INTERNATIONAL MONETARY FUND

IMF Country Report No. 19/375

ICELAND

December 2019

2019 ARTICLE IV CONSULTATION—PRESS RELEASE AND STAFF REPORT

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2019 Article IV consultation with Iceland, the following documents have been released and are included in this package:

- A **Press Release.**
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on laps-of-time basis, following discussions that ended on November 12, 2019, with the officials of Iceland on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 4, 2019.
- An **Informational Annex** prepared by the IMF staff.

The documents listed below have been or will be separately released.

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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December 19, 2019

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2019 Article IV Consultation with Iceland

On December 19, 2019, the Executive Board of the International Monetary Fund (IMF) concluded its 2019 Article IV consultation[1] with Iceland.

After years of robust growth, economic activity has significantly weakened. Supply disruptions in tourism, the engine of recent growth, and the associated uncertainty have triggered a drop in domestic demand and an increase in unemployment. A swift policy response, with fiscal relaxation and monetary easing, has stabilized expectations and cushioned the effects. A moderate but fragile growth recovery is expected in 2020. Significant downside risks weigh on the outlook, including world trade tensions, weaker than expected global growth, the UK's still uncertain Brexit process, and further worsening in tourism activity. Over the medium term, growth is projected to recover to about 2 percent, inflation is expected to remain close to the 2.5 percent target, and the current account balance is projected to narrow but remain positive.

Executive Board Assessment[2]

The authorities' swift policy response to Iceland's weaker economic growth has been appropriate. Supply disruptions in tourism, the engine of growth over the past five years, and the associated increase in uncertainty has triggered a drop in domestic demand and an increase in unemployment. Fiscal relaxation and monetary easing have stabilized expectations and cushioned the effects of the tourism shock, averting a deeper growth slowdown. The recent collective wage agreement, completed with active government involvement, has dampened the negative impact on employment.

Solid economic fundamentals have also allowed the economy to weather the downturn, although significant downside risks remain. Public and private balance sheets are comfortable. Fiscal surpluses have contributed to the rapid decline in public debt. The current account is in surplus,

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

net external assets are positive, and international reserves are ample. Iceland's external position is broadly in line with fundamentals and desired policies. Inflation expectations are at the CBI's target. Banks' balance sheets show high capital adequacy and strong liquidity ratios. In this context, growth is poised to recover to 1.6 percent in 2020 and 2 percent over the medium term.

Policy space is available, and further easing would be warranted if risks materialize. With output close to potential, there is no urgency for further policy easing. However, growth remains fragile, and negative spillovers from global risks and further worsening in tourism activity could still tilt the economy into a recession. The authorities' medium-term fiscal plan is appropriate in view of the weakening of the economy, and there is some fiscal space to provide further support if needed. Further room for monetary easing is also available if economic conditions deteriorate significantly, and inflation expectations fall well below target.

Confidence in Iceland's policy framework continues to build. The inflation targeting regime—with CPI as a monetary policy target—has worked well. The CBI's foreign exchange arrangement has preserved exchange rate flexibility and maintained adequate international reserve buffers. Iceland's fiscal framework has helped gain credibility and some fiscal space. Refining its implementation could make discretionary fiscal actions more effective in smoothing economic cycles. In the medium-term, completing the planned government spending reviews and active public sector balance sheet management could expand the options for more growth-friendly spending. Macroprudential policies are helping to preserve buffers for managing financial stability risks. Looking forward, the macroprudential policy toolkit could be expanded to include loan-to-value limits for commercial real estate loans and income-based measures to contain potential risks in the loan portfolio over the medium term.

The ongoing merger of the CBI and FME should achieve greater efficiency, operational independence, and powers in financial oversight. It should provide for an integrated approach to policymaking, enhancing the synergies between the oversight, lender-of-last resort, and resolution functions, while strengthening policy accountability. While full integration in practice will take time, the framework should be implemented as swiftly as possible, and the new internal organization should bolster the technical capacity and resource adequacy for supervisory work. The future planned reviews of the framework provide opportunities to strengthen its effectiveness if necessary.

Iceland's recent grey-listing by the FATF increases the urgency of ensuring a more effective AML/CFT framework. The authorities have adopted a number of legislative and institutional reforms to improve the AML/CFT legal and institutional framework as well as domestic coordination and have increased AML/CFT resources. Swift actions are needed to implement all remaining recommendations of the FATF and demonstrate that the framework is effective. Continued vigilance and broader public awareness of the potential effects on households and companies is needed.

Structural reforms could reignite Iceland’s growth potential. Iceland’s labor market arrangements are inclusive, and in the face of large adverse shocks, the wage-setting process has proven flexible in preventing large job losses. Securing stable long-term growth and high living standards going forward requires efforts in education, focusing on teacher training and targeted support for immigrant children; improving the transparency of unlisted companies with large impact on the Icelandic economy; and preserving the natural endowments of the country to support the sustainability of Iceland’s traditional economic activities.

Iceland: Selected Economic Indicators, 2015–19

	2015	2016	2017	2018	2019 Proj.
	(Percentage change unless otherwise indicated)				
National Accounts (constant prices)					
Gross domestic product	4.7	6.6	4.4	4.8	0.3
Total domestic demand	5.9	7.5	7.0	4.7	-0.3
Private consumption	4.5	7.2	8.1	4.7	1.9
Public consumption	1.1	1.9	3.7	3.5	2.9
Gross fixed investment	21.3	17.8	10.2	4.0	-8.9
Net exports (contribution to growth)	-0.5	-0.2	-2.0	0.4	0.6
Exports of goods and services	9.1	10.9	5.4	1.7	-4.9
Imports of goods and services	13.8	14.5	12.3	0.8	-7.3
Output gap (percent of potential output)	-0.7	1.2	1.1	1.7	-0.3
Selected Indicators					
Gross domestic product (ISK bn.)	2,294	2,491	2,613	2,812	2,931
GDP per capita ($ thousands)	52.8	62.0	72.3	74.5	66.3
Private consumption (percent of GDP)	50.0	49.6	50.4	50.6	51.5
Public consumption (percent of GDP)	23.3	22.9	23.5	23.7	24.7
Gross fixed investment (percent of GDP)	19.4	21.1	21.9	22.3	20.2
Gross national saving (percent of GDP)	24.7	28.8	25.7	25.5	23.5
Unemployment rate (percent of labor force)	4.0	3.0	2.8	2.7	3.7
Employment	3.4	3.7	1.8	2.3	1.3
Labor productivity	1.4	3.5	3.4	2.1	-0.9
Real wages	5.7	7.3	7.3	1.7	1.9
Nominal wages	7.4	9.1	9.2	4.5	4.8
Consumer price index (average)	1.6	1.7	1.8	2.7	3.0
Consumer price index (end period)	2.0	1.9	1.9	3.7	2.6
ISK/€ (average)	146	134	121	128	...
ISK/$ (average)	132	121	107	108	...
Terms of trade (average)	6.7	2.4	1.7	-3.6	-2.1
Money and Credit (end period)					
Base money (M0)	27.8	3.0	37.9	-1.7	3.4
Broad money (M3)	5.6	-4.6	5.0	7.0	5.2
Bank credit to nonfinancial private sector	3.5	4.4	9.2	11.9	3.4
Central bank 7-day term deposit rate 1/	5.75	5.00	4.25	4.50	3.00
	(Percent of GDP unless otherwise indicated)				
General Government Finances 2/					
Revenue	40.6	56.9	43.6	42.8	40.6
Expenditure	41.4	44.5	43.0	42.0	40.9
Overall balance	-0.8	12.4	0.5	0.8	-0.3
Structural primary balance	2.8	3.4	1.8	1.4	1.1
Gross debt	65.0	51.2	43.3	35.9	29.8
Net debt	47.4	39.7	35.8	27.6	26.7
Balance of Payments					
Current account balance 3/	5.1	7.6	3.8	2.8	2.9
Capital and financial account (+ = outflow)	5.0	8.8	2.0	6.5	2.8
Gross external debt 4/	175.7	125.2	90.0	73.3	74.0
Central bank reserves ($ bn.)	5.0	7.2	6.6	6.1	6.2

Sources: Central Bank of Iceland; Ministry of Finance; Statistics Iceland; and IMF staff projections.

1/ For 2019, rate as of November 21.

2/ Data for 2018 are preliminary.

3/ Actual data include accrued interest payments on intracompany debt held by a large multinational; projected data do not.

4/ Data reflect the impact of the bank estates' compositions.

INTERNATIONAL MONETARY FUND

ICELAND

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION

December 4, 2019

KEY ISSUES

After years of robust growth, economic activity has significantly weakened. Supply disruptions in tourism, the engine of recent growth, and the associated uncertainty have triggered a drop in domestic demand and an increase in unemployment. A swift policy response, with fiscal relaxation and monetary easing, has stabilized expectations and cushioned the effects. A moderate but fragile growth recovery is expected in 2020.

Significant downside risks weigh on the outlook. World trade tensions and weaker than expected global growth, the UK's still uncertain Brexit process, worsening of tourism activity in Iceland, and pressures in financial markets or payments due to Iceland's grey-listing by the FATF could negatively impact the economy.

The authorities' policy mix is appropriate. With output near potential, a neutral policy stance will keep debt on a downward path in the medium term. With inflation expectations near the target, the projected baseline economic outlook, and lagged expected effects of recent policy cuts, further monetary policy easing is not immediately needed. Policy space is available, and further easing would be warranted if economic conditions deteriorate significantly.

Macroprudential measures are helping to preserve buffers for managing financial stability risks. Macroprudential policies are adequate, given still elevated household debt and real estate prices and benign external financing conditions. Looking forward, the macroprudential toolkit could be expanded to contain potential risks in the loan portfolio over the medium term.

Reforms should strengthen the financial sector oversight architecture and the AML/CFT framework. The approved merger of the supervisory authority and the central bank should enhance the synergies between the oversight, lender-of-last resort, and resolution functions. Full and swift implementation of the FATF recommendations is needed to improve effectiveness of the AML/CFT framework.

Structural reforms could reignite Iceland's long-term growth. Ongoing education reforms would boost human capital and productivity, greater transparency of large unlisted companies would preserve the business environment, and strategic policies in tourism and fisheries would protect the sustainability of traditional economic sectors.

Approved By
Julie Kozack (EUR) and Kristina Kostial (SPR)

Discussions took place in Reykjavík during October 30–November 12, 2019. The team comprised Iva Petrova (head), Jorge Canales-Kriljenko, Davide Malacrino, and Seng Guan Toh (all EUR) and Carolina Claver (LEG). Jon Sigurgeirsson (OED) observed. The mission met with senior officials from the government, the central bank, and the financial supervisory authority, as well as representatives from trade unions and the business and financial community. Chikako Baba (EUR) supported the mission from headquarters. Chun Jin and Indra Mahadewa (both EUR) provided analytical and administrative support.

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ANNEXES

AT A GLANCE

1. After six years of robust growth, adverse shocks to the Icelandic tourism industry have led to a significant economic slowdown. Two low-cost airlines focused on Icelandic travel have ceased to exist within a year, reflecting high operating costs and intense global competition. WOW air, a systemically important Icelandic airline, accounting for 31 percent of flights into Iceland in 2018 and about 50 percent of the increase in passengers since the company's first flight in 2012, collapsed in March 2019. Primera Air, another Icelandic-owned airline based abroad, had collapsed in 2018. The global grounding of Boeing 737 Max hampered Icelandair's capacity to boost supply and further offset the loss of tourist arrivals. Real GDP growth has fallen from over 4¾ percent in 2018 to a projected 0.3 percent in 2019.

2. Fearing a downturn, the authorities have swiftly taken policy measures to soften the impact on the economy. They have eased fiscal policy in 2019 by about ½ percent of GDP in structural terms. Targeted near- and medium-term general government balances have been relaxed by an annual 1 percent of GDP, with a margin for further policy action of about ½ percent of GDP annually should conditions turn out worse than expected (Box 1). Policy interest rates have been reduced by 150 basis points sequentially during the five scheduled policy meetings since March 2019. The tightening bias in macroprudential policy has been put on hold. The triennial collective wage agreement—completed in April with government involvement—has moderated average wage growth to about 4 percent per year for the next three years (compared to 8 percent on average in the last 3 years), softening the impact of the adverse shocks on employment.

3. Reforms have taken place in line with previous Article IV recommendations (Annex I). A planned relaxation in capital flow management policies was implemented smoothly. The special reserve requirement rate on selected debt inflows was set to zero and regulations relaxed to allow eventual market trading of required positions. Regulations were modified in March 2019 to allow the exit of the remaining blocked offshore krónur, worth some 3 percent of GDP. Parliament also approved legislation to merge the Central Bank of Iceland (CBI) and the Financial Supervisory Authority (FME), which will become effective in 2020.

4. The authorities have made efforts to address weaknesses in the anti-money laundering and combating terrorism financing (AML/CFT) framework. Progress in technical compliance has been noted by the Financial Action Task Force (FATF) in its first enhanced follow-up report (September 2019). However, Iceland's October 2019 designation by the FATF as a jurisdiction with strategic AML/CFT deficiencies (grey-listing) underscores that further efforts are needed to ensure the effective implementation of the international standard.

5. Political support for the three-party coalition remains strong. Partly due to their decisive response to the recent adverse economic developments, the incumbent three-party coalition has consolidated its support in the polls. Presidential elections are scheduled for June 2020, and parliamentary elections the following year.

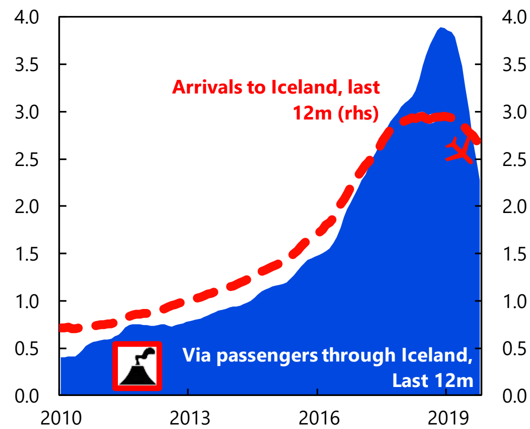
THE SETTING

6. *A tourism decline has caused a rapid deceleration in growth, and already deployed policy measures will support a gradual recovery in the near and medium-term.* *Iceland's fundamentals have remained solid, with declining public and external debt and strong public and private balance sheets. The available policy space has allowed the authorities to support the economy and keep unemployment at bay. The reduction in policy rates has eased the debt burden of household mortgages and is expected to help the recovery in investment. The fiscal relaxation is helping prop up domestic demand. Nonetheless, the outlook for the economy is still fragile and subject to significant downside risks.*

A. Recent Indicators

7. Tourism revenues have declined significantly. Since the collapse of WOW air through October, the number of passengers going through Iceland has dropped by 30 percent y/y, reflecting a 53 percent decline in via passengers. Arrivals have declined by 14 percent, back to 2016 levels. Overnight stays in hotels by foreigners have declined by only 1 percent y/y, partly because WOW air passengers tended to stay for a shorter period and spend less than other tourist visitors to Iceland. The combined receipts from passenger transport by air and travel fell by 7 percent y/y in the first half of 2019.

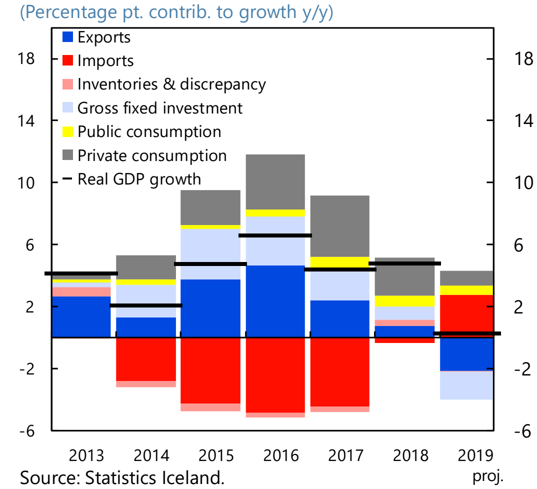
Air Traffic through Iceland
(Million)



Sources: CBI; Isavia; and Statistics Iceland.

8. GDP growth has decelerated rapidly in 2019. The increase in economic uncertainty associated with the collapse of WOW air dented consumer and investor confidence. Reflecting the tourism shock and a sharp slowdown in domestic demand, the average four-quarter GDP growth rate slowed from 4.8 percent in 2018Q4 to 1 percent in 2019Q3, led by a contraction in import-intensive investment and a slowdown in consumption. Mirroring this slowdown, the external sector generated a net positive contribution to GDP growth, as an 8.6-percent contraction in imports of goods and services more than offset a 6.4-percent contraction in exports. On the supply side, tourism-related activity—tour operations, financial transactions, accommodation, and car rentals—contracted. A ban on capelin catch and supply disruptions in the aluminum sector contributed to the deceleration.

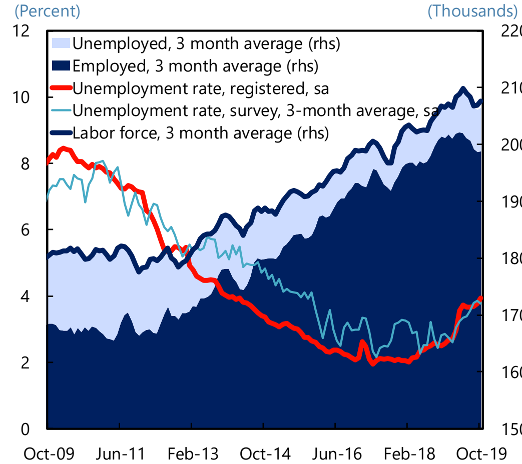
Real GDP
(Percentage pt. contrib. to growth y/y)



Source: Statistics Iceland.

9. Unemployment has gradually moved towards its long-run average. Since March 2019, it has risen by 1 percentage point y/y, mainly reflecting decline in labor demand and growth in the labor force due to ongoing net immigration. Annual employment growth decelerated to 1.7 percent by end-October. With the wage settlement agreement signed in April 2019, real wage growth moderated to 1.8 percent in the first 9 months of the year, compared to 6.4 percent in 2016–18.

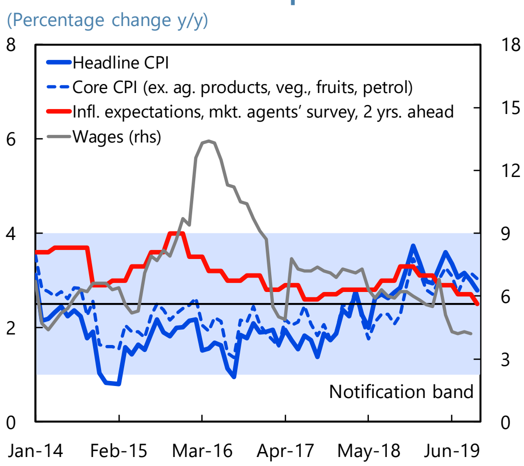
Labor Force and Unemployment



Sources: Directorate of Labor and Statistics Iceland.

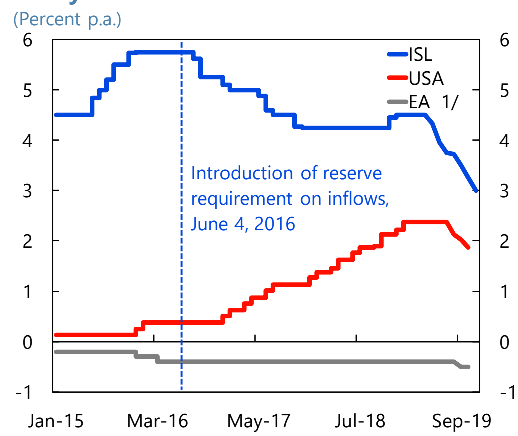
10. Inflation expectations are on target. An inflation uptick to a 4.9-percent annual rate due to króna depreciation in 2018Q4 has gradually receded in 2019. Emerging slack in the economy, moderating wage growth, housing price deceleration, and tapering exchange rate passthrough have eased inflation pressures. While inflation has remained above the 2.5-percent target, one- and two-year ahead inflation expectations are on target. Rapid decline in inflation expectations toward the target has allowed the CBI to relax its policy stance, attenuating carry-trade pressures on the exchange rate. Risk spreads have fallen across the term structure, with nominal and real yield curves shifting downward, in tandem with the policy rate cuts.

Inflation and Inflation Expectations



Source: Statistics Iceland.

Policy Rates

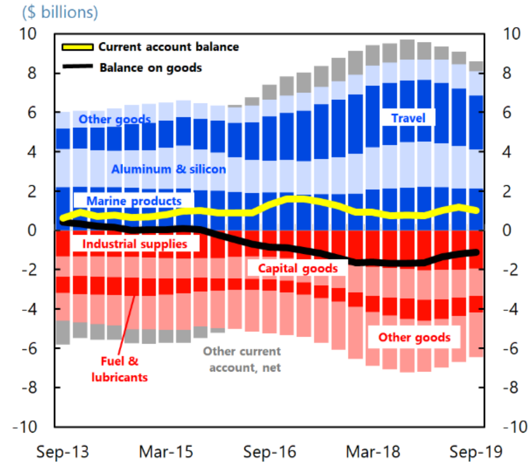


1/ Deposit rate.
Sources: CBI; ECB; and U.S. Federal Reserve.

11. The current account is in surplus, and reserves are ample. With a sharp decline in investment and tourism-related goods imports, the trade deficit narrowed, while a reduction in residents' vacation travel kept the service balance in surplus. Fishery and related exports recorded sustained growth despite the capelin ban, supported by higher prices and growth in aquaculture. The current account surplus, and higher direct and portfolio investment abroad, contributed to a further improvement of the net international investment position (NIIP), estimated at 22 percent of GDP as of mid-2019. Official international reserves have risen to $6.8 billion—about 155 percent of the Fund's reserve adequacy metric (RAM)—since the lifting of remaining crisis-era capital controls in March 2019, reflecting a euro bond issuance in June to cover external debt payments coming due in 2020.

12. Iceland's external position is broadly in line with fundamentals and desired policies (Box 2). The current account "gap"—the cyclically adjusted current account surplus minus estimated "norm"—was at a marginal -0.1 percent of GDP in 2018. Uncertainty around the external assessment is large, however, given Iceland's size, openness, and reliance on a few export sectors.

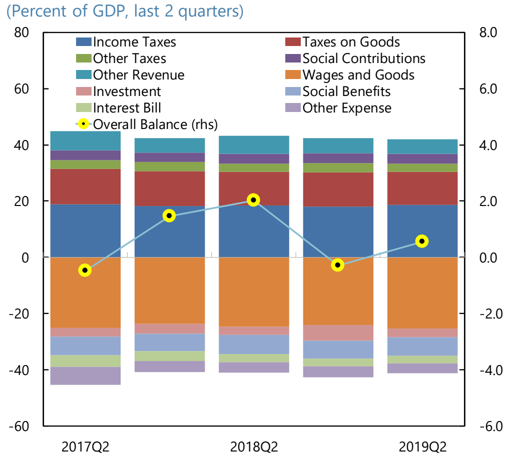
Balance on Goods
($ billions)



Source: Statistics Iceland.

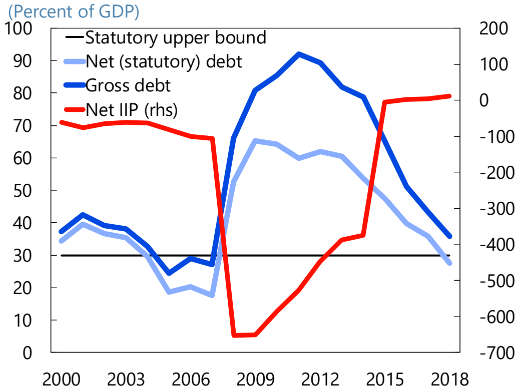
13. Overall fiscal surpluses have helped public debt's rapid decline. The general government surplus was ¾ percent of GDP in 2018, broadly in line with the budget and staff's projections and better than the 2017 outturn by ¼ percentage point of GDP, as cuts in local government spending more than offset lower indirect tax revenues. The first half of 2019 registered a surplus of ½ percent of GDP, 1½ percentage points lower than in 2018H1 due to lower dividend revenue and a small increase in spending. Net general government debt, declined by more than 8 percentage points of GDP and stood at 27.6 percent of GDP in 2018, well below the statutory public debt limit of 30 percent of GDP. In November 2019, Moody's upgraded Iceland's sovereign rating.

General Government Accounts
(Percent of GDP, last 2 quarters)



Sources: Statistics Iceland; and IMF staff calculations.

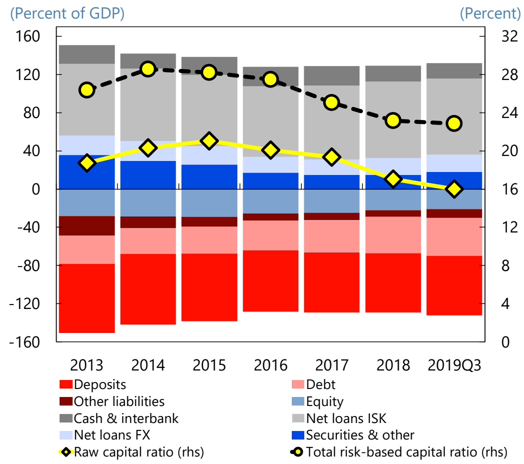
Public Debt and IIP
(Percent of GDP)



Sources: Central Bank of Iceland and Statistics Iceland.
Notes: The Net International Investment Position (Net IIP) represents the difference between residents' financial assets abroad and their financial liabilities to nonresidents.

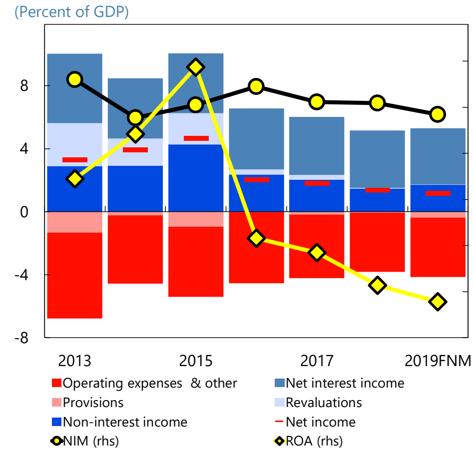
14. Banks' balance sheets are strong, but profitability has worsened (Table 3)**.** Despite a gradual decrease in capital ratios in recent years due to high dividend payouts and NPL write-offs, banks' capital adequacy levels stood at 23 percent in September 2019—close to 3 percentage points above required levels. Liquidity buffers have diminished but remain ample compared to requirements in both domestic and foreign currencies. Reflecting the slowing real economy, bank profitability has waned. Average return on assets and return on equity fell by 0.35 and 1½ percentage points y/y, respectively, due to sizable corporate loan impairments written off in the first half of 2019, reflecting the two airline collapses and defaults in the tourism and silicon sectors.

Three Main Banks' Balance Sheets



Sources: CBI, FME and IMF staff calculations.

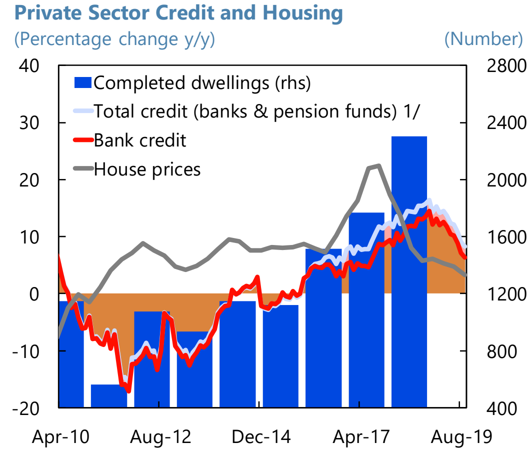
Three Main Banks' Income Statements



Sources: CBI, FME and IMF staff calculations.

15. Amid strong credit growth, housing risks have so far been contained. Total bank credit growth has remained robust at around 8 percent y/y in September 2019 after peaking in 2018. The share of bank loans funded with bonds (including covered and some subordinated) has gradually risen since 2015 and has been directed mainly to construction and commercial real estate. While residential housing prices have increased by almost 60 percent since the crisis, their growth has moderated in the last 2 years, both in real terms and relative to disposable income, and LTV ratios are still at historical lows. Commercial real estate (CRE) prices have continued to gain pace, elevating risks in the hotel sector, where the amount of loans with LTV ratios above 80 percent increased by 30 percent in 2018, but leading indicators show signs of moderation in the CRE market (Annex V).

Private Sector Credit and Housing



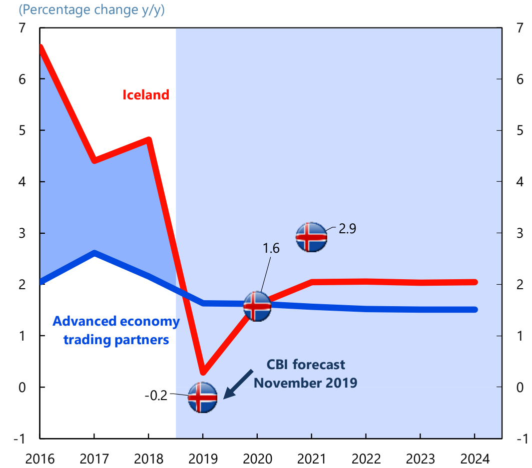
Sources: CBI; and Statistics Iceland.
1/ Excludes Housing Financing Fund.

B. Baseline Outlook

16. Growth is projected to slow markedly in 2019 and recover moderately in the medium term. While recognizing that large historical growth revisions imply high uncertainty even as end-2019 nears, given still positive growth in the first three quarters of 2019, favorable short-term indicators, and policy easing to support the economy, staff projects growth to reach 0.3 percent in 2019—0.5 percentage point higher than the CBI's projection. The recent monetary policy easing is expected to support domestic demand in 2020. With a relaxation in targeted 2020–24 general government balances, budgeted public spending will contribute to growth in 2020 and the medium term. A partial recovery in tourism should support near-term growth. Staff projects that, medium-term growth will recover to about 2 percent (vs. 2.5 percent projected previously). Reflecting WOW Air's collapse, potential growth—which is also subject to significant uncertainty—will be lower than staff's previous projections due to a more subdued demand for foreign workers and labor force growth and lower capital accumulation, with TFP growth also slightly below its historical rate. In the medium term, credit demand will moderate in line with slower capital accumulation, and credit to GDP is projected to settle around 90 percent. Inflation is expected to continue easing and converge to CBI's target, in line with moderation in wage growth.

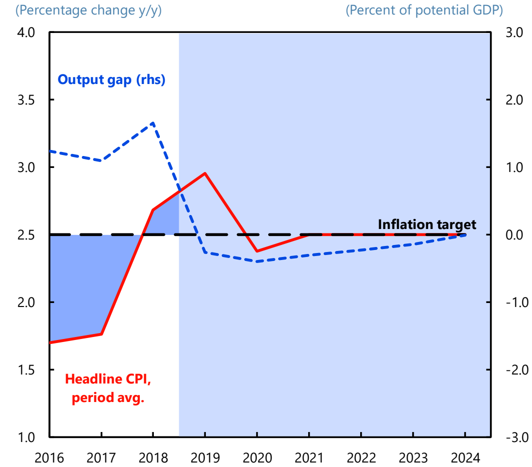
17. The current account surplus is expected to gradually shrink, but reserves will remain sizable over the medium term. Barring further disruptions, tourism will likely stabilize, as temporary factors, such as the aircraft grounding, dissipate. Net investment income should stay positive given the improved NIIP. The current account is projected to gradually narrow, reflecting the permanent impact of the recent tourism shock and the lower fiscal balance projected over the medium term. In the financial account, staff assumes no major divestment proceeds, and no substantive capital outflows related to the liberalization in 2019 of the remaining blocked offshore krónur, worth some 2 percent of GDP as of September 2019 (see 2016 and 2017 Staff Reports). Reserves remain relatively stable in dollar terms and as a ratio to GDP and RAM at about 20 percent and 133 percent, respectively, by 2024.

Real GDP Growth
(Percentage change y/y)



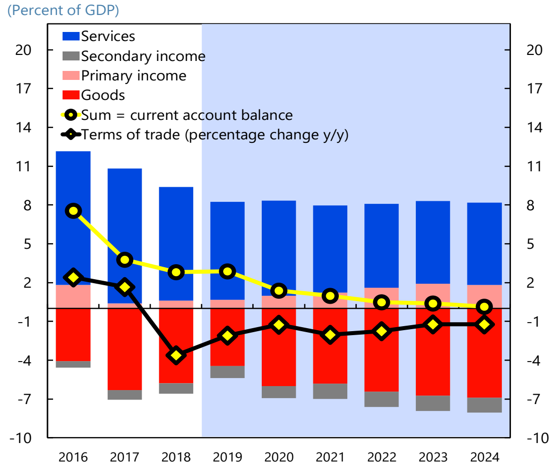
Sources: CBI and IMF staff calculations.

Inflation and Output Gap
(Percentage change y/y) (Percent of potential GDP)



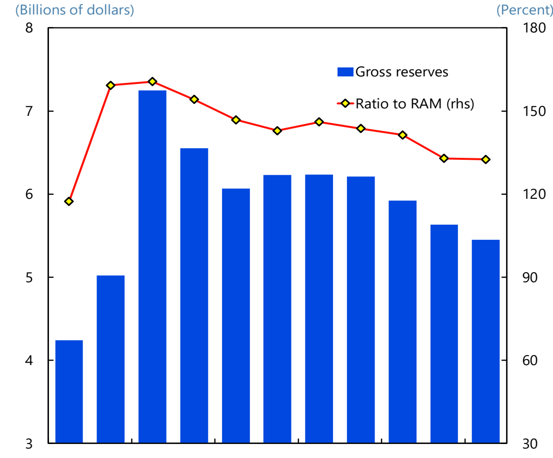
Sources: CBI and IMF staff calculations.

Current Account
(Percent of GDP)



Sources: CBI and IMF staff calculations.

Gross Reserves
(Billions of dollars) (Percent)

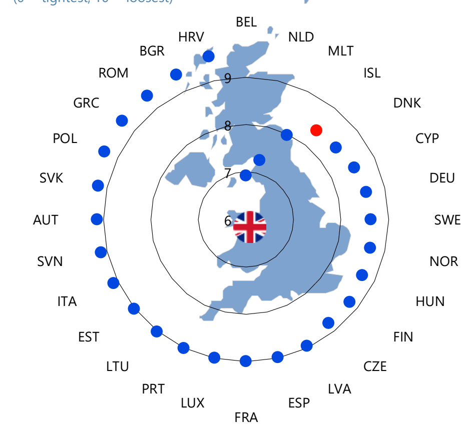


Sources: CBI and IMF staff calculations.

C. Risks Around the Baseline

18. Risks to the outlook are tilted to the downside. Negative spillovers from global risks, including a disorderly Brexit, rising protectionism and retreat from multilateralism, weaker-than-expected global and European growth, can further tilt economic activity toward recession (RAM Annex II). Further worsening in tourism activity also remains a risk, especially if capacity constraints due to the grounding of Boeing 737 Max remain in place longer. On the financial side, Iceland's grey-listing by the FATF can negatively affect correspondent banking relationships and stress the financial system and international payments. Other domestic risks are mainly related to natural phenomena, including changing fish migration patterns and volcanic eruptions. Risks arising from external and public debt payments are limited. Public debt falling due in 2020 has already been covered by a new euro bond issue and government deposit buffers. Risks arising from bunching of external debt maturities in 2020–2021 are moderate and manageable in view of Iceland's ample international reserves (Public debt and external debt sustainability Annexes III and IV).

Synthetic Index of Integration with the U.K. [1/]
(0 = tightest; 10 = loosest)



Sources: IMF staff calculations.
1/ Ireland, with a value of close to 0, is off the scale.

Authorities' Views

19. The authorities shared most of staff's views on the baseline outlook. They agreed that the sharp deceleration in economic activity has created some moderate slack in the economy that will be closed next year. They concurred that the adverse export shocks created significant uncertainty, but the outcome turned out much better than many initially expected. However, the authorities' growth estimates for 2019 are more pessimistic and point to a slight recession. There was agreement that potential growth would slow, partly due to capacity constraints in the airline industry, inflation is expected to remain close to target, and the current account surplus would gradually decline but remain positive over the medium-term. The authorities agreed that downside risks—especially external ones—are sizable. However, they pointed out that upside risks also exist, such as those related to an early resolution of the grounding of the Boeing 737 Max, new Icelandic or foreign airlines servicing travelers to Iceland, and rapid growth in aquaculture exports.

MACROECONOMIC POLICIES

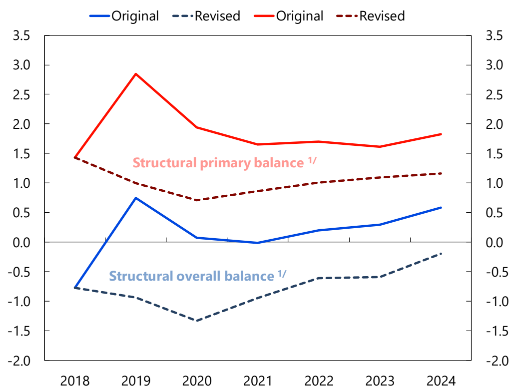
20. Policy discussions focused on the appropriate policy mix to support demand in the near term and to reinforce financial stability and growth in the medium term. *Staff's baseline projection of a near closed output gap suggests that no further policy easing is needed. Should large downward deviations from the baseline path emerge, ample fiscal and monetary policy space built over the last few years of prudent macroeconomic management allows the authorities to take significant discretionary policy action. Staff also called for prompt implementation of institutional and structural reforms to: (i) strengthen the institutional architecture supporting financial stability;*

(ii) improve the AML/CFT framework to ensure compliance with the international standard and help mitigate potential pressures in financial markets or payments; and (iii) provide an environment supportive of more dynamic and sustainable long-term growth.

A. Fiscal and Public Debt Management Policy

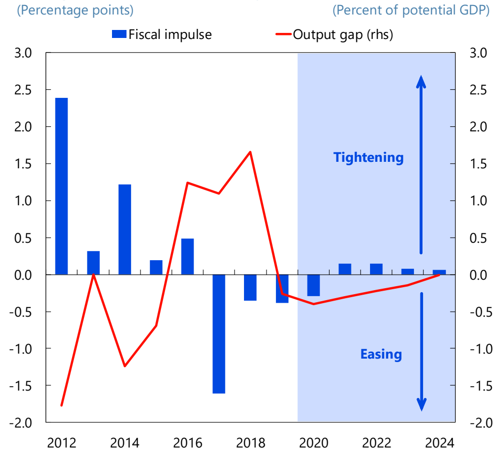
21. *The authorities have planned an appropriately moderate fiscal easing in 2019 and a broadly neutral fiscal stance in the medium term.* Staff projects that the structural balance will ease by about ½ percentage point in 2019— partly reflecting a budgeted reduction in social security contributions and increased child benefits —by ¼ percentage point in 2020, and remain around a balanced position in the medium term. This neutral fiscal stance is consistent with staff's baseline projection of a nearly closed—slightly negative—output gap. The primary surplus, exceeding the debt stabilizing level by 1 percentage point of GDP, is projected to anchor public debt at its low precrisis level over the medium term. Should downside risks to the outlook materialize, the fiscal buffers accumulated through years of prudent macro-fiscal management allow for further fiscal easing, while still preserving public debt at the current low level. Parliament has already authorized a further contingent relaxation in the overall fiscal targets of about ¾ percent of GDP per year should growth recede much below expected (Box 1). This would allow automatic stabilizers to operate freely in case the economy nears a recession, with scope for discretionary action depending on the magnitude of the potential slowdown. Should growth fall below 0 in 2020, full operation of automatic stabilizers may require parliamentary approval.

Structural Fiscal Balances
(Percent of GDP)



1/ Measures the structural balances under staff's macroeconomic outlook and the percent of GDP fiscal targets in the original and revised 2020-2024 fiscal plans and policy statements.
Sources: Ministry of Finance and IMF staff calculations and projections.

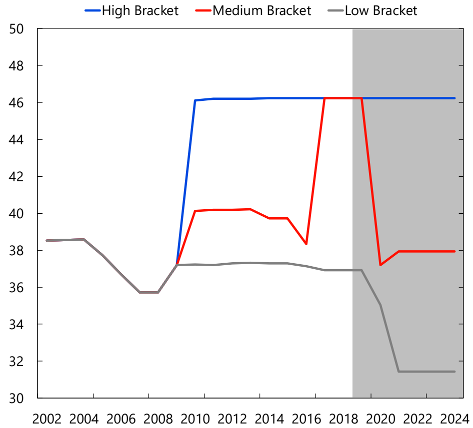
Change in Structural Primary Balance
(Percentage points) (Percent of potential GDP)



Sources: Ministry of Finance and IMF staff estimates.

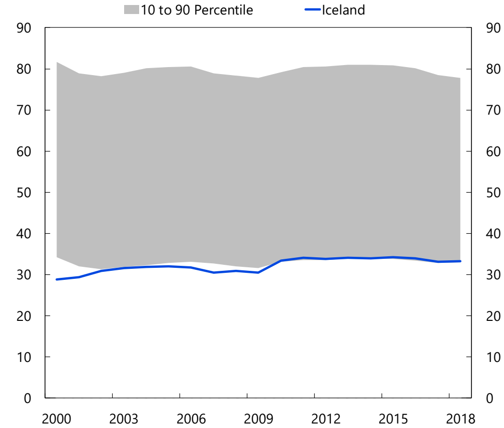
22. Envisaged changes to the tax system will improve its progressivity and growth-friendliness. Personal income tax rates will be reduced mainly for low- and middle-income families by introducing a third tax bracket in 2020. The reform is expected to reduce, on impact, the average tax rate by 0.8–1 percentage point. In addition, the employers' social security contribution rate will be reduced from 6.6 percent to 6.35 percent in 2020. Together, these changes are expected to have a small permanent cost of ¼–½ percent of GDP. The measures are expected to improve tax progressivity and further enhance work incentives by reducing the tax wedge, which is already among the lowest in OECD countries.

Personal Income Tax, Statutory Rates
(Percent)



Sources: Ministry of Finance.

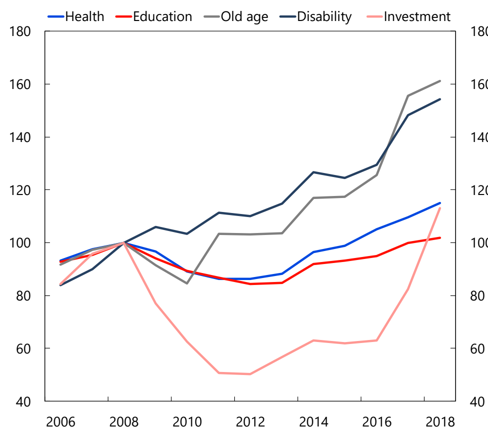
Tax Wedge Distribution in OECD European Countries
(Percentile rank)



Sources: OECD.

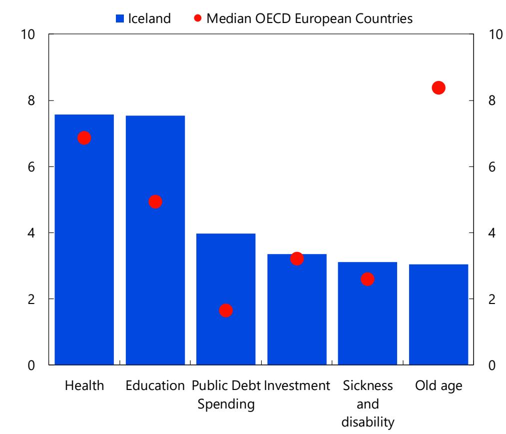
23. Completing the planned spending reviews may reveal opportunities for efficiency gains in public spending. The recovery from the crisis has allowed decompression in public spending on education, health, social protection, and public investment ([2016 Selected Issues Paper](#)). Disability and old-age spending has doubled compared to its pre-crisis level.[1] Iceland now

Selected Real General Government Expenditures
(Index, 2008 = 100, 2016 prices)



Sources: Statistics Iceland and IMF staff calculations.

Public Spending on Selected Categories, 2017
(Percent of GDP)



Sources: IMF's Government Finance Statistics.

spends significantly more as a share of GDP on education, health, disability benefits, and debt service than advanced peer economies. The medium-term fiscal plan envisages a reduction in interest expenses, capitalizing on the rapidly declining public debt stock, risk premiums, and debt service. The rest of the public spending is envisaged to remain broadly in line with current levels in percent of GDP over the medium term. The time is now ripe to complete the previously planned comprehensive spending reviews. This could provide a framework to rank outlays by their

[1] Iceland's relatively low public old-age spending reflects that most pension liabilities are accrued by private pension funds managing a mandatory second pillar. Iceland's population is relatively young compared to other advanced European countries, and the retirement age and labor force participation among the elderly are high ([2016 Selected Issues Paper](#)).

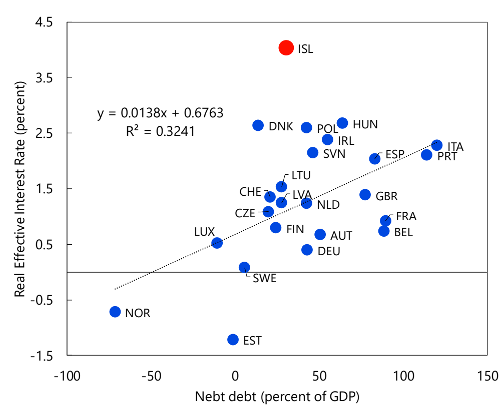
medium-term effects on growth and productivity and help identify opportunities for efficiency gains, while improving the quality of government services and infrastructure.

24. Iceland's fiscal framework has encouraged fiscal prudence and built policy credibility. It has helped focus fiscal policy discussions on spending priorities and needed revenue effort to support them. The rapid deceleration of the economy has also provided an opportunity to test the framework's ability to soften cyclical fluctuations. The GDP growth-dependent easing of the medium-term fiscal targets demonstrated the framework's pragmatic degree of flexibility, which was welcome given high uncertainty of macroeconomic outcomes (reflected in wide dispersion of macroeconomic forecasts). It also signaled an appropriate balance between a commitment to fiscal prudence and a willingness to use fiscal tools to prop up demand as needed. Following the fiscal relaxation, the government was able to tap international markets at historically low rates, testifying to the solid credibility of the framework.

25. Improvements to the implementation of the framework could strengthen fiscal policy effectiveness and coordination. An easing of structural primary balances during rapid growth and large positive output gaps in 2016–18 suggests that there is scope to refine fiscal policy implementation. Building government debt cushions and aligning the timing of fiscal interventions with Iceland's position in the cycle and the need for policy action would help prevent procyclicality (see Selected Issues Paper). Further effort is also needed to better coordinate the independent budget processes within the general government. In this regard, staff welcomes the ongoing discussions and proposals to improve local government fiscal policy and accountability and the authorities' efforts to strengthen state governance.

26. Active management of the public sector balance sheet should continue to consolidate gains and mitigate risks. First, although Iceland's public debt has fallen significantly and is now one of the lowest among advanced European countries, public debt service is still among the highest (even after allowing for higher inflation). There could be scope to reduce debt service costs faster than envisaged taking advantage of historically low interest rates through suitable debt management operations. Second, extracting dividends from public enterprises above normal ownership returns is not a sustainable revenue source. The creation of a sovereign wealth fund—already tabled in parliament—could set aside potential windfall revenues from exceptional dividends and divestment proceeds to meet emergencies. In particular, the planned divestment of state-owned banks should proceed expeditiously, as the circumstances allow, while prioritizing ownership that ensures sound governance and management of the financial institutions.

Net Debt and Real Effective Interest Rates: 2018



Sources: IMF's World Economic Outlook Database.
1/ Nominal effective interest rate deflated by average CPI inflation over last 5 years. Iceland is excluded from the regression. Interest bill excludes returns on pension obligations not accounted into Iceland's debt levels.

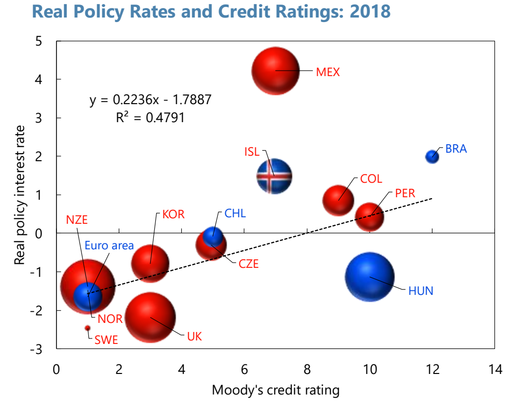
Authorities' Views

27. The authorities concurred with staff's fiscal policy assessment. The fiscal relaxation has helped smooth the impact of the adverse shocks on economic activity, while keeping net debt on a declining path. They emphasized that their initial ambitious targeted fiscal path would have caused undue policy tightening in the current economic environment and agreed that a broadly neutral fiscal stance over the next few years is appropriate. The authorities emphasized that the fiscal framework has instilled fiscal prudence and focused policy discussions on high level priorities. They recognized that there is scope to mitigate fiscal procyclicality by carefully managing the timing and composition of discretionary policy interventions. They acknowledged the potential long-term benefits of completing the spending reviews, some of which are currently ongoing. The authorities were receptive to the idea of taking a holistic look into the public sector balance sheet. While recognizing that the interest bill remains exceptionally high, to a large extent reflecting legacy issues, they emphasized that the interest burden would continue to decline as debt falls due. They expressed continued willingness to scale down their ownership in the banking system as conditions permit.

B. Monetary, Exchange Rate, and Reserve Management Policy

28. Monetary easing has been appropriate, but further action is not warranted at this stage. With core and headline inflation within the threshold band—and falling toward the point inflation target—and moderate slack in the economy, the CBI's dovish policy stance has helped smooth the impact of adverse shocks on economic activity. The ongoing broader capital account liberalization and concern about reemerging carry trade pressures have also called for policy rate cuts. Further relaxation would be warranted if downside risks materialize and inflation is expected to fall below the tolerance band. Over the medium-term, it is likely that a gradual alignment of the policy rate with Iceland's declining risk premiums will take place, consistent with confidence in the monetary framework as evidenced by anchored inflation expectations, low public debt level, and commitment to prudent fiscal policies.

Real Policy Rates and Credit Ratings: 2018

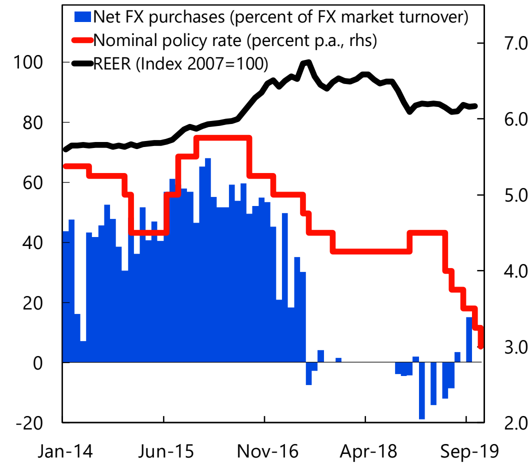


Sources: The Moody's and IMF staff calculations.
Notes: The real policy rate is computed using the 12-month ahead inflation expectations. Moody's credit rating has been numerically ordered from the highest investment grade (0) to the least creditworthy (14). Red bubbles indicate countries in which inflation expectations exceed targets and blue bubbles in which they are below. Bubble size indicates distance from target.

29. Iceland's inflation targeting framework has kept inflation expectations anchored and allowed policy rate changes to effectively alleviate adjustment to shocks. Despite public calls to exclude housing costs from the consumer price index due to their volatility and rapid increase, the headline CPI has worked well as a monetary policy target and accountability device. Ongoing efforts to review the computation of the CPI away from asset price movements should follow best practices and be well communicated to the market to preserve the credibility and accountability of Iceland's inflation targeting framework (2018 Selected Issues Paper). The recent wage negotiations also underscored the crucial role of monetary policy communication, as the wage agreement was conditioned on policy rate reductions and redefinition of the inflation target to soften the impact of housing prices on mortgage debt (Annex V). Clear policy communication has so far helped draw a line between the outcome of the agreement and monetary policy decisions.

30. The real exchange rate has adjusted commensurately with the adverse export shock. Recent instances of CBI intervention in the thin foreign exchange market have preserved exchange rate flexibility and maintained reserve adequacy while countering disorderly market conditions. Communication of intervention policy decisions should continue to unequivocally affirm the absence of an exchange rate objective and the limited role of foreign exchange intervention to maintaining reserve adequacy and countering disorderly market conditions. The current level of foreign reserves is adequate, providing a comfortable buffer to face adverse external liquidity shocks, especially in view of the amortization profile of private and public external debt in 2020–21. The 2016–17 reserve buildup contributed to an accumulation of a large structural liquidity in the banking system (Annex VI). Sterilization costs have so far been manageable and the impact of the structural liquidity on the monetary transmission and systemic liquidity management can be further contained by introducing fine-tuning liquidity management instruments (2017 Staff Report).

FX Intervention, Policy Rate, and REER



Source: CBI.

Authorities' Views

31. The authorities concurred that the inflation targeting framework was instrumental in anchoring inflation expectations. They emphasized that the recent policy rate cuts of 150 basis points were critical to stabilize expectations in 2019 and preempt downside risks. They agreed that based on the current economic outlook, no further easing of monetary policy is needed to return the economy to full capacity. The authorities reiterated their intention that foreign exchange interventions remain limited to stabilizing disorderly market conditions. They also felt that the current level of reserves was broadly comfortable and provided credibility in the monetary policy framework and in the face of shocks but were concerned about costs of holding reserves amidst depressed global yields. Reducing the number of counterparties eligible for central bank remunerated deposits was also being undertaken to better promote liquidity intermediation in the market.

C. Macroprudential and Capital Flow Management Policy

32. Iceland's proactive macroprudential policy has helped preserve strong capital and liquidity cushions and remains appropriate. Capital requirements have gradually risen in the context of Basel III implementation, rapid credit growth, a real-estate boom, and easy external financial conditions. Iceland's three systemic banks are required to hold sizable (relative to EU peers) total regulatory capital—around 20 percent until January 2020, when the countercyclical capital buffer is planned to increase from 1.75 percent to 2 percent. Following a gradual decline in banks' high post-crisis restructuring capital levels, these capital requirements are close to binding now. A downward trend in the average LTV ratio halted at a historical low of 60 percent—well below the regulatory cap (Annex V). With still elevated household debt and real estate prices and benign external financing conditions, macroprudential policy easing seems currently unwarranted. Capital buffer requirements—once the planned increase is implemented—and other macroprudential policies should be maintained, unless the financial cycle (e.g., credit growth and asset prices) shifts markedly. More comprehensive macroprudential policies, including an LTV cap for commercial real estate loans and income-based measures (limits on debt service to income and/or debt to income) and limits on foreign currency-linked loans, would better counteract buildup of real estate market risks at the outset of a potential new housing price cycle.

33. The lifting of capital flow management measures (CFM) and remaining crisis-era outflow controls has proceeded smoothly. In March 2019, the special reserve requirement on selected debt inflows was reduced to zero from 20 percent. Since its deactivation, all related debt inflows have increased only moderately. The authorities maintain the legal power to reimpose CFMs should conditions so warrant. Staff supported the liberalization as it saw no compelling reason for Iceland's original activation of the special reserve requirement in mid-2016, nor any justification for its retention subsequently. In March, the last offshore krónur—some 3 percent of GDP—leftover from the pre-crisis carry trade was allowed to exit Iceland at market exchange rates, but 2 percent of GDP—mainly deposits—remained in Iceland.

Authorities' Views

34. The authorities agreed with staff that a relaxation of macroprudential measures is unwarranted at this time, as the data has not yet shown a downturn of the financial cycle. The authorities are considering expanding their macroprudential toolkit and think that further use of borrower-based measures might be relevant at some point in time. In the wake of the lifting of capital controls, the authorities have appointed a working group to review the legal framework, reflecting the lessons learned from Iceland's experience in enforcing the Foreign Currency Act in recent years.

FINANCIAL SECTOR OVERSIGHT

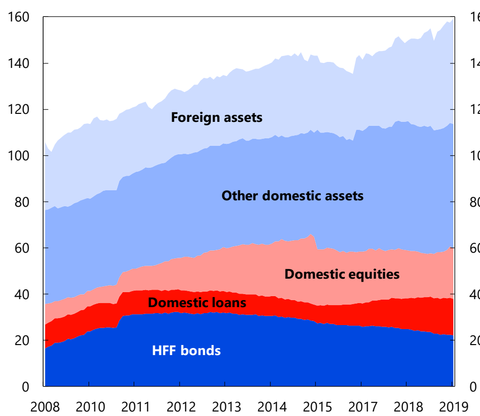
35. *Financial sector oversight will become increasingly important as Iceland fully reintegrates into global financial markets.* *In this context, important steps in strengthening the financial oversight architecture and the financial crime prevention framework have already been made, and staff encouraged their effective implementation.*

A. Financial Oversight Architecture Reform

36. The merger of the financial regulator and the central bank aims to achieve greater efficiency, operational independence, and powers in financial oversight (Annex VII). Under the new law, the merged CBI will pursue multiple policy objectives, with three internal committees deciding monetary, macroprudential, and microprudential policy. The merger is envisaged to enhance the synergies between the oversight, lender-of-last-resort, and resolution functions, and allow an integrated approach to monetary, macroprudential and microprudential policies. The new framework places greater focus on financial stability functions while diffusing powers and strengthening policy accountability. While full integration in practice will take time, the framework should be implemented as swiftly as possible, and the new internal organization should bolster the technical capacity and resource adequacy for supervisory work. Planned future reviews of the framework, including as early as 2021, would be an opportunity to further strengthen its effectiveness if needed, e.g., by providing greater rulemaking and enforcement powers to microprudential supervision.

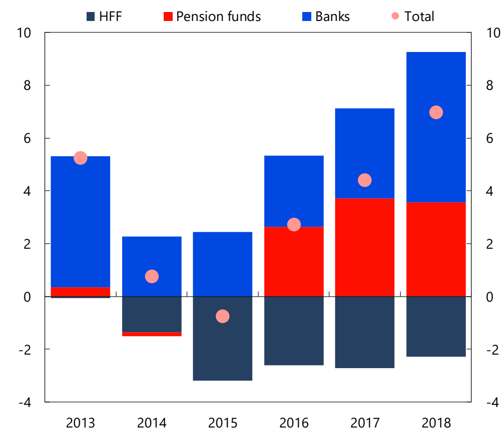
37. Continued growth of pension fund assets warrants stronger supervision in the new oversight framework. Pension fund assets have continued to outsize the economy, reaching 160 percent of GDP in 2018—the third largest in OECD countries. Retail lending by pension funds—which represents about ¼ of the total mortgage loan stock to individuals at end 2018—has continued to attract better quality borrowers by offering more favorable lending terms than banks,

Pension Fund Assets
(Percent of GDP)



Sources: CBI.

Change in Mortgage Stock
(Percent of GDP)



Sources: CBI and IMF staff calculations.

reflecting a tax advantage and a lower supervisory fee. Pension funds have also had a dominant role in the domestic bond and equity markets.[2] Given the presence of pension funds in retail lending and their large asset size in general, their financial oversight needs to be significantly strengthened in line with best practice. Greater supervisory scrutiny—equipped with adequate resources—should aim to improve pension funds' transparency, ensure adequate risk management, and set supervision of their' lending activities on a level playing field with banks.

Authorities' Views

38. The authorities concurred that the merger between the CBI and FME would enhance efficiency, trust, and transparency. They emphasized that the legislation focused on the integration of tasks within the merged institution, particularly allowing for a greater focus on financial stability and macroprudential policy. The legislative changes do not legally change oversight resources and powers, which they view as adequate. The authorities emphasized that details of the merger remained to be worked out in practice. They did not see major risks associated with the direct mortgage exposures of pension funds as this largely represented a switch from their previously held indirect exposures through the Housing Finance Fund and

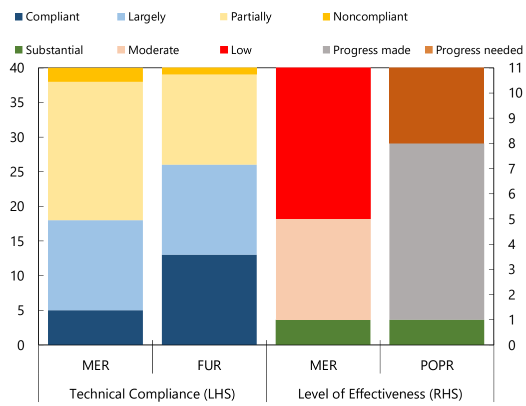
[2] As of September 2019, the pension funds held 39 percent of Iceland's listed equity and 52 percent of listed bonds.

covered bonds issued by banks. They emphasized that tightening of loan-to-value limits, which were also already tighter relative to banks, was implemented at several funds and that the classification of Icelandic pension funds as public interest entities makes them subject to more stringent regulatory restrictions.

B. Strengthening the AML/CFT Framework

39. FATF's recommended actions should be fully and swiftly implemented to mitigate possible reputational risks (Annex VIII). With the emergence of money laundering related scandals in the region, weak AML/CFT frameworks pose great reputational and financial stability risks and could impede smooth access to global financial markets. The authorities have thus actively sought to address the FATF recommendations. A new AML Act, which implemented the 4th EU AML Directive, addressed many shortfalls in the legal and institutional framework. The National Risk Assessment was revised, and comprehensive outreach was conducted to promote a better understanding and awareness of the ML/TF risks across sectors. Interagency coordination and information sharing were improved. Additional resources were allocated to AML/CFT-related work, albeit insufficiently for the Financial Intelligence Unit (FIU). While recognizing that reforms to date have improved Iceland's technical compliance with the standard, the FATF concluded that Iceland was yet to show tangible progress in the effectiveness of the AML/CFT framework in collecting beneficial ownership information for legal persons, introducing an automated system for collection of suspicious transaction reports and strengthening the FIU's capacity to conduct operational and strategic analysis, implementing effective preventive measures among financial and nonfinancial institution, and overseeing risks related to terrorism financing in the non-profit organization sector. Swift implementation of the action plan agreed with FATF is needed to improve the effectiveness of the AML/CFT framework, protect the integrity of the financial system, and mitigate potential pressures on correspondent banking relations and payments.

Iceland: AML/CFT Assessment Ratings



MER=Mutual evaluation report, April 2018; FUR=First follow-up report, September 2019; POPR=Post-observation period report, October 2019. Technical complaince assessment is done on the basis of 40 technical recommendations, as they relate to the relevant legal and institutional framework of the country, and the powers and procedures of the competent authorities (building blocks of the AML/CFT system). The effectiveness assessment seeks to assess the adequacy of the implementation of the FATF recommendations and provide an appreciation of the AML/CFT system and how well it works.
Sources: Financial Action Task Force (FATF), *Consolidated Assessment Ratings,* November 5, 2019; Iceland Ministry of Justice.

40. An active communication strategy should continue to instill confidence in the domestic financial system.[3] Iceland has not experienced significant pressures in financial markets or payments due to the grey-listing so far, but continued vigilance is required. Frequent dialogue with correspondent banks and their home supervisors could gauge their risk tolerance and expectations and is an opportunity to build confidence and explain the soundness of the risk management systems and practices of Icelandic financial institutions for addressing ML/TF, and the Icelandic authorities' progress and plans to swiftly improve the effectiveness of

[3] See IMF, 2017 and 2016 for additional details.

the overall AML/CFT framework. This is needed to mitigate potential risks to the financial system and the economy associated with the grey-listing. Ongoing public dialogue should ensure that companies and individuals are aware of the implications of the grey-listing and are ready to provide additional information to prevent disruptions in their payments and financial transactions.

Authorities' Views

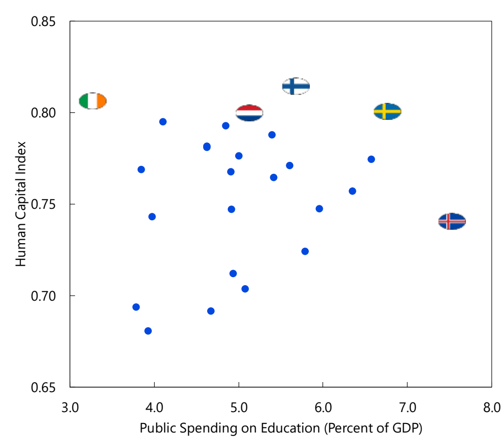
41. The authorities view the grey-listing as disappointing given the progress that Iceland has made in strengthening the AML/CFT framework. Nonetheless, they agreed on the need to demonstrate AML/CFT effectiveness and ensure full compliance with the international standard. The authorities showed strong commitment to completing expeditiously the remaining actions recommended by the FATF to prevent reputational risks for Iceland. While no significant pressures in financial markets have been experienced so far in the wake of the grey-listing, the authorities see the benefits in promoting active dialogue with foreign banks and supervisory agencies to mitigate any potential negative consequences resulting from it and in raising awareness among companies and households of the possible implications on payments and financial transactions with foreign banks and other countries.

STRUCTURAL REFORMS

42. Iceland's productivity is strong but decelerating. Iceland's level of productivity is high compared to European peer countries. Nonetheless, as in other advanced economies, productivity growth has waned since the crisis. Securing stable long-term growth and high living standards going forward requires efforts in areas such as: (i) building stronger human capital through well targeted education reforms; (ii) further strengthening governance arrangements to maintain the integrity and reputation of economic activity in Iceland; and (iii) carrying out well articulated public policy strategies to preserve the marine and touristic endowments of the country and support the sustainability of traditional Icelandic economic activity.

- **Education and Human Capital Formation.** Iceland's human capital is low compared to advanced peer countries due to relatively weaker education achievement scores.[4] Raising education achievement above the average appears feasible given Iceland's healthy public spending on education and is likely to boost labor productivity by about 3–5 percent. Efforts should continue to focus on refreshing the pool and skills of teachers through appropriate incentives for young professionals and improving teachers' professional development, especially in the use of new technologies;

Education Spending and Human Capital



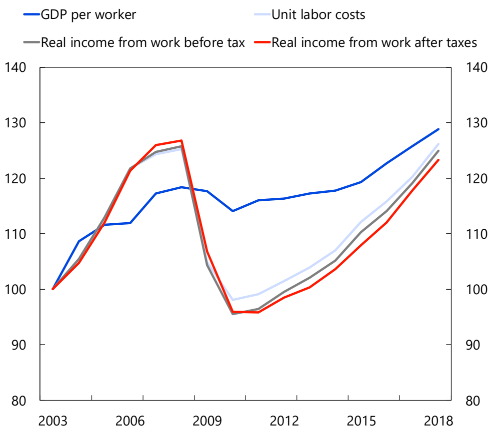
Sources: World Bank, OECD and IMF staff calculations.

[4] See World Bank, 2018, The Human Capital Project. World Bank, Washington, DC.

strengthening the link between school funding and educational performance; and better integrating immigrant children through targeted school programs.[5] The authorities' efforts at developing a progressive education system that takes into account the needs of the future for knowledge would also promote innovation and fill existing skill gaps, especially in professional, technical, and scientific, IT, and communication sectors.

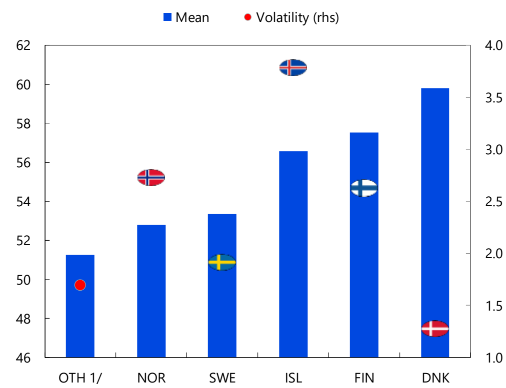
- **Wages.** The recent nationwide wage agreement—completed in the wake of WOW air's collapse—demonstrates that in the face of large adverse shocks, Iceland's collective bargaining

Real GDP per Worker and Income from Work
(Index, 2003=100)



Sources: Statice and IMF staff calculations.

Labor Share in OECD Countries
(Percentage points, 1973-2016)



Note: OTH is a balanced panel of other OECD countries. Volatility is standard deviation of labor share time series detrended with a quadratic in time.
Sources: OECD and IMF staff calculations.

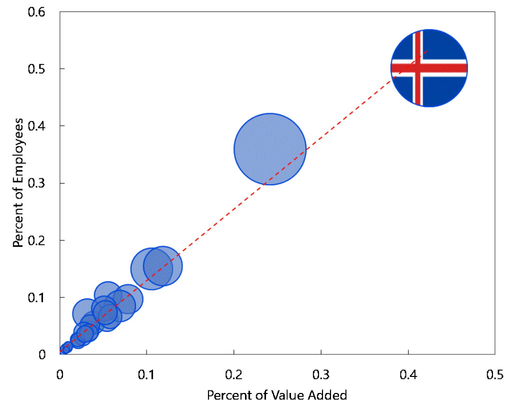
is swift and flexible and able to prevent large job losses. Delivering one of the lowest gender wage gaps and employment gaps for disadvantaged groups—Iceland's wage setting and broader labor market rules top OECD inclusiveness rankings. Iceland's labor share is also among the highest in OECD countries. Nonetheless, large swings in wage awards—out of line with productivity growth—can cause abrupt changes in competitiveness, exacerbate macroeconomic volatility, and deanchor inflation expectations.[6] The recent agreement to link wage growth to positive GDP per capita growth is welcome, and consideration should be given to making this link symmetric.

[5] See OECD, 2019, OECD Economic Surveys: Iceland 2019, OECD Publishing, Paris.

[6] See IMF, Regional Economic Outlook: Europe, November 2019. In countries with well anchored expectations, such as the Nordic countries, a one percentage point increase in wages increases inflation by a cumulative 0.9 percentage point over 3 years.

- **Governance.** WOW air's bankruptcy demonstrates that individual companies could have systemic impact in small economies. The G20/OECD *Principles of Corporate Governance* recommend that disclosure of listed and large unlisted companies include audited financial statements, major share/beneficial owners, remuneration of key executives, related party transactions, foreseeable risk factors, and other information that is of critical importance to assess the implications of their economic activities. Including such requirements in Iceland's legislation governing private companies would help mitigate the risks stemming from nontransparent companies with large economic footprint and align the legislation with good practices in other advanced European countries.[7]

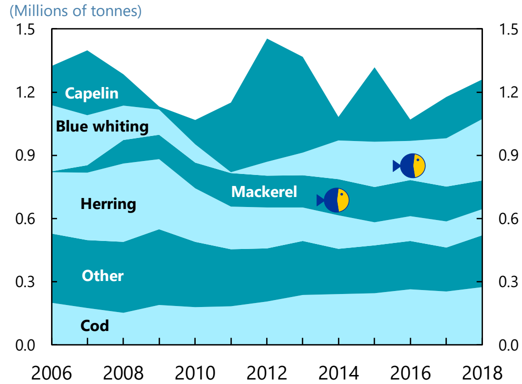
Footprint of Average Large Firms in European Countries



Notes: Larger size of the bubble indicates fewer firms. Data are for 2016 and refer to the private sector. Malta is excluded due to missing data. Large firms have more than 250 employees.
Sources: Eurostat; and IMF staff calculations.

- **Endowments.** Overuse of natural resources calls for more decisive policy action to stem negative externalities. Both tourism and fishing enjoyed a big productivity windfall of more than 50 percent in 2012–15. Such growth pace is not sustainable and can have negative environmental and social impact. The authorities' efforts to prepare a comprehensive tourism strategy is welcome. It needs to be based on appropriate pricing of tourism services—e.g., including removal of tax expenditures—and evaluation of environmental risks (protection of fragile tourist sites, volcanic eruptions, etc.). The risk of depletion of some pelagic stocks in the North Atlantic calls for better international cooperation among all coastal states including Iceland, e.g., to agree on their regional sustainable quota shares ([2018 Selected Issues Paper]).

Icelandic Fish Catch and International Overfishing [1/]
(Millions of tonnes)



Source: International Council for the Exploration of the Sea (ICES); and Statistics Iceland.
1/ "Ocean waves" show Icelandic catch; "swimming fish" show, in gold, overfishing by all countries fishing in the northeast Atlantic relative to ICES advice, 2014–16 average.

Authorities' Views

43. The authorities agreed that reigniting the engine of growth is a priority and concurred that structural reforms are needed. They emphasized the significant efforts they have already undertaken to improve the conditions and financial incentives for teacher training and professional development and the range of targeted measures seeking to ensure that immigrant children are not left behind. They pointed out that results of these measures are already bearing fruit, such as

[7] The Wates Corporate Governance Principles for Large Private Companies, to which the UK legislation was aligned in December 2018, suggest the following thresholds for companies to qualify for reporting: 2,000 employees (0.003 percent of population), turnover of £200 million (0.01 percent of UK's GDP) and assets of £2 billion (0.1 percent of UK's GDP).

significant increases—up to 40 percent year-on-year—in the applications to the Teacher's College. The authorities recognized that large companies in Iceland have a significant footprint on the economy and their growth and decline could cause substantial GDP growth volatility. They have explored ways of monitoring the risks and concurred that transparency requirements for large unlisted companies could be useful. The authorities have made significant progress in mapping the risks associated with overuse of tourism resources and expect to complete a comprehensive tourism strategy in early 2020.

STAFF APPRAISAL

44. The authorities' swift policy response to Iceland's weaker economic growth has been appropriate. Supply disruptions in tourism, the engine of growth over the past five years, and the associated increase in uncertainty has triggered a drop in domestic demand and an increase in unemployment. Fiscal relaxation and monetary easing have stabilized expectations and cushioned the effects of the tourism shock, averting a deeper growth slowdown. The recent collective wage agreement, completed with active government involvement, has dampened the negative impact on employment.

45. Solid economic fundamentals have also allowed the economy to weather the downturn, although significant downside risks remain. Public and private balance sheets are comfortable. Fiscal surpluses have contributed to the rapid decline in public debt. The current account is in surplus, net external assets are positive, and international reserves are ample. Iceland's external position is broadly in line with fundamentals and desired policies. Inflation expectations are at the CBI's target. Banks' balance sheets show high capital adequacy and strong liquidity ratios. In this context, growth is poised to recover to 1.6 percent in 2020 and 2 percent over the medium term.

46. Policy space is available, and further easing would be warranted if risks materialize. With output close to potential, there is no urgency for further policy easing. However, growth remains fragile, and negative spillovers from global risks and further worsening in tourism activity could still tilt the economy into a recession. The authorities' medium-term fiscal plan is appropriate in view of the weakening of the economy, and there is some fiscal space to provide further support if needed. Further room for monetary easing is also available if economic conditions deteriorate significantly, and inflation expectations fall well below target.

47. Confidence in Iceland's policy framework continues to build. The inflation targeting regime—with CPI as a monetary policy target—has worked well. The CBI's foreign exchange arrangement has preserved exchange rate flexibility and maintained adequate international reserve buffers. Iceland's fiscal framework has helped gain credibility and some fiscal space. Refining its implementation could make discretionary fiscal actions more effective in smoothing economic cycles. In the medium-term, completing the planned government spending reviews and active public sector balance sheet management could expand the options for more growth-friendly spending. Macroprudential policies are helping to preserve buffers for managing financial stability risks. Looking forward, the macroprudential policy toolkit could be expanded to include loan-to-value limits for commercial real estate loans and income-based measures to contain potential risks in the loan portfolio over the medium term.

48. The ongoing merger of the CBI and FME should achieve greater efficiency, operational independence, and powers in financial oversight. It should provide for an integrated approach to policymaking, enhancing the synergies between the oversight, lender-of-last resort, and resolution functions, while strengthening policy accountability. While full integration in practice will take time, the framework should be implemented as swiftly as possible, and the new internal organization should bolster the technical capacity and resource adequacy for supervisory work. The future planned reviews of the framework provide opportunities to strengthen its effectiveness if necessary.

49. Iceland's recent grey-listing by the FATF increases the urgency of ensuring a more effective AML/CFT framework. The authorities have adopted a number of legislative and institutional reforms to improve the AML/CFT legal and institutional framework as well as domestic coordination and have increased AML/CFT resources. Swift actions are needed to implement all remaining recommendations of the FATF and demonstrate that the framework is effective. Continued vigilance and broader public awareness of the potential effects on households and companies is needed.

50. Structural reforms could reignite Iceland's growth potential. Iceland's labor market arrangements are inclusive, and in the face of large adverse shocks, the wage-setting process has proven flexible in preventing large job losses. Securing stable long-term growth and high living standards going forward requires efforts in education, focusing on teacher training and targeted support for immigrant children; improving the transparency of unlisted companies with large impact on the Icelandic economy; and preserving the natural endowments of the country to support the sustainability of Iceland's traditional economic activities.

51. The next Article IV Consultation is expected to be completed on the standard 12-month cycle.

Box 1. Revised Fiscal Policy Statement and Medium-Term Plan

In response to the sharp deceleration in economic activity, the authorities have eased their fiscal policy targets until 2022 and introduced a contingent escape clause allowing further easing, should the economy plunge into a deeper recession.

New medium-term fiscal targets. With official forecasts of impending recession, in April 2019, Parliament approved a revised 2018–22 fiscal policy statement, reducing the targeted average general government surplus over the period to 0.3 from 1.1 percent of GDP. The authorities also modified their draft 2020–24 fiscal policy strategy and proposed a central government budget for 2020 consistent with the new targets.

A contingent escape clause. The fiscal policy rules enshrined in the 2015 Public Finance Act require the five-year average of the fiscal balances of the general government to be higher than zero, and the annual balance to exceed -2.5 percent of GDP in any given year. In addition, under the Act, net general government debt (excluding pension liabilities and accounts payable and net of currency and deposits) should not exceed 30 percent of GDP or, otherwise, the excess should decline by about 5 percent per year. Through the changes in the 2018–22 fiscal policy statement, Parliament approved an uncertainty margin that would allow the administration to run deficits from 2019 through 2022, up to an average five-year deficit for the period of 0.3 percent of GDP. Thus, Parliament approved an escape clause to the fiscal rules for the administration, which exempt it from the balanced 5-year fiscal rule, with the eventual use of the uncertainty margin explained in each budget and related to deviations from the official April 2019 macroeconomic outlook. Consistent with the revised fiscal policy statement, the government submitted a draft 2020 budget with a deficit of 0.3 percent of GDP for the central administration.

The 2020–24 medium-term fiscal strategy (MTFS). The MTFS path roughly follows the point estimate in the fiscal policy statement through 2022 and anticipated three years of fiscal developments under a new administration afterward. Between 2020 and 2022, the fiscal strategy envisages a 0.5 percent reduction in fiscal revenue, arising mainly from lower dividend income and similar reduction in fiscal expenditures of 0.7 percent of GDP mainly due to lower interest expenses and savings in the use of goods and services.

Revised Fiscal Policy Statement 2018-2022

(Percent of GDP)

	2018	2019	2020	2021	2022	Average 2018-22
General government balance						
Original 1/	1.4	1.2	1.1	1.0	1.0	1.1
Revised 1/	1.4	0.0	0.0	0.0	0.3	0.3
With uncertainty margin 1/	1.4	-0.8	-0.8	-0.8	-0.5	-0.3
Net general government debt						
Original 2/	33.8	31.0	28.5	27.3	25.0	
Revised	33.8	30.0	29.5	29.0	28.5	

Sources: Ministry of Finance.

1/ The latest revision indicates that general government balance was 0.8 percent of GDP in 2018, with which the 5-year average would be 0.2 percent of GDP

2/ The latest data revision indicates that net general government debt was 27.6 percent of GDP in 2018.

Iceland: Fiscal Strategy Plan, General Government Operations, 2020–24

(Percent of GDP)

	2020	2021	2022	2023	2024
Total revenue	**42.0**	**41.8**	**41.5**	**41.2**	**40.9**
Taxes	33.7	33.5	33.5	33.2	33.0
of which: income and profits	18.6	18.5	18.5	18.4	18.3
of which: goods and services	12.2	12.2	12.2	12.1	12.0
Social contributions	3.3	3.4	3.4	3.4	3.4
Grants	0.2	0.2	0.2	0.2	0.2
Other revenues	4.8	4.7	4.4	4.3	4.3
of which: dividends	1.2	1.2	0.9	0.9	0.9
Total expenditure	**41.9**	**41.7**	**41.2**	**40.9**	**40.5**
Compensation of employees	14.6	14.6	14.7	14.8	14.9
Use of goods and services	10.1	9.9	9.8	9.9	9.9
Consumption of fixed capital	2.0	1.9	1.9	1.8	1.8
Interest	2.3	2.1	1.9	1.7	1.6
Subsidies	1.5	1.5	1.5	1.5	1.4
Grants	0.3	0.4	0.4	0.4	0.4
Social benefits	7.5	7.5	7.4	7.3	7.2
Other expense	2.0	2.0	2.0	2.0	1.9
Nonfinancial assets, acquisition	3.7	3.8	3.6	3.4	3.2
Net lending/borrowing	**0.1**	**0.1**	**0.3**	**0.3**	**0.4**

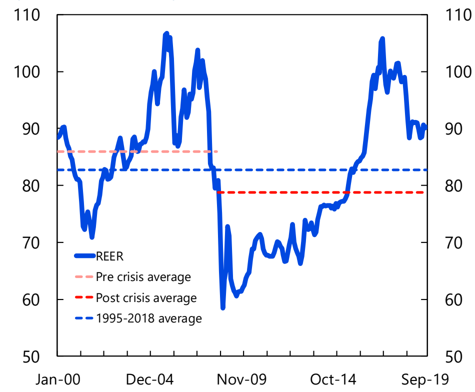
Sources: Ministry of Finance.

Box 2. External Sector Assessment (ESA)

Based on a combination of model-based findings, statistical observations, and judgement, staff assesses Iceland's external position as broadly in line with fundamentals and desired policy settings.

Iceland's external balance sheet is strong. The NIIP continued to climb to 11½ percent of GDP in 2018 from 3½ percent in 2017. The increase reflected a current account surplus, high returns on investments abroad, and valuation effects from króna depreciation. Gross assets stood at close to 121 percent of GDP at end 2018, with some 34 percent of the total in portfolio equities and 22 percent in outward FDI. Gross liabilities were about 109 percent of GDP, with inward FDI comprising about 39 percent of the total. External debt fell to 73 percent of GDP in 2018 from 90 percent in 2017, largely reflecting lower FDI-related debt.

Real Effective Exchange Rate
(Index, Jan-2005=100)



Sources: Central Bank of Iceland; and IMF staff calculations.

The cyclically adjusted current account balance was in line with the estimated norm in 2018. The headline current account surplus narrowed to 2¾ percent of GDP (3¾ percent of GDP in 2017), reflecting a deteriorating services trade surplus, notwithstanding a stable income deficit and a small narrowing of the goods trade deficit. Staff puts the cyclically adjusted current account balance at 3.1 percent of GDP, only a marginal gap to the norm estimated at 3.2 percent of GDP. Developments in the current account in the first half of 2019 remain broadly in line with this assessment.

ESA Summary

EBA-lite CA model	
CA-Actual	2.8%
Cyclically adjusted CA	3.1%
Multilaterally Consistent	
Cyclically adjusted CA Norm	3.2%
CA-Gap	-0.1%
Elasticity	-0.34
Implied REER gap	0%
EBA-lite REER model	
Ln(REER) Actual	4.94
Ln(REER) Fitted	5.05
Ln(REER) Norm	5.04
Residual	-0.11
REER Gap	-9.4%
of/which Policy gap	1.4%

Source: IMF staff calculations

Staff's real effective exchange rate (REER) assessment is based on its current account gap model. The REER depreciated by 2.6 percent in 2018. Whereas the REER model suggested króna undervaluation in 2018 by some 9 percent, the current account gap model (with an estimated elasticity of -0.34) indicates a REER gap of zero percent—broadly in line with fundamentals and desired policy settings.

Gross capital inflows were broadly subdued in 2018, continuing the trend in recent years. Gross FDI liabilities recorded a decline (-1.6 percent of GDP) as inflows into equity were outweighed by a reduction in FDI-related debt. Modest portfolio inflows into equities were also outweighed by reductions in debt holdings.

Capital flow management measures were unwound in 2019, with little impact. The special reserve requirement on selected debt inflows was reduced from 20 percent to zero in March, but all related debt inflows increased only moderately. The broad absence of outflow controls since the big liberalization in March 2017 (with the last remaining controls removed in March 2019), has seen residents, especially pension funds, continue increasing their holdings of foreign securities, mostly equities (see 2017 and 2018 Staff Reports).

Conditions in the exchange market were broadly stable in 2018 and intervention was negligible. Net foreign currency sales by the CBI totaled only about $0.03 billion in 2018, compared to $0.6 billion in 2017. Gross reserves stood at $6.1 billion at end 2018, from $6.6 billion a year earlier. This level was equivalent to 23 percent of GDP, 147 percent of RAM, and about 7 months of prospective goods and services imports—amply covering expected short-term net drains.

Table 1. Iceland: Selected Economic Indicators, 2015–24

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
				Prel.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
	(Percentage change unless otherwise indicated)									
National Accounts (constant prices)										
Gross domestic product	4.7	6.6	4.4	4.8	0.3	1.6	2.0	2.1	2.0	2.0
Total domestic demand	5.9	7.5	7.0	4.7	-0.3	2.8	1.7	2.1	1.9	1.7
Private consumption	4.5	7.2	8.1	4.7	1.9	1.7	1.7	1.8	1.5	1.5
Public consumption	1.1	1.9	3.7	3.5	2.9	2.9	2.1	2.8	3.0	3.1
Gross fixed investment	21.3	17.8	10.2	4.0	-8.9	5.6	1.3	2.5	1.8	0.9
Net exports (contribution to growth)	-0.5	-0.2	-2.0	0.4	0.6	-1.0	0.5	0.0	0.3	0.4
Exports of goods and services	9.1	10.9	5.4	1.7	-4.9	-0.1	1.4	1.6	1.9	2.2
Imports of goods and services	13.8	14.5	12.3	0.8	-7.3	2.7	0.3	1.8	1.5	1.3
Output gap (percent of potential output)	-0.7	1.2	1.1	1.7	-0.3	-0.4	-0.3	-0.2	-0.1	0.0
Selected Indicators										
Gross domestic product (ISK bn.)	2,294	2,491	2,613	2,812	2,906	3,008	3,124	3,247	3,382	3,525
Gross domestic product ($ bn.)	17.4	20.6	24.5	26.0	23.6	23.9	24.4	24.9	25.7	26.7
GDP per capita ($ thousands)	52.8	62.0	72.3	74.5	66.3	65.7	65.7	66.0	67.1	68.6
Private consumption (percent of GDP)	50.0	49.6	50.4	50.6	51.5	51.8	52.0	52.2	52.1	52.0
Public consumption (percent of GDP)	23.3	22.9	23.5	23.7	24.7	25.3	25.7	26.1	26.6	27.0
Gross fixed investment (percent of GDP)	19.4	21.1	21.9	22.3	20.2	21.2	21.1	21.3	21.3	21.2
Gross national saving (percent of GDP)	24.7	28.8	25.7	25.5	23.5	22.9	22.4	22.1	22.1	21.6
Unemployment rate (percent of labor force)	4.0	3.0	2.8	2.7	3.7	3.8	3.9	3.9	4.0	4.0
Employment	3.4	3.7	1.8	2.3	1.3	-0.1	0.5	0.5	0.6	0.6
Labor productivity	1.4	3.5	3.4	2.1	-0.9	-0.1	0.5	0.8	1.0	1.0
Real wages	5.7	7.3	7.3	1.7	1.9	2.1	1.8	1.7	1.7	1.7
Nominal wages	7.4	9.1	9.2	4.5	4.8	4.5	4.3	4.2	4.2	4.2
Consumer price index (average)	1.6	1.7	1.8	2.7	3.0	2.4	2.5	2.5	2.5	2.5
Consumer price index (end period)	2.0	1.9	1.9	3.7	2.6	2.6	2.5	2.5	2.5	2.5
ISK/€ (average)	146	134	121	128	...	...	...	...	...	...
ISK/$ (average)	132	121	107	108	...	...	...	...	...	...
Terms of trade (average)	6.7	2.4	1.7	-3.6	-2.1	-1.3	-2.0	-1.7	-1.2	-1.2
Money and Credit (end period)										
Base money (M0)	27.8	3.0	37.9	-1.7	3.4	3.5	3.8	3.9	4.2	4.2
Broad money (M3)	5.6	-4.6	5.0	7.0	5.2	3.7	3.9	4.0	4.2	4.2
Bank credit to nonfinancial private sector	3.5	4.4	9.2	11.9	3.4	3.5	3.8	3.9	4.2	4.2
Central bank 7 day term deposit rate 1/	5.75	5.00	4.25	4.50	3.00	...	...	...	...	...
	(Percent of GDP unless otherwise indicated)									
General Government Finances 2/										
Revenue	40.6	56.9	43.6	42.8	40.6	41.8	41.8	41.5	41.3	40.9
Expenditure	41.4	44.5	43.0	42.0	40.9	42.0	41.8	41.3	41.1	40.6
Overall balance	-0.8	12.4	0.5	0.8	-0.3	-0.3	0.0	0.2	0.2	0.4
Structural primary balance	2.8	3.4	1.8	1.4	1.1	0.9	1.0	1.1	1.2	1.3
Gross debt	65.0	51.2	43.3	35.9	29.8	29.0	27.0	24.9	22.5	21.2
Net debt	47.4	39.7	35.8	27.6	26.7	26.0	25.1	23.9	22.7	21.4
Balance of Payments										
Current account balance 3/	5.1	7.6	3.8	2.8	2.9	1.4	1.0	0.5	0.4	0.1
of which: services balance	8.7	10.3	10.4	8.8	7.6	7.3	6.7	6.5	6.4	6.4
Capital and financial account (+ = outflow)	5.0	8.8	2.0	6.5	2.8	1.3	0.8	0.4	0.3	0.0
of which: direct investment, net (+ = outflow)	-4.0	-3.5	-0.7	1.8	-0.2	-1.7	-1.8	-2.3	-2.8	-3.1
Gross external debt 4/	175.7	125.2	90.0	73.3	74.0	73.4	73.0	72.2	70.4	68.4
Central bank reserves ($ bn.)	5.0	7.2	6.6	6.1	6.2	6.2	6.2	5.9	5.6	5.4

Sources: CBI; Ministry of Finance; Statistics Iceland; and IMF staff projections.

1/ For 2019, rate as of November 21.

2/ Data for 2018 are preliminary.

3/ Actual data include accrued interest payments on intracompany debt held by a large multinational; projected data do not.

4/ Data reflect the impact of the bank estates' compositions.

Table 2. Iceland: Money and Banking, 2015–24
(Billions of krónur, unless otherwise indicated)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
					Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Central Bank										
Net foreign assets	295	587	565	604	779	797	839	840	885	890
Assets	653	817	687	737	769	785	799	772	779	782
Liabilities	358	230	122	133	-10	-11	-40	-67	-106	-108
of which: central government foreign currency deposits	301	185	81	87	-56	-58	-86	-113	-153	-154
of which: bank estates' foreign currrency deposits 1/	18	0	0	0	0	0	0	0	0	0
Net domestic assets	-191	-479	-417	-458	-629	-641	-678	-672	-710	-708
Central government, net	7	-30	-23	-108	-108	-108	-108	-108	-108	-108
Assets	98	41	56	0	0	0	0	0	0	0
of which: recapitalization bond	91	29	0	0	0	0	0	0	0	0
Liabilities (current account)	91	71	79	108	108	108	108	108	108	108
Credit institutions (incl. nonbanks), net	-216	-407	-378	-302	-522	-534	-570	-564	-602	-600
Assets	58	2	6	6	55	55	55	55	55	55
Liabilities	274	410	384	308	577	589	625	619	657	655
of which: term deposits and CDs	242	339	303	231	407	424	466	467	512	517
Other items, net	17	-42	-16	-48	-88	-74	-60	-44	-27	-9
ESI (asset management company)	127	36	9	5	0	0	0	0	0	0
Capital	79	44	22	58	48	34	18	2	-16	-35
Base Money	104	107	148	145	150	155	161	168	175	182
Currency issued	56	62	68	73	110	117	122	127	132	137
Deposit money banks' deposits at the central bank	48	45	80	72	41	38	40	41	43	45
Deposit Money Banks										
Net foreign assets	66	-257	-277	-270	-263	-255	-246	-239	-236	-233
Assets	349	251	324	414	421	429	438	444	448	451
Liabilities	283	508	601	684	684	684	684	684	684	684
of which: bonds	175	406	504	577	577	577	577	577	577	577
Net domestic assets	1,608	1,845	1,942	2,052	2,105	2,161	2,225	2,297	2,379	2,467
Central bank, net	238	385	379	293	388	402	446	448	495	502
Assets	295	385	379	294	438	452	496	498	545	552
Liabilities	56	0	0	1	50	50	50	50	50	50
General government, gross	231	184	91	59	51	49	49	47	45	44
of which: bonds	210	164	70	38	30	29	29	27	24	23
Private sector, gross	2,217	2,285	2,483	2,781	2,873	2,973	3,085	3,205	3,337	3,476
Nonfinancial	2,043	2,133	2,328	2,606	2,693	2,787	2,894	3,009	3,134	3,267
Corporations	1,128	1,174	1,302	1,464	1,513	1,566	1,626	1,690	1,761	1,835
Households	915	959	1,027	1,142	1,180	1,221	1,268	1,318	1,373	1,431
Financial	174	152	154	175	180	186	191	197	203	210
Other items, net	-1,078	-1,009	-1,011	-1,081	-1,206	-1,264	-1,356	-1,404	-1,498	-1,555
Domestic deposits	1,674	1,588	1,665	1,782	1,842	1,906	1,979	2,057	2,143	2,234
Krona deposits	1,393	1,448	1,502	1,560	1,613	1,669	1,733	1,802	1,877	1,956
Foreign currency deposits	281	140	164	222	229	237	246	256	266	278
Consolidated Banking System										
Net foreign assets	361	330	289	334	516	542	593	600	649	657
Net domestic assets	1,362	1,314	1,437	1,513	1,427	1,473	1,500	1,575	1,618	1,706
General government, net	238	154	68	-49	-57	-59	-58	-60	-63	-64
Private sector, gross	2,217	2,285	2,483	2,781	2,873	2,973	3,085	3,205	3,337	3,476
Other items, net	-1,093	-1,125	-1,113	-1,219	-1,389	-1,442	-1,527	-1,570	-1,656	-1,706
Broad money	1,723	1,643	1,726	1,846	1,943	2,015	2,093	2,176	2,267	2,363
of which: currency in circulation	49	55	60	64	101	109	113	118	123	129

Sources: CBI; and IMF staff projections.
1/ Deposits of successor holding companies to the bank estates from 2016.

Table 3. Iceland: Financial Soundness Indicators, 2015Q4–19Q3 1/

(Percent)

	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4	2017Q1	2017Q2	2017Q3	2017Q4	2018Q1	2018Q2	2018Q3	2018Q4	2019Q1	2019Q2	2019Q3
Regulatory capital to risk-weighted assets 2/	28.2	29.4	28.5	27.7	27.5	26.3	26.6	25.6	25.1	23.3	22.6	22.9	23.2	22.3	22.6	22.9
Regulatory tier 1 capital to risk-weighted assets 2/	27.4	28.6	27.6	27.5	27.0	25.8	26.1	25.1	24.2	22.8	22.1	21.7	21.7	20.8	20.9	21.0
Net interest margin 2/	2.9	3.0	3.5	3.2	3.3	3.0	3.4	3.0	3.0	3.0	3.3	3.0	3.2	3.0	3.0	2.9
Return on assets 2/	4.9	1.2	3.1	1.9	0.1	1.8	2.2	0.7	1.2	1.5	1.3	1.0	0.6	1.2	0.9	0.6
Return on equity 2/	24.9	6.1	15.3	9.4	0.5	8.7	11.1	3.5	6.2	7.9	7.2	5.5	3.5	7.0	5.6	3.9
Net interest income to total income 2/ 3/	32.2	65.0	48.6	56.8	73.0	55.9	62.9	77.5	58.9	64.0	68.4	66.2	91.2	68.6	75.4	72.5
Noninterest expense to total income 2/ 3/	56.7	212.8	89.2	120.1	2833.8	145.2	106.7	352.0	231.0	159.1	178.1	282.5	273.9	192.0	234.7	318.1
Liquid assets to total assets 2/ 4/	25.0	24.2	23.6	24.7	24.0	25.4	24.5	23.9	21.9	21.8	21.6	23.1	18.7	20.2	19.9	19.8
High-quality liquid assets to total assets	19.0	18.6	18.0	19.3	17.3	17.6	16.1	14.6	13.2	12.8	11.9	11.3	10.8	10.7	11.0	12.6
Net open foreign exchange position to capital 2/	9.0	5.4	1.7	0.6	1.2	0.2	0.3	1.2	0.5	0.3	2.2	0.0	0.3	0.0	0.7	1.0
Total nonperforming loans (NPLs), facility level 5/	1.7	1.6	1.6	2.2	2.0	1.6	1.7	2.5	2.7	3.0	2.5	2.3	2.2	2.2	2.2	2.7
Household NPLs, cross default basis 6/ 7/	7.2	5.9	5.4	4.9	4.8	4.3	3.3	3.2	3.0	2.7	2.4	2.3	2.1	2.0	2.2	2.3
Corporate NPLs, cross default basis 6/	9.0	8.7	7.4	5.9	5.8	6.0	6.6	7.3	6.6	7.1	7.0	6.6	6.7	5.9	4.6	4.7
Household and corporate NPLs, cross default basis 6/	7.7	7.4	6.5	5.4	5.2	5.1	5.2	5.5	4.9	5.1	5.0	4.7	4.7	4.2	3.5	3.6
Allowances to household loans in default	50.4	49.6	50.1	50.0	39.4	40.5	39.4	27.6	62.7	71.0	53.0	68.0	69.5	71.1	73.5	62.8
Allowances to corporate loans in default	36.5	35.8	39.1	41.8	38.9	35.5	27.3	35.2	41.7	49.0	40.0	45.0	50.7	46.3	49.5	47.6
Allowances to total loans in default	41.8	40.9	43.2	45.1	39.2	36.9	30.9	32.5	48.6	57.0	44.4	53.0	56.5	53.5	56.8	52.8

Sources: CBI; Fjármálaeftirlitid; and IMF staff calculations.

1/ Three largest deposit money banks unless otherwise indicated.

2/ Data for 2015Q1 through 2016Q4 are IMF staff estimates.

3/ Total income is total comprehensive income.

4/ Liquid assets comprise cash and balances with the central bank, claims on credit institutions, and bonds and debt instruments.

5/ Over 90 days in default. From 2017Q4 EBA definition for non-performing loans is used, i.e. facility level, over 90 days in default or unlikely to pay.

6/ Over 90 days in default or deemed unlikely to be paid.

7/ Includes loans from the Housing Financing Fund.

Table 4. Iceland: General Government Operations, 2015–24
(Percent of GDP)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
				Prel.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Total revenue	**40.6**	**56.9**	**43.6**	**42.8**	**40.6**	**41.8**	**41.8**	**41.5**	**41.3**	**40.9**
Taxes	**31.9**	**47.4**	**34.2**	**33.4**	**32.8**	**32.8**	**32.7**	**32.7**	**32.6**	**32.6**
Taxes on income and profits	16.6	17.2	18.5	18.2	18.3	17.8	17.6	17.7	17.8	17.9
Personal income tax	13.0	13.5	14.3	14.7	14.4	14.3	13.9	14.1	14.2	14.4
Corporate income tax	2.3	2.5	3.1	2.4	2.8	2.6	2.6	2.6	2.6	2.6
Capital gains tax and rental income	1.3	1.2	1.1	1.1	1.1	0.9	1.0	0.9	0.9	0.9
Taxes on payroll and workforce	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Taxes on property	1.9	17.4	2.1	2.0	1.8	1.9	1.9	1.9	1.9	1.9
Taxes on goods and services	11.2	11.7	12.5	12.1	11.8	12.0	12.2	12.2	12.1	12.0
Value added tax	8.0	8.2	9.0	8.7	8.1	8.3	8.4	8.4	8.3	8.2
Other taxes on goods and services	3.2	3.4	3.6	3.4	3.7	3.7	3.8	3.8	3.8	3.8
Taxes on international trade	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other taxes	1.7	0.6	0.6	0.6	0.4	0.6	0.6	0.5	0.4	0.4
Social contributions	**3.5**	**3.4**	**3.4**	**3.5**	**3.4**	**3.3**	**3.3**	**3.3**	**3.3**	**3.1**
Grants	**0.1**	**0.1**	**0.1**	**0.1**	**0.1**	**0.2**	**0.2**	**0.2**	**0.2**	**0.2**
Other revenues	**5.1**	**6.0**	**5.8**	**5.8**	**4.3**	**5.5**	**5.6**	**5.2**	**5.2**	**5.1**
Property income	1.8	2.9	2.4	2.3	2.0	1.9	2.0	1.8	1.7	1.6
of which: interest income	0.8	0.9	0.8	0.7	0.6	0.3	0.3	0.2	0.2	0.1
Total expenditure	**41.4**	**44.5**	**43.0**	**42.0**	**40.9**	**42.0**	**41.8**	**41.3**	**41.1**	**40.6**
Current expenses	**40.9**	**44.0**	**41.7**	**39.7**	**38.9**	**40.3**	**39.9**	**39.6**	**39.5**	**39.1**
Compensation of employees	13.4	13.3	14.0	14.1	14.1	14.6	14.6	14.7	14.8	14.9
Use of goods and services	10.5	10.2	10.3	10.3	9.7	10.1	9.9	9.9	9.9	9.9
Consumption of fixed capital	2.3	2.1	2.0	2.0	1.6	2.0	1.9	1.9	1.8	1.8
Interest	4.4	3.9	3.9	2.8	2.5	2.4	2.1	1.9	1.9	1.5
Subsidies	1.3	1.4	1.3	1.3	1.4	1.5	1.5	1.5	1.4	1.4
Grants	0.2	0.2	0.2	0.2	0.5	0.3	0.4	0.4	0.4	0.4
Social benefits	6.2	5.9	6.4	6.5	7.0	7.5	7.5	7.4	7.3	7.2
Other expense 1/	2.5	6.9	3.6	2.4	2.1	2.0	2.0	2.0	2.0	2.0
Nonfinancial assets	**0.5**	**0.5**	**1.3**	**2.3**	**2.0**	**1.7**	**1.9**	**1.7**	**1.6**	**1.4**
Nonfinancial assets, acquisition	2.8	2.7	3.3	4.4	3.6	3.7	3.8	3.6	3.4	3.2
Consumption of fixed capital (-)	-2.3	-2.1	-2.0	-2.0	-1.6	-2.0	-1.9	-1.9	-1.8	-1.8
Net lending/borrowing	**-0.8**	**12.4**	**0.5**	**0.8**	**-0.3**	**-0.3**	**0.0**	**0.2**	**0.2**	**0.4**
Financial assets, transactions	**-7.7**	**6.6**	**-5.8**	**0.4**	**-4.6**	**0.3**	**-0.6**	**-0.5**	**-0.9**	**0.3**
Currency and deposits	-5.0	-3.3	-4.1	1.3	-4.9	0.0	-0.9	-0.8	-1.2	0.0
Securities other than shares	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Loans	-1.9	1.5	-2.0	-0.7	0.3	0.3	0.3	0.3	0.3	0.3
Shares and other equities	0.0	7.0	0.0	-0.9	0.0	0.0	0.0	0.0	0.0	0.0
Other accounts receivable	-0.8	1.3	0.4	0.8	0.0	0.0	0.0	0.0	0.0	0.0
Liabilities, transactions	**-6.9**	**-5.9**	**-6.3**	**-0.4**	**-4.4**	**0.5**	**-0.6**	**-0.7**	**-1.1**	**-0.1**
Securities other than shares	0.4	-1.9	-3.7	-2.6	-2.8	-1.2	-0.5	-0.6	-0.7	0.3
Loans	-6.8	-5.5	-3.2	-1.7	-1.9	1.4	-0.5	-0.5	-0.6	-0.7
Krona denominated	-2.1	-2.7	0.2	-2.0	-0.2	-0.3	-0.5	-0.5	-0.6	-0.7
Foreign currency denominated	-4.7	-2.7	-3.4	0.3	-1.7	1.7	0.0	0.0	0.0	0.0
Insurance technical reserves	0.2	0.1	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3
Other accounts payable	-0.7	1.4	0.4	3.8	0.0	0.0	0.0	0.0	0.0	0.0
Gross debt	**65.0**	**51.2**	**43.3**	**35.9**	**29.8**	**29.0**	**27.0**	**24.9**	**22.5**	**21.2**
Krona denominated	51.7	43.1	38.8	31.5	27.2	24.8	23.0	21.0	18.8	17.6
Foreign currency denominated	13.3	8.1	4.4	4.4	2.6	4.2	4.0	3.9	3.8	3.6
Net debt 2/	**47.4**	**39.7**	**35.8**	**27.6**	**26.7**	**26.0**	**25.1**	**23.9**	**22.7**	**21.4**
Memorandum items:										
Primary revenue	39.8	56.0	42.8	42.1	40.1	41.5	41.5	41.2	41.1	40.8
Primary expenditure	36.9	40.6	39.1	39.1	38.4	39.7	39.7	39.4	39.2	39.1
Primary balance	2.8	15.5	3.6	3.0	1.7	1.8	1.8	1.8	1.9	1.7
Structural balance	-0.8	0.3	-1.4	-0.8	-0.9	-1.1	-0.8	-0.5	-0.5	0.0
Structural primary balance	2.8	3.4	1.8	1.4	1.1	0.9	1.0	1.1	1.2	0.0
Gross domestic product (ISK bn)	2,294	2,491	2,613	2,812	2,906	3,008	3,124	3,247	3,382	3,525

Sources: Ministry of Finance; Statistics Iceland; and IMF staff projections.

1/ Figure for 2016 includes a one off contribution by the central government to the state pension fund of ISK 117.2 billion.

2/ Gross debt less currency and deposits.

Table 5. Iceland: General Government Financial Balance Sheet, 2015–24
(Percent of GDP)

	2015	2016	2017	2018 Proj.	2019 Proj.	2020 Proj.	2021 Proj.	2022 Proj.	2023 Proj.	2024 Proj.
Financial assets	**49.1**	**50.9**	**56.2**	**54.3**	**47.9**	**46.5**	**44.2**	**42.0**	**39.4**	**38.1**
Currency and deposits	17.7	11.6	7.5	8.3	3.1	2.9	1.9	1.0	-0.2	-0.2
Other assets	31.5	39.4	48.6	46.0	44.8	43.6	42.3	41.0	39.6	38.3
Securities other than shares	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Loans	6.6	7.6	5.1	4.0	4.2	4.4	4.5	4.6	4.7	4.8
Shares and other equities	16.8	21.5	34.1	33.6	32.5	31.4	30.2	29.1	27.9	26.8
Other accounts receivable	8.1	10.2	9.4	8.4	8.2	7.9	7.6	7.3	7.0	6.7
Liabilities	**95.3**	**84.2**	**75.5**	**68.7**	**61.8**	**60.3**	**57.4**	**54.5**	**51.2**	**49.0**
Gross debt	65.0	51.2	43.3	35.9	29.8	29.0	27.0	24.9	22.5	21.2
Securities other than shares	38.9	34.0	28.8	24.2	20.9	19.0	17.8	16.6	15.2	14.9
Loans	26.1	17.2	14.5	11.7	8.9	10.0	9.1	8.3	7.3	6.3
Krona denominated	12.7	9.0	10.0	7.3	6.2	5.7	5.1	4.3	3.5	2.7
Foreign currency denominated	13.4	8.2	4.5	4.5	2.6	4.2	4.1	4.0	3.8	3.7
Other liabilities	30.3	33.0	32.2	32.8	32.1	31.3	30.4	29.6	28.7	27.8
Insurance technical reserves	25.3	27.8	27.2	26.5	25.9	25.3	24.7	24.1	23.4	22.8
Other accounts payable	5.0	5.1	5.0	6.3	6.1	5.9	5.7	5.5	5.3	5.1
Net financial worth	**-46.2**	**-33.3**	**-19.3**	**-14.4**	**-13.9**	**-13.7**	**-13.2**	**-12.5**	**-11.8**	**-10.9**
Memorandum item:										
Net debt 1/	47.4	39.7	35.8	27.6	26.7	26.0	25.1	23.9	22.7	21.4

Sources: Ministry of Finance; Statistics Iceland; and IMF staff projections.

1/ Gross debt less currency and deposits.

Table 6. Iceland: Balance of Payments, 2015–24

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
					Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
				(Billions of dollars)						
Current account 1/	**0.9**	**1.6**	**0.9**	**0.7**	**0.7**	**0.3**	**0.2**	**0.1**	**0.1**	**0.0**
Trade balance	1.2	1.3	1.0	0.8	0.7	0.3	0.2	0.0	-0.1	-0.1
Balance on goods	-0.3	-0.8	-1.5	-1.5	-1.1	-1.4	-1.4	-1.6	-1.7	-1.8
Merchandise exports f.o.b.	4.7	4.5	5.0	5.7	5.4	5.3	5.5	5.7	5.9	6.1
Merchandise imports f.o.b.	4.9	5.3	6.5	7.2	6.5	6.7	6.9	7.3	7.6	8.0
Balance on services	1.5	2.1	2.6	2.3	1.8	1.8	1.6	1.6	1.6	1.7
Exports of services, total	4.4	5.4	6.3	6.6	5.5	5.6	5.7	5.8	6.1	6.3
Imports of services, total	2.8	3.2	3.8	4.3	3.7	3.9	4.1	4.2	4.4	4.6
Primary income balance 1/	-0.1	0.4	0.1	0.2	0.2	0.2	0.3	0.4	0.5	0.5
Receipts	0.9	1.0	0.8	0.6	0.6	0.7	0.7	0.7	0.7	0.7
of which: dividends and reinvested earnings	0.3	0.4	0.4	0.4	0.3	0.4	0.4	0.4	0.4	0.4
of which: interest receipts	0.4	0.5	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Expenditures	0.9	0.7	0.7	0.5	0.5	0.4	0.4	0.3	0.2	0.2
of which: dividends and reinvested earnings	0.0	0.0	0.0	-0.1	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2
of which: interest payments	0.9	0.6	0.6	0.5	0.5	0.4	0.4	0.3	0.2	0.2
Secondary income balance	-0.3	-0.1	-0.2	-0.2	-0.2	-0.2	-0.3	-0.3	-0.3	-0.3
Capital and financial account (+ = outflow)	**0.9**	**1.8**	**0.5**	**1.7**	**0.7**	**0.3**	**0.2**	**0.1**	**0.1**	**0.0**
Capital account balance (+ = inflow)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account (+ = outflow)	0.9	1.8	0.5	1.7	0.7	0.3	0.2	0.1	0.1	0.0
Direct investment (+ = outflow)	-0.7	-0.7	-0.2	0.5	-0.1	-0.4	-0.4	-0.6	-0.7	-0.8
Portfolio investment ("+" = outflow)	3.8	1.9	2.4	1.1	0.4	0.6	0.6	0.7	0.8	0.8
Assets (+ = outflow)	-3.0	0.9	1.2	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Liabilities (+ = inflow)	-6.8	-0.9	-1.3	-0.1	0.6	0.3	0.3	0.2	0.2	0.2
of which: net borrowing (+ = inflow)	-6.7	-1.0	-1.7	-0.3	0.4	0.2	0.2	0.1	0.0	0.0
Other investment (+ = outflow)	-3.4	-1.8	-1.0	0.1	0.1	0.0	0.0	0.2	0.3	0.2
Assets (+ = outflow)	-0.5	-5.5	-0.9	0.1	0.1	0.1	0.1	0.2	0.2	0.2
Liabilities (+ = inflow)	2.9	-3.8	0.2	0.0	0.0	0.0	0.1	0.0	-0.1	0.0
of which: net outflows related to bank estates' compositions	0.2	0.2	0.0	-0.3	0.0	0.0	0.0	0.1	0.0	0.0
Change in reserve assets (+ = increase/outflow)	1.1	2.4	-0.8	0.0	0.2	0.0	0.0	-0.3	-0.3	-0.2
Net errors and omissions (+ = inflow)	**0.0**	**0.3**	**-0.4**	**1.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
				(Percent of GDP)						
Current account 1/	**5.1**	**7.6**	**3.8**	**2.8**	**2.9**	**1.4**	**1.0**	**0.5**	**0.4**	**0.1**
Trade balance	7.1	6.2	4.1	3.0	3.2	1.3	0.9	0.0	-0.3	-0.5
Balance on goods	-1.5	-4.1	-6.3	-5.8	-4.4	-6.0	-5.8	-6.4	-6.7	-6.9
Merchandise exports f.o.b.	26.8	21.7	20.3	21.8	22.9	22.2	22.5	22.8	22.9	23.0
Merchandise imports f.o.b.	28.3	25.8	26.6	27.6	27.4	28.2	28.4	29.2	29.7	29.9
Balance on services	8.7	10.3	10.4	8.8	7.6	7.3	6.7	6.5	6.4	6.4
Exports of services, total	25.0	25.9	25.9	25.3	23.4	23.5	23.4	23.5	23.6	23.5
Imports of services, total	16.3	15.6	15.4	16.5	15.8	16.2	16.7	17.1	17.1	17.2
Primary income balance 1/	-0.3	1.8	0.4	0.6	0.7	1.0	1.2	1.6	1.9	1.8
Receipts	5.1	5.1	3.1	2.5	2.6	2.7	2.7	2.7	2.7	2.6
of which: interest receipts	2.4	2.3	1.0	0.6	0.7	0.7	0.7	0.7	0.7	0.6
Expenditures	5.4	3.2	2.8	1.8	1.9	1.7	1.5	1.1	0.8	0.8
of which: interest payments	5.3	3.0	2.3	1.9	2.0	1.8	1.6	1.2	0.8	0.8
Secondary income balance	-1.7	-0.5	-0.7	-0.8	-0.9	-1.0	-1.2	-1.2	-1.2	-1.2
Capital and financial account (+ = outflow)	**5.0**	**8.8**	**2.0**	**6.5**	**2.8**	**1.3**	**0.8**	**0.4**	**0.3**	**0.0**
Capital account balance (+ = inflow)	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Financial account (+ = outflow)	5.1	8.8	2.0	6.5	2.8	1.3	0.9	0.4	0.3	0.1
Direct investment (+ = outflow)	-4.0	-3.5	-0.7	1.8	-0.2	-1.7	-1.8	-2.3	-2.8	-3.1
Portfolio investment ("+" = outflow)	22.0	9.2	10.0	4.1	1.7	2.7	2.5	3.0	3.1	3.0
Assets (+ = outflow)	-17.0	4.6	4.7	3.7	4.1	4.1	4.0	3.9	3.9	3.9
Liabilities (+ = inflow)	-39.0	-4.6	-5.3	-0.4	2.4	1.4	1.4	0.9	0.8	0.8
of which: net borrowing (+ = inflow)	-38.4	-4.8	-7.0	-1.1	1.7	0.7	0.7	0.2	0.1	0.1
Other investment (+ = outflow)	-19.3	-8.5	-4.2	0.3	0.5	0.2	0.1	0.8	1.0	0.6
Assets (+ = outflow)	-2.7	-26.9	-3.5	0.3	0.3	0.2	0.4	0.6	0.6	0.6
Liabilities (+ = inflow)	16.6	-18.3	0.8	0.0	-0.2	0.0	0.4	-0.1	-0.4	0.0
Change in reserve assets (+ = increase/outflow)	6.3	11.6	-3.3	0.2	0.7	0.0	-0.1	-1.2	-1.1	-0.7
Net errors and omissions (+ = inflow)	**0.0**	**1.3**	**-1.7**	**3.8**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Central bank reserves ($ bn)	**5.0**	**7.2**	**6.6**	**6.1**	**6.2**	**6.2**	**6.2**	**5.9**	**5.6**	**5.4**
(Percent of GDP)	28.9	35.2	26.8	23.4	26.3	26.1	25.5	23.8	21.9	20.4
Memorandum item:										
Gross domestic product ($ bn)	17.4	20.6	24.5	26.0	23.6	23.9	24.4	24.9	25.7	26.7

Sources: CBI; and IMF staff projections.

1/ Actual data include accrued interest payments on intracompany debt held by a large multinational; projected data do not.

Table 7. Iceland: International Investment Position, 2009–18

(Percent of GDP)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Assets	**293.6**	**259.1**	**265.2**	**277.6**	**277.4**	**251.8**	**214.6**	**158.5**	**117.0**	**121.1**
Direct investment	112.7	88.2	89.1	95.6	110.0	100.0	91.8	64.2	26.1	26.6
Portfolio investment	54.4	47.0	52.3	58.1	62.3	63.9	40.5	37.7	44.5	47.2
Equity and investment fund shares	45.2	33.1	32.5	34.2	34.6	36.9	35.6	35.2	40.9	41.6
Debt securities	9.2	13.9	19.8	23.9	27.7	27.0	4.9	2.5	3.6	5.7
Financial derivatives	0.1	0.0	0.0	0.1	0.2	0.6	0.5	0.3	0.5	0.4
Other investment	96.7	84.2	64.2	94.5	79.9	61.7	53.3	23.5	19.7	20.7
Reserve assets	29.8	39.7	59.6	29.3	24.9	25.6	28.5	32.7	26.3	26.2
Liabilities	**945.1**	**845.3**	**792.6**	**725.7**	**664.9**	**627.2**	**219.3**	**155.6**	**113.5**	**109.5**
Direct investment	100.7	90.4	97.0	82.0	97.6	97.0	93.1	81.4	45.5	42.7
Portfolio investment	407.4	350.8	327.3	324.8	287.6	290.9	42.1	49.4	43.4	42.8
Equity and investment fund shares	3.8	3.2	3.2	3.2	3.5	3.7	4.0	3.6	4.9	5.5
Debt securities	403.6	347.6	324.1	321.5	284.1	287.3	38.1	45.8	38.5	37.3
Financial derivatives	0.0	0.1	0.2	0.1	0.3	0.9	0.6	0.4	0.4	0.2
Other investment	437.0	404.1	368.1	318.8	279.5	238.4	83.5	24.5	24.2	23.8
Net international investment position	**-651.5**	**-586.2**	**-527.5**	**-448.2**	**-387.5**	**-375.4**	**-4.7**	**2.9**	**3.5**	**11.6**

Sources: CBI; and IMF staff calculations.

Note: The large reductions in external assets and liabilities in 2017 were primarily due to changes in direct investment, driven mainly by adjustments within consolidated entities

Annex I. Responses to Past Policy Recommendations

2018 Article IV Recommendations	Authorities' Responses
Financial Sector Unify prudential oversight and resolution of banks at the CBI, endowing the new oversight function with needed powers, resources, and independence.	**Consistent** Parliament approved the merger of the CBI and FME, revising the Central Bank Act and related legislation.
Monetary Policy Monetary policy settings should remain data-driven and focused on price stability. Articulate an exchange market intervention policy consistent with the inflation targeting framework. The inflation target should capture as well as possible households' spending patterns.	**Consistent** The CBI relaxed the monetary policy stance by cutting policy rates by 150 basis points, following a large shock threatening economic activity. Foreign exchange intervention in 2019 was sporadic and focused on preventing disorderly market conditions in a context of heightened uncertainty.
Fiscal Policy Set fiscal policy geared toward increasing fiscal space that will allow net debt to fall below the statutory ceiling by end 2019 and remain on a downward trend thereafter. Conduct a comprehensive review of expenditures that should seek to identify areas offering scope for savings, and to develop a guiding framework to rank outlays by their medium-term effects on growth and productivity. Staff saw merit in creating a wealth fund.	**Partly Consistent** In 2018, fiscal policy delivered a surplus in line with medium-term plans, and public debt remained on a downward trend toward the statutory ceiling. In 2019, fiscal policy was modified to provide fiscal stimulus, in line with the recommendations in the risk assessment matrix in the event of an adverse shock to the tourism sector, which materialized. Little progress was made in completing the comprehensive reviews of fiscal spending. A draft law establishing a sovereign wealth fund has been submitted to Parliament.
Capital Flow Management Dial down the special reserve requirement while keeping the tool on the books. Use microprudential oversight to prevent excessive risk taking by banks. Deploy macroprudential policies as needed to minimize systemic risks. CFMs should not substitute for warranted macroeconomic adjustment.	**Consistent** The CBI set the special reserve requirement rate to zero and freed offshore krónur accounts. FME accepted the Financial stability council's recommendation to increase the countercyclical balance and stopped the tightening cycle when the adverse shock to economic activity hit.
Structural Undertake reforms to wage bargaining and education to better support competitiveness, address bottlenecks in tourism, and further joint efforts to secure equitable and environmentally sustainable regional agreements in fishing.	**Partly Consistent** The wage bargaining round concluded with moderate growth increases, with further wage increases contingent on GDP growth outcomes, and government commitments on a wide array of fiscal issues, including lowering personal income tax rates and regulatory measures affecting housing contracts. A road transportation plan was set to help address bottlenecks in tourism.

Annex II. Risk Assessment Matrix[1]

Risks	Relative Likelihood	Impact if Realized	Policy Response
DOMESTIC RISKS			
Worse than expected tourism activity	Medium • Continued reduction in tourist arrivals • Lower than expected exports • Natural *force majeure*	Medium • Lower than expected growth in 2020 and lower prospects going forward • Deterioration in current account	• Reassess cyclical position and potential growth. • Allow fiscal stabilizers to operate, using existing fiscal policy space. • Ease monetary policy if economic conditions deteriorate significantly and inflation expectations fall well below target. • Boost tourism-related infrastructure.
Disruptions arising from FATF gray listing of Iceland	Medium • Loss of correspondent banking relations complicate external payments and create financial stress.	High • Near-term interruption in international payments • Liquidity stress in the banking sector • Contraction in exports, imports, and economic activity	• Enhance communication among all stakeholders including foreign bank supervisors. • Continue with measures keeping confidence in domestic banking system. • Allow exchange rate to adjust as needed. • Consider a temporary use of centralized payments systems in the extreme event.
GLOBAL RISKS			
Rising protectionism and retreat from multilateralism	High • Erosion of trust in the rules-based system • Threat to labor mobility, regulatory collaboration	High • Near- and medium- term fall in exports • Deterioration in current account • Drain on reserves • Borrowing terms abroad worsen as Iceland risk premium rises • Some capital outflows	• Step up support for the rules-based global trading system. • Ease monetary policy if economic conditions deteriorate significantly and inflation expectations fall well below target. • Limit reserve drawdowns to countering disorderly market conditions. • Allow fiscal stabilizers to operate.
Weaker than expected global growth	High • Structurally weak growth in European trading partners, including through Brexit	Medium • Near- and medium- term weakening of export demand, including for tourism	• Accelerate structural reforms to increase competitiveness, including a revamp of wage bargaining.
Sharp rise in risk premia	High • Term premiums decompress as investors reassess policy fundamentals • More rapid Fed normalization	Medium • Borrowing terms abroad worsen as Iceland risk premium rises • Some capital outflows	• Ease monetary policy if economic conditions deteriorate significantly and inflation expectations fall well below target. • Limit reserve drawdowns to countering disorderly market conditions. • Allow fiscal stabilizers to operate.

[1] Shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of the IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability of 10–30 percent, and "high" a probability of over 30 percent). Reflects the staff's views on the source of risks and overall level of concern at the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

Annex III. Public Sector Debt Sustainability Analysis

1. *Iceland's public debt sustainability has continued to improve, with the public debt ratio on a firm downward path. Staff's baseline projections rely on prudent primary surplus objectives over the medium term.*

2. Gross general government debt has declined considerably since the financial crisis. It has reached around 36 percent of GDP in 2018, down from 92 percent of GDP in 2011, reflecting sustained primary surpluses, a positive growth–interest differential, and large irregular income receipts.

3. General government debt risks are low. As of August 2019, 86 percent of the stock of treasury bills and bonds is held by domestic investors, and 78 percent of central government debt is denominated in króna. The average time to maturity of central government debt is around 5.8 years, with 17 percent maturing in the next 12 months. Iceland's market access is very favorable. In June 2019, the government placed a €500 million bond at a historically low interest rate of 0.1 percent. Treasury deposits are about 3.6 times the foreign-currency denominated bonds maturing over the next 12 months.

4. Contingent liabilities remain significant and concentrated but continue to decline. In August 2019, state-guaranteed liabilities amounted to 32 percent of GDP, down from a peak of about 80 percent of GDP in 2009, with HFF and Landsvirkjun being the main beneficiaries (91 percent of total guarantees).

5. The debt analysis is based on staff's baseline fiscal projections. In line with the draft 2020 Budget and the Fiscal Strategy Plan for 2020–24, the authorities aim for a small general government deficit in 2020 and small overall surpluses at or under 0.4 percent of GDP in the medium term. This implies an average primary surplus of 1.8 percent of GDP over the projection period, at about twice the debt-stabilizing primary balance. The 3-year adjustment in the cyclically adjusted primary balance is feasible. Staff's forecast errors do not show any persistent bias**.**

6. The heatmap suggests that current debt levels present low levels of risks. Gross debt and gross financing needs are expected to remain well below 85 percent and 20 percent of GDP, respectively, under all considered macro-fiscal stress tests. External financing requirements remain slightly above the lower risk-assessment benchmark of 17 percent of GDP but have decreased significantly since 2016.

7. Unlikely extreme shocks could, however, seriously affect the debt trajectory. An asymmetric distribution of shocks based on the stochastic properties of Icelandic data (with restrictions on downside shocks), demonstrates that the debt ratio could peak at about 60 percent of GDP in 2024 in less than 10 percent of cases.

8. The debt ratio is resilient to standard shock scenarios:

- **Growth shock**. Real GDP growth is subjected to a 2-percentage point decline relative to baseline for two years. Reflecting higher risk premiums, nominal interest rates rise. The debt ratio rises to about 33 percent of GDP by 2021 and falls thereafter, reaching about 29 percent of GDP by 2024.

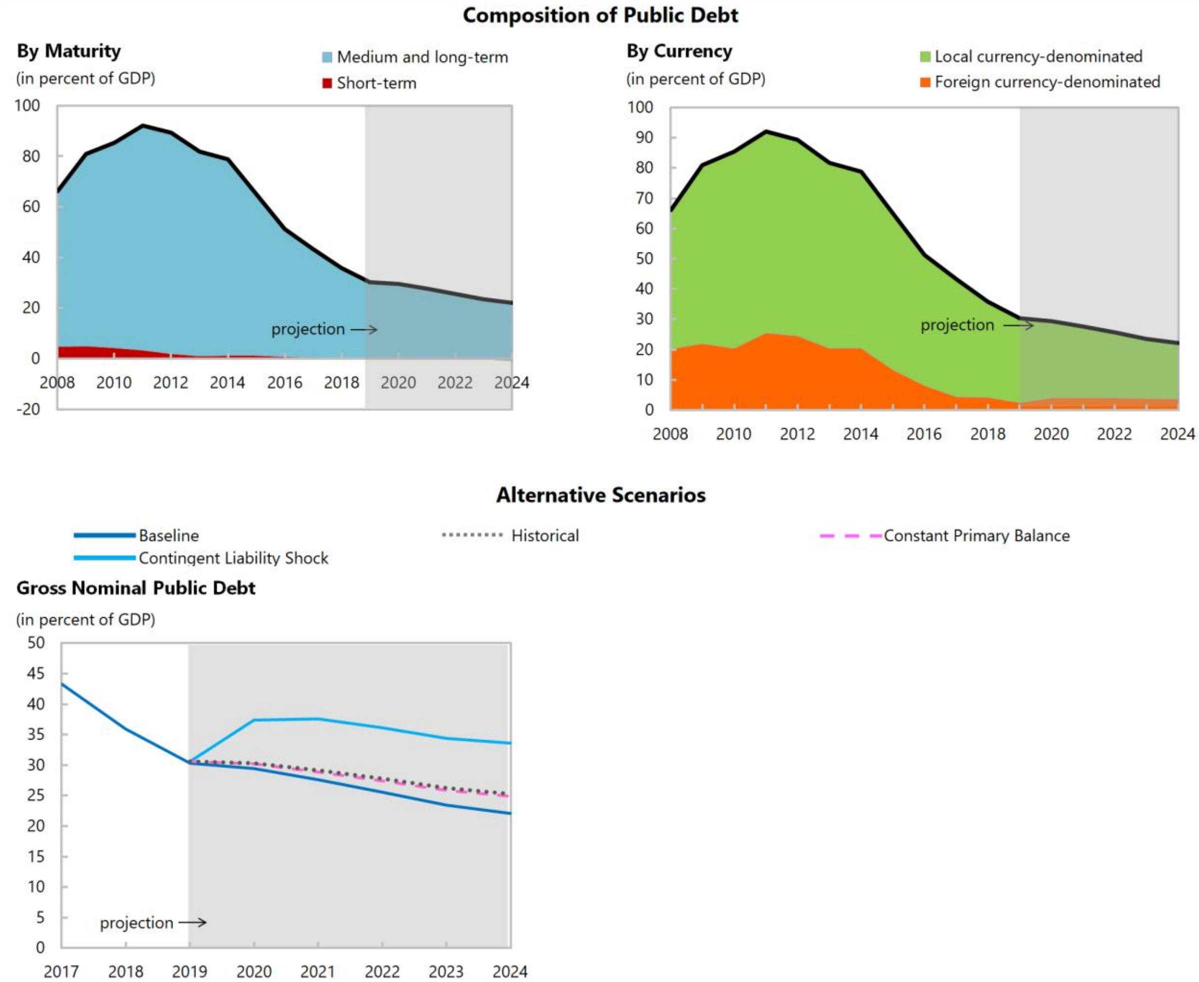
- **Primary balance shock**. A 4-percentage point of GDP decline in revenues is applied over 2 years, coupled with a rise in interest rates. The debt to revenue ratio deteriorates relative to the baseline before recovering.

- **Interest rate shock**. A 200-basis point increase in spreads is applied throughout the projection period, with a negative feedback effect on growth of 1 percentage point in 2020–21 relative to baseline. The debt ratio remains on a downward trajectory, albeit at a slightly slower pace.

- **Real exchange rate shock**. A 25-percent devaluation of the real exchange rate is applied in the first year, with pass through effects to inflation. The rate of decline in the debt ratio accelerates very slightly relative to the baseline in 2020 but tracks the baseline path thereafter.

Combined macro-fiscal shock. This test combines shocks to growth, the interest rate, the exchange rate, and the primary balance. The debt ratio climbs to around 41 percent, where it stays in the medium term.

Figure 1. Iceland: Public DSA—Composition of Public Debt and Alternative Scenarios



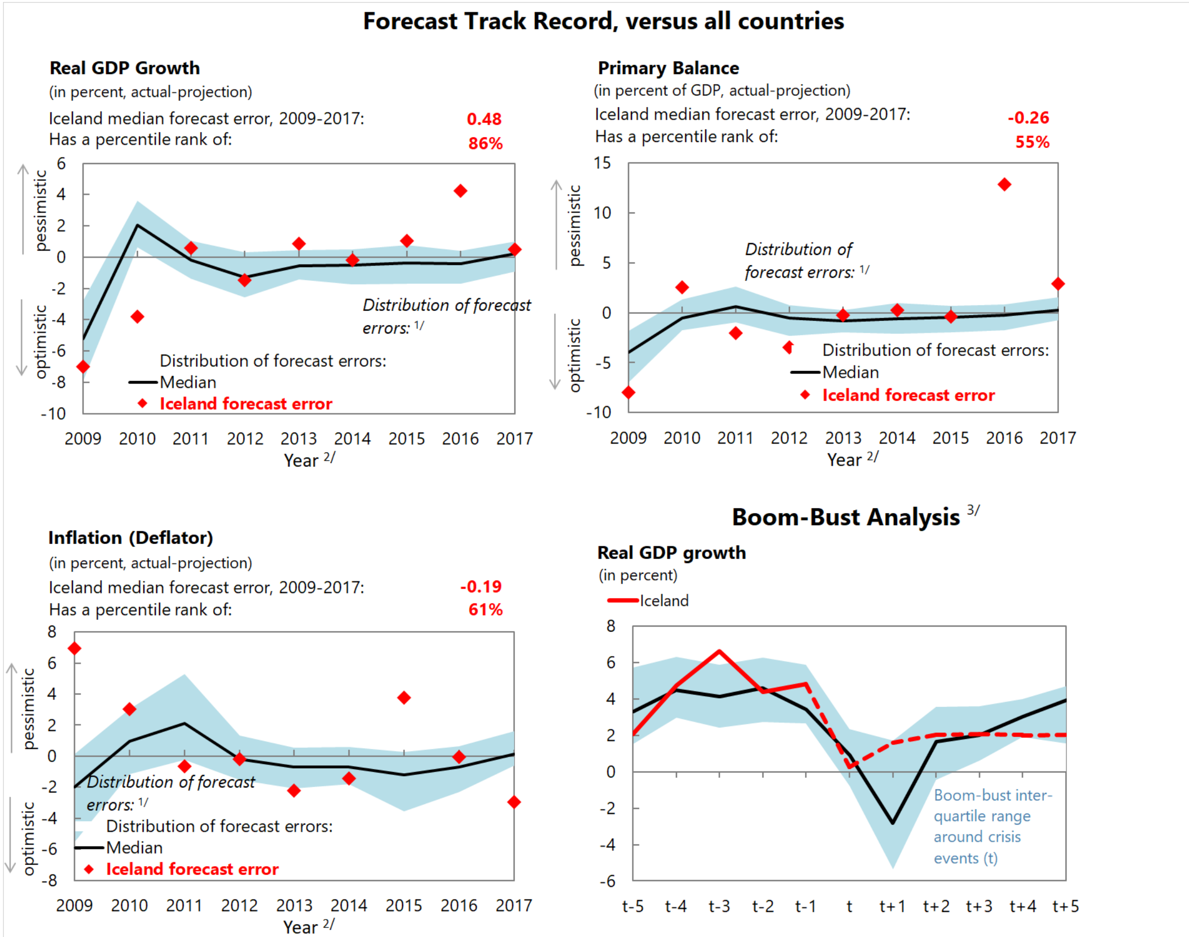
Underlying Assumptions
(in percent)

Baseline Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	0.3	1.6	2.0	2.1	2.0	2.0
Inflation	3.1	1.8	1.8	1.9	2.1	2.1
Primary Balance	1.6	1.7	1.8	1.8	1.9	1.7
Effective interest rate	7.2	8.0	7.4	6.9	8.3	6.5
Constant Primary Balance Scenario						
Real GDP growth	0.3	1.6	2.0	2.1	2.0	2.0
Inflation	3.1	1.8	1.8	1.9	2.1	2.1
Primary Balance	1.6	1.6	1.6	1.6	1.6	1.6
Effective interest rate	7.2	7.9	7.2	6.8	8.1	6.4

Historical Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	0.3	2.0	2.0	2.0	2.0	2.0
Inflation	3.1	1.8	1.8	1.9	2.1	2.1
Primary Balance	1.6	1.4	1.4	1.4	1.4	1.4
Effective interest rate	7.2	7.9	6.8	6.1	6.8	5.1
Contingent Liability Shock						
Real GDP growth	0.3	-1.5	-1.1	2.1	2.0	2.0
Inflation	3.1	1.1	1.0	1.9	2.1	2.1
Primary Balance	1.6	-4.1	1.8	1.8	1.9	1.7
Effective interest rate	7.2	8.6	7.3	6.8	7.9	6.5

Source: IMF staff.

Figure 2. Iceland: Public DSA—Realism of Baseline Assumptions



Source : IMF staff.
1/ Plotted distribution includes all countries, percentile rank refers to all countries
2/ Projections made in the spring WEO vintage of the preceding year
3/ Iceland has had a positive output gap for 3 consecutive years, 2016-2018. For Iceland, t corresponds to 2019; for the distribution, t corresponds to the first year of the crisis.

Figure 3. Iceland: Public DSA—Baseline Scenario

(Percent of GDP, unless otherwise indicated)

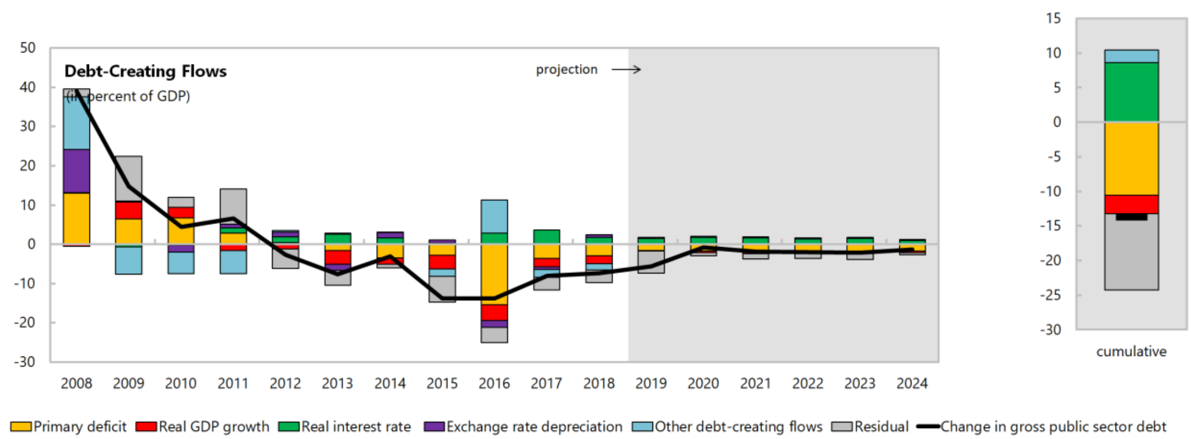
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2008-2016 [2/]	2017	2018	2019	2020	2021	2022	2023	2024
Nominal gross public debt	76.7	43.3	35.9	30.3	29.5	27.6	25.6	23.5	22.1
Public gross financing needs	7.2	13.3	4.3	4.5	3.8	3.2	6.7	0.4	2.1
Real GDP growth (in percent)	1.4	4.4	4.8	0.3	1.6	2.0	2.1	2.0	2.0
Inflation (GDP deflator, in percent)	5.5	0.5	2.7	3.1	1.8	1.8	1.9	2.1	2.1
Nominal GDP growth (in percent)	6.9	4.9	7.6	3.4	3.5	3.8	3.9	4.2	4.2
Effective interest rate (in percent) [4/]	6.9	7.9	7.1	7.2	8.0	7.4	6.9	8.3	6.5

As of September 06, 2019		
Sovereign Spreads		
EMBIG (bp) 3/		220
5Y CDS (bp)		69
Ratings	Foreign	Local
Moody's	A3	A3
S&Ps	A	A
Fitch	A	A

Contribution to Changes in Public Debt

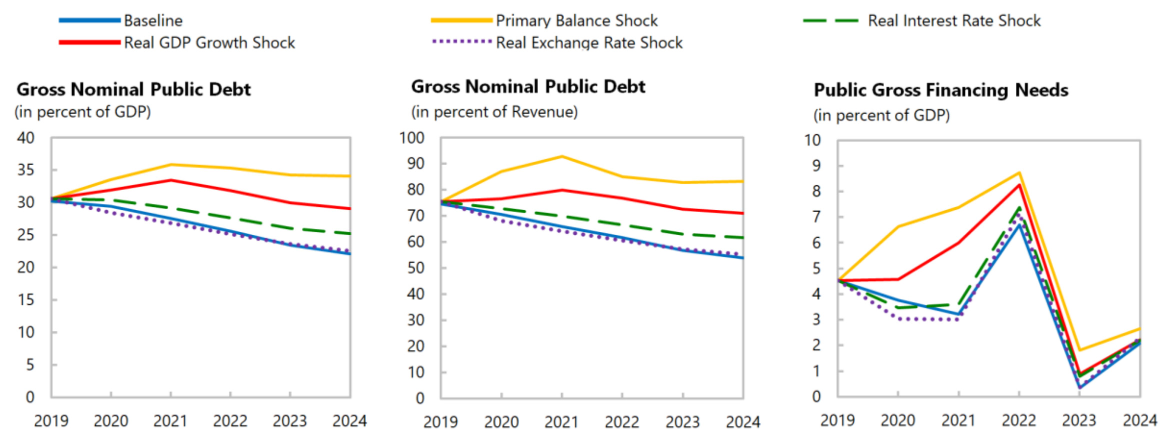
	Actual			Projections							
	2008-2016	2017	2018	2019	2020	2021	2022	2023	2024	cumulative	debt-stabilizing
Change in gross public sector debt	2.7	-8.0	-7.4	-5.6	-0.8	-1.9	-2.0	-2.1	-1.4	-13.8	primary
Identified debt-creating flows	2.1	-4.8	-4.2	0.1	-0.1	-0.5	-0.7	-0.6	-0.9	-2.8	balance [9/]
Primary deficit	0.7	-3.6	-3.0	-1.6	-1.7	-1.8	-1.8	-1.9	-1.7	-10.6	0.8
Primary (noninterest) revenue and grants	40.5	42.8	42.1	40.0	41.4	41.5	41.2	41.1	40.8	246.0	
Primary (noninterest) expenditure	41.2	39.1	39.1	38.4	39.7	39.7	39.4	39.2	39.1	235.4	
Automatic debt dynamics [5/]	1.2	0.9	0.4	1.3	1.3	1.0	0.8	1.0	0.5	6.0	
Interest rate/growth differential [6/]	0.1	1.5	-0.2	1.3	1.3	1.0	0.8	1.0	0.5	6.0	
Of which: real interest rate	1.0	3.6	1.7	1.4	1.8	1.6	1.3	1.5	1.0	8.6	
Of which: real GDP growth	-0.9	-2.2	-1.9	-0.1	-0.5	-0.6	-0.5	-0.5	-0.5	-2.7	
Exchange rate depreciation [7/]	1.1	-0.6	0.7	...	...	...	...	...	...	...	
Other identified debt-creating flows	0.2	-2.1	-1.6	0.3	0.3	0.3	0.3	0.3	0.3	1.8	
General government net privatization proceeds (negative)	0.8	0.0	-0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Net lending	-0.5	-2.0	-0.7	0.3	0.3	0.3	0.3	0.3	0.3	1.8	
Residual, including asset changes [8/]	0.5	-3.2	-3.2	-5.7	-0.7	-1.4	-1.3	-1.5	-0.5	-11.0	



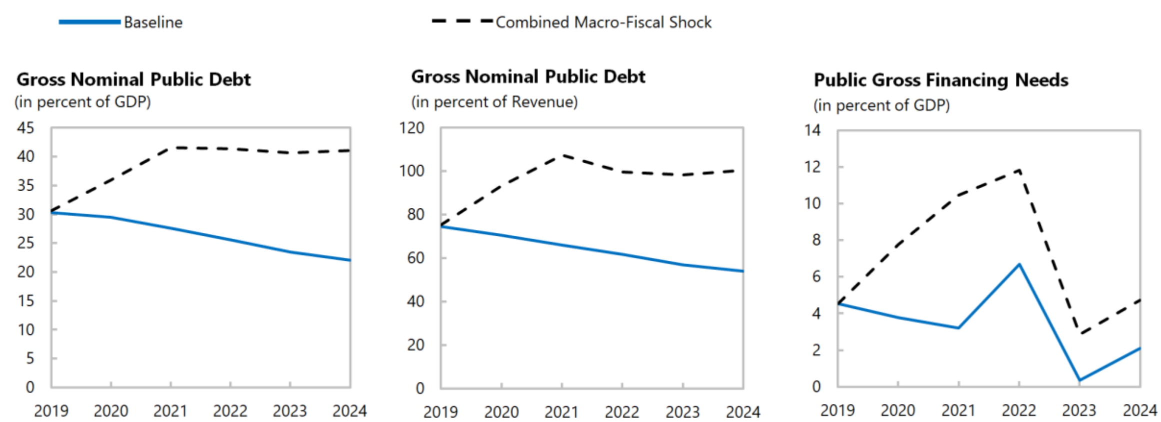
Source: IMF staff.
1/ Public sector is defined as general government.
2/ Based on available data.
3/ Long-term bond spread over U.S. bonds.
4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.
5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate;
a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.
7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure 4. Iceland: Public DSA—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

Primary Balance Shock	2019	2020	2021	2022	2023	2024
Real GDP growth	0.3	0.6	2.0	2.1	2.0	2.0
Inflation	3.1	1.8	1.8	1.9	2.1	2.1
Primary balance	1.6	-1.5	-1.3	1.8	1.9	1.7
Effective interest rate	7.2	7.9	8.7	9.3	10.0	8.6
Real Interest Rate Shock						
Real GDP growth	0.3	0.6	1.0	2.1	2.0	2.0
Inflation	3.1	1.8	1.8	1.9	2.1	2.1
Primary balance	1.6	1.7	1.8	1.8	1.9	1.7
Effective interest rate	7.2	7.9	7.5	7.2	9.0	7.3
Combined Shock						
Real GDP growth	0.3	-0.5	0.0	2.1	2.0	2.0
Inflation	3.1	1.3	1.2	1.9	2.1	2.1
Primary balance	1.6	-2.5	-3.4	1.8	1.9	1.7
Effective interest rate	7.2	7.9	8.6	9.5	10.5	9.3

Real GDP Growth Shock	2019	2020	2021	2022	2023	2024
Real GDP growth	0.3	-0.5	0.0	2.1	2.0	2.0
Inflation	3.1	1.3	1.2	1.9	2.1	2.1
Primary balance	1.6	0.7	-0.3	1.8	1.9	1.7
Effective interest rate	7.2	7.9	7.2	6.7	7.9	6.4
Real Exchange Rate Shock						
Real GDP growth	0.3	1.6	2.0	2.1	2.0	2.0
Inflation	3.1	10.2	1.8	1.9	2.1	2.1
Primary balance	1.6	1.7	1.8	1.8	1.9	1.7
Effective interest rate	7.2	7.9	7.1	6.7	8.1	6.4

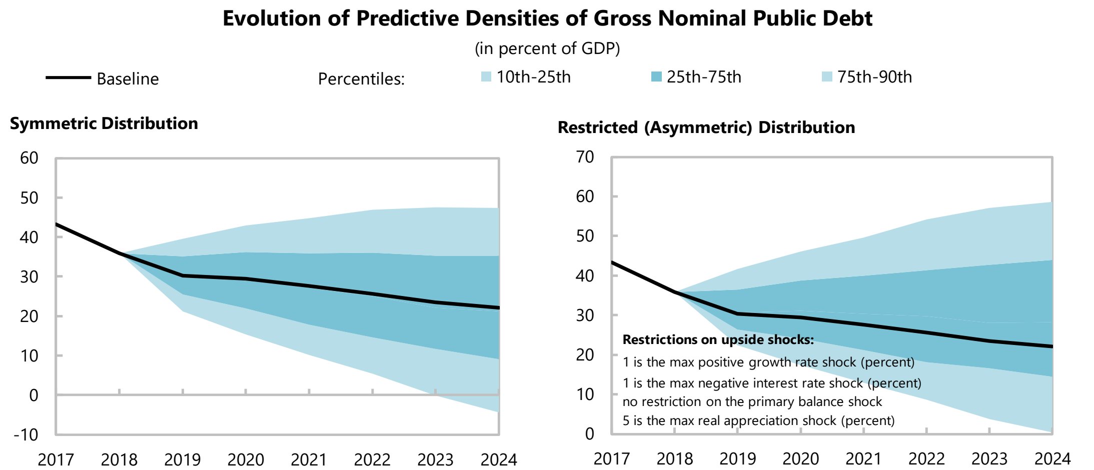
Source: IMF staff.

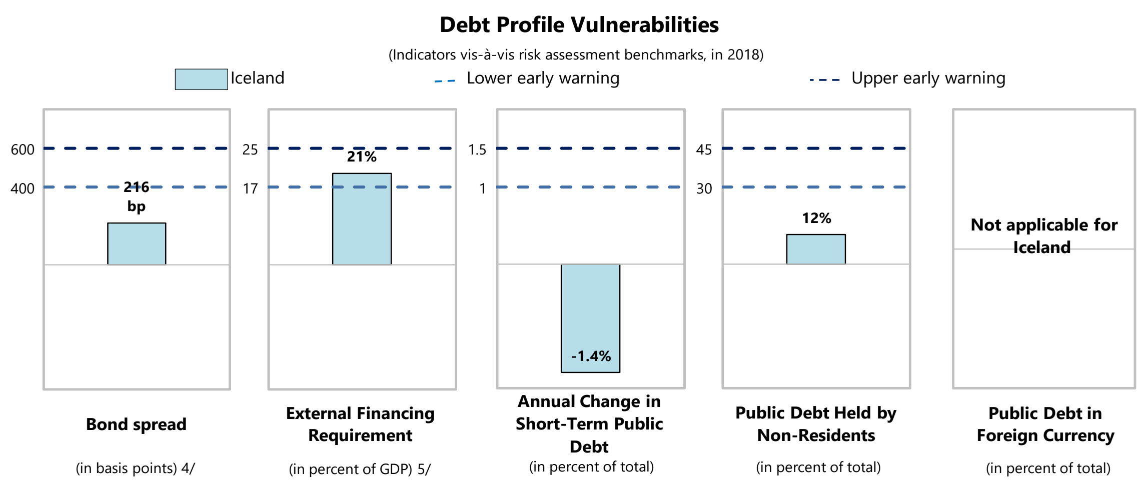
Figure 5. Iceland Public DSA—Risk Assessment

Iceland Public DSA Risk Assessment

Heat Map

Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt





Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 85% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 20% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

400 and 600 basis points for bond spreads; 17 and 25 percent of GDP for external financing requirement; 1 and 1.5 percent for change in the share of short-term debt; 30 and 45 percent for the public debt held by non-residents.

4/ Long-term bond spread over U.S. bonds, an average over the last 3 months, 08-Jun-19 through 06-Sep-19.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

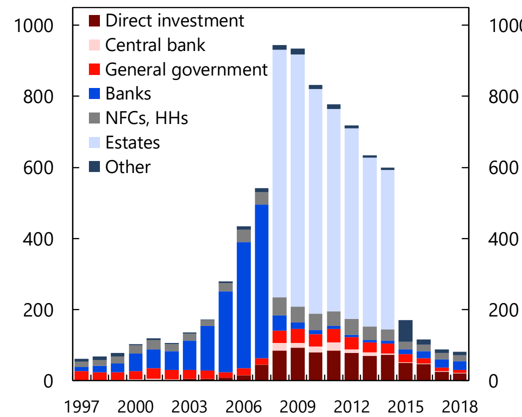
Annex IV. External Debt Sustainability Analysis

Iceland's external debt position has continued to improve. It appears robust to most stresses, with exception of króna depreciation. Total external debt is projected to reach 68 percent of GDP by 2024 (from 125 percent in 2016), reflecting much improved solvency.

Iceland's external debt continues to decline markedly. It fell, on average, by about a third per year, between 2013 and 2018, from 240 percent of GDP in 2013 to 73 percent in 2018. This was mainly due to reductions in public and, above all, banking sector debt—the bank estates' massive external debts were cleared in the winter of 2015–16 (See 2016 Staff Report). Robust growth played a supporting role, as did the introduction of the special reserve requirement on selected debt inflows in June 2016, which slowed nonresidents' investment in króna-denominated debt. In the past two years, reductions in FDI-related debt such as due to changes in internal financing arrangements have also contributed, albeit with little net effect on the IIP.

Gross External Debt

(Percent of GDP)

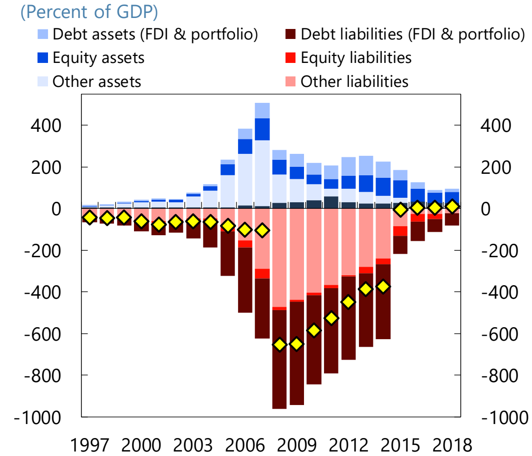


Sources: CBI; and IMF staff calculations.

External debt is projected to gradually decline. Gross debt is projected to remain around 74 percent of GDP in 2019 and to continue a gradual decline thereafter, stabilizing at around 68 percent of GDP by 2024.

IIP Assets and Liabilities

(Percent of GDP)



Source: CBI.

The maturity structure is comfortably long. Short-term debt accounts for less than 20 percent of the total.

The gross external financing requirement has fallen but remains significant. Iceland's external financing need was about 16 percent of GDP in 2018—a significant improvement from 53 percent of GDP in 2015, and almost halved compared to 2017. It is projected to drop to 10 percent of GDP by 2024—marking a further reduction in liquidity risk. The mix of much lower external debt, a current account surplus, and steady reserve levels will continue to improve the ratio of reserves to the gross external financing requirement.

The projected downward path for total external debt is robust to most shocks. Standard growth and current account shocks do not materially alter the baseline trajectory. The sensitivity of the baseline path to exchange rate shocks remains the most significant.

Table A1. Iceland: External Debt Sustainability Framework, 2014–24

(Percent of GDP, unless otherwise indicated)

	Actual							Projections						Debt-stabilizing
	2014	2015	2016	2017	2018			2019	2020	2021	2022	2023	2024	non-interest CA 7/
Baseline: External debt (including old banks) 1/	198.8	175.7	125.2	90.0	73.3			**74.0**	**73.4**	**73.0**	**72.2**	**70.4**	**68.4**	**1.8**
Change in external debt	-41.4	-23.0	-50.6	-35.1	-16.8			0.7	-0.6	-0.4	-0.9	-1.7	-2.0	
Identified external debt-creating flows (4+8+9)	-29.7	-4.7	-31.3	-19.9	-4.8			-1.5	-2.4	-2.4	-2.4	-2.9	-2.9	
Current account deficit, excluding interest payments	-9.1	-10.0	-11.6	-7.0	-4.8			-4.9	-3.2	-2.5	-1.6	-1.2	-0.9	
Deficit in balance of goods and services	-6.0	-7.1	-6.2	-4.1	-3.0			-3.2	-1.3	-0.9	0.0	0.3	0.5	
Exports	51.5	51.8	47.6	46.2	47.1			46.3	45.7	46.0	46.3	46.5	46.6	
Imports	45.5	44.7	41.4	42.0	44.1			43.2	44.4	45.1	46.3	46.8	47.1	
Net non-debt creating capital inflows (negative)	-3.5	-1.2	2.6	1.4	3.5			1.7	0.1	0.1	-0.5	-1.1	-1.4	
Automatic debt dynamics 2/	-17.1	6.5	-22.4	-14.3	-3.5			1.8	0.6	0.1	-0.4	-0.6	-0.6	
Contribution from nominal interest rate	5.2	4.8	3.4	3.3	2.0			2.0	1.8	1.6	1.1	0.8	0.8	
Contribution from real GDP growth	-4.5	-9.6	-9.8	-4.6	-4.1			-0.2	-1.2	-1.5	-1.5	-1.4	-1.4	
Contribution from price and exchange rate changes 3/	-17.8	11.3	-16.0	-12.9	-1.3			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 4/	-11.6	-18.3	-19.3	-15.2	-12.0			2.2	1.8	2.0	1.6	1.1	0.9	
External debt-to-exports ratio (in percent)	385.8	339.3	262.8	195.0	155.6			159.8	160.5	158.9	155.9	151.5	146.8	
Gross external financing need (in billions of US dollars) 5/	9.4	9.1	5.8	7.5	4.1			2.6	6.0	4.3	3.8	2.7	2.7	
in percent of GDP	53.2	52.6	28.3	30.6	15.8			11.1	25.0	17.6	15.3	10.4	10.1	
						10-Year	10-Year							
Scenario with key variables at their historical averages 6/								**74.0**	**63.3**	**53.2**	**43.0**	**33.3**	**23.8**	
						Historical	Standard							
Key Macroeconomic Assumptions Underlying Baseline						Average	Deviation							
								2019	**2020**	**2021**	**2022**	**2023**	**2024**	
Real GDP growth (in percent)	2.1	4.7	6.6	4.4	4.8	2.0	4.1	0.3	1.6	2.0	2.1	2.0	2.0	
GDP deflator in US dollars (change in percent)	8.5	-6.5	11.2	13.6	1.3	2.4	10.5	-9.2	-0.6	-0.1	0.1	1.3	1.8	
Nominal external interest rate (in percent) 8/	2.4	2.4	2.3	3.1	2.3	3.0	0.7	2.5	2.5	2.2	1.5	1.2	1.1	8/
Underlying external interest rate (in percent)	3.5	3.4	2.3	3.1	2.3	2.8		2.5	2.5	2.2	1.5	1.2	1.1	
Growth of exports (US dollar terms, in percent)	6.7	-1.5	9.0	15.0	8.3	5.7	8.7	-10.5	-0.3	2.5	2.8	3.7	4.1	
Growth of imports (US dollar terms, in percent)	9.9	-3.8	9.9	20.4	11.5	5.3	15.4	-10.9	3.9	3.5	4.8	4.5	4.5	
Current account balance, excluding interest payments	9.1	10.0	11.6	7.0	4.8	6.6	4.0	4.9	3.2	2.5	1.6	1.2	0.9	
Net non-debt creating capital inflows	3.5	1.2	-2.6	-1.4	-3.5	4.4	13.6	-1.7	-0.1	-0.1	0.5	1.1	1.4	

1/ External debt includes recovered domestic and foreign assets of old banks.

2/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

3/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

4/ For projection, line includes the impact of price and exchange rate changes, inflows of extraordinary financing (and Fund repurchases), and external asset recovery of the old bank estates.

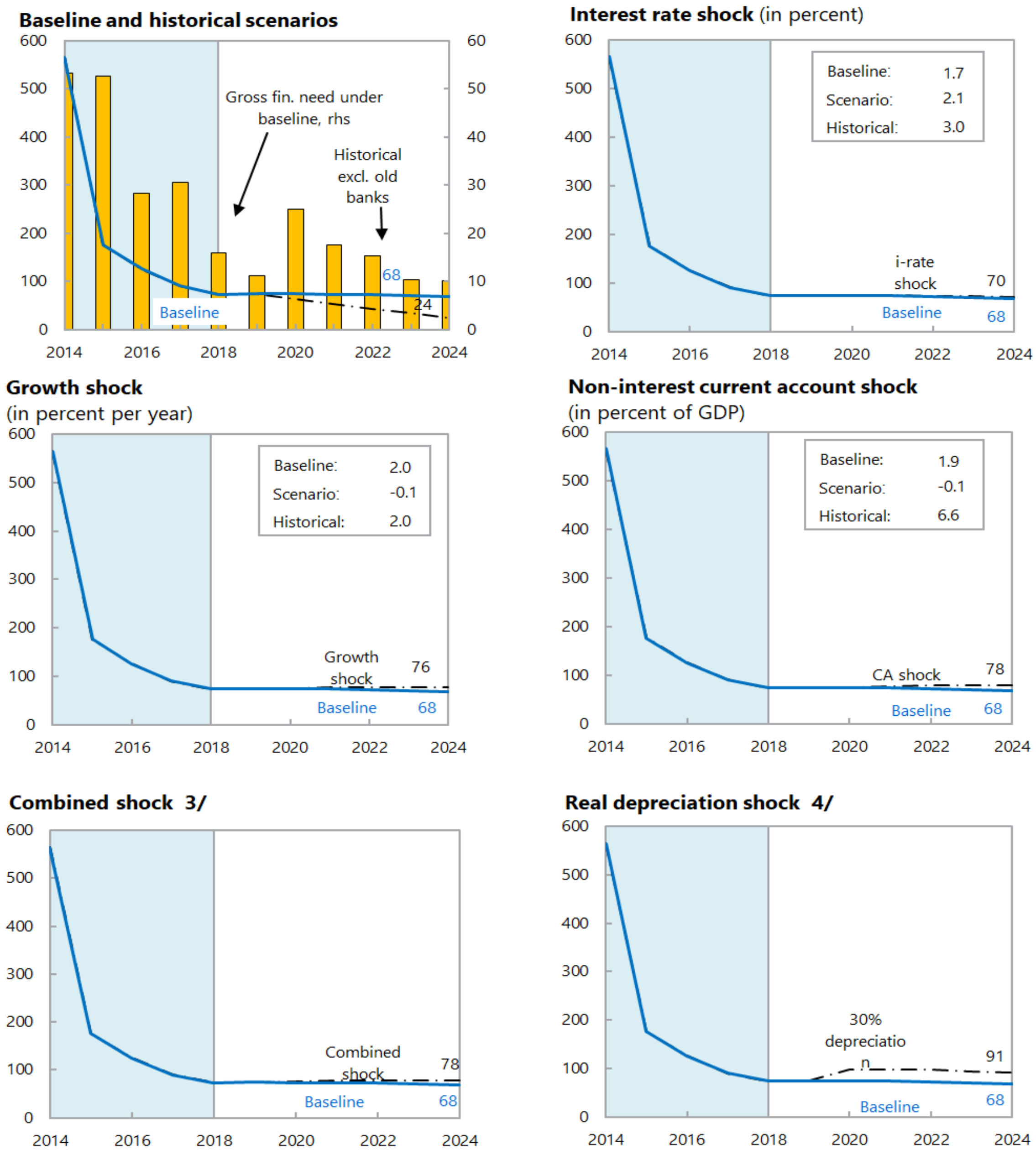
5/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

6/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

7/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

8/ Since interest payment projections exclude old bank related interest payments while the external debt stock includes old bank debt, this results in an understatement of the external interest rate. Hence, for the computation of debt stabilizing current account we use the 2024 underlying interest rate that would exclude old bank debt stock as well.

Figure A1. Iceland: External Debt Sustainability Bound Tests 1/ 2/
(External debt in percent of GDP)



Sources: International Monetary Fund; country desk data, and IMF staff projections.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2020.

Annex V. The Real Estate Market in Iceland

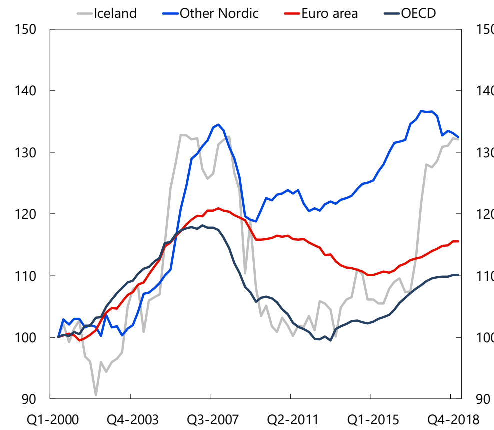
Iceland's real estate price to income ratio has decelerated significantly. Between the post crisis bust (Q2–2010) and late 2016 Iceland's price to income ratio increased by about 1 percent per year, broadly aligned with the euro area and OECD countries. In 2016–17, the ratio increased by almost 20 percentage points, and while still in line with other Nordic countries, it vastly exceeded the growth rate in other advanced peer countries. However, in 2018, its growth moderated to less than 3 percent.

Residential Real Estate

Residential housing prices have flattened, while supply has picked up quickly. In 2018 the ratio of new homes to total housing stock was estimated to have reached near 2.5 percent—about 5 times larger than in the post-crisis dip. The growth in the house price to building cost index—albeit still above precrisis levels—thus slowed to 1 percent in 2018, compared to a 12 percent increase in 2016 and a 7 percent increase in 2017.

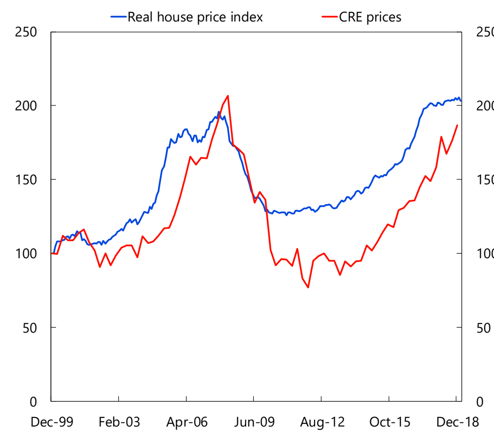
An empirical model suggests that the evolution of house prices is well captured by fundamentals. The model suggests that house price growth can be well explained by the recent evolution of short-term demand factors and medium-term supply factors. Misalignments in house prices are estimated using an error-correction model, where changes in house prices serve as dependent variable. The explanatory variables capture demand-side factors, while supply is assumed to be relatively inelastic in the short run but has an impact on house prices in the long run. House price levels in 1997–2001 are used as alternative base levels from which the fitted values of the house price increases are accrued. The findings are summarized by a 0-1 variable that takes 1 if the average estimated overvaluation is at or above 10 percent of the equilibrium price. The model finds housing overvaluation in 21 out of 50 countries included in the sample but does not find overvaluation in Iceland. That said, model results are subject to uncertainty.

Real Estate Price to Income Ratio
(Index, Q1-2000=100)



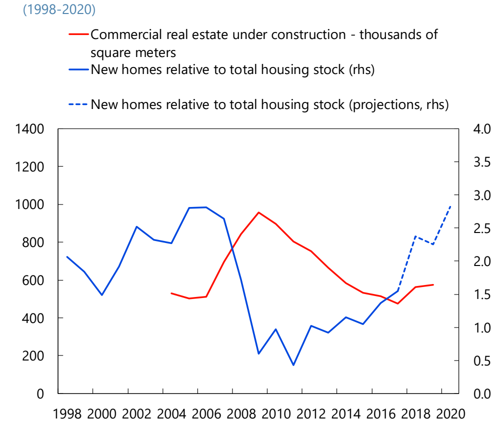
Sources: OECD, Global Property Guide and IMF staff calculations.

Real Estate Indices
(Index, Dec-1999=100)



Sources: CBI and IMF staff calculation.

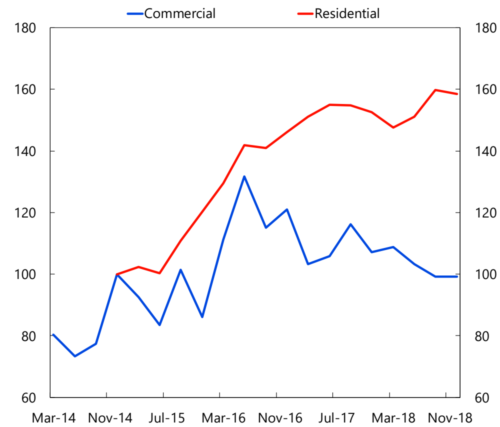
Supply of Housing and Commercial Real Estate
(1998-2020)



Sources: Federation of Islandic Industries, Registers Iceland, Reykjavik Economics, Statistics Iceland, CBI and IMF staff calculations.

Risks related to residential mortgages appear mitigated, unless prices were to fall quickly. Mortgage debt increased by 4 percent in 2018, and total household debt to disposable income rose by 3.6 percentage points to 148.6 percent—well below the average in advanced peer countries (200 percent in 2017). Iceland's regulatory cap on LTVs is 0.85. Albeit one of the highest among Northern European countries, it is below the median cap among advanced economies.[8] The average LTV ratio was at a historical low (0.6) in 2018 and well below the macroprudential regulations, although its continued decline observed in 2010–2017 has recently halted. With still high prices and elevated household debt, mortgage loan quality could deteriorate if the price growth slowdown were to turn into a quick fall.

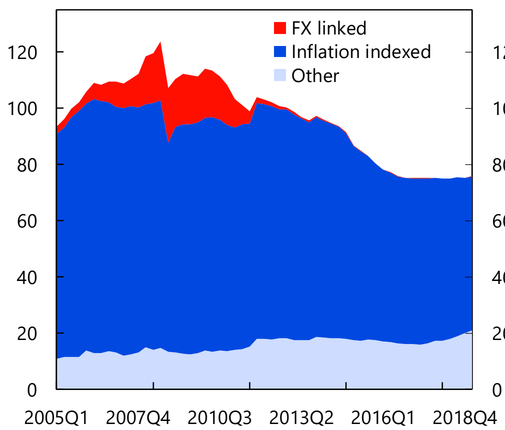
Real Estate Turnover
(Index Dec 2014=100)



Sources: Registers Iceland, Statistics Iceland, CBI and IMF staff calculations.

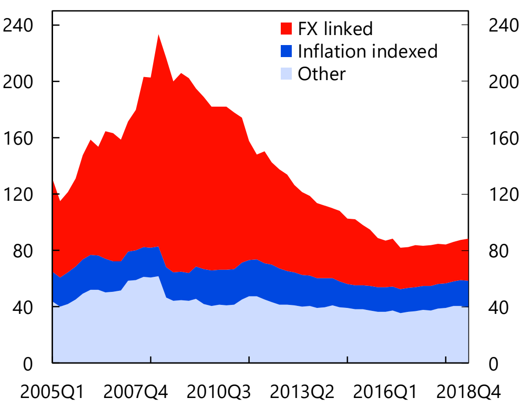
Recent regulations on CPI-indexed debt could further curb price growth of residential real estate. CPI-indexed debt is a significant portion of household debt, representing approximately 78 percent of total household debt (vs. 19 percent of corporate debt) and 24 percent of new household loans in 2019 (down from 33 percent in 2018). While the debt service burden for non-indexed loans is higher than that for indexed loans at the beginning of the loan period, equity accumulates faster. The gradual decline in the share of indexed loans might reflect the

Household Debt
(Percent of GDP)



Sources: CBI; and Statistics Iceland.

Nonfinancial Corporate Debt 1/
(Percent of GDP)



Sources: CBI; and Statistics Iceland.
1/ Excludes holding companies.

choice of Icelandic households to shield themselves from inflation, even at the cost of higher monthly debt service burden at the beginning of the loan period. A recently proposed bill would require banks to apply a quasi-CPI index that excludes house prices for indexed mortgages. This could make it difficult for banks to finance such mortgages with covered bonds, possibly increasing interest rates and cooling down the housing market.

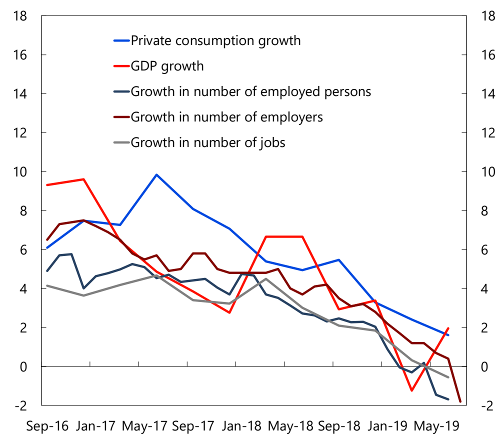
[8] First-time home buyers might be granted loans up to 90 percent of the property values. The LTV cap for some pension funds is set at 75 percent.

Commercial Real Estate

Commercial real estate (CRE) prices are growing, but signs of slowing have emerged. The supply of new CRE was on a declining path ever since the crisis and increased for the first time in 2017–2018. Commercial real estate prices rapidly accelerated by 18 percent in 2018, compared to an average of 15 percent in previous five years. However, with turnover decreasing by 5 percent in 2019H1 year on year, and declining leading indicators of demand for commercial property, signs point to an incoming slowdown.

Risks in CRE-backed lending are moderate despite emerging pressure points. Lending backed by commercial real estate grew by 10.2 percent at constant prices in 2018, concentrated in construction, hotels and retail sectors. The outstanding balance of loans of the three largest banks to real estate firms amounted to ISK 362 billion—14 percent of the total stock of customer loans in 2019H1. LTV ratios have declined, mostly thanks to higher prices, and banks have been successful at limiting their exposure to CRE risk. Nonetheless, banks' exposure to the hotel sector remains elevated. While the hotel sector accounts for only 7 percent of total bank exposure to CRE-backed loans, hotel-related loans with LTV ratios above 80 percent increased by 30 percent in 2018. This emerging source of risk could present a problem in case of a prolonged tourism sector slowdown and warrants careful monitoring.

Measures of Growth in Demand for Commercial Property
(Year-on-year percent change)



Sources: CBI.

Annex VI. Foreign Reserves and the Buildup of Excess Structural Liquidity

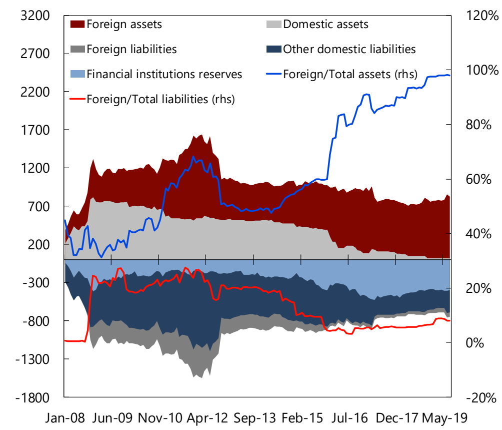
CBI's foreign assets have nearly doubled since the financial crisis. In 2005–12, CBI's balance sheet grew eighteenfold before reaching its highest point in February 2012, approximately ISK1.638 bn in assets, equivalent to almost 100 percent of GDP. Since then, it has gradually contracted reaching half the size in July 2019—ISK823 bn (29 percent of GDP, and still twice as much as it was at the onset of the 2008 crisis). The share of foreign assets has increased significantly in the last ten years, rising from 26 percent of total assets at the end of 2008, to 97 percent of total assets in July 2019. These foreign assets back domestic liabilities that today represent about 90 percent of total CBI liabilities (which have largely displaced foreign liabilities accumulated during the crisis).

CBI's foreign asset accumulation has taken place alongside a large buildup of structural liquidity in the system. In 2015–2017, CBI's share of total FX market turnover peaked above 50 percent of total turnover, aiming to ensure accumulation of adequate international reserves prior to the planned lifting of CFM. In this period the CBI bought ISK840 bn worth of foreign currency. Low returns on foreign assets and high sterilization costs, which have varied with exchange rate fluctuations, have worsened the CBI's income position. The structural liquidity accumulated in the system because of reserve accumulation has cost the CBI about 6.5 billion ISK (¼ percent of GDP).

Iceland's gross foreign reserves provide a comfortable buffer. Gross reserves are at a level equivalent to 26 percent of GDP, 147 RAM, and about 4 times the size of short-term external debt payments (Box 2). With the ongoing process of CFM liberalization and bunching of external debt payments in 2020 and 2021—8.5 and 7.6 percent of GDP respectively—the existing reserve buffer provides a safe cushion to balance of payments risks and does not suggest that international reserves are excessive yet.

Balance Sheet

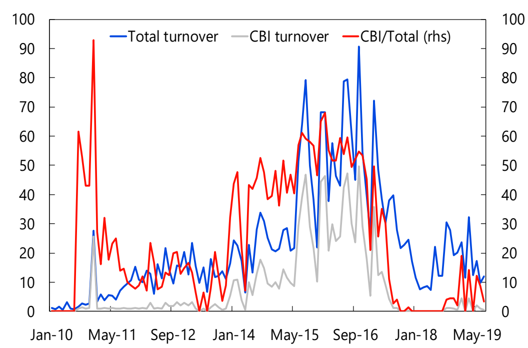
(Billion ISK) (Percentage points)



Sources: CBI and IMF staff calculations.

FX Turnover

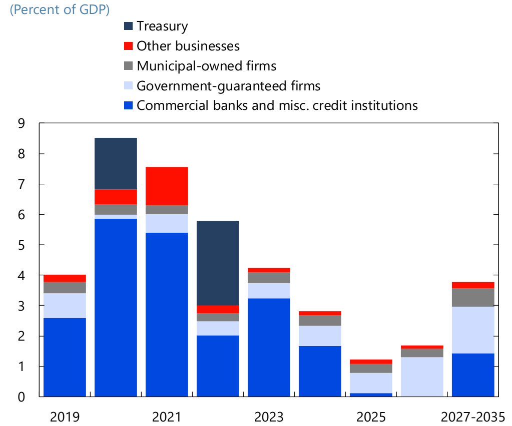
(Billion ISK) (Percent)



Sources: CBI and IMF staff own calculations.

Repayment Profile of Long-term Foreign Loans [1/]

(Percent of GDP)



1/ Foreign long-term loans based on position as of end-2018 and exchange rate of 26 February 2019.

Sources: Statistics Iceland and CBI.

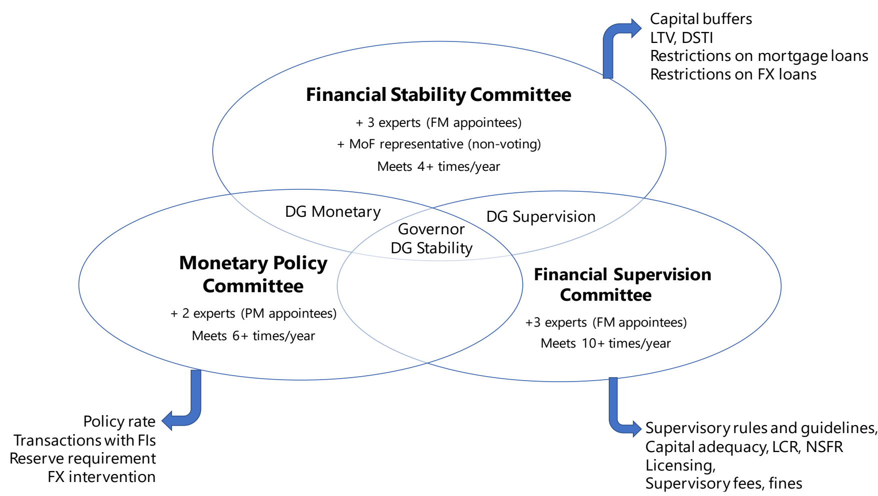
There are a options to mitigate the negative impact of maintaining high levels of foreign assets on CBI's income position while also improving systemic liquidity management. In June 2018, the CBI changed its reserve remuneration policy, excluding one of the 2-percent reserve requirement from remuneration. This, jointly with the concurrent ISK devaluation, has likely contributed to improving the CBI's income position.[1] Swapping a part of CBI's foreign assets with the Ministry of Finance for treasury bills—despite their extremely limited availability—would help improve CBI's income position. The CBI could use the treasury bills in repurchase operations, thus strengthening its capacity to sterilize foreign exchange operations (See 2017 Staff Report). The CBI could also consider a revision of the remuneration of excess reserves, currently at 25 basis points below the policy rate.

[1] See also Jónsdóttir (2019) for an extensive overview of the CBI's liquidity management system.

Annex VII. Iceland's Financial Oversight Architecture Reform

In June 2019, Parliament passed legislation to merge the CBI and FME, which will take effect in January 2020.

The CBI will pursue several objectives, supported by three internal policy committees. CBI's primary objectives will include price stability, financial stability, and sound and secure financial activities. Three policy committees and three deputy governor (DG) positions will be created to achieve each policy objective. All committees will be chaired by the Governor. The Financial Supervisory Committee will be chaired by DG for supervision when the discussion is not related to issues of solvency and liquidity of systemically important financial institutions (SIFIs). The committees have overlapping membership and include external experts appointed by the Prime Minister (PM) or the Finance Minister (FM) (see figure). The Permanent Secretary or a representative from the Ministry of Finance (MoF) participates in the Financial Stability Committee meetings as a non-voting member. The decisions that are not entrusted to the committees (such as management of international reserves, lender-of-last resort, CFM) are made by the Governor and DGs.



The effectiveness of the framework, including the committees' task distribution, will be reviewed in two years. With three commercial banks considered systemic and accounting for 98 percent of system assets, the distinction between micro-prudential and macroprudential policies is inherently difficult in Iceland, leading to overlapping tasks in the supervision of SIFIs. The new framework assigns decisions on the buffer requirement (countercyclical capital buffer and systemic risk buffer) and the SIFI designation to the macroprudential committee, while the micro-prudential committee is tasked with the calibration of prudential requirements, including capital (minimum and pillar 2) and liquidity requirements.

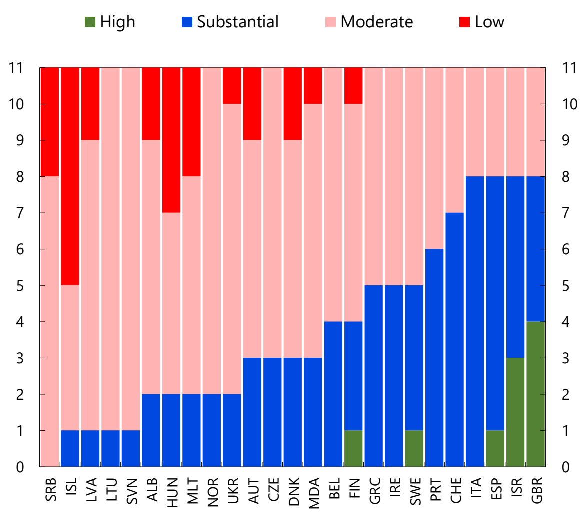
Depending on the details of its implementation and the framework being tested in practice another area that may warrant a future review is the operational independence entrusted to the CBI committees. The legislation provides the parliamentary-elected supervisory board of the central bank with a task to endorse the rules of the policy committees. Care may be needed that their endorsements do not go beyond ensuring compliance with statutory provisions. Also, the MoF maintains the powers to formulate a financial stability strategy. Given that the financial stability mandate is given to the CBI, and the FM has indirect influences through appointment of the DGs and experts participating in the Financial Stability Committee, it could be more appropriate to provide greater autonomy on this strategy to the CBI's Financial Stability Committee.

The implementation of these institutional changes would also need to ensure the adequacy of resources and powers for supervisory work, which is not explicitly addressed in the legislation, but was previously raised in the 2014 Basel Core Principles. The legislation rather focuses on merging the FME in the current form with the CBI and does not clearly spell out the availability of these requisites to ensure that the CBI pursues its additional mandate. This need is particularly acute in the context of high government ownership of the banking sector. Care should also be taken that the current practice of an annual parliament-approved supervisory fee does not undermine autonomy or adequate resources for supervisory work.

Annex VIII. Strengthening Iceland's AML/CFT Framework

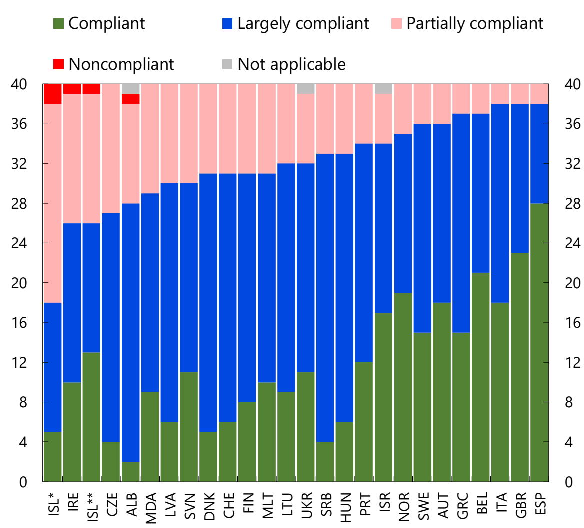
In 2018, the FATF identified a number of weaknesses in Iceland's AML/CFT framework. The mutual evaluation found that Iceland complied/largely complied with 18 out of the FATF 40 recommendations that relate to the legal and institutional AML/CFT framework. The report also found that Iceland had achieved a sufficient level of effectiveness under only one out of 11 predefined outcomes—criteria defining jurisdictions' AML/CFT effectiveness. Iceland entered a review process in June 2018 and had a one-year observation period to address its main deficiencies. In October 2019, while recognizing the progress made by the authorities since the 2018 report, the FATF publicly listed Iceland as a jurisdiction with strategic AML/CFT deficiencies (grey-listing). An action plan was developed to address the remaining deficiencies in the AML/CFT regime.

European Countries: Assessment Ratings of Effectiveness



Note: Includes only European countries for which assessments under the 2013 FATF Methodology are available. Based on MONEYVAL assessments for ALB, CZE, HUN, ISR, LVA, LTU, MDA, MDA, SRB, SVN, and UKR; FATF assessments for AUT, BEL, CHE, DNK, ESP, FIN, GBR, GRC, IRE, ISL, NOR, PRT, and SWE; and IMF/FATF assessment for ITA. Ratings reflect the extent to which a country's measures are effective. The assessments are conducted on the basis of 11 immediate outcomes, which represent key goals that an effective AML/CFT system should achieve.
Source: Financial Action Task Force (FATF), *Consolidated Assessment Ratings*, November 5, 2019.

European Countries: Assessment of Technical Compliance



Note: Includes only European countries for which assessments under the 2013 FATF Methodology are available. Based on MONEYVAL assessments for ALB, CZE, HUN, ISR, LVA, LTU, MDA, MDA, SRB, SVN, and UKR; FATF assessments for AUT, BEL, CHE, DNK, ESP, FIN, GBR, GRC, IRE, ISL, NOR, PRT, and SWE; and IMF/FATF assessment for ITA. Ratings reflect the extent to which a country has implemented the 40 technical (legal) requirements of the FATF Recommendations. *=Mutual evaluation report, April 2018; **=First follow-up report, September 2019.
Source: Financial Action Task Force (FATF), *Consolidated Assessment Ratings*, November 5, 2019.

The authorities have actively sought to implement the FATF's recommendations. Interagency coordination and information sharing were improved through a steering committee on AML/CFT and cooperation agreements. Increased risk-based supervision of obliged entities has taken place, and a new supervisory division within the Directorate of Internal Revenue was created to ensure proper oversight and monitoring of non-financial institutions. An automated system to enhance operational and strategic analysis has been secured and is expected to be fully operational by April 2020. The Act on the Registration of Beneficial Ownership, which sets up a beneficial ownership register within the business registry, entered into force in June 2019 and is expected to be fully implemented by end-2019. In September 2019, the FATF concluded a follow-up report of Iceland's technical compliance and upgraded its ratings with regard to 13 recommendations.

Several actions demonstrating AML/CFT effectiveness remain outstanding. Iceland is yet to show tangible progress in: (i) ensuring access to accurate basic and beneficial ownership information for legal persons by competent authorities in a timely manner; (ii) introducing an automated system for suspicious transaction reports filing and strengthening the FIU's capacity to conduct operational and strategic analysis; (iii) ensuring implementation of the targeted financial sanctions requirements among financial and non-financial institutions through effective supervision; and (iv) ensuring effective oversight and monitoring of non-profit organizations in line with identified terrorism financing risks.

Despite the recent grey-listing, Iceland has not experienced significant pressures in financial markets or payments, but continued vigilance is required. The authorities and banks preemptively secured open channels of communication with domestic and foreign counterparties to provide updates on AML/CFT progress and avert possible adverse effects of the grey-listing. No interruptions or restrictions on existing correspondent banking relationships have occurred, but there is uncertainty as to whether there will be an impact on the ease of establishing new relationships. Some global banks—especially those that are under pressure to derisk—are requesting additional information as part of customer due diligence processes and applying stringent ownership requirements.

INTERNATIONAL MONETARY FUND

ICELAND

December 4, 2019

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

The European Department
(in consultation with other departments)

CONTENTS

FUND RELATIONS

(As of October 31, 2019)

Membership Status: Joined December 27, 1945

General Resources Account:	**SDR Million**	**Percent of Quota**
Quota	321.80	100.00
Fund holdings of currency	252.00	78.31
Reserve tranche position	69.80	21.69

SDR Department:	**SDR Million**	**Percent of Allocation**
Net cumulative allocation	112.18	100.00
Holdings	113.10	100.82

Outstanding Purchases and Loans: None

Latest Financial Arrangements:

Type	**Approval Date**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
Stand-By	Nov. 19, 2008	Aug. 31, 2011	1,400.00	1,400.00
Stand-By	Mar. 22, 1962	Mar. 21, 1963	1.63	0.00
Stand-By	Feb. 16, 1961	Dec. 31, 1961	1.63	0.00

Projected Payments to the Fund [1]
(SDR million; based on existing use of resources and present holdings of SDRs):

	2018	2019	2020	2021	2022
Principal	0.00	0.00	0.00	0.00	0.00
Charges/Interest	0.00	0.00	0.00	0.00	0.00
Total	0.00	0.00	0.00	0.00	0.00

Implementation of HIPC Initiative: Not applicable

Implementation of Multilateral Debt Relief Initiative (MDRI): Not applicable

Implementation of Catastrophe Containment and Relief (CCR): Not applicable

[1] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Exchange Rate Arrangement and Exchange Restrictions:

The *de jure* exchange rate arrangement is free floating, and the *de facto* exchange rate arrangement under the IMF classification system is floating. In the period from November 2018 to October 31, 2019, the Central Bank of Iceland (CBI) intervened in the foreign exchange market on 14 of the 248 working days. The CBI publishes daily data on its foreign exchange intervention with a lag.

Iceland has accepted the obligations under Article VIII, Sections 2(a), 3, and 4 and maintains no exchange restrictions subject to Fund jurisdiction under Article VIII, Section 2(a). Iceland continues to maintain certain measures that constitute exchange restrictions imposed for security reasons based on UN Security Council Resolutions.

Safeguards Assessment:

Iceland repaid all Fund credit outstanding ahead of schedule in October 2015. The CBI is no longer subject to safeguards monitoring.

Last Article IV Consultation:

Discussions for the 2018 Article IV Consultation were held in Reykjavik during September 13–25. The staff report (Country Report No. 18/318) was considered by the Executive Board on November 9, 2018. Article IV consultations with Iceland are currently held on a 12-month cycle.

Technical Assistance:

Department	Purpose	Date
MCM	Capital account liberalization	March 2010
MCM	Reserves building and liquidity management	June 2010
MCM	Public debt management	July 2010
FAD	Fiscal framework issues	August 2010
MCM	Capital controls liberalization	November 2010
MCM	Converging to EU regulations-credit bureaus	January 2011
MCM	Liquidity management	March 2011
FAD	Tax policy	March 2011
STA	External Sector Statistics	April 2011
FAD	Organic Budget Law	October 2011
FAD	Follow up on Organic Budget Law	May 2012
MCM	Capital account liberalization	March 2013
FAD	IPSAS in Iceland: Towards Enhanced Fiscal Transparency	December 2013
FAD	VAT reform	February 2014
MCM	Capital controls liberalization	May 2014
MCM	Banking supervision	February 2015
MCM	Banking supervision	March 2015

MCM	Stress testing	April 2015
FAD	Workshop on Distributional Effects of Tax Reforms and Expenditure Measures	April 2015
MCM	Banking supervision	September 2015
MCM	Banking supervision	March 2016
FAD	Organic Budget Law implementation	April 2016

STATISTICAL ISSUES

I. Assessment of Data Adequacy for Surveillance
General. Data provision to the Fund is adequate for surveillance purposes. The composition agreements reached by the bank estates in the winter of 2015–16 had large impacts on the fiscal, monetary, and external sectors. The estates' "stability contributions" are recorded in the general government data on an accrual basis in 2016. The monetary data have been affected in both 2015 and 2016. In the external sector, the compositions entailed a large step reduction in the estates' foreign liabilities in December 2015, and a reclassification of their remaining foreign assets and liabilities from "deposit money banks in winding up proceedings" (which no longer exists as a category) to "financial holding companies"—classified in both the balance of payments (BoP) and the international investment position (IIP) under "Other sectors—other financial corporations."
National accounts. The existing methodological framework for producing national accounts data was replaced in September 2014 with the new *European System of Accounts 2010* and data starting in 1997 were revised. Expenditure-based GDP data are available by component on a quarterly basis. Nonetheless, there is still scope for improvement: • Income accounts by sector are not sufficiently detailed and available only on an annual basis with a significant lag; and • Production-based GDP or gross value added by industry are available only on an annual basis and only in nominal terms, with a considerable lag.
Price statistics. Data provision is adequate for surveillance.

I. Assessment of Data Adequacy for Surveillance (concluded)	
Government finance statistics. The authorities publish a treasury cash flow statement monthly, data on general government operations on an accrual basis quarterly and annually, and data on general government financial assets and liabilities annually. Iceland reports government finance statistics in accordance with the *Government Finance Statistics Manual* 2014 framework in the *Government Finance Statistics Yearbook* and is an up-to-date contributor to the *International Financial Statistics.*	
Monetary and financial statistics. The concepts and definitions conform to the guidelines of the *Monetary and Financial Statistics Manual*. The CBI reports detailed monetary (CBI and deposit money bank) balance sheet data promptly at a monthly frequency.	
Financial sector surveillance. Iceland reports quarterly financial soundness indicators to STA, with data availability starting in Q4 2015.	
External sector statistics. Since 2014, the CBI has compiled BoP and IIP data according to the 6th edition of the *Balance of Payments and International Investment Position Manual.* Data were back-cast to 1995 for both the BoP and the IIP. The BoP data do not provide a breakdown of services before 2013.	
II. Data Standards and Quality	
Subscriber to the *Special Data Dissemination Standard (SDDS)* since June 1996. Uses SDDS flexibility options on the periodicity and timeliness of the industrial production index.	A *Report on the Observation of Standards and Codes* data module was published in November 2005.

Table 1. Iceland: Table of Common Indicators Required for Surveillance

(as of October 31, 2019)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]	Memorandum Items:[8]	
						Data Quality – Methodological Soundness[9]	Data Quality – Accuracy and Reliability[10]
Exchange Rates	October 30, 2019	October 30, 2019	D and M	D and M	D and M		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Aug. 2019	Sept. 2019	M	M	M		
Reserve/Base Money	Aug. 2019	Sept. 2019	M	M	M	LO, O, LO, LO	LO, O, O, O, O
Broad Money	Aug. 2019	Sept. 2019	M	M	M		
Central Bank Balance Sheet	Aug. 2019	Sept. 2019	M	M	M		
Consolidated Balance Sheet of the Banking System	Aug. 2019	Sept. 2019	M	M	M		
Interest Rates[2]	October 30, 2019	October 30, 2019	D	D	D		
Consumer Price Index	Aug. 2019	Sept. 2019	M	M	M	O, O, O, O	O, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Q2, 2019	Aug. 2019	Q	Q	Q	O, LO, O, LO	LO, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	Q2, 2019	Aug. 2019	Q	Q	Q		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Q2, 2016	Aug. 2019	Q	Q	Q		
External Current Account Balance	Q2, 2019	Aug. 2019	Q	Q	Q	O, O, LO, O	LO, O, O, O, O
Exports and Imports of Goods and Services	Q2, 2019	Aug. 2019	Q	Q	Q		
GDP/GNP	Q2, 2019	Aug. 2019	Q	Q	Q	O, LO, O, LO	LO, O, LO, LO, O
Gross External Debt	Q2, 2019	Aug. 2019	Q	Q	Q		
International Investment Position[6]	Q2, 2019	Aug. 2019	Q	Q	Q		

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

[7] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

[8] These columns should only be included for countries for which Data ROSC (or a Substantive Update) has been published.

[9] This reflects the assessment provided in the data ROSC or the Substantive Update (published in November 2005) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).

[10] Same as footnote 7, except referring to international standards concerning (respectively) source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.