

The Icelandic Economy and Outlook

Gylfi Magnússon
Minister of Economic Affairs

April 9th 2010



Collapse of a financial system

- Unprecedented collapse of a financial system and corresponding destruction of financial assets.
- Losses by lenders and equity holders expected to end up somewhere between 4-6 times annual GDP.
- The creditors of the three main banks that collapsed may end up losing approximately 30 billion USD.
- Most of the loss incurred by foreign creditors substantial losses also borne by domestic parties.



The economy did *not* collapse

- The Icelandic *economy* did however not collapse.
- It suffered a heavy blow but the bulk of Iceland's economic activity continues.
- We need to discern between the financial system (*Wall Street*) and the real economy (*Main Street*).



Losses in a financial crisis

- **Loss of financial assets is real from viewpoint of the owners.**
- **For economy as a whole, losses of real assets however far more important.**
- **Damage from a financial crisis from a macro-economic viewpoint primarily due to real assets damage or production slow-down.**
- **A temporary or prolonged contraction of GDP is undoubtedly a real loss.**
- **Vital to get the economy back on track ASAP and reverse increase in unemployment and under-utilization of resources.**
- **It is also vital to maintain prospects for long-term growth.**
- **An increase in foreign debt or loss of foreign assets can also cause domestic economic harm.**



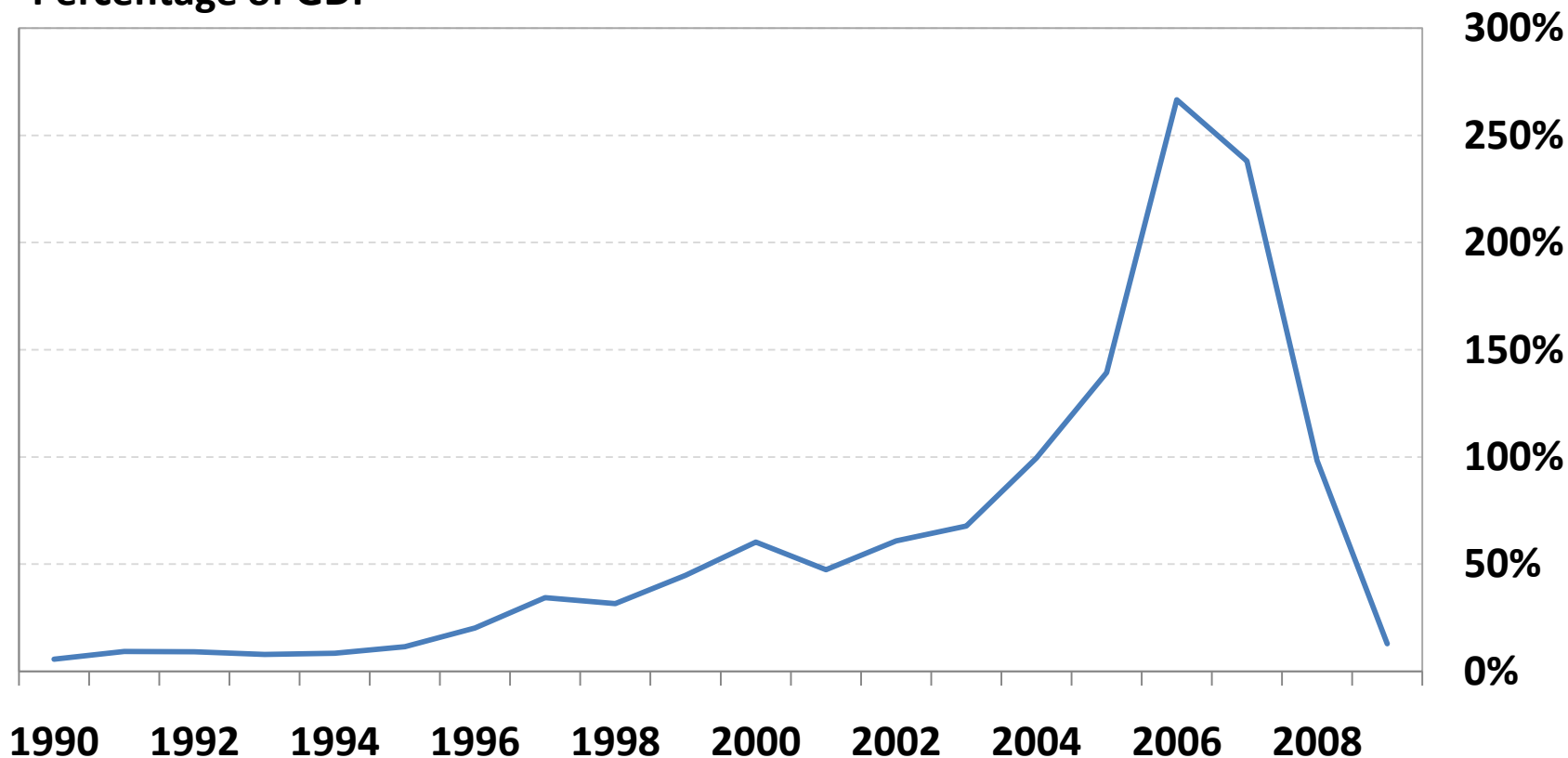
An asset price bubble expanding and bursting

- The effects of the destruction of financial assets on income and wealth distribution can be substantial.
- Likewise, the expansion of an asset price bubble has a significant effect on income and wealth distribution.
- Iceland experienced both.
- The effects of the bubble first expanding and then bursting only cancel each other out in a limited way.
- Many come out of this roughly where they started, others do not. A number of households are in deep financial trouble and corporate balance sheets have suffered heavy damage.



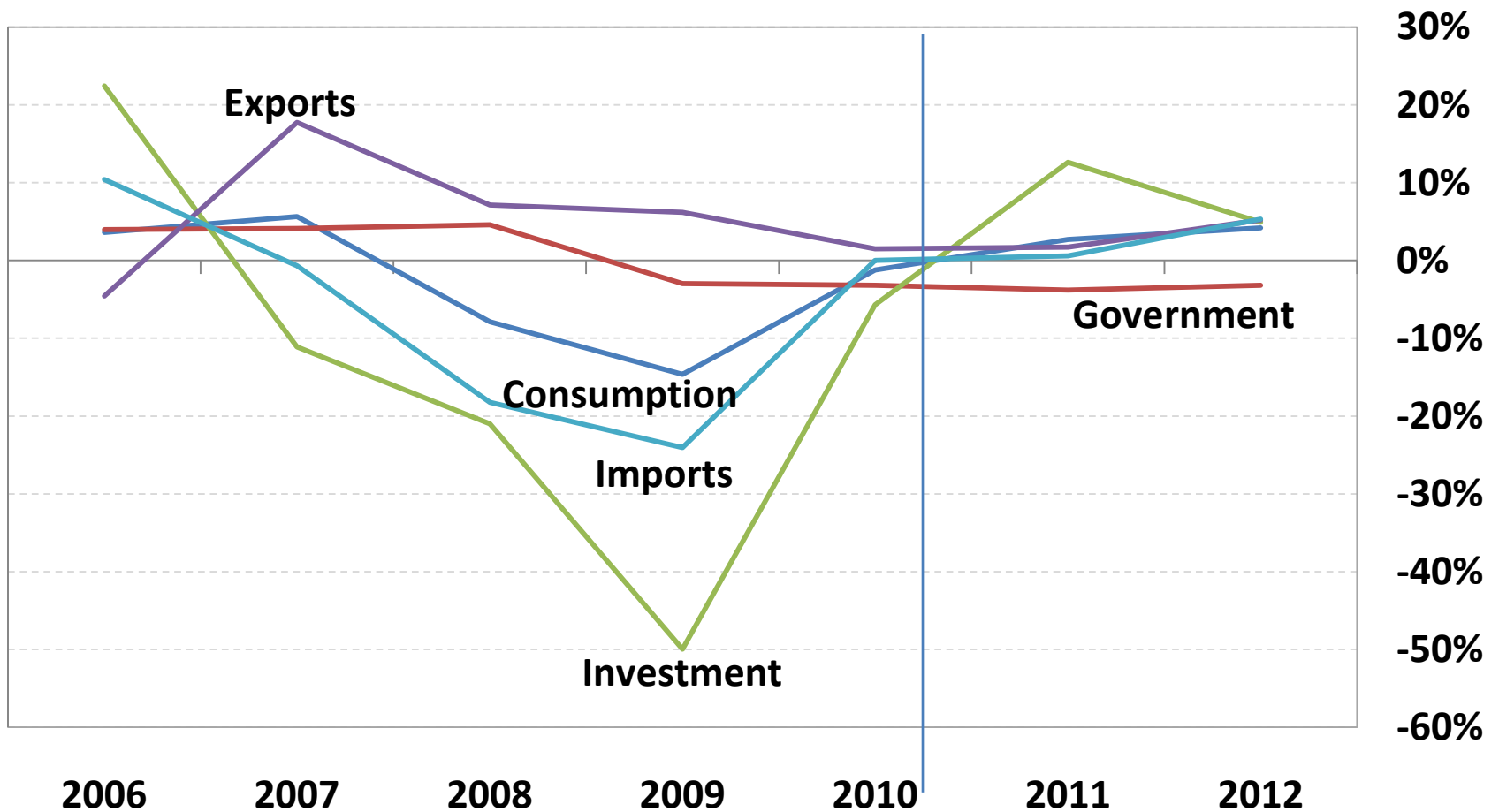
Market capitalization, listed stocks

Percentage of GDP

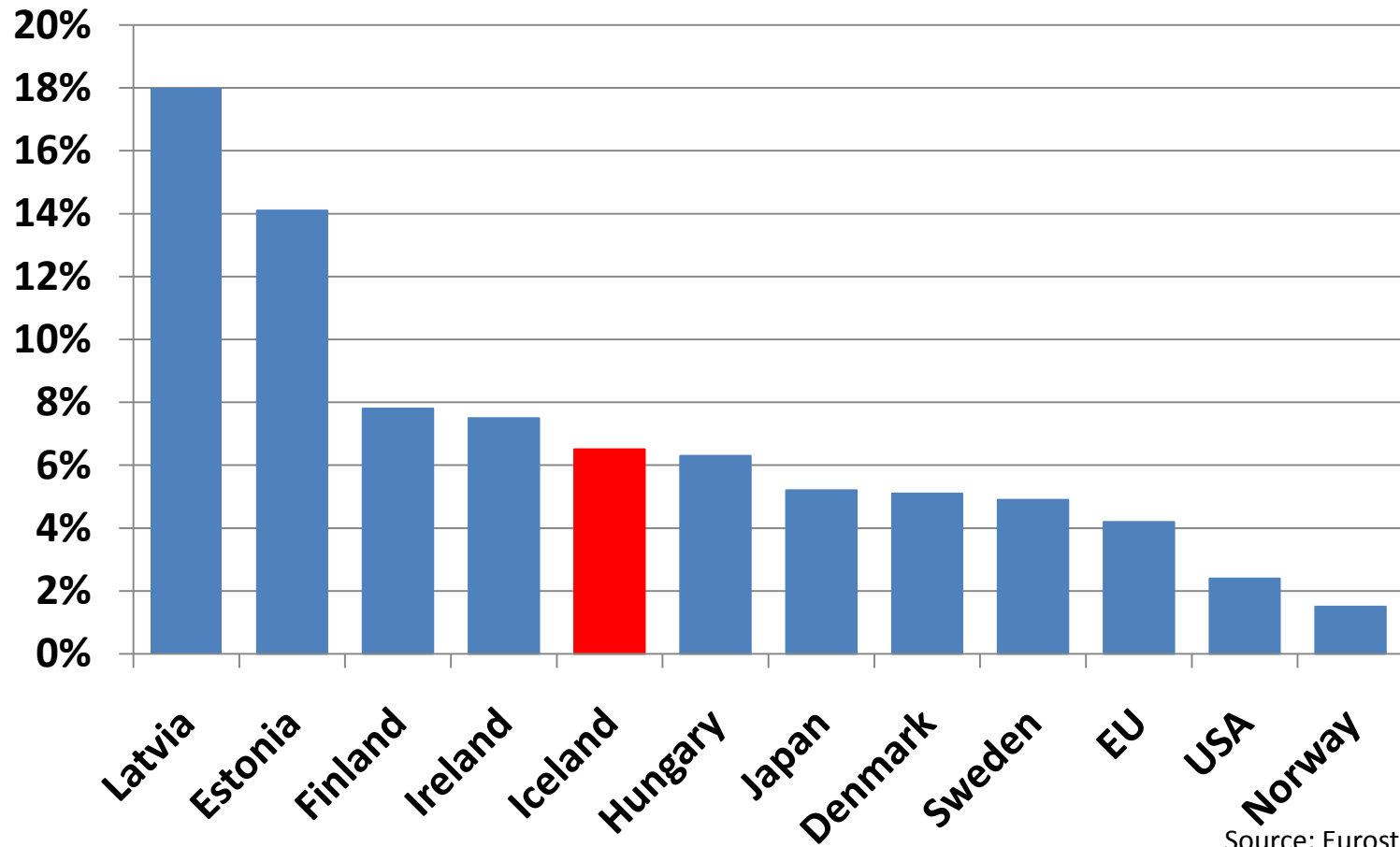


GDP

Annual changes in main components of GDP



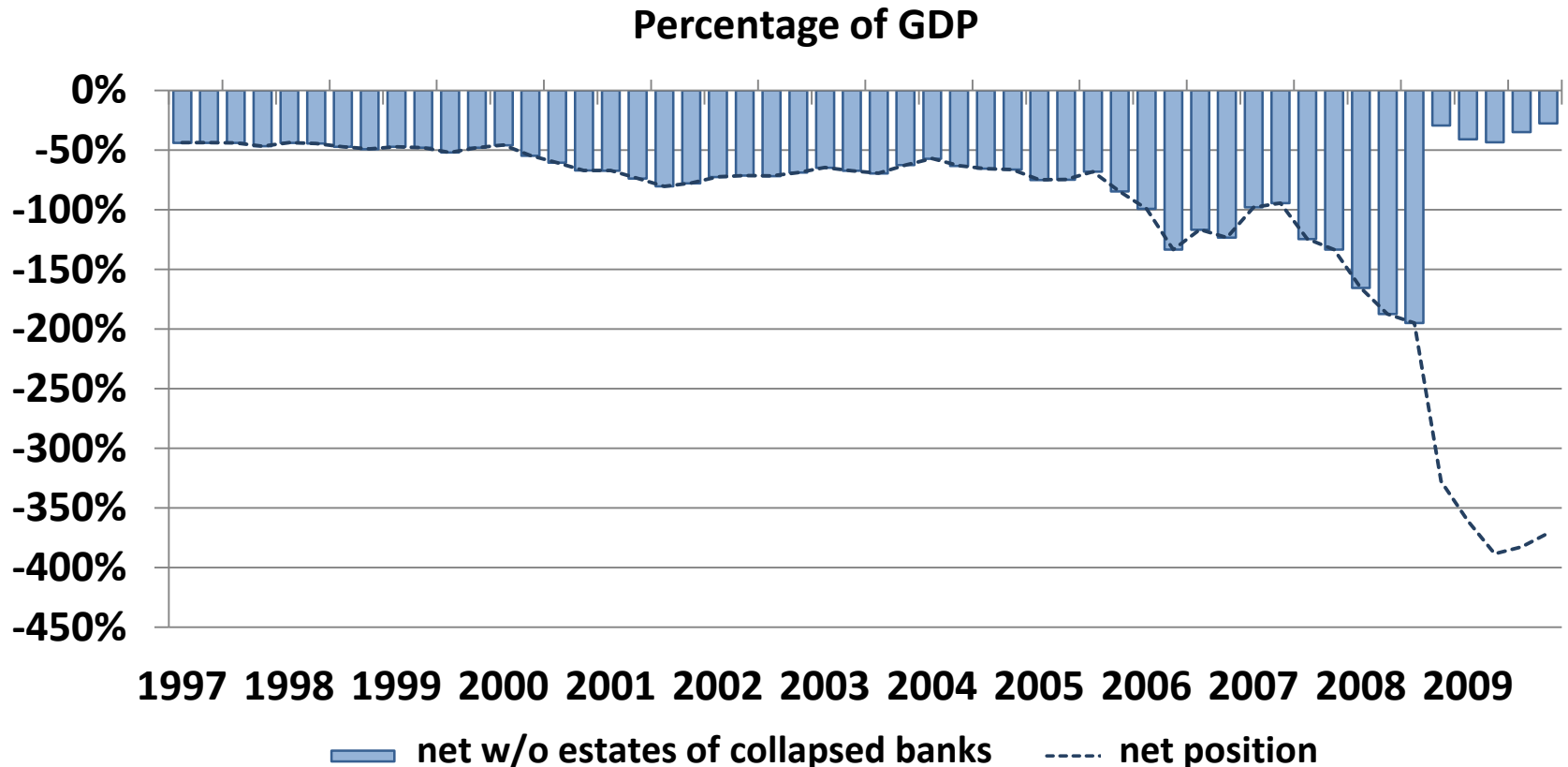
Contraction of GDP 2009



Source: Eurostat

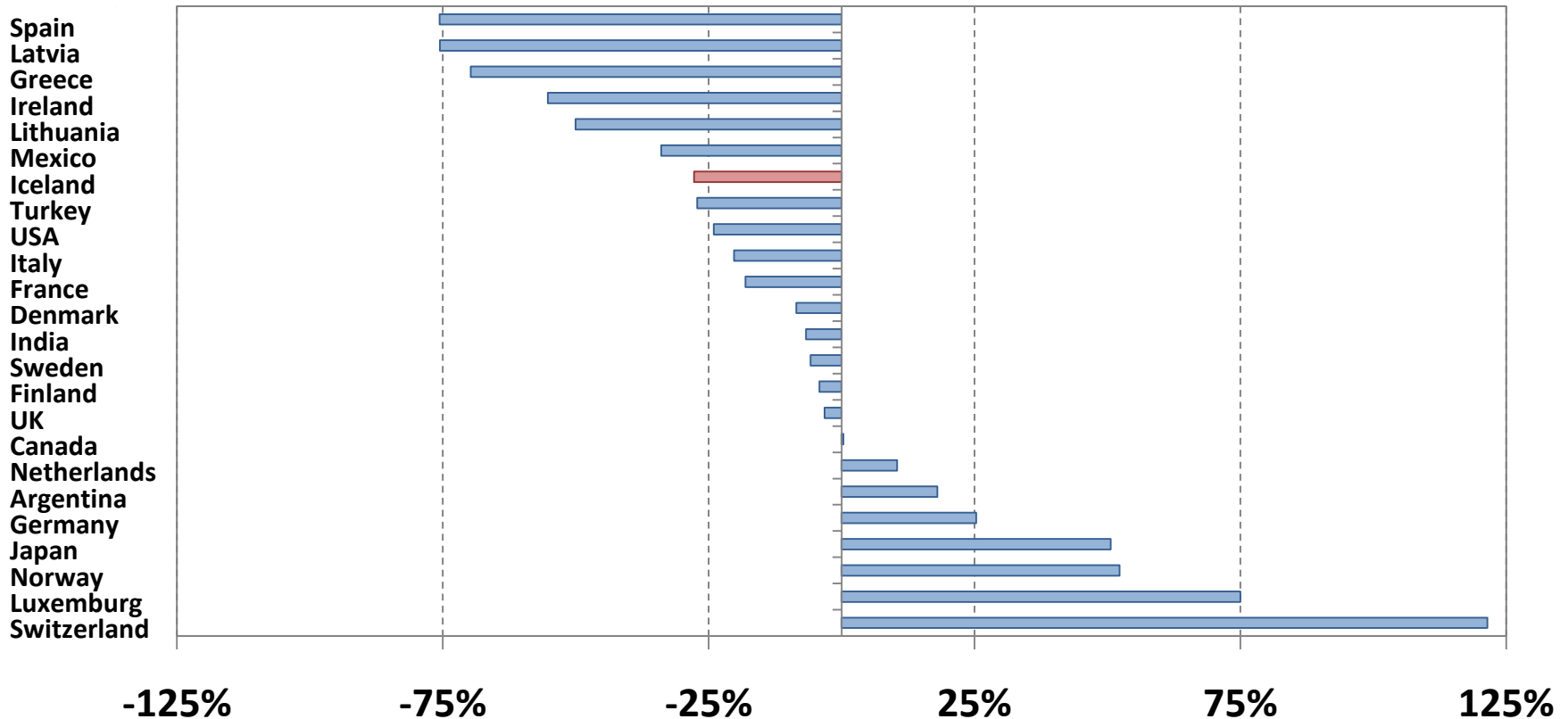


Net International Investment Position



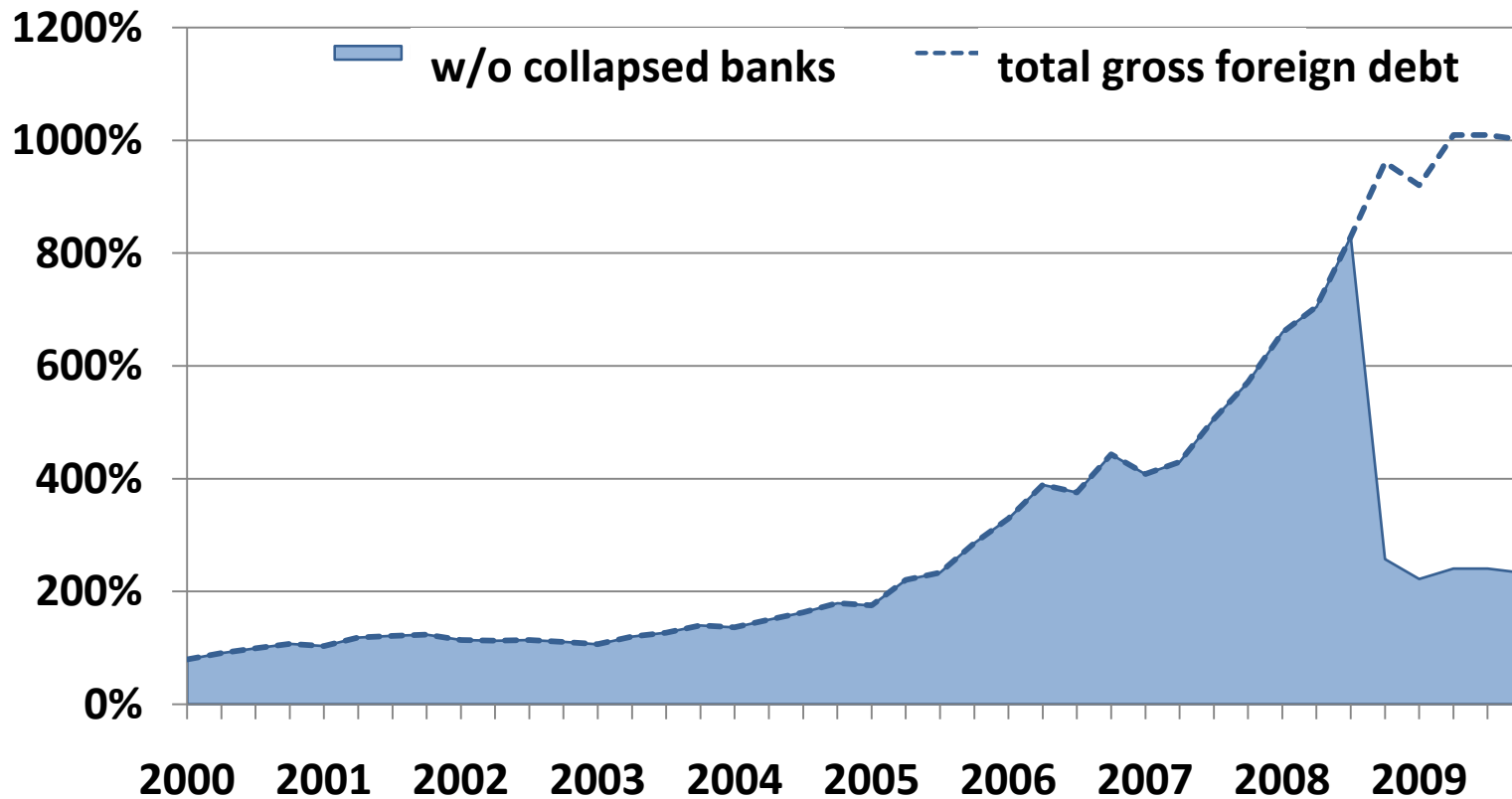
Net International Investment Position

Percentage of GDP



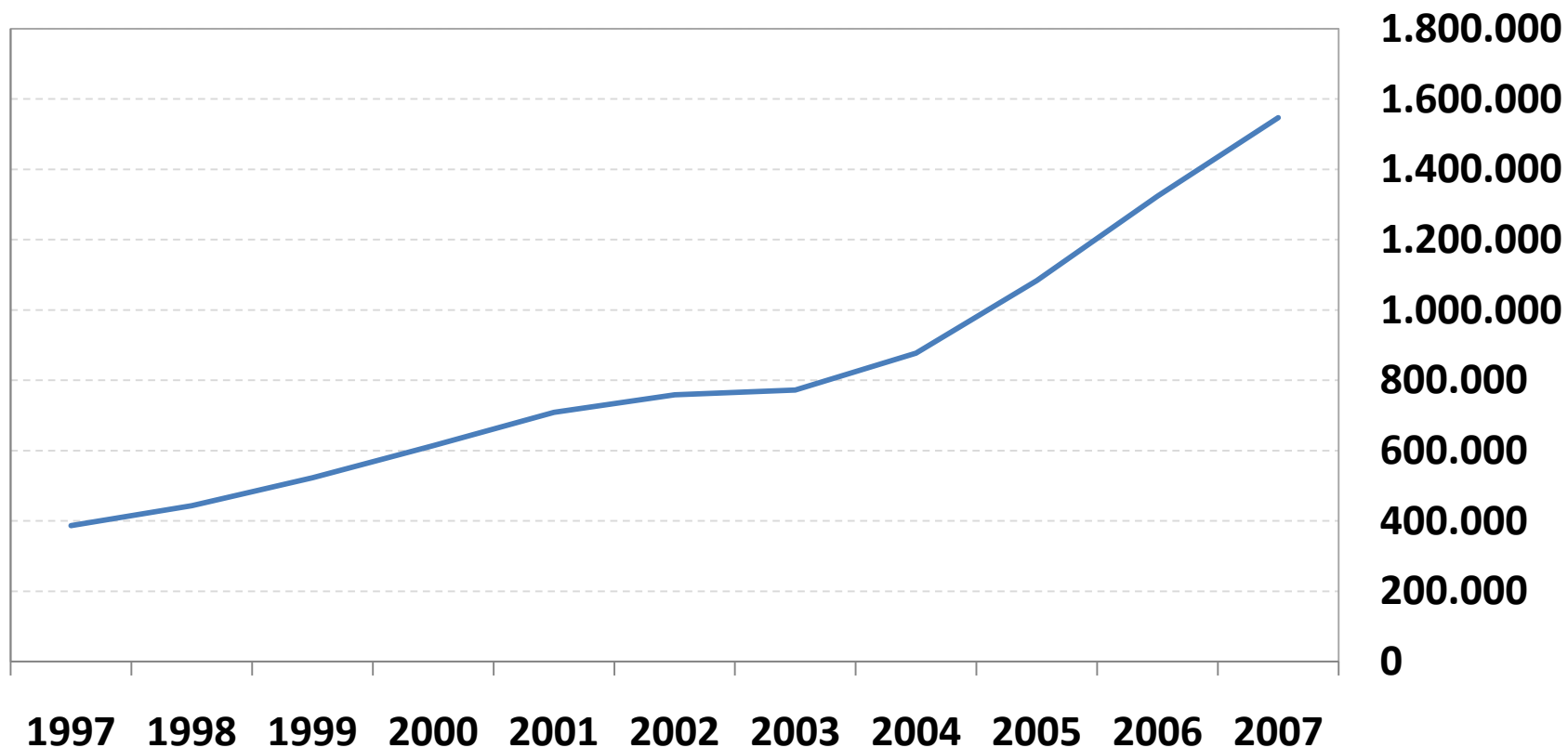
Gross Foreign Debt

Percentage of GDP



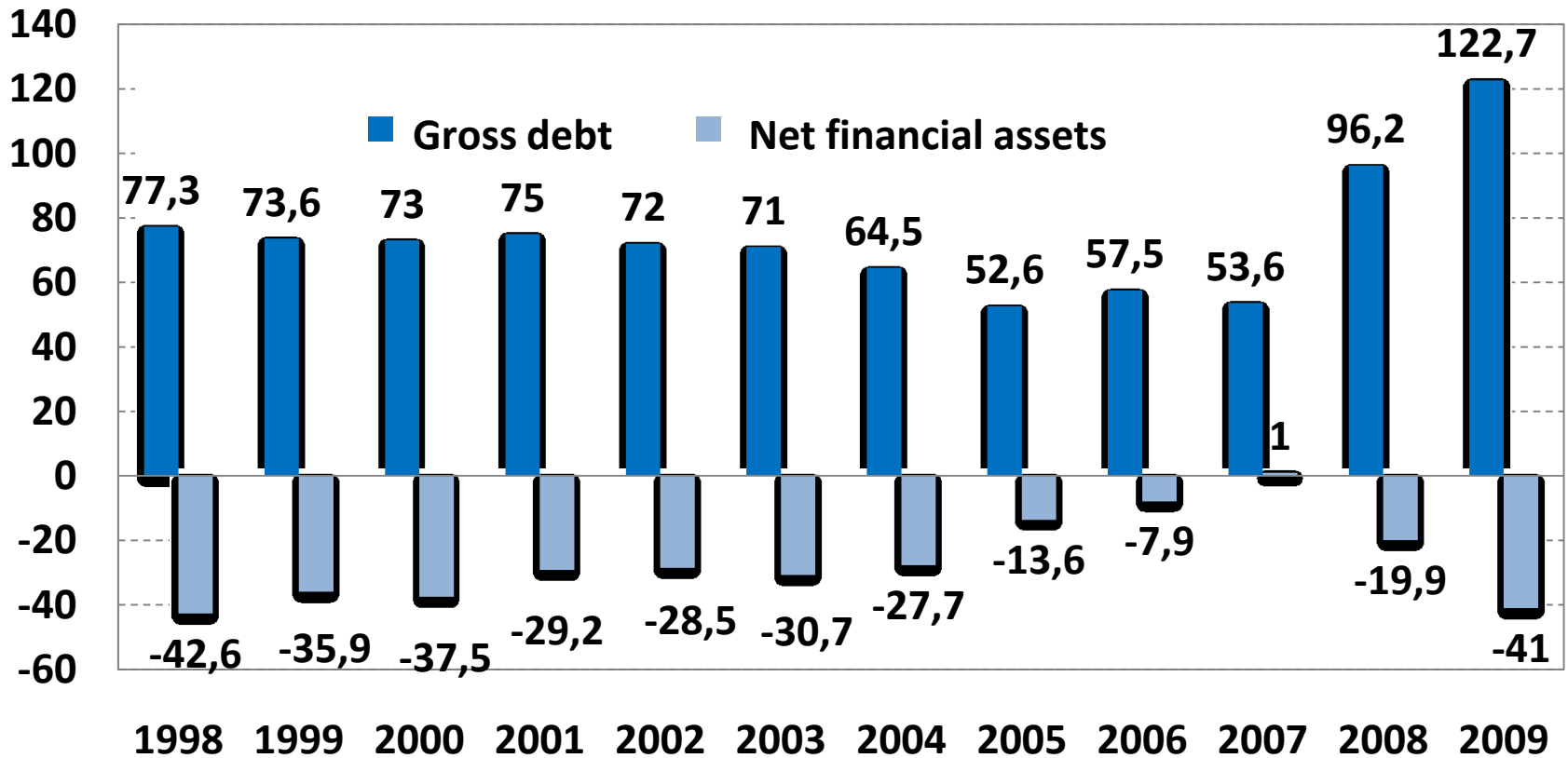
Household debt - leading up to crisis

Millions of ISK



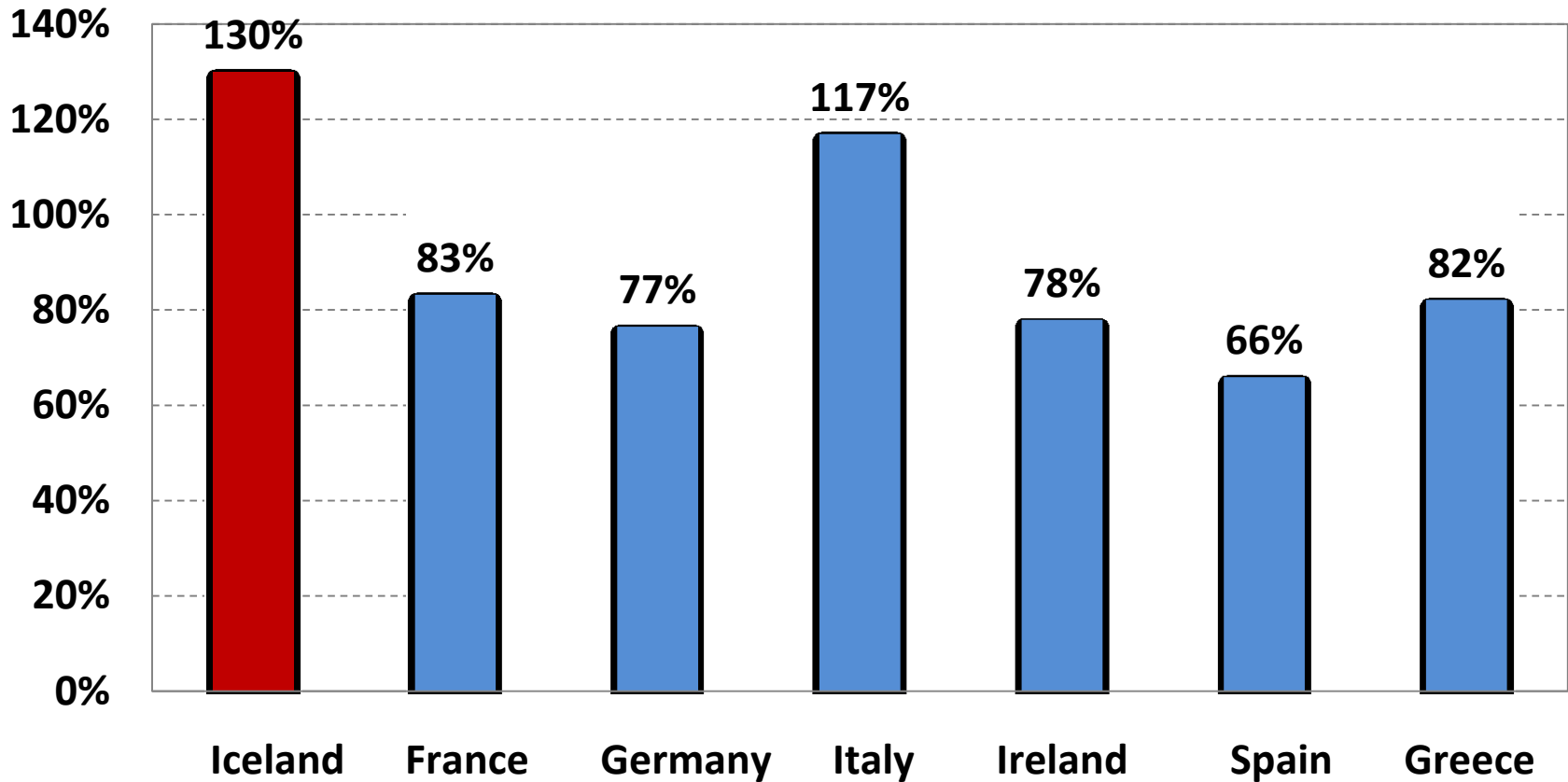
Government Debt

Percentage of GDP



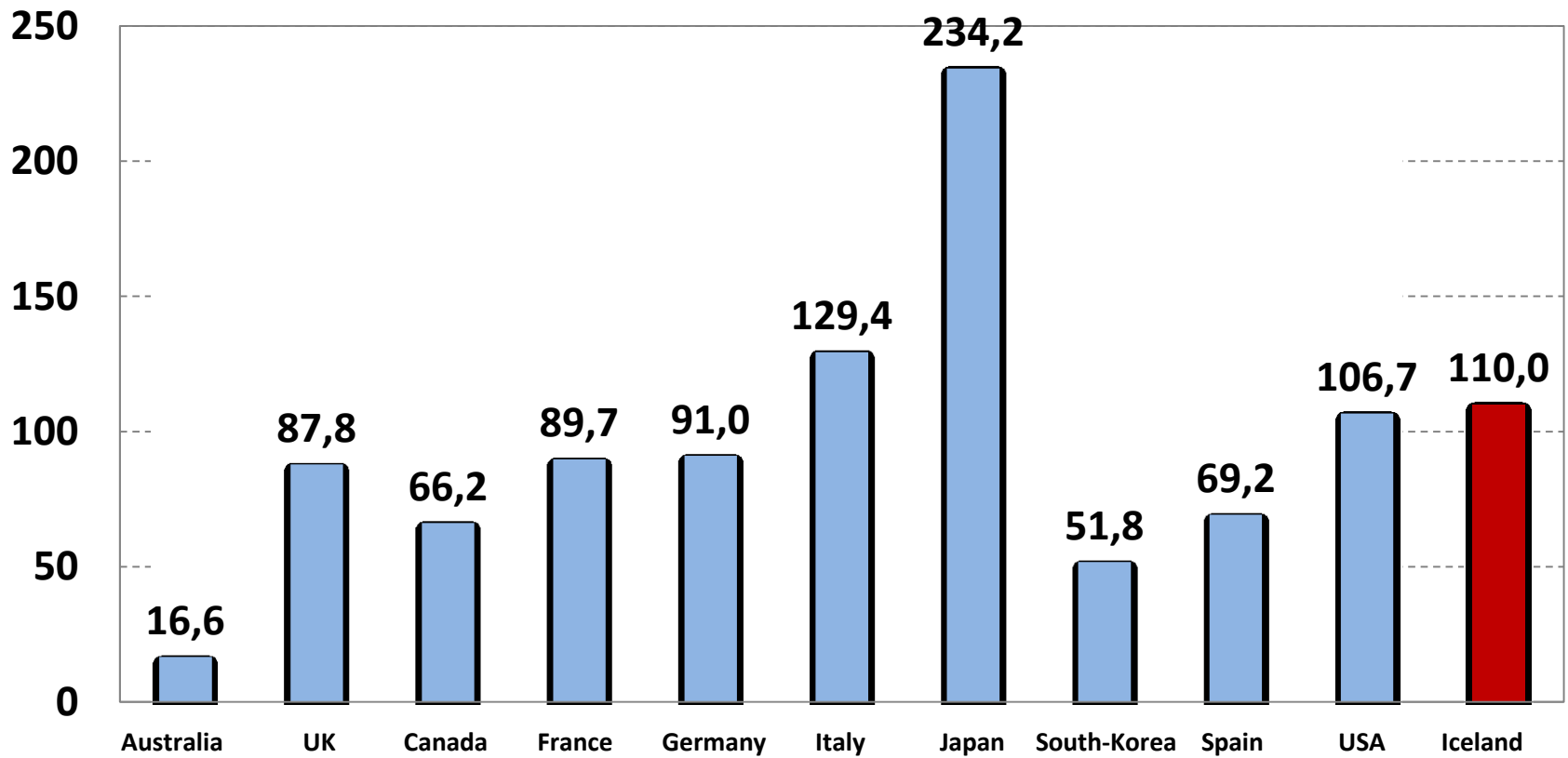
Government Debt

Percentage of GDP, 2010

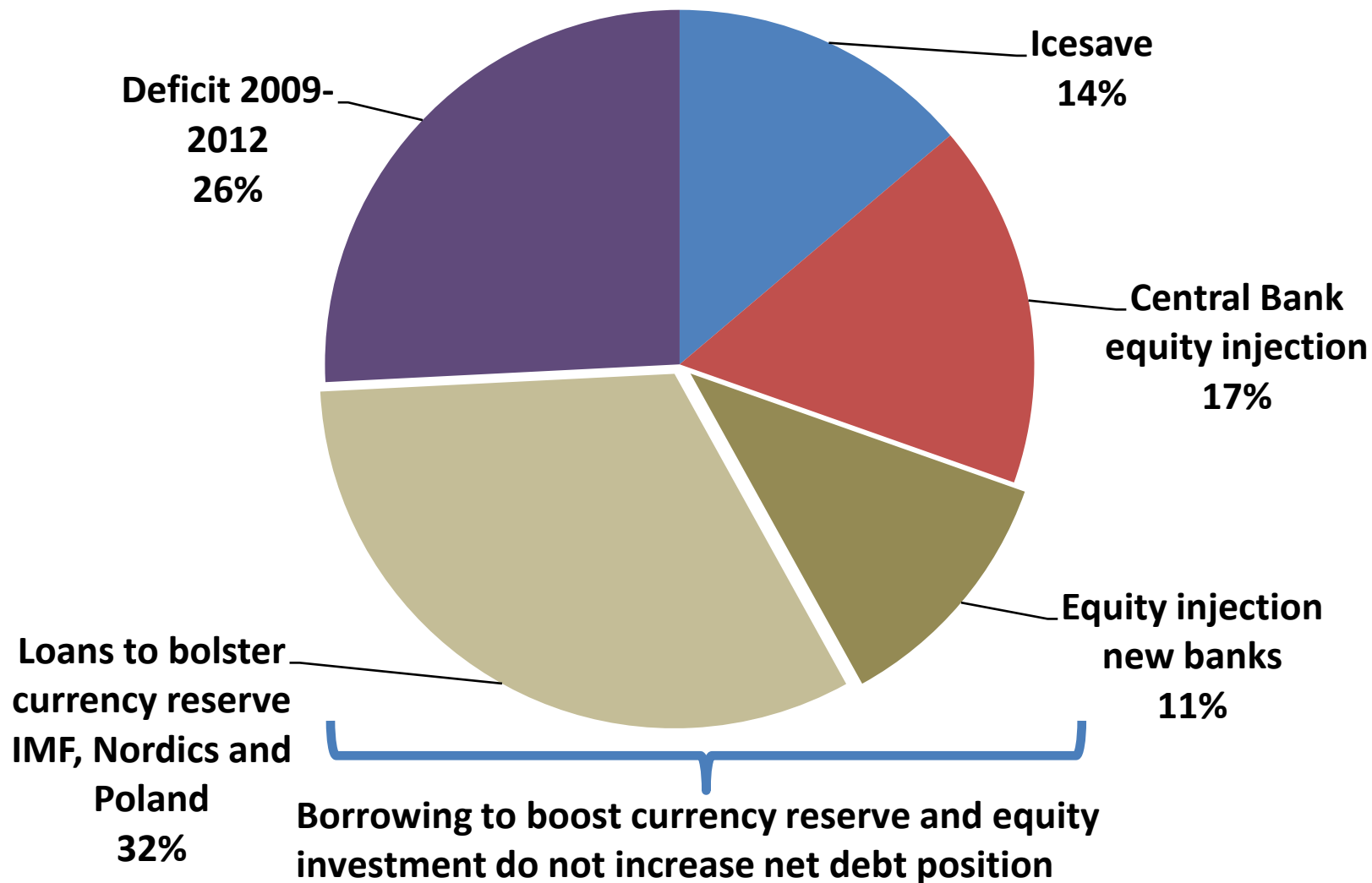


Government Debt in 2014

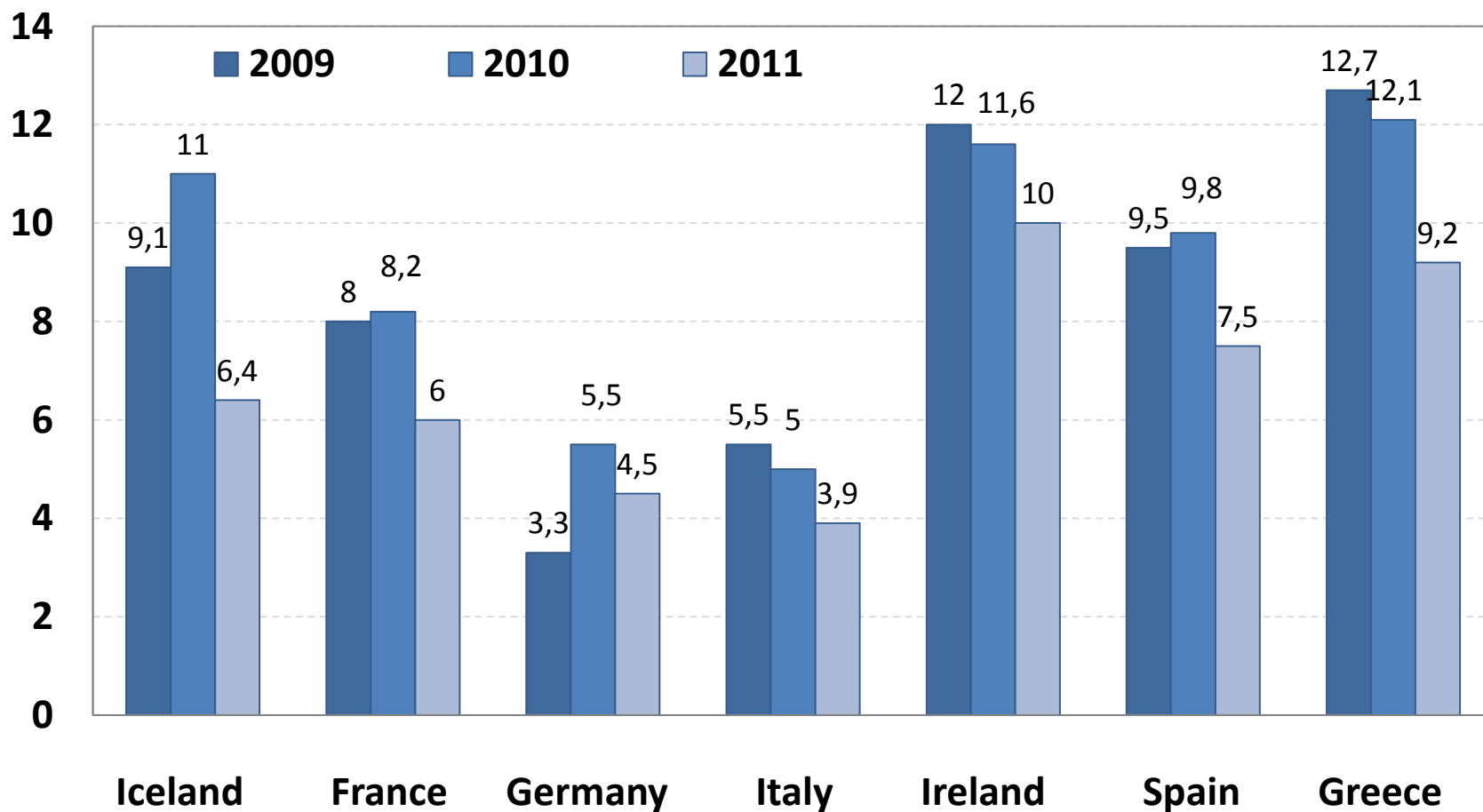
Gross government debt 2014 - OECD and IMF forecasts



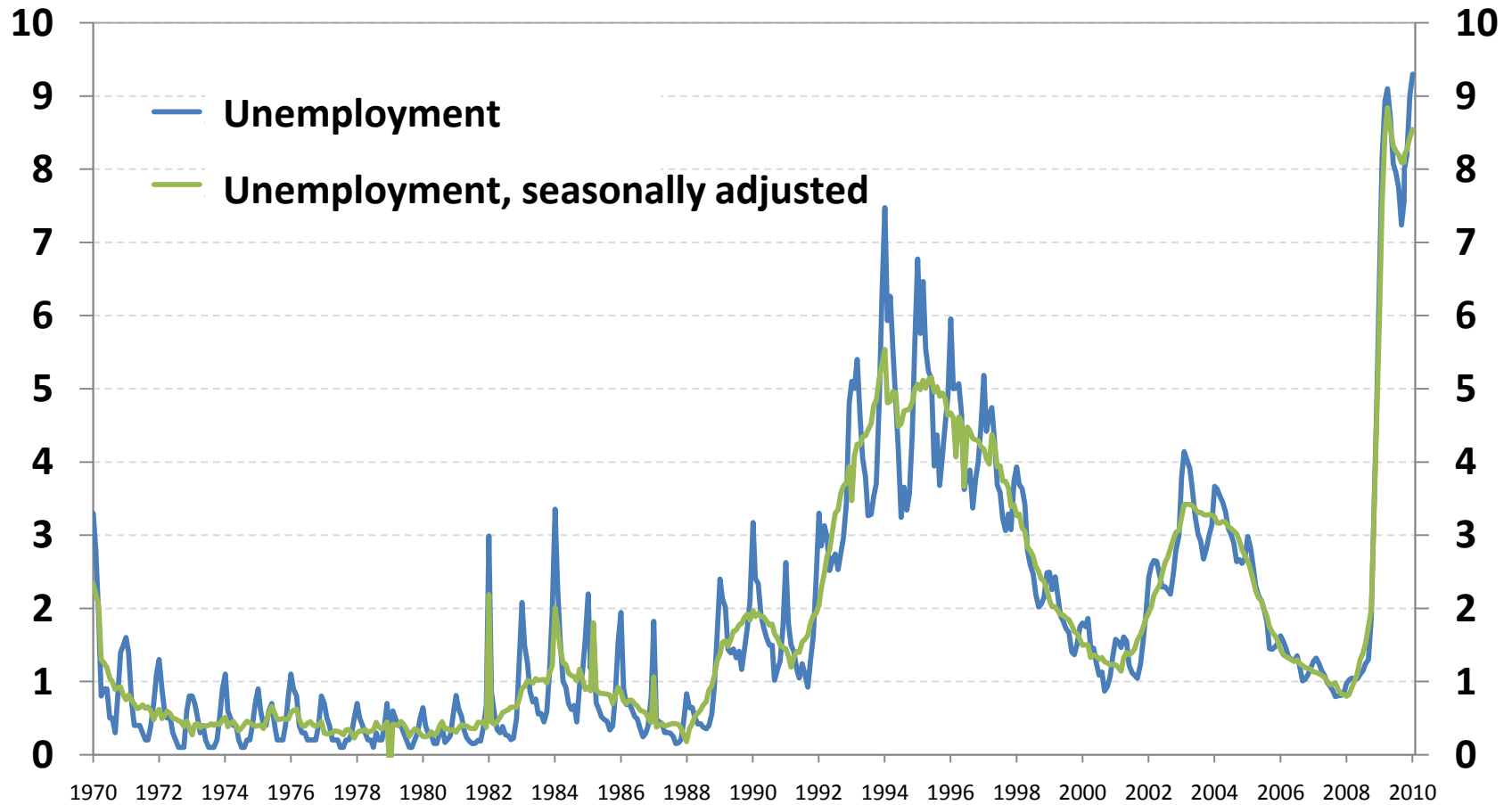
Sources of additional public debt



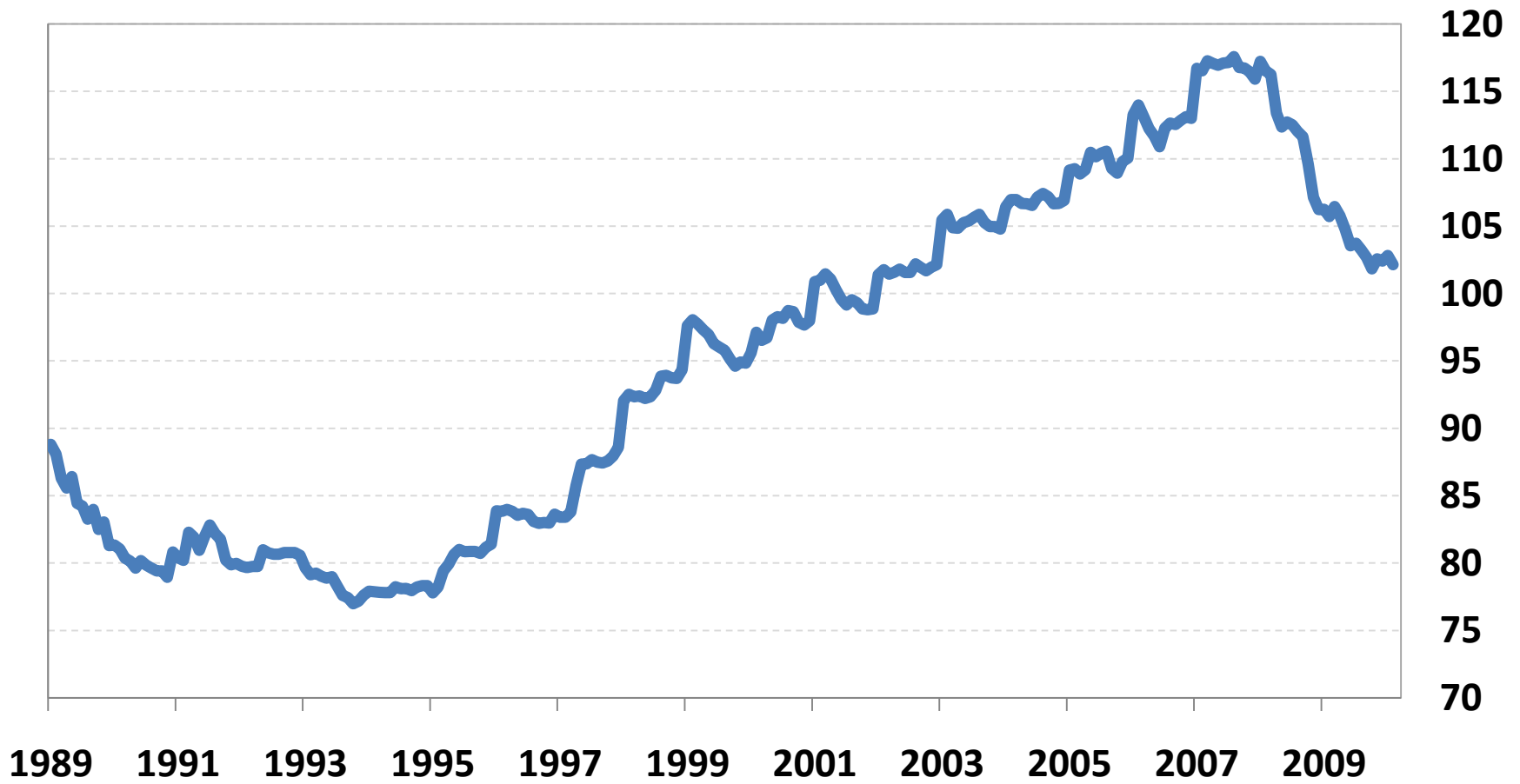
Fiscal Deficit



Historical Unemployment



Purchasing Power (seasonally adjusted)



Future prospects

- **The Icelandic economy is doing considerably better than initially projected.**
- **Under the circumstances, one might even claim that it is doing very well.**
- **Iceland is however not out of the woods yet.**
- **Several tasks have yet to be completed:**
 - ✓ Financial reorganization of the corporate sector.
 - ✓ Further fiscal consolidation.
 - ✓ Winding down the estates of the collapsed banks and sorting out and subsequently paying out claims.
 - ✓ Further adjustments to the real economy.
 - ✓ Lifting of capital controls.



Future prospects

- **Some successes thus far:**
 - ✓ Fiscal consolidation going somewhat better than projected.
 - ✓ Establishment of a new financial system with considerably less government involvement than initially planned.
 - ✓ The banks are well financed and have healthy balance sheets, with distressed assets already marked down.
 - ✓ Reasonably robust current account surplus with exports holding their own and imports contracting dramatically.
 - ✓ The exchange rate has stabilized and inflation and interest rates are rapidly coming down.



Long-term prospects

- **The fundamental strengths of the Icelandic economy are all still there:**
 - Human capital
 - Infrastructure
 - Natural resources
- **Iceland gets consistently good marks for human development, competitiveness and natural resource management.**
- **It is by any measure a vibrant, open and democratic society.**
- **These strengths will help Iceland solve its present problems and provide excellent long-term prospects.**

