

ISSUER COMMENT

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Contacts

Michael S. Higgins +1.212.553.1619
Associate Analyst
michael.higgins@moodys.com

Kristin Lindow +1.212.553.3896
Senior Vice President
kristin.lindow@moodys.com

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Americas	1-212-553-1653
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Government of Iceland

Iceland's Keflavik Airport investment will expand economic benefits of tourism

From [Credit Outlook](#)

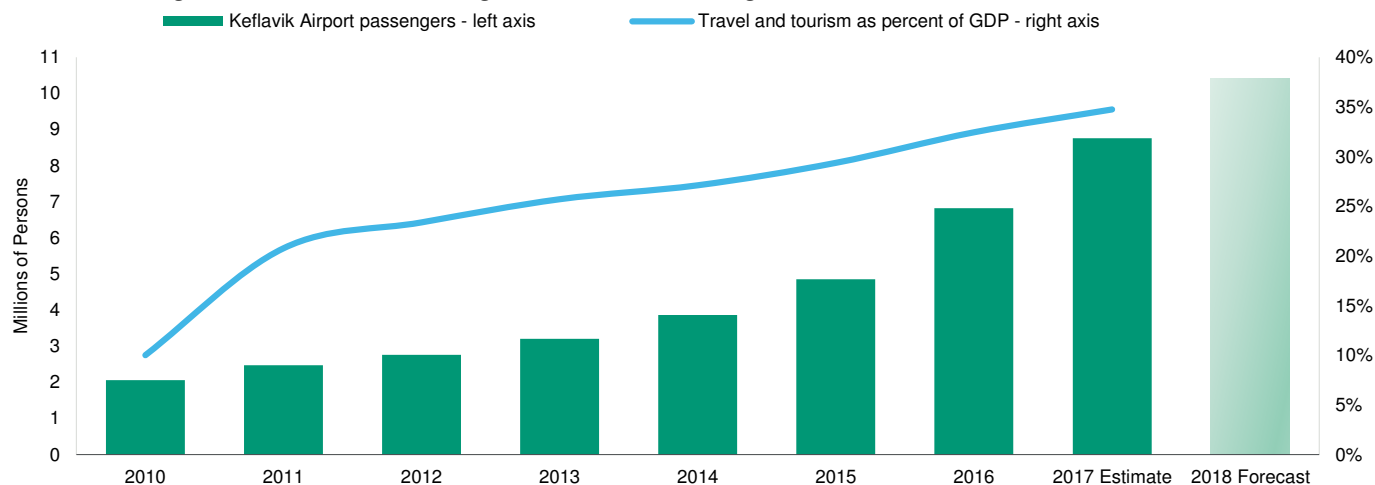
On 14 January, the [Iceland](#) (A3 stable) state-owned airport authority announced that it anticipates investing approximately ISK105 billion (\$1 billion or 4.3% of GDP) in infrastructure expansions at Keflavik Airport over the next seven to eight years. We consider the airport investment credit positive because it would ease capacity constraints at the country's key international transit point, Keflavik Airport, and maintain and support the growth of tourism, which has buoyed Iceland's economic growth and large balance of payments surpluses in recent years.

In the austerity years following Iceland's financial system collapse, the government postponed many infrastructure improvements, including at the airport. However, the new coalition government, which came into office in November, has made infrastructure a top priority. Upgrades to Icelandic infrastructure, particularly at Keflavik Airport, have not kept up with the growth of tourism, which surged when the country's unique natural beauty and culture came into global consciousness after the eruption of the Eyjafjallajökull volcano in 2010.

Since 2011, investment in Keflavik airport, which serves 96% of total passenger travel, has been only about ISK39 billion (\$372 million). The airport has become a chokepoint constraining foreign passenger arrivals and the opening of new airlines and routes. As a part of the government's support for tourism and growth in tourism initiatives, the Keflavik Airport 2015-40 Master Plan identified a strategy to unclog the overcrowded facility and optimize nearby land use, allowing continued growth in the sector for years to come.

Over the past seven years, total passengers (departures, arrivals, and in transit) at the Keflavik Airport have more than tripled. The airport authority forecasts total passengers at 10.4 million this year. Although passenger growth decelerated slightly in 2017, the travel & tourism industry now accounts for nearly 35% of GDP, up from 9.7% in 2009, as shown in Exhibit 1. As of 2016, tourism provided Iceland approximately ISK466 billion of foreign exchange (FX) earnings, or about 30% of total FX earnings.

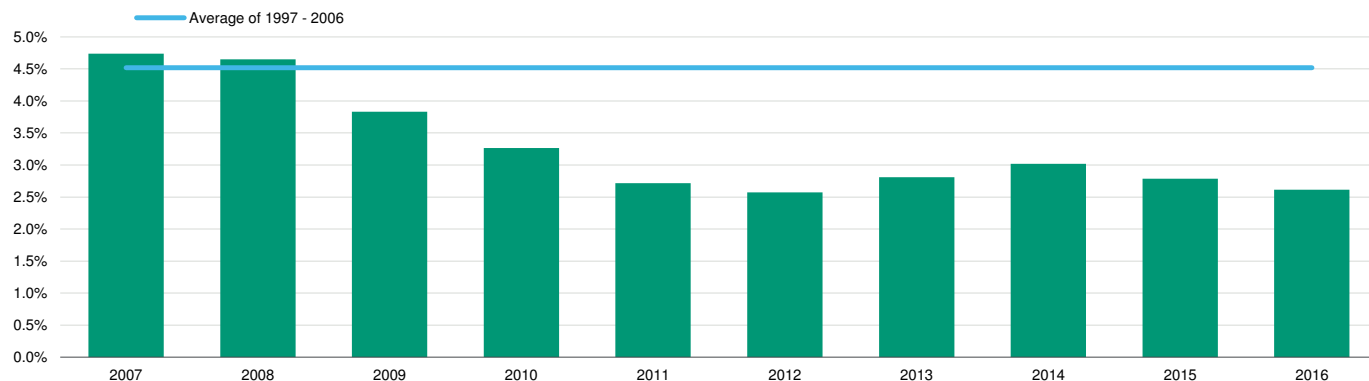
Exhibit 1

Iceland's booming tourism sector is an increasing contributor to economic growth

Sources: ISAVIA, Icelandic Tourism Board, World Travel & Tourism Council, and Moody's Investors Service estimates and forecast

After several years of fiscal austerity and relatively low government investment in infrastructure during Iceland's economic recovery, as shown in Exhibit 2, the newly elected government promises to increase spending on infrastructure. According to the Federation of Icelandic Industries, approximately ISK372 billion (\$3.5 billion or 15.2% of 2016 GDP) of repairs are needed to fix the nation's infrastructure. As a direct outcome of the recent tourism boom, the government's revenue from tourism-related activities (such as VAT-taxable turnover) has increased substantially, in part helped by broadening the entities on which such taxes are assessed. With the government's fiscal balance in a healthy surplus in 2016 and 2017, increasing public infrastructure investment is now possible.

Exhibit 2

Constrained government finances after the financial crisis limited public investment spending**Government investment as a percent of GDP**

Sources: Statistics Iceland/Haver Analytics and Moody's Investors Service

The strong inflows of foreign currency that have led to the appreciation of Iceland's currency, the króna, are contributing to the current "soft landing" in Icelandic real GDP growth, which we anticipate will be 3.5% this year, and 2.8% in 2019, down from a high of 7.4% in 2016. As the economy continues to readjust, tourism will remain a vital economic sector for the island nation, whose population of roughly 334,000 is dwarfed by the yearly arrivals of foreign visitors. With tourism continuing to support the government budget through travel and tourism tax revenue, the authorities will have the fiscal resources to build the necessary infrastructure that allows the sector to prosper.

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