



# 1H 2019 Financial Results



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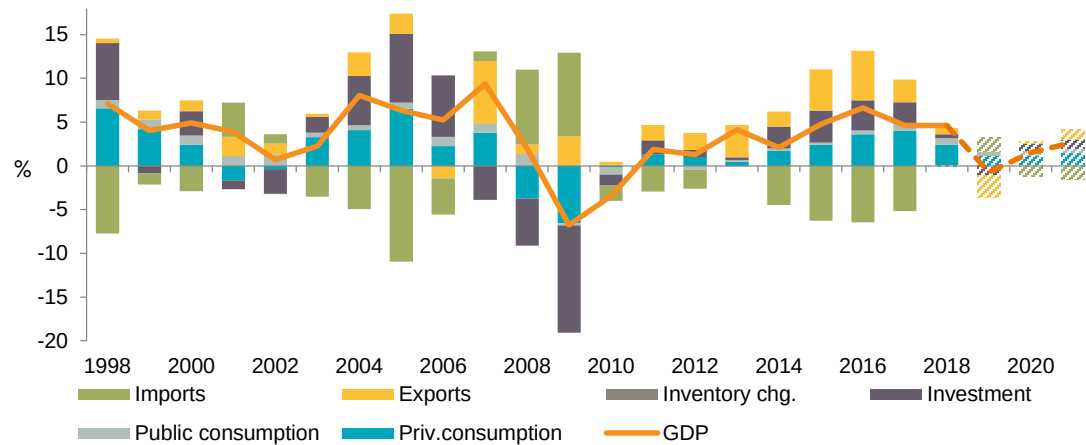
# 1. 1H 2019 highlights



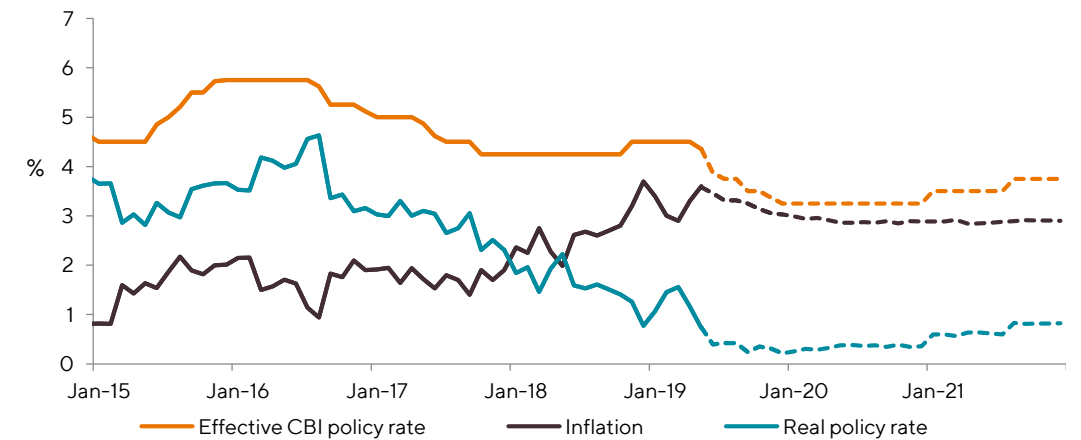
# Economic highlights

A year of consolidation after a long and prosperous upswing

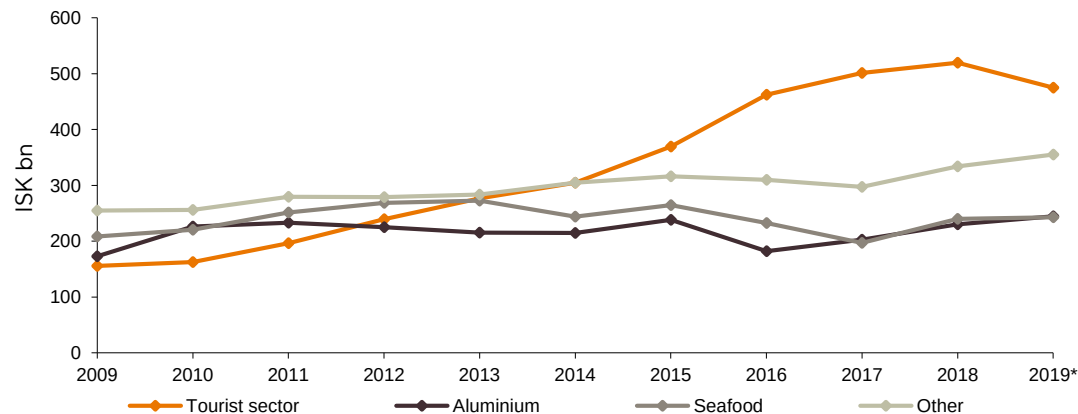
A short-lived recession expected in 2019 as export sector faces setbacks<sup>1</sup>...



...a cooling economy will lead to decreasing inflationary pressures<sup>1</sup>...

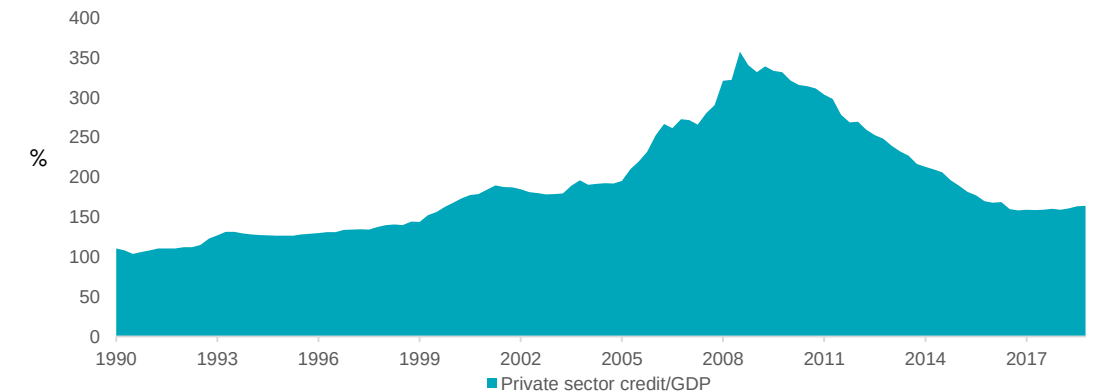


...and revenues from tourism likely to fall to 2016-2017 levels...



1. Shaded areas and dotted lines indicate ISB research/ forecasts.  
Source: Statistic Iceland and ISB research.

...and economy-wide deleveraging in 2010-2017 has increased economic resilience





# Financial highlights

## Key figures & ratios

|                      |                                                      | 1H19  | 1H18  | 2Q19  | 2Q18  | 2018   |
|----------------------|------------------------------------------------------|-------|-------|-------|-------|--------|
| <b>PROFITABILITY</b> | ROE 16% CET1 (regular operations) <sup>1</sup>       | 7.2%  | 9.4%  | 7.8%  | 11.1% | 8.0%   |
|                      | ROE (after tax)                                      | 5.4%  | 8.2%  | 4.9%  | 11.6% | 6.1%   |
|                      | Net interest margin (of total assets)                | 2.8%  | 2.8%  | 2.8%  | 2.8%  | 2.9%   |
|                      | Cost to income ratio <sup>2</sup>                    | 62.0% | 67.3% | 61.4% | 65.0% | 66.3%  |
|                      | After tax profit, ISK m                              | 4,709 | 7,130 | 2,120 | 5,033 | 10,645 |
|                      | Earnings from regular operations, ISK m <sup>3</sup> | 5,707 | 6,843 | 3,054 | 3,881 | 12,042 |

|                      |                                        | 30.06.2019 | 31.03.2019 | 31.12.2018 | 31.12.2017 | 31.12.2016 |
|----------------------|----------------------------------------|------------|------------|------------|------------|------------|
| <b>BALANCE SHEET</b> | Total assets, ISK m                    | 1,229,976  | 1,205,228  | 1,130,403  | 1,035,822  | 1,047,554  |
|                      | Loans to customers, ISK m              | 894,446    | 873,530    | 846,599    | 755,175    | 687,840    |
|                      | Deposits from customers, ISK m         | 615,869    | 611,303    | 578,959    | 567,029    | 594,187    |
|                      | Customer deposit / customer loan ratio | 68.9%      | 70.0%      | 68.4%      | 75.1%      | 86.4%      |
| <b>CAPITAL</b>       | Total equity, ISK m                    | 175,784    | 173,621    | 176,313    | 181,045    | 178,925    |
|                      | Tier 1 capital ratio                   | 18.8%      | 19.1%      | 20.3%      | 22.6%      | 24.9%      |
|                      | Total capital ratio                    | 21.4%      | 20.9%      | 22.2%      | 24.1%      | 25.2%      |
|                      | Leverage ratio                         | 13.4%      | 13.5%      | 14.6%      | 16.2%      | 16.0%      |

1. Return from regular operations and corresponding ratios on normalized CET1 of 16%, adjusted for risk free interest on excess capital.

2. Calculated as (Administrative expenses + Contribution to the Depositors' and Investors' Guarantee Fund – One off items) / (Total operating income – one off items).

3. Earnings from regular operations is defined as earnings excluding one-off items e.g. bank tax, one-off costs and income. As the future level of bank tax is unclear, it is regarded as a one-off item in these calculations.





# This is Íslandsbanki

A leader in financial services in Iceland, with a clear vision to be #1 for service

Moving Iceland forward by empowering our customers to **succeed** articulates the Bank's role in shaping and progressing society. Driven by the **vision to be #1 for service**, the Bank provides services to its customer through three business divisions that manage and build relationships with customers

## Universal banking



ÍSLANDSSJÓÐIR



## Awards



ÍSLENSKA  
ÁNÆGJUVOGIN  
2013-2018

Leading the Icelandic Customer Satisfaction Index for **six consecutive years**

## Credit ratings

**S&P Global**  
Ratings

**BBB+/A-2**  
Negative outlook

## 1H19 Key figures for the Group

ROE (Regular operations) **7.2%**

Cost to income ratio **62.0%**

Total Capital Ratio **21.4%**

Total Assets **ISK 1,230bn**

## Employees of the Bank



**806**

Number of **FTE's** for parent company at end of 2Q2019



**91%**

**Job satisfaction** among Íslandsbanki's employees



**5**

training courses a year per employee

## Market share <sup>1</sup>



**30%**

Individuals

**37%**

SMEs

**33%**

Large companies and investors

## Ways to bank



**57 ATMs**



**14 Branches**



**88,700 Total app users**

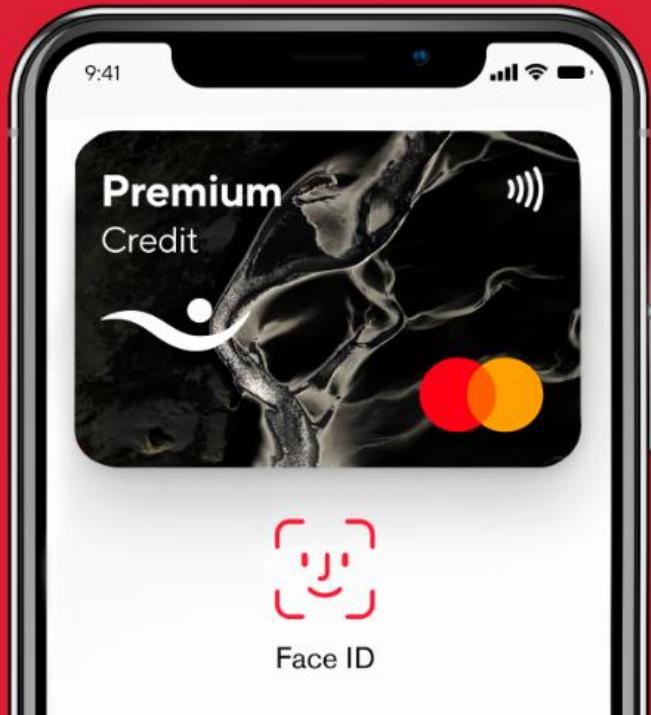


**113,000 Online banking users**

1. Based on Gallup survey regarding primary bank.

# Íslandsbanki's digital offering continues to grow

Now offering Apple Pay and a fully automated online mortgage application and evaluation process

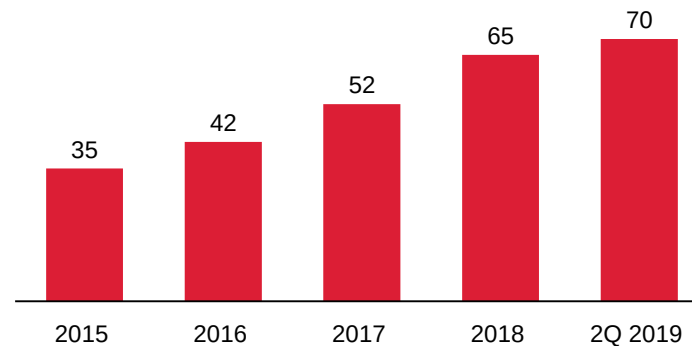


## Digital innovation enhancing the customer experience

- All credit scoring for individuals now made digitally
- 46% of our customers are buying financial products „after hours“ via our new onboarding service
- 71% of our credit card customers are changing their credit limits in our Kort app
- 57% of all split payments are conducted through Kort app
- All unsecured funding below ISK 2m now processed fully digital through our new solution “loan in app”

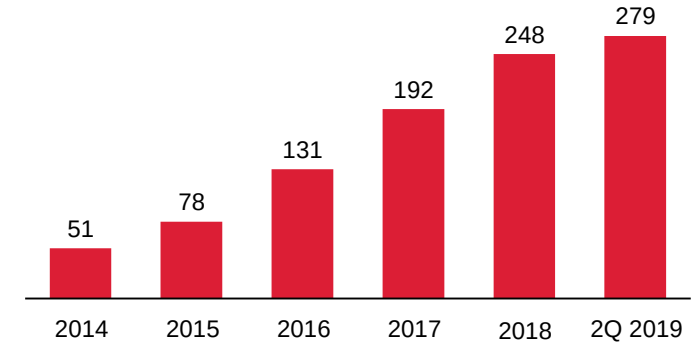
## Active Íslandsbanki App users

Thousands, end of period



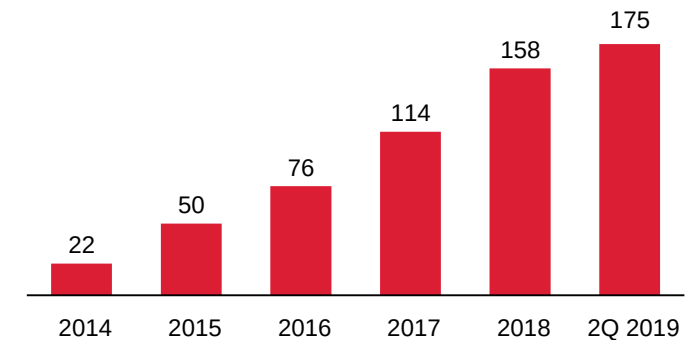
## Bank transfers via App

Thousands, per month



## Payment of invoices via App

Thousands, per month





REYKJAVÍKUR  
MARAFON  
ÍSLANDBANKA

## Íslandsbanki Reykjavík Marathon — 24 August 2019

- The largest charity event of the year
- Around 14.000 runners every year
- The largest charity fundraising event in Iceland
- ISK 820 millions raised since 2016
- ISK 156 millions raised in 2018 alone
- Over 180 charities benefit



**HLAUGHTU**  
**ÞAÐ BORGAR SIG**





## 2. Income statement



# Income statement

## Negative net impairments main cause for lower profits

| ISKm                                                          | 1H19            | 1H18            | Δ              | 2Q19           | 2Q18           | Δ              |
|---------------------------------------------------------------|-----------------|-----------------|----------------|----------------|----------------|----------------|
| Net interest income                                           | 16,778          | 15,342          | 1,436          | 8,626          | 7,602          | 1,024          |
| Net fee and commission income                                 | 6,623           | 5,810           | 813            | 3,406          | 3,032          | 374            |
| Net financial income (expense)                                | 621             | 95              | 526            | 173            | 378            | (205)          |
| Net foreign exchange loss                                     | (101)           | (67)            | (34)           | (71)           | (57)           | (14)           |
| Other operating income                                        | 1,173           | 1,600           | (427)          | 29             | 1,587          | (1,558)        |
| <b>Total operating income</b>                                 | <b>25,094</b>   | <b>22,780</b>   | <b>2,314</b>   | <b>12,163</b>  | <b>12,542</b>  | <b>(379)</b>   |
| Salaries and related expenses                                 | (8,363)         | (7,952)         | (411)          | (4,312)        | (4,026)        | (286)          |
| Other operating expenses                                      | (6,000)         | (5,770)         | (230)          | (2,961)        | (2,846)        | (115)          |
| <b>Administrative expenses</b>                                | <b>(14,363)</b> | <b>(13,722)</b> | <b>(641)</b>   | <b>(7,273)</b> | <b>(6,872)</b> | <b>(401)</b>   |
| Contribution to the Depositor's and Investors' Guarantee Fund | (510)           | (579)           | 69             | (198)          | (287)          | 89             |
| Bank tax                                                      | (1,814)         | (1,597)         | (217)          | (934)          | (812)          | (122)          |
| <b>Total operating expenses</b>                               | <b>(16,687)</b> | <b>(15,898)</b> | <b>(789)</b>   | <b>(8,405)</b> | <b>(7,971)</b> | <b>(434)</b>   |
| <b>Profit before net impairment on financial assets</b>       | <b>8,407</b>    | <b>6,882</b>    | <b>1,525</b>   | <b>3,758</b>   | <b>4,571</b>   | <b>(813)</b>   |
| Net impairment on financial assets                            | (1,848)         | 1,934           | (3,782)        | (929)          | 1,846          | (2,775)        |
| <b>Profit before tax</b>                                      | <b>6,559</b>    | <b>8,816</b>    | <b>(2,257)</b> | <b>2,829</b>   | <b>6,417</b>   | <b>(3,588)</b> |
| Income tax expense                                            | (1,779)         | (2,480)         | 701            | (626)          | (1,465)        | 839            |
| <b>Profit for the period from continuing operations</b>       | <b>4,780</b>    | <b>6,336</b>    | <b>(1,556)</b> | <b>2,203</b>   | <b>4,952</b>   | <b>(2,749)</b> |
| Discontinued operations, net of income tax                    | (71)            | 794             | (865)          | (83)           | 81             | (164)          |
| <b>Profit for the period</b>                                  | <b>4,709</b>    | <b>7,130</b>    | <b>(2,421)</b> | <b>2,120</b>   | <b>5,033</b>   | <b>(2,913)</b> |

### Highlights

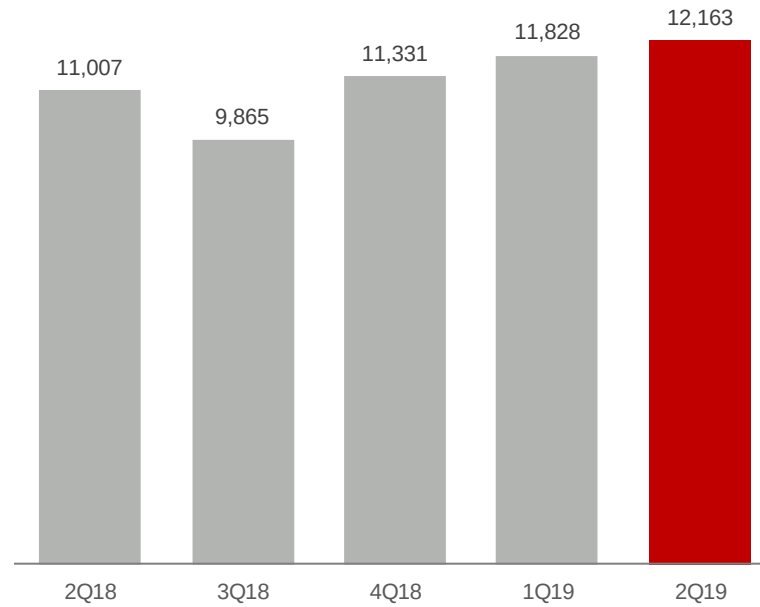
- Total income amounted to ISK 25bn in 1H19, an increase of 9.4% between years as a result of strong interest and fee income
- Positive changes in the CPI index and continuous loan growth contribute to higher net interest income
- Overall net fee income showed a 14% increase year on year
- Other operating income is ISK 1.1bn, a result from settlement with old Byr bank and the Icelandic Government
- Administrative expenses increase by 4.7% which can be attributed to employment terminations, collective wage increases and higher depreciations due to heavy investment in the core banking system
- Profit for the period is ISK 4.7bn which is a decrease of 34% from 1H18
  - Largely caused by negative net impairment of ISK 1.8bn compared to positive impairment of ISK 1.9bn for the same period in 2018



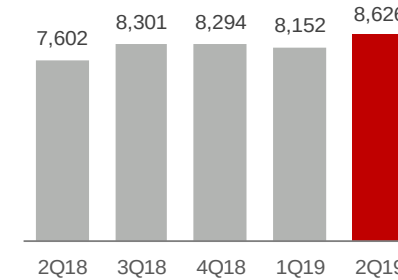
# Operating income

Net fee and commission up by 14% and net interest income up by 9.4% compared to 1H18

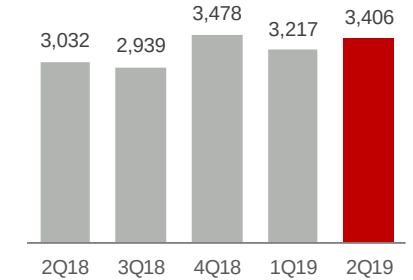
**Total operating income<sup>1</sup>**  
ISK m



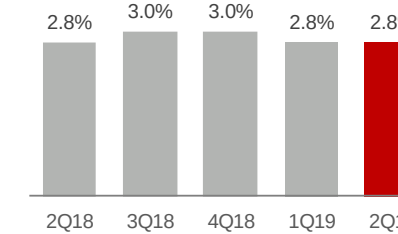
**Net interest income**  
ISK m



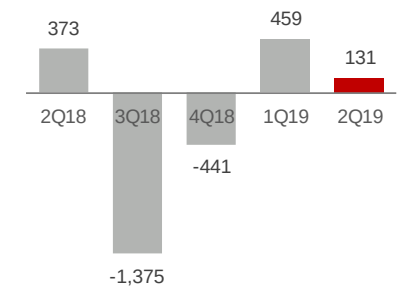
**Net fee and commission income**  
ISK m



**Net interest margin**  
%



**Other income<sup>1</sup>**  
ISK m



1. Excluding one-off income.



# Net interest income and net fee and commission income

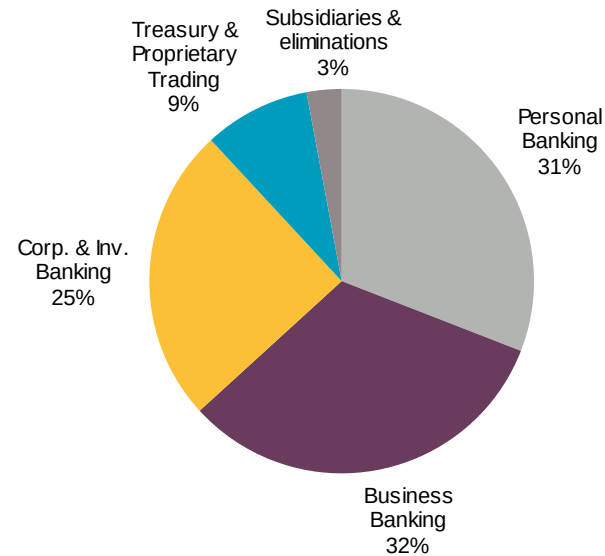
## Breakdown by segments

### Highlights

- Net interest income was ISK 16.8bn, an increase of 9.4% between years and the net interest margin was 2.8% which is comparable to 1H18
- Net interest income evenly distributed between the three business divisions
- Net fee and commission income was ISK 6.6bn (1H18: ISK 5.8bn) an increase of 14% between years
- Personal Banking was the main contributor to net fee and commission income

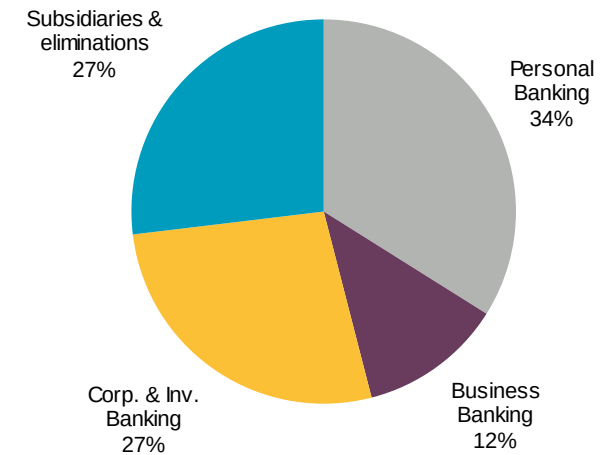
### Net interest income

%



### Net fee and commission income

%







# Earnings from regular operations

Excludes one-off items and ROE calculation is adjusted to normalised CET1 of 16%

## Resilient ROE from regular operations

| ISKm                                           | 1H19    | 1H18    | Δ       | 2Q19  | 2Q18    | Δ       |
|------------------------------------------------|---------|---------|---------|-------|---------|---------|
| Reported after tax profit                      | 4,709   | 7,130   | (2,421) | 2,120 | 5,033   | (2,913) |
| One-off revenue                                | (1,103) | (2,546) | 1,443   | -     | (2,546) | 2,546   |
| One-off costs                                  | -       | -       | -       | -     | -       | 0       |
| Bank tax                                       | 1,814   | 1,597   | 217     | 934   | 812     | 122     |
| Tax impact of adjustments                      | 287     | 662     | (375)   | -     | 662     | (662)   |
| Earnings from regular operations <sup>1</sup>  | 5,707   | 6,843   | (1,137) | 3,054 | 3,881   | (827)   |
| ROE 16% CET1 (regular operations) <sup>2</sup> | 7.2%    | 9.4%    |         | 7.8%  | 11.1%   |         |
| ROA from regular operations (after tax)        | 1.0%    | 1.3%    |         | 1.0%  | 1.4%    |         |
| Net interest margin adj. 16% CET1              | 2.7%    | 2.7%    |         | 2.8%  | 2.7%    |         |
| Cost / income ratio adj. 16% CET1              | 60.4%   | 70.2%   |         | 63.0% | 72.3%   |         |

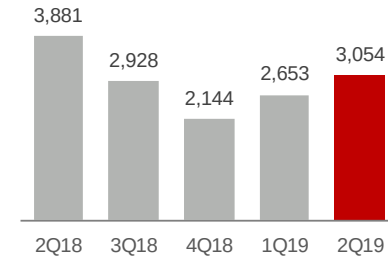
## Earnings from regular operations

- Lower earnings from regular operations largely explained by negative changes in net impairments

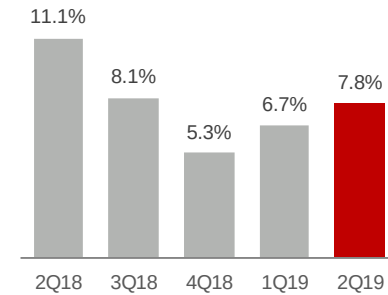
## One off items in 2019

- ISK 1.1bn from an agreement with Old Byr on the settlement of the dispute deriving from the acquisition with Byr savings bank in 2011

## Earnings from regular operations ISK m



## ROE reg. operations CET1 16% %



1. Earnings from regular operations is defined as earnings excluding one-off items e.g. bank tax.

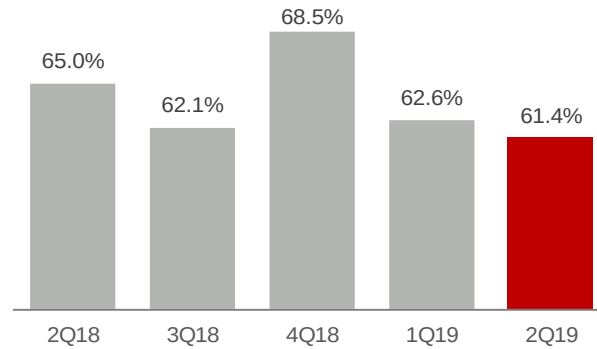
2. Return from regular operations and corresponding ratios on normalized CET1 of 16%, adjusted for risk free interest on excess capital.



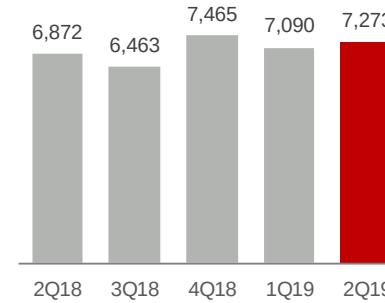
# Cost structure improving overall

Cost to income ratio on the decline with parent company at 55% target

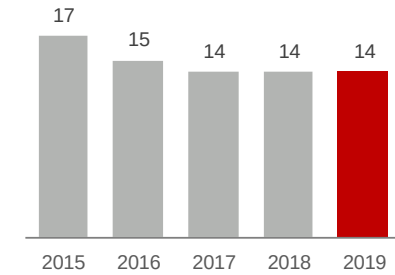
**Efficiency – Cost to income ratio<sup>1</sup>**  
Group



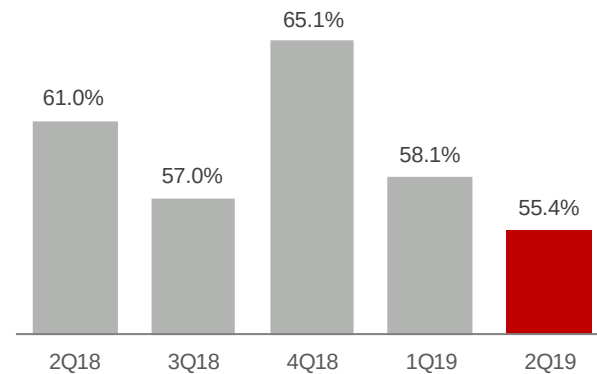
**Administrative expenses**  
ISK m



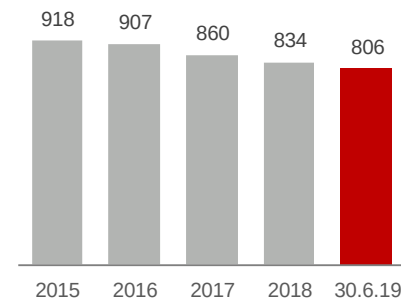
**Branch network**



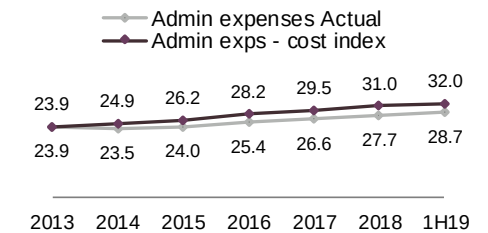
**Efficiency – Cost to income ratio<sup>1</sup>**  
Parent



**Period end FTE numbers<sup>2</sup>**  
Parent



**Annualised admin. exp. vs cost index<sup>3</sup>**  
ISK bn, excl. one-off cost, Parent



1. The cost-to-income ratio excludes bank tax and one-off cost and revenue items.

2. FTE numbers exclude seasonal employees.

3. Administrative expense - cost index is calculated as 40% inflation and 60% salary index excluding one-off items.



## 3. Balance sheet



# Assets

Total assets are 8.8% up from year-end 2018

| Assets, ISK m                       | 30.06.2019       | 31.12.2018       | Δ             |
|-------------------------------------|------------------|------------------|---------------|
| Cash and balances with Central Bank | 122,794          | 135,056          | (12,262)      |
| Bonds and debt instruments          | 77,033           | 69,415           | 7,618         |
| Shares and equity instruments       | 19,176           | 13,074           | 6,102         |
| Derivatives                         | 5,843            | 4,550            | 1,293         |
| Loans to credit institutions        | 77,387           | 41,577           | 35,810        |
| Loans to customers                  | 894,446          | 846,599          | 47,847        |
| Investment in associates            | 687              | 682              | 5             |
| Property and equipment              | 9,504            | 5,271            | 4,233         |
| Intangible assets                   | 4,882            | 5,002            | (120)         |
| Other assets                        | 18,224           | 9,177            | 9,047         |
| <b>Total Assets</b>                 | <b>1,229,976</b> | <b>1,130,403</b> | <b>99,573</b> |

## Highlights

### Liquid assets

- The Bank lowered its cash level with the Central Bank by ISK 12bn from year-end 2018, largely due to the March 2019 ISK 5.3bn dividend pay-out
- Three line items – cash and balances with the Central Bank, bonds and debt instruments, and loans to credit institutions – amount to about ISK 277bn of which ISK 235bn are liquid assets

### Loans to customers

- Net increase in loan portfolio amounted to ISK 47.8bn at end June 2019 – an increase of 5.7% since year-end 2018

### Property and equipment

- On transition to IFRS 16, the Group recognised ISK 4,489 million of right-of-use assets and the same amount in lease liabilities. All lease liabilities and right-of-use assets at transition and throughout the first half of 2019 stem from CPI-linked real estate lease commitments for offices, branches and storage

### Asset encumbrance

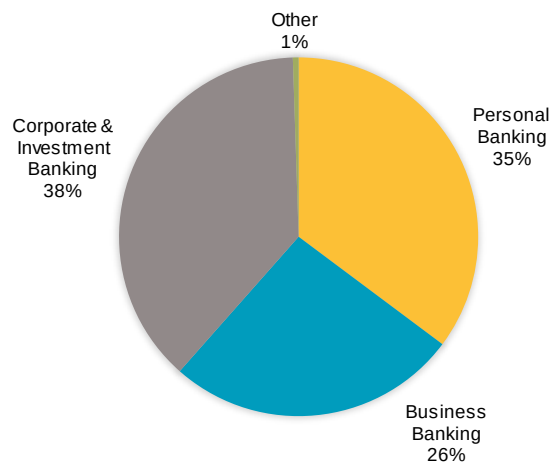
- The Bank's asset encumbrance ratio was 17.2% at end of 1H19, compared to 18.0% at end 2018



## Diversified loan portfolio

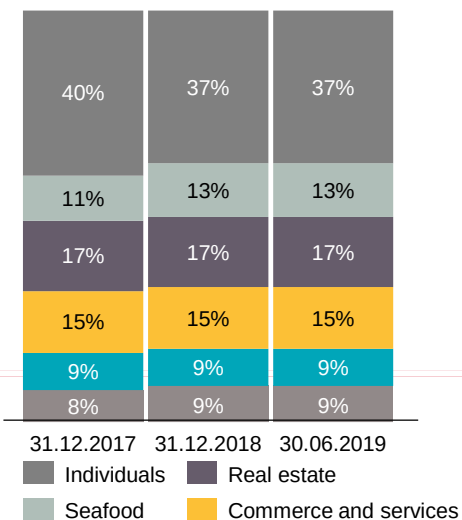
Loans to customers grew by 5.7% in 1H 2019, growth rate not expected to continue in 2H 2019

**Loan portfolio broken down by business divisions**  
Consolidated

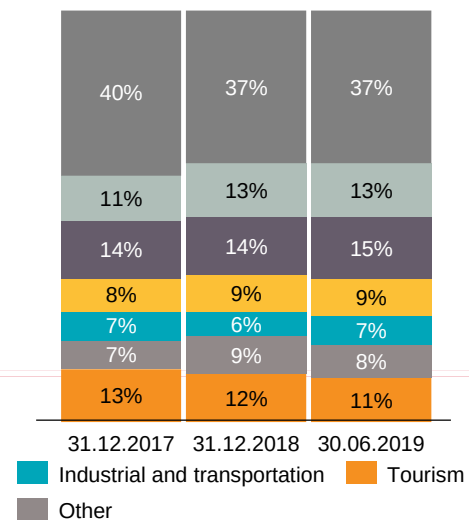


**Loans to customers**  
By sector, consolidated

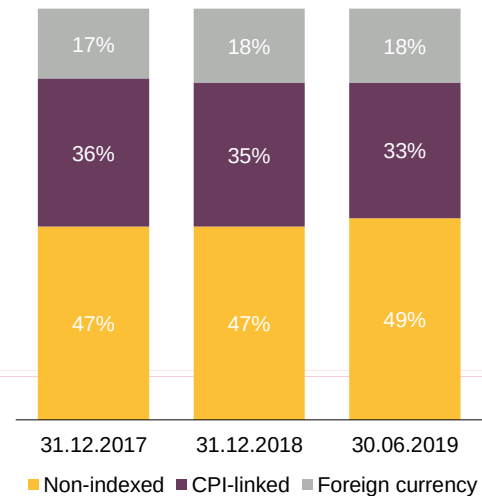
**Standard sectors**



**Including tourism**



**Loans to customers**  
% of loans by currency type, consolidated



### Highlights

- Strong demand for loans across all sectors in 1H 2019
- The mortgage portfolio increased by 7% since year-end 2018
- Exposure to tourism is 11% of loans to customers, slightly decreasing from year-end 2018
- Real estate (hotels), commerce & services (car rentals, restaurants, tour operators) and industrials and transportation are the largest underlying sectors in tourism
- Loan portfolio evenly spread out by the three business divisions although CIB is the largest
- The ratio of non-indexed loans has increased in 1H 2019





# LTV distribution of loan portfolio

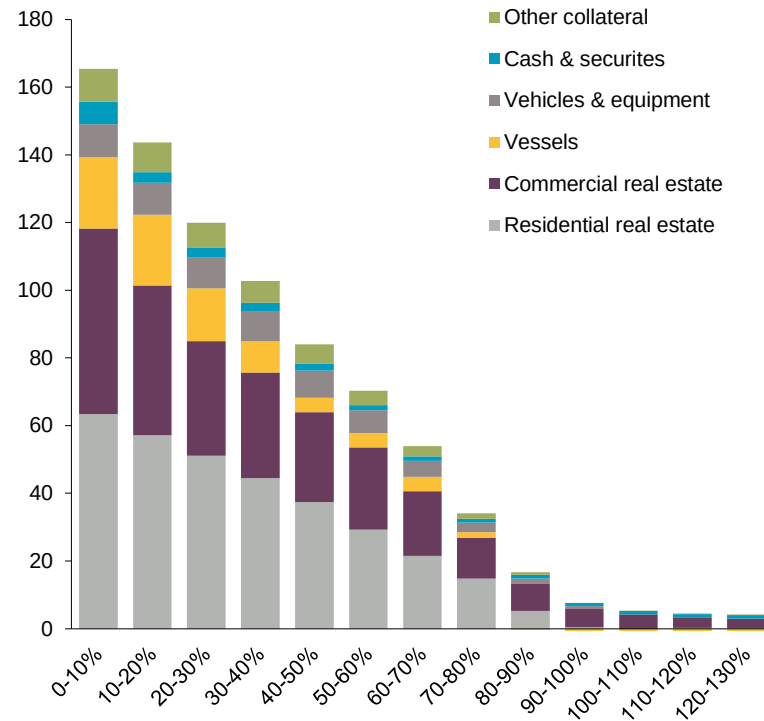
Loans generally well covered by stable collateral, majority in residential and commercial real estate

## Highlights

- Most of the Bank's collateral is in the form of residential and commercial real estate
- The second most important collateral type is vessels, mostly fishing vessels
- For seasoned mortgages, the LTV distribution is calculated from tax value of properties, which is published annually in June, but for newly granted mortgages the purchase price of the property is used as a valuation while it is considered more accurate

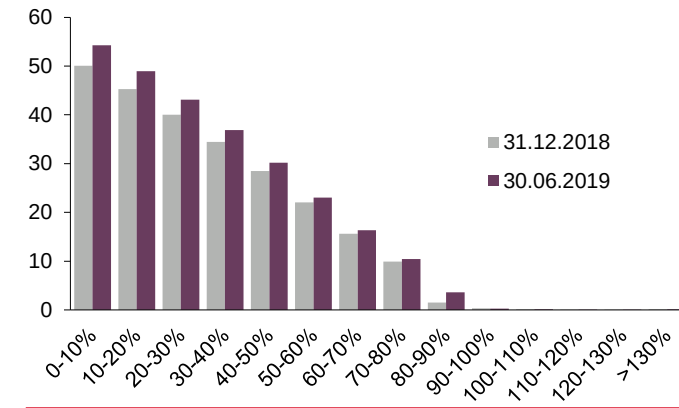
## LTV distribution by underlying asset class

ISK bn, by type of underlying asset, as of 30.06.2019



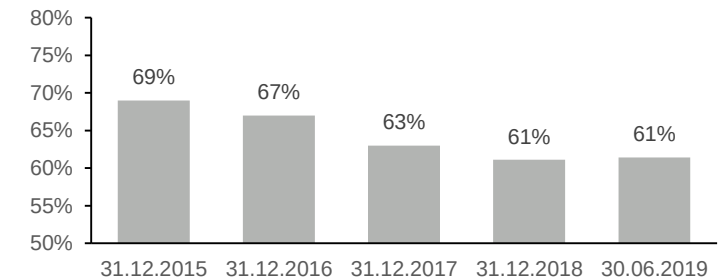
## LTV distribution of mortgages to individuals

ISK bn, as of 30.06.2019



## Average LTV of mortgages to individuals<sup>1</sup>

Development of average LTV



1. The average LTV can be calculated in many different ways and therefore the definition is important for comparison to other banks. The weight is Islandsbanki's total amount outstanding on the property and the LTV used is the maximum LTV of all Islandsbanki's loans of the property.



# Asset quality

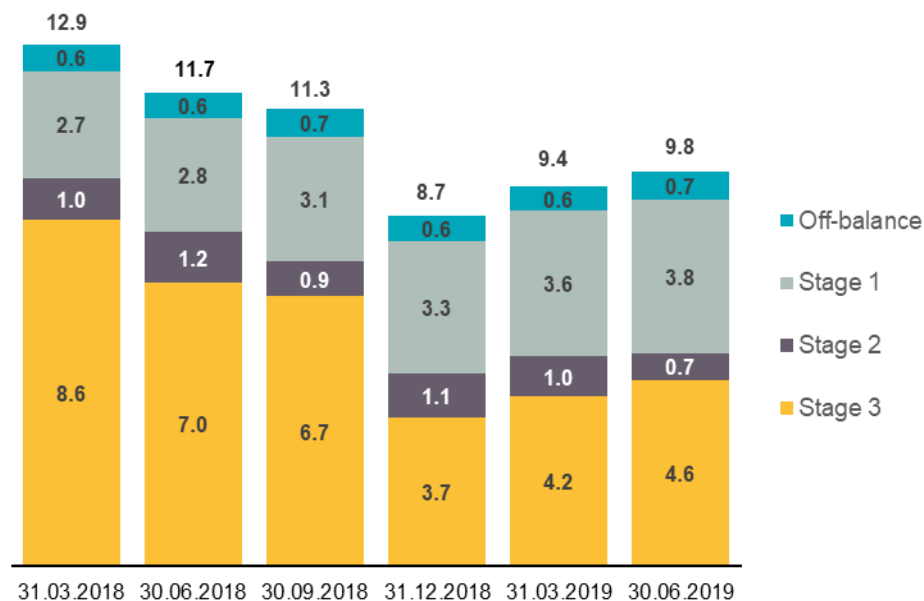
Asset quality stable with increased impairment allowance due to economic environment

## Highlights

- In 1H2019, the impairment allowance increased due to less favourable economic environment
- According to the forward-looking impairment model of IFRS 9 which is based on a probability-weighted average over several scenarios, it can be expected that such uncertainty will lead to an increase in the impairment allowance
- The gross amount of loans in stage 2 remained more or less unchanged from YE 2018, while decreasing from 3.4% to 3.1% measured as a percentage of the loan book. At the same time, loans in stage 3 increased from ISK 17bn (2.0%) to ISK 22bn (2.4%) as a result of deterioration in the economic environment and a handful of medium-sized credit cases
- Using the European Banking Authority's definition of NPL, which does not only include loans to customers but also loans and advances to central banks and credit institutions, the Bank's NPL ratio was 2.0% at the end of Q2 2019, compared to 3.1% average for European banks<sup>1</sup>

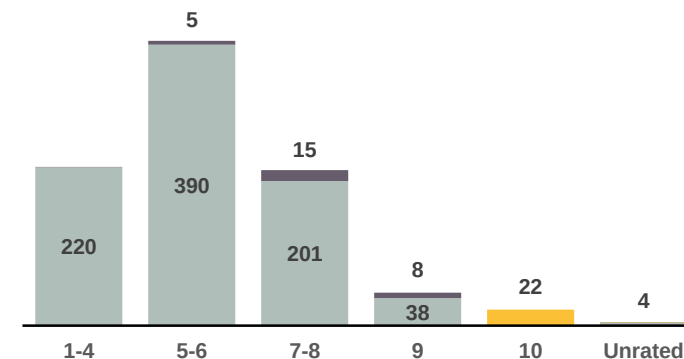
## Loans to customers & off-balance sheet items: impairment allowance account

Development of allowance account, ISK bn



## Loans to customers: gross carrying amount

Risk class and impairment stage, ISK bn



## Loans to customers: credit quality

Break-down of loans to customers

|         | Gross carrying amount |            | Impairment allowance |       | Net carrying amount |            |
|---------|-----------------------|------------|----------------------|-------|---------------------|------------|
|         | (ISK bn)              | % of total | (ISK bn)             | RCR   | (ISK bn)            | % of total |
| Stage 1 | 853                   | 94.5%      | 3.8                  | 0.4%  | 849                 | 94.9%      |
| Stage 2 | 28                    | 3.1%       | 0.7                  | 2.4%  | 27                  | 3.1%       |
| Stage 3 | 22                    | 2.4%       | 4.6                  | 20.9% | 17                  | 2.0%       |
| Total   | 903                   | 100%       | 9.1                  | 1.0%  | 894                 | 100%       |

1. Source European Banking Authority, data as of Q1 2019.



# Liabilities

Diversified funding strategy

| Liabilities & Equity, ISK m                        | 30.06.2019       | 31.12.2018       | Δ              |
|----------------------------------------------------|------------------|------------------|----------------|
| Deposits from Central Bank and credit institutions | 19,830           | 15,619           | 4,211          |
| Deposits from customers                            | 615,869          | 578,959          | 36,910         |
| Derivative instruments and short positions         | 6,903            | 5,521            | 1,382          |
| Debt issued and other borrowed funds               | 337,473          | 300,976          | 36,497         |
| Subordinated loans                                 | 23,431           | 16,216           | 7,215          |
| Tax liabilities                                    | 8,674            | 7,150            | 1,524          |
| Other liabilities                                  | 42,012           | 29,649           | 12,363         |
| <b>Total Liabilities</b>                           | <b>1,054,192</b> | <b>954,090</b>   | <b>100,102</b> |
| <b>Total Equity</b>                                | <b>175,784</b>   | <b>176,313</b>   | <b>(529)</b>   |
| <b>Total Liabilities and Equity</b>                | <b>1,229,976</b> | <b>1,130,403</b> | <b>99,573</b>  |

## Highlights

### Deposits

- Customer deposits increased by 6.4% in the period
  - The increase in deposits was mainly from institutional clients and pension funds
  - The customer deposit to customer loan ratio was 68.9% at end of 1H19

### Debt issued and other borrowings

- The Bank continued to have good access to capital markets and issued ISK 25bn in covered bonds in the first half of 2019 and about ISK 72bn in foreign currency denominated senior unsecured debt
- In June, the Bank issued a SEK 500m Tier 2 bond, which was the Bank's third Tier 2 transaction

### Equity

- At the March 2019 AGM, it was approved that ISK 5.3bn was to be paid in dividends to shareholders for the 2018 financial year. The dividend corresponded to about 50% of after tax profits for 2018, and was consistent with the Bank's dividend pay out ratio target of 40-50%



# Deposits remain the main source of funding

Core deposits continue to be stable

## Highlights

### Stable core deposit base

- Deposits remain the main funding source for the Bank and the deposit to loan ratio remains high
- At the end of the period, 71% of the deposits were in non-indexed ISK, 15% CPI linked and 14% in foreign currencies

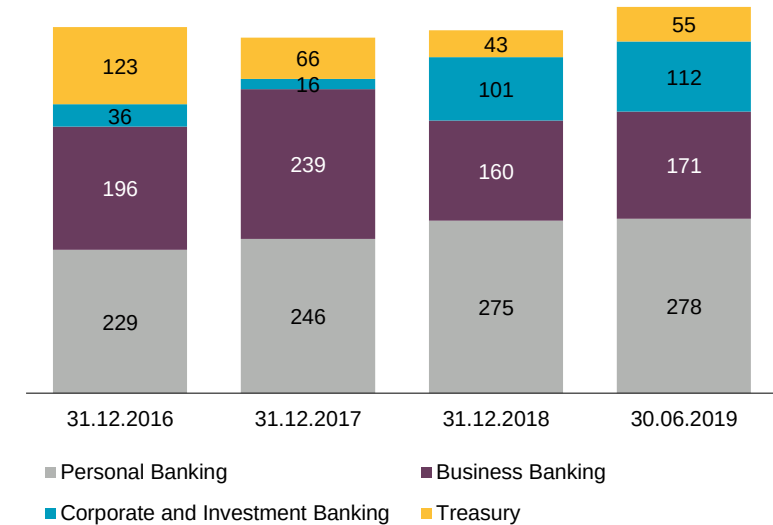
### Deposits concentration remains stable

- At the end of June 2019, 15% of the Bank's deposits belonged to the 10 largest depositors and 38% belonged to the 100 largest depositors, compared to 15% and 37% respectively for year-end 2018

## Customer and credit institutions deposits by LCR category 30.06.2019 compared with year end-2018, ISK bn, consolidated

| Customer type                                        | Less stable | Δ         | Stable    | Δ        | Term deposits | Δ         | Total deposits | Δ         |
|------------------------------------------------------|-------------|-----------|-----------|----------|---------------|-----------|----------------|-----------|
| Retail                                               | 219         | 3         | 85        | 5        | 76            | (2)       | 381            | 5         |
| Operational relationship                             | 3           | 1         | -         | -        | -             | -         | 3              | 1         |
| Corporations                                         | 71          | 7         | 0         | (0)      | 23            | 0         | 94             | 7         |
| Sovereigns, central-banks and public sector entities | 9           | 1         | 0         | 0        | 1             | (0)       | 9              | 1         |
| Pension funds                                        | 35          | 4         | -         | -        | 31            | 4         | 67             | 9         |
| Domestic financial entities                          | 29          | 1         | -         | -        | 37            | 13        | 66             | 14        |
| Foreign financial entities                           | 5           | 2         | -         | -        | 10            | 3         | 15             | 4         |
| <b>Total deposits</b>                                | <b>370</b>  | <b>18</b> | <b>86</b> | <b>5</b> | <b>179</b>    | <b>18</b> | <b>636</b>     | <b>41</b> |

## Breakdown of deposits from customers by divisions ISK bn, consolidated





# Borrowings

Successful international and domestic market transactions

## Highlights

Íslandsbanki is one of the largest issuers of covered bonds in the domestic market

- ISK 13bn issued in covered bonds in 2Q19

In April, the Bank issued a new public 3yr EUR 300m bond and bought back EUR 300m of the EUR 500m bond maturing in 2020 through a public tender

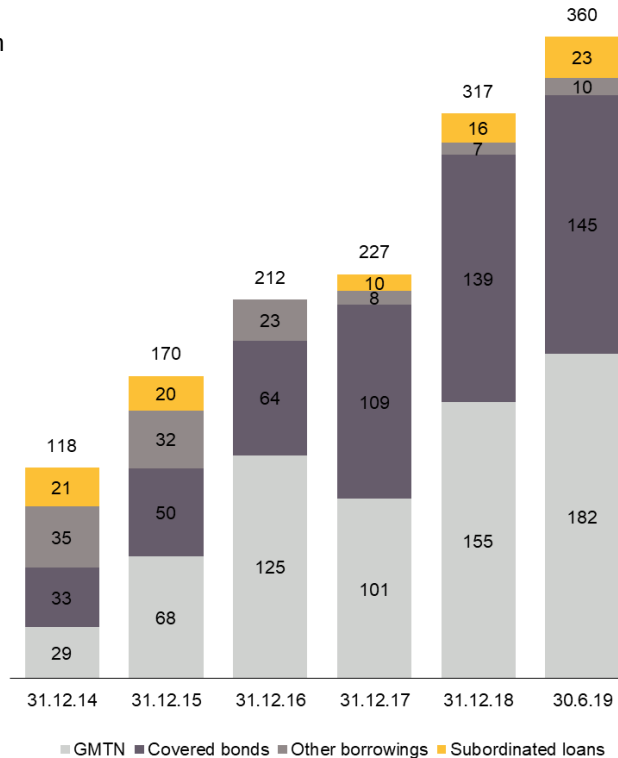
- Thus reducing the 2020 maturity by approximately ISK 42bn

SEK 500m Tier 2 issued in June

- Bringing the Bank's total Tier 2 bond issuance to SEK 1,750m

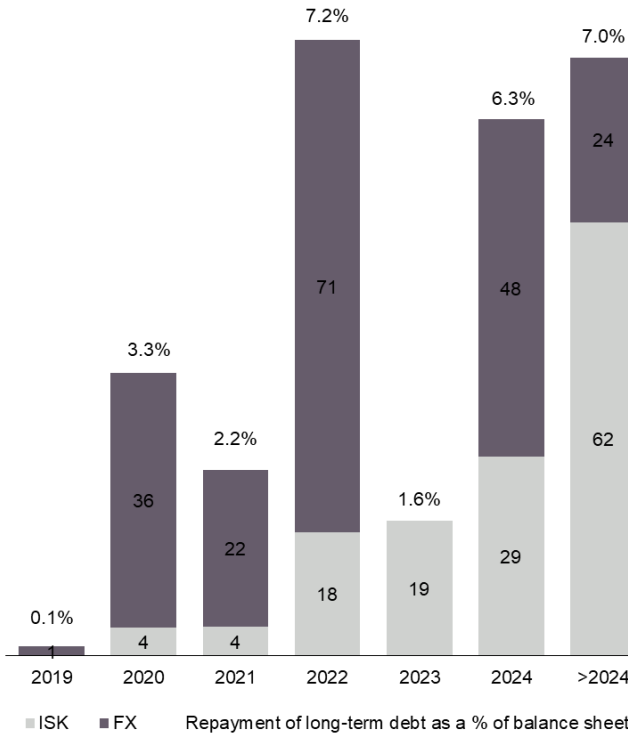
## Borrowing sources

Book value, ISK bn



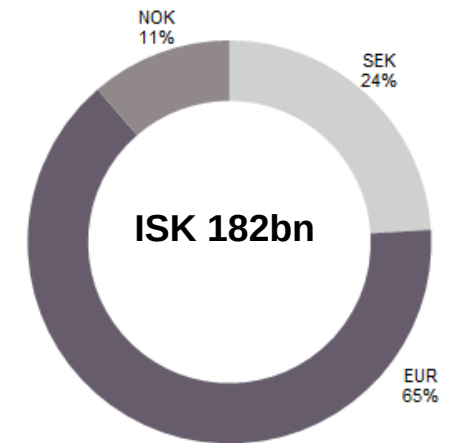
## Maturity profile of long-term debt and repayment of long term debt as percentage of balance sheet<sup>1</sup>

30.06.2019, Nominal value, ISK bn



## Currency split of GMTN borrowing sources

30.06.2019, Nominal value, ISK bn



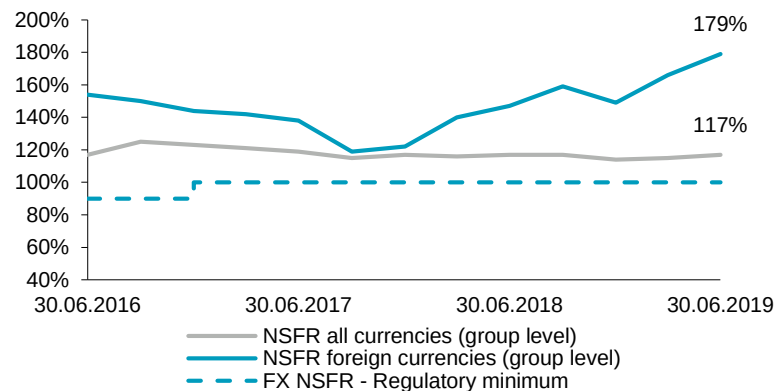
1. Final maturity assumed for callable bonds.



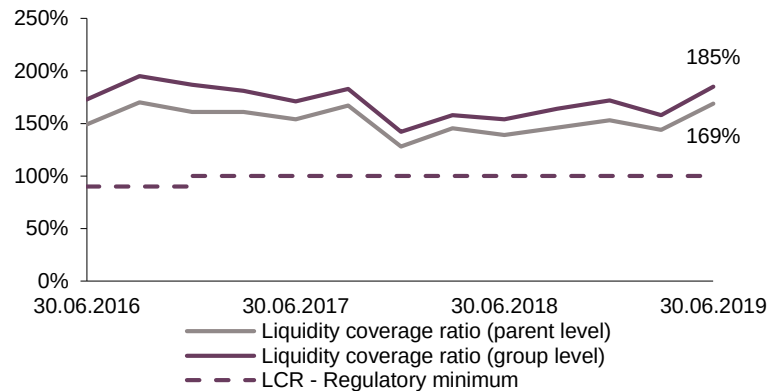
# Sound management of liquidity

Liquid assets of ISK 235bn are prudently managed

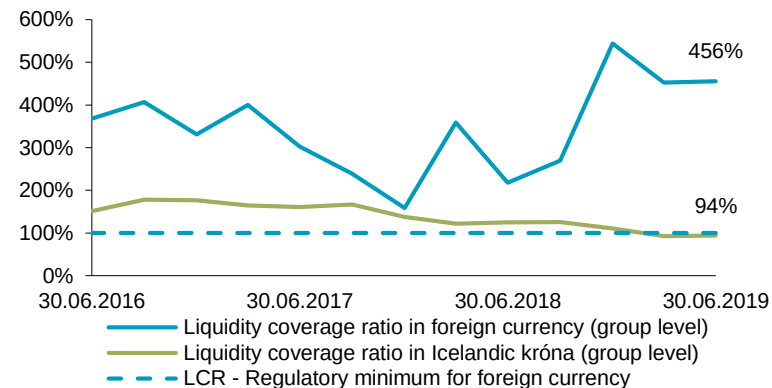
## Net stable funding ratio (NSFR)



## Liquidity coverage ratio (LCR)



## Liquidity coverage ratio – foreign currencies and Icelandic króna



## Highlights

- All liquidity measures well above regulatory requirements
- FX liquid assets are composed of government bonds that have a minimum requirement of AA rating and cash placed with highly rated correspondent banks
- Stress testing of liquidity position is an integrated part of the annual ICAAP/ILAAP process as well the annual regulatory stress test
- Liquidity Contingency Plan is in place and is tested regularly



# Sound capital position

The capital ratio in line with target

## Highlights

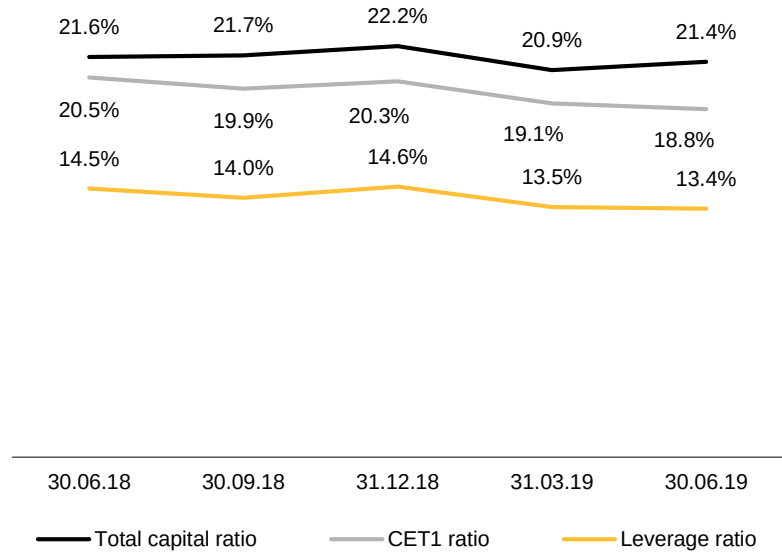
### Capital ratios

- The capital base was ISK 195bn at end 1H19 compared to ISK 188bn at year-end 2018
- The increase in the capital base is due to a subordinated loan issuance in June 2019
- The CET1 capital remains at ISK 171bn with the ISK 5.3bn dividend payment in March 2019 offset by retained earnings for the period

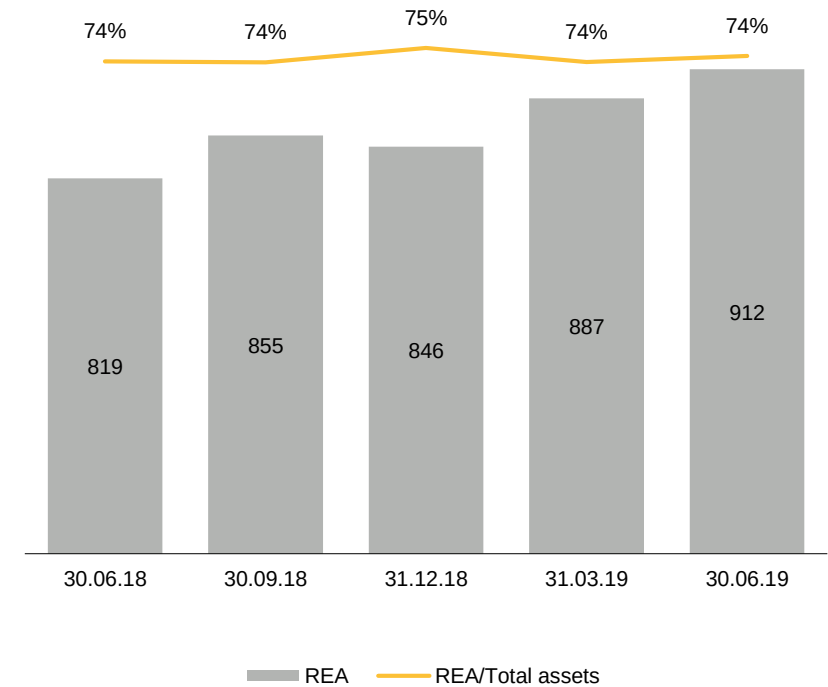
### Risk exposure amount (REA)

- The REA growth is mainly due to increase in loans to customers during the period
- The implementation of IFRS 16, where the right-of-use assets is capitalised, contributes to an ISK 4.3bn increase of REA
- The ratio of REA of total assets remains fairly stable at 74%

## Capital and leverage ratios



## Risk exposure amount (REA) ISK bn







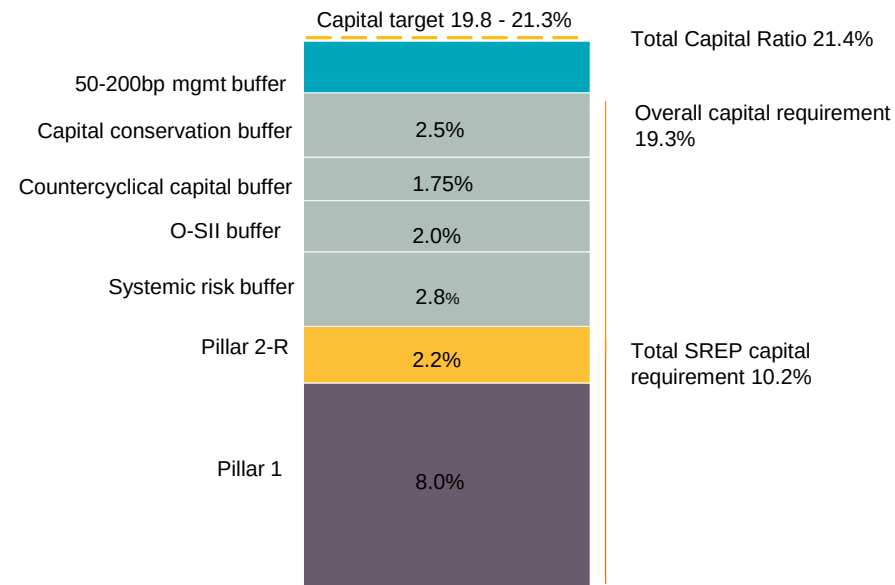
# Íslandsbanki's capital target

Based on the regulatory requirement and 50 – 200bp management buffer

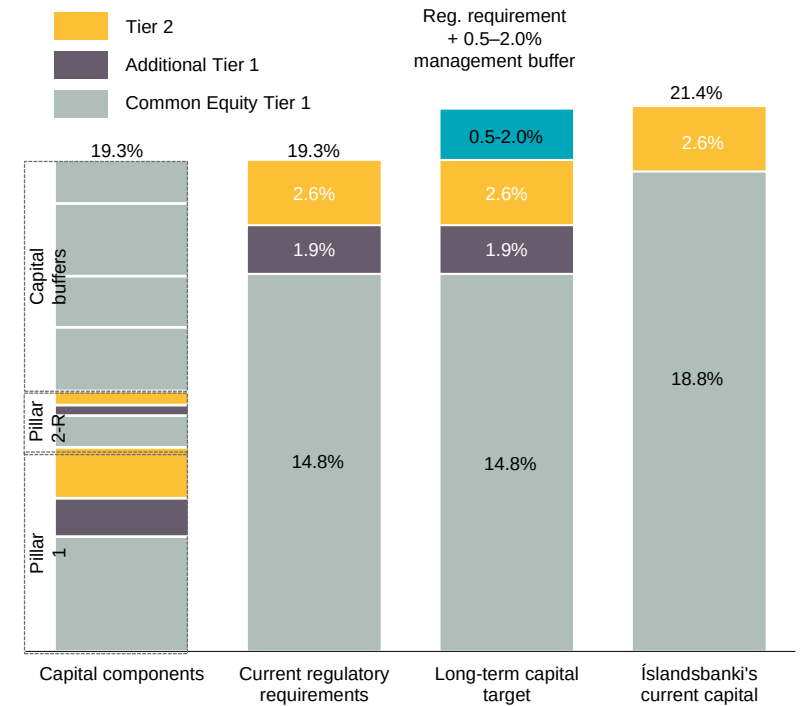
## Íslandsbanki's capital target

- The sum of Pillar 1, Pillar 2-R and the combined capital buffers form the overall regulatory capital requirement
- Based on the SREP 2018 results, published in October 2018, the overall capital requirement for Íslandsbanki is 18.8% of risk exposure amount (REA)
- The countercyclical capital buffer increased from 1.25% to 1.75%, effective May 2019 and will increase again by 0.25% in February 2020
- Íslandsbanki's total capital target ratio is based on the overall regulatory requirement in addition to a 50-200bp management buffer
- The size of the management buffer is based on factors such as volatility in the capital ratios due to currency fluctuations, volatility in earnings and REA and uncertainties in the regulatory or operating environment

## Íslandsbanki's capital target



## Capital requirement composition





## Íslandsbanki

|               | S&P      |
|---------------|----------|
| Long-term     | BBB+     |
| Short-term    | A-2      |
| Outlook       | Negative |
| Rating action | Jul 19   |

## Icelandic sovereign

|               | S&P    | FITCH  | MOODY'S  |
|---------------|--------|--------|----------|
| Long-term     | A      | A      | A3       |
| Short-term    | A-1    | F1     | -        |
| Outlook       | Stable | Stable | Positive |
| Rating action | May 19 | Dec 18 | Jul 18   |

## Íslandsbanki credit ratings

Ratings affirmed from S&P in July 2019

## S&amp;P

**BBB+/A-2 Negative Outlook**

Press Release 23 July 2019

In July, S&P Global Ratings **affirmed** Íslandsbanki's ratings of **BBB+/A-2** but changed the outlook from **stable to negative** along with three other Icelandic financial institutions. S&P had in October 2017 upgraded the Bank to this rating.

In its press release, S&P refers to Íslandsbanki's **stable domestic market position** and acknowledges the Bank's **success in introducing new digital products and improving its IT infrastructure**, placing it well ahead of many other European banks. S&P also notes the Bank's **exceptional capitalisation, strong liquidity levels and robust asset quality**.

S&P's rationale for **the change to negative outlook** is mostly derived from its view that Iceland's **operating environment will remain challenging**, affected by the 2019 economic recession, declining interest rates, still-high taxation, and stiff competition from pension funds in mortgage lending, and thus contributing to the declining profitability of the Bank.



## 4. Financial targets and next steps



# Financial targets

Medium and long term strategies structured around achieving key financial targets

|                                           | Target         | 1H19    | 2018    | 2017    | Guidance                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |
|-------------------------------------------|----------------|---------|---------|---------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>ROE regular operations<sup>1</sup></b> | 8-10%          | 7.2%    | ✓ 8.0%  | ✓ 9.9%  | <ul style="list-style-type: none"> <li>Based on risk free rate + 4-6% which is considered to be CBI current account rate, currently at 3.5% (average in 2019 = 4.17%)</li> <li>As the Bank retains substantive liquid assets, interest rate levels in Iceland can have a substantial impact on ROE</li> <li>The bank tax, excluded from target returns, will have an impact on profitability if kept at current high levels</li> <li>ROE target will be challenging to reach in the near term in a slowing economy and before a full realisation of the Bank's planned efficiency gains</li> </ul> |
| <b>Cost/ Income ratio<sup>2</sup></b>     | <55%           | 62.0%   | 66.3%   | 62.5%   | <ul style="list-style-type: none"> <li>This is a medium to long term target, C/I ratio can be expected to be higher than target in the near term</li> <li>Headcount and non-headcount related cost control programmes in place</li> <li>Lower C/I on parent company basis than on a consolidated basis (55.4% at 1H19)</li> </ul>                                                                                                                                                                                                                                                                  |
| <b>CET1</b>                               | >16% LT        | ✓ 18.8% | ✓ 20.3% | ✓ 22.6% | <ul style="list-style-type: none"> <li>Current target for CET1 ratio is 14.8% -16.3% based on SREP requirements and management buffer</li> <li>Long term CET1 target is 16%</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                             |
| <b>Total capital ratio</b>                | > 19.8 – 21.3% | ✓ 21.4% | ✓ 22.2% | ✓ 24.1% | <ul style="list-style-type: none"> <li>Based on the regulatory SREP requirement with a 50 – 200 bp management buffer</li> <li>Current SREP requirement is 19.3% including recently increased countercyclical capital buffer</li> </ul>                                                                                                                                                                                                                                                                                                                                                             |
| <b>Dividend payout ratio</b>              | 40-50%         | ---%    | ✓ 50%   | ✓ 100%  | <ul style="list-style-type: none"> <li>Dividend pay-out ability could be impacted if the bank tax will be kept at current high levels</li> <li>The BoD agreed to pay out ISK 5.3 billion in dividend for the 2018 financial year which is in line with the Bank's dividend pay out target</li> </ul>                                                                                                                                                                                                                                                                                               |

1. Return from regular operations and corresponding ratios on normalized CET1 of 16%, adjusted for risk free interest on excess capital.

2. Calculated as (Administrative expenses + Contribution to the Depositors' and Investors' Guarantee Fund – One off items) / (Total operating income – one-off items).



# Key takeaways

Íslandsbanki is well positioned to succeed in a slowing but stabilising Icelandic economy

## 1 Stabilising economy

- GDP set to contract in 2019 with outlook for growth to pick up in 2020 and continue 2021
- Tourism sector consolidating, labour market cooling and real wage growth moderating with market for real estate balancing
- Debt levels historically low across the board and in international comparisons, inflation easing and ISK volatility low

## 4 Exceptional capitalisation

- Capital ratio at 21.4% and in line with long term target
- Regulator has lowered SREP capital requirement for Íslandsbanki (from 11.2% to 10.2%) in recognition of reduced market risk
- Capitalisation considered exceptionally high in international comparisons

## 2 Strong credit quality

- Stable asset quality with increased impairment allowance due to economic environment
- NPL ratio 2.0% in 1H2019, compared to 3.1% average for European banks
- Robust risk management practices and conservative lending policies in place
- Exposure to tourism now a smaller proportion of loan portfolio than at end-2018

## 5 Stable regular earnings and cost cutting

- Earnings in line with long term targets
- Cost to income ratio for parent company now at 55% target ratio
- Digitalisation and IT investments expected to generate more cost savings going forward

## 3 Digitalisation in full force

- Substantial IT investments, including a new core payment and deposit system
- Recent roll out of impressive new digital customer solutions in apps and online banking such as new digital mortgage credit assessment
- Already resulting in enhanced customer satisfaction and more automatisisation

## 6 Funding success and high liquidity

- Leading issuer of covered bonds in Iceland
- Successful FX funding programme in EUR, SEK and NOK
- Focus on stable deposit growth
- Strong liquidity position and in line with internal targets and regulatory requirements



## 5. Annex – Icelandic economy update

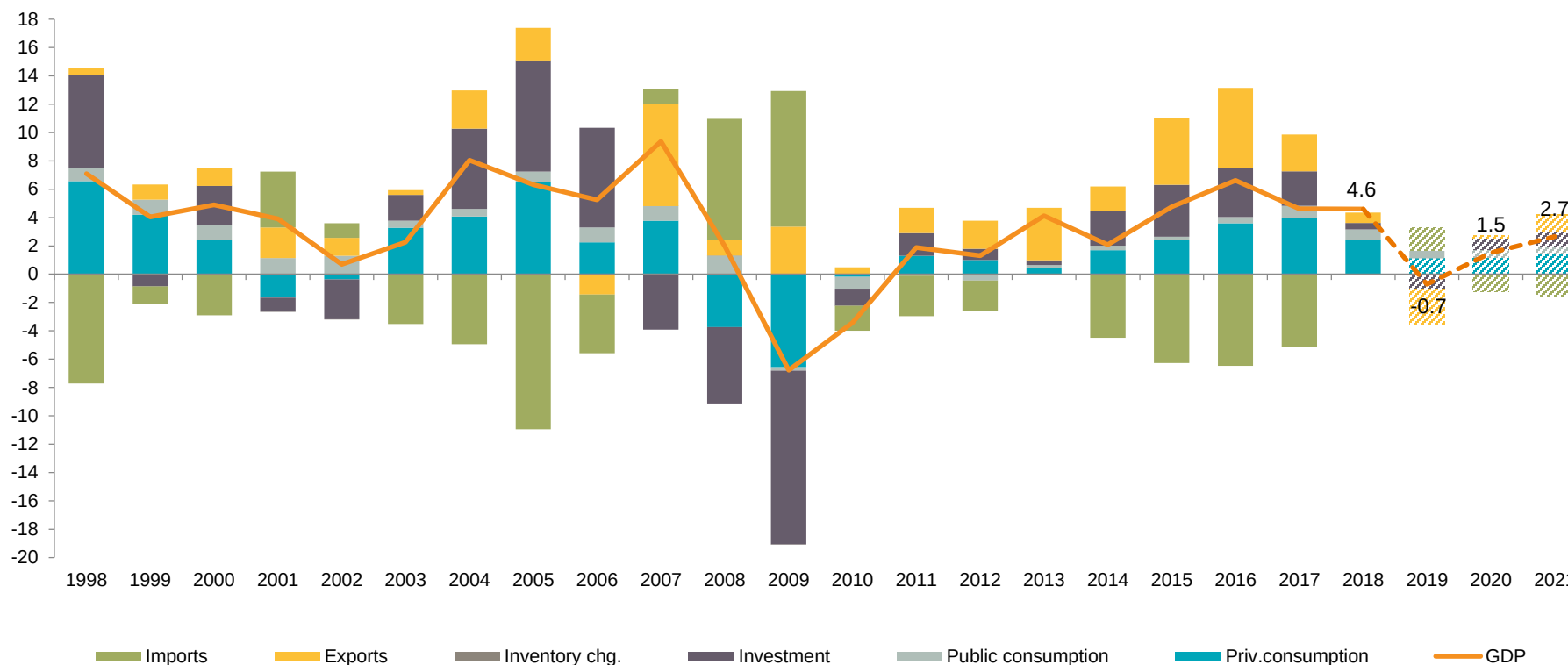


# A short-lived recession in 2019

Investment and exports will contract this year

- A long period of continuous upswing in the Icelandic economy appears to be at an end
- An identical 4.6% growth rate in 2017 and 2018 masks significantly different growth drivers between 2017 and 2018
- The fall of WOW Air at the end of Q12019 marks a clear turning point in the domestic economy
- GDP looks set to contract by 0.7% in 2019, making this year the first to see a contraction since 2010
- An abrupt decline in exports is the main factor in this year's economic downturn, aided by a marked reduction in business investment. Private consumption growth will be sluggish as well. On the other hand, imports will probably also contract significantly between years
- The outlook is for growth to pick up again and measure 1.5% in 2020, buoyed up by livelier private consumption growth, a resumption of growth in exports and business investment, and continued growth in other investment

**GDP and the contribution of major subitems <sup>1</sup>**  
YoY change (%)



1. Shaded areas indicate ISB Research/ forecasts.  
Source: Statistic Iceland and ISB Research.

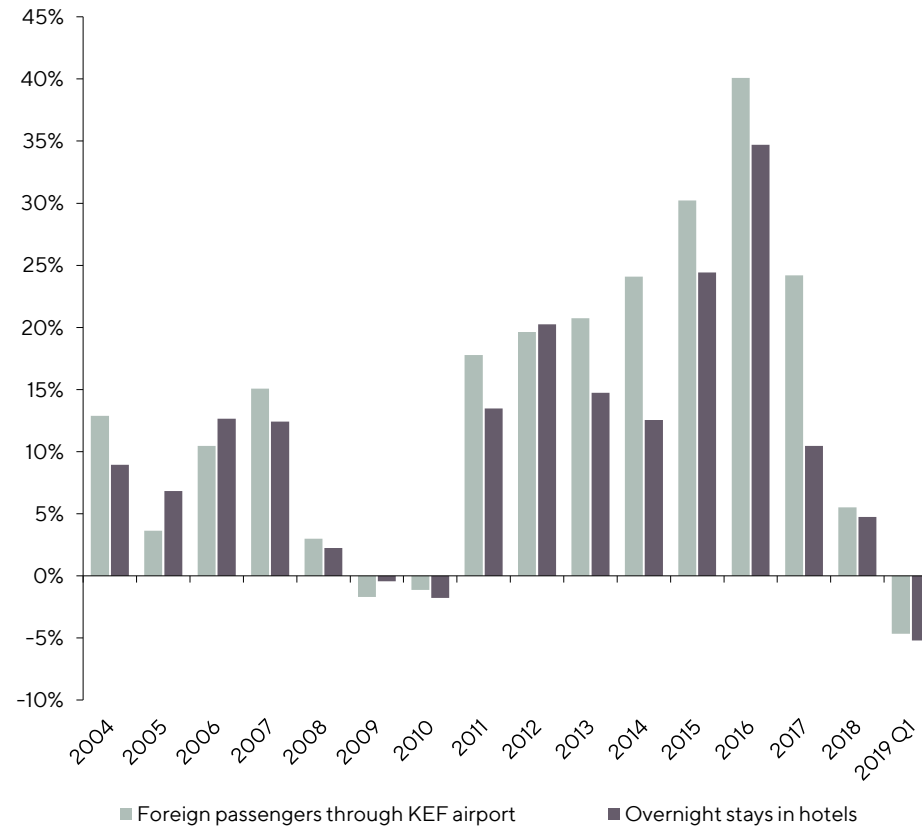


# Tourism sector faces headwinds after rapid growth

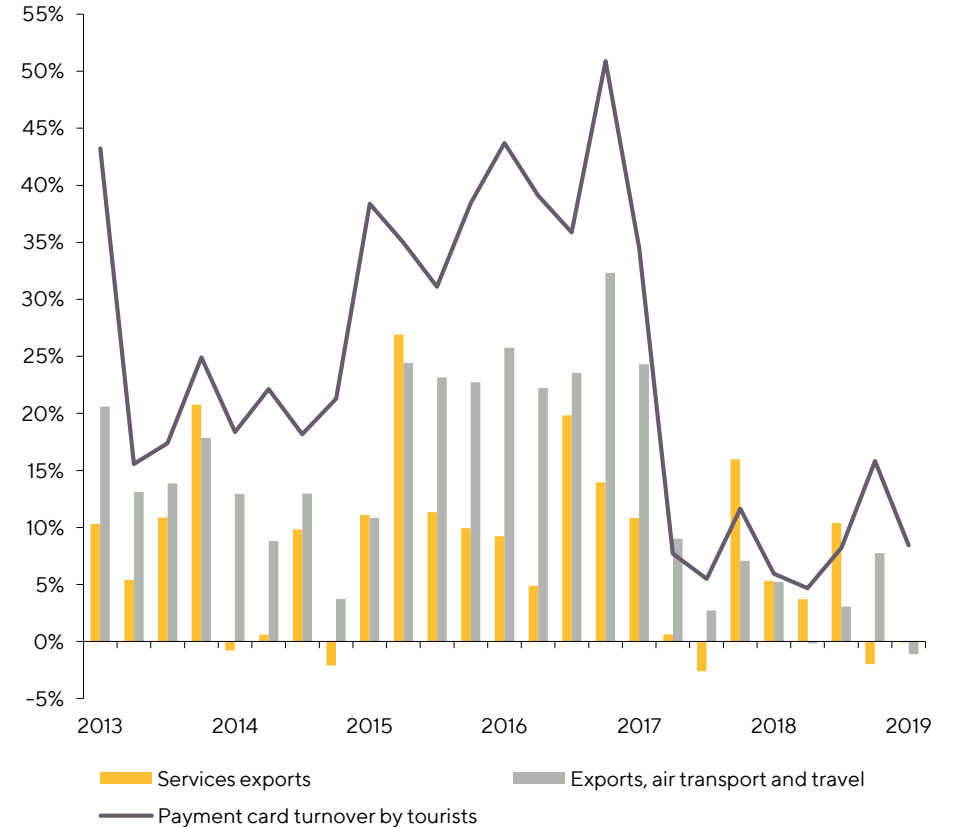
Largest export sector likely to contract significantly in 2019

- Following rapid expansion throughout most of the decade, the tourism sector has entered a phase of consolidation
- In 2018, the number of foreign tourists increased by 5.5% YoY and overnight hotel stays went up by 2.3%
- In Q1 2019, the number of foreign tourists declined by 4.7% and overnight stays decreased by 5.2% YoY
- An updated forecast by airport operator ISAVIA estimates a 17% YoY decline in the number of tourists visiting Iceland in 2019. Still, the number of visitors will exceed all previous years except 2017 and 2018
- The tourism sector shows various signs of maturing, with increased emphasis on streamlining and mergers taking over from rapid growth and supply-side increases among many providers
- Tourism is likely to return to moderate growth in the coming term as airlines gradually fill the supply gap left by Wow air and Icelandair's fleet becomes fully operational once more

**Foreign visitors and overnight hotel stays**  
YoY change



**Services exports and foreign card turnover**  
YoY change





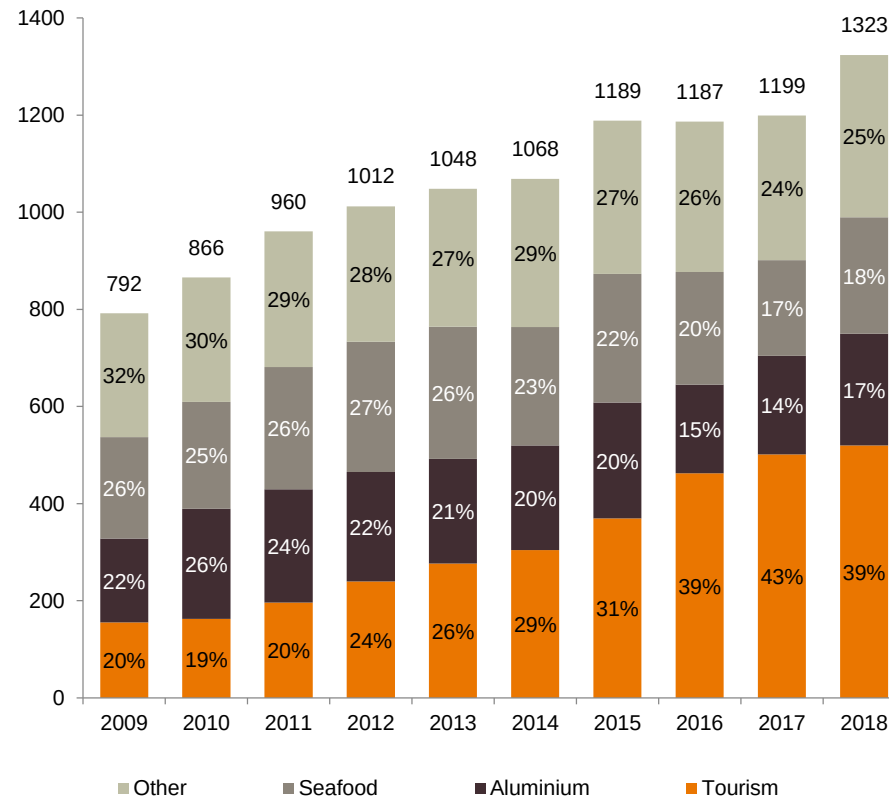


# Current account moving from surplus to balance

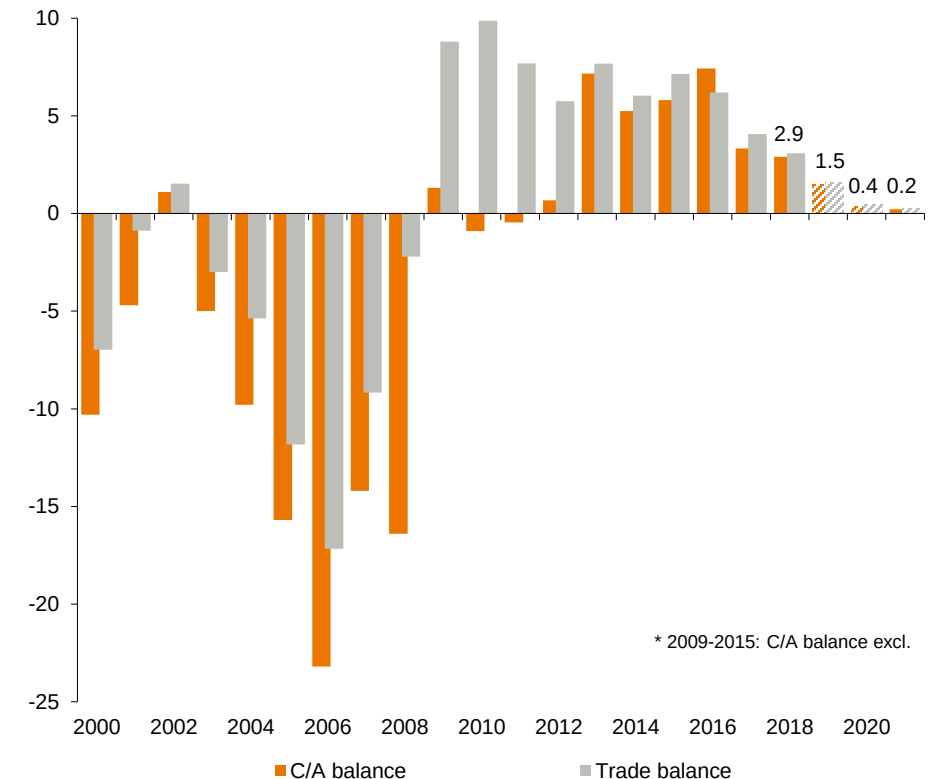
Strong net external position increases resilience

- The outlook is for a significant contraction in both imports and exports in 2019
- On the imports side, the contraction stems largely from less tourism-related imports
- Services exports are expected to contract by around 10% this year, with increased industrial goods exports and the sale of WOW Air's aircraft counterbalancing a contraction in marine product exports
- A current account surplus of 1.5% of GDP forecast for this year, followed by a broadly balanced current account in 2020 and 2021
- Iceland's net international investment position will remain positive, with external assets exceeding external liabilities by a full 1/5 of GDP as of end-March 2019
- The positive NIIP is conducive to a higher equilibrium real exchange rate than would otherwise occur, as financial income from abroad should generally exceed financial expense

**Export revenues**  
ISK bn



**Current account balance<sup>1</sup>**  
% of GDP\*



\* 2009-2015: C/A balance excl.

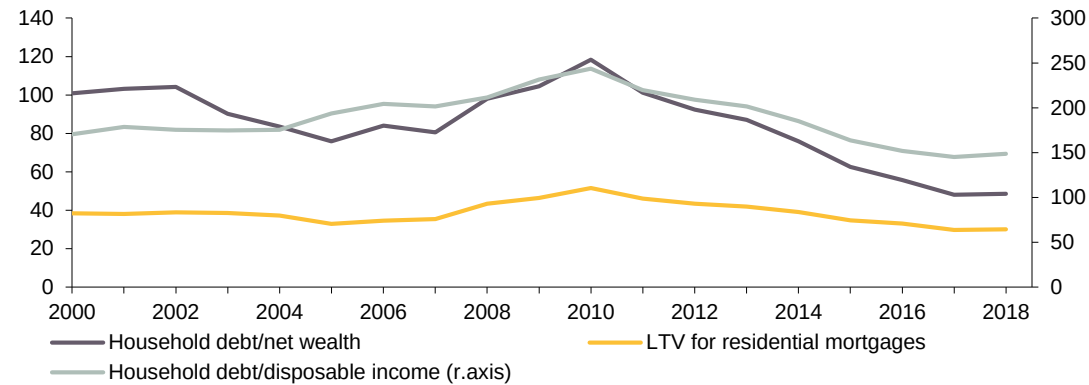
1. Shaded areas and dotted lines indicate ISB Research/ forecasts  
Source: Central bank of Iceland, Statistics Iceland and ISB Research



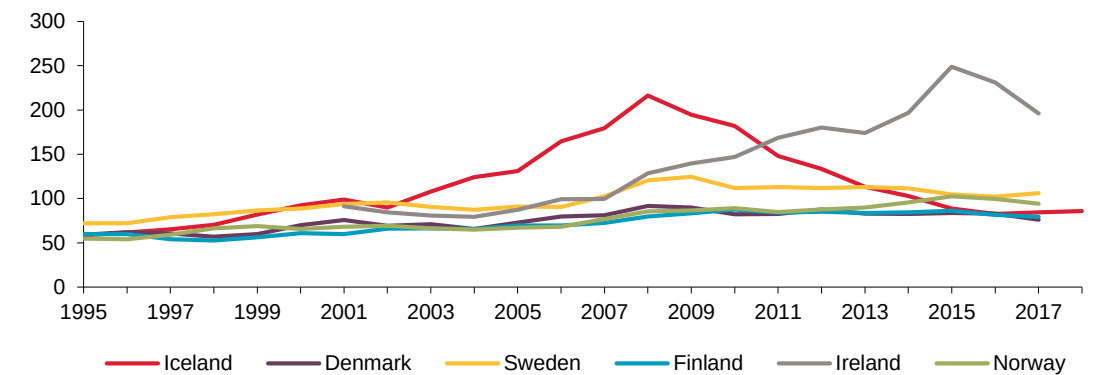
# Domestic balance sheets well placed to weather setbacks

Economy-wide leverage moderate in comparison with peers and historical levels

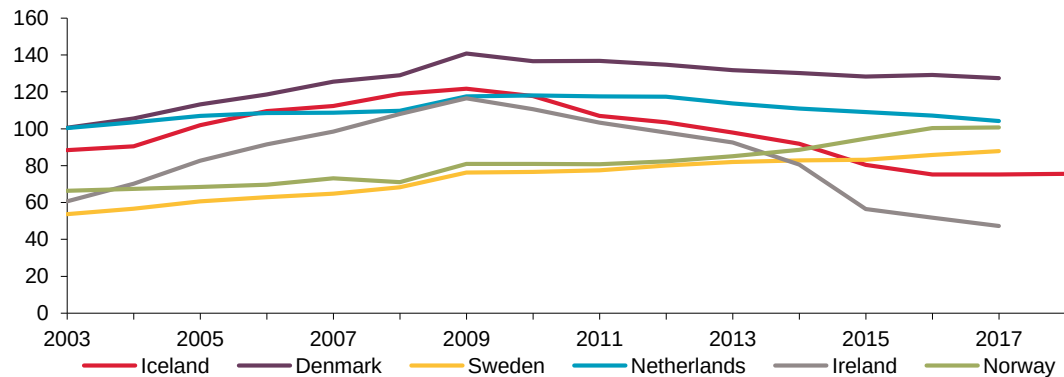
## Household debt %



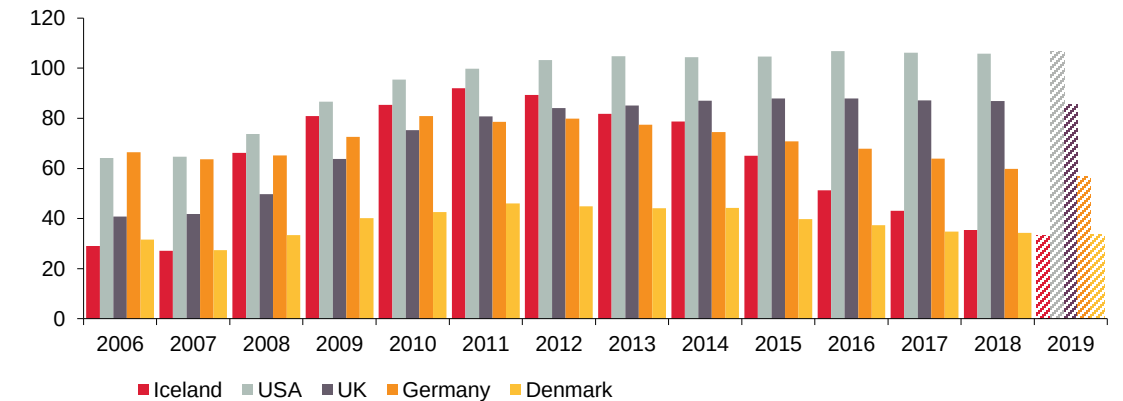
## Corporate debt % of GDP



## Household debt % of GDP



## General government gross debt<sup>1</sup> % of GDP



1. Shaded areas and dotted lines indicate ISB research/ forecasts.  
Source: Central Bank of Iceland, Statistics Iceland, IMF.



# Businesses brace for leaner times

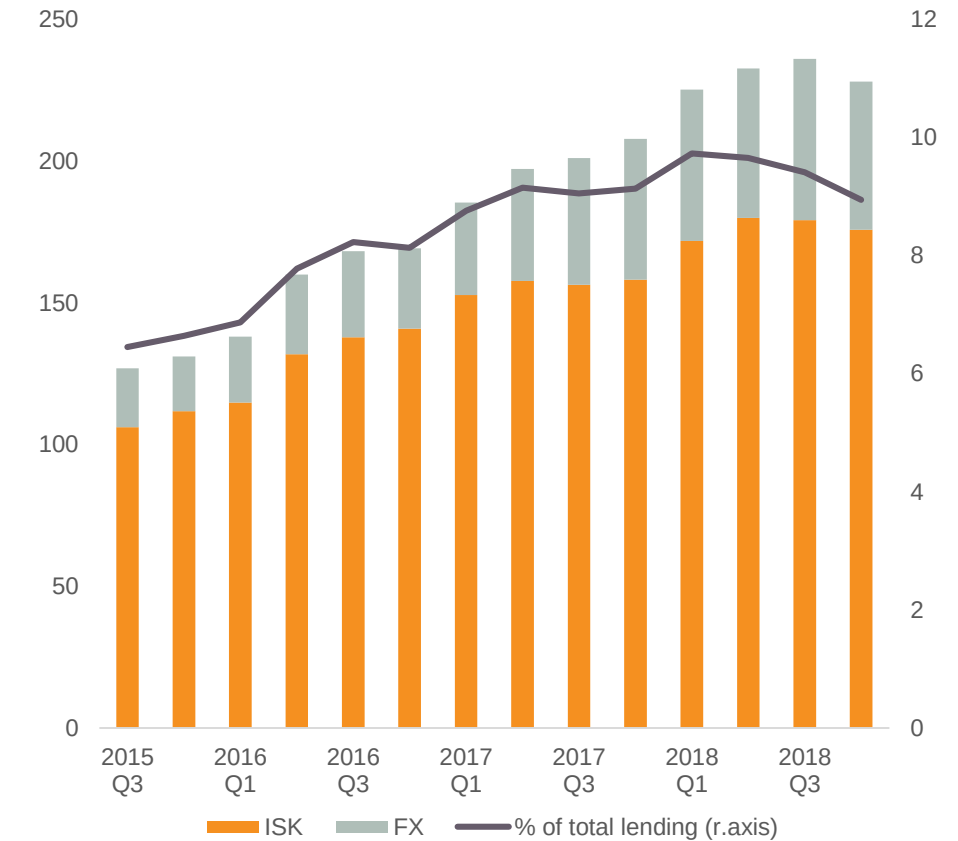
## Slowdown in lending growth to tourist sector

- Business investment contracted by 5.4% in 2018 following four years of robust growth
- Contraction in 2018 largely due to significant reduction in transport equipment investment as well as one-off factors
- Further 12% contraction in business investment likely for 2019 as the private sector adjusts to weaker economic outlook
- Business sentiment has dropped considerably in recent quarters as tourist sector growth stalled, Wow-air financial difficulties escalated and the ISK depreciated
- Investment in the tourist sector has slowed and lending into the sector has moderated. This trend is likely to continue
- Business investment expected to pick up moderately in the coming year with the pace of growth quickening in 2021
- Investment level to remain robust, at around 22% of GDP in coming years

**Business sentiment, 400 largest companies**  
Index



**Deposit money banks' lending to tourist sector**  
ISK bn



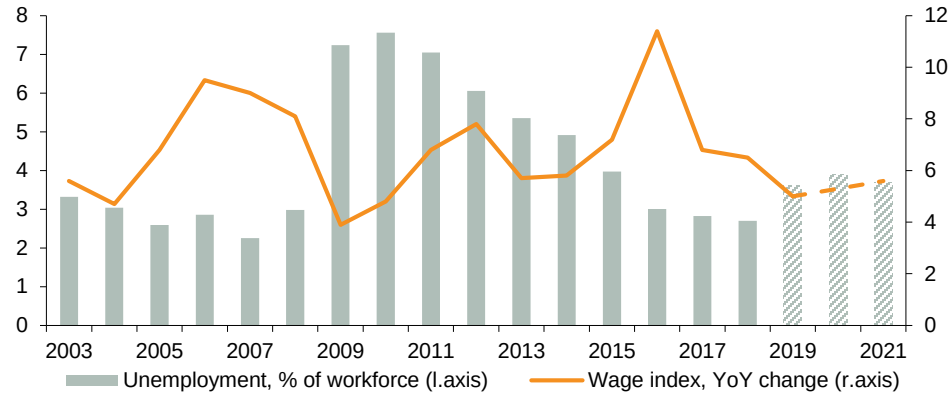


# Household consumption growth tapers off

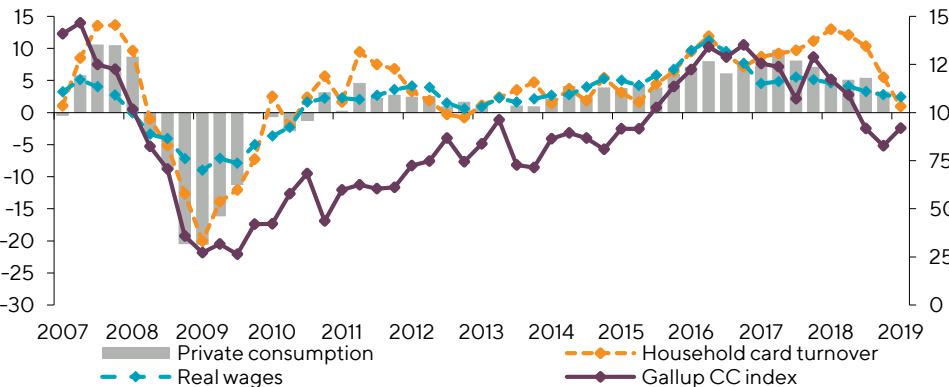
Labour market cooling and real wage growth moderating

- In recent quarters, private consumption growth has levelled off following rapid growth in 2015-2017
- Developments in key indicators suggest a further slowdown ahead. Both real wage growth and payment card turnover growth have eased, and households' expectations are much more muted
- The labour market is cooling. Unemployment shot upwards after WOW collapsed and looks set to keep rising in the coming term. We forecast that it will peak at around 4% in 2020
- We also expect real wage growth to be considerably weaker than in the recent past
- Icelandic households have responded to slower real wage growth and darkening outlook by consolidating instead of taking on additional debt to finance spending
- Private consumption growth was 4.8% in 2019. ISB Research forecasts private consumption growth at 2.2% in 2019, 2.3% in 2020, and 2.8% in 2021

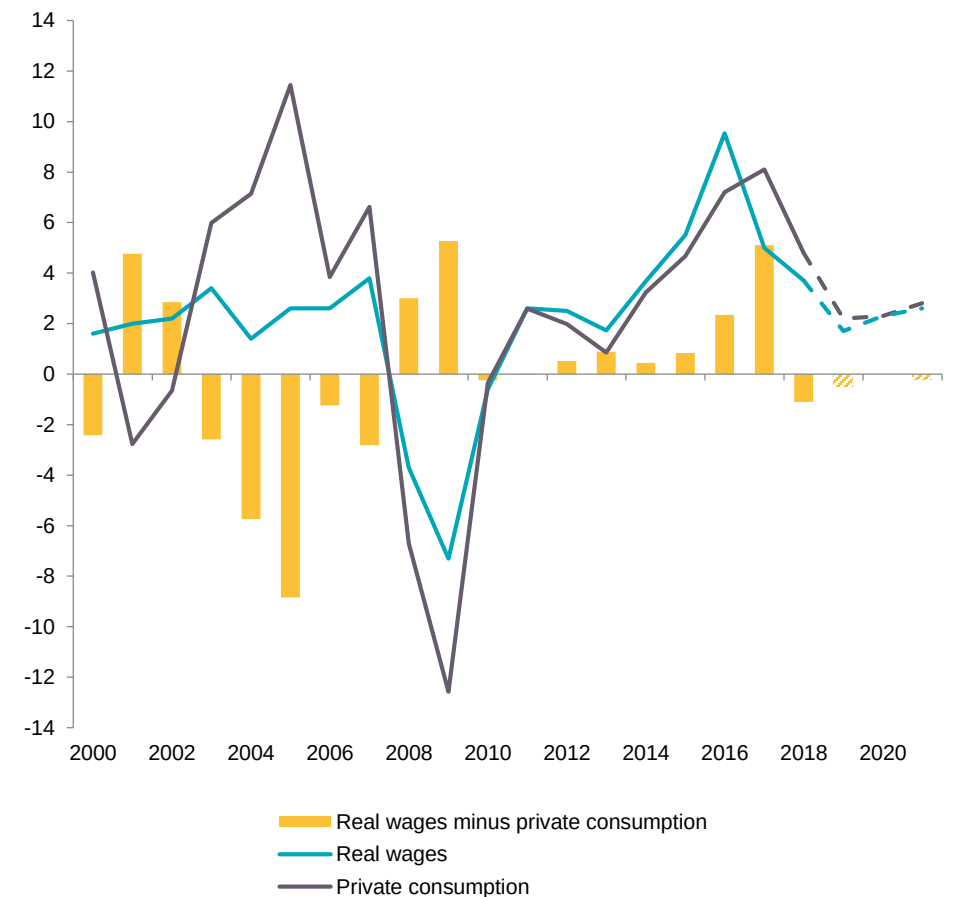
Unemployment and wage growth<sup>1</sup>  
%



YoY change (l.axis) and index (r.axis)



Real wages, population and private consumption<sup>1</sup>  
YoY change (%)



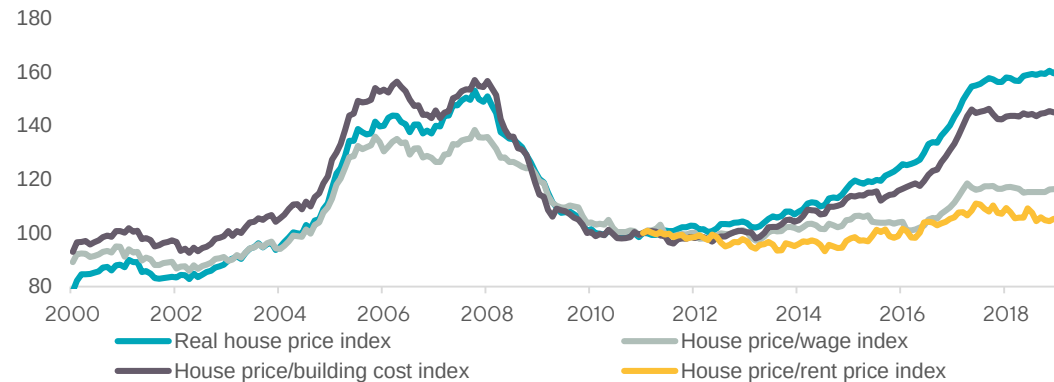
1. Shaded areas and dotted lines indicate ISB research/ forecasts.  
Source: Statistic Iceland and ISB research.



# Real estate market balancing

Supply is increasing, demand has been easing and the pace of residential price rises is moderating

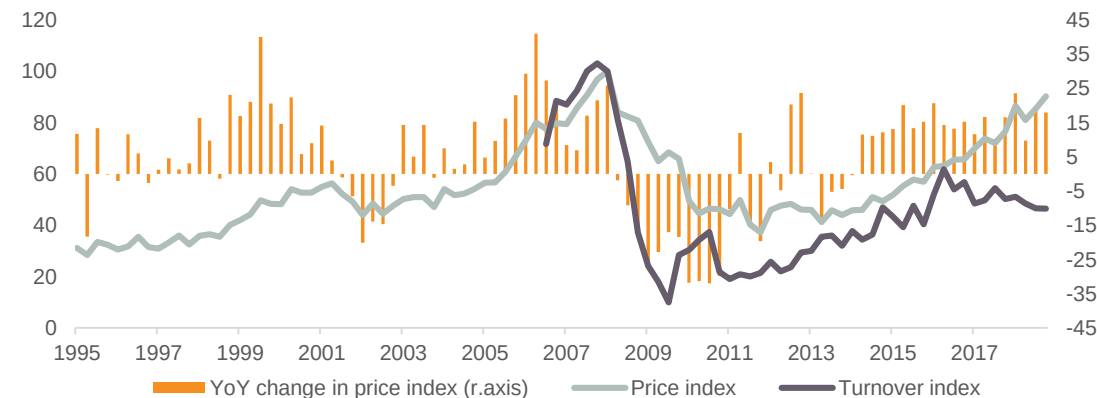
## Residential capital region house prices and determinants Indices



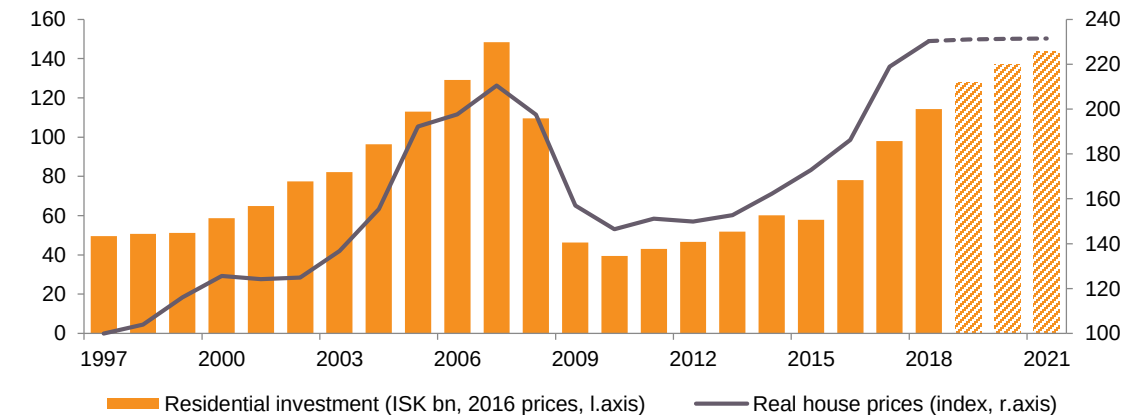
## New apartments and population increase in the capital region<sup>1</sup>



## Commercial real estate real price and turnover index



## House prices and residential investment<sup>1</sup>



1. Shaded areas and dotted lines indicate forecasts by Statistics Iceland and the Federation of Icelandic Industry.  
Source: Statistic Iceland and ISB research.

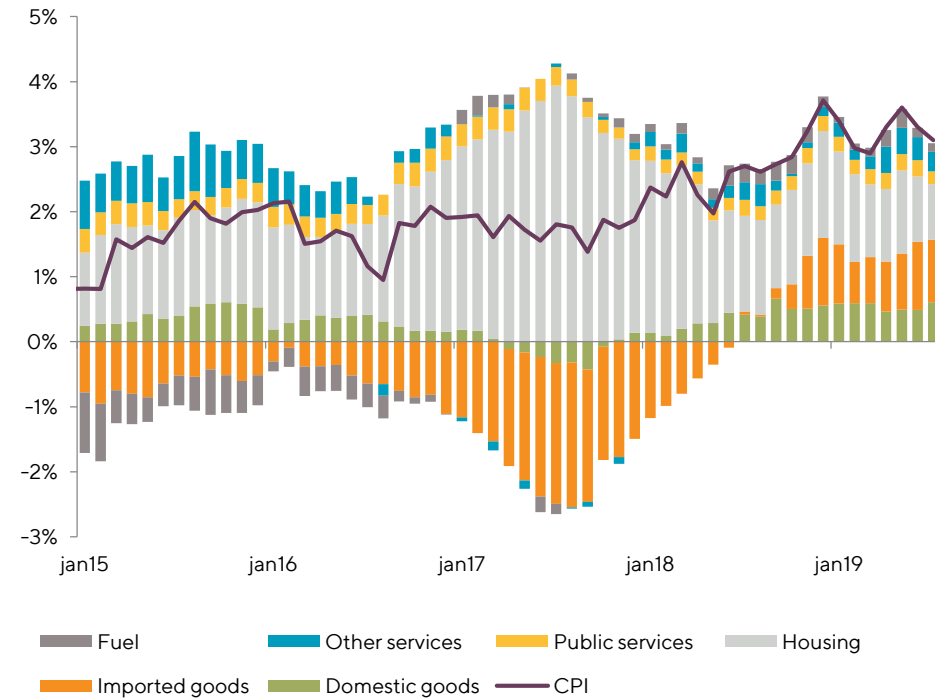


# Inflation set to ease in coming quarters

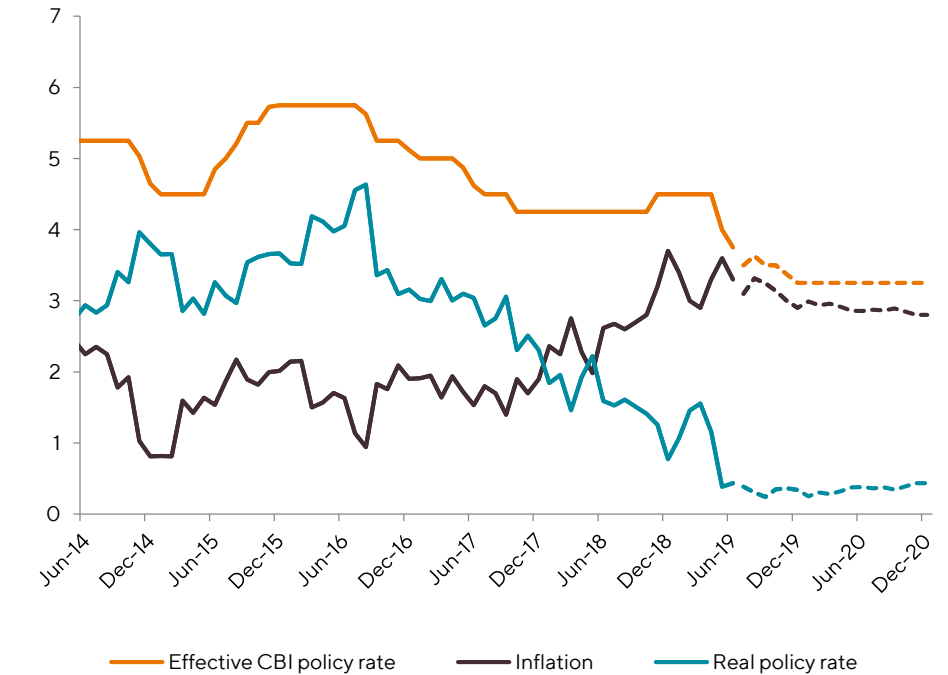
## Further policy rate cuts in the offing

- Inflation measured 3.1% in July
- The composition of inflation has changed: Housing cost, imported inflation and domestic cost pressures each account for roughly 1/3 of current inflation
- The outlook is for inflation to subside gradually in coming quarters 2019 and measure 2.7% by year-end
- Inflation expected to measure 2.8% at the end of both 2020 and 2021
- The Central Bank of Iceland's policy rate is currently 3.75%, following a 0.5% rate cut in May 2019 and 0.25 rate cut in June
- Further rate cuts expected throughout 2019 as inflation pressures subside, housing prices rise more moderately, inflation expectations stabilize and economy cools
- Policy rate assumed to hold at 3.25% throughout 2020

**Inflation and contribution of main subitems**  
%



**Inflation, policy rate and real policy rate<sup>1</sup>**  
%



1. Shaded areas and dotted lines indicate forecasts by ISB research.  
Source: Statistic Iceland, the Central Bank of Iceland and ISB research.

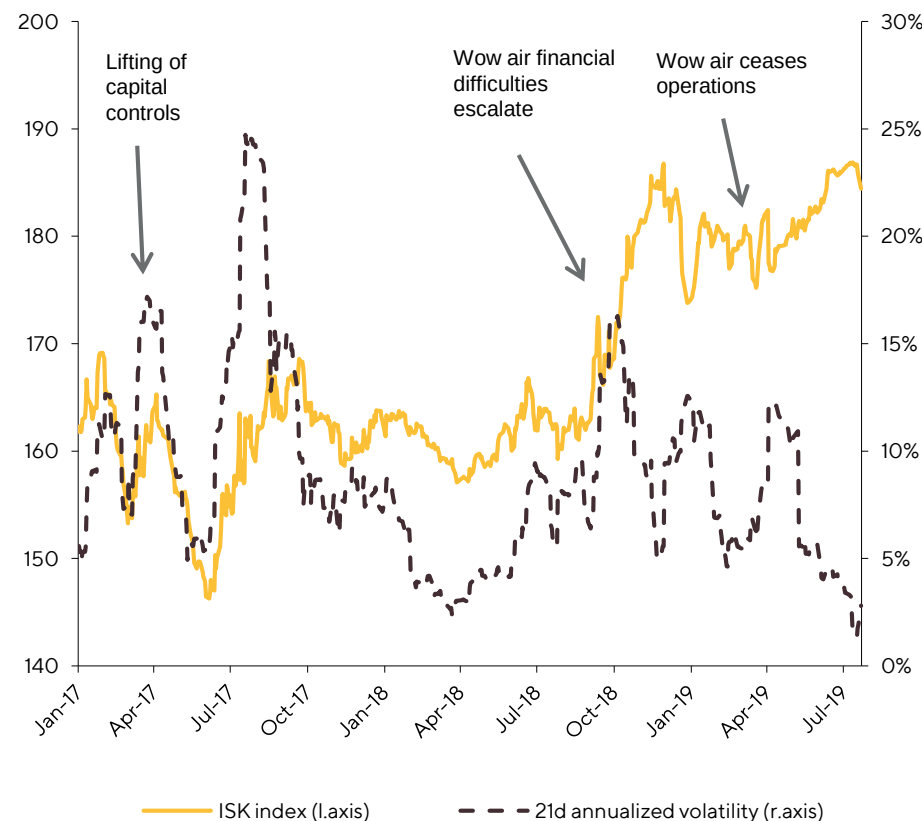


# Is the ISK at equilibrium?

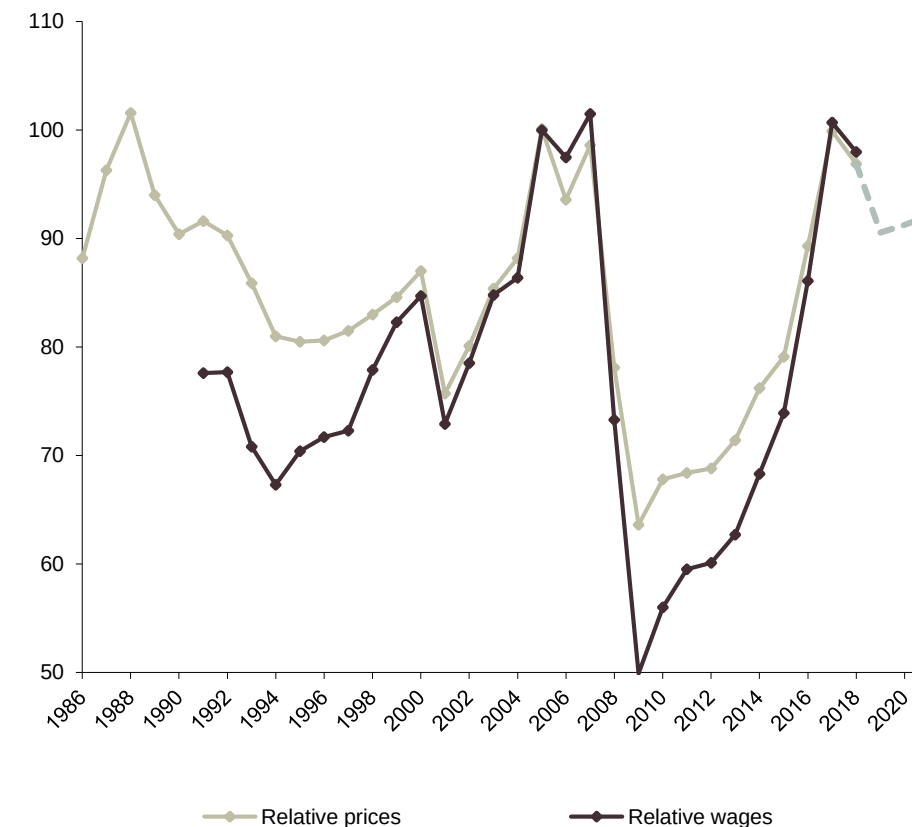
Real exchange rate likely to remain relatively high through this decade

- Following 7% depreciation in H2 of 2018, the ISK has been broadly rangebound in 2019
- Volatility has decreased and turnover has subsided in the interbank market, indicating more balanced day-to-day FX flows
- In Q2 2019, the ISK was around 11% weaker on average than in Q2 2018 and close to the 2016 average
- Export sectors have welcomed the depreciation, as it makes manufacturing sectors' more competitive and makes Icelandic prices more tolerable for foreign tourists
- The current real exchange rate, while somewhat over its historical average, seems to reflect a real exchange rate consistent with a balanced eternal trade. The vast improvement in Iceland's net external position plays a pivotal role in this regard

## ISK exchange rate, daily values and volatility



## Real exchange rate indices<sup>1</sup>



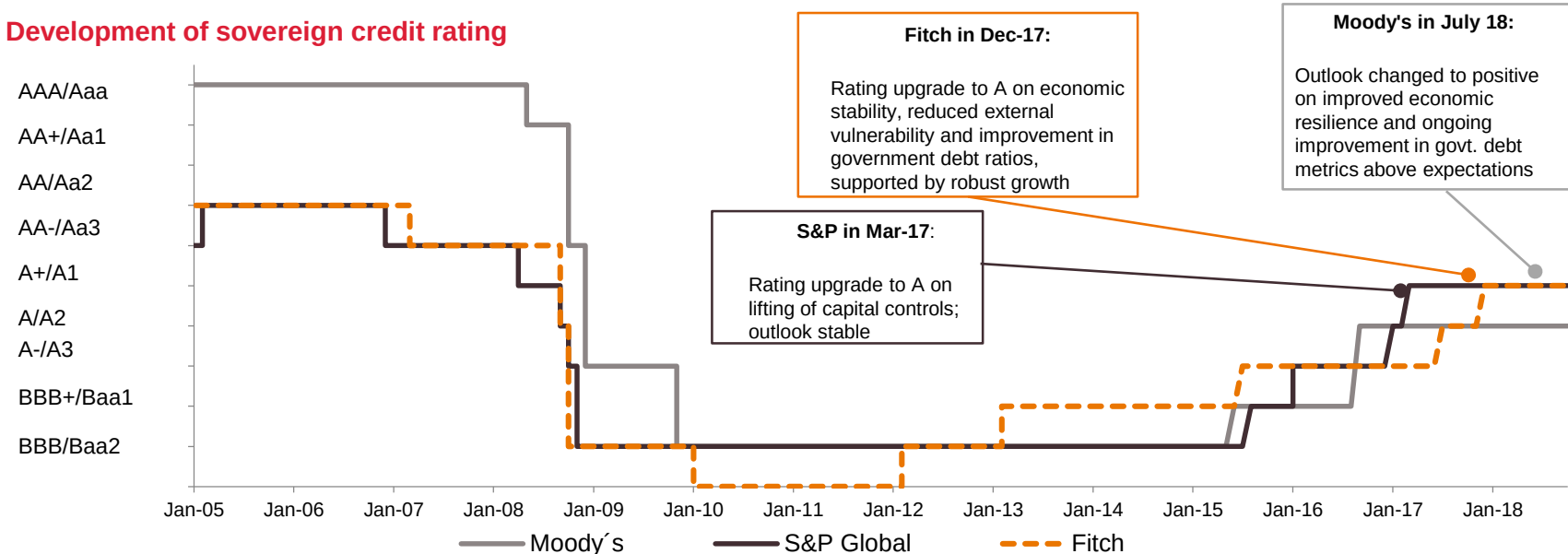
1. Shaded areas and dotted lines indicate forecasts by ISB research.  
Source: Central Bank of Iceland, Statistics Iceland, ÍSB research.



# Iceland's credit rating has improved markedly

Upgrades from S&P and Fitch following lifting of capital controls have been affirmed in 2019

## Development of sovereign credit rating



### MOODY'S IN JULY 2018

- The positive outlook also reflects progress made in the past two years on the major preconditions we laid out at the time of the upgrade to A3 in September 2016, including the smooth removal of capital controls and the settlement of the offshore krónur situation.

### FITCH IN JUNE 2018

- The outlook is stable.
- The A rating balances the economy's high income per capita, strong performance on governance, human development and doing business indicators against its high commodity export dependence, vulnerability to external shocks and experience of macroeconomic and financial volatility.

### S&P IN JULY 2018

- S&P Global Ratings affirmed its 'A/A-1' long- and short-term foreign and local currency sovereign credit ratings on the Republic of Iceland. The outlook is stable.
- The stable outlook balances the risks stemming from the domestic economy overheating against the potential for more rapid improvements in the government and external balance sheets over the next few years.





## More about Íslandsbanki

Learn more about the Bank on the Investor Relations website and through our contacts



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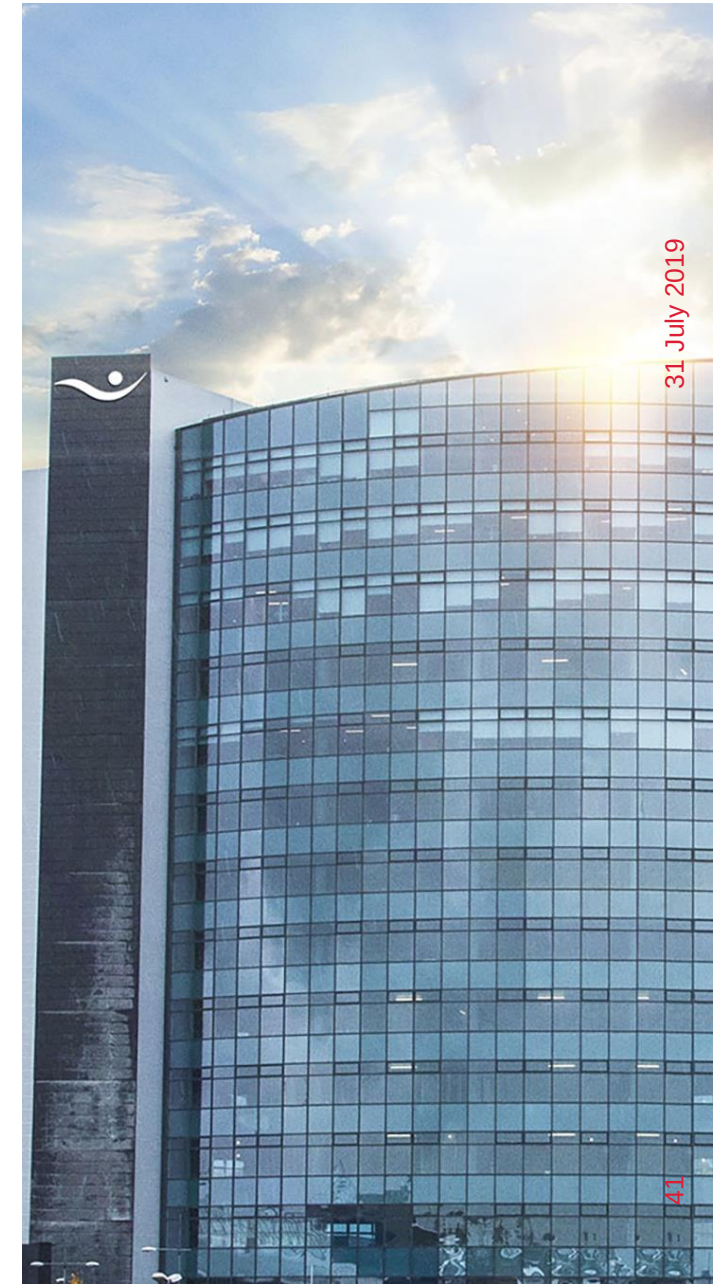
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### Investor material

Further investor information can be found at the Íslandsbanki IR website  
<https://www.islandsbanki.is/en/landing/about/investor-relations>

Please visit the Icelandic IR site for material in Icelandic  
<https://www.islandsbanki.is/is/flokkur/bankinn/fjarfestatengsl>





## Forward looking statements

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