Key conclusions

• Despite the fact that official figures exaggerate the actual number of foreign visitors, the big picture remains unchanged – numbers have grown remarkably and the importance of tourism to the economy has grown. Rising numbers of tourist not only generate revenue but also call for stronger infrastructure and various services.

• We expect a continued growth of tourism but at a more modest pace. In our baseline scenario the number of tourists increases by 11% in 2018 and 8% in 2019. The availability of flights to Iceland is the determining factor and there is considerable uncertainty in this regard.

• Occupancy rates at hotels have declined slightly in recent months so RevPAR has grown slower than ADR. We expect continued strong hotel investment which will probably be sufficient to meet the growing number of tourists.

• Tourism, as the largest export sector by far, has a major impact on the exchange rate of the króna. It is extremely rare for tourism to be such a determining factor for an economy and a currency area.

• The strong króna seems to have shortened the length of stay, which is reflected in a decrease in overnight stays in areas away from Keflavík International Airport. Tourists seem to have shifted their consumption away from goods towards experience, which might partly be explained by the high prices and strong króna. The effects of a high real exchange rate on tourism remains to be fully seen.

• Financial performance has recently been good overall but different circumstances, such as a stronger exchange rate, higher wages, higher VAT rate and slower growth present challenges. Mergers, acquisitions and other changes are likely to be the consequence of the current turmoil.
Arion Research is presenting its special report on tourism in English for the fourth time

Click the pictures to view previous reports
People are still coming (even though we’re expensive)

Erna Bjorg Sverrisdottir
Arion Research
Importance is growing

From zero to hero
The old clichés

Tourist numbers have increased, seasonal fluctuations smoothed out and the tourist sector has flourished.

Total number of tourists - millions

Seasonality

Proportion of exports

How many foreign tourists actually visit Iceland?

If we use the definition that a tourist is someone who stays overnight, the estimated number of tourists last year was 1.55 million, not 1.77 million as stated in official figures. Doesn’t change the big picture.

<table>
<thead>
<tr>
<th>Year</th>
<th>Official numbers by the Icelandic Tourist board</th>
<th>Adjusted for self-connecting passengers and foreigners living in Iceland</th>
<th>Adjusted for self-connecting passengers, foreigners living in Iceland and travellers who don't stay overnight</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>1.55 million</td>
<td>1.55 million</td>
<td>1.55 million</td>
</tr>
<tr>
<td>2011</td>
<td>1.65 million</td>
<td>1.65 million</td>
<td>1.65 million</td>
</tr>
<tr>
<td>2012</td>
<td>1.75 million</td>
<td>1.75 million</td>
<td>1.75 million</td>
</tr>
<tr>
<td>2013</td>
<td>1.85 million</td>
<td>1.85 million</td>
<td>1.85 million</td>
</tr>
<tr>
<td>2014</td>
<td>1.95 million</td>
<td>1.95 million</td>
<td>1.95 million</td>
</tr>
<tr>
<td>2015</td>
<td>2.05 million</td>
<td>2.05 million</td>
<td>2.05 million</td>
</tr>
<tr>
<td>2016</td>
<td>2.15 million</td>
<td>2.15 million</td>
<td>2.15 million</td>
</tr>
<tr>
<td>2017*</td>
<td>2.25 million</td>
<td>2.25 million</td>
<td>2.25 million</td>
</tr>
</tbody>
</table>

Forecast for last 4 months of 2017.

Sources: Icelandic Tourist Board, Statistics Iceland, Arion Research. *
Importance of tourism in national accounts is growing

Tourism accounted for more than 10% of GDP last year – likely to be closer to 12% this year

Sources: Statistics Iceland, Arion Research
7.4% GDP growth last year excluding tourism? Don’t think so!

According to these measurements, GDP growth in 2016 would have been closer to 4% and GDP far lower than it is today.

Economic growth and effects of tourism

- Economic growth without tourism contribution to GDP
- Economic growth without tourism contribution to GDP and business investment
- Economic growth with 5% annual growth in revenues of foreign travellers since 2010

Sources: Statistics Iceland, Arion Research
Arion Research’s projections for number of tourists

Slower growth ahead
Tourist forecast: what do you do when the statistics let you down?

Until now we have based our forecast on data and past trends. What would the last few years tell us? Stronger króna, more tourists? Wait, what?

Sources: Icelandic Tourist Board, Central Bank of Iceland, Arion Research.
* Forecast for last 4 months of 2017.
For a small island nation, the availability of flights is the key to increasing the number of tourists.

In 2005 two airlines flew to Iceland all year. In the winter of 2017 there will be 15. Any changes to the availability of flights will clearly have an effect on the numbers of foreign tourists visiting Iceland.

Number of airlines flying regularly to and from Iceland

Sources: Icelandic Tourist Board, ISAVIA. * Forecast for last 4 months of 2017.
Base case: We expect almost 2.5 million tourists next year

Based on expected flight availability in next few years, which is in fact subject to considerable uncertainty

Tourist arrivals via KEF airport* - millions annually, % increase

Sources: Icelandic Tourist Board, Arion Research. *As by official numbers, not estimates presented earlier.
Three different scenarios: Optimistic, pessimistic and base case

Changing the assumptions regarding the operations of the airlines produces different scenarios

Optimistic scenario
- millions annually, % increase

Base case
Optimistic scenario

Pessimistic scenario
- millions annually, % increase

Base case
Pessimistic scenario

Sources: Icelandic Tourist Board, Arion Research
Great uncertainty, especially as you get further into the future

The availability of flights places certain restrictions on the growth of the number of tourists. However, there is no limit to how much the number of tourists can decrease – uncertainty underestimated?

- **Key factors:**
  - Airlines
    - Price of oil
    - Salary expenses
    - Competition
  - Other factors:
    - Exchange rate of the ISK
    - Economic conditions for trading partners
    - Natural disasters
    - Competition with other destinations
    - Reaching the limits of tolerance for
      - The countryside
      - Infrastructure
      - The locals
      - Tourists

Sources: Icelandic Tourist Board, Arion Research
Playing with numbers: What does the base case mean for the Icelandic economy?

More tourists not only generate more revenue but also place more strain on infrastructure and require more service in the form of accommodation and entertainment.
Revenue from foreign tourists will continue to grow but at a slower rate

In our base case, we estimate that revenue from foreign tourists in 2017-2020 will be approximately ISK 2,400 billion, or the equivalent of Iceland’s GDP last year!

Sources: Icelandic Tourist Board, Statistics Iceland, Central Bank of Iceland, Arion Research
Increasing number of people in Iceland at any one time

Over the next 3 years the number of people in Iceland at any one time is expected to grow by 8,000 persons a year.

Sources: Icelandic Tourist Board, Statistics Iceland, Arion Research
Tolerance limits of infrastructure: Strain on road system has grown

If things continue in same vein, the total number of cars will have rarely, if ever, grown so much in a single year.

Traffic and registered passenger cars
- numbers and increase from previous year, % of total in columns

Sources: Icelandic Transport Authority, The Icelandic Road and Coastal Administration, Statistics Iceland, Icelandic Tourist Board, Arion Research. * The Icelandic Road and Coastal Administration forecast.
Tolerance limits of infrastructure: Estimate of required accommodation if the base case is accurate

Registered overnight stays at all kinds of accommodation increase by an average of 2,000 a day over the next three years – the equivalent of 1,100 new hotel rooms a year.

Sources: Statistics Iceland, Icelandic Tourist Board, Arion Research
Rapidly growing hotel market

Swift development, rising revenue and good occupancy rates – in most places
Hotels are responsible for majority of registered overnight stays, and the Reykjavík hotel market is by far the largest.

In other parts of the country, other types of accommodation play a larger role.

**Number of hotel rooms by regions in July 2017**

- Capital region: 5%
- Southwest: 62%
- West: 0%
- North: -1%
- East: 0%
- South: 5%

- Numbers and increase from previous year

**Distribution of overnight stays within regions in 2016**

- Capital region: 70%
- Southwest: 24%
- West: 29%
- North: 31%
- East: 27%
- South: 30%
- All regions: 51%

**Source:** Statistics Iceland, Arion Research
17% of overnight stays in the capital area last year were not registered

Statistics Iceland estimated that in 2016 almost 3,600 rooms/apartments were regularly let through Airbnb, 2,000 of which were in the capital region.

Registered and unregistered overnight stays - in millions and share of total in each region

Sources: Statistics Iceland, Arion Research
The occupancy rate of hotel rooms in the capital region has slumped during the summer

Occupancy rates outside Reykjavík have remained more stable, but it must be remembered that the number of available hotel rooms has increased, both in and outside Reykjavík

Source: Statistics Iceland, Icelandic Tourist Board, Arion Research
Tourists have faced increasingly expensive accommodation

The average price of accommodation in Reykjavík has increased significantly in euros. The increase in ISK has been less, and virtually zero over the summer.

Source: Benchmarking Alliance, Central Bank of Iceland, Arion Research
Poorer occupancy rates this summer means that revenue per available room has grown more slowly than the average price.

The average price of a room (in ISK) at peak times has increased by 2% between years while revenue per available room has increased by 1%. The opposite applies off peak, as occupancy is greatly improved.

Revenue per available room (RevPAR) in Reykjavík
- ISK, thousands and change from previous year

Source: Benchmarking Alliance, Central Bank of Iceland, Arion Research
There will be severe hotel shortage in the capital region if no investment is made and hotels maintain their competitive position.

Few European cities, if any, top Reykjavík in terms of hotel occupancy. If no investment is made in new hotels and overnight stays continue to increase in step with the rise in the number of tourists, hotels in Reykjavík will soon be full to bursting.
We estimate that 2,700 new hotel rooms will be added in the capital region over the next few years

Scheduled construction projects seem likely to cover demand placed by increasing tourists. The high level of uncertainty is reflected in great delays to hotel projects recently and the fact that the majority of projects are still under development.

Source: The City of Reykjavik, Arion Research
The króna and tourism: A stormy marriage

Konráð S. Guðjónsson
Arion Research
Cause and effect is like a merry-go-round...

Tourism benefited from a weak króna at the start of the growth period. A strong króna is now cooling down the tourist sector.
... and it’s complex too

No wonder so much appears to be unclear... A lot is unclear!

Impact of tourism on the exchange rate:
- Revenue from tourists
  - number
  - length of stay
  - consumption pattern
- Expectations of trends in tourism
- Foreign investment in tourism
- Etc.

Impact of the exchange rate on tourism:
- Revenue from tourists
  - number
  - length of stay
  - consumption pattern
- Travel pattern within Iceland
- Performance of companies in tourism
- Etc.

*Impact often hard to measure and effects often delayed*
Effect of tourism on the króna

Tourism is in the driving seat as the biggest export sector
Extremely rare for a country, let alone a currency area, to be so dependent on tourism

Tourism-related exports per capita in Iceland probably six times higher than in Spain

<table>
<thead>
<tr>
<th>Country</th>
<th>International tourism, receipts per capita</th>
</tr>
</thead>
<tbody>
<tr>
<td>Macao SAR, China</td>
<td>73.5</td>
</tr>
<tr>
<td>Sint Maarten (Dutch part)</td>
<td>24.5</td>
</tr>
<tr>
<td>British Virgin Islands</td>
<td>16.1</td>
</tr>
<tr>
<td>Aruba</td>
<td>15.9</td>
</tr>
<tr>
<td>Virgin Islands (U.S.)</td>
<td>12.8</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>11.1</td>
</tr>
<tr>
<td>Cayman Islands</td>
<td>10.9</td>
</tr>
<tr>
<td>Iceland</td>
<td>8.8</td>
</tr>
<tr>
<td>Palau</td>
<td>7.3</td>
</tr>
<tr>
<td>Maldives</td>
<td>7.0</td>
</tr>
<tr>
<td>Switzerland</td>
<td>2.6</td>
</tr>
<tr>
<td>Austria</td>
<td>2.4</td>
</tr>
<tr>
<td>Ireland</td>
<td>2.4</td>
</tr>
<tr>
<td>Croatia</td>
<td>2.4</td>
</tr>
<tr>
<td>New Zealand</td>
<td>2.0</td>
</tr>
<tr>
<td>Portugal</td>
<td>1.7</td>
</tr>
<tr>
<td>United Arab Emirates</td>
<td>1.5</td>
</tr>
<tr>
<td>Norway</td>
<td>1.5</td>
</tr>
<tr>
<td>Slovenia</td>
<td>1.4</td>
</tr>
<tr>
<td>Spain</td>
<td>1.4</td>
</tr>
</tbody>
</table>

- In th. USD, excluding transport. Highest value in 2014-2015, except for 2017 in Iceland

Only sovereign state above Iceland

Sources: World Bank, Arion Research.
Huge relative size of tourism sector in Iceland means it has greater impact on exchange rate than elsewhere

Without growth in the tourism sector we could import far less and/or would have a large current account deficit

![Graph showing current account with or without tourism](chart)

**Current account with or without tourism**
- b. ISK at fixed exchange rates

![Graph showing ISK real exchange rate](chart)

**ISK real exchange rate**
- Relative prices, index
- Relative labour costs, index

Sources: Statistics Iceland, Central Bank of Iceland, Arion Research.
Strong growth of tourism sector restricts ability of other exports to compete: Symptoms of Dutch disease

Exports of various other commercial services fell short of our expectations in Q2 2017, because of the króna?

Export revenue growth at fixed exchange rates

Sources: Statistics Iceland, Central Bank of Iceland, Arion Research.
What do the different scenarios mean for the króna?

We haven’t estimated the impact of tourism on imports and other indirect effects on the current account balance, but the effect is considerable. The scenarios do give us an idea of how things might develop.

Tourism FX revenues and current account assuming different tourism scenarios other things being equal

- Stronger ISK
- Strong GDP growth
- Probably decline in other exports
- Similar exchange rate throughout the period
- In line with Economic Outlook
- Modest GDP growth
- Weaker króna
- Slow growth or a recession
- Yet, more revenues than in 2015

Sources: Statistics Iceland, Central Bank of Iceland, Arion Research.
Effect of the króna on tourism

Tourism will cool itself down
Iceland is one of the most expensive destinations in the world – if not the most expensive

We do not know yet what the end effect will be – but it’s gradually materializing

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**Relative prices of restaurants and hotels**
- EU=100

**Relative prices of recreation and culture**
- EU=100

**Relative prices of transport**
- EU=100

*Sources: Eurostat, Statistics Iceland, Central Bank of Iceland, Arion Research.*

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Strong króna appears to have shortened tourists’ length of stay and/or changed where they stay

There is some correlation between trend of real exchange rate and length of stay. Airbnb etc. undoubtedly distorts the picture.

Total registered overnight stays per tourist and real exchange rate

Growth in hotel overnight stays and no. of tourists - contribution by region

Sources: Statistics Iceland, Central Bank of Iceland, Arion Research.
Outside the capital region, tourists have become even more concentrated in SW corner

Contrary to the aim of spreading tourists across the country more evenly

Tourist overnight stays distribution** during winter -November-March

Tourist overnight stays distribution** during spring and summer - April-July

Tourists have responded to strong króna by changing consumption patterns

Shopping has given way to visitor experiences – may also be due to greater popularity of adventure tourism

**Total foreign card turnover June-August 2017**
- % change from previous year in ISK

- Cash withdrawals: -22%
- Other retail: -12%
- Toll-free retail: -3%
- Souvenirs: -19%
- Clothing: -5%
- Groceries: 8%
- Other services: 13%
- Cultural services: 3%
- Other transport: 7%
- Fuel and car related expences: 7%
- Other travel services: 5%
- Transport by land: 6%
- Catering and restaurants: 10%
- Accommodation: 5%
- Total, excluding flights: -1%

**Tourist’s consumption pattern**
- Distribution of card turnover in January-July

- Accommodation and other necessities: 26%
- Experience: 44%
- Goods: 30%

Sources: RSV, Central Bank of Iceland, Arion Research.
Although strong currency has meant that each tourists spends fewer krónur, spending in tourists’ home currency has remained stable.

Strong indications that Iceland has successfully managed to attract bigger spending tourists. Cheaper flights might also play a role and increase purchasing power once people have arrived.

Sources: RSV, Statistics Iceland, Icelandic Tourist Board, Central Bank of Iceland, Arion Research.
Increase in tourists has changed revenue structure

More dependent now on US dollar and therefore the USD/ISK exchange rate – which has been one of the more stable exchange rates since 2013

Sources: Statistics Iceland, Central Bank of Iceland, Arion Research.
Performance of tourism companies in the króna economy

Effect of a strong króna and other changes in the tourism sector create challenges and opportunities
Financial performance has been good and better than in other sectors.

At the same time the financial position of tourism companies has improved.

Sources: Statistics Iceland, SAF, Arion Research.
On the whole the tourism sector seems well prepared to cope with more challenging times

Large uncertainty about how things pan out and even larger heterogeneity within tourism sub-sectors

Sources: Statistics Iceland, SAF, Arion Research.
Salary expenses have grown faster than revenue in tourism sector

One of the main reasons that results in 2016/2017 probably deteriorated/will deteriorate
Debts in króna but clients’ revenue in foreign currency – where are the foreign loans?

There is a risk involved in having high debts in ISK when the underlying revenue is in foreign currency.
Over next few years the adaptability of tourism companies will be put to even greater test if our forecasts prove accurate

Slower growth, higher VAT, even higher salary increases and continued strong exchange rate
Where are the mergers? Accommodation sector shows that there are opportunities in this area

Growth in tourism largely achieved through creation of more companies – a sensible development?

### Gross operating surplus/revenue in accommodation

<table>
<thead>
<tr>
<th>Year</th>
<th>50-100</th>
<th>&gt;100</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>7%</td>
<td>5%</td>
</tr>
<tr>
<td>2013</td>
<td>9%</td>
<td>7%</td>
</tr>
<tr>
<td>2014</td>
<td>11%</td>
<td>9%</td>
</tr>
</tbody>
</table>

### Average number of employees per company, activities related to tourism

<table>
<thead>
<tr>
<th>Year</th>
<th>50-100</th>
<th>&gt;100</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>2013</td>
<td>8</td>
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<td>2014</td>
<td>10</td>
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<td>2015</td>
<td>12</td>
<td>12</td>
</tr>
<tr>
<td>2016</td>
<td>14</td>
<td>14</td>
</tr>
<tr>
<td>2017</td>
<td>16</td>
<td>16</td>
</tr>
</tbody>
</table>

Sources: Statistics Iceland, Central Bank of Iceland, Arion Research. *að undanskilinni lyfjaframleiðslu, fjármála- og vátrygingastarfsemi*
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