



Tourism in Iceland: Here to stay?

Arion Research
September 2017

 Arion bank


Key conclusions

- Despite the fact that official figures exaggerate the actual number of foreign visitors, the big picture remains unchanged – numbers have grown remarkably and the importance of tourism to the economy has grown. Rising numbers of tourist not only generate revenue but also call for stronger infrastructure and various services.
- We expect a continued growth of tourism but at a more modest pace. In our baseline scenario the number of tourists increases by 11% in 2018 and 8% in 2019. The availability of flights to Iceland is the determining factor and there is considerable uncertainty in this regard.
- Occupancy rates at hotels have declined slightly in recent months so RevPAR has grown slower than ADR. We expect continued strong hotel investment which will probably be sufficient to meet the growing number of tourists.
- Tourism, as the largest export sector by far, has a major impact on the exchange rate of the króna. It is extremely rare for tourism to be such a determining factor for an economy and a currency area.
- The strong króna seems to have shortened the length of stay, which is reflected in a decrease in overnight stays in areas away from Keflavík International Airport. Tourists seem to have shifted their consumption away from goods towards experience, which might partly be explained by the high prices and strong króna. The effects of a high real exchange rate on tourism remains to be fully seen.
- Financial performance has recently been good overall but different circumstances, such as a stronger exchange rate, higher wages, higher VAT rate and slower growth present challenges. Mergers, acquisitions and other changes are likely to be the consequence of the current turmoil.

Arion Research is presenting its special report on tourism in English for the fourth time

Click the pictures to view previous reports





People are still coming (even though we're expensive)

Erna Bjorg Sverrisdottir
Arion Research



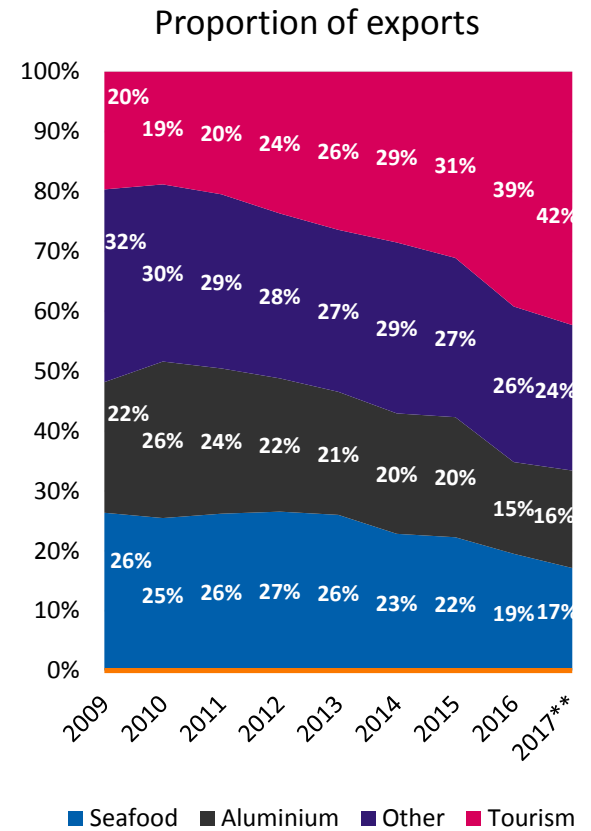
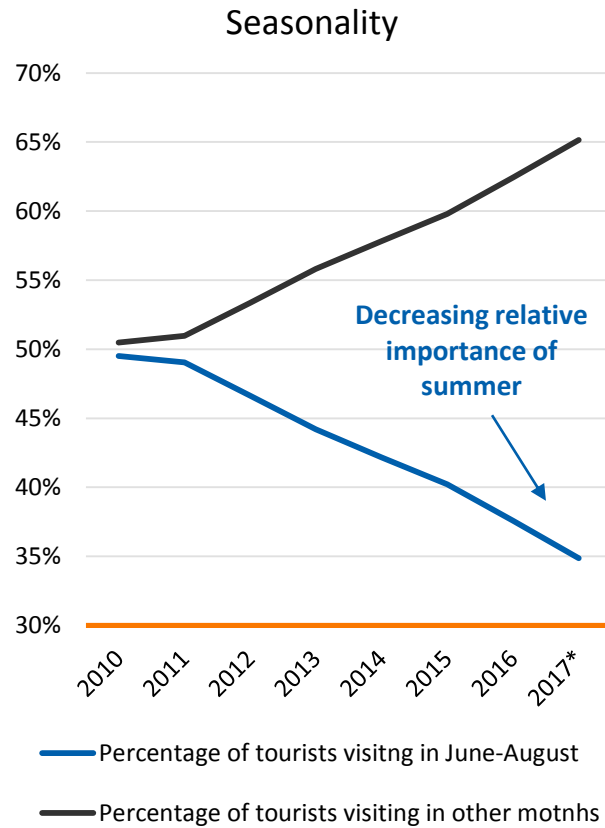
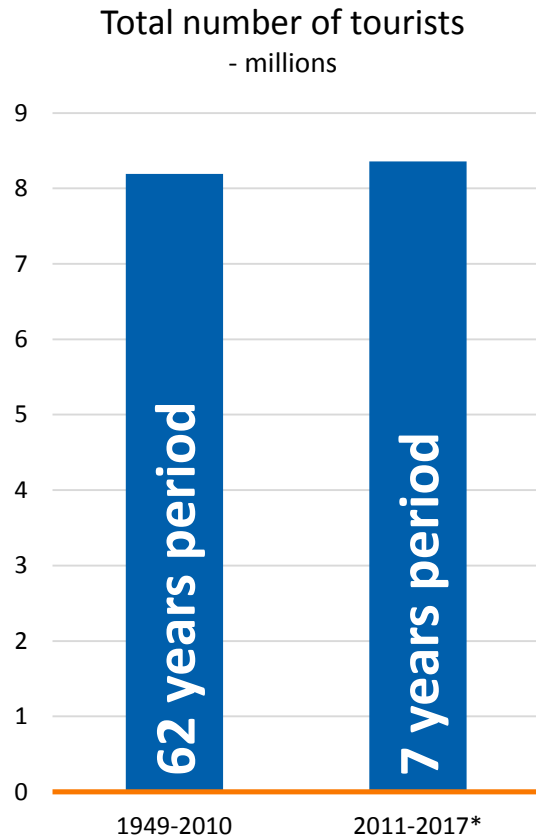


Importance is growing

From zero to hero

The old clichés

Tourist numbers have increased, seasonal fluctuations smoothed out and the tourist sector has flourished



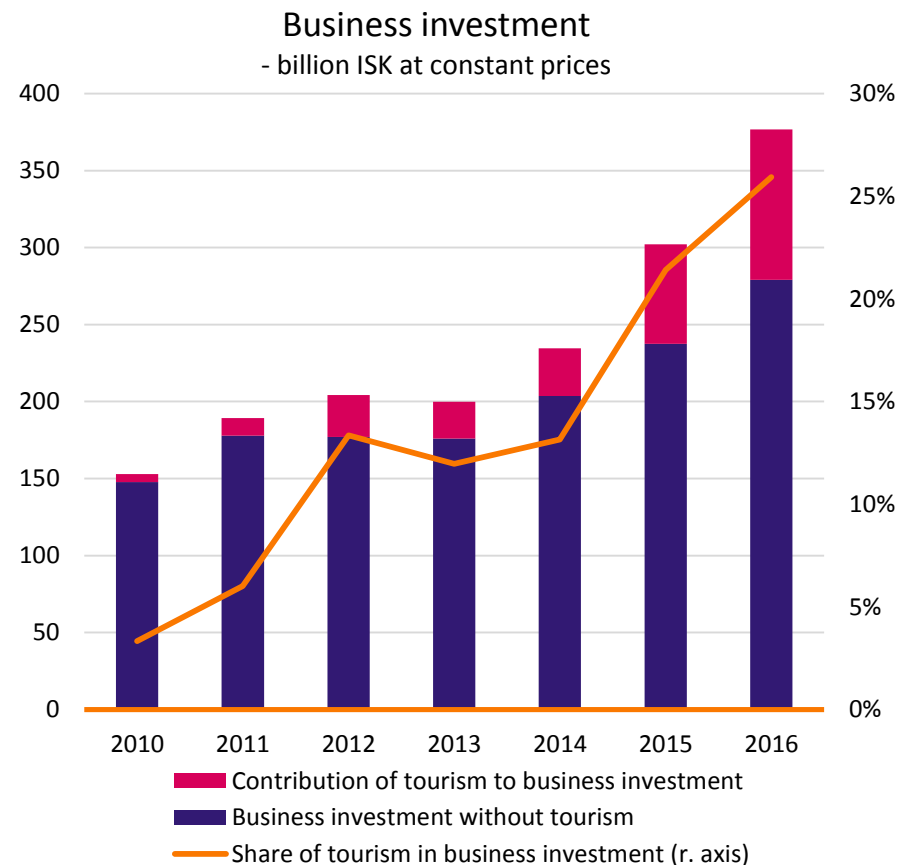
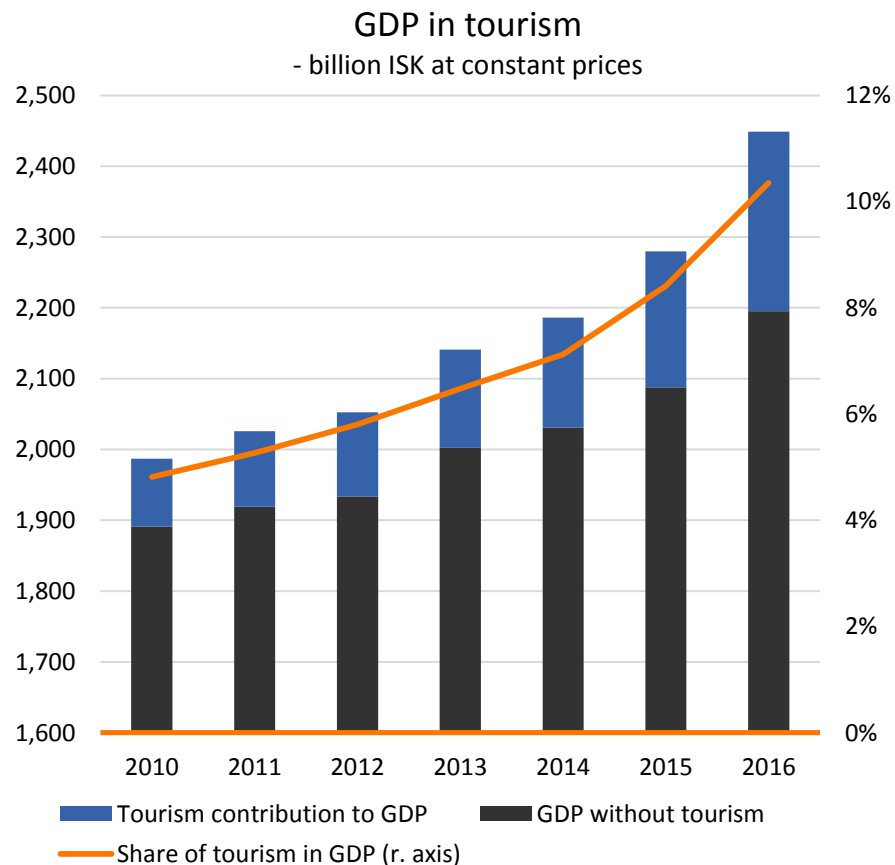
How many foreign tourists actually visit Iceland?

If we use the definition that a tourist is someone who stays overnight, the estimated number of tourists last year was 1.55 million, not 1.77 million as stated in official figures. Doesn't change the big picture.



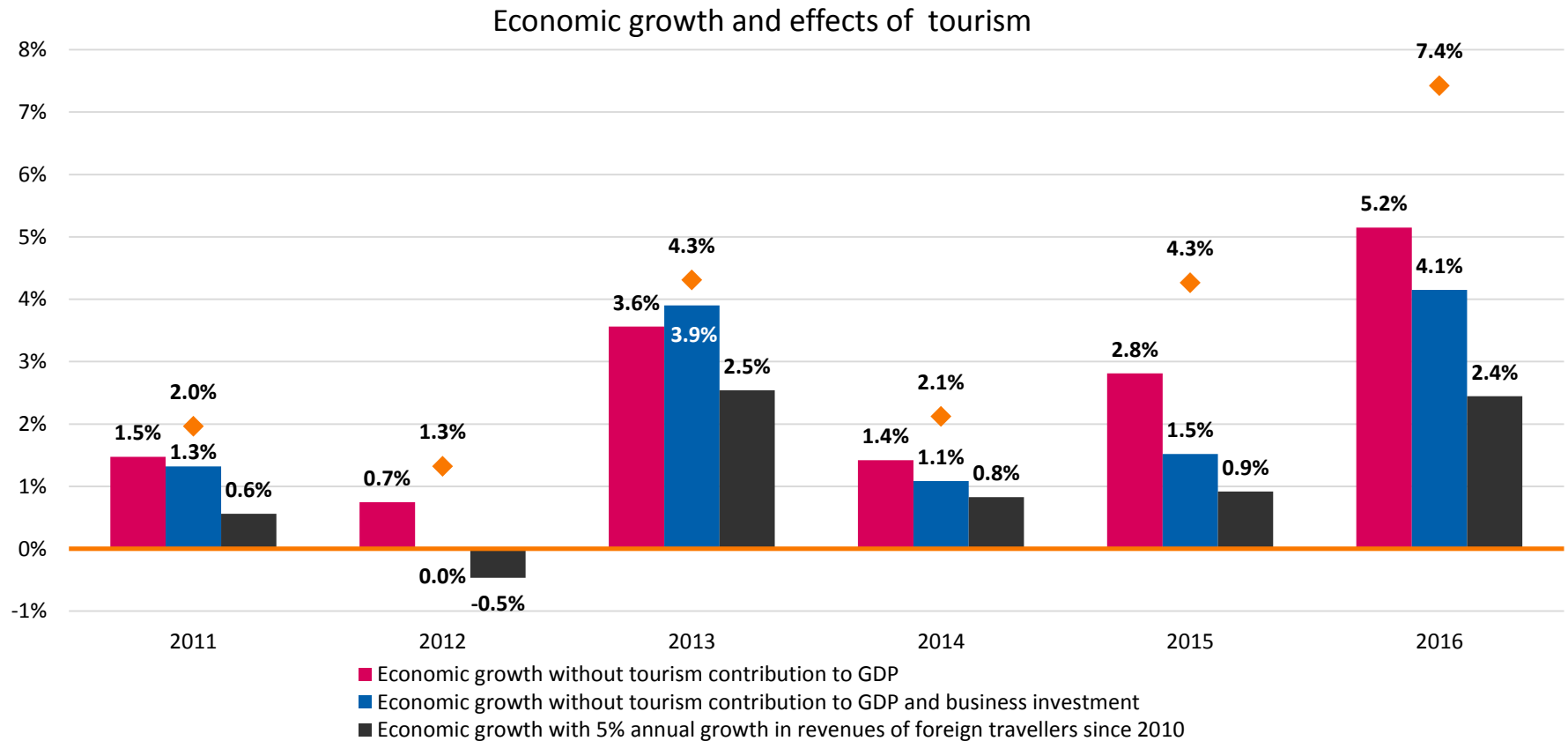
Importance of tourism in national accounts is growing

Tourism accounted for more than 10% of GDP last year – likely to be closer to 12% this year



7.4% GDP growth last year excluding tourism? Don't think so!

According to these measurements, GDP growth in 2016 would have been closer to 4% and GDP far lower than it is today



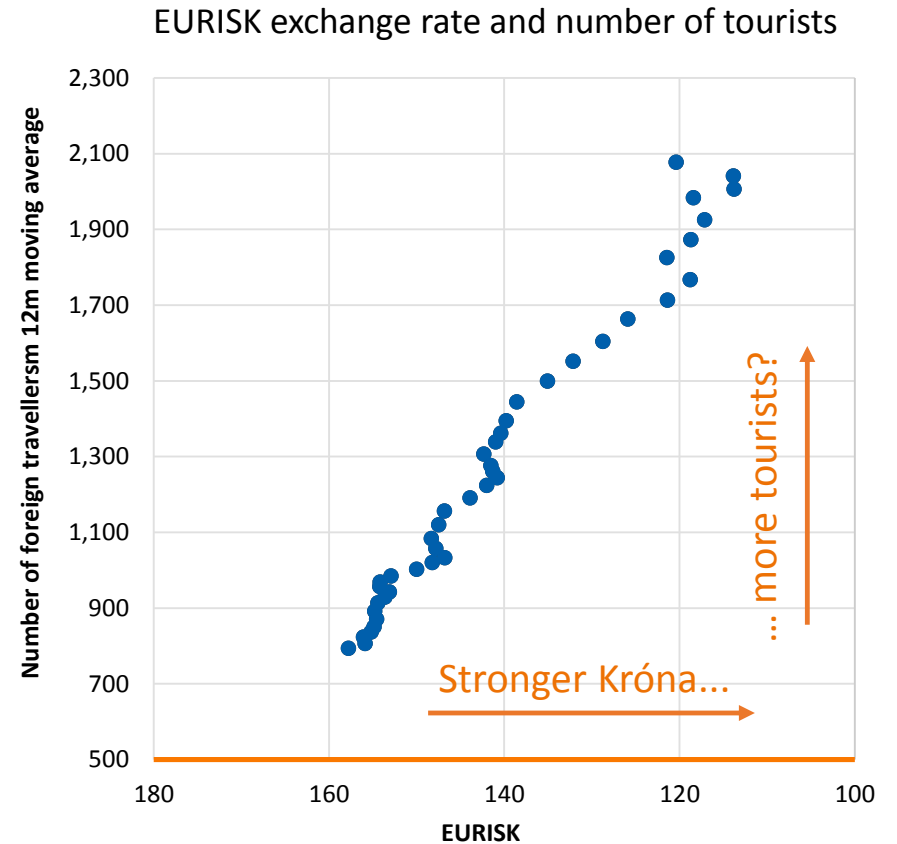
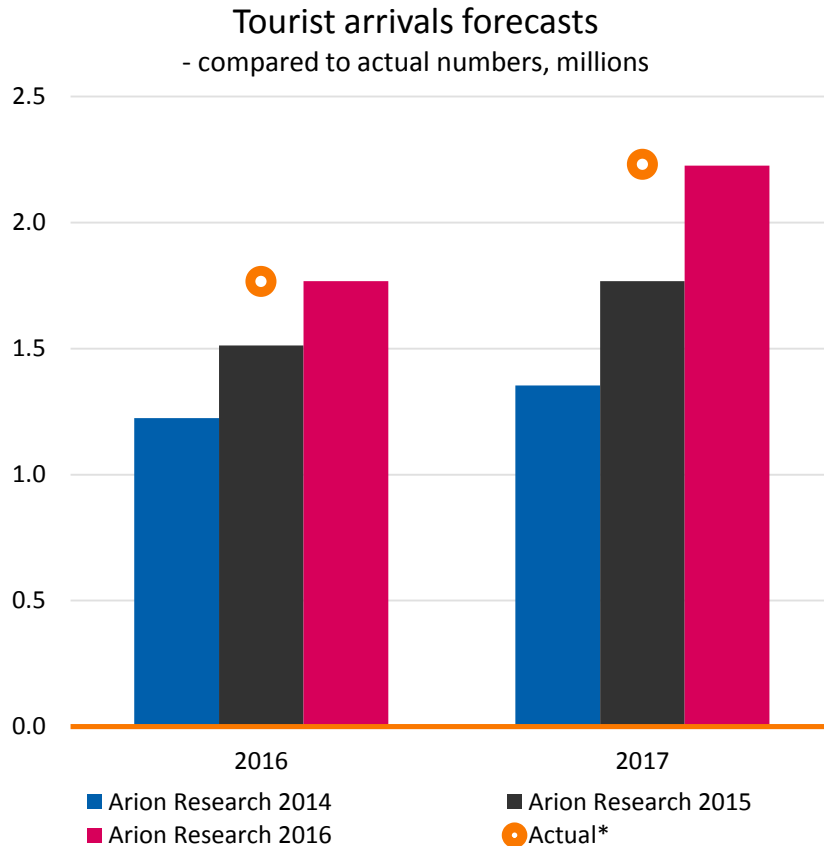


Arion Research's projections for number of tourists

Slower growth ahead

Tourist forecast: what do you do when the statistics let you down?

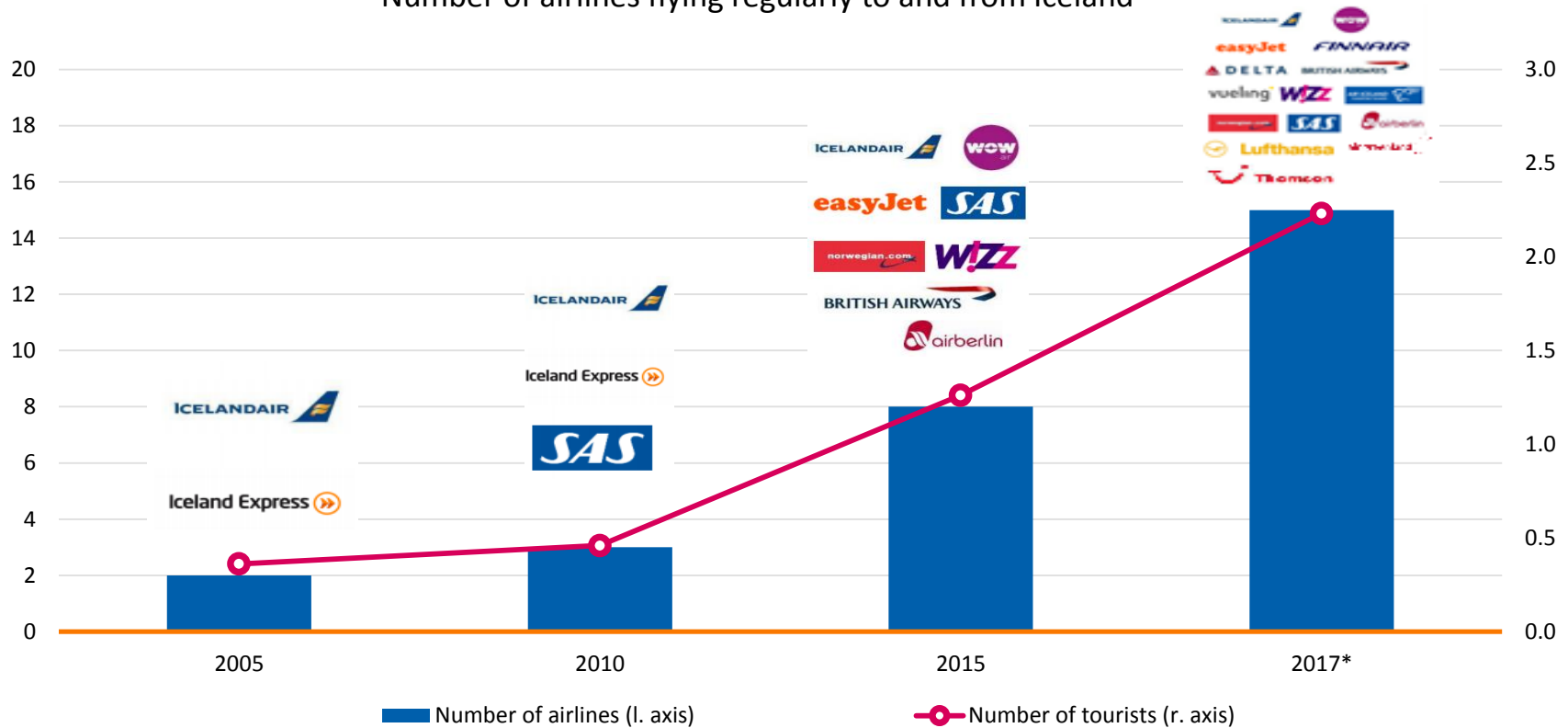
Until now we have based our forecast on data and past trends. What would the last few years tell us? Stronger króna, more tourists? Wait, what?



For a small island nation, the availability of flights is the key to increasing the number of tourists

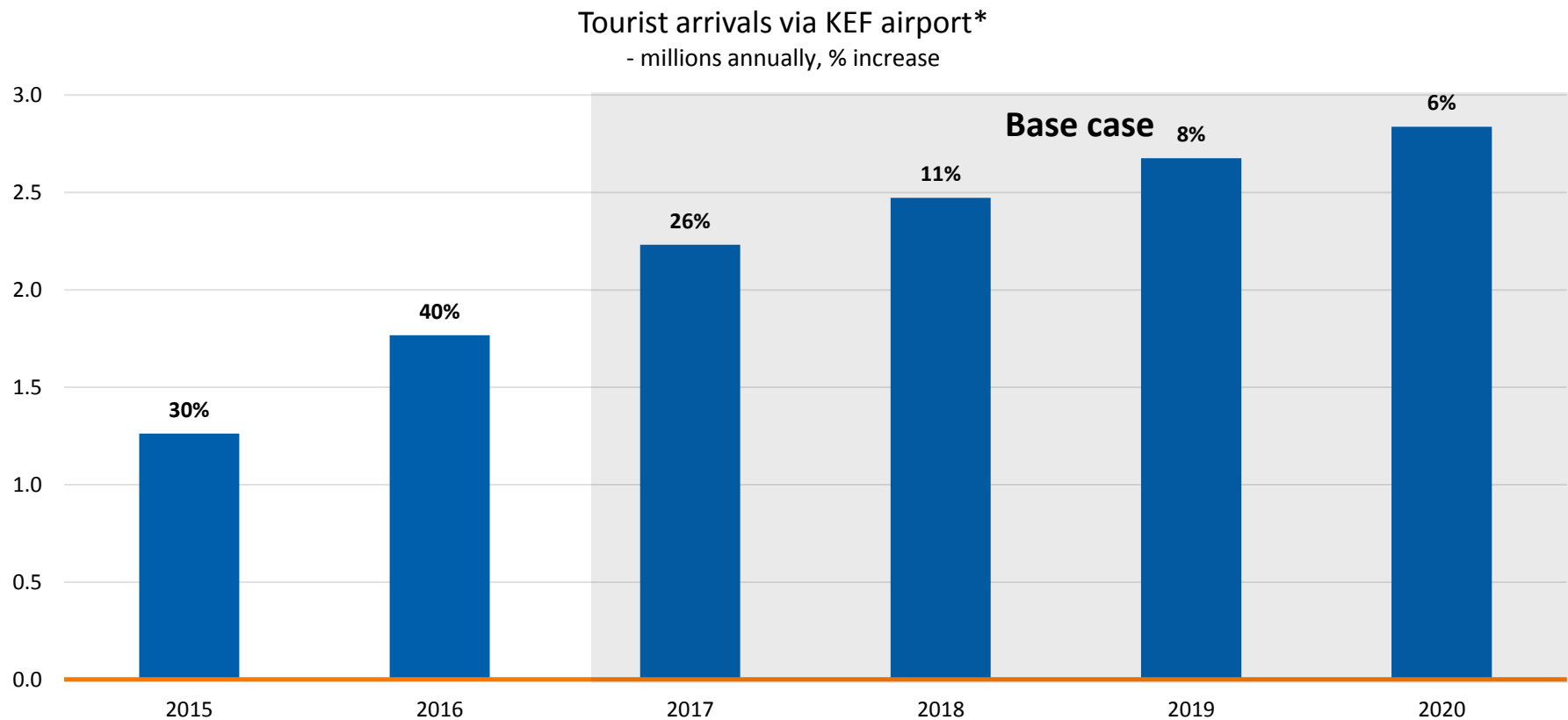
In 2005 two airlines flew to Iceland all year. In the winter of 2017 there will be 15. Any changes to the availability of flights will clearly have an effect on the numbers of foreign tourists visiting Iceland.

Number of airlines flying regularly to and from Iceland



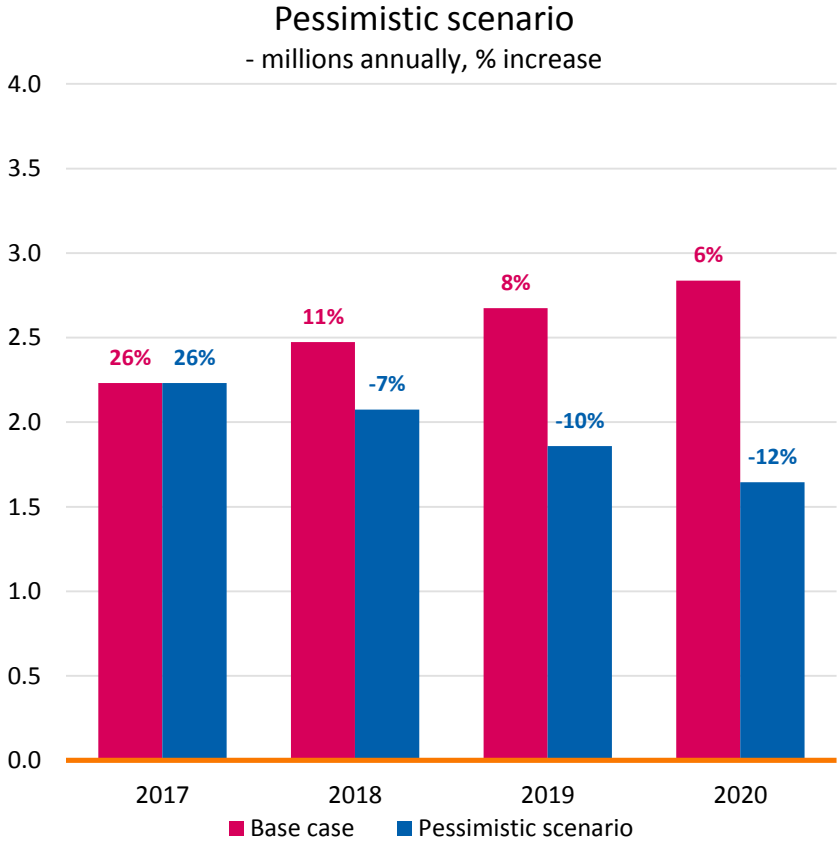
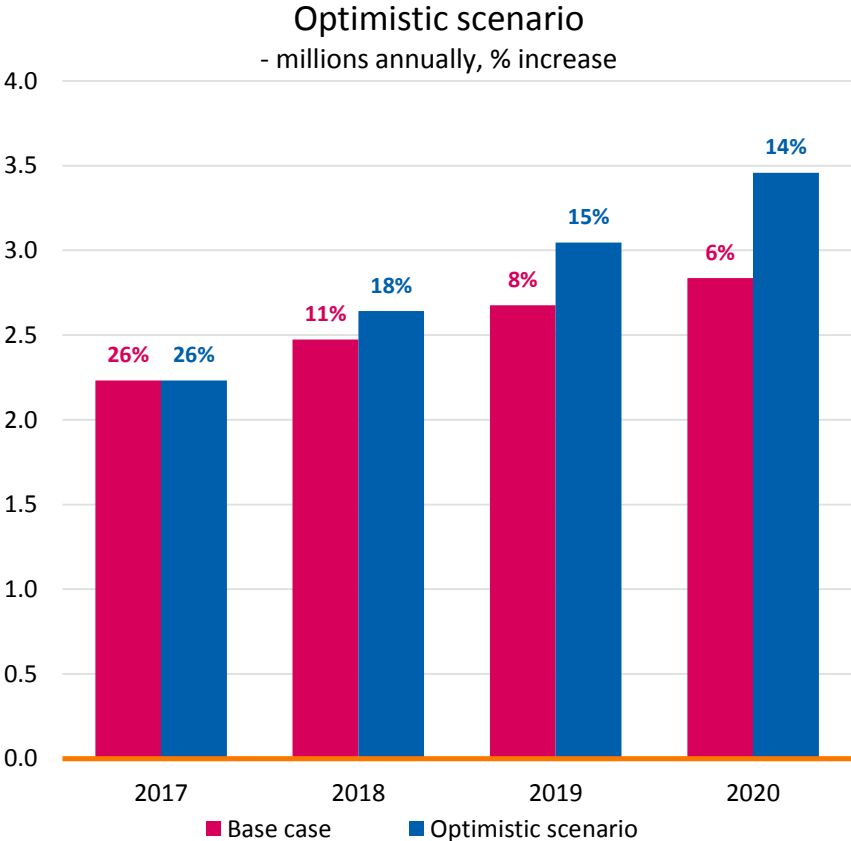
Base case: We expect almost 2.5 million tourists next year

Based on expected flight availability in next few years, which is in fact **subject to considerable uncertainty**



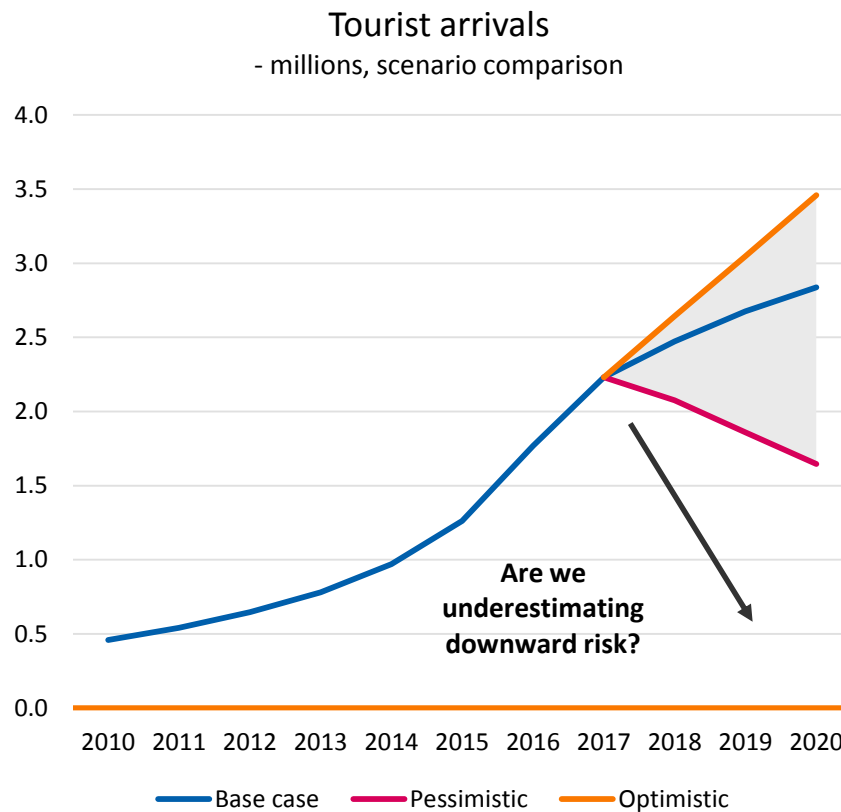
Three different scenarios: Optimistic, pessimistic and base case

Changing the assumptions regarding the operations of the airlines produces different scenarios



Great uncertainty, especially as you get further into the future

The availability of flights places certain restrictions on the growth of the number of tourists. However, there is no limit to how much the number of tourists can decrease – uncertainty underestimated?



- **Key factors:**

- Airlines

- Price of oil
- Salary expenses
- Competition

- Other factors:

- Exchange rate of the ISK
- Economic conditions for trading partners
- Natural disasters
- Competition with other destinations
- Reaching the limits of tolerance for
 - The countryside
 - Infrastructure
 - The locals
 - Tourists

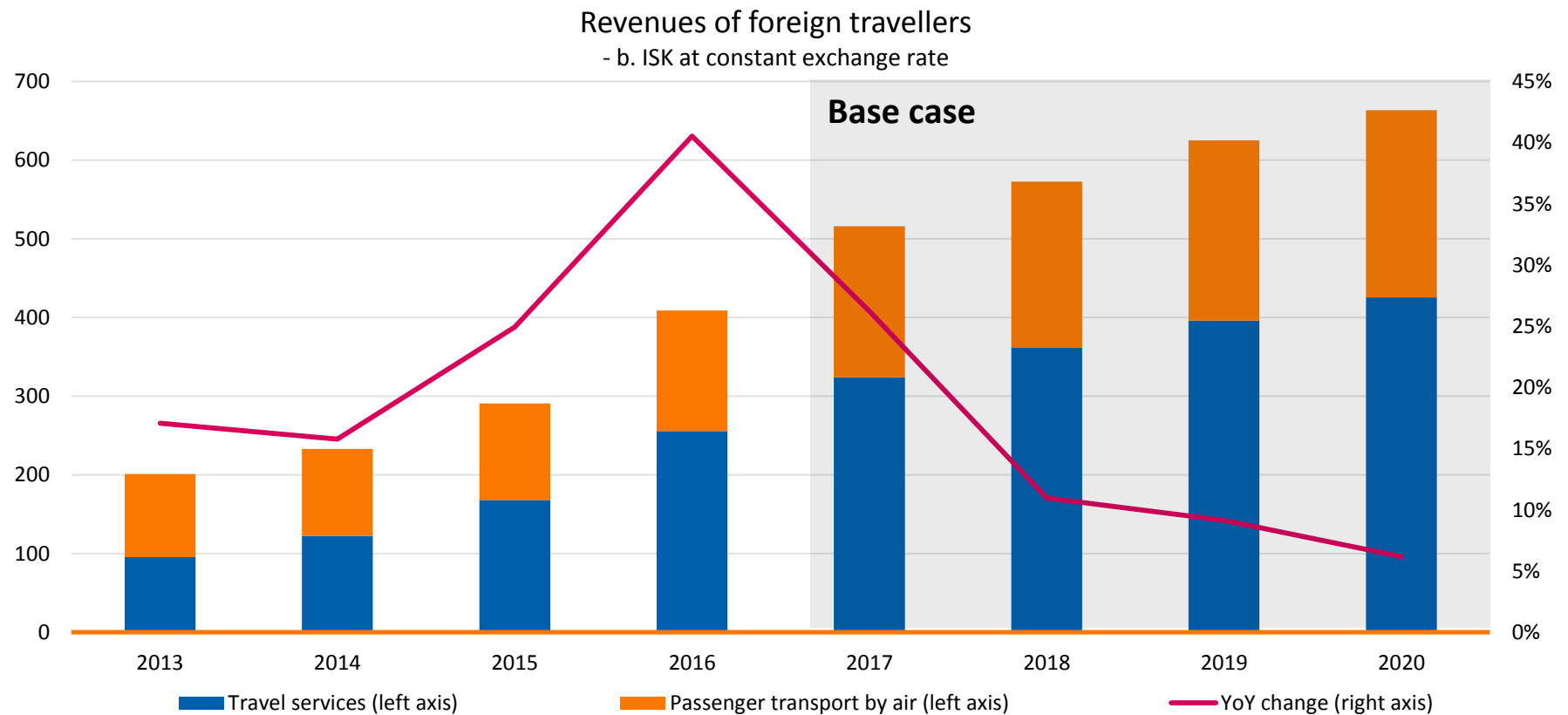


Playing with numbers: What does the base case mean for the Icelandic economy?

More tourists not only generate more revenue but also place more strain on infrastructure and require more service in the form of accommodation and entertainment

Revenue from foreign tourists will continue to grow but at a slower rate

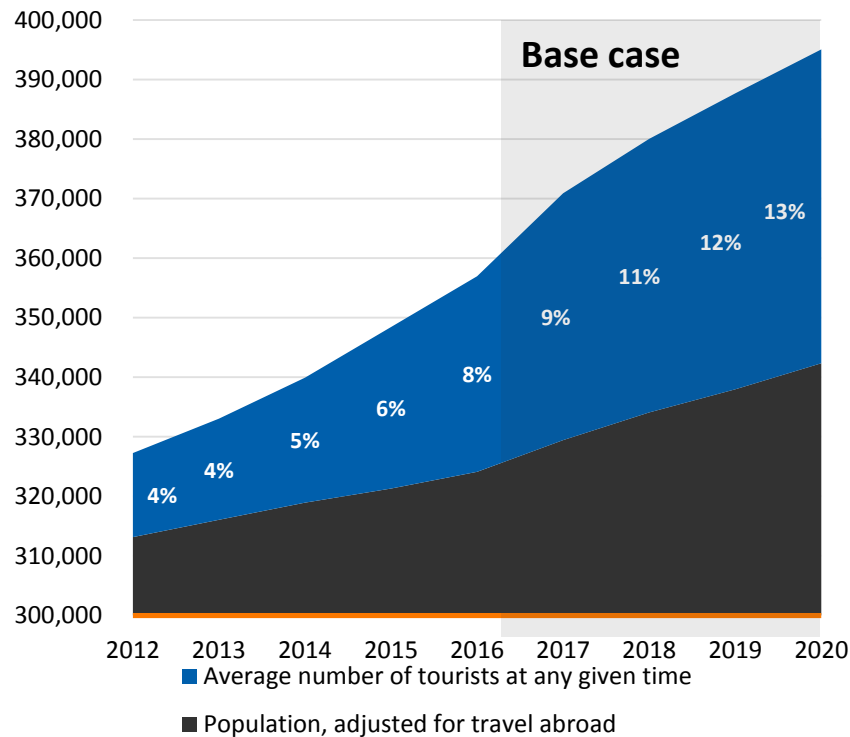
In our base case, we estimate that revenue from foreign tourists in 2017-2020 will be approximately ISK 2,400 billion, or the equivalent of Iceland's GDP last year!



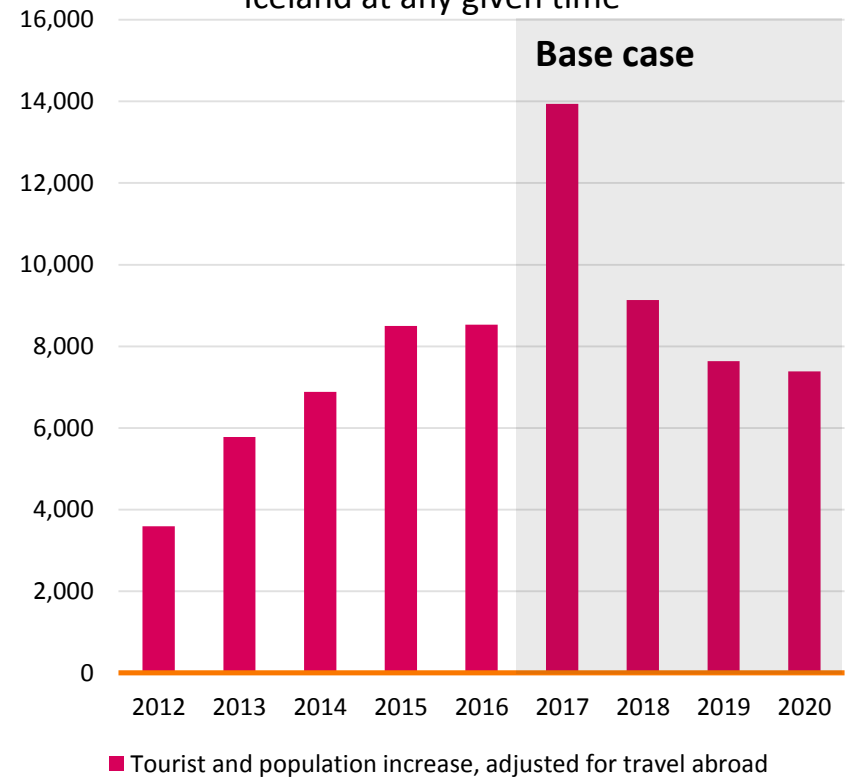
Increasing number of people in Iceland at any one time

Over the next 3 years the number of people in Iceland at any one time is expected to grow by 8,000 persons a year

Average number of people in Iceland
- and tourist % of total

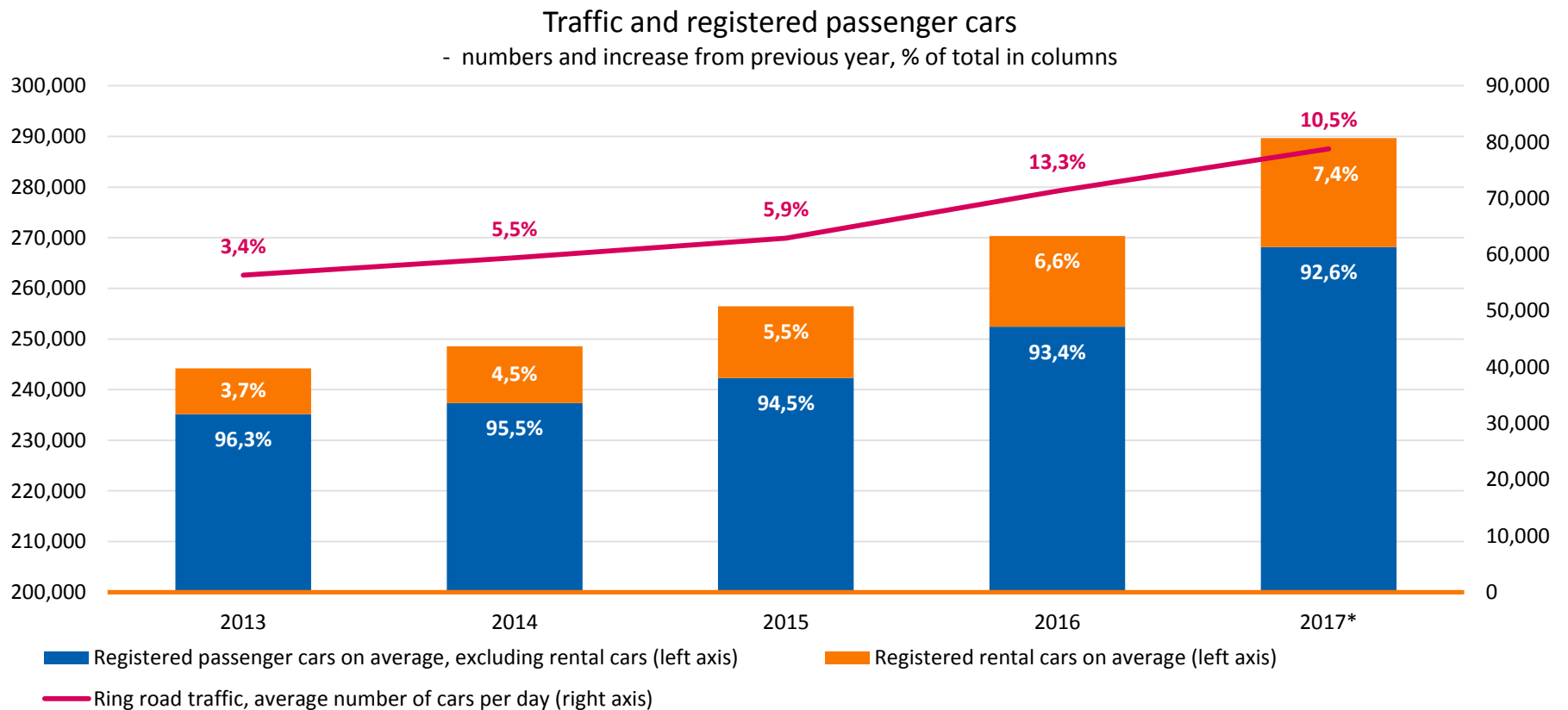


Increase in average number of people in
Iceland at any given time



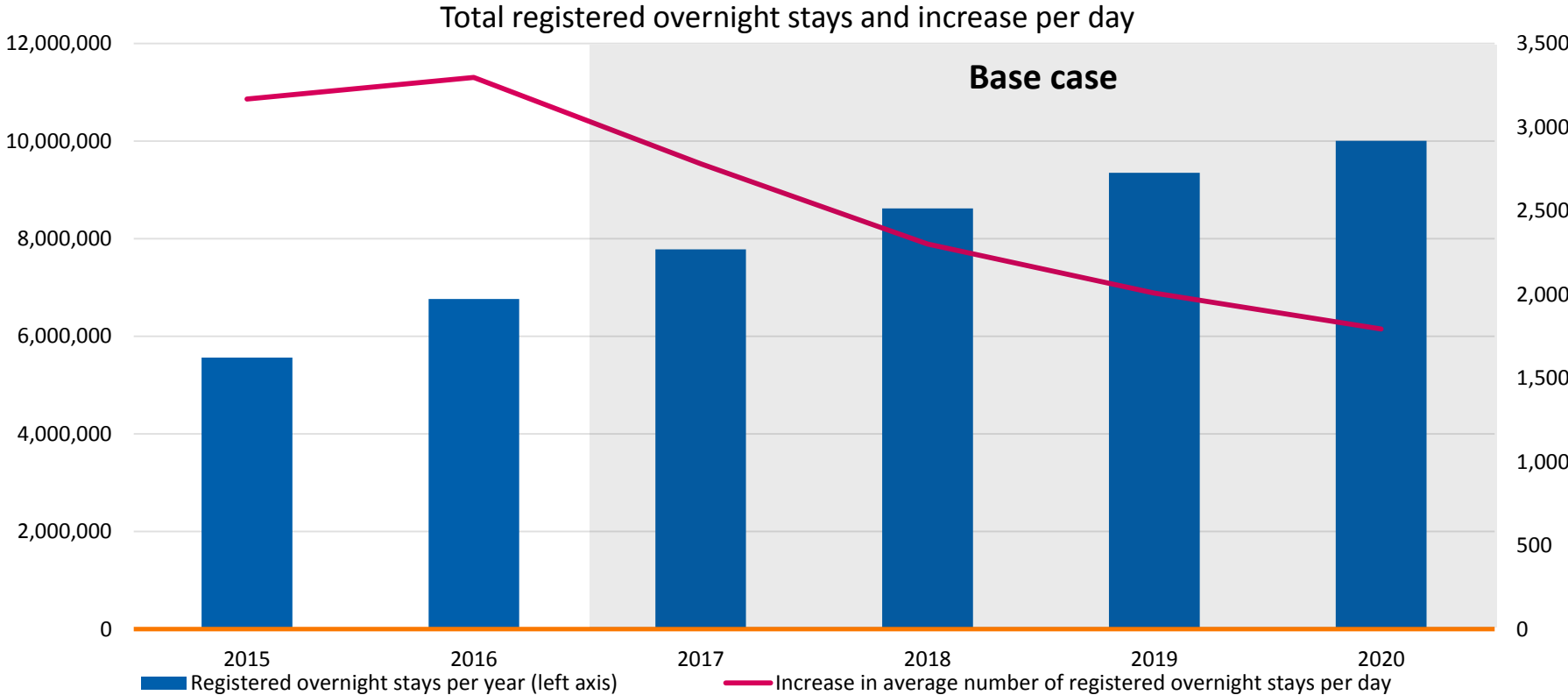
Tolerance limits of infrastructure: Strain on road system has grown

If things continue in same vein, the total number of cars will have rarely, if ever, grown so much in a single year



Tolerance limits of infrastructure: Estimate of required accommodation if the base case is accurate

Registered overnight stays at all kinds of accommodation increase by an average of 2,000 a day over the next three years – the equivalent of 1,100 new hotel rooms a year



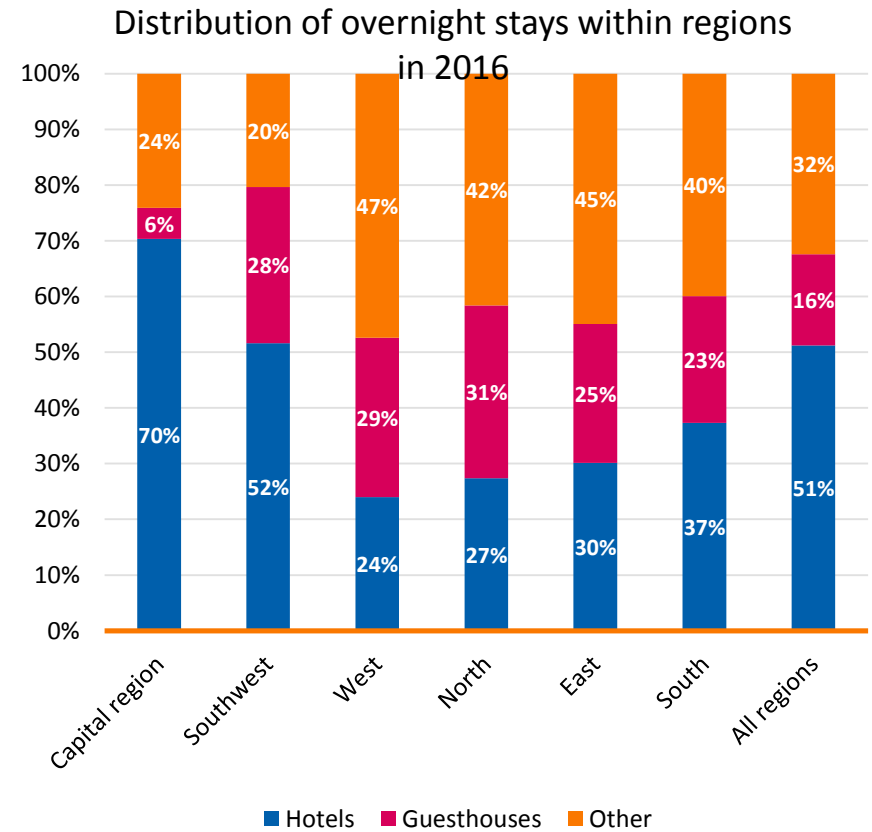
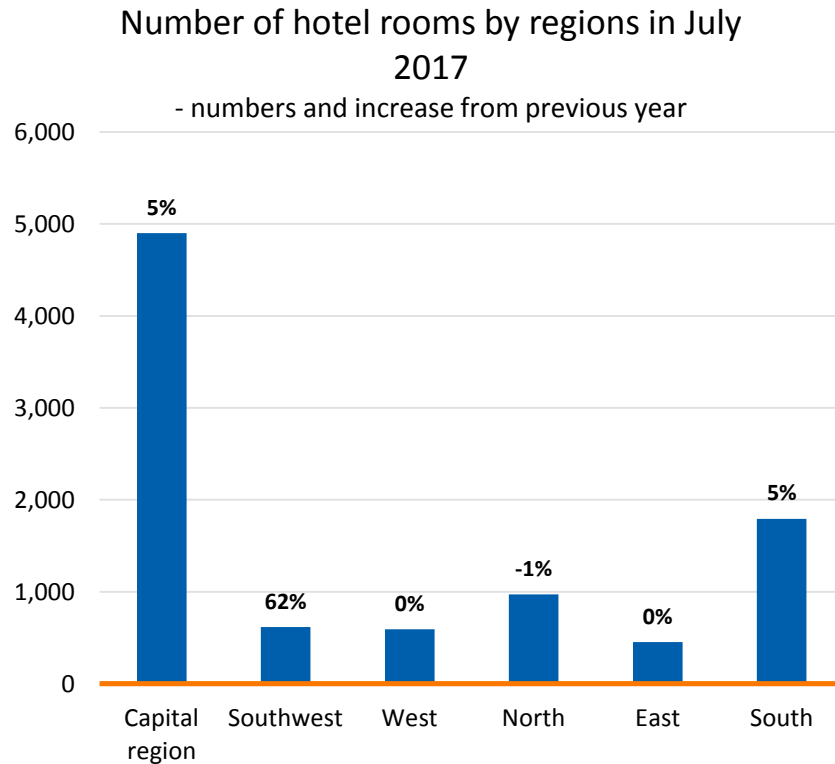


Rapidly growing hotel market

Swift development, rising revenue and good occupancy rates – in most places

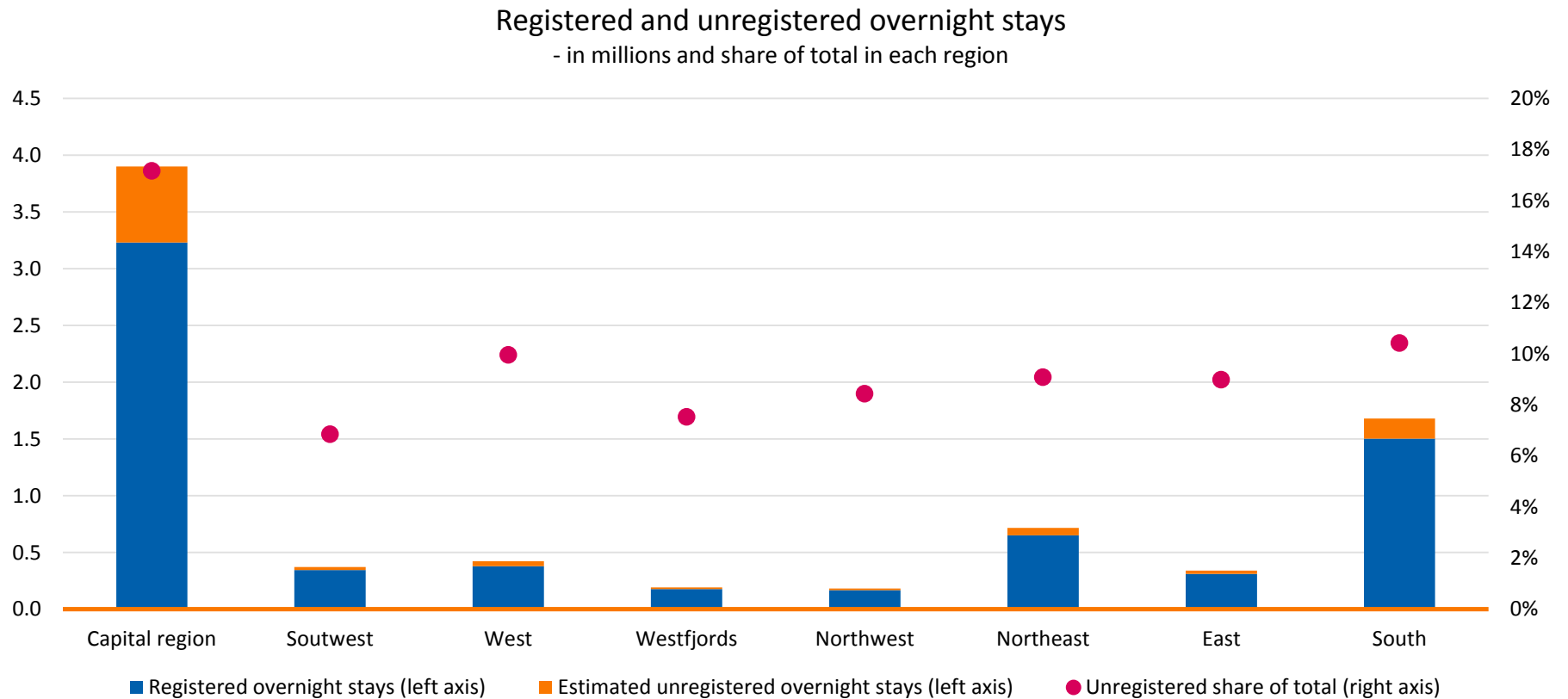
Hotels are responsible for majority of registered overnight stays, and the Reykjavík hotel market is by far the largest

In other parts of the country, other types of accommodation play a larger role



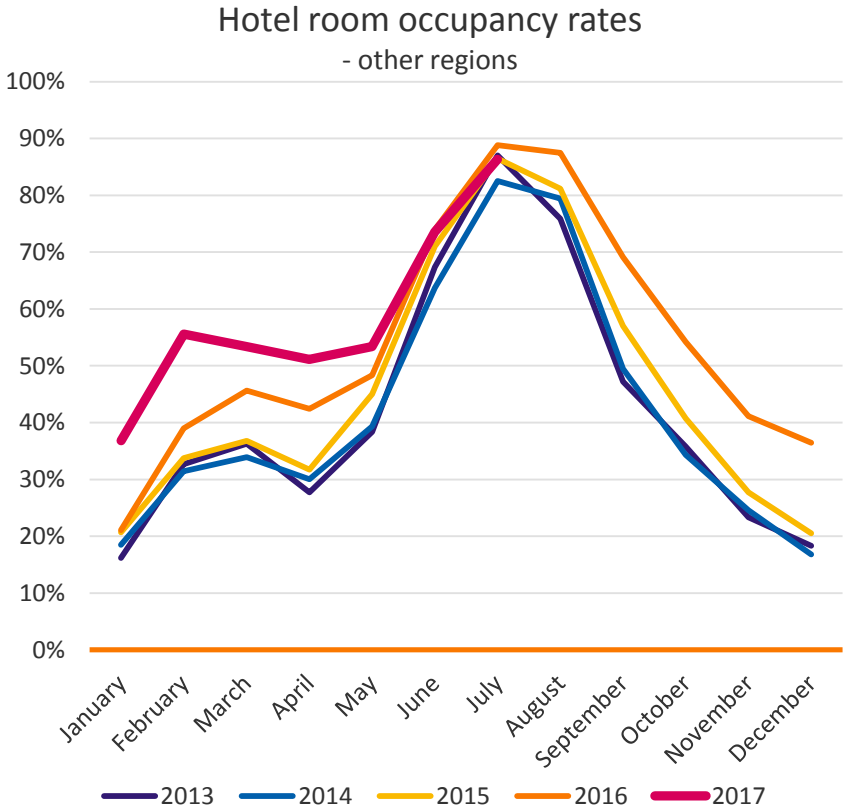
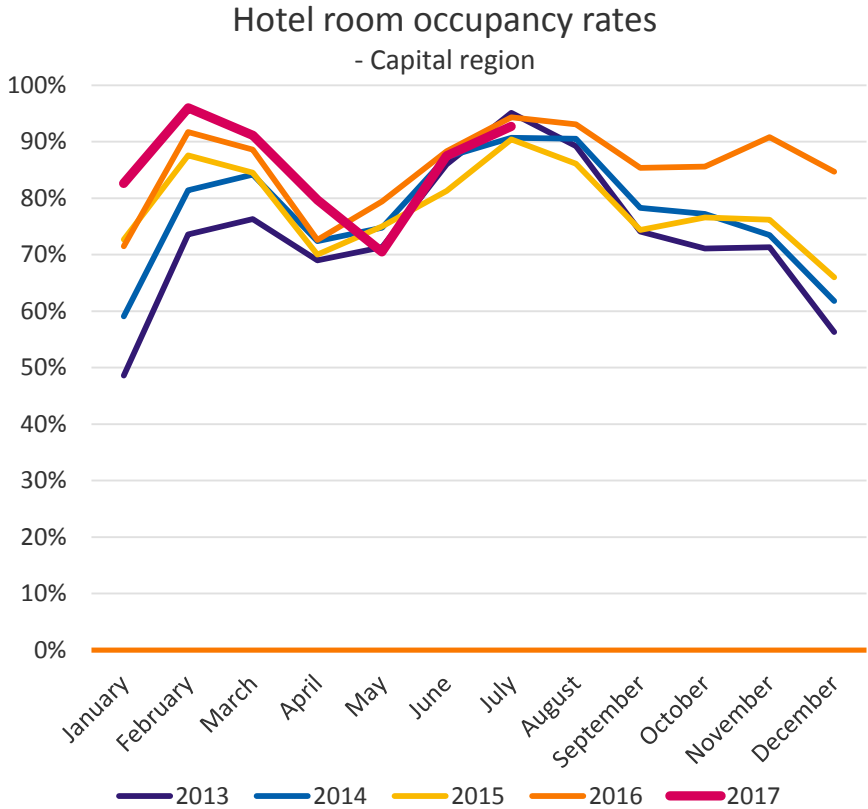
17% of overnight stays in the capital area last year were not registered

Statistics Iceland estimated that in 2016 almost 3,600 rooms/apartments were regularly let through Airbnb, 2,000 of which were in the capital region



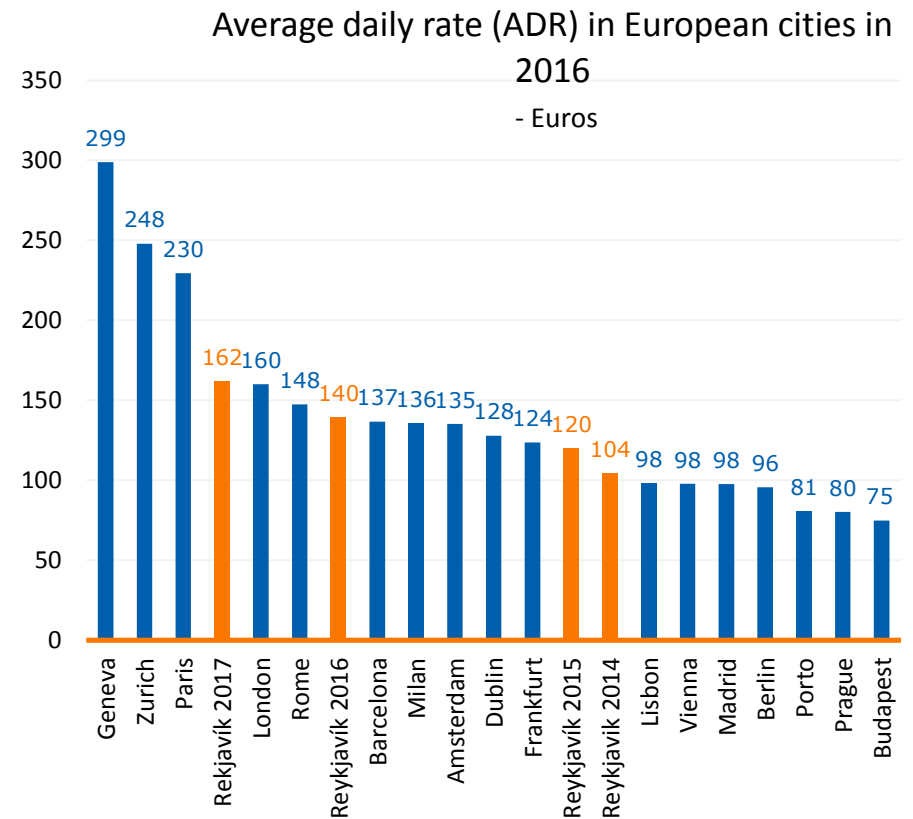
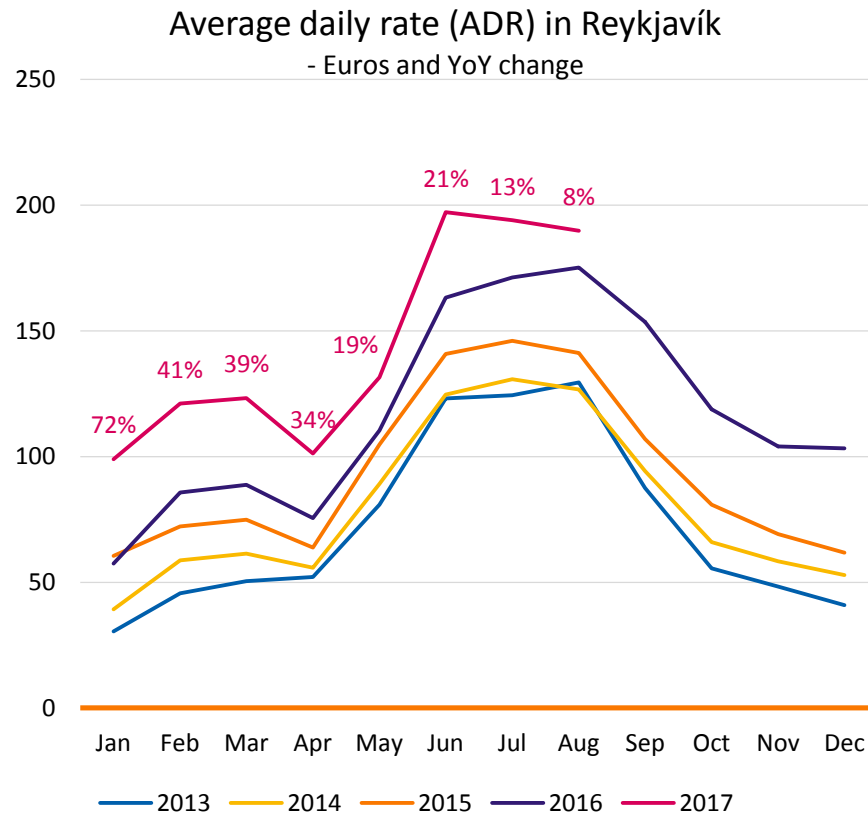
The occupancy rate of hotel rooms in the capital region has slumped during the summer

Occupancy rates outside Reykjavík have remained more stable, but it must be remembered that the number of available hotel rooms has increased, both in and outside Reykjavík



Tourists have faced increasingly expensive accommodation

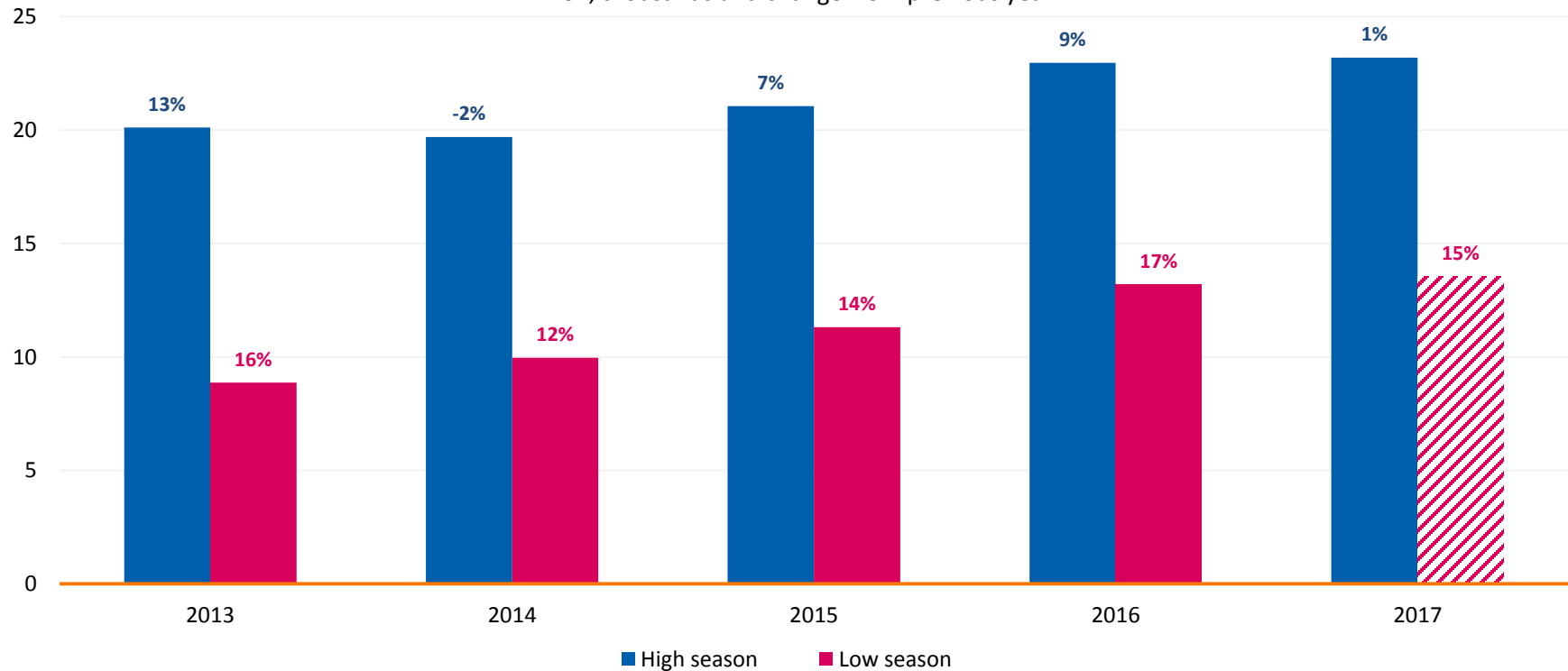
The average price of accommodation in Reykjavík has increased significantly in euros. The increase in ISK has been less, and virtually zero over the summer.



Poorer occupancy rates this summer means that revenue per available room has grown more slowly than the average price

The average price of a room (in ISK) at peak times has increased by 2% between years while revenue per available room has increased by 1%. The opposite applies off peak, as occupancy is greatly improved.

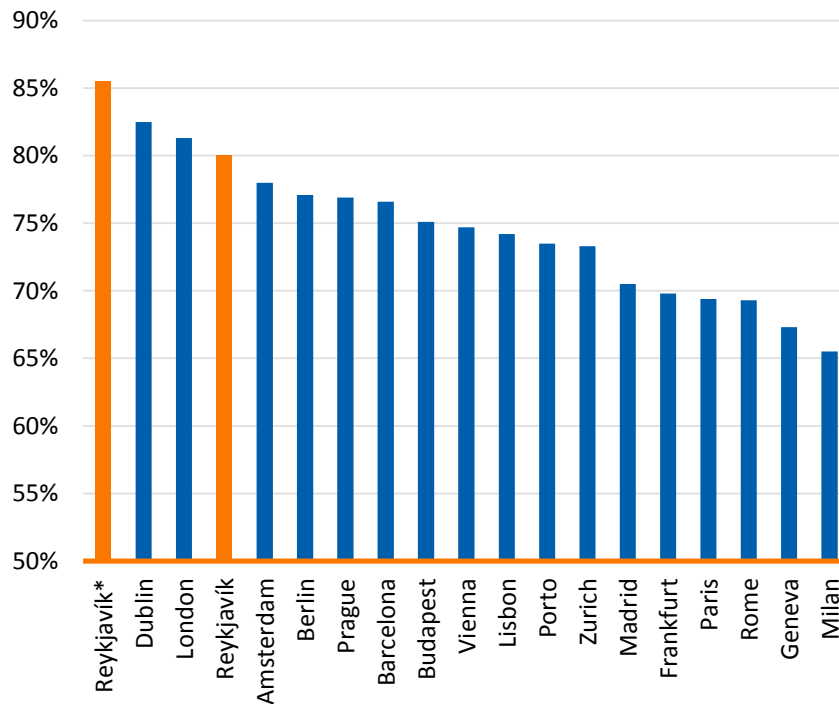
Revenue per available room (RevPAR) in Reykjavík
- ISK, thousands and change from previous year



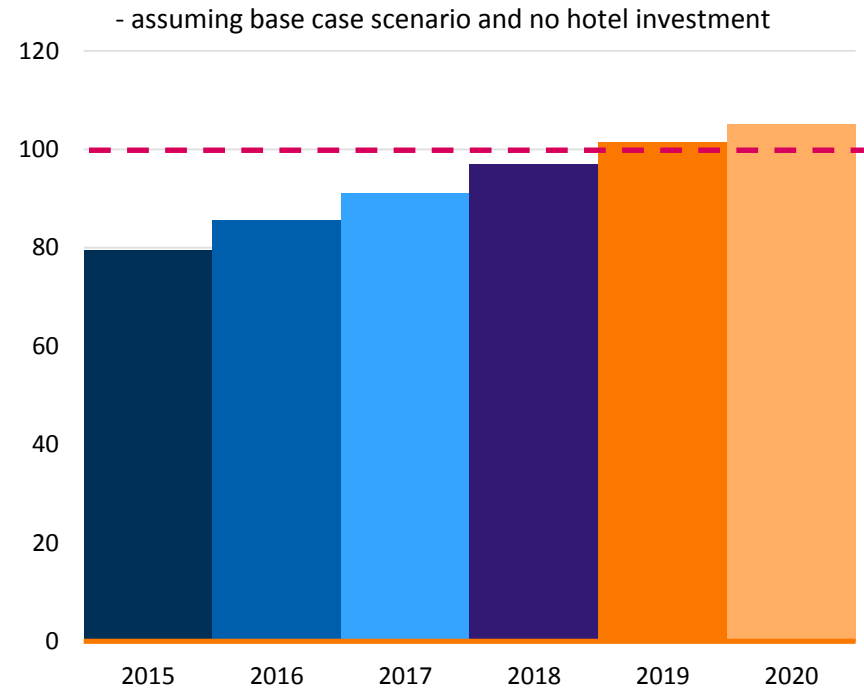
There will be severe hotel shortage in the capital region if no investment is made and hotels maintain their competitive position

Few European cities, if any, top Reykjavík in terms of hotel occupancy. If no investment is made in new hotels and overnight stays continue to increase in step with the rise in the number of tourists, hotels in Reykjavík will soon be full to bursting.

Hotel occupancy rates in Europe in 2016

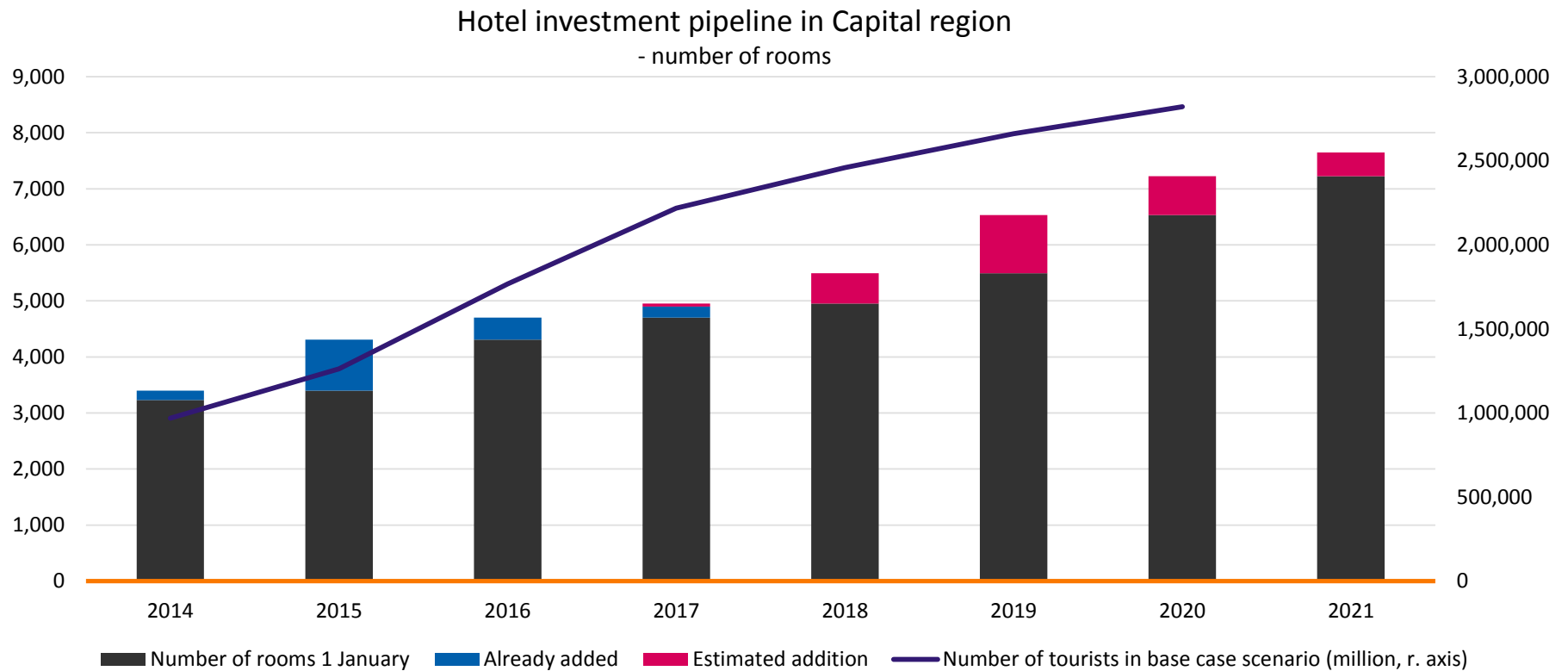


Hotel occupancy rate in Capital region



We estimate that 2,700 new hotel rooms will be added in the capital region over the next few years

Scheduled construction projects seem likely to cover demand placed by increasing tourists. The high level of uncertainty is reflected in great delays to hotel projects recently and the fact that the majority of projects are still under development.





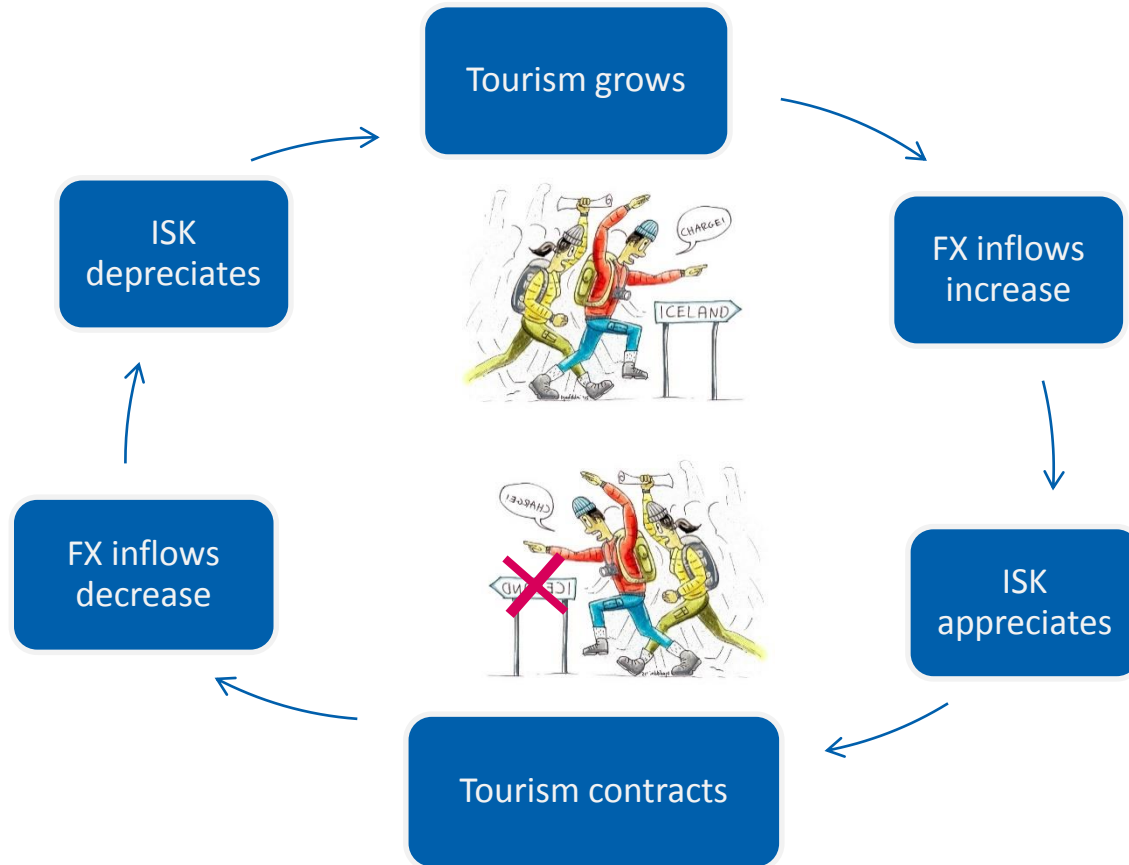
The króna and tourism: A stormy marriage

Konráð S. Guðjónsson
Arion Research



Cause and effect is like a merry-go-round...

Tourism benefited from a weak króna at the start of the growth period. A strong króna is now cooling down the tourist sector.



... and it's complex too

No wonder so much appears to be unclear... A lot is unclear!

Impact of tourism on the exchange rate:

- Revenue from tourists
 - number
 - length of stay
 - consumption pattern
- Expectations of trends in tourism
- Foreign investment in tourism
- Etc.



Impact of the exchange rate on tourism:

- Revenue from tourists
 - number
 - length of stay
 - consumption pattern
- Travel pattern within Iceland
- Performance of companies in tourism
- Etc.

Impact often hard to measure and effects often delayed

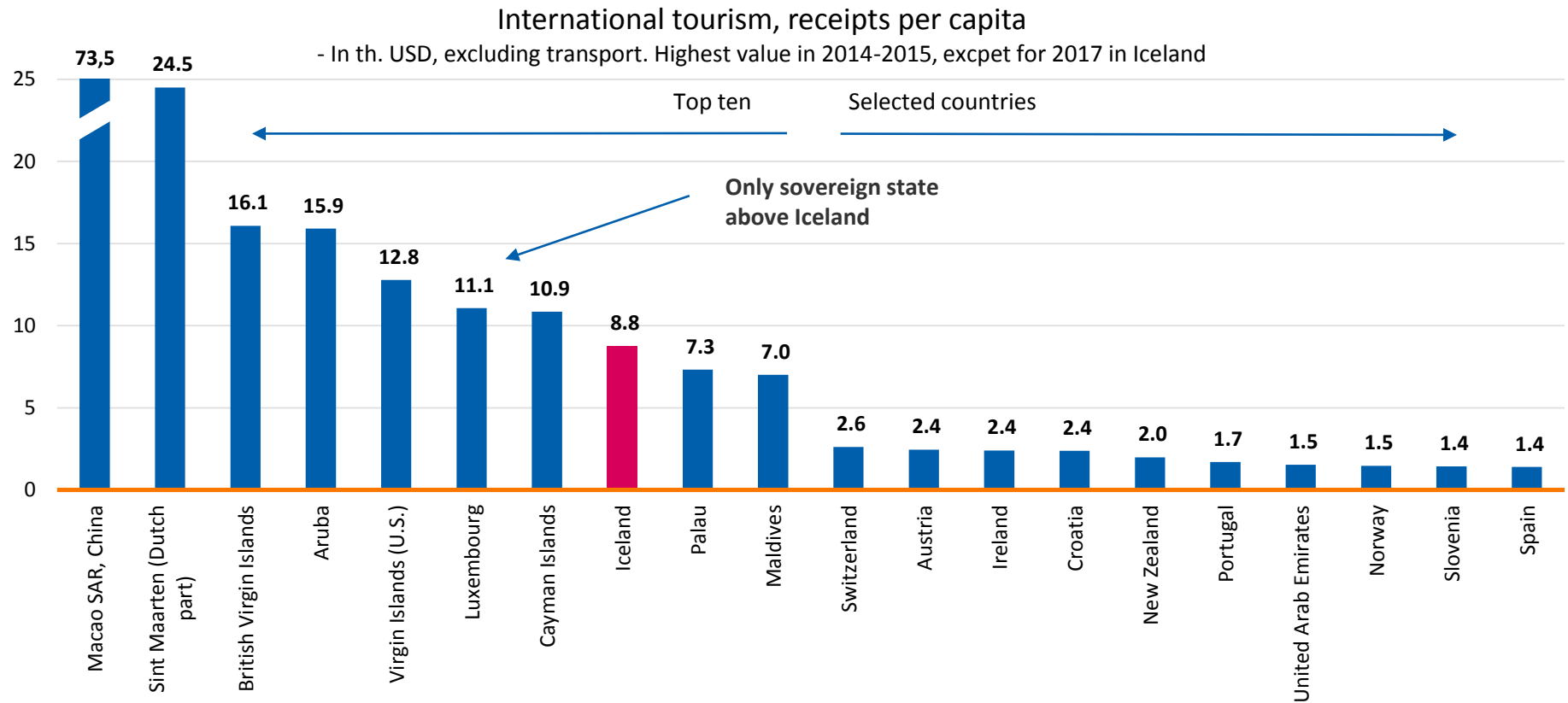


Effect of tourism on the króna

Tourism is in the driving seat as the biggest export sector

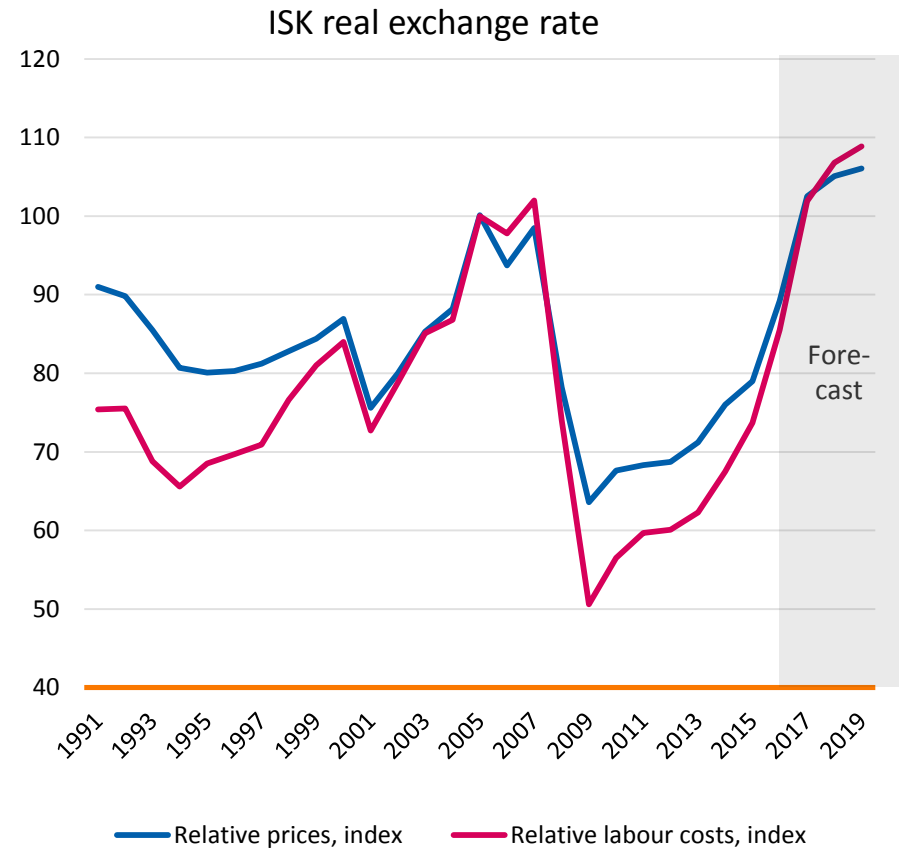
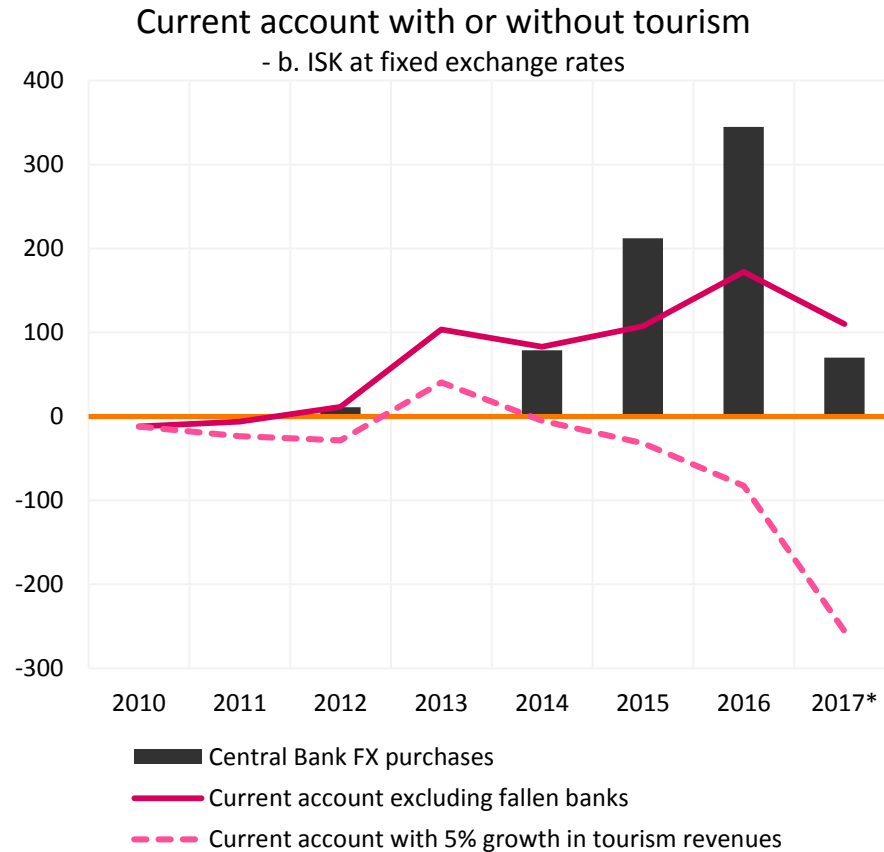
Extremely rare for a country, let alone a currency area, to be so dependent on tourism

Tourism-related exports per capita in Iceland probably six times higher than in Spain



Huge relative size of tourism sector in Iceland means it has greater impact on exchange rate than elsewhere

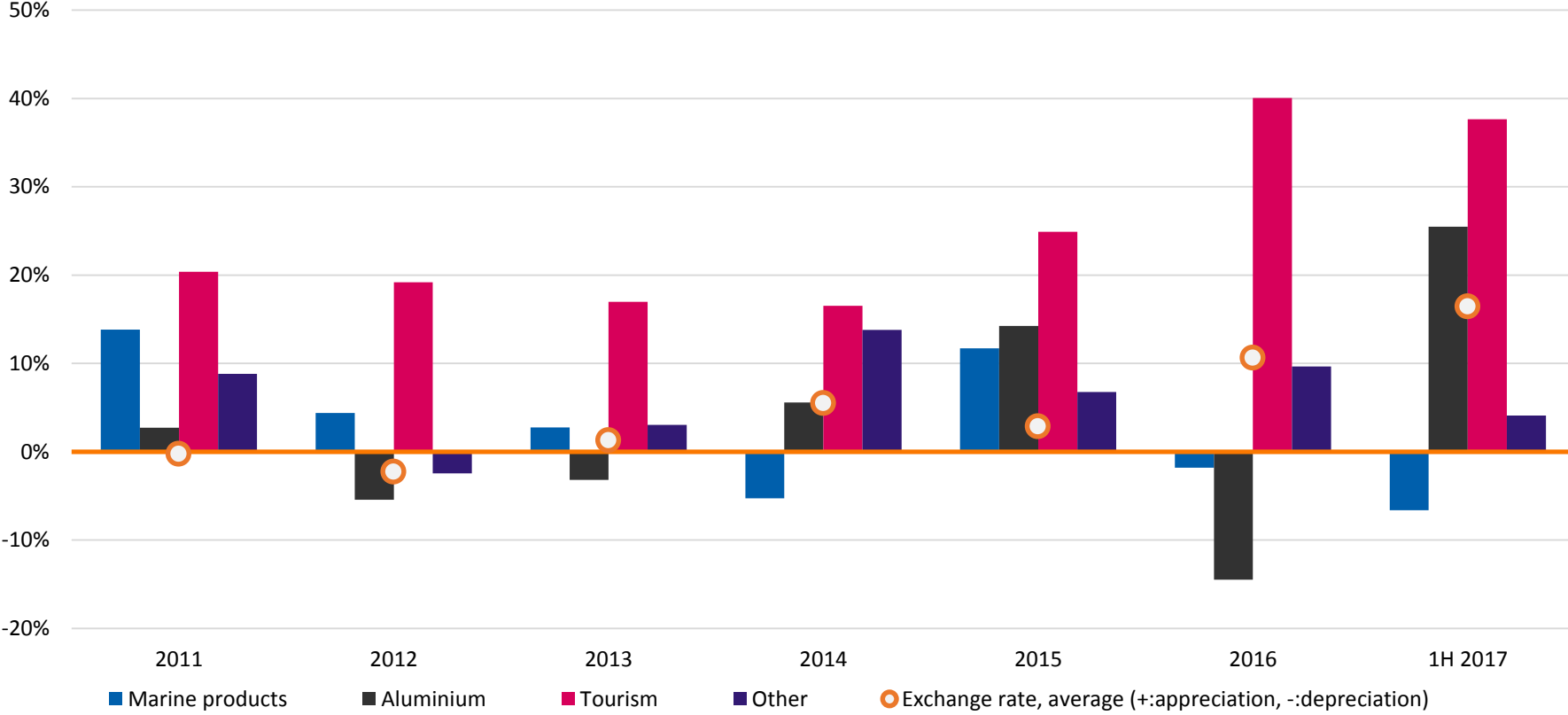
Without growth in the tourism sector we could import far less and/or would have a large current account deficit



Strong growth of tourism sector restricts ability of other exports to compete: Symptoms of Dutch disease

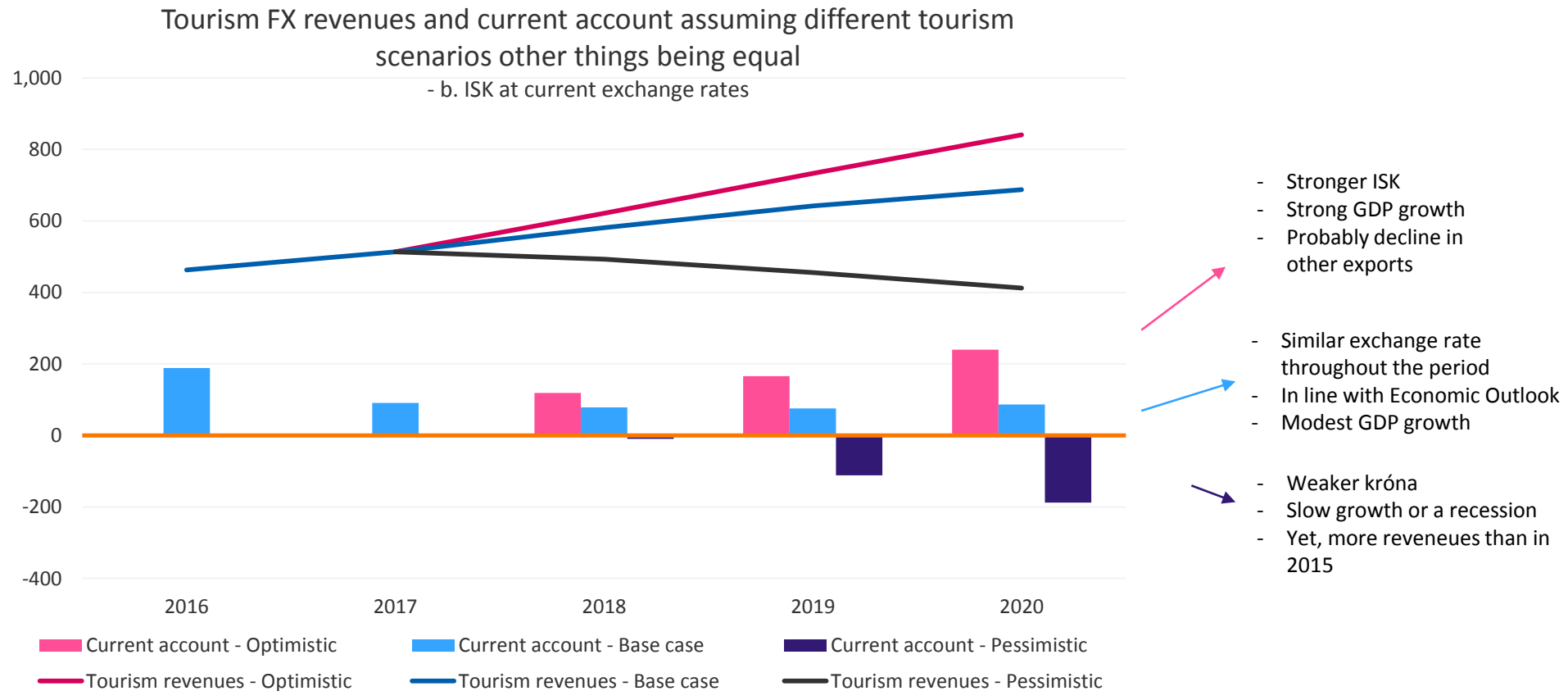
Exports of various other commercial services fell short of our expectations in Q2 2017, because of the króna?

Export revenue growth at fixed exchange rates



What do the different scenarios mean for the króna?

We haven't estimated the impact of tourism on imports and other indirect effects on the current account balance, but the effect is considerable. The scenarios do give us an idea of how things might develop.



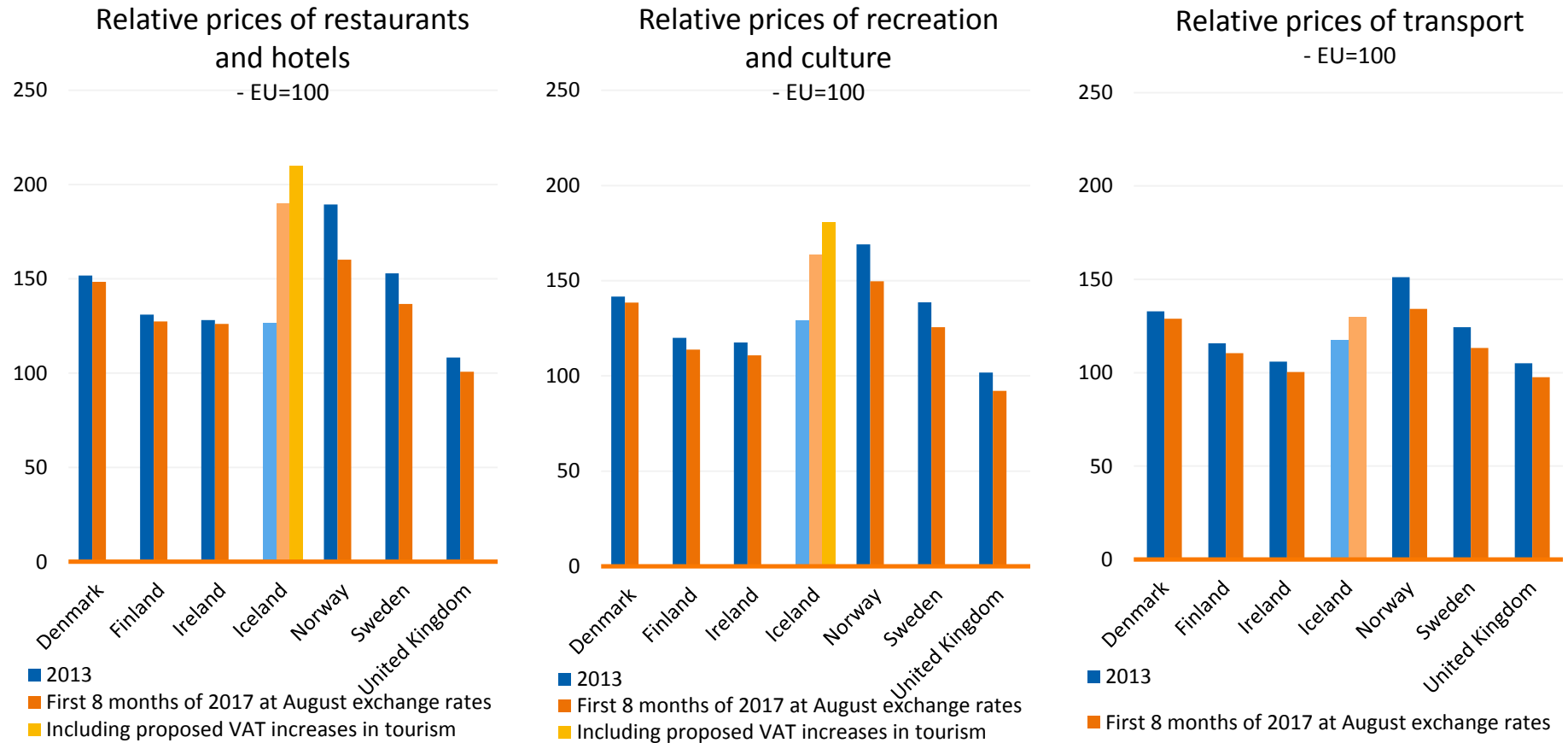


Effect of the króna on tourism

Tourism will cool itself down

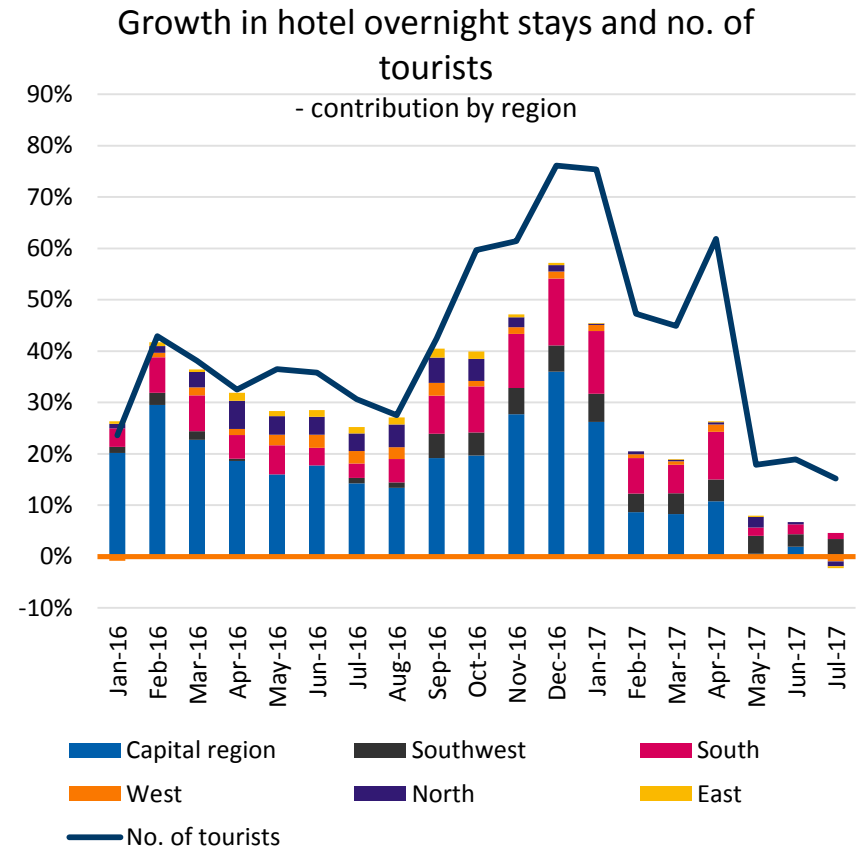
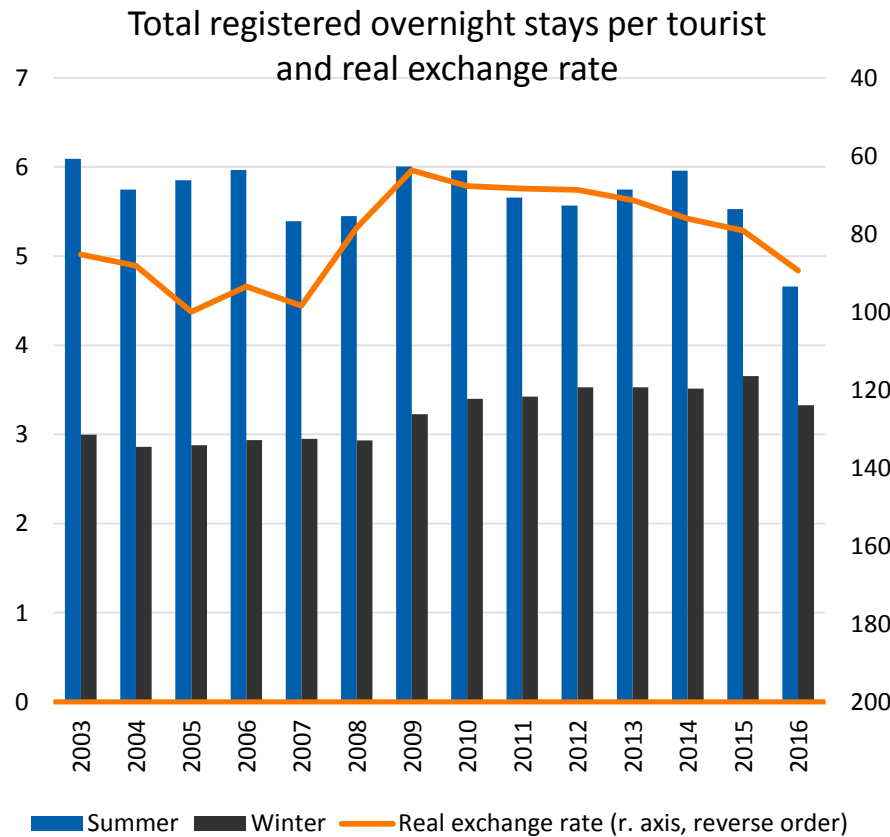
Iceland is one of the most expensive destinations in the world – if not the most expensive

We do not know yet what the end effect will be – but it's gradually materializing



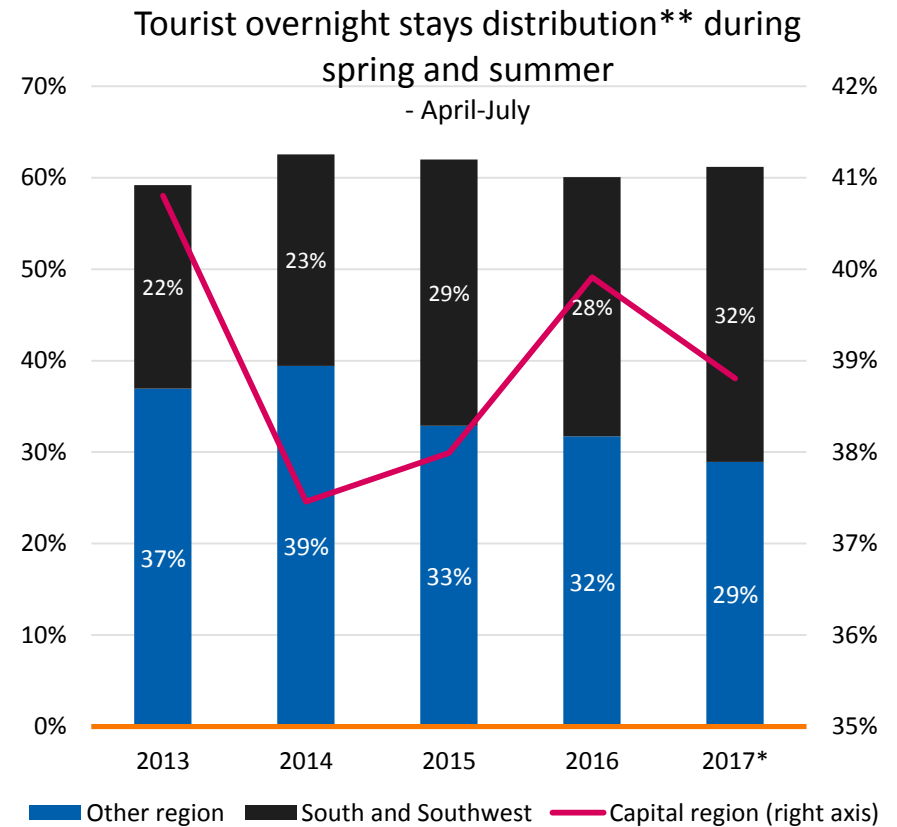
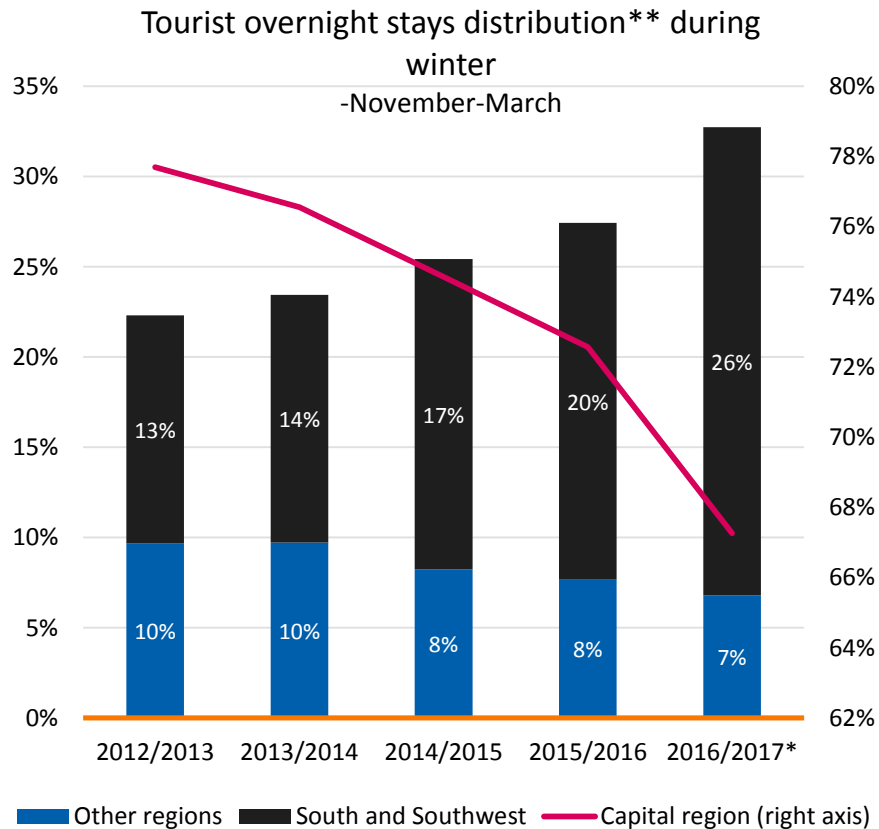
Strong króna appears to have shortened tourists' length of stay and/or changed where they stay

There is some correlation between trend of real exchange rate and length of stay. **Airbnb etc. undoubtedly distorts the picture.**



Outside the capital region, tourists have become even more concentrated in SW corner

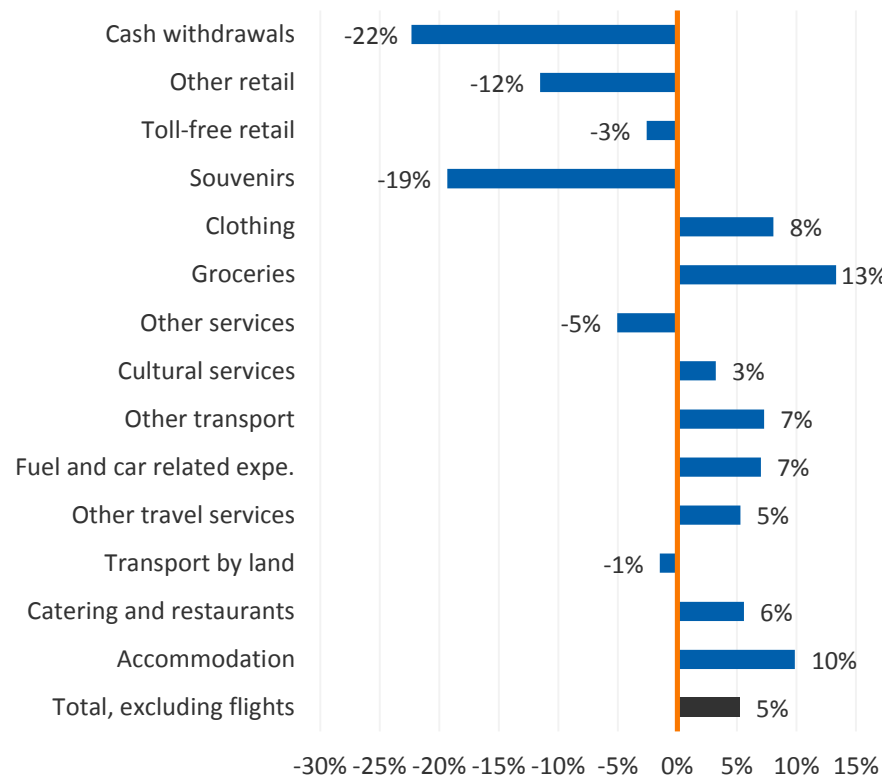
Contrary to the aim of spreading tourists across the country more evenly



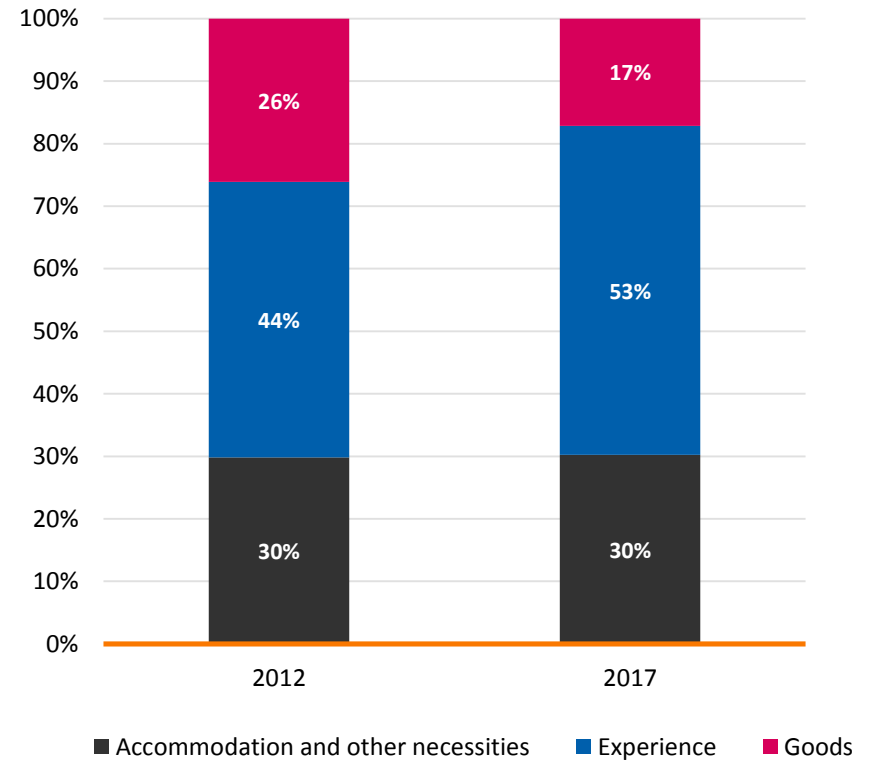
Tourists have responded to strong króna by changing consumption patterns

Shopping has given way to visitor experiences – may also be due to greater popularity of adventure tourism

Total foreign card turnover June-August 2017
- %change from previous year in ISK

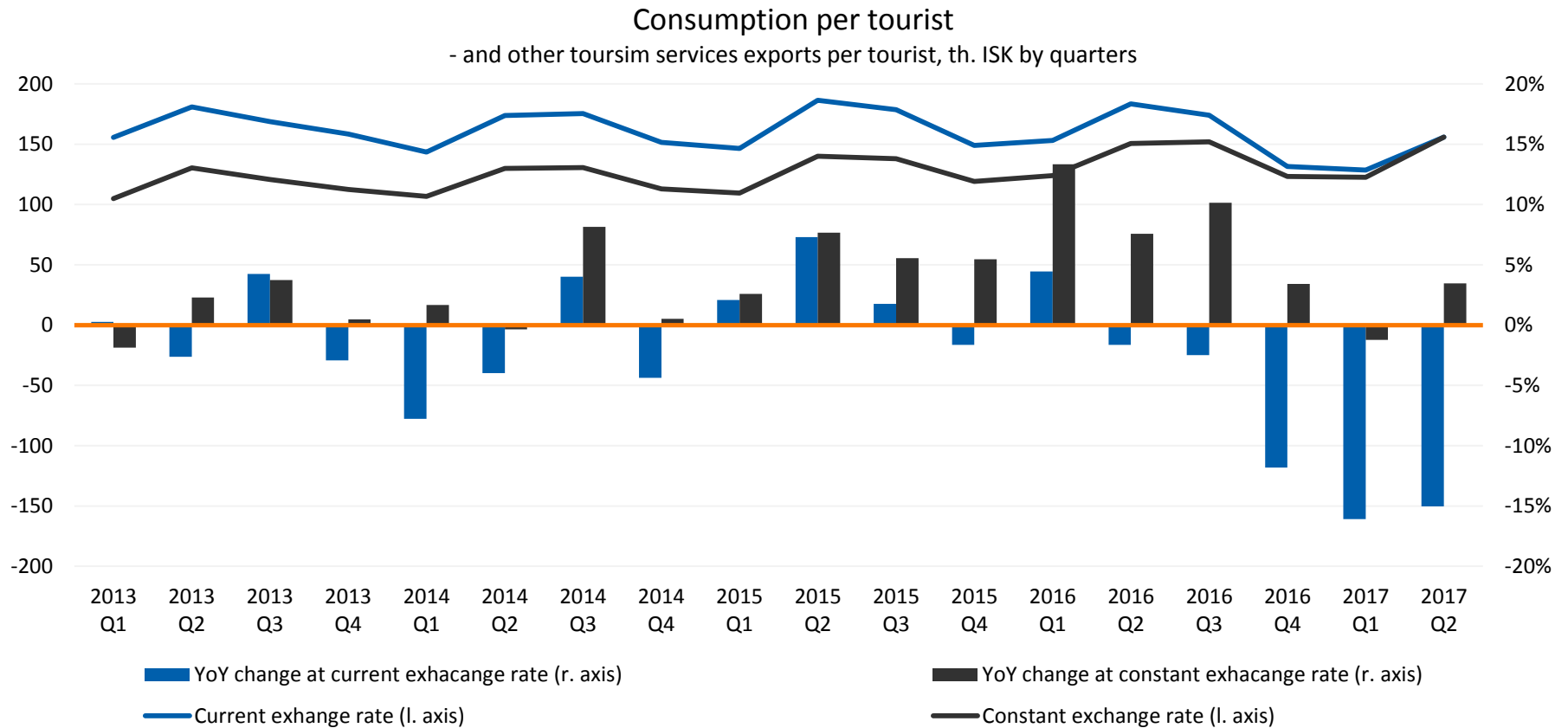


Tourist's consumption pattern
- distribution of card turnover in January-July



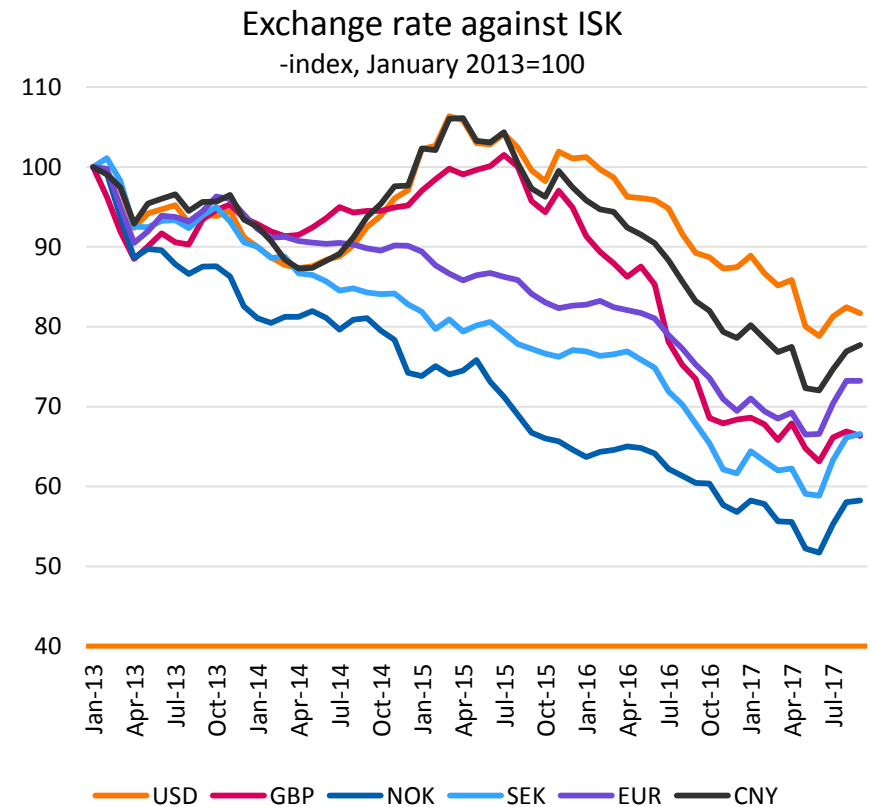
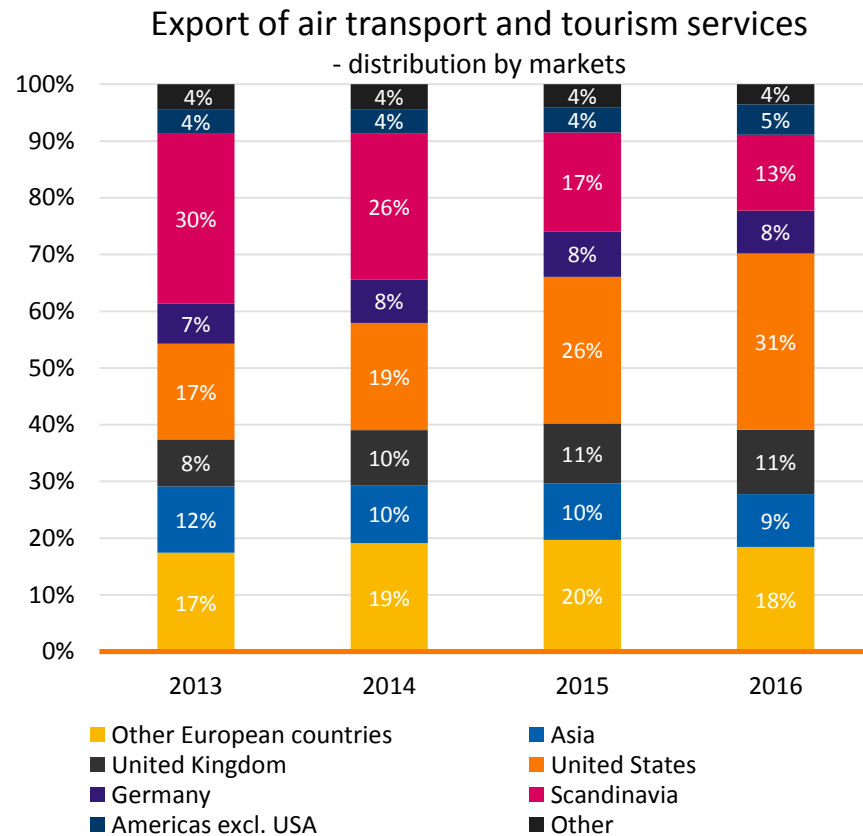
Although strong currency has meant that each tourists spends fewer krónur, spending in tourists' home currency has remained stable

Strong indications that Iceland has successfully managed to attract bigger spending tourists. Cheaper flights might also play a role and increase purchasing power once people have arrived.



Increase in tourists has changed revenue structure

More dependent now on US dollar and therefore the USD/ISK exchange rate – which has been one of the more stable exchange rates since 2013



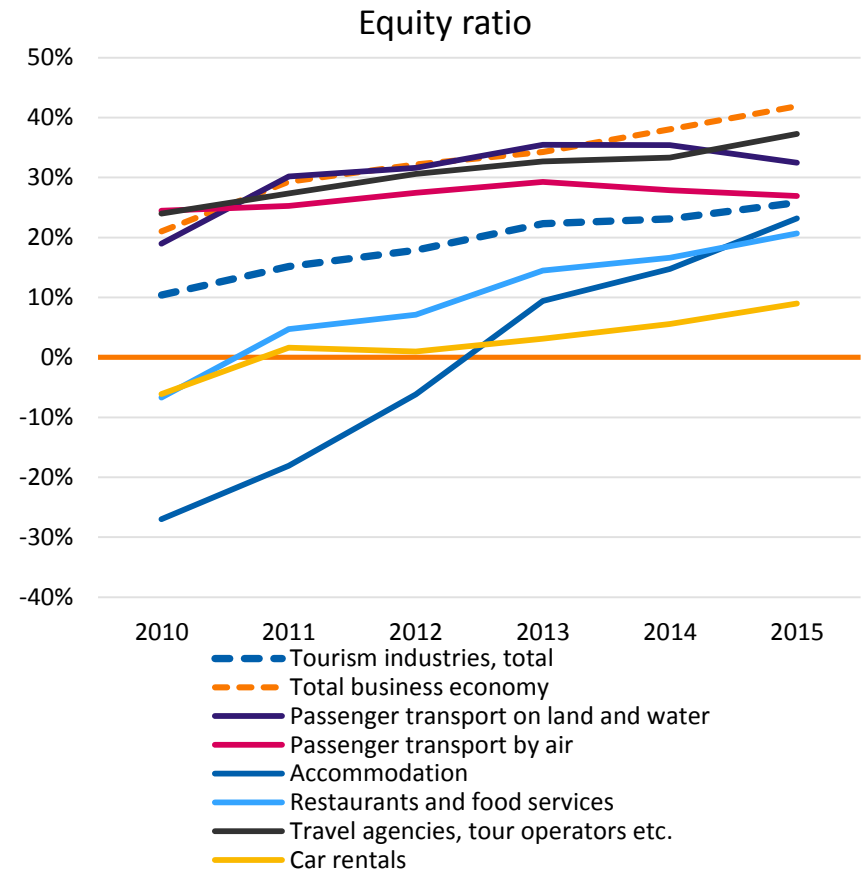
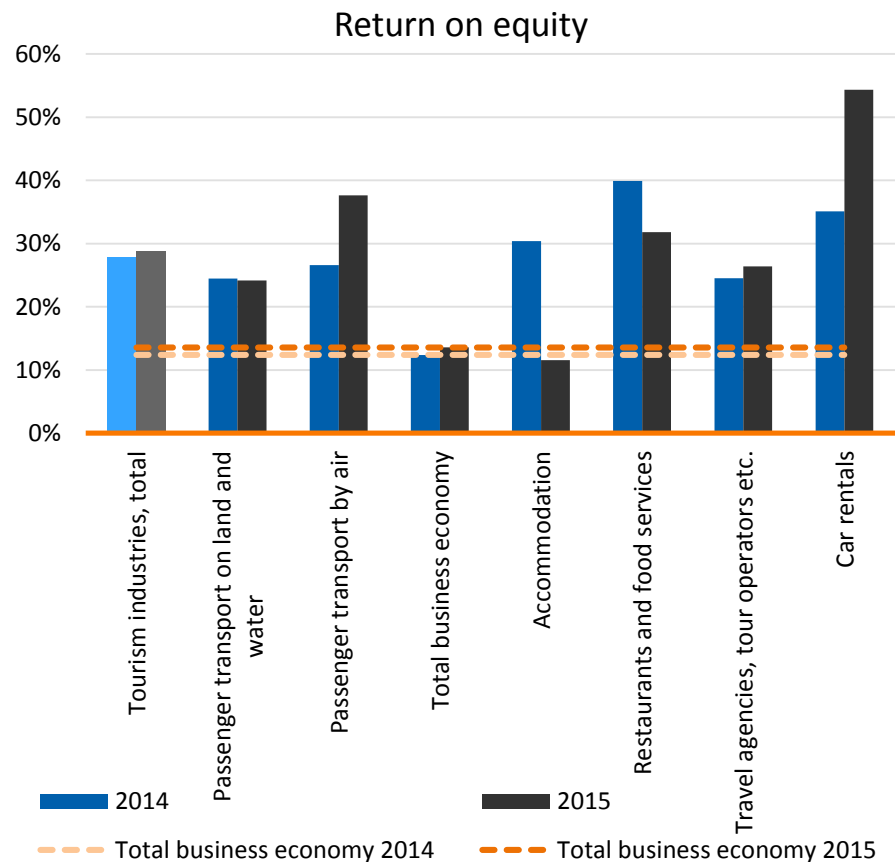


Performance of tourism companies in the króna economy

Effect of a strong króna and other changes in the tourism sector create challenges and opportunities

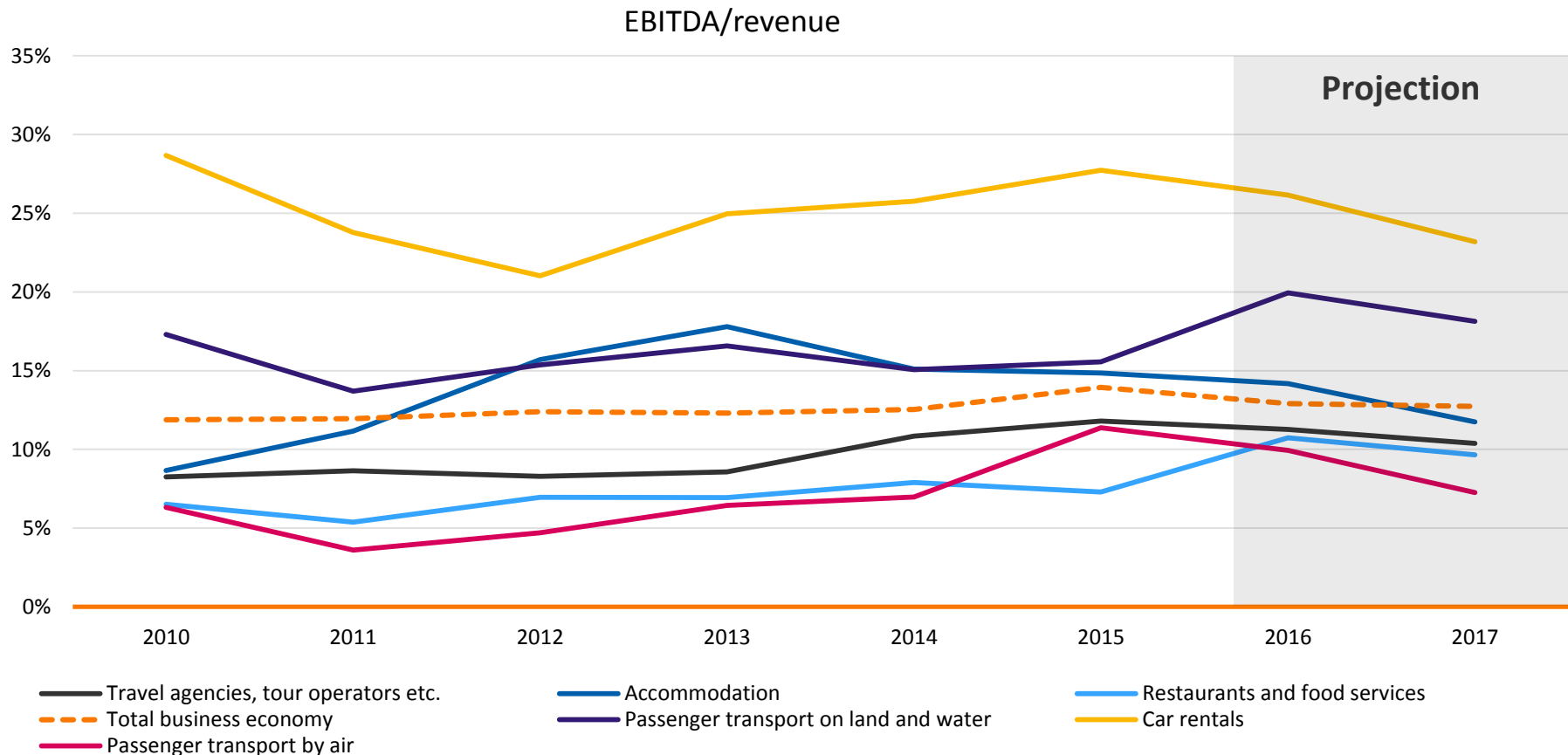
Financial performance has been good and better than in other sectors

At the same time the financial position of tourism companies has improved



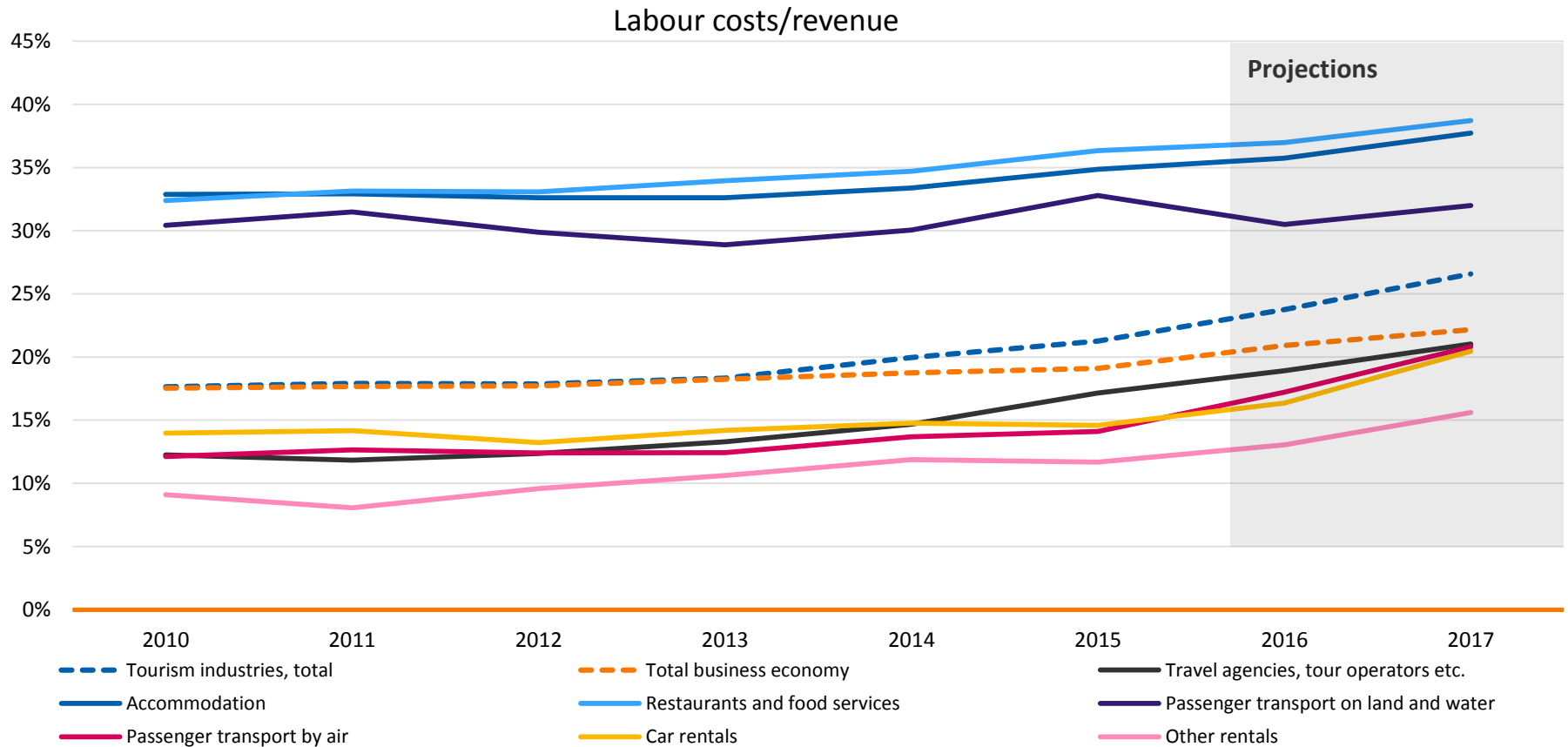
On the whole the tourism sector seems well prepared to cope with more challenging times

Large uncertainty about how things pan out and even larger heterogeneity within tourism sub-sectors



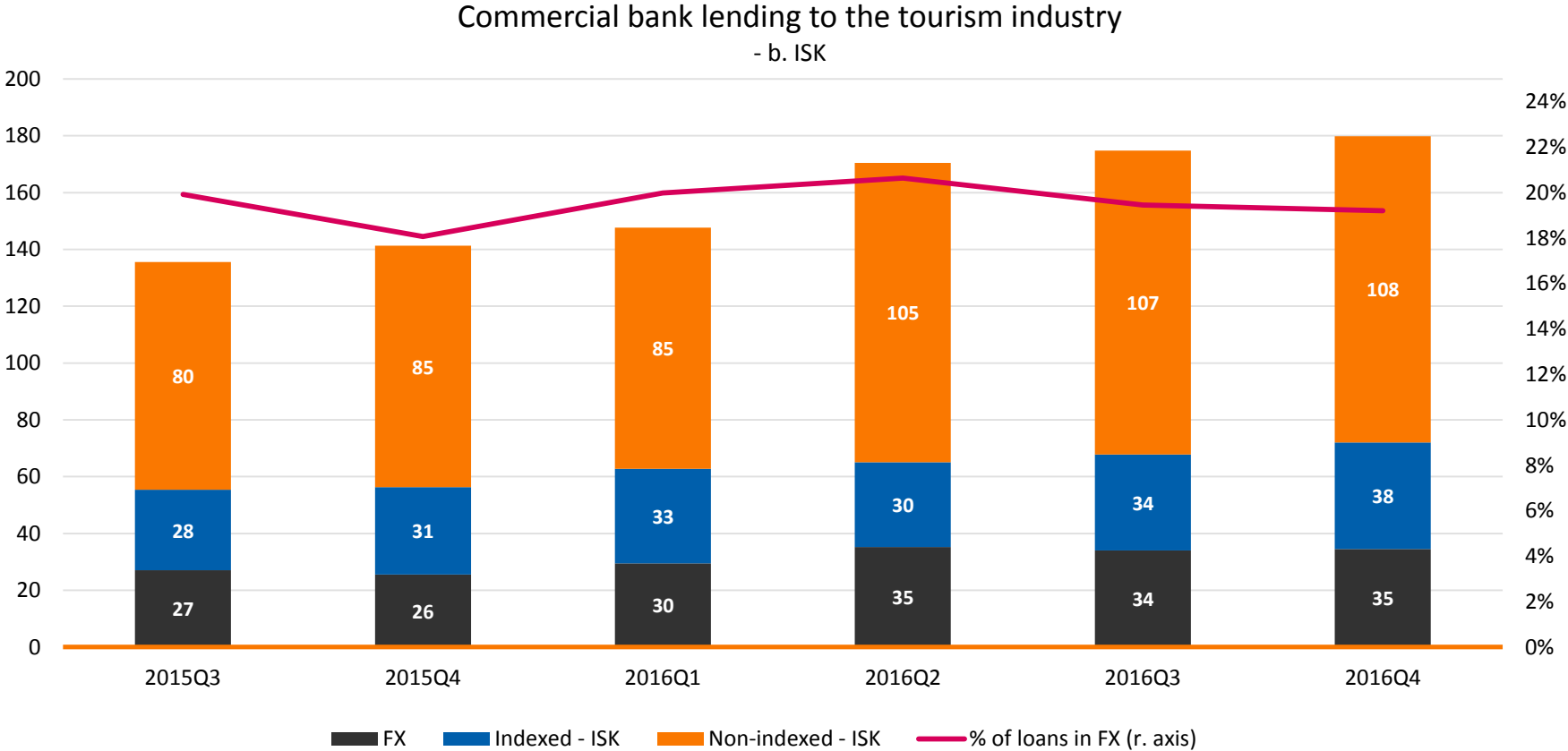
Salary expenses have grown faster than revenue in tourism sector

One of the main reasons that results in 2016/2017 probably deteriorated/will deteriorate



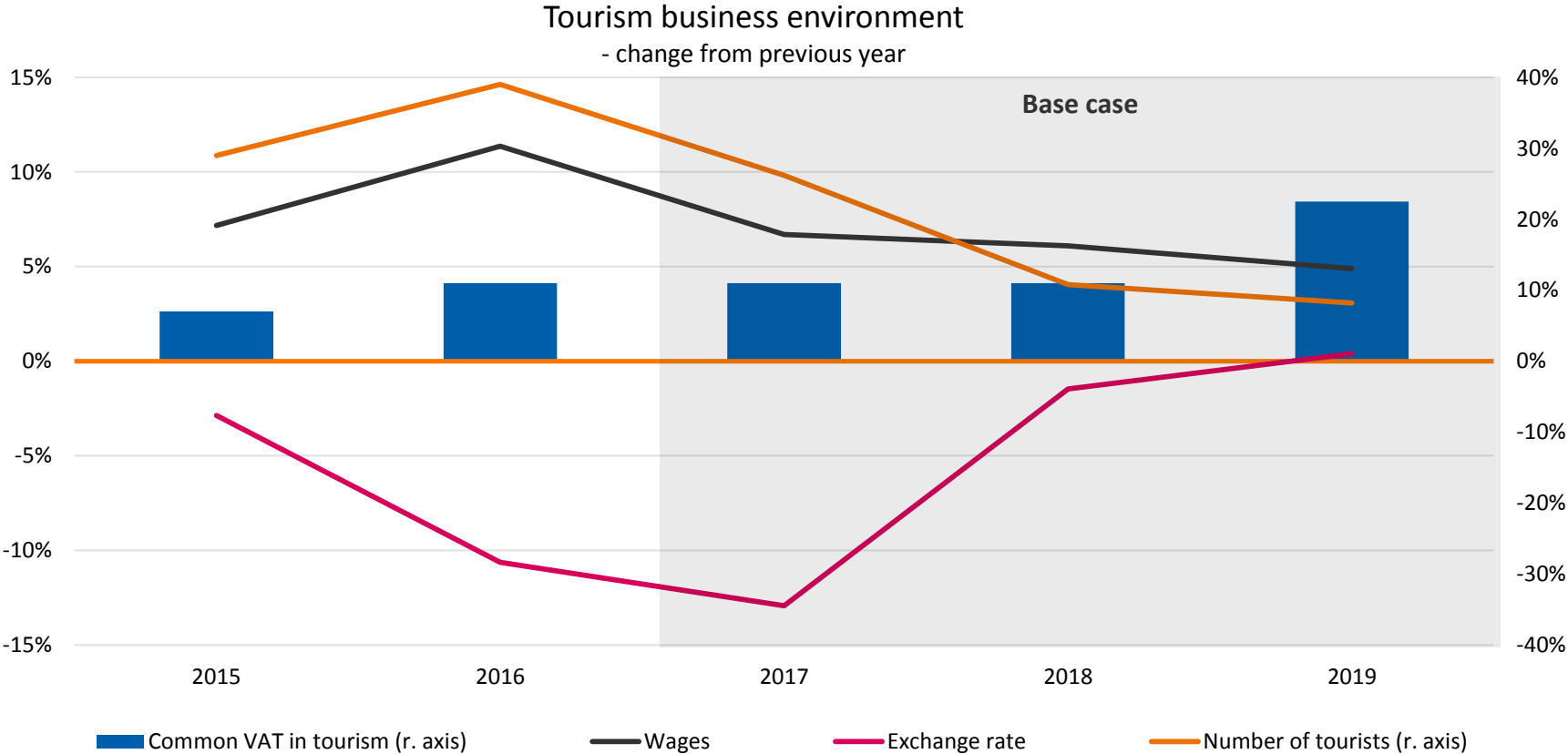
Debts in króna but clients' revenue in foreign currency – where are the foreign loans?

There is a risk involved in having high debts in ISK when the underlying revenue is in foreign currency



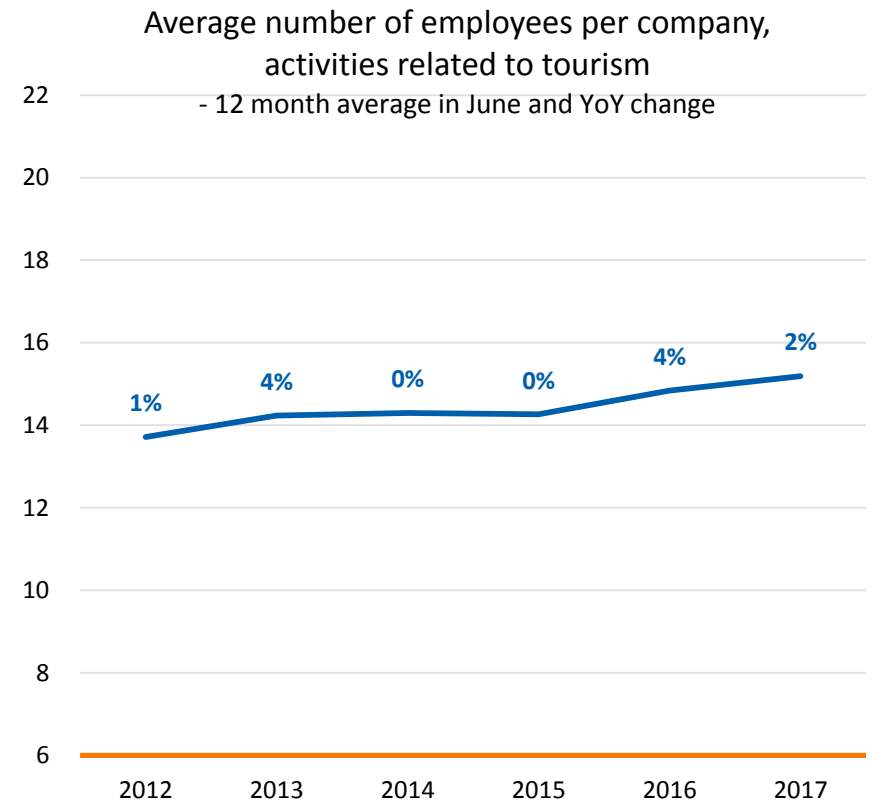
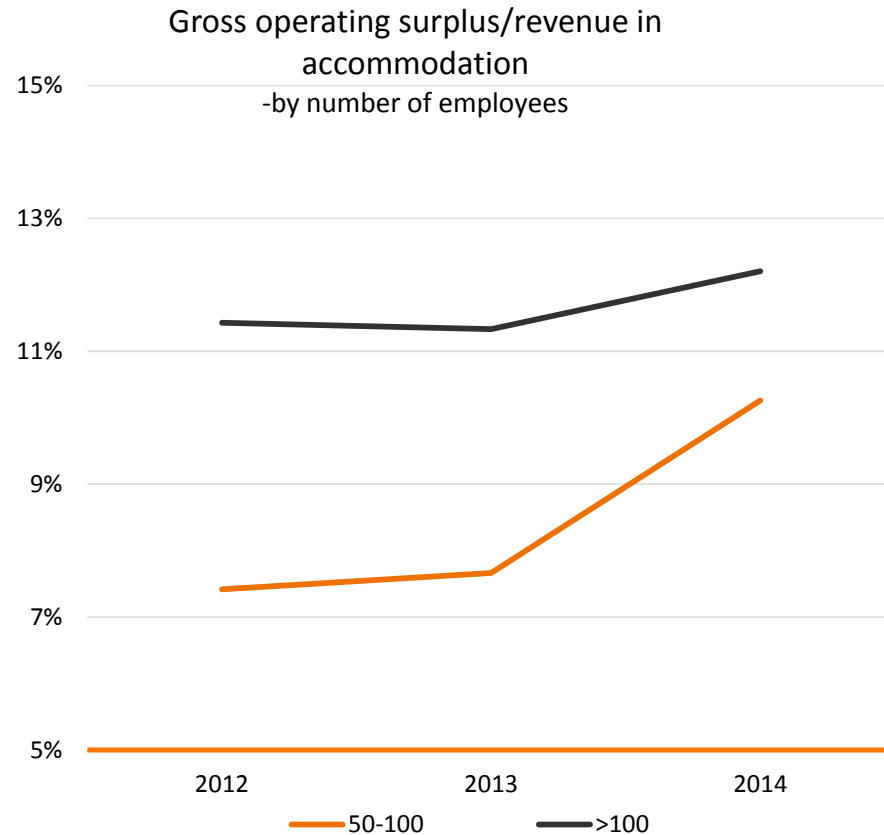
Over next few years the adaptability of tourism companies will be put to even greater test if our forecasts prove accurate

Slower growth, higher VAT, even higher salary increases and continued strong exchange rate



Where are the mergers? Accommodation sector shows that there are opportunities in this area

Growth in tourism largely achieved through creation of more companies – a sensible development?



Contacts

Erna Bjorg Sverrisdottir
erna.sverrisdottir@arionbanki.is

Konrad S. Gudjonsson
konrad.gudjonsson@arionbanki.is

Head of Research

Stefan Broddi Gudjonsson
stefan.gudjonsson@arionbanki.is

Disclaimer

- This presentation is for information purposes only and is not designed to form a basis on which recipients should make decisions. The information contained in this presentation does not represent any promise or forecast of future events. The Bank is not obliged to provide the recipient with access to further information than that contained in this presentation or to update the information contained within. The Bank is not obliged to correct information should it turn out to be incorrect.
- The information on the Bank, its subsidiaries and associate companies has not been verified. This presentation does not represent exhaustive information on the Bank, its subsidiaries or associate companies.
- The information contained in this presentation is based on existing information, projections of expected developments in external conditions etc. The information is subject to various uncertain factors and may change without warning.
- The Bank, including shareholders, management, employees and their advisers, take no responsibility for the information, assumptions and conclusions contained in the presentation or the information or information provided in connection with it. The above parties will not issue statements that the information, assumptions or conclusions are accurate, reliable or sufficient and they shall not be liable for damage which can be traced to such information being inaccurate, unreliable or insufficient.
- Receiving this presentation does not represent investment advice on the part of the Bank.
- By receiving this presentation the recipient accepts the above disclaimer.