



Iceland's rise after the crisis and avenues for the future

Gylfi Magnússon, University of Iceland

Presentation May 22nd 2018 in Helsinki

*The Nordic Region – an attractive place for
advanced businesses?*

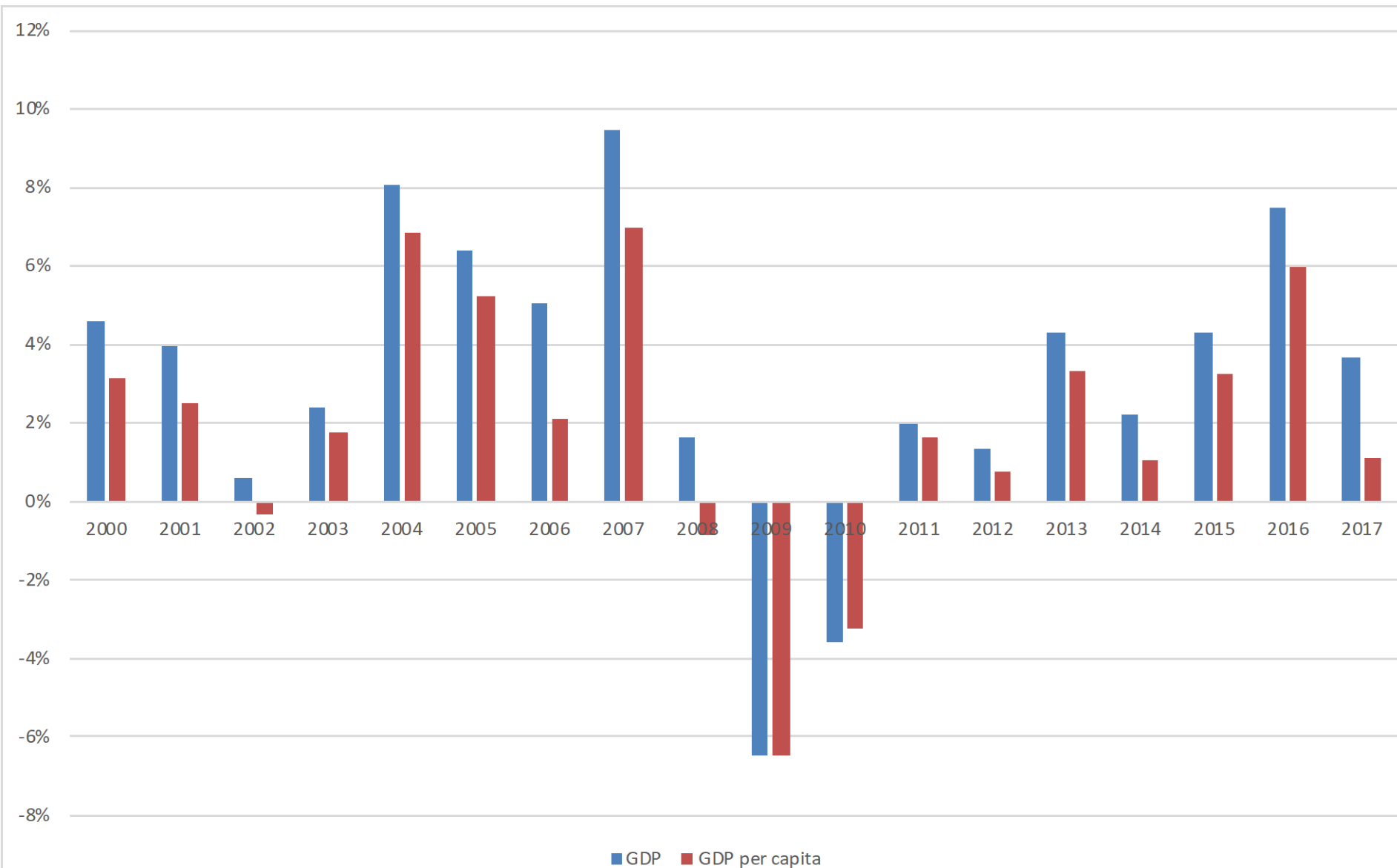
Crisis of Autumn 2008

- The bulk of the financial system collapsed.
- Currency collapsed (50% drop in value).
- GDP contracted (10% by mid 2010)
- Stock market almost disappeared (97% of value lost)
- Corporations and households with severely damaged balance sheets. Huge debt problem.
- Household purchasing power shrinking fast.
- Whole sectors practically vanished (construction in particular).
- Political instability, little trust in institutions. Riots.
- Currency reserves depleted, access to international payment system broken down.

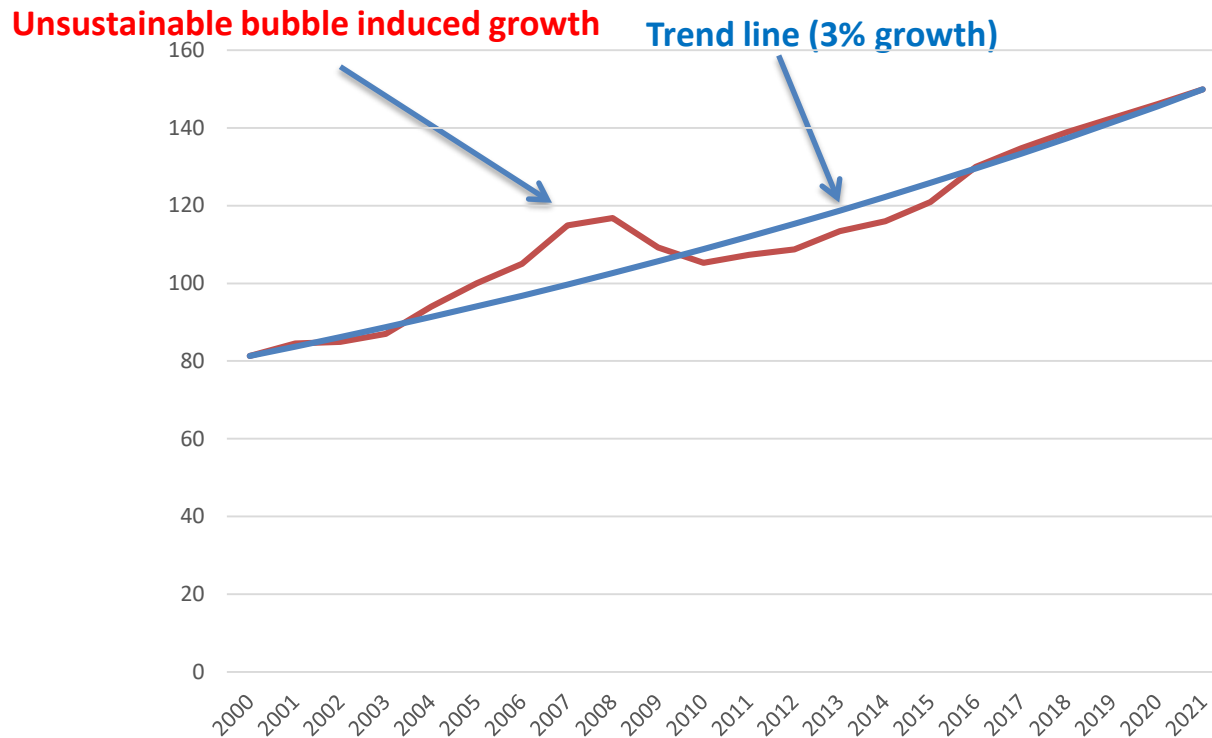
Ten years later

- Robust economic growth (GDP per capita up 18% from post-crisis low, up 6% from pre-crisis high)
- Substantial current account surplus (approx. 6% of GDP)
- Household purchasing power well above pre-crisis peak
- Very little unemployment, 3% or so (and substantial inflow of foreign labor, record last year with a net inflow equal to 2,4% of population.)
- Net international investment position (NIIP) the best in 70 years (+7,5% of GDP)
- Capital controls mostly gone
- Fiscal surplus (1,5% of GDP in 2017)
- Rapidly shrinking household and government debt.
- **Overheating?** (Building boom, in particular hotels. House prices well above pre-crisis peaks, strong króna crowding out some exports and import competition. Tourism boom peaked?)

GDP and economic growth.

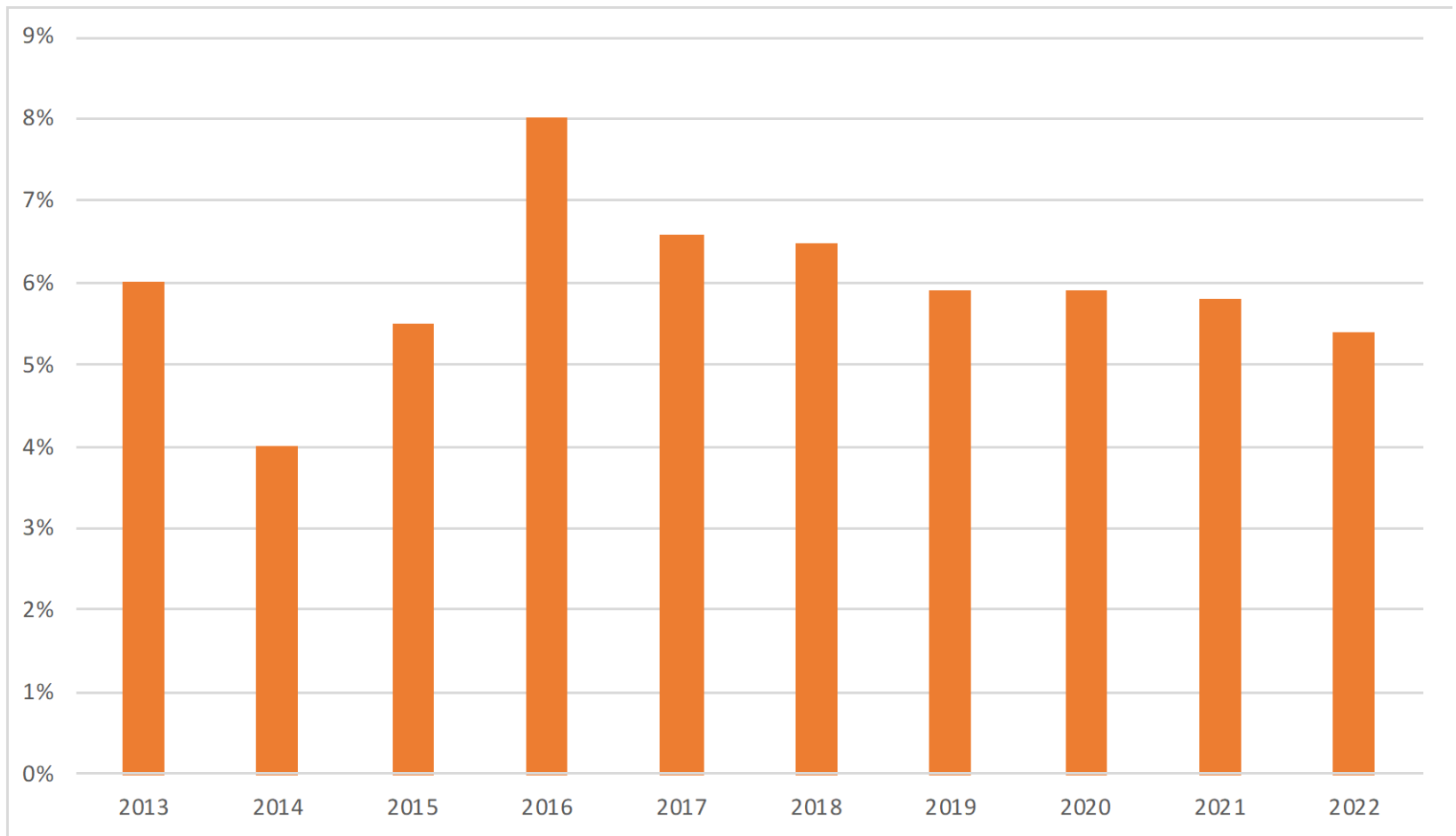


GDP in real terms (2005=100)



- Fell by 10,3% before recovery started in 2010.
- Exceeded pre-crash level in 2015.
- GDP per capita exceeded pre-crash level in 2016.
- **Now back on reasonable long-term path (we hope!).**

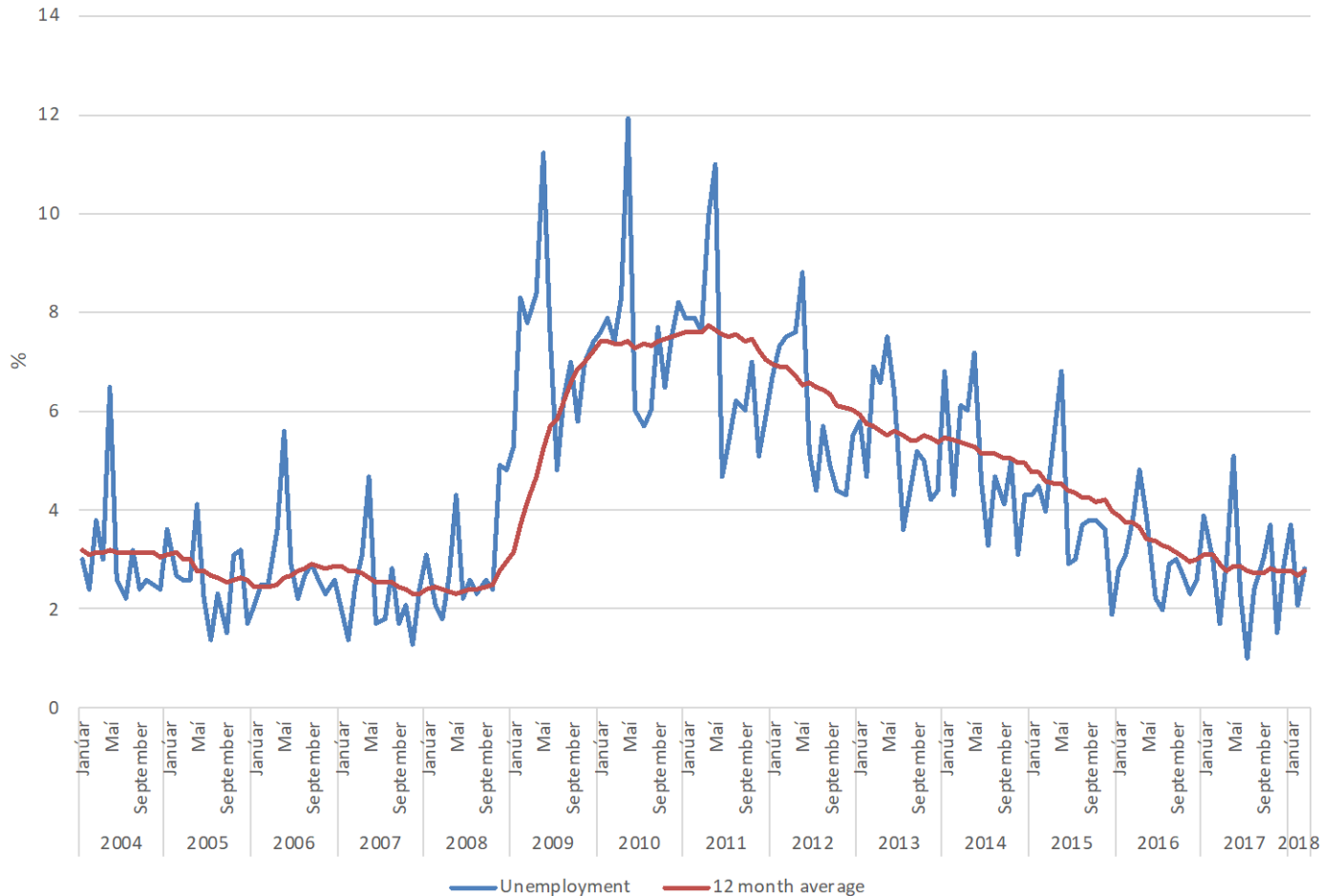
IMF estimate and projection for current account



Share of GDP.

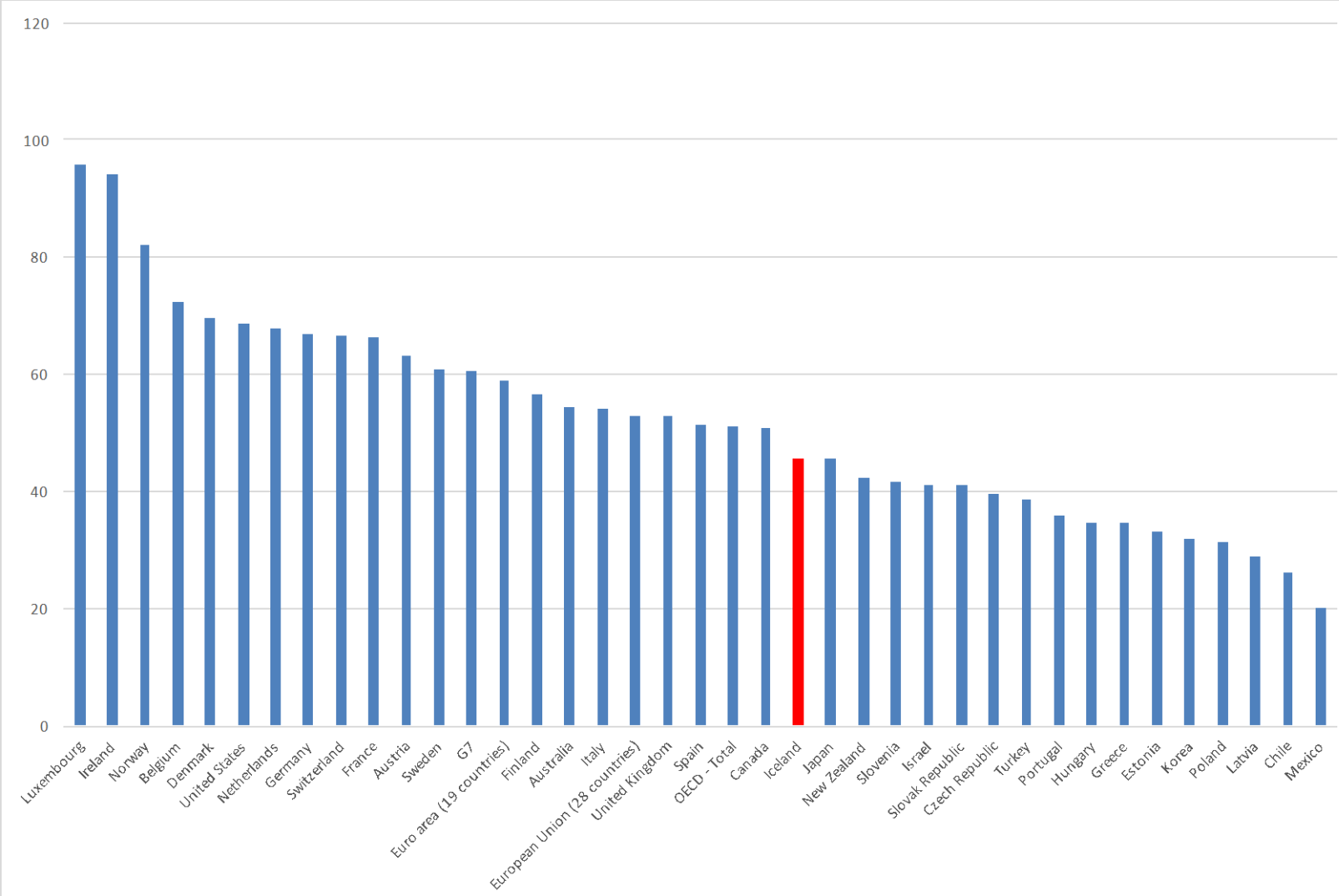
Pre-crisis, Iceland had a chronic current account deficit.

Unemployment



- The labour market proved quite flexible during the crisis.
- Migration, shorter work weeks, increased academic enrolment etc. helped.
- Growth in tourism sector and import substitution created new jobs. Export sectors also healthy. Service sector hired, construction sector fired.

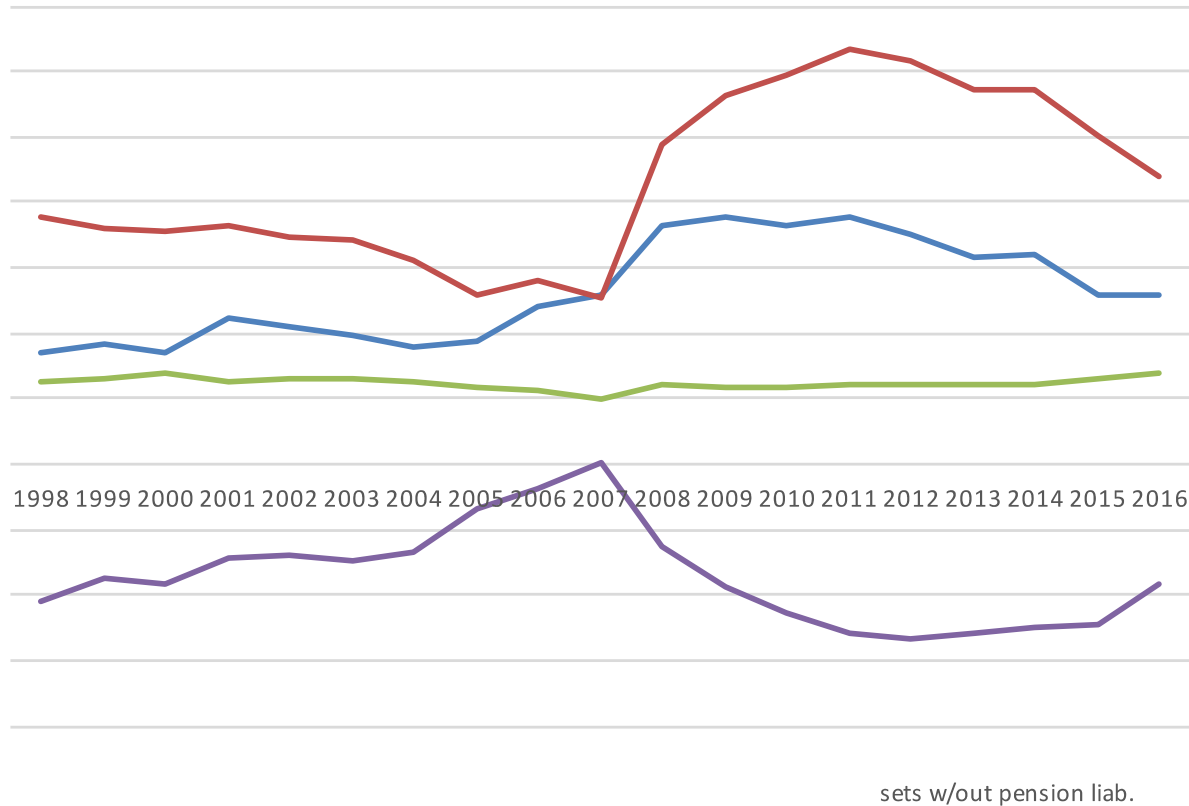
GDP per hour worked in 2015



In USD, adjusted for price level.

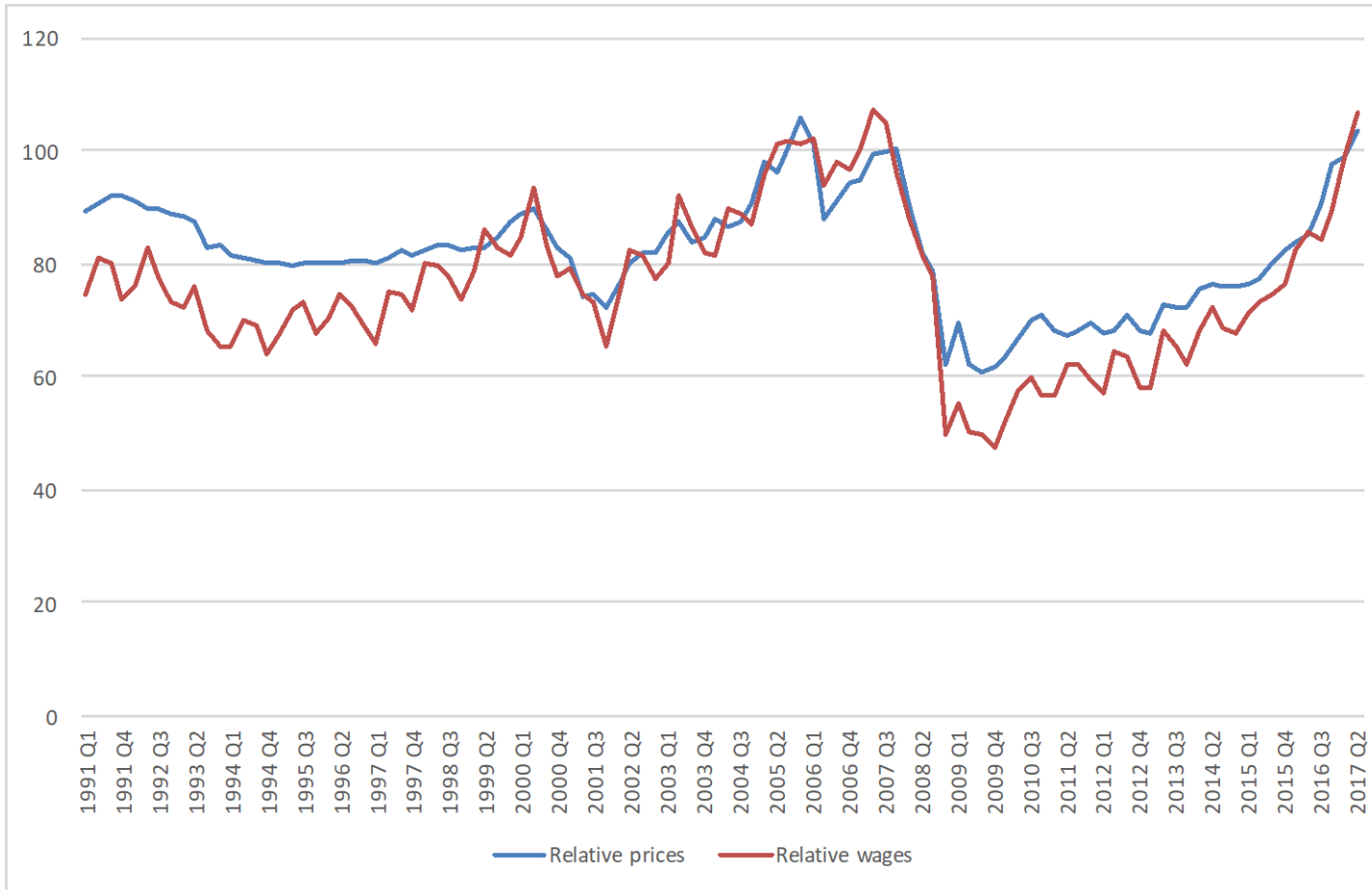
Low productivity – despite substantial natural resources!

Public debt (% of GDP)



Net debt in 2016 (-36,4%) a bit lower than 1998 (-41,7%).

Real exchange rate of the króna



Note that higher figures represent a **stronger** (higher) real exchange rate. The real exchange rate in Q2 2017 was well above the average for 1991-2007, w.r.t. prices (20% higher) and for relative wages 32% higher.

Peaks and troughs

| | Increase starts | Increase stops | Real increase | Decrease stops | Real decrease |
|-------------|-----------------|----------------|---------------|----------------|---------------|
| Stocks | August 2001 | July 2007 | 694% | April 2009 | 97% |
| Real estate | April 2002 | October 2007 | 106% | April 2010 | 39% |
| Króna | November 2001 | November 2005 | 46% | November 2008 | 46% |

An asset price bubble that bursts

- An asset price bubble that bursts can have a profound effect on the distribution of income and wealth.
- During the expansion of the bubble many become rich, at least on paper.
- Likewise many lose a lot when the bubble bursts.
- The process is chaotic. It is not the case that early gains are simply offset by late losses, leaving everybody as well off as before the process started.
- The effects are similar to those of a pyramid or Ponzi-scheme.

Long-term view

- Long-run prospects for Iceland are for the most part good.
- Economic growth will though be far slower in the 21st century than the 20th.
- 2,5% average annual growth of per capita GDP in the 20th century – but probably less than half that (at best) in the 21st.

Long-term view

- A. Worse demographics play a role here. Iceland reaped a demographic dividend in the period 1960-2009, with the proportion of people of working age (20-64) increasing substantially, from 49% in 1960 to 60% in 2009.
- B. In addition, female labour market participation rates kept on rising, from 34% to 77% in the period 1960-2011.

A and **B** together explain about 40% of economic growth in Iceland in the last half century.

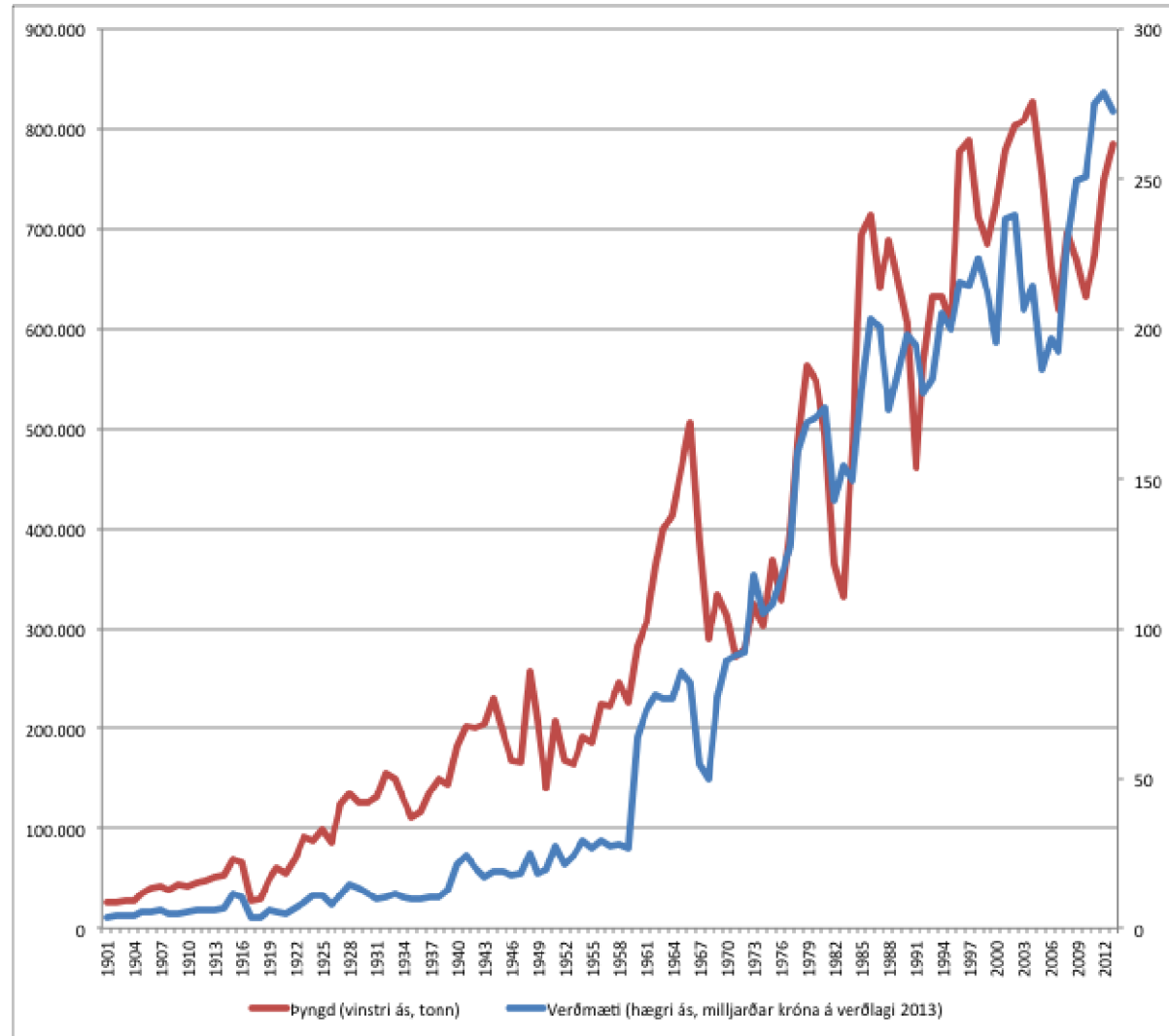
A has been reversed (peaked in 2009-2010) and **B** has probably more or less plateaued.

Natural resources: Seafood exports

Little or no long run growth in the last quarter century (fluctuating around approx. 2 billion USD at current prices).

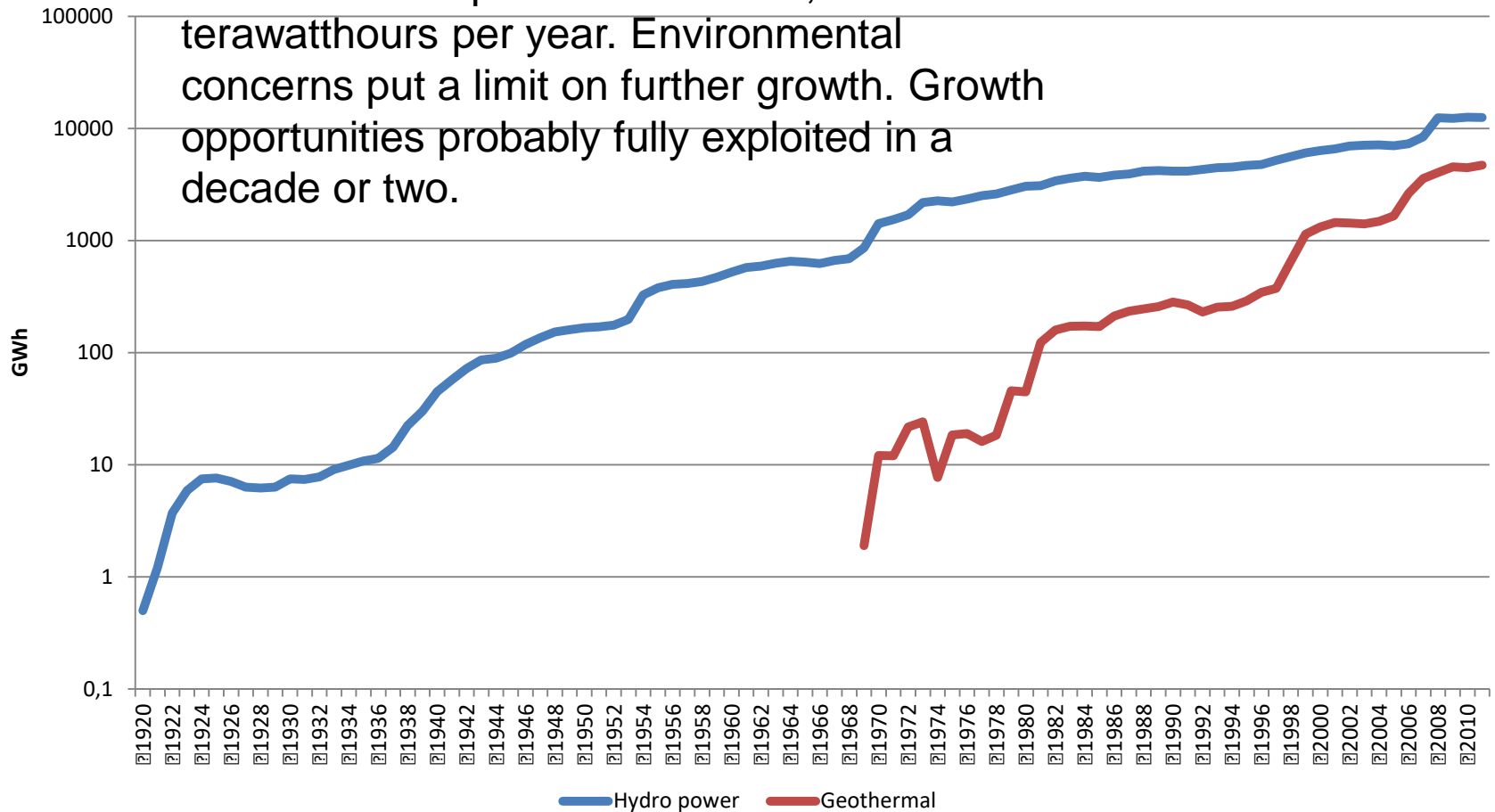
Red: Weight, tonnes

Blue: Value, billions of ISK at 2013 prices.

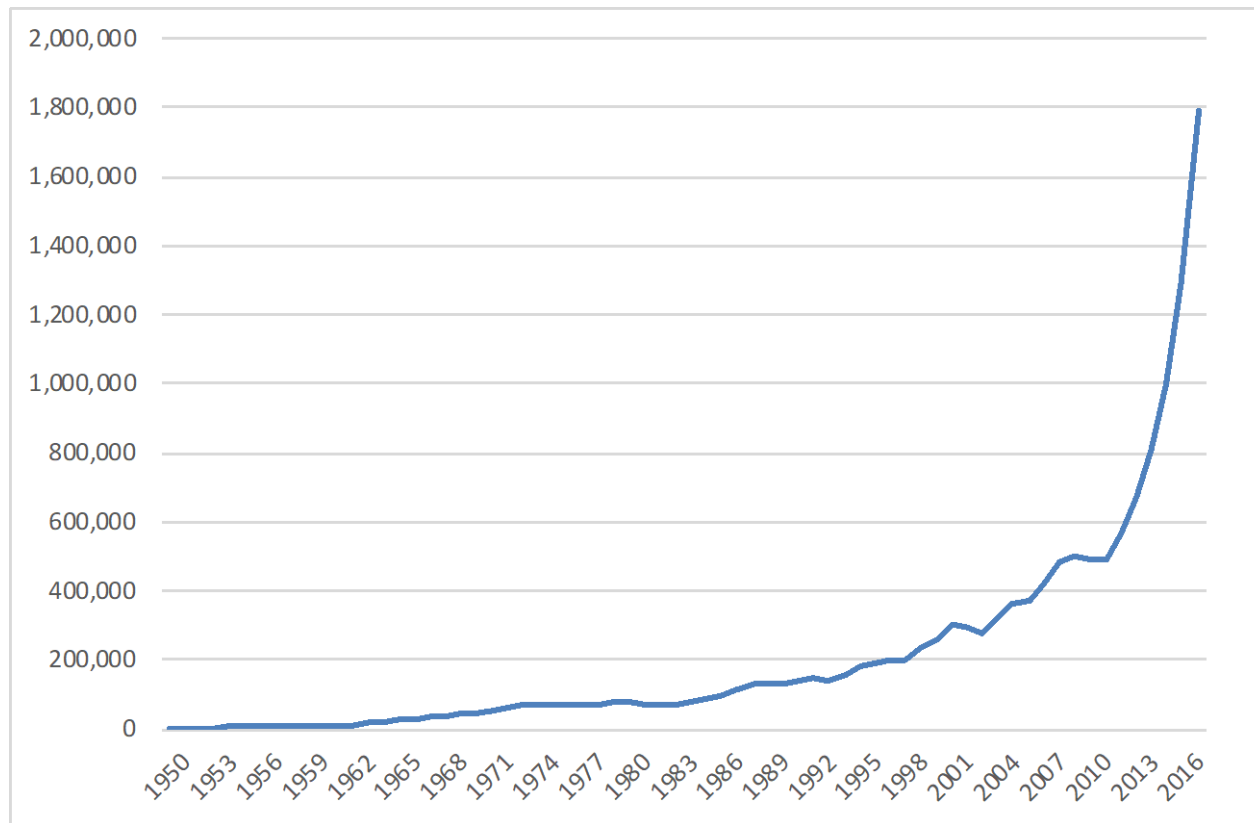


Energy intensive sector: Electricity Generation

Phenomenal growth still continuing. 136% increase in the period 2000-2014, to 18 terawatthours per year. Environmental concerns put a limit on further growth. Growth opportunities probably fully exploited in a decade or two.

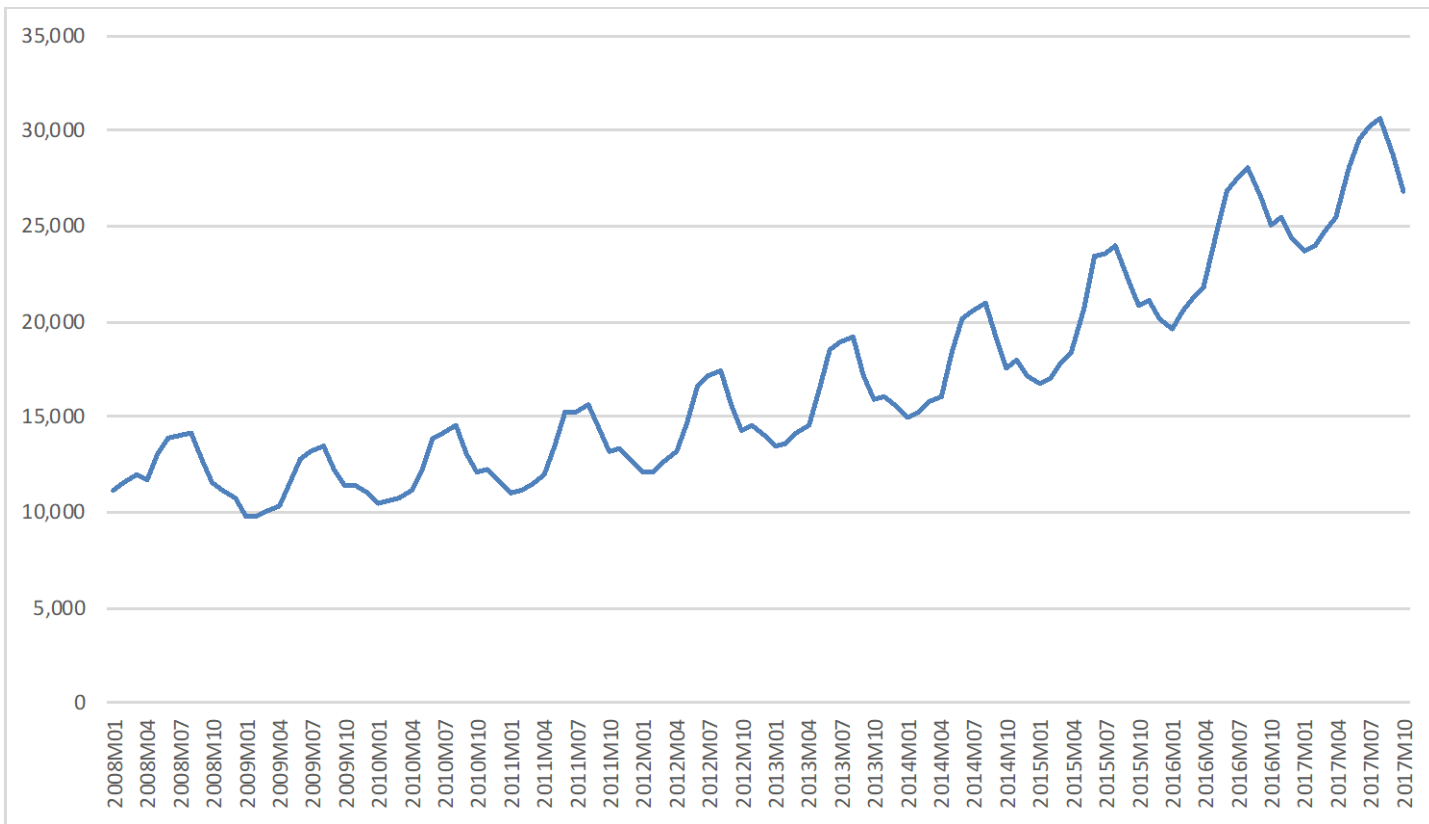


The number of tourists visiting grew six-fold in the period 2000-2016

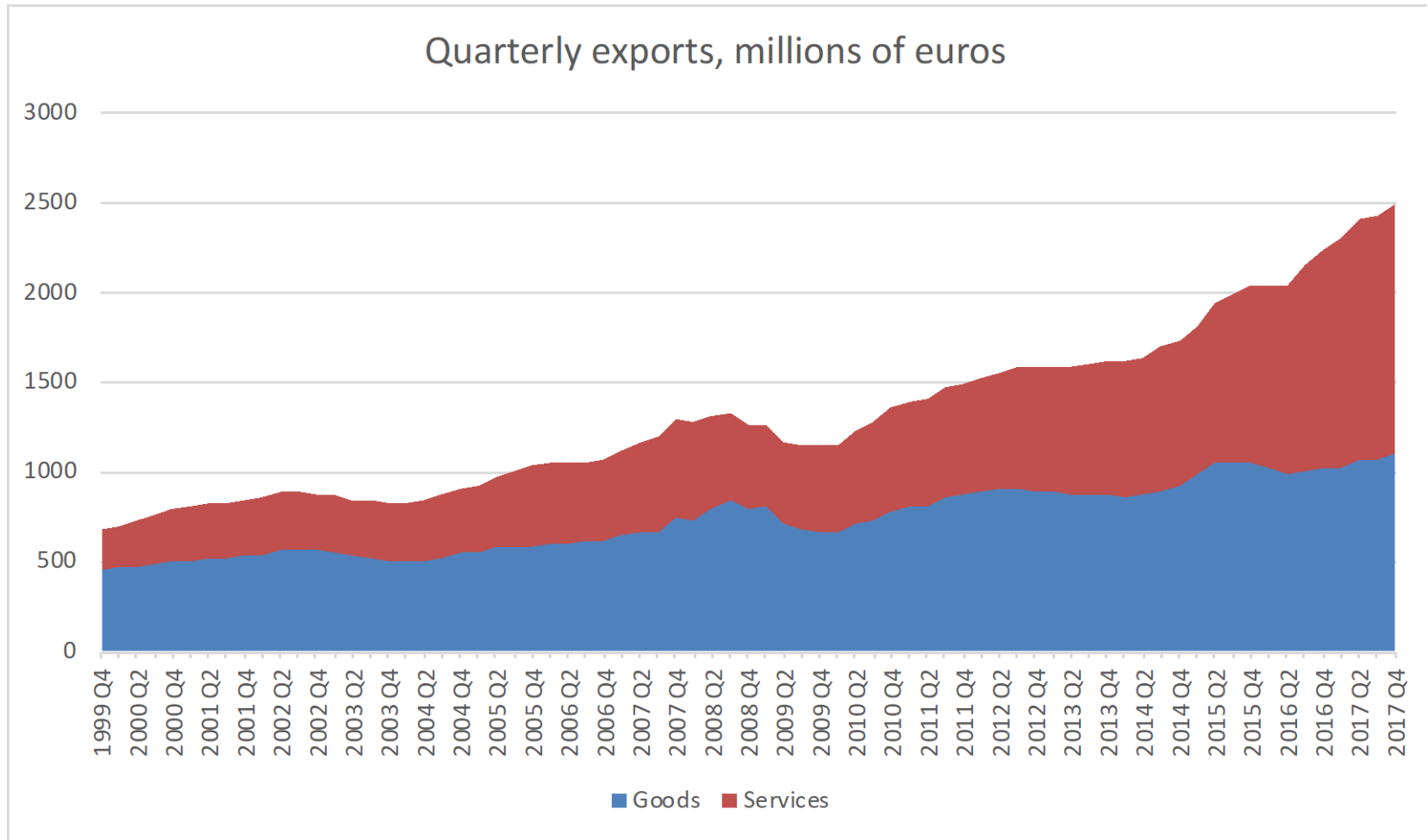


The annual growth in the period 2010-2016 was 24%.

Approximately 15 thousand new jobs in tourism sector since 2008

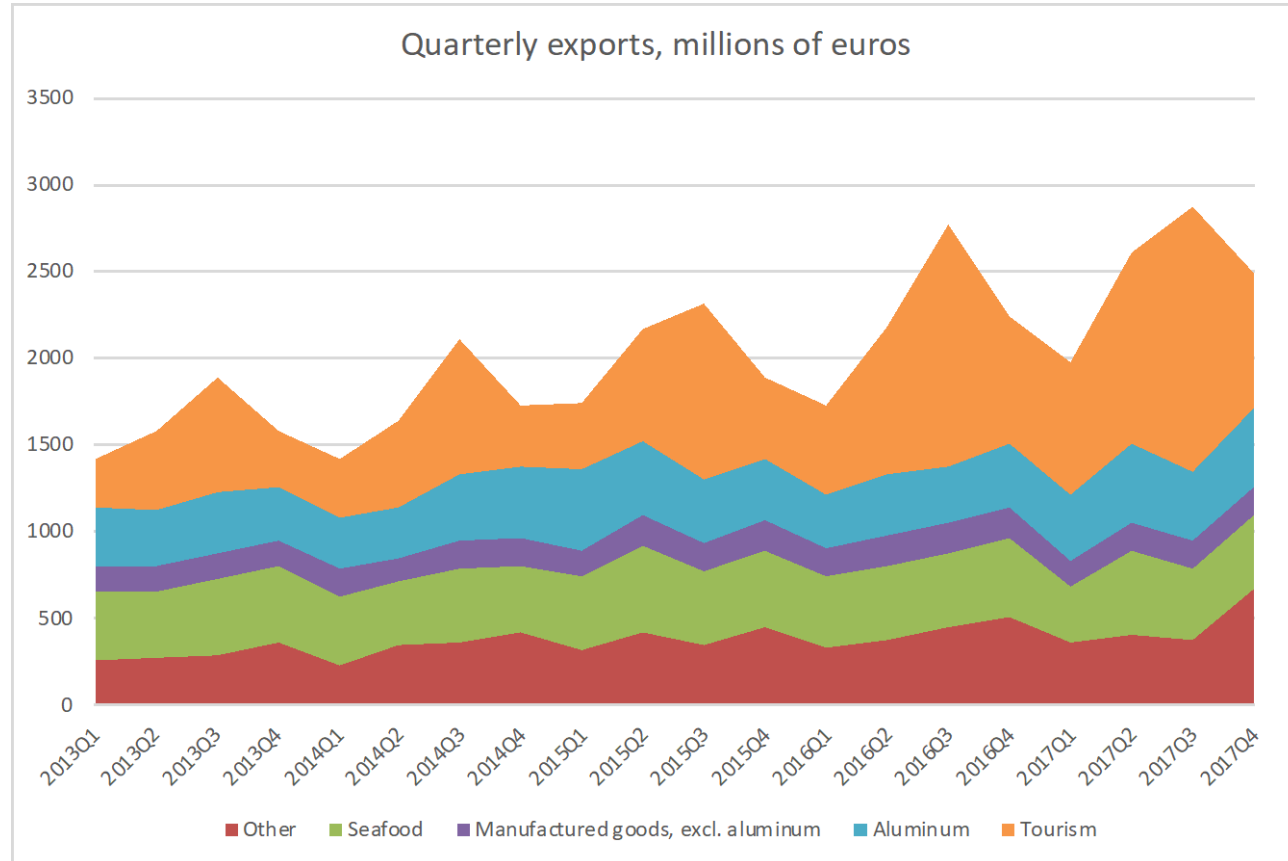


Exports have almost quadrupled in euros in 18 years (7,5% annual growth)



Services, in particular tourism, have doubled their share of exports in this period.

Last five years

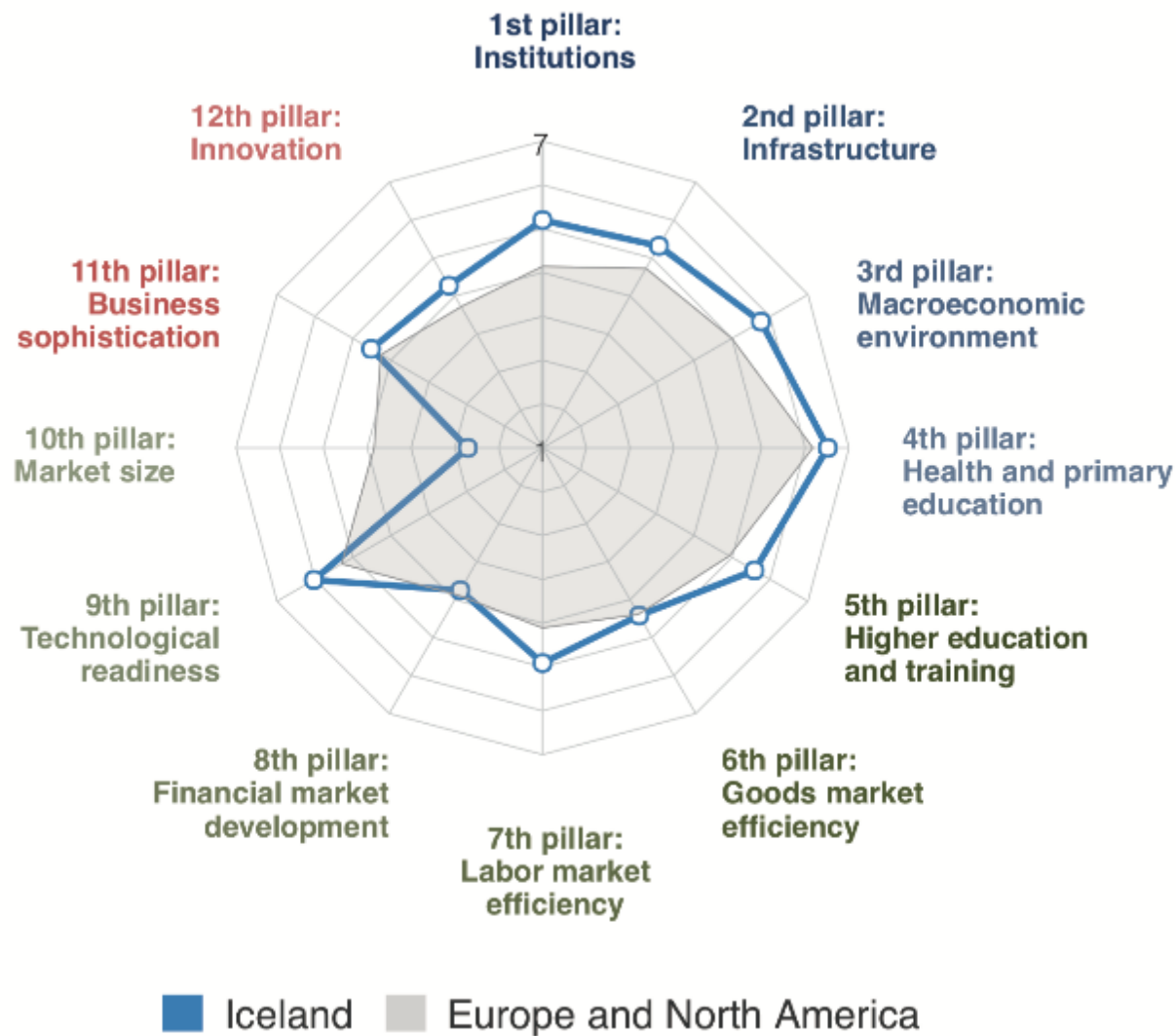


| Sector | Growth rate | Share in 2017 |
|--|--------------|---------------|
| Other | 22,5% | 18,2% |
| Seafood | 1,1% | 16,5% |
| Manufactured goods, excl. aluminum | 2,8% | 6,4% |
| Aluminum | 6,4% | 16,9% |
| Tourism | 24,9% | 41,9% |
| Total exports, goods and services | 12,7% | 100% |

The sector 'other' contains mainly various types of non-tourism related services but also agricultural goods.

Competitiveness Report for Iceland (WEF)

Now in 28th place out of 137, below other countries in Northwest-Europe. The other Nordic countries rank from 6-12.



Resource curse?

- Growth has been heavily dependent on natural resources (marine, energy and natural attractions).
- All these sectors seem to be close to the maximum sustainable resource use (and capital productivity has been low in the energy intensive sector).
- The resource rent affects the real exchange rate, making it hard for other sectors to compete internationally:
 - Iceland is a very expensive country to live in or buy factors of production (with notable exceptions such as energy, water, land).

Challenges

- Move beyond resource dependence
- Small home market (350.000 inhabitants): *Scale problems.*
- Small labor market (200.000 or roughly twice the size of Nokia's global labor force)
- High cost of living and doing business
- Recent growth mainly in low-wage, low-productivity sector dependent on foreign labor (tourism)
- Unstable currency (exchange rate, inflation rate, capital controls)
- Little inbound FDI beyond energy intensive sector
- Nature (always!)

Promising sectors (‘Other’ in official statistics)

- Bio-medical field (e.g. prosthetics, genetics, generic drugs, fish-skin based wound treatment)
- IT and related sectors (e.g. computer games, business services, server farms)
- Marine related technology (ocean cluster)
- Art and design (music, tv/film, clothes, books)
- *Generally high value added sectors that create high wage jobs for highly skilled labor.*

Some strengths

- Sector specific knowledge (e.g. marine, geo-thermal, bio-medicine)
- Infrastructure (IT, telecom, legal, air-travel)
- EEA agreement and various free-trade agreements, including with China
- Flexible (but small) labor market
- Strong welfare system and fairly equal distribution of income and wealth
- Gender equality

Needed investments

- R&D
 - Education
 - Startup sector
 - Science park
-
- Government can not successfully 'pick winners'