

# The Icelandic Economic Situation

Status Report - July 2013



ICELAND CHAMBER  
OF COMMERCE

\*SUNSET NEAR JÖKULSÁRLÓN

## The Icelandic Economic Situation - Status Report

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All editions, from October 2008 until April 2012, can be found [here](#).

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### About the Iceland Chamber of Commerce

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



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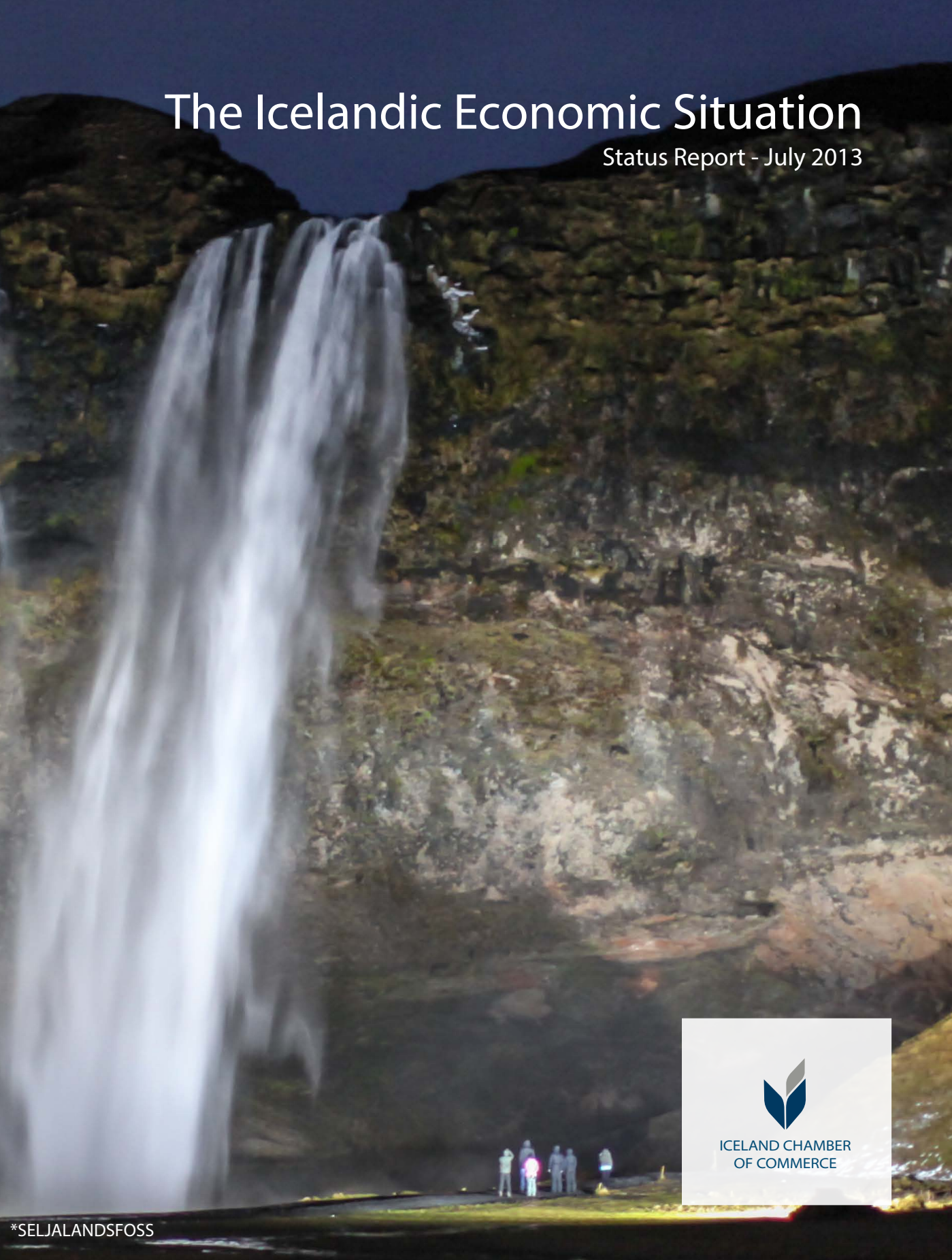
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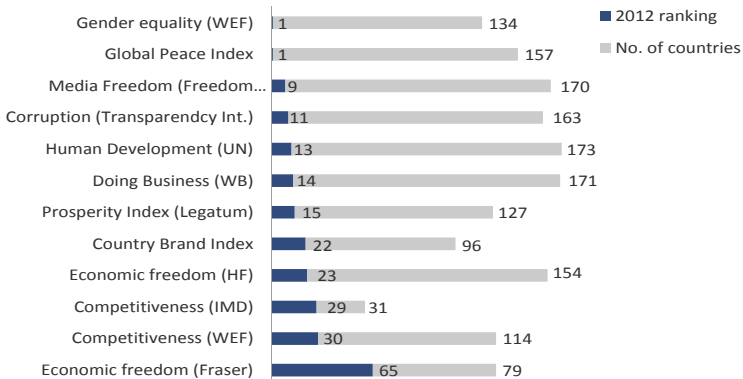
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# Republic of Iceland



Figure 1 Iceland's ranking in various competitiveness lists.



Source: Institute websites



## Useful websites

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

## Iceland's location on the world map





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## Introduction

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

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

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

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

### Status Highlights

#### Positive developments

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

#### Ongoing challenges

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

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# Part A Developments 2012-2013

## 1 Overview

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

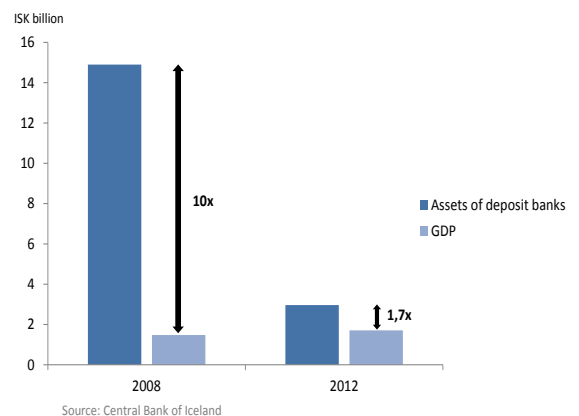
### 1.1 The Financial Sector

#### Significantly smaller system

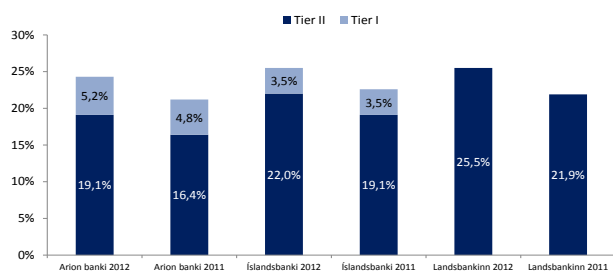
The complexity and the large relative size of the banking sector were the most significant contributors to Iceland's high risk exposure before the financial crisis. Aggregated balance sheet of the Icelandic banking system was 11 times the GDP at its peak, compared to 2 times the GDP today.

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

**Figure 2** *Bankin system 's assets compared to GDP.*



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



Source: Icelandic State Financial Investments

### Risk has declined

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

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

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

### Markets slowly opening

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

### Unresolved matters

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

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

**Figure 4** The State’s holdings in financial institutions.

Financial institution	Share	Possible timing of sell		Permission to sell according to law.	Book value (ISK million)
		2013	2014		
		First half	Second half	First half	Second half
Savings bank	49,5-86,3%	[Dashed box]		49,5-86,3%	1.735
Íslandsbanki	5,0%	[Dashed box]		5,0%	6.332
Arion banki	13,0%	[Dashed box]		13,0%	9.862
Landsbankinn	97,9%	[Dashed box]		27,9%	122.000
<b>Total</b>					<b>139.929</b>

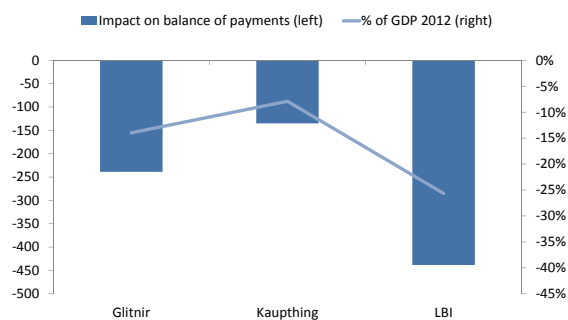
Source: Icelandic State Financial Investments

Some challenges have emerged regarding settlement and repayment terms between Landsbankinn and the old Landsbanki (NBI), which is currently going through administrative liquidation.

The two parties have agreed that Landsbankinn will prepay a quarter of the principal of so-called A-bonds, see [here](#). However, general payment terms will have to be renegotiated, mainly due to shortage of foreign currency required to service pre-agreed payment schedule. Landsbankinn has already formally asked NBI to start the negotiations.

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

Figure 5 Estimated impact of Banks in WuP on net IIP.



Source: Claims lists and financial information Glitnir, Kaupthing, LBI, Statistic Iceland, Central Bank of Iceland

## 1.2 Banks in Administrative Liquidation Procedure

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

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

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

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

## 2 The Economy and Business Sector

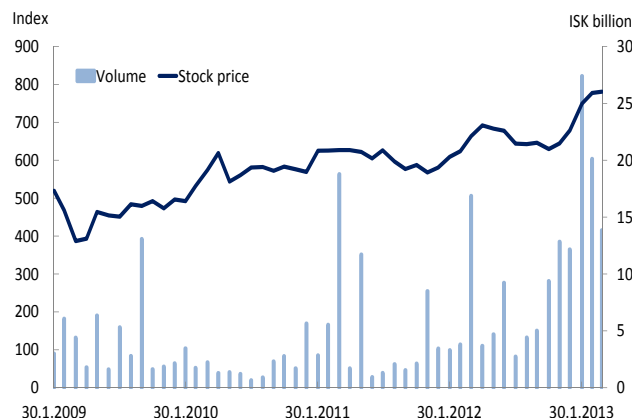
### Stock market on the rise

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

- Hagar, see [here](#).
- Reginn, see [here](#) and [here](#).
- Eimskip, see [here](#) and [here](#).
- Vodafone, see [here](#).
- VIS Insurance, see [here](#) and [here](#).
- TM Insurance, see [here](#), [here](#) and [here](#).



Figure 6 NASDAQ OMX Iceland main index.



Source: Central Bank of Iceland

Additionally, six other companies are considered likely to follow, e.g. Skeljungur and N1, both domestic oil distributors and retailers, and Reitir, commercial real estate firm. See [here](#) (only in Icelandic), [here](#) and [here](#).

### Capital controls prolonged

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

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

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

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

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

### Lower household and business debt level

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

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

The new government has declared that lowering household debt is one of their key objectives.

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

### Wave of Collective agreements

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

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

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

### Trade and investment

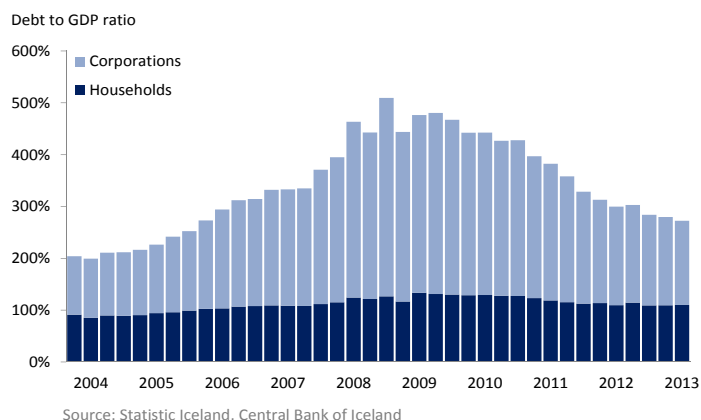
Business investment remains well below historical value. This can be contributed to both internal and external factors, most noticeably high uncertainty in the domestic economy and the on going crisis in the EU. According to *Maplecroft*, Iceland is one of the countries that are in most danger due to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

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

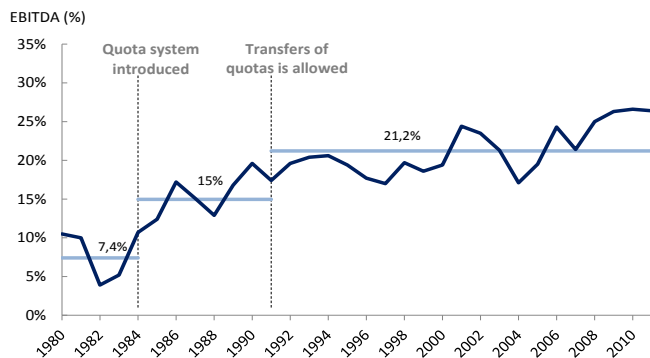
## 2.1 The Fisheries Sector

Fisheries have been Iceland's fundamental industry over past decades. It is among the most productive industries in the economy and is highly competitive in international perspective. Although the fisheries system has proven biologically and economically strong, remains politically disputed.

Figure 7 Debts of households and corporations.



**Figure 8** Fisheries Sector's EBITDA 1980-2011.



Source: Statistic Iceland and National Institute Iceland

Previous Government submitted a legislative proposal to change the fisheries management system and to implement additional fees in the spring of 2012, see [here](#), [here](#), [here](#) and [here](#).

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

To a large degree, the debate is on the topic of how to share resource rent from fisheries. Although the future solution is likely to include some form of resource tax, it is important that the extent of taxation is balanced. Otherwise, the fees could impede the

sector's fundamentals and therefore its efficiency. Maintaining these strengths is critical given the highly regarded status of the sector in international comparison. See [here](#) for further information on the fishing industry.

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

## 2.2 The Energy Sector

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

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

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

### Aluminum an important pillar

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

Constructions at the new [Century Aluminum smelter](#) in Helguvik (South-West of Iceland) have been delayed for several years. One reason being two arbitration cases, one settled in late 2011 and the other in May 2013, see [here](#) and [here](#). The company representatives have stated that they hope that the arbitration results will facilitate the construction process.

Among other recent news on heavy-industry projects, the former Government passed a legislative act in Mars 2013, allowing for an investment contract to be signed with PCC SE on a metallurgical grade silicon metal production plant in the North of Iceland, see [here](#) for related information.

### Rising oil expectations

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

Furthermore, Norway has notified NEA of its decision to participate in both if the issued licences, see [here](#).

### Inter-connector feasibility looked into

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

### Data Centers gaining foothold

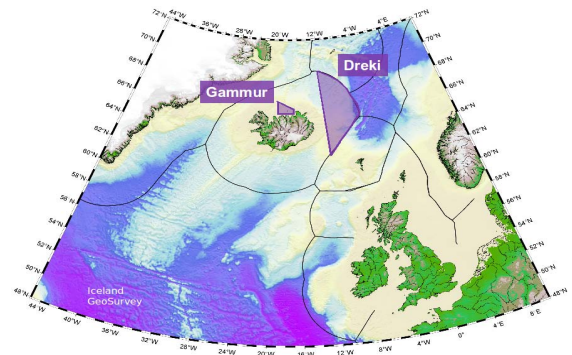
*BroadGroup*, an information media technology and professional services company has undertaken an independent analysis of Iceland as a global data center hub, comparing it using a wide variety of criteria with today's leading data center locations from around the world. It is estimated that a 10 year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

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

## 2.3 The Tourism Sector

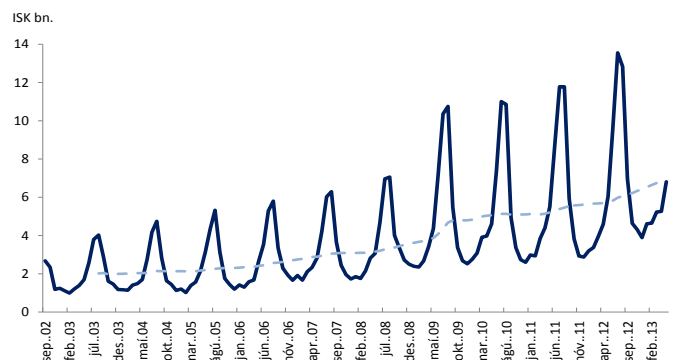
The tourism sector has grown significantly over recent years and is now one of the three major export industries in Iceland, amounting to 23,5% of Iceland's export revenues.

Figure 9 The Icelandic Continental Shelf.



Source: [www.nea.is](http://www.nea.is)

Figure 10 Total turnover of foreign debt and credit cards in Iceland.



Source: Central Bank of Iceland

Between 2009 and 2012 the number of tourists increased by 36%, or roughly 11% a year. Total inbound tourism consumption increased by 48% over the same time period. Number of tourists in 2012 was more than double the population of the country, or 672.000 tourists. In the first six months of 2013 the number of tourists increased over 25% compared to the first six months of 2012. For more information, see [here](#) and [here](#).

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

## 3 The Public Sector

### 3.1 Fiscal Consolidation Plan

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

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

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

Figure 11 New government, formed in May 2013.



Source: [www.government.is](http://www.government.is)

### 3.2 A New Government

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

Furthermore, the Government has announced that the negotiations with the EU will be postponed, see [here](#). A special report will be written on the negotiation process and the status of the EU which will be put before the Parliament this autumn. The negotiations will not be continued until after a referendum.

With regards to the fiscal plan the Government has established a Consolidation Committee. Its role is to put forth long-term proposals to consolidate, prioritise and enhance efficiency in the State's operations. The Committee consists of MP's, government officials and external experts. See more information [here](#) (only in Icelandic).

## 4 Other Notable Events and Publications

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

# Energy Industry Infrastructure



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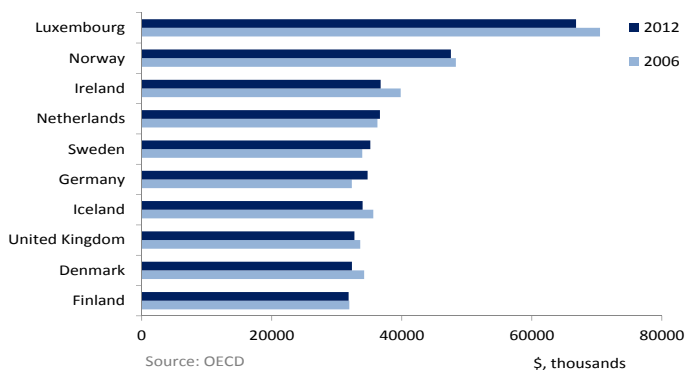
# Part B The Economic Landscape

## 5 Overview

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

### 5.1 Gross Domestic Product (GDP)

**Figure 12** *GDP fell by 10,4% between 2008-2010. GDP growth picked up in 2011 and is predicted to reach its pre-crisis peak in 2015.*



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

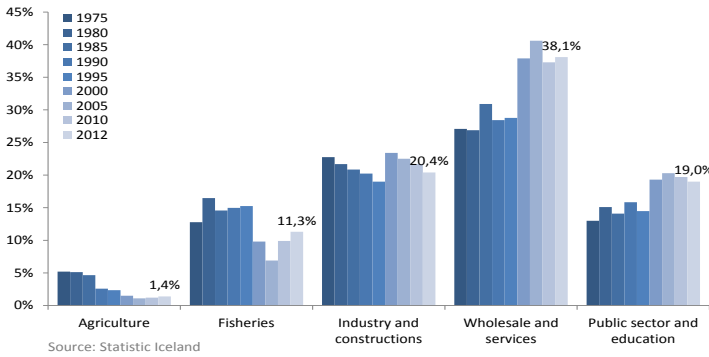


Figure 14 Iceland's GDP contribution by sectors. The economic landscape has changed significantly in recent decades.

## 5.2 State Debt

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

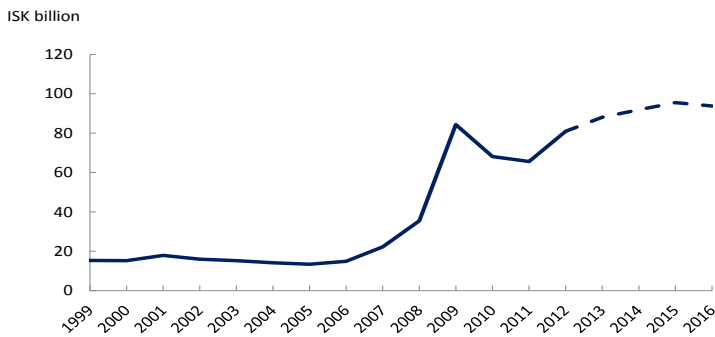
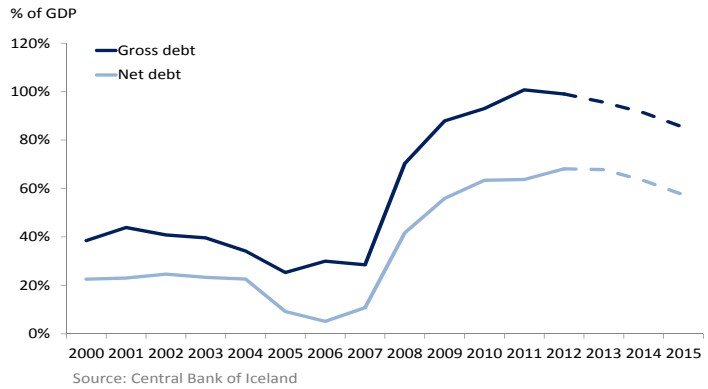
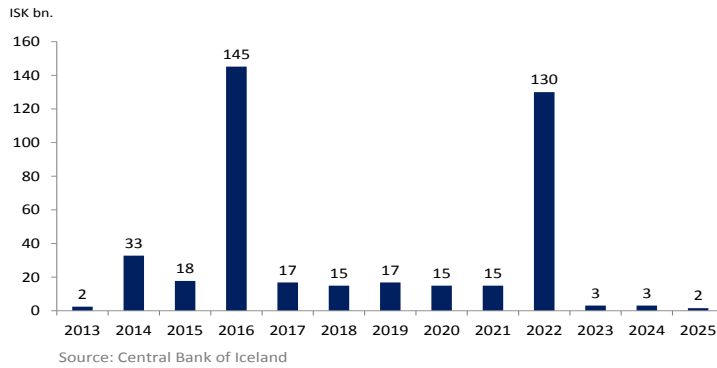
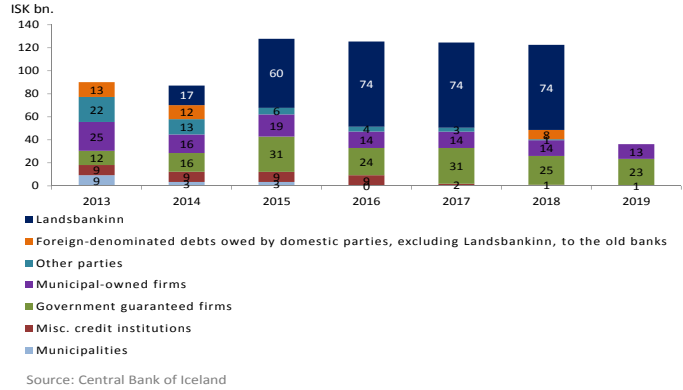


Figure 16 Interest payments have increased dramatically due to increased debt level.

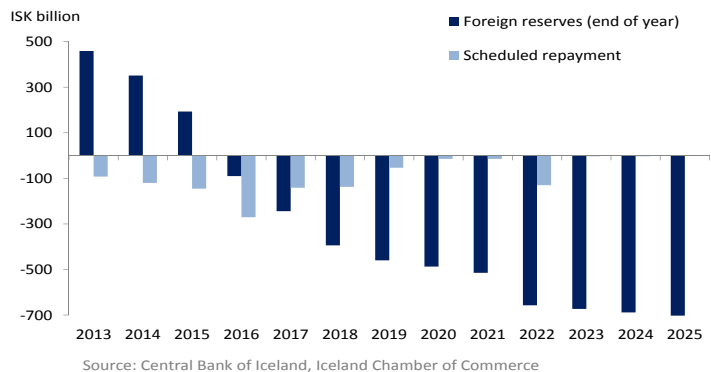
**Figure 17** *Scheduled repayments of foreign loans by other parties, excluding the Treasury.*



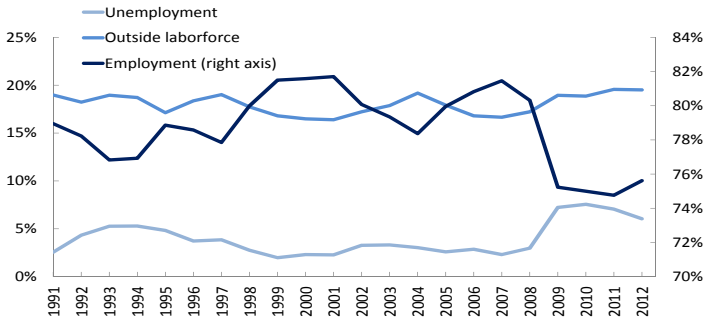
**Figure 18** *Scheduled repayments of the Treasury foreign loans show spikes in 2016 and 2022.*



**Figure 19** *Scheduled repayments of foreign loans demand significant refinancing in order to preserve foreign reserves*



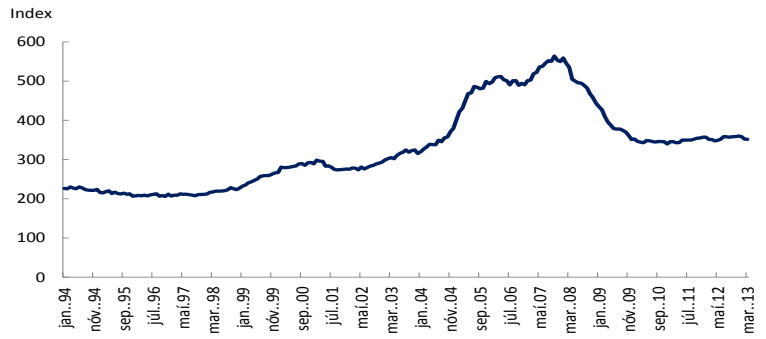
### 5.3 Households and Corporations



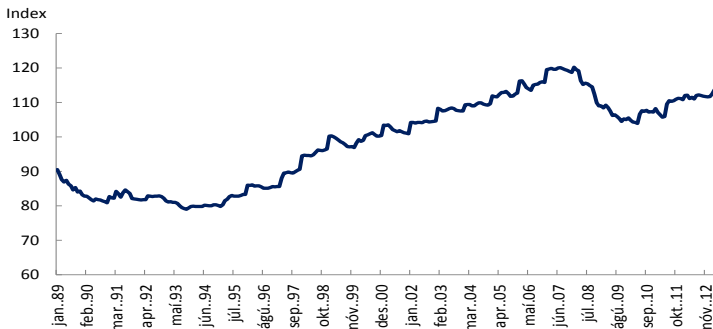
Source: Statistic Iceland

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

**Figure 21** *Real house prices decreased by 33,5% and are close to late 2004 level.*



Source: Registers Iceland, Statistics Iceland and Iceland Chamber of Commerce



Source: Statistic Iceland

**Figure 22** *Purchasing power decreased substantially in 2008 but is now back to mid-2005 level, measured in ISK.*

Figure 23 Households ability to service their debt has gradually improved from 2010.

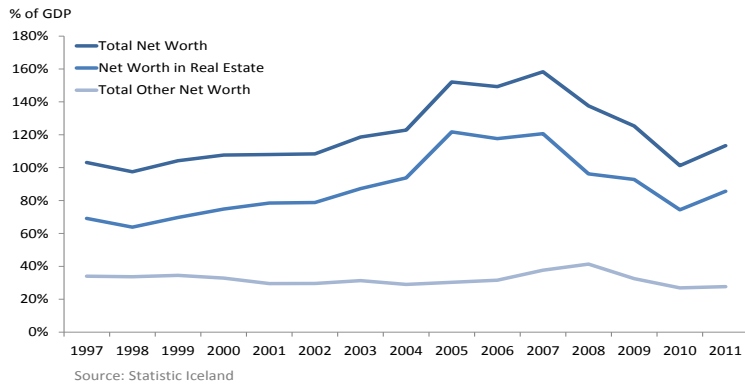
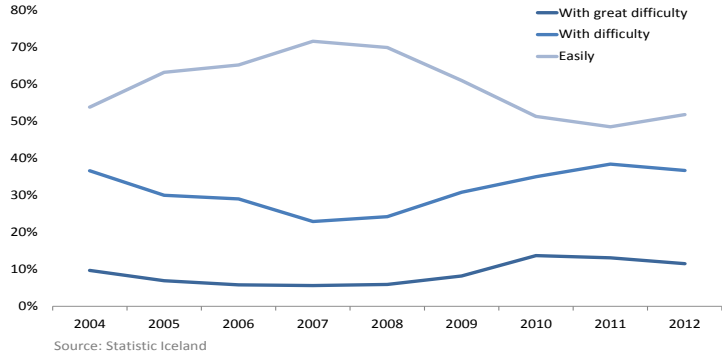
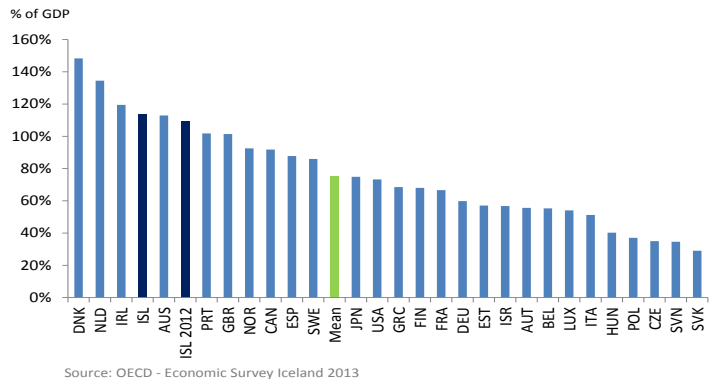


Figure 24 Net worth of individuals, has grown since 2010.

Figure 25 Household debt is fairly high in international comparison.



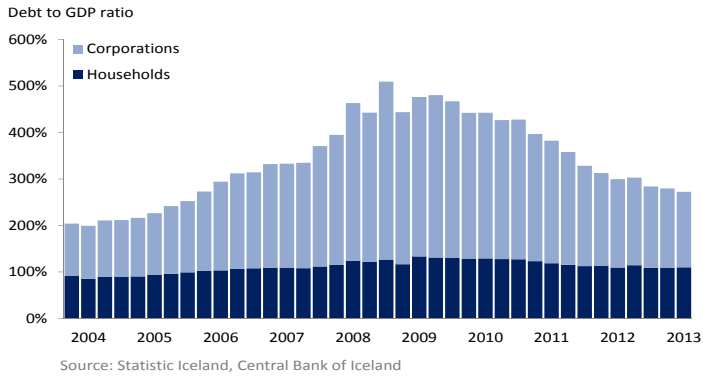


Figure 26 Corporate debt has decreased to same level as in mid-2005 while household debt is down to mid-2006 level.

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

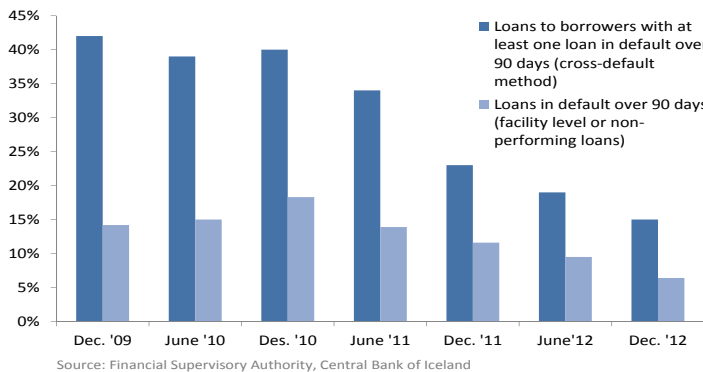
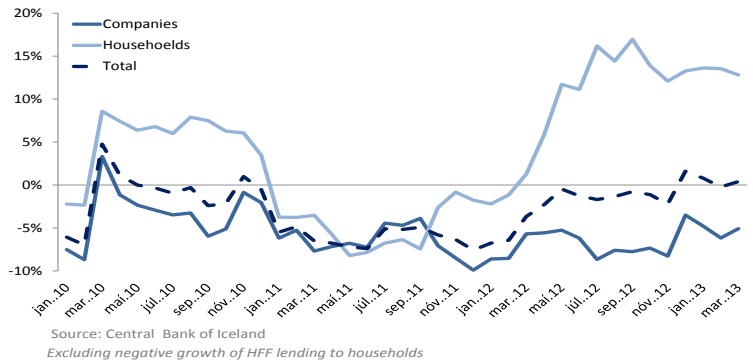
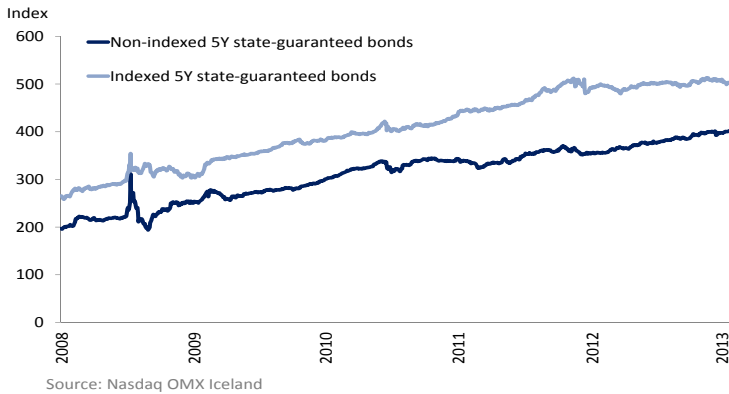
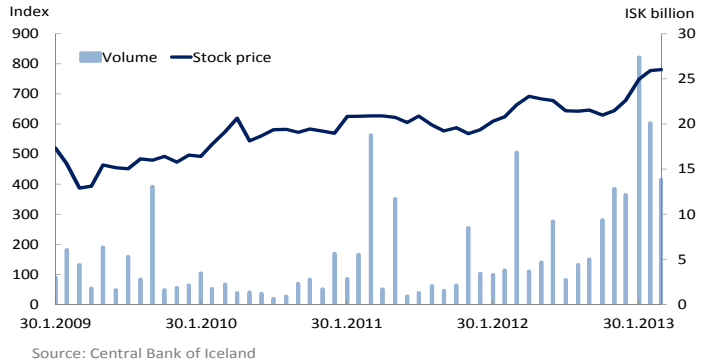


Figure 28 Loan defaults have decreased substantially since 2009.

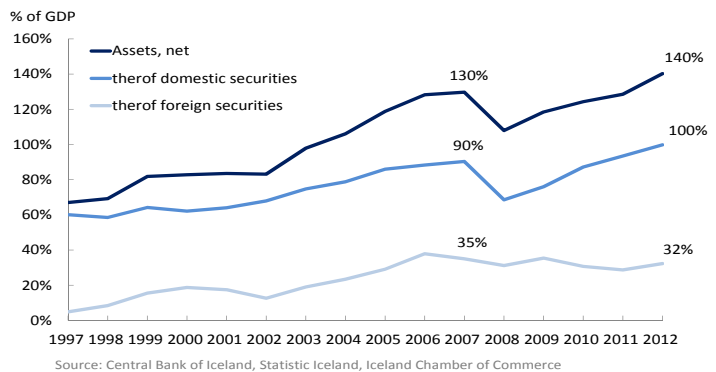
## 5.4 Stock Market and Pension System

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

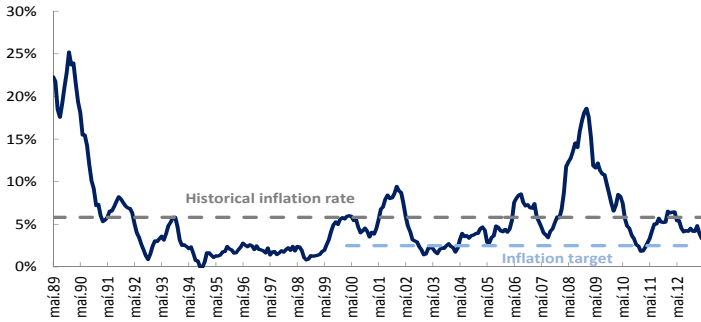


**Figure 30** *Since the bust of the stock market the bond market has been booming with bonds doubling in price.*

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



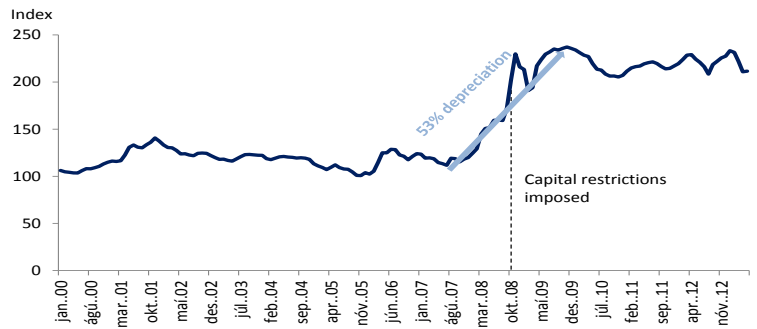
## 5.5 Monetary Policy



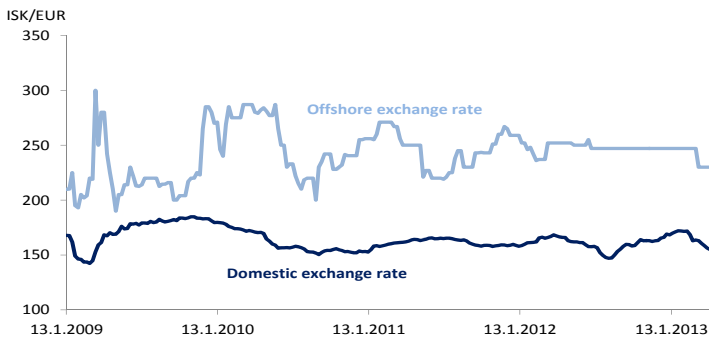
Source: Statistic Iceland, Iceland Chamber of Commerce

**Figure 32** Inflation is close to its targeted level of 2,5%. Historically, inflation has been well above the target.

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



Source: Central Bank of Iceland

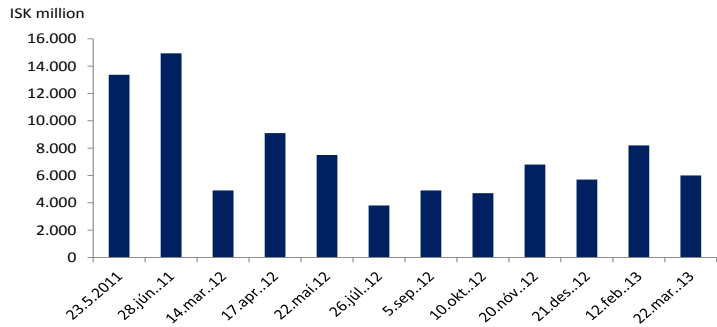


Source: Central Bank of Iceland

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

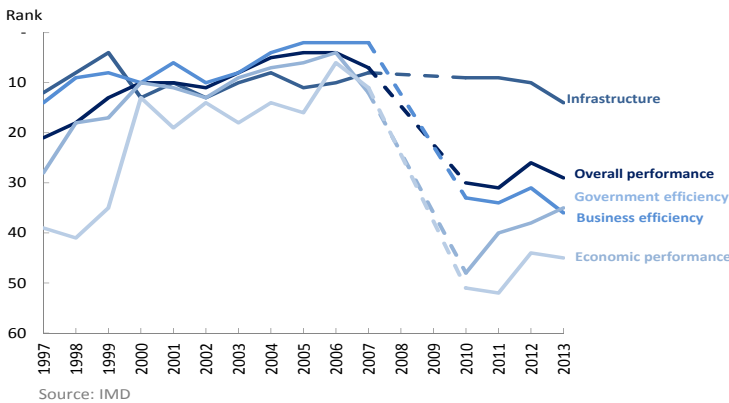


**Figure 35** The CB estimates that volatile króna assets are equal to 22% of GDP or ISK 367 bn. Through ISK auctions, illustrated here, the CB has lifted some of that pressure.



Source: Central Bank of Iceland

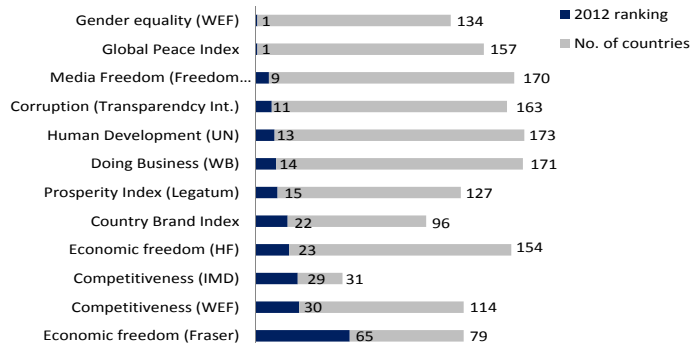
## 5.6 Competitiveness



Source: IMD

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

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



Source: Institute websites



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# Part C Developments 2009-2012

## 6 Overview

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

### 6.1 The Housing Fund and new Bank Agency

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

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

**Figure 38** The logo of the EFTA Court



### 6.2 The Icesave Dispute

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

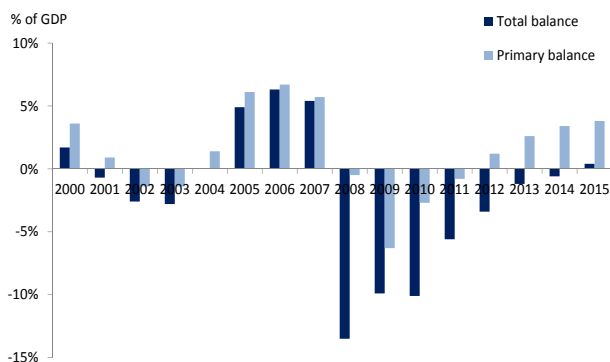
Source: [www.eftacourt.int](http://www.eftacourt.int)

### 6.3 The IMF Plan

On the 28<sup>th</sup> of October 2009 the IMF’s Executive Board approved the 1<sup>st</sup> review of the Economic Recovery Program, giving Iceland access to \$167,4 million from the IMF and also \$675 million from the Nordic countries and Poland, see [here](#).

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

Figure 39 Primary and total balance of the State.



Source: Central Bank of Iceland and Statistic Iceland

### 6.4 The State Treasury

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

On June 9<sup>th</sup> 2011 Iceland issued USD 1 billion worth of bonds due in 2016, see [here](#).

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

### 6.5 The Central Bank

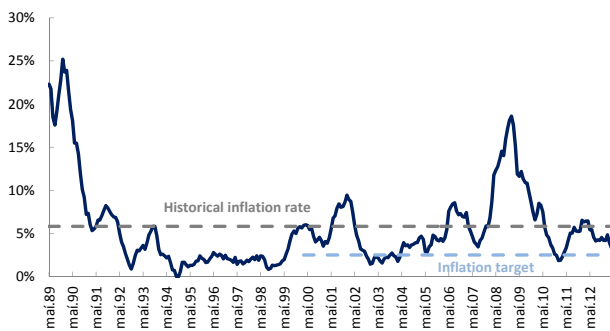
After the collapse of the three major banks and the exchange rate, inflation rose above 18% in January 2009 and the CB increased its policy rate to 18%.

Due to massive devaluation in the exchange rate the CB imposed capital restrictions to hinder further devaluation of the ISK. On the 5<sup>th</sup> of August 2009 the CB introduced a *Capital Account Liberalization Strategy*. The first step of the strategy was implemented on 1<sup>st</sup> of November 2009 allowing for foreign direct investments into Iceland. See [here](#)

for report on monetary policy in Iceland after capital controls.

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

Figure 40 Inflation 1989-2012.



Source: Statistic Iceland, Iceland Chamber of Commerce

### 6.6 The Labor Market

After the collapse in 2008 unemployment rose to 9,2% in September 2011. On a yearly basis 2010 was the worst year regarding unemployment when it was on average 8%.

Near the end of June 2009 the Government, the Confederation of Employers and the Confederation of Employees signed an agreement, *The Stability Pact*, see [here](#) and [here](#). In 2011, unemployment was down to 7% on a yearly basis. Find more information in chapter 17 in the [2012 edition](#) of this report.

## 6.7 The Investigation Committee and Constitutional Assembly

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

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

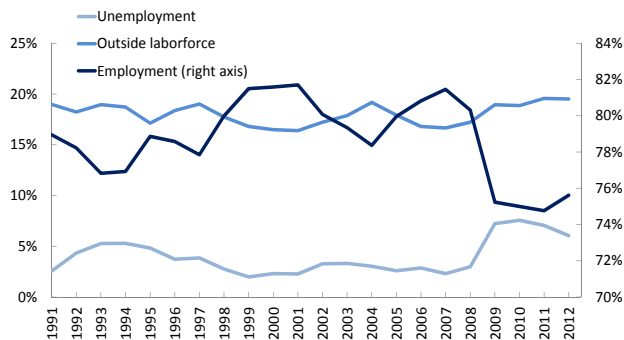
## 6.8 The EU Application

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

## 6.9 Other Notable Events and Publications

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

Figure 41 Unemployment 1991-2012.



Source: Statistic Iceland



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# Part D Future Prospects

## 7 Overview

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

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

### 7.1 Iceland Growth Forum

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

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

The Forum's main goal is to address the productivity gap between Iceland and neighboring countries. Currently, Iceland has a strong and flexible labor market, but when it comes to productivity and

Figure 42 The logo of the Iceland Growth Forum.



Source: [www.growthforum.is](http://www.growthforum.is)

investment rates Iceland lags behind. The Secretariat proposed economic goals which are considered to be ambitious but possible.

1. Average GDP growth of 3,5% until 2030
2. Government debt below 60% of GDP before 2030
3. Price stabilization with average inflation 2,5% until 2030.

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

## 7.2 The McKinsey & Company Report

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

Figure 43 Sector priorities according to McKinsey & Company.



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

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

Source: [www.mckinsey.com](http://www.mckinsey.com)

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

## 7.3 The Iceland Chamber of Commerce Action Handbook

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

### Resource based sector

1. Increased investment in tourism infrastructure
2. Efficiency in the fishing industry a priority in all policy making
3. Competitive environment for the resource sector

4. More efficient and diversified agricultural policy
5. All possible benefits of energy utilisation fully explored

**International sector**

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

**Domestic service sector**

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

Figure 44 Iceland Chamber of Commerce Action Handbook.



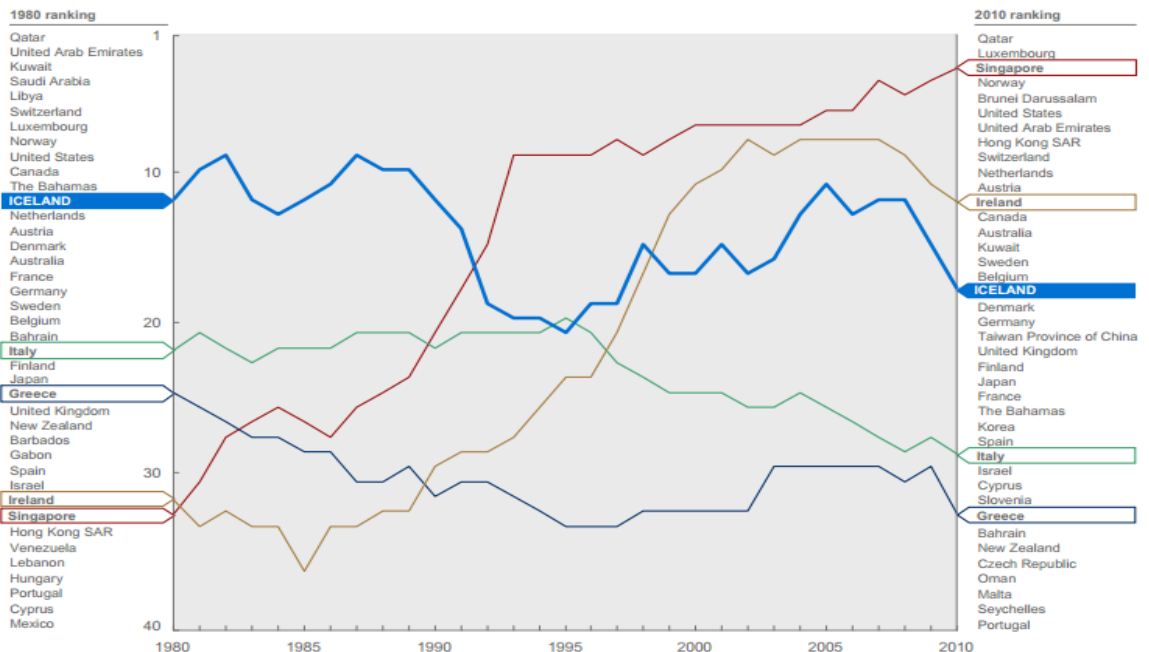
The Handbook is accessible [here](#) (only in Icelandic) and an English translation of the 13 actions points, [here](#).

## 7.4 180 Reports on Iceland

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

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

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



Source: IMF World Economic Outlook (April 2012); McKinsey analysis

## About the Iceland Chamber of Commerce

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

Figure 46 *Logo of the ICoC.*



ICELAND CHAMBER  
OF COMMERCE

## Operations of the Chamber

### General Safeguarding of Interests

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

### An Advocate Towards the Authorities

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

### The Chambers Annual Business Forum

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

### Corporate Governance

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

### Communication and Acquisition of Information

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

### Legal Counsel and Arbitration

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

## A Backbone for Business Education

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

### The Commercial College of Iceland

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

**Figure 47** The logo and main building of the Commercial College of Iceland.



### Reykjavik University

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

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

**Figure 48** The logo and main entrance of Reykjavik University.



## Joining the Iceland Chamber of Commerce

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

Information about the location and opening hours of the ICoC office can be found [here](#).

Iceland Chamber of Commerce bilateral Chambers





ICELAND CHAMBER  
OF COMMERCE



\*SUNSET NEAR JÖKULSÁRLÓN