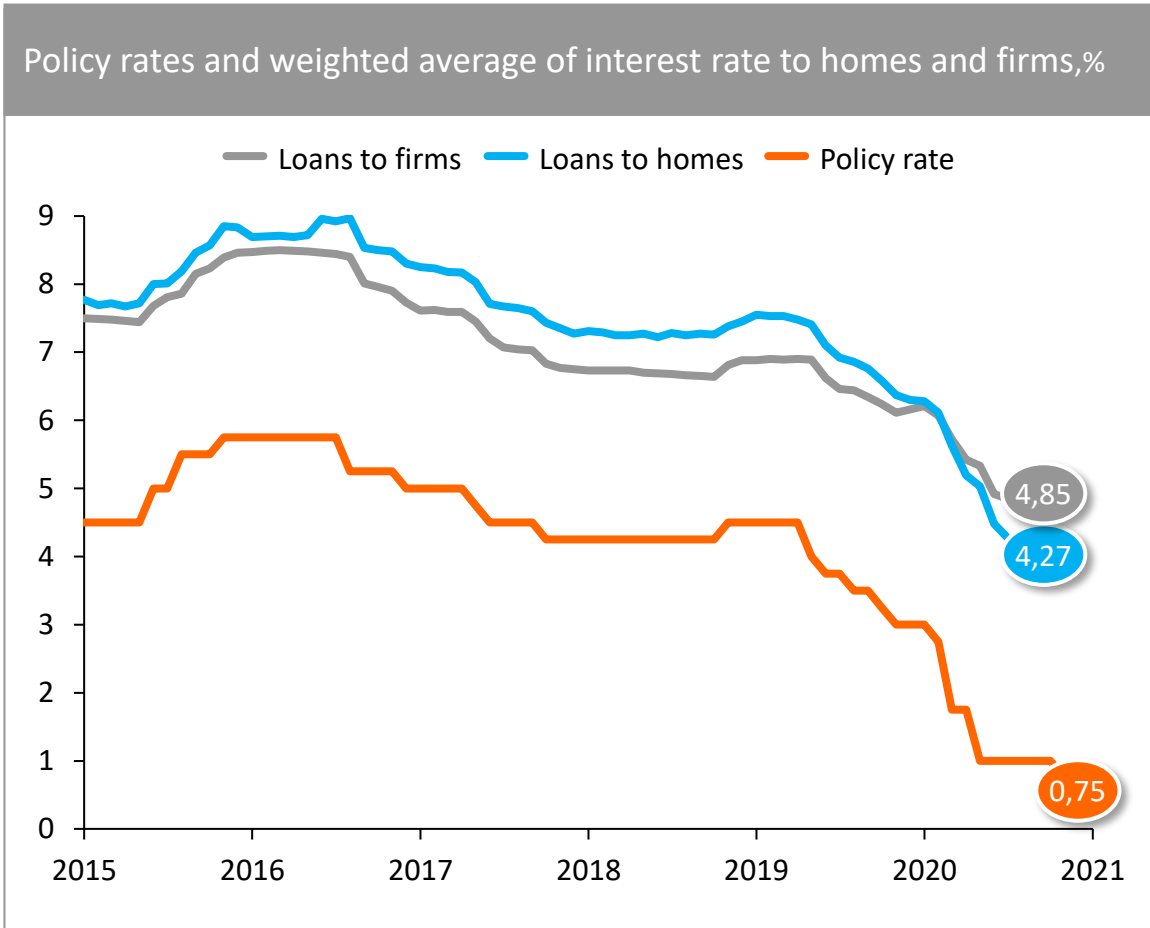


Beneficiaries of government policy responses

Bn. Kr.



The Central Bank Has Responded by Lowering its Rates. Although the Central Bank lowered rates by 2,25 pp, interest rates to firms have not decreased accordingly. Meanwhile interest rates on mortgages have lowered substantially, with positive effects on the disposable income of households.



Source: Central Bank of Iceland, staff calculations



Inflation Has Stayed Close to Target in Recently but Currently Above Target. This success comes in spite of a 56% wage increase since 2015, resulting in a 36% increase in purchasing power. One-off factors have helped to explain this recently found stability.

Iceland's economic history is tainted by price instability. This trend has been turned around in recent years. Many things have contributed to this success, e.g.:



Increased competition in retail due to the arrival of international retailers lowered prices.



Many custom duties and excise taxes were abolished in recent years.



Terms of trade improved dramatically with the surge of tourism, which also increased production.



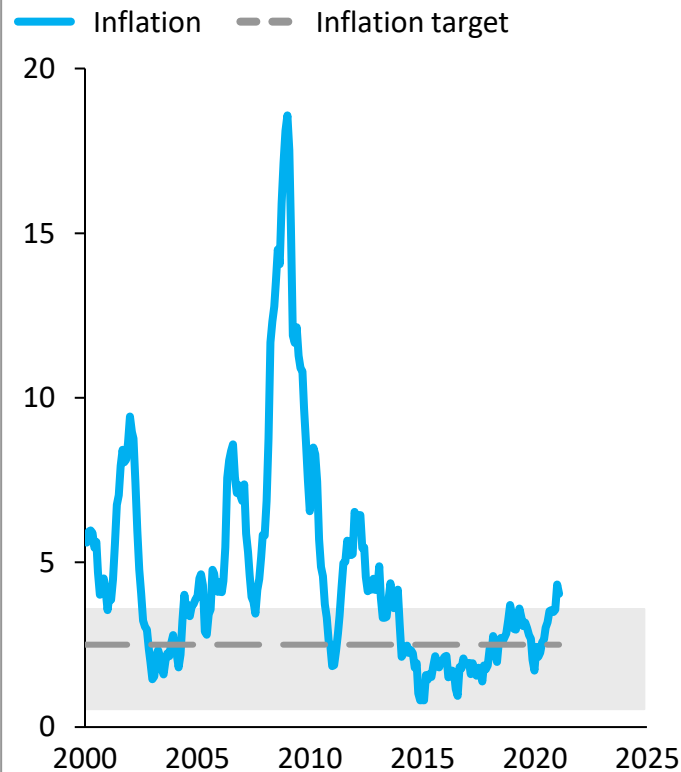
As a result, the króna also appreciated and has remained relatively stable throughout, with support from the Central Bank.



The Central Bank accumulated foreign reserves whilst the economy has accumulated foreign assets. Stronger economic foundation is thus one of the biggest factors.

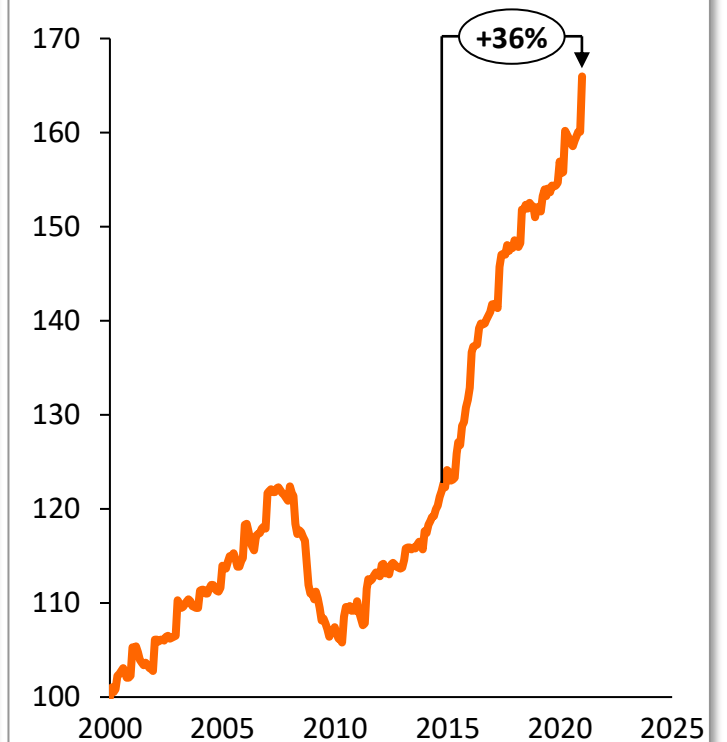
Inflation and the inflation target

Year on year change (%)



Purchasing power

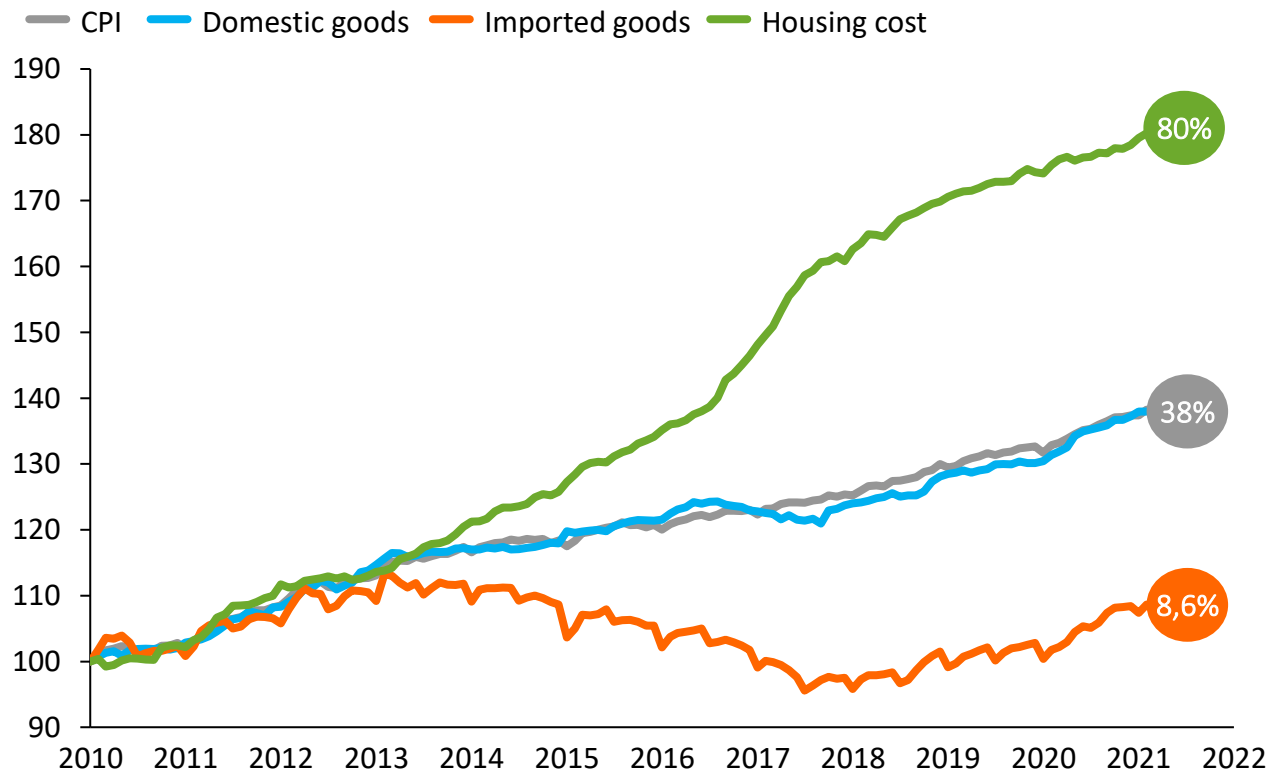
Index, 2000 = 100



Yet, Iceland Is Among the Most Expensive Countries in the World; but no longer the most expensive in Europe. Historically, main drivers of inflation have been imported goods and housing cost. Inflation is currently above target but is expected to decrease fast as pass-through effects of depreciated króna die out.

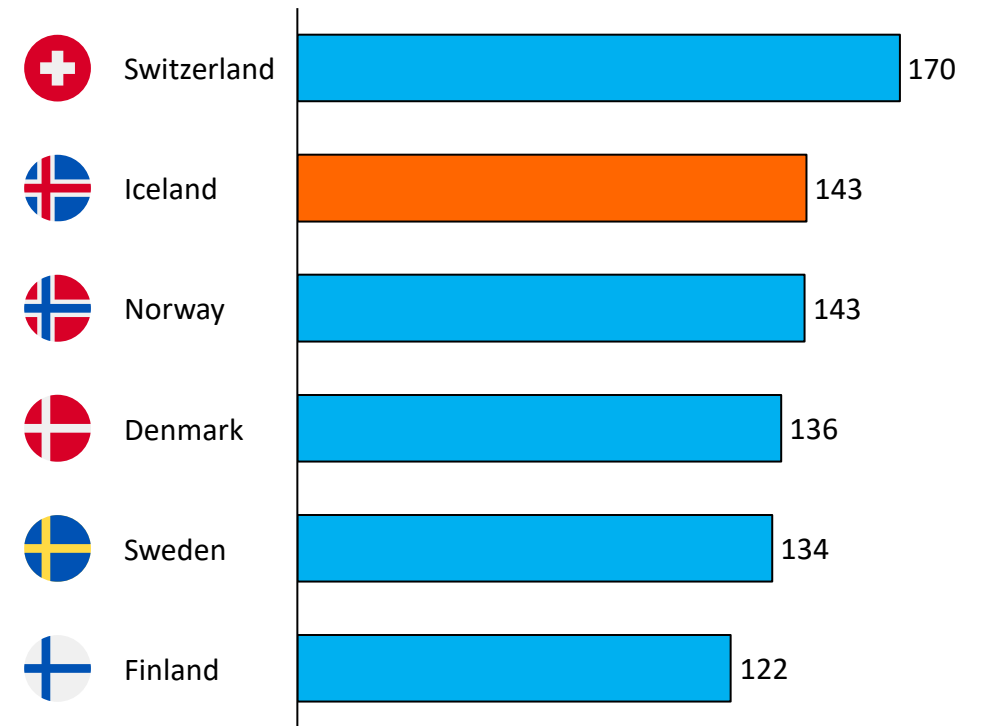
Main drivers of inflation

Index (Jan 2010 = 100)

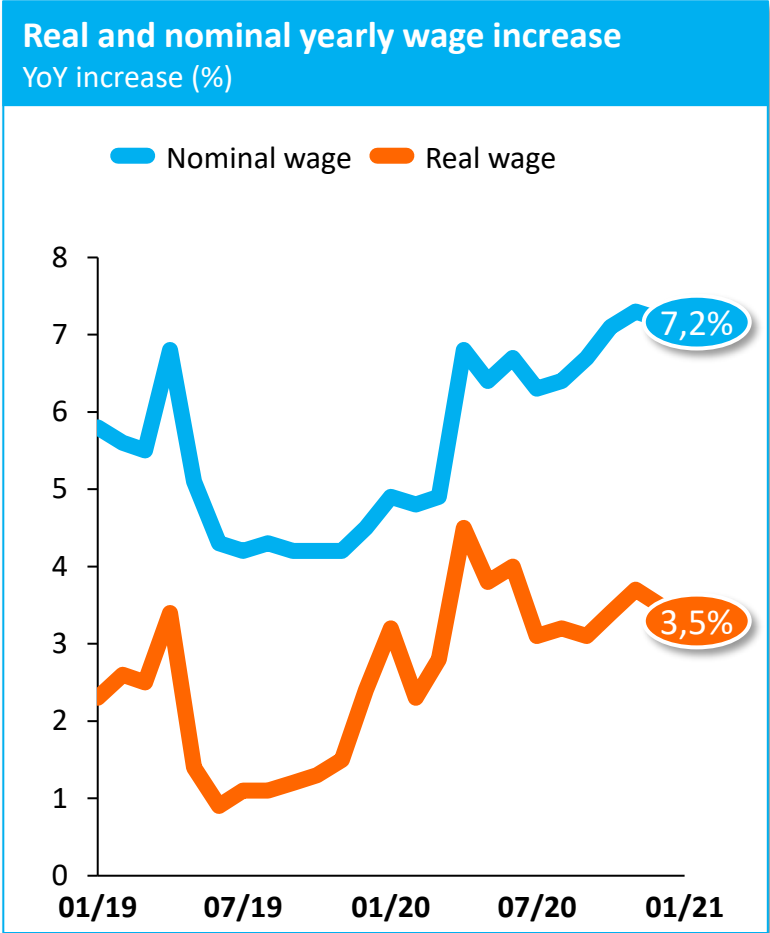
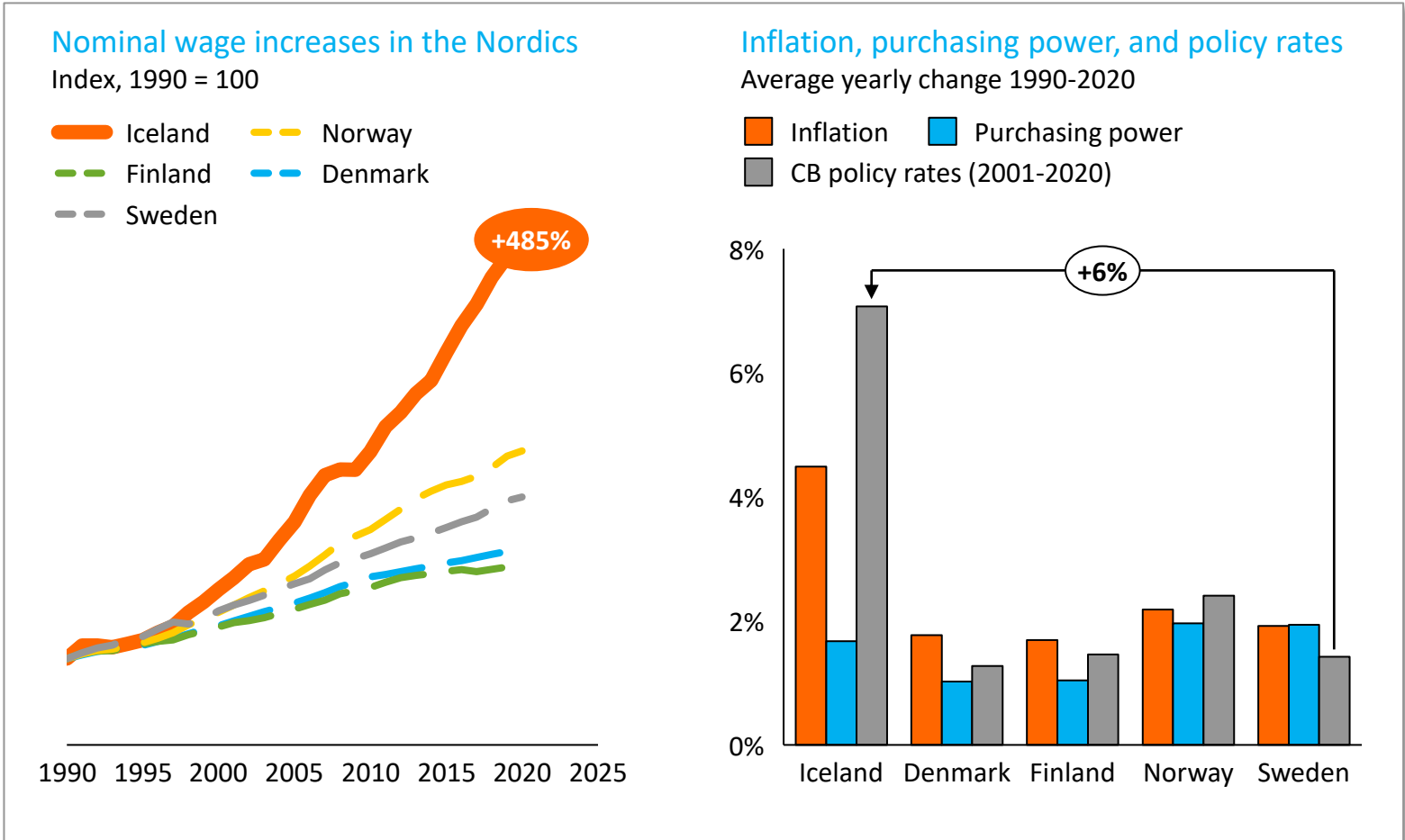


Relative price level

January 2021 (EU27 = 100)



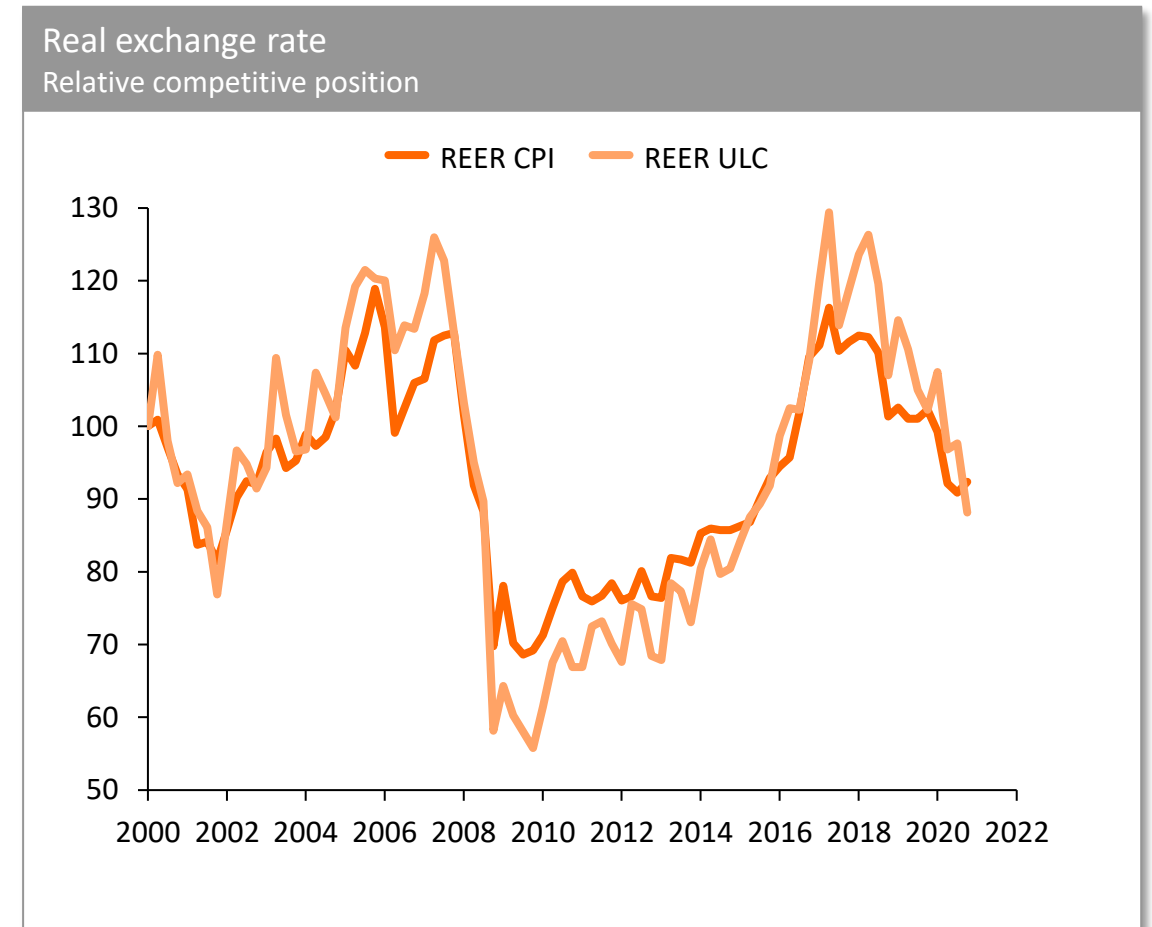
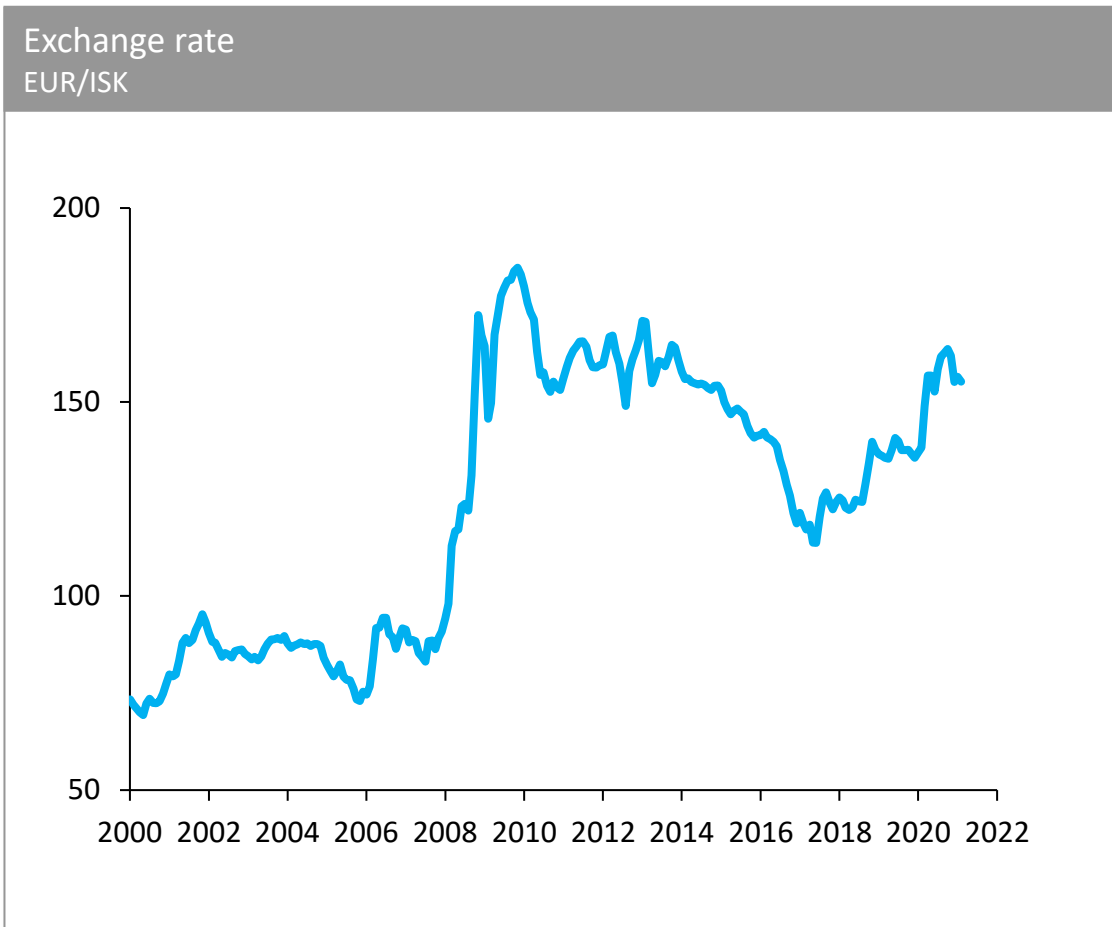
The Icelandic Wage Bargaining Model. Wages in Iceland have increased almost four times more than wages in the Nordic countries in the last 30 years. The result is generally higher inflation and higher policy rates. On average, wages increased by 3,4% in 2020 despite rising unemployment rates across most sectors.



Source: Macrobond, Directorate of Labour, Statistics Iceland



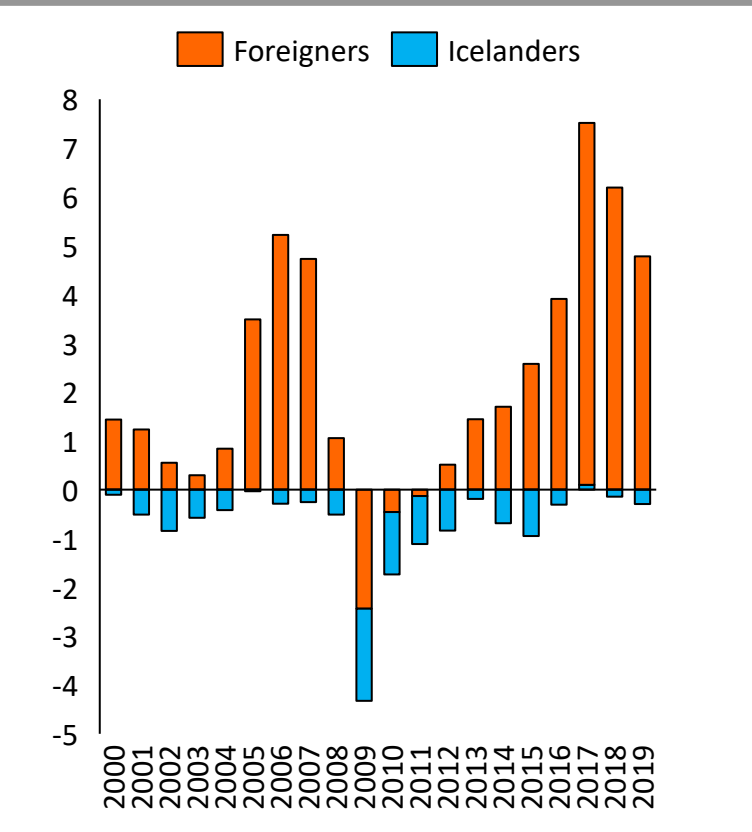
The Króna Poses a Threat to Competitiveness; Yet an Important Security Valve. The competitiveness of exporting industries diminished considerably due to a strengthening króna in the years prior to the pandemic but has recovered more recently. The currency will most likely play a big role following the COVID-19 crisis.



Imported Labour Alleviates an Otherwise Tight Labour Market. In recent years, foreigners have migrated to Iceland in search of opportunities. This group is heavily hit by unemployment following the pandemic.

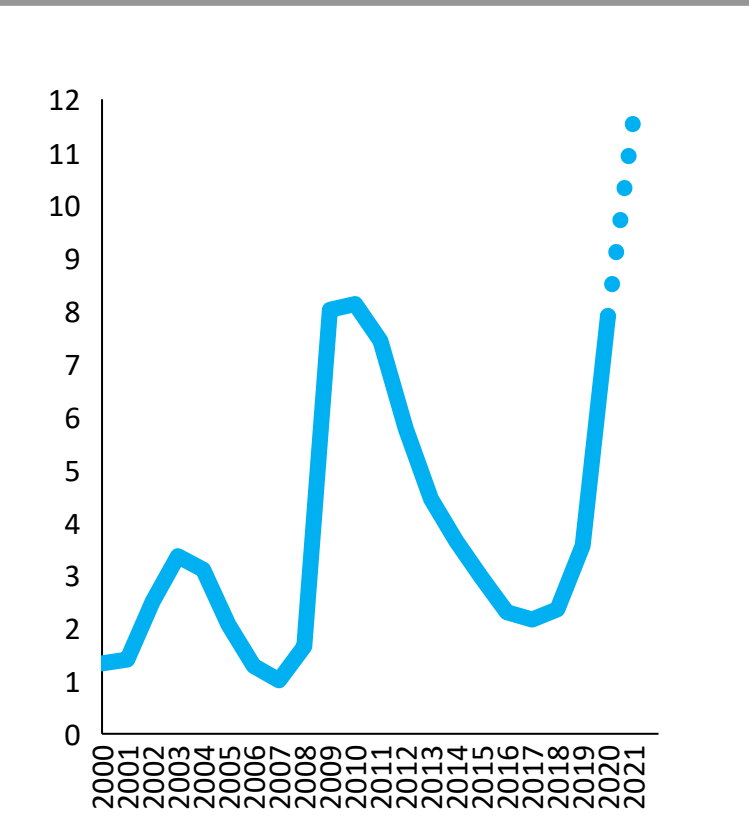
Net import of labour

Labour force: persons 16-74 yr. old (thousands)



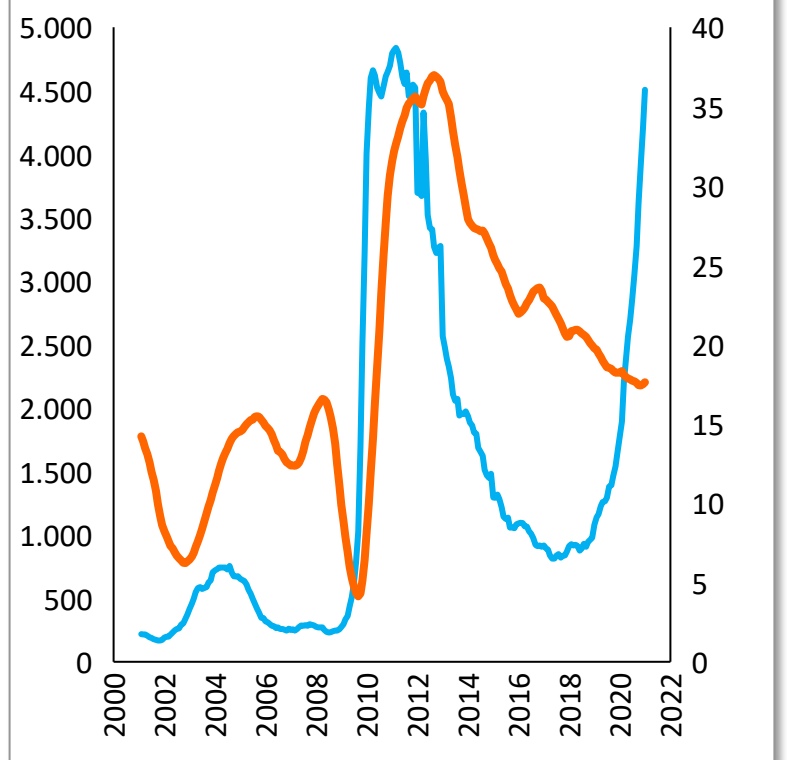
Average monthly unemployment rate

Excluding reduced employment (%)



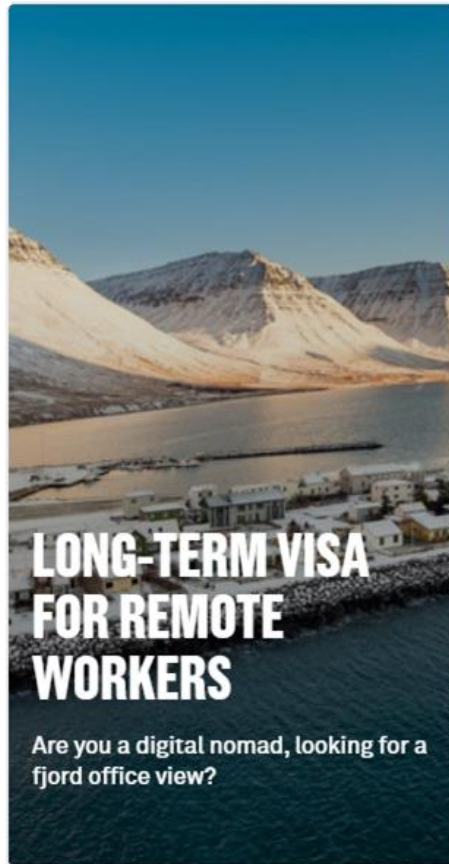
Long term unemployment

— % of total (12m mov. avg, right) — Total (left)



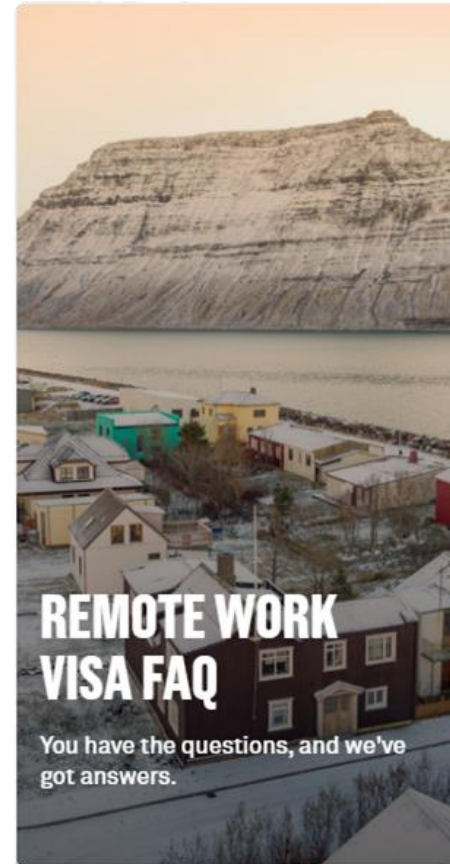
WANT TO WORK IN ICELAND?

Iceland is not as far away as you think! Ideally located between Europe and North America, Iceland is a vibrant and progressive place to live and work. The business landscape is diverse, with many sectors regarded as leaders in their field.



LONG-TERM VISA FOR REMOTE WORKERS

Are you a digital nomad, looking for a fjord office view?



REMOTE WORK VISA FAQ

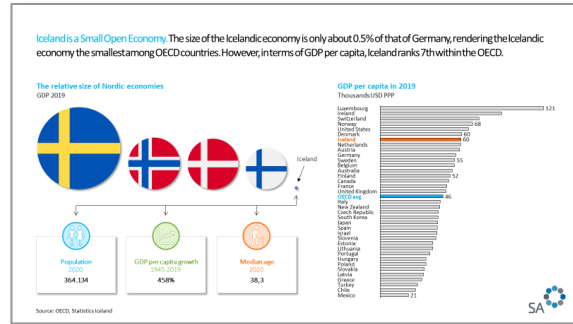
You have the questions, and we've got answers.



TAX DISCOUNT FOR FOREIGN EXPERTS

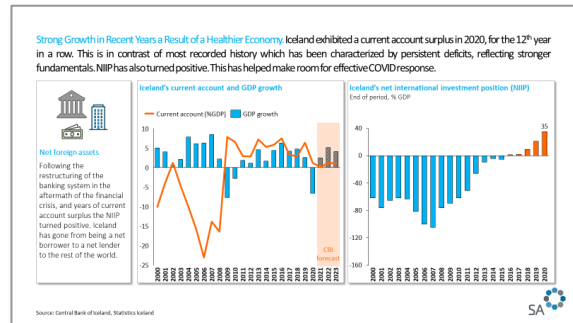
Every króna counts!

Iceland Has Many Things to Offer. Going forward, it is important we maintain and support sound economic fundamentals, as well as providing future industries with room to grow and prosper.



High standard of living

- GDP per capita grew x% between 2011 and 2019, leaving Iceland among the countries with the highest standard of living in the world.
- Despite significant wage increases in recent years inflation has been low, resulting in a substantial growth in purchasing power among households, increasing quality of life.



Strong economic foundation

- In the last economic upswing, growth of new exporting industries made ground for stronger general economic foundations.
- Government debts were lowered, current account surplus generated and NIIP turned increasingly positive. In addition, policy rates lowered significantly.
- This has helped Iceland battle the COVID-19 crisis and made room for adequate government response.



Green energy and sustainability

- Iceland has been successful in utilising its natural resources.
- Majority of electricity and domestic heating stems from renewables, and main exporting industries rely on nature in one way or the other.
- Future growth opportunities lie, for example, in increasing the use of renewable energy in exports, as well as in the pharmaceutical and intellectual property industry.

