

THE ICELANDIC ECONOMY



ICELAND CHAMBER
OF COMMERCE

CURRENT STATE, RECENT DEVELOPMENTS
AND FUTURE OUTLOOK



2019 EDITION

The Icelandic Economy

Current State, Recent Developments and Future Outlook
2019 edition

Editors

Ásta S. Fjeldsted
Ísak Einar Rúnarsson
Konráð S. Guðjónsson
Védís Hervör Árnadóttir

Artwork

by Inga Dóra
Cover photo: Eins og var
Photos inside report are named where situated
Back cover photo: Blámi

Layout and Design

Védís Hervör Árnadóttir

Current Edition

22nd edition (August 2019)

Previous Edition

21st edition (August 2018)

Further Information

A presentation that accompanies the report, previous editions and a mailing list for future editions are accessible on the Chamber's website, www.chamber.is.

About the Chamber

The Iceland Chamber of Commerce is a non-governmental organization consisting of firms and individuals with the mission of improving the business environment in Iceland and increasing economic prosperity.



Iceland Chamber of Commerce

Borgartún 35
105, Reykjavík
ICELAND

The publication can be copied without a license from the Iceland Chamber of Commerce as long as the source is cited.

Legal Disclaimer

This report is for information purposes only and is not designed to form a basis on which recipients should make decisions. The information contained in this report does not represent any promise or forecast of future events. The Iceland Chamber of Commerce (ICoC) is not obliged to provide the recipient with access to further information than that contained in this presentation or to update the information contained within. The ICoC is not obliged to correct information should it turn out to be incorrect.

The information contained in this report is based on existing information, projections of expected developments in external conditions etc. The information is subject to various uncertain factors and may change without warning.

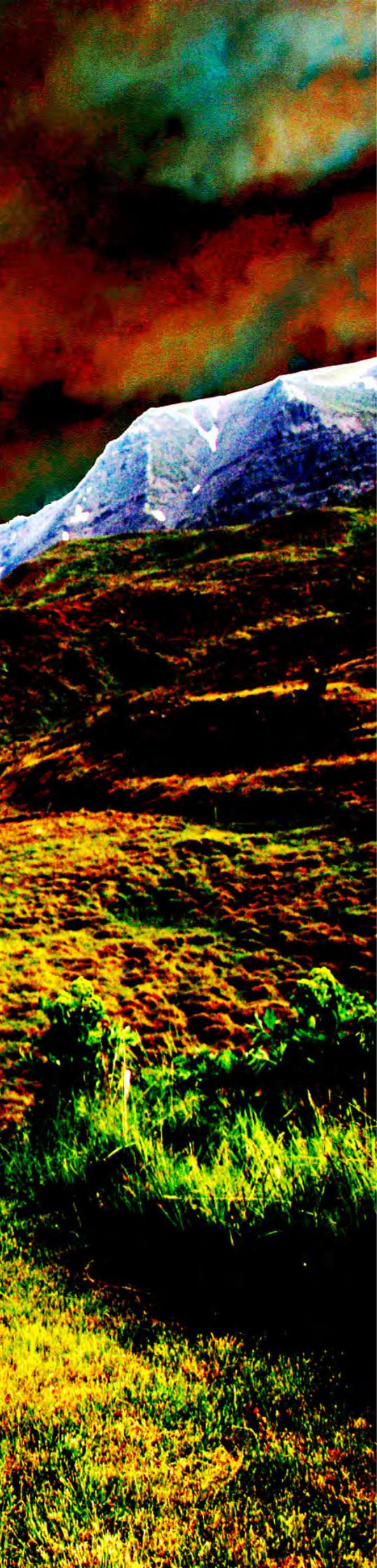
Did you know?

- The total land area is 103,000 km² and the population is 360,384
- Iceland's parliament, Althing (Alþingi), is the oldest surviving parliament in the world, founded in 930 AD
- The official language is Icelandic and the main religion is Lutheran
- Iceland is a founding member of NATO but does not have any military forces
- Iceland has the most developed IT infrastructure of any developed nation, according to the UN
- Former president Vigdís Finnbogadóttir became the first democratically elected female head of state in 1980
- Iceland's search and rescue services are solely volunteer-run

Key facts about the economy

- Iceland's Gross Domestic Product (GDP) per capita in 2018 was USD 55,917 (PPP)
- In 2018 unemployment was 2.7% and in July 2019 inflation was 3.1%
- The main exports are tourism (39% of total), seafood (18%) and aluminium (17%)
- The currency is Icelandic Króna (ISK), USD 1= ISK 121 (25 July 2019)
- Iceland's current account surplus was 2.9% of GDP in 2018
- Government debt-to-GDP was 38% in 2018





THE ICELANDIC ECONOMY

TABLE OF CONTENTS

FOREWORD

1. ECONOMIC LANDSCAPE

| | |
|--|----|
| 1.1 Overview of the Society | 11 |
| 1.2 Competitiveness | 12 |
| 1.3 Macroeconomic Environment | 14 |
| 1.4 International Trade and Investment | 18 |

2. INSTITUTIONAL FRAMEWORK

| | |
|-------------------------|----|
| 2.1 Political Landscape | 25 |
| 2.2 Government Finances | 28 |
| 2.3 Monetary Policy | 31 |
| 2.4 The Icelandic Króna | 31 |

3. FINANCIAL SECTOR

| | |
|------------------------|----|
| 3.1 The Banking System | 37 |
| 3.2 Access to Credit | 38 |
| 3.3 Capital Markets | 38 |
| 3.4 Pension Funds | 40 |

4. DOMESTIC SECTOR

| | |
|--------------------|----|
| 4.1 Labour Market | 48 |
| 4.2 Housing Market | 50 |

5. RESOURCE SECTOR

| | |
|---------------------------------|----|
| 5.1 Tourism | 53 |
| 5.2 Energy Intensive Industries | 56 |
| 5.3 Seafood Industry | 58 |

6. INTERNATIONAL SECTOR

| | |
|-------------------------------|----|
| 6.1 Enhancing Innovation | 64 |
| 6.2 Deepening The Talent Pool | 67 |

7. FUTURE PROSPECTS

| | |
|---|----|
| 7.1 Economic Growth | 69 |
| 7.2 Key Challenges Ahead | 70 |
| 7.3 Infrastructure Needs and Potential Projects | 72 |

ABOUT THE CHAMBER

We make buying and selling easy.

Serving Icelandic customers and partners since 1983, Valitor has grown into an international payment solutions company. Today we operate across 28 European countries, offering a single connection for payments of all kinds, from in-store through online and everything in-between.



VALITOR

www.valitor.is

www.valitor.com



The best of both worlds

Meeting friends or making that meeting? Flying Icelandair is a smart choice for both business and pleasure. Our route network connects more than 40 destinations on both sides of the Atlantic, from the airline's hub at Keflavik airport, which opens up a whole new world of possibilities.



Deloitte.



**Your partner in Iceland
and all over the world**

Audit & Assurance / Consulting / Financial
Advisory / Risk Advisory / Tax & Legal

deloitte.is

FOREWORD

ÁSTA S. FJELDSTED

Managing Director
Iceland Chamber of Commerce



“What goes up must come down.” Those words of Sir Isaac Newton have undoubtedly come to someone’s mind in recent years watching the Icelandic economy outgrowing most other OECD countries. Particularly since Iceland faced an unprecedented financial and economic crisis when its three major banks, which assets amounted to over 9-fold GDP collapsed in the matter of days just over a decade ago. This recovery story is something Icelanders and others can learn from and is ingrained in this report.

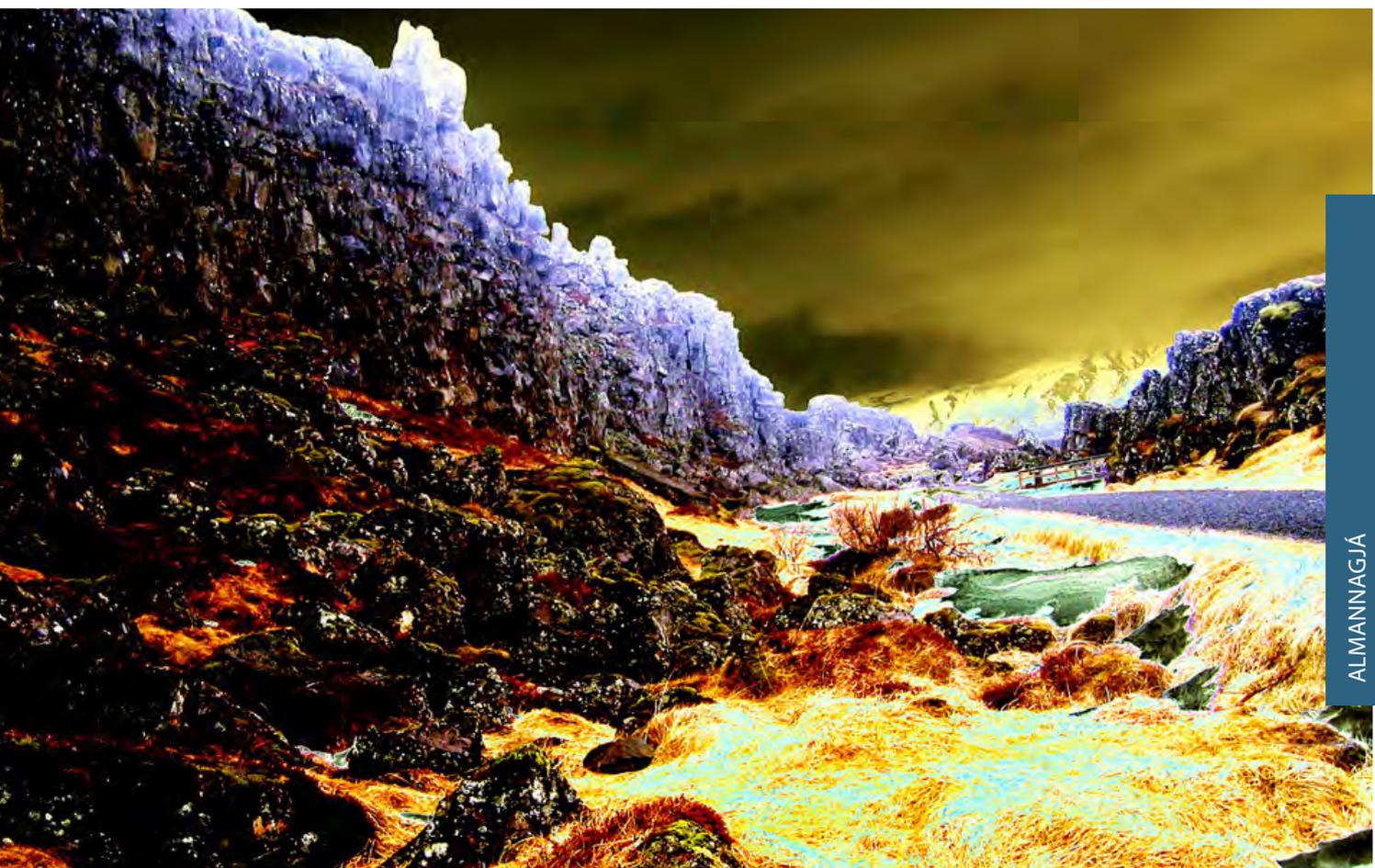
Newton’s words are probably right to an extent because it seems that Iceland’s economic boom has come to a halt and most analysts are expecting a stagnation or a recession. The culprit this time is not of the financial type but is mainly tourism which in turn is the main reason for the recent economic boom. The collapse of Iceland’s second largest airline; WOW air in March 2019 is a big hit for the economy as it carried one-third of passengers to the country. However, short-term indicators such as card turnover suggest that the impact might not be as large as first anticipated and there is still a high demand for Iceland as a tourist destination. Overall, there are reasons to be optimistic.

This shift in the economy is also a reminder and even an opportunity to leverage Iceland’s strengths. With good infrastructure, human capital and strong entrepreneurship there are opportunities to grow new industries and businesses to support a young but ageing population and diversify the economy. It is also important to remember other important issues and Iceland, like other countries, needs to take decisive steps towards fighting imminent climate change. Fortunately, Iceland is well positioned to do so with abundant renewable energy. We at the Chamber are putting more emphasis than ever on environmental issues.

In the aftermath of the financial crisis a lack of holistic overview of the Icelandic economy sparked off this report, now published for the 22nd time. Today, The Iceland Chamber of Commerce (ICoC) publishes The Icelandic Economy report annually. Despite some changes each year, the aim has always been the same; to provide an objective overview of the current economic-, business- and political landscape in Iceland, recent events and developments, and future prospects.

There are seven chapters in the report. The first chapter provides a broad overview of Iceland’s current economic landscape. The second chapter gives an overview of the political landscape and chapters three to seven cover some key sectors of the economy with focus on export industries in two of the chapters. Lastly, the seventh chapter reflects on long-term growth prospects, key challenges and potential infrastructure projects in Iceland.

Our hope is that this report will provide valuable insights into the Icelandic economy and the state of its current affairs.



ECONOMIC LANDSCAPE

1.1 OVERVIEW OF THE SOCIETY

Iceland is a small society with a population of 360 thousand, of which nearly 44 thousand are foreign citizens. The state is relatively young and gained independence from Denmark in 1944. Iceland has its own currency, the Icelandic Króna, which makes it one of the smallest currency areas in the world.

Iceland is a relatively urbanised country with 94% of its inhabitants living in urban areas and almost two-thirds of the entire population live in Greater Reykjavík. Furthermore, the nation is relatively young (Section 3.4) and among the more educated in OECD; 42.4% of people aged 25-64 years old have graduated from university.

The Icelandic economy is an open high-income economy combining a free market economy with a welfare state, which is sometimes referred to as the Nordic model and as such it has attained 2nd place, after Norway, on the Social Progress Index. Although income per capita is high, Iceland is the smallest economy within the OECD, with last year's annual gross domestic production (GDP) of USD 25.9 billion (ISK 2,803 billion)¹.

Iceland has come a long way as it was one of the least affluent countries in Western Europe in the first half of the 20th century. In 2018 its GDP per capita was 56,000 USD (PPP²) and has consistently ranked among the countries with the highest standard of living in the last few decades (Figure 1.1). Notwithstanding, Iceland's GDP per capita rank fell in the aftermath of the financial crisis in 2008 but has recently managed to climb above its pre-crisis position ranking. In terms of GDP per capita, Iceland currently sits in 16th place.

“

The Icelandic economy is an open high-income economy combining a free market economy with a welfare state.

¹ Central Bank of Iceland (USD 1 = ISK 108.38, average for the year 2018).

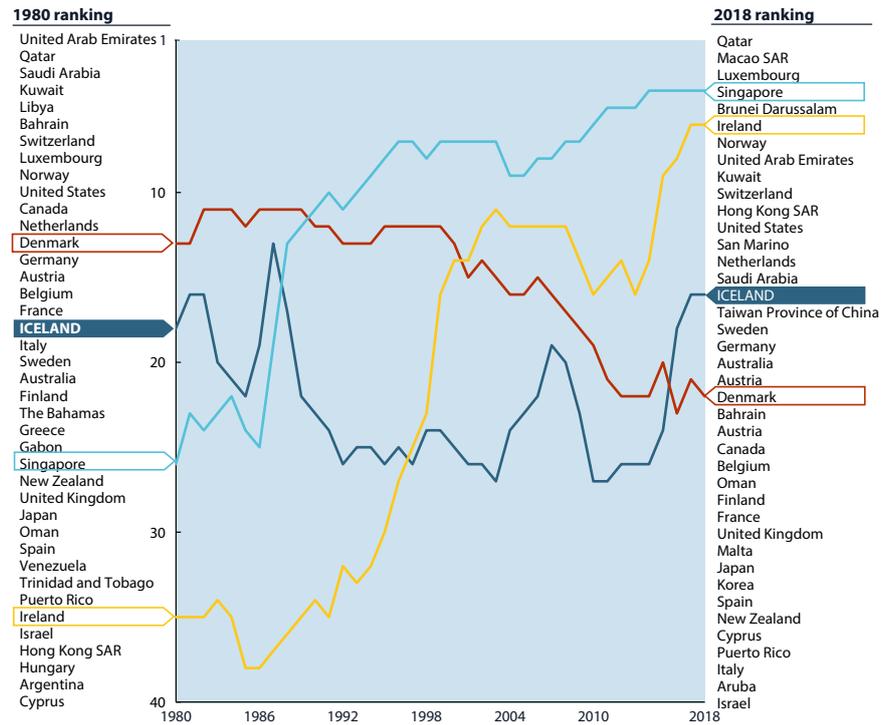
² Purchasing Power Parity is when statistics such as GDP are adjusted for price differences across countries to make them comparable in real terms.

Figure 1.1

Iceland has outgrown most developed countries in recent years

Country Rankings

GDP per capita, PPP adjusted



Source: Iceland Chamber of Commerce

1.2 COMPETITIVENESS

Iceland's success as a society can be attributed to factors such as a strong institutional framework, skilled workforce, high degree of economic freedom, sound democracy and low levels of corruption. Various cross-country comparative indices reflect these qualities (Figure 1.2). Iceland ranks number one in terms of gender equality and peace. High labour force participation rate, the country's openness and the economy's flexibility are key strong-points of the Icelandic economy. As for the peace index, Iceland has held its place as the most peaceful country in the world since 2008.

Figure 1.2

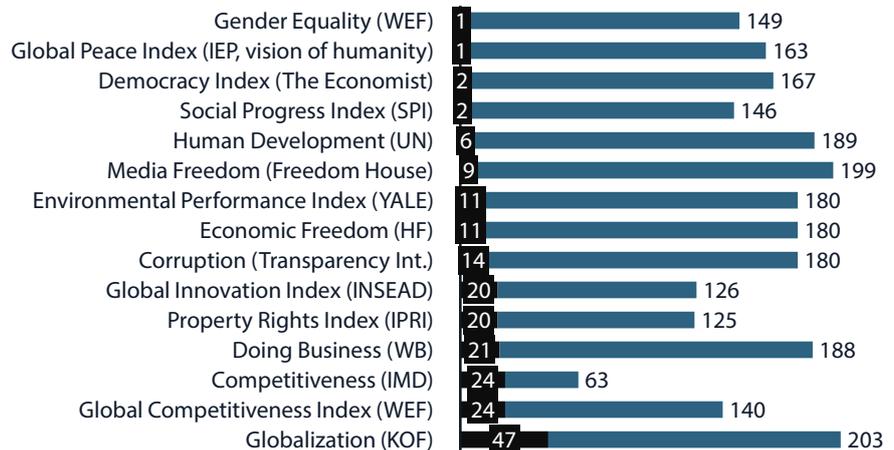
Iceland ranks high in numerous competitive indices

Competitiveness Rankings

Iceland's most recent rank¹ / total number of countries

Iceland's ranking

of countries ranked



¹ Sources obtained May 2019, with the exception of the Global Innovation Index, which was obtained in July 2019

Source: Respective websites

“ High labour force participation rate, the country's openness and the economy's flexibility are key strong-points of the Icelandic economy.

Given Iceland's small size it punches above its weight in competitiveness, which has been improving over the last decade. In the 2018 Global Competitiveness Report by the World Bank, Iceland ranks 24th out of 140 countries. Iceland's relative strengths, according to the report, are macroeconomic stability, information and communication technology (ICT) adaptation and human capital while it's lagging behind in market size, transport infrastructure and product market.³

The Iceland Chamber of Commerce is IMD Business School's partner in IMD World Competitiveness Ranking. Out of 63 countries, Iceland is currently ranked 20th while Singapore is no. 1. As in the World Bank report, Iceland has been on an upward trajectory since 2010 when Iceland was 30th (Figure 1.3). However, Iceland falls behind the other Nordic countries which is largely explained by the economy's small size which, according to the methodology, affects the Economic performance factor. Iceland does better in other factors, particularly infrastructure where it is ranked 13th.⁴

³ Iceland in Global Competitiveness Index 2018: <http://reports.weforum.org/global-competitiveness-report-2018/country-economy-profiles/#economy=ISL>

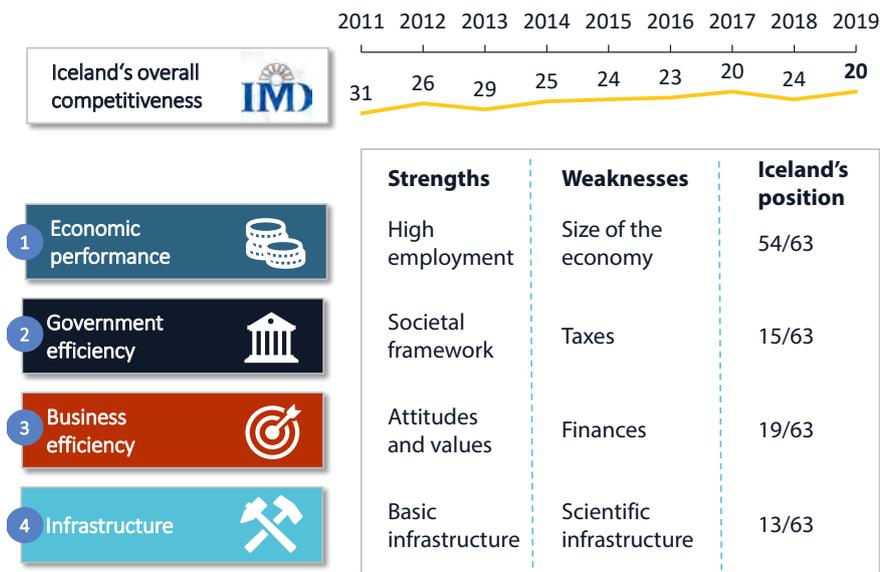
⁴ IMD World Competitiveness Ranking 2019: <https://www.imd.org/wcc/world-competitiveness-center-rankings/world-competitiveness-ranking-2019/>

Figure 1.3

Iceland's competitiveness has slowly but steadily been improving this decade

Iceland's Competitiveness in IMD's report

Strengths, weaknesses and recent developments



Sources: IMD Business School; Iceland Chamber of Commerce

“Iceland ranks 24th out of 140 countries, in the 2018 Global Competitiveness Report by the World Bank.”

Small economies are by nature often more volatile than larger economies. This is mainly caused by a lack of diversification and relatively large external influences.⁵ Consequently, Iceland has historically experienced significant business cycle fluctuations as was evident during the boom-and-bust cycle around the financial crisis of 2008.

During the boom, growth in Iceland was unparalleled among high income countries, averaging 6,5% per annum over the four years preceding 2008. Conversely, the economy contracted more severely than most other European economies after the bust (Figure 1.4).

Notwithstanding the financial crisis, policymakers have promoted and worked towards increased diversification of the economy, initially by attracting energy intensive industries to the country and more recently by fostering tourism and the international sector.

5 Beedon, Pétursson and Rose (2011): <http://faculty.haas.berkeley.edu/arose/BPR.pdf>

Figure 1.4

The economy has been experiencing robust growth but a mild recession is anticipated this year while growth is expected to resume next year



Sources: Statistics Iceland; Central Bank of Iceland (Monetary Bulletin 2019/2); Iceland Chamber of Commerce

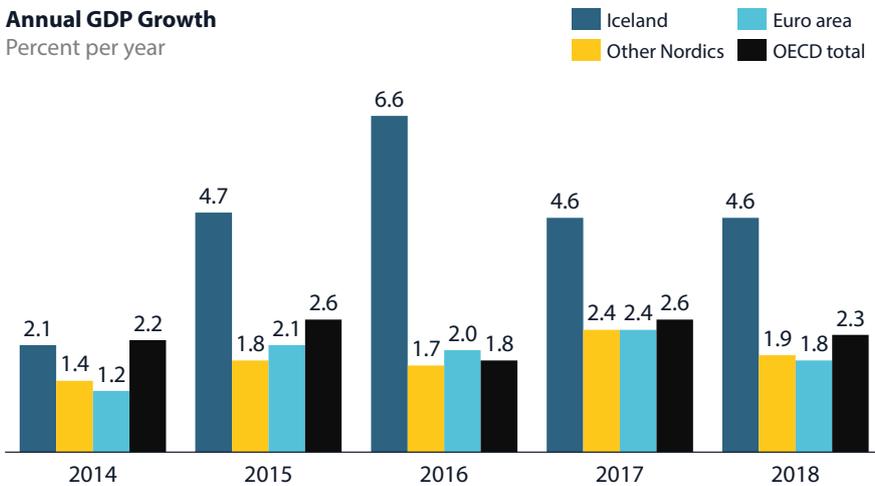
After the debt driven boom of the first decade of the 21st century, more emphasis has been put on promoting sustainable growth by ensuring sound macroeconomic fundamentals. The last six years have brought robust economic growth, that exceeds growth levels of the neighbouring countries, as well as other high-income OECD countries (Figure 1.5). This year however, the economy is expected to contract by 0.4%, mainly due to a contraction in tourism after the exponential growth of previous years. In March Iceland's second largest airline, WOW air, ceased operations which is the main reason for decline in tourism and thus the contraction (Section 5.1). Even so, the recession is expected to be mild and short lived.

“

Iceland has historically experienced significant business cycle fluctuations.

Figure 1.5

Iceland's economy was one of the fastest growing in the world in 2016, but growth has since slowed



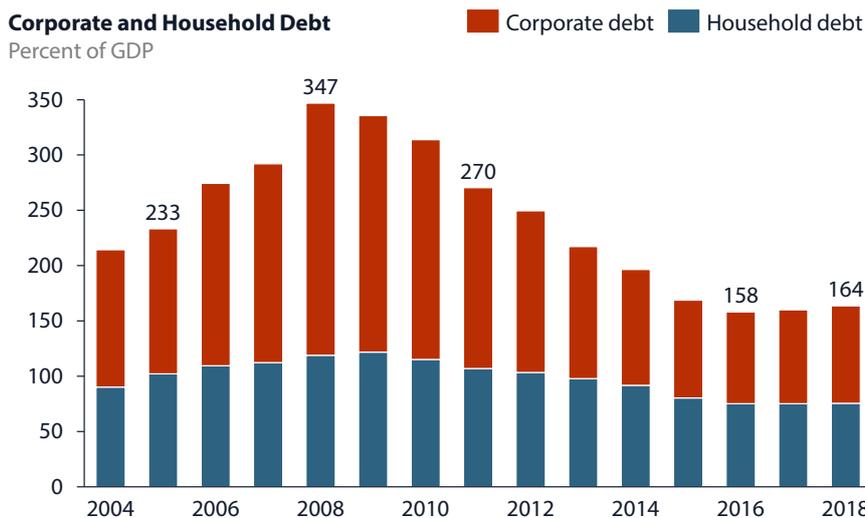
Sources: OECD statistics; Iceland Chamber of Commerce; Statistics Iceland

During the recent expansion, the economy was also in a deleveraging phase as households, corporations and the government has been reducing debt levels, which enables them to adjust to less favourable economic conditions.

After the financial crisis debt ratios declined rapidly and ultimately to historically low levels in 2016 but started increasing slightly again in 2017. Corporate debt went from a high of 228% to 83% of GDP in 2016 and household debt from 122% in 2009 to 75% of GDP in 2017. Furthermore, general government debt that surged in the aftermath of the financial crisis, has been reduced from roughly 95% of GDP in 2011 to 38% in 2018 (Section 2.2).

Figure 1.6

Private debt declined considerably after the financial crisis but has increased slightly in the last two years



Source: Central Bank of Iceland (Monetary Bulletin 2019/2)

“

The last six years have brought robust economic growth, that exceeds growth levels of the neighbouring countries, as well as other high-income OECD countries.

“

After the financial crisis debt ratios declined rapidly and ultimately to historically low levels in 2016 but started increasing slightly again in 2017.

Employment, inflation and interest rates

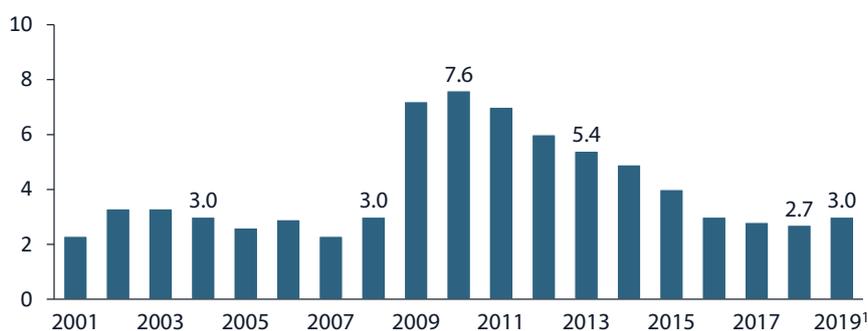
The changing tide in the economy has also meant that unemployment is rising again after a gradual decline since 2010 when it last peaked at 7,6%. In 2018 the unemployment rate was a meagre 2,7% but in the first quarter of 2019 it had risen to a seasonally adjusted level of 3%, prior to WOW air's bankruptcy (Figure 1.7). As the previously mentioned levels of unemployment indicate, the structural unemployment rate in Iceland is relatively low and has trended between 3,5-4%.⁶

Figure 1.7

Unemployment is rising again after a gradual decline since 2010

Unemployment Rate

Percent; yearly average



¹ First quarter

During the recent expansion wages have risen substantially following a number of collective wage agreements. Over 80% of the workforce is enrolled in labour unions which is one of the highest ratios globally. The wage index on average grew by 8.4% from 2014 to 2018. In comparison the average wage growth in the other Nordic countries was 2.2% for the same period.⁷

High inflation has long been a concern in Iceland. In March 2001, the Central Bank of Iceland (CBI) converted from an exchange rate targeting policy and adopted an inflation-targeting policy with a 2.5% inflation target. During the first decade after switching to inflation-targeting, inflation was regularly well above the target. Since 2014 however, despite the positive output gap, inflation has remained low in historical terms at around or close to target (Figure 1.8). This may be explained by the combination of favourable terms of trade, the appreciation of the Króna and high interest rates. Significant reduction of inflation expectations also plays a key role.

⁶ OECD Structural unemployment: <https://stats.oecd.org/Index.aspx?QueryId=61365#>

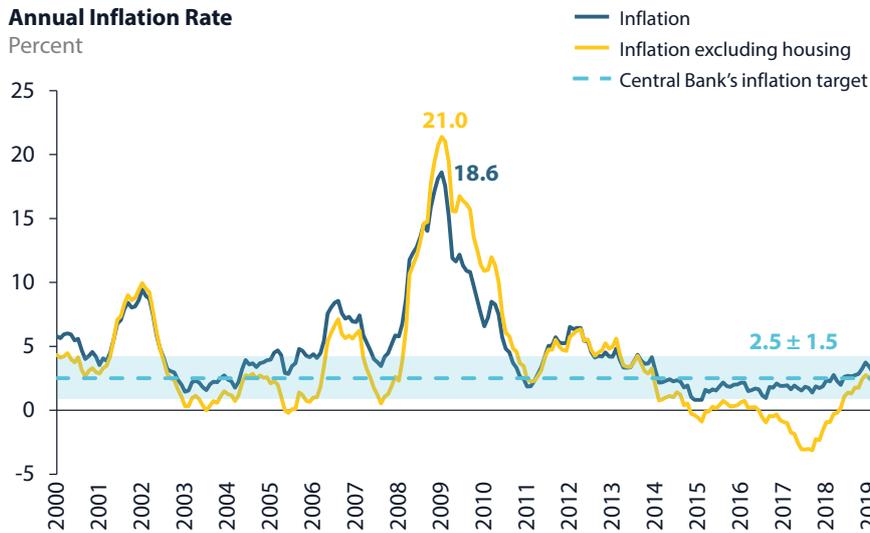
⁷ OECD Average wages: <https://data.oecd.org/earnwage/average-wages.htm#indicator-chart>

“

The changing tide in the economy has also meant that unemployment is rising again after a gradual decline since 2010 when it last peaked at 7,6%.

Figure 1.8

Inflation has been near the Central Bank's inflation target for over five years partly due to inflation expectations being better anchored than in the past



“

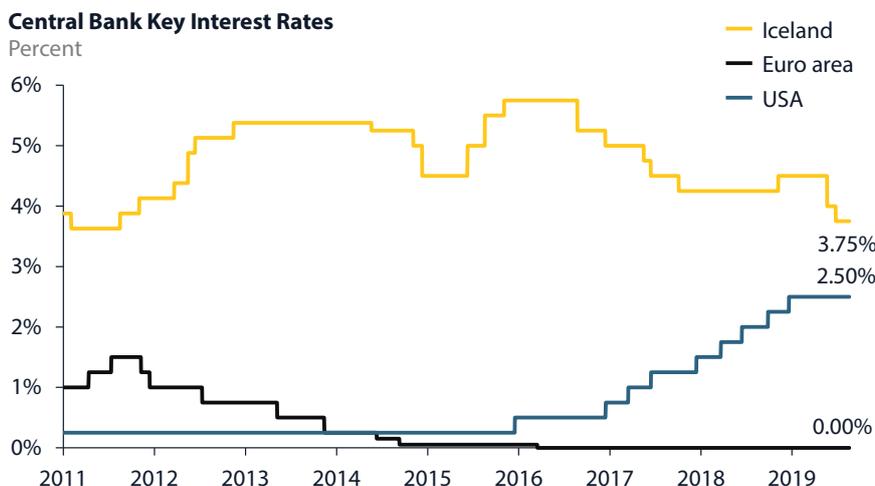
Since 2014 however, despite the positive output gap, inflation has remained low in historical terms at around or close to target.

One of the characteristics of the Icelandic economy is the small and volatile currency, the Icelandic Króna, and the large impact of exchange rate fluctuations on inflation (Figure xx). Currently, imported goods account for roughly 30% of the consumer price index (CPI). The large impact of currency fluctuations on inflation were evident in 2008 and 2009, when the Króna depreciated by 50%, resulting in inflation peaking at 18,6%.

Although interest rates are currently low in Iceland in historical terms, they are still considerably higher than in the US and EU. Currently, the CBI policy rate is 3.75% and has mostly been on a downward trajectory since 2016 when the CBI raised interest rates in response to high nominal wage increases (Figure 1.9). In the light of recent events such as the collapse of WOW air and improving short-term inflation outlook the CBI has quickly lowered interest by 75 basis points to the current rate of 3.75% (Section 2.3)

Figure 1.9

Interest rates are high but appear to be converging to other developed economies



Sources: Central Bank of Iceland; Iceland Chamber of Commerce

“

In the light of recent events such as the collapse of WOW air and improving short-term inflation outlook the CBI has quickly lowered interest by 75 basis points.

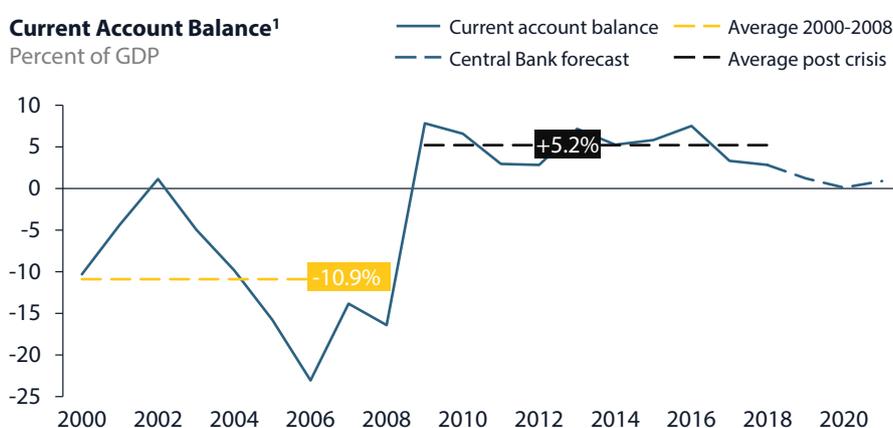
The small size of the domestic economy makes Iceland highly dependent on imports since various goods and services are not produced domestically. To fund these imports, a strong export sector is required. Thus, international trade plays an important role when examining Iceland's economic performance.

International trade

Iceland's balance of trade has seen drastic changes this century. Historically, Iceland had a significant trade deficit with a corresponding current account deficit, which contributed to a build-up of high levels of external debt. That has turned around over the last decade, with Iceland running a consistent current account surplus due to a strong trade surplus and lower debt payments (Figure 1.10). The underlying current account surplus has averaged about 5.2% of GDP since 2009.

Figure 1.10

The devaluation of the Króna balanced out a persistent current account deficit and Iceland has been running an underlying current account surplus since 2009



¹ Underlying current account, excludes the effects of the failed banks' estates. The current account is a broader measure than trade balance and also takes into consideration factor income and financial transfers.

Sources: Central Bank of Iceland; Iceland Chamber of Commerce

This shift is largely explained by the Króna exchange rate (Figure 1.11). The Króna depreciated fast at the onset of the crisis in 2008 as investors pulled out of Iceland, reducing imports and boosting exports. Iceland's economic recovery, led by export growth particularly in tourism (Section 5.1), helped the Króna retain its value. In 2016 Iceland's real exchange rate was back to similar levels as in the years before the financial crisis. However, in the last year, both the real and nominal exchange rates have depreciated, helping Iceland maintain a trade surplus. In 2018, exports of goods and services amounted to around 47% of Iceland's GDP and the trade surplus was 3.6%. In 2019, the Central Bank expects the trade surplus to be 1.9% of GDP.

“

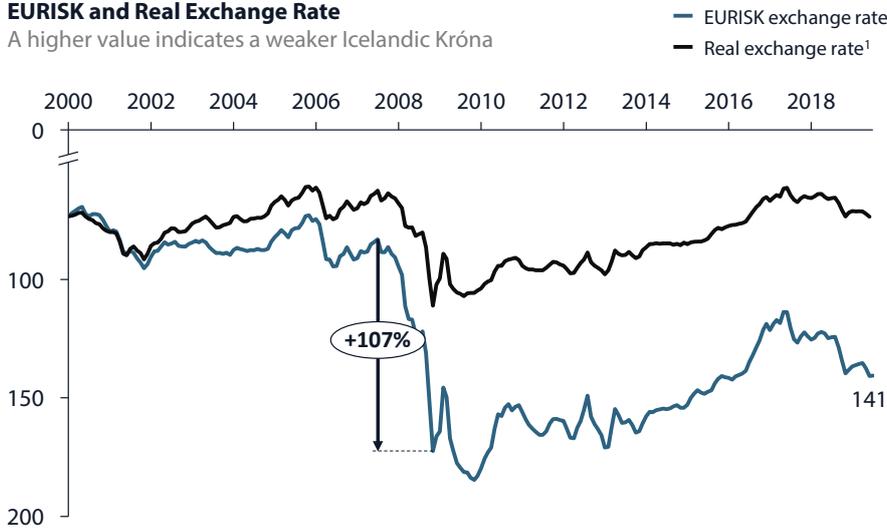
International trade plays an important role when examining Iceland's economic performance.

Figure 1.11

Even though the Króna has depreciated in the last two years, the real exchange rate remains high compared to 2010-2015

EURISK and Real Exchange Rate

A higher value indicates a weaker Icelandic Króna



1 Inversed values, normalised at EURISK's initial value

Source: Central Bank of Iceland

International investment

Iceland's historically negative net international investment position (NIIP) explains why the current account surplus has normally been smaller than the trade surplus.⁸ Thus, a negative NIIP results in a net outward flow of interest and dividends. Iceland's NIIP became progressively more negative at the onset of the century, approaching unsustainable levels before 2008.

After a restructuring of the banking system in the aftermath of the financial crisis and years of current account surplus, the position has now been reversed. The main driver of the improvement in 2015 was a settlement made between the government and the failed banks' estates, the so-called stability contributions, which eliminated the balance of payment risk associated with the estates.

Today, the NIIP reflects that Iceland's net external debt has not been as low in decades. Iceland has in fact transformed from a net borrower to a net lender to the rest of the world (Figure 1.12). This development has been a key to improving credit rating (Section 3.2). Less external debt could help the economy sustain a more long-term stable exchange rate and improve its position to dampen any negative shocks in the future as well as preventing balance of payment crisis.

“

However, in the last year, both the real and nominal exchange rates have depreciated, helping Iceland maintain a trade surplus.

⁸ The NIIP measures assets owned by domestic entities abroad, minus domestic assets owned by foreign entities.

“

In the past few decades, three additional export foundations have emerged: the aluminium industry, tourism and the international sector.

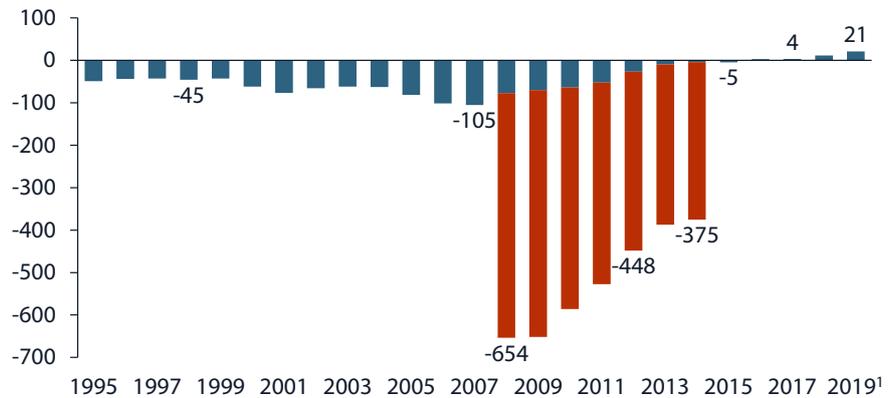
Figure 1.12

Iceland’s net foreign position has completely transformed with Iceland becoming a net lender to the rest of the world

Iceland’s Net International Investment Position (NIIP)

Percent of GDP. With and without failed banks’ estates

■ NIIP w/o estates
■ Failed banks estates



1 First quarter of 2019

Source: Central Bank of Iceland; Iceland Chamber of Commerce

Export foundations

A major challenge for Iceland is to maintain a healthy current account to support sustainable growth. Export growth is key in this respect. Two decades ago the country was heavily dependent on fisheries with more than half of exports originating from the seafood industry (Figure 1.13). Since then, fish-related exports have remained relatively stable, as the industry is limited by the quantity it can harvest, to preserve the size and sustainability of the fishing stock (Section 5.3).

In the past few decades, three additional export foundations have emerged: the aluminium industry, tourism and the international sector. Around the new millennium, the international sector grew rapidly. The sector engages in international trade but is not reliant on natural resources (Chapter 6). Between 2005 and 2008, exports of aluminium took off following the construction of one new aluminium smelter and the expansion of another. Finally, in the last few years, Iceland has witnessed rapid growth in the tourism industry which now makes up two fifths of Iceland’s total exports (Section 5.1). Overall, Iceland’s exports of goods and services have grown rapidly and become more diversified over the last two decades.

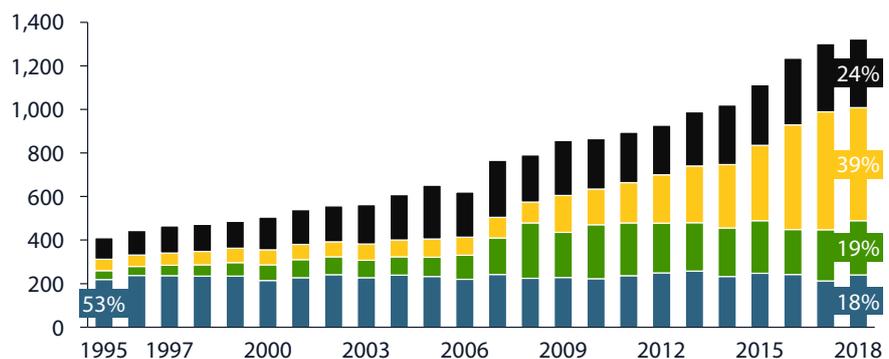
Figure 1.13

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

Iceland’s Exports¹

Total exports in real terms by sector

■ International sector¹ ■ Energy
■ Tourism¹ ■ Seafood



1 All air transport is included in the tourism sector whereas 50% of passenger transport by air is usually included in the international sector in Chamber analysis.

Sources: Statistics Iceland; Iceland Chamber of Commerce

Your financial partner in Iceland

Landsbankinn is Iceland's largest financial institution. We are a trusted financial partner for individuals, companies and investors, focusing on our customer's needs and building strong business relationships. Landsbankinn is your financial partner in Iceland.





Pure Knowledge

EFLA Consulting Engineers is a general engineering and consulting group providing high quality solutions in Iceland and worldwide.



LEX IS ONE OF ICELAND'S LEADING LAW FIRMS

providing clients with comprehensive services over a wide range of financial, corporate and commercial issues, as well as most other aspects of Icelandic law.



LAW OFFICES

Borgartun 26
105 Reykjavik
Iceland

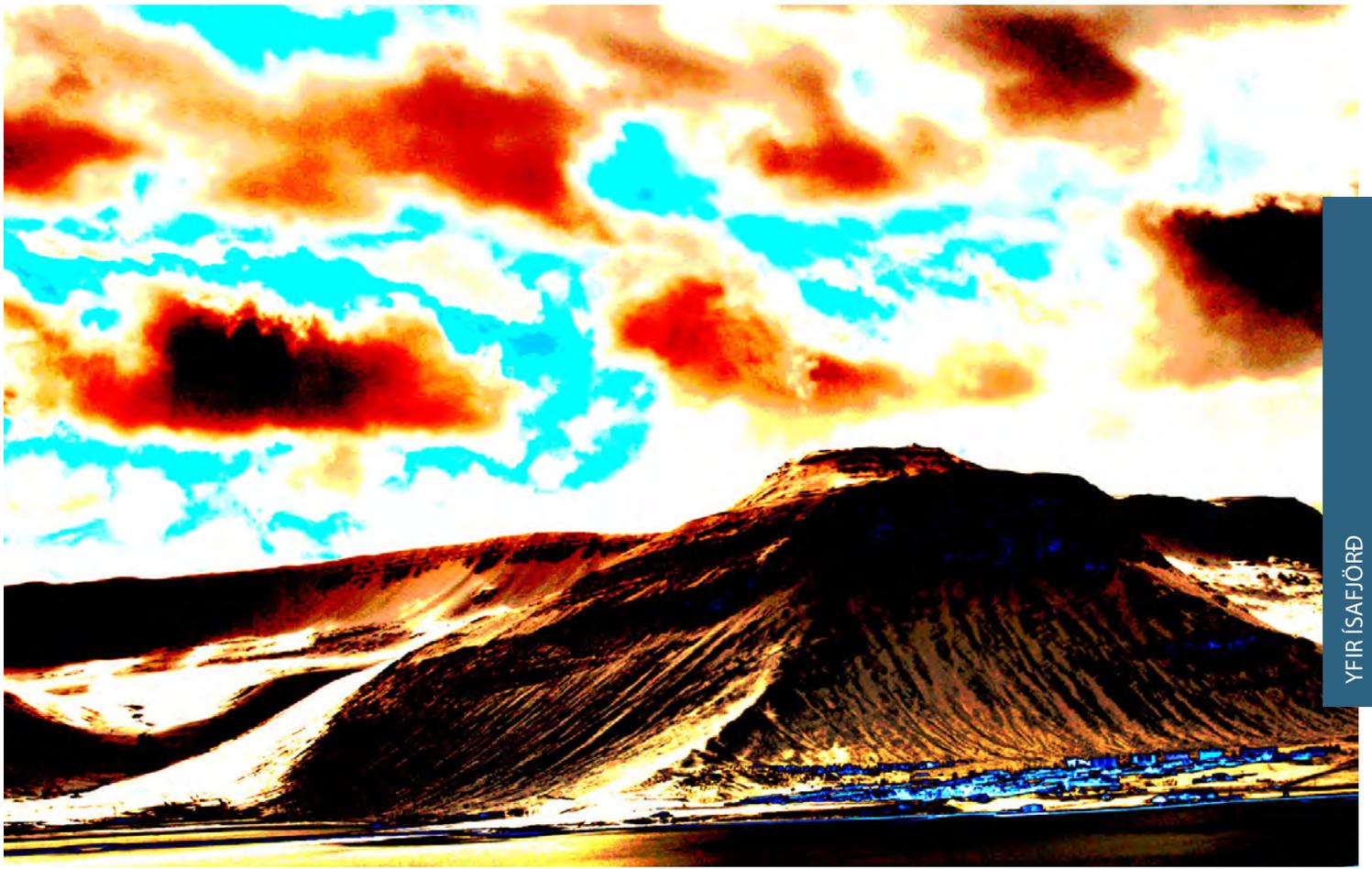
Tel +354 590 2600
lex@lex.is
www.lex.is

Providing a safe and
efficient dispute resolution
since 1920



**NORDIC
ARBITRATION
CENTRE**

ICELAND CHAMBER OF COMMERCE



YFIR ÍSAFJÖRÐ

INSTITUTIONAL FRAMEWORK

2.1 POLITICAL LANDSCAPE

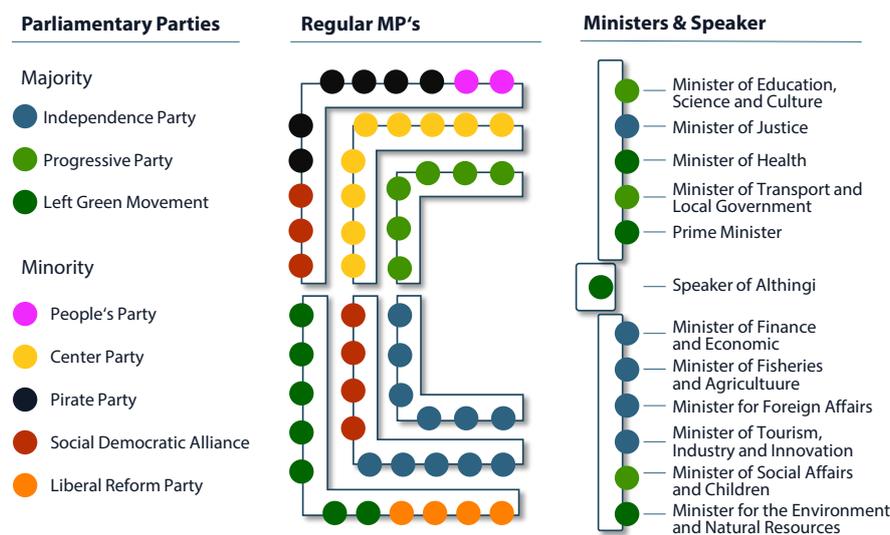
Iceland is a constitutional republic with a multi-party parliamentary system. The current government was formed in November 2017 under the leadership of Prime Minister Katrín Jakobsdóttir. The government is a coalition government that consists of three of the eight parties that are represented in parliament; the Prime Minister's Left Green Movement, the Independence Party and the Progressive Party.

The government parties received 53% of the popular vote in the 2017 snap election and 35 out of 63 parliamentary seats (Figure 2.1). Public approval ratings, which started out strong at 74%, have however dwindled, as has been the trend for previous governments as well, and in May 2019 the approval rating stood at 49%.

Figure 2.1
Eight parties have representatives in Althingi – Iceland’s Parliament

Althingi – Iceland’s Parliament

Illustrative; Parliamentary parties, number of MP’s and ministerial posts



Sources: Alþingi

The government is a grand coalition, in the sense that it is made up of political parties that span the full classic political spectrum from left to right. At the time of its formation in 2017 it was the third government to hold power in two years. Regaining political stability was therefore one of the priorities of the leaders of the governing parties.

“The government parties received 53% of the popular vote in the 2017 snap election and 35 out of 63 parliamentary seats.”

Government agenda

At the onset the government set out its political agenda listing the priorities of its duration. In addition to the aforementioned political stability, the agenda stresses social and economic stability as well as promoting innovation, gender equality and environmental protection.

To achieve its aims, the government has set out to be proactive and forward looking by working on long-term policy agendas in numerous fields. Among those are an innovation policy until 2030, a Whitepaper on the future of the financial system, an education agenda until 2030, a climate change action plan, a health care policy until 2030, proposals to reform the foreign service and an energy policy for the next 20-30 years.

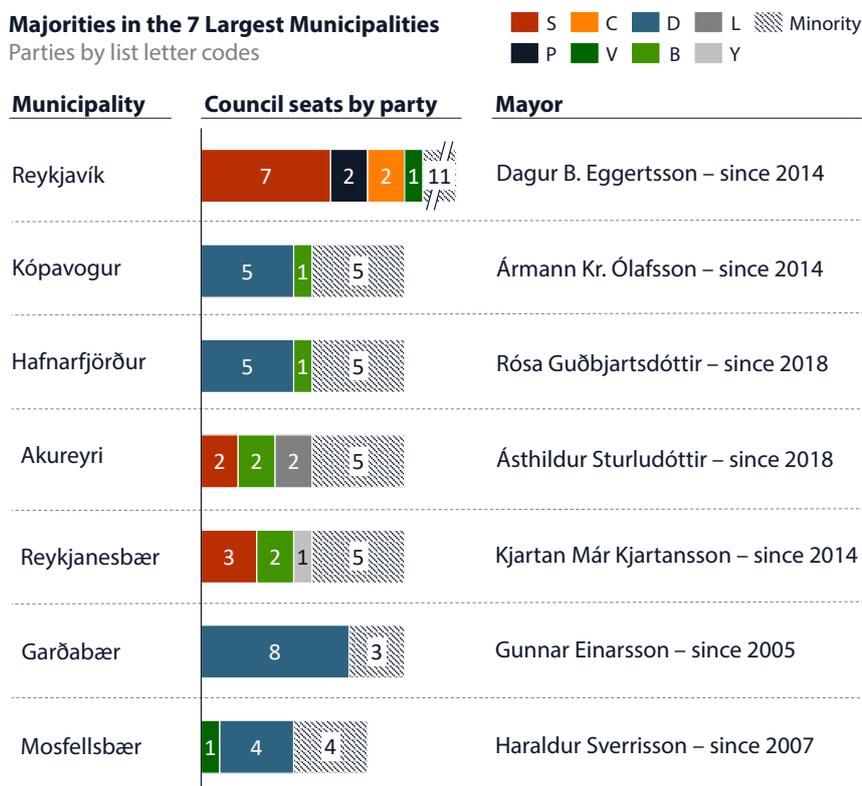
However, at least three current issues have proved challenging. First, a major labour market bargaining round commenced at the end of 2018 which is halfway through (Section 4.1). Second, the economy is slowing down and is predicted to contract in 2019 (Section 1.3). Thirdly, tensions have been mounting around Iceland’s participation in the European Economic Area.

Municipalities

Municipalities in Iceland govern zoning and planning and provide a number of services. Those include kindergartens, primary education, waste management, public transportation, public housing and some healthcare as well as social services. The total number of municipalities is 72 and their expenditures are 13% of GDP, making them a large player in the Icelandic economy.

Figure 2.4

Most mayors in the largest municipalities have served longer than one term



1 S – Social Democratic Alliance, C – Reform Party, D – Independence Party, P – Pirate Party, V – Left Green Movement, B – Progressive Party, L – L-list, Y – Direct way.



To achieve its aims, the government has set out to be proactive and forward looking by working on long-term policy agendas in numerous fields.

Municipal elections took place in May 2018 as they do every four years. In most of the larger municipalities the results signalled stability as majority of the mayors held their posts (Figure 2.2). In Reykjavík, the capital city, the Liberal Reform Party joined the majority from the previous term to form a new majority under the leadership of Dagur B. Eggertsson which has served as mayor since 2014.

European and International Relations

Iceland was a founding member of the North Atlantic Treaty Organisation (NATO) in 1949 and has been a member ever since, even though it has no military. It has also been a member of the European Free Trade Association (EFTA), since 1970, and entered into the European Economic Agreement (EEA) in 1994. Furthermore, the country is a member of the Schengen area. In essence, Iceland's membership in these institutions can be seen as the cornerstones of Iceland's foreign policy, although it carries out 25 diplomatic missions in 21 countries of the world, including Russia, India and China.

In 2019, Iceland assumed presidency of the Arctic Council, which is the chief body for cooperation within the Arctic. Eight states are members of the Arctic Council, and an additional 13 have observer status. Iceland is an important stakeholder in the Arctic and it's widely expected that issues regarding the Arctic will become more prominent as time passes, with opportunities such as new shipping routes opening to East-Asia (Section 7.3).

Iceland is not a member of the European Union. The country did apply for member status in 2009 but the negotiations were halted in 2013 and unilaterally terminated by Iceland in 2015. The current government does not plan on resuming negotiations.

In addition, tensions have been mounting around Iceland's participation in the EEA. These tensions have manifested themselves in the so called "Third Energy Package", an EU directive on energy regulation that has been agreed upon by EFTA and EU institutions and included in the EEA agreement. Being the largest energy producer per capita in the world, Iceland has considerable interests regarding common regulation in the energy field. A substantial portion of the nation believes that the new directive will erode the nation's control over its energy resources and should be rejected on that basis. Somewhat paradoxically, recent surveys conducted on behalf of the Foreign Ministry have shown that there is a majority for continued participation in the EEA agreement and only roughly 12% are against.

Additionally, it must be noted that most legal scholars do not believe that the nation's control of its resources is at stake. Even though rejecting a directive, that has been approved for the EEA, is legally provided for in the EEA agreement, this has never been done before and could have serious and doubtful implications for Iceland's continued participation in the EEA. Much is at stake as the EEA agreement is arguably Iceland's most important trade agreement which is underscored by that fact that the EEA countries are some of Iceland's largest trading partners, together accounting for 65% of the country's international trade (Figure 2.3).

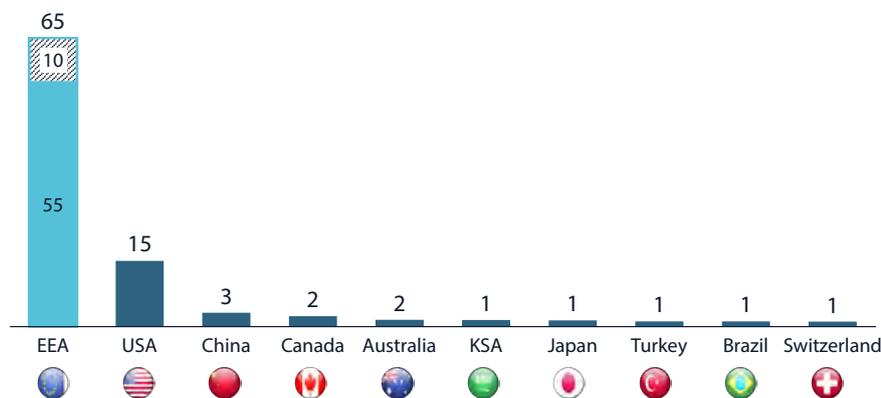
“

Iceland has also been a member of the European Free Trade Association (EFTA), since 1970, and entered into the European Economic Agreement (EEA) in 1994.

Figure 2.3

The EEA member states are some of Iceland’s largest trading partners

Iceland’s Largest Trading Partners ■ Other states ■ Britain ■ EEA states
Percentage of total trade in goods and services in 2017



Sources: Statistics Iceland, Iceland Chamber of Commerce

It remains to be seen whether the controversy surrounding the Third Energy Package is an isolated event or whether it will carry over to other proposed EEA legislation. As for the foreseeable future, Iceland will remain a participant of the EEA.

2.2 GOVERNMENT FINANCES

Government finances and fiscal policy have undergone major changes in recent years. Iceland’s public debt used to be low by international standards but surged in the aftermath of the financial crisis in 2008 (Figure 2.4). During the crisis, the government stepped in and recapitalised both the Central Bank and the large domestic banks. Additionally, tax revenues declined because of the economic contraction and welfare expenditures increased. All of this led to a large budget deficit which persisted for several years following the crisis.

Figure 2.4

Public debt has decreased significantly in recent years and is primarily domestic

General Government Debt¹ ■ Gross debt ■ Net debt
Percent of GDP



¹ Central Bank forecast after 2018

Sources: Central Bank of Iceland (Economic Indicators June 2019).

“
After austerity measures and economic recovery, the central government achieved a budget surplus again in 2014.

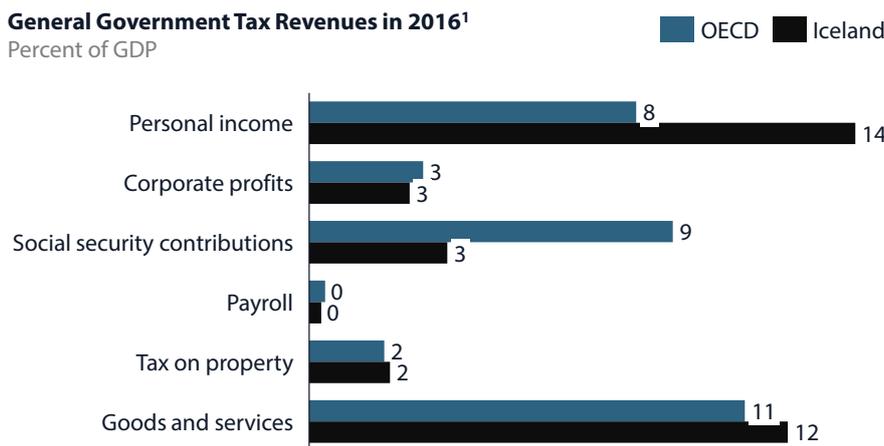
After austerity measures and economic recovery, the central government achieved a budget surplus again in 2014. In 2016, the budget surplus amounted to a whopping 12% of GDP. However, this result is primarily due to one-off payments as part of the failed banks estates' settlements. In 2018 the budget surplus was down to 1.3% of GDP. Due to the economic slowdown a -0,8% of GDP deficit is expected this year in an updated fiscal policy statement.

The fiscal policy framework has changed and improved in recent years mainly due to an Act on Public Finances passed in 2015. The main objective of the Act is to ensure sound macro-fiscal policy based on comprehensive medium-term budgeting and reporting. The Act entails a 5-year fiscal policy statement and fiscal plan and numerical fiscal rules on public debt and surplus/deficit.¹

Tax revenues in Iceland amounted to 1.028 bn. ISK in 2018, over one-third of GDP, of which 30% was municipalities' revenue that mostly consists of personal income tax and tax on property. The largest difference between Iceland and other OECD countries in terms of tax revenues is in personal income tax and social security contributions (Figure 2.5). The latter is mostly explained by Iceland's fully funded private pension fund system meaning that only a relatively small portion of pension payments comes from the government (Section 3.4). When adjusted for this difference, Iceland has relatively high taxes which in turn are mostly explained by higher taxes on personal income than the OECD average.

Figure 2.5

Taxes on personal income are high in Iceland while social security contributions are low due to high prevalence of private occupational pensions



¹ Tax on property in 2017 for Iceland due to one-off transactions regarding stability contributions of failed bank estates

Sources: OECD; Statistics Iceland.

The differences in pension systems are also reflected in significantly lower government spending on social protection (Figure 2.6). In other spending categories the Icelandic government relatively outspends the OECD countries. The main exception is defence where Iceland's spending is negligible since it has no military. As with taxes, majority of the spending is done by the central government, but municipalities are largely responsible for recreation and culture, social protection and education.

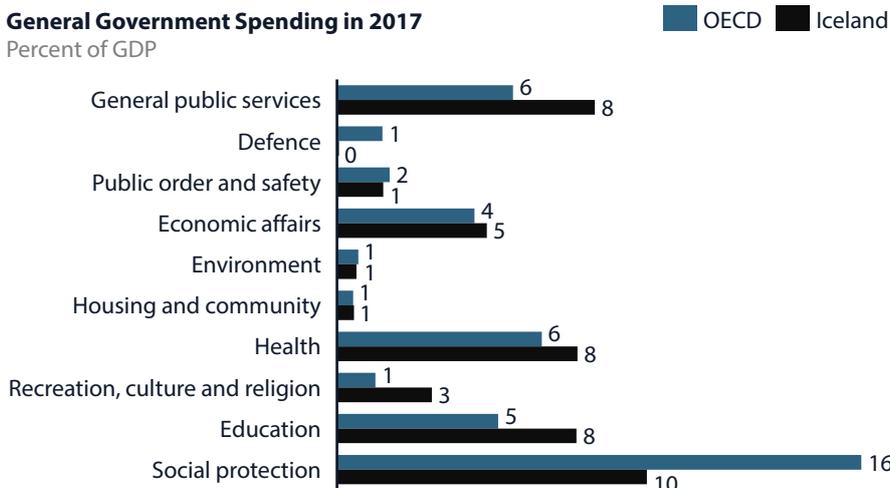


The differences in pension systems are also reflected in significantly lower government spending on social protection.

¹ 1. The balance result over a five-year period must always be positive, and the annual deficit may not exceed 2.5% of GDP. 2. Total debt may not exceed 30% of GDP. 3. If the debt ratio rises above 30%, the excess portion must decline by an average of at least 5% per year in each three-year period.

Figure 2.6

Public spending is relatively high in Iceland with the exception of defence and social protection, due to no army and a unique pension system



Sources: OECD; Statistics Iceland

Recently, as part of the collective bargaining agreement known as the Living Standard Agreement, the government committed to introducing a new low bracket with a 33% tax rate. Furthermore, the government, when formed in 2017, pledged to a number of other changes to the tax code, some of which have not yet been implemented. Among these are the reduction of the payroll tax by at least 0.25 percentage points and a reduction of the special bank tax from 0.376% to 0.145%. Moreover, R&D tax rebates are to be increased and the carbon tax (levied on gasoline) will also increase.



Recently, as part of the collective bargaining agreement known as the Living Standard Agreement, the government committed to introducing a new low bracket with a 33% tax rate.

Figure 2.7

The Icelandic tax system relies heavily on consumption and labor income

Key Taxes in Iceland

| Tax | Rate | Recent and proposed changes |
|----------------------------|---|---|
| VAT ¹ | 11% (Lower bracket), 24% (Higher bracket) | <ul style="list-style-type: none"> Lowered from 25.5%; lower bracket raised from 7% to 11% in 2015 |
| Labour income ² | 37% (Lower bracket), 46% (Higher bracket) | <ul style="list-style-type: none"> New lower bracket of 33% introduced in 2020. |
| Corporate tax | 20% | <ul style="list-style-type: none"> Unchanged since 2011 when it was increased from 18% to 20% |
| Dividends / Capital gains | 22% | <ul style="list-style-type: none"> Increased from 20% to 22% in 2017. Tax base is under review. |
| Payroll tax | 6.6% | <ul style="list-style-type: none"> Lowered by 0.25 pp in 2019 and a further 0.25 pp is planned |

¹ Consumption taxes fall into two brackets, the lower being 11% which includes e.g. tourism related activities, media, books, and groceries; the higher 24% which is the general rate; some service is exempt from consumption taxes, such as health service, public transport and schools.

² Income taxes are divided between two brackets, the lower being 36.94% for the first ~895 thousand ISK of an individual's monthly income, and the higher being 46.24% for income above ~895 thousand ISK. Further, each individual has a tax free allowance in the form of a tax credit, ~56 thousand ISK in 2019, which is subtracted from the gross tax payable each month.

Sources: PwC; Directorate of Internal Revenue; Finance Ministry and Economic Affairs; Iceland Chamber of Commerce

The Central Bank of Iceland (CBI) has the principal objective of promoting price stability with a 2.5% inflation target by setting key interest rate. Following the financial crisis, the CBI adopted the so-called “inflation targeting plus” with more intervention in the foreign exchange market, macroprudential tools, controls on certain capital inflows, which now have been lifted, and other adjustments.

Steady inflation within the 1.5 pp limits of the 2.5% target since January 2014 and better anchored inflation expectations have helped the CBI to lower rates in recent years, despite an economic boom. Rates remained unchanged from mid-2017 until 2018 when rates were hiked by 25 bps after inflation outlook worsened following depreciation of the Króna. Since, inflation has peaked, inflation outlook has improved and economic outlook significantly worsened after the collapse of WOW air. Those factors and less uncertainty of wage developments, after major collective agreements were signed in April (Section 4.2), have helped the CBI to lower rates by a total of 75 bps (Figure 1.9).² Currently, the key interest rate is 3.75% and at the end of July most analysts were expecting further rate cuts later in 2019.

The Central Bank is going through major changes in the coming months. Firstly, Már Guðmundsson's term as governor has ended and Dr. Ásgeir Jónsson, Dean of the Faculty of Economics at the University of Iceland, will assume the position. Secondly, new act on the Central Bank was passed at Althing in June which merges the CBI with the Financial Supervisory Authority. The Act doesn't change the main objectives and tasks of the two institutions but instead aims to improve efficiency and put more emphasis on financial stability with such roles merged in one institution. The act is largely based on a report by a task force on monetary policy framework which Dr. Jónsson chaired.³

² See more on wage agreements in section 4.1.

³ 11 proposals by the task-force, of which some will be implemented while other are under consideration: <https://www.government.is/lisalib/getfile.aspx?itemid=e49cb03e-6a48-11e8-942c-005056bc530c>

2.4 THE ICELANDIC KRÓNA

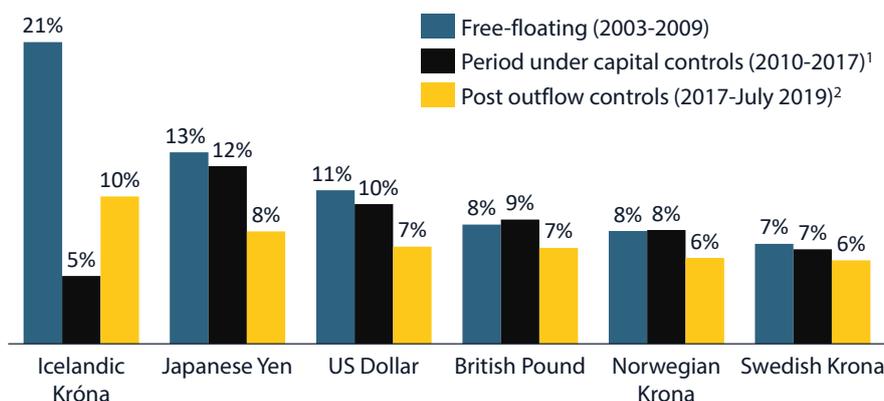
Iceland is among the smallest countries in the world to have its own floating currency, the Icelandic Króna (ISK). The monetary history of Iceland is a story of high inflation and exchange rate instability highlighted in the fact that the Króna has lost over 99% of its value to the Danish Krone since it was unpegged in 1922. That is hopefully only history and in recent years inflation has been subdued as discussed in Section 1.3 and short-term exchange volatility has been lower than prior to 2008 (Figure 2.9).

Figure 2.8

The Icelandic Króna has historically been a volatile currency

Exchange Rate Fluctuations Against the Euro

Annualised volatility of daily returns



¹ From 1st of January 2010 till 13th of March 2017. Capital controls were initially implemented in 2008 but were not effective until late 2009.

² From 13th of March 2017 till 14th of July 2017

“

The Central Bank of Iceland (CBI) has the principal objective of promoting price stability with a 2.5% inflation target by setting key interest rate.

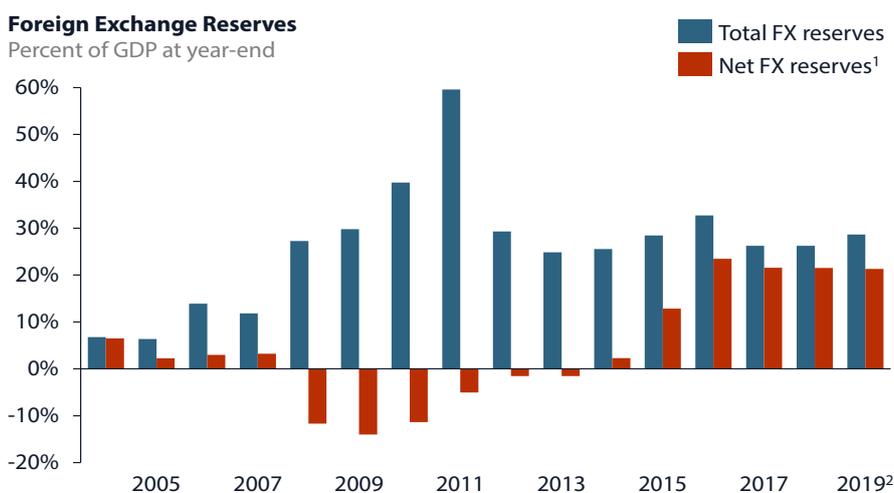
Before 2008 the Króna was a free-floating currency and capital flows were mostly unrestrained. During the financial crisis capital controls were implemented as a response to a sharp depreciation to minimise the impact of the ensuing balance of payment crisis. Under strict capital controls on outflows the economy recovered and the Central Bank amassed large reserves while the Króna appreciated in 2014-16 (Figure 2.10). As one would expect, fluctuation increased, once the most important steps to lift capital controls were taken. Since 2017 the Central Bank has stopped amassing FX reserves and its policy has been to prevent “spirals” in the FX market by intervening during large intra-day fluctuations.

Figure 2.9

The Central Bank has a large cushion to fend off short-term exchange rate fluctuations

“

The Central Bank has stopped amassing FX reserves and its policy has been to prevent “spirals” in the FX market.



¹ FX reserves less Central Bank's foreign currency liabilities, i.e. FX reserves financed in ISK.
² June 2019

Sources: Central Bank of Iceland; Iceland Chamber of Commerce

To further support monetary policy and prevent fluctuations due to carry trade the Central Bank put in place restrictions on capital inflows, with the so-called Special Reserve Requirement (SRR) in 2016. The measure was highly controversial and after interest rate differential decreased, as the economic outlook worsened, it was abolished in March 2019. More on the SRR and the capital controls can be found in previous versions of *The Icelandic Economy*.



We help startups grow within and out of Iceland by accelerating their businesses, and connecting them with leading experts, investors, and global startup hubs.

Our goal is to create value and contribute to economic growth with sustainable solutions for a sustainable future.

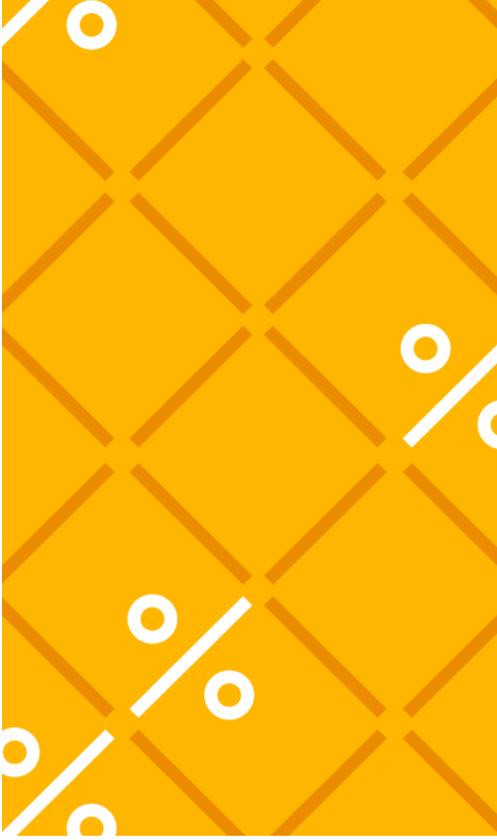


Together we make good things happen

Arion Bank is a leading universal relationship bank with a differentiated and innovative approach. We always aim to work closely with individuals, companies, and investors and help our customers prepare for the future.

If you are looking for an Icelandic financial partner that values innovation and provides unparalleled expertise, look no further.

Visit arionbanki.is/english or call us on **+354 444 7000** to see what we can accomplish together.



Helping companies doing business in Iceland since 1924

- Tax & Legal
- Accounting
- Consulting
- Assurance

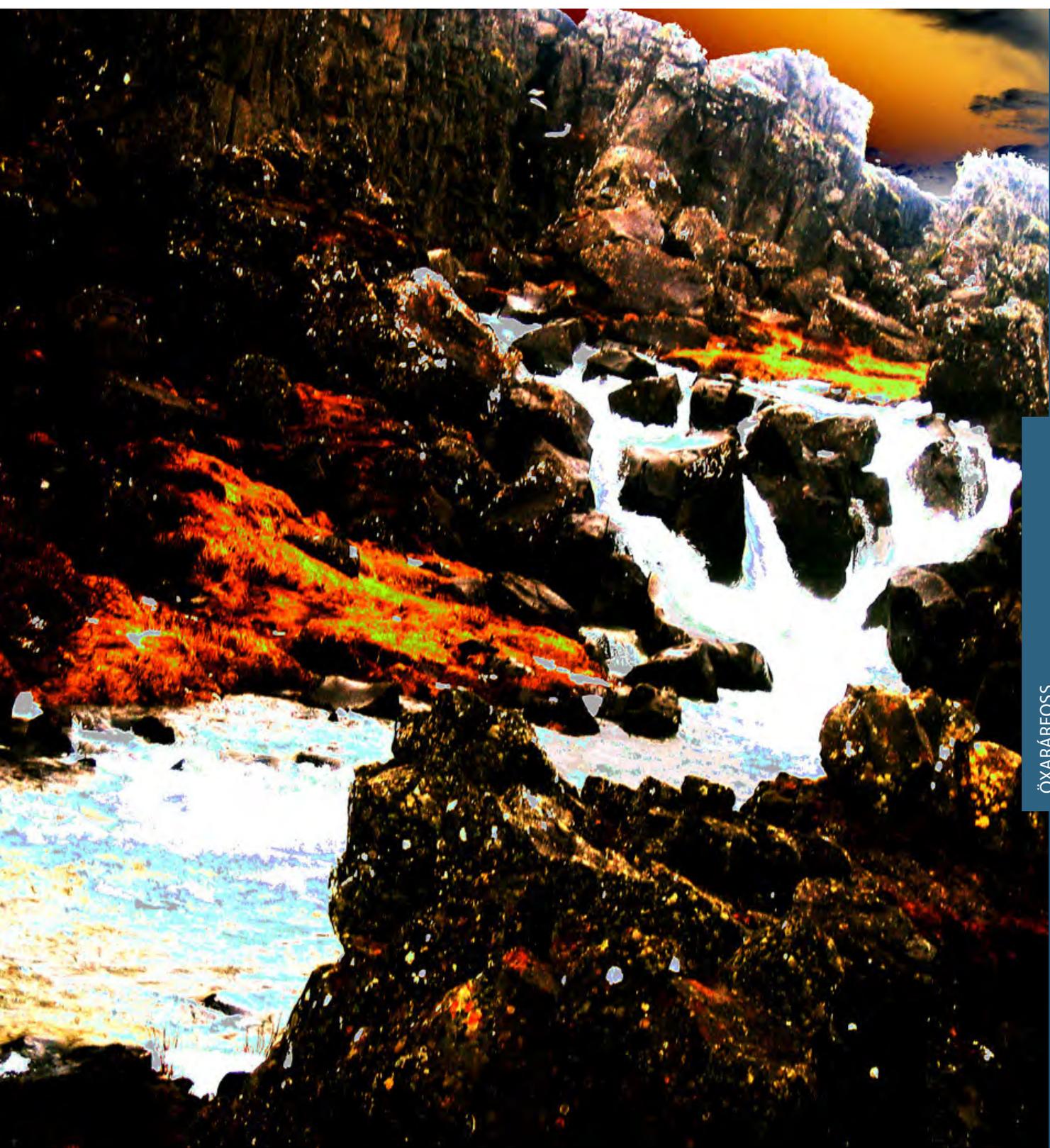
At PwC, our purpose is to build trust in society and solve important problems. It is this focus which informs the services we provide and the decisions we make.

PwC | Tel.: +354 550 5300 | www.pwc.is

Reykjavík | Akureyri | Reykjanesbær | Húsavík | Selfoss | Hvolsvöllur | Vestmannaeyjar

@ 2019 PricewaterhouseCoopers ehf. | All rights reserved





ÖXARÁRFOSS

FINANCIAL SECTOR

The Icelandic financial system underwent major changes leading up to, during and following the financial crisis of 2008. Important measures to improve the long-term competitiveness of the finance sector, most importantly the lifting of capital controls, have been taken. Still, Iceland generally lags the other Nordic countries in competitiveness on indicators related to financing such as access to venture capital and the cost of capital (Section 1.2). There are further opportunities to improving as illustrated in a recent government *“White Paper on a Future Vision for the Financial System”*.¹

3.1 THE BANKING SYSTEM

The Icelandic banking system consists mainly of three universal banks: Arion Bank, Íslandsbanki and Landsbankinn, amounting to more than 95% of the system’s total assets. Other banks are Kvika (primarily an investment bank), and small savings banks, as well as a few smaller financial institutions.

After the financial crisis the banking system almost entirely fell in the hands of the government and the old bank’s creditors. Following the settlement of the estates the government became the sole owner of Íslandsbanki. The government has also owned 98% of Landsbankinn since 2009 meaning that only Arion Bank is owned by private investors and publicly listed. The government aims to start selling its shares in Landsbankinn and/or Íslandsbanki later this electoral term.¹²

The banks’ function and balance sheets have changed enormously over the past decade. Large part of the Icelandic banks’ operations and funding were overseas and the balance sheets had expanded rapidly until 2008. Today the banking system is much smaller, more equity and deposit funded and with almost exclusive focus on the Icelandic economy (Figure 3.1).

“The government aims to start selling its shares in Landsbankinn and/or Íslandsbanki later this electoral term.

¹ Overview of the White paper in English: <https://www.government.is/news/article/?newsid=c572f06d-fc6f-11e8-942f-005056bc4d74>

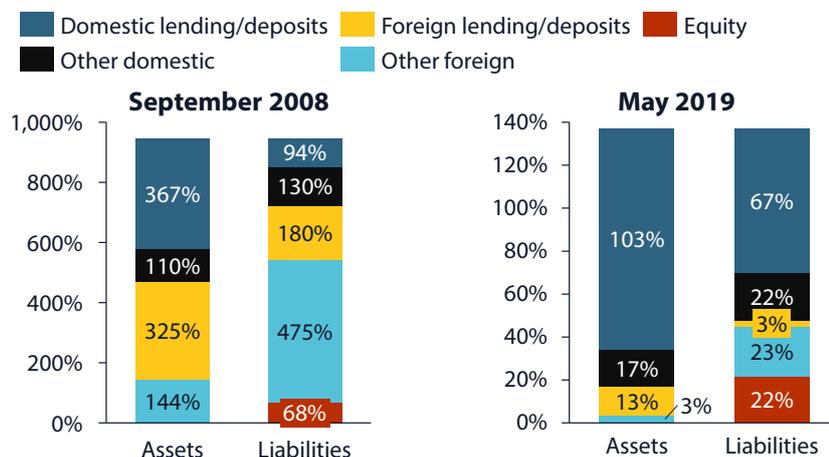
² Interview with Icelandic State Financial Investments’ chairman: <https://www.vb.is/frettir/bankarnir-seldir-naestu-tveimur-arum/155614/>

Figure 3.1

The Icelandic banking system is less leveraged, much smaller and primarily serves the domestic market

Aggregated Deposit-Taking Bank’s Balance Sheet¹

Percent of GDP



¹ Arion Bank, Íslandsbanki, Kvika, Landsbankinn, savings banks and their predecessors. Assets and liabilities are classified by location, not currency. That means domestic assets can, for instance, be denominated in foreign currency.

Over the past few years, investors' trust in Iceland has been rising. Since mid-2015, Iceland's credit rating has improved from BBB- to A. The abolishment of capital controls, strong economic growth and the improved external position of the economy have played a major role in improving Iceland's credit rating since 2012 (Figure 3.2). According to foreign credit rating agencies, the indicators driving this positive development include the accumulation of wealth in the economy which has provided significant shock-absorption capacity, strong institutional focus on avoiding vulnerabilities that led to the 2008 banking crisis and a well-funded pension system. Strong government finances and high per capita income levels have also been a rationale for the rise in credit rating.

Figure 3.2

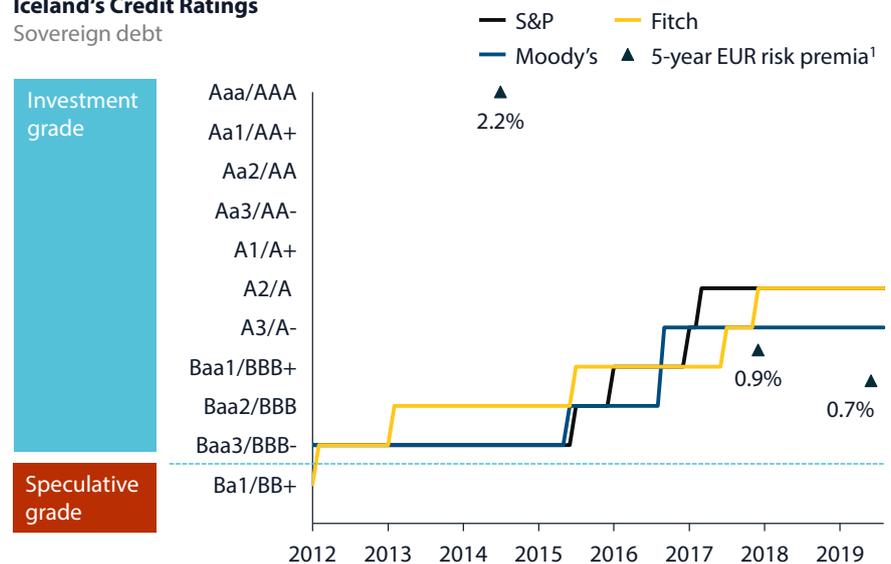
Iceland's credit rating has improved in recent years but is now stagnant due to rising uncertainties



Over the past few years, investors' trust in Iceland has been rising. Since mid-2015, Iceland's credit rating has improved from BBB- to A.

Iceland's Credit Ratings

Sovereign debt



¹ Interest rate differential between Icelandic and German government bonds at the time of issuance of Icelandic EUR bonds.

Sources: Central Bank of Iceland; Iceland Chamber of Commerce

These improvements have been reflected in a substantial decrease in the risk premia on Icelandic government foreign debt. The main risks facing the Icelandic economy, according to the agencies, are a sharper economic downturn and balance of payments related risks such as excessive outflows and the resorting back to capital controls.

Over the past few years, both the Icelandic stock exchange NASDAQ Iceland (ICEX) and bond markets have evolved and gradually gained momentum. Since December 2011, more and more Icelandic firms have been listed on the main stock exchange, most recent being Kvika bank in March 2019. The number of firms listed at the Icelandic Stock Exchange are 23, 19 of whom are listed at OMX Iceland. The total market capitalisation of OMX Iceland and First North (a less strict listing for smaller firms), is ISK 1.179 billion (42% of GDP 2018).³

The equity market yielded high returns until stagnating in 2015 (Figure 3.3). This year returns have, particularly due to a surge in the price of Marel (the largest listed company) prior to dual-listing in Amsterdam. In comparison, bonds have yielded strong returns and about 9% YoY in June this year driven by lowering interest rates and lower yields. Real estate price increases were rapid up until 2017 when new housing entered the market, economic growth peaked and prices were historically high on most relative measures (Section 4.2).

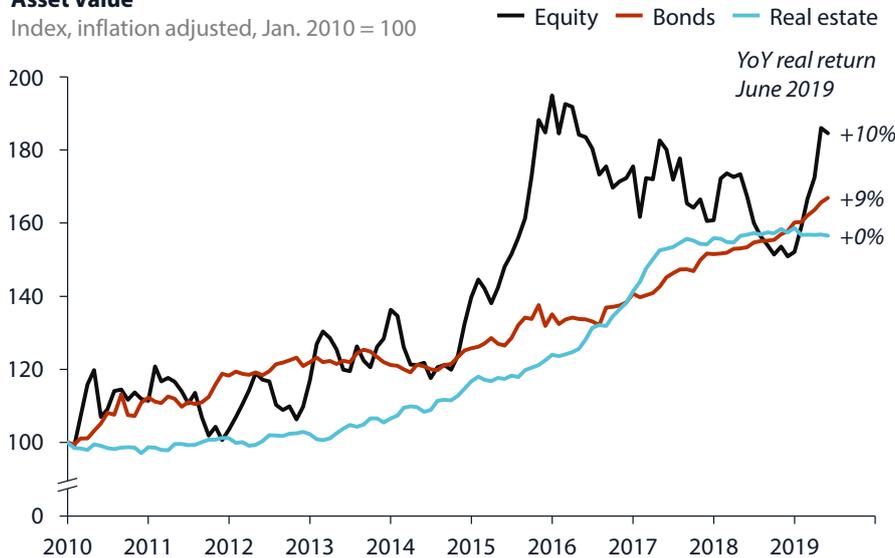
³ As of 29 July 2019.

Figure 3.3

Domestic assets appreciated significantly during Iceland's recovery but valuation of equities and real-estate has recently been sluggish

Asset Value

Index, inflation adjusted, Jan. 2010 = 100



Sources: GAM Management; Registers Iceland; Statistics Iceland; Iceland Chamber of Commerce

A small economy such as Iceland does neither encompass asset markets as deep as those typical of larger developed economies, nor as many asset classes. Ownership within the Icelandic stock market has been rather concentrated over the past few years with pension funds owning 38% of listed shares.⁴ General public stock market investment decreased significantly after the crisis, and was only around 4% in 2017, compared to 11-17% in 2002-2007. Mutual funds, other private investors and foreign investors own bulk of other stock.

Foreign investment in Iceland picked up around when plan for lifting capital controls was announced but has remained relatively modest with foreign investors owning only 15% of government bonds in June 2019 and seemingly comparable minority of stocks. After the Central Bank announced a new capital flow instrument (SRR) in November 2015 and imposed it in June 2016 there was a notable slowdown in bond investments coming from abroad (Figure 3.4). Thus, investments were more directed towards the stock market. In early 2017 there were substantial capital inflows into unlisted equities, tied to the sale of the holding of Arion Bank to foreign investors. Over the past year there has been a significant slowdown in investment flows despite decent returns, which have contributed to a depreciating Króna.

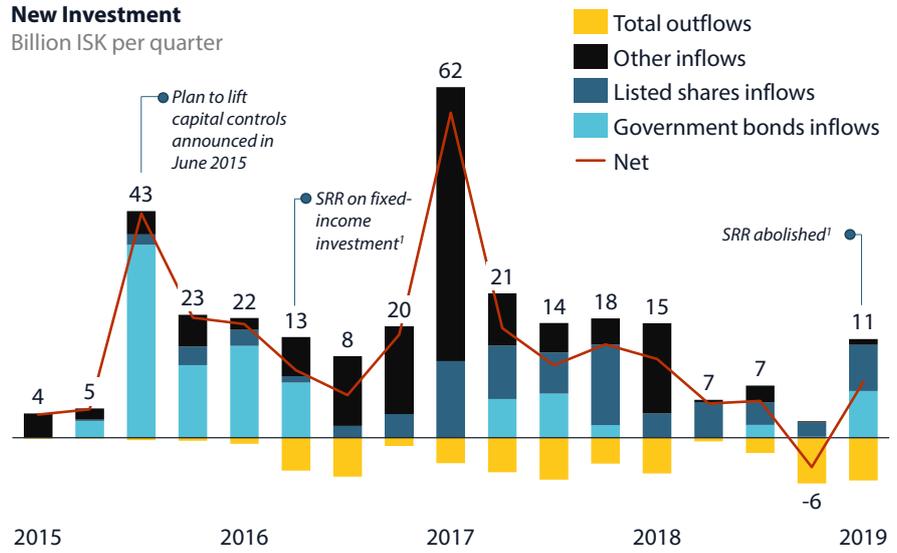
⁴ CBI's Financial Stability 19/1.

“Ownership within the Icelandic stock market has been rather concentrated over the past few years with pension funds owning 38% of listed shares.”

“
The Icelandic pension system is different from many other countries as it relies more on mandatory savings, making it fully-funded, rather than pay-as-you-go.

Figure 3.4

Restrictions on capital inflows (SRR), which have now been lifted, have influenced the composition of investment inflows



1 SRR=Special Reserve Requirement

Sources: Central Bank of Iceland (Economic Indicators June 2019); Iceland Chamber of Commerce

3.4 PENSION FUNDS

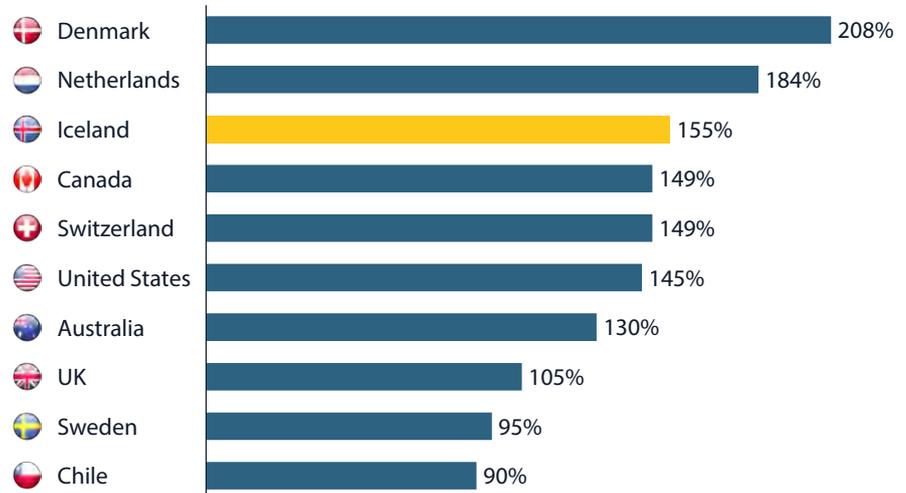
The Icelandic pension system is different from many other countries as it relies more on mandatory savings, making it fully-funded, rather than pay-as-you-go. The system is one of the largest in the world relative to the economy (Figure 3.5). It is expected to continue growing over the coming decades, partly because of Iceland’s relatively young population which has the second lowest old-age dependency among the EEA countries (Figure 3.6). Premiums have increased in recent years which also will enhance the funds’ growth.

Figure 3.5

Despite a young population, Iceland has relatively one of the largest pension systems in the world

Private Pension Assets 2018

Percent of GDP



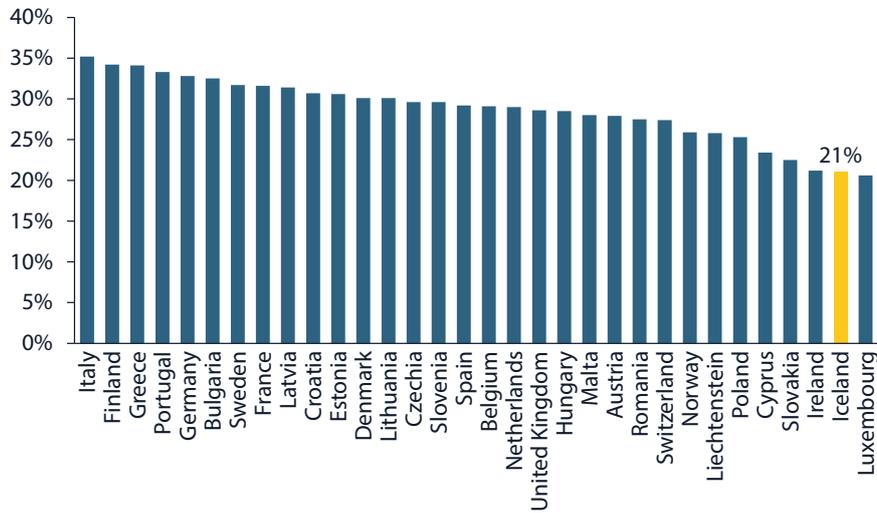
Source: OECD Global Pension Statistics

Figure 3.6

Iceland's population is the second youngest in the European Economic Area

Old-Age Dependency Ratio in 2018

Population 65 and over to population 15 to 64 years



Source: Eurostat

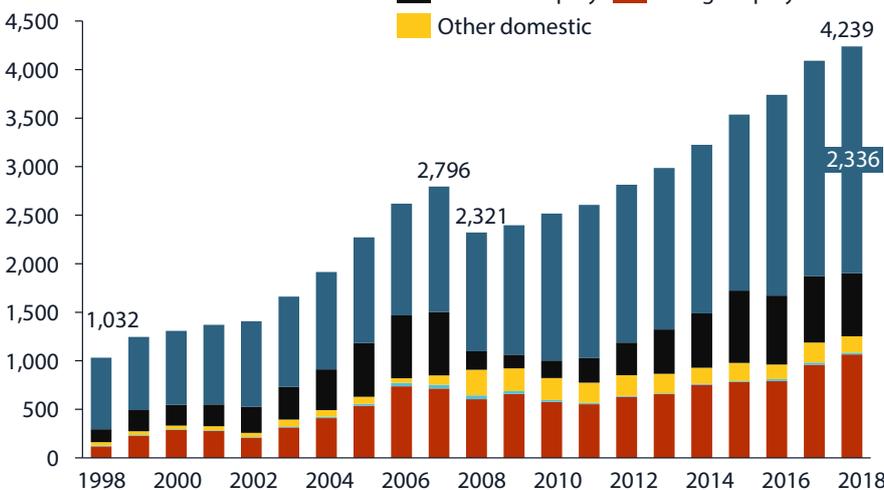
The system consists of 21 funds where the three largest funds hold approximately half of all assets. The pension funds played a key role in kickstarting the economy during the restructuring of many businesses after the financial crisis and they remain prominent in most business sectors. However, majority of pension fund assets are government bonds, mortgage backed bonds and lending and other debt instruments (Figure 3.7). Since 2016 many pension funds have increased mortgage lending to members which amounted to 95 bn. ISK, net, in the last 12 months.

Figure 3.7

Pension funds are outgrowing the economy due to decent returns and high premiums

Pension Funds' Total Assets

Billion ISK at 2018 prices



Sources: Central Bank of Iceland; Statistics Iceland; Iceland Chamber of Commerce



The pension funds played a key role in kickstarting the economy during the restructuring of many businesses after the financial crisis and they remain prominent in most business sectors.

“

Despite having few investment options while restricted to the local economy, the funds had good returns on investments.

After free capital outflows were allowed in March 2017 the pension funds were able to diversify their portfolio abroad. The Central Bank estimates that the pension funds in total invested ISK 109 billion (4% of GDP) abroad in 2018. Some have argued that 40-50% of total pension assets should be invested abroad but today this proportion is 27%, up from 20% in 2016.⁵

Despite having few investment options while restricted to the local economy, the funds had good returns on investments. From 2010 - 2015 the Icelandic pension system had a real return of 5.7%, while over the same period the OECD average was 3.6%.⁶ Unfortunately returns in 2016-2018 averaged in 2.3%, substantially below the 3.5% discount rate of pension benefits. Maintaining 3.5% or higher returns in a lower interest rate environment will be a big challenge for pension funds.

⁵ Áhættudreifing eða einangrun (2014): <http://audfraedi.is/library/Skrar/A%CC%81h%C3%A6ttudreifing%20e%C3%B0a%20einangrun.pdf>

⁶ „Umsvif lífeyrissjóða í Íslensku efnahagslífi“, Institute of Economic Studies (Hagfræðistofnun), October 2017.

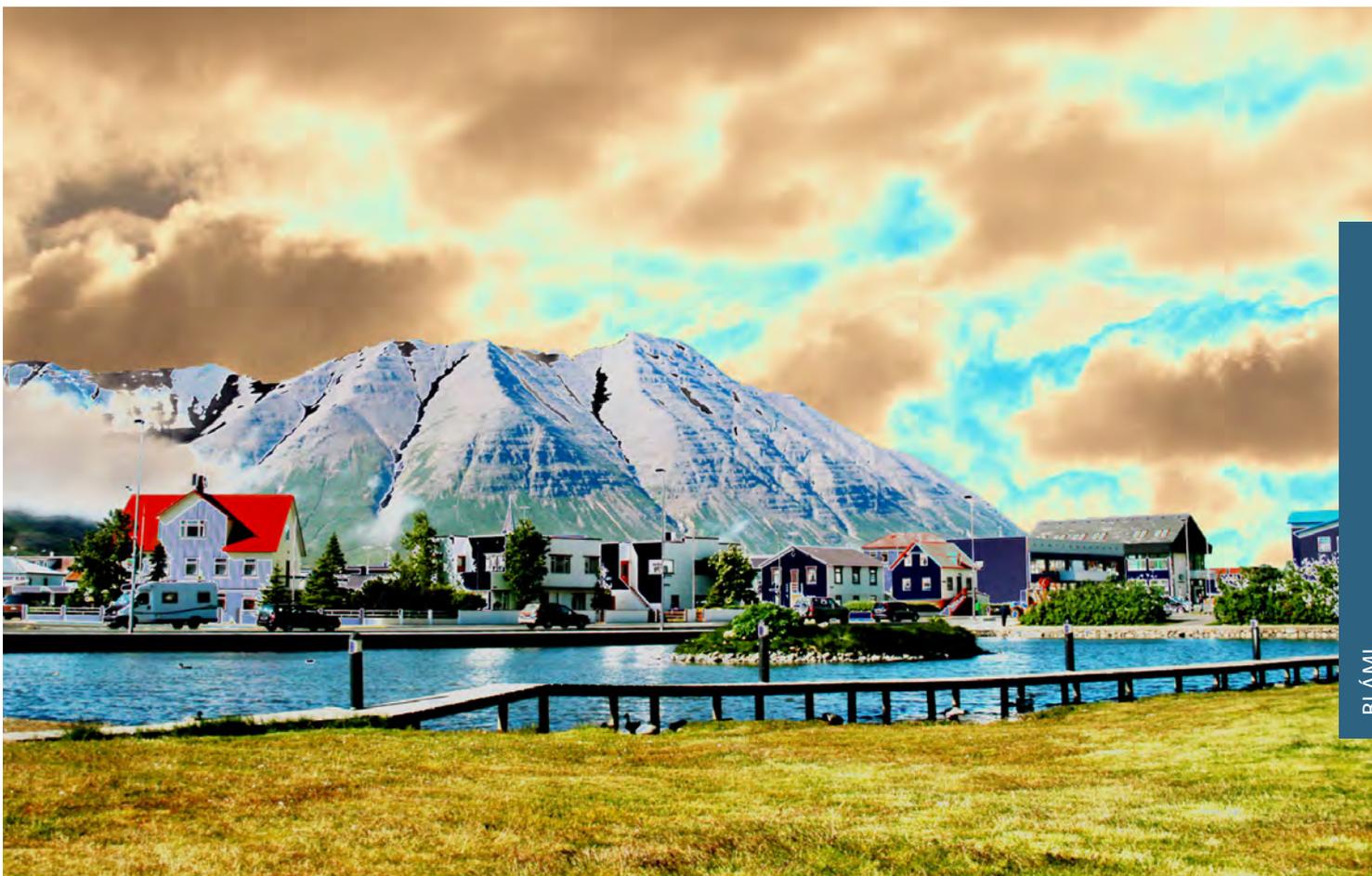


Leading for over 100 years. As the largest law firm in Iceland, we provide legal advice that is practical, relevant and individually tailored to meet the specific needs of each client. LOGOS also holds the leading position as adviser to international clients with interests in the Icelandic market.

A small minority
of executives are
fortune tellers.

Gallup is for everyone else.

GALLUP



DOMESTIC SECTOR

Iceland's domestic sector consists of industries that mostly provide non-tradeable goods and services for the domestic market. This includes, wholesale & retail, real estate, construction, arts & entertainment, public services, the domestic components of information & communication, tourism & logistics and business services as well as and financial services, which were covered extensively in chapter 3.

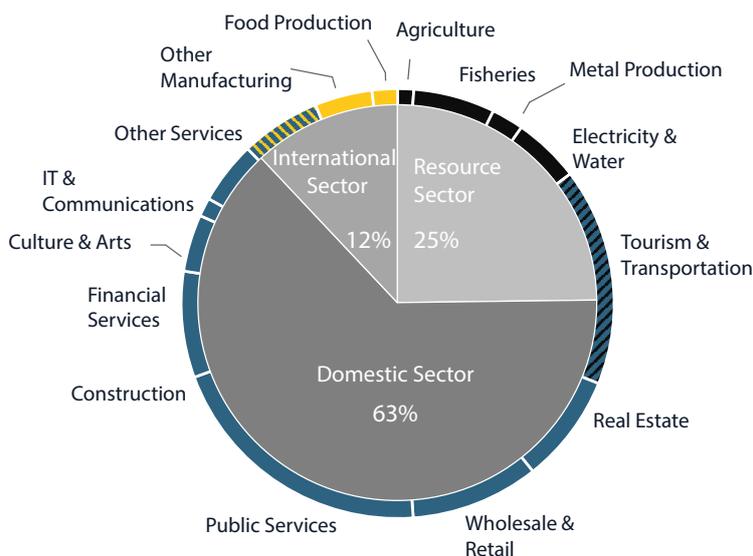
The domestic sector as a whole directly produces almost two thirds of the nation's GDP where public services account for a third of the domestic sector or approximately 20% of GDP (Figure 4.1). The development of the sector therefore plays a vital role in the economy's performance. In general, the industries that make up the domestic sector, are mature, with a demand strongly linked to the business cycle.

Figure 4.1

The domestic sector accounts for about two thirds of the economy

Composition of the Icelandic Economy

Percent of GDP



Sources: Statistics Iceland; McKinsey & Company; Iceland Chamber of Commerce

As such, increased productivity is the key challenge for the sector which was underscored in a 2012 McKinsey report which identified the domestic sector as lagging behind other sectors in terms of productivity. McKinsey estimated that by catching up to the other Nordics in terms of productivity in the domestic sector, roughly 13,000 jobs could be moved to other exporting sectors.



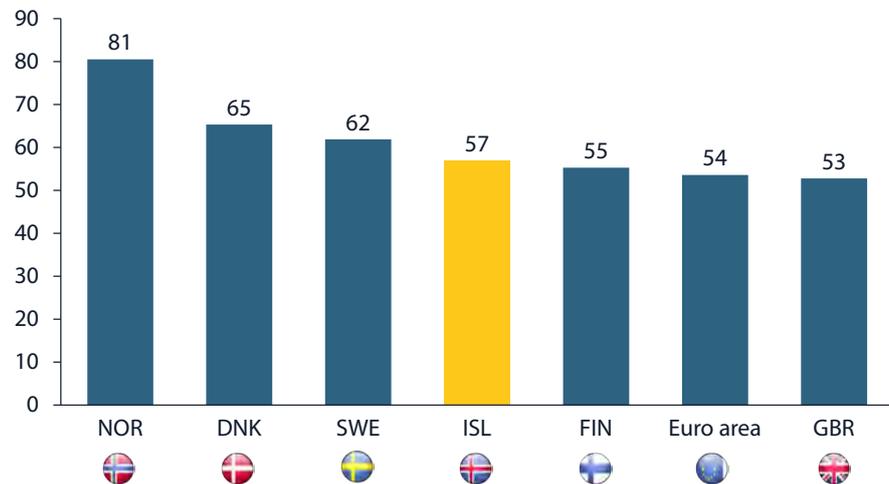
Iceland's domestic sector consists of industries that mostly provide non-tradeable goods and services for the domestic market.

Figure 4.2

Productivity has been increasing in Iceland, putting it above Finland and United Kingdom in terms of GDP per hour worked

GDP per Hour Worked in 2018

US dollars, constant prices 2010 (PPP)



Source: OECD

“

When measured as GDP per hour worked, Iceland's overall productivity level is slightly above the average European level.

When measured as GDP per hour worked, Iceland's overall productivity level is slightly above the average European level of productivity but slightly below the productivity levels of the all the other Nordic countries with the exception of Finland (Figure 4.2). This is based on 2018 data from Statistics Iceland which has a new and more estimate for actual hours worked, which shows that Iceland's productivity is relatively higher than previously estimated.

There is still room for improvement and evidence indicates that restrictive regulation may be a drawback of productivity levels in the economy. When it comes to services trade restrictiveness of regulation Iceland is the most restrictive out of all the OECD countries. Iceland moreover ranks third on the list of most heavily regulated OECD countries when it comes to FDI regulation.

Iceland has experienced a relatively strong productivity growth over the last decade. Total labour productivity growth peaked at 3,5% increase in GDP per hours worked in 2016. However, with the economy set to contract in 2019 the Central Bank is now forecasting a slight productivity decline this year before getting back on the growth path in 2020.

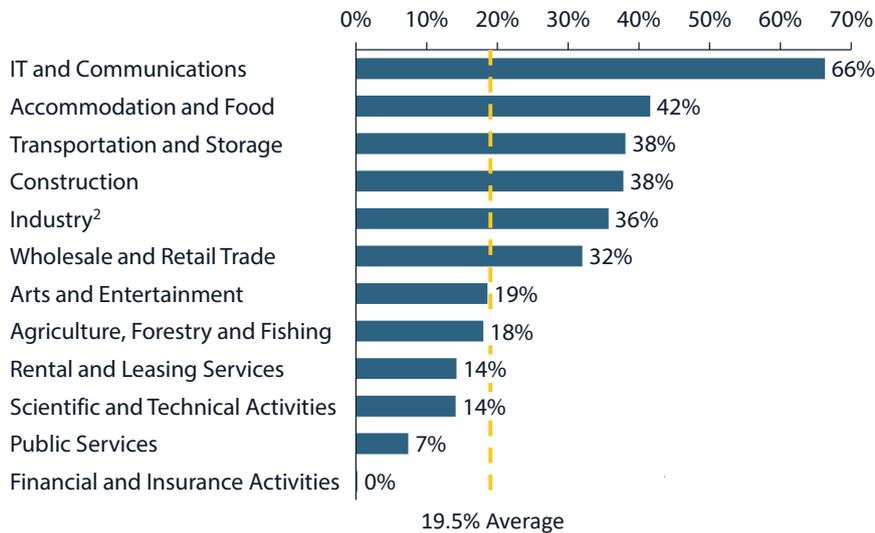
On an industry level, productivity has grown most in those industries affected by tourism and technological improvements, while those lagging behind are rental and leasing activities, the public sector and financial and insurance activities. The Chamber estimates, with a generous confidence interval, that since 2010, 4.000 jobs have been moved from the domestic sector, mostly to the resource sector due to tourism but also to the international sector (Figure 4.3).

Figure 4.3

Productivity gains are different across sectors but are seemingly largest in sectors affected by tourism and technology

Productivity Changes by Sectors¹

Cumulative percentage change from 2008 to 2018



¹ All sector definitions are according to NACE V.2

² Mining and quarrying; manufacturing; electricity, gas, steam and air conditioning supply; water supply; sewerage, waste management and remediation activities

Source: Statistics Iceland

Furthermore, several measures have been implemented in the past years to increase the openness of the economy and foster increased competition, which were believed to be the key drivers of productivity in the aforementioned McKinsey report. Competition was seen to drive innovation and promote incentives to reduce inefficiencies while openness supported increased competition, expanded market size and mitigated the trade-off between operating scale and market dominance. Chief among those measures was the abolition of custom duties on all goods and services excluding agricultural goods.

“

The landscape in Icelandic retail has changed considerably in the last years with the entry of global brands and companies into the retail market and a growing e-commerce.

Changed landscape in retail

The landscape in Icelandic retail has changed considerably in the last years with the entry of global brands and companies into the retail market and a growing e-commerce. The two most notable entries have been the clothing retailer H&M which has opened three stores in recent years and Costco, the American warehouse club, which opened their first store in the Nordics in May 2017 and took Iceland by storm.

This development along with global trends in e-commerce and other cross border trade in goods and services has intensified competition in the retail market which prompted consolidation by domestic players in the market in response. The country's largest supermarket retailers announced plans to merge with petrol station retailers and pharmacies. In the end two of the largest retailers, Hagar and Festi, merged with two of the three largest petrol stations, Olís and N1, respectively. Competition authorities blocked some mergers which has fuelled debate on whether Icelandic authorities are not fully recognising that digitisation and globalisation have introduced new competition to the market.

The Icelandic labour market is highly unionised, with union density over 80%. The market is very regulated in the sense that collective bargaining agreements cover approximately 88% of the workforce.¹

Compared to other OECD economies the structural unemployment rate in Iceland is fairly low at around 3.5-4.0%. After the financial crisis unemployment rose to roughly 7.6% but gradually declined up until 2018 when it was 2,7% on average (Figure 4.4). This development occurred even though Iceland experienced a large influx of foreign labour that has substantially expanded the labour force (Figure 4.5). Moreover, the wage level has risen substantially in recent years underscoring strong economic growth. With the changing economic landscape, particularly the bankruptcy of WOW air, unemployment has been rising again in 2019 and in May seasonally adjusted unemployment stood at 4,7%.

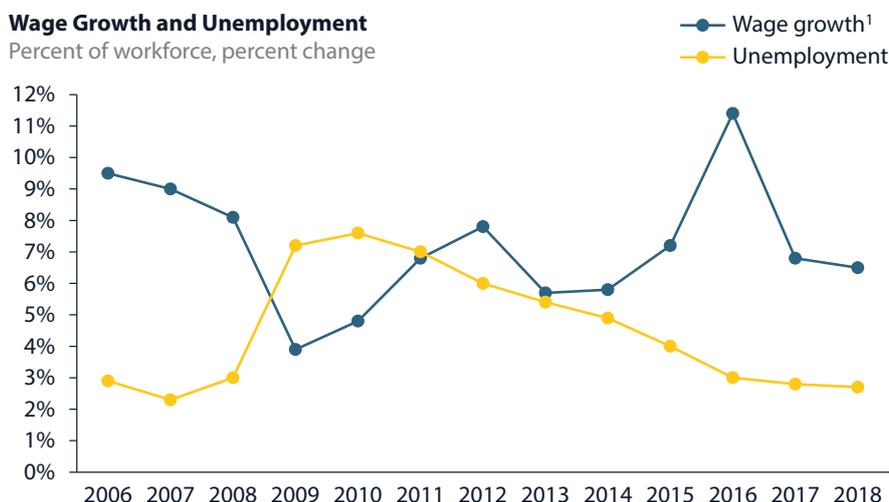
¹ The Icelandic Confederation of Labour: <https://www.asi.is/engpol>



The market is very regulated in the sense that collective bargaining agreements cover approximately 88% of the workforce.

Figure 4.4

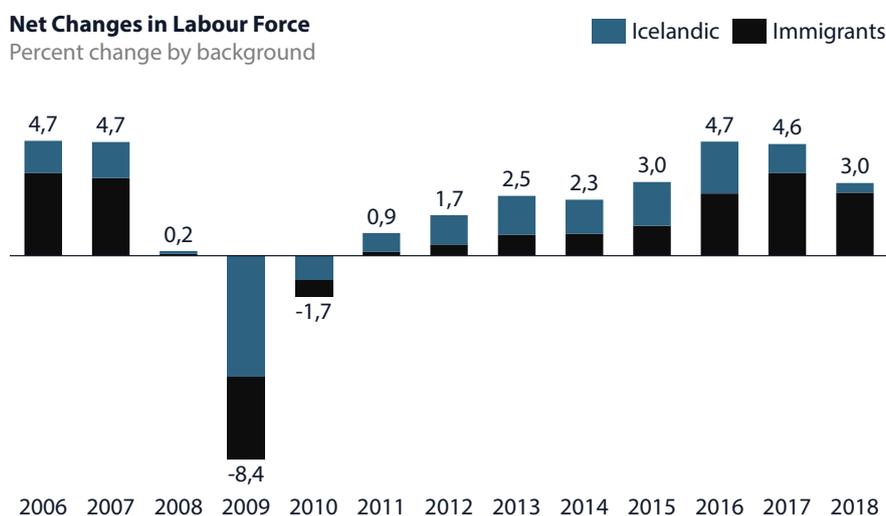
The labour market had a declining unemployment rate amid very high wage growth but that trend is now shifting



¹ Measured as yearly change in the Wage Index
Source: Statistics Iceland

Figure 4.5

Iceland has experienced a strong influx of foreign labour in recent years



Sources: Statistics Iceland; Iceland Chamber of Commerce

Major Bargaining Round Ongoing

The Icelandic labour market has historically been a driver of instability where wage negotiations have resulted in high nominal wage increases, often in excess of productivity increases plus inflation target. This has resulted in higher levels of inflation, counteracting benefits to the workforce.

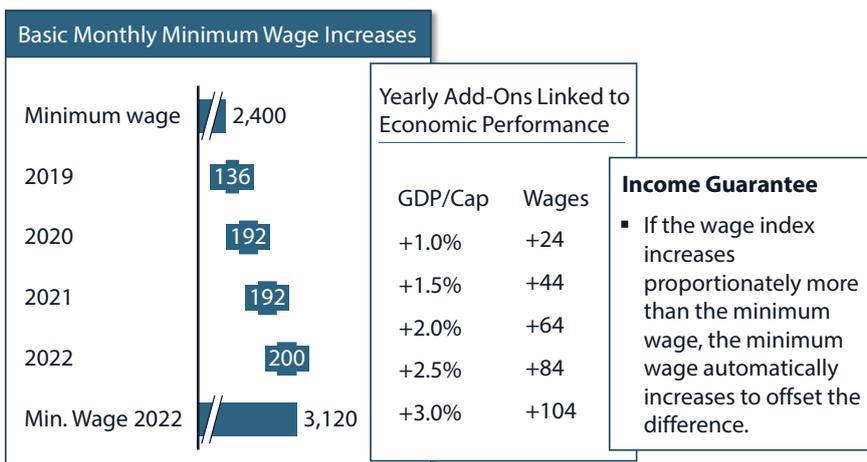
A bargaining round is ongoing, the first for a new and more radical leadership in the labour unions. Over 240 collective agreements were up for renegotiation at the beginning of the year and in the early months of 2019 labour negotiations seemed destined to follow the historical path of high nominal wage increases with the ensuing inflation. However, Wow air bankruptcy occurred in the middle of negotiations and somewhat changed the basis on which they took place, as expectations of an uptick in unemployment took hold. A week later, the largest labour unions in the private sector and the Confederation of Icelandic Enterprise signed a 4-year agreement dubbed "The Living Standards Agreement." It partially links wage hikes to economic performance, measured as GDP per capita, and prioritises absolute wage increases as opposed to percentage increases.

Figure 4.6

The Living Standard Agreement has multiple components with emphasis on absolute wage increases

Wage Increases in the Living Standard Agreement

USD¹



¹ All numbers are USD based on the USDISK Exchange rate of 125

Source: Confederation of Icelandic Enterprise

As is customary in order to solidify major labour market agreements, the government pledged to a number of changes to public policy that are estimated to cost 80 billion ISK over the four-year period, which is just short of 10% of government expenditures in 2018. The most significant government measure is to overhaul the personal income tax code by instituting a new lower tax bracket and increasing child benefits.² Further, parental leave will be expanded from 9 months to 12 months and several measures will be implemented to improve affordability of housing.

The Living Standards Agreement was a benchmark for other collective agreements and most of the private market soon followed suit with similar agreements. As of August 2019, the only major piece of the puzzle left unsolved is the public market where no major agreements have yet been made. The composition of the public market is somewhat different to the private market with a higher share of university educated workers and specialists whose interests may not align with the framework of the Living Standards Agreement. Therefore, it remains to be fully seen whether the ongoing bargaining round will align fully with the business cycle or provide grounds for inflation to break out.

² Child benefits are a part of the personal income tax code as they are tax free and income related.

“

Over 240 collective agreements were up for renegotiation at the beginning of the year.

Iceland's housing market recovered at a modest pace in the first half of this decade after a sharp decline following the financial crisis when the housing market effectively came to a halt in terms of prices, turnover and housing investment reached a historical low. Prices then surged, particularly in 2015-17, largely because of demand pressures - rising incomes, booming tourism and population growth while residential housing investment remained low. Furthermore, the CBI has since August 2016 cut rates by 2 pp and pension funds have actively been financing household mortgages, which has increased competition. These factors have increased demand fast, resulting in real estate and rent price increases.

Figure 4.7

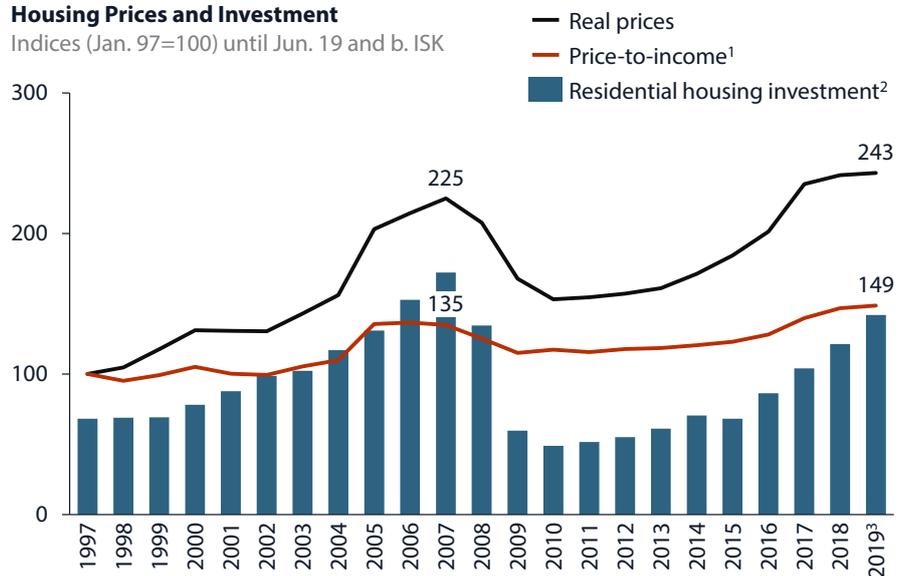
Housing prices are at historical high but since mid-2017 price increases have been subdued

“

Prices then surged, particularly in 2015-17, largely because of demand pressures - rising incomes, booming tourism and population growth while residential housing investment remained low.

Housing Prices and Investment

Indices (Jan. 97=100) until Jun. 19 and b. ISK



¹ Housing prices/Median disposable income per capita.

² Billion ISK at 2018 prices.

³ Inflation and housing prices for June 2019 and Investment and income based on CBI forecast for the year.

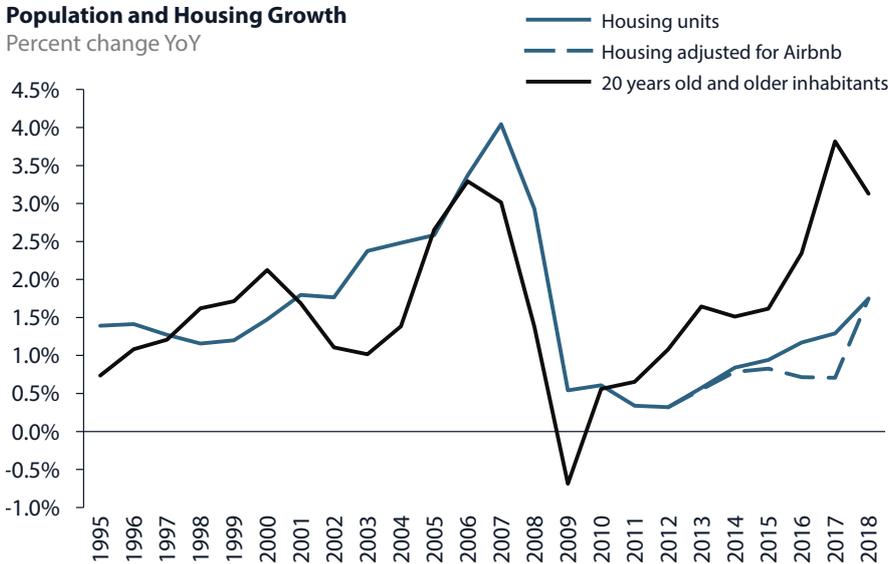
Sources: Statistics Iceland; Central Bank of Iceland; Registers Iceland; Iceland Chamber of Commerce

These price surges peaked in May 2017 when the year-on-year increases in Greater Reykjavík reached 24%. Since then the market has levelled off with the economy cooling down and more new housing construction (Figure 4.7). In June 2019 the year-on-year price increases had dropped to 3.2%. Price increases are still relatively strong in municipalities neighbouring Greater Reykjavík (7% year-on-year in June 2019).

Since January 2011 rent prices in Greater Reykjavík have increased by 96% and real estate prices climbed by 105% in nominal terms. Housing prices have in real terms reached a historical high but after rising in previous years, price-to-income has almost levelled off in 2019, which indicates that supply and demand may be reaching an equilibrium for the time being at least.

Figure 4.8

A large gap has emerged between housing construction and population growth which finally appears to be closing



Sources: Statistics Iceland; Registers Iceland, Icelandic Tourist Board; Central Bank of Iceland; Iceland Chamber of Commerce

Since 2011 and until now supply has been lagging far behind housing demand as population growth had exceeded housing growth with the imbalance peaking in 2017. At that time, the population grew at a record pace, 3% overall, 4% for 20 years and older, mostly due to immigration. Meanwhile, the stock of housing grew by 1,2% (Figure 4.8). Furthermore, demand pressures were accruing directly from tourism and a Central Bank working paper estimated that Airbnb rentals have effectively reduced the housing stock by more than 1%.³

However, with a slowdown of the economy and signs of a slackening labour market (jobs only increased by 0,2% between Q1 2018 and Q1 2019 compared to 4,4% between Q1 2017 and Q1 2018) demand seems to be increasing more slowly while supply is increasing faster (1,7% in 2018), thus aligning more closely with demand.

³ Working paper no. 76 (2018): <https://www.cb.is/publications/publications/publication/2018/02/27/New-working-paper-on-the-effects-of-Airbnb-on-the-residential-housing-market/>



Housing prices have in real terms reached a historical high but after rising in previous years, price-to-income has almost levelled off in 2019.



LITRÆN ÁSETNING

RESOURCE SECTOR

Iceland is endowed with abundant natural resources, which the country's rise from poverty since the early 20th century has been built on. Industries based on those resources, the resource sector, constitute 25% of Iceland's GDP and roughly 76% of exports. The exact definition of resource-based sectors is open to interpretation as most economic activity is reliant on natural resources to a certain extent. The definition in this report is based on if the sectors are heavily reliant on Iceland's natural resources. The resource sector consists of three main sectors: Tourism, which is by far the largest, seafood industry and energy intensive industries, of which the aluminium production is the largest.

5.1 TOURISM

Iceland's unique and largely unspoiled nature is a key reason for the success of tourism in the recent decade. Around 91% of visitors cite nature and 87% outdoor activities as the reason for their visit.¹ A large part of the tourism sector, air transport, is also a part of the international sector since Icelandair's business model, and WOW air's previously, is largely dependent on transatlantic flights with Keflavík airport as a hub.

Tourism is mostly concentrated around the southern and western part of Iceland with 81% of overnight stays in those regions which include the capital, Reykjavík, Keflavík airport and some popular tourist destinations. Visitors mostly come from both sides of the Atlantic with the greatest number of tourists coming from the United States in 2018 (30% of total), followed by United Kingdom (13%) and Germany (6%).

In less than a decade the number of tourists grew by a factor of five in a boom that started in 2010 and peaked in 2016 (Figure 5.1). This has been the main driver of Iceland's rapid economic growth in recent years which was reflected in appreciating exchange rate, world class hotel occupancy rate (78% in Greater Reykjavík in 2018) wage growth, population growth and rising housing prices.

¹ Icelandic Tourist Board's border survey (2017).

“

Industries based on natural resources constitute 25% of Iceland's GDP and roughly 76% of exports.

“

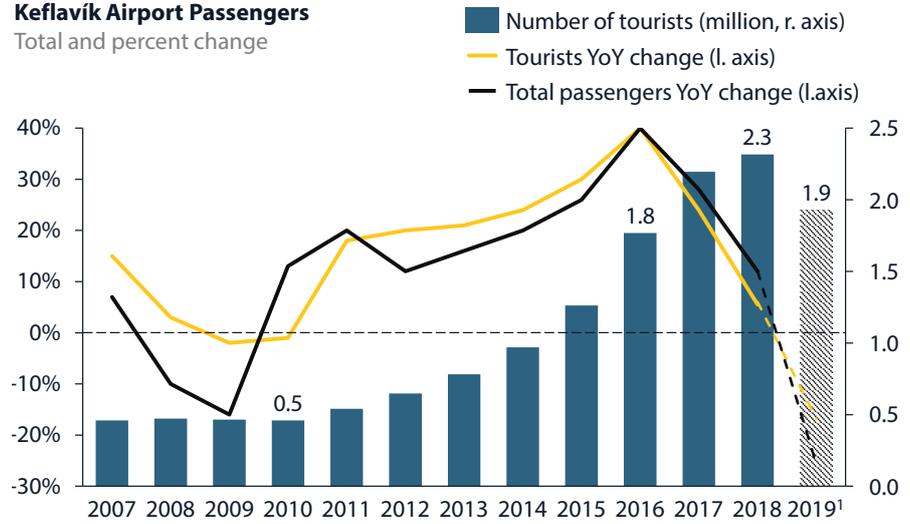
This decline is inevitably a shock to the economy and the tourism sector, but it must be kept in mind that the number of visitors is likely to be higher than in 2016.

Figure 5.1

Tourism is having a large set-back this year after double-digit growth for almost a decade

Keflavík Airport Passengers

Total and percent change



¹Isavia's forecast in June 2019

Sources: Isavia; Icelandic Tourist Board; Iceland Chamber of Commerce

The tide has now shifted and Isavia, Keflavík airport's operator, is expecting a 17% decline in number of tourists this year. The main reason for this is WOW air's bankruptcy in March this year. WOW air was founded in 2011 and quickly became one of the largest companies in Iceland in terms of staff and revenue. In 2018, the airline carried 3.5 million passengers, 36% of all passengers travelling through Keflavík airport. The other reason for this decline is the grounding of Boeing 737 MAX aircraft which limits Icelandair's ability to increase capacity. This decline is inevitably a shock to the economy and the tourism sector, but it must be kept in mind that the number of visitors is likely to be higher than in 2016 and the third largest year ever for the sector.

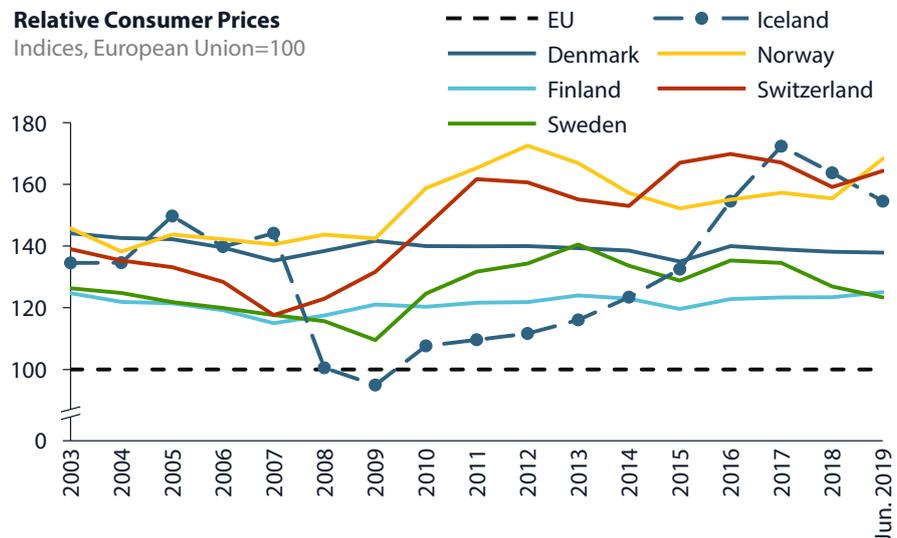
While the decline in numbers is substantial, the long-term outlook remains positive and other factors are contributing to a less painful adjustment. Firstly, the Icelandic Króna has recently depreciated and is, as of August 2019, around 10% weaker than in the summer of 2018, meaning Iceland is probably no longer the most expensive country in Europe and therefore more competitive (Figure 5.2).

Figure 5.2

Consumer prices in Iceland are among the highest in Europe

Relative Consumer Prices

Indices, European Union=100



Sources: Eurostat; Central Bank of Iceland; Iceland Chamber of Commerce

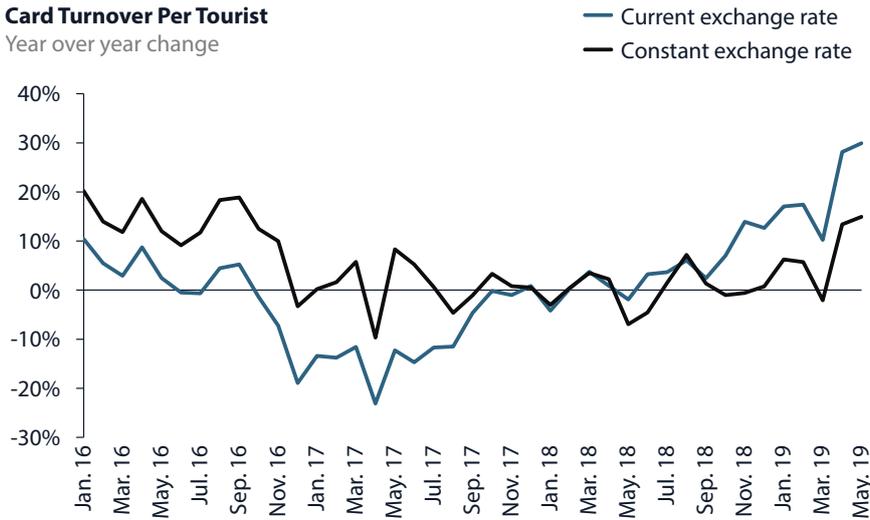
Secondly, the depreciation in combination with a different passenger mix has had a positive effect on spending. The depreciation of the Króna has increased tourist spending per capita as expected. But the recent increase beyond that was less expected. It seems that tourists in Iceland post WOW air are spending more (Figure 5.3) driven by longer length of stays which in April and May jumped up by 23%, which is unprecedented. The passenger profile of WOW air could explain this but also the sharp decline in number of connecting passengers at the airport (-48% in Q2) after WOW air ceased operation and Icelandair put more emphasis on transporting passengers to and from Iceland.

Figure 5.3

Depreciated Króna and more spending per tourist weighs against the drop in numbers

Card Turnover Per Tourist

Year over year change



Sources: Centre for Retail Studies; Statistics Iceland; Iceland Chamber of Commerce



After WOW air ceased operations and Icelandair put more emphasis on transporting passengers to and from Iceland, there was a sharp decline in the number of connecting passengers at Keflavík Airport (-48% in Q2).

Iceland is located on the Mid-Atlantic Ridge between two tectonic plates, placing the country in an excellent position to harness geothermal power. Iceland also has large highlands, glaciers and abundant precipitation. As a result, Iceland produces renewable energy at a low cost where 73% of electricity is produced from hydropower, while geothermal power accounted for 27%. Not only does this make Iceland the biggest per capita renewable energy producer in the world but also the largest per capita total energy producer (Figure 5.4). Potential infrastructure investments related to the energy sector is covered in section 7.3.

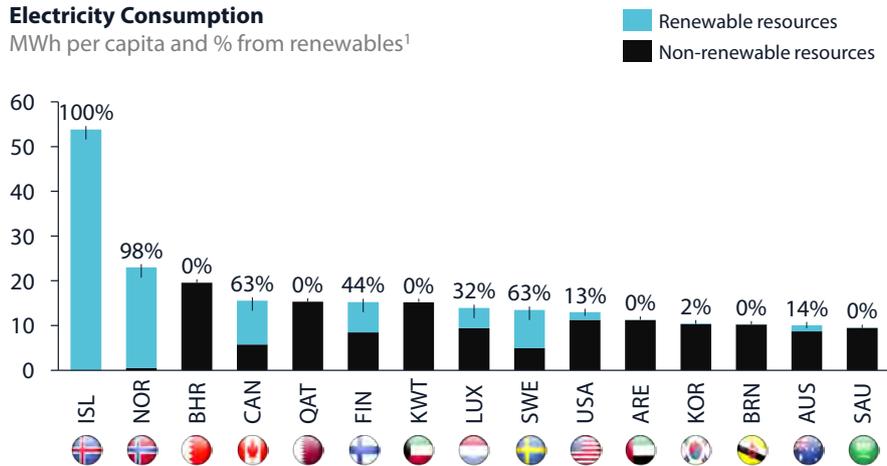
Figure 5.4

Iceland is the largest producer of renewable power per capita in the world. All electricity is produced with geothermal power and hydropower.

“
Iceland produces renewable energy at a low cost where 73% of electricity is produced from hydropower, while geothermal power accounted for 27%.

Electricity Consumption

MWh per capita and % from renewables¹



¹ World Bank only publishes distribution of electricity by output, not consumption, so the distribution between renewables and non-renewables might be slightly inaccurate.

Sources: World Bank, Iceland Chamber of Commerce

Energy intensive industries consume 77% of all electricity in Iceland and provide 19% of total exports. Aluminium is thereof by far the largest product and Iceland’s three aluminium smelters consume 67% of Iceland’s electricity.² Other energy intensive industries include the second largest ferrosilicon plant in the world (Elkem Iceland), aluminium foil plant, two silicon plants (one currently in operation), as well as data centres.

Aluminium

Three large aluminium plants are situated in Iceland and they accounted for over 17% of Iceland’s total exports in 2018 and over 1% of global aluminium production. The largest plant is Alcoa Fjarðaál, located in Reyðarfjörður in East Iceland. It started production in 2007 and has a capacity of 350,000 tonnes per year. Norðurál, a part of Century Aluminium, is based in Grundartangi port in the west of Iceland. Its plant capacity is 300,000 tonnes a year. The third aluminium plant, ISAL, is located in Straumsvík in Hafnarfjörður. It is a part of Rio Tinto and the oldest of the three, opening in 1969. Today, ISAL has production capacity of over 200,000 tonnes a year.

Aluminium played a key part in industrialising and diversifying the Icelandic economy. Before ISAL started production in 1969 around 90% exports were marine products but that shifted below 70% soon after the plant opened. Aluminium production has coincided with power generation and grid investments of Landsvirkjun, which produces 73% of all electricity in Iceland, and other power companies.

² Orkustofnun (2018) Energy Forecast 2018-2050 [In Icelandic]: <https://orkustofnun.is/gogn/Skyrslur/OS-2018/OS-2018-03.pdf>

The most significant recent development is that in 2018 Rio Tinto put ISAL, the oldest plant in Iceland, up for sale. In 2018 Norsk Hydro, a Norwegian aluminium company, made a binding offer but the deal fell through due to competition approval taking longer than anticipated.³

Silicon

Silicon plants have been among the largest investments in Iceland in recent years. A ferrosilicon plant has operated since 1979, but recently, two silicon plants have been built and there are proposals to build one more. There were also plans to build a solar silicon plant but those plans have been cancelled, for the time being.

In November 2016 United Silicon in Helgúvík, near Keflavík airport, started production but soon severe technical problems occurred. The Environmental Agency of Iceland received several complaints from the surrounding area and decided to shut the plant down indefinitely in September 2017. Soon it became apparent that the plant needed significant and expensive improvements and the company went bankrupt. Arion Bank, as the largest creditor, took over the facilities in February 2018 and intends to sell the plant either before or after it gets up and running again.

The other silicon plant, PCC Bakki Silicon near Húsavík, commenced production in April last year. Annual production will be 33,000 tons of metallurgical grade silicon. There are also plans by another company, Thorsil, to construct another silicon plant in Helgúvík.

Data Centre Industry

The data centre industry is a new and rapidly growing industry in Iceland, partly due to growing global demand for data storage and partly the recent boom in cryptocurrencies. The fact that data centres consumed 2,9% of all electricity in Iceland in 2018 compared to 0,2% in 2014, highlights the growth. The industry is related to the tech-industry and the international sector but is classified as a part of the resource sector in this report.

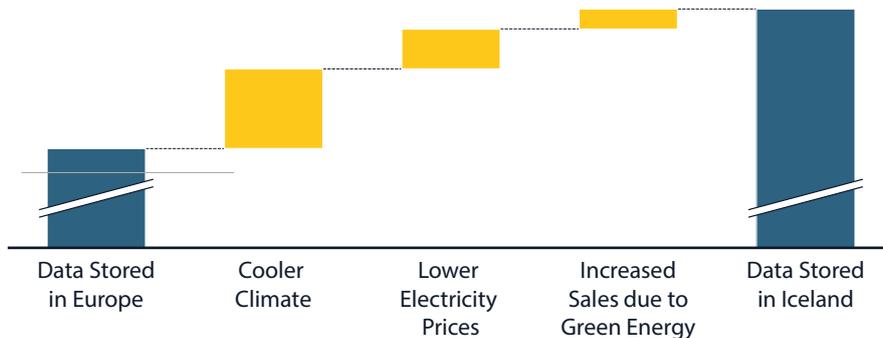
Multiple data centres have been constructed in recent years and as of August 2019 one has recently been opened in northern Iceland and one is being constructed in Reykjavík. Further growth is anticipated and the National Energy Authority expects the sector to double from 2018 to 2022. Iceland’s cold climate, affordable prices and renewable energy production has made it an attractive location for such operations (Figure 5.5). Yet some challenges are ahead for further growth, for instance a potential shortage of electricity in coming years (Section 7.3) and the fact that Iceland only has three submarine communications cables.

Figure 5.5

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

Potential Increase in Profitability by Storing Data in Iceland

Profits; Illustrative



Source: Iceland Chamber of Commerce



The data centre industry is a new and rapidly growing industry in Iceland, partly due to growing global demand for data storage and partly the recent boom in cryptocurrencies.

³ Norsk Hydro (2018): <https://www.hydro.com/en/media/news/2018/hydro-and-rio-tinto-end-acquisition-process-for-icelandic-aluminium-plant-isal/>

“Recently the fishing fleet and other equipment have largely been renewed so investments in the seafood industry climbed to a record high in 2017.

Fisheries and the whole seafood industry, have long been the backbone of the Icelandic economy. Before 2006, seafood accounted for over half of goods exports. Since, the economy has diversified further so in 2018 seafood was the source of 18% of Iceland’s exports.

The Icelandic fisheries management is based on “individual transferable quotas” (ITQ or simply “a quota system”). It was established in the 1980s and 90s after years of instability and overfishing in important species such as cod. The system’s main objective is to protect and ensure sustainable fisheries while maximising the economic value of the scarce resource. Fishing quotas can be bought and sold in the market, with the ITQ system helping companies to plan and invest with strong incentives for a long-term view.

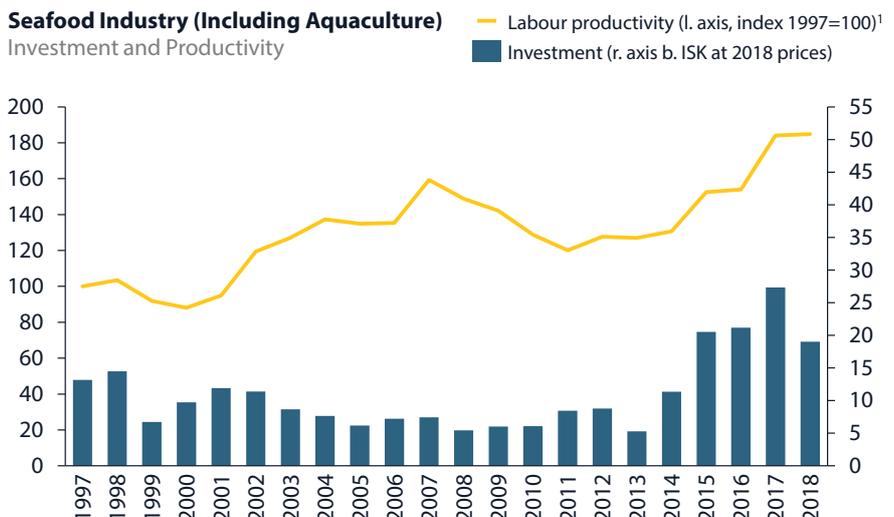
The Icelandic fishing industry is internationally renowned for its adherence to a sustainable fisheries policy, resulting in strong fish stocks. The Icelandic cod population has for instance seldom been larger since systematic measurements began in 1985, a particularly positive development since cod exports are 42% of total seafood exports.⁴ However, not all stocks are growing and the decline in capelin populations is a cause for concern.

The seafood industry is experiencing rapid technological advances. Labour productivity has increased over the years and the industry has had a spillover effect into other sectors and helped create new businesses.⁵ Since 1997, the seafood industry’s productivity has outgrown other industries by 1 percentage point on average, with an 3% average growth. Recently the fishing fleet and other equipment have largely been renewed so investments in the seafood industry climbed to a record high in 2017 (Figure 5.6). These new vessels are largely financed by a historically high 42% industry equity ratio. Part of the boost in investment is explained by the recent rise in a related industry, aquaculture.

4 Icelandic groundfish survey 2019: <https://www.hafogvatn.is/static/research/files/hv2019-26pdf>
 5 Marel, one of Iceland’s largest companies with a market cap of over 3.3 billion USD, started by designing scales for the seafood industry. There are more examples, which is reflected in that it is estimated that the seafood industry’s indirect contribution to GDP is close to the direct contribution: <https://www.iceland.is/files/icelandic-fisheries-press-kit-enska-30-sept-2013.pdf>

Figure 5.6

Iceland’s seafood industry has seen productivity gains amidst erratic business environment. The sector’s investments are near record levels.



1 Working hours and thus productivity has a break in series in 2008
 Sources: Statistics Iceland; Iceland Chamber of Commerce.

As illustrated in volatile labour productivity, the seafood industry has been susceptible to shocks in fish stocks, markets and the economy. The appreciation of the Króna from 2015 to 2017 proved challenging for the industry and wage increases have also been challenging (Section 4.1). Challenges in important

markets such as Russia (sanctions), United Kingdom (depreciated GBP following Brexit) and Nigeria (depreciating NGN following an economic downturn) also had negative effects so the industry profit margin in 2017 was the lowest since 2004. The tide has now somewhat shifted and a depreciated Króna has helped the industry with an 18% increase in export value in 2018. The UK remains the most important market for Icelandic seafood with a 15% share with France being second and the fastest growing market (11%). Spain, Norway and The United States respectively follow with 9-10% share.

Aquaculture

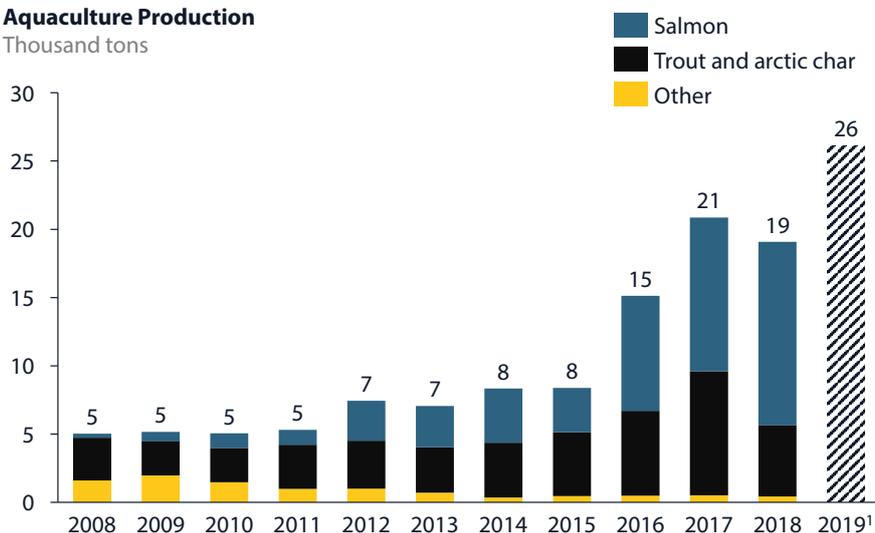
Fish farming, or aquaculture, has historically yielded mixed results in Iceland but the current wave of investments in aquaculture is stronger than ever. However, aquaculture remains small compared to the catch of wild fish stock and only accounts for around 1% of total exports. In 2018 around 19,000 tons of farmed fish was produced compared to 7,000 in 2013 (Figure 5.7). The growth has continued in 2019 which is on track to become the biggest year in history. Arctic char has for long been the main species but the growth in recent years has been driven by salmon farming which in 2018 accounted for 70% of the total production.

Figure 5.7

Aquaculture is expanding fast, salmon production in particular

Aquaculture Production

Thousand tons



¹ Projection of total production based on growth in January-May 2019

Sources: Statistics Iceland; Iceland Chamber of Commerce.

“

Fish farming, or aquaculture, has historically yielded mixed results in Iceland but the current wave of investments in aquaculture is stronger than ever.

Foreign direct investment has been a key factor in the rise of aquaculture and largely explains a total of 13.8 bn. ISK FDI in agri- and aquaculture in the period of 2013-2017. There are plans of continued expansion of open-cage salmon farming in coming years in both the Westfjords and the Eastfjords. Those plans have been heavily debated due to environmental concerns and effect on wild Atlantic salmon, which Iceland is famous for, and in June 2019 Althing passed two bills on aquaculture with the aim of providing a stronger foundation to ensure a sustainable industry.

Agriculture

As in most societies, agriculture was historically the most important source of livelihood in Iceland despite the harsh climate. Today, agriculture is a relatively small part of the economy (1% of GDP and 0.6% of exports) and remains protected and subsidised by the government. The main produce are livestock (sheep, cattle, poultry and pigs) but also crops, for instance, grown in geothermally heated greenhouses. Recently, efforts have been made to increase exports of agricultural products such as *skyr*, a yoghurt like dairy product, and lamb meat.



*Kvika is a specialized bank focusing
on asset management and investment services*

KV\KA

kvika.is



Landsvirkjun

National Power Company of Iceland

Spend the night at a snow-powered hotel

In Iceland, all electricity is generated from renewable sources;
falling water, the heat of the earth and the force of the wind.

Welcome to the land of renewable energy.

landsvirkjun.com/visitus





ISLAND

INTERNATIONAL SECTOR

The international sector consists of businesses that produce tradable goods and services that are independent of natural resources and compete in an international environment. Those industries instead rely more on intellectual property and technology which is mostly or completely unrelated to Iceland's natural resources. In 2018 the international sector produced 12% of GDP.

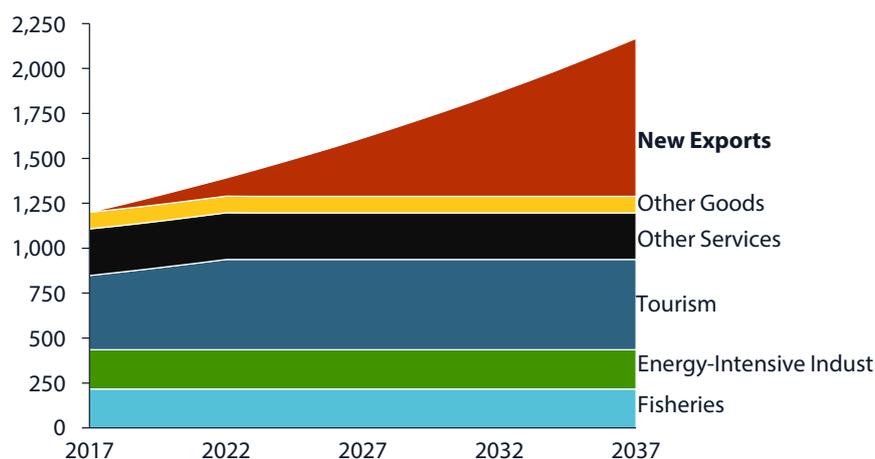
The growth of the international sector has been on the agenda since the financial crisis and its importance was highlighted in a 2012 report by McKinsey & Co which set out to chart a long-term growth path for Iceland. In the report the importance of maintaining an external balance of the Icelandic economy was highlighted. To achieve external balance, export growth needs to at least match the growth of the economy over the long term. If the economy grows at 3% p.a. that necessarily entails an 80% increase in exports which amounts to around 1.000 bn. ISK over the span of 20 years. This policy objective has since been dubbed the "1.000 billion challenge" (Figure 6.1).

Figure 6.1

New exports in knowledge based goods and services are needed to support a balanced long-term growth trajectory¹

Export Requirements Along a 3% Economic Growth Path

Bn. ISK; Illustrative²



¹ McKinsey assumed a goal of 4% growth p.a. but the Chamber believes a 3% growth rate is more realistic over the long run. Tourism exports are assumed to grow at a 4% rate until 2022

² Real ISK

Source: McKinsey & Company (Charting a Growth Path for Iceland), Iceland Chamber of Commerce, Statistics Iceland, Central Bank of Iceland

The resource sector, which had been the primary source of prosperity for most of the 20th century, was considered to have mostly hit its natural limits and therefore the growth path for the economy lay through the international sector.

“

The international sector is not bound by the same constraints of nature as the resource sector and its growth potential therefore unlimited.

“

Since 2004, the Technology Development Funds budget has increased six-fold in real terms and the budget of the Icelandic Research fund has increased by a factor of three in the same period.

Additionally, the international sector is not bound by the same constraints of nature as the resource sector and its growth potential therefore unlimited. It was also deemed paramount to increase productivity in the domestic services sector to shift resources over to the international sector.

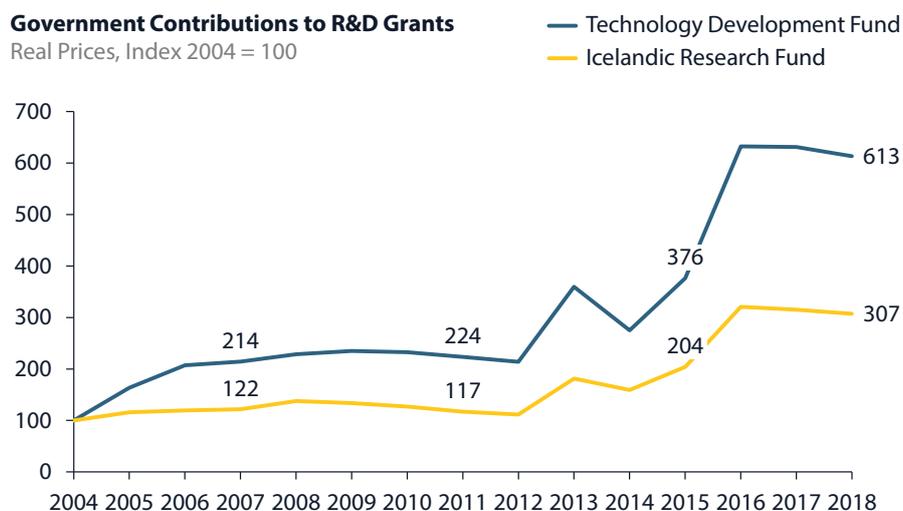
However, the extraordinary tourist boom was unforeseen and as exports grew rapidly in the resource sector the focus was taken off the international sector and in some ways the government and the public paid less attention to it in terms of policy. Nevertheless, the sector has grown quite rapidly albeit quietly since 2010 and still needs to grow to maintain external stability of the economy.

6.1 ENHANCING INNOVATION

Several steps have recently been taken to foster the international sector. The government has introduced a few new incentives to foster innovation in addition to expanding existing ones. One of those actions was to increase substantially contributions to the two main funds that provide grants for research and technology development. Since 2004, the Technology Development Funds budget has increased six-fold in real terms and the budget of the Icelandic Research fund has increased by a factor of three in the same period (Figure 6.2).

Figure 6.2

Government grants towards R&D have increased manyfold in the last 15 years



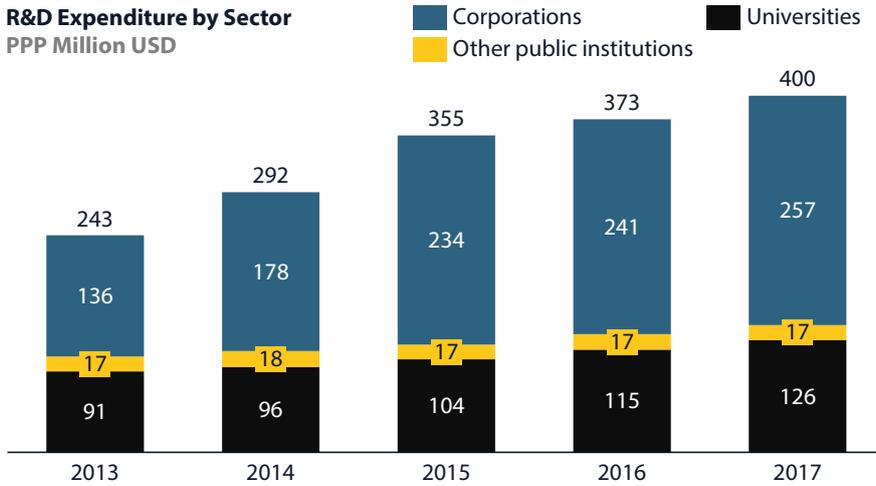
Source: The Icelandic Centre for Research.

In 2010 the government also established an incentive to further spark innovation in existing companies. It allowed companies to claim a tax rebate for 20% of their expenditure towards R&D for up to 50m ISK (approx. 0,4m USD). Since then, the government has expanded this policy and as of 2019 allows for 20% rebates of up to 600m ISK (approx. 5m USD) expenditures towards R&D. Hopes are that these rebates will further increase over the next few years.

The extension of the incentive to conduct R&D has coincided with a widespread increase in R&D spending by the private sector as well as for universities (Figure 6.3). While the measure has boosted Iceland's competitiveness in terms of feasibility of conducting R&D projects within the country, more needs to be done if Iceland is to be at the top in terms of incentivising R&D spending (Figure 6.4).

Figure 6.3

Investment in R&D has been steadily increasing over the last few years



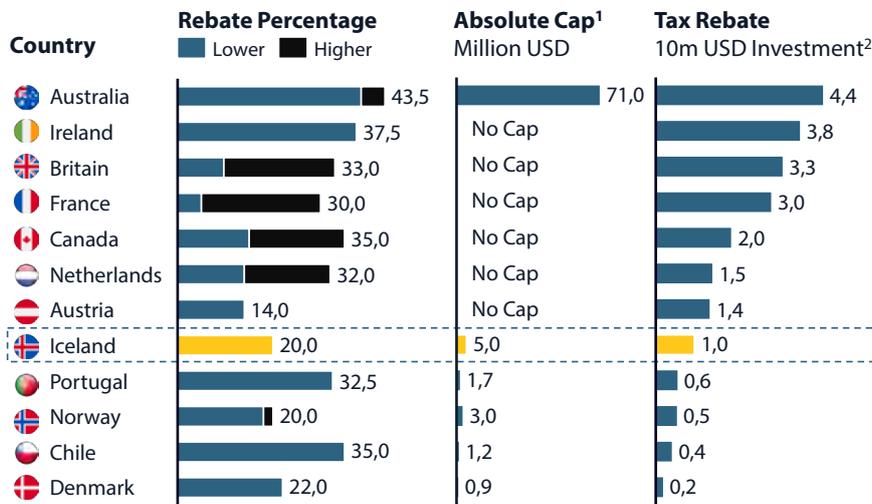
Source: Statistics Iceland, OECD, Iceland Chamber of Commerce

Figure 6.4

While Iceland has been improving incentives to conduct R&D it still trails a number of countries in terms of tax credits for such expenditures

Government R&D Tax Credits and/or Rebates

Percent by bracket, million USD



1 Australia: Higher bracket only available to companies whose revenue does not exceed 13,5m USD, lower bracket only available to companies whose revenue does not exceed 14,2m USD; France: Higher bracket cap is 115,8m USD, no cap on lower bracket; Netherlands: Higher bracket cap is 0,4m USD, no cap on lower bracket; Britain: Higher cap only available to companies who do not employ more than 500 people.; Norway: Higher bracket only available to SME's
 2 The tax rebate/credit is calculated based on a gross investment in R&D of 10m USD.

Sources: OECD; Ernst&Young, Iceland Chamber of Commerce



The extension of the incentive to conduct R&D has coincided with a widespread increase in R&D spending by the private sector as well as for universities.

“

Investors were further allowed to claim a tax rebate of up to 50% of a 10m ISK (approx. 80,000 USD) investment in a start-up company that meets certain criteria.

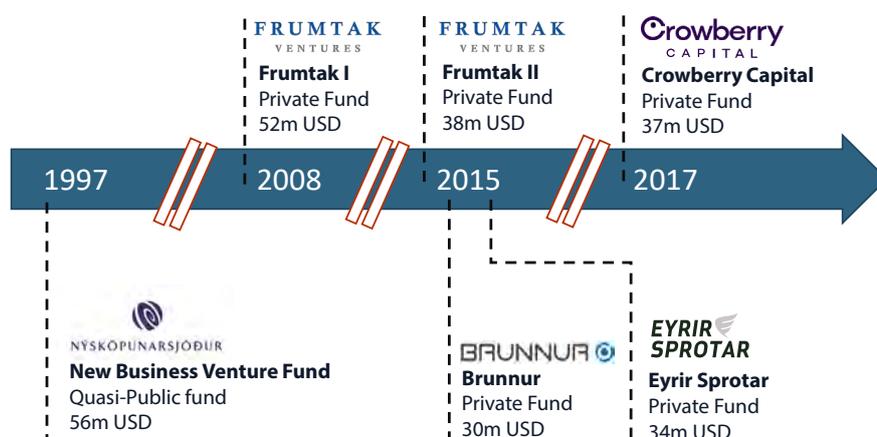
Recently individual investors were further allowed to claim a tax rebate of up to 50% of a 10m ISK (approx. 80,000 USD) investment in a start-up company that meets certain criteria. The private sector has not remained idle either when going the extra mile to boost innovation. The number and quality of incubators and access to venture capital have improved. Previously, the venture capital environment mainly consisted of a single quasi-government fund, whose cash on hand fluctuated greatly between years, perverting the efficiency of the venture capital market. Since 2008 however, five new funds have been established (Figure 6.5). Furthermore, some of Iceland's most innovative companies have attracted attention from respected global venture capital funds and institutions.

Figure 6.5

2015 was the breakout year for the VC industry in Iceland

Timeline of Iceland Based Venture Capital Funds

Year, Type of ownership, USD



Source: Northstack, Central Bank, Iceland Chamber of Commerce

6.2 DEEPENING THE TALENT POOL

As Iceland's population is only around 360,000, making it one of the least populous countries of the world, deepening the talent pool is a constant challenge. This is an especially important challenge to take on for the international sector as access to highly talented professionals is vital to the sector. The challenge can be approached from two sides, by attracting foreign talent to country and by improving education levels.

Firstly, tax breaks and expedited work visa arrangements for foreign specialists have been introduced to better enable companies to make use of available talent, regardless of nationality. Notwithstanding, companies that operate in the international sector note that the process of getting work visas for foreign specialists, is still very cumbersome, especially regarding non-EEA nationals, which is worrisome.

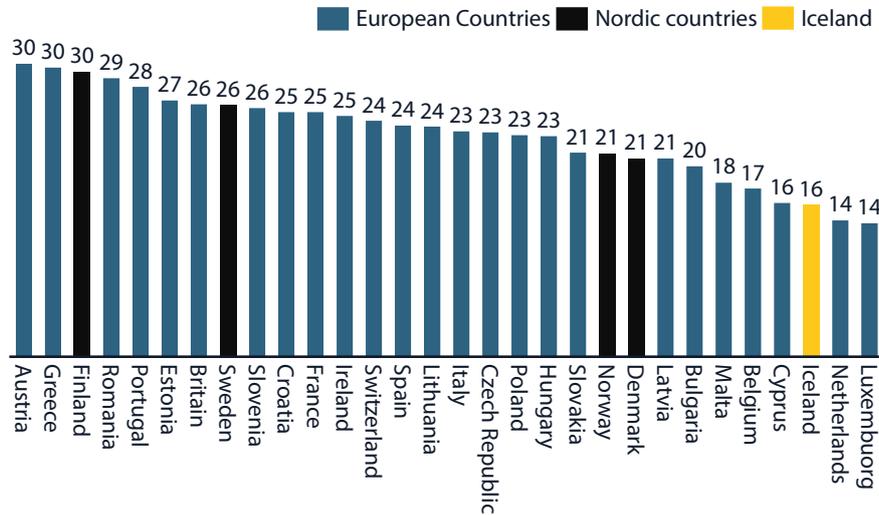
Secondly, progress has been made towards deepening the domestic talent pool as Iceland's number of university graduates has tripled since 2000. Conversely, evidence suggests that Icelanders hold proportionally few "STEM" degrees compared to the other Nordic Countries (Figure 6.6).

Going forward, it will be crucial for the international sector to have access to a wide array of talent. The Chamber therefore believes that reform is needed both in the education system to deliver domestic talent but also when it comes to removing hurdles for foreign professionals.

Figure 6.6

Iceland has a relatively low proportion of students graduating with STEM degrees

STEM Degree Graduates as Percentage of Total Number of Graduates
Percent



Sources: INSEAD – Global Innovation Index 2018, Iceland Chamber of Commerce

As the nature of companies in the international sector is global there is always the risk that they will relocate their operations abroad if the domestic operating environment is not globally competitive. Therefore, further steps must be taken to ensure the competitiveness of Icelandic innovative businesses. This is in line with the governments' thinking as there is a policy group currently working on forming an innovation policy for Iceland for the coming decade. The proposals are set to be published in the fall of 2019.

“

Tax breaks and expedited work visa arrangements for foreign specialists have been introduced.



UNDIR FJÖLLUNUM

FUTURE PROSPECTS

The Icelandic economy is in many ways stronger than prior to financial crisis. Growth has recently been robust and the long-term outlook remains favourable despite evidence of a slowdown or recession in 2019-2020. The external imbalance of the economy, arising from a persistent trade deficit and significant foreign debt obligations, has been erased as exports have increased and settlements with foreign creditors finalised. The economy is therefore, more resilient than before.

However, more uncertainty prevails regarding longer-term growth prospects. Looking further than a few years ahead, growth will largely be determined by two factors. Firstly, on a specific note, whether Iceland will be able to realise economic growth in the longer term through an increase in productivity and exports. This will, among other things, require significant infrastructure investments. Secondly, in more general terms, growth is determined by how prepared the country is to face the number of disruptive trends that are now shaping the global economy.

7.1 ECONOMIC GROWTH

In 2012, the global management consulting firm McKinsey & Co. published a report titled “Charting a Growth Path for Iceland”, where Iceland’s long-term growth prospects and key challenges were assessed. The report has had a significant impact on public debate in Iceland and provided insights to the future prospects of the Icelandic economy. One of the key messages of the report is concerns over the composition of Iceland’s production and low productivity compared to neighbouring countries. Therefore, it is good news that productivity has increased and is not as low as previously estimated which places Iceland’s labour productivity 13th out of the 36 OECD countries. Regardless, productivity gains are an ever-important goal to ensure long-term sustainable economic growth.

Increased competition domestically and market openness on a global scale would help improve domestic productivity. Improvements could also be made through public sector reform, as public employees account for up to a fifth of employed individuals in the economy.

Although exports have grown over the past few years, as discussed in previous chapters, this is largely due to increase in tourism – a resource-based sector. Given the limited growth potential of resource-based sectors, the importance of the international sector must be emphasised as a sustainable source of export revenue (Section 6.1).

“

The Icelandic economy is in many ways stronger than prior to financial crisis. Growth has recently been robust and the long-term outlook remains favourable despite evidence of a slowdown or recession in 2019-2020.

Following the publication of the McKinsey & Co. report, the so-called *Iceland Growth Forum* was established (Figure 7.1) to develop further its policy recommendations. The Forum’s aim was also to increase alignment and facilitate cooperation between key stakeholders in the economy; political party leaders, CEOs from a broad range of significant Icelandic companies, academia and labour organisations.

Figure 7.1

A slide from The Iceland Growth Forum’s presentation on 37 reform proposals to support a long-term sustainable growth trajectory

“Let’s look outside... And see the big picture”



Source: Iceland Growth Forum presentation

“
Although the underlying focus remains on the challenges associated with the sectors, the Chamber has since 2017 sought to shift its focus more outward, acknowledging the global disruptive trends that undeniably shape economies around the world.

Many of the proposals put forth in the Forum have already been implemented, with the aim of supporting Iceland’s long-term growth prospects. The Chamber has been an avid supporter of the Forum and suggestions set out in the McKinsey report. Over the past few years the work of the Chamber has focused specifically on the four sectors discussed in the report; public, domestic services, resource and international sector.

Although the underlying focus remains on the challenges associated with the sectors, the Chamber has since 2017 sought to shift its focus more outward, acknowledging the global disruptive trends that undeniably shape economies around the world. Iceland’s economy is no exception there. The government has also shifted emphasis from the Growth Forum to specific economic policy initiatives on environmental issues, innovation and the “fourth industrial revolution” in cooperation with the business community and other stakeholders (Section 2.1).

7.2 KEY CHALLENGES AHEAD

Like the rest of the world, Iceland is greatly affected by global disruptive trends and challenges that go beyond traditional economic policy. The business sector is keen on seeking to align strategies with government forces, since technology is rapidly transforming industries while facing new and somewhat unprecedented challenges. The Chamber’s goal is to capture these trends by operating under four focus lenses (Figure 7.2).

Figure 7.2

To capture the disruptive trends that are shaping the global economy, the Chamber is operating under four focus lenses

The Four Focus Lenses of Disruptive Trends

| Lenses | Examples | | |
|---|--|--|--|
|  Digitisation | <ul style="list-style-type: none"> Embrace technological changes to drive productivity improvements | <ul style="list-style-type: none"> Improve services and achieve cost efficiency through digitization | <ul style="list-style-type: none"> Use big data insights to connect with customers and transform operations |
|  Regeneration | <ul style="list-style-type: none"> Support and grow knowledge driven export sectors of the Icelandic economy | <ul style="list-style-type: none"> Ensuring that all generation's talents match the needs of a changing society | <ul style="list-style-type: none"> Determining how business leaders can navigate through present challenges |
|  Environmental Sustainability | <ul style="list-style-type: none"> Maximize value creation in Iceland's resource sectors | <ul style="list-style-type: none"> Protect nature with focus on productivity and sustainability | <ul style="list-style-type: none"> Leverage Iceland's unique situations to fight climate change |
|  Global Connections | <ul style="list-style-type: none"> Boost global position of Iceland as the country to base and do business in | <ul style="list-style-type: none"> Safeguarding Iceland's position in the EEA and openness to trade | <ul style="list-style-type: none"> Focus on business development in new markets |

Source: Iceland Chamber of Commerce

The four lenses are Digitisation, Regeneration, Environmental Sustainability and Global Connections. All of these topics tie into current challenges in Iceland and provide the Chamber with additional perspective through which to analyse policies for further improvement across the four sectors.

Digitisation and how the Icelandic society will embrace technological changes could help drive productivity and service improvements across sectors. This was the theme of the ICoC's Business Forum in 2018.

Regeneration ties into leadership, entrepreneurship and educational matters which are of great relevance with regard to the international sector and growth of the knowledge economy in Iceland. All generations will have to reinvent themselves to meet the needs and challenges of the future economy. Changed leadership style with focus on trust, sustainability and impact on society was the theme of some of the Chamber's key meetings this year.

Environmental Sustainability is of great relevance for a natural resource rich economy such as Iceland, where origin, purity and quality play a key role in global branding and sale. The fight against climate change has been gaining momentum and the government has put forth a plan to reduce CO2 emission from certain sectors by 30% by 2030 and a policy to make Iceland carbon neutral by 2040. The lens is currently in focus by the Chamber.

“ All of these topics tie into current challenges in Iceland and provide the Chamber with additional perspective through which to analyse policies for further improvement across the four sectors.

Finally, **Global Connections** is the undercurrent within all these themes, as shorter pathways of information, capital, production and increased flexibility of labour will change the way markets operate. Iceland has been mostly insulated from rising protectionism in trade worldwide. However, recent debate surrounding the adaptation of certain EEA legislation (Section 2.1) has shown that the country's openness should not be taken for granted.

There is a great reason to be optimistic about the future of the Icelandic economy as long as policymakers, business leaders and the general public are willing and able to embrace current and upcoming changes and meet the challenges that they entail. The Chamber will continue to cooperate broadly with its members, policy makers, academia and other stakeholders to support the sustainable growth of the Icelandic economy.



It would take 28 years to reach the previous high of infrastructure per capita at current investment levels.

7.3 INFRASTRUCTURE NEEDS AND POTENTIAL PROJECTS

Debate and discussion over specific, as well as overall, infrastructure projects, have been prominent in recent years. The reasons could be mainly threefold. Firstly, efficient and reliable infrastructure is key for increased productivity and future prosperity. Secondly, investment was limited in the years after the financial crisis and Iceland is in a healthy state to catch up after de-leveraging. Finally, Iceland's population is ageing and growing, and there is furthermore more strain on infrastructure after the recent boom in tourism.

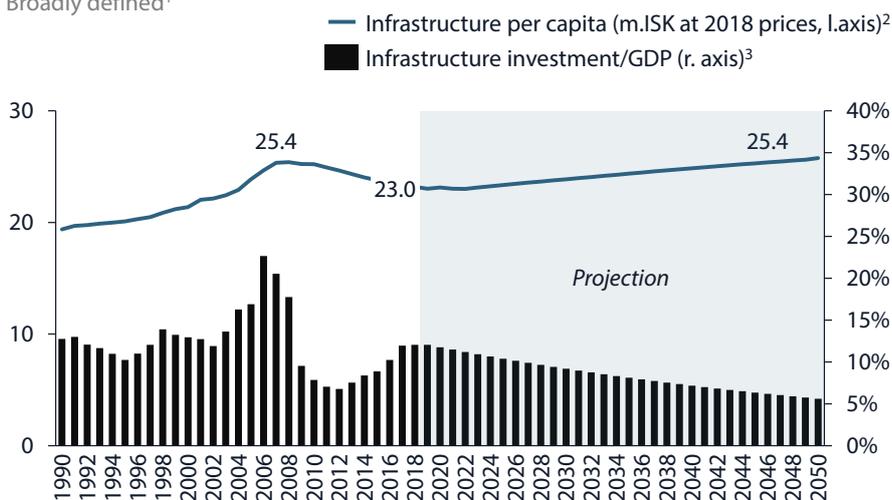
A recent report by the Federation of Icelandic Industries suggests that an investment of 372 b. ISK investment (15% of GDP) is needed for the maintenance of infrastructure.¹ Looking at the capital stock in infrastructure it seems that number is plausible as it would take 28 years to reach the previous high of infrastructure per capita at current investment levels, in spite of recent boost in investments (Figure 7.3). More is required.

Figure 7.3

More investment in infrastructure is required to soon reach previous infrastructure levels

Infrastructure Stock and Investment

Broadly defined¹



¹ Infrastructure is the total amount of capital stock and capital formation (investment) in housing and other buildings, roads, bridges, sewers and business sector construction.

² See 3 for investment. Population based on Statistics Iceland projections.

³ Assuming constant investment level in real terms 2019 onwards, 0% GDP growth in 2019 and 2,5% growth 2020 onwards

Sources: Statistics Iceland; Iceland Chamber of Commerce.

1 The Federation of Icelandic Industries, (2018): https://www.si.is/media/_eplica-uppsetning/Innvidir-a-Islandi_skyrsla2017.pdf

The scenario painted in figure 7.3 is very uncertain. For instance, it remains unclear how it will be financed. With the Icelandic pension funds recently putting more weight on foreign investment (Section 3.3) and the government bound by fiscal rules (Section 2.2), foreign investors and other private parties could play an important role.

Following is a short list of potential infrastructure projects that have been a significant topic of debate in recent years and could have a large impact.² The list is neither complete nor ranked in any way and should only be taken as a list of examples. Profitability and viability are furthermore debated in many cases, often on the grounds of environmental concerns.

Finnafjord Port Project

With new Arctic shipping lanes opening, an opportunity arises to better connect cargo from Asia to Europe and North-America. Iceland's location puts the country in a key position to embrace the opportunities that could open up. For years there have been ideas and research on this possibility in Iceland and finally this year some important steps were taken towards a new international port and industrial zone at Finnaþjórdur in Northeast Iceland.³ Bremenports, EFLA engineers and two neighbouring municipalities formed a new company for the project in April, FFPD, but despite that many things remain unclear, as the project could potentially be large and complex, particularly relative to Iceland. In addition to a port, the development of land-based aquaculture, airport and various industries is being considered.⁴

Keflavik Airport Expansion

The boom in tourism and air traffic to and from the country has been followed up with significant investment at Keflavik airport such as a 30% expansion of the terminal since 2010. The expansion is, however, modest in the light of 400% growth in number passengers. Furthermore, ISAVIA expected an increase of over 14 million passengers until 2040, with a total of 24 million passengers. That would put Keflavik airport close to today's Brussels Airport in terms of number of passengers.⁵ Those projections should be taken with a grain of salt as they were made prior to WOW air's bankruptcy. Nevertheless, further investment in airport infrastructure will be needed. Also, an airport express train to downtown Reykjavik has been considered by private investors.

A New Domestic and International Airport

A new airport between Reykjavik and Keflavik Airport in Hvassahraun has also been considered in recent years. Initially to replace Reykjavik's domestic airport in central Reykjavik but has recently also been considered as a new international airport. A government task force that released its findings this year concluded that the potential airport should be further investigated. An airport in Hvassahraun would be closer than Keflavik airport to Greater Reykjavik, where 2/3 of the population lives. It would also pave the way for valuable land for development in central Reykjavik. However, it is a large investment and many questions remain unanswered.⁶

² Some of these projects, and more, are found in GAMMA Capital Management's report on infrastructure in Iceland: https://www.gamma.is/media/skjol/GAMMA---Innvidir_x28.pdf

³ Information on Bremenports website: <https://bremenports.de/finnafjord/finnafjord/>

⁴ Presentation by EFLA Engineers (2017): <https://www.efla.is/media/utgefird-efni/Finnaþjórd-Cargo-Hub-Edinburgh-November-2017-Hafsteinn-Helgason-wide-screen.pdf>

⁵ ISAVIA's forecast: <https://www.isavia.is/fyrirtaekid/fjolmidlators/frettir/storframkvaemdir-a-keflavikurlflugvelli-og-skiptifarthegum-fjolgur>

⁶ Icelandair estimates the first phase would cost up to ISK 200 billion: <https://www.stjornarradid.is/lisalib/getfile.aspx?itemid=cc40ae48-0c39-11e8-9426-005056bc530c>

“

Traffic on the Ring Road has increased by 53% since 2011. A substantial lack of maintenance is therefore estimated, as new roads, bridges and tunnels are also needed.

Roads

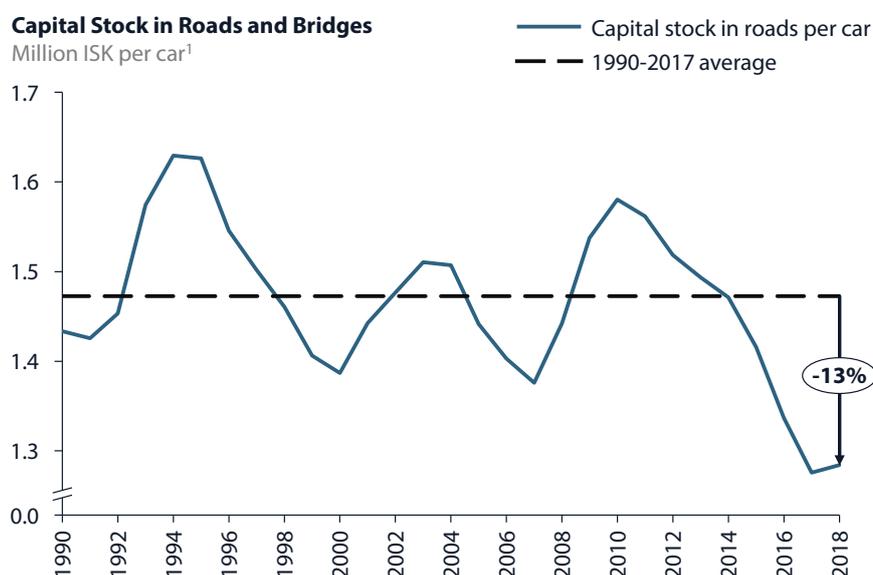
The Icelandic road system was perhaps the largest victim of declining investment following the financial crisis. Meanwhile, traffic on the Ring Road has increased by 53% since 2011. It is therefore estimated that there is a substantial lack of maintenance but also new roads, bridges and tunnels. If the capital stock in roads and bridges per vehicle is anything to go by, there is a need for investment of close to ISK 50 billion to maintain the long run average (Figure 7.4). At the same time the government, the owner of almost all road infrastructure, is constrained by fiscal responsibility and other priorities. That could give ground for Public-Private Partnership (PPP) projects, which so far have been uncommon in Iceland. Specific projects, such as *Sundabraut*, a highway north out of Reykjavík, have been proposed as a potential PPP project.

Figure 7.4

Lack of investment on top of traffic increasing by half in less than a decade indicates that investment in roads and bridges needs to pick-up



The Reykjavík City Line is a planned Bus rapid transit system (BRT) with a cost estimate of over ISK 70 billion.



¹ ICoC projection for 2018 based on Althingi's budget. Number of cars growth projected the same as GDP growth in 2017-18

Sources: Statistics Iceland; Althingi; Iceland Chamber of Commerce

Reykjavík City Line

During the local government election in 2018, one topic of debate was the proposed "Borgarlína" or Reykjavík City Line in Greater Reykjavík. The Reykjavík City Line is a planned Bus rapid transit system (BRT) with a cost estimate of over ISK 70 billion. The current majority of Reykjavík's City Council has proposed to carry out those plans and other local government in Greater Reykjavík are on board. Financing remains partly unclear but necessary preparations are being made to start construction of bus lanes.

Wind Power and Other Power Generation

In recent years the option of wind power, has been tested with promising results. The National Power Company of Iceland (Landsvirkjun), has plans of a 200 MW wind farm near Búrfell Power Station but no dates have been set yet. Other companies and private investors have also recently shown interest in constructing wind farms and some pilot projects have been initiated. Iceland can be very windy and is mostly powered by hydropower, making wind power an interesting option in Iceland.

Landsnet, the grid operator, recently published a controversial report with projections on power generation and consumption.⁷ According to the report the probability of power shortage in 2022 is over a threshold value. It goes without saying that power generation then might need to increase and or consumption decrease/grow slower. With growing population and electrification of the car fleet, this might become a challenge that demands other investments in power generation and the grid.

Interconnector to the UK

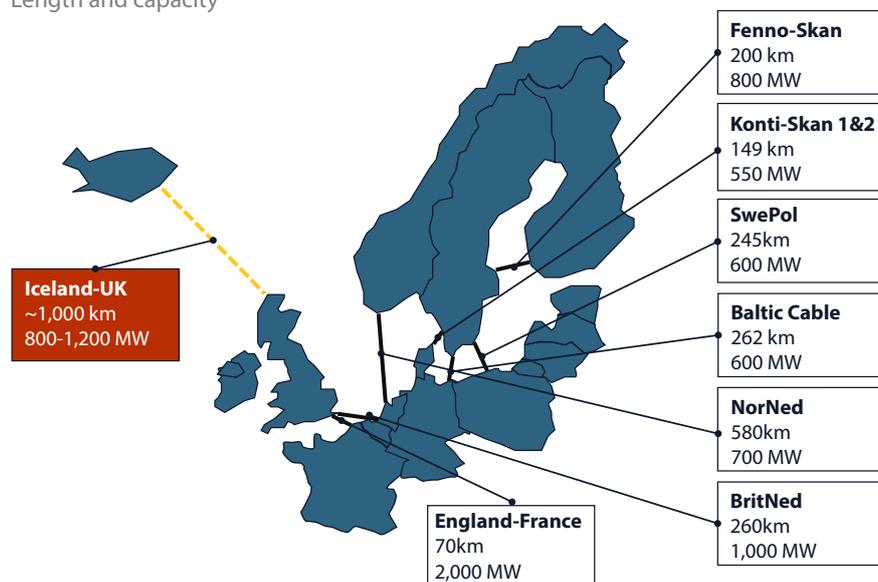
The possibility of constructing an electrical interconnector between Iceland and United Kingdom has been explored in recent years (Figure 7.4). Such an interconnector could be a source of new export revenues for the Icelandic economy and could strengthen electricity supply security of the two respective countries. The interconnector would be over 1000 km long, and with a transport capacity of between 800 and 1200 MW.⁸ A report from 2016 estimated the total cost at ISK 800 billion, about a third of Iceland's 2016 GDP.⁹ The project has hardly progressed for a while, for reasons such as political opposition but declining costs of renewable energy could also be a factor. Landsvirkjun, the national power company and producer of 71% of Iceland's electricity has, however, announced that the company is still keen on the project.¹⁰

Figure 7.5

A proposed interconnector from Iceland to the UK would be one of the longest in Europe and requires a significant investment

Interconnectors in Northern Europe

Length and capacity



Sources: Kvika banki; GAM Management; Iceland Chamber of Commerce



The possibility of constructing an electrical interconnector between Iceland and United Kingdom has been explored in recent years.

⁷ Landsnet's report (only available in Icelandic): <https://www.landsnet.is/library/Skrar/utgefna-skyrslur/Orku--og-aflofnudur/Afl%20og%20orkuj%C3%B6fnu%C3%B0ur%202019-2023.pdf>

⁸ Information from Landsvirkjun: <https://www.landsvirkjun.com/researchdevelopment/research/submarineabletoeurope>

⁹ Kvika and Pöyry on cost-benefit analysis of an interconnector (only available in Icelandic): https://www.stjornarradid.is/media/atvinnuvegaraduneyti-media/media/myndaalbum/2007/Raforkusaestrennur_lokaskyrslan_islenska.pdf

¹⁰ Visir.is, an online newspaper: <http://www.visir.is/g/2018180229216>

Electricity Transmission System

While Iceland's electricity production is in a healthy state, the transmission system ("the grid") is lagging in terms of investment and maintenance. In the aforementioned report on Icelandic infrastructure, the transmission system is stated as one of the key weaknesses, as connections between some regions are insufficient.¹¹ Therefore, electricity supply security is a concern and hinders optimal operation of power stations. The report estimates that an ISK 70 billion investment is needed in the transmission system. Nevertheless, the outlook is good and Landsnet, the operator of the grid, has increased investments in recent years and plans to invest ISK 77-100 billion in the grid until 2028.¹²

11 The Federation of Icelandic Industries, (2018): https://www.si.is/media/eplica-uppsetning/Innvidir-a-Islandi_skyrsla2017.pdf

12 Landsnet (2019, only available in Icelandic): <https://www.landsnet.is/library/Skrar/KerfisaAetlanir/2019-2028/Kerfis%C3%A1%C3%A6tlun%202019-2028%20-%20Verkefnis%20oq%20matsl%C3%BDsing.pdf>

“

While Iceland's electricity production is in a healthy state, the transmission system ("the grid") is lagging in terms of investment and maintenance.



83 listings* on Nasdaq's Nordic Markets** in 2018

business.nasdaq.com

*Includes IPOs, listings with no offerings, company spin-offs as well as switches from non-Nasdaq Markets
**Main markets and Nasdaq First North at Nasdaq Copenhagen, Nasdaq Helsinki, Nasdaq Iceland and Nasdaq Stockholm.

Source: Nasdaq Nordic, Econ & Stat Research



ABOUT THE CHAMBER



The Iceland Chamber of Commerce (ICoC) is a non-governmental organisation based on voluntary participation of companies and individuals with the mission of improving the operating environment of business in Iceland and to enhance economic prosperity. The Chamber has been diligent in its mission, celebrating its centennial anniversary in 2017.

Operations of the Chamber

Safeguarding of Interests

As an organisation of the business community, the Chamber works in the interests of everyone conducting business. The Chamber is a powerful tool for the business community in its work towards improvements to the business environment and overall enhanced productivity.

A Representative Towards the Authorities

The Chamber strives for positive changes to the laws, regulations and other influencing factors concerning the business community. The Chamber reviews all major legislative bills that concern the business community. Comments are made in collaboration with members and are presented to the relevant parliamentary committees.

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 of the Chamber, politicians and government officials, as well as others interested in Iceland's business community. The Chamber issues a report in connection with the Forum that outlines ways to improve the Icelandic business environment.

Corporate Governance

The Chamber has taken the initiative in publishing guidelines for corporate governance, in collaboration with the Confederation of Icelandic Employers and Nasdaq OMX Iceland. The guidelines were first issued in 2004 and have since been updated and published several times. The fifth edition of the guidelines was issued in June 2015 and is available online here: www.corporategovernance.is

Communication of Information

Since 2008, the Chamber has regularly published an overview of the Icelandic economy with this report. It aims to provide a factual description of the economy – recent events, the status and outlook. Over the years the report has evolved in to a summary of the current economic, business, and political landscape in Iceland. The Chamber has also taken on the role of communicating the key messages of the report to foreign parties interested in Iceland's business and economic environment.

Legal Counsel and Arbitration

The Chamber's General Counsel supervises various projects for members, free of charge. The Counsel assists members with matters such as: the import and export of goods, employee/employer relations and specific laws or regulations concerning or impacting the business environment of its members.

The Chamber operates an independent arbitration institute, called the Nordic Arbitration Centre. Its purpose is to provide companies and individuals with alternative means to the judiciary to resolve commercial disputes in a secure and timely manner. The arbitration process and the Arbitral Tribunal final awards are strictly confidential.

“ The Chamber reviews all legislative bills that concern the business community.

A Backbone for Business Education

The ICoC is an active advocate of technological and business education. Globalisation, as well as the openness of the Icelandic economy has resulted in 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 three-year secondary school for students 16 years or older who have completed Icelandic elementary school, grades 1-10. The College has over one thousand students. Its main stated objectives are to promote the competitiveness of Icelandic business, both domestically as well as internationally, by providing and furthering education in general, and business education at the secondary and lower tertiary level.

Reykjavik University

Reykjavik University is an international university located in Reykjavik, the capital of Iceland. Reykjavik University (RU) is Iceland's largest private university with around 3,000 students. The university's stated focus is on research, excellence in teaching, entrepreneurship, law, technological development, and co-operation with the business community. The university's stated objective is to educate students to become leaders in business, technology, and society.

Joining the Iceland Chamber of Commerce

Membership of the Chamber provides 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 relate both to the business community as a whole, as well as to specific interests of individual member companies. More information on joining the Iceland Chamber of Commerce may be found on its webpage: www.chamber.is.

Iceland Chamber of Commerce Bilateral Chambers

The ICoC operates 14 bilateral Chambers, both directly and in collaboration with others. An important role of the bilateral Chambers is strengthening the relationship with other similar organisations in their respective countries. They also cooperate in several ways with embassies and consulates on promoting Icelandic businesses abroad.

American-Icelandic
Established 1988

Faroese-Icelandic
Established 2012

Italian-Icelandic
Established 2001

Spanish-Icelandic
Established 1997

Arctic-Icelandic
Established 2013

French-Icelandic
Established 1990

Japanese-Icelandic
Established 2017

Swedish-Icelandic
Established 1997

British-Icelandic
Established 1997

German-Icelandic
Established 1995

Norwegian-Icelandic
Established 2011

Danish-Icelandic
Established 2000

Greenlandic - Icelandic
Established 2011

Russian-Icelandic
Established 2019



ICELAND CHAMBER OF COMMERCE