

ISSUER COMMENT

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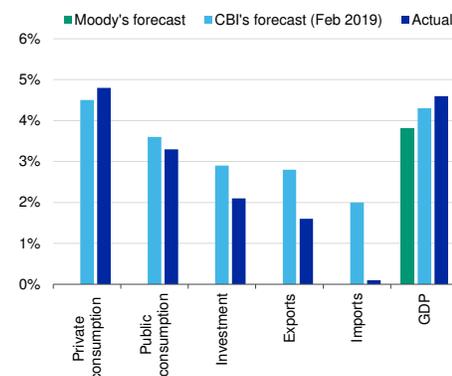
Government of Iceland

Stronger-than-expected growth will support decline in Iceland's debt/GDP ratio, a credit positive

On 5 March, Statistics Iceland, [Iceland's](#) (A3 positive) statistical office, published preliminary figures showing that the economy grew by 4.6% in real terms in 2018, significantly higher than both the Central Bank of Iceland's (CBI) forecast of 4.3% and our own forecast of 3.8%, and in line with growth in 2017. Higher-than-expected growth will help the government reduce debt as a proportion of GDP more quickly than we anticipated, a credit positive. However, we expect growth to slow significantly over the next two years as the tourism sector matures and the government seeks to engineer a soft landing for the economy.

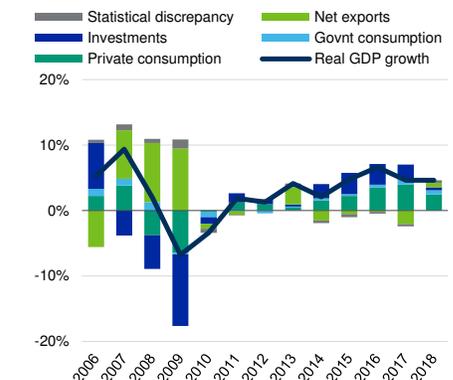
Growth was broad-based, with private consumption increasing more strongly than the CBI estimated in February (see Exhibit 1). Private consumption was also the main driver, rising by 4.8% compared with the CBI's expectation of 4.5% (see Exhibit 2), while investments grew by 2.1% compared with a forecast 2.9%. Much lower-than-expected import growth (0.1% versus 2.0%), which more than compensated for a weaker-than-expected performance in exports, produced a positive net exports contribution for the first time since 2013.

Exhibit 1
Iceland's 2018 growth outperformed expectations
 Real GDP growth, percent change



Sources: Statistics Iceland, Central Bank of Iceland and Moody's Investors Service

Exhibit 2
Iceland's consumption continues to drive growth
 Real GDP growth and its contributions



Sources: Statistics Iceland and Moody's Investors Service

We have increased our 2019-20 growth forecasts to reflect stronger-than-expected 2018 growth, and now expect average GDP growth of 2%-3% over the next two years compared with 2% previously. Reflecting these higher projections, we expect general government debt/GDP, which has declined precipitously from a peak of more than 114% in 2011, to fall more

quickly than we expected over the period (all else equal), supported by the prudent fiscal stance outlined in the government's 2019 budget.

While we continue to expect the economy to slow significantly as growth in tourist arrivals declines, the tourism sector will still grow, indicating a soft landing for the economy. Private consumption will remain the main driver of growth, supported by a tight labour market and rising real disposable incomes, although consumer confidence indices point to slower consumption growth in the coming years. Investments will also ease as demand for infrastructure declines in tandem with the slowdown in tourist arrivals, while tighter monetary policy is likely to weigh on domestic demand in 2019-20.

Risks to our forecast include a wage dispute between trade unions and the government that has increased the risk of strikes with the potential to affect the tourism sector. Liquidity problems at an Icelandic budget airline could also weigh on the tourism sector and, combined with higher fuel prices, cause air fares to rise. In addition, given the small size of its economy and its currency area, Iceland is much more exposed than larger sovereigns to a potential no-deal Brexit or increased trade protectionism. As we noted when assigning a positive outlook to the sovereign rating last year, our assessment of Iceland's overall creditworthiness will depend in part on the government's ability to manage a soft landing for the economy without its external position deteriorating materially.

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Moody's related publications

- » **Credit Opinion:** [Government of Iceland - A3 positive: Regular update](#), 4 December 2018
- » **Issuer Comment:** [Government of Iceland: Central bank's reduced reserve requirements on capital inflows are credit positive](#), 7 November 2018
- » **Issuer In-depth:** [Government of Iceland – A3 positive: Annual credit analysis](#), 3 August 2018
- » **Rating Action:** [Moody's changes Iceland's outlook to positive from stable and affirms A3 ratings](#), 20 July 2018

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