1Q22
Financial Results

5 May 2022

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Chief Executive Officer

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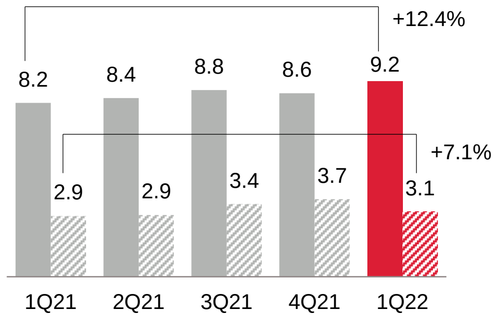
islandsbanki.is

Delivering on financial targets and guidance

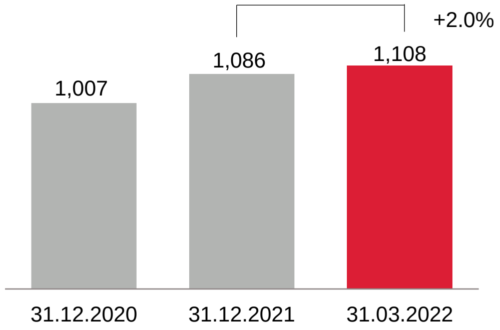
Operating income increased by 8.7% in 1Q22 (YoY) and costs were flat despite high inflation

Growth in line with guidance

NII and NFCI, ISKbn

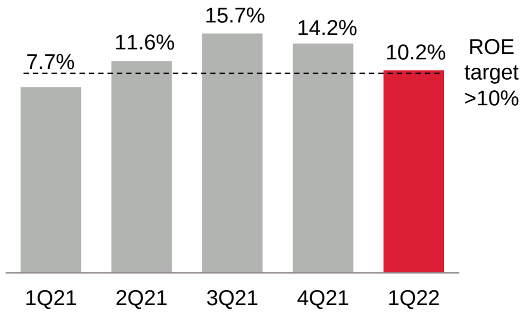


Loans to customers, ISKbn

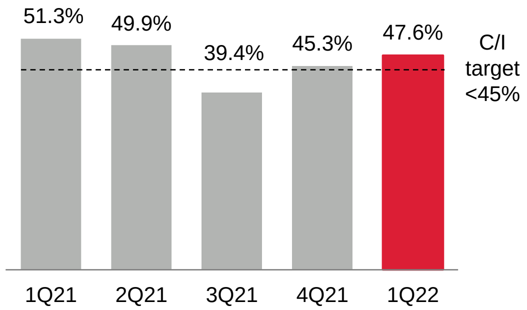


ROE in upper range of guidance

ROE

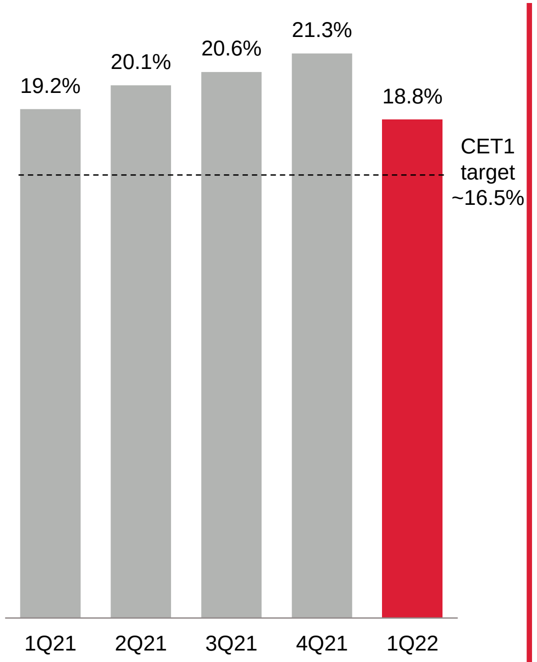


C/I ratio



Excess capital optimised in the next 12-24 months

CET1 ratio[1]



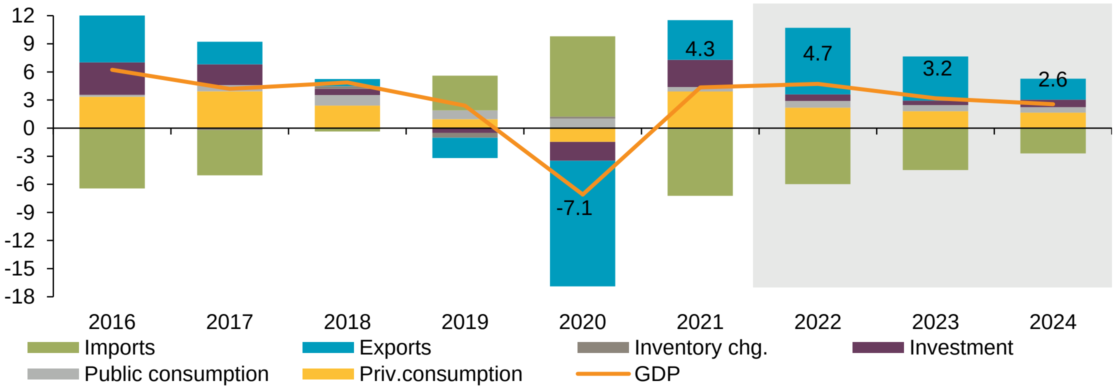
1. Including first quarter profit for 1Q22 and third quarter profit for 3Q21

Economic recovery continues

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

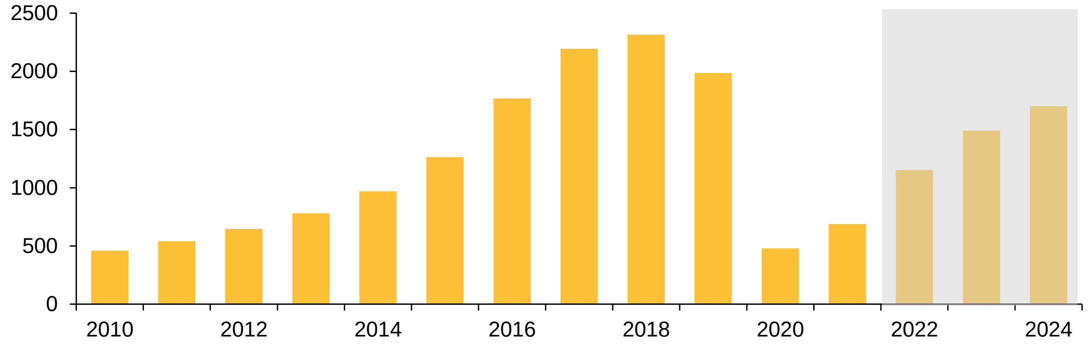
Exports replace domestic demand as the key catalyst of healthy GDP growth..

Real GDP and main subitems, YoY change, %



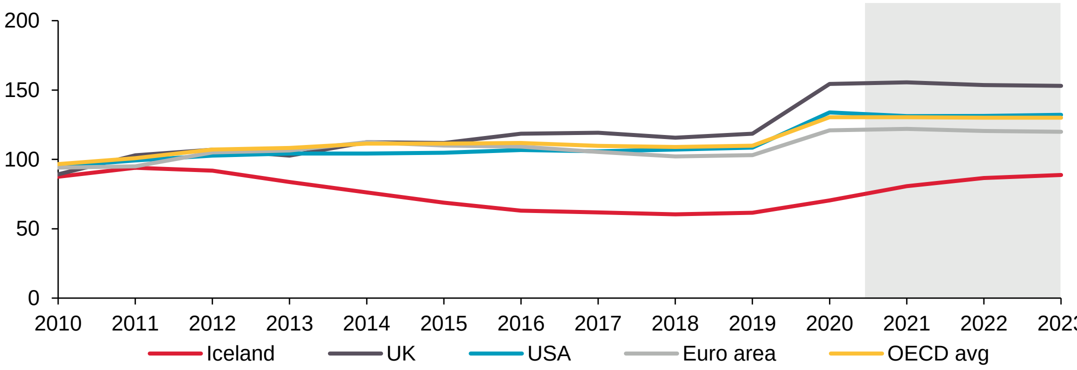
...as tourism rebounds due to fading pandemic impact

Number of foreign tourists per year, thousands



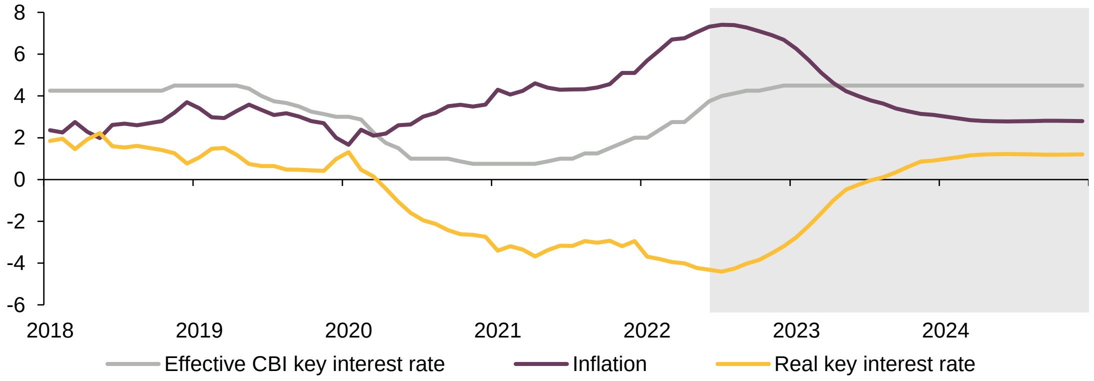
Government finances remain on a sustainable path post-pandemic..

General government gross debt as % of GDP



...and monetary policy normalises as inflation peaks and economy recovers

Inflation and policy rate, %



1. Shaded areas indicate ISB Research forecasts. 2. Source: Statistics Iceland, the Central Bank of Iceland and ISB Research

An eventful first quarter of 2022

Strong ROE in all business units

Personal Banking

- **10.3%** ROE
- **60.3%** Cost-to-income ratio
- **2.6%** NIM

Market share
31% individuals[2]

NPS ranking
#2 vs domestic peers[2]

- Continued growth in mortgages lending
- New sales platform where retail and SME customers can now check out products in seconds

Business Banking

- **20.2%** ROE
- **44.6%** Cost-to-income ratio
- **5.2%** NIM

Market share
37% Iceland[3]

NPS ranking
#1 vs domestic peers[3]

- Good lending activity with 2.8% growth from YE21
- 95% of SME customers now app users

Corporate & Investment Banking

- **11.0%** ROE
- **40.7%** Cost-to-income ratio
- **2.8%** NIM

Market share
35% Iceland's largest companies[4]

NPS ranking
#1 vs domestic peers[4]

- Highest share of combined turnover in listed bonds and equities in Iceland

Iceland Funds

- **27.5%** ROE
- **49.0%** Cost-to-income ratio[1]

Market share
30% Domestic mutual funds[5]

AUM
ISK 413bn

- EQUUS fund continued with the highest return of all funds at the end of 1Q22

Sustainability

- Publication of initial financed emissions
- New sustainable savings account
- NIB and Íslandsbanki signed a EUR 79m loan for green and SME lending
- Íslandsbanki issued a EUR 300m 0.75% fixed rate senior preferred sustainable
- Íslandsbanki and its employees held a fundraising for the Red Cross Emergency Fund
- Nordic CEOs for a Sustainable Future publish Diversity & Inclusion Guide

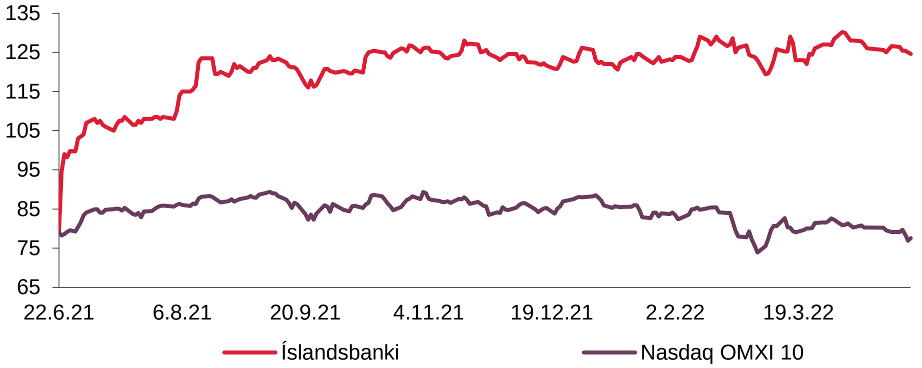
1. As calculated from the Bank's Consolidated Income Statement 2. Gallup Iceland Internet-panel survey age 18+, rolling average 12 months conducted for Islandsbanki. 3. Gallup Iceland telephone/internet survey among companies with +4 employees in Iceland as of December 2021 conducted for Íslandsbanki. 4. Gallup Iceland telephone/internet survey among 300 largest companies in Iceland December 2021 conducted for Islandsbanki.
5. Market share of Icelandic fund management companies as of 31.12.2021

Strong and more diversified shareholder group

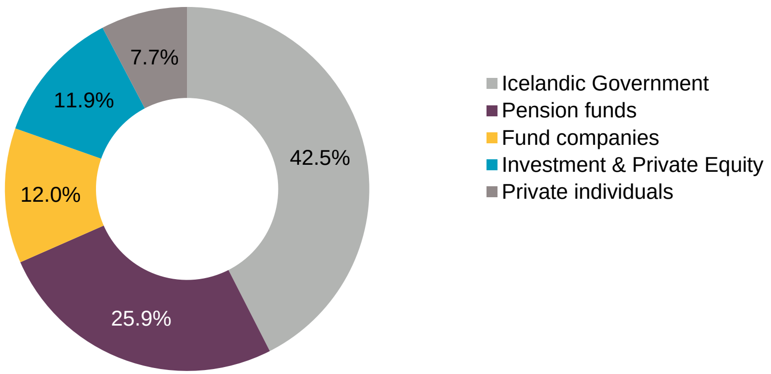
Icelandic government sold a 22.5% stake at the end of March

Íslandsbanki's share price development since IPO

Closing price



Shareholder composition



Largest shareholders

31.3.2022

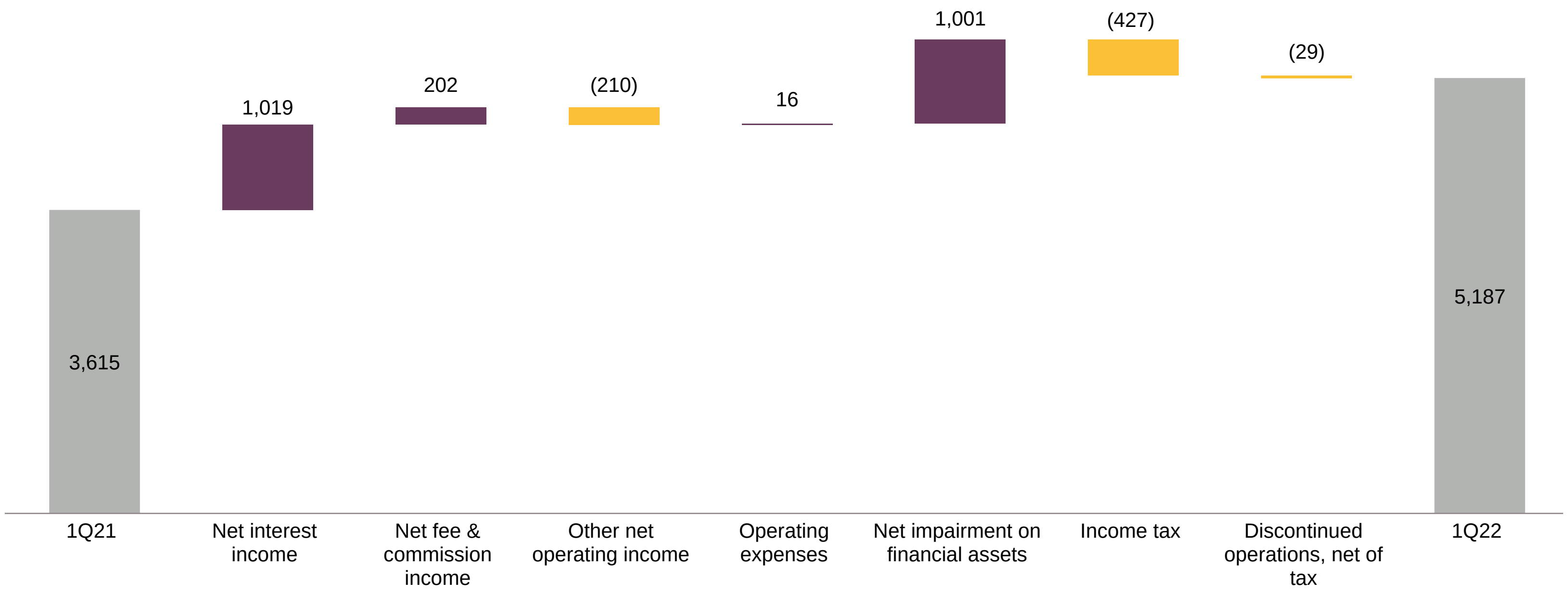
Largest shareholders	Capital
The Icelandic Government	42.5%
LSR Pension Fund	6.0%
Gildi Pension Fund	5.1%
Capital Group	5.1%
Live Pension Fund	4.6%
Brú Pension Fund	2.0%
Arion Banki hf.	2.0%
Stapi Pension Fund	1.6%
Iceland Funds	1.6%
Landsbankinn hf.	1.5%
RWC Asset Management LLP	1.3%
Lífsverk Pension Fund	1.2%
Jakob Valgeir ehf.	1.0%
Frjálsi Pension Fund	1.0%
Other shareholders	23.6%
	100.0%

Financial overview

Good performance in 1Q22 supported by an increase in NII

Flat expenses and reversed impairments further enhance a positive result

Profit for the period – 1Q21 vs 1Q22
ISKm



NII growing strongly in the quarter and between years

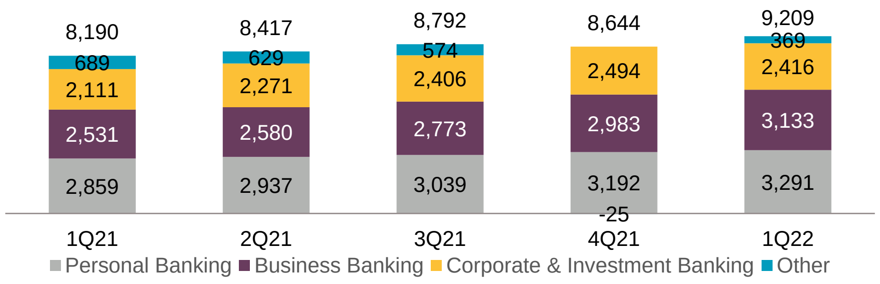
NIM rises to 2.6% due to a higher interest rate environment

Highlights

- Rise in NII in 1Q22 is a result of rise in the Bank´s loan book and higher interest rate environment net positively affecting other interests
- NIM on loans was 2.0% in 1Q22 (2.2% in 1Q21) while NIM on deposits was 1.6% in 1Q22 (1.1% in 1Q21)

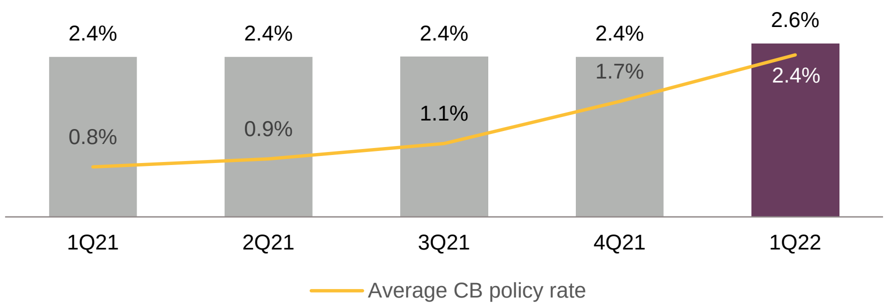
Net interest income

By business segments, ISKm



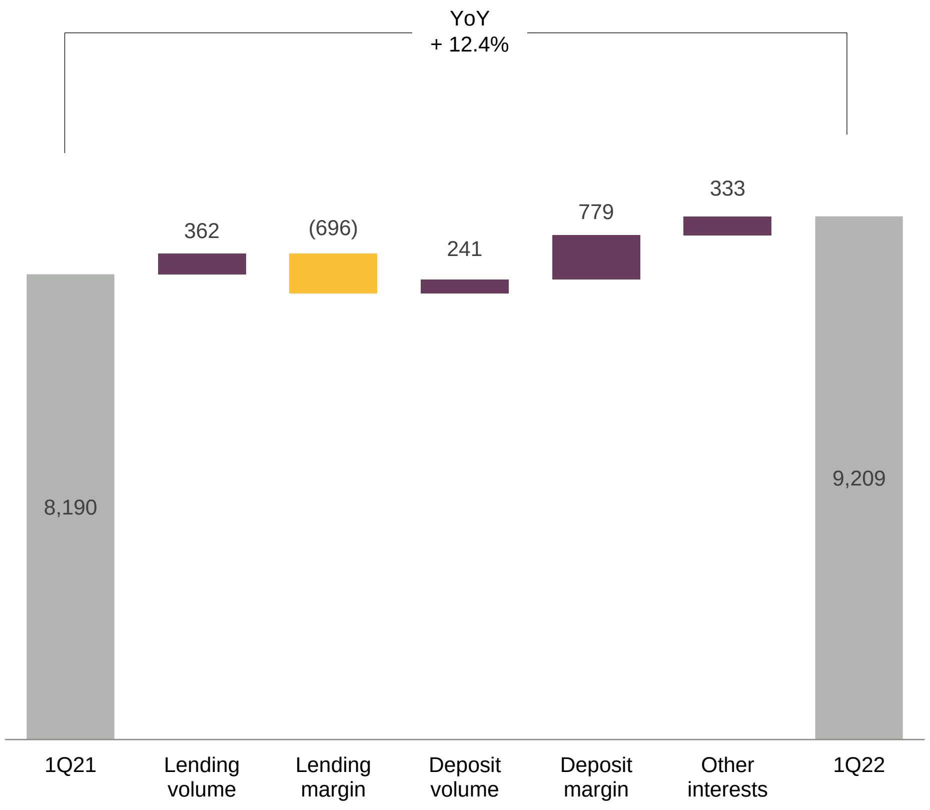
Net interest margin

On total assets



NII – comparison 1Q YoY

ISKm



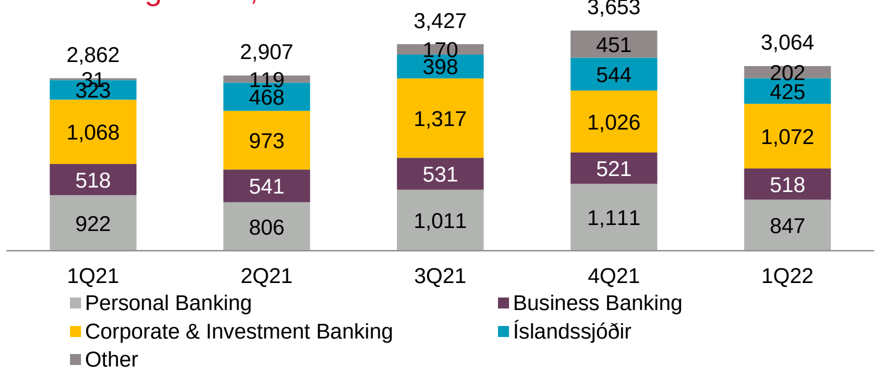
NFCI continues an upwards trend with a 7.1% rise YoY

Broad-based fee generation across the business units

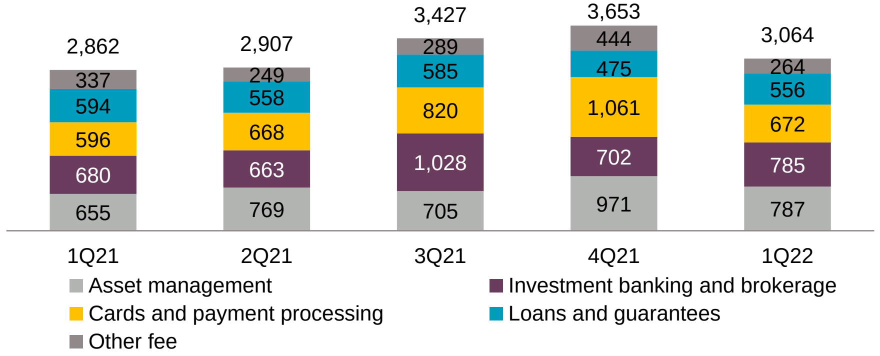
Highlights

- Revenue from Cards and payment processing increased in 1Q22 YoY due to increased card activity
- Seasonality in revenues explains the drop in fees from cards and payment processing between quarters
- Strong growth in fees from asset management between years, but reduction between quarters due to performance related fees in 4Q21

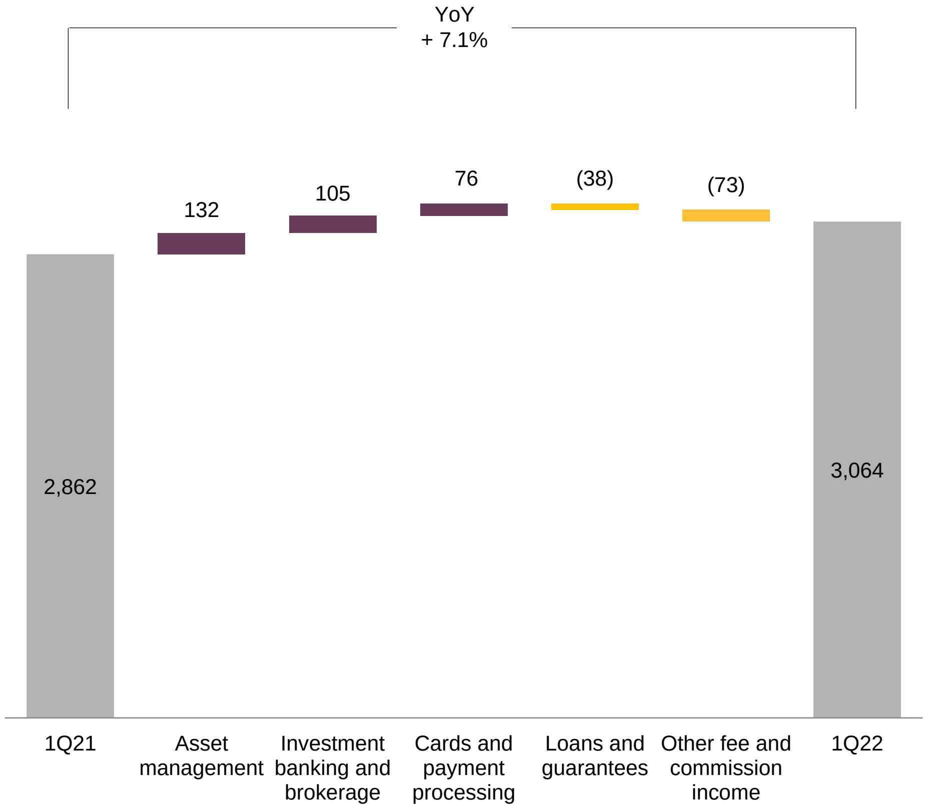
Net fee and commission income
Business segments, ISKm



Net fee and commission income
By type, ISKm



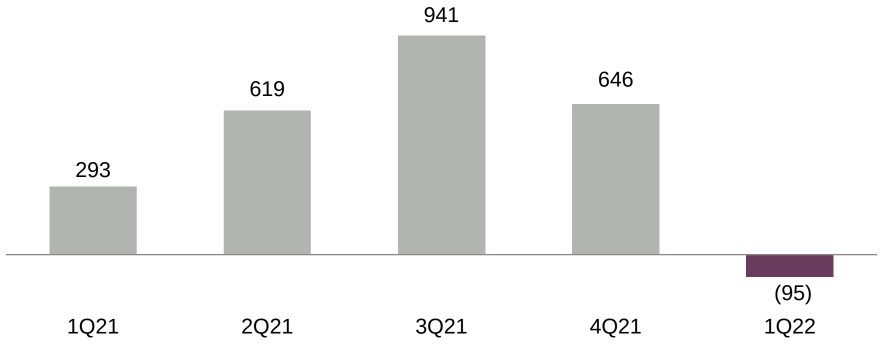
NFCI – comparison 1Q YoY
ISKm



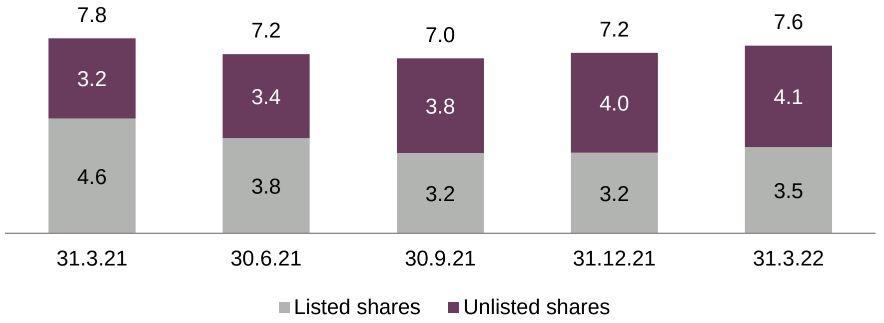
Unfavourable credit markets affect NFI in 1Q22

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

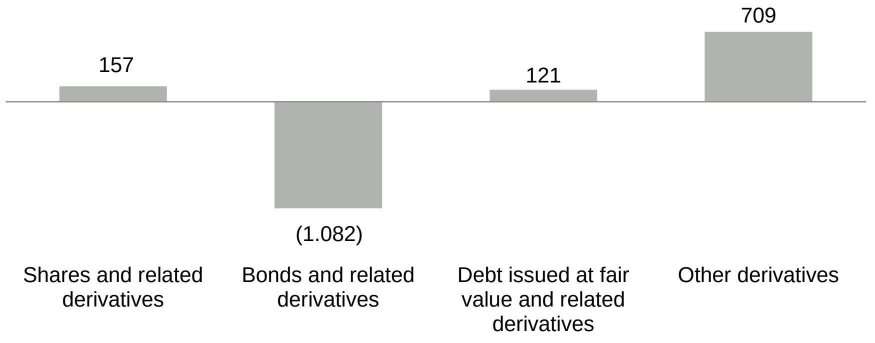
Net financial income
ISKm



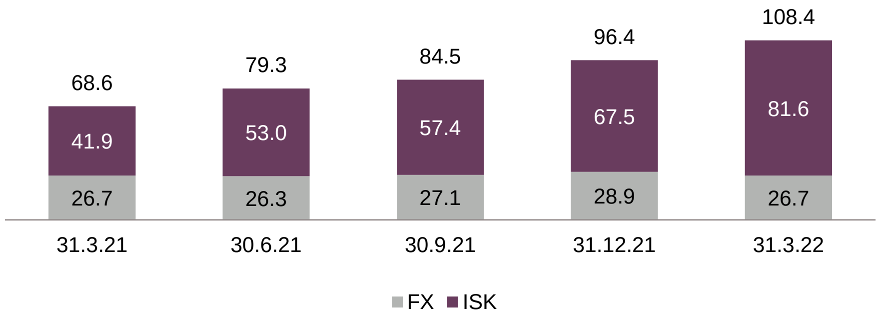
Shares and equity instruments[1]
ISKbn



Net financial income by type in 1Q22
ISKm



Bonds and debt instruments[2]
ISKbn

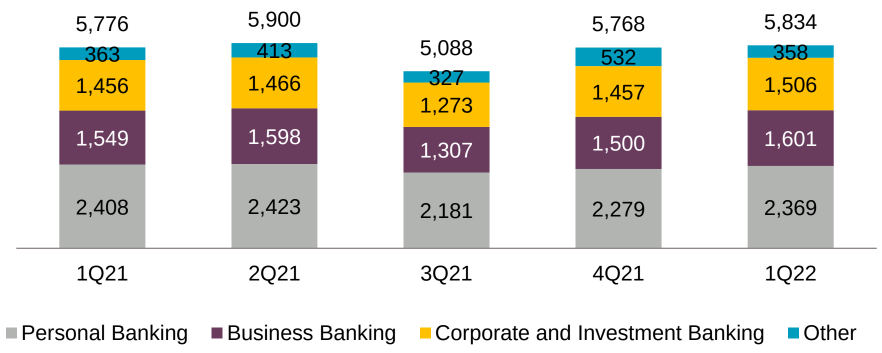


1.Excluding listed shares and equity instruments used for economic hedging. 2. Excluding listed bonds and debt instruments used for economic hedging

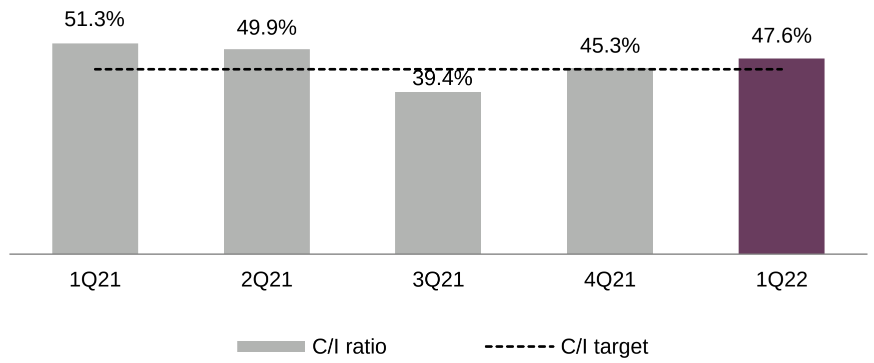
Administrative expenses stable in 1Q22

6.1% reduction in real terms driven by lower salary cost

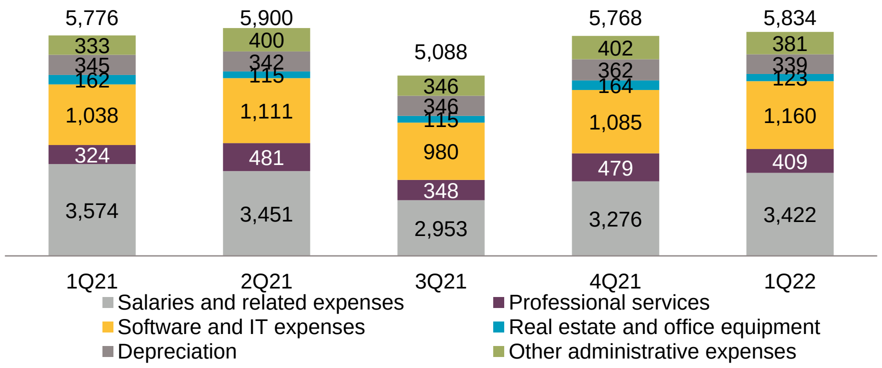
Administrative expenses[1]
ISKm



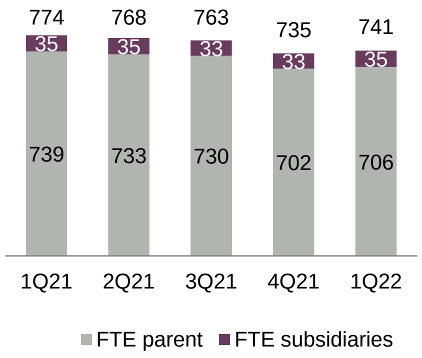
Cost-to-income ratio[2]



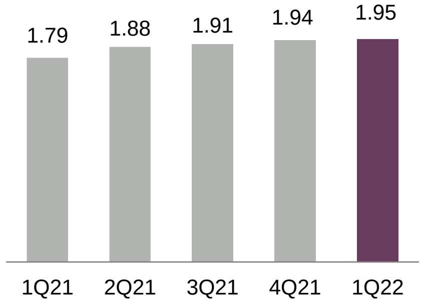
Administrative expenses[1] – by type
ISKm



FTE period end[3]



Total assets / FTE[3]
ISKbn



1. Administrative expenses in 1Q21 and 2Q21 are excluding one-off cost related to the Bank‘s IPO, 76m in 1Q21 and 588m in 2Q21. 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.

Positive net impairment in 1Q22 as the economy recovers

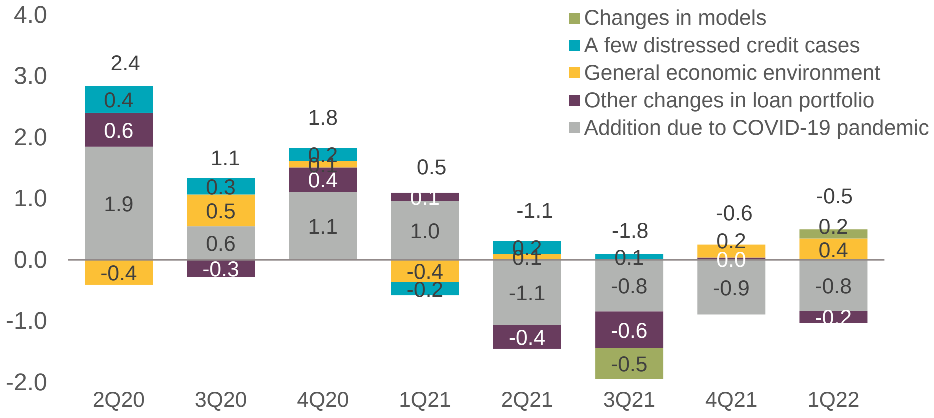
Majority of forbearance borrowers have resumed payments

Highlights

- Reserve coverage ratio (RCR) ratio for impairment allowance on Stage 3 was 27.2% at end of 1Q222
- The definition of forbearance includes a 24-month probation period. Therefore, loans are classified with forbearance even after normal payments have resumed. Loans amounting to ISK 70bn or 80% are expected to exit forbearance probation in 2022

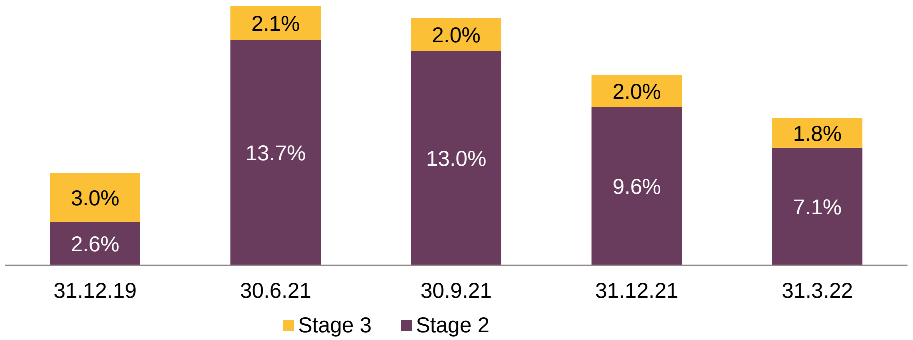
Net impairment on financial assets[1]

By period, ISKbn



Loans to customers: Stage 2 and 3 (NPL)

Development of gross carrying amount as ratio of total loans

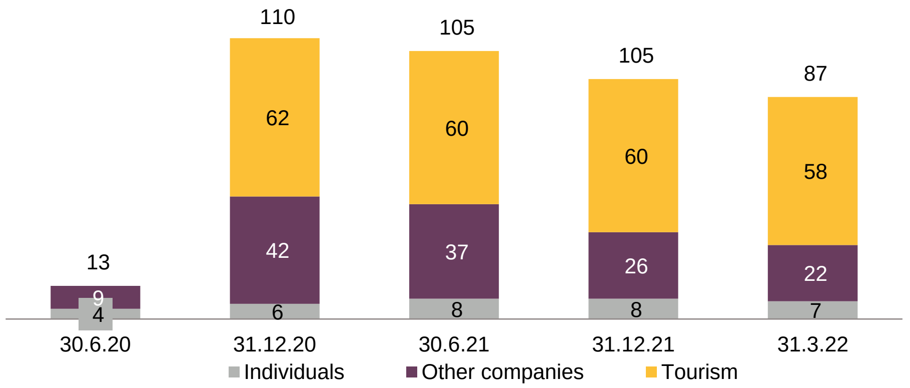


Current and expected cost-of-risk

- Annualised cost of risk was -17bp in 1Q22 compared to +20bp for 1Q21
- Additional impairment allowance currently attributable to the tourism overlay and stage transfer is approx. ISK 1.2bn at end of 1Q22 down from 2.0bn at YE21
- The probability weights of economic scenarios were shifted to 20% (good), 45% (baseline), and 35% (bad) at end of 1Q22. A shift of 5% from baseline to the bad scenario would increase the impairment allowance by ISK 0.4bn while a 5% shift from the baseline to the good would decrease the allowance by ISK 0.2bn
- The Group stands to receive approximately ISK 700m on a loan that had previously been fully written off, as a result of a favourable court ruling passed in the second quarter 2022

Performing loans with forbearance

Gross carrying amount, ISKbn

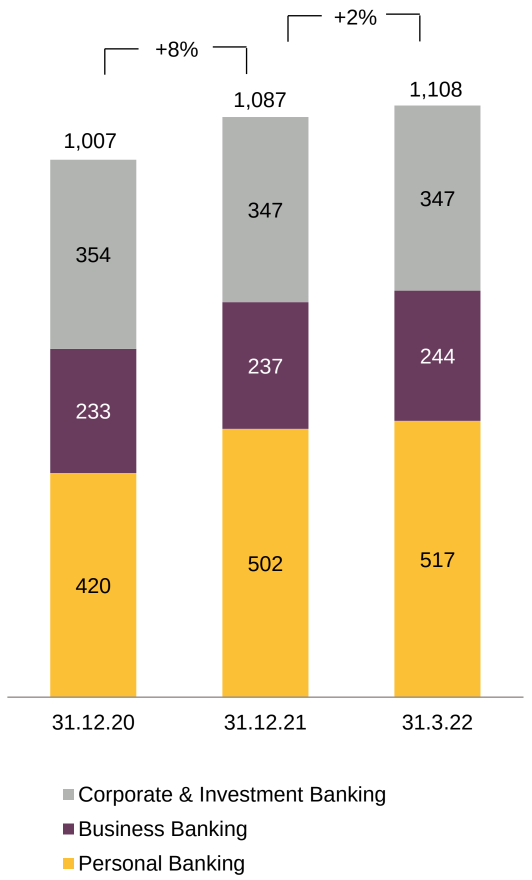


1. See further in note 2 in Consolidated Financial Statements first quarter 2022

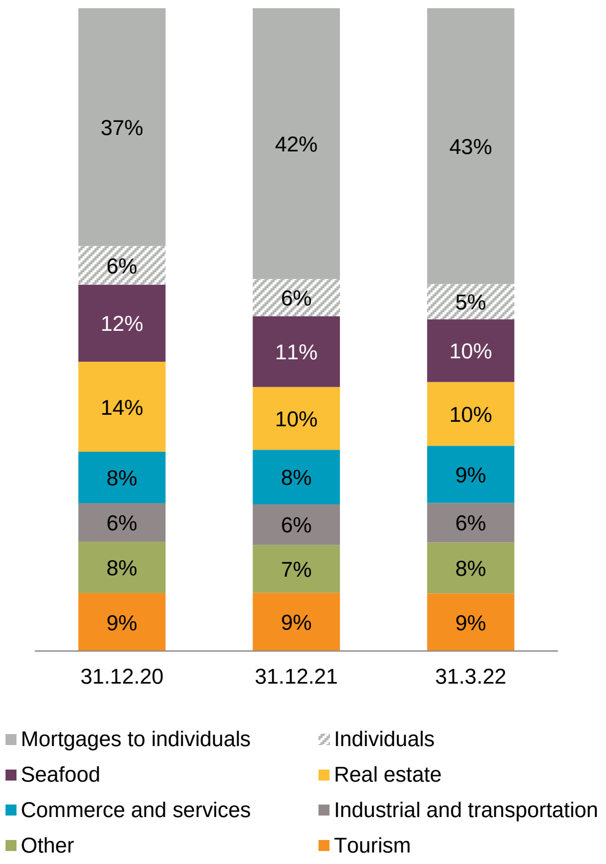
Diversified and highly collateralised loan portfolio

Loans to individuals are 48% of loans to customers, mainly residential mortgages

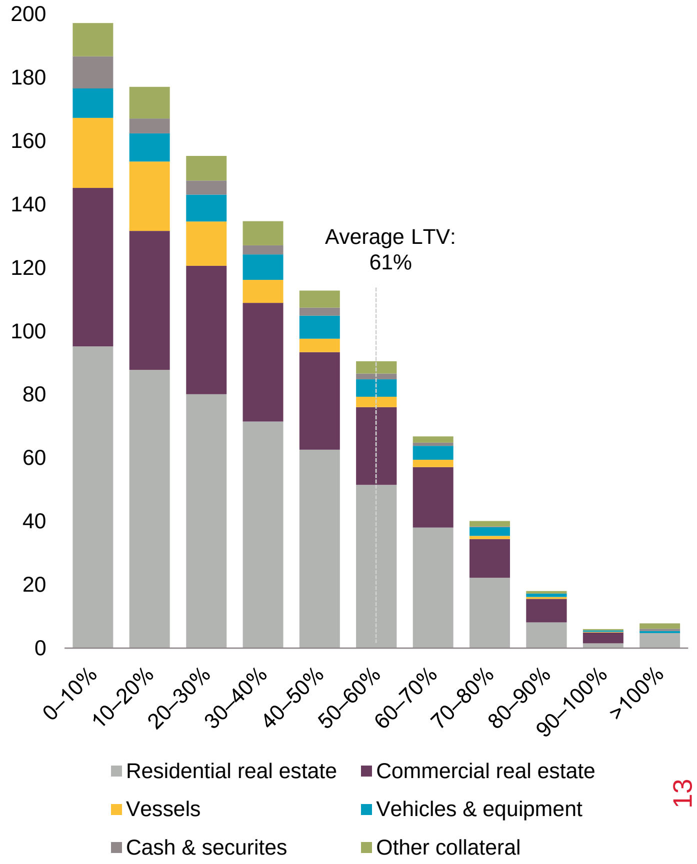
Loans to customers
By business division, ISKbn



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



LTV distribution by underlying asset class
31.3.2022, loan splitting approach, ISKbn



Strong growth in mortgages and increased market share

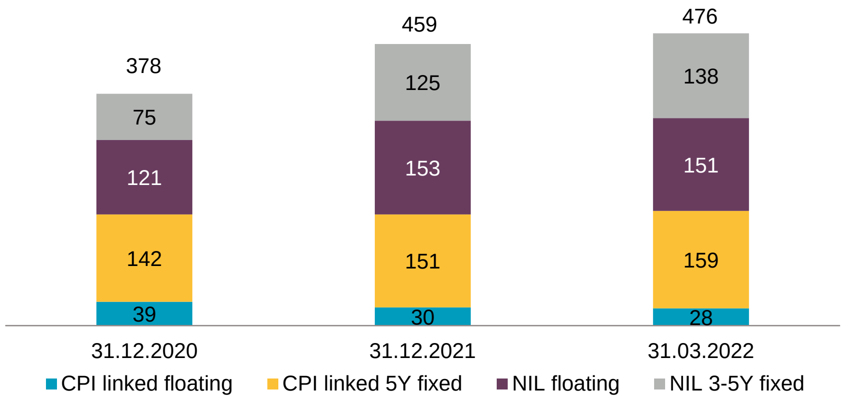
Average LTV's stable and built-in buffers for rate increases

Highlights

- Conservative payment assessment for non-indexed variable rates mortgages in low interest environment
- Sensitivity analysis if rates rise shows that the financial impact on the Bank is expected to be insignificant
- The Bank offers services to facilitate hedging against rising rates with possibility of changing to fixed rates

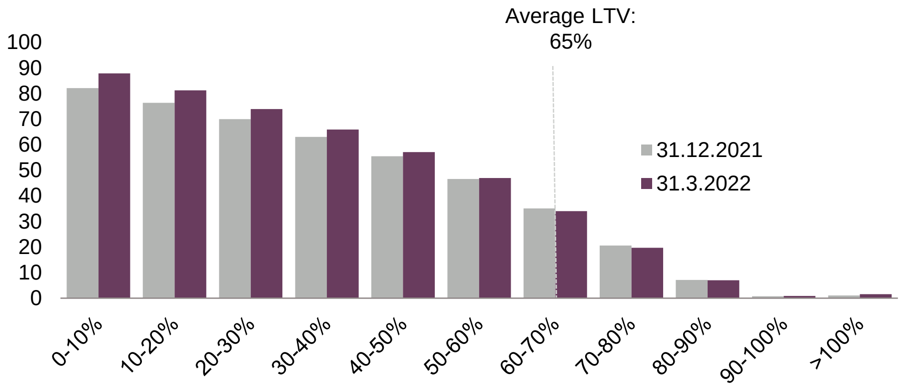
Mortgage loans

Gross carrying amount, ISKbn



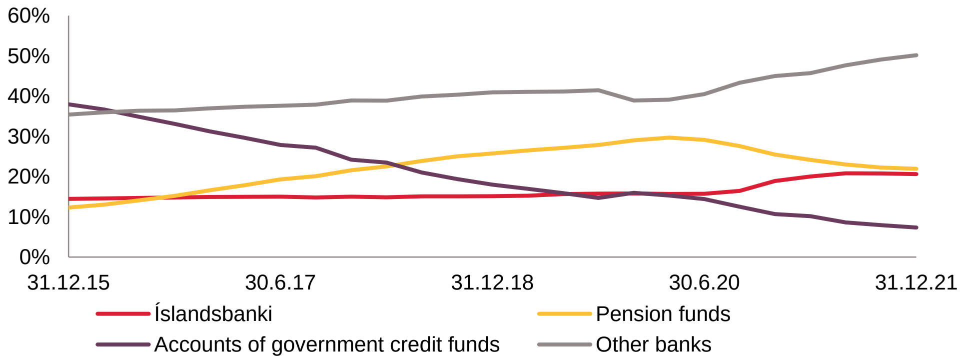
LTV distribution of mortgages to individuals

Gross carrying amount, ISKbn



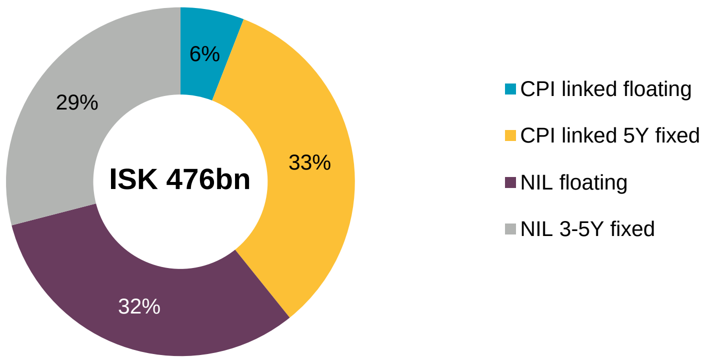
Mortgage market[1]

Market share development



Mortgages portfolio[2]

Gross carrying amount, 31.3.2022



1. Source: Central Bank of Iceland 2. NIL stands for non-index linked loans

Deposits are the largest source of funding

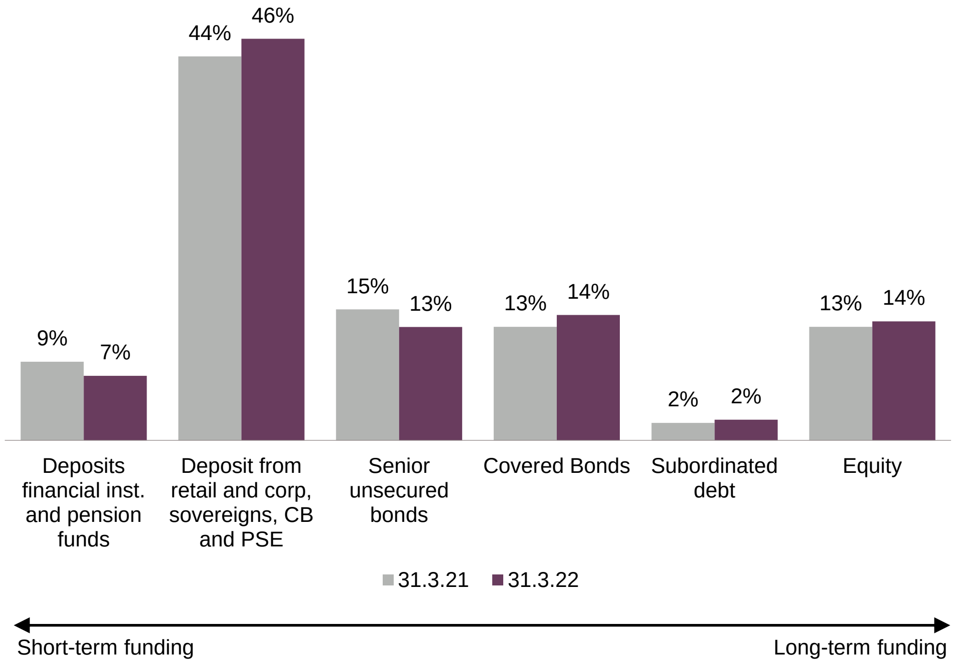
Deposits from individuals continue to increase

Highlights

- Term deposits are 19% of total deposits
- Deposit concentration is stable. 13% of the Bank's deposits belonged to the 10 largest depositors and 28% to the 100 largest depositors at 1Q22, compared to 12% and 28% respectively at YE21
- At 1Q22 75% of deposits were in non-indexed ISK, 13% CPI-linked and 12% in foreign currencies

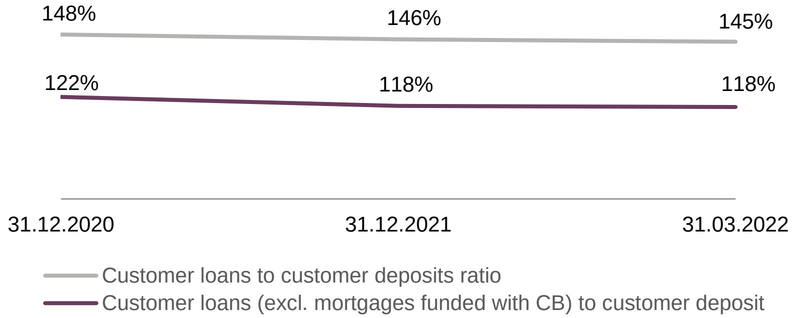
Funding sources

By type, % of total liabilities and equity



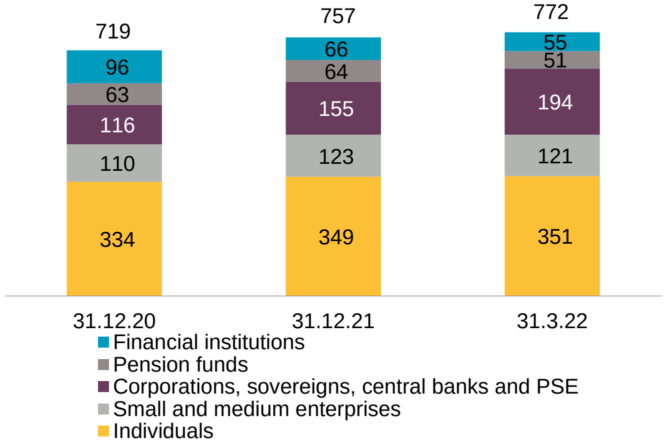
Customer loans to customer deposits ratio

Development, %



Deposits from customers and credit institutions

Development, by LCR category, ISKbn



Seasoned and diversified long-term funding programme

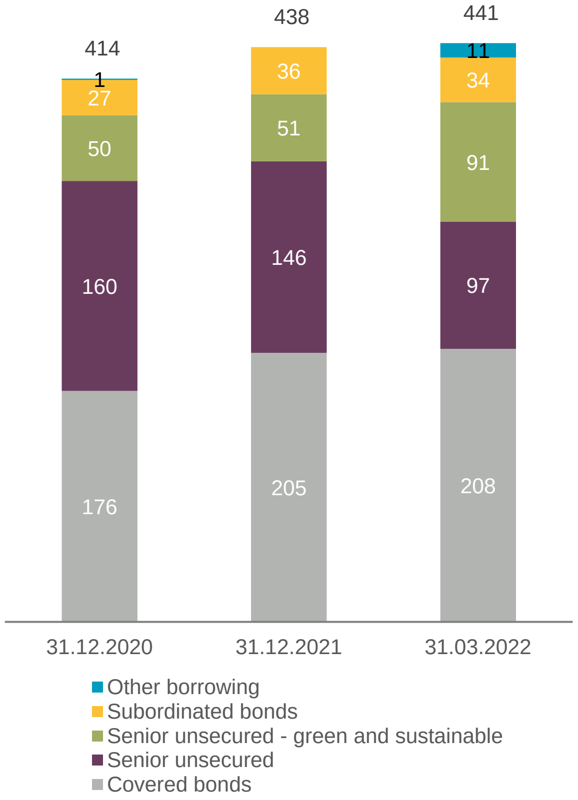
Majority of 2022 maturities already funded through a recent €300m sustainable bond issue

Highlights

- S&P Global ratings BBB/A-2 with stable outlook confirmed on 25 January 2022
- As of 1Q22 the Bank has EUR 100m left maturing in foreign currency this year after a successful EUR 300m issue in January and a EUR 200m buyback of the EUR 300m April maturity
- NIB and Íslandsbanki signed a USD 87m loan for on-lending to environmental projects and SMEs in Iceland
- At end of 1Q22, total LCR ratio was 195%, FX LCR was 235% and total NFSR was 123%
- The Banks 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

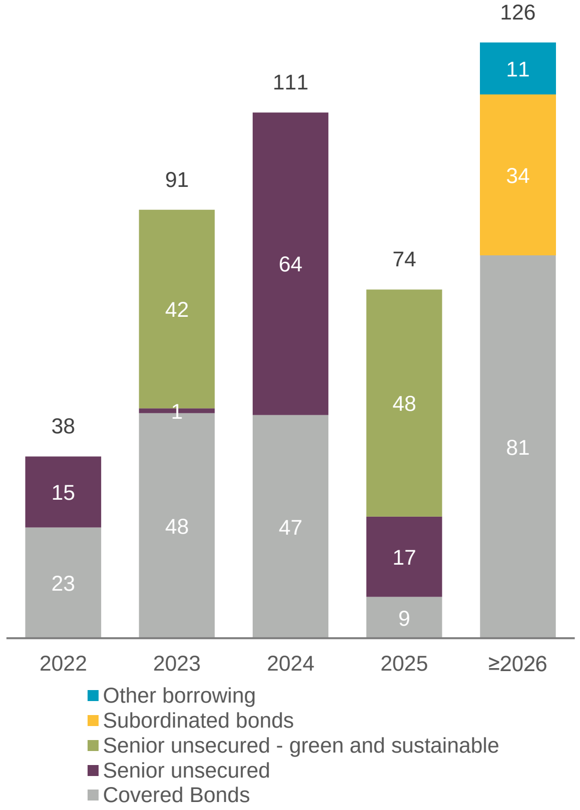
Sources of borrowings

Development, ISKbn



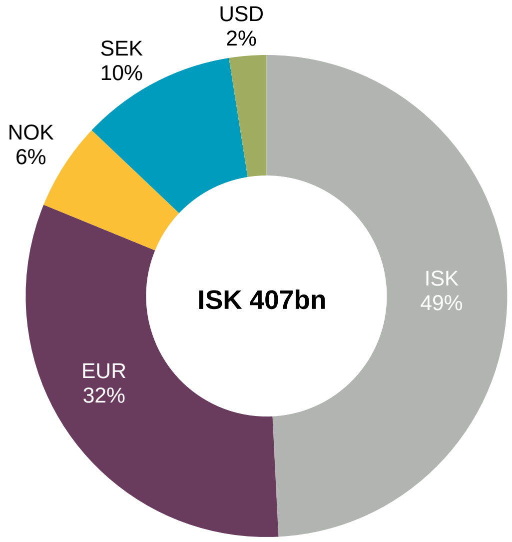
Contractual maturity profile of borrowings

ISKbn



Currency split of borrowings

31.3.21



Strong capital position and dividend capacity

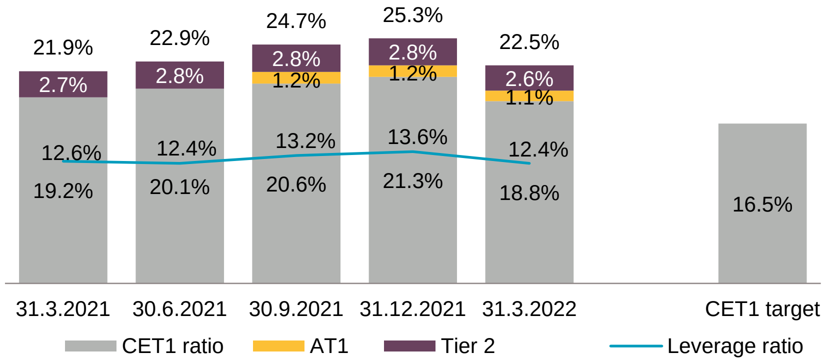
Opportunity exist to optimise capital composition and to continue consistent dividends

Highlights

- Current and long term expected total capital requirements of 17.8% and 19.0% respectively
- Additional AT1 issuance potential of ISK 6-7bn to optimise capital structure
- Drop in CET1 in Q1 due to
  - Planned ISK 15bn buyback excluded from CET1
  - REA growth
- The rise in REA is a result of rise in loans to customers and loans to credit institutions as well as in derivatives and more accurate data processing regarding off-balance sheet items and the SME factor

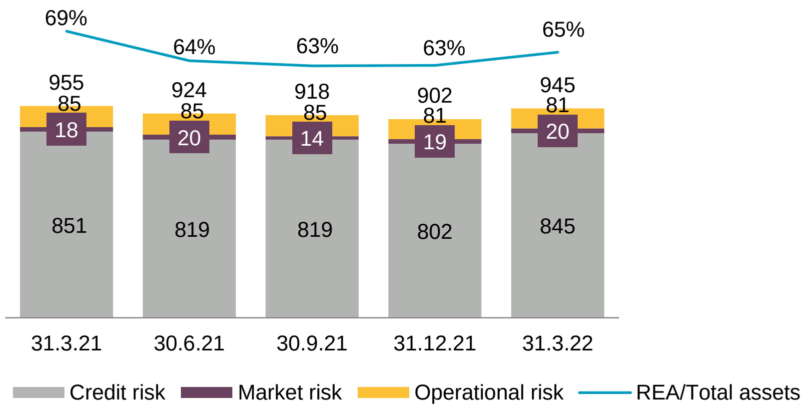
Capital ratios and leverage ratio[1]

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



Risk exposure amount (REA)

ISKbn



1. Including 1Q22 profit.

Capital distribution plans

- **A dividend of ISK 5.95 per share was disbursed in March**
  - Amounting to 50% of profit, in line with the dividend policy
- **ISK 35-40bn of excess CET1 capital**
  - Optimised in the next 12-24 months
  - Distribution in the form of share buybacks or special dividends, method and timing subject to the market conditions
  - ISK 15bn buyback of own shares in the coming months

Q&A

5 May 2022

5 May 2022

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 706 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 1Q22

- Íslandsbanki regarded as most sustainable bank in Iceland according to a Gallup survey
- Estimates of the financed emissions for 2020 and 2019 published
- Íslandsbanki issued a EUR 300m 0.75% fixed rate senior preferred sustainable bond

Key Figures 1Q22

ROE	10.2%	LCR Group, all currencies	195%
Cost-to-income ratio	47.6%	NSFR Group, all currencies	123%
CET1 ratio[2]	18.8%	Leverage ratio[2]	12.4%
Total capital ratio[2]	22.5%	Total assets	ISK 1,446bn

Ratings and certifications

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

EQUAL PAY CERTIFICATE 2018 - 2021

EXEMPLARY IN CORPORATE GOVERNANCE

Digital milestones 1Q22

- Unified digital sales platform released[3]
- Up to date price information for securities implemented in the app
- Cardless ATM services

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. 2. Including 1Q22 profit. 3. In beta version at 31 March 2022, and released on 27 April 2022.

Financial targets on track

Clear path to ROE expansion, attractive capital return and optimisation

Targets	Revised	2022 Guidance	1Q22	4Q21	2021
Return on equity	>10%	8-10% by 2023	10.2% ✓	14.2% ✓	12.3% ✓
Cost-to-income ratio[1]	<45%	45-50%	47.6% ✓	45.3% ✓	46.2% ✓
CET1 capital ratio[2]	~16.5%	Normalise before YE2023	18.8% ✓	21.3% ✓	21.3% ✓
Dividend-payout-ratio	50%	50%			50% ✓

1. Calculated as (Administrative expenses + Contribution to the Depositors' and Investors' Guarantee Fund – One-off items) / (Total operating income – One-off items). 2. Long term CET1 capital target is subject to regulatory requirements and includes a management buffer of 50-200bp. 2. Including profit for 1Q22

Financial overview

Key figures & ratios

		1Q22	4Q21	3Q21	2Q21	1Q21
PROFITABILITY	Profit for the period, ISKm	**5,187**	7,092	7,587	5,431	3,615
	Return on equity	**10.2%**	14.2%	15.7%	11.6%	7.7%
	Net interest margin (of total assets)	**2.6%**	2.4%	2.4%	2.4%	2.4%
	Cost-to-income ratio[1]	**47.6%**	45.3%	39.4%	49.9%	51.3%
	Cost of risk	**(0.17%)**	(0.23%)	(0.64%)	(0.42%)	0.20%

		31.3.22	31.12.21	30.9.21	30.6.21	31.3.21
BALANCE SHEET	Loans to customers, ISKm	**1,107,893**	1,086,327	1,081,418	1,089,723	1,029,415
	Total assets, ISKm	**1,446,355**	1,428,821	1,456,372	1,446,860	1,385,235
	Risk exposure amount, ISKm	**945,321**	901,646	917,764	924,375	954,712
	Deposits from customers, ISKm	**761,471**	744,036	754,442	765,614	698,575
	Customer loans to customer deposits ratio	**145%**	146%	143%	142%	147%
	Non-performing loans (NPL) ratio[2]	**1.8%**	2.0%	2.0%	2.1%	2.4%
LIQUIDITY	Net stable funding ratio (NSFR), for all currencies	**123%**	122%	121%	122%	119%
	Liquidity coverage ratio (LCR), for all currencies	**195%**	156%	225%	187%	172%
CAPITAL	Total equity, ISKm	**197,201**	203,710	197,381	190,355	185,471
	CET 1 ratio[3]	**18.8%**	21.3%	20.6%	20.1%	19.2%
	Tier 1 ratio[3]	**19.9%**	22.5%	21.8%	20.1%	19.2%
	Total capital ratio[3]	**22.5%**	25.3%	24.7%	22.9%	21.9%
	Leverage ratio[3]	**12.4%**	13.6%	13.2%	12.4%	12.6%

1.Calculated as (Administrative expenses + Contribution to the Depositors' and Investors' Guarantee Fund – One-off items) / (Total operating income – One-off items).
2. Stage 3, loans to customers, gross carrying amount. 3. Including 3Q21 profit for 30.9.21 and 1Q22 profit for 31.3.22

Income growth of 9% YoY driven by NII and NFCI

Robust profitability in 1Q22 a result of strong business foundations

Income statement, ISKm	1Q22	1Q21	Δ%	4Q21	Δ%	2021
Net interest income	**9,209**	8,190	12%	8,644	7%	34,043
Net fee and commission income	**3,064**	2,862	7%	3,653	(16%)	12,849
Net financial income (expense)	**(95)**	293	-	646	-	2,499
Net foreign exchange gain	**166**	130	28%	159	4%	479
Other operating income	**265**	123	115%	15	1,667%	302
Total operating income	**12,609**	11,598	9%	13,117	(4%)	50,172
Salaries and related expenses	**(3,422)**	(3,574)	(4%)	(3,276)	4%	(13,397)
Other operating expenses	**(2,412)**	(2,278)	6%	(2,492)	(3%)	(9,799)
Administrative expenses	**(5,834)**	(5,852)	(0%)	(5,768)	1%	(23,196)
Contribution to the Depositor's and Investors' Guarantee Fund	**(165)**	(183)	(10%)	(170)	(3%)	(688)
Bank tax	**(430)**	(410)	5%	(389)	11%	(1,683)
Total operating expenses	**(6,429)**	(6,445)	(0%)	(6,327)	2%	(25,567)
Net impairment on financial assets	**483**	(518)	-	639	(24%)	3,018
Profit before tax	**6,663**	4,635	44%	7,429	(10%)	27,623
Income tax expense	**(1,463)**	(1,036)	41%	(1,416)	3%	(5,119)
Profit for the period from continuing operations	**5,200**	3,599	44%	6,013	(14%)	22,504
Discontinued operations held for sale, net of income tax	**(13)**	16	-	1,079	-	1,221
Profit for the period	**5,187**	3,615	43%	7,092	(27%)	23,725

Key ratios						
Net Interest Margin (NIM)	**2.6%**	2.4%		2.4%		2.4%
Cost-to-income ratio (C/I)	**47.6%**	51.3%		45.3%		46.2%
Return on Equity (ROE)	**10.2%**	7.7%		14.2%		12.3%
Cost of risk (COR)	**(0.17%)**	0.20%		(0.23%)		(0.28%)

Balance sheet reflects balanced loan and funding profile

Broad product offering, strong liquidity portfolio and stable funding

Assets

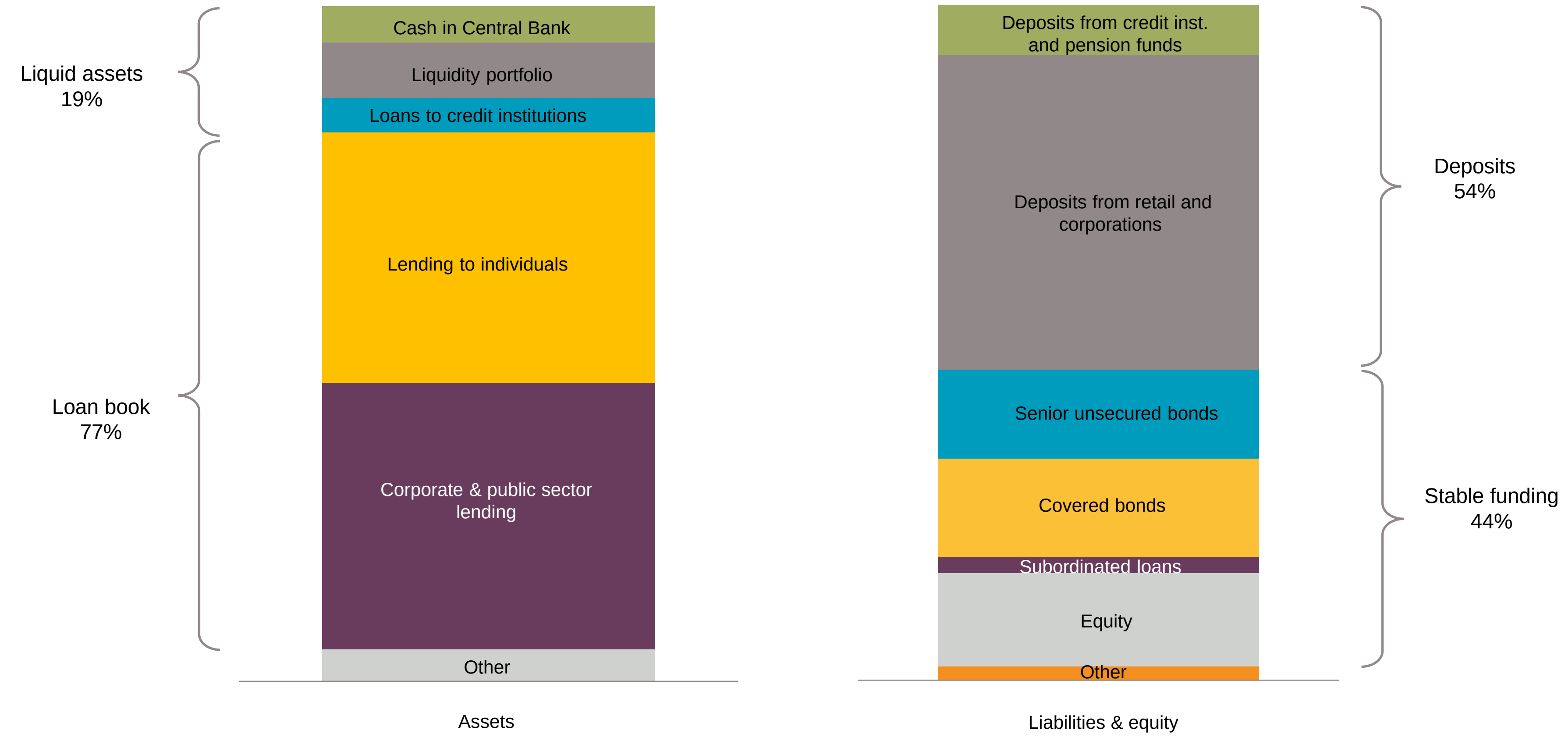
- Vast majority of assets consist of lending to both individuals and corporates
- Strong liquidity portfolio is a consistent factor in balance sheet management
- Very limited exposure to non-liquid or non-lending assets

Liabilities

- Deposits from retail and corporations 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

31.3.2022, ISK 1,446bn



Growth in loans to customers continues

Steady mortgage growth supported by a strong capital base

Assets, ISKm	31.3.22	31.12.21	Δ	Δ%
Cash and balances with Central Bank	**77,799**	113,667	(35,868)	(32%)
Loans to credit institutions	**73,220**	43,988	29,232	66%
Bonds and debt instruments	**130,700**	132,289	(1,589)	(1%)
Derivatives	**4,245**	2,445	1,800	74%
Loans to customers	**1,107,893**	1,086,327	21,566	2%
Shares and equity instruments	**28,655**	31,677	(3,022)	(10%)
Investment in associates	**767**	939	(172)	(18%)
Property and equipment	**6,911**	7,010	(99)	(1%)
Intangible assets	**3,327**	3,351	(24)	(1%)
Other assets	**11,170**	5,784	5,386	93%
Non-current assets and disposal groups held for sale	**1,668**	1,344	324	24%
Total Assets	**1,446,355**	1,428,821	17,534	1%

Key ratios				
Risk Exposure Amount (REA)	**945,321**	901,646	43,675	5%
Non-performing loans (NPL) ratio[1]	**1.8%**	2.0%		
Asset encumbrance ratio	**19.2%**	19.6%		

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

Diversified funding base

Deposits are largest source of funding

Liabilities & Equity, ISKm	31.3.22	31.12.21	Δ	Δ%
Deposits from Central Bank and credit institutions	**10,949**	13,384	(2,435)	(18%)
Deposits from customers	**761,471**	744,036	17,435	2%
Derivative instruments and short positions	**11,013**	9,467	1,546	16%
Debt issued and other borrowed funds	**406,845**	402,226	4,619	1%
Subordinated loans	**34,139**	35,762	(1,623)	(5%)
Tax liabilities	**6,980**	6,432	548	9%
Other liabilities	**16,802**	12,848	3,954	31%
Non-current liabilities and disposal groups held for sale	**955**	956	(1)	(0%)
Total Liabilities	**1,249,154**	1,225,111	24,043	2%
Total Equity	**197,201**	203,710	(6,509)	(3%)
Total Liabilities and Equity	**1,446,355**	1,428,821	17,534	1%

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

1. Including 1Q22 profit

5 May 2022

Appendix II – Icelandic economy update

Economic recovery likely to accelerate as pandemic recedes

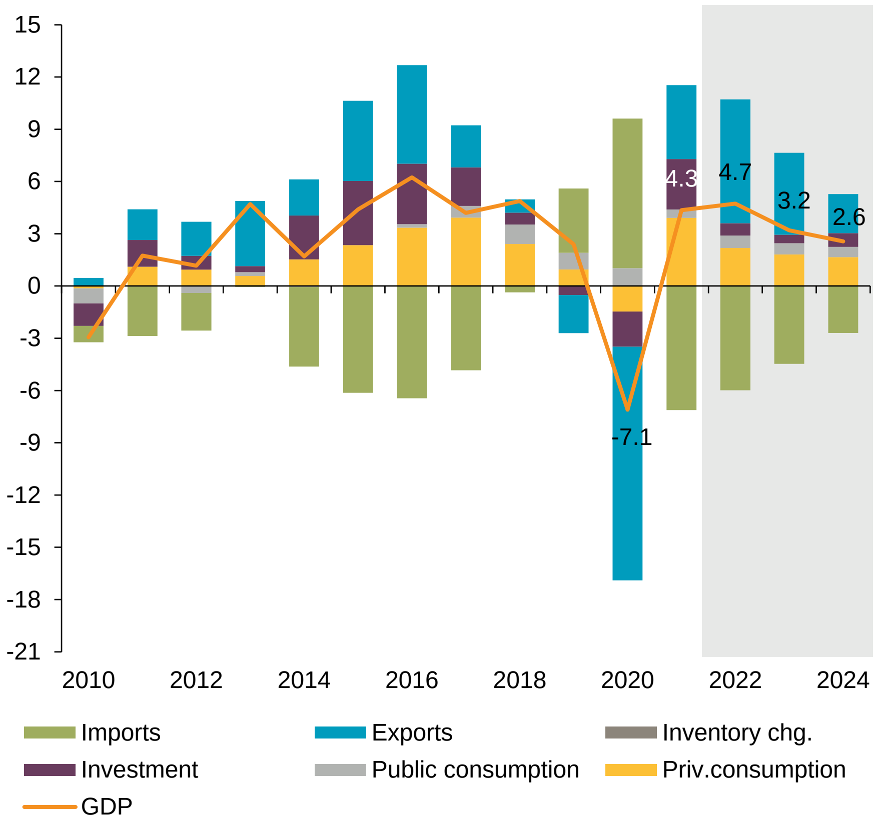
Exports replace domestic demand as the key catalyst of growth

Highlights

- After a deep contraction in 2020, the economic recovery took hold in Iceland in 2021. Year-2021 GDP growth is estimated at 4.3%
- Domestic demand gained considerable traction and, despite a modest current account deficit, exports also rebounded strongly
- ISB Research (forecast published in Jan-22) forecasts GDP growth at 4.7% in 2022, the fastest growth rate since 2018
- The surge is due mostly to robust growth in exports, mainly tourism and fishing. Private consumption also fuels GDP growth in 2022, while the share of investment will ease markedly relative to 2021
- For 2023, 3.2% growth is projected, driven by exports and domestic demand in roughly equal measure
- For 2024, the final year of the forecast horizon, GDP growth at 2.6% is forecast. By then, export growth will have started to ease significantly, and tighter economic policy and capacity constraints will slow the pace of domestic demand growth

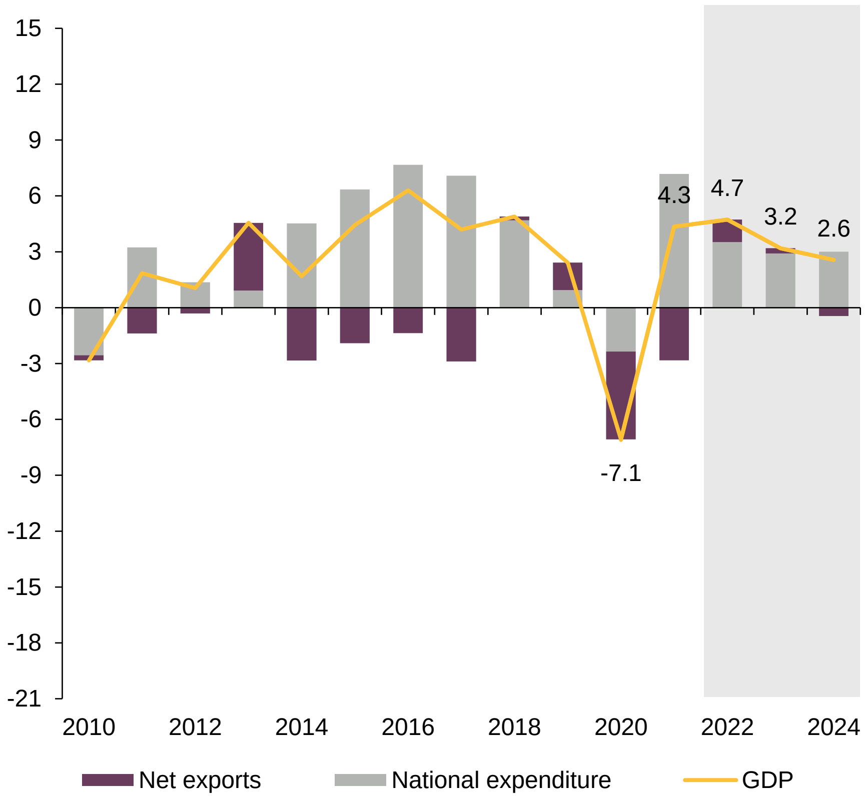
GDP and contribution of its subcomponents

Volume change from prior year, %



GDP, domestic demand, and external trade

Volume change from prior year, %



Sources: Statistics Iceland, ÍSB Research.

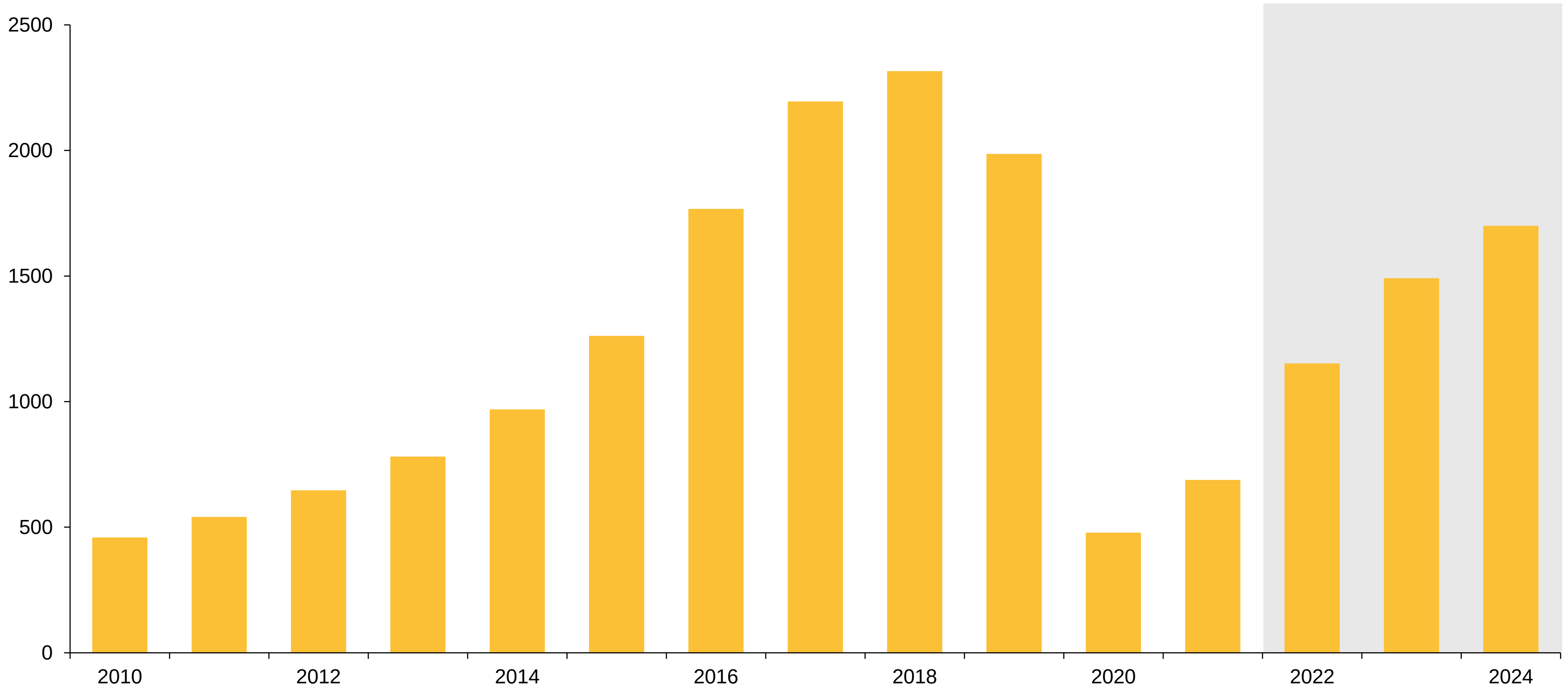
Tourism reloaded

At least 1.1 million tourists are projected to visit Iceland in 2022, rising to 1.5 million in 2023

Highlights

- Nearly 700,000 tourists visited Iceland in 2021, an increase of nearly 45% relative to 2020 but still only a third of the 2019 total
- The short-term outlook for tourism has undeniably worsened with the rise of the Omicron variant in Iceland and elsewhere. Even so, appetite for travel is keen and many seem to view Iceland as a desirable destination
- Recent survey data as well as booking trends reported by Icelandic travel companies give grounds for cautious optimism from the summer onwards
- 1.1-1.2 million tourist arrivals are expected this year. This would be close to 2015 numbers, albeit ony 60% of 2019 numbers
- Tourist numbers are expected to rise to 1.5 million in 2023 and 1.7 million in 2024
- Recent trends in booking data and flight frequency at KEF airport suggest uncertainty in the forecast for 2022 is increasingly to the upside
- Even though the pandemic has upended tourism in the past two years, those who visited Iceland in 2021 generally stayed longer and spent more than pre-pandemic travellers did. A continuation of this trend would provide a further boost for the sector

Number of foreign tourists, by year
Thousands



Sources: Icelandic Tourist Board, ÍSB Research.

Current account likely revert to surplus following a deficit in 2021

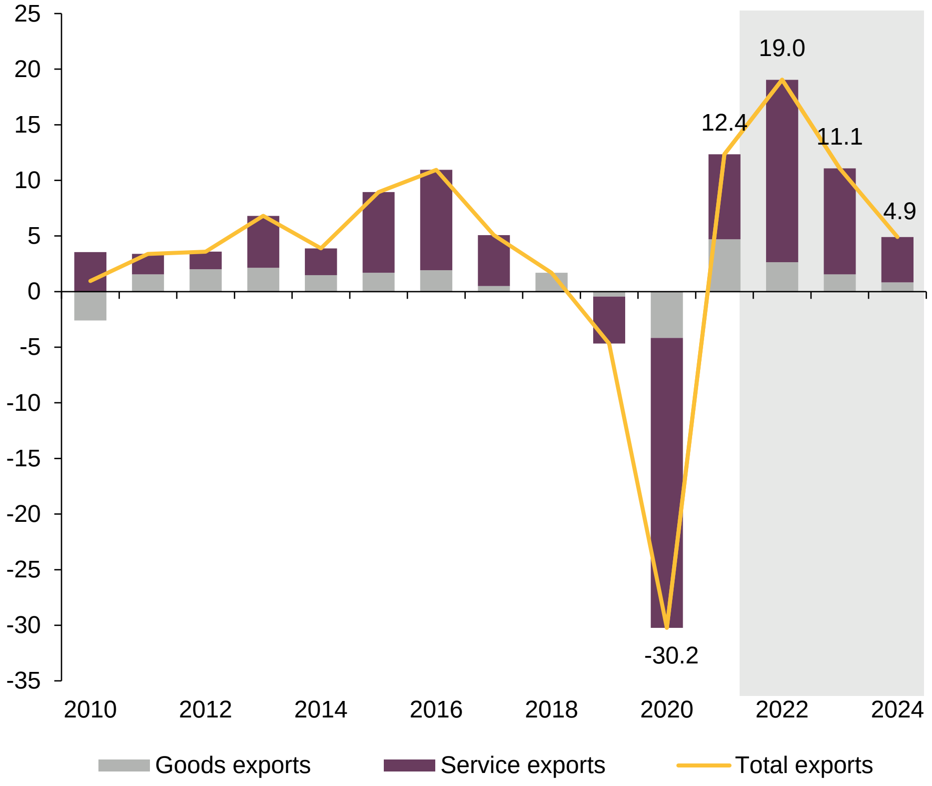
The short-lived deficit is due to domestic demand, which is a few steps ahead of the recovery of exports

Highlights

- A surge in tourist arrivals will deliver the lion's share of the forecasted 20% export growth in 2022 and just over 7% growth in 2023
- Furthermore, the outlook is for stronger exports, for instance, of capelin and farmed fish, aluminium and other industrial goods, and increasingly, intellectual property usage as well. Pulling in the opposite direction are weaker exports of groundfish, as a result of quota reductions
- 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
- ÍSB Research forecasts that export growth will deliver current account surpluses measuring 1.8% of GDP in 2022 and 3.1% of GDP in 2023
- The country's net external assets are currently equivalent to just over 40% of GDP – a situation that could improve further over the forecast horizon, as external trade strengthens

Exports and contribution from subcomponents

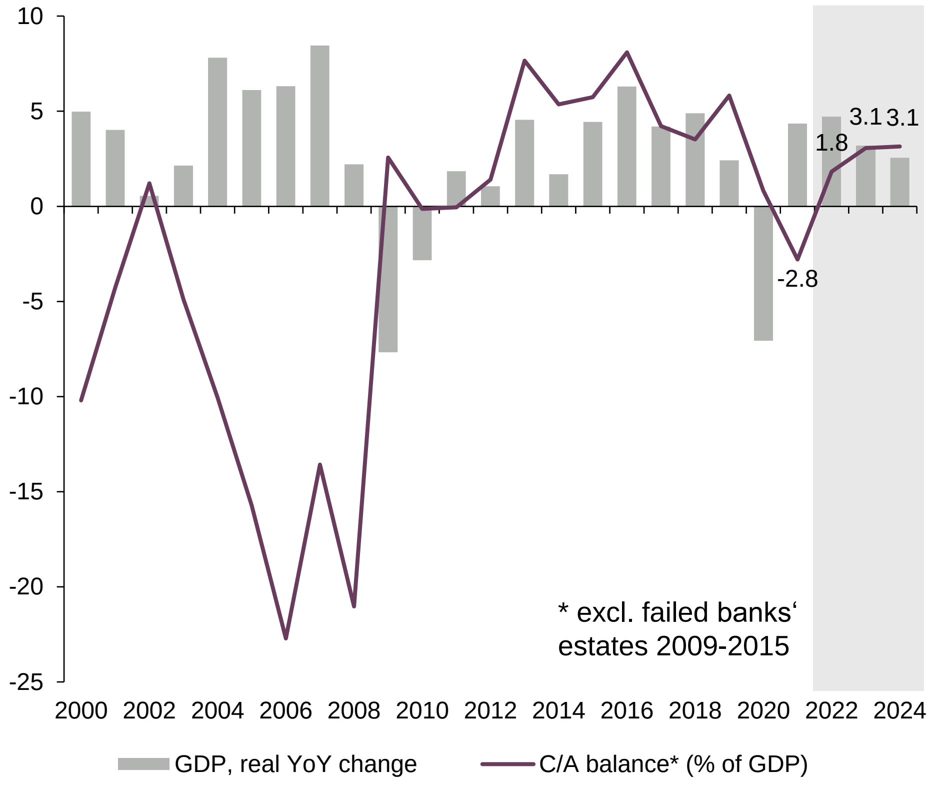
% change



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

Current account balance and GDP growth

% of GDP and % change YoY

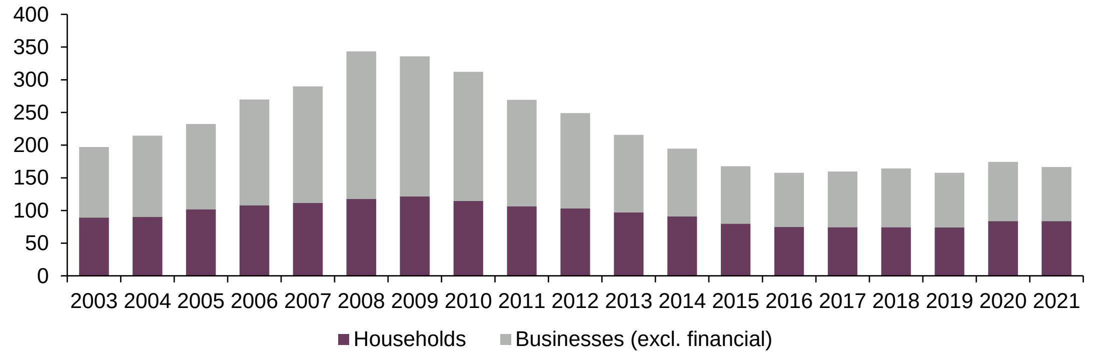


Sources: Statistics Iceland, ÍSB Research.

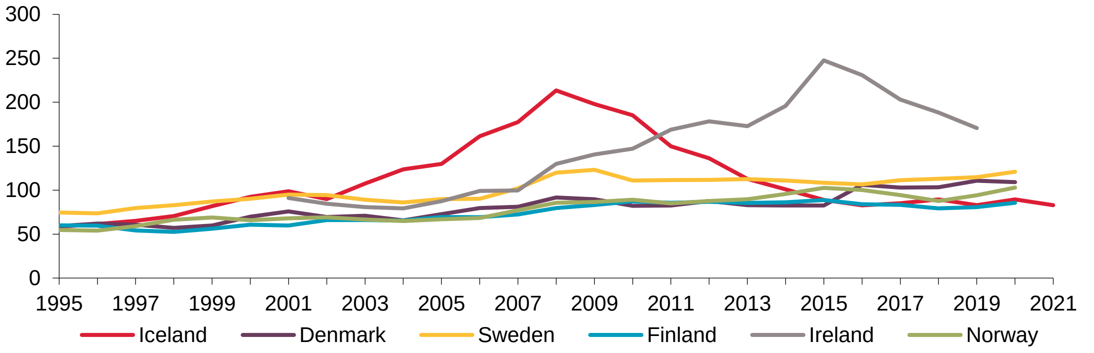
Domestic balance sheets still healthy despite COVID-19

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

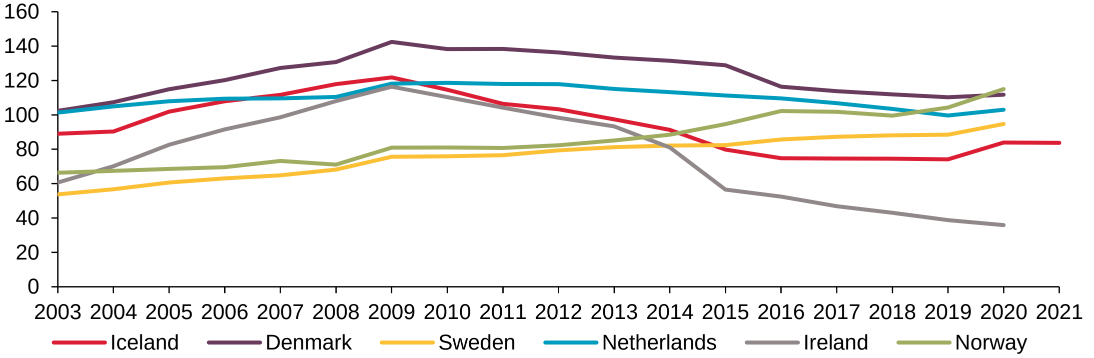
Private sector debt
% of GDP



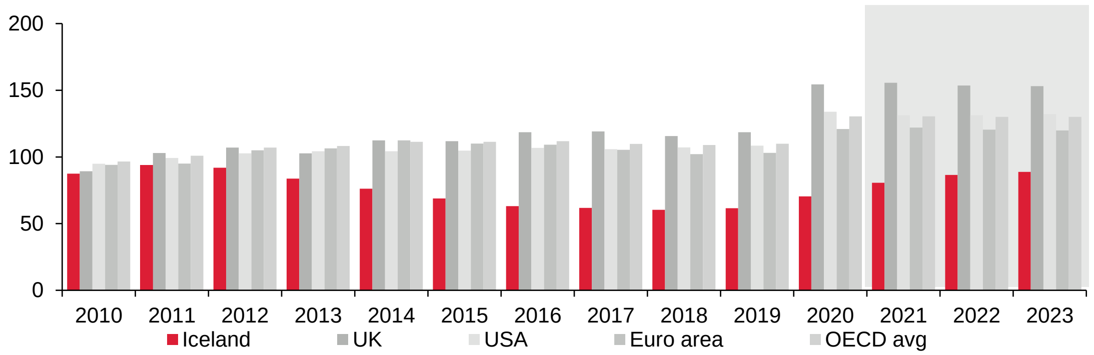
Corporate debt
% of GDP



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

5 May 2022

Moderate investment growth following a spike in 2021

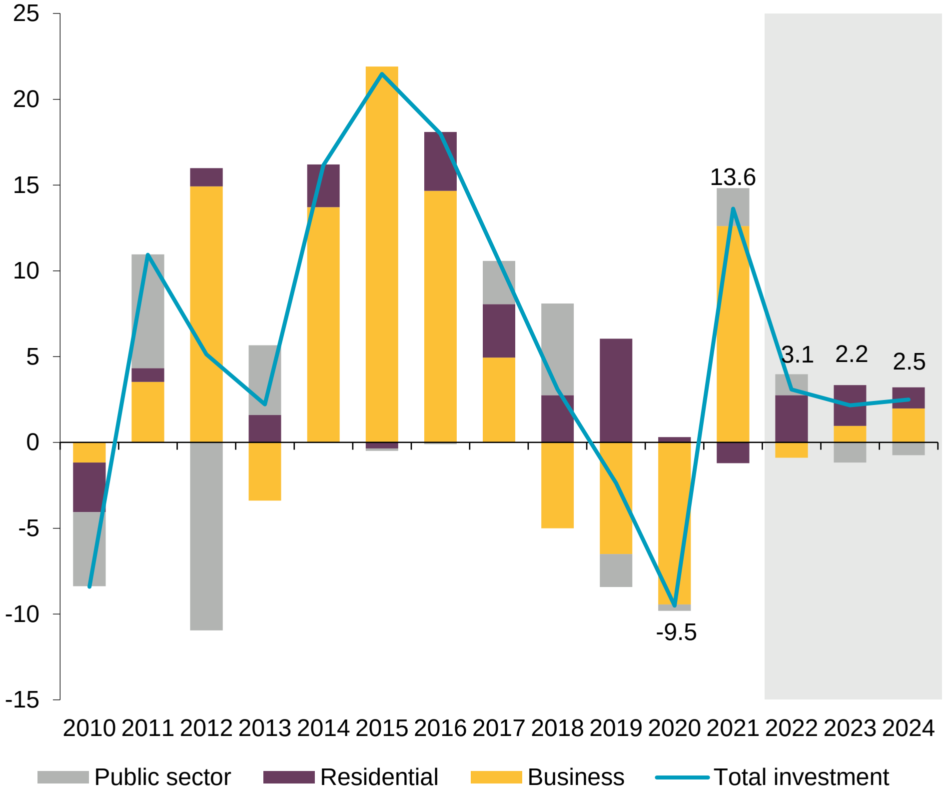
Residential investment to gain steam, while public investment will contract further ahead

Highlights

- After a two-year contraction, investment spiked in 2021, increasing by almost 14% which is the fastest growth rate in five years
- The growth was fuelled in particular by over 23% growth in business investment and 12% in public investment, whereas residential investment contracted
- For 2022, the outlook is for residential investment to finally rebound after last year's contraction as flats in early stages of construction have increased markedly in number and demand for new homes is strong
- Furthermore, public investment will gain momentum this year, although business investment looks set to contract slightly
- In 2023, however, household and business investment will be the main driver of growth, and public investment will contract year-on-year
- ISB Research forecasts that total investment will grow by 3.1% in 2022, 2.2% in 2023, and 2.5% in 2024. The investment level in the economy will therefore be relatively stable, and rather high in historical context

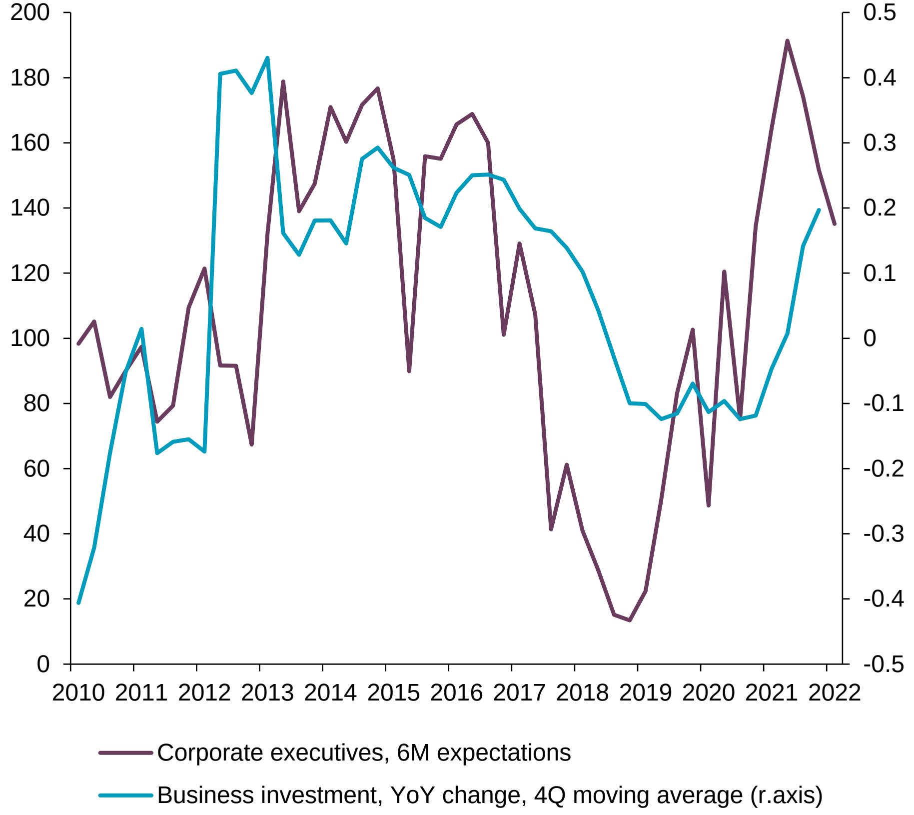
Investment, real change, and contribution of subcomponents

%



Executives' expectations and business investment

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



Source: Statistics Iceland, Gallup

Unemployment converging to a new equilibrium

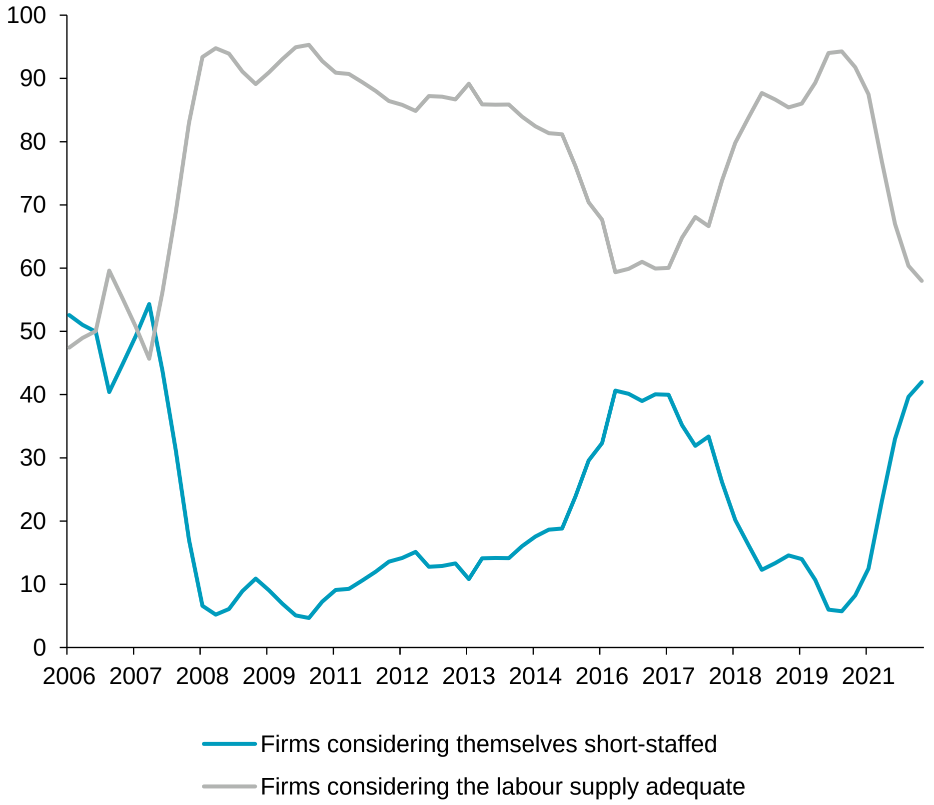
The relatively swift economic recovery has caused a rapid decline in unemployment

Highlights

- Unemployment fell rapidly in 2021, from 11.6% of the labour force at the start of the year to 4.9% by year-end
- The relatively swift economic recovery in 2021 has fostered job growth and the decline in unemployment is expected to continue in 2022, albeit more slowly than last year
- ISB Research forecasts average year-2022 unemployment at 4.5%
- According to a recent Gallup survey, 42% of company executives consider themselves short-staffed
- Construction and tourism companies in particular envision adding on staff in 1H 2022. 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. This is roughly the level seen in 2019

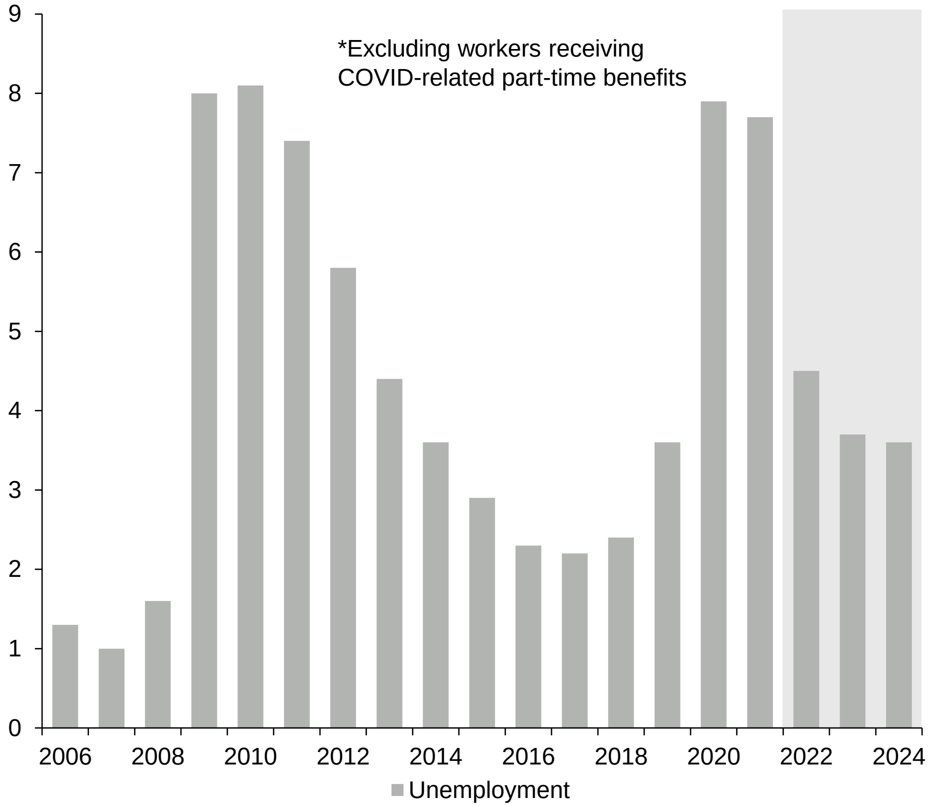
Labour supply according to corporate executives

%



Unemployment*

% of workforce, annual average



Source: Statistics Iceland, The Central Bank of Iceland, Gallup

Further private consumption growth ahead after robust 2021

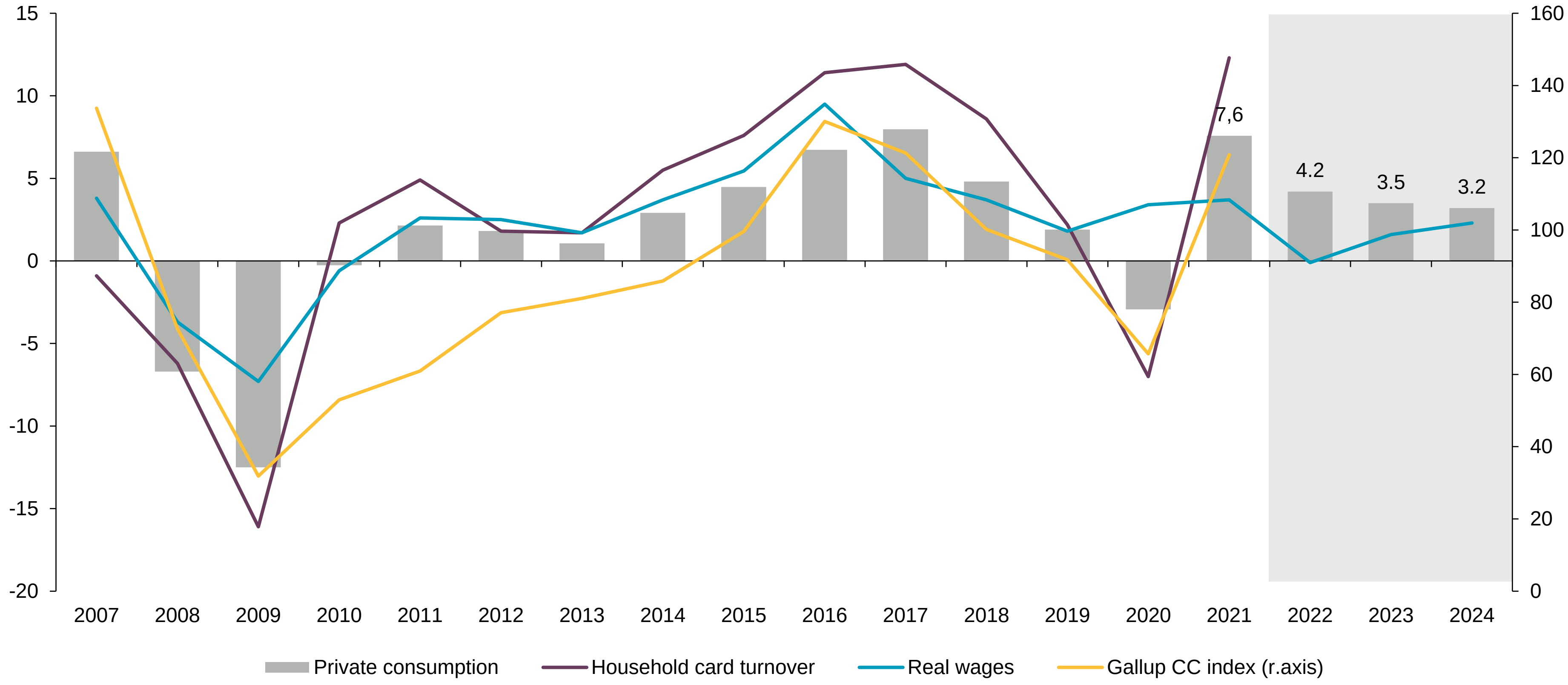
Household consumption supported by strong labour market, demographics and sound asset position

Highlights

- Following 3.0% contraction in 2020, domestic demand gained strongly in 2021. The growth was particularly robust in private consumption which grew by 7.6% in 2021
- Relevant indicators, such as card turnover, real wage growth and the Gallup consumer confidence index, all suggest a relatively strong start to 2022
- Real wages grew by an average of 3.7% in 2021, despite high inflation
- Real wage growth likely to be halted by a temporary inflation spike in 2022, but assumed to return in coming years
- A considerable YoY increase in employment and a sound financial position of most households are likely to support consumption growth despite near-term slowdown in real wage growth .
- ISB Research expects appetite for consumption to remain strong, and growth will continue over the forecast horizon, although the pace will ease gradually
- Private consumption growth is forecast at 4.2% in 2022, 3.5% in 2023, and 3.2% in 2024
- Recent geopolitical developments could affect consumption negatively compared to the baseline forecast for 2022

Private consumption and related indicators

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



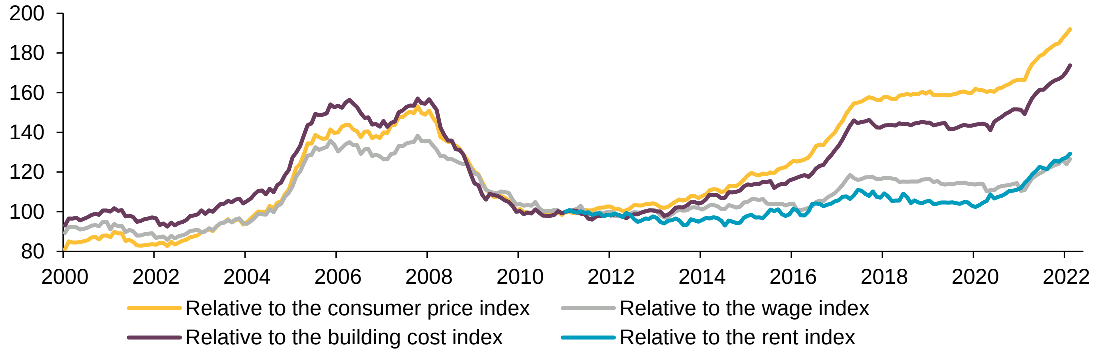
Sources: Central Bank of Iceland, Gallup, Statistics Iceland, ÍSB Research.

Real estate markets lively despite pandemic

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

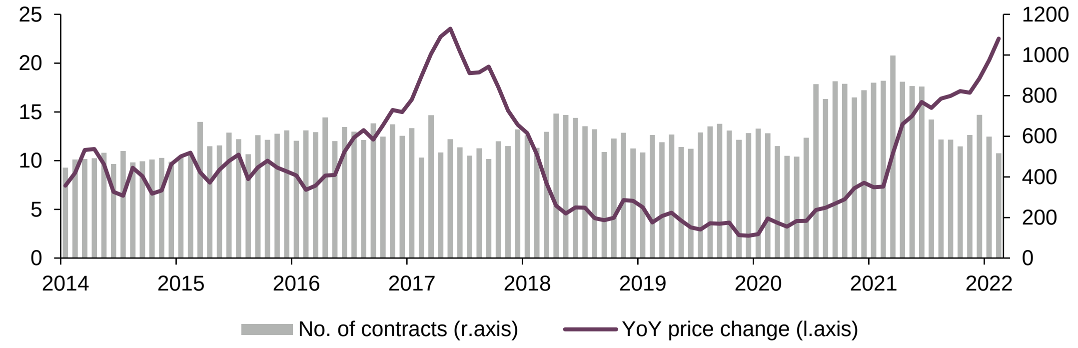
Capital area house prices relative to macroeconomic fundamentals

Index, January 2011=100



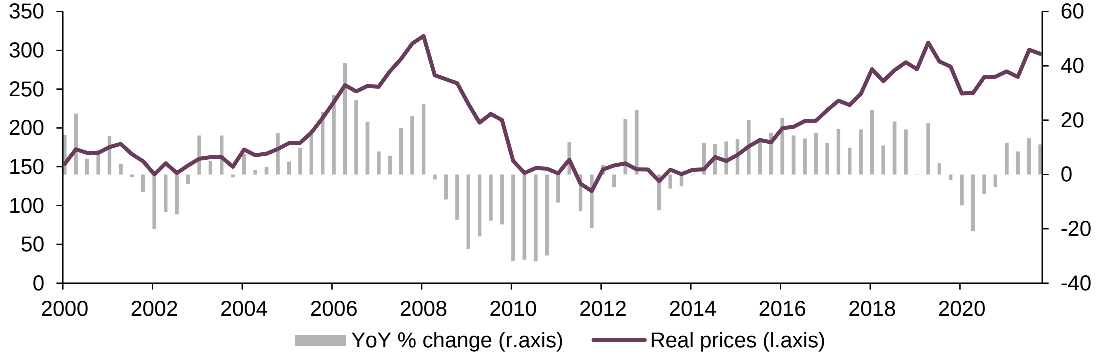
Residential house prices and turnover in greater Reykjavik

% change (l.axis) and number (r.axis)



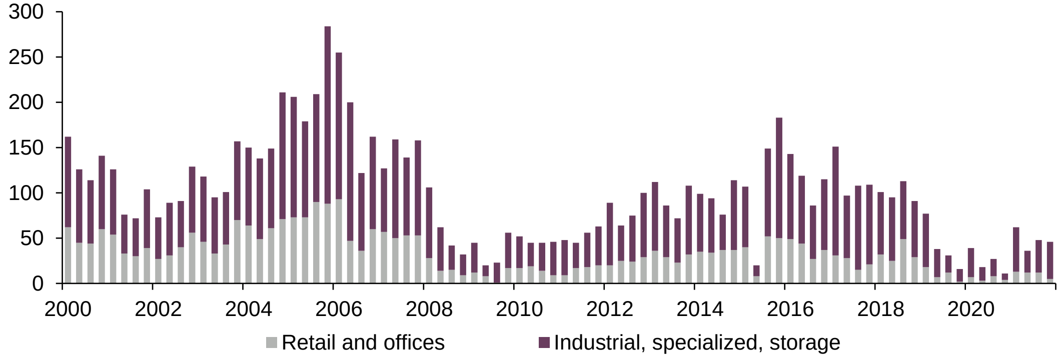
Commercial property real prices in greater Reykjavik

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 2022 and decline gradually thereafter

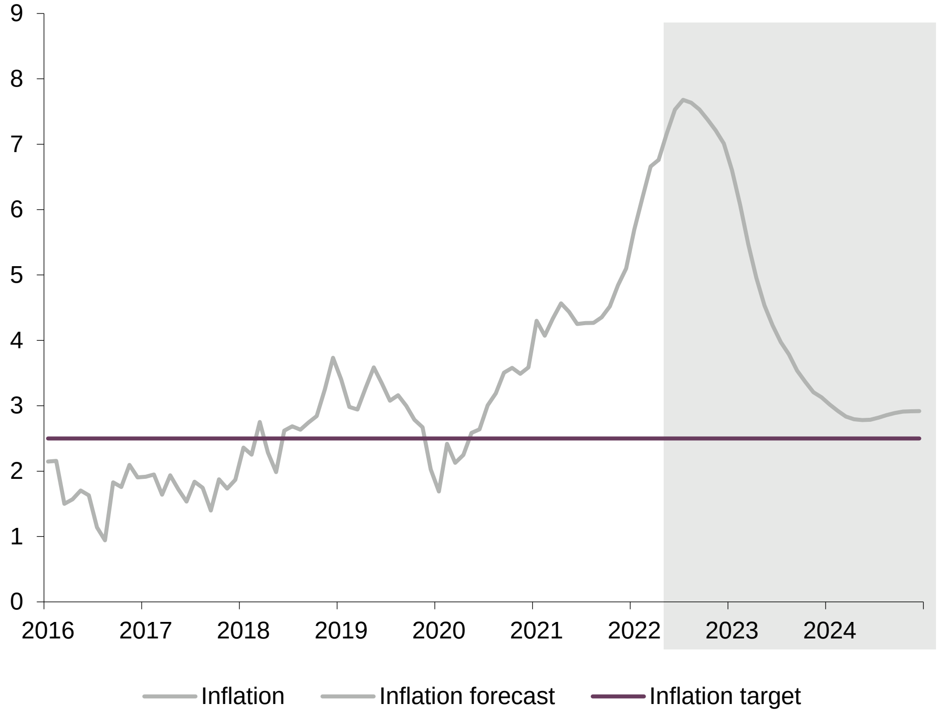
House prices and import costs the main drivers short-term but wage costs also matter

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 March inflation reached a 12 year peak of 6.7%
- Inflation has proven more persistent than expected, but ultimately it will fall
- ÍSB Research expects inflation to average 6.9% in 2022 and 4.2% in 2023, finally approaching the CBI's 2.5% target by Q1 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

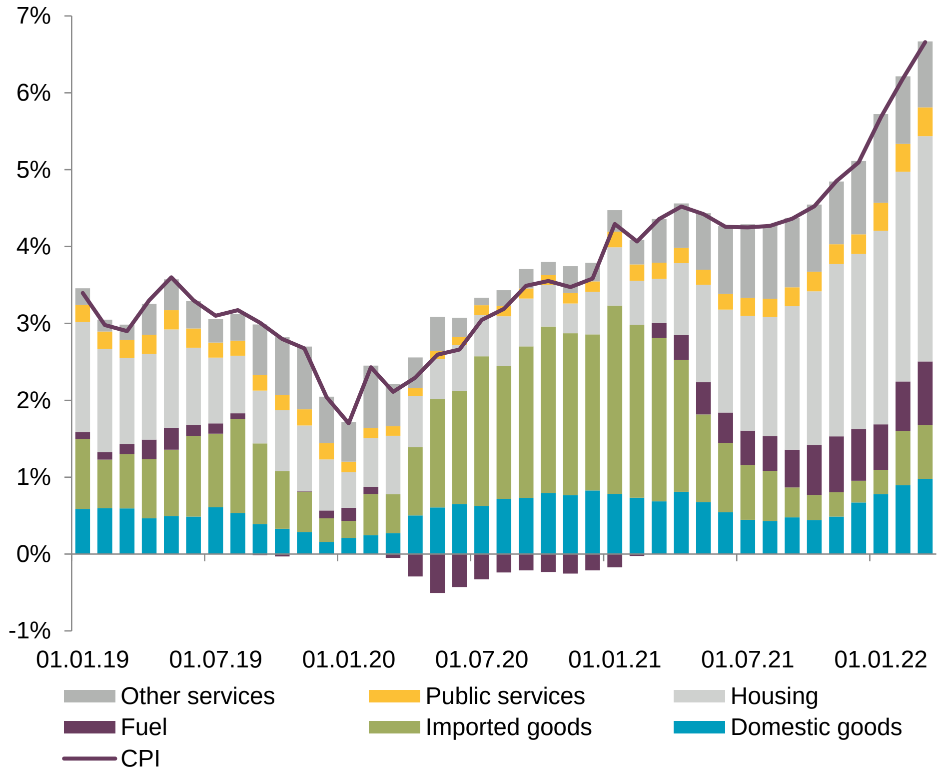
Inflation and the CBI inflation target

%



Inflation by contribution of main categories

%



Sources: Statistics Iceland, ÍSB Research

Policy rate on the rise

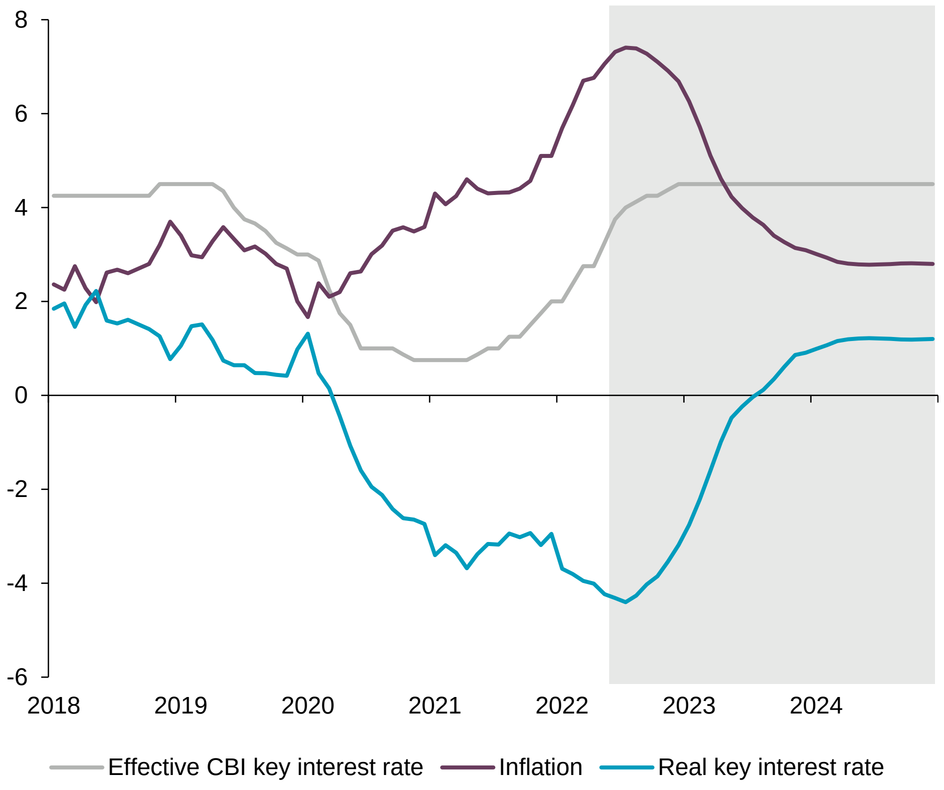
Long-term interest rates approaching equilibrium within the forecast horizon

Highlights

- The Central Bank of Iceland has hiked its policy by 3 percentage points since May 2021, after reaching an all-time low of 0.75% in Q4 2020
- The policy rate is now 3.75%, its highest since Q3 2019
- Further monetary tightening is likely as inflation peaks and the policy rate could reach 4.5% by year-end 2022
- Monetary tightening is probably already largely priced into long-term nominal rates while the real rate on CPI-linked treasury bonds remains held back by short-term inflation pressures
- Further ahead, long-term rates are expected to approach a medium-term equilibrium, which ISB Research estimates at around 4.4% for nominal rates and just over 1% for the real rate

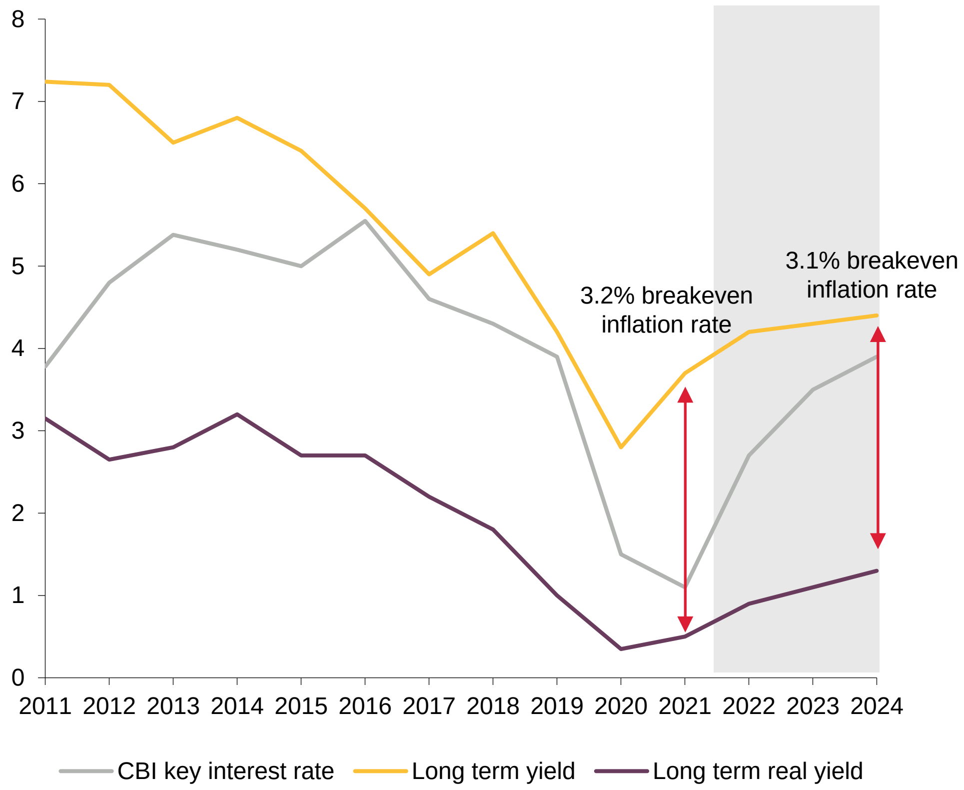
Policy rate and inflation

%



Interest rates

%



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

ISK set to appreciate further with growth in export revenues

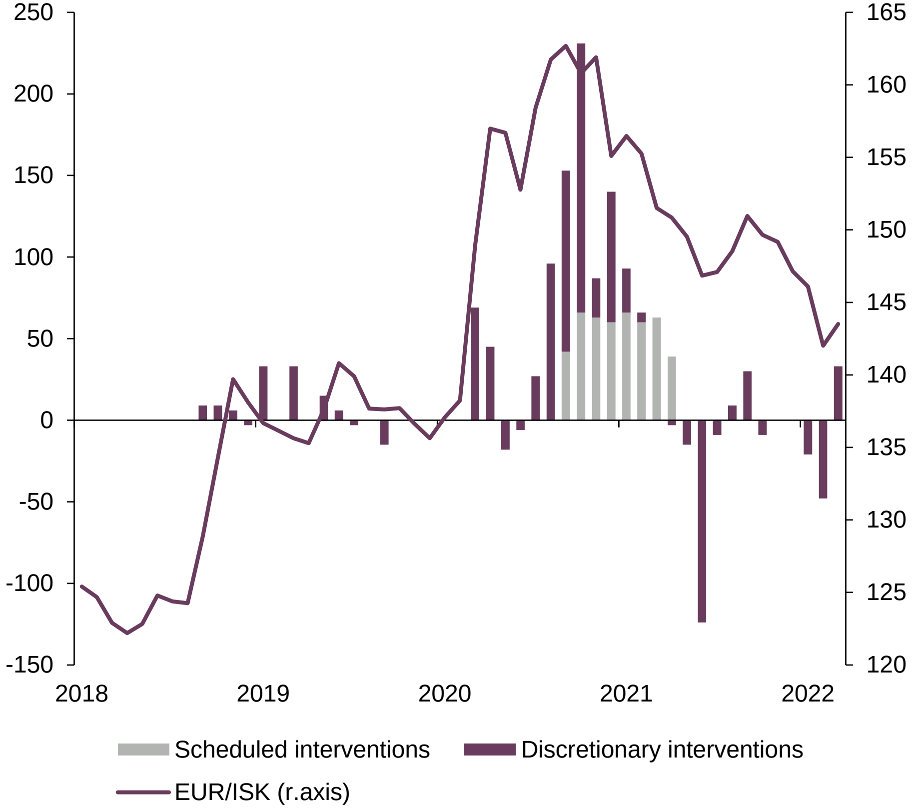
The ISK was relatively stable in 2H 2021 but has been more volatile in 2022 so far

Highlights

- The ISK appreciated by nearly 3% in 2021, with all of the strengthening occurring in H1, while in H2 it fluctuated within a relatively narrow range
- The CBI steadily scaled down its FX market intervention over the course of the year, and in Q4/2021 it hardly traded in the market at all
- Increased ISK volatility in Q1 2022 led to the CBI stepping up FX interventions once more
- 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
- Although the high uncertainty inherent in exchange rate forecasts should be noted, ISB Research assumes that the ISK exchange rate will be 8-9% stronger by 2H 2024 than it was at the beginning of 2022
- The real exchange rate in terms of relative consumer prices will then be similar to that in 2018

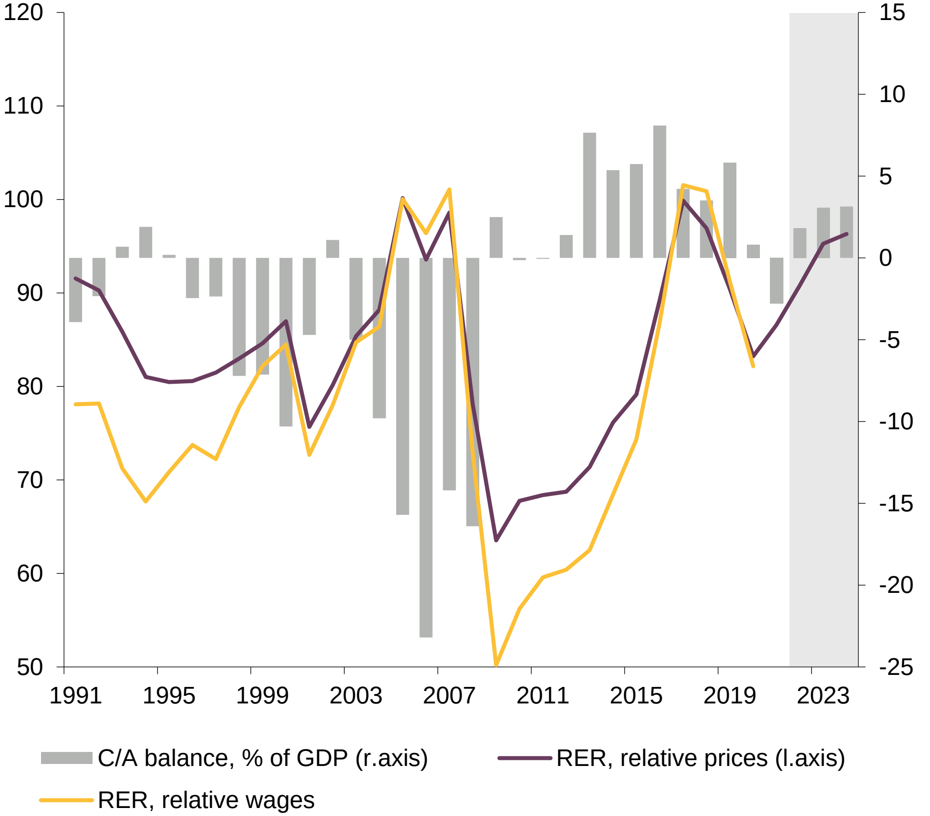
ISK exchange rate and CBI FX market intervention

EUR m (left) and EURISK (right)



Real exchange rate and current account balance

Index and % of GDP



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

The Ukraine war increases uncertainty to the downside

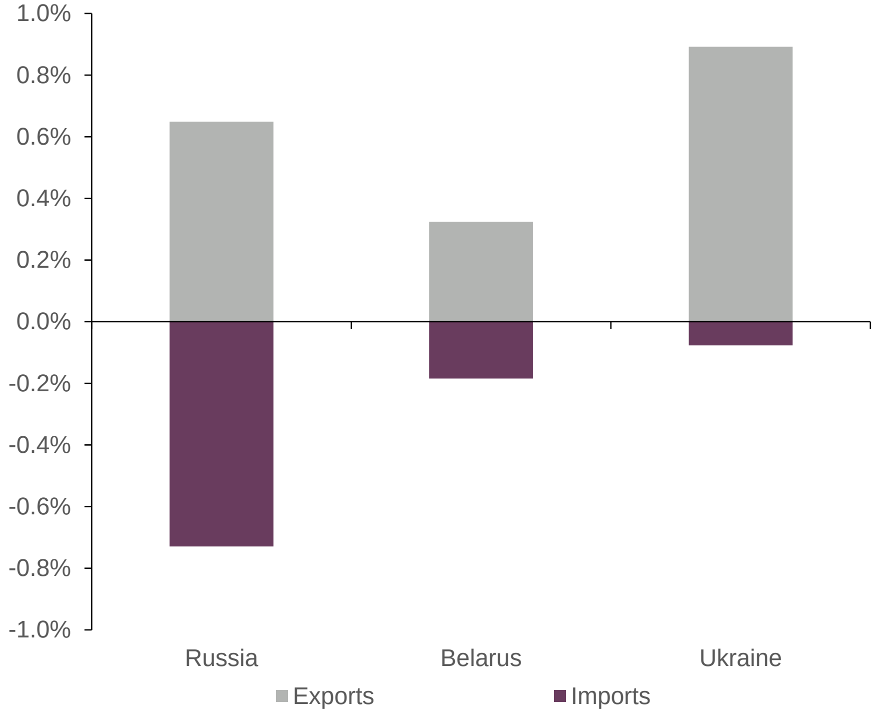
Impact likely to be moderate compared to peers with closer ties to Ukraine and Russia

Highlights

- Russia’s invasion of Ukraine and the economic sanctions imposed on Russia in response will doubtless have a tangible impact on economic developments in Iceland
- The inflation outlook has deteriorated, and short-term uncertainty increased
- The sudden spike in imported goods prices has a negative impact on the current account, all else being equal, due to deteriorating terms of trade
- However, price increases in Iceland’s main export commodities have a partially offsetting impact on the C/A balance
- Exports to Ukraine, Russia and Belarus totaled around 2% of total exports in 2021, mostly pelagic fish products
- Uncertainty for the tourism sector has increased but so far, the impact has been minimal
- Private consumption impact milder than peers as households' utility costs remain stable
- Worsening inflation outlook could prompt more monetary tightening by the CBI but weaker GDP growth and increased near-term uncertainty may weigh in the opposite direction
- Most probably, the economic recovery will continue, although it may hit a rocky patch as a result of the war

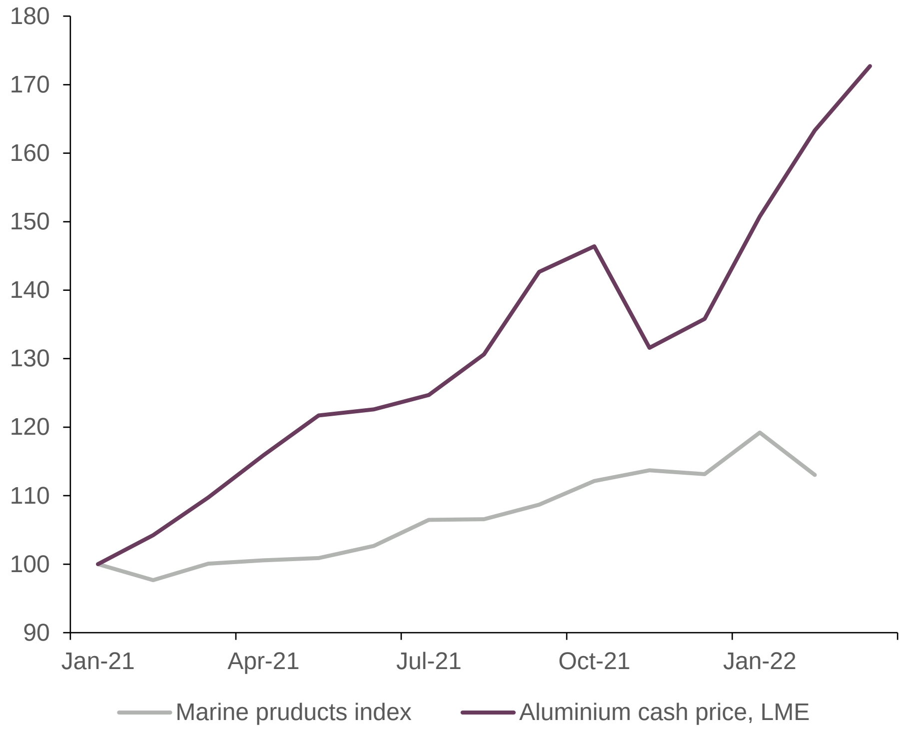
Trade in goods and services with selected countries

% of total exports/imports. Goods trd 2021 and services trd 2020



Price of main export commodities

Indices, global price. Jan-2021=100

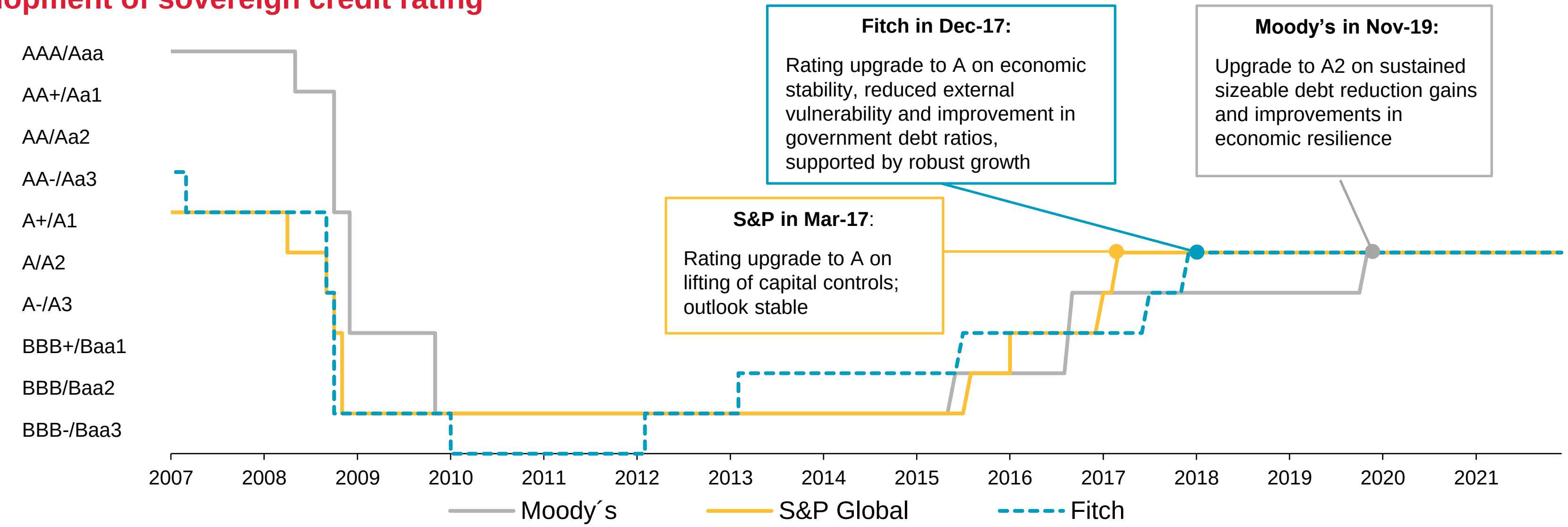


Sources: Government of Iceland, Statistics Iceland, Reuters Eikon

Iceland’s credit rating has remained at A

Setbacks in the tourist sector have not affected the sovereign ratings

Development of sovereign credit rating



MOODY’S IN AUGUST 2021

- “Iceland's credit strengths include the economy's flexibility, wealth, competitiveness and favourable demographics, all of which support its long-term growth prospects and help it to absorb shocks.”
- “In our baseline scenario we expect the recovery to gather pace into next year, helped by the authorities' strong and swift policy action, high wealth buffers and stronger-than-expected resilience of Iceland's other key industries.

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 NOVEMBER 2021

- “The economic recovery has been stronger than S&P Global Ratings expected”
- “Despite risks to the tourism recovery, we believe the medium-term growth trajectory will be strong, and supported by a public investment program.”
- “Iceland's stable institutional framework and effective policymaking also support the ratings.”

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

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