The Icelandic Economic Situation
Status Report - July 2013
The Icelandic Economic Situation - Status Report

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Up to Date Reports and Slides
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About the Iceland Chamber of Commerce
The Iceland Chamber of Commerce (ICoC) is a voluntary association of companies and individuals with the mission of improving the operating environment of business in Iceland and to increase economic prosperity.

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The Icelandic Economic Situation
Status Report - July 2013
Republic of Iceland

The Icelandic Economic Situation

The language is Icelandic

Inflation in May 2013 was 3.3%  
Fiscal deficit in 2012 was 1.5%  
Unemployment in Q1 2013 was 5.8%

Investment in 2012 was 12,3%

Per capita GDP in PPP terms in 2012 was 37,800

The capital is Reykjavik

The population is 320,000

The monetary unit is Króna (ISK)

Figure 1 Iceland’s ranking in various competitiveness lists.

<table>
<thead>
<tr>
<th>Index</th>
<th>2012 Ranking</th>
<th>No. of Countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gender equality (WEF)</td>
<td>1</td>
<td>134</td>
</tr>
<tr>
<td>Global Peace Index</td>
<td>1</td>
<td>157</td>
</tr>
<tr>
<td>Media Freedom (Freedom House)</td>
<td>19</td>
<td>170</td>
</tr>
<tr>
<td>Corruption (Transparency Int.)</td>
<td>11</td>
<td>163</td>
</tr>
<tr>
<td>Human Development (UN)</td>
<td>13</td>
<td>173</td>
</tr>
<tr>
<td>Doing Business (WB)</td>
<td>14</td>
<td>171</td>
</tr>
<tr>
<td>Prosperity Index (Legatum)</td>
<td>15</td>
<td>127</td>
</tr>
<tr>
<td>Country Brand Index</td>
<td>22</td>
<td>96</td>
</tr>
<tr>
<td>Economic freedom (HF)</td>
<td>23</td>
<td>154</td>
</tr>
<tr>
<td>Competitiveness (IMD)</td>
<td>29</td>
<td>31</td>
</tr>
<tr>
<td>Competitiveness (WEF)</td>
<td>30</td>
<td>114</td>
</tr>
<tr>
<td>Economic freedom (Fraser)</td>
<td>65</td>
<td>79</td>
</tr>
</tbody>
</table>

Source: Institute websites
The main religion is Lutheran, with 80% followers.

The geographic size is 100,000 km².

GDP Growth in 2012 was 1.6%.

Per capita GDP in PPP terms in 2012 was 37,800 USD.

Useful websites

- Central Bank of Iceland
- Parliament of Iceland (Althingi)
- Government of Iceland
- Statistics Iceland
- OMX Nordic Exchange in Iceland
- Government Debt Management
- Promote Iceland
- National Association of Pension Funds
- Invest in Iceland Agency
- Financial Supervisory Authority
- The Official Gateway to Iceland
- Icelandic Fisheries
- World Bank (Iceland)
- Iceland Chamber of Commerce
The Icelandic Economic Situation
Introduction

In 2008 the Icelandic economy went through dramatic changes with the collapse of its financial sector. Due to lack of external information flow, misconceptions developed concerning the sequence of events and the status of the economy following the crisis. This Status Report aims to give a factual description of the events leading to and following the financial crisis as well as a summary on the current economic, business and political landscape in Iceland. Despite substantial difficulties, general economic activity is well functional and most Icelandic businesses remain strong and prosperous.

Since October 2008, Iceland Chamber of Commerce has regularly published its Status Report on the development and status of the Icelandic economy. This is the 16th edition. Major revisions were made in the 13th and 14th version, where many graphs, charts and pictures were added. Considerable changes have been made in this edition, with more focus on the current economic landscape, on-going challenges and future prospects and less focus on past events.

The report is a collection of facts, data and references to websites rather a deep economic analysis on Iceland. The report includes hundreds of links which form its foundation. More detailed information on the banking collapse and its immediate consequences can be found in the earlier versions, in particular the 15th edition. The most up to date slides, raw data, figures and Status Report can be accessed here: www.chamber.is/statusreport.

Overall Iceland is gradually on its way out of the recession. In the past two years Iceland has experienced a positive growth of 2,9% in 2011 and 1,6% in 2012. Iceland’s main challenges at the moment are external funding, capital controls, low employment growth rates and price instability.

Status Highlights

Positive developments

- Stock market picking up, 6 new listings
- No state guarantee on Icesave
- Iceland finished the IMF program
- The state reimbursed a part of the IMF loan and issued foreign bonds
- Public Finances recovering
- Large current account deficits been eliminated
- Banks issued listed bonds
- Credit ratings on the rise with stable outlook
- Banks share in companies decreasing
- Real estate prices slowly moving up
- The Icelandic Growth Forum ongoing

Ongoing challenges

- Capital controls still in place
- Household and corporate debt still too high
- Public debt close to 100%
- State Housing fund halters
- Fiscal surplus delayed until 2014
- Resolution of the old banks unresolved
- Investment still under historical norm
- Iceland’s competitiveness decreasing
- Employment not picking up as unemployment is going down
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Managed Services
Cloud Services

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Contact info: info@advania.com  www.advania.com/datacentres
1 Overview

In 2013 Iceland is still working its way out of the recession. With positive GDP growth two years in a row (2011 and 2012) Iceland is on the right path even though growth has slowed down (0.8% Q1 2013) and growth projections have been reduced for 2013 and 2014.

1.1 The Financial Sector

Significantly smaller system

The complexity and the large relative size of the banking sector were the most significant contributors to Iceland's high risk exposure before the financial crisis. Aggregated balance sheet of the Icelandic banking system was 11 times the GDP at its peak, compared to 2 times the GDP today.

Not only is the banking system much smaller than before but also simpler. The sector’s stake in Icelandic businesses is significantly lower than in previous years, with the banks currently holding shares in 83 companies where only 13 of them have any on-going business in Iceland. Nonetheless, the Icelandic Competition Authority (ICA) still considers it a high priority for the financial system to sell these shares in order to promote competition and minimize market distortions. See here, here (p. 12 only in Icelandic) and here for Nordic report on competition.
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Risk has declined

Risk in the financial system has declined over the past year according to the latest issue of Financial Stability published by the Central Bank of Iceland (CB). Uncertainty regarding the impact of the Supreme Court ruling on foreign denominated loans has been reduced and the ruling is not considered likely to alter financial stability, see here.

Nonetheless, the banking sector has yet to reduce further the share of non-performing loans (NPL). The share of NPLs fell from 18% of all loans in late 2010 to 8% in late 2012, compared to 1-2% for a bank with a healthy loan portfolio as is mentioned in the OECD 2013 Economic Survey for Iceland, see here.

In March 2012 the Ministry of Industries and Innovation (former Ministry of Economic Affairs) published a report on the Future Structure of the Icelandic Financial System. Furthermore, the Ministry published another report on Framework for Financial Stability in Iceland, see here and here. In February 2013 the FSA held a press conference, where its conclusions from investigation of issues connected to the banking collapse were presented, see here.

Markets slowly opening

International and domestic market funding seems to be gradually opening for Icelandic banks. In February 2013 Arion Bank completed a bond offering in Norwegian kroner (NOK) in a contract arranged by Pareto Öhman, see here. In March 2013 Islandsbanki was the first of the three big banks to list commercial papers, see here.

Unresolved matters

As mentioned in Part C Developments 2009-2012 the Housing Finance Fund (HFF) has received sizeable amount of financial contribution due to its operation loss, see here for its 2012 financial statement. The HFF has a State guarantee that amounts to ISK 942 billion or 71% of all State guarantees see here, chapter 7, for further information.

In April 2013 a special committee set up by the Ministry of Welfare issued its report on the HFF future prospects and role, see here (only in Icelandic).

Figure 3 The banks equity ratio, end of year 2011 and 2012.

![Figure 3: The banks equity ratio, end of year 2011 and 2012.](source: Icelandic State Financial Investments)

Figure 4 The State’s holdings in financial institutions.

<table>
<thead>
<tr>
<th>Financial institution</th>
<th>Share</th>
<th>Possible timing of sell 2013</th>
<th>Possible timing of sell 2014</th>
<th>Permission to sell according to law</th>
<th>Book value (ISK million)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>First</td>
<td>Second</td>
<td>First</td>
<td>Second</td>
</tr>
<tr>
<td>Savings bank</td>
<td>49,5-86,3%</td>
<td>half</td>
<td>half</td>
<td>half</td>
<td>half</td>
</tr>
<tr>
<td>Islandsbanki</td>
<td>5,0%</td>
<td>half</td>
<td>half</td>
<td>half</td>
<td>half</td>
</tr>
<tr>
<td>Arion banki</td>
<td>13,0%</td>
<td>half</td>
<td>half</td>
<td>half</td>
<td>half</td>
</tr>
<tr>
<td>Landsbankinn</td>
<td>97,9%</td>
<td>half</td>
<td>half</td>
<td>half</td>
<td>half</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Icelandic State Financial Investments

Some challenges have emerged regarding settlement and repayment terms between Landsbankinn and the old Landsbanki (NBI), which is currently going through administrative liquidation.
The two parties have agreed that Landsbankinn will prepay a quarter of the principal of so-called A-bonds, see here. However, general payment terms will have to be renegotiated, mainly due to shortage of foreign currency required to service pre-agreed payment schedule. Landsbankinn has already formally asked NBI to start the negotiations.

Finally, there is still uncertainty on whether the Government will sell its shares in the new banks and under what terms. In that context, it should be noted that IMF released an update to the Systematic Banking Crises Database in June 2012. The report says „In terms of fiscal costs, the still ongoing banking crisis in Iceland and Ireland already rank among the ten costliest crises”. The report can be found here.

1.2 Banks in Administrative Liquidation Procedure

All three former major banks are still in Administrative Liquidation Procedure. Estimated recovery of NBI’s asset portfolio has gradually increased, see here, and it has paid more than 50% of priority claims to Icesave creditors, see here. Information on Kaupthing and Glitnir can be found here and here.

Furthermore, at the end of January 2013 the EFTA Court ruled that the Icelandic government was not obligated to reimburse the UK and Dutch authorities for their contribution to Icesave depositors, see here. Click here for Moody’s opinion and the 2012 edition of this report, where chapter 13 and appendixes 8-10 include more information on the Icesave conflict.

Finally, the CB has increased its control on the outflow of foreign exchange. An amendment of Foreign Exchange Act on March 13th 2012 rescinds the exemption for payments form a bankruptcy estate and payments for contractual claims in accordance with composition of creditors agreement in domestic currency when payment is disbursed from the payer’s account with a financial institution in Iceland, see here.

The amendment can most likely be attributed to the fact that without greater underlying current account surplus or FDI Iceland will have to refinance or extend the foreign loans in order not to default, see figure 16 in Part B Economic Landscape.

2 The Economy and Business Sector

Stock market on the rise

Since March 2009 the Stock market main index has roughly doubled and six new companies have been listed on the stock exchange:

- Hagar, see here.
- Reginn, see here and here.
- Eimskip, see here and here.
- Vodafone, see here.
- VIS Insurance, see here and here.
- TM Insurance, see here, here and here.
Additionally, six other companies are considered likely to follow, e.g. Skeljungur and N1, both domestic oil distributers and retailers, and Reitir, commercial real estate firm. See here (only in Icelandic), here and here.

Capital controls prolonged

Originally, the CB imposed capital controls in late 2008 due to heavy outflow of foreign currency.

The capital controls were, by law, to be lifted at the end of 2013. However, the law has been changed and lifting of the capital controls will now be based on economic terms. Because of a slowdown in the economy, i.e. lower GDP growth, stagnated employment and limited foreign reserves, the capital controls are likely to remain in place over the next years.

However, the new Prime Minister has stated that the Government aims to remove capital controls and reintroduce a free-floating currency, see here. For further information on the topic, see here, here and the 2012 issue of the Status Report, chapter 16, for more detailed information on the capital controls.

In a special publication on Prudential Rules following Capital controls the CB stated „New rules are to be adopted and existing statutory provisions utilized to significantly reduce domestic financial undertakings’ possibilities to taking deposits in foreign currencies from non-residents”. See here. Lately the CB has not only used the policy rate to stabilize inflation but also actively intervened on the FX market. The CB also published a report on Iceland’s currency and exchange rate policy options, see here.

For further information on the challenges regarding outstanding offshore krona’s and the CB’s mitigating actions, see here and here.

Lower household and business debt level

Households have been severely affected by the recent economic challenges in the form of decline in real disposable income, drop in real estate prices and increased debt levels. Mortgages principals were - to a large extent - linked to either inflation or a basket of currencies (a structure adopted due to high inflation uncertainty). Consequently, the steep drop in the ISK had a significant impact on household balance sheets with principal rising for both currency and inflation linked mortgages.

After challenging years following the financial crisis, housing market is gradually recovering. According to the latest issue of OECD Economic Outlook real estate prices are considered neither too high nor too low at the moment, see here (p. 24) and figure 23 in chapter B. The debt of Icelandic households was slightly above 110% of GDP at the end of 2012, which is lower than Denmark, Cyprus, The Netherlands and Switzerland but higher than Ireland, UK, Norway and Sweden. See here (p. 44).
The new government has declared that lowering household debt is one of their key objectives.

Debt restructuring of corporations has been ongoing for a while and corporate debt is down to 162% of GDP from a peak of 383% in September 2008. Defaults on smaller firms have decreased since the collapse and are around 35%, down from roughly 40%. Defaults of larger firms have decreased more, from 75% to 40%, see here (p. 4 and 5), only in Icelandic.

Wave of Collective agreements

Over 200 collective agreements will expire in 2013-2014, see here. Historically, wage increases from collective bargaining have tended to be beyond what productivity growth enables and thus fuelled inflation.

As an illustration of this challenge, the wage index in Iceland has risen about 80% since 2003 but purchasing power only about 3%. In comparison, these figures for Denmark and Sweden are approximately 25-30% wage increase compared to 12-14% increase in purchasing power over the same period.

Social partners are aware of this and are currently exploring the possibility of adopting a negotiation process based on the model used by other Nordic countries. More information is available in a joint report by the social partners, see here (only in Icelandic).

Trade and investment

Business investment remains well below historical value. This can be contributed to both internal and external factors, most noticeably high uncertainty in the domestic economy and the ongoing crisis in the EU. According to Maplecroft, Iceland is one of the countries that are in most danger due to the Euro crisis, see here. This is attributed to the fact that more than 2/3 of Iceland exports are to Europe. See here for related comment by Danske Bank macro research on the euro area.

A Free Trade Agreement between Iceland and China was signed on the 15th of April 2013 in Beijing. Iceland is the first European country to sign free trade agreement with China. The central aim of the Iceland-China Free Trade Agreement is to promote trade by abolishing tariffs on imports and further enhance economic cooperation between the two countries, see here for further information.

2.1 The Fisheries Sector

Fisheries have been Iceland’s fundamental industry over past decades. It is among the most productive industries in the economy and is highly competitive in international perspective. Although the fisheries system has proven biologically and economically strong, remains politically disputed.
Previous Government submitted a legislative proposal to change the fisheries management system and to implement additional fees in the spring of 2012, see here, here, here and here.

The law was heavily debated and the new Government has already set forth a legislative proposal to change it.

To a large degree, the debate is on the topic of how to share resource rent from fisheries. Although the future solution is likely to include some form of resource tax, it is important that the extent of taxation is balanced. Otherwise, the fees could impede the sector’s fundamentals and therefore its efficiency. Maintaining these strengths is critical given the highly regarded status of the sector in international comparison. See here for further information on the fishing industry.

Fish farming is a growing sector globally and investment in the Icelandic fish farming sector has been increasing, (here and here), although the performance has not been in accordance with forecasts. In 2006, total production was around 10 thousands metric tons. Due to fish diseases the production shrank to 5 thousands metric tons and has not increased dramatically since then, see here (only in Icelandic).

### 2.2 The Energy Sector

Renewable energy remains one of Iceland’s core strengths. Energy production has enabled the country to attract energy intensive industries while simultaneously supplying households and firms with energy at affordable prices.

Geothermal energy has caught increasing attention in recent years. An example of this is a meeting and a workshop on cooperation in geothermal issues with representatives of government and industry from Iceland, Japan and the European Union, in Brussels the first week in March 2012, see here.

Later in 2012 a handbook on geothermal energy was published. See here and here for the handbook. See also here for information of Iceland being the key partner in extensive development project on geothermal energy.

**Aluminum an important pillar**

Aluminum is one of the three main exporting sectors in Iceland along with fisheries and tourism. The export revenue of aluminum in 2012 was ISK 225 billion and it is estimated that around ISK 90-95 billion remains in the economy. See here for further information on the economic impact of the aluminum sector in Iceland.

Constructions at the new Century Aluminum smelter in Helguvik (South-West of Iceland) have been delayed for several years. One reason being two arbitration cases, one settled in late 2011 and the other in May 2013, see here and here. The company representatives have stated that they hope that the arbitration results will facilitate the construction process.
Among other recent news on heavy-industry projects, the former Government passed a legislative act in Mars 2013, allowing for an investment contract to be signed with PCC SE on a metallurgical grade silicon metal production plant in the North of Iceland, see here for related information.

Rising oil expectations

The National Energy Authority (NEA) has issued two licenses for exploration and production of hydrocarbons in the Dreki Area and one application is pending, see here and here. Norway has been actively assisting Iceland in the oil administration, e.g. by submitting comments to NEA and viewing draft licences. Furthermore, Norway has notified NEA of its decision to participate in both if the issued licences, see here.

Inter-connector feasibility looked into

A Consulting Committee for the Minister of Industry has rendered its recommendations regarding the feasibility of an inter-connector. The committee’s mandate was to analyse the economical, technological and environmental aspects along with the legal environment and relevant treaties. The committee was unanimous in its interim recommendation that additional information would be required before concluding on the overall impact of an interconnector between Iceland and Britain, see here and here.

Data Centers gaining foothold

BroadGroup, an information media technology and professional services company has undertaken an independent analysis of Iceland as a global data center hub, comparing it using a wide variety of criteria with today’s leading data center locations from around the world. It is estimated that a 10 year cost of data center operations are the lowest in Iceland among the nations compared. The report can be found here.

Today there are two operating data centers in Iceland, Advania data center (former Thor data center) and Verne Global. One of Iceland’s advantage is high power reliability and quality of 100% green energy. Iceland is well connected through Greenland Connect, FARICE and DANICE with new capacity is planned to be added over the next several year which will enable up to 30Tbit/s of full capacity.

2.3 The Tourism Sector

The tourism sector has grown significantly over recent years and is now one of the three major export industries in Iceland, amounting to 23,5% of Iceland’s export revenues.
Between 2009 and 2012 the number of tourists increased by 36%, or roughly 11% a year. Total inbound tourism consumption increased by 48% over the same time period. Number of tourists in 2012 was more than double the population of the country, or 672,000 tourists. In the first six months of 2013 the number of tourists increased over 25% compared to the first six months of 2012. For more information, see here and here.

Tourists paid approx. 238 bn ISK to Icelandic companies in 2012. Along with important job-creation, this boom has contributed to the economic stabilisation of Iceland e.g. through increased currency reserves.

3 The Public Sector

3.1 Fiscal Consolidation Plan

According to previous Government plan a fiscal surplus of 0.9% of GDP was projected for 2014. These expectations were based on three main factors; continued GDP growth, increased revenue from natural resources and fiscal restraint measures. These projections are not likely to materialize considering that GDP growth in 2012 was much lower than expected and there is still significant uncertainty surrounding the latter two factors. See here for more information.

Further information and break-down on outstanding public debt can be found in The Ministry of Finance and Economic Affairs report on debt here. It shows the Central Government debt and its sub-groups. As can be seen in figure 14 in Part B The Economic Landscape the budget deficit rose to 13% of GDP in 2008 but has declined steadily since then. The debt of the municipalities also increased steadily in 2002-2007 in ISK terms. The municipalities’ debt was 230% as a share of total revenues at year-end 2012, see here (chapter 7.3.2).

Net public debt was 68% of GDP at the end of 2012 (99% gross) and is expected to drop to 57% in 2015 (85% gross). For the latest figures on the state budget from January-May 2013 see here.

3.2 A New Government

In May 2013 after the elections a new government was formed between the Independence Party and the Progressive Party, whom have 38 MP’s against the oppositions 25 MP’s, see here and here. The Government aims - among other things - to lower taxes and simplify the tax system and reduce household debt through resolution of the old banks.

Furthermore, the Government has announced that the negotiations with the EU will be postponed, see here. A special report will be written on the negotiation process and the status of the EU which will be put before the Parliament this autumn. The negotiations will not be continued until after a referendum.
With regards to the fiscal plan the Government has established a Consolidation Committee. Its role is to put forth long-term proposals to consolidate, prioritise and enhance efficiency in the State’s operations. The Committee consists of MP’s, government officials and external experts. See more information here (only in Icelandic).

4 Other Notable Events and Publications

- The American pharmaceutical company Watson acquired privately held Actavis for an upfront payment of EUR 4.25 bn. in April 2012, see here.
- The CB published a working paper on the Icelandic pension system. According to the paper, the Icelandic pension system is the second biggest in the world measured as assets to GDP, see here.
- At the European Biotechnology Congress in Bratislava in May 2013 the ISOkine growth factors produced by ORF Genetics were chosen this year’s Best Biotechnology Product in the category of innovative products that solve or tackle important problems in human health, see here.
- CLARA, an Icelandic software company startup specializing in online business and marketing intelligence. Earlier this year San Francisco-based Jive Software announced that they’ve acquired Clara for US 9 million, see here.
- CCP, an Icelandic game developer, held a conference called Eve Online Fanfest in April 2013, see here. CCP has developed two games, Eve Online and Dust 514.
- Meniga is a Icelandic start-up company with operations in eight countries. The company’s online personal finance software was awarded its second “Best of Show”Trophy at Finovate in February, see here.
- Moody’s held its credit rating on Reykjavik Energy unchanged or B1 with negative outlook, see here (only in Icelandic).
- A Memorandum of Understanding to establish an Icelandic-Arctic Chamber of Commerce (IACC) was signed 24th of April 2013, see here. The Iceland Chamber of Commerce, the Icelandic Arctic Cooperation Network, the Confederation of Industry and the Ministry for Foreign Affairs are the founding partners. Related information see here, here, here and here.
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ON THE WAY TO ÞAKAGIL
Part B  The Economic Landscape

5  Overview

It is important that the public debate on future prospects of the Icelandic economy is based on factual data. The aim of this chapter is to illustrate the broad strokes of Iceland’s economy, based on economic indicators and international comparisons.

5.1 Gross Domestic Product (GDP)

Figure 12  GDP fell by 10.4% between 2008-2010. GDP growth picked up in 2011 and is predicted to reach its pre-crisis peak in 2015.

Source: Statistic Iceland

Figure 13  Iceland ranks no. 12 amongst the OECD countries in GDP per capita.

Source: OECD
5.2 State Debt

Figure 14 Iceland's GDP contribution by sectors. The economic landscape has changed significantly in recent decades.

Figure 15 Debt to GDP ratio is predicted to decrease in coming years due to increase in GDP rather than debt repayments.

Figure 16 Interest payments have increased dramatically due to increased debt level.
Figure 17 Scheduled repayments of foreign loans by other parties, excluding the Treasury.

Figure 18 Scheduled repayments of the Treasury foreign loans show spikes in 2016 and 2022.

Figure 19 Scheduled repayments of foreign loans demand significant refinancing in order to preserve foreign reserves.
5.3 Households and Corporations

Figure 20 Unemployment has decreased while employment is slowly picking up. Number of people outside of laborforce has increased.

Figure 21 Real house prices decreased by 33.5% and are close to late 2004 level.

Figure 22 Purchasing power decreased substantially in 2008 but is now back to mid-2005 level, measured in ISK.
**Figure 23** Households ability to service their debt has gradually improved from 2010.

**Figure 24** Net worth of individuals, has grown since 2010.

**Figure 25** Household debt is fairly high in international comparison.
The Icelandic Economic Situation

Figure 26 Corporate debt has decreased to same level as in mid-2005 while household debt is down to mid-2006 level.

Figure 27 Total lending by the financial system has decreased, which can be attributed to development of private debt.

Figure 28 Loan defaults have decreased substantially since 2009.
5.4 Stock Market and Pension System

Figure 29 The stock market has picked up but is still small compared to pre-crisis level in terms of volume and number of listed companies.

Source: Central Bank of Iceland

Figure 30 Since the bust of the stock market the bond market has been booming with bonds doubling in price.

Source: Nasdaq OMX Iceland

Figure 31 Net assets of the pension system have increased above pre-crisis level. Foreign securities are approximately quarter of total assets.

Source: Central Bank of Iceland, Statistic Iceland, Iceland Chamber of Commerce
5.5 Monetary Policy

Figure 32 Inflation is close to its targeted level of 2.5%. Historically, inflation has been well above the target.

Source: Statistic Iceland, Iceland Chamber of Commerce

Figure 33 The exchange rate depreciated by 53% over 28 month period but has stabilized since.

Source: Central Bank of Iceland

Figure 34 Due to the capital controls international value of the ISK is different from the domestic one.

Source: Central Bank of Iceland
5.6 Competitiveness

Figure 35 The CB estimates that volatile króna assets are equal to 22% of GDP or ISK 367 bn. Through ISK auctions, illustrated here, the CB has lifted some of that pressure.

Source: Central Bank of Iceland

Figure 36 The competitiveness of the Icelandic economy has decreased and is now ranked no. 29 out of 60 countries.

Source: IMD

Figure 37 Iceland remains highly ranked on various indexes, showing its resilience despite recent recession.

Source: Institute websites
A highly professional outfit, BBA Legal is one of the top firms that outside investors and players look to when they wish to become involved in Iceland.

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6 Overview

Substantial changes occurred the first two years after the collapse. In October 2008 the Financial Supervision Authority (FSA) took over the operation of the banks and appointed Special Resolution Committees and new banks have been established around the old banks domestic operations. The cost of capitalizing the new banks, ISK 135 billion, is significantly lower than estimated commitment of ISK 385 billion at the time of the original transfer in October 2008. The decision of the FSA on the disposal of assets and liabilities, information about the resolution committees and various FAQ can be found here.

6.1 The Housing Fund and new Bank Agency

After the banking collapse new equity was needed to finance the HFF. The fund has received a total of ISK 46 bn. in capital contribution over the past years, see here. This issue has not been settled as mentioned in Part A Developments 2012-2013.

The Government set up a Banking Agency, Icelandic State Financial Investments, in August 2009. Its main object is to control the State’s holding in financial undertakings in compliance with currently applicable law, good administrative and business practices, and the State’s current ownership policy, and provide them with funding on behalf of the Treasury based on budget allocations. Information on the ownership policy can be found here. More information can be found in the 2012 edition, chapter 1 and 12.

6.2 The Icesave Dispute

The Landsbanki operated the online savings banks Icesave in the UK and Netherlands. The UK and Dutch governments demanded an Icelandic state guarantee to reimburse the deposits. As mentioned in Part A Developments 2012-2013 at the end of January 2013 the EFTA Court ruled that the Icelandic government was not obligated to repay UK and the Netherlands, see more information in the 2012 edition of this report, chapter 13 and appendixes 8-10.

Figure 38 The logo of the EFTA Court

Source: www.eftacourt.int
6.3 The IMF Plan

On the 28th of October 2009 the IMF’s Executive Board approved the 1st review of the Economic Recovery Program, giving Iceland access to $167,4 million from the IMF and also $675 million from the Nordic countries and Poland, see here.

On August 26th the Executive Board of the IMF completed the sixth and the final review of Iceland’s economic performance under program supported by the Stand-By Arrangement making the country the first to complete such a program, see here and the 2012 edition of this report, chapter 14, for further information.

Figure 39 Primary and total balance of the State.

![Graph of Primary and total balance of the State.](image)

Source: Central Bank of Iceland and Statistic Iceland

6.4 The State Treasury

The fiscal consolidation plan by the government is one of the cornerstones of the IMF economic program. The first goal was a primary balance in 2011 and overall surplus in 2013. Those two goals were later postponed for one year due to favorable position of the state treasury.

On June 9th 2011 Iceland issued USD 1 billion worth of bonds due in 2016, see here.

For further information on the state treasury see the 2012 edition of this report, chapter 18. See also here (only in Icelandic) and here (chapter 3) for information on the fiscal policy.

6.5 The Central Bank

After the collapse of the three major banks and the exchange rate, inflation rose above 18% in January 2009 and the CB increased its policy rate to 18%.

Due to massive devaluation in the exchange rate the CB imposed capital restrictions to hinder further devaluation of the ISK. On the 5th of August 2009 the CB introduced a Capital Account Liberalization Strategy. The first step of the strategy was implemented on 1st of November 2009 allowing for foreign direct investments into Iceland. See here for report on monetary policy in Iceland after capital controls.

In March 2011 a report was introduced that contains a new strategy for liberalization of capital controls. Later that year a new plan on capital controls was introduced called the Investment Program. See here and here for those two programs and the 2012 edition of this report, chapter 16, for further information.

Figure 40 Inflation 1989-2012.

![Graph of Inflation 1989-2012.](image)

Source: Statistic Iceland, Iceland Chamber of Commerce

6.6 The Labor Market

After the collapse in 2008 unemployment rose to 9,2% in September 2011. On a yearly basis 2010 was the worst year regarding unemployment when it was on average 8%.
Near the end of June 2009 the Government, the Confederation of Employers and the Confederation of Employees signed an agreement, The Stability Pact, see here and here. In 2011, unemployment was down to 7% on a yearly basis. Find more information in chapter 17 in the 2012 edition of this report.

6.7 The Investigation Committee and Constitutional Assembly

A Special Investigation Commission of the Parliament was formed in December 2008 to investigate whether any public officials were responsible for misconduct. In April 2010 the investigation committee delivered its report, see here and here for the report and in the 2012 edition of this report, chapter 20.

After the collapse of the banking sector there was a widespread demand for a revision of the constitution. On June 16th 2010 Parliament passed a new law, The Act on a Constitutional Assembly in which consultative Constitutional Assembly is summoned for the purpose of reviewing the Constitution of the Republic from June 1944, see here and in the 2012 edition of this report, chapter 21.

6.8 The EU Application

The Icelandic Parliament voted on 16th of July 2009 in favor of applying for membership to the EU. As mentioned in Part A Developments 2012-2013 the Government has announced that the negotiations will be postponed. More information can be found in the 2012 edition of this report, chapter 17.

6.9 Other Notable Events and Publications

- New government was formed in May 2009 between the Left-Green and the Social Democrats, which continued after the national elections in April, see the 2012 edition of this report, chapter 4.
- The Iceland Chamber of Commerce, NASDAQ OMX Iceland and the Confederation of Employers issued in March 2012 new guidelines on Corporate Governance, see here.
- The Enterprise Investment Fund was formally established in December 2009 by 16 pension funds, see here.
- At the Iceland Chamber of Commerce Annual Business Forum in 2012 it was announced that McKinesy & Company would review Iceland’s growth potentials, the report can be found here.
- From 2007 until 2013 over 100 changes to the tax system were introduced, mostly constituting increased taxation. This has created uncertainty as to the future tax environment of business and households, see here.
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7 Overview

Although the global financial crisis hit Iceland's economy relatively hard, it is gradually working its way out of the recession. The economy is based on strong foundations and possesses strong growth opportunities going forward. The society is dynamic and technology-driven with a young and well educated workforce. The country has the privilege of abundant natural resources and its nature and culture has attracted an increasing number of tourists each year.

Additionally, and equally important, there is a growing understanding of the importance of co-operation between all relevant stakeholders to foster future growth.

7.1 Iceland Growth Forum

A sign of increased willingness for a broad collaboration is the Iceland Growth Forum, see here (only in Icelandic). The Forum, which was set up in January 2013 by the Prime Minister’s office, consists of political leaders from all parties in parliament, representatives of the business community, public administration, academics and the labor market.

In short, the Forum is a platform to promote factual and constructive discussion on ways to promote long-term economic growth. Its objective is to draw up and discuss a holistic plan of actions aimed at enhancing growth and economic stability. An independent secretariat drafted a proposed plan which is now pending further discussion within the Forum itself, see here (only in Icelandic).

The Forum’s main goal is to address the productivity gap between Iceland and neighboring countries. Currently, Iceland has a strong and flexible labor market, but when it comes to productivity and
investment rates Iceland lags behind. The Secretariat proposed economic goals which are considered to be ambitious but possible.

1. Average GDP growth of 3.5% until 2030
2. Government debt below 60% of GDP before 2030
3. Price stabilization with average inflation 2.5% until 2030.

If these goals will be achieved, Iceland is projected to move up the ranks on the list of OECD countries on GDP per capita in 2030, from it’s current 12th place to 4th place. If Iceland stays on the same track with regards to GDP growth it could fall three places, to the 15th. With stagnation and no reforms Iceland could fall to the 28th place.

### 7.2 The McKinsey & Company Report

At the Iceland Chamber of Commerce Annual Business Forum, in February 2012, it was announced that McKinsey & Company planned to embark on a review of Iceland’s economic performance, focusing on opportunities for productivity growth across sectors. Similar reviews have been conducted for the economies of Sweden, Finland and Denmark.

The report, called “Charting a Growth Path for Iceland”, was published on October 30th 2013, see [here](#). The report’s main messages are that Iceland’s productivity lags behind our peer nations. One of the main reasons for Iceland wellbeing is long working hours and high labor market participation. Iceland’s strongest industry is the fishing industry where labor- and capital productivity is high.

McKinsey split the Icelandic economy into three main sectors; the domestic service sector, the resource-based sector and the international sector. The main priorities in those three sectors are shown in figure 43.

Additionally, the report underlined the importance of more social and political cohesion. In order for Iceland to address it’s fundamental challenges, it is considered important to form a bi-partisan agreement on the broad strokes of a long-term economic strategy. Although the report underlines some of Iceland’s main challenges, it also illustrates some of the core strengths of the economy and it’s unique opportunities for long term sustainable growth.

### 7.3 The Iceland Chamber of Commerce Action Handbook

In February 2013, in relation to its Annual Business Forum, Iceland Chamber of Commerce published a report, called The Action Handbook. This handbook, as the title suggests, sets forth 13 actions to increase efficiency and productivity in the Icelandic economy. The 13 action points are the following:

**Resource based sector**

1. Increased investment in tourism infrastructure
2. Efficiency in the fishing industry a priority in all policy making
3. Competitive environment for the resource sector
4. More efficient and diversified agricultural policy
5. All possible benefits of energy utilisation fully explored

**International sector**
1. Competitive human resources
2. Consensus on a long-term strategic plan
3. Improved investment environment for businesses
4. Improved connections

**Domestic service sector**
1. Simplified consumption taxes
2. Improved competitiveness of domestic services
3. Increased efficiency of public services
4. Extensive collection and publication of statistics

The Handbook is accessible [here](#) (only in Icelandic) and an English translation of the 13 actions points, [here](#).

**7.4 180 Reports on Iceland**

Since the financial collapse over 180 reports on the Icelandic economy, education, institutions, risk etc. has been published, both in Iceland and abroad. Over all the reports form a factual basis which should facilitate decision making by policy makers in Iceland in the near future.

See [here](#) for the 180 reports (mostly in Icelandic).

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**Figure 44 Iceland Chamber of Commerce Action Handbook.**

**Figure 45 League of Nations: Country ranking in terms of GDP per capita (PPP), top 40.**

Source: IMF World Economic Outlook (April 2012); McKinsey analysis
About the Iceland Chamber of Commerce

The Iceland Chamber of Commerce (ICoC) is a voluntary association of companies and individuals with the mission of improving the operating environment of business in Iceland and to increase economic prosperity.

Operations of the Chamber

General Safeguarding of Interests
As a general organization of the business community the Chamber works integral for the interests of every one conducting business. The Chamber is a powerful tool for the business community in its contest for improvements in the business environment and enhanced working conditions.

An Advocate Towards the Authorities
The Chamber exerts itself for positive changes in law, regulation and administrative decisions which regard the business community. The Chamber receives from parliamentary committees, for review, all bills that bear upon the interests of the business community. Comments are made in collaboration with members and are presented to the committees.

The Chambers Annual Business Forum
The Chamber’s annual Business Forum is the largest and most attended event in the Icelandic business community. The Forum is attended by members, politicians and governmental officials and others that take an interest in Iceland’s business community. The Chamber issues a report in connection with the Forum. The latest publications can be found here.

Corporate Governance
The Chamber has taken on the initiative of publishing guidelines on corporate governance in collaboration with the Confederation of Icelandic Employers and NasdaqOMX Iceland. The guidelines were first issued in 2004 and the fourth edition was issued in March 2012, see here and here for the new verification process (in Icelandic).

Communication and Acquisition of Information
In recent years the Chambers has worked heavily on preparing accessible information and communicating them to foreign parties which are interested in Iceland’s business and financial environment.

Legal Counsel and Arbitration
The Chambers lawyer supervises various projects for members, free of charge. The lawyer assists members with matters relating e.g. to import and export of goods, employee and employer relations and specific law or regulations regarding companies.
A Backbone for Business Education

The ICoC is an active advocate of technical and business education. Globalization and openness of the Icelandic economy has increased demand for educated individuals in Icelandic companies. To meet this demand, the ICoC owns and operates the following educational institutions:

The Commercial College of Iceland

The Commercial College of Iceland is a four-year senior high school / college for students 15 years + who have completed the Icelandic elementary school, grades 1-10. The College has a student population of over one thousand students. It’s main objectives are to promote the competitiveness of Icelandic business, both internally and internationally, by providing and furthering education in general and business education at secondary and tertiary levels in particular.

Reykjavik University

Reykjavik University is a vibrant international university located at the heart of Reykjavik, the capital of Iceland. Reykjavik University (RU) is Iceland’s largest private university and counts about 3,000 students.

The university’s focus is on research, excellence in teaching, entrepreneurship, law, technology development and co-operation with the active business community. The university’s objective is to educate students to become leaders in business, technology and society at large, starting new companies and creating jobs.

Joining the Iceland Chamber of Commerce

A membership to the Chamber gives companies an opportunity to influence its strategy and to promote their interests in a robust forum. The issues that the Chamber deals with on a daily basis can both concern the business community as a whole and also specific interests of individual member companies. For more information about the role of the Chamber and joining the Chamber contact Ragnar Thorvardarson, Communications Director (ragnar@vi.is). More information about the Chamber can be found here.

Information about the location and opening hours of the ICoC office can be found here.