2Q22 Financial Results

28 July 2022

Birna Einarsdóttir
Chief Executive Officer

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Chief Financial Officer

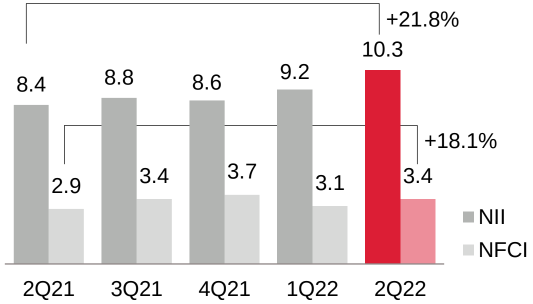
islandsbanki.is

Sound operations deliver strong performance

ROE of 11.7% driven by higher revenues

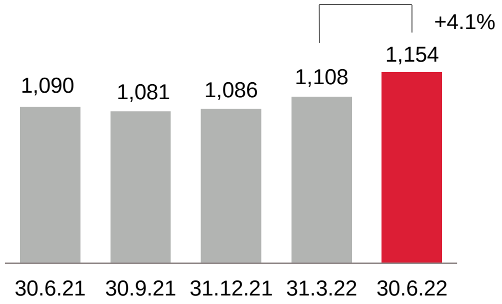
Growth above 2022 guidance

NII and NFCI, ISKbn



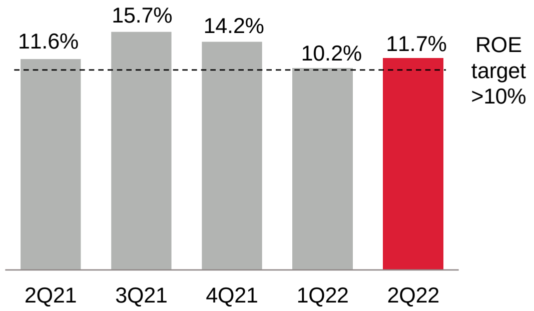
Strong growth in lending

Loans to customers, ISKbn



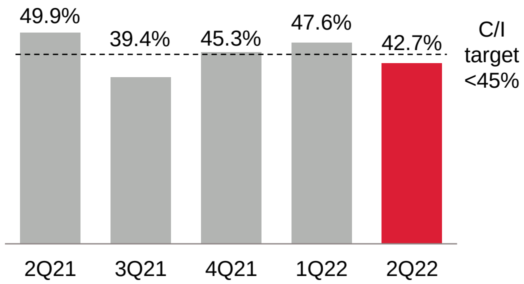
ROE above 2022 guidance

ROE



C/I ratio below 2022 guidance

C/I ratio



Revised 2022 guidance and financial targets on track

Guidance of over 10% ROE for 2022 following good financial result

Targets	Targets	Revised 2022 Guidance	Previous 2022 Guidance	2Q22	1Q22	2021
Return on equity	>10%	**>10%[1]**	8-10% by 2023	11.7% ✓	10.2% ✓	12.3% ✓
Cost-to-income ratio[2]	<45%	**44-47%**	45-50%	42.7% ✓	47.6% ✓	46.2% ✓
CET1 capital ratio[3]	~16.5%	Unchanged	Normalise before YE2023	18.2% ✓	18.8% ✓	21.3% ✓
Dividend-payout-ratio	50%	Unchanged	50%			50% ✓

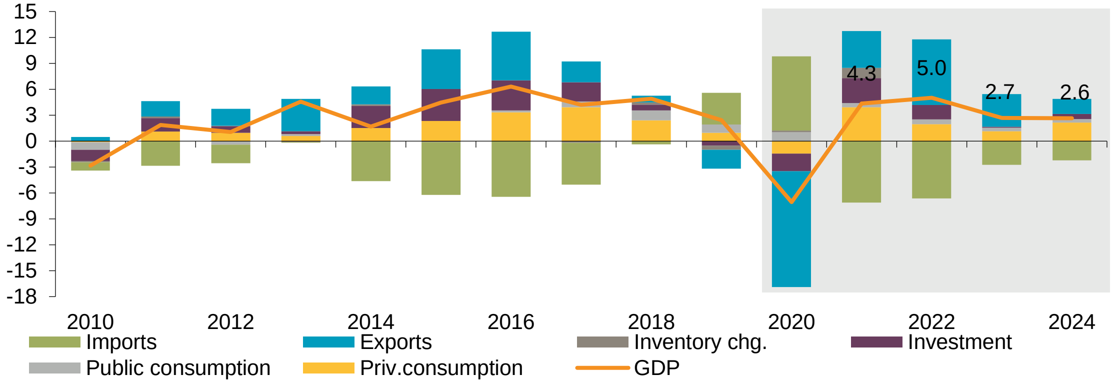
1. ROE is highly dependent on the cost of risk. Cost of risk was negative 17bp in 1H2022 and with CoR of zero, ROE for that period would have been approximately 10.0%. 2. Calculated as (Administrative expenses + Contribution to the Depositors' and Investors' Guarantee Fund – One-off items) / (Total operating income – One-off items). 3. Long term CET1 capital target is subject to regulatory requirements and includes a management buffer of 50-200bp.

Export-driven GDP growth following robust growth in demand

Strong foundations facilitate a vigorous recovery as world-wide pandemic impact fades

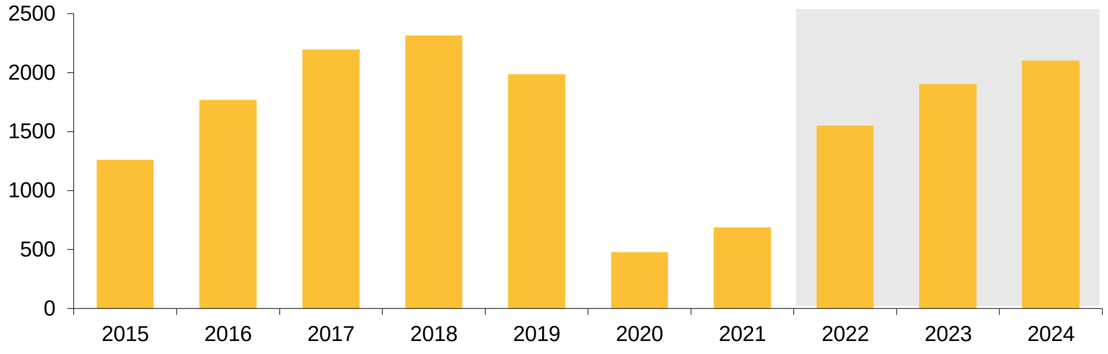
Exports replace domestic demand as the key catalyst of healthy GDP growth…

Real GDP and main subitems, YoY change, %



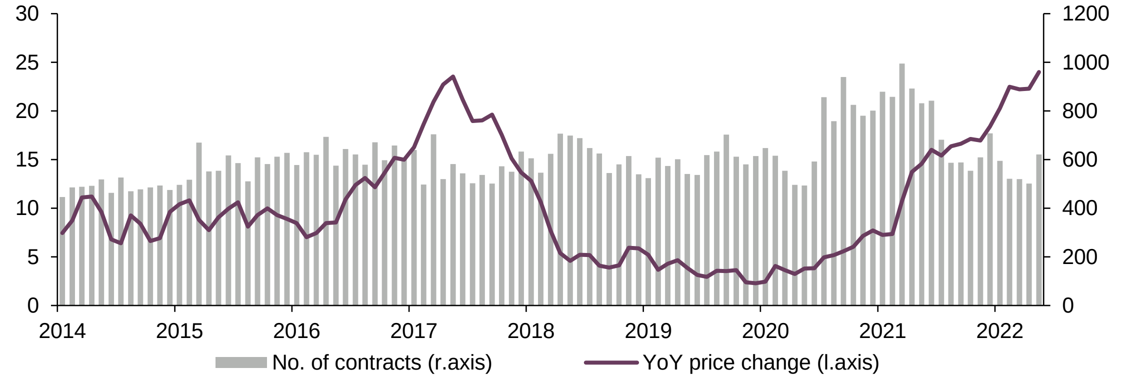
…as tourism sector recovery continues following receding pandemic impact

Number of foreign tourists per year, thousands



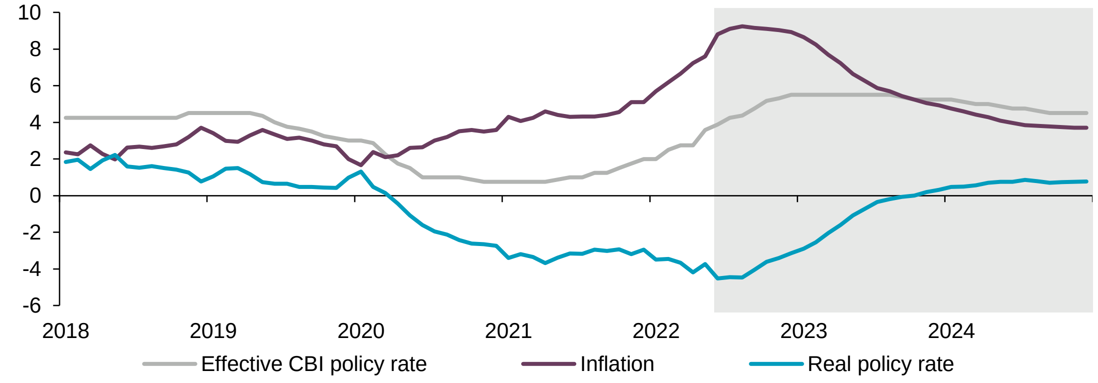
A buoyant housing market has been one of the main drivers of inflation…

Prices and turnover in the capital region residential housing market



…which has prompted considerable monetary tightening by the central bank

Inflation and policy rate, %



Shaded areas indicate ISB Research forecasts. Source: Statistics Iceland, the Central Bank of Iceland and ISB Research.

Strong second quarter of 2022

Íslandsbanki awarded the Euromoney "Award for Excellence" in 2022

Personal Banking

16.2% ROE
49.2% Cost-to-income ratio
2.7% NIM

- Growth in mortgages lending of 4.4% in 2Q22
- Increased card spending supports strong fee revenue
- New pension platform enables self service for pension customers

Business Banking

18.9% ROE
39.0% Cost-to-income ratio
5.4% NIM

- Good growth in lending volumes with 6.5% growth in 2Q22
- ergo Brisk lending with 16.4% growth for Ergo financing in 2Q22 and over a third of new car loans are for Green cars[2]

Corporate & Investment Banking

13.0% ROE
33.7% Cost-to-income ratio
3.1% NIM

- Highest market share in equity sales and #2 in bonds brokerage in 1H22
- First loan granted in cooperation with the IS Corporate Credit Fund
- Corporate Finance completed many milestone transactions, including a sale of a real estate portfolio for SKEL

Iceland Funds

18.0% ROE
61.0% Cost-to-income ratio[1]
AUM ISK **392bn**

- Inflows to asset allocation, equity and covered bond funds but total AuM decrease due to outflow from short bond funds and market performance

Sustainability

- Íslandsbanki receives top ESG score (90/100) from Reitun for the second year in a row
- The Bank's score for environmental practices has risen by 12.9% year-on-year
- Good progress on Secondary objectives for 2022

1. As calculated from the Bank's Consolidated Income Statement. 2. Green financing is offered when a vehicle emits less than 50g/km CO2.

Smarter, faster digital services for happier customers at the best bank in Iceland

EUROMONEY AWARDS FOR EXCELLENCE 2022
ICELAND BEST BANK

99%

of all touchpoints are via digital channels,10% YoY increase in active app customers

25%

of all active app customers under 40 years have activated carbon calculator in app

80%

of fund sales to retail customers digital. Savings, cards, loans and fund sales easy app access and securities in pipeline

21%

increase in corporate app visits in 1H22 and 95% have tried the app

32%

increase in use of electronic signatures YoY. The solution enhances better service for customers

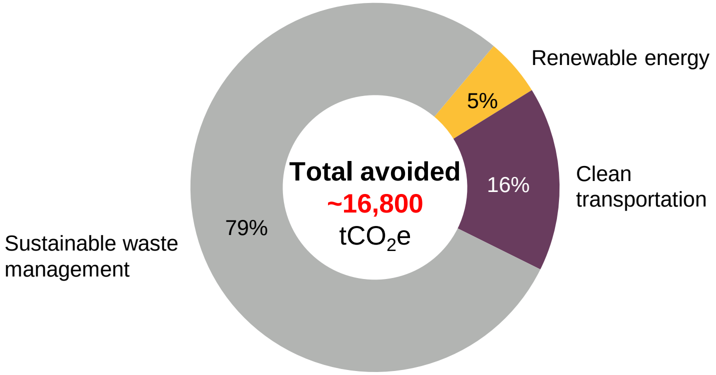
3

fintech initiatives: The Icelandic Fintech Cluster, Copenhagen Fintech and offering open APIs

Summary of environmental and social impact in 2021

Avoided emissions from sustainable lending increased by nearly 200% YoY

Avoided greenhouse gas emissions in 2021



Key developments in 2021

- Sustainable lending more than doubled year-on-year
- Sustainable Financing Framework categories in use increased from 7 to 11 out of 18 categories defined
- MSC certified seafood companies saw the biggest growth, accounting for 34% of eligible assets while green and social lending account for 50% and 16%, respectively
- Sustainable waste management created the most impact in terms of avoided emissions. Biogas produced by the financed waste management plant is assumed to replace fossil fuels, preventing 13,200 tCO_2e from being released into the atmosphere[1]

Additional impact indicators for sustainable lending

2,200 clean vehicles

97 GWh of clean energy produced

84,000 sqm of eco-efficient buildings

44,000 tonnes of MSC certified products sold

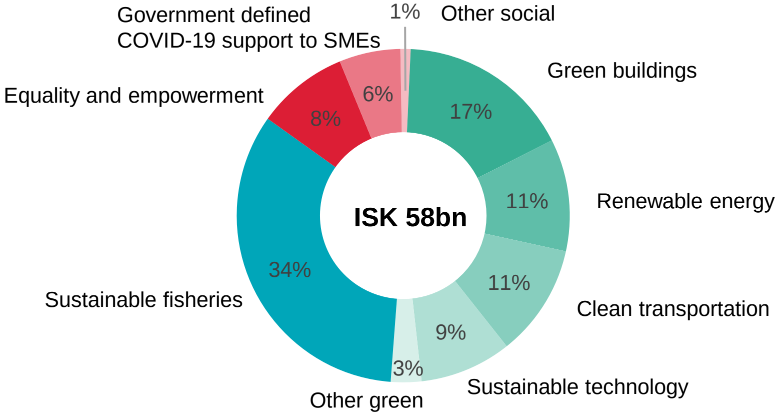
60 social housing units

30 loans to gender balanced companies

2 early childhood education facilities

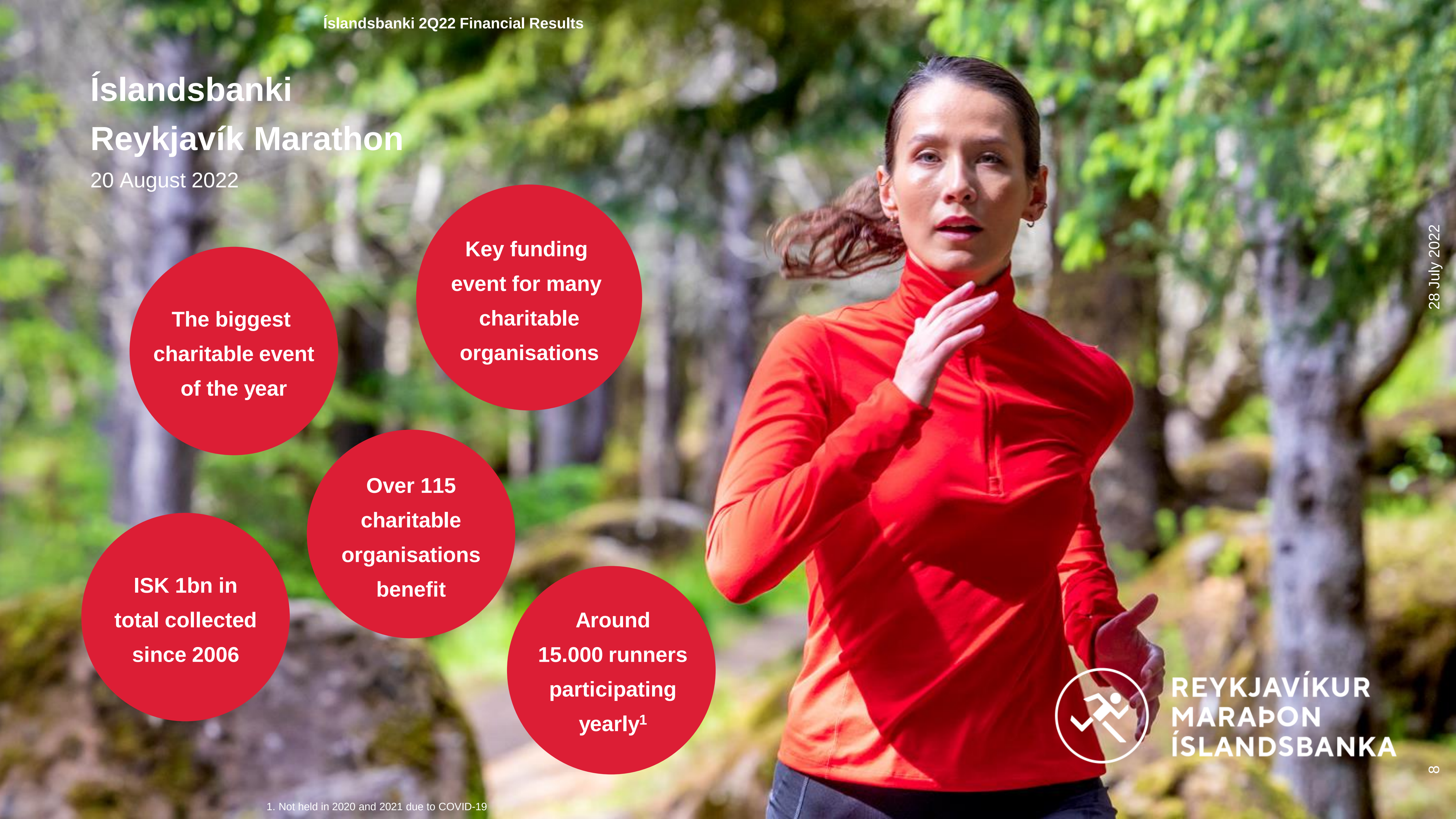
440 companies supported with COVID-19 loans

Sustainable loans by category at year-end 2021



Report link

1. In the impact calculations for sustainable waste management, biogas produced from waste is assumed to replace fossil fuels and estimated avoided emissions from recycling the two types of waste used in the production (which would otherwise have been landfilled and composted, respectively) are also considered.



Íslandsbanki Reykjavík Marathon

20 August 2022

The biggest charitable event of the year

Key funding event for many charitable organisations

Over 115 charitable organisations benefit

ISK 1bn in total collected since 2006

Around 15.000 runners participating yearly[1]

REYKJAVÍKUR MARAÞON ÍSLANDSBANKA

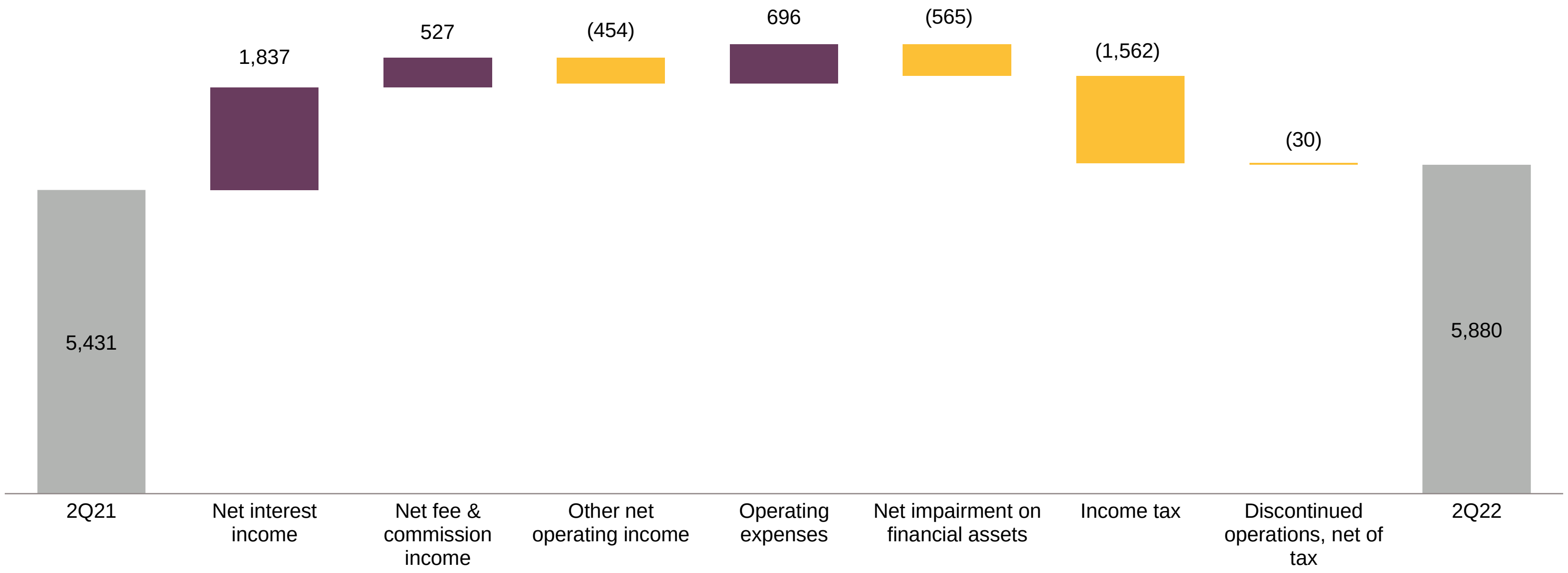
1. Not held in 2020 and 2021 due to COVID-19

Financial overview

Increase in core revenues in a good quarter

Control of costs further boost a positive result

Profit for the period – 2Q21 vs 2Q22
ISKm



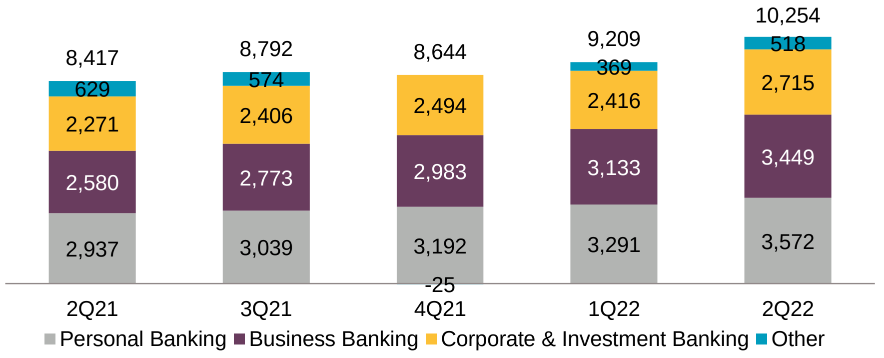
NII rose strongly in all business segments

NIM rose to 2.9% due to a higher interest rate environment

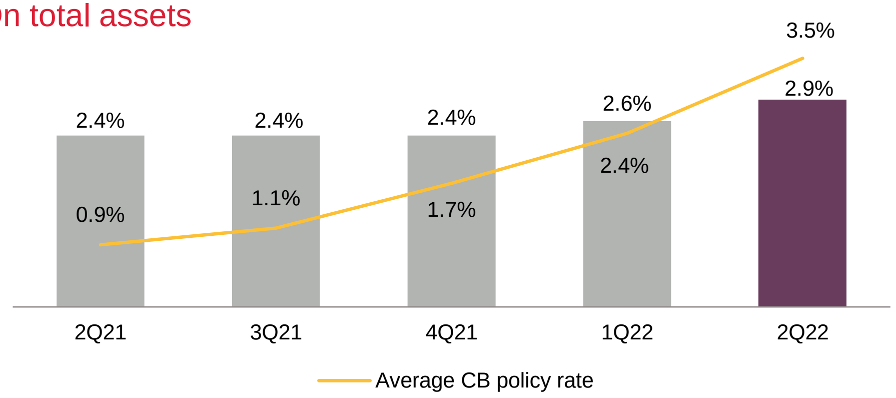
Highlights

- NII continued a positive trend supported by higher interest rate environment leading to a rise in deposit margin YoY and positively affecting the Bank's liquidity portfolio
- Additional positive effect came from higher lending and deposit volumes which increased YoY across all business segments
- Lending margin was 1.9% in 2Q22 (2.2% in 2Q21) while deposit margin was 1.8% in 2Q22 (1.1% in 2Q21)

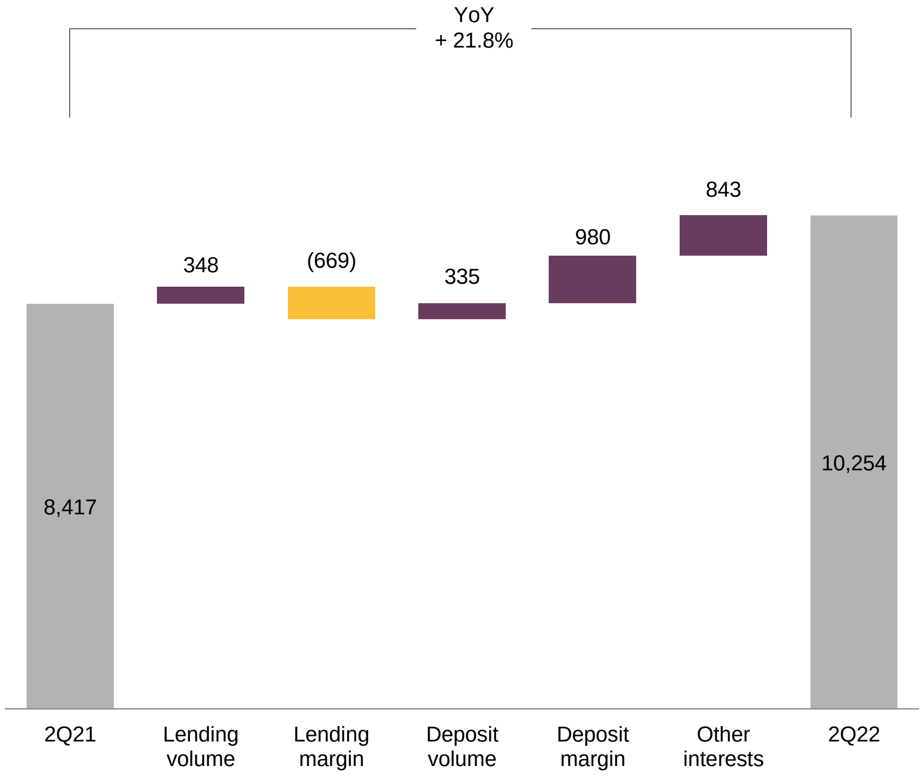
Net interest income
By business segments, ISKm



Net interest margin
On total assets



NII – comparison 2Q YoY
ISKm



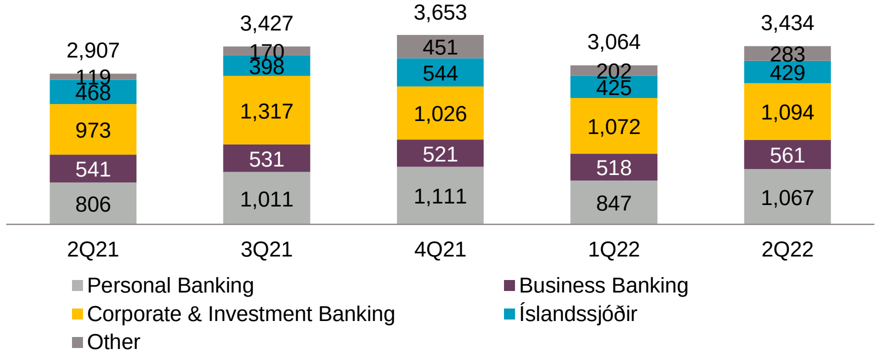
NFCI rose 18.1% YoY

Broad-based fee generation across the business units

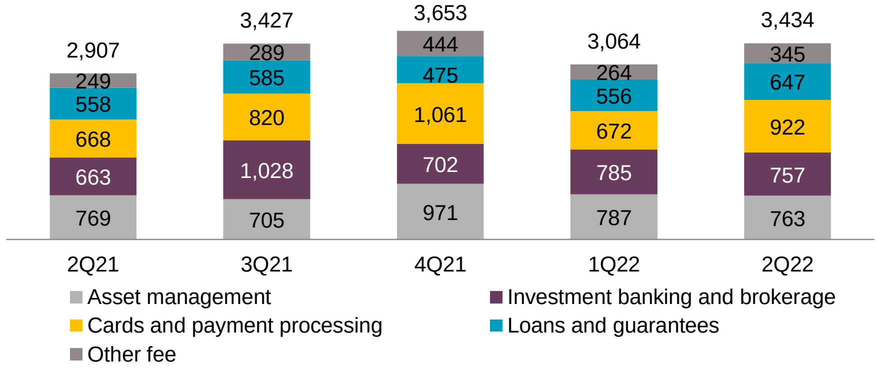
Highlights

- Revenues from investment banking and brokerage increase from currency sales and increased revenues from market making agreements
- Increased card transaction income and interchange income from cards, both domestic and foreign. Card expenses increased at the same time
- NFCI from loans and guarantees rose due to increased fees from guarantees and fees from changes of loan terms

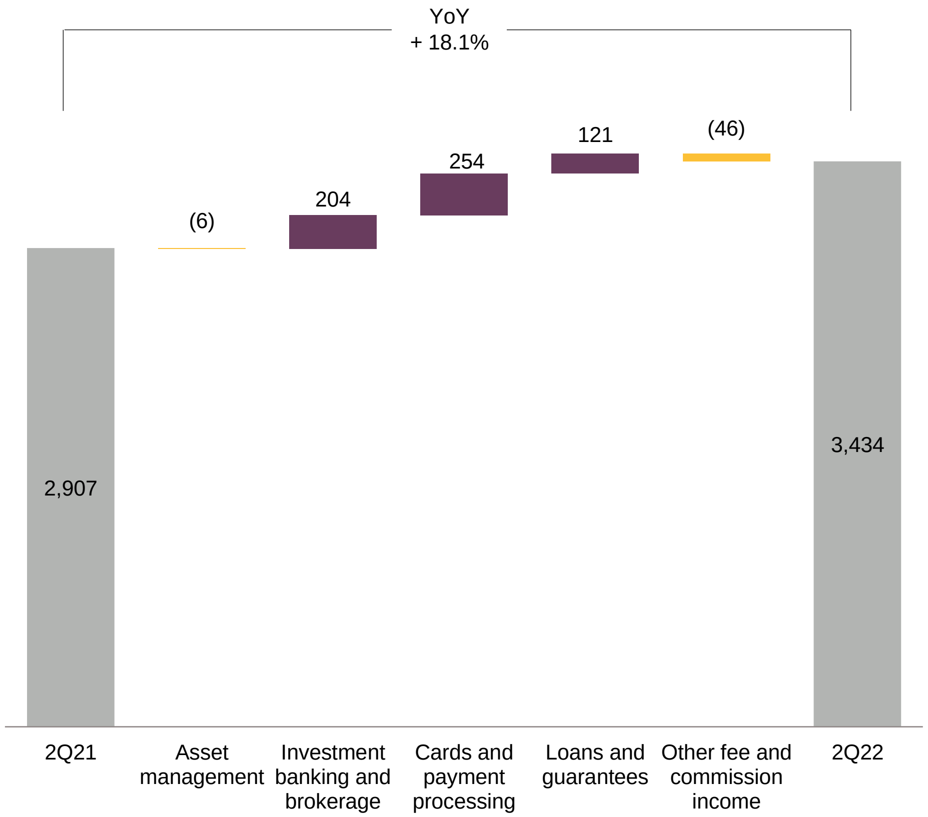
Net fee and commission income
Business segments, ISKm



Net fee and commission income
By type, ISKm



NFCI – comparison 2Q YoY
ISKm



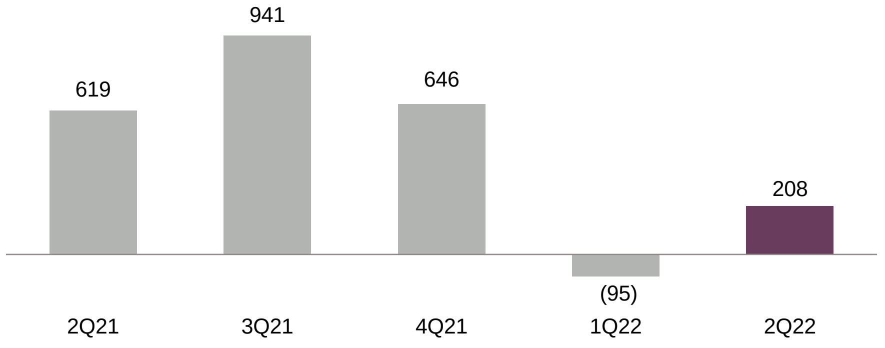
Positive NFI in turbulent markets

Rising benchmark interest rates do however support financial income in other derivatives

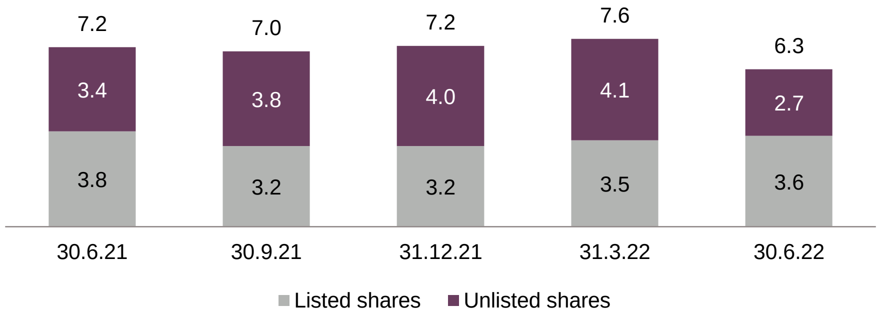
Highlights

- Reduction in shares and equity instruments in 2Q22 is explained by Norðurturninn hf. (owner of the Bank's headquarters) which was classified as shares and equity instrument but is now classified as an associate

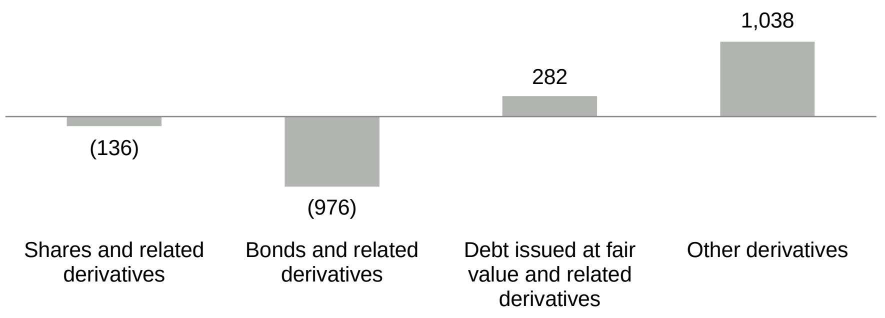
Net financial income
ISKm



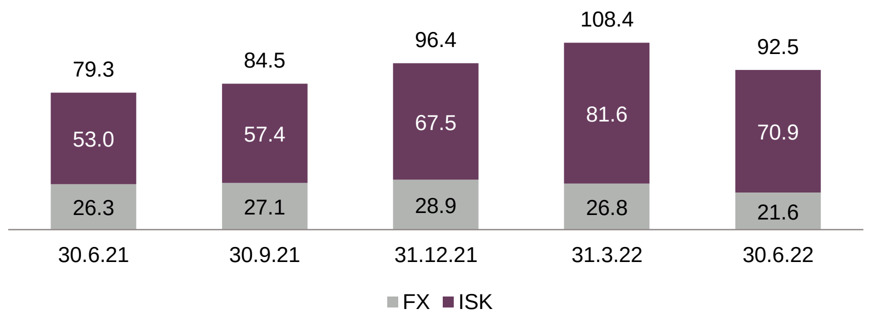
Shares and equity instruments[1]
ISKbn



Net financial income by type in 2Q22
ISKm



Bonds and debt instruments[2]
ISKbn



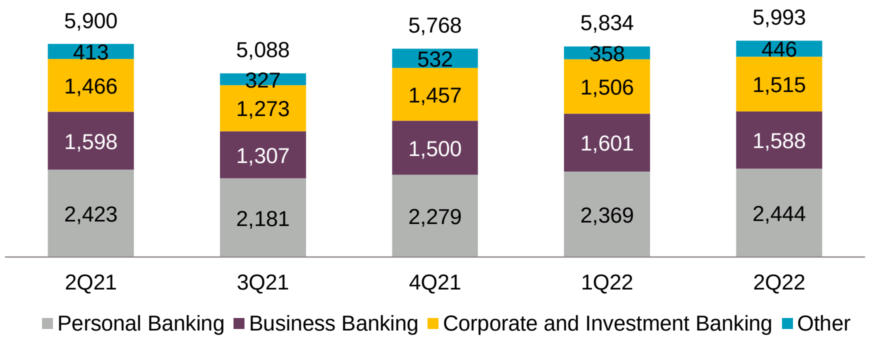
1.Excluding listed shares and equity instruments used for economic hedging. 2. Excluding listed bonds and debt instruments used for economic hedging.

Administrative expenses stable in 2Q22

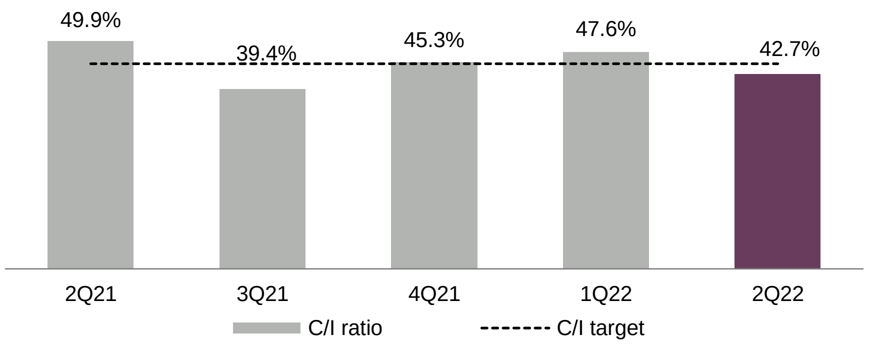
5.9% reduction in real terms driven by lower salary costs

Administrative expenses[1]

ISKm

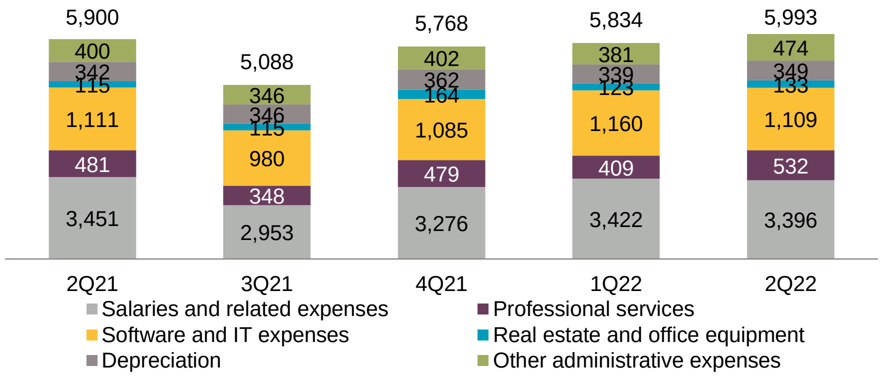


Cost-to-income ratio[2]

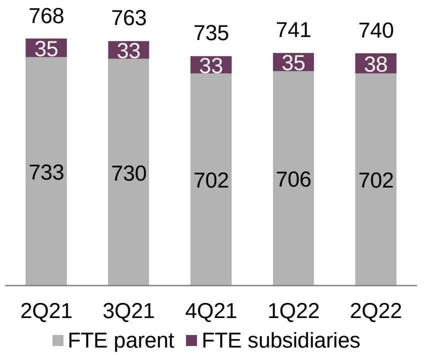


Administrative expenses[1] – by type

ISKm

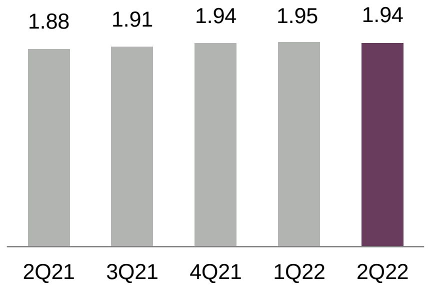


FTE period end[3]



Total assets / FTE[3]

ISKbn



1. Administrative expenses in 2Q21 are excluding 588m one-off cost related to the Bank's IPO. 2. Calculated as (Administrative expenses + Contribution to the Depositor's and Investors' Guarantee Fund – one off items) / Total operating income – one-off items). 2. Target was updated in 1Q21 from the previous <55% 3. FTE numbers exclude seasonal employees.

Impairment reversals continued in 2Q22

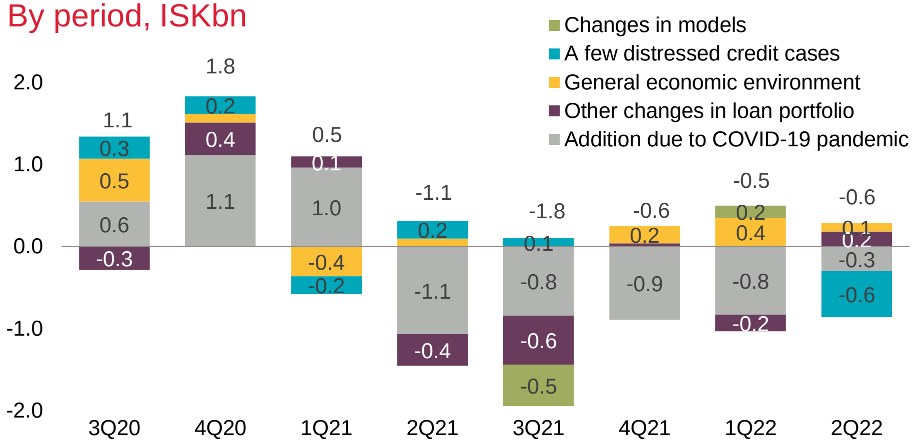
Majority of forborne borrowers have resumed payments

Highlights

- Reserve coverage ratio (RCR) for impairment allowance on Stage 3 was 24% at end of 2Q22
- The RCR fell when a disputed loan that had been fully impaired was paid up following a favourable court ruling
- The definition of forbearance includes a 24-month probation period. Therefore, loans are classified as forborne even after normal payments have resumed
- Loans amounting to ISK 66bn (80% of total) are expected to exit forbearance probation in 2022

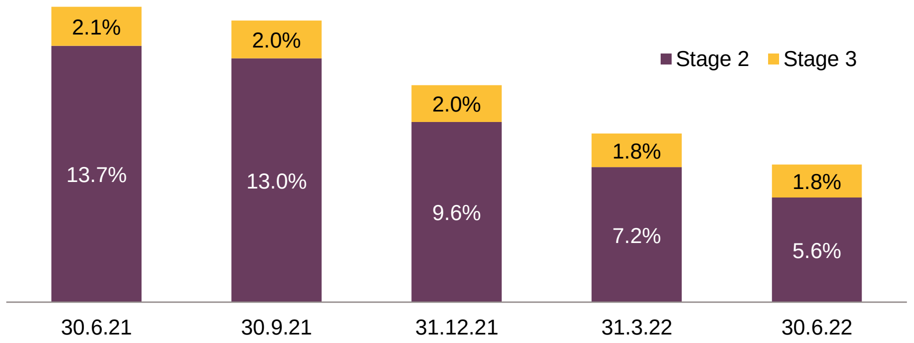
Net impairment on financial assets

By period, ISKbn



Loans to customers: Stage 2 and 3 (NPL)

Development of gross carrying amount as ratio of total loans

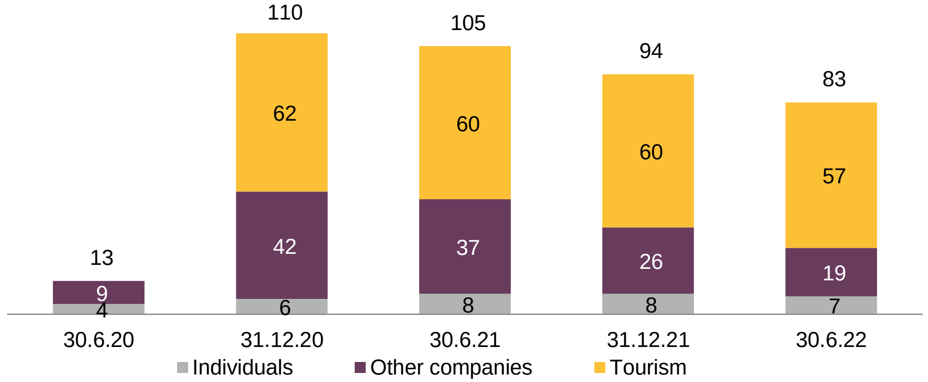


Current and expected cost-of-risk

- Annualised cost of risk was -20bp in 2Q22 compared to -42bp for 2Q21
- Additional impairment allowance currently attributable to the tourism overlay and stage transfer is approx. ISK 0.9bn at end of 2Q22 down from 2.0bn at YE21
- The probability weights of economic scenarios were shifted to 20% (good), 50% (baseline), and 30% (bad) at end of 2Q22. A shift of 5% from baseline to the bad scenario would increase the impairment allowance by ISK 0.3bn while a 5% shift from the baseline to the good would decrease the allowance by ISK 0.15bn
- In 2Q22 a total of approximately ISK 750m of impairment reversals was a result of a favourable court ruling regarding a fully impaired loan

Performing loans with forbearance

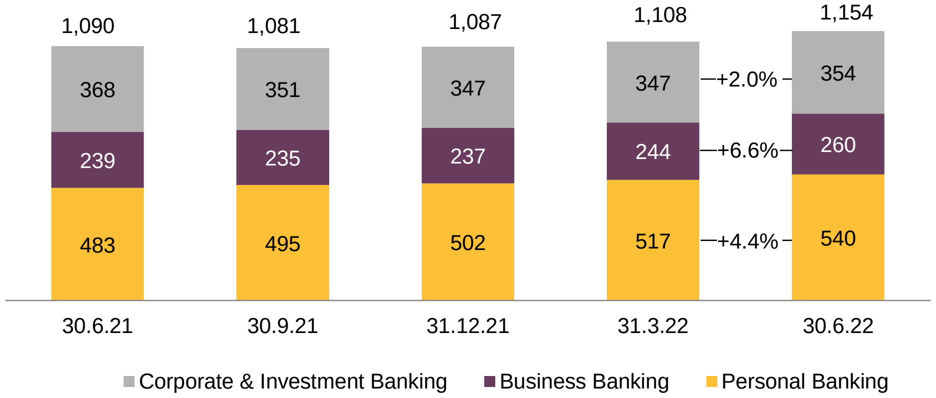
Gross carrying amount, ISKbn



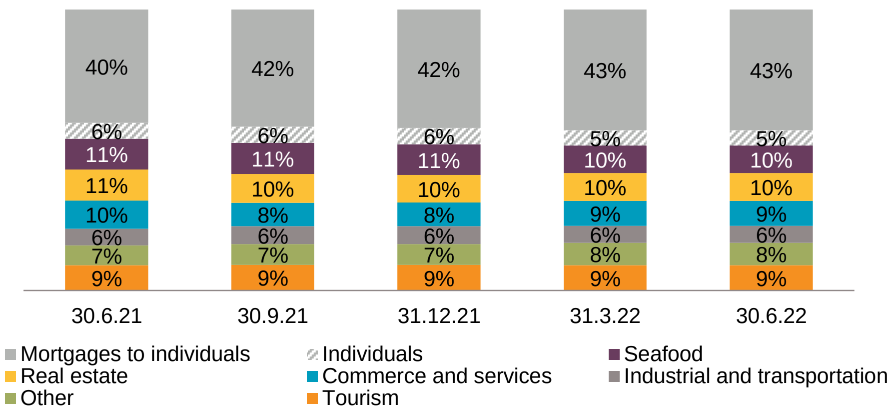
Lending volume growth across all business units

Credit quality remains strong and highly collateralised loan portfolio

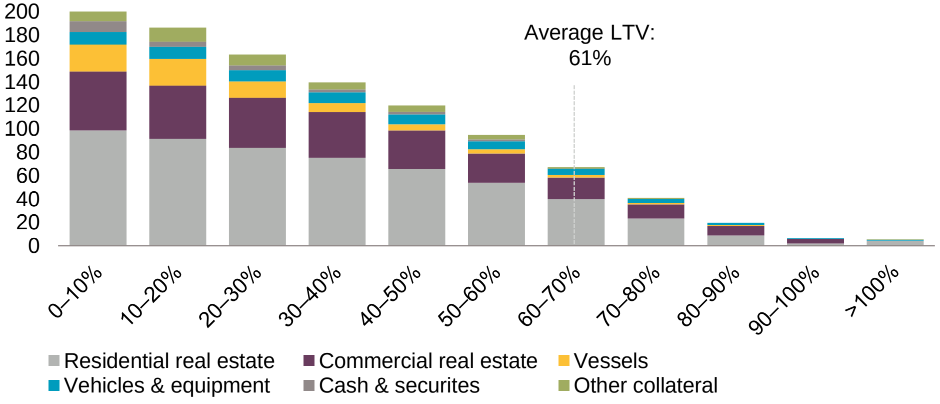
Loans to customers
By business division, ISKbn



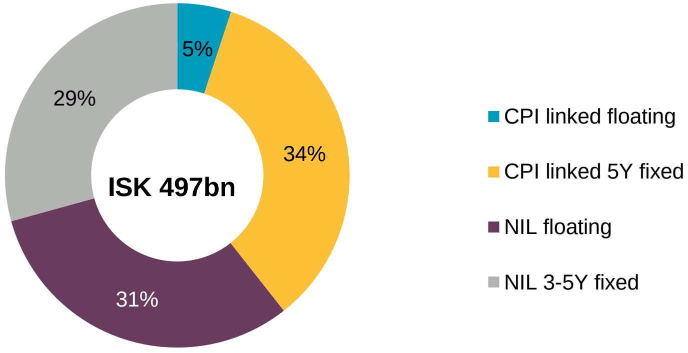
Loans to customers
By sector, with tourism as a separate sector



LTV distribution by underlying asset class
30.6.2022, loan splitting approach, ISKbn



Mortgage portfolio[1]
Gross carrying amount, 30.6.2022



1. NIL stands for non-index linked loans.

28 July 2022

Deposits are the largest source of funding

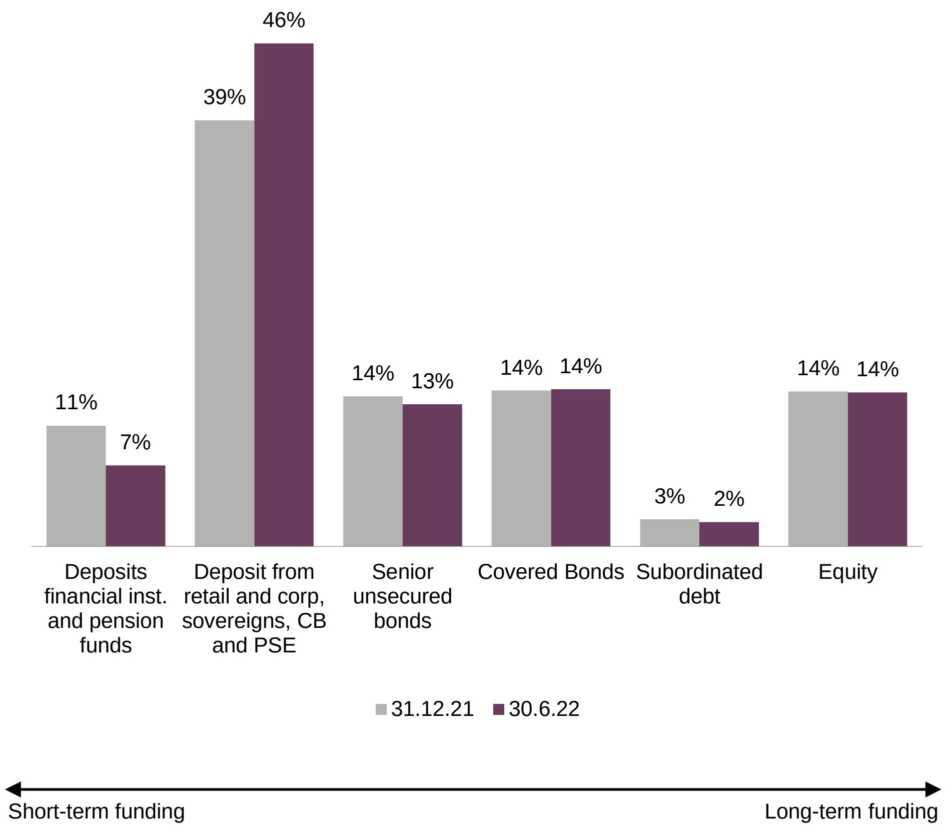
Retail deposits continue to increase

Highlights

- Term deposits are 18% of total deposits
- Deposit concentration is stable. 11% of the Bank's deposits belonged to the 10 largest depositors and 27% to the 100 largest depositors at 2Q22, compared to 12% and 28% respectively at YE21
- At end of 2Q22 75% of deposits were in non-indexed ISK, 13% CPI-linked and 12% in foreign currencies

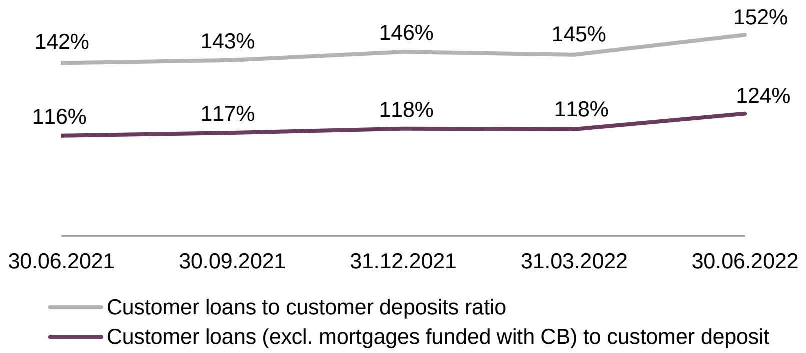
Funding sources

By type, % of total liabilities and equity



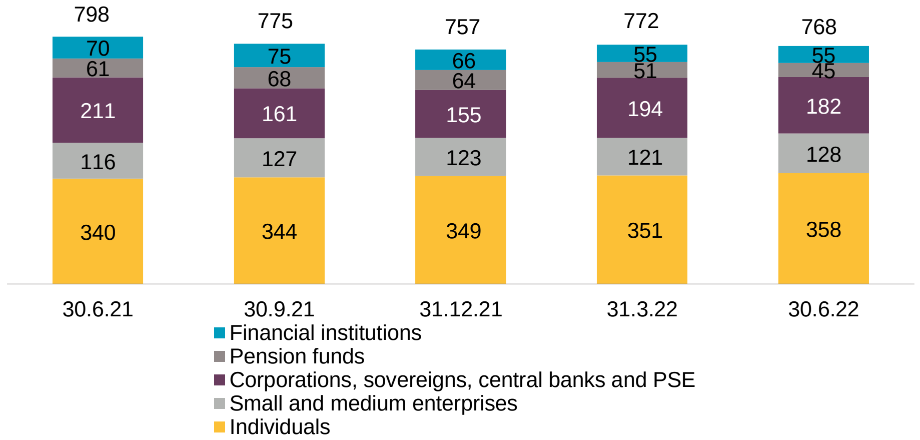
Customer loans to customer deposits ratio

Development, %



Deposits from customers and credit institutions

Development, by LCR category, ISKbn



Seasoned and diversified long-term funding programme

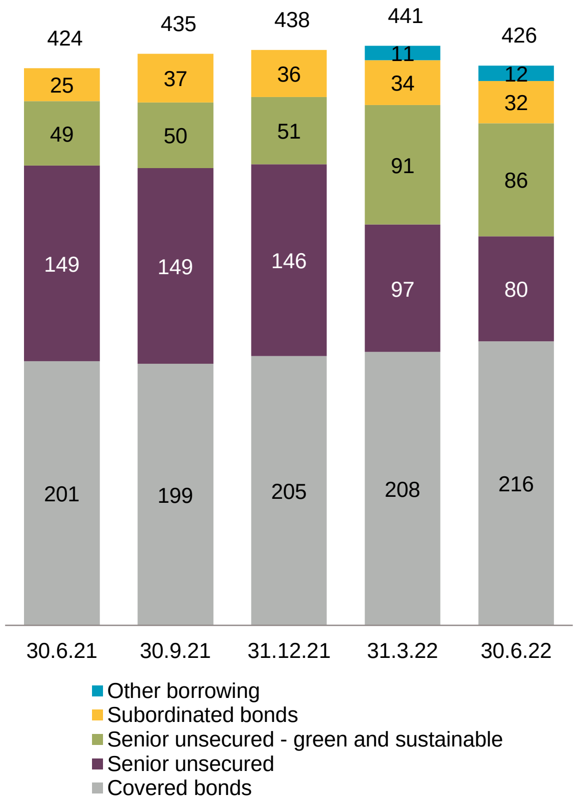
Majority of 2022 maturities already funded through €300m sustainable bond issue in January

Highlights

- S&P Global ratings BBB/A-2 with stable outlook confirmed on 13 July 2022
- In June, the Bank signed a new covered bond programme. Rated A by Standard & Poor's, it will permit issuance in foreign currencies, allowing broader market access and investor diversification
- The Bank has a call option on its SEK 750 Tier 2 of 2027 in November 2022 and a January 2023 call on its EUR 300m senior bond maturing in January 2024
- At end of 2Q22, total LCR ratio was 147%, FX LCR was 240% and total NFSR was 118%
- The Bank's MREL requirement is 21% of total risk exposure amount (TREA) and applies from the date of the announcement, 26 April 2022. The Bank will fulfil the MREL requirement from the outset

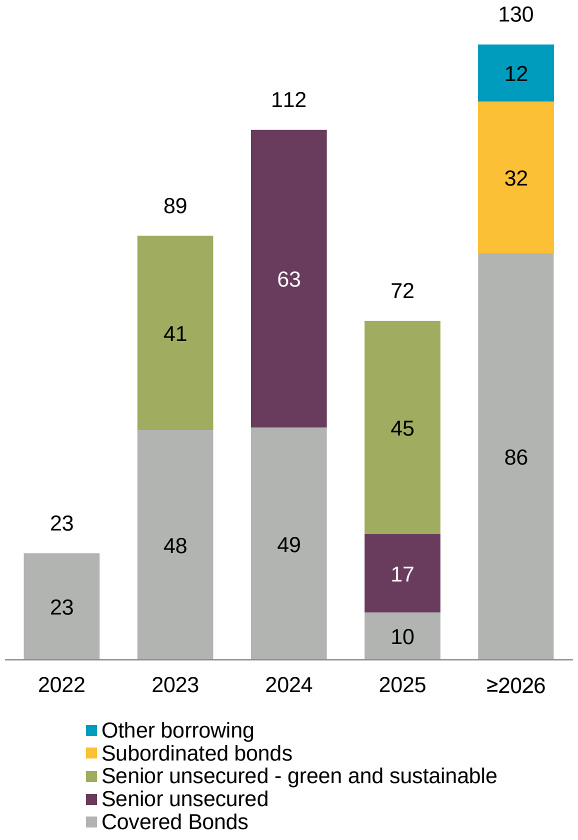
Sources of borrowings

Development, ISKbn



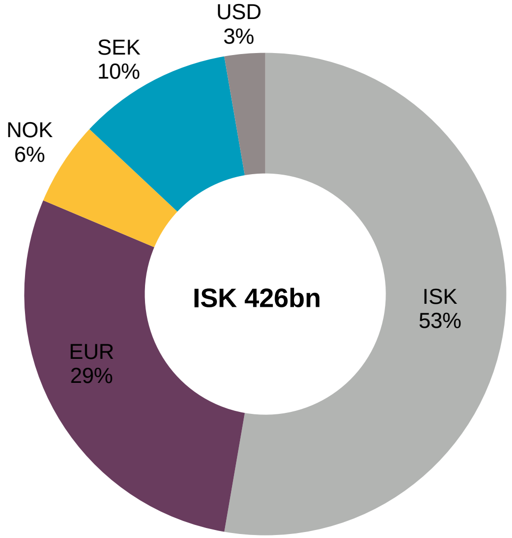
Contractual maturity profile of borrowings

ISKbn



Currency split of borrowings

30.6.22



Strong capital position and dividend capacity

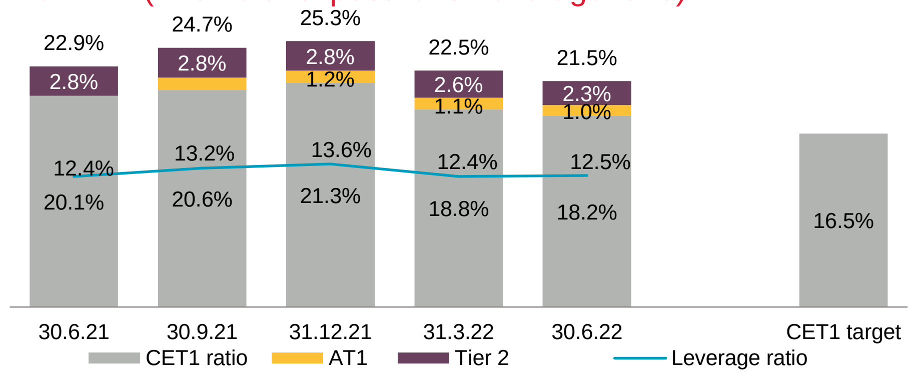
Opportunity exists to optimise capital composition and to continue consistent dividends

Highlights

- Current and long-term expected total capital requirements of 17.9% and 19.0% respectively
- Additional AT1 issuance potential of ISK 6-7bn to optimise capital structure
- Increase in REA in 2Q22 due to strong and profitable loan growth in 2Q22. This leads to drop in CET1 ratio and a reduction in excess capital

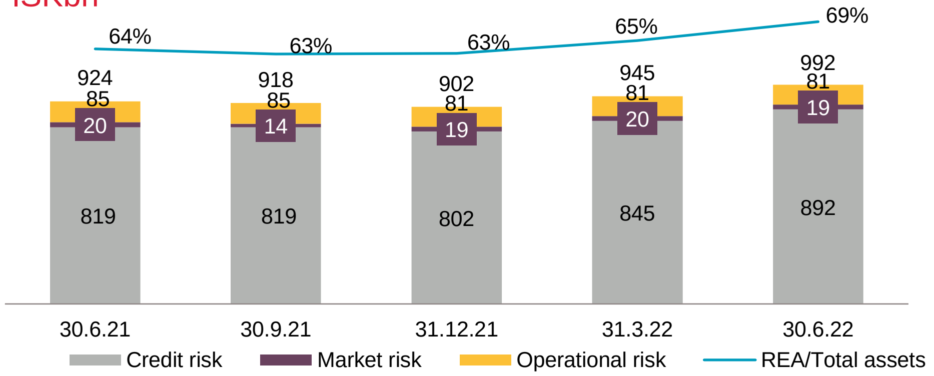
Capital ratios and leverage ratio

% of REA (% of total exposure for leverage ratio)



Risk exposure amount (REA)

ISKbn



Capital distribution plans

- **ISK 30-35bn of excess CET1 capital**
  - Plan to optimise capital structure before year-end 2023
  - Distribution in the form of share buybacks or special dividends, method and timing subject to the market conditions
  - ISK 15bn of capital release planned in the coming months, subject to market conditions

Q&A

Appendix I – About Íslandsbanki and additional financial information

This is Íslandsbanki

Moving Iceland forward by empowering our customers to succeed

Vision and Values

Vision to be
#1 for service

Passion
Professionalism
Collaboration

The Bank

FTEs
702
number of FTEs at Íslandsbanki at period end

12 branches

Listed to Nasdaq Iceland as of June 2021

Market share[1]

31% retail customers

37% SMEs

35% large companies

Sustainability 2Q22

Íslandsbanki receives top ESG score (90/100) from Reitun for the second year in a row

The Bank's score for environmental practices has risen by 12.9% year-on-year

Total avoided greenhouse gas emissions in 2021 ~16,800 tCO2e

Key Figures 2Q22

ROE	11.7%	LCR Group, all currencies	147%
Cost-to-income ratio	42.7%	NSFR Group, all currencies	118%
CET1 ratio[2]	18.2%	Leverage ratio[2]	12.5%
Total capital ratio[2]	21.5%	Total assets	ISK 1,437bn

Ratings and certifications

S&P Global Ratings
BBB/A-2
Stable outlook

EQUAL PAY CERTIFICATE 2018 - 2021

EXEMPLARY IN CORPORATE GOVERNANCE

Digital milestones 2Q22

New pension platform released, enables self service for pension customers

Corporates can apply for and modify overdraft in app

App available in Polish

1. Based on Gallup surveys regarding primary bank. 12 months rolling average for retail customers, December 2021 survey for SMEs and 2021 average for large companies.

Financial overview

Key figures & ratios

		2Q22	1Q22	4Q21	3Q21	2Q21
PROFITABILITY	Profit for the period, ISKm	**5,880**	5,187	7,092	7,587	5,431
	Return on equity	**11.7%**	10.2%	14.2%	15.7%	11.6%
	Net interest margin (of total assets)	**2.9%**	2.6%	2.4%	2.4%	2.4%
	Cost-to-income ratio[1]	**42.7%**	47.6%	45.3%	39.4%	49.9%
	Cost of risk[2]	**(0.20%)**	(0.17%)	(0.23%)	(0.64%)	(0.42%)
		30.6.22	31.3.22	31.12.21	30.9.21	30.6.21
BALANCE SHEET	Loans to customers, ISKm	**1,153,677**	1,107,893	1,086,327	1,081,418	1,089,723
	Total assets, ISKm	**1,437,253**	1,446,355	1,428,821	1,456,372	1,446,860
	Risk exposure amount, ISKm	**992,883**	945,321	901,646	917,764	924,375
	Deposits from customers, ISKm	**756,862**	761,471	744,036	754,442	765,614
	Customer loans to customer deposits ratio	**152%**	145%	146%	143%	142%
	Non-performing loans (NPL) ratio[3]	**1.8%**	1.8%	2.0%	2.0%	2.1%
LIQUIDITY	Net stable funding ratio (NSFR), for all currencies	**118%**	123%	122%	121%	122%
	Liquidity coverage ratio (LCR), for all currencies	**147%**	195%	156%	225%	187%
CAPITAL	Total equity, ISKm	**203,662**	197,201	203,710	197,381	190,355
	CET 1 ratio[4]	**18.2%**	18.8%	21.3%	20.6%	20.1%
	Tier 1 ratio[4]	**19.2%**	19.9%	22.5%	21.8%	20.1%
	Total capital ratio[4]	**21.5%**	22.5%	25.3%	24.7%	22.9%
	Leverage ratio[4]	**12.5%**	12.4%	13.6%	13.2%	12.4%

1.Calculated as (Administrative expenses + Contribution to the Depositors' and Investors' Guarantee Fund – One-off items) / (Total operating income – One-off items). 2. Negative cost of risk means that there is a net release of impairments. 3. Stage 3, loans to customers, gross carrying amount. 4. Including 3Q21 profit for 30.9.21 and 1Q22 profit for 31.3.22.

Income growth of 16% YoY driven by NII and NFCI

Robust profitability in 2Q22 built on a solid platform

Income statement, ISKm	**2Q22**	2Q21	Δ%	**1H22**	1H21	Δ%	2021
Net interest income	**10,254**	8,417	22%	**19,463**	16,607	17%	34,043
Net fee and commission income	**3,434**	2,907	18%	**6,498**	5,769	13%	12,849
Net financial income (expense)	**208**	619	(66%)	**113**	912	(88%)	2,499
Net foreign exchange gain	**75**	95	(21%)	**241**	225	7%	479
Other operating income	**59**	82	(28%)	**324**	204	59%	302
Total operating income	**14,030**	12,120	16%	**26,639**	23,717	12%	50,172
Salaries and related expenses	**(3,396)**	(3,594)	(6%)	**(6,818)**	(7,168)	(5%)	(13,397)
Other operating expenses	**(2,597)**	(2,894)	(10%)	**(5,009)**	(5,172)	(3%)	(9,799)
Administrative expenses	**(5,993)**	(6,488)	(8%)	**(11,827)**	(12,340)	(4%)	(23,196)
Contribution to the Depositor's and Investors' Guarantee Fund	0	(162)	(100%)	**(165)**	(344)	(52%)	(688)
Bank tax	(412)	(451)	(9%)	**(842)**	(861)	(2%)	(1,683)
Total operating expenses	**(6,405)**	(7,101)	(10%)	**(12,834)**	(13,545)	(5%)	(25,567)
Net impairment on financial assets	**575**	1,140	(50%)	**1,058**	622	70%	3,018
Profit before tax	**8,200**	6,159	33%	**14,863**	10,794	38%	27,623
Income tax expense	**(2,331)**	(769)	203%	**(3,794)**	(1,805)	110%	(5,119)
Profit for the period from continuing operations	**5,869**	5,390	9%	**11,069**	8,989	23%	22,504
Discontinued operations held for sale, net of income tax	**11**	41	(73%)	**(2)**	57	(104%)	1,221
Profit for the period	**5,880**	5,431	8%	**11,067**	9,046	22%	23,725

Key ratios

Net Interest Margin (NIM)	**2.9%**	2.4%		**2.7%**	2.4%		2.4%
Cost-to-income ratio (C/I)	**42.7%**	49.9%		**45.0%**	50.6%		46.2%
Return on Equity (ROE)	**11.7%**	11.6%		**10.9%**	9.7%		12.3%
Cost of risk (COR)	**(0.20%)**	(0.42%)		**(0.19%)**	0.12%		(0.28%)

Balance sheet reflects a balanced loan and funding profile

Conservative mix of assets and stable funding

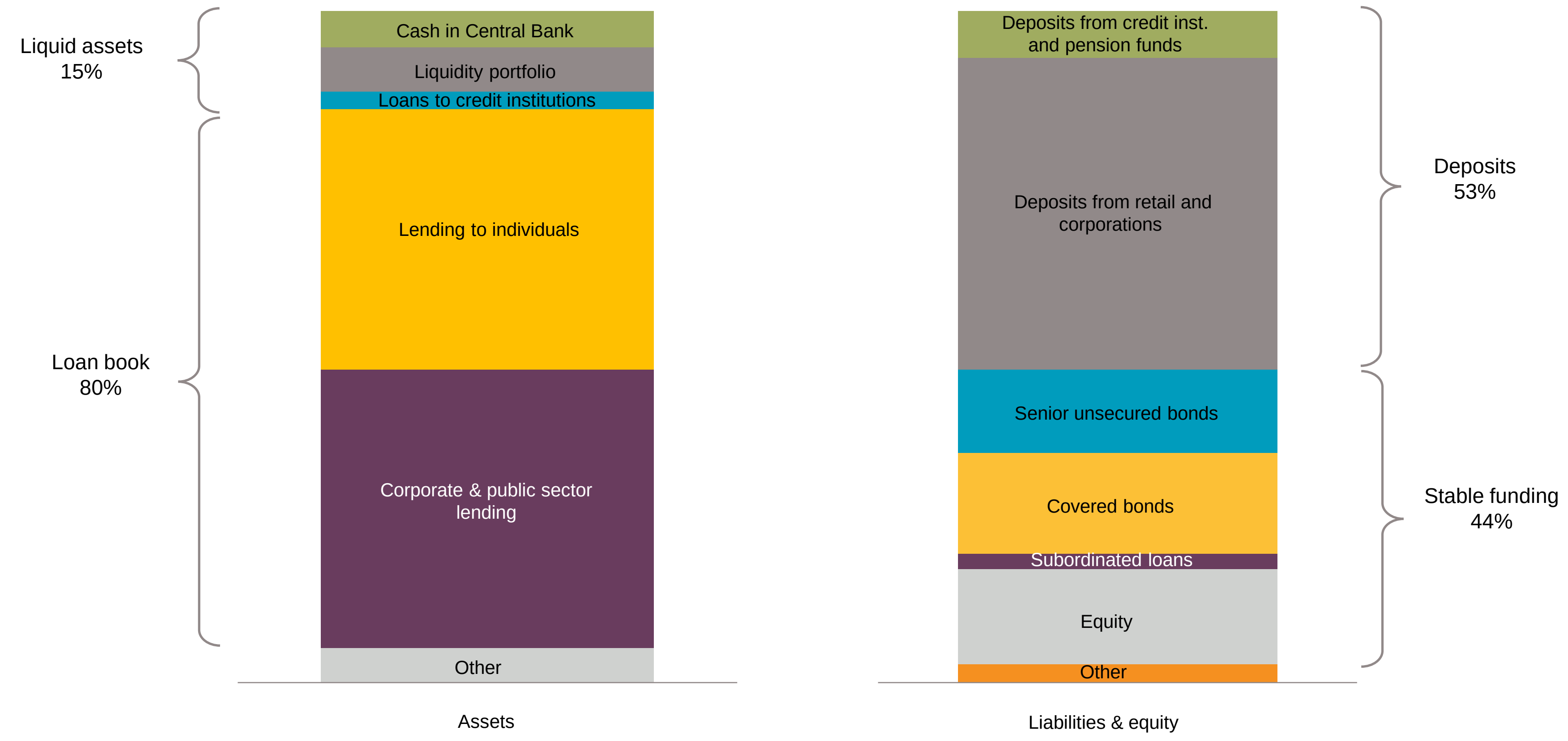
Assets

- Vast majority of assets consist of lending to both retail and corporates
- Strong liquidity portfolio is a consistent factor in balance sheet management
- Very limited exposure to non-liquid or non-lending assets

Liabilities

- Deposits from retail and corporates are the single largest funding source
- Bonds and debt instruments have become a more prominent part of the funding mix thanks to continuous focus on attracting new pockets of demand, including foreign currency and ESG issuance

Simplified balance sheet structure
30.6.2022, ISK 1,437bn



Growth in loans to customers continues

Steady mortgage growth supported by a strong capital base

Assets, ISKm	30.6.22	31.3.22	Δ	Δ%	31.12.21	Δ	Δ%
Cash and balances with Central Bank	**77,884**	77,799	85	0%	113,667	(35,783)	(31%)
Loans to credit institutions	**37,226**	73,220	(35,994)	(49%)	43,988	(6,762)	(15%)
Bonds and debt instruments	**108,477**	130,700	(22,223)	(17%)	132,289	(23,812)	(18%)
Derivatives	**6,193**	4,245	1,948	46%	2,445	3,748	153%
Loans to customers	**1,153,677**	1,107,893	45,784	4%	1,086,327	67,350	6%
Shares and equity instruments	**25,789**	28,655	(2,866)	(10%)	31,677	(5,888)	(19%)
Investment in associates	**3,836**	767	3,069	400%	939	2,897	309%
Property and equipment	**6,846**	6,911	(65)	(1%)	7,010	(164)	(2%)
Intangible assets	**3,304**	3,327	(23)	(1%)	3,351	(47)	(1%)
Other assets	**12,126**	11,170	956	9%	5,784	6,342	110%
Non-current assets and disposal groups held for sale	**1,895**	1,668	227	14%	1,344	551	41%
Total Assets	**1,437,253**	1,446,355	-9,102	(1%)	1,428,821	8,432	1%

Key ratios

Risk Exposure Amount (REA)	**992,883**	945,321	47,562	5%	901,646	91,237	10%
Non-performing loans (NPL) ratio[1]	**1.8%**	1.8%			2.0%		

1. Stage 3, loans to customers, gross carrying amount.

Diversified funding base

Deposits are the largest source of funding

Liabilities & Equity, ISKm	30.6.22	31.3.22	Δ	Δ%	31.12.21	Δ	Δ%
Deposits from Central Bank and credit institutions	**11,437**	10,949	488	4%	13,384	(1,947)	(15%)
Deposits from customers	**756,862**	761,471	(4,609)	(1%)	744,036	12,826	2%
Derivative instruments and short positions	**11,410**	11,013	397	4%	9,467	1,943	21%
Debt issued and other borrowed funds	**393,754**	406,845	(13,091)	(3%)	402,226	(8,472)	(2%)
Subordinated loans	**32,181**	34,139	(1,958)	(6%)	35,762	(3,581)	(10%)
Tax liabilities	**8,498**	6,980	1,518	22%	6,432	2,066	32%
Other liabilities	**18,498**	16,802	1,696	10%	12,848	5,650	44%
Non-current liabilities and disposal groups held for sale	**951**	955	(4)	(0%)	956	(5)	(1%)
Total Liabilities	**1,233,591**	1,249,154	(15,563)	(1%)	1,225,111	8,480	1%
Total Equity	**203,662**	197,201	6,461	3%	203,710	(48)	(0%)
Total Liabilities and Equity	**1,437,253**	1,446,355	(9,102)	(1%)	1,428,821	8,432	1%

Key ratios	30.6.22	31.3.22	31.12.21
Customer loans to customer deposits ratio	**152%**	145%	146%
REA/total assets	**69.1%**	65.4%	63.1%
Net stable funding ratio (NSFR)	**118%**	123%	122%
Liquidity coverage ratio (LCR)	**147%**	195%	156%
Total capital ratio[1]	**21.5%**	22.5%	25.3%
Tier 1 capital ratio[1]	**19.2%**	19.9%	22.5%
Leverage ratio[1]	**12.5%**	12.4%	13.6%

1. Including first quarter profit for 31.3.22.

Appendix II – Icelandic economy update

Export-driven GDP growth following robust growth in demand

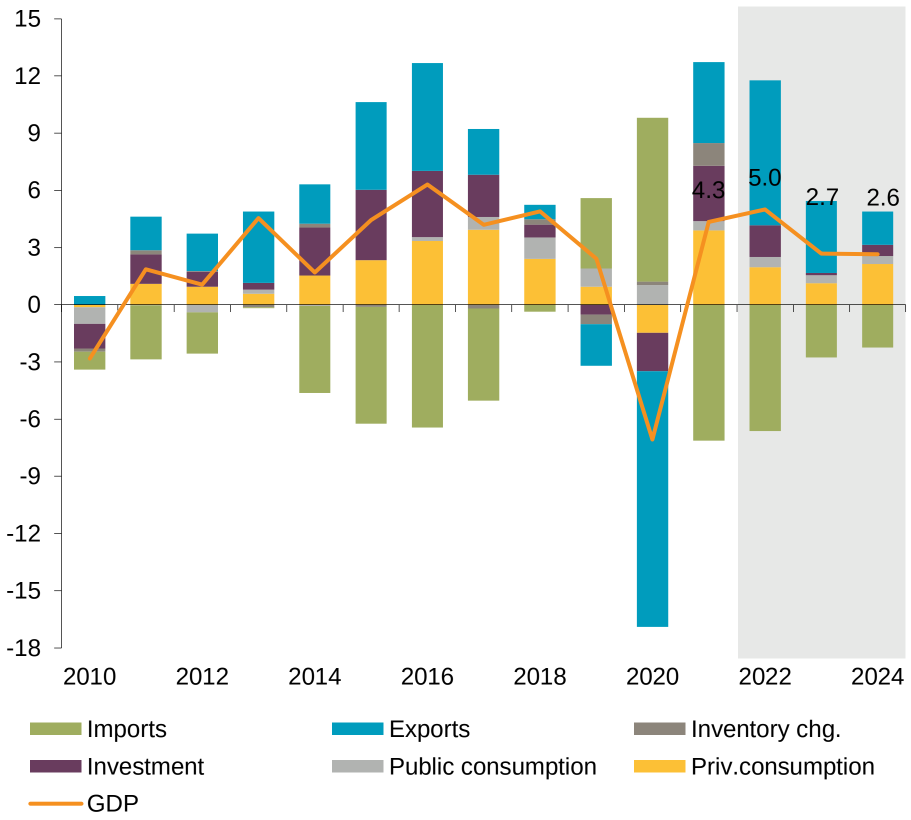
GDP growth rapid in 2022 but slower in coming years

Highlights

- After a 7.1% contraction in 2020, the Icelandic economy recovered strongly in 2021, with GDP growth measuring 4.3%
- Growth was driven mainly by domestic demand. Exports also picked up strongly, albeit outpaced by import growth
- ISB Research (forecast published in May-2022) expects GDP growth at 5.0% in 2022, the fastest growth rate since 2016
- Exports take over from domestic demand as the main catalyst of growth, with a rapid recovery of tourism and an increase in other exports. Growing consumption and investment also fuel GDP growth in 2022
- For 2023, GDP growth is forecast to measure 2.7%, with exports once again the main driver, although growth in exports as well as domestic demand will ease year-on-year
- For 2024, GDP growth is projected at 2.6% as export growth eases further and tighter economic policy and supply constraints slow the pace of growth
- If either or both the Ukraine war and the COVID-19 endgame put severe pressure on the global economy in the coming term, it could weaken the Icelandic economy further ahead

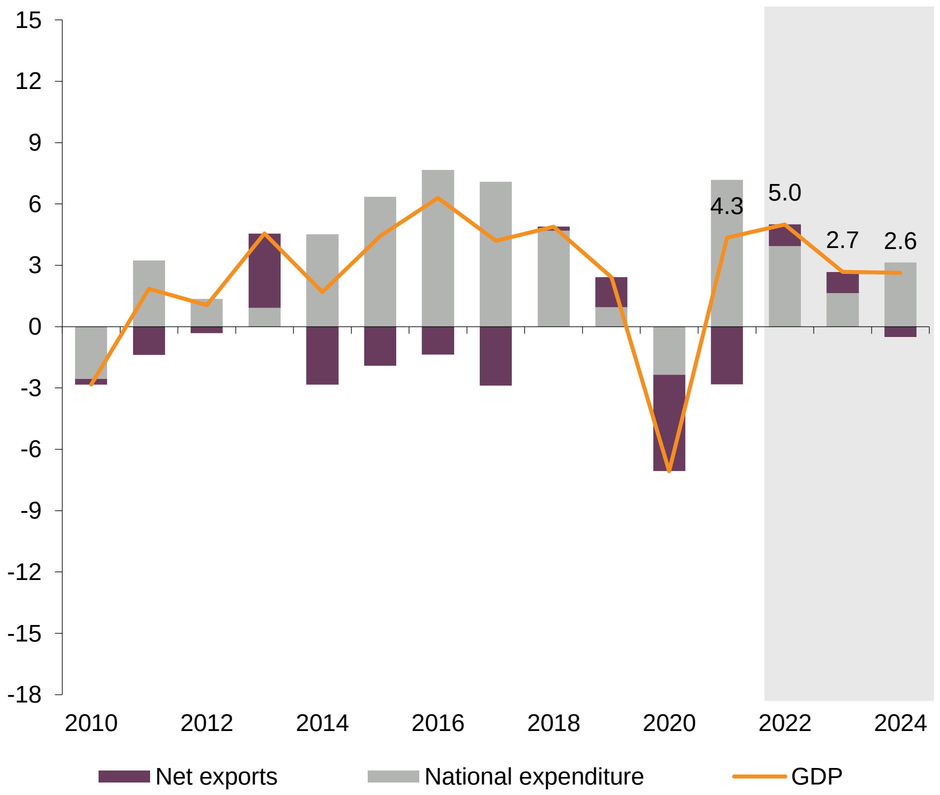
GDP and contribution of its subcomponents

Volume change from prior year (%)



GDP, domestic demand, and external trade

Volume change from prior year (%)



Sources: Statistics Iceland, ÍSB Research.

Tourism recovering swiftly from a two-year drought

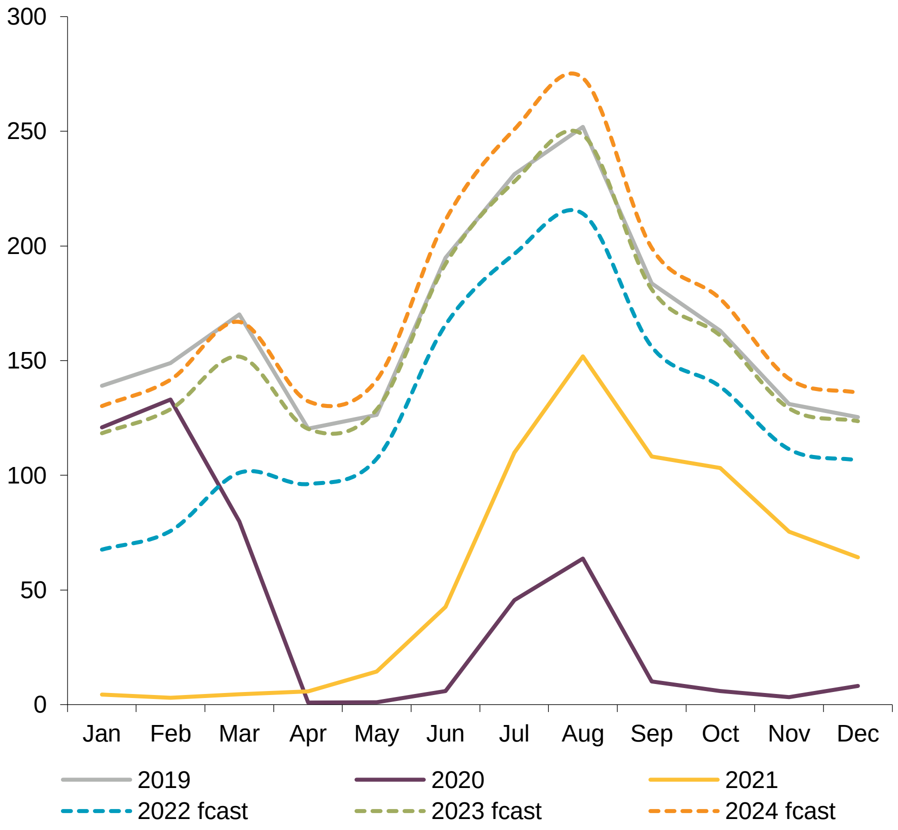
We forecast that 1.5-1.6 million tourists will visit Iceland in 2022

Highlights

- After a turbulent two-year period the tourist sector appears poised for a swift recovery
- 636,000 tourists visited Iceland in 1H of 2022, the largest total for this period since 2019
- Tourism operators are upbeat about the summer and autumn. This year's tourist numbers could come to 80-90% of the 2019 total
- ISB Research expects 1.5-1.6 million tourists this year, about the same number as in the mid-2010s
- Tourist numbers are assumed to rise to 1.9 million in 2023 and 2.1 million in 2024
- The slowdown in growth further ahead is due in part to a higher real exchange rate and the prospect of weaker growth in global demand
- Even though visitors were far fewer in 2021 than before the pandemic, stayed longer and spent more on average in Iceland than they did previously
- Average revenues per tourist will likely continue to be somewhat higher than in the past decade

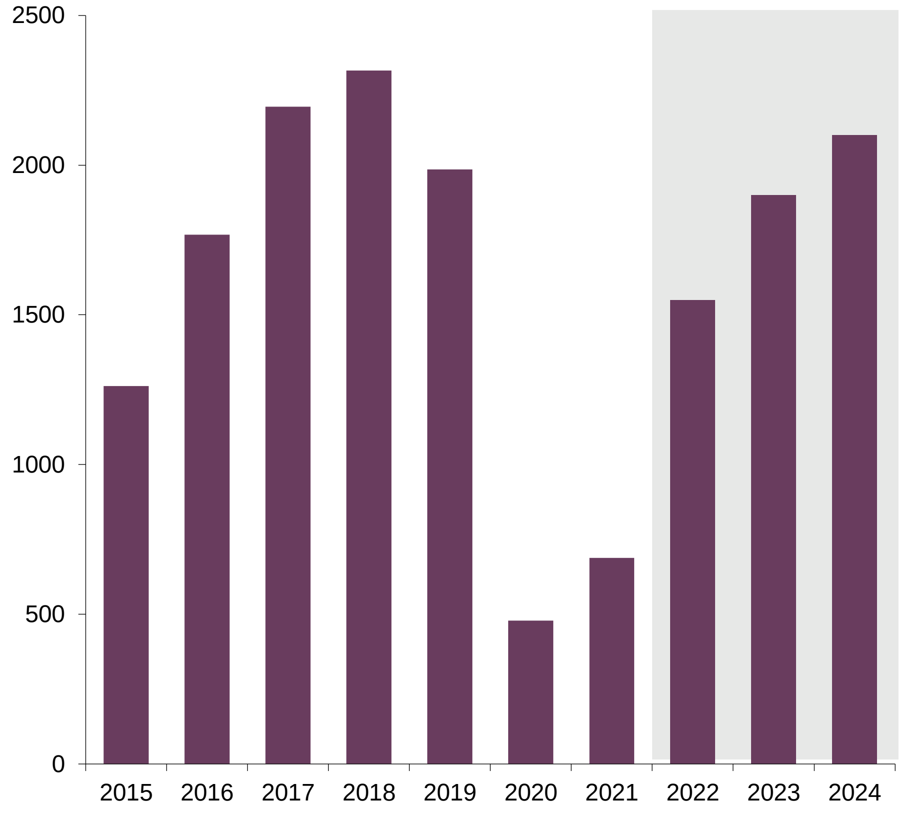
Number of foreign tourists, by month

thousands



Number of foreign tourists, by year

thousands



Sources: Icelandic Tourist Board, ÍSB Research.

Current account balance set to improve in the near term

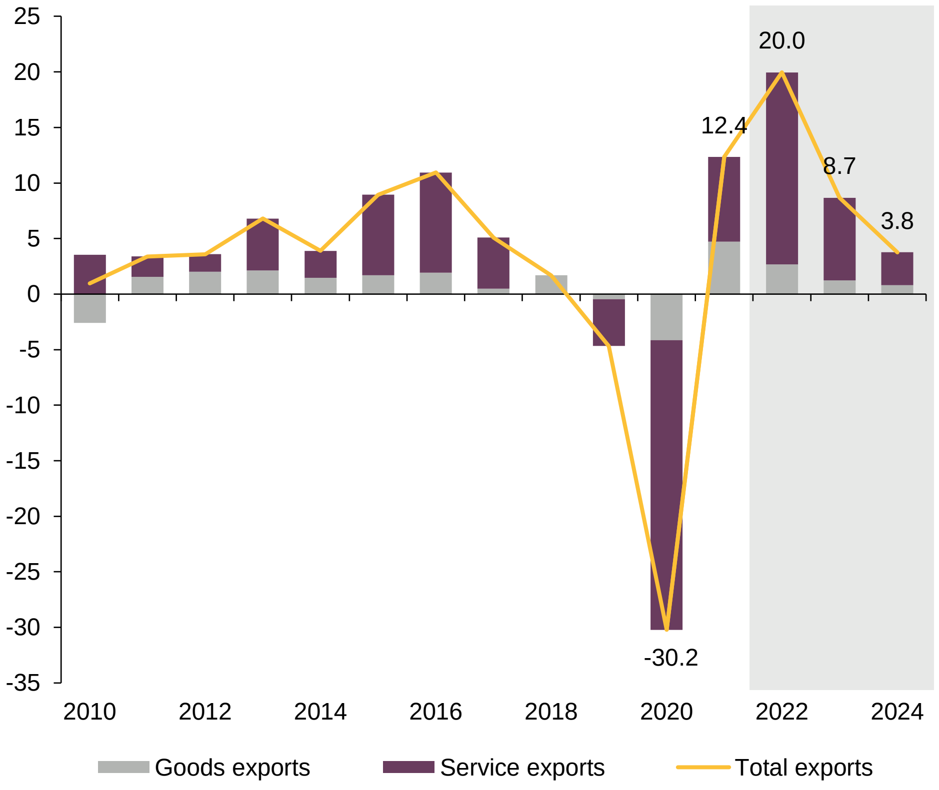
Increased share of exports in GDP growth spurs a recovery of external trade in coming quarters

Highlights

- The rapid recovery of tourism explains a large share of the forecasted 20% export growth in 2022 and just almost 9% growth in 2023
- Furthermore, the outlook is for stronger exports of farmed fish, capelin, aluminium and other industrial goods, and increasingly, intellectual property usage
- The export growth in the abovementioned goods is partly offset by a contraction in exports of groundfish, particularly cod
- For 2021 Iceland recorded a current account deficit of ISK 90.2bn, or 2.8% of GDP. It was the first full-year deficit since 2011
- For 2022, though, the outlook is for the current account to be in balance
- For 2022-2023, a return to current account surplus is expected as export growth outpaces import growth and terms of trade improve somewhat
- Iceland's net external assets currently total just over 4/10 of GDP. This could improve even further during the forecast horizon

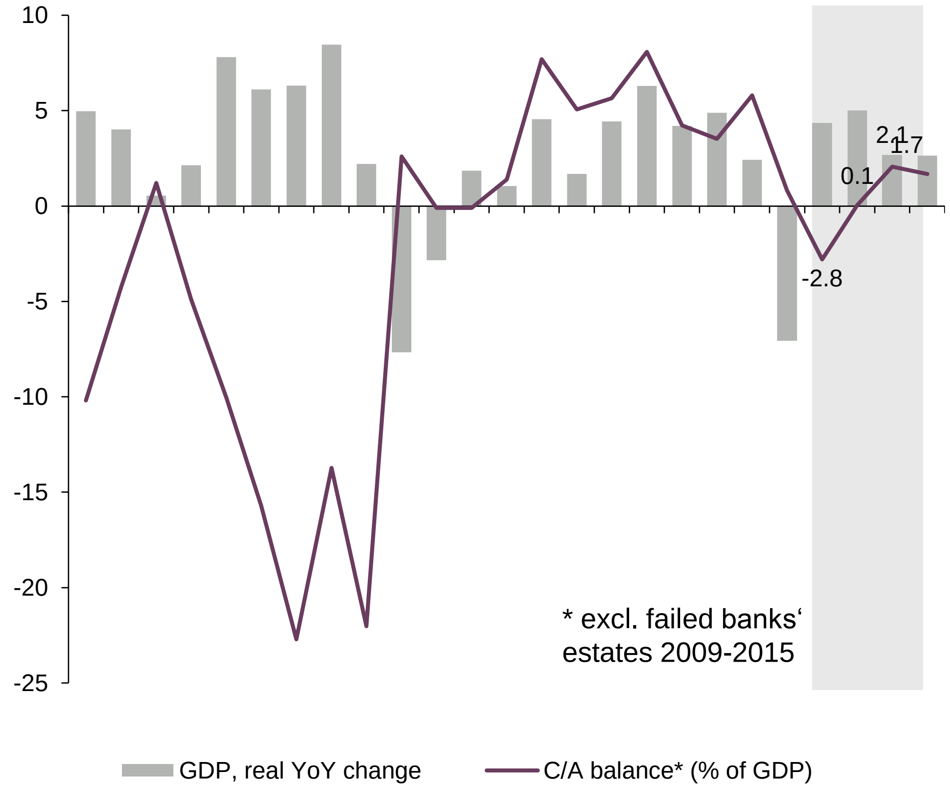
Exports and contribution from subcomponents

% change



Current account balance and GDP growth

% of GDP and % change YoY



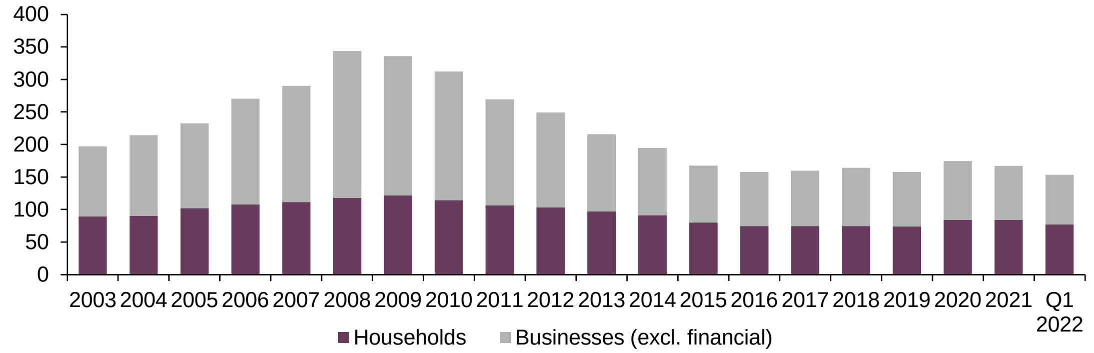
Sources: Statistics Icelandic, Central Bank of Iceland, ÍSB Research.

Domestic balance sheets still healthy

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

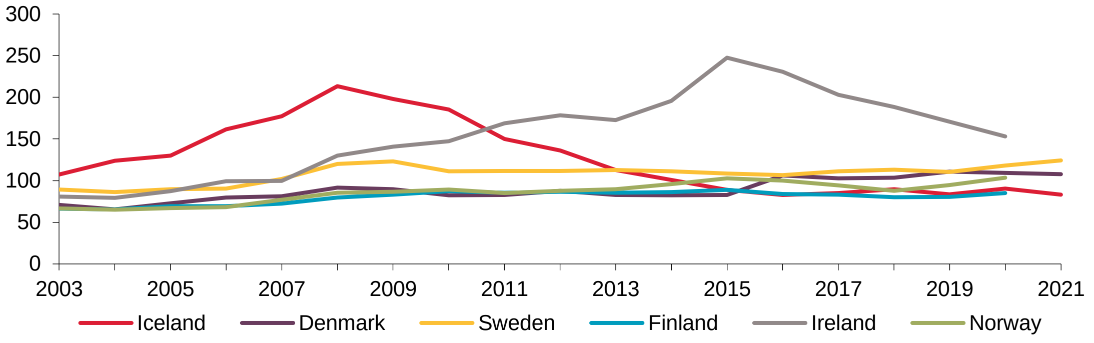
Private sector debt

% of GDP



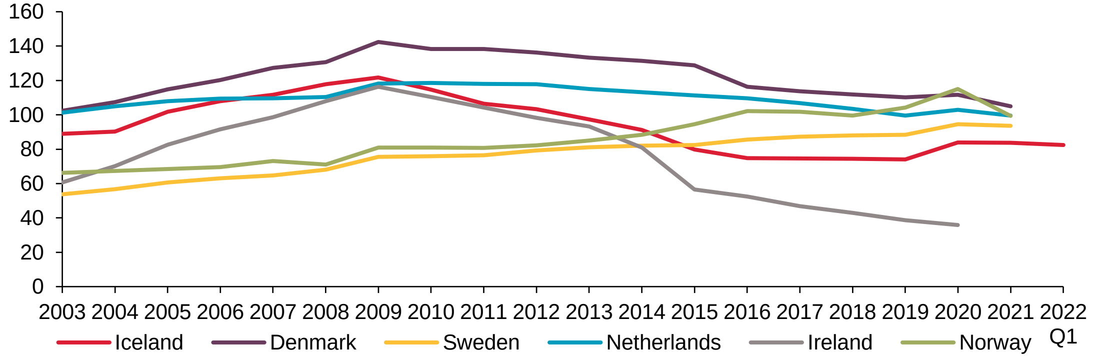
Corporate debt

% of GDP



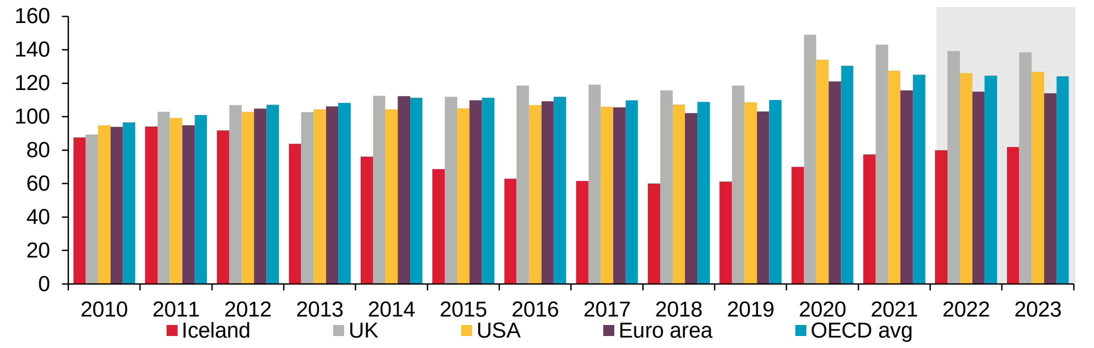
Household debt

% of GDP



General government gross financial liabilities

% of GDP



Shaded areas indicate OECD forecasts.

Source: Central Bank of Iceland, Statistics Iceland, OECD and ISB Research.

Investment growth loses pace after a growth spurt

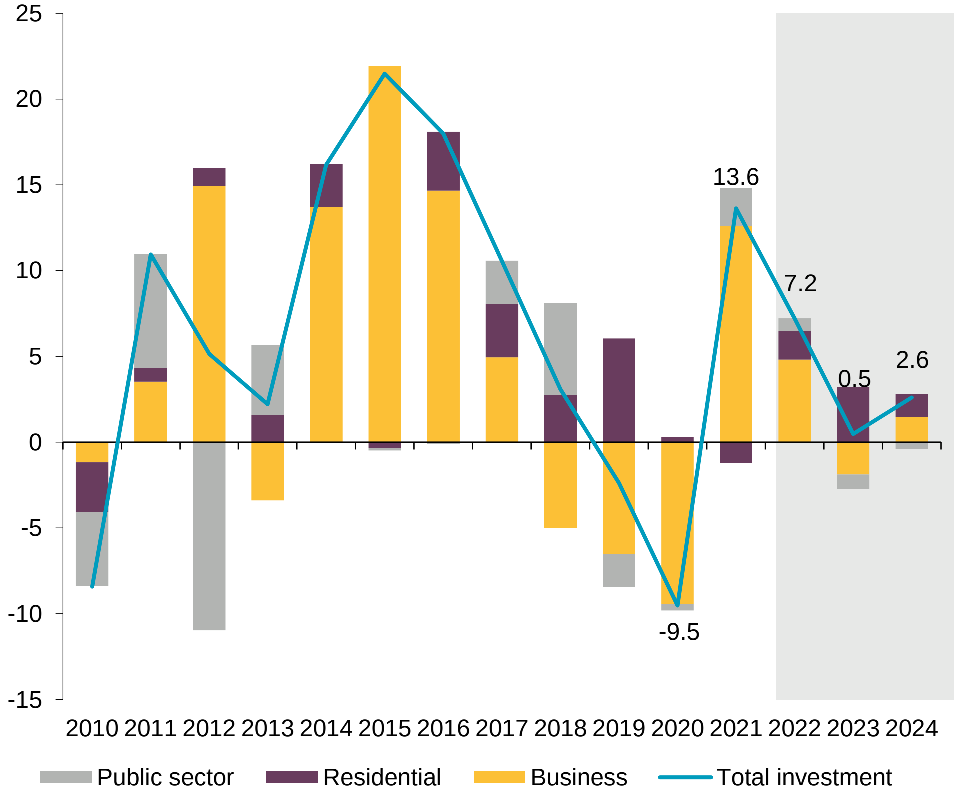
Residential investment to take over from business investment as the driver of growth

Highlights

- After a two-year contraction, investment spiked in 2021, with growth measuring just under 14%, its fastest pace in five years
- Business investment growth was extremely strong, and public investment also grew handsomely, while residential investment shrank by over 4%
- The outlook is for relatively robust growth in business investment in 2022. Residential investment will also pick up again and public sector investment looks sett to increase moderately
- In 2023, residential investment will likely be the sole driver of growth, as business investment looks set to contract because of rising interest rates and bleaker expectations about firms' operating environment
- 2024 will probably see moderate growth in private sector investment coupled with a contraction in public investment
- ISB Research forecasts that total investment will grow by over 7% in 2022, less than 1% in 2023, and nearly 3% in 2024
- The investment-to-GDP ratio will therefore taper off gradually, although investment will be relatively strong in historical context

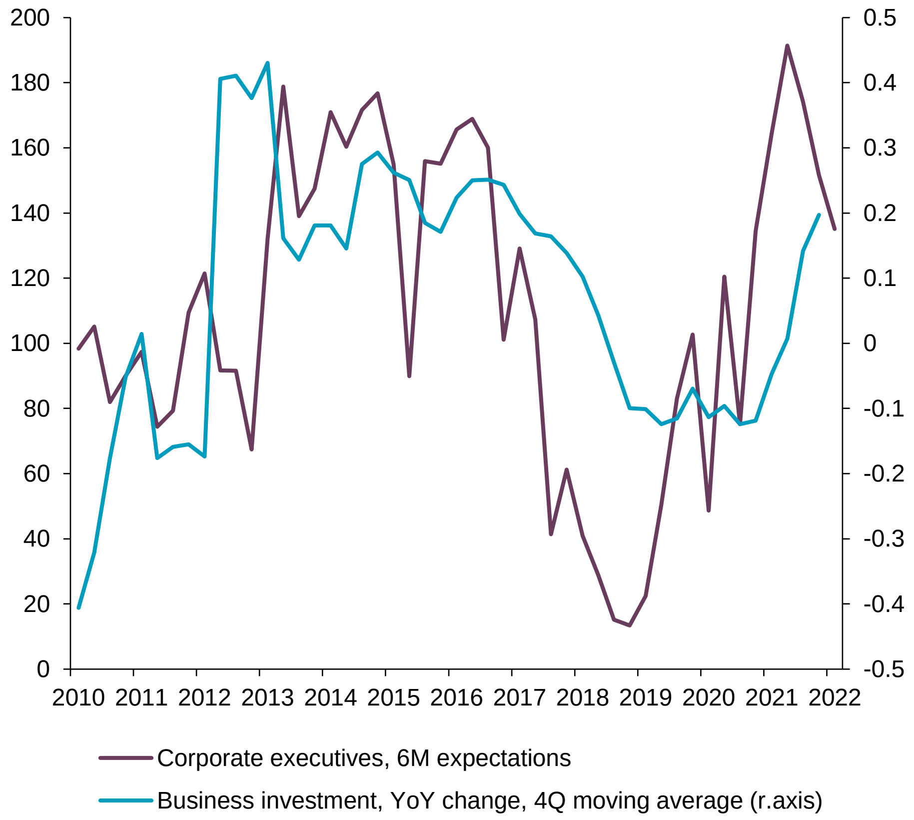
Investment, real change, and contribution of subcomponents

%



Executives' expectations and business investment

Index value (left) and % change year-on-year (right)



Source: Statistics Iceland, Gallup.

Unemployment continues to fall

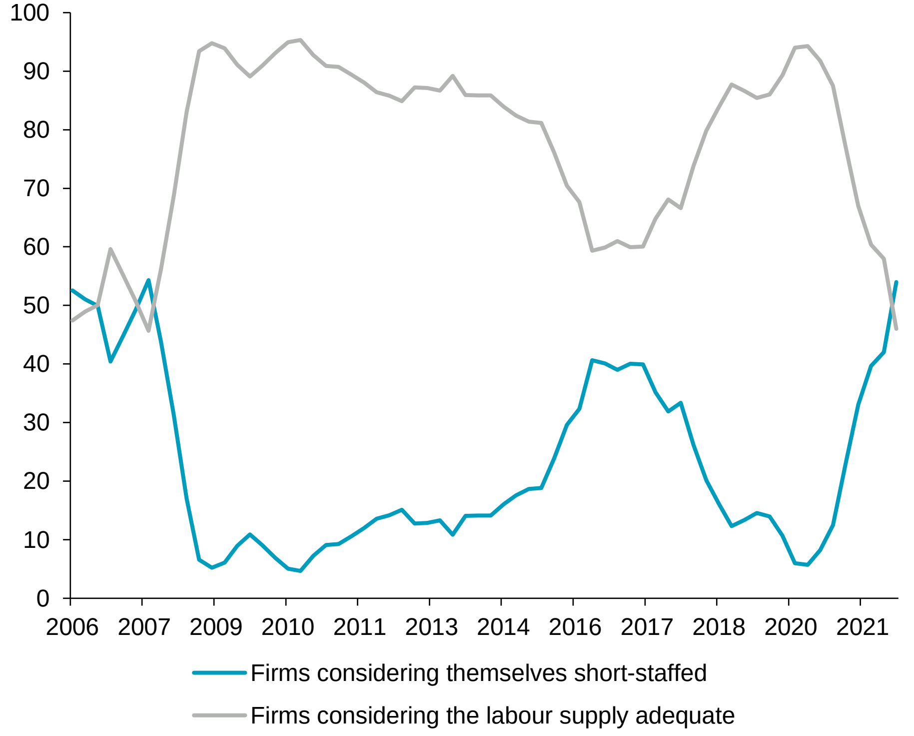
A growing labour shortage will probably be one of the greatest challenges

Highlights

- Unemployment has fallen swiftly after peaking in January 2021as the relatively swift economic recovery in 2021 has fostered job growth
- Registered unemployment measures 3.3% in June 2022 and looks set to fall even further in coming months
- ISB Research forecasts average year-2022 unemployment at 4.4%
- According to a recent Gallup survey, 54% of company executives consider themselves short-staffed
- Construction and tourism companies in particular envision adding on staff
- As foreign workers have been prominent in these sectors, labour importation is likely to increase markedly this year
- Unemployment seems likely to fall to a new equilibrium in the coming term, averaging 3.7% in 2023 and 3.6% in 2024, which will bring it back to the 2019 level

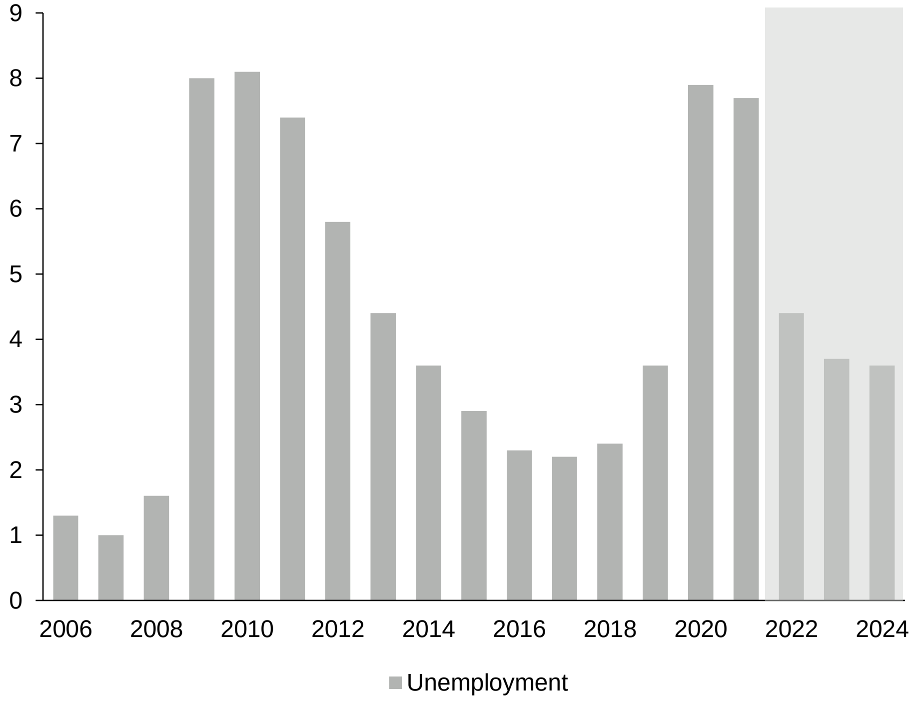
Labour supply according to corporate executives

%



Unemployment[1]

% of workforce, annual average



1. Excluding recipients of part-time unemployment benefits. Source: Statistics Iceland, The Central Bank of Iceland, Gallup.

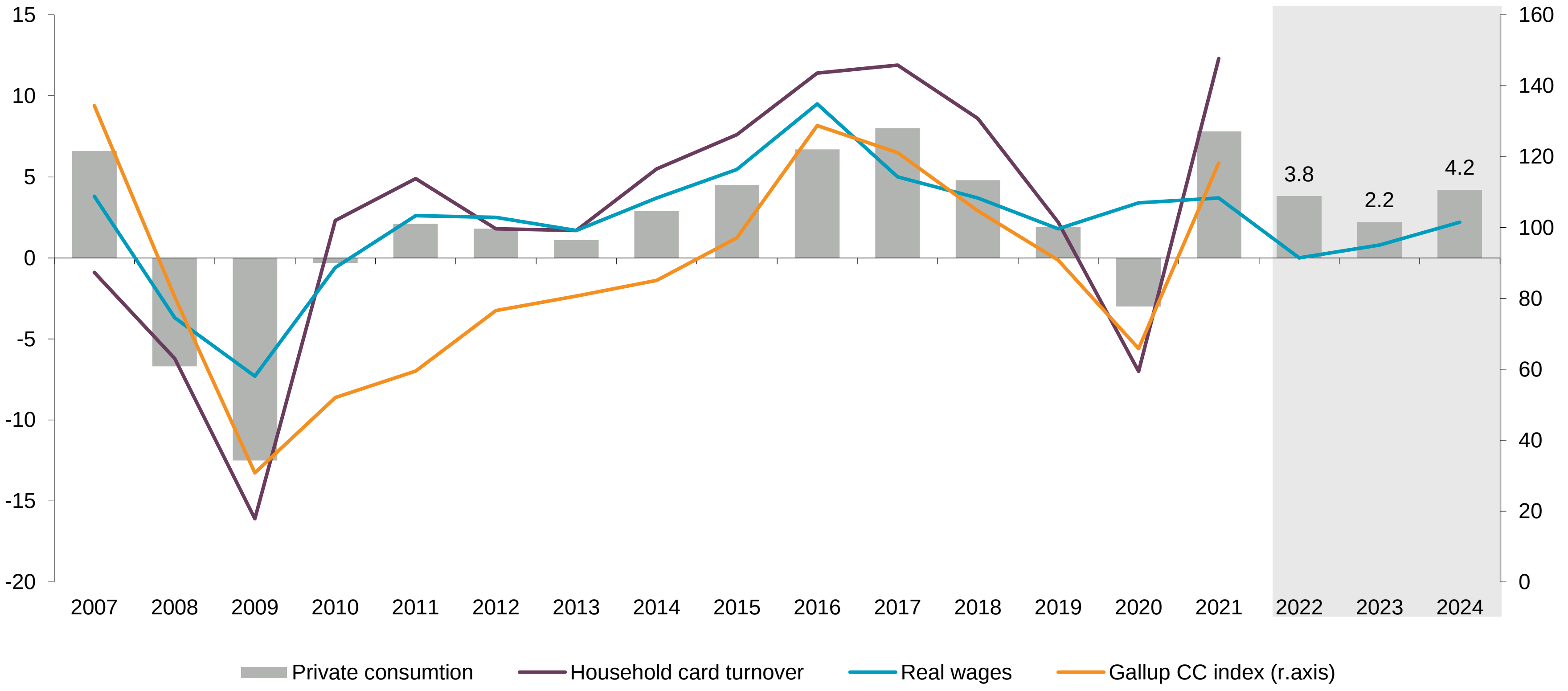
Inflation erodes household purchasing power

Private consumption growth will be weaker in the near term as a result

Highlights

- Private consumption rallied last year, growing by 7.6% YoY, after contracting by 3% in 2020
- In real terms, private consumption was 4.4% more in 2021 than in 2019, indicating that Icelanders have more than recovered their pre-pandemic consumption level
- Private consumption is estimated to have increased by 8.8% YoY in 1Q2022, which can largely be attributed to increase in travel and direct purchases abroad by resident households
- Relevant indicators, such as card turnover and real wage growth suggest a relatively strong 2Q2022 as well
- But as the year advances, private consumption growth will probably lose momentum due to declining optimism among households and both inflation and higher rates eroding their purchasing power
- Real wage growth is likely to be halted by a inflation spike in 2022, but assumed to return slowly in coming years
- Households are well positioned, though, and have accumulated significant savings which will probably help sustain private consumption growth for the rest of the year
- Private consumption growth is forecast at 3.8% in 2022, 2.2% in 2023 and 4.2% in 2024

Private consumption and related indicators
% change year-on-year (left) and index value (right)

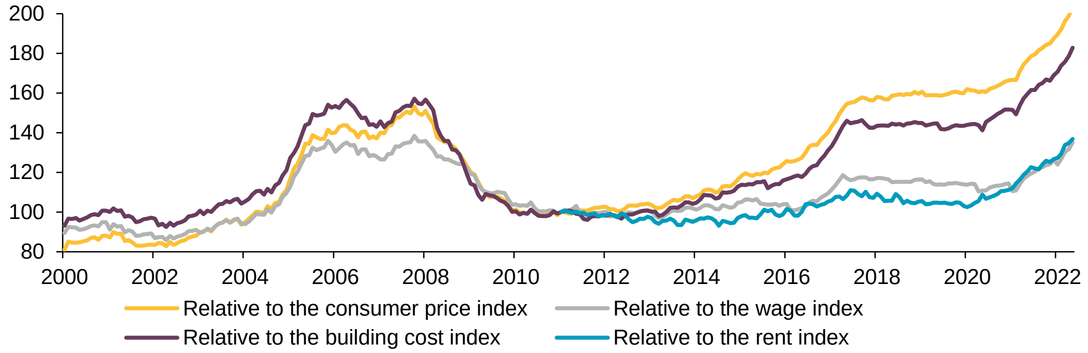


Sources: Central Bank of Iceland, Gallup, Statistics Iceland, ÍSB Research.

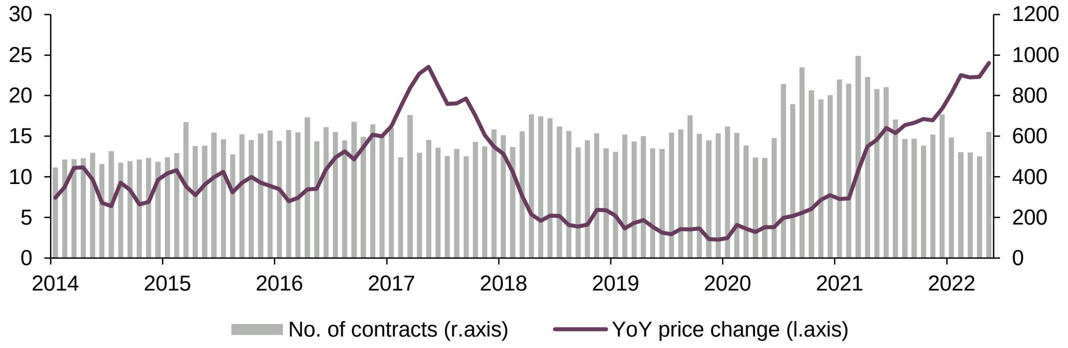
Real estate markets still buoyant

Commercial property prices rising again while residential house price rises have gained steam

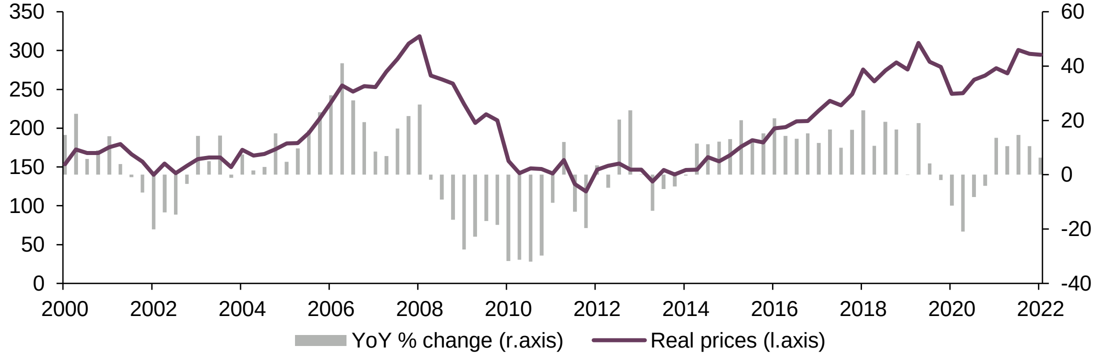
Capital area house prices relative to macroeconomic fundamentals
Index, January 2011=100



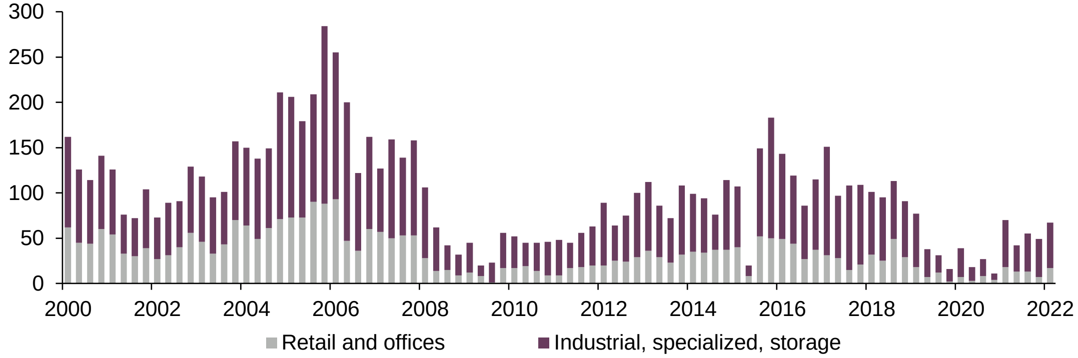
Residential house prices and turnover in greater Reykjavik
% change (l.axis) and number (r.axis)



Commercial property real prices in greater Reykjavik
Index, 1995=100 (l.axis) and % change (r.axis)



Commercial real estate market activity
No. of registered purchase agreements



Source: The Central Bank of Iceland.

Inflation to spike in autumn 2022

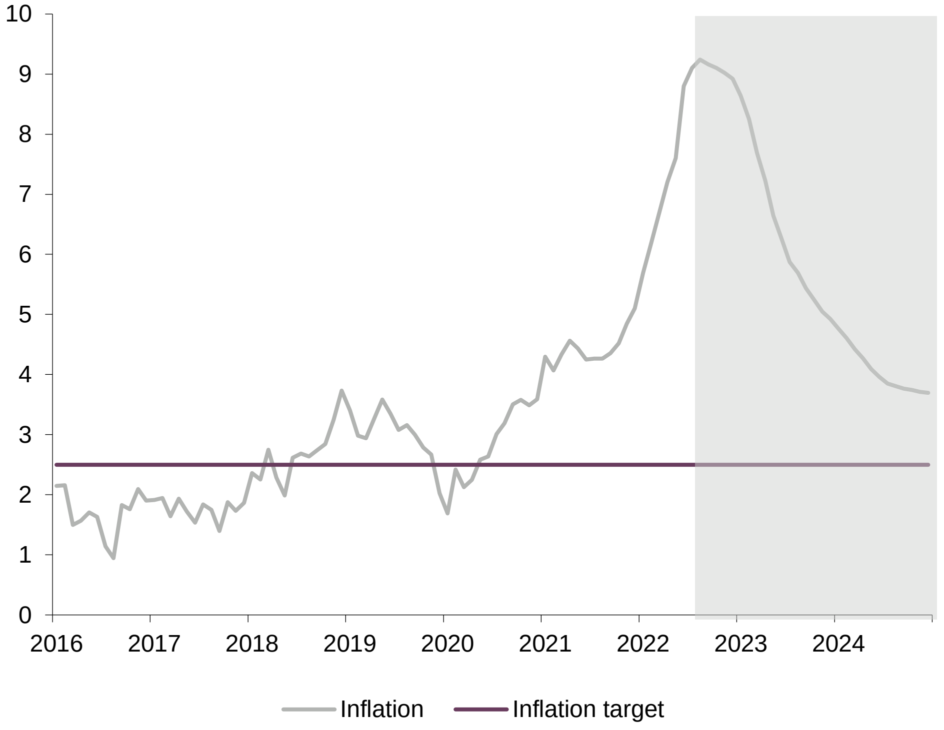
House prices and import costs the main drivers short-term but wage costs also matter

Highlights

- Inflation started rising in mid-2020, in the wake of the Corona Crisis and the depreciation of the ISK
- Rising import costs due to pandemic-related supply/demand imbalances and, more recently, the Ukraine war have been partly offset by ISK appreciation
- Rapid house price increases play an outsized role in recent inflation increase due to inclusion in SI inflation measurement
- In June inflation reached a 13 year peak of 8.8%
- Inflation has proven more persistent than expected, but ultimately it will fall
- ÍSB Research expects inflation to average 8.1% in 2022, 6.4% in 2023, and 4.1% in 2024
- The forecast assumes that the ISK will appreciate in coming quarters. On the other hand, inflationary pressures from wages and/or house prices could turn out stronger than anticipated
- Furthermore, imported inflation could turn out higher if price hikes abroad continue unabated

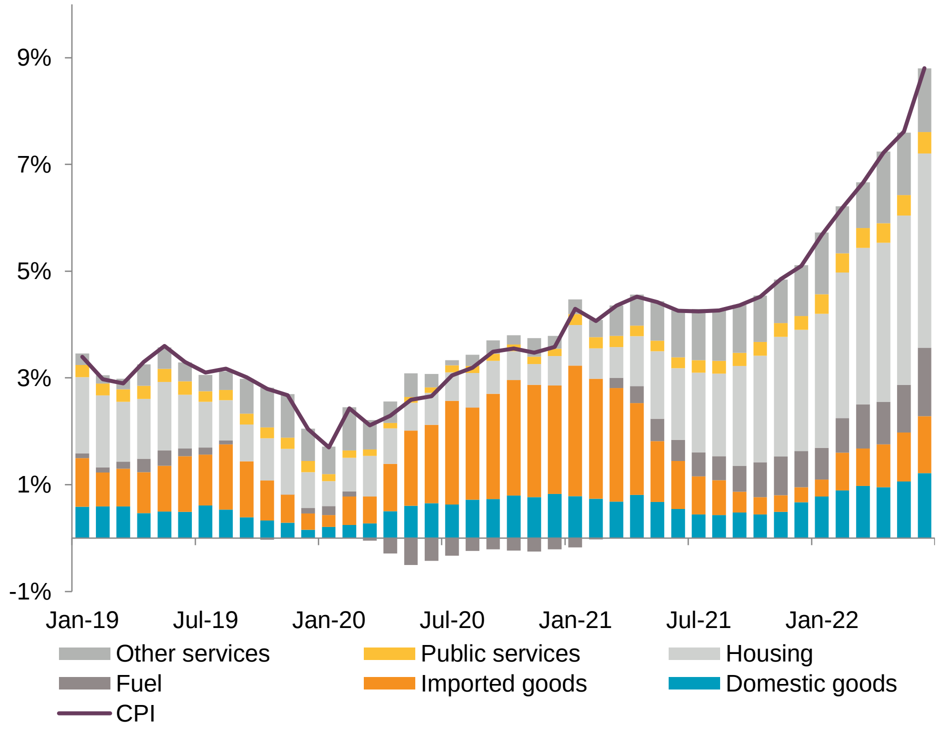
Inflation and the CBI inflation target

%



Inflation by contribution of main categories

%



Sources: Statistics Iceland, ÍSB Research.

Policy rate to rise rapidly throughout 2022

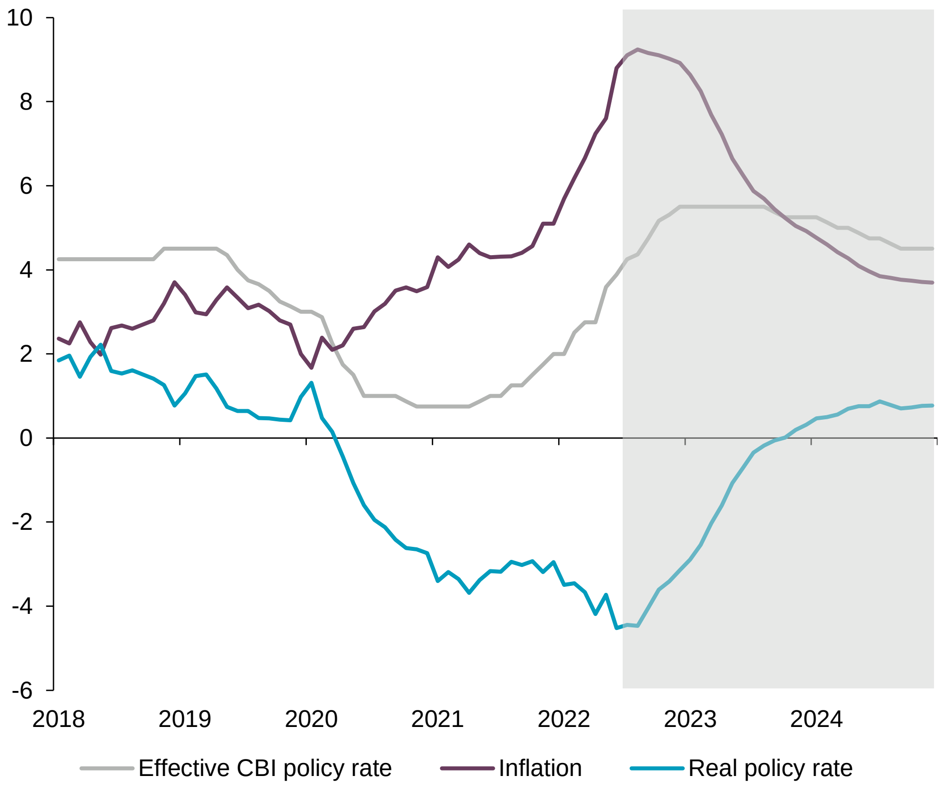
Gradual easing further ahead; equilibrium rate in sight by the end of the horizon

Highlights

- The Central Bank of Iceland has hiked its policy by 4 percentage points since May 2021, after reaching an all-time low of 0.75% in 4Q2020
- The policy rate is now 4.75%, its highest since 2Q2017. The real policy rate remains negative, however
- Further steep rate hikes are expected in the near future, so as to rein inflation in, keep inflation expectations under wraps, and push the real policy rate above zero
- We forecast that the policy rate will continue to rise swiftly, peaking at 5-6% by end-2022 before declining gradually from 2H2023 onwards
- Long term nominal rates are likely to remain elevated during the policy rate hike cycle, then decrease moderately
- Long term real rates, currently around the 1% mark, are expected to rise gradually in coming quarters

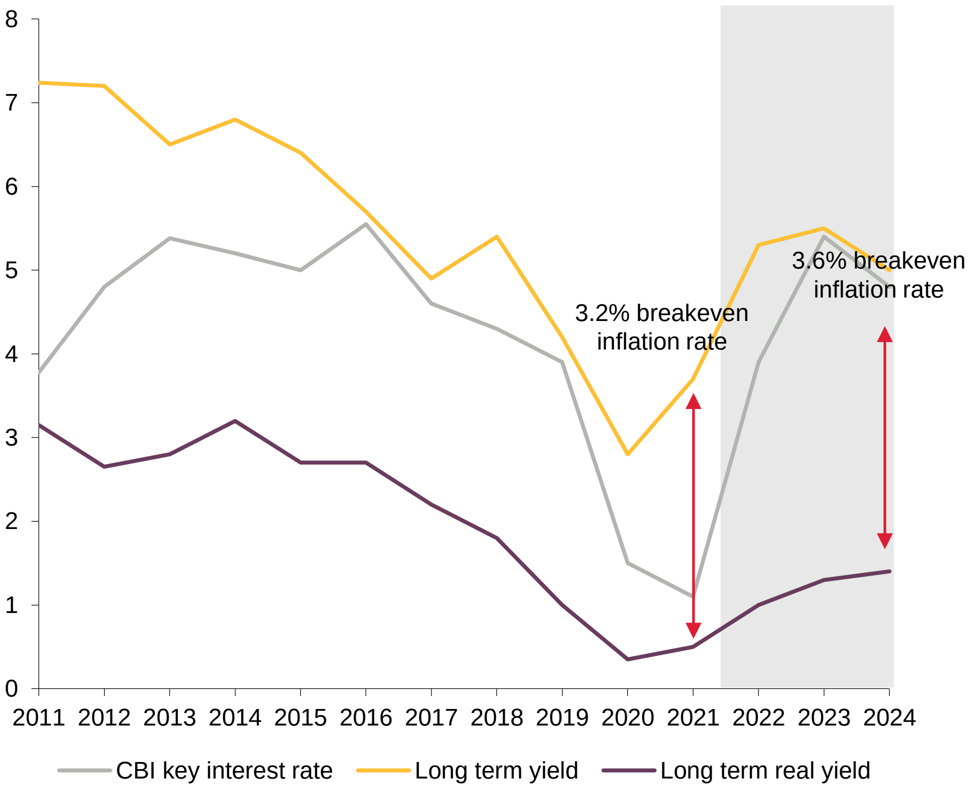
Policy rate and inflation

%



Interest rates

%



Sources: Central Bank of Iceland, Kodiak, Statistics Iceland, ÍSB Research.

ISK likely to appreciate further

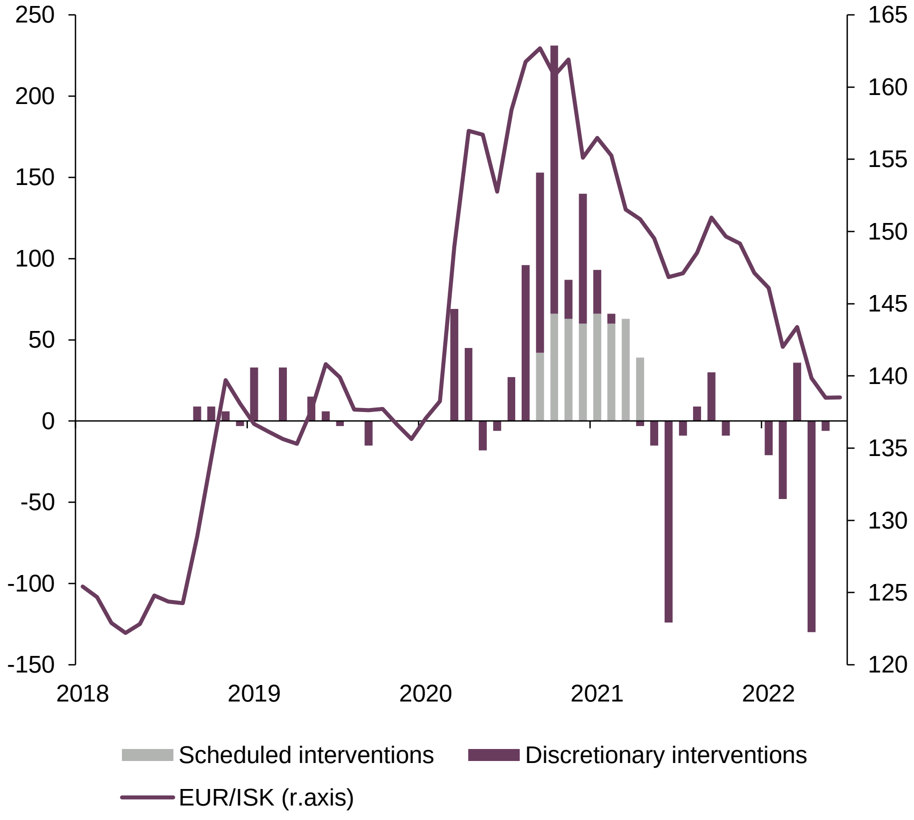
CA surplus and inflows for securities purchases offset pension funds' foreign investments

Highlights

- Following nearly 3% appreciation in 2021, the ISK strengthened further by just over 5% in 1H2022
- The CBI steadily scaled down its FX market intervention over the course of 2021
- Increased ISK volatility in the first third of 2022 led to the CBI stepping up FX interventions once more, mainly leaning against short-term appreciation trends
- Improving C/A balance outlook, rising interest rates, Iceland's strong IIP, solid growth outlook and limited non-residents' securities holdings all weigh in favour of stronger ISK in the medium term
- Increasing foreign investment by pension funds and possible CBI FX reserve purchases may weigh against ISK strengthening
- It is impossible to pinpoint how the appreciation will materialise, but ISB Research's forecast assumes that the ISK will be about 5% stronger at the end of the forecast horizon than at the end of June 2022
- The real exchange rate in terms of relative consumer prices will then be similar to that in 2018

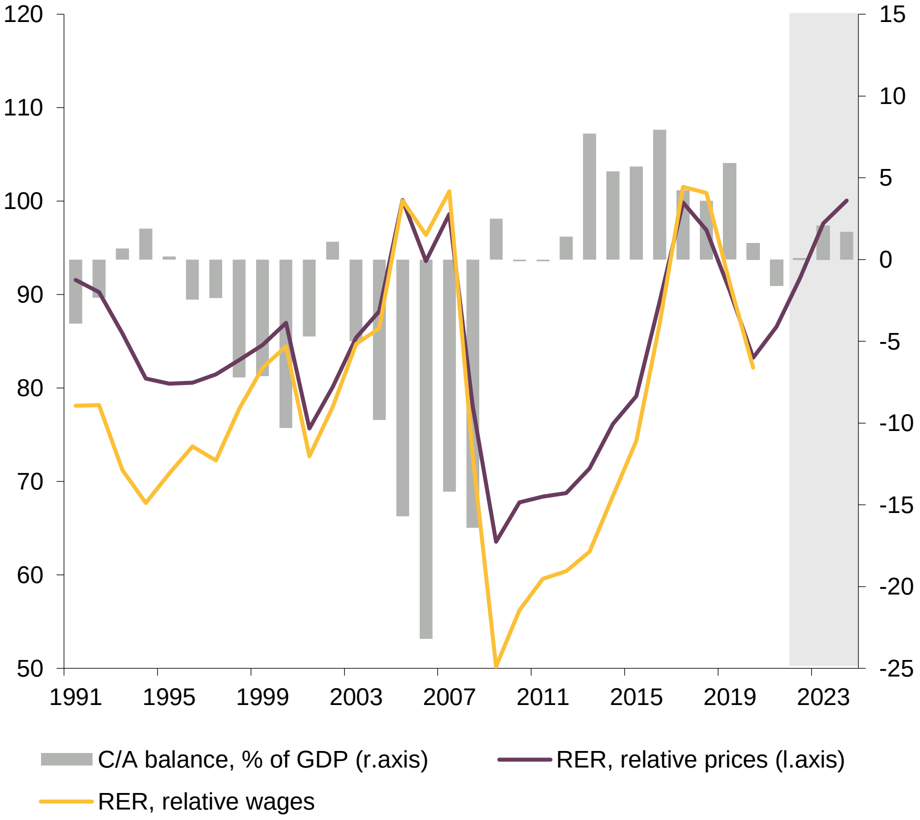
ISK exchange rate and CBI FX market intervention

EUR m (left) and EURISK (right)



Real exchange rate and current account balance

Index and % of GDP



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Source: Statistics Iceland, The Central Bank of Iceland, ISB Research.

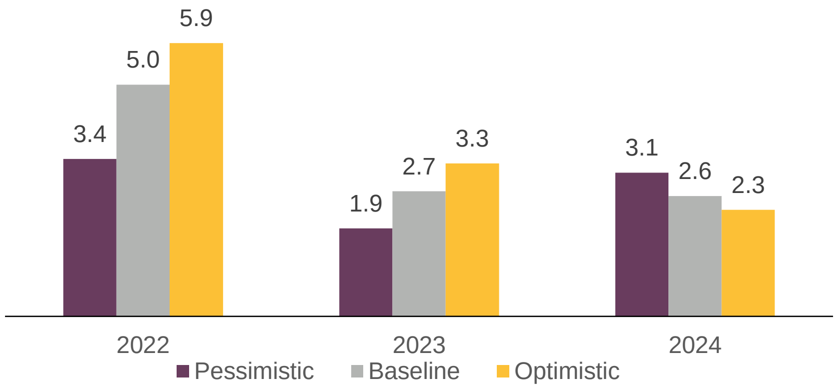
Alternative scenarios demonstrate impact of key uncertainties

COVID-19, war in Ukraine and upcoming wage negotiations could have significant impact

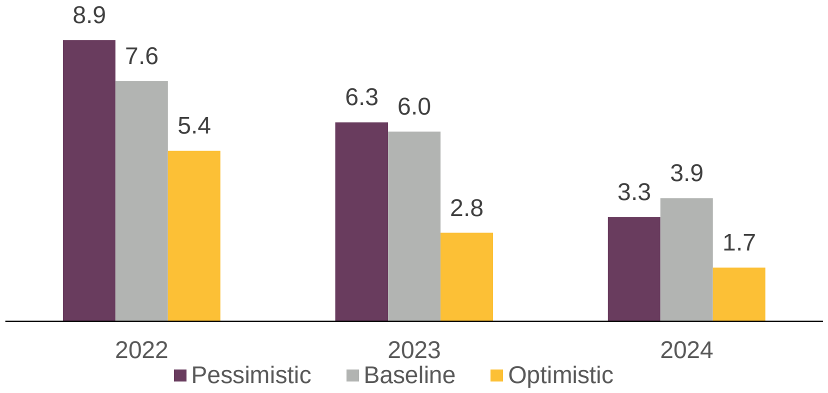
Highlights

- The economic outlook for Iceland, like the global outlook, has fluctuated widely in recent quarters
- ISB Research has identified three major sources of uncertainty for the near-to-medium term economic development:
  - The war in Ukraine
  - COVID-19 developments
  - Upcoming private sector wage negotiations in 4Q2022
- An optimistic scenario assumes a more favourable outcome for those factors than the baseline forecast while the opposite is true in the pessimistic scenario
- It is assumed that there is roughly a 10% probability of a more favourable outcome than the optimistic scenario and the converse holds for the pessimistic one
- GDP growth could prove 1.2% higher in 2022-2024 than baseline if those three factors develop relatively favourably
- Should the three factors prove more challenging, GDP growth could prove 1.9% lower in the period
- It should be noted that the pessimistic scenario is not a stress scenario, and it is possible to sketch out a more unfavourable path than is done here

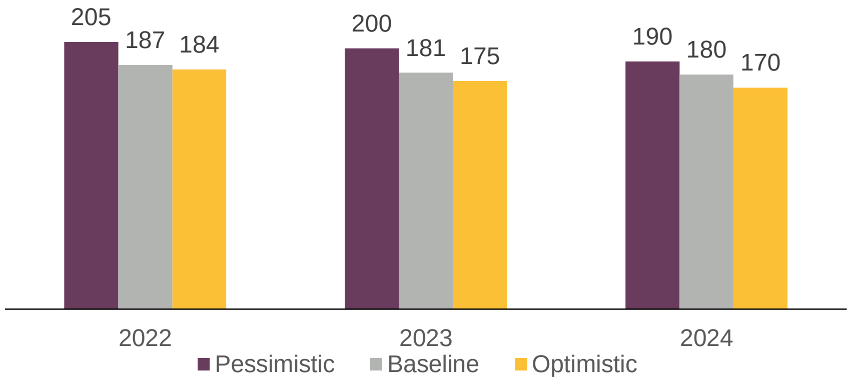
GDP growth, %



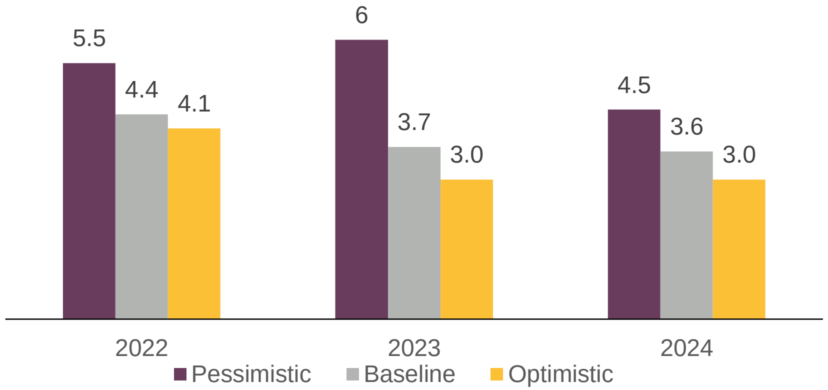
Inflation, %



Trade-weighted exchange rate index



Unemployment, % of labour force

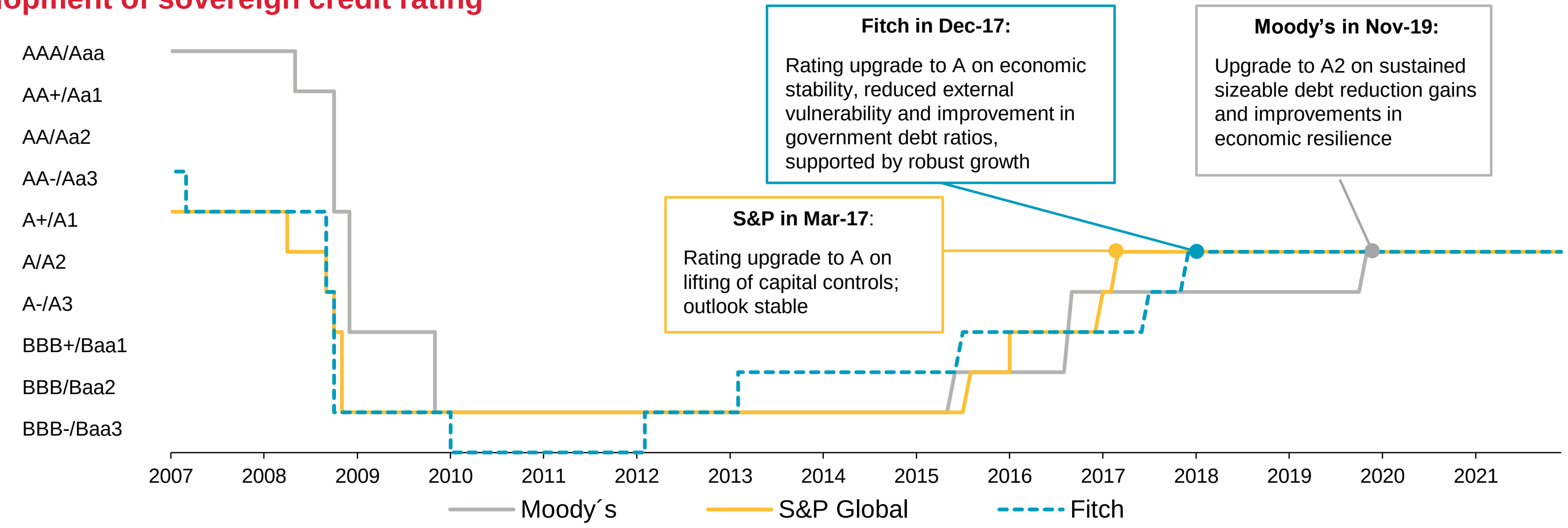


Sources: Islandsbanki Research forecast.

Iceland’s credit rating has remained at A

Rating companies acknowledge the flexibility of the economy and resilience to the pandemic shock

Development of sovereign credit rating



MOODY’S IN AUGUST 2021

- “The credit profile of Iceland is supported by its wealthy and flexible economy with favourable demographics that support its long-term growth prospects. Current-account surpluses have contributed to a net external creditor position and large foreign-currency reserves.”
- “The credit profile is mainly constrained by the economy’s small size and concentration in a limited number of sectors, which increase its vulnerability to shocks and cause volatility in growth.”

FITCH IN APRIL 2022

- Rating affirmed at A with a stable outlook
- “Iceland’s ‘A' rating is driven by its very high income per capita, very strong governance, human development and doing business indicators that are more consistent with those of 'AAA' and 'AA' rated countries”
- “The revision of the Outlook to Stable reflects the resilience shown by the Icelandic economy to the pandemic shock and Fitch Ratings’ expectation of a sustained growth recovery, which should facilitate a fiscal deficit and debt reduction over time.”

S&P IN MAY 2022

- “The stable outlook indicates S&P‘s expectation that Iceland's economy will continue to recover and remain relatively unaffected by the war in Ukraine.”
- “The agency believes fiscal deficits will continue to decrease over the next few years, stabilizing the debt to GDP ratio net of liquid assets.”
- “At the same time, ample foreign reserves will enable the CBI to deal with external pressures or exchange-rate volatility, should they occur.”

Source: Moody’s, S&P, Fitch Ratings and Central Bank of Iceland.

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28 July 2022

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