

Revised economic outlook – 4,9% economic growth in 2016

Arion research has revised its economic growth forecast for the year 2016 in light of new data for high frequency indicators such as payment card turnover and external trade. We expect growth in 2016 to be 4.9%, 0.6 percentage points higher than our 4.3% forecast in March.

The Icelandic labor market – now and then

There has been substantial drive in the Icelandic labor market as of late; unemployment has come down fast, labor participation rates have increased significantly and total working hours increased. What is fueling the growth of the labor market? We have decomposed the growth in the labor market between 2010 and 2015 and to little surprise the answer seems to lie in tourism related activities. Nevertheless, there has been a net emigration of Icelanders, meaning that increased employment has to some extent been met with foreign labor.

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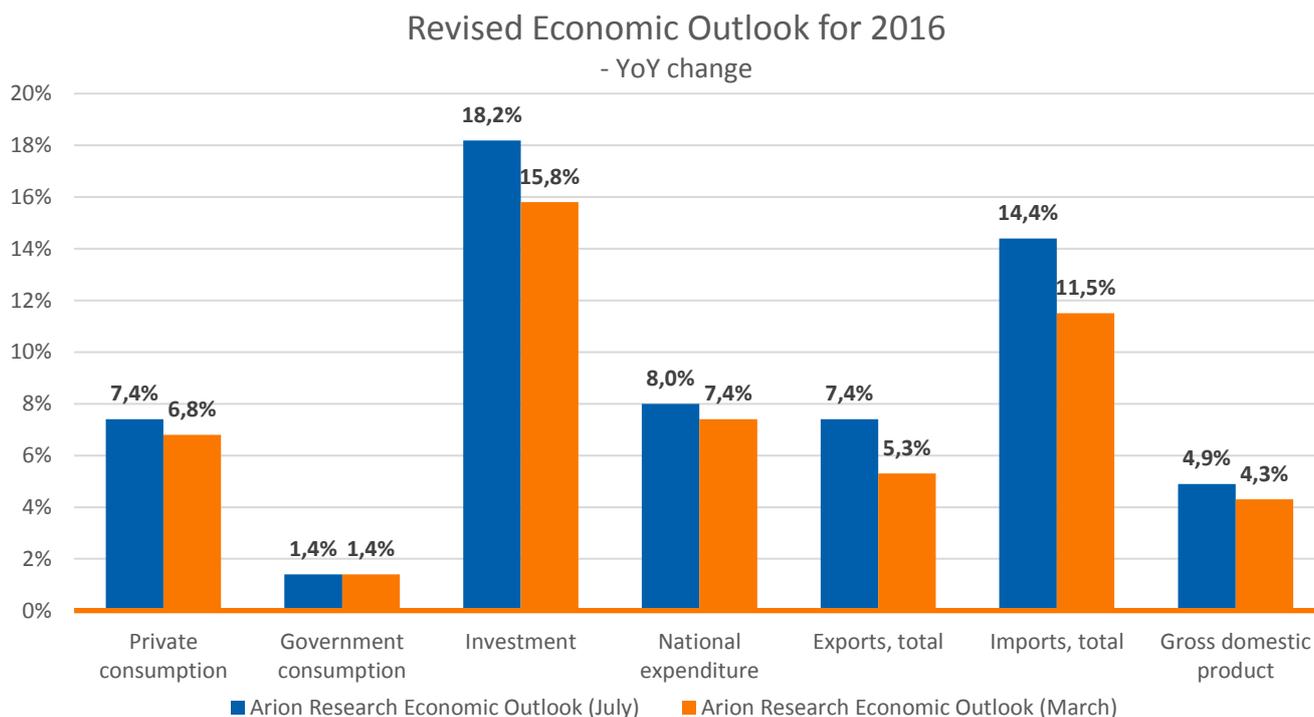
Provisional release:

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Economic growth 4,2% in Q1 2016

Statistics Iceland (Stattice) recently published GDP data for Q1 which indicate there being substantial drive in the economy. GDP growth measured at 4.2% in the first quarter this year, compared to the same quarter in 2015, and is the strongest first quarter since 2008. Out of the 35 member states of OECD, only three can boast of higher growth than Iceland in Q1. The growth exceeded our forecast, with us underestimating every GDP subcomponent except for government consumption. Now when the second quarter has passed and high frequency indicators, such as payment card turnover and external trade data have been published we have updated our economic outlook from March. Note that this is only a revision, not a new economic outlook.

The revised economic outlook for the year 2016 now predicts 4.9% GDP growth, 60 bp higher than our March forecast. The key driver behind the growth is increased national expenditure, i.e. the sum of private consumption, investment and public consumption, while external trade contribution to GDP growth remains similar to our previous forecast.



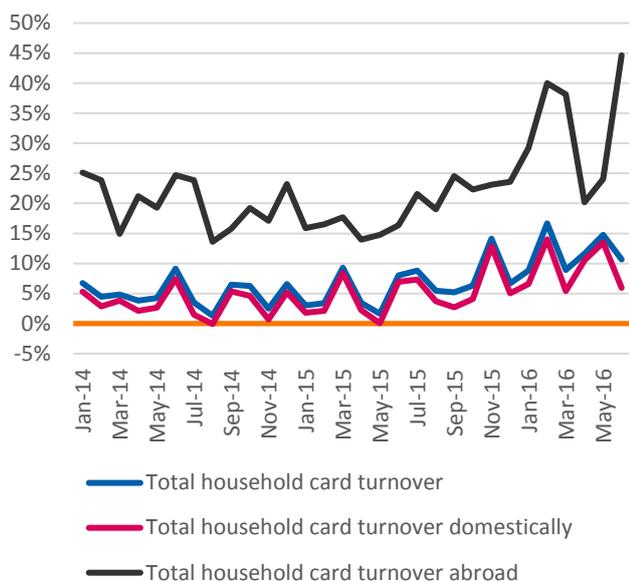
Sources: Statistics Iceland, Arion Research

Payment card turnover is usually a good indicator for development in private consumption. In Q1 this year payment card turnover rose by 11.3% and private consumption by 7.1%, the highest private consumption growth in any one quarter since 2008. The second quarter this year raised the stakes, with card turnover growth adding up to 12.4%. This increased payment card turnover indicates that private consumption is picking up and is one of the key drivers behind our upward revised private consumption forecast.

The first half of this year has brought strong payment card turnover and it therefore appears that the recent wage settlements and increased purchasing power is beginning to show. The data is however unusual as card usage abroad soared in February, March and June. The Euro 2016 tournament undoubtedly plays a critical role in this development, as most people paid for tickets, transportation and accommodation in February and March, along with a host of people flying out in June to see the Icelandic national team compete in the round of 16 and in the quarter finals (a record number of 67.000 Icelanders traveling abroad). It therefore comes as no surprise that card turnover abroad rose by no less than 44.6% in June.

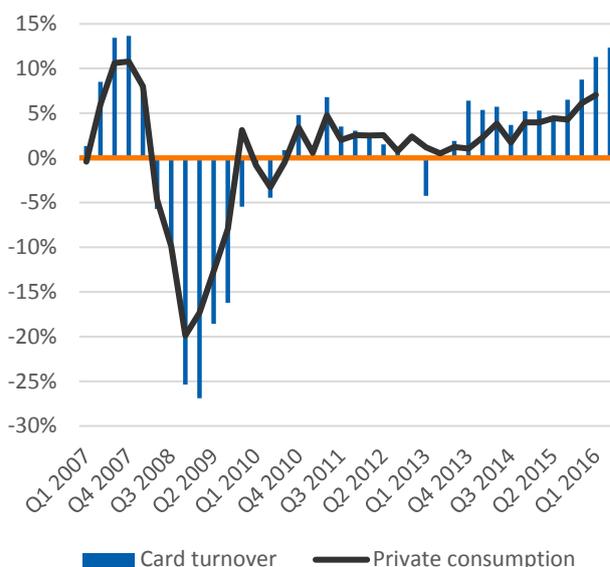
Payment card turnover

- YoY change, constant prices/exchange rate



Card turnover & private consumption

- YoY change



Sources: Statistics Iceland, The Central Bank of Iceland, Arion Research

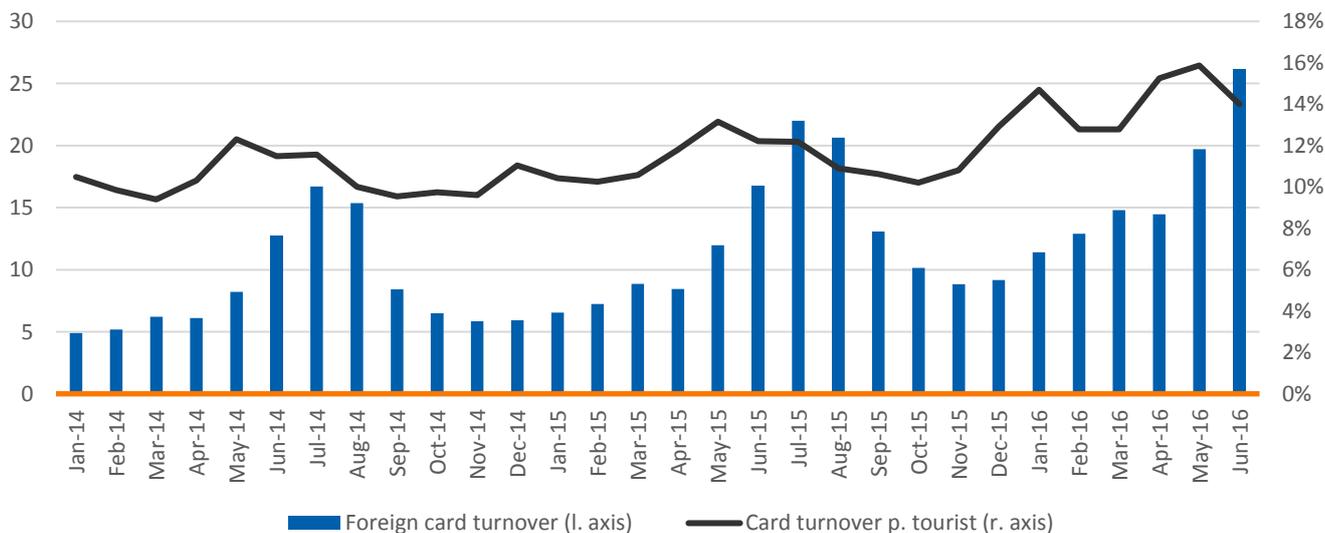
This year is heading to the record books for arrival of foreign tourists. In the first six months of the year nearly 700,000 tourists visited the country which is more than the whole year of 2012. Foreign payment card turnover, or in most cases card turnover per tourist, has increased substantially along with more tourists. Total foreign card turnover amounted to 99 bn. ISK in the first half of the year, which adds up to 66% increase between years on constant exchange rates. At the same time the number of tourists increased by 35% between years, translating to a considerable increase in card turnover per tourist. However, increased weight of passenger transport by domestic airlines shows up in domestic card acquirers' transactions which might inflate these numbers.

Despite the Icelandic spending spree abroad, the increase in tourism has led to record highs in the card turnover balance, i.e. the difference between foreign payment card use in Iceland and Icelanders' payment card use abroad. Card turnover balance for the first six months of the year on constant exchange rates amounted to 52 bn. ISK, compared to 24 bn. ISK last year.

The robust increase in tourism and increased card turnover per tourist are the key drivers behind our upward revised exports.

Foreign payment card turnover

- bn. ISK, constant exchange rate



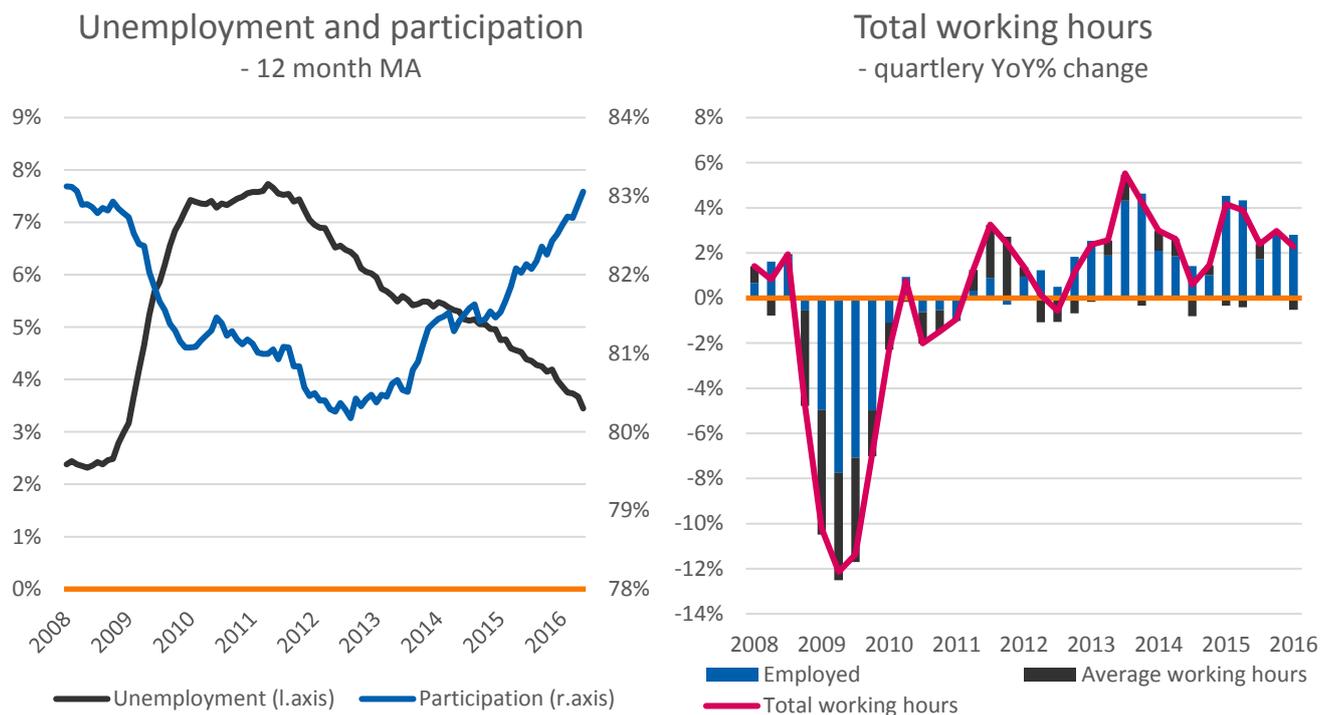
Sources: The Central Bank of Iceland, The Icelandic Tourist Board, Arion Research

The Icelandic labor market – now and then

Few Icelandic household were unaffected by the economic crisis of 2008 and labor market data shows just that. The labor force remained in a slump until late 2011, but since 2013 the labor market has been booming and a recent headline by Statistics Iceland (“Lowest unemployment in May since 2005”) confirms that.

At present, labor market conditions show signs of how they were before the financial crisis, with unemployment coming down rapidly in recent months and measuring at 2.3% in June 2016. Considering the twelve month moving average the unemployment rate measures at 3.5% according to Statistics Iceland and 2.6% according to the Directorate of Labor. Likewise, participation rates have risen markedly and approach their previous high.

The graph below to the right depicts quarterly YoY changes in total working hours, average working hours and employment. As the graph show there has been an ongoing increase in total working hours for fourteen quarters in a row. Contrary to what was happening when the economy was taking its first steps towards recovery and companies increased production and demanded higher productivity from their employees, increased economic activity in recent years has been met with increased employment rather than longer working hours. Therefore, Iceland appears to have evaded the trap that some of our trade partners got stuck in, i.e. economic recovery without employment growth. The question remains, how did we do it? Where did these jobs come from and how has the labor force changed from how it was?

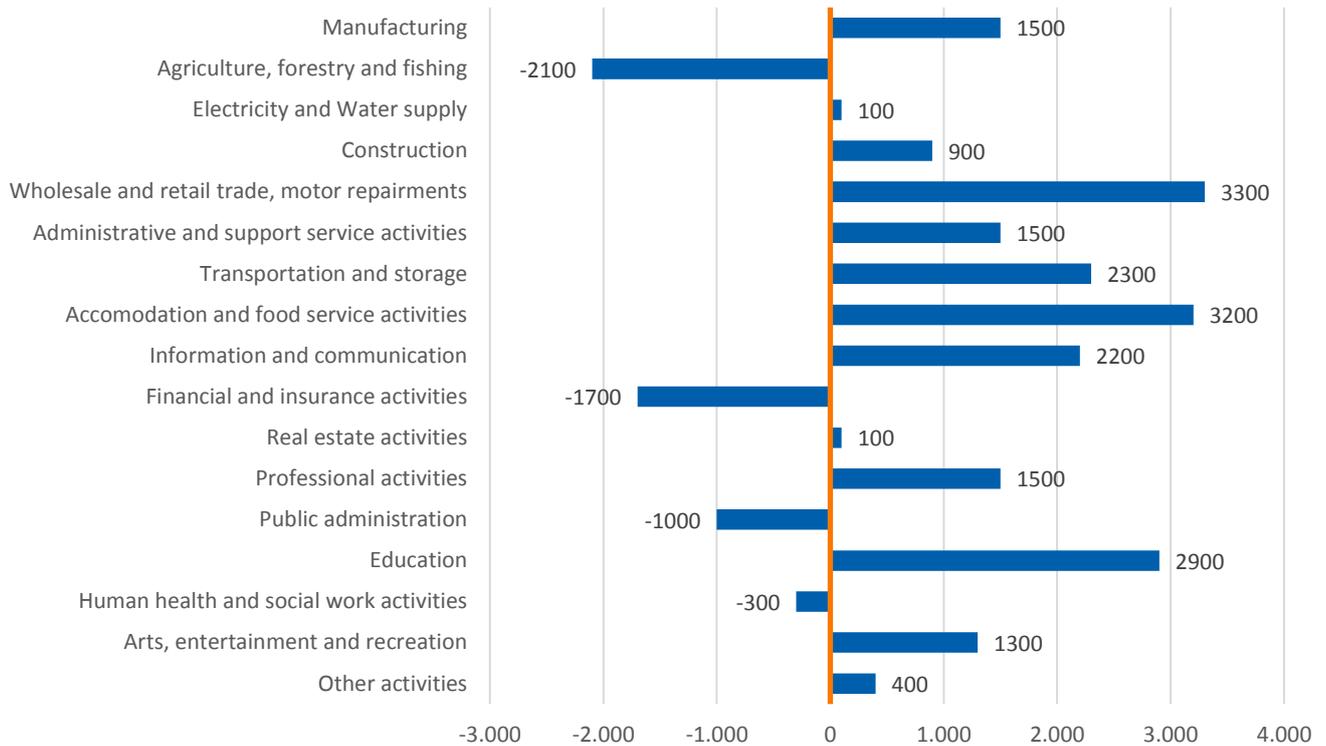


Sources: Statistics Iceland, The Central Bank of Iceland, Arion Research

An answer to that question can be found by for example walking down Laugarvegur (main shopping street in Iceland), doing the Golden Circle or looking around at Keflavik airport – or by looking at the picture below. The vast majority of job growth is due to tourism related activities. For instance, jobs relating to accommodation and food service have increased by 3,200 in the period from 2010 to 2015, work relating to transportation and storage has increased by 2,300 and jobs with travel agencies and booking services (covered by administrative and support service activities in the picture below) have increased by 1,000. The greatest reduction is in work within the financial sector and agriculture and fisheries.

The labor market was at a crossroad last year when for the first time since the economic crisis, more people were employed than in 2008. Or in other words, for the 12,000 jobs that were lost between 2008 and 2010 there have been 16,300 created instead, with the last year alone creating no more than 6,000 new jobs. To put these figures in further context, a total of 202,000 people were on the labor market in June according to data from Statistics Iceland.

Change in number employed - between 2010-2015

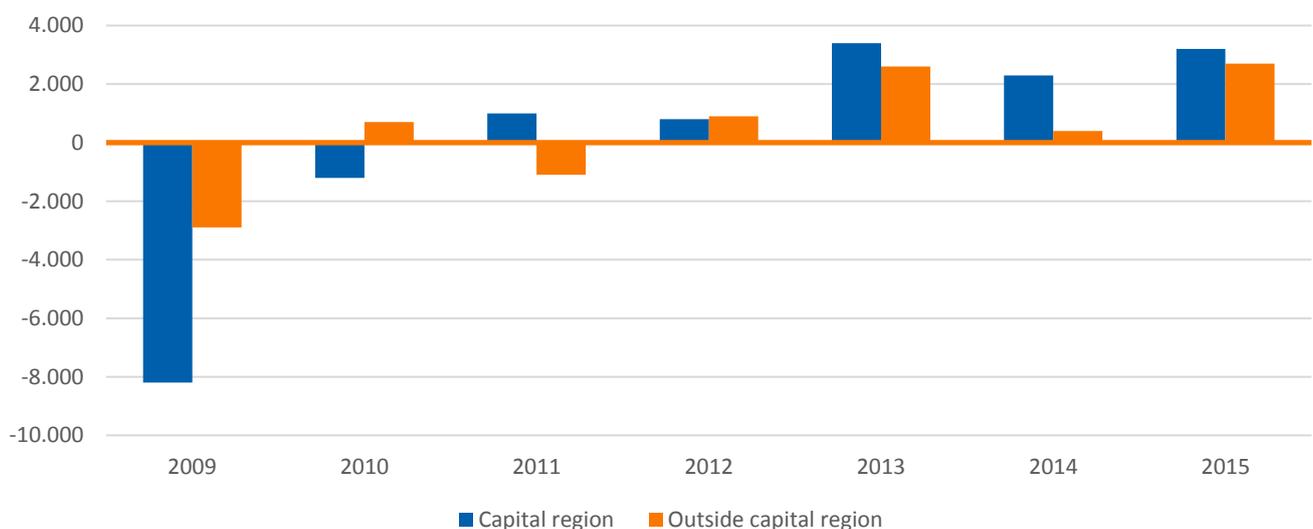


Sources: Statistics Iceland, Arion Research

Employment growth has not been secluded to the greater capital area, on the contrary. Certainly there have been created more jobs in the capital area, as significantly more jobs were lost there compared to other regions during the economic crisis, but the percent growth between regions has been similar. If the years 2010 and 2011 are used for reference, when employment reached its low capital area and outside the capital area, respectively, employment growth has been 10% in the capital area and 11.2% outside it.

Outside the capital area education has created the most jobs have by far. In that sense education related jobs have increased by 40% since 2011, or about 2,660 jobs, the largest increase in full-time positions within and outside of the capital area. Furthermore, work relating to accommodation and food service activities has increased substantially along with jobs in transportation and retail sector. In the capital area job creation in professional, scientific and technical activities has been high, along with the ever-growing IT sector.

Change in number employed by region - change from previous year



Sources: Statistics Iceland, Arion Research

The Central Bank of Iceland assumes in its macroeconomic model an unemployment equilibrium rate, or “natural unemployment” of 4%, suggesting that the Icelandic labor market is heading towards an imbalance – a shortage of labor.

Last year there was a net emigration of Icelanders of 1,265, and it therefore appears that increased employment has been to a large extent met with foreign labor, as net immigration of foreign citizens amounted to 2,716 last year. So when there is shortage forming on the domestic labor market, why are Icelanders net moving out of the country? Of course there are various reasons for people moving abroad for an extended or short period and it is undeniably a positive development that individuals have the opportunity to seek their luck abroad. However, this development indicates that the job creation in recent years is only partially meeting Icelanders desired field of work and terms of employment.

All other things aside, it will be interesting to watch the developments in the labor market in the coming years, especially whether tourism related activities will continue to be the main source of job creation or if other industries will take more of the burden.