Tourism in Iceland:
Soft landing or a belly flop?

Arion Research
October 2018

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Key findings

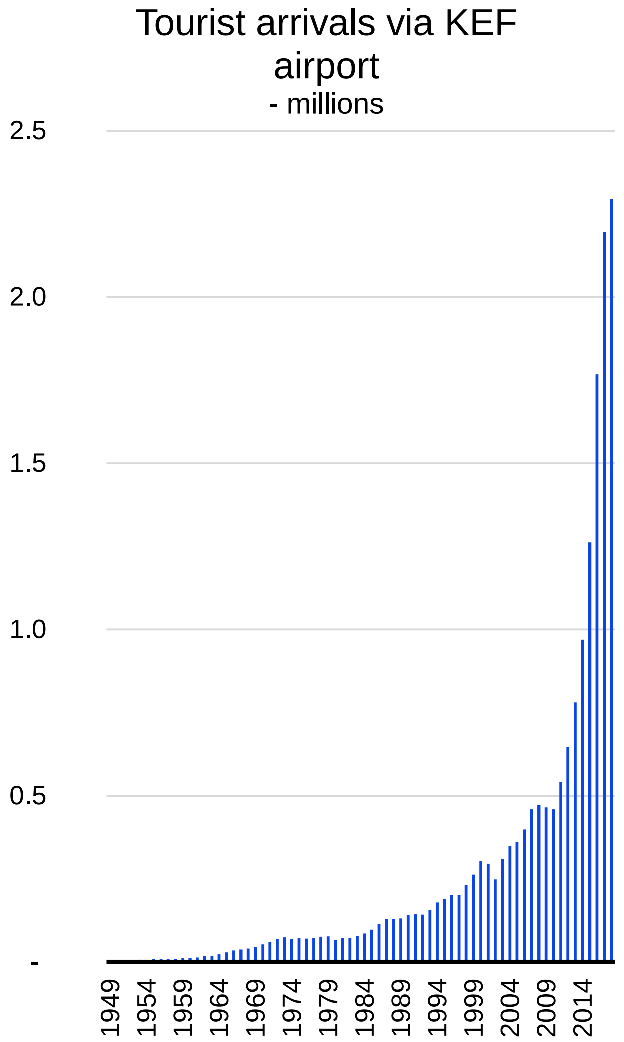
- **Increased capacity of the Icelandic airlines has played a large role** in the sensational growth in tourist arrivals to Iceland.
- **Although oil prices have surged since 2016, airfares have not followed.** According to estimates, the Icelandic airlines will pay around one thousand ISK with each passenger in 2018, a development that is unsustainable in the long run. Airfares are simply too cheap and they need to increase. Analysis of tourist's price elasticity of demand indicate that rising airfares could lead to decrease in number of tourists, especially if the ISK remains strong.
- **We predict very little growth in tourism in the coming years**. In our base case tourist arrivals will increase by 1.4% next year and 2.4% in 2020. There is quite a lot of uncertainty, but we consider the downward risk to be greater. For example, if growth in VIA passengers continues at the same rate in 2019 as it has done in 2018, number of inbound tourists could slightly decrease. Global trade tension could also slow growth in passenger transport, a development which would affect Iceland.
- **Last year, hotels accounted for less than half of all registered overnight stays in Iceland**. In recent years, the vast majority of hotel nights have been in the capital area. However, countryside hotels have been attracting increased shareholding, mostly in Southern Iceland, Reykjanes Peninsula (South-West) and West Iceland.
- Increase in tourism beyond supply growth in hotels has created basis for Airbnb to gain market share. However, recent numbers indicate that Airbnb's activities are shrinking, **as Airbnb's overnight stays reduced significantly over the summer.**
- It appears that strong króna and high prices **has not shortened tourist's vacation time as much as previously thought** because tourists have increasingly sought after cheaper accommodation, such as Airbnb. **Tourist's consumption in ISK has in turn contracted, but pretty much stayed unchanged in foreign currency.** Developments differ from nationalities where some are more vulnerable than others.
- **For the economy in general, consumer behavior is now more important than before, since the tourism industry can no longer rely on revenue growth through an increased number of tourists.**

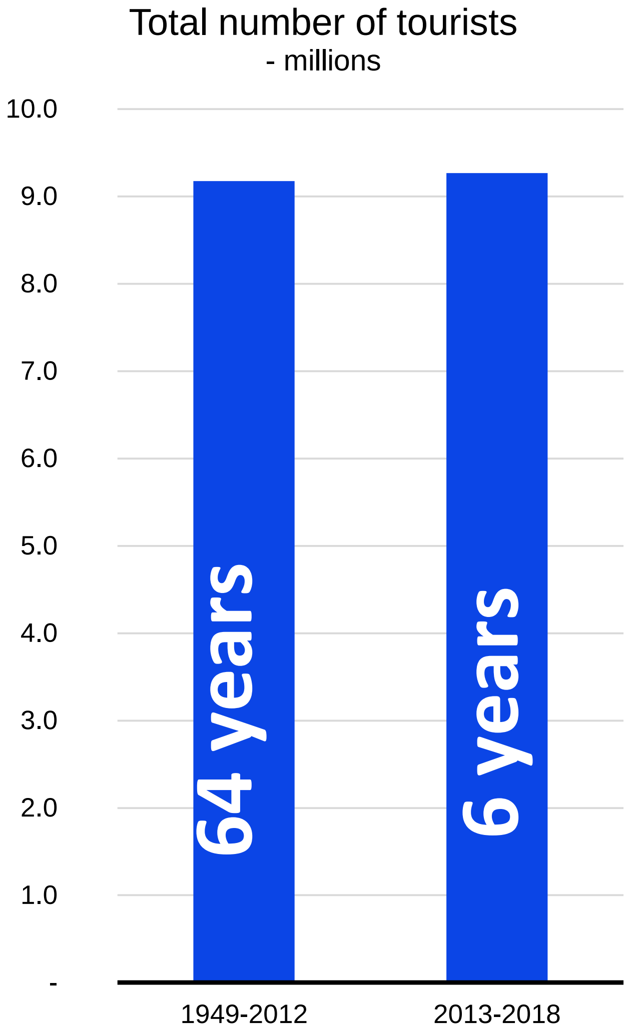
From zero to hero

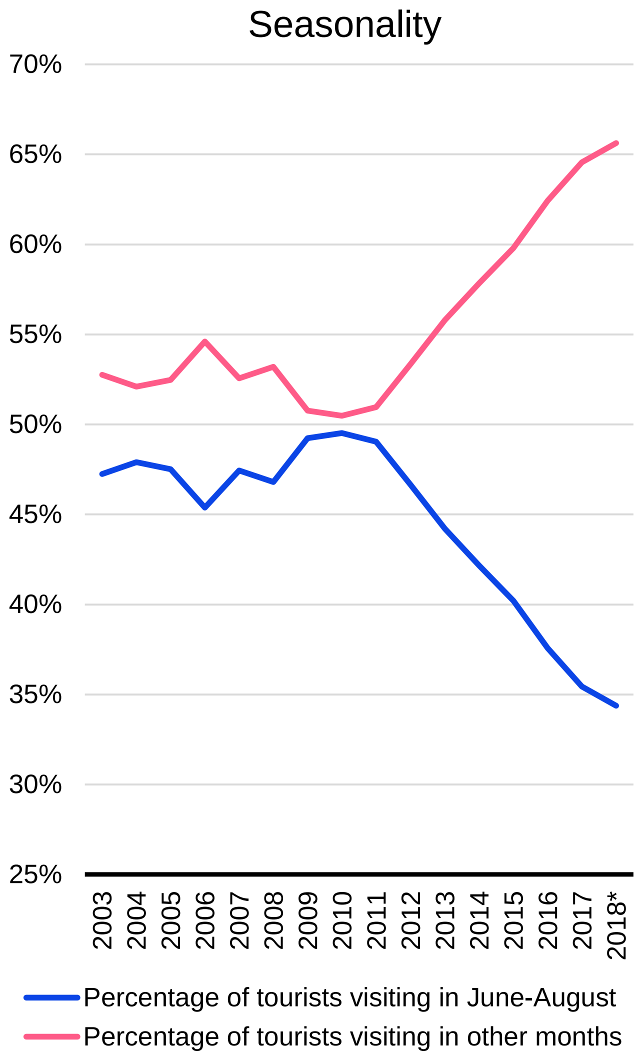
In a very short period of time, tourism has gone from a small industry to the largest export sector in the country.

A Cinderella Story

More and more foreign tourists, less and less seasonality



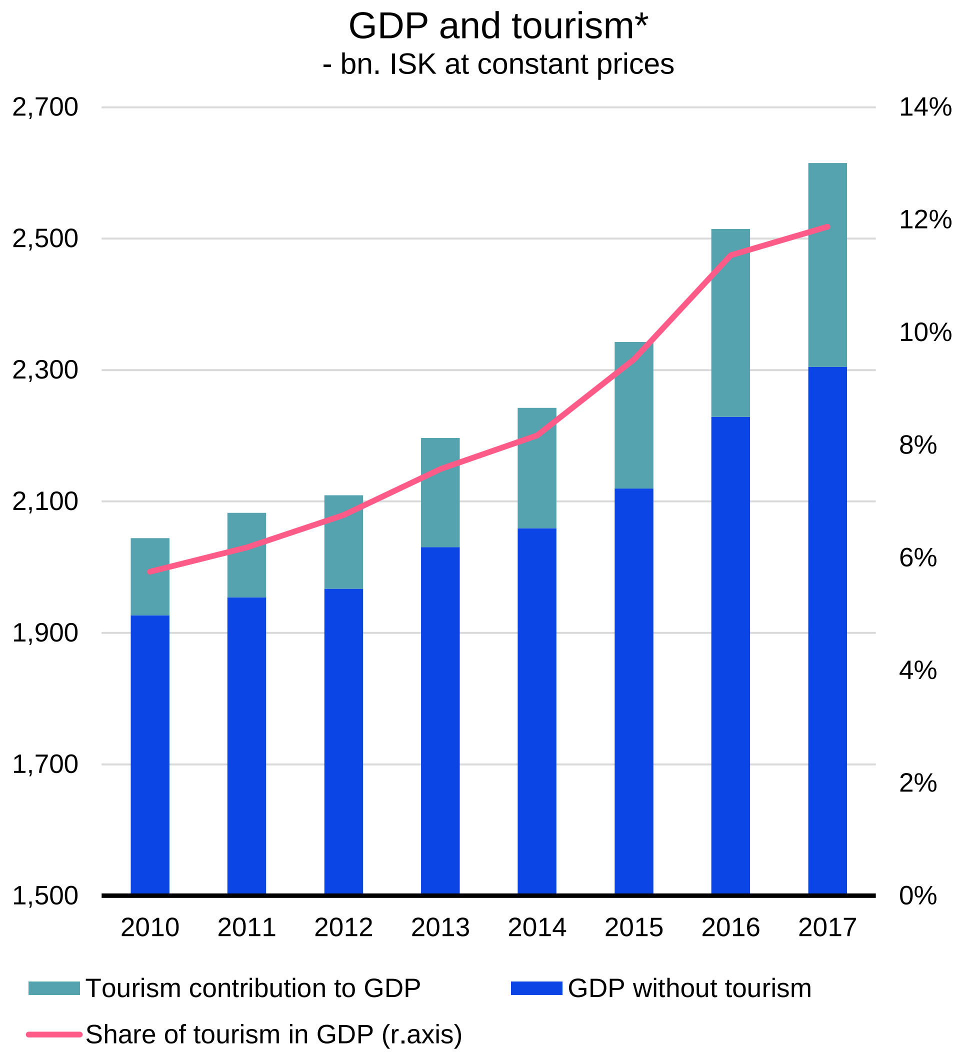


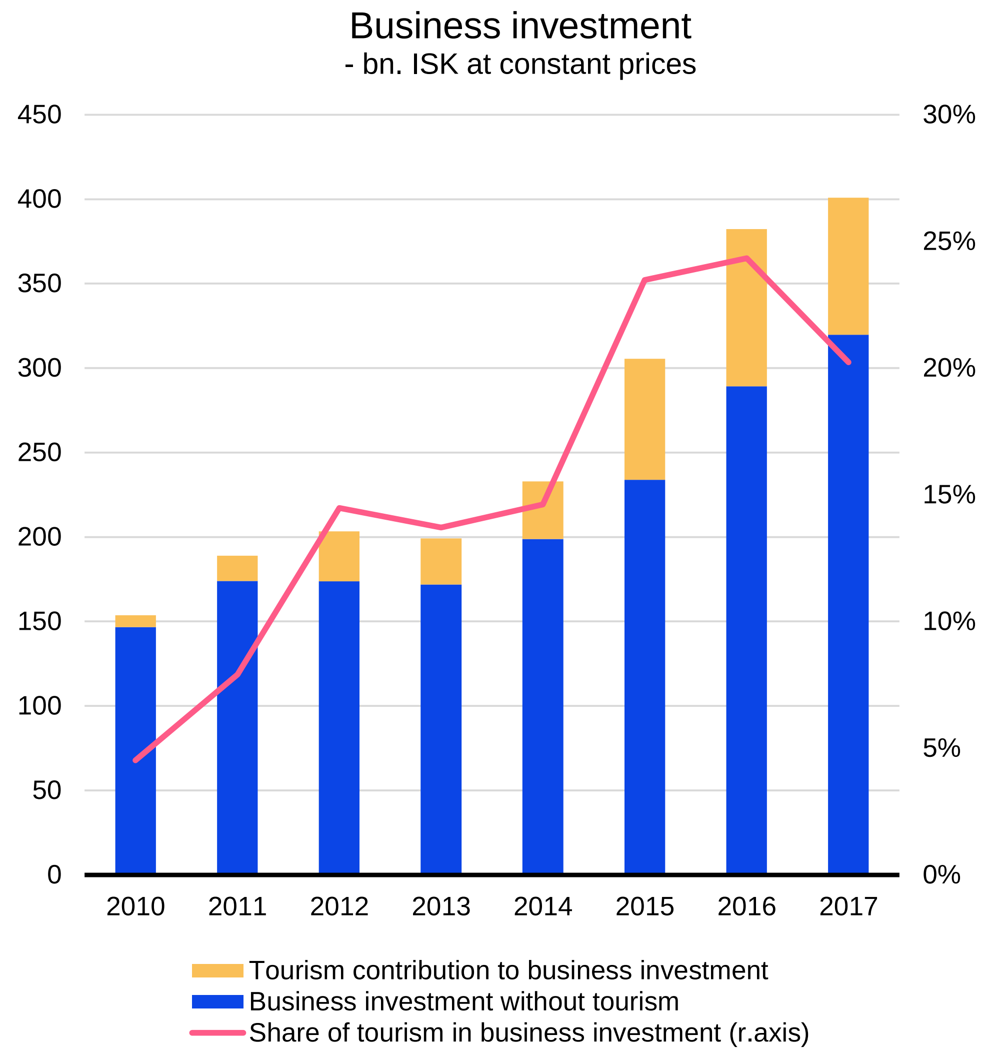


Sources: Icelandic Tourist Board, Arion Research. * Based on Research's forecast.

Tourism contribution to GDP has doubled

For the past three years, tourism has accounted for roughly 23% of business investment

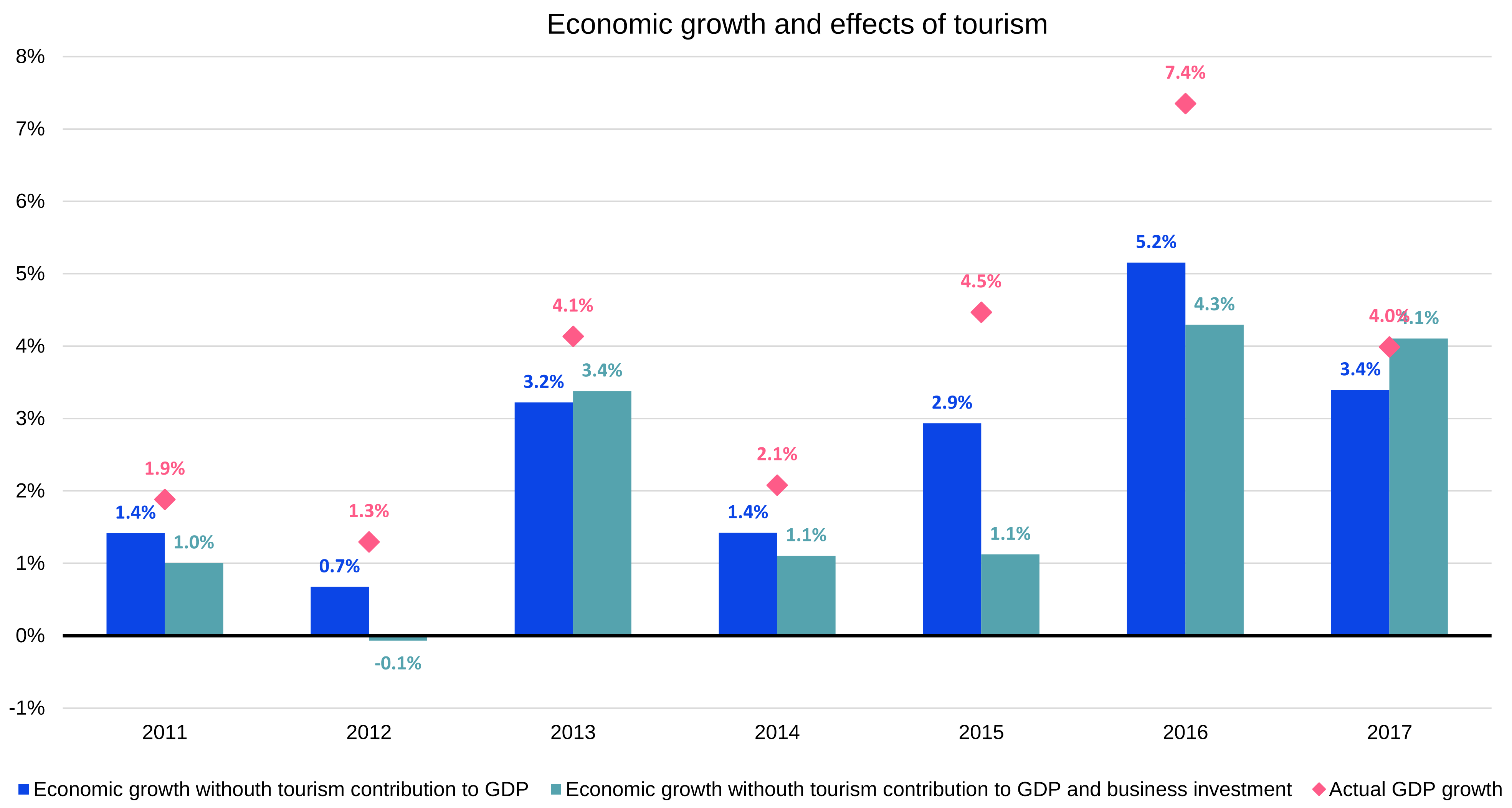




Sources: Statistics Iceland, Arion Research. * The weight of tourism in GDP is not in perfect accordance with Statistics Iceland's TSA, as air passenger transportation weighs more here than in the TSA.

The recovery time would have been much longer…

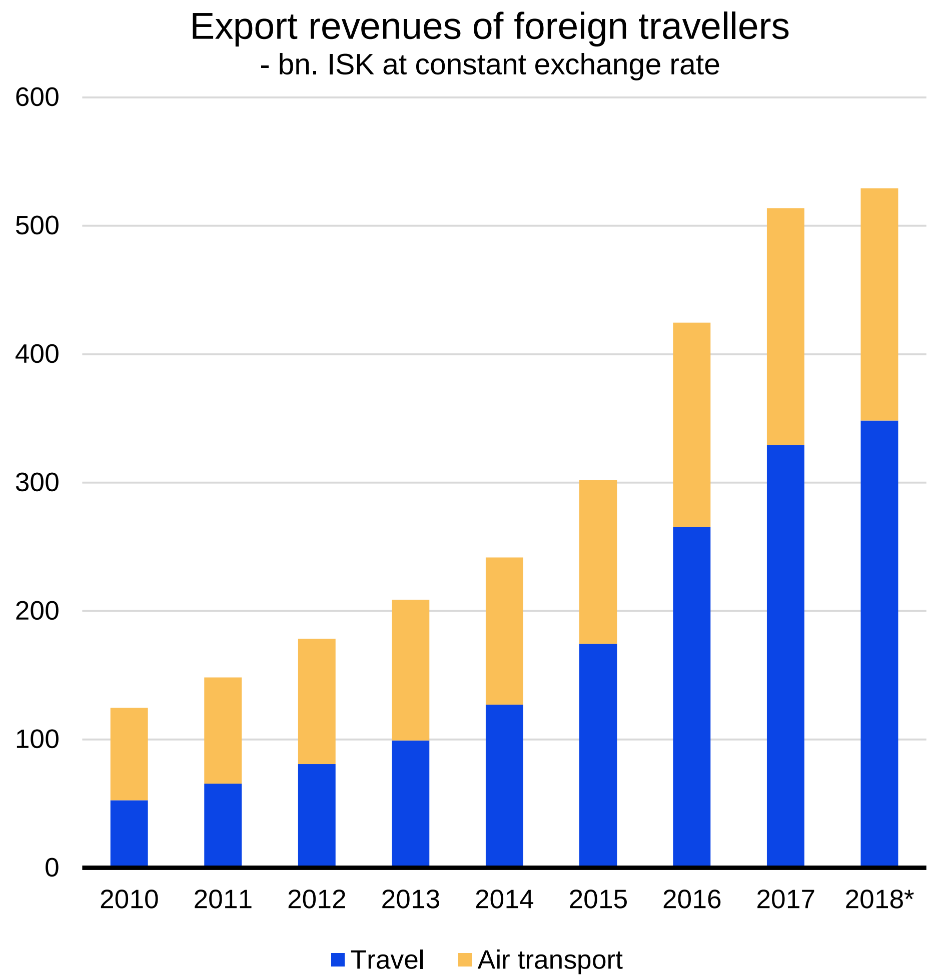
The economic upturn in Iceland has been in a class of its own, largely due to growth in tourism

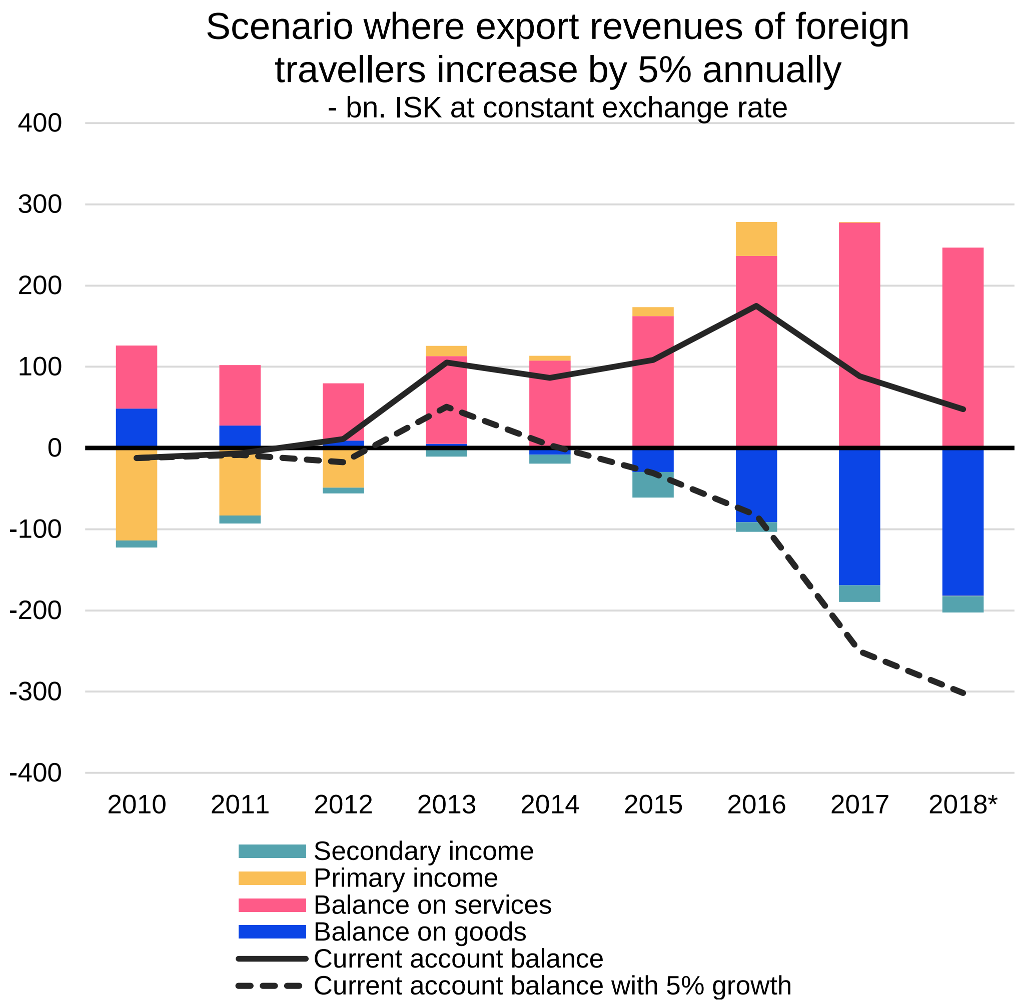


Sources: Statistics Iceland, Arion Research

… and the current account would only be a shadow of its current self

The surplus of trade in services, which is primarily due to tourism, has carried the trade surplus. It should be noted that the analysis below is likely inaccurate, as the impact of tourism on imports has not been taken into account.

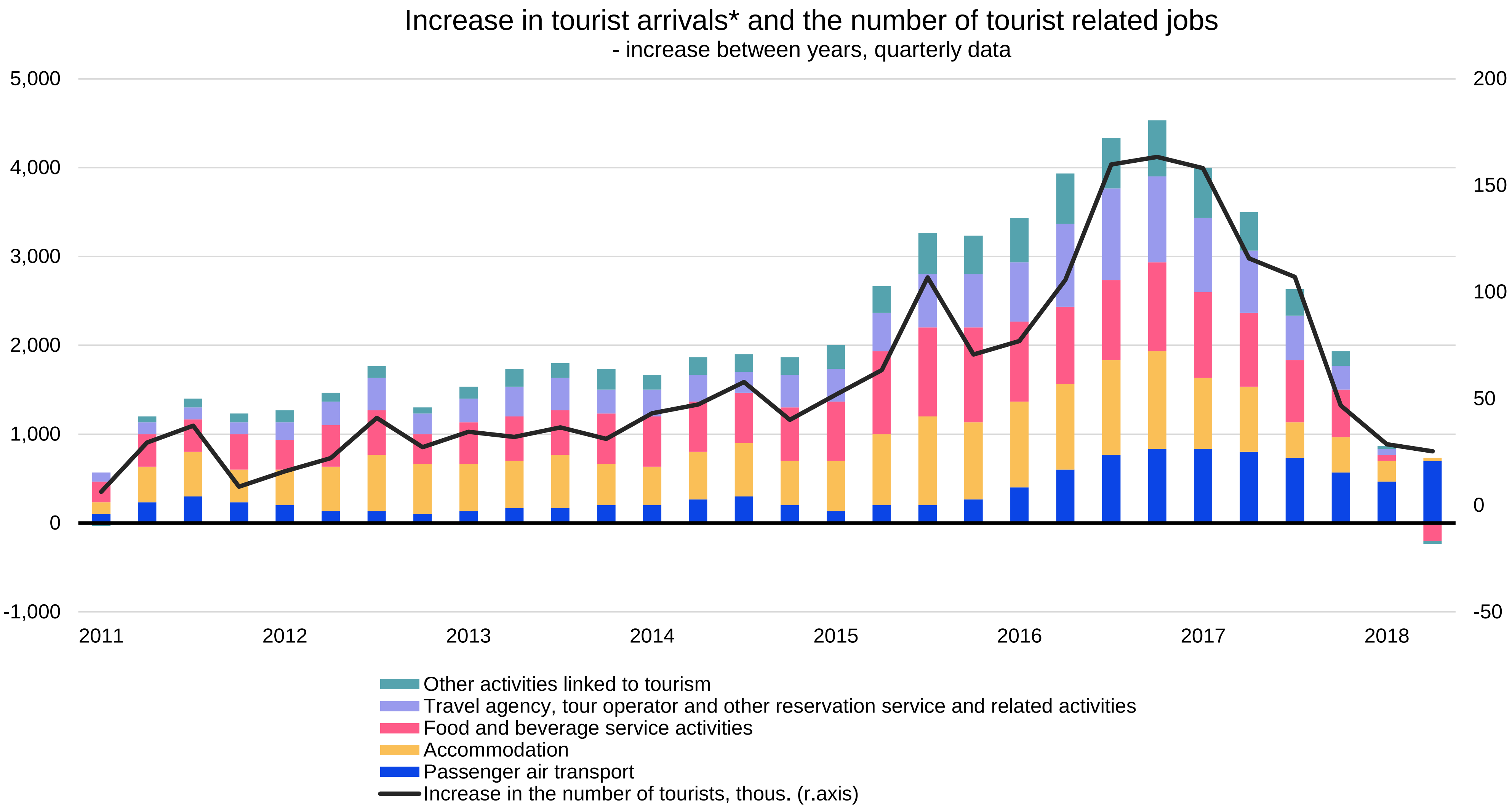




Sources: Statistics Iceland, Arion Research. * Research's forecast from August.

For every 100 tourists, one new job has been created

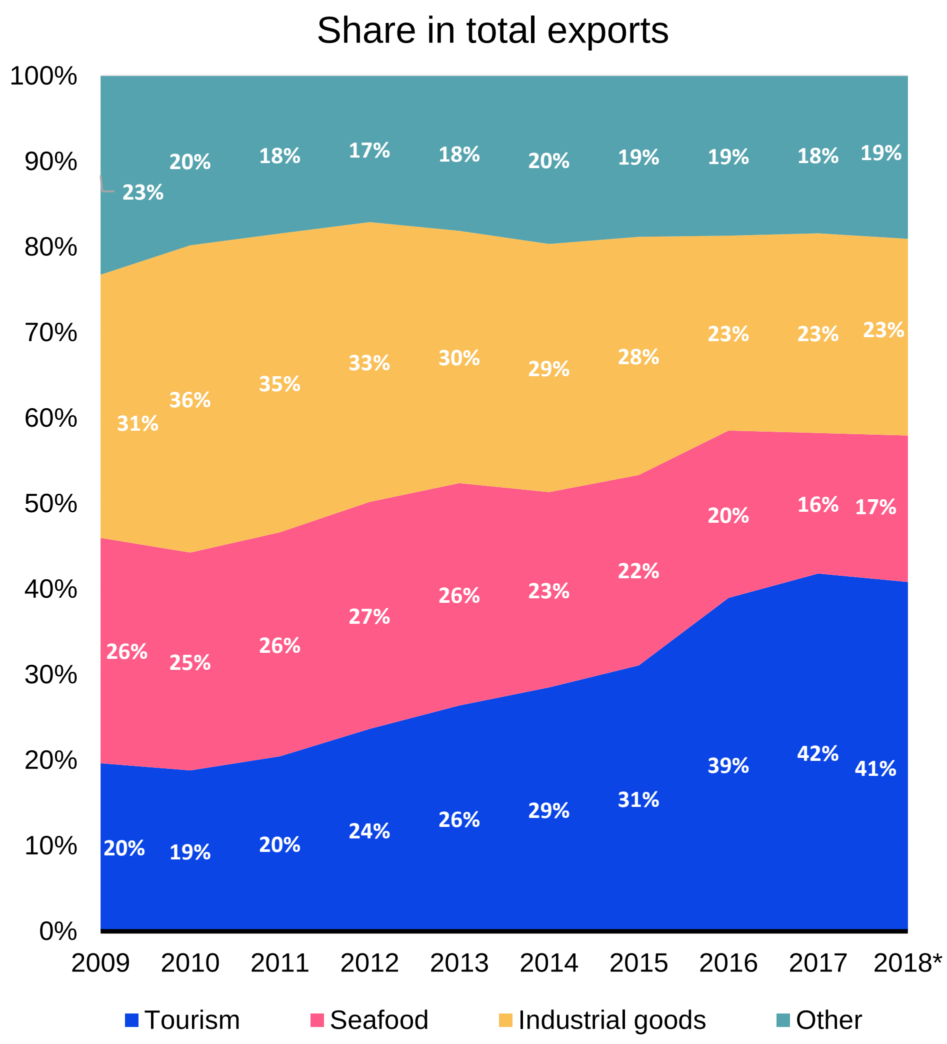
The increase in tourist related jobs has closely followed the increase in tourist arrivals. The figures for Q2 indicate that the slowdown in tourist arrivals has begun to affect the labor market.

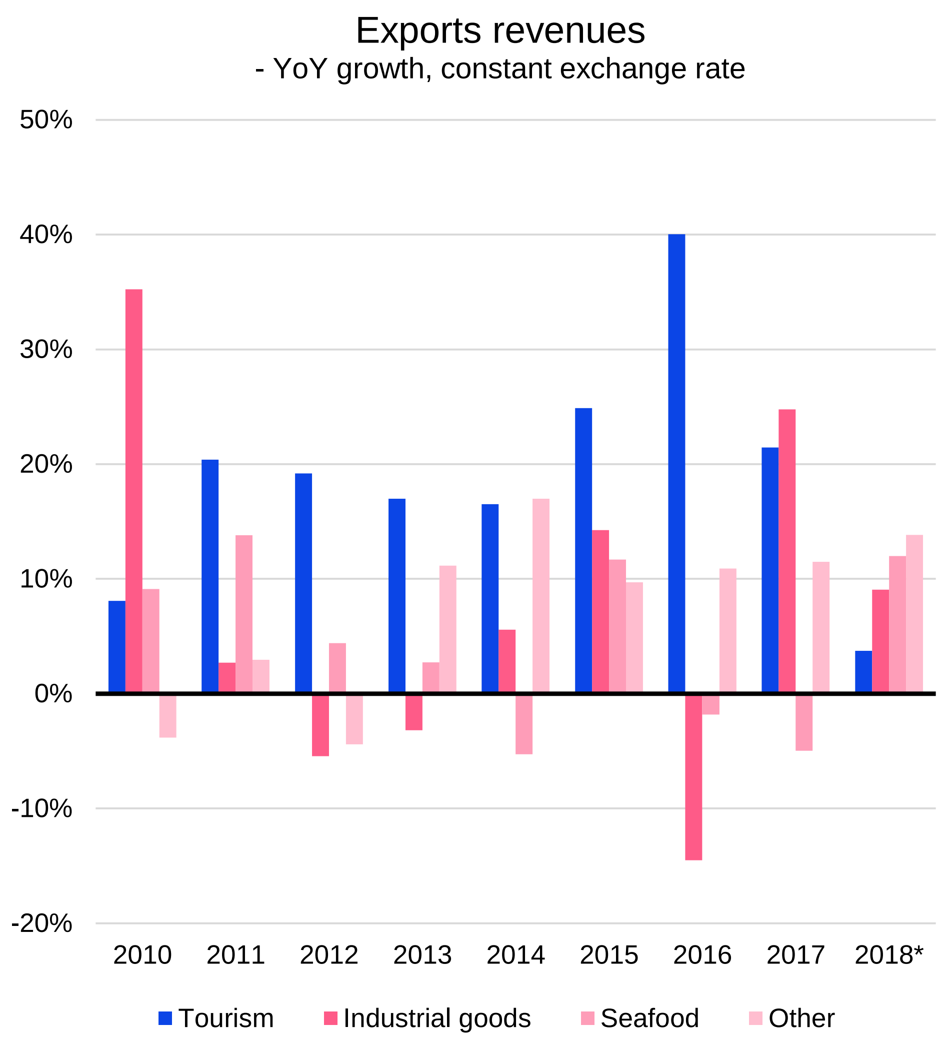


Sources: Statistics Iceland, Icelandic Tourist Board, Arion Research. * Tourist arrivals via KEF airport.

Handing over the growth reins

According to our forecast from August, other export sectors will grow more than tourism in 2018





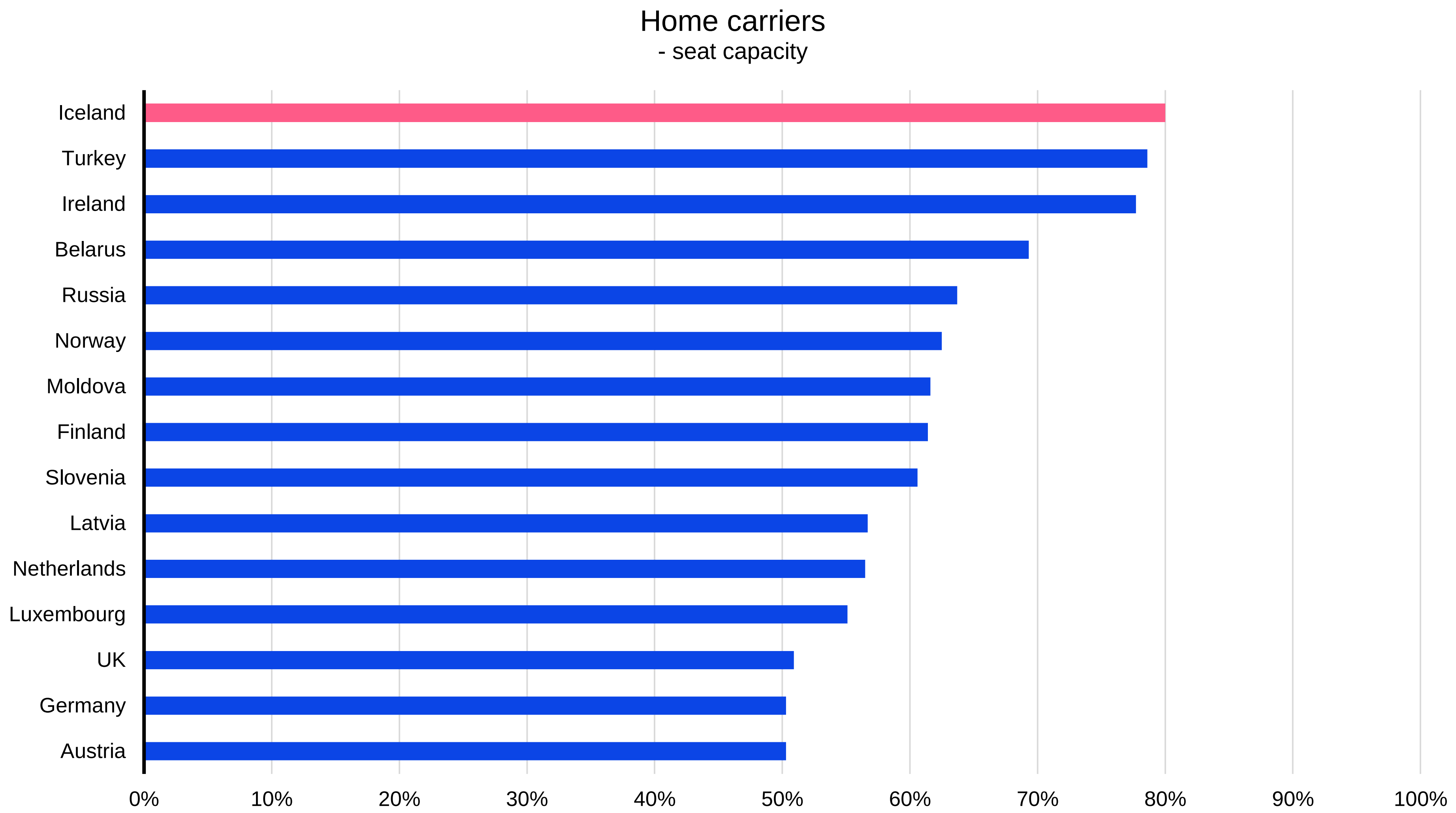
Sources: Statistics Iceland, Arion Research. * Research‘s forecast from August.

Airlines operating environment and impact on tourist arrivals

For small islands, passenger transport is the key driver of tourism. With rising oil prices and fierce competition, Icelandic airlines are now facing considerable headwinds. How will that impact the amount of tourists coming to the country?

Out of European countries, Iceland is the most dependent on home-based airlines

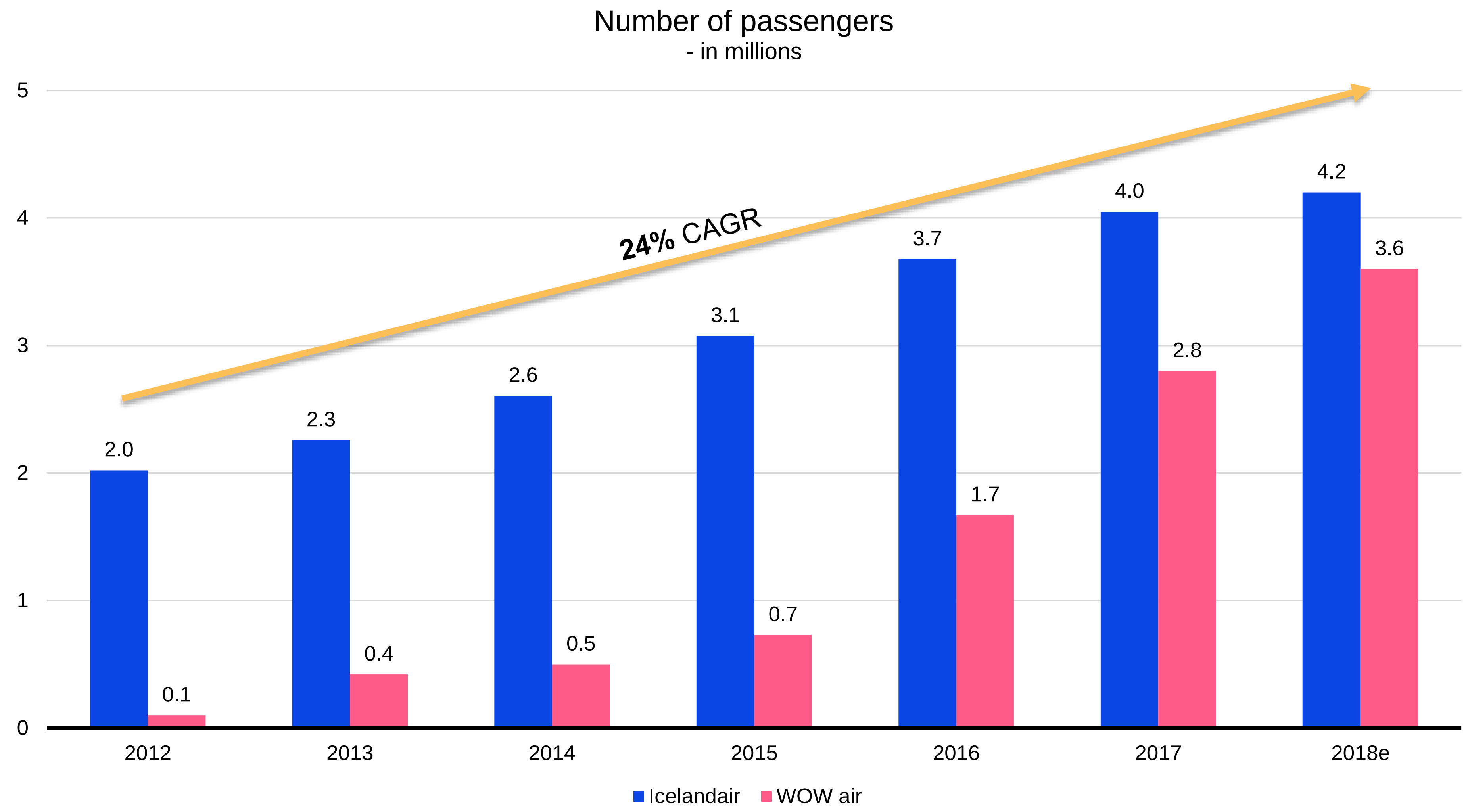
Two other Nordic countries are on the list of top 15 European countries for home carriers



Sources: Anna aero, Arion Research

Capacity has increased a lot

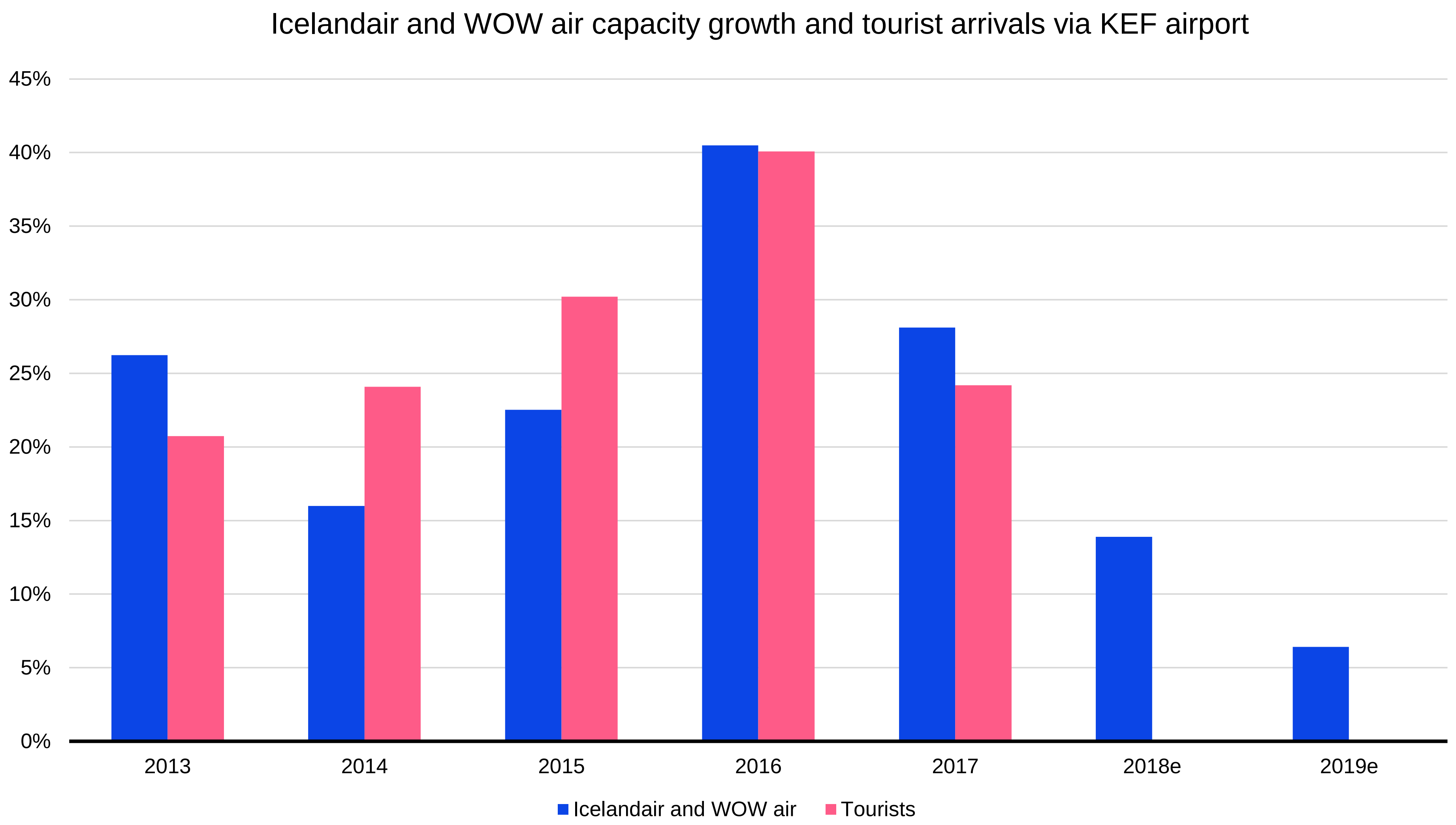
The Icelandic airlines will carry around eight million passengers this year



Sources: Icelandair Group, WOW air, Arion Research

Tourism has followed the Icelandic airlines capacity increase

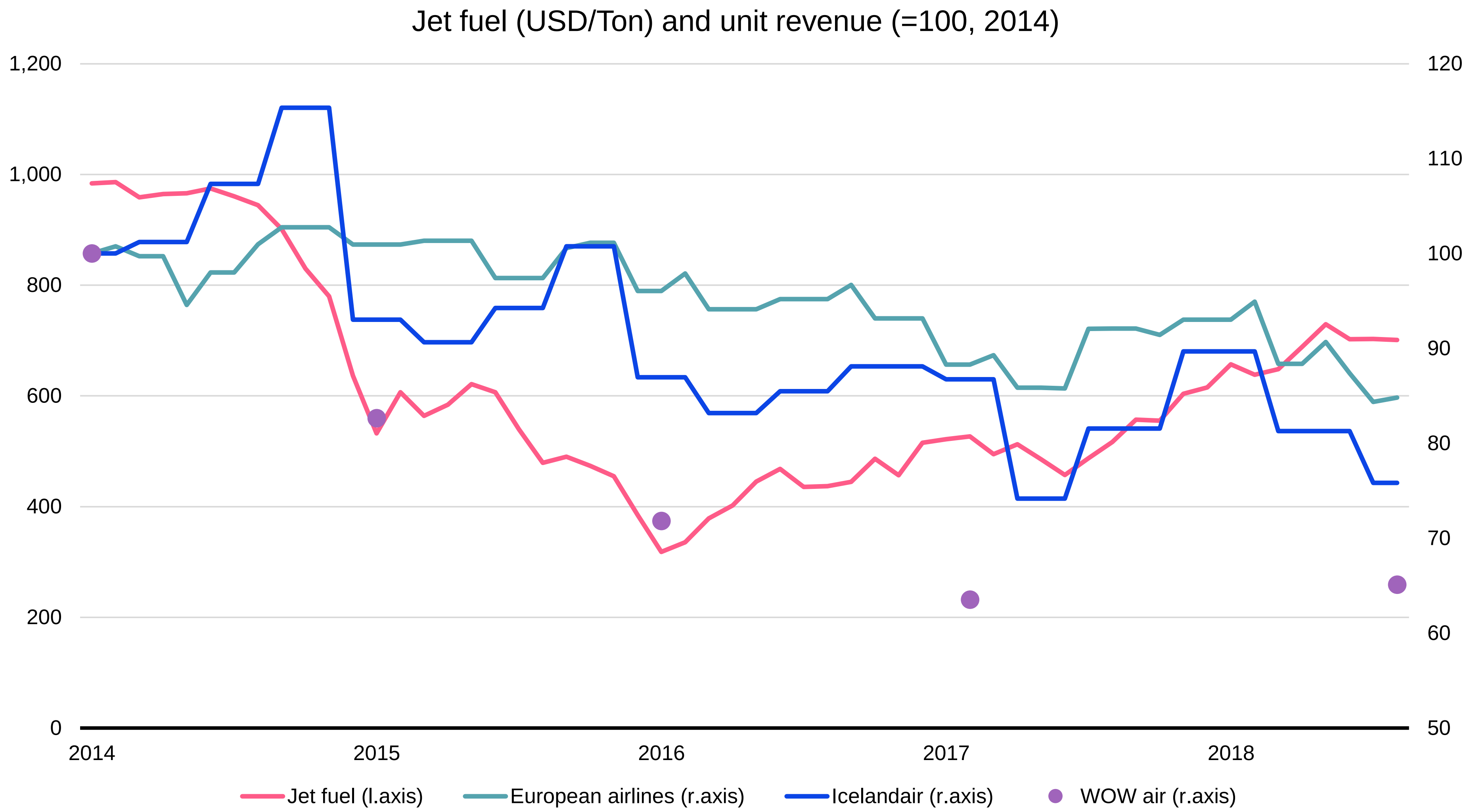
Proportionately higher growth in tourism 2014 and 2015 than increased airline capacity, can possibly be explained by increased flight offerings from foreign airlines



Sources: Icelandair Group, WOW air, Icelandic Tourist Board, Arion Research

Broken up since 2016: Oil price and airfares

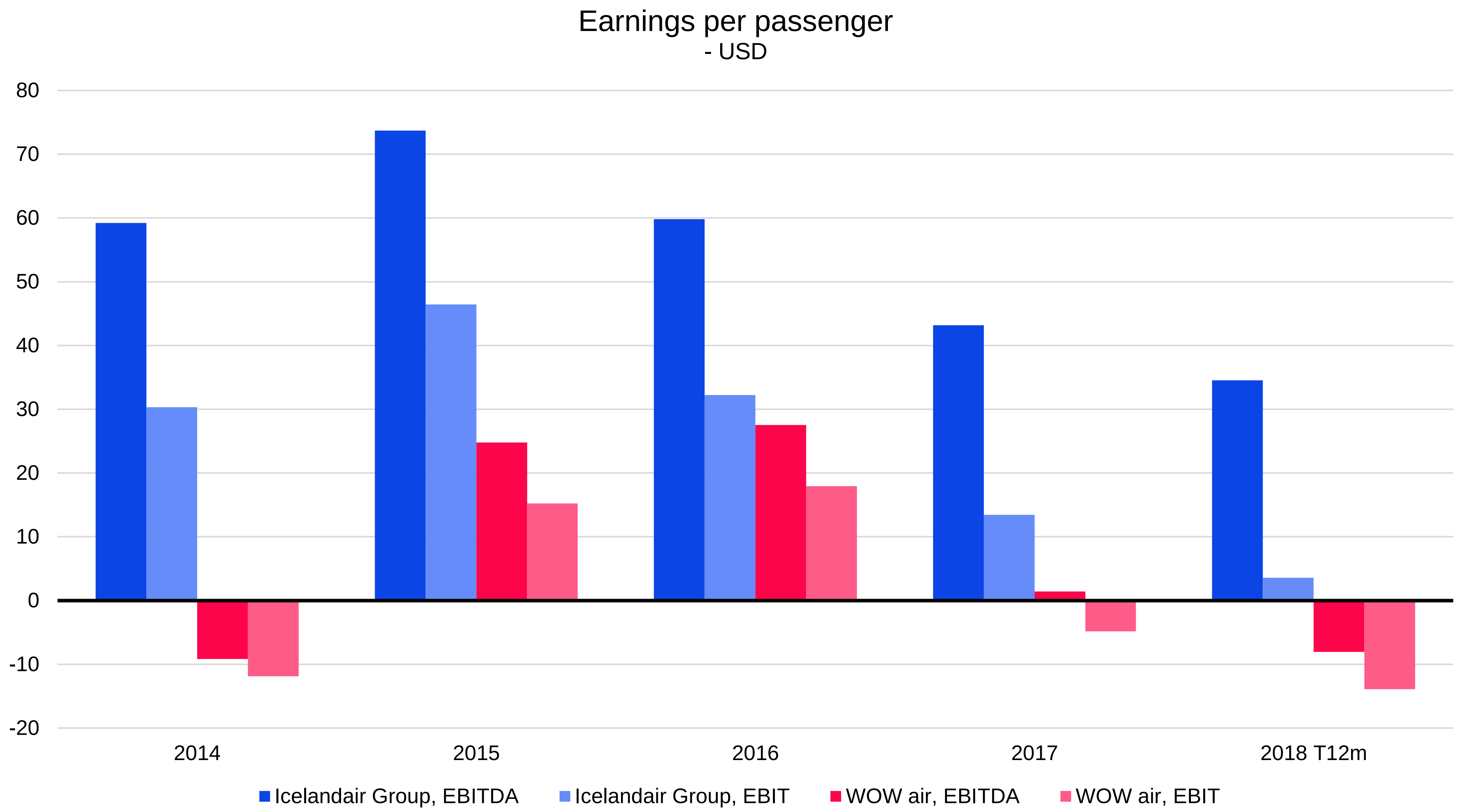
When oil price started plummeting, airfares followed. However, that has not been the case since oil price started rising again.



Sources: Bloomberg, Icelandair Group, WOW air, Arion Research
Unit revenue = Revenues / Revenue passenger kilometers (RPK)

Parallel with unfavorable development of external factors, earnings have gone south

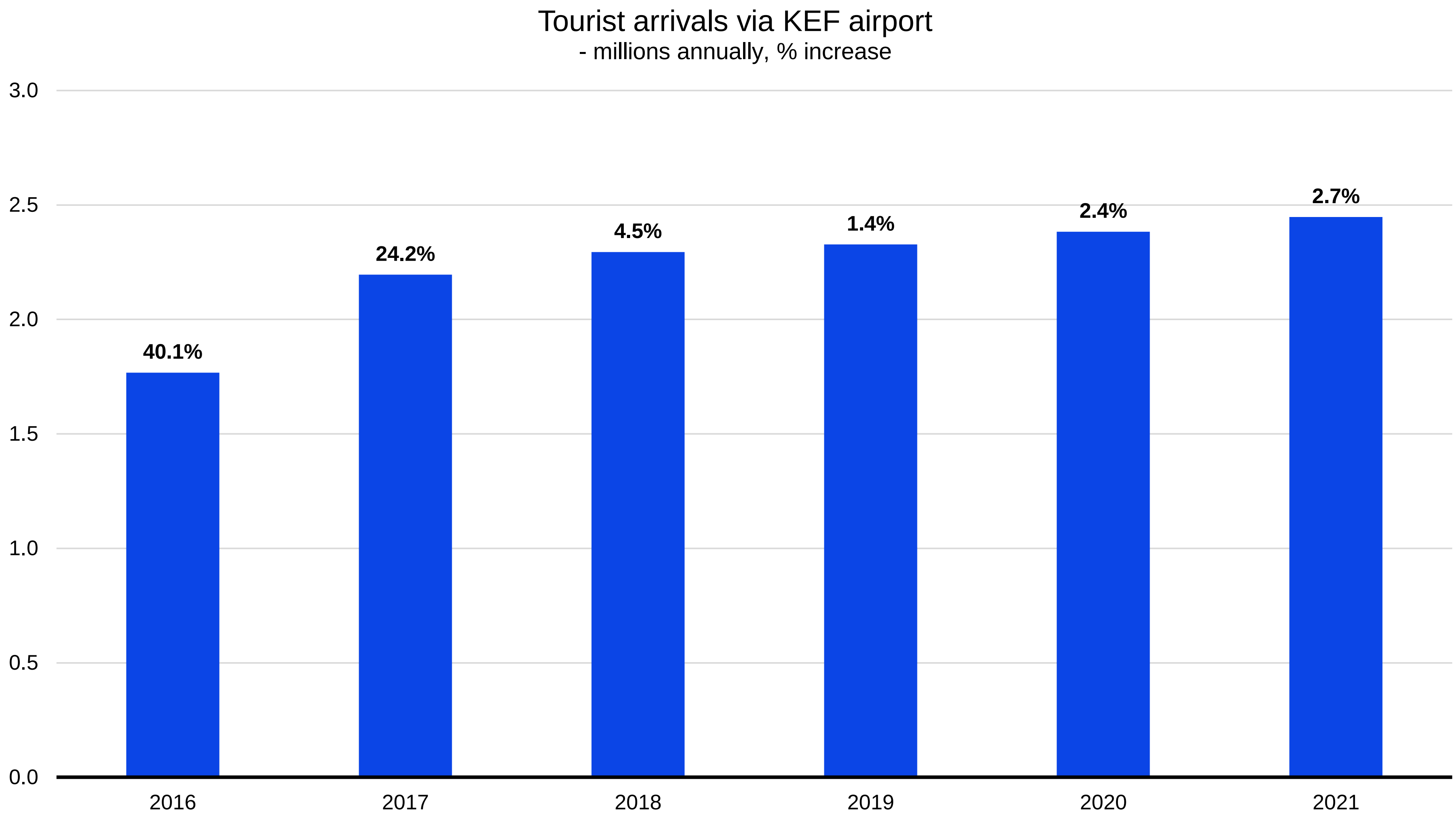
Icelandair Group and WOW air projections assume that operating loss (EBIT) for 2018 will be around thousand ISK per passenger



Sources: Icelandair Group, WOW air, Arion Research
Arion Research projections for 2018 Icelandair Group's EBIT based on company's EBITDA guidance

Our base case projects very little growth in tourism in the coming years

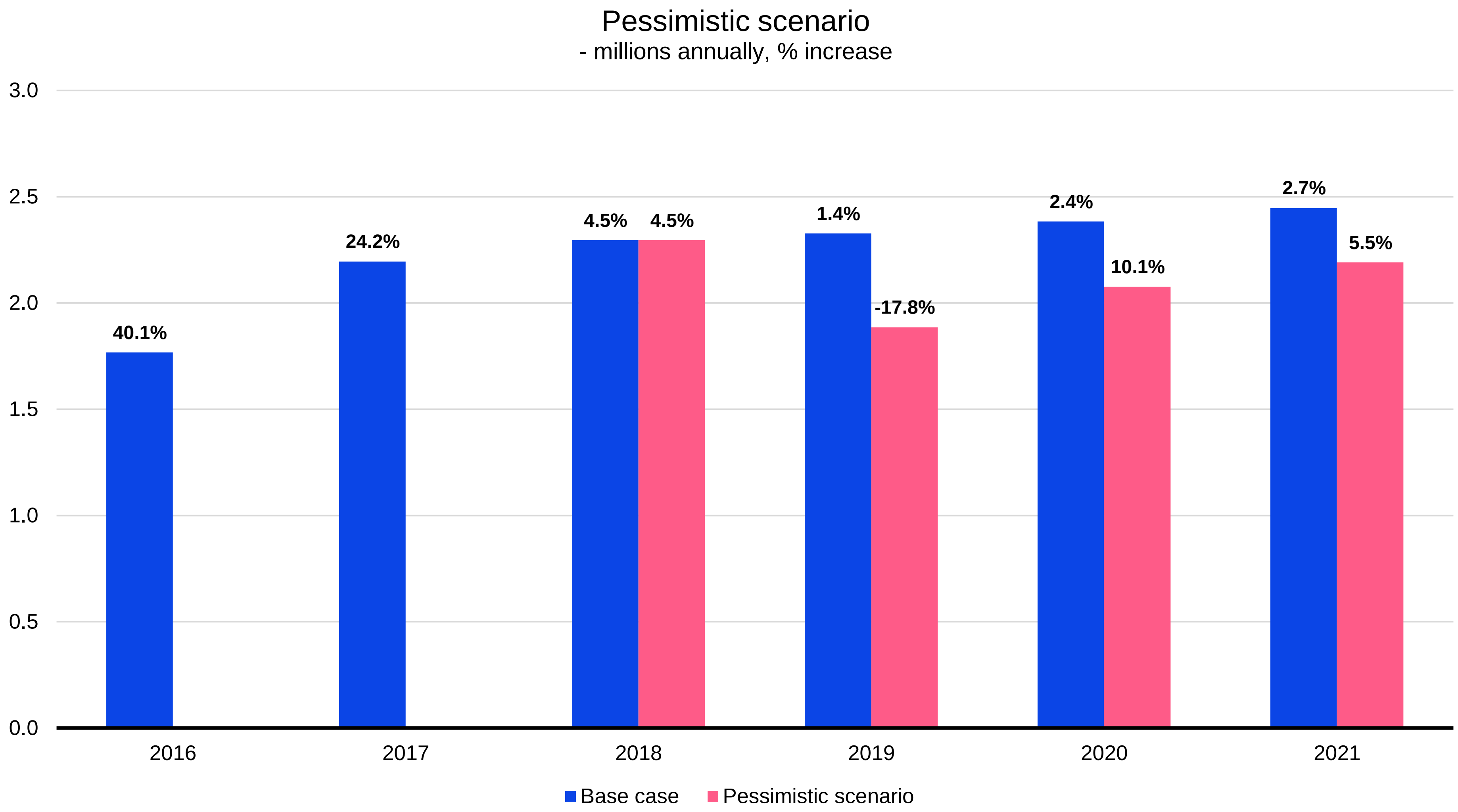
Based on expected flight capacity and continuing growth in share of VIA passengers



Sources: Icelandic Tourist Board, Arion Research

With capacity blow, we could go roughly two years back in time

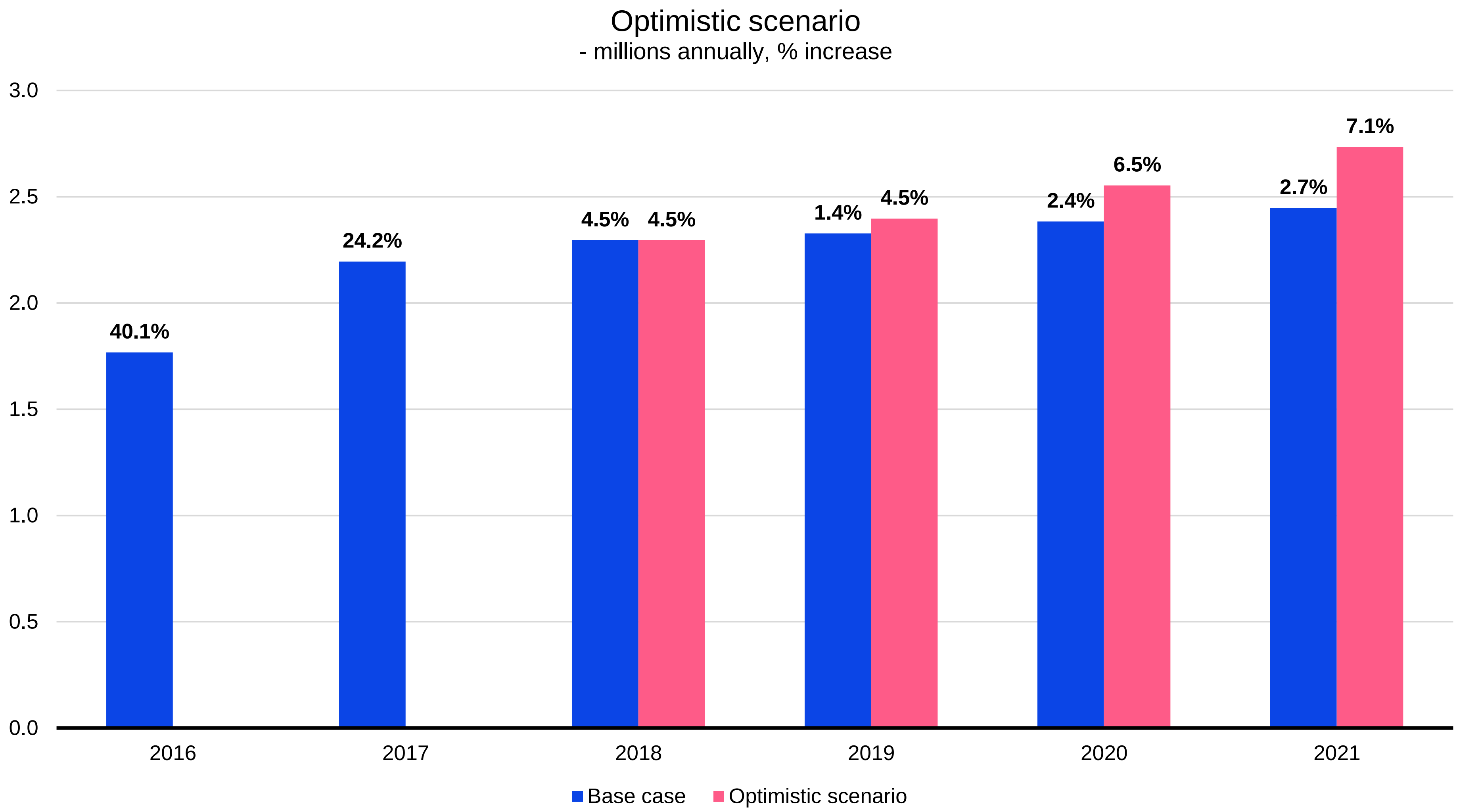
Pessimistic scenario: Capacity of a major airline disappears



Sources: Icelandic Tourist Board, Arion Research

Less fluctuations are in our optimistic scenario than the pessimistic

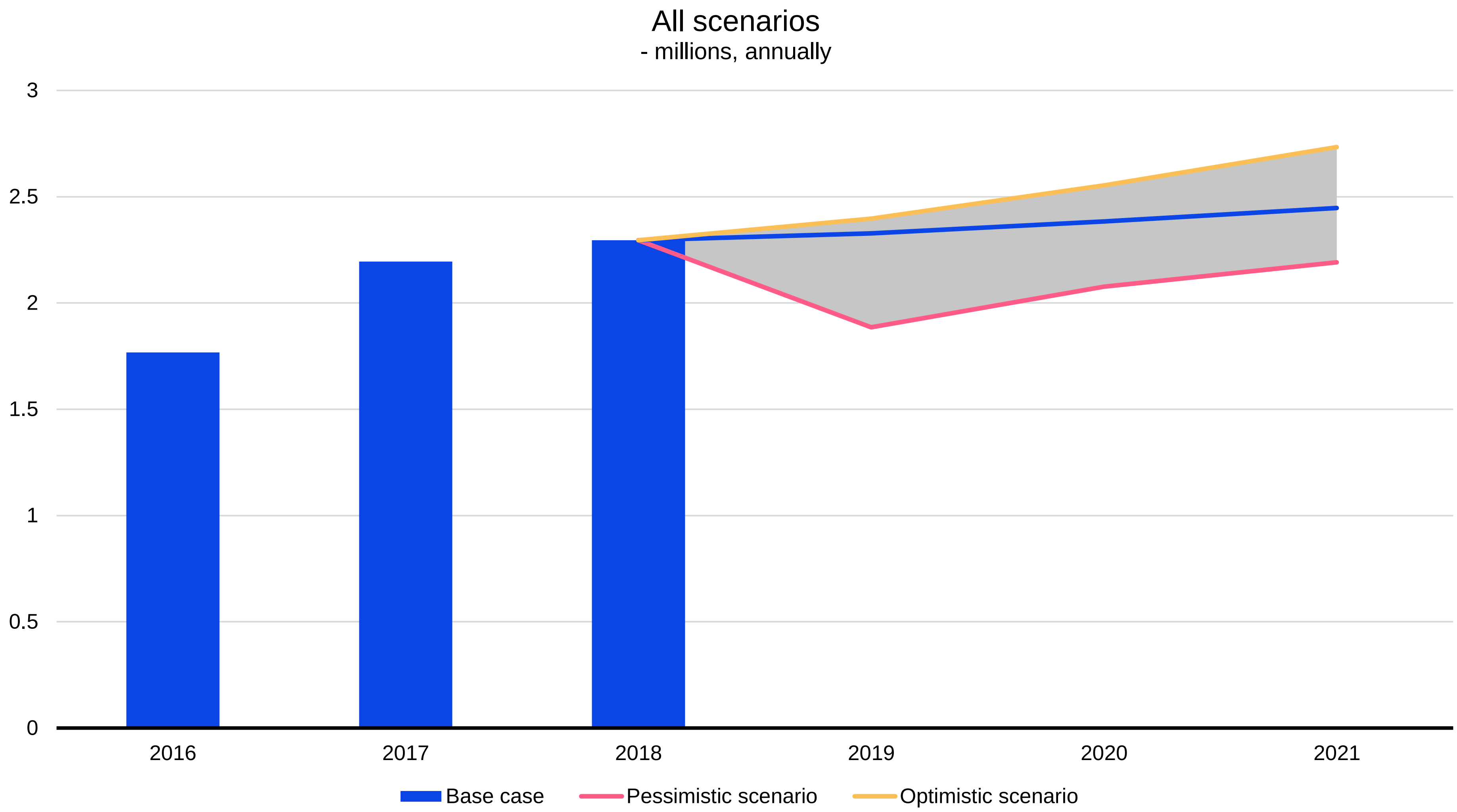
Optimistic scenario: Airline operations improve and they continue to grow



Sources: Icelandic Tourist Board, Arion Research

The scenarios are three, but possible outcomes are more

If airfares increase and the ISK stays strong, we could see results in the gray area between the base- and pessimistic scenarios



Sources: Icelandic Tourist Board, Arion Research

The downside risk is significant

What if airfares increase significantly?

What if the world economy slows down?

CHEAPEST - ICELAND - GETTING THERE IS A BREEZE

getting there is. Food and accommodation is more expensive that you'd imagine, however if you're smart about it then thanks to the cheap flights, your overall journey costs will remain below average.

Home | Destinations | *The Flights Are Cheap, But Iceland Is Expensive. Here's How to Budget.*

The Flights Are Cheap, But Iceland Is Expensive. Here's How to Budget.

March 8, 2017
Caroline Lupini

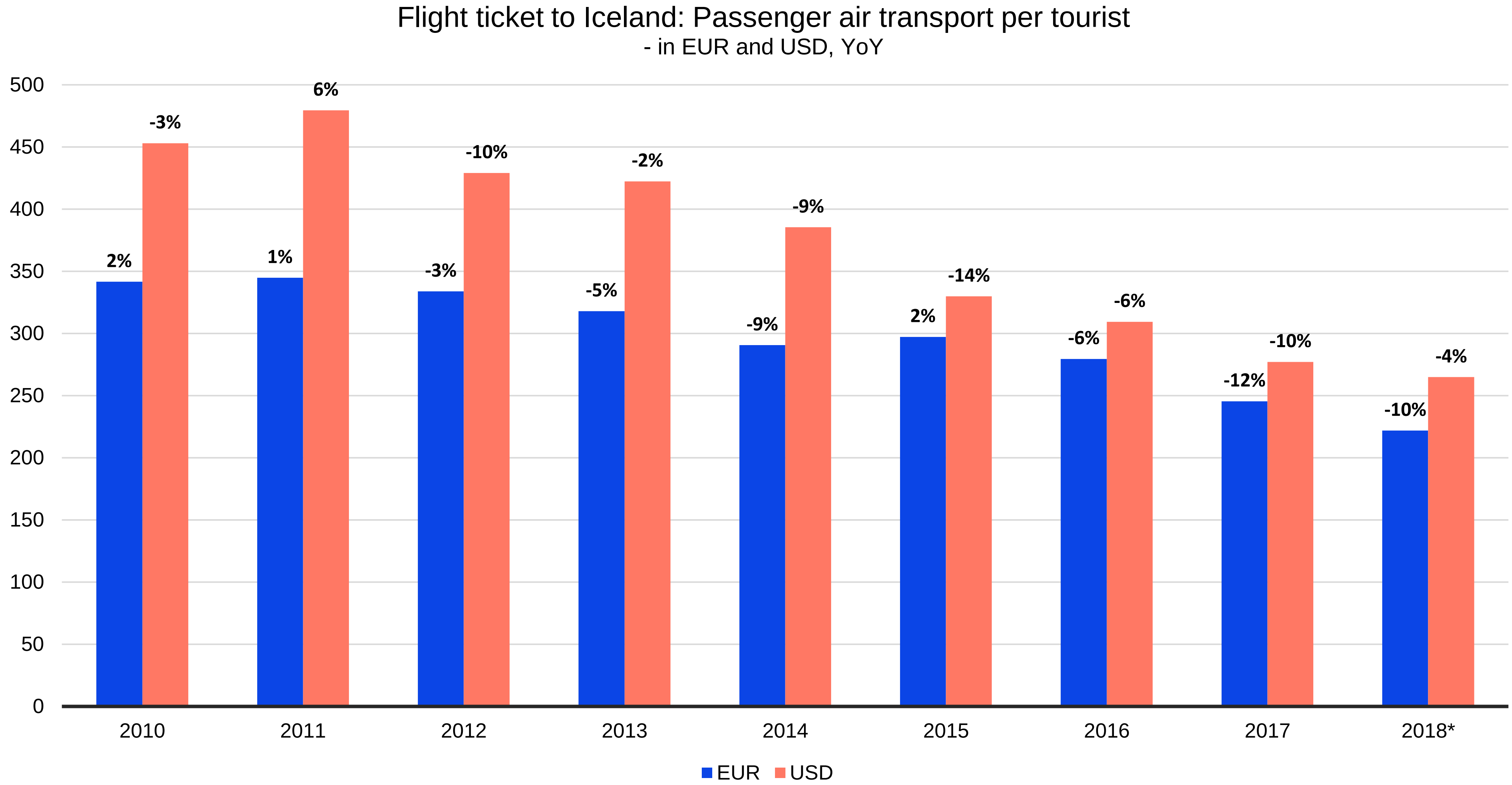
Are you one of the millions of travelers who are visiting Iceland this year? Have you been cautiously watching the rise of the Icelandic Krona in preparation for your trip? Are you caught in the void between "the airfare is basically free" and "Iceland is *so* expensive" and you're not sure which statement holds more weight for you? Fear not: here are some tips to financial survival in everyone's favorite (sub)arctic island.

Reasonably priced flights make Iceland an appealing destination for millions of tourists each year. But the country can easily break your bank if you're on a budget. From a glass of wine to a meal at a restaurant to a piece of clothing, everything will cost significantly more than you're used to paying in the US.

Sources: The Travel, Insider, Frugal Travel Guy

Flying to and from Iceland has never been so cheap

While the ISK has appreciated, flights to Iceland have become cheaper. Lower airfares have somewhat offset the rising cost of staying in the country.



Sources: Statistics Iceland, Icelandic Tourist Board, CBI, Arion Research. * Estimation based on airfares in 1H 2018.

What could it mean if airfares increase?

First, we have to look at the price elasticity of demand. For tourism in Iceland, Europe and North-America are the most important markets, although the Asia market is growing. According to studies, tourists from America are more sensitive to price changes than others. Europeans are fairly price sensitive as well.

Destination	Origins				
	Africa	America	Asia	Oceana	Europe
Africa	-0.282	-3.081	-0.579		-2.190
America	-0.704	-1.619	-1.310	-0.804	-1.136
Asia	-1.767	-1.223	-1.818	-1.246	-1.436
Oceana		-0.675	-1.046	-0.917	-0.449
Europe		-1.374		-0.750	-1.205

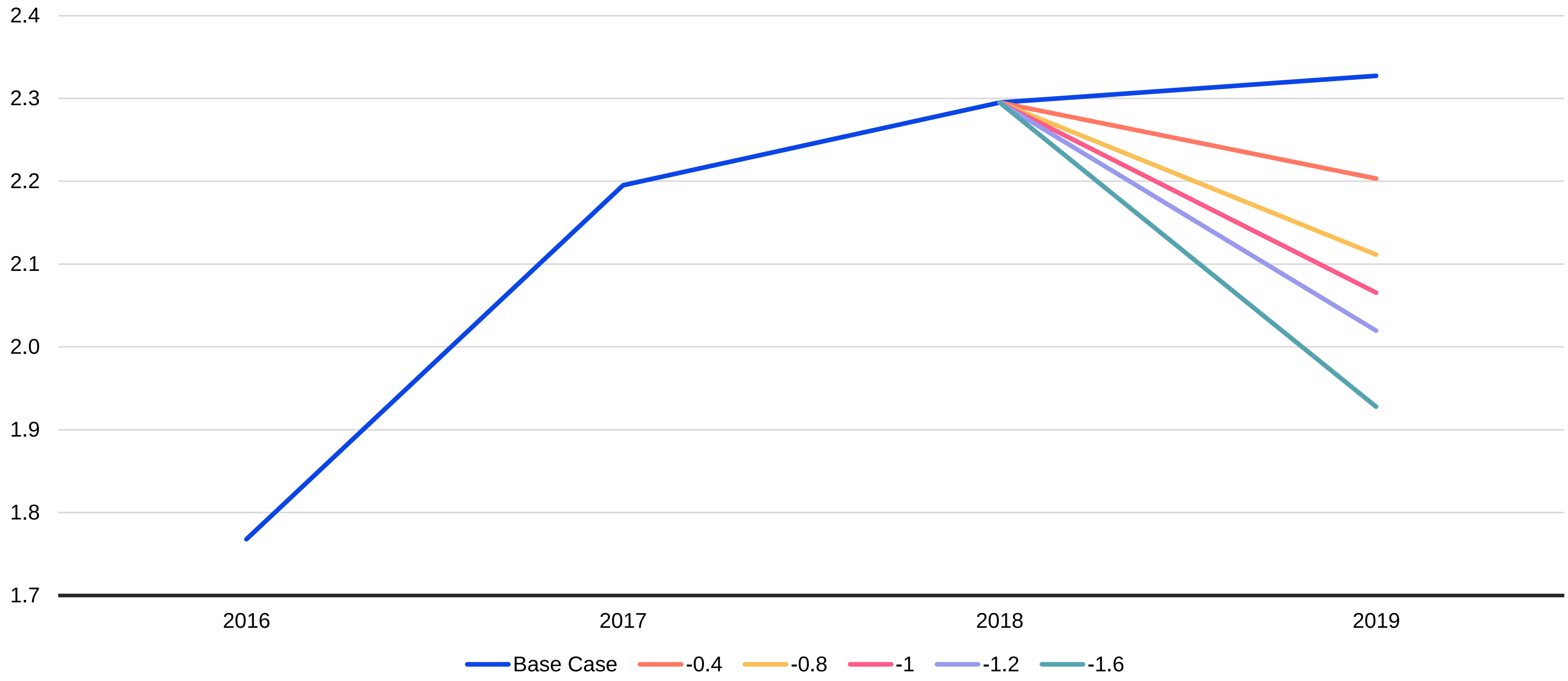
Sources: A Meta-Analysis of International Tourism Demand Elasticities.

If airfares to Iceland rise, it could have significant impact

Depends on the price elasticity of demand, whether airfares to Iceland would increase relatively more than to other destinations and whether other costs would decrease, for example through depreciation of the ISK.

Effect of 10% increase in airfares on tourist arrivals

- millions of tourists, based on different price elasticity of demand and Research's base case, **all other things being equal**

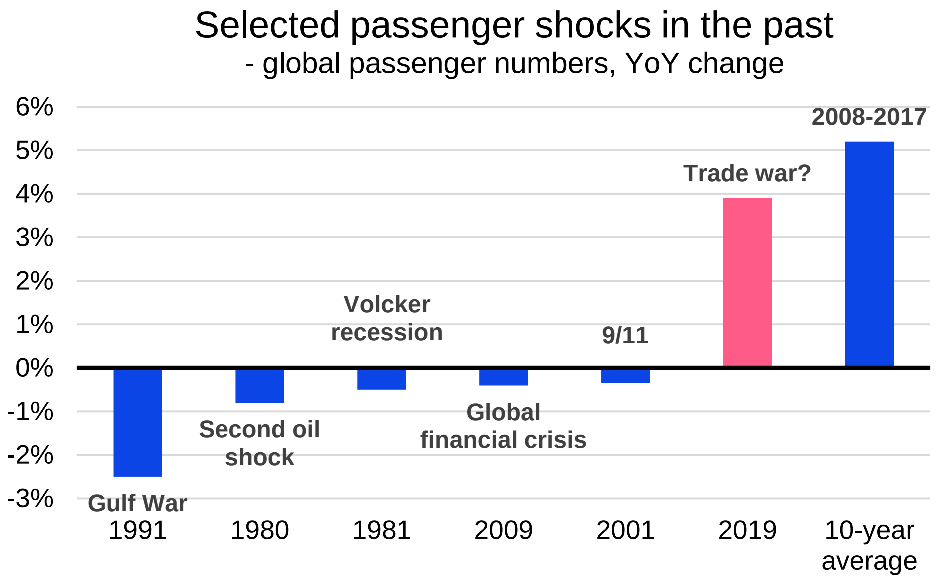


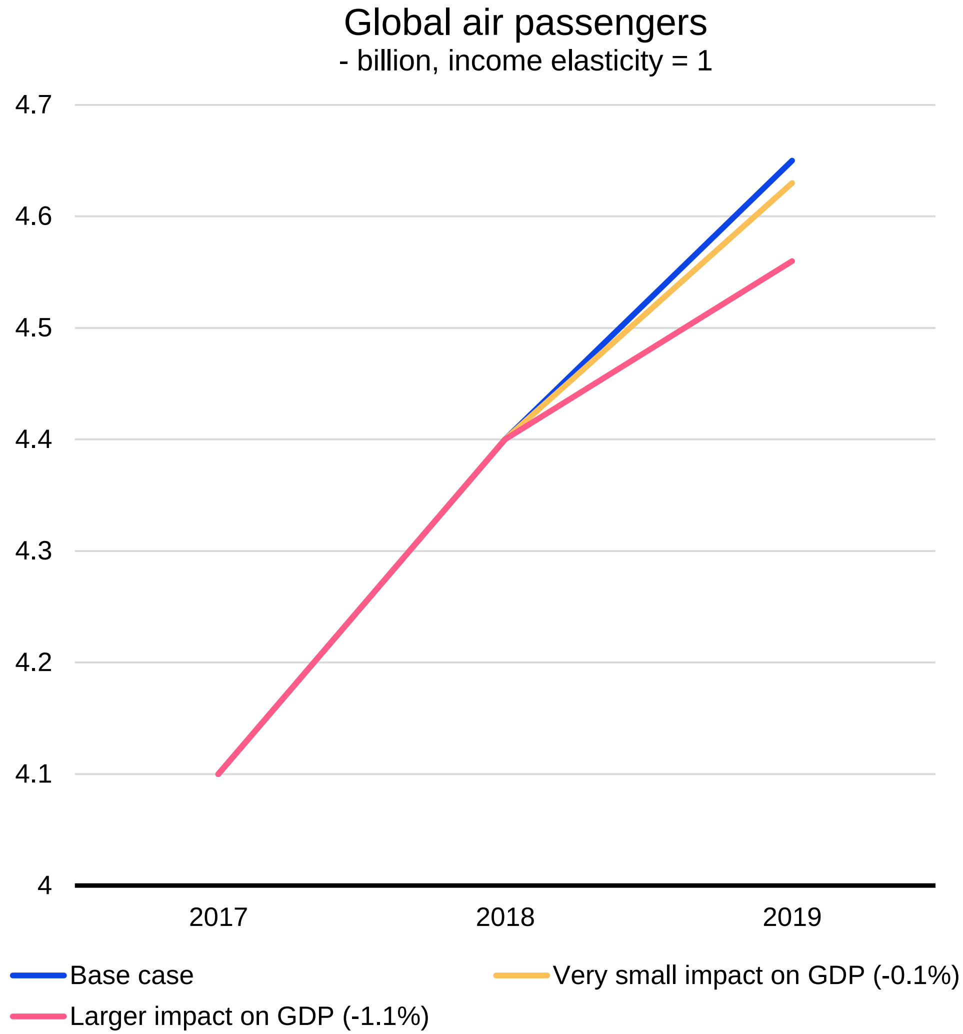
Sources: Icelandic Travel Board, Arion Research

Economic growth is the fundamental driver of demand for air travel

Further escalation in global trade protectionism could have negative effect on air transport

Estimated negative impact on GDP	Assumed income elasticity		
	1	1.3	1.8
-0.1%	-0.1% (-4)*	-0.1% (-6)	-0.2% (-8)
-0.4%	-0.4% (-18)	-0.5% (-23)	-0.7% (-32)
-1.1%	-1.1% (-48)	-1.4% (-63)	-2.0% (-87)

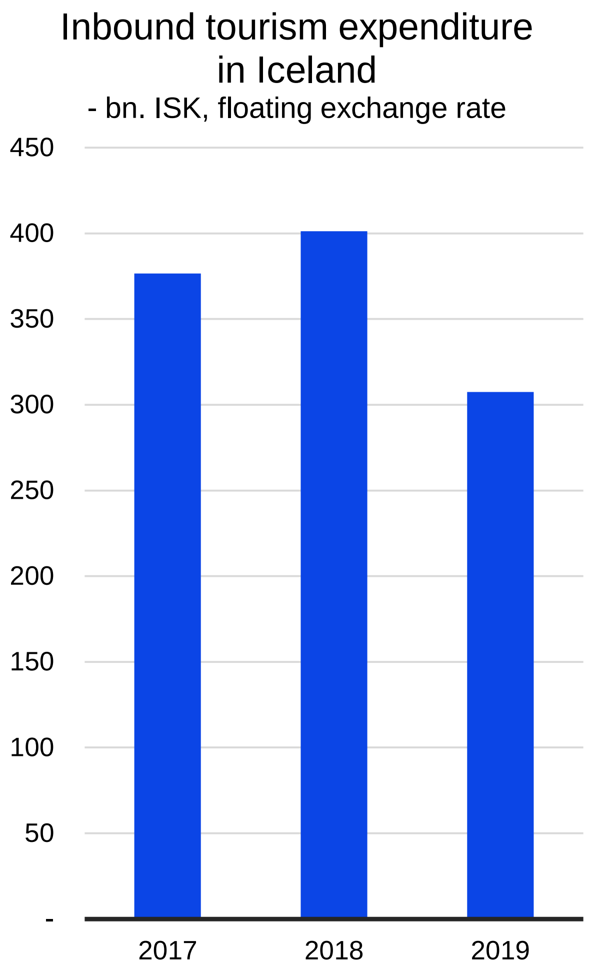


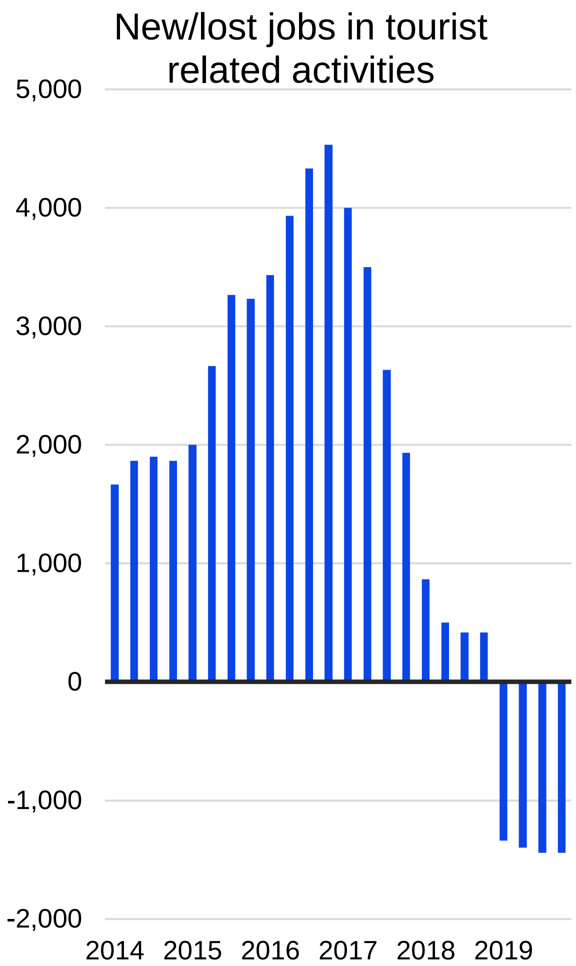


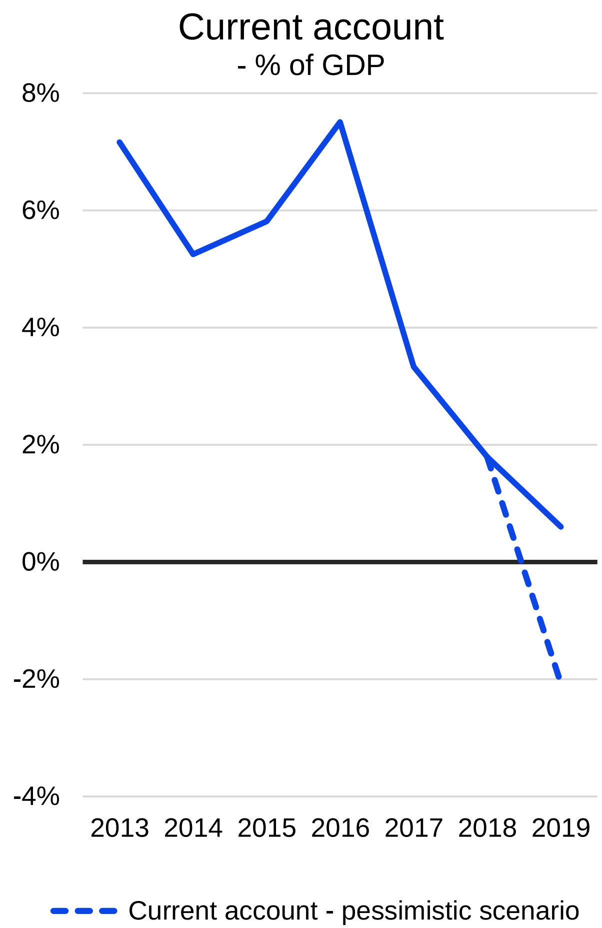
Sources: IATA. * Numbers in brackets represent millions of tourists.

What does the pessimistic scenario mean for the economy?

All other things being equal, fewer tourists would mean a drop in tourism expenditure, which could lead to firings. The current account surplus could easily be reversed. The graphs below show what could be called the worst case scenario, as the ISK is kept stable and the effects of tourism on imports is ignored.







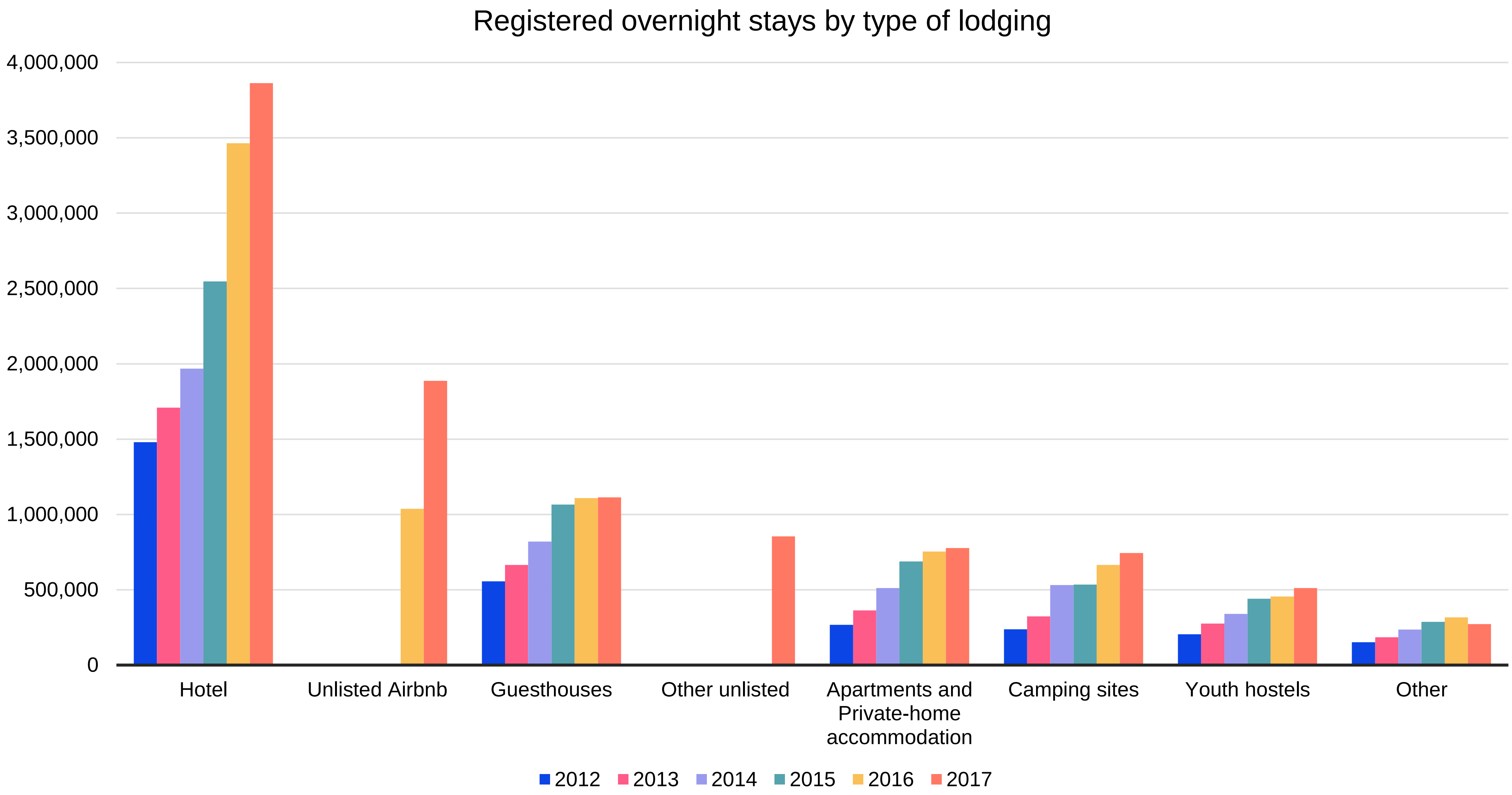
Sources: Statistics Iceland, CBI, Arion Research

Are we getting ahead of ourselves in hotel construction?

Accommodation is on average the largest expense of traveling. Hotel construction has been trying to keep pace with booming demand from tourists. With tourist arrivals slowing down rapidly, the question is raised: Are we getting ahead of ourselves in hotel construction?

Hotels shoulder the burden

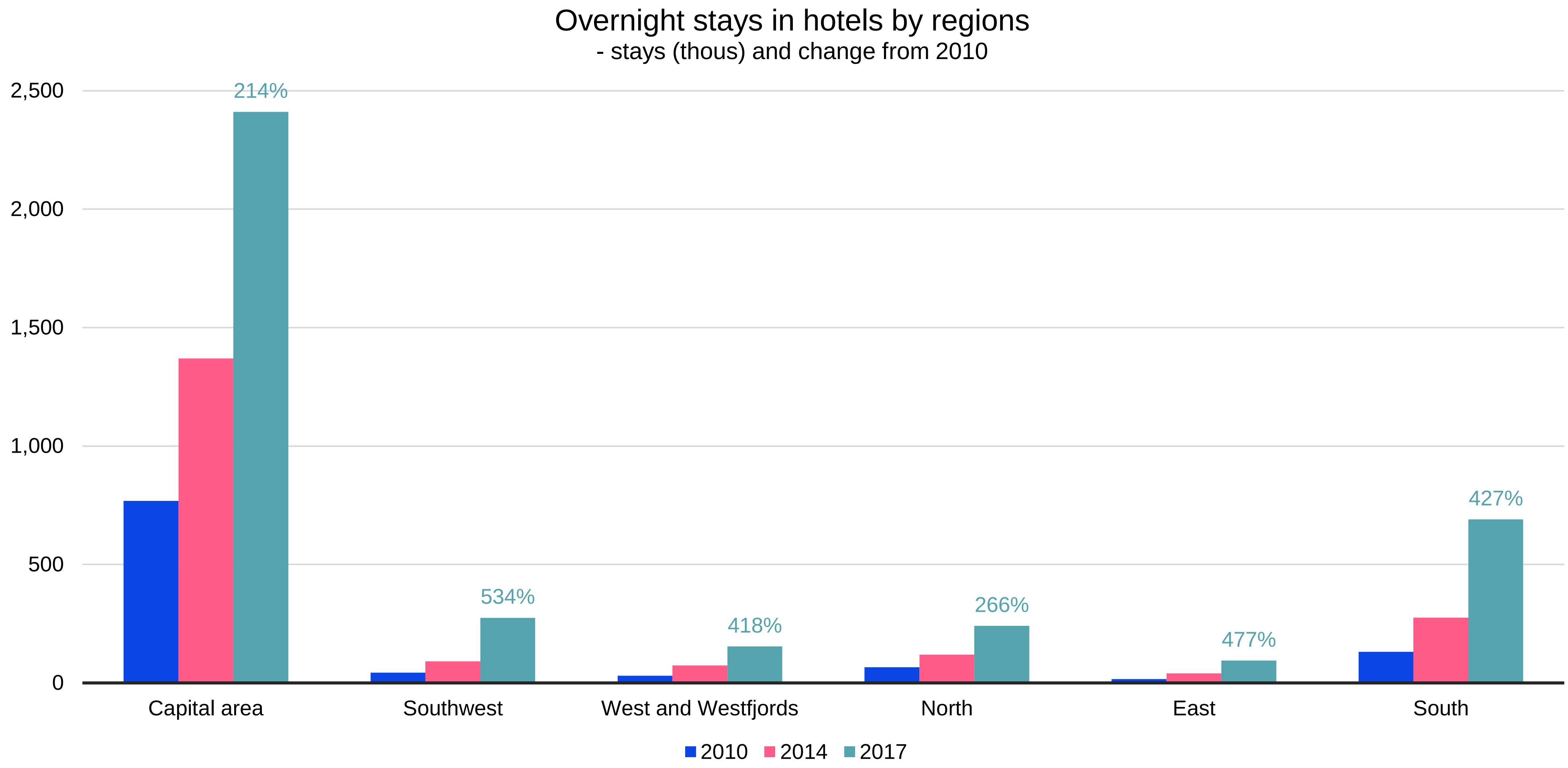
Every four in ten overnight stays by tourists were spent at hotels in 2017



Sources: Statistics Iceland, Arion Research

Lion‘s share of overnight stays are spent in the capital area

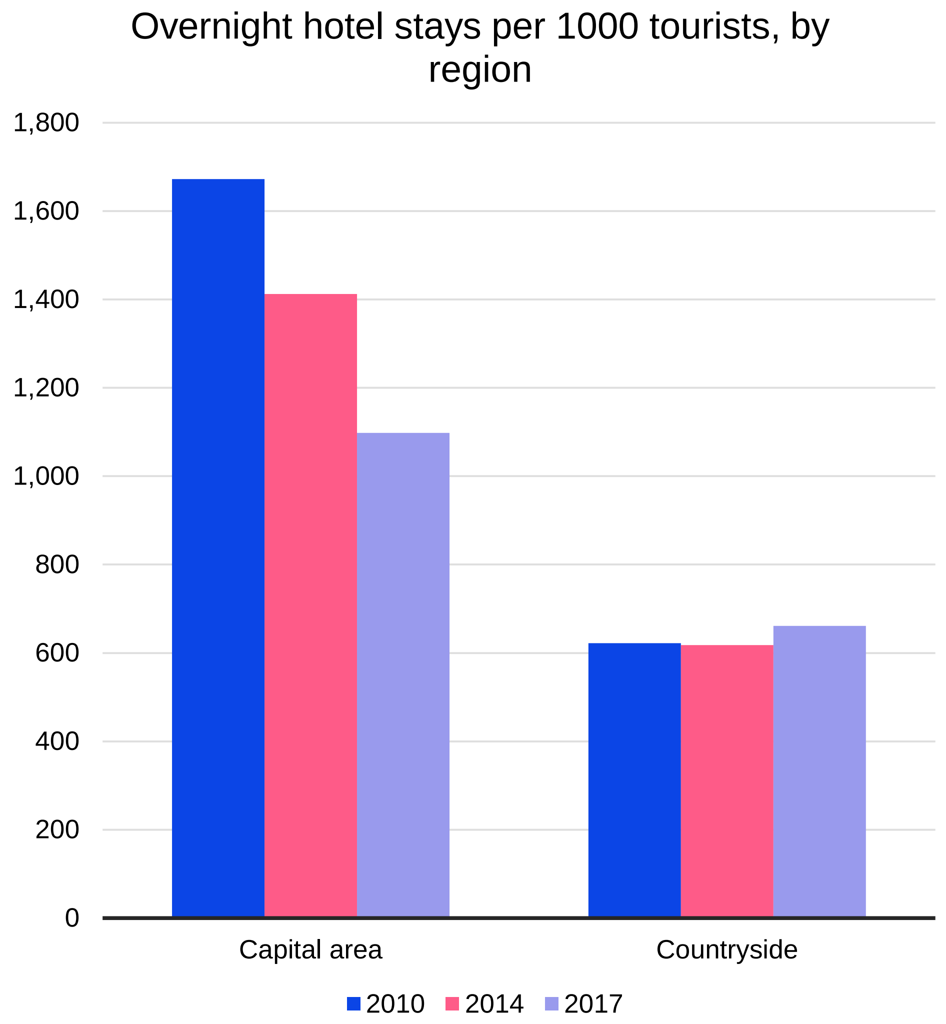
In relative terms, however, growth has been slowest in the capital area as occupancy rates have been very high. The number of tourists visiting the country has outpaced hotel construction, growing 378% since 2010 while the latter has grown by 79%.

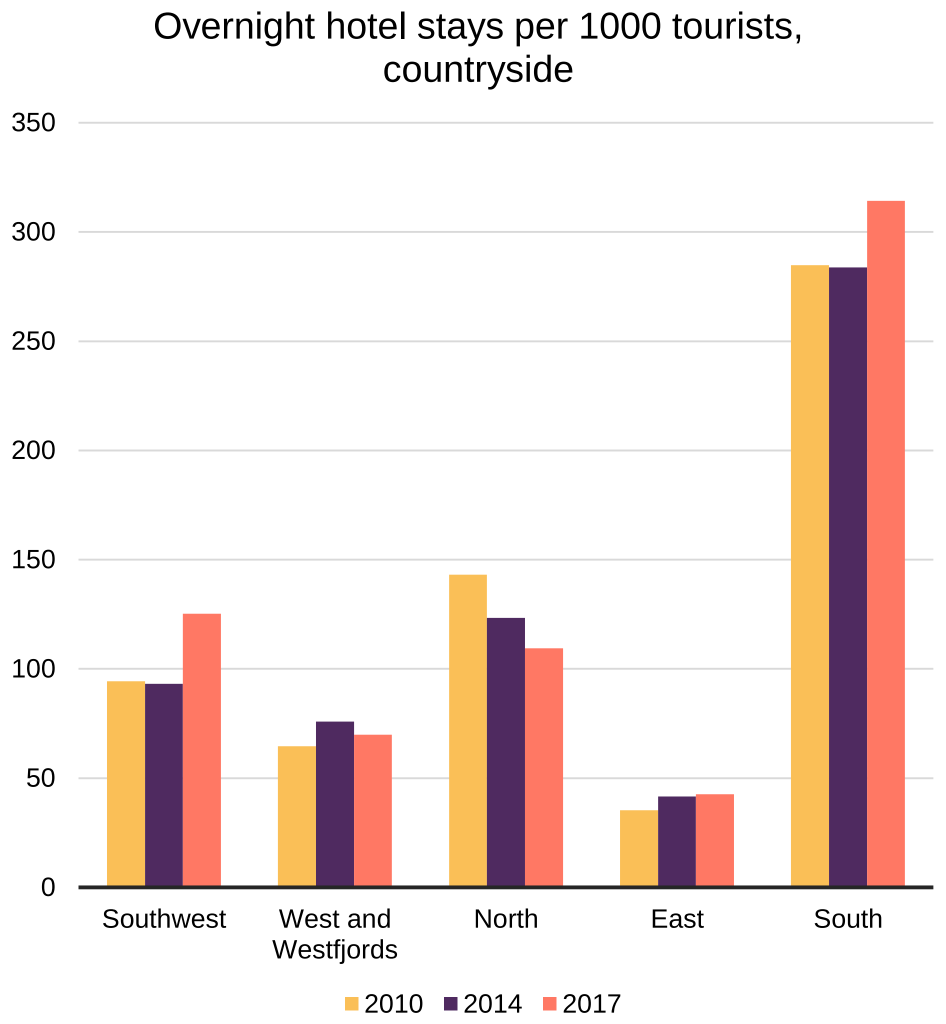


Sources: Statistics Iceland, Arion Research

Overnight hotel stays per thousand travelers has decreased

Supply shortage, appreciation of the króna and competition with Airbnb seem to be the main causes

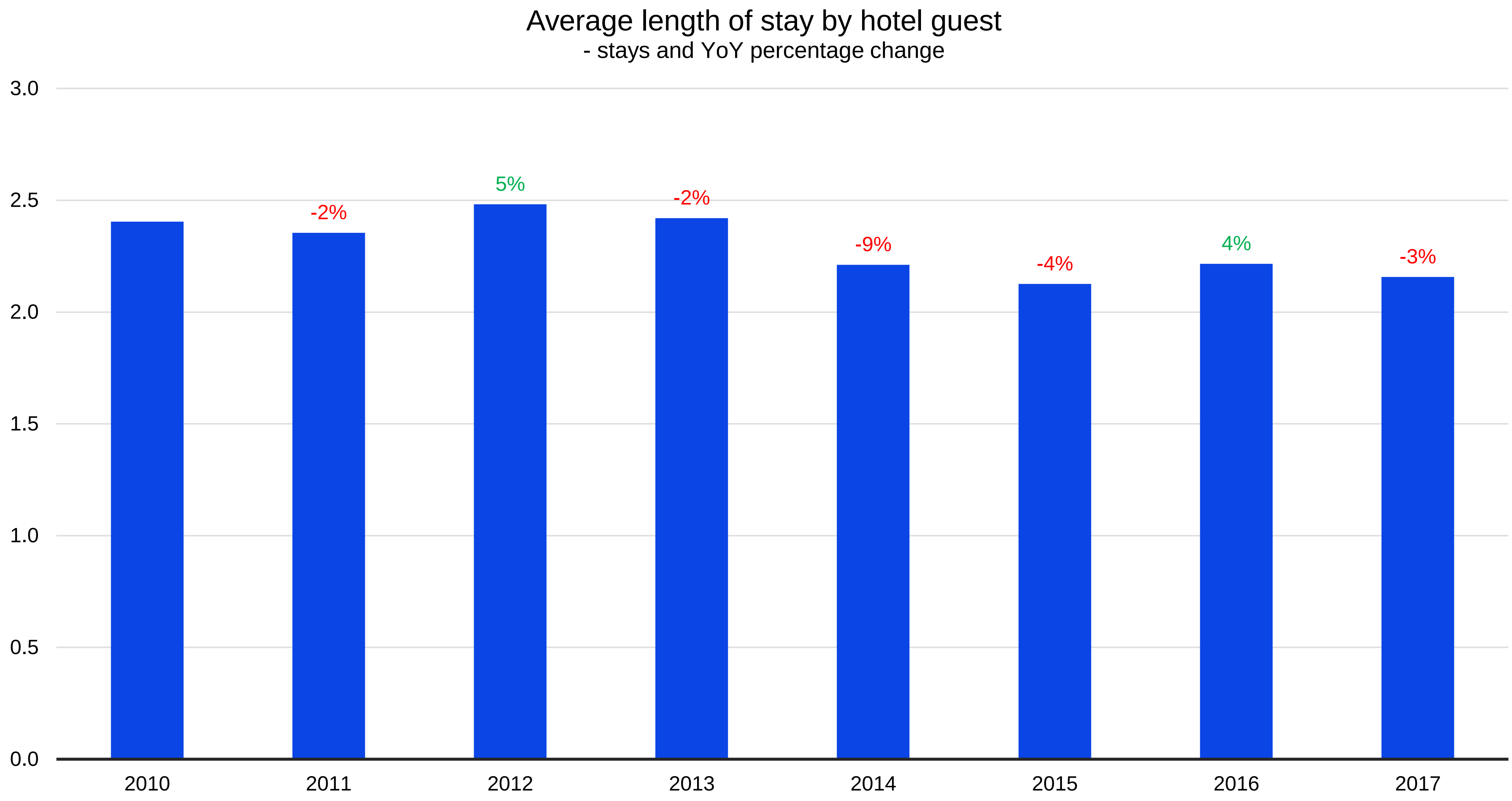




Sources: Statistics Iceland, Arion Research

Length of stay per each hotel guest has not decreased markedly, indicating supply shortage

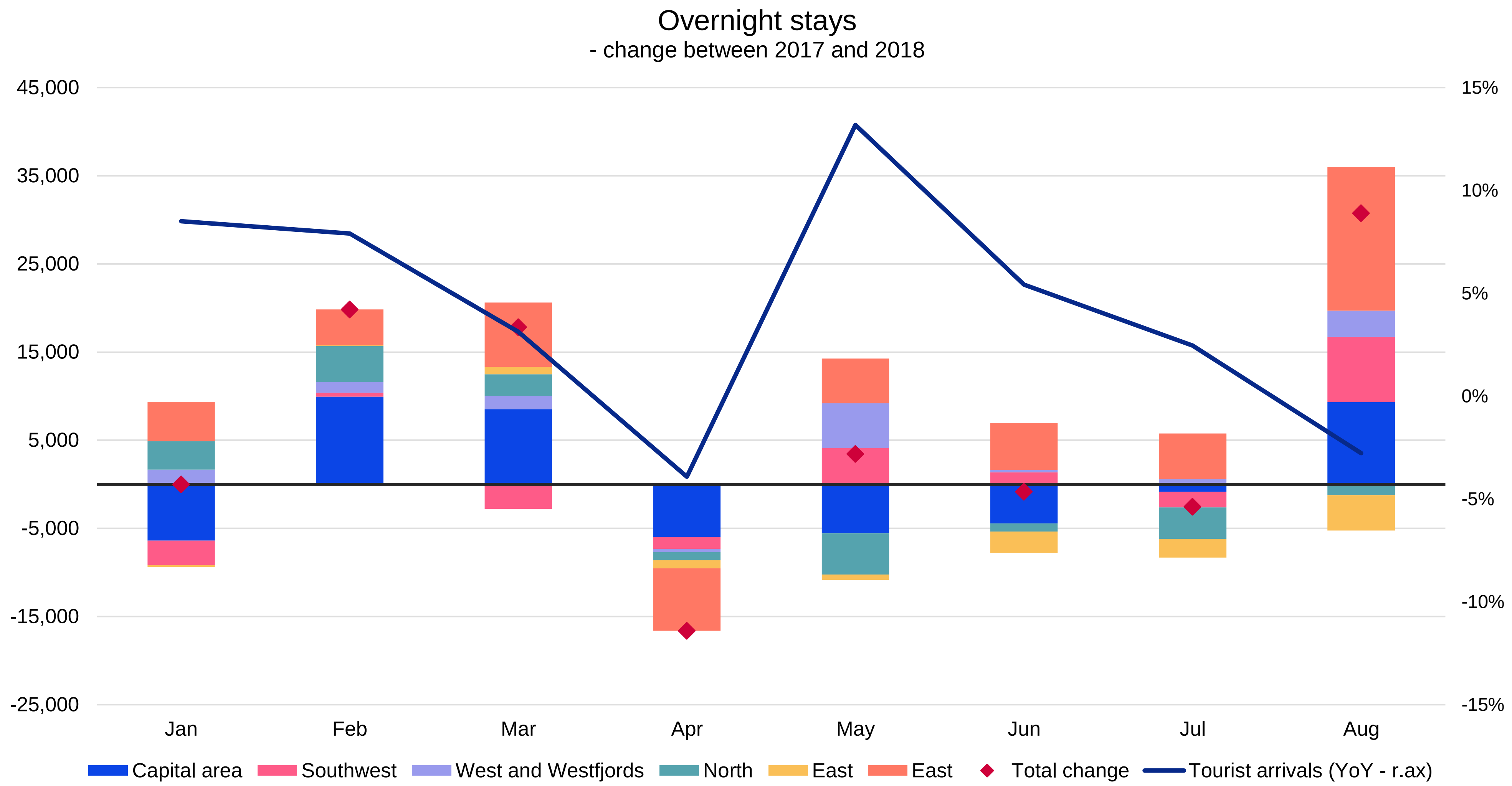
Tourists cut their stay in the capital area in 2014, but since then their average stay has hovered around 2.2 nights



Sources: Statistics Iceland, Arion Research

In the beginning of the year, overnight stays decreased in all parts of the country except South Iceland and West Iceland

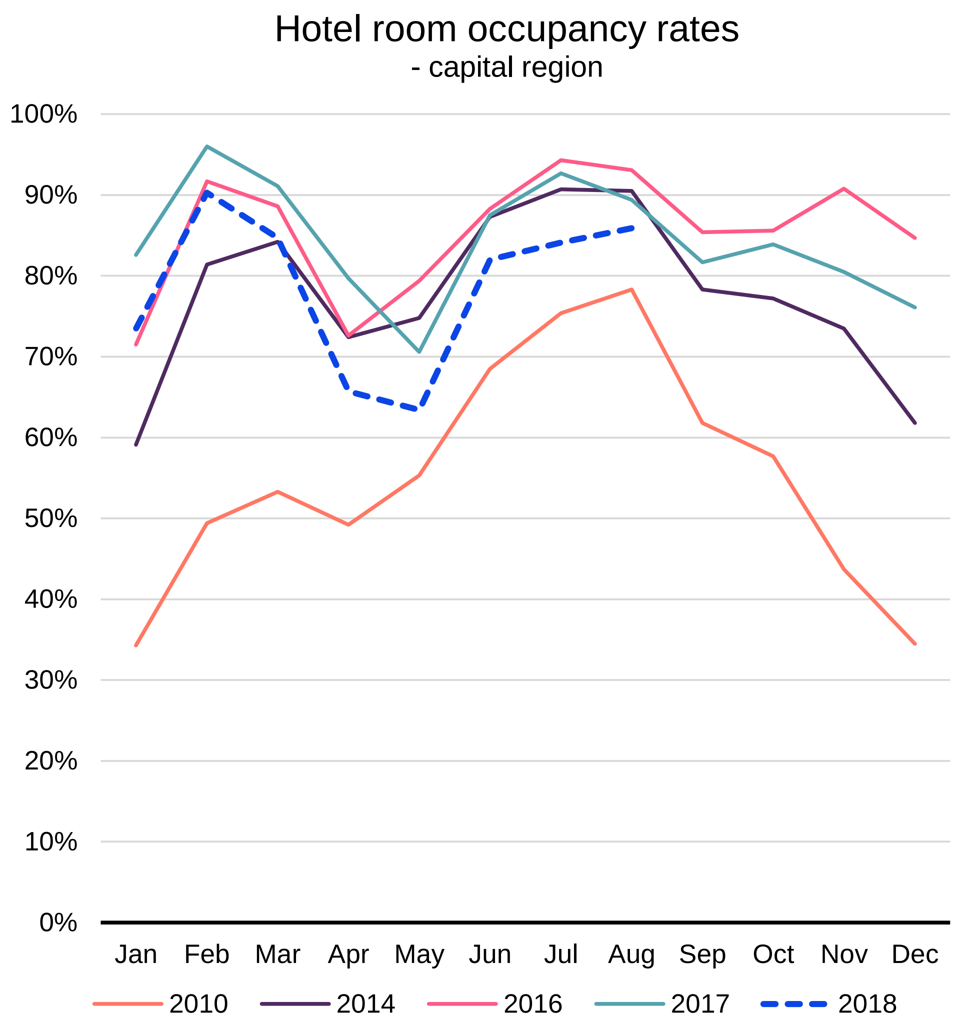
This trend reversed in August with travelers lengthening their stay at hotels

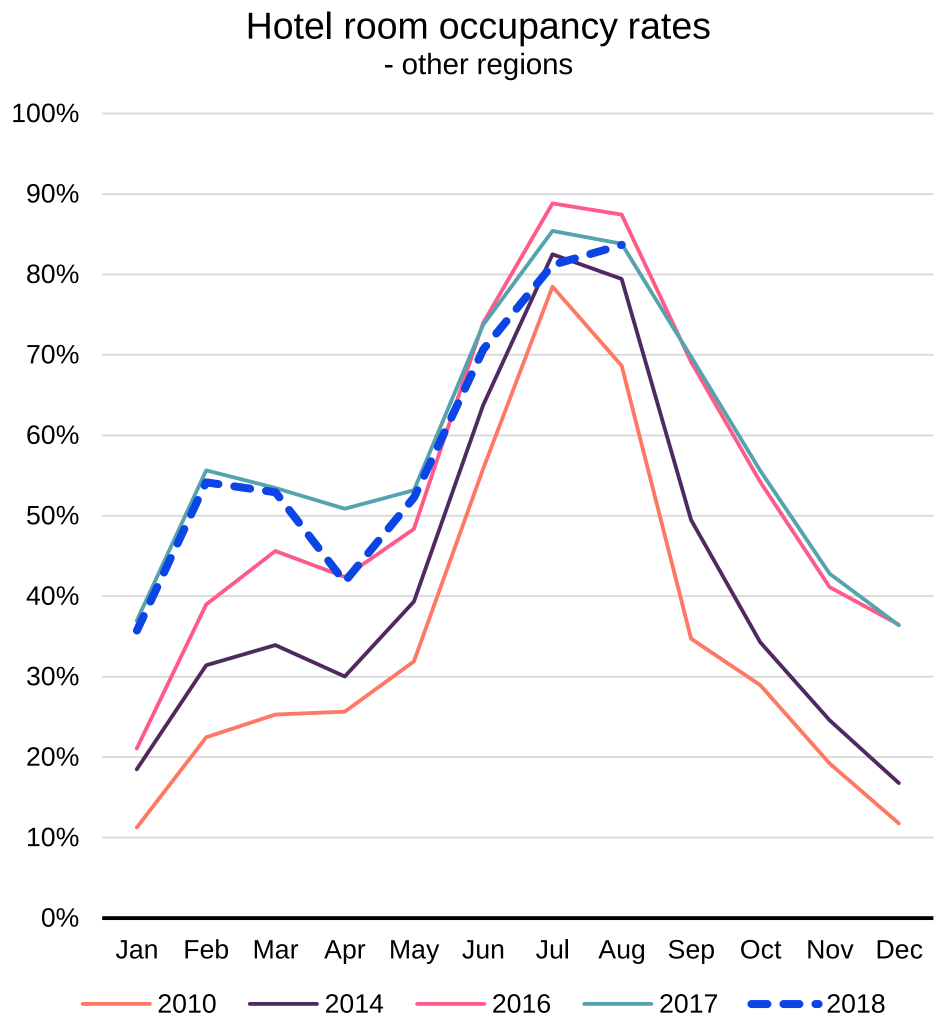


Sources: Statistics Iceland, Arion Research

Which has coincided with lower occupancy rates

Occupancy rates in the capital area are still robust and higher than outside the capital area

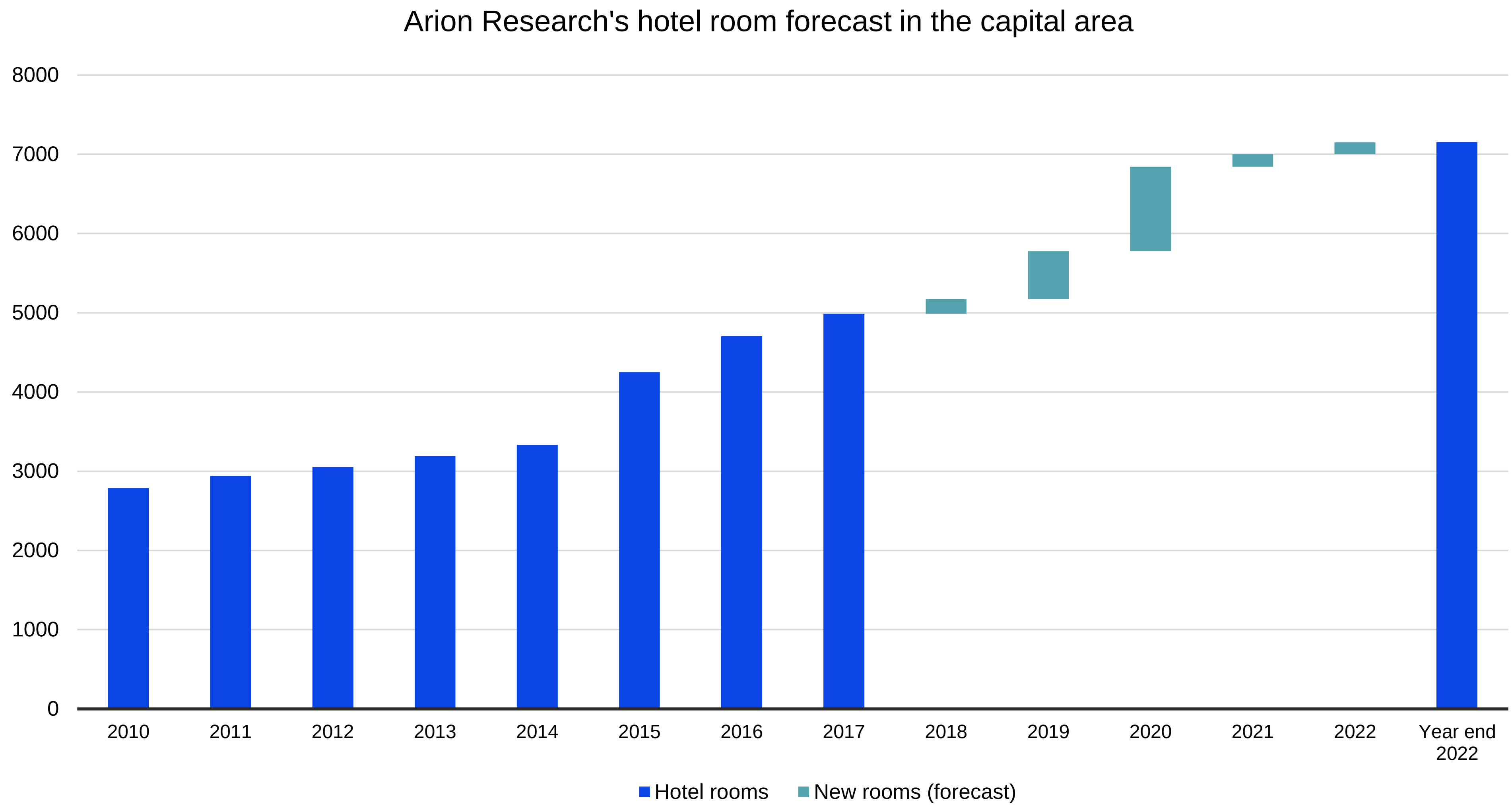




Sources: Statistics Iceland, Arion Research

We forecast that the number of hotel rooms in the capital area will be around 7,000 by 2022

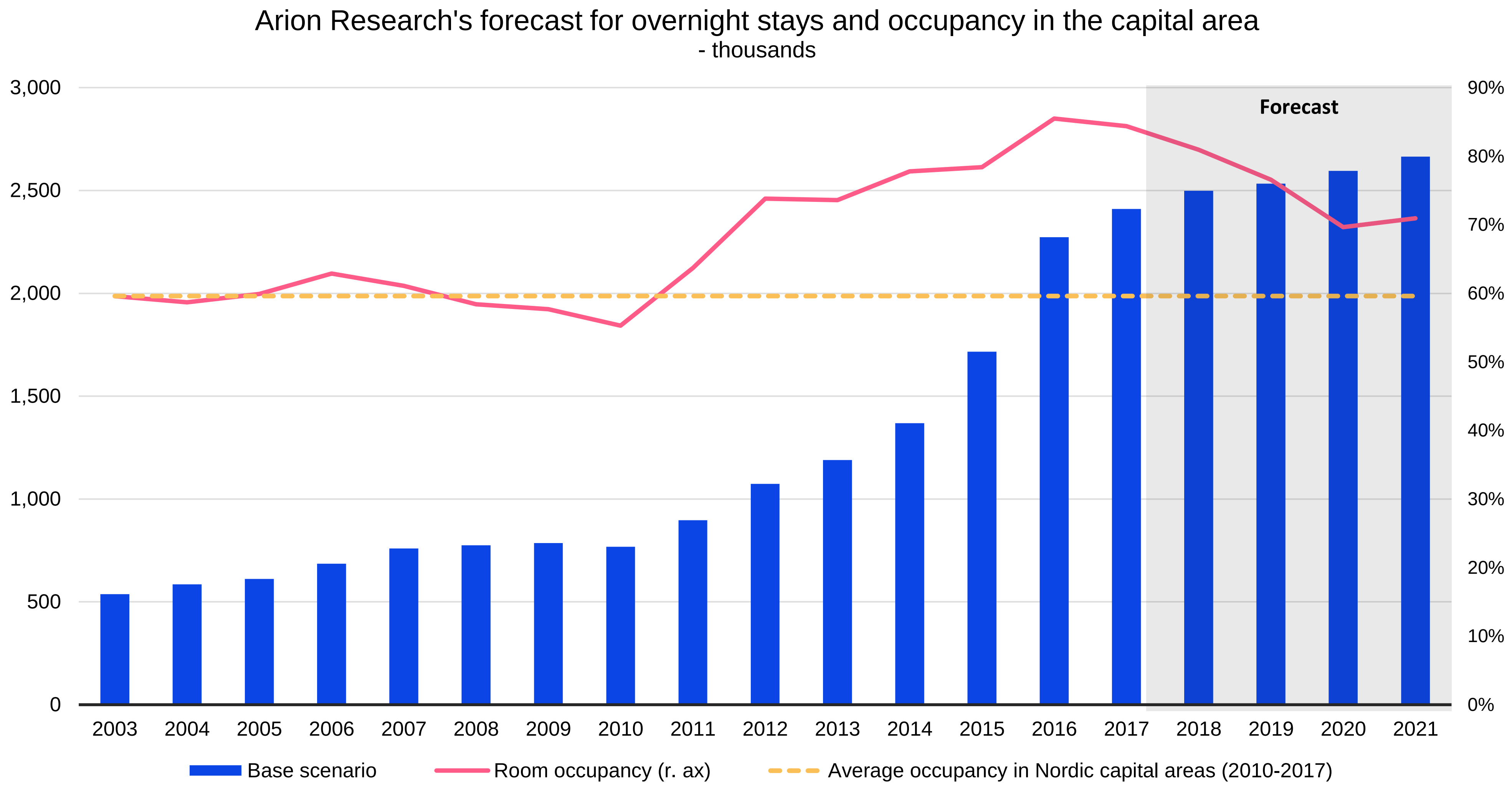
Should our forecast materialize hotel rooms will increase by 43%



Sources: Statistics Iceland, City of Reykjavik, media, Arion Research

We expect overnight stays at hotels to increase

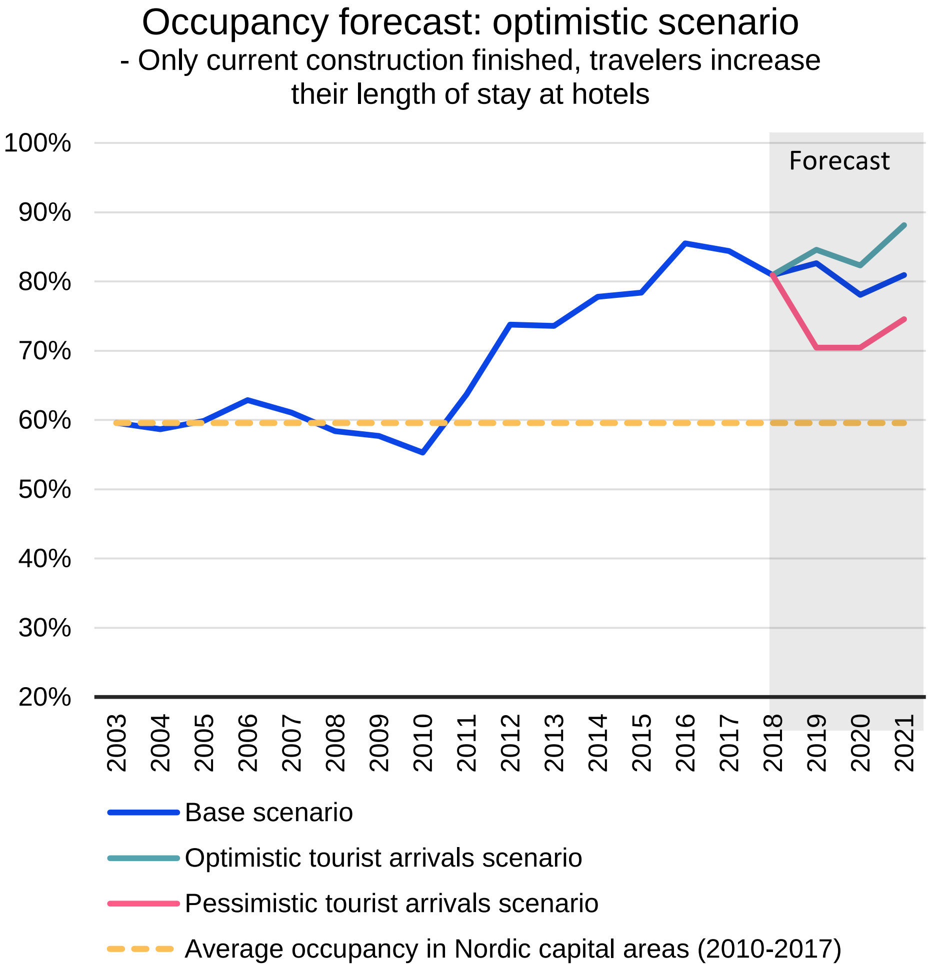
Increased supply, together with slower growth in tourist arrivals, lead to a decline in occupancy rates

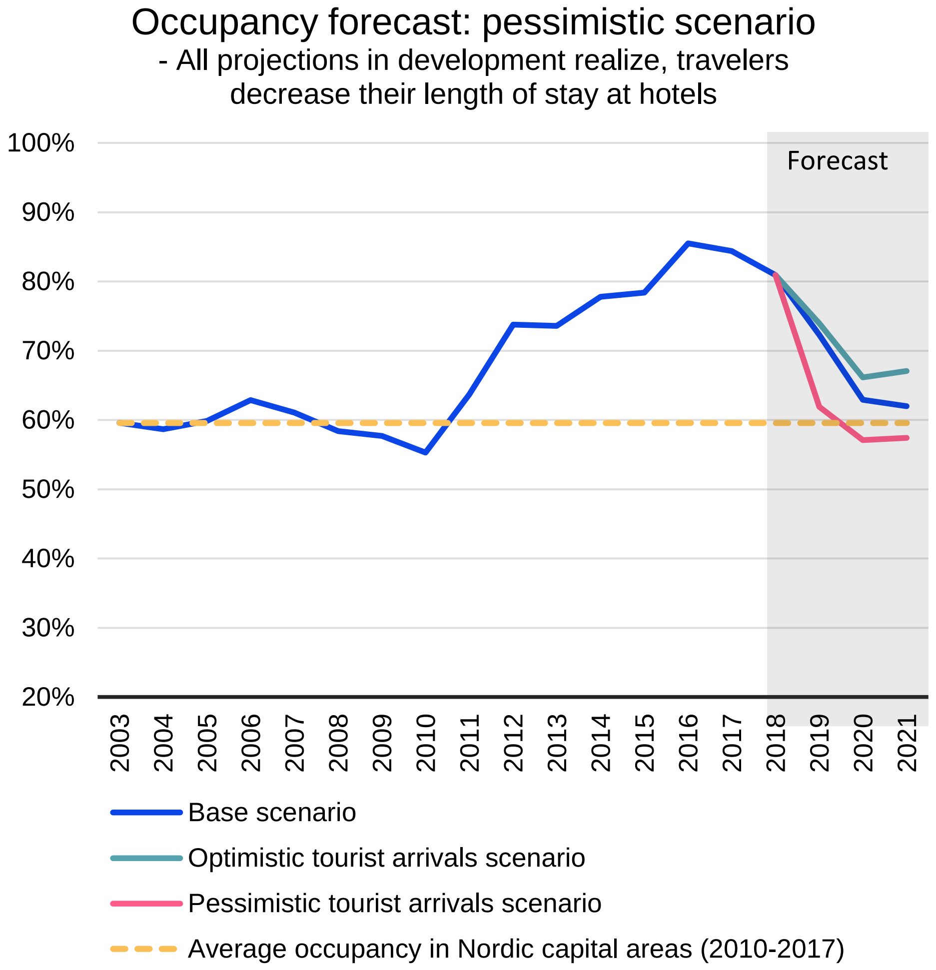


Sources: Statistics Iceland, Arion Research

Are we getting ahead of ourselves in hotel construction?

Compared to the Nordic countries, it seems we are rather reaching a sustainable long-term equilibrium. The substitution effect over to other accommodation has been considerable since 2010 in the capital area. That development seems to have reversed over the last few months when supply has increased.





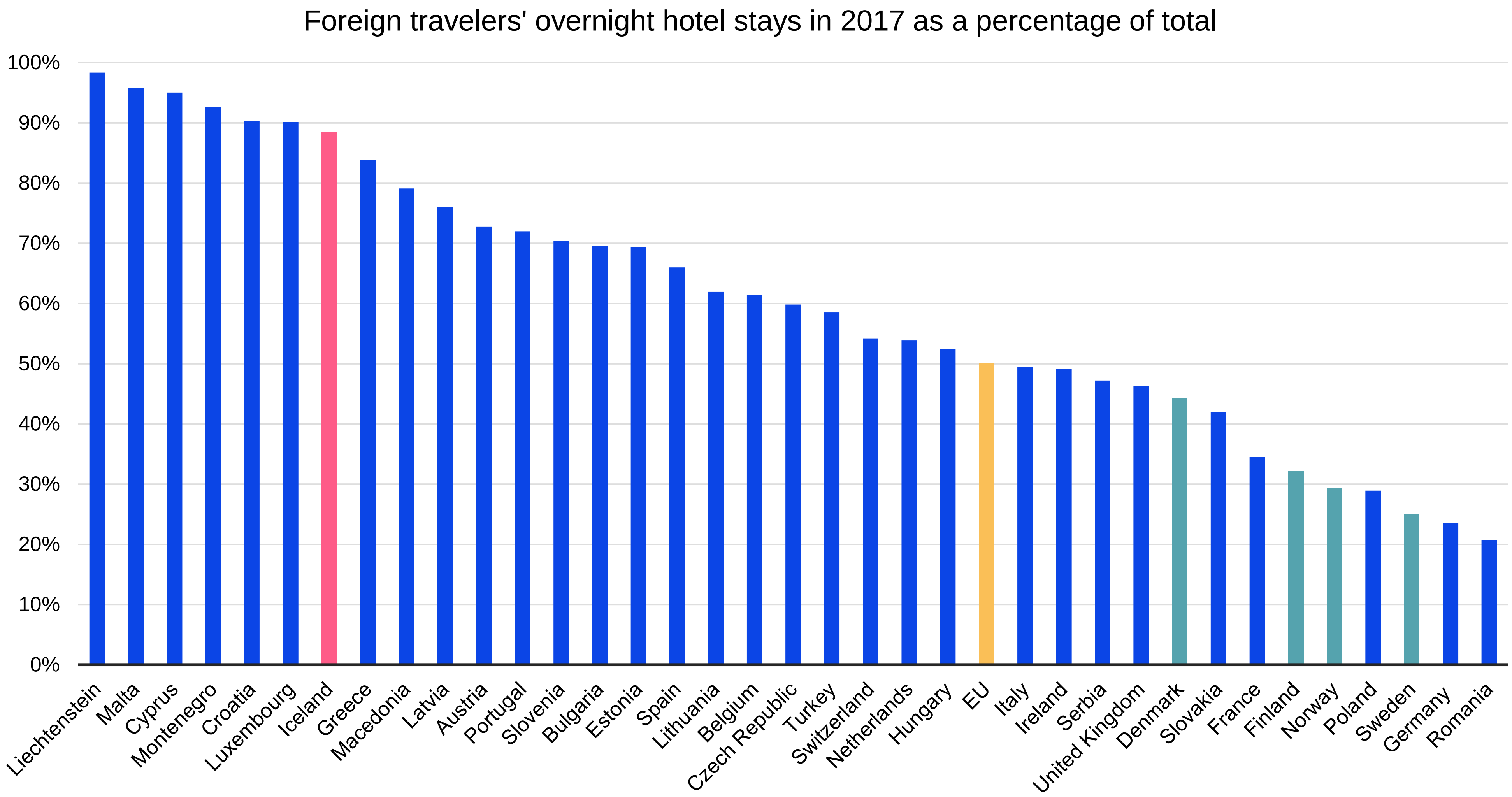
Sources: Statistics Iceland, Arion Research

How do Icelandic hotels fare in international comparison?

What do sliding occupancy rates mean in the big picture?

Icelandic hotels rely on foreign travelers

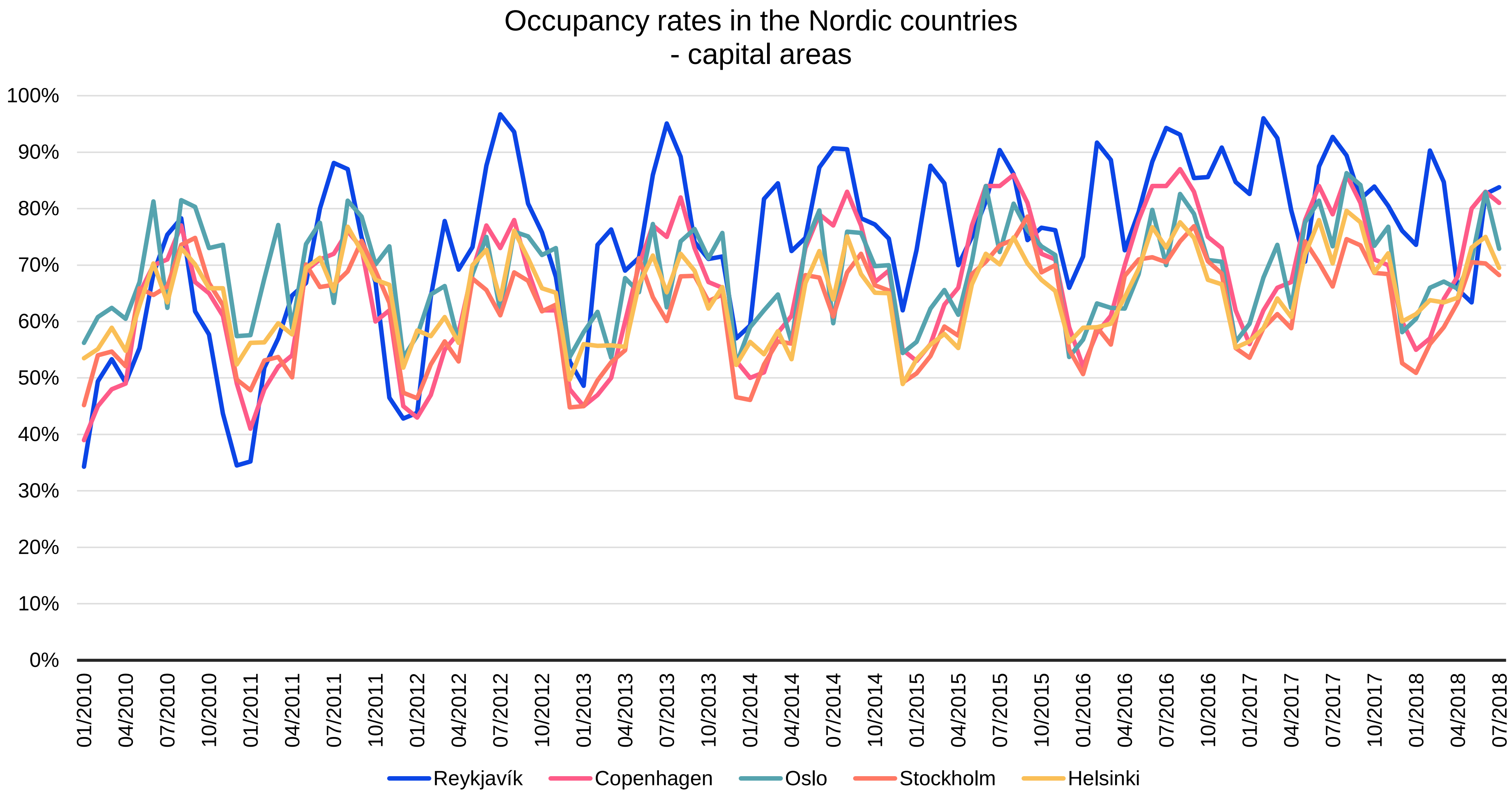
In other Nordic countries locals comprise the majority of overnight hotel stays



Sources: Eurostat, Arion Research. *2017 data for those available

The capital area reaching occupancy seen in the Nordic countries over the summertime

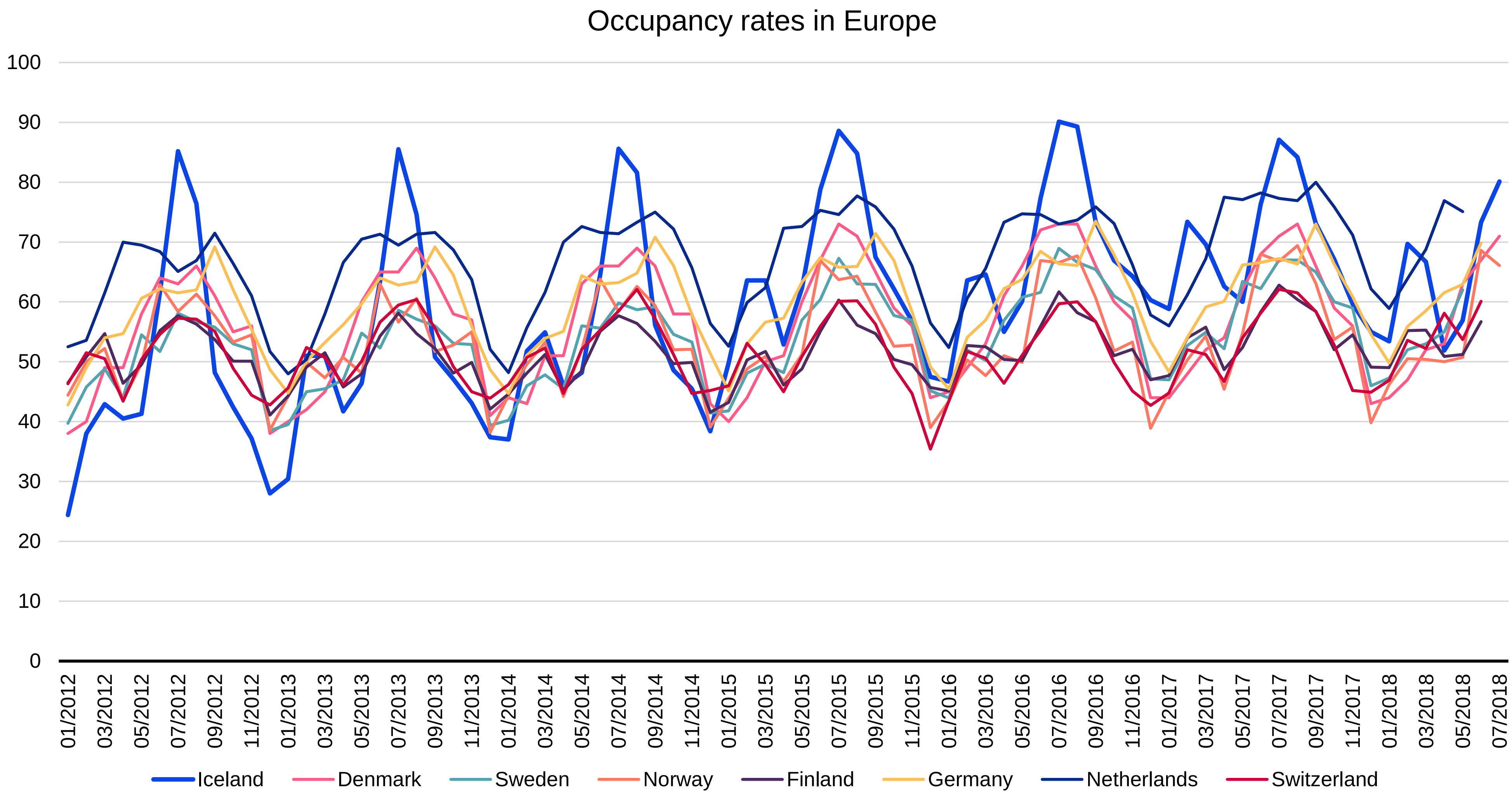
The occupancy in Reykjavík is generally better during winter than in other capital areas



Sources: Statistics Iceland, local statistics agencies in Nordic countries, Arion Research

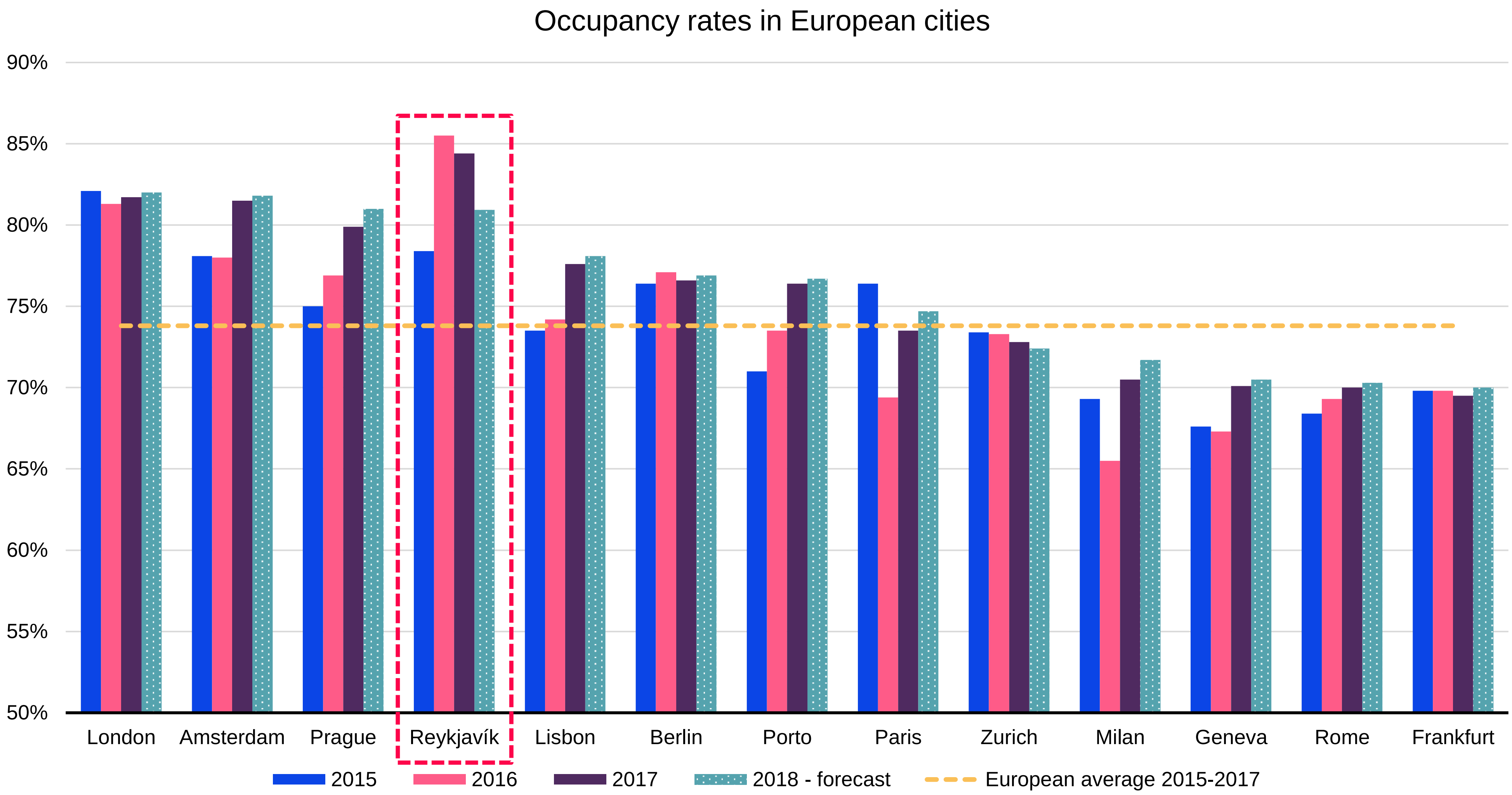
Occupancy of hotel rooms at a national level is very good in European comparison

The seasonality is similar to that seen in the Nordic countries



Sources: Eurostat, Arion Research

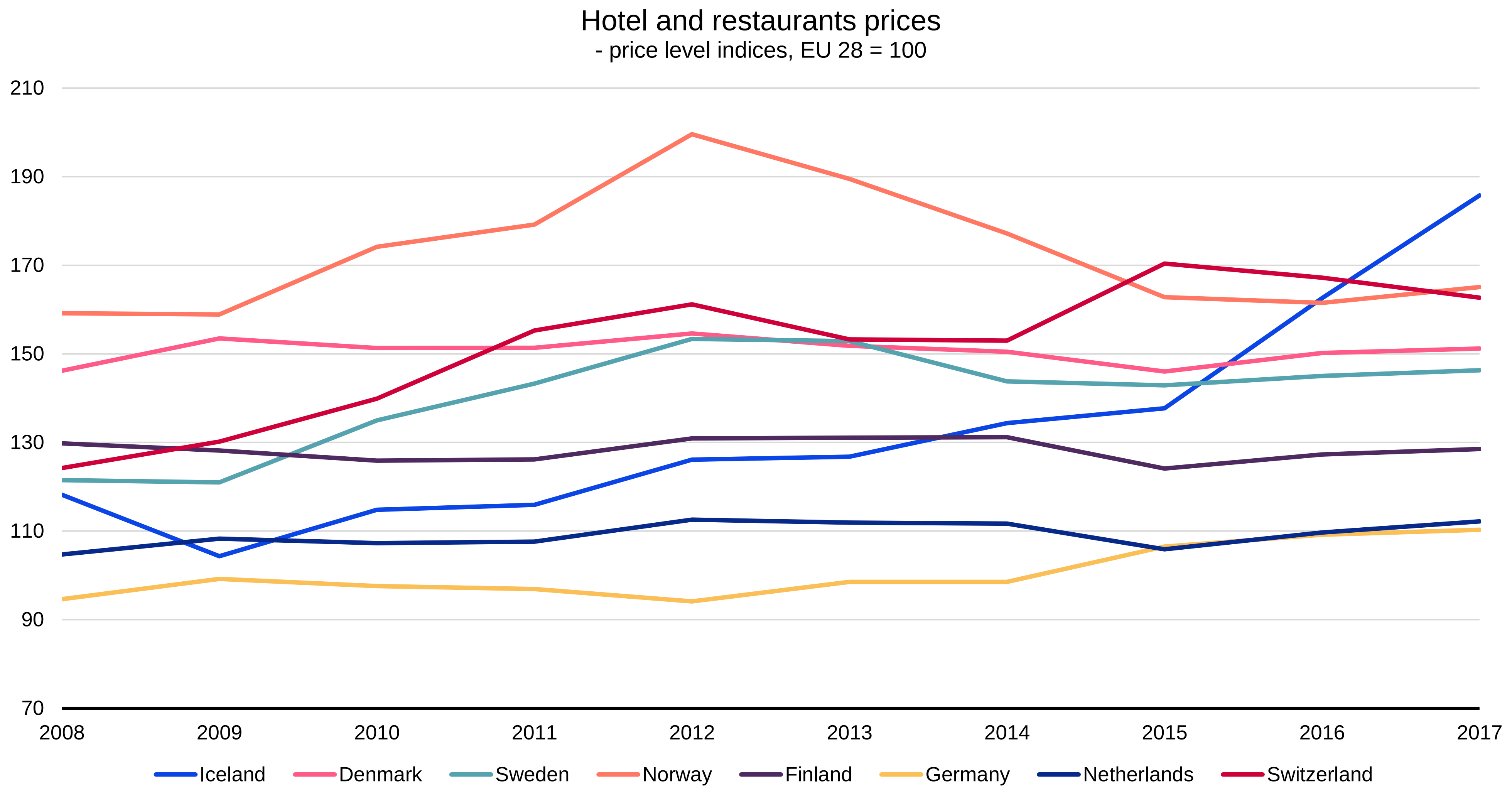
Occupancy in Reykjavík will remain with the best in class



Sources: Statistics Iceland, PwC, Benchmarking Alliance, Arion Research

Prices are, however, very high

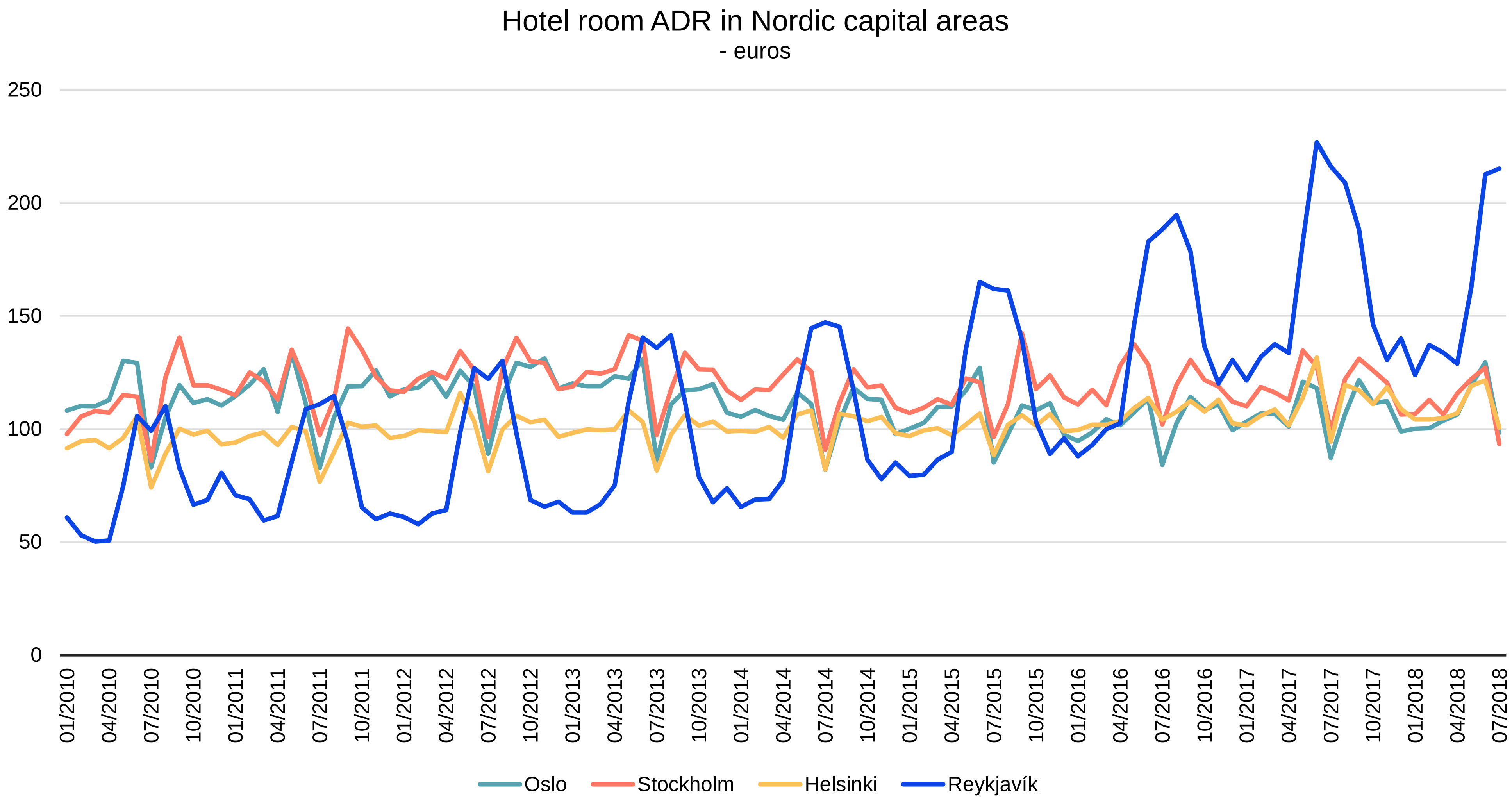
Accommodation prices have more than doubled over the last decade. Prices of hotels and restaurants in Iceland are among the highest in Europe.



Sources: Statistics Iceland, Eurostat, Arion Research

Considerable seasonality in ADR as well

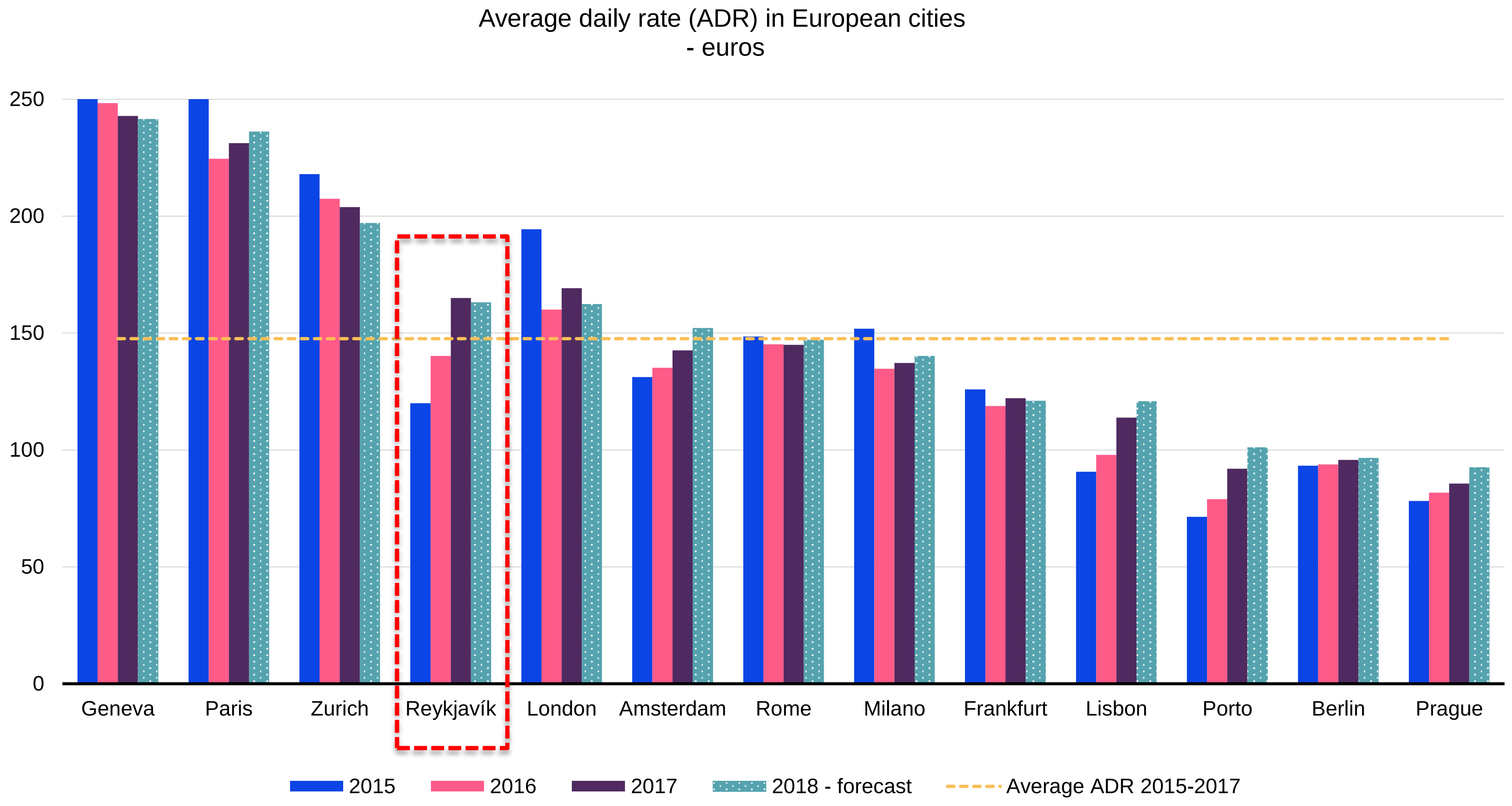
Rising ISK prices in parallel with the appreciation of the króna has led to hotel rooms in the capital becoming more expensive than in the Nordic countries



Sources: Benchmarking Alliance, local statistics agencies in Nordic countries, Arion Research

ADR similar to that seen in London and Amsterdam

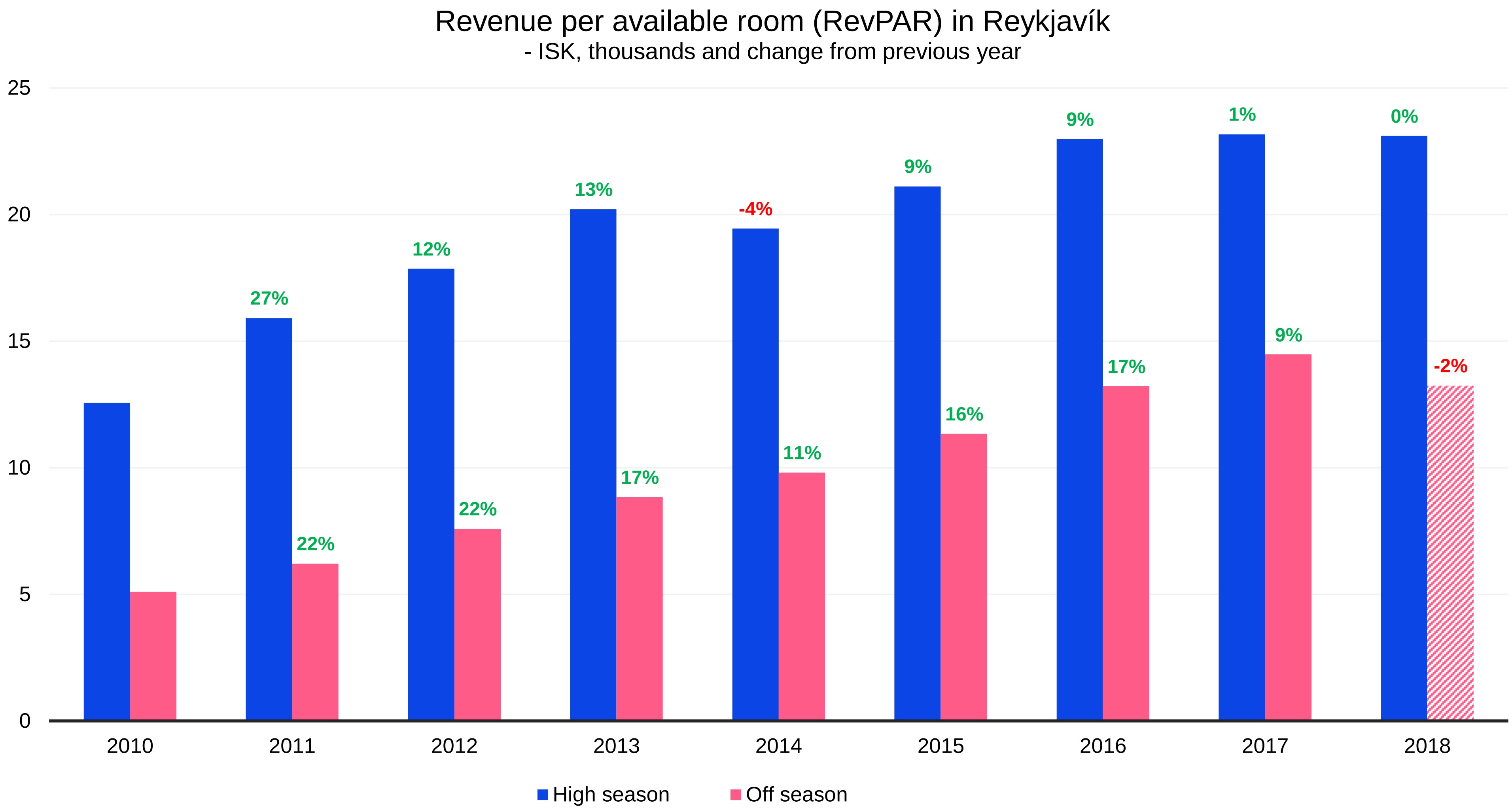
It should be borne in mind that there are still no five-star hotels in Reykjavik that distorts comparison to some extent



Sources: Statistics Iceland, PwC, Arion Research

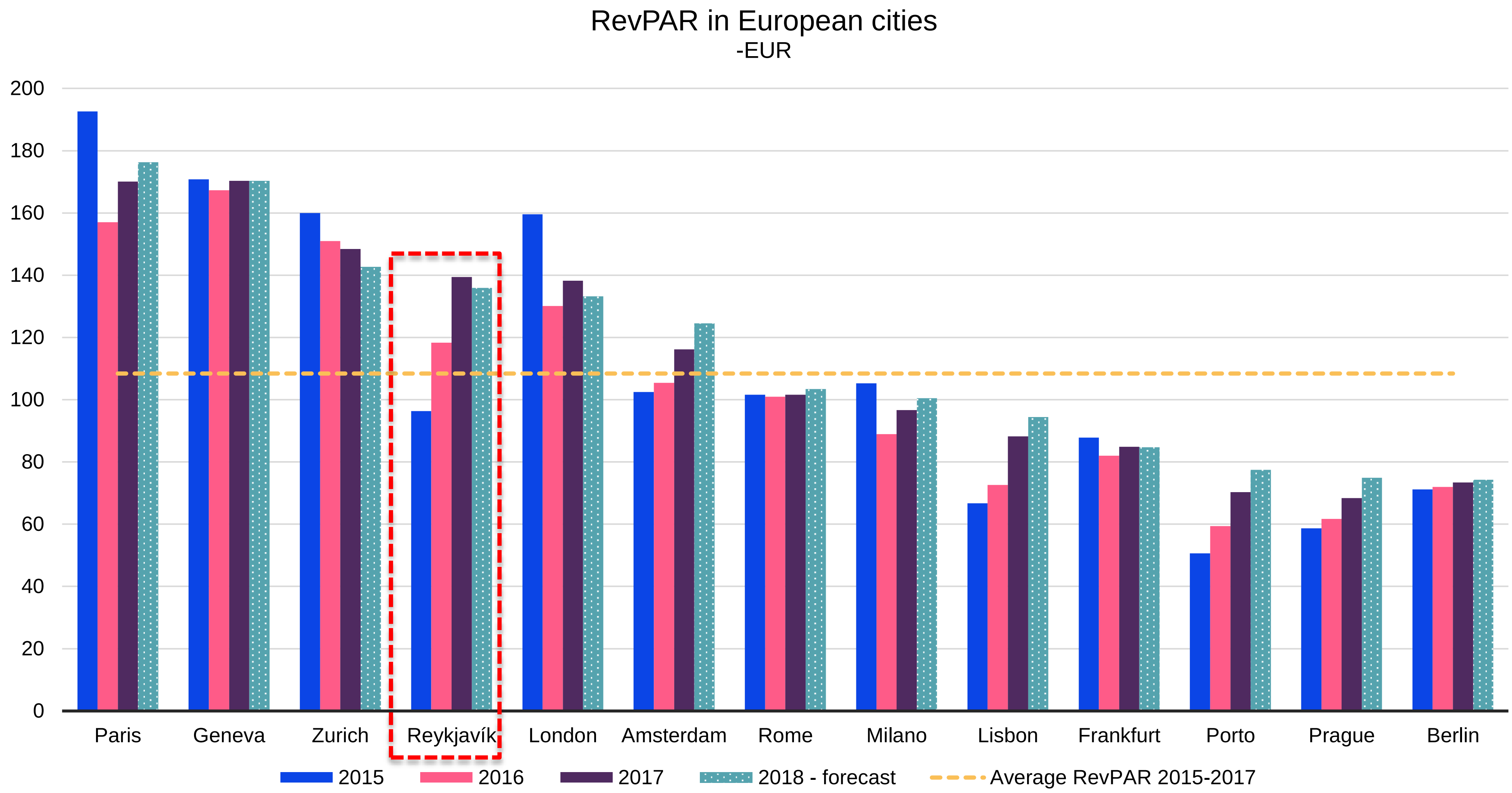
RevPAR has been largely unchanged since 2016

Off season RevPAR decreased YoY in 2018*



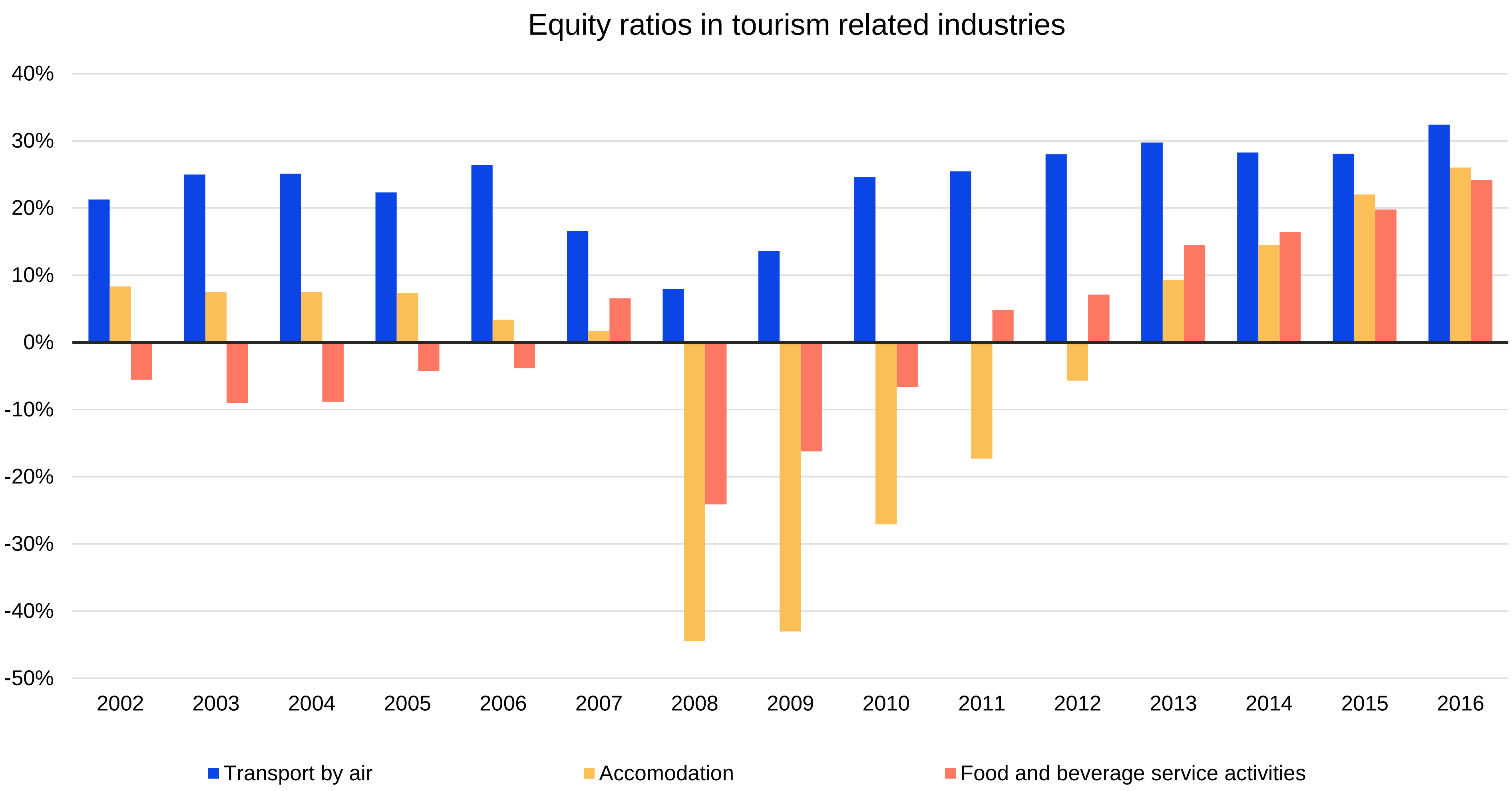
Sources: Statistics Iceland, Benchmarking Alliance, Arion Research *Jan-May

RevPAR among the highest in Europe



Sources: Statistics Iceland, PwC, Arion Research

Equity ratios have never been better



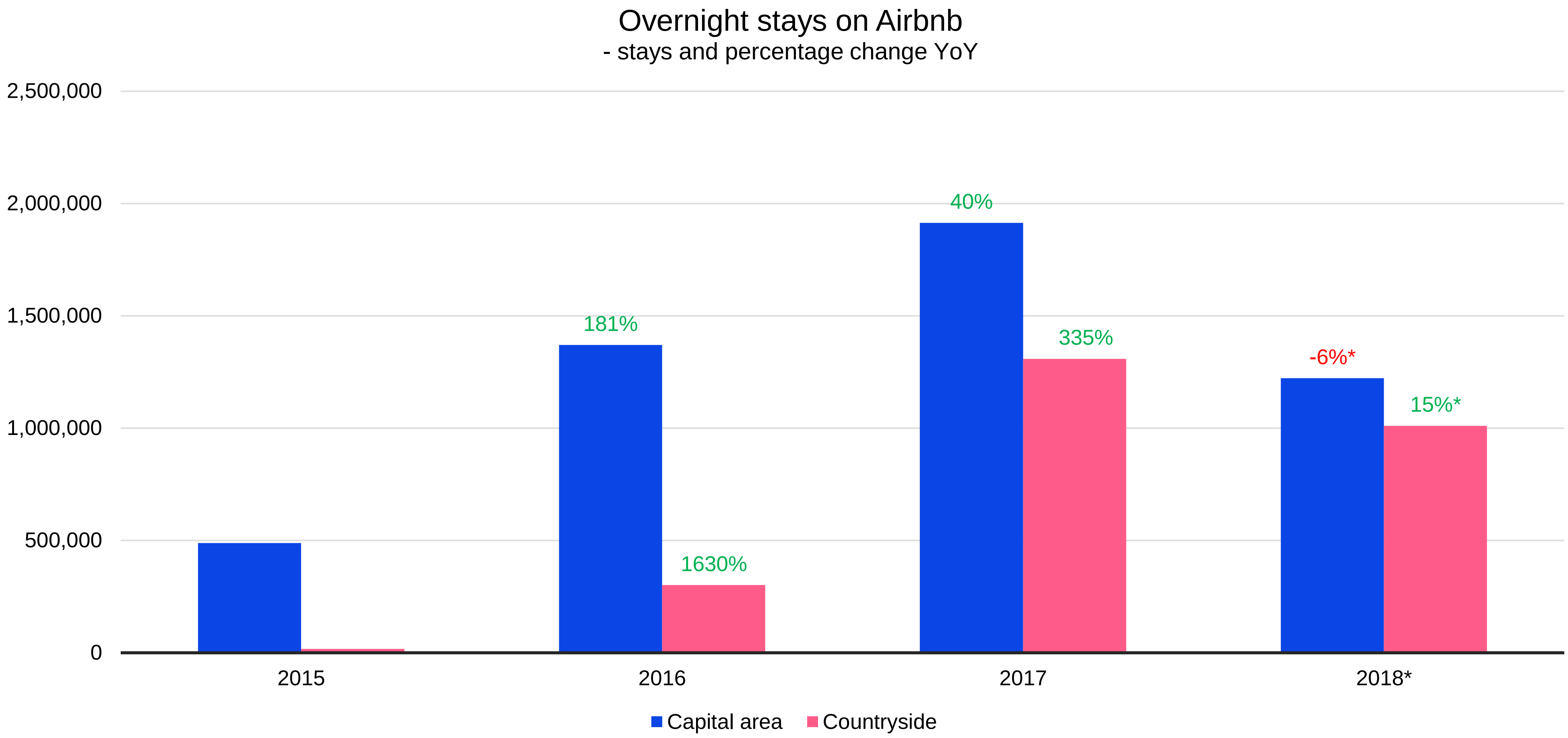
Sources: Statistics Iceland, Arion Research

Airbnb showing signs of growing pains

Airbnb has soaked up demand for overnight stays in the past three years, especially in the capital area. However, the development over this summer indicates the sharing economy for overnight stays is shrinking

Same old story: Airbnb has been growing

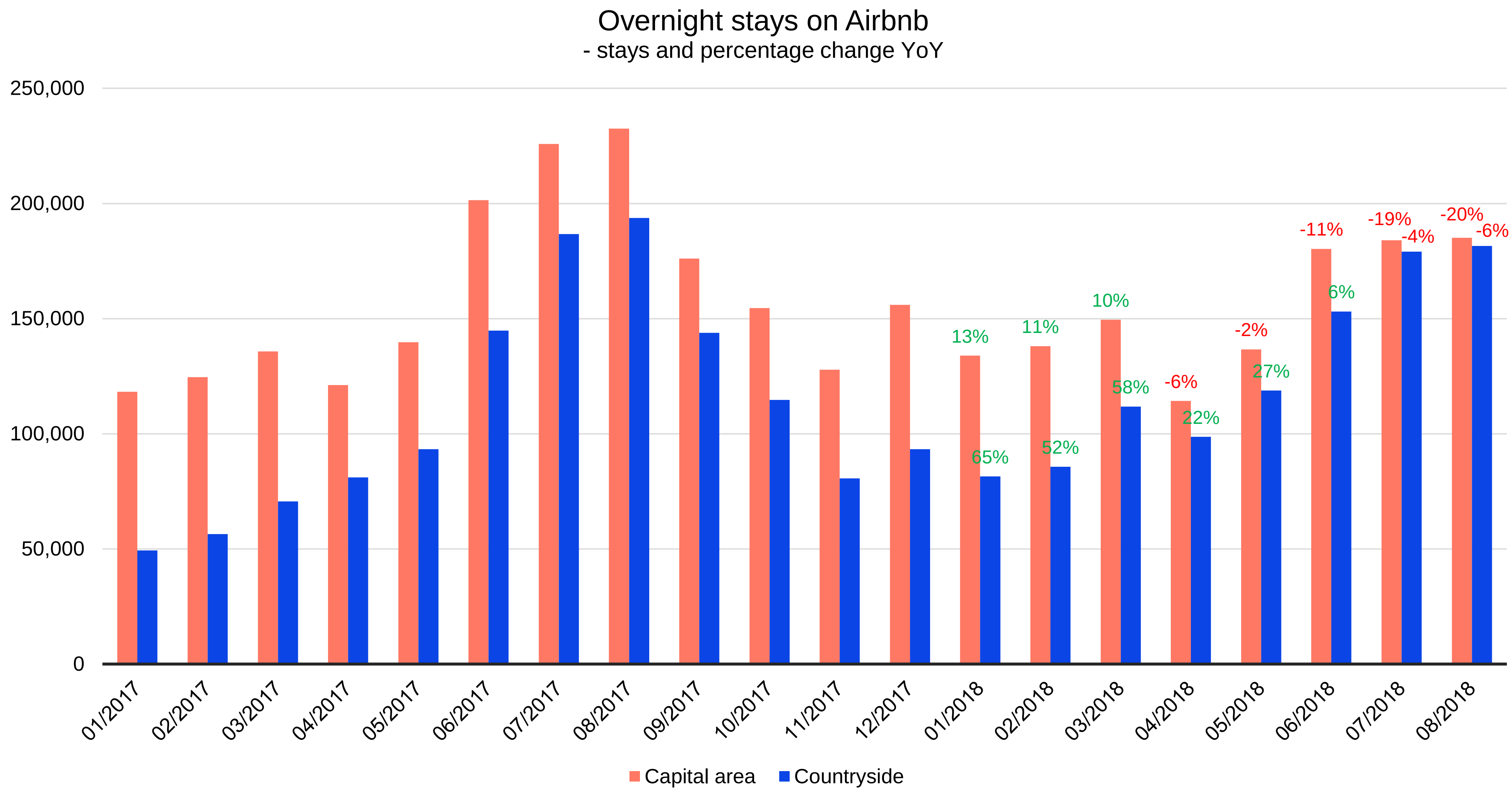
The growth has been particularly powerful outside the capital area. However, it is difficult to quantify the actual number of overnight stays on Airbnb, as Airdna and Statistics Iceland tell a different story. Thus, the total share of Airbnb was 21% in 2017, based on data from Statistics Iceland, but 31% based on Airdna's data.



Sources: Statistics Iceland, Airdna.com, Arion Research *Jan-Aug

But growing pains are appearing

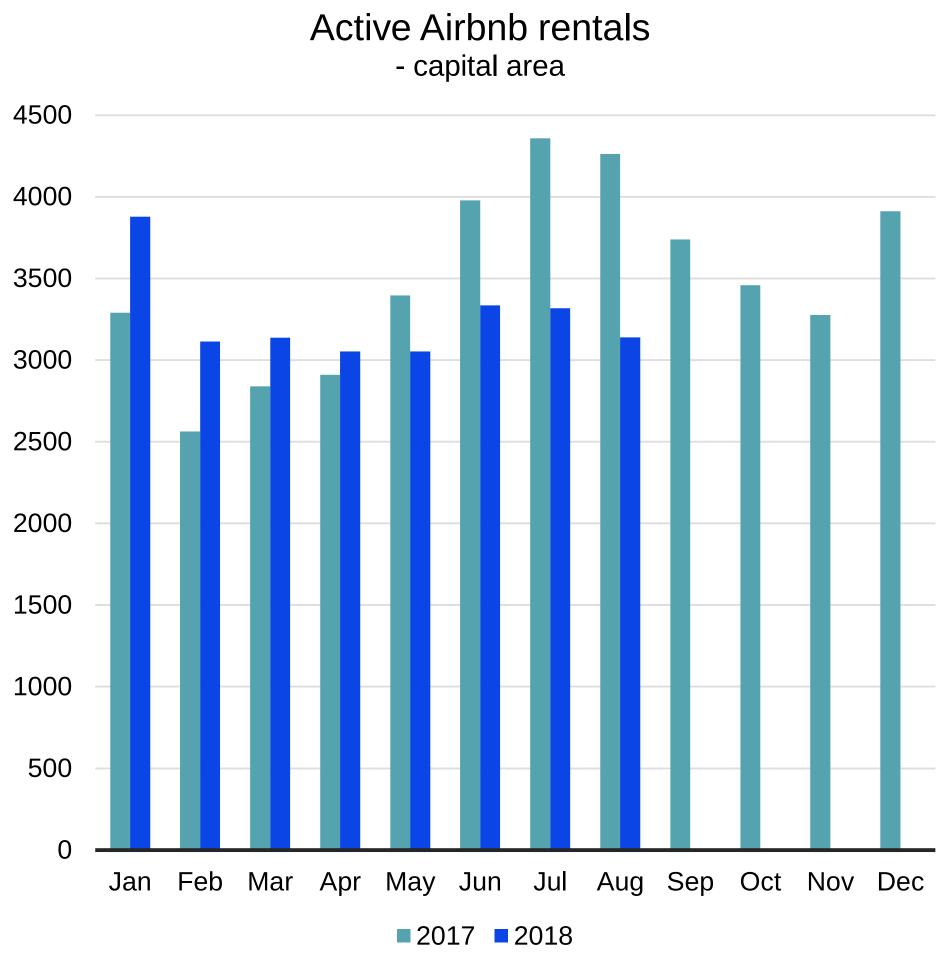
Following growth spur over the last two years overnight stays in Airbnb have decreased YoY over the past five months in the capital area

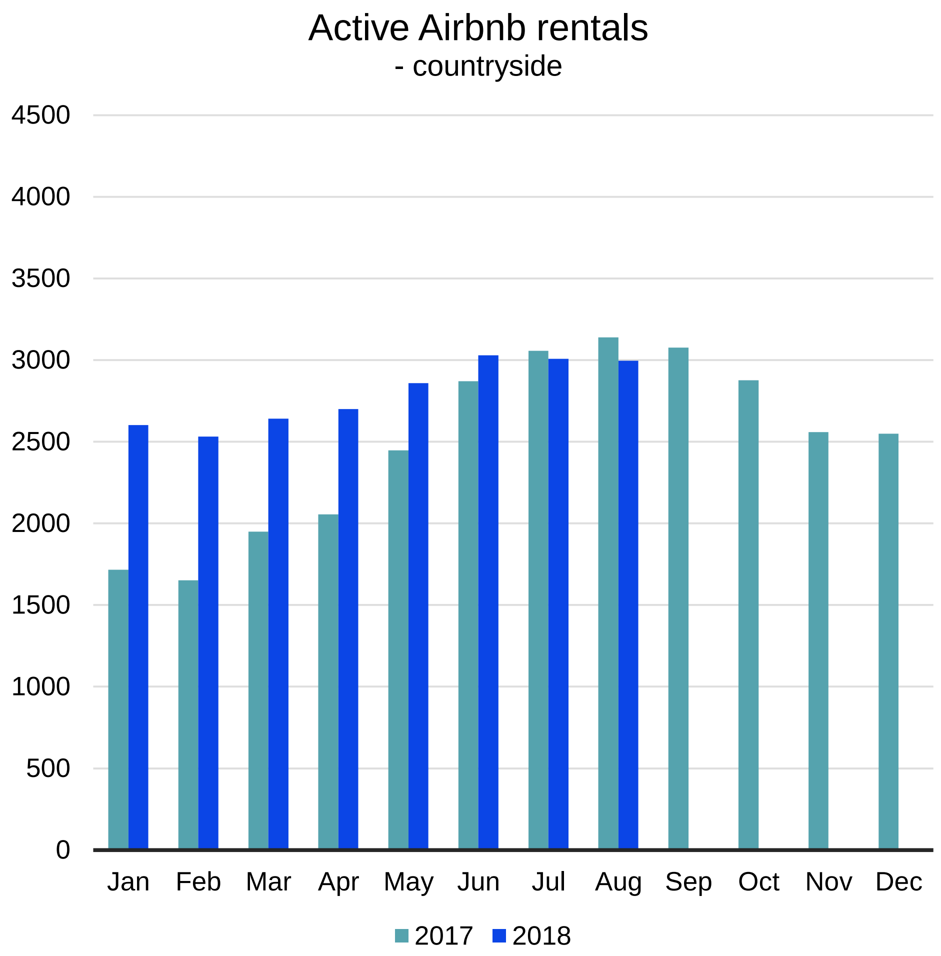


Sources: Statistics Iceland, Airdna.com, Arion Research

Supply of Airbnb rentals has started to decrease

A strong real exchange rate, tightening regulation and increased competition with hotels has potentially reduced the incentive to rent out assets through Airbnb. Rising real estate prices have also made selling more attractive.

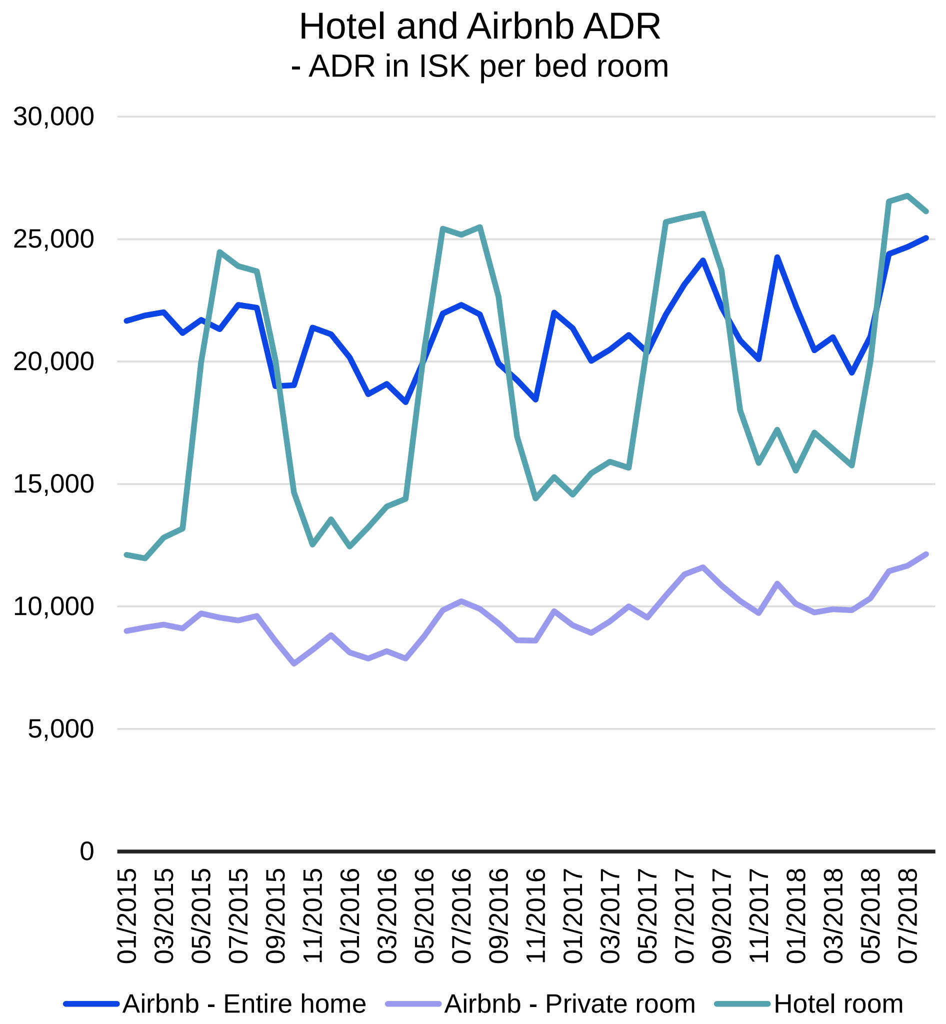


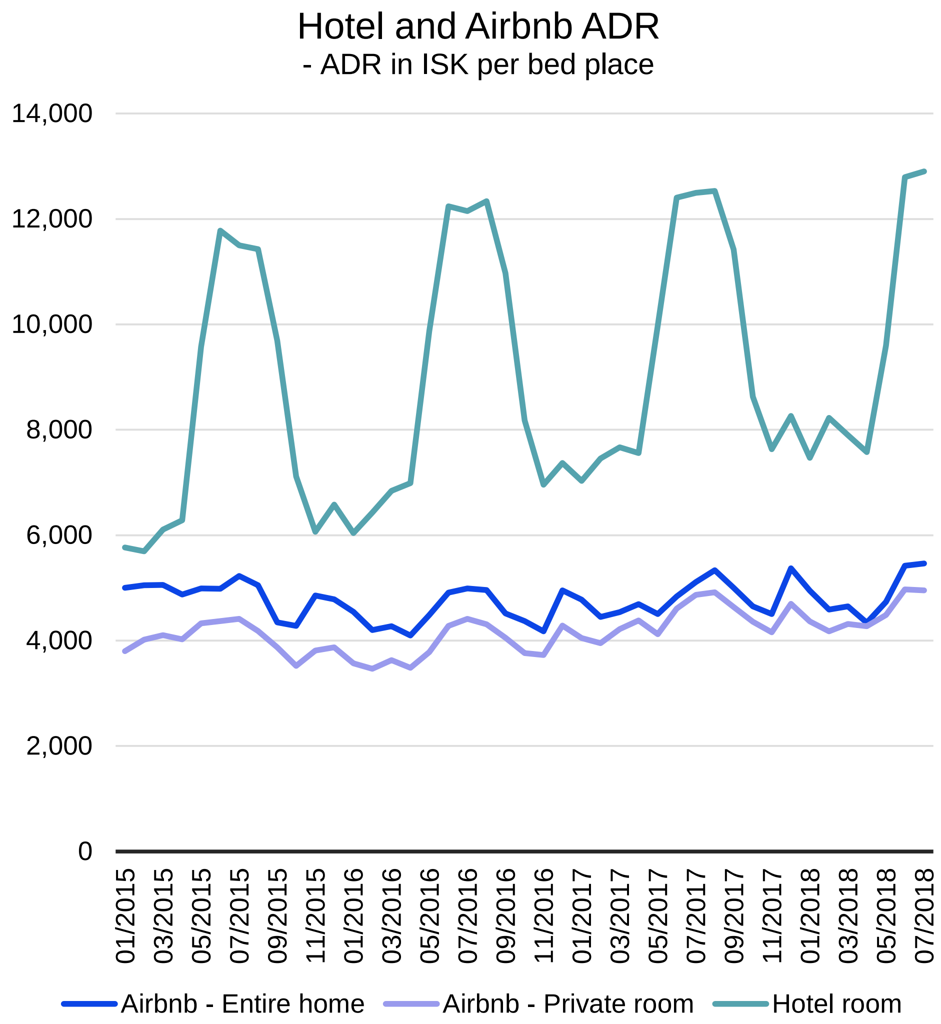


Sources: Statistics Iceland, Airdna.com, Arion Research *A working paper by the Central Bank of Iceland suggests that full time rentals on Airbnb in 2017 were around 752-1,898 in the capital area and 204-902 in the countryside.

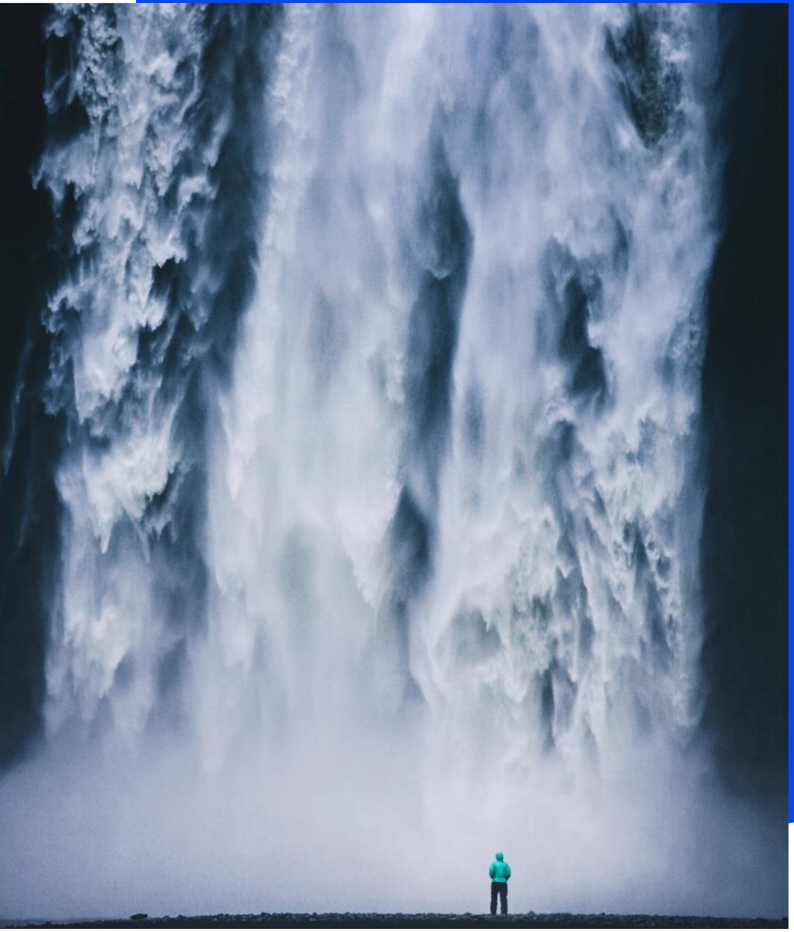
Less seasonality in Airbnb ADR

On average there are more bed places per bedroom on Airbnb, compared to hotel rooms





Sources: Statistics Iceland, Airdna.com, Arion Research

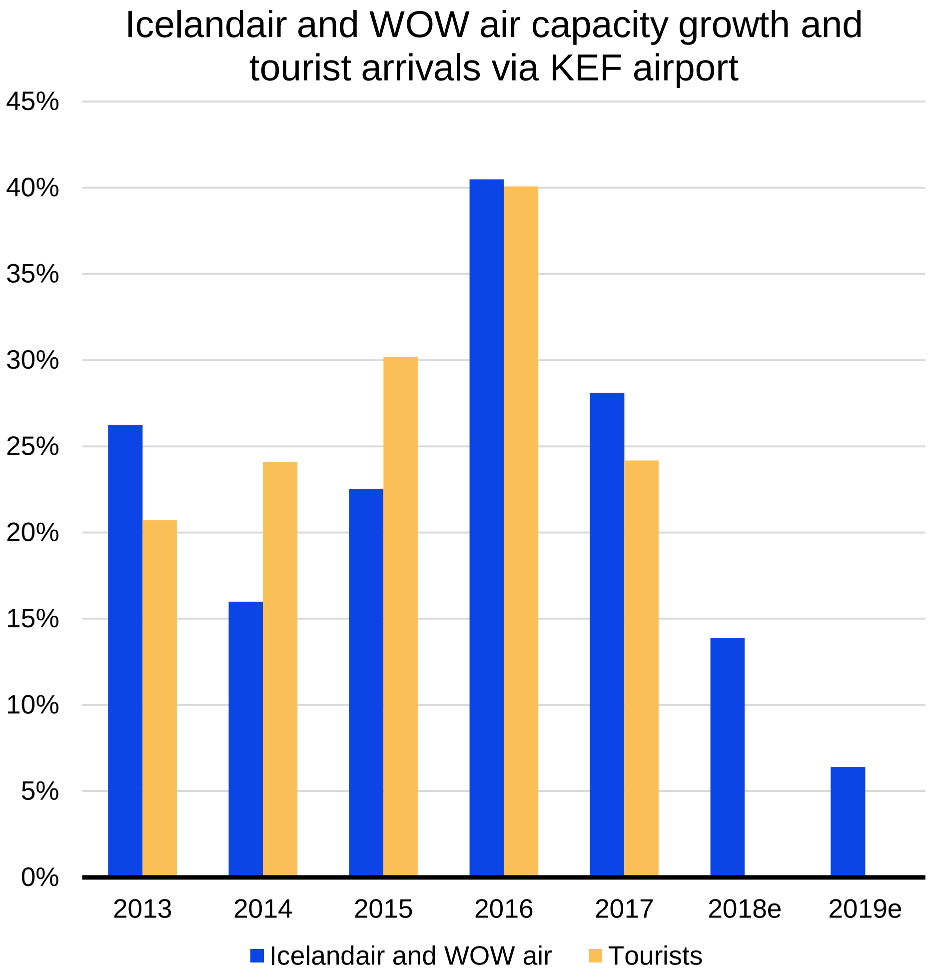


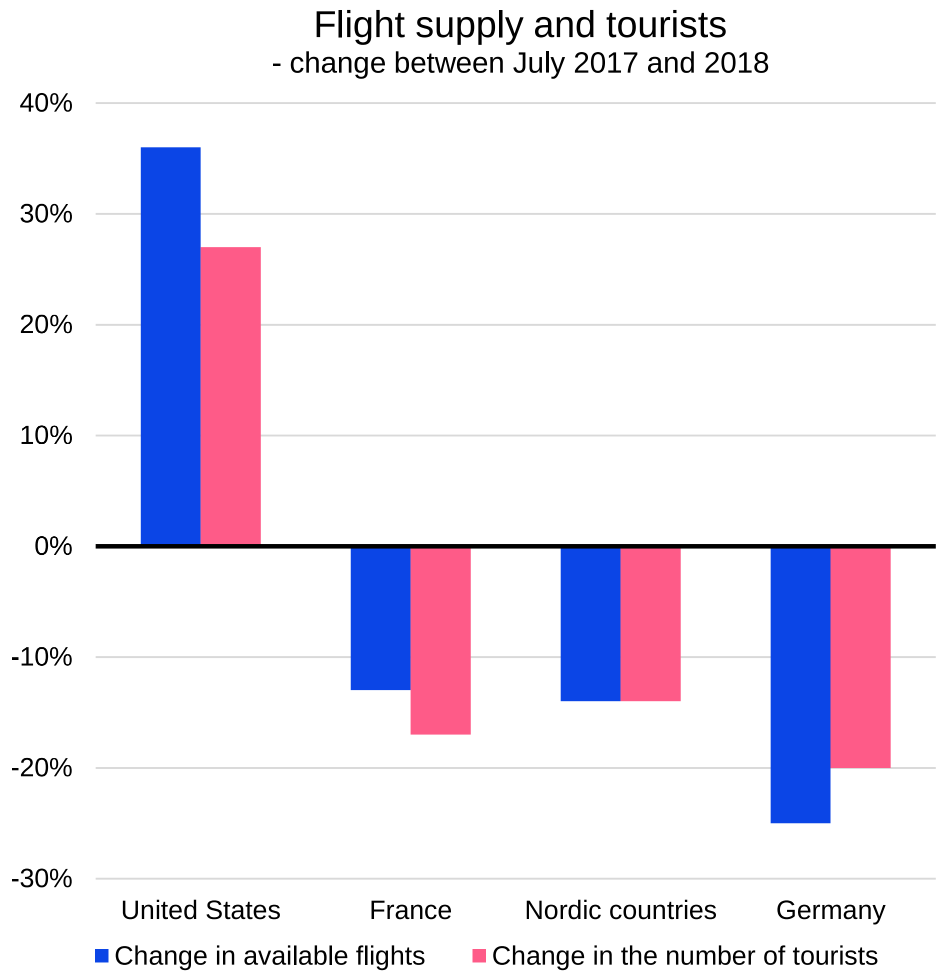
How quickly the tide turns

In no time at all the tourist industry has gone from double digit growth to much more sustainable levels. What happened?

The Icelandic airlines are not expanding as fast

The main reason for slower growth in tourist arrivals is that the Icelandic airlines route network is not expanding as fast as before. The composition of nationalities visiting Iceland largely depends on where, and how often, the airlines fly.

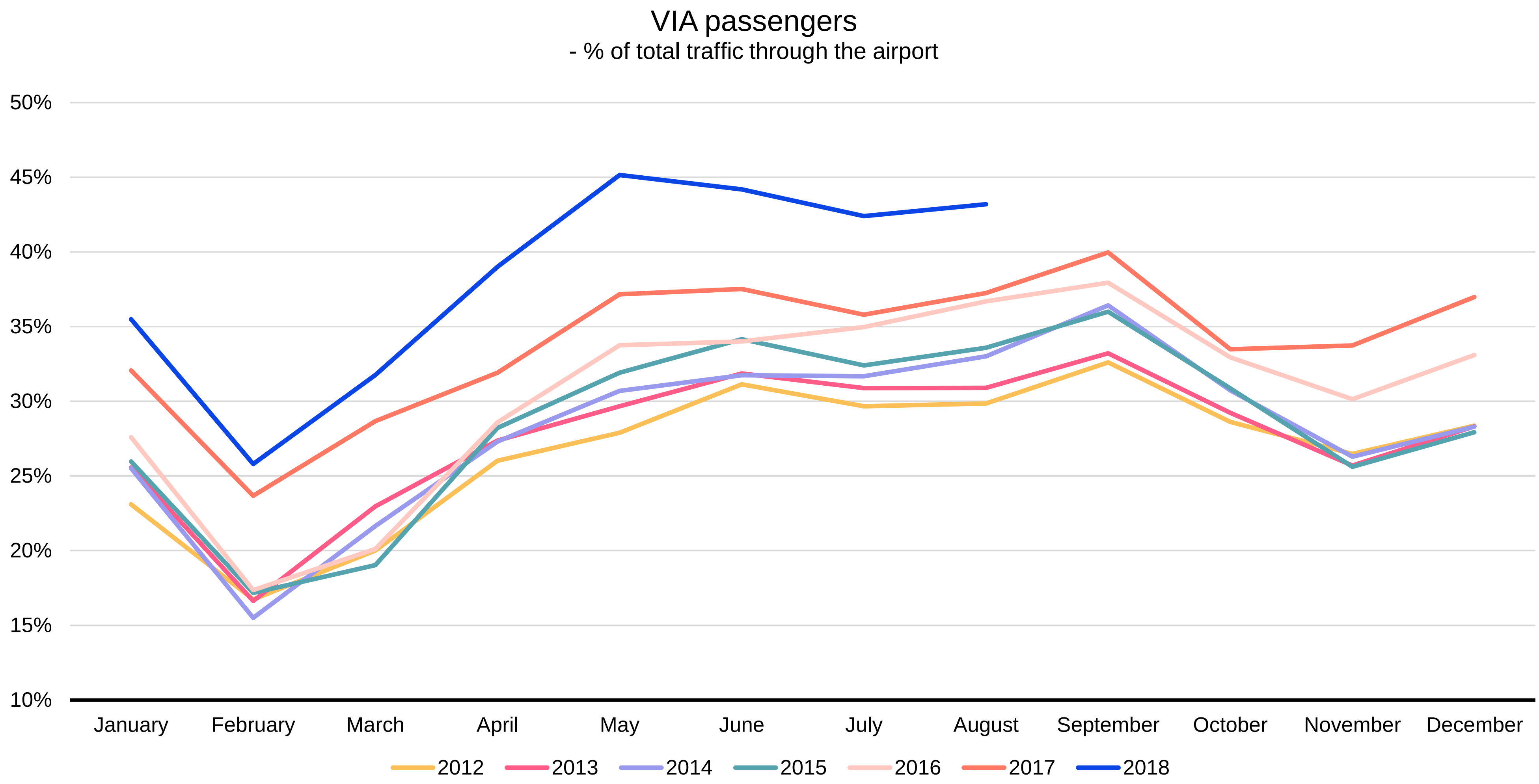




Sources: Icelandair Group, WOW air, Túristi.is, Icelandic Tourist Board, Arion Research

More VIA passengers than ever before

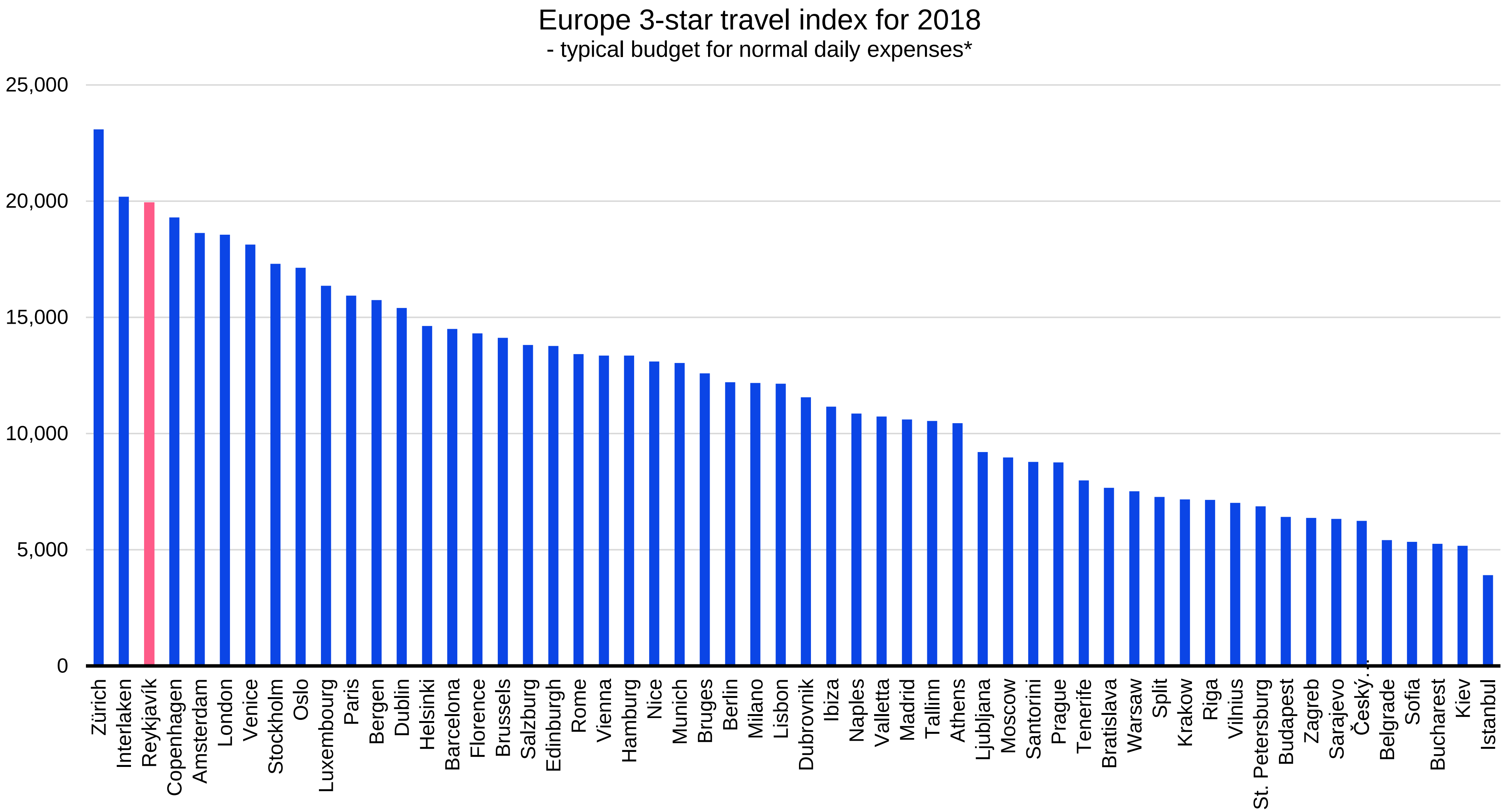
Other development that contributes to slower growth in tourist arrivals is the growing importance of VIA passengers. To some extent, this trend can be attributed to new destinations in the Icelandic airlines route network, but another important factor is how expansive the country has become.



Sources: Isavia, Arion Research

One of the most expensive destination in the world

Few places are as expensive as Iceland for the typical tourist, both because of strong króna and high prices



Sources: Priceoftravel.com, CBI, Arion Research. * Prices from May, in ISK. Exchange rate from September 18.

This is the most expensive tourist destination in the WORLD

THE MOST expensive tourist destination in the world has been revealed thanks to its strengthening currency making it a pricey holiday choice for British travellers. Surprisingly, it isn't London.

By KARA GODFREY
PUBLISHED: 16:41, Tue, Jun 19, 2018 | UPDATED: 19:44, Tue, Jun 19, 2018

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Most expensive tourist destination: Which country is the priciest? (Image: Getty)

The most expensive tourist destination in the world may come as a surprise to many.

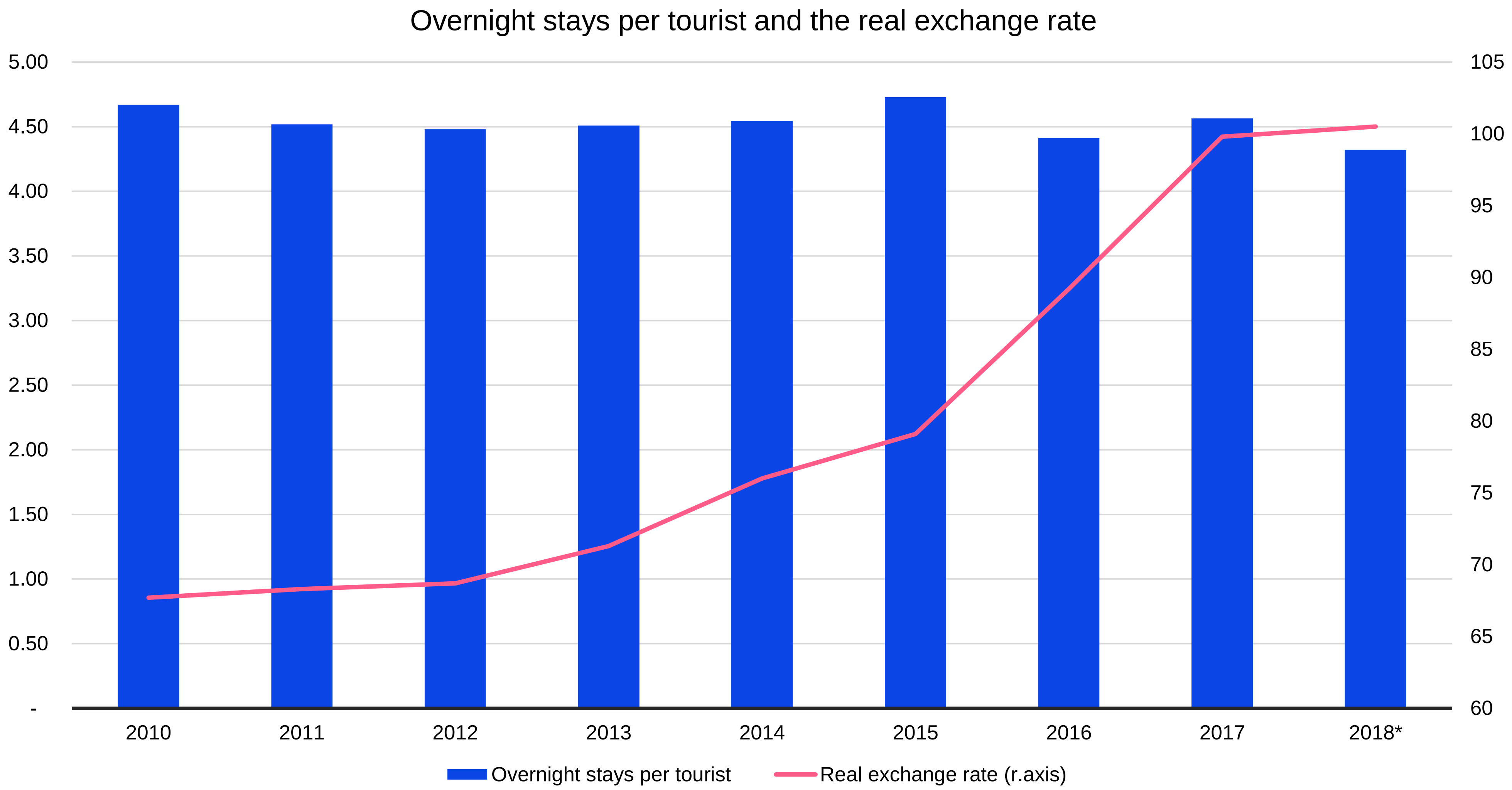
According to Bloomberg, Iceland is now one of the priciest locations for a holiday.

What does this dubious title mean for the consumption pattern of foreign tourist?

Studies indicate that consumer behavior and the duration of stay is more vulnerable to price increases than arrivals. This is especially true for small islands.

The income effect seems to be relatively small

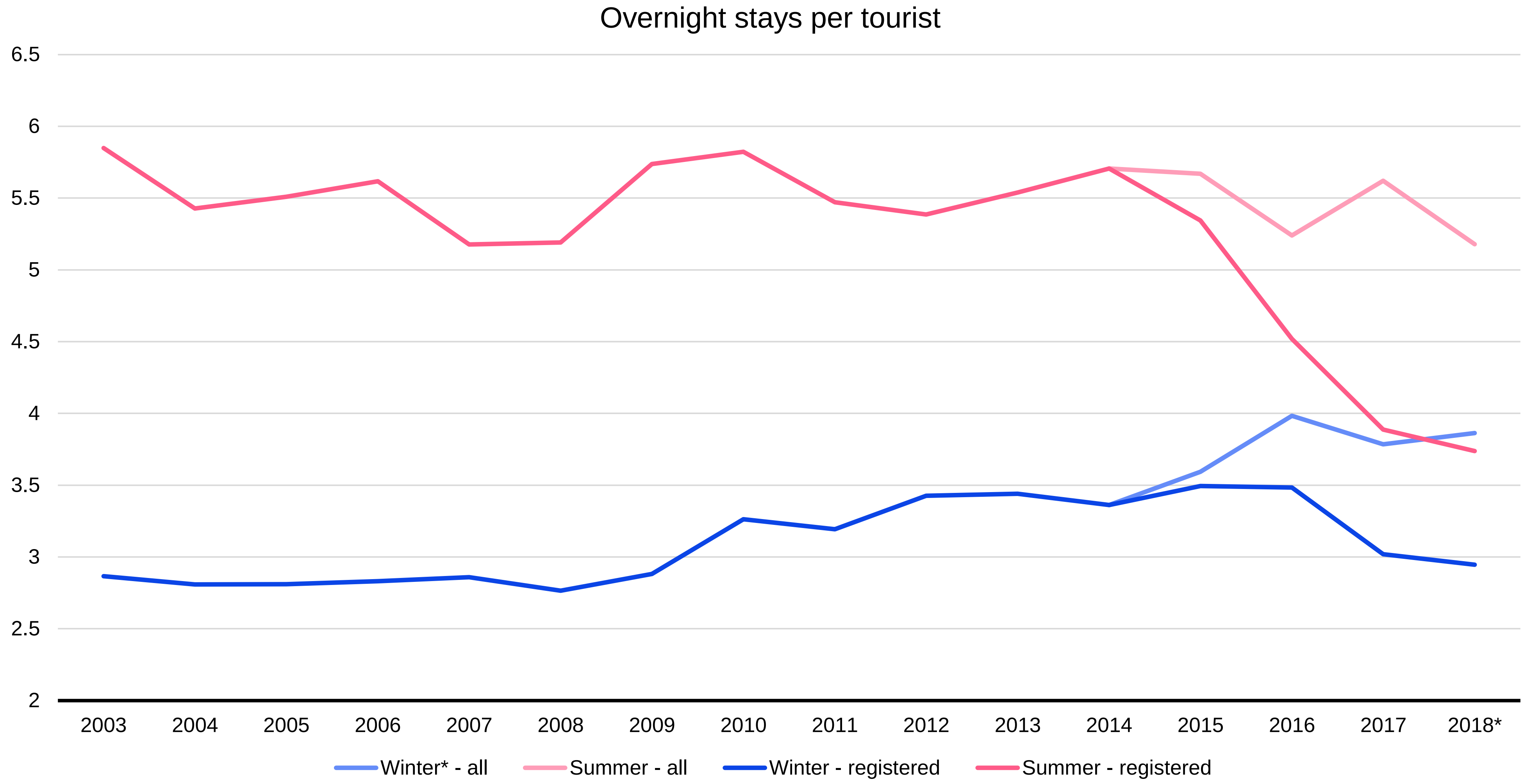
When the trip becomes more expensive, many tourists respond by shortening their stay. Looking at **all overnight stays** in the country, registered and unlisted, the effect seems to be small – so far.



Sources: Statistics Iceland, Airdna, Arion Research. *Research's estimation for 2018.

The substitution effect is clearer

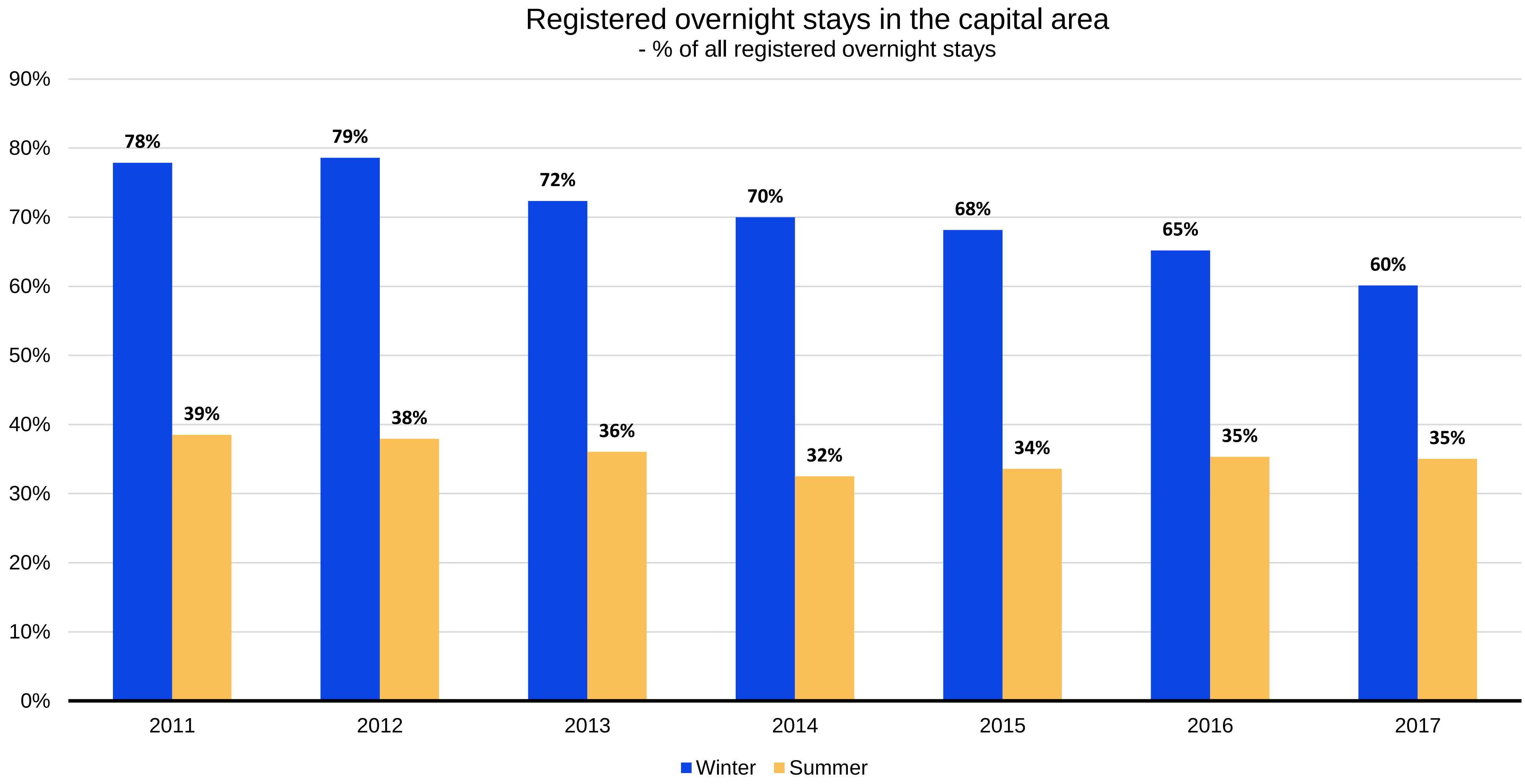
If all overnight stays are summarized, the duration of stay has changed only slightly, while registered overnight stays per tourist have dropped. This indicates that as prices of hotels and guesthouses increase, tourists look to cheaper options, i.e. Airbnb.



Sources: Statistics Iceland, Airdna, Arion Research. * Summer 2018 based on the latest figures. Winter period is from September to April.

Winter stay stretches to the countryside

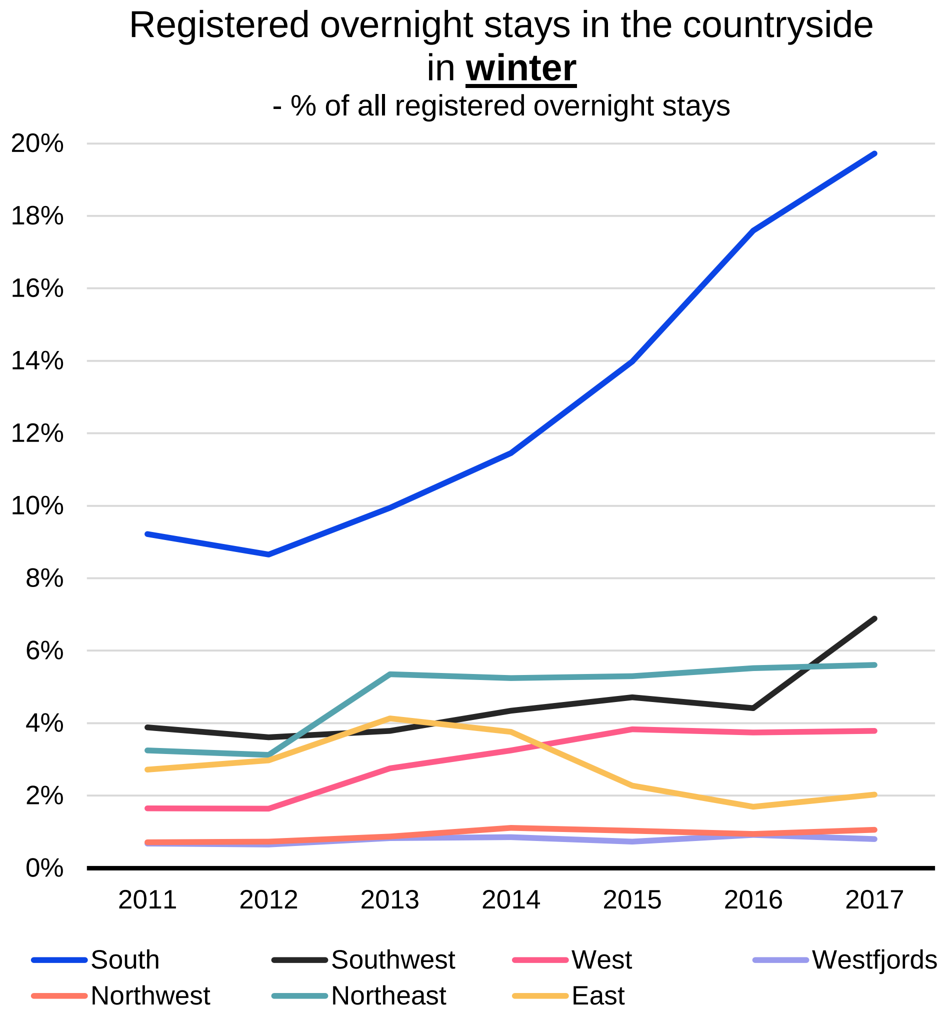
While tourists seem to be increasingly moving out of the capital area for the winter months, there have been little changes over the summer. According to overnight stays in hotels, this trend has continued in 2018.

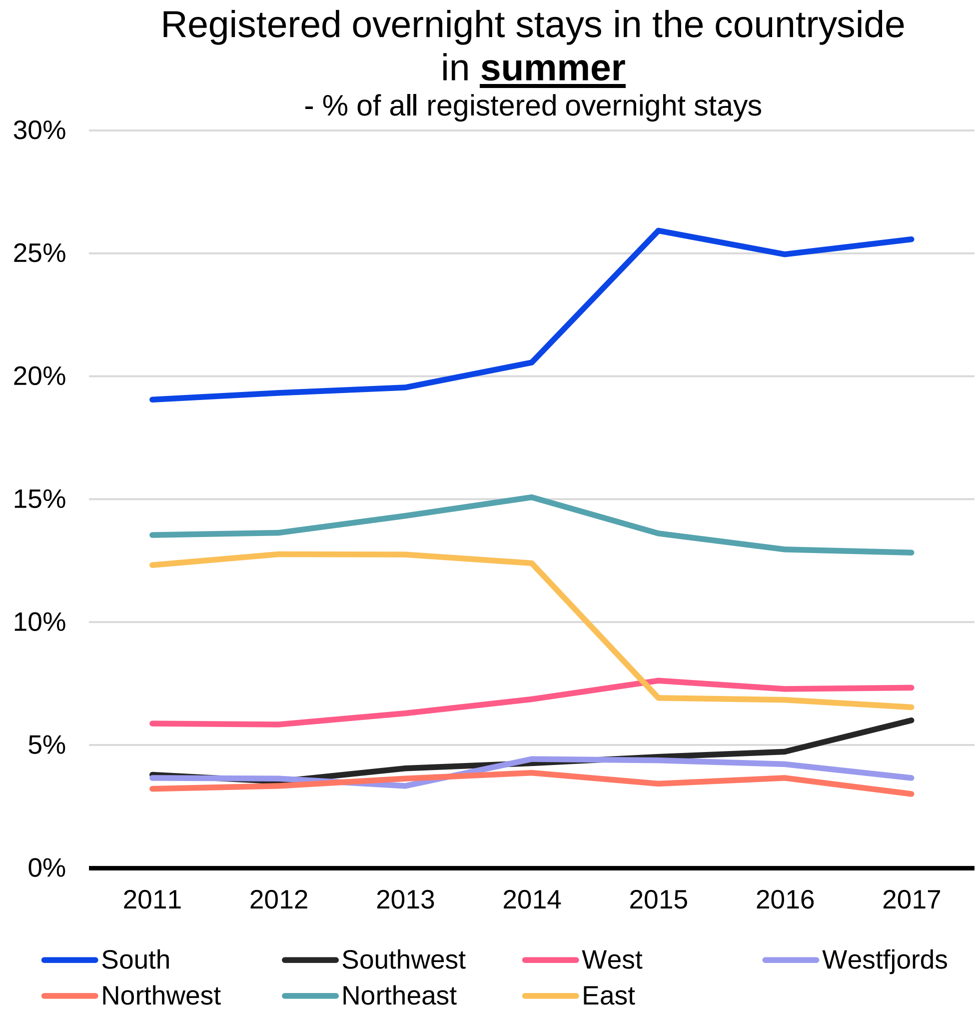


Sources: Statistics Iceland, Arion Research

Tourists migrate South for winter

During the winter months, tourists increasingly travel to the South and Southwest. This means that tourists are more concentrated than ever, contrary to the goal of better distribution.

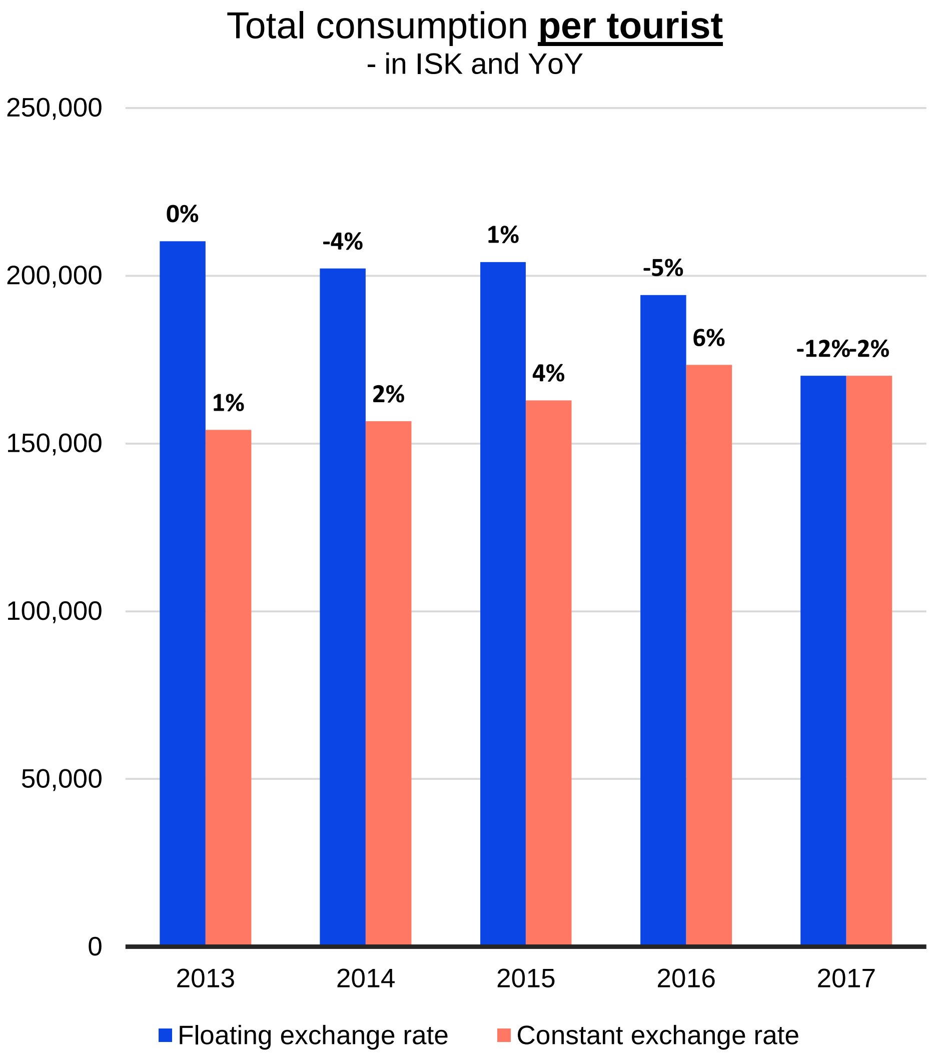


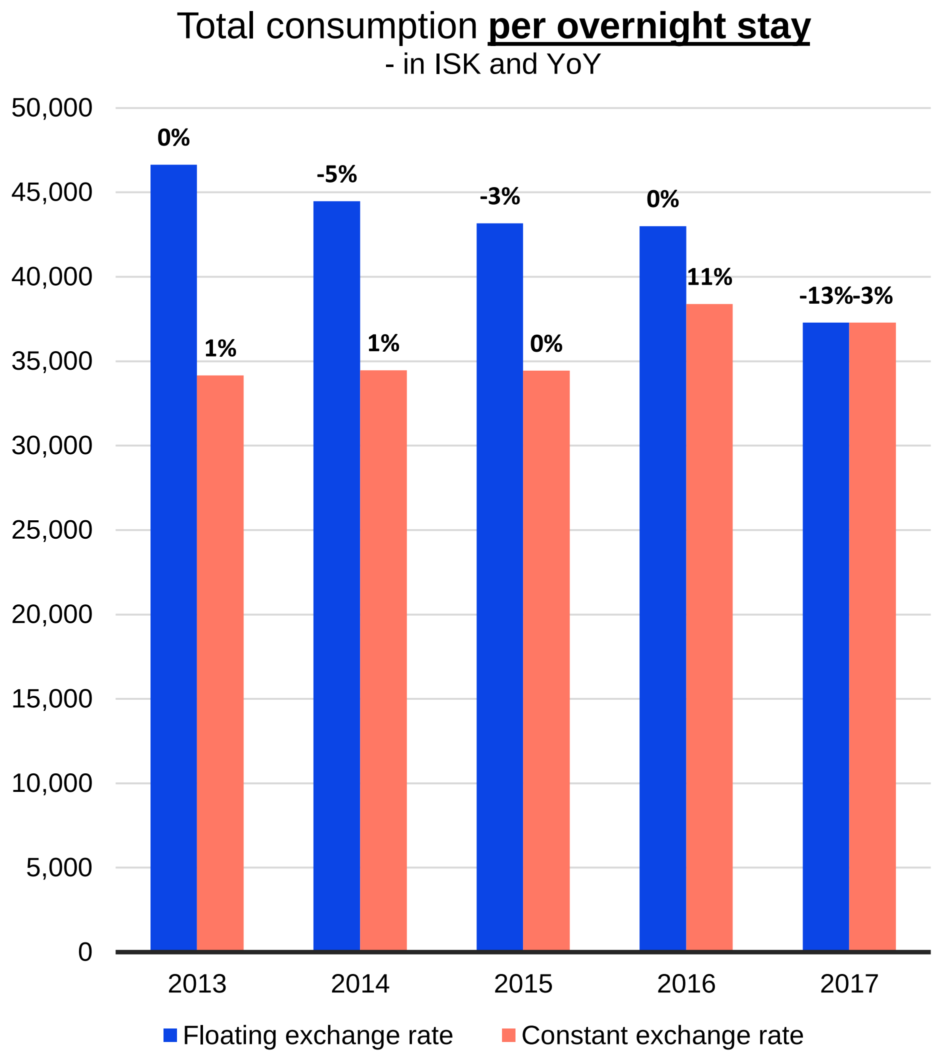


Sources: Statistics Iceland, Arion Research

Each tourists spends fewer ISK than before

The bright side is that each tourist has been spending more and more in his/her own currency. In fact, 2017 was the first year where this trend reversed.

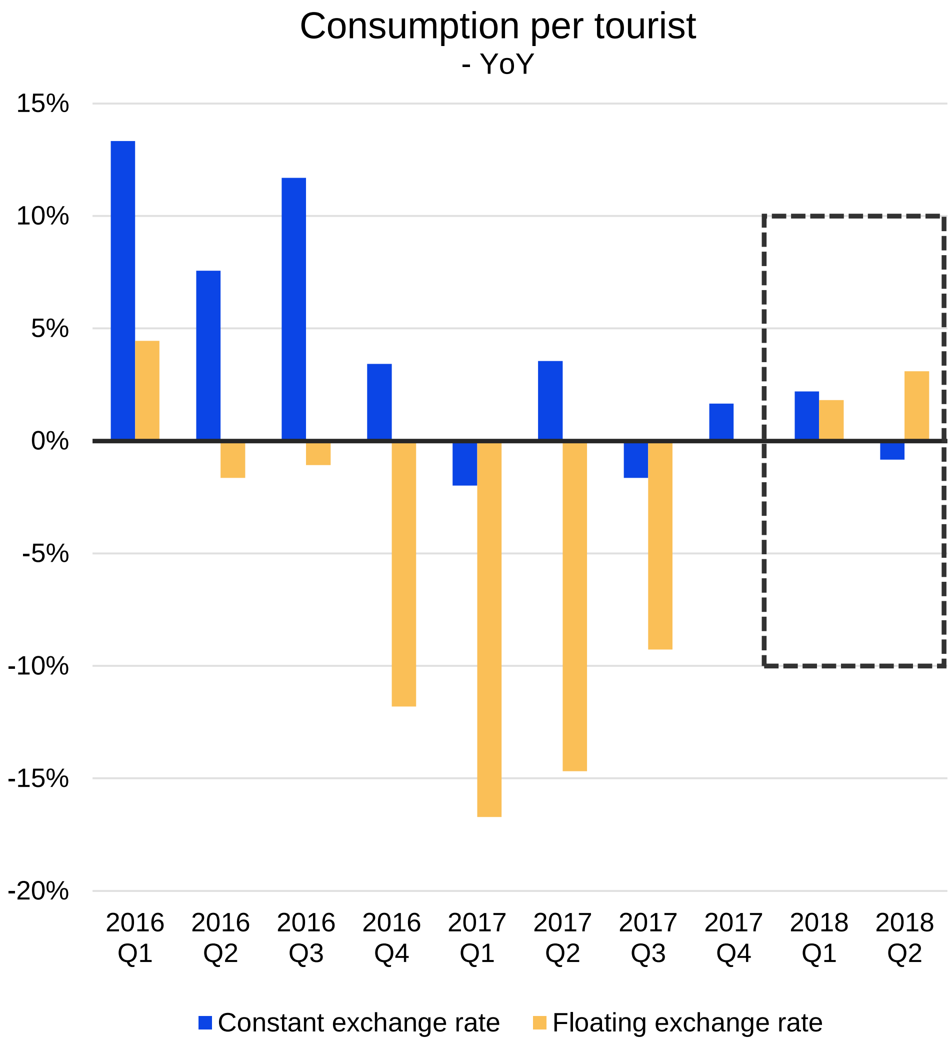


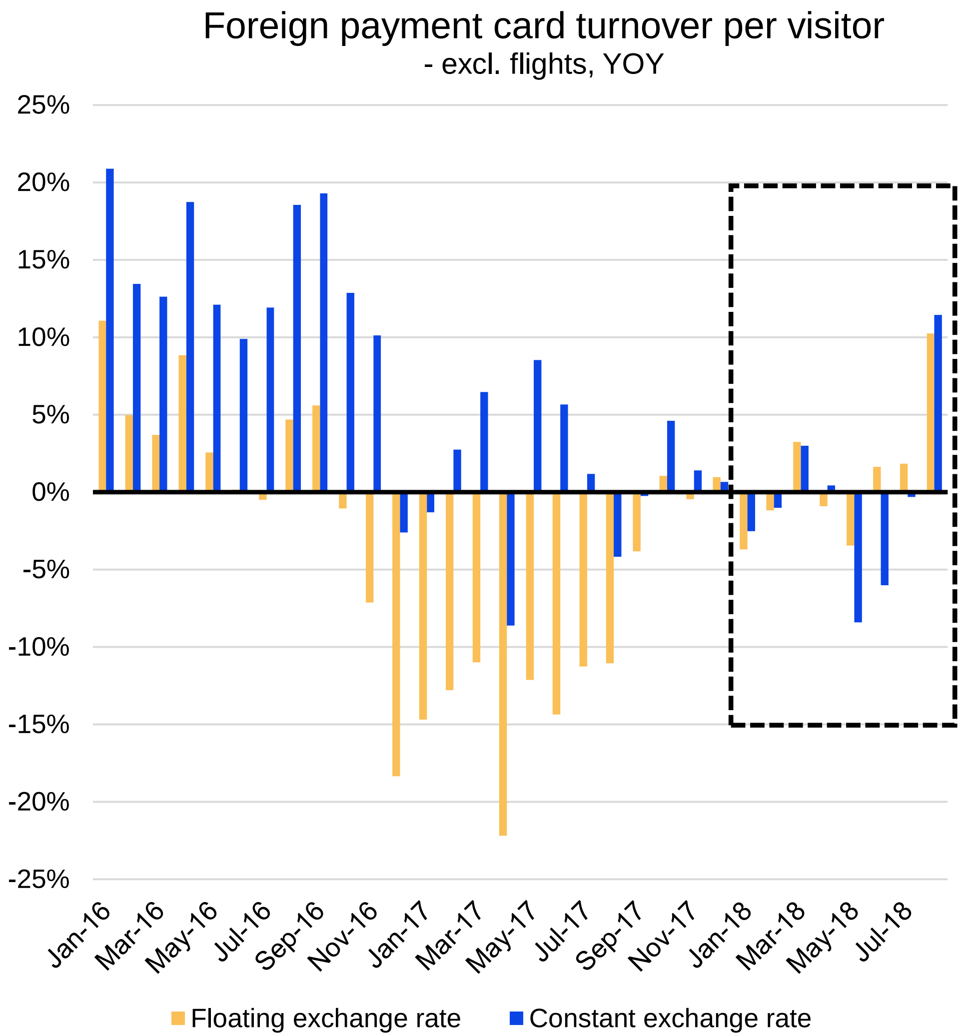


Sources: Statistics Iceland, Airdna, CBI, Arion Research

Weaker ISK = more spending in ISK

Latest figures for 1H of 2018 show that each tourist is spending more in ISK than before, which isn‘t surprising as the ISK has depreciated in 2018. Spending in foreign currency has stood its ground.



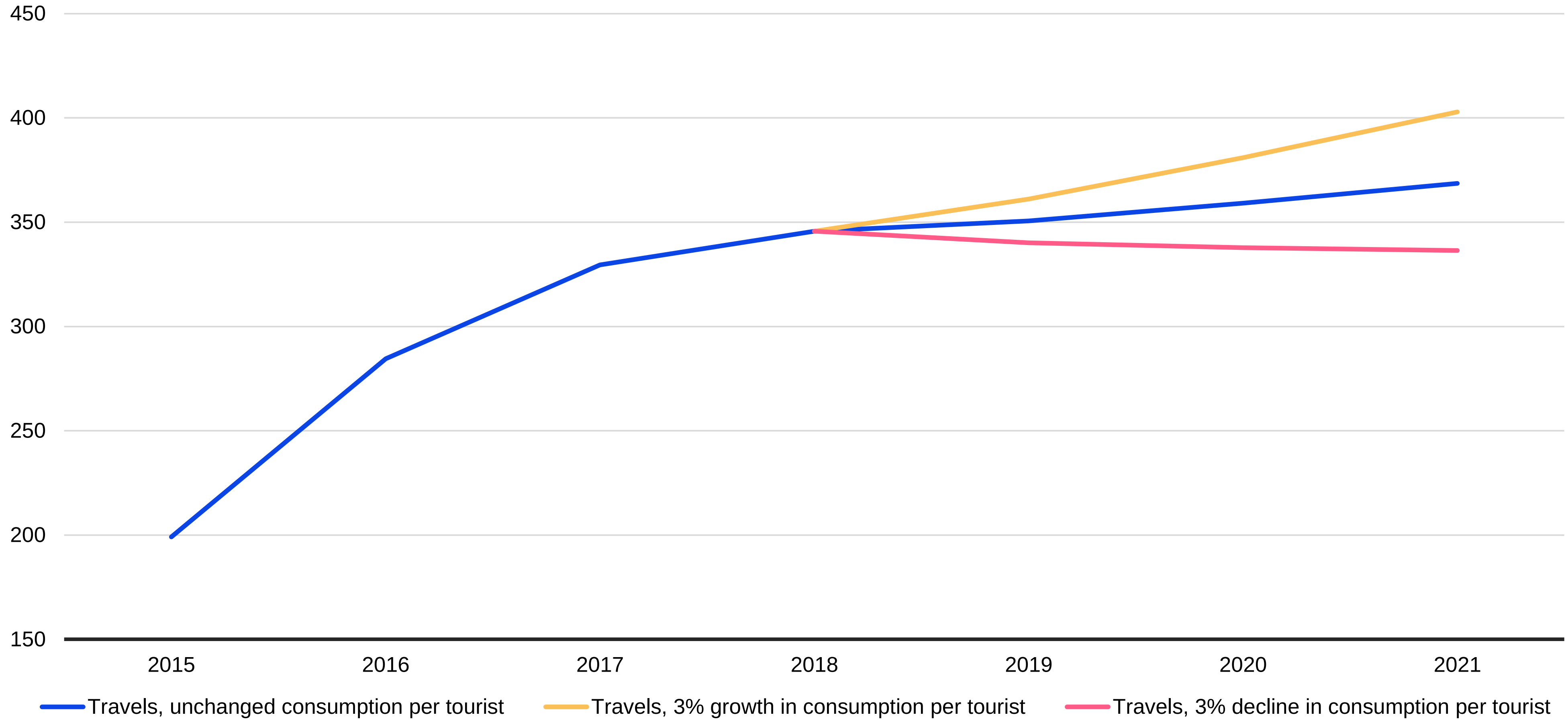


Sources: Statistics Iceland, CBI, the Centre for Retail Studies, Arion Research

Why does consumer behaviour matter?

Because we can no longer rely on revenue growth through growth in tourist arrivals. In 2017 each tourist spent less than before, both in ISK and foreign currency. However, as tourist arrivals increased by 24%, export revenues continued to increase.

Export revenues of foreign travellers, based on different developments of consumption
- Research's base case for tourist arrivals, bn. ISK at constant prices



Sources: Icelandic Tourist Board, Statistics Iceland, Arion Research

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