3Q21
Financial Results

28 October 2021

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islandsbanki.is

Agenda

1. Financial and operational highlights

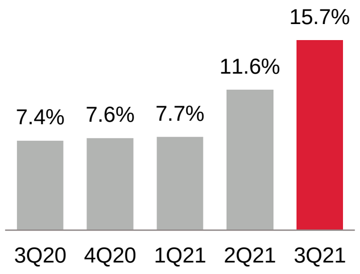
3Q21 Financial highlights – above market expectations

ROE above financial targets supported by economic recovery and resilience of borrowers

1. Exceptionally strong third quarter earnings

- Profit of ISK 7.6bn and ROE of 15.7% - best quarter in +5 years
- Impacted by positive impairment due to improving economic conditions along with robust income generation
- Annualised cost of risk was -64bps in the quarter compared with 0.44bps in 3Q20

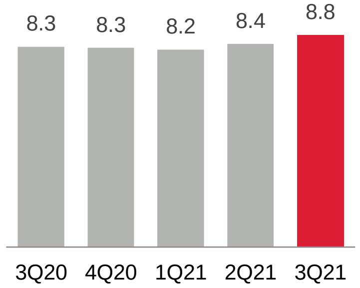
ROE



2. Strong customer relationships lay foundation for growing income generation

- Total operating income up 21% YoY, with solid growth in main line items
- Core income (NII and NFCI) up 9.4% YoY
- Having defended margin erosion as rates fell, NIM can be expected to improve in a rising rates environment

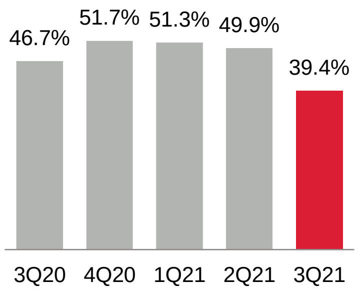
NII, ISKbn



3. Improved operational efficiency with C/I ratio substantially down

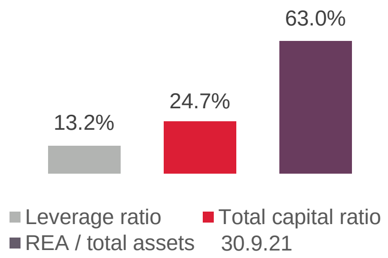
- Substantial YoY reduction in C/I ratio due to revenue and cost improvements and seasonality in Q3
- Strong track record of cost savings (incl. FTE and branch reductions) without impacting revenue growth

C/I ratio



4. High quality balance sheet and stable deposits the base for profitable bank operations

- Positive IFRS 9 stage migration, payments have resumed for 59% of loans in forbearance
- Robust liquidity and capital metrics, high REA density and low leverage versus Nordic peers

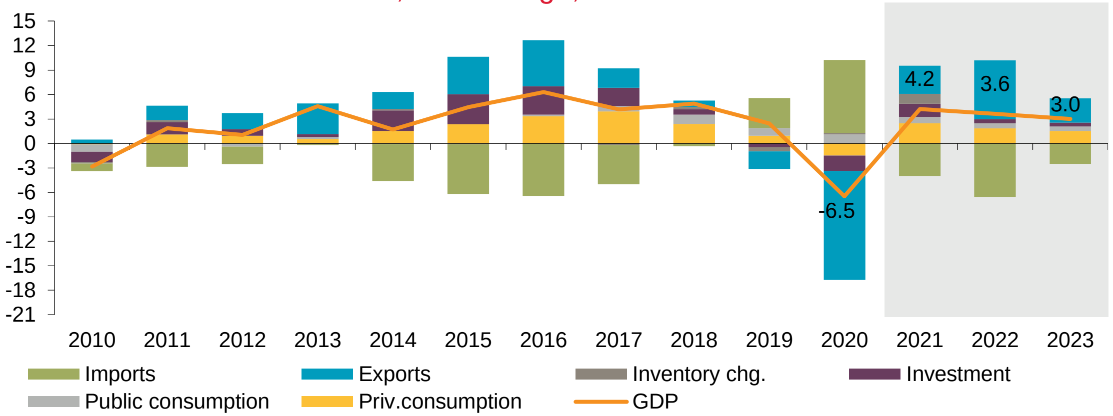


Economic recovery underway following COVID-19 recession

Strong foundations facilitate a robust recovery as world-wide pandemic impact fades

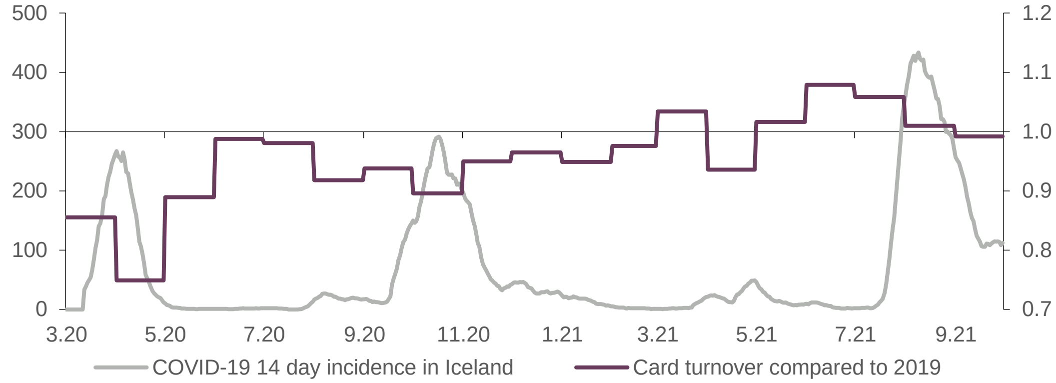
Corona Crisis takes its leave, strong GDP growth takes the stage..

Real GDP and main subitems, YoY change, %



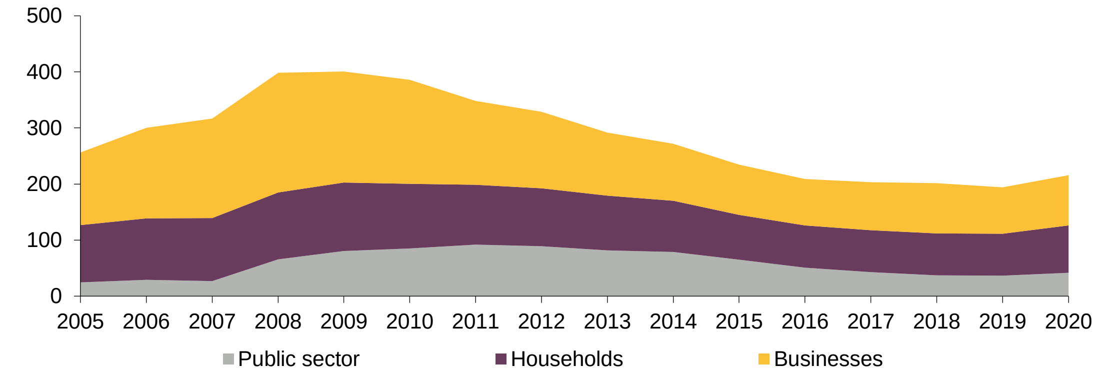
...as economic activity is increasingly resilient to short-term pandemic trends

COVID-19 incidence per 100,000 (l.axis) and payment card turnover (r.axis)



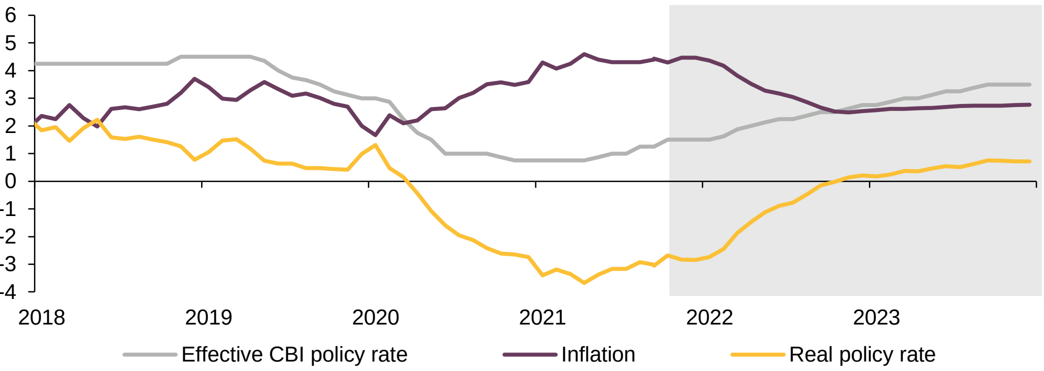
Moderate leverage throughout the economy increases resilience to shock..

Gross debt as % of GDP

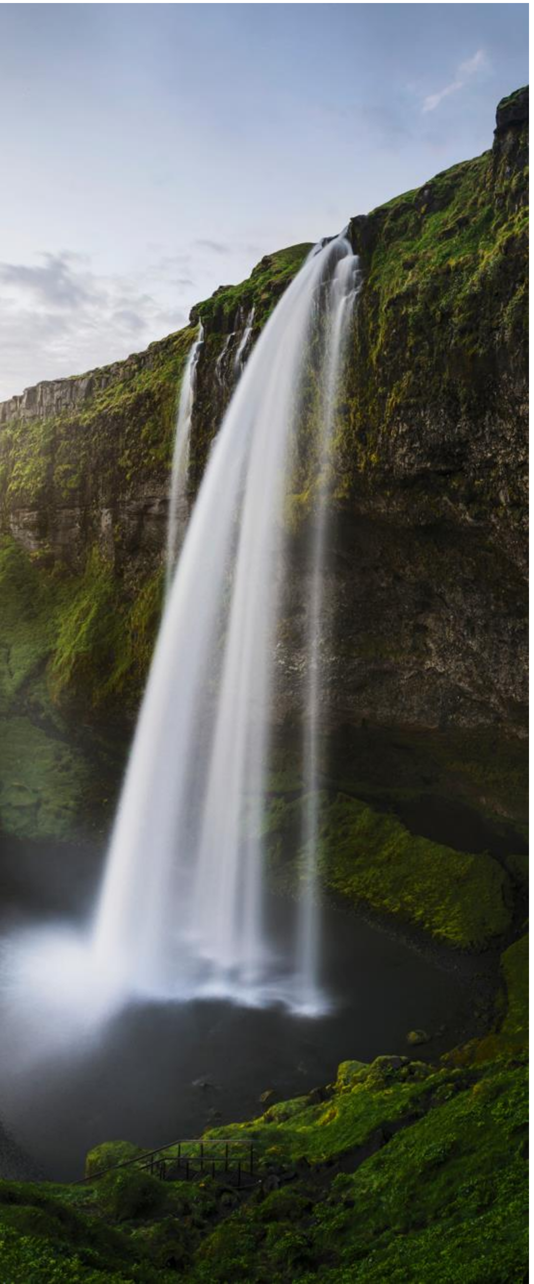


...and economic policy is on a normalisation path as economy recovers

Inflation and policy rate, %



1. Shaded areas indicate ISB Research forecasts. 2. Source: Statistics Iceland, the Central Bank of Iceland and ISB Research



3Q21 operational highlights

The app is now the primary channel for active retail customers as digital journey continues

Corporate activity

- Strong business activity in all business areas
- Business banking had 39% market share in September[1]
- Highest YTD market share in bonds brokerage, 18%
- Íslandsbanki launched its inaugural AT1 of SEK 750m
- Software development centre in Poland, aim to evolve extended delivery model and gain access to talent
- Nomination committee appointed

Sustainability

- Social bond issue for Grunnstoð, subsidiary of Reykjavik University of ISK 12bn
- Green/blue bond for seafood company Brim of ISK 2.5bn
- Íslandsbanki became a supporter of Grænvangur, a collaboration forum on climate issues and green solutions
- 29% of all Ergo car loans in 3Q21 were for electric cars
- 5,674 tco2í avoided emissions by IS Green Bonds fund in 2020 according to impact report presented in September
- Customers can now estimate their carbon footprint based on their spending profile via the app

#1 for service

- Assets in funds managed by Iceland Funds have increased by 28.1bn YTD
- 30% of all fund sales now take place via the Íslandsbanki app
- Users of Fríða, Íslandsbanki's cashback reward system more than tripled YTD
- The Bank's chatbot, Fróði, 4th best chatbot in Europe by Boost.ai
- Íslandsbanki was recognised for Excellence in Corporate Governance for the eighth year in a row
- ISK 50m was raised for charity despite a cancelled Íslandsbanki Reykjavik Marathon

1. Based on Gallup surveys regarding primary bank. 2021 average for SMEs

Íslandsbanki‘s shares have performed better than any other Nordic bank since IPO

Both compared to large, mid and small cap banks

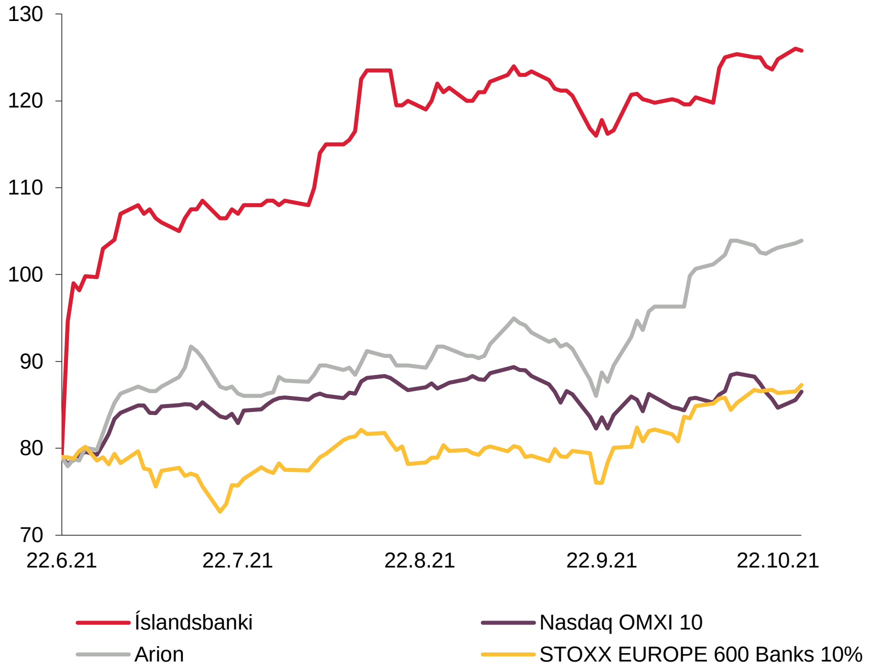
Largest Icelandic IPO ever

+17,000
shareholders

ISK 356m
Average daily turnover from end June 2021

Íslandsbanki´s share price development since IPO

Closing price[1]



Íslandsbanki‘s shareholders

Ten largest shareholders, 30.9.21

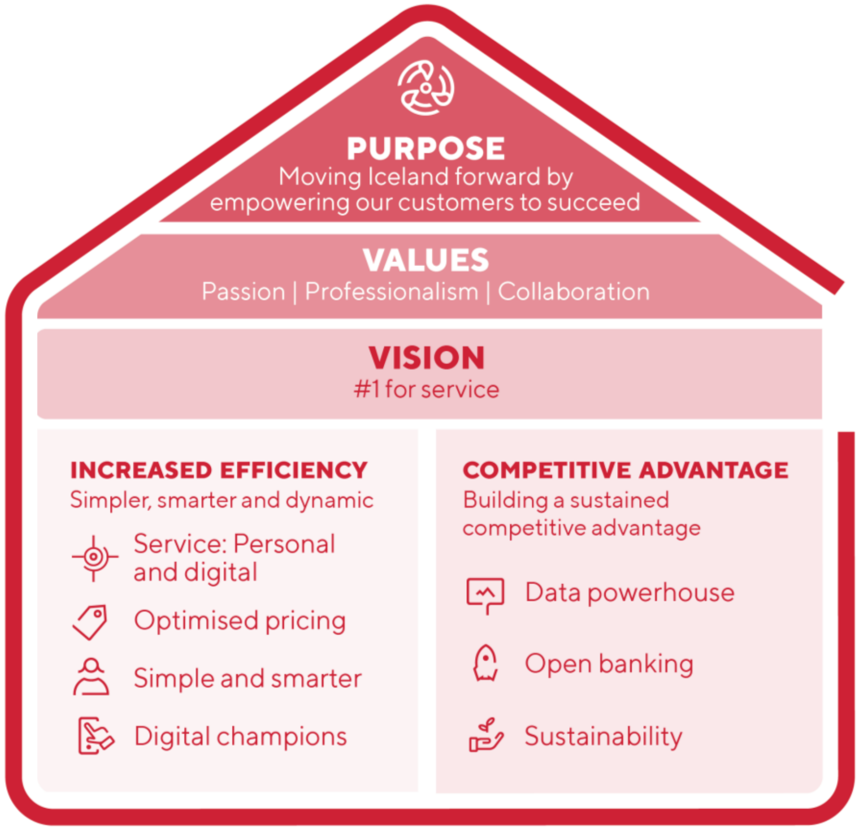
The Icelandic Government	65.0%
Capital Group	4.3%
Live Pension Fund	3.4%
Gildi Pension Fund	3.3%
LSR Pension Fund	2.9%
RWC Asset Management	1.3%
Iceland Funds	1.0%
Kvika banki hf.	0.9%
Landsbankinn – Nominee account 1	0.8%
Almenni Pension Fund	0.8%
Other shareholders with less than 0.82% shareholding	16.2%
Total	**100.0%**

1. Source: Nasdaq Iceland

Strategic projects for autumn 2021 on track

Íslandsbanki‘s strategy house, introduced in 2019, remains a guiding light in the Bank‘s actions

Íslandsbanki‘s strategy house



Strategic projects for autumn 2021

Direct link to the RoE bridge:

1. Normalisation of credit losses
2. NFCI growth
3. Simplification (cost efficiencies)
4. Capital optimisation

Indirect support to the RoE bridge:

5. Service strategy and KPIs
6. Digital business banking
7. Future payment landscape
8. Net zero by 2040

Clear path to a long term double-digit ROE

Strong revenue generation and reversed impairments main drivers in a vigorous quarter

Reported annualised ROE 9M21
11.7%

Reported ROE 2020

Reported annualised cost of risk in 9M21
-30bps

Normalisation of credit losses
- Negative CoR in 3Q21 and favourable short-term outlook if economic recovery continues
- Mortgages larger part of BS, might lower future CoR[1]

Steady progress

Base rate
1.5% vs. 0.75% at YE20

Rising risk-free rates
- Higher base rate feeds into NIM and liquidity portfolio with a lag
- Economic forecasts and market curves indicate quarterly 25bp increase during the next 18-24 months

Ahead of forecast

NFCI growth YoY
20%

Net fee & commission income growth
- Strong growth YoY with growth coming from asset management, Investment banking and brokerage
- Payments and asset management areas of opportunities

Ahead of forecast

Real cost decrease YoY excluding one-offs
4%

Cost efficiencies
- Ongoing efforts via continued digital uptake, branch optimisation and contained cost inflation

On track

AT1 issue of SEK
750m
in 3Q21

Capital optimisation
- Headroom for further AT1 issue is ISK 6bn
- A partial release of excess capital to commence in 1Q22
- Excess capital of ISK >35bn[2]
- Financial targets will be reviewed in 4Q21

On track

Target ROE
8-10%
by 2023
>10%
long-term

1. The average cost of risk in 2019 and 2020, excluding the effect of COVID-19, amounted to +0.35%, which would have been closer to +0.30% based on the current composition of the loan book with a higher proportion of mortgages. 2. Based on long term capital targets. An increase in 3Q21 in excess of CET1 is due to strong financial result and lower REA. This amount will fluctuate with the level of net profits and changes in REA.

2. Income statement

Substantial increase in total operating income YoY

Economic recovery yields positive net impairment

Highlights

- The Bank focuses on core banking operations with NII and NFCI accounting for around 92% of total operating income in 3Q21
- Cost-to-income is 39.4%, below target, due to strong revenue generation, cost reduction efforts and seasonality in other operating expenses
- Annualised cost of risk was -0.64% in 3Q21 and -0.30% in 9M21, compared to +0.91% for the full year 2020 and +0.44% for 3Q20
- The average cost of risk in 2019 and 2020 excluding the effect of COVID-19 amounted to +0.35%, which would have been closer to +0.30bp based on the current composition of the loan book with a higher proportion of mortgages
- The positive net impairment in 3Q21 is mostly due to the brightening outlook for the tourism industry and reduced impairments on loans to individuals resulting from an updated risk assessment model
- Lower effective tax rate due to tax treatment of equity forwards

Income statement, ISKm	3Q21	3Q20	Δ%	2Q21	Δ%	9M21	9M20	Δ%	2020
Net interest income	**8,792**	8,305	6%	8,417	4%	**25,399**	25,113	1%	33,371
Net fee and commission income	**3,427**	2,862	20%	2,907	18%	**9,196**	7,660	20%	10,525
Net financial income (expense)	**941**	(255)	-	619	52%	**1,853**	(2,174)	-	(1,391)
Net foreign exchange gain	**95**	101	(6%)	95	0%	**320**	364	(12%)	451
Other operating income	**82**	44	86%	82	0%	**286**	134	113%	197
Total operating income	**13,337**	11,057	21%	12,120	10%	**37,054**	31,097	19%	43,153
Salaries and related expenses	**(2,953)**	(2,842)	4%	(3,594)	(18%)	**(10,121)**	(9,536)	6%	(12,917)
Other operating expenses	**(2,135)**	(2,268)	(6%)	(2,894)	(26%)	**(7,307)**	(7,137)	2%	(9,829)
Administrative expenses	**(5,088)**	(5,110)	(0%)	(6,488)	(22%)	**(17,428)**	(16,673)	5%	(22,746)
Contribution to the Depositor's and Investors' Guarantee Fund	**(173)**	(50)	246%	(162)	7%	**(517)**	(525)	(2%)	(679)
Bank tax	**(433)**	(416)	4%	(451)	(4%)	**(1,294)**	(1,174)	10%	(1,588)
Total operating expenses	**(5,694)**	(5,576)	2%	(7,101)	(20%)	**(19,239)**	(18,372)	5%	(25,013)
Profit before net impairment on financial assets	**7,643**	5,481	39%	5,019	52%	**17,815**	12,725	40%	18,140
Net impairment on financial assets	**1,757**	(1,058)	-	1,140	54%	**2,379**	(6,987)	-	(8,816)
Profit before tax	**9,400**	4,423	113%	6,159	53%	**20,194**	5,738	252%	9,324
Income tax expense	**(1,898)**	(1,350)	41%	(769)	147%	**(3,703)**	(2,238)	65%	(2,472)
Profit for the period from continuing operations	**7,502**	3,073	144%	5,390	39%	**16,491**	3,500	371%	6,852
Discontinued operations held for sale, net of income tax	**85**	288	(70%)	41	107%	**142**	(270)	-	(97)
Profit for the period	**7,587**	**3,361**	**126%**	**5,431**	**40%**	**16,633**	**3,230**	**415%**	**6,755**

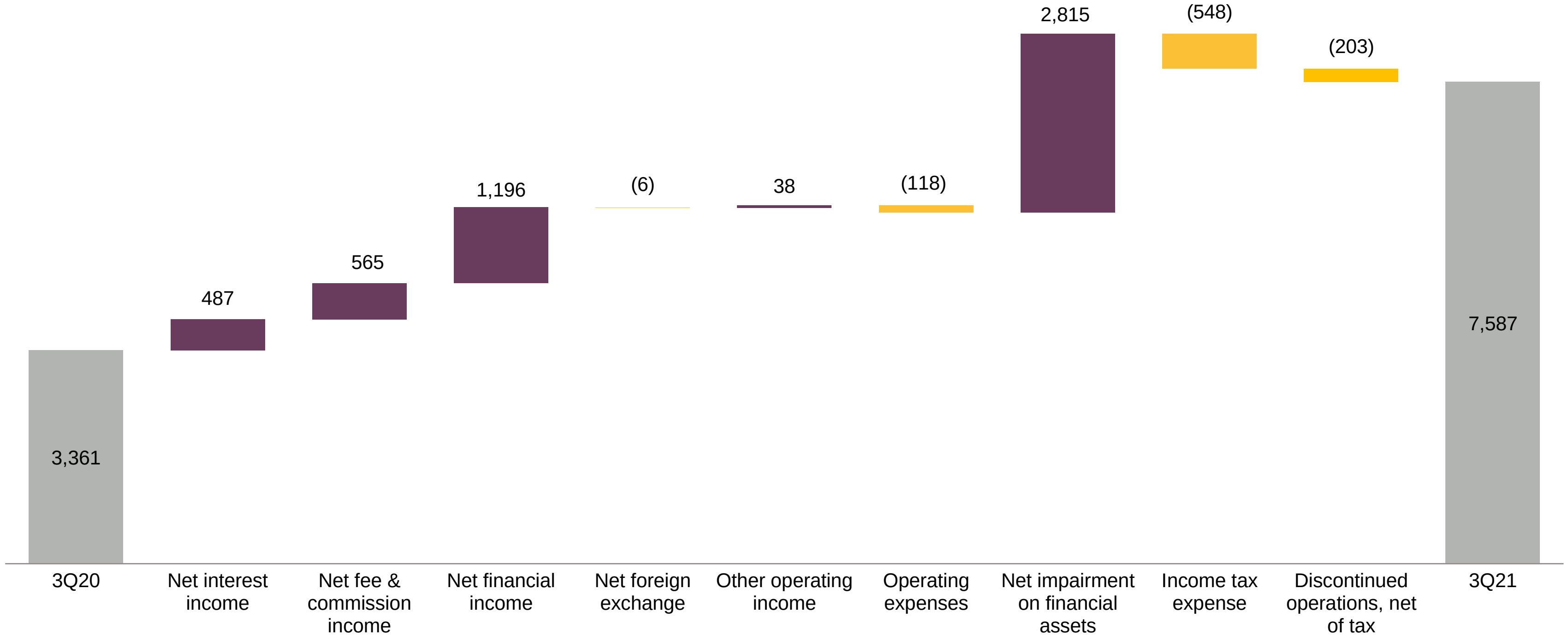
Key ratios	3Q21	3Q20	2Q21	9M21	9M20	2020
Net Interest Margin (NIM)[1]	**2.4%**	2.5%	2.4%	**2.4%**	2.6%	2.6%
Cost-to-income ratio (C/I)[2]	**39.4%**	46.7%	49.9%	**46.6%**	55.3%	54.3%
Return on Equity (ROE)	**15.7%**	7.4%	11.6%	**11.7%**	2.4%	3.7%
Cost of risk (COR)	**(0.64%)**	0.44%	(0.42%)	**(0.30%)**	0.98%	0.91%
Effective income tax rate	**20.2%**	30.5%	12.5%	**18.4%**	39.0%	26.5%

1. On total assets. 2. Calculated as (Administrative expenses + Contribution to the Depositors' and Investors' Guarantee Fund – One-off items) / (Total operating income – One-off items).

Best quarter in 5 years

Core revenue growth from robust underlying business and reversed impairments drive good result

Profit for the period – 3Q20 vs 3Q21
ISKm



Net interest income rises following increased lending

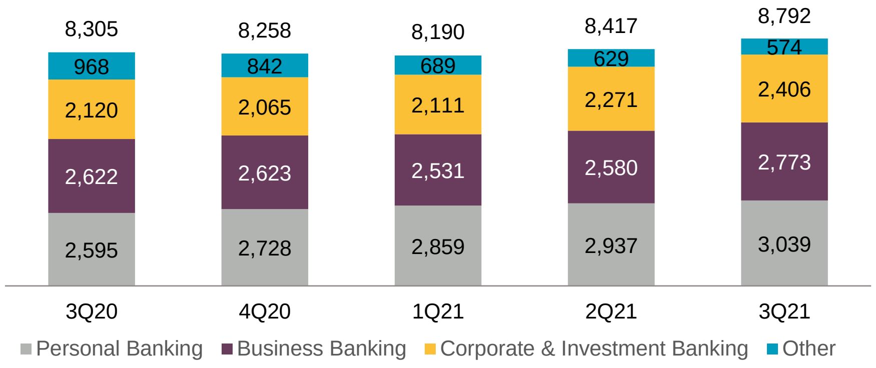
NIM likely to be supported by rising policy rates

Highlights

- Greater lending volumes drive the higher NII YoY
- Net interest margin on loans fell from 2.3% to 2.2% in 3Q21 while net interest margin on deposits increased from 1.1% to 1.3% in 3Q21
- The CB policy rate was hiked once in 3Q21, on 25 August. Average CB policy rate in 3Q21 was 1.1% compared to 1.0 in 3Q20
- Higher rate feeds into NIM and liquidity portfolio with a lag
- Based on the Bank's assessment, a 100bp increase in Central Bank rates can increase the ROE by 60-70bp over time, mainly due to improved earnings in the liquidity portfolio

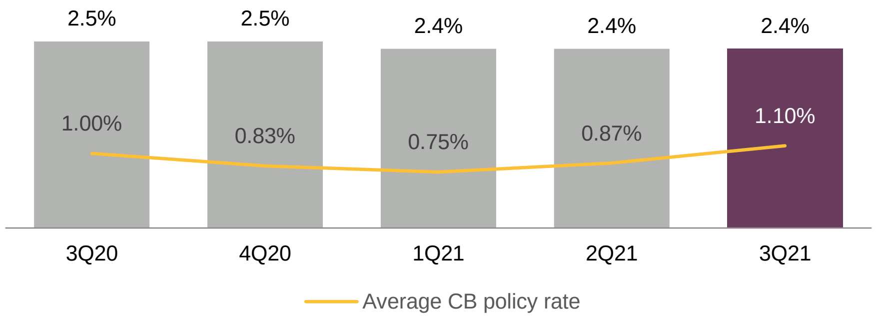
Net interest income

By business segments, ISKm



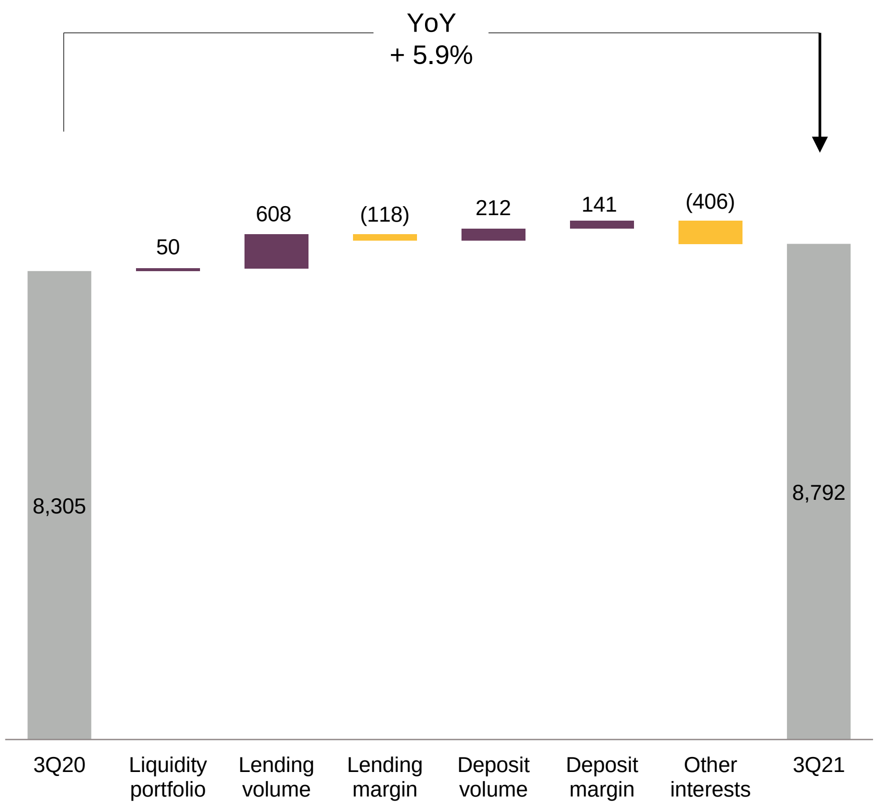
Net interest margin

Total assets



NII – 3Q20 vs 3Q21

ISKm



28 October 2021

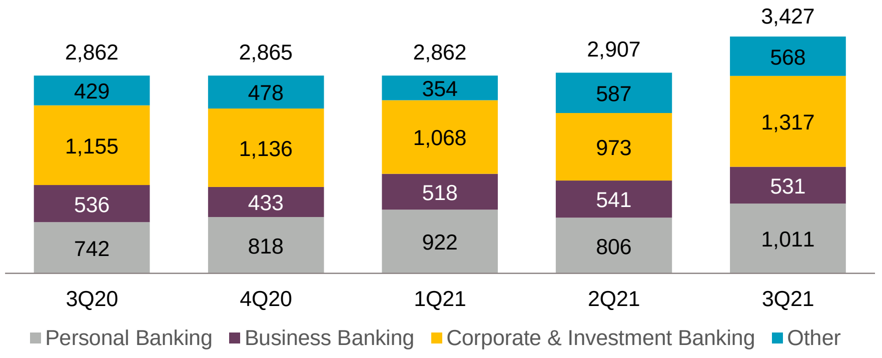
Diversified sources of NFCI

20% increase YoY distributed across business segments

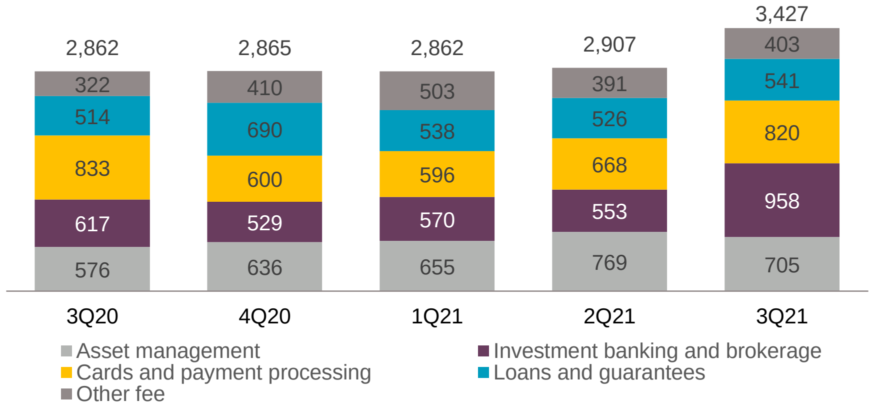
Highlights

- Asset management and Investment banking and brokerage are primary drivers for the increase in NFCI
- Asset management saw a strong inflows into equity funds, balanced funds and asset portfolios from all client segments leading to a strong growth in fee and commission income
- Strong performance in all fee generating divisions within investment banking
- Several corporate finance projects completed including successful IPO of the Bank
- Future growth expected to be in line with nominal GDP growth on average through the business cycle
- Payments and asset management areas of opportunities

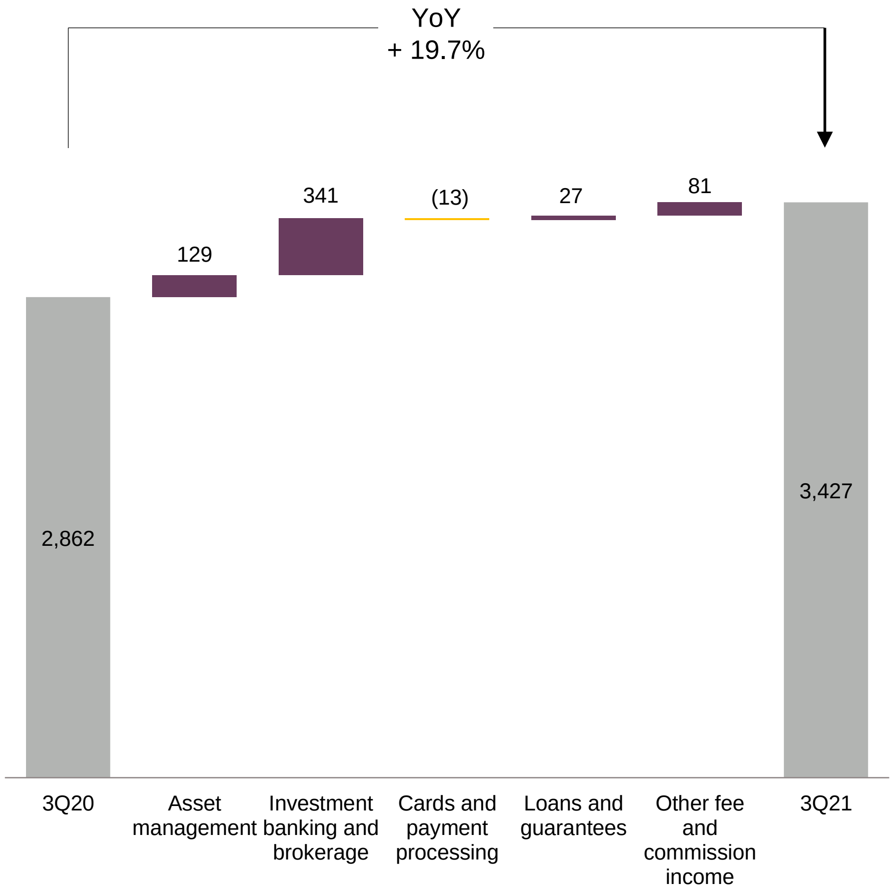
Net fee and commission income
Business segments, ISKm



Net fee and commission income
By type, ISKm



NFCI – 3Q20 vs 3Q21
ISKm



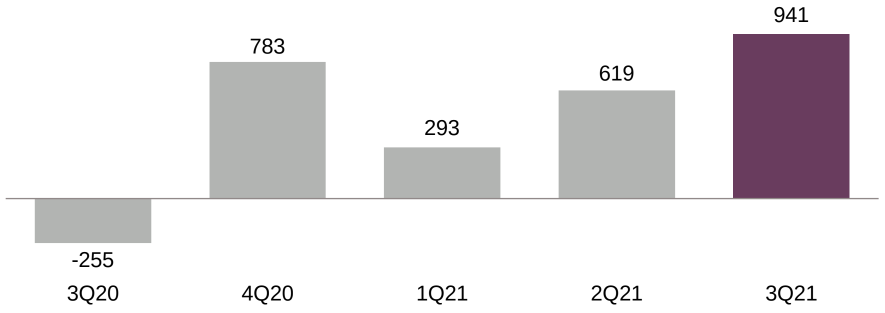
Strong NFI due to favourable market conditions

Positive value changes of unlisted shares and a strong equity market are the main factors

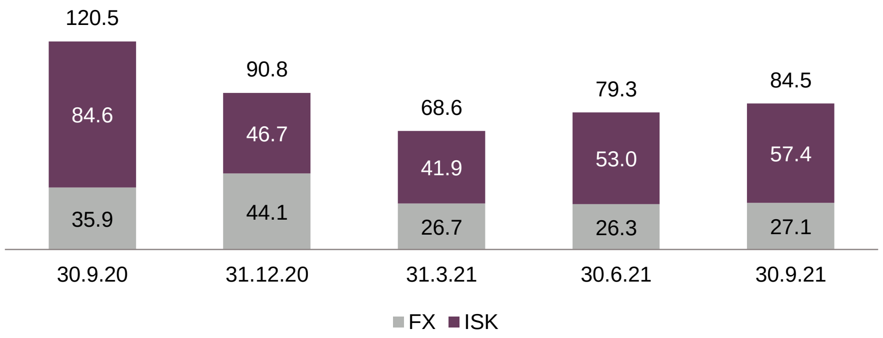
Highlights

- The increase in net financial income in 3Q21 YoY is largely explained by:
  - a positive value change in unlisted equity instruments
  - income from listed shares and equity instruments in a strong domestic equity market
  - mark-to-market of balance sheet management derivatives in Treasury
- The domestic equity market has shown strong performance
- The domestic equity market index rose by 26% in 9M21
- Low interest rates, good operating results and the opening of the economy all contributed to higher equity prices
- Approximately ISK 1.1bn of listed shares are assets in domestic bond funds

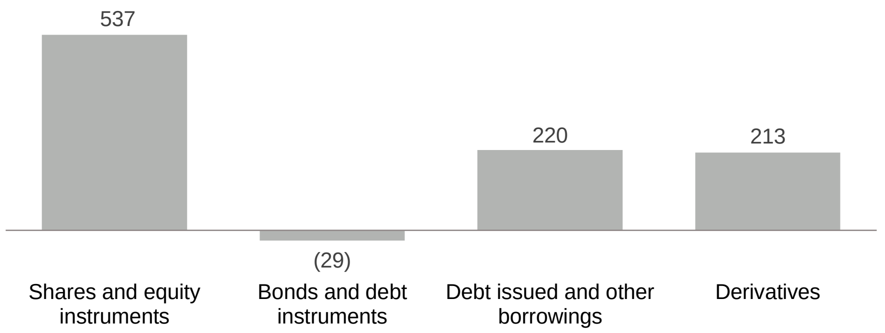
Net financial income
ISKm



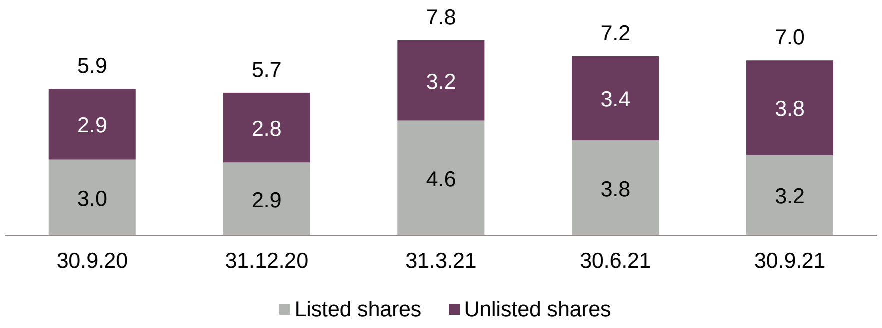
Bonds and debt instruments[1]
ISKbn



Net financial income by type in 3Q21
ISKm



Shares and equity instruments[2]
ISKbn



1. Excluding listed bonds and debt instruments used for economic hedging. 2.Excluding listed shares and equity instruments used for economic hedging.

Cost/income ratio at an all-time low level and beats target

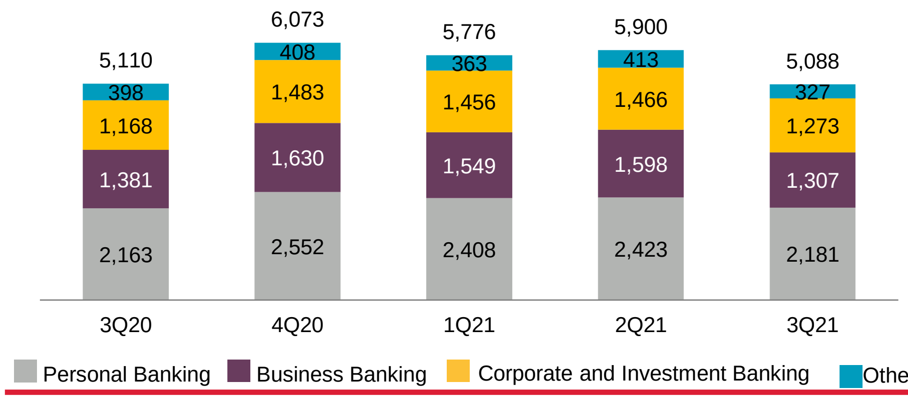
Supported by strong revenue generation, cost reduction efforts and cyclicality in expenses

Highlights

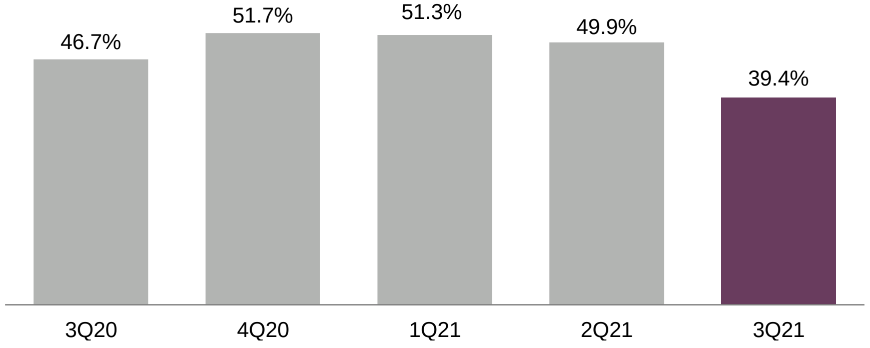
- Cost-to-income ratio was 39.4% in 3Q21, below the Bank's target, and is 46.7% for 9M21
- The reduction in administrative expenses between 2Q21 and 3Q21 is largely due to seasonality in salary expenses along with decrease in other operating expenses
- The increase in salaries YoY is due to collective salary increase and redundancy costs following layoffs
- One-off cost related to IPO totalled ISK 663m in 1H21

Administrative expenses[1]

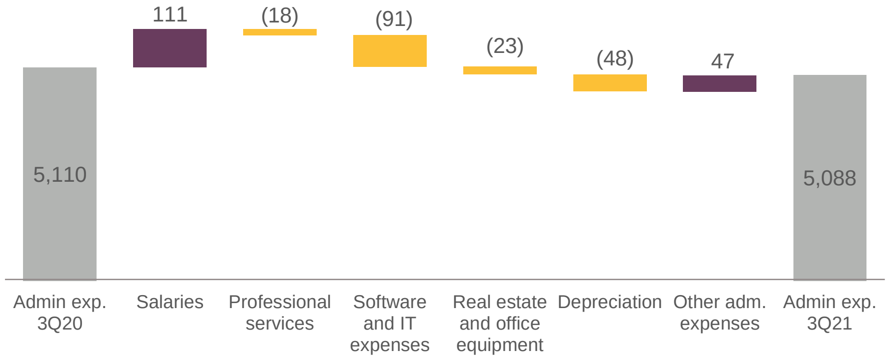
ISKm



Cost-to-income ratio[2]

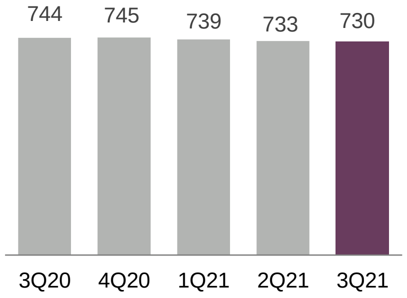


Administrative expenses – 3Q20 vs 3Q21



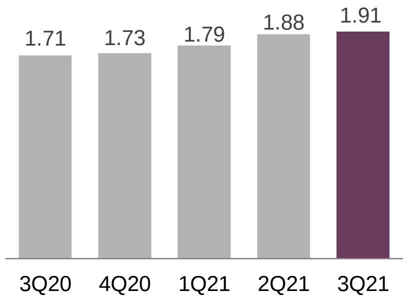
FTE period end[3]

Parent company



Total assets / FTE[3]

ISKbn



1. Administrative expenses in 1Q21 and 2Q21 are excluding one-off cost related to the Bank's IPO, 76m in 1Q21 and 588m in 2Q21. 2. Calculated as (Administrative expenses + Contribution to the Depositor's and Investors' Guarantee Fund – one off items) / Total operating income – one-off items). IPO costs in 1Q21 were not adjusted for when 1Q21 results where published. 3. FTE numbers exclude seasonal employees.

3. Balance sheet

Balance sheet reflects balanced loan and funding profile

Broad product offering, strong liquidity portfolio and stable funding

Assets

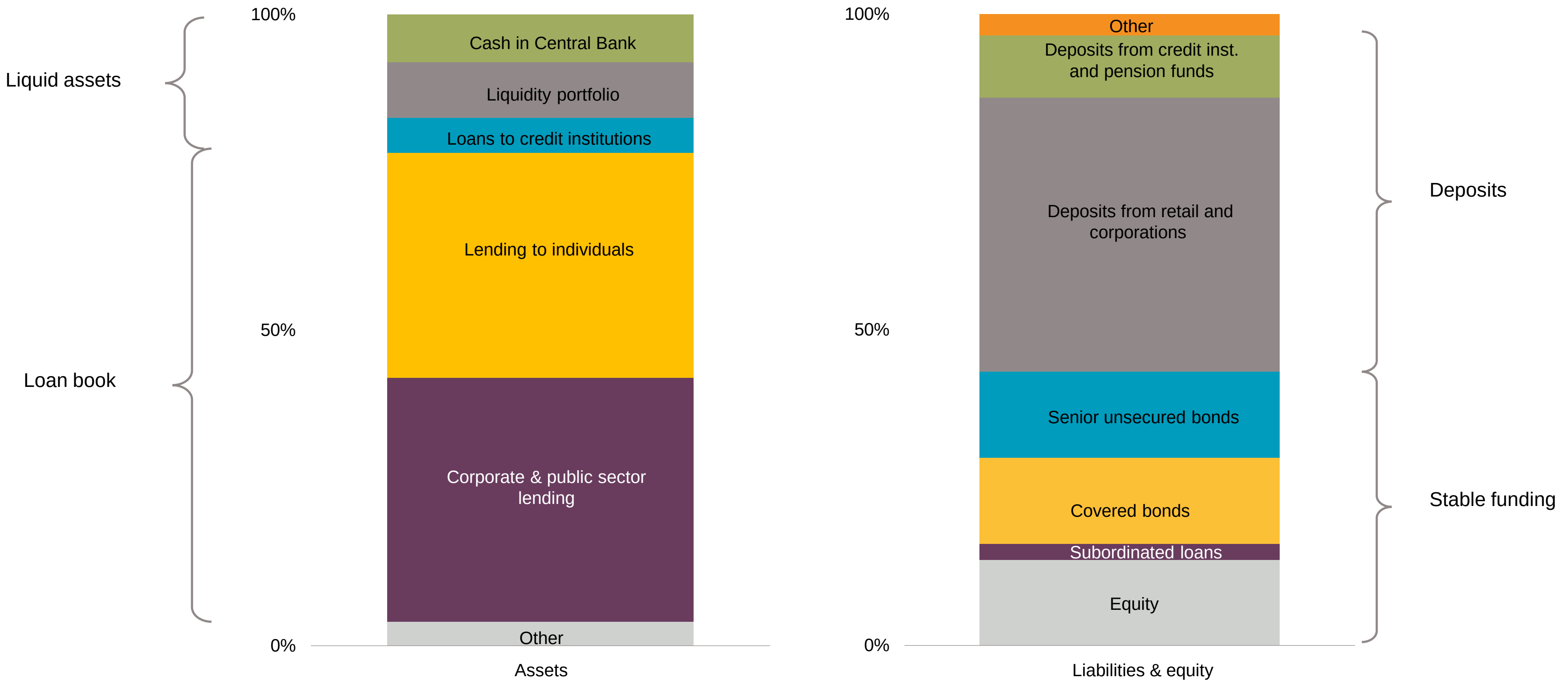
- Vast majority of assets consist of lending to both individuals and corporates
- Strong liquidity portfolio is a consistent factor in balance sheet management
- Very limited exposure to non-liquid or non-lending assets

Liabilities

- Deposits from retail and corporations are the single largest funding source
- Bonds and debt instruments have become a more prominent part of the funding mix thanks to continuous focus on attracting new pockets of demand, including foreign currency and ESG issuance

Simplified balance sheet structure

30.9.2021, ISK 1,456bn



Robust growth in total assets in 9M21

Steady mortgage growth supported by an even stronger capital base

Highlights

- Four line items:
  - cash and balances with the Central Bank
  - loans to credit institutions
  - bonds and debt instruments, and
  - shares and equity instruments,

  amounted to about ISK 346bn of which ISK 314bn are liquid assets
- Loans to customers contracted by 0.8% in 3Q21 as growth in mortgages lending normalises following Central Bank rate hikes
- Increase in bonds and debt instruments is mostly due to issuance of AT1 notes in 3Q21

Assets, ISKm	30.9.2021	30.6.21	Δ	Δ%	31.12.20	Δ	Δ%
Cash and balances with Central Bank	**110,233**	130,968	(20,735)	(15.8%)	78,948	31,285	39.6%
Loans to credit institutions	**81,117**	57,793	23,324	40.4%	89,920	(8,803)	(9.8%)
Bonds and debt instruments	**123,599**	110,499	13,100	11.9%	128,216	(4,617)	(3.6%)
Derivatives	**2,374**	2,649	(275)	(10.4%)	6,647	(4,273)	(64.3%)
Loans to customers	**1,081,418**	1,089,723	(8,305)	(0.8%)	1,006,717	74,701	7.4%
Shares and equity instruments	**31,456**	31,751	(295)	(0.9%)	14,851	16,605	111.8%
Investment in associates	**952**	911	41	4.5%	775	177	22.8%
Property and equipment	**7,082**	7,246	(164)	(2.3%)	7,341	(259)	(3.5%)
Intangible assets	**3,249**	3,307	(58)	(1.8%)	3,478	(229)	(6.6%)
Other assets	**13,954**	10,474	3,480	33.2%	4,125	9,829	238.3%
Non-current assets and disposal groups held for sale	**938**	1,539	(601)	(39.1%)	3,173	(2,235)	(70.4%)
Total Assets	**1,456,372**	**1,446,860**	**9,512**	**0.7%**	**1,344,191**	**112,181**	**8.3%**

Key ratios							
Risk Exposure Amount (REA)	**917,764**	924,375	(6,611)	(0.7%)	933,521	(15,757)	(1.7%)
Non-performing loans (NPL) ratio[1]	**2.0%**	2.1%			2.9%		
Asset encumbrance ratio	**18.9%**	18.9%			18.7%		

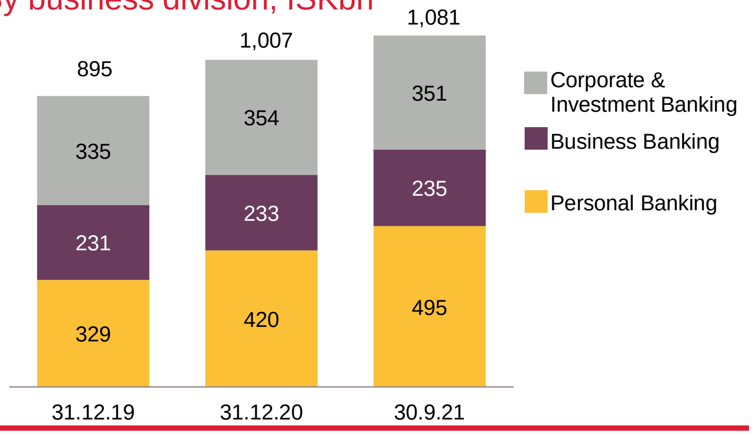
1. Stage 3, loans to customers, gross carrying amount

Diversified and highly collateralised loan portfolio

Loans to individuals are 48% of loans to customers, mainly residential mortgages

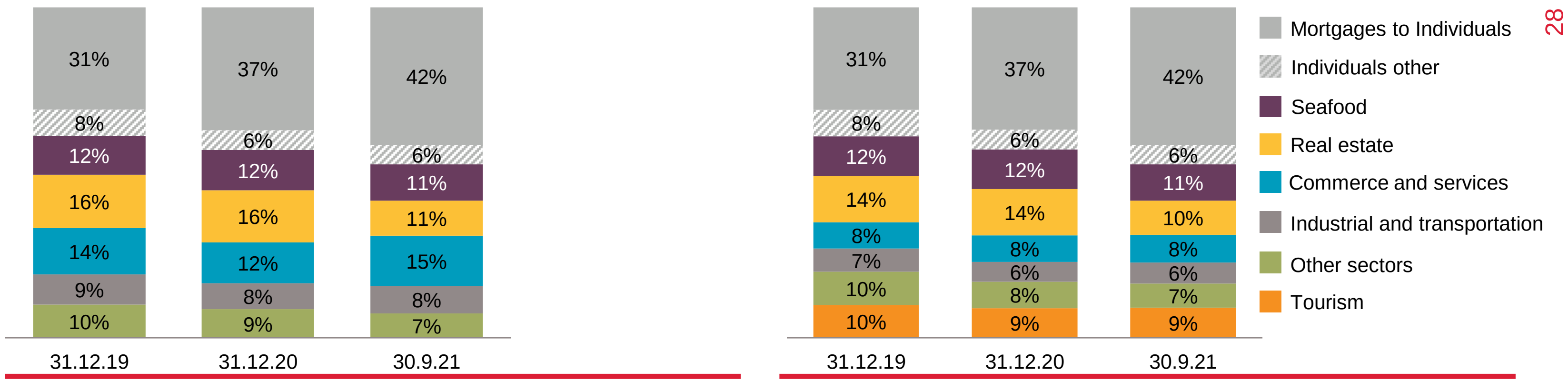
Loans to customers

By business division, ISKbn



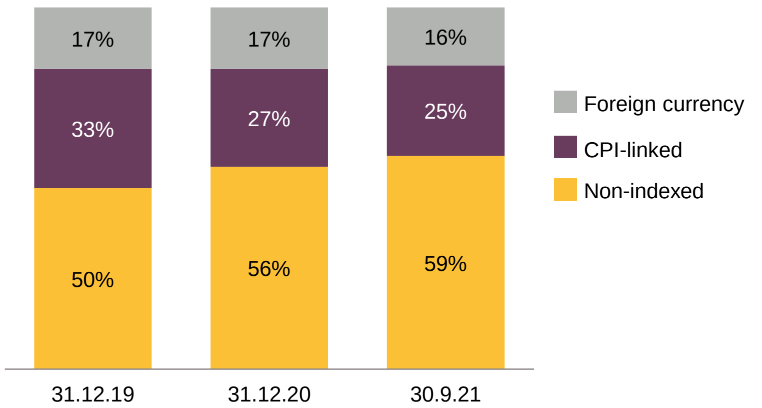
Loans to customers

By sector, standard sectors (left graph) and with tourism as a quasi-sector (right graph)



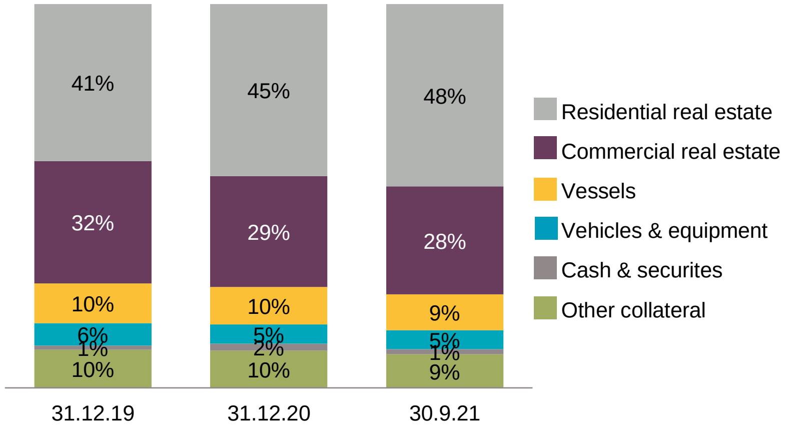
Loans to customers

By currency type



Credit exposure covered by collateral: ISK 1,042bn

By collateral type



Comments

- The sector classification is generally based on information from the tax authorities although the Bank has the possibility to reclassify customers internally based on a "see-trough principle" when another sector is more descriptive of the underlying risk
- In the case of real estate companies, this can be appropriate if the real estate is specialised and the credit risk depends more on the operations located in the building than general real estate or rental prices
- In 2021 around ISK40bn was reclassified from Real estate, mostly to Commerce & services (hotel buildings) and Industrial & transportations. The result is visible in the centre graph above

LTV distributions point to healthy coverage ratios

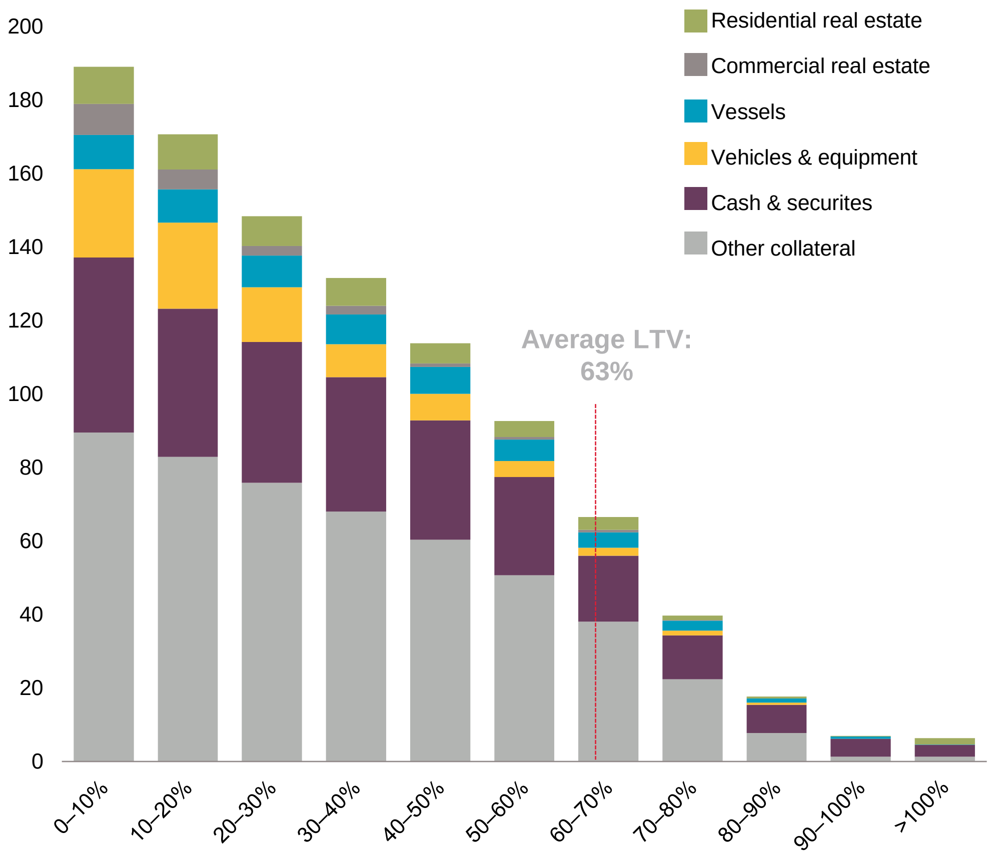
Majority of collateral is in residential and commercial real estate

Highlights

- The weighted average LTV for mortgages[1] was 66% at end of Q3, compared to 64% at year-end 2020. Increase in LTV due to strong new loan origination, where new mortgages are often at close to 80% LTV
- The LTV distribution for commercial real estate is shown for the industry sectors where this is the most important collateral type: real estate, commerce & services and industrials & transportation
- Valuation of collateral is based on market price, official valuation for tax purposes or expert opinion of the Group's employees, depending on availability
- Íslandsbanki's registered value of commercial real estate is less vulnerable to market fluctuations as collateral valuation has risen at a much slower rate and lagged market prices in prior years

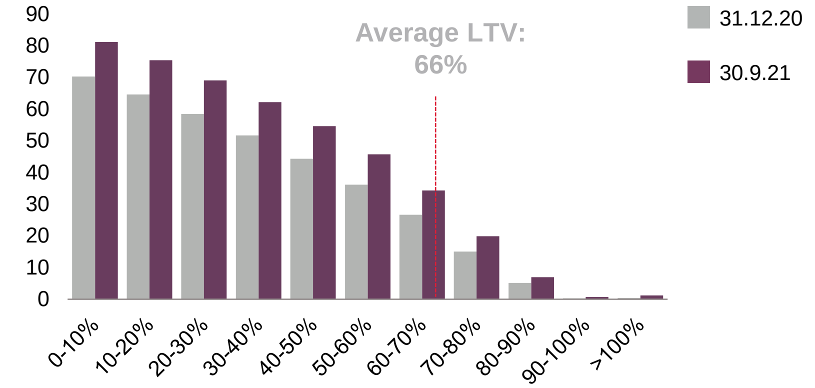
LTV distribution by underlying asset class

30.9.2021, loan splitting approach, ISKbn



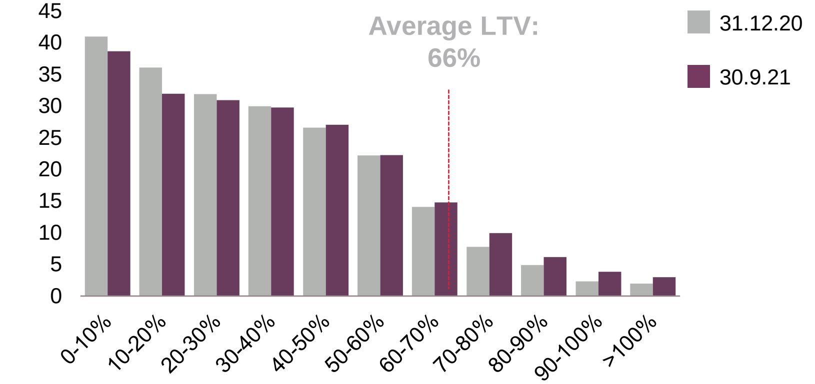
LTV distribution of mortgages to individuals

Loan splitting approach, ISKbn



LTV distribution of loans secured by commercial real estate

Loan splitting approach, ISKbn



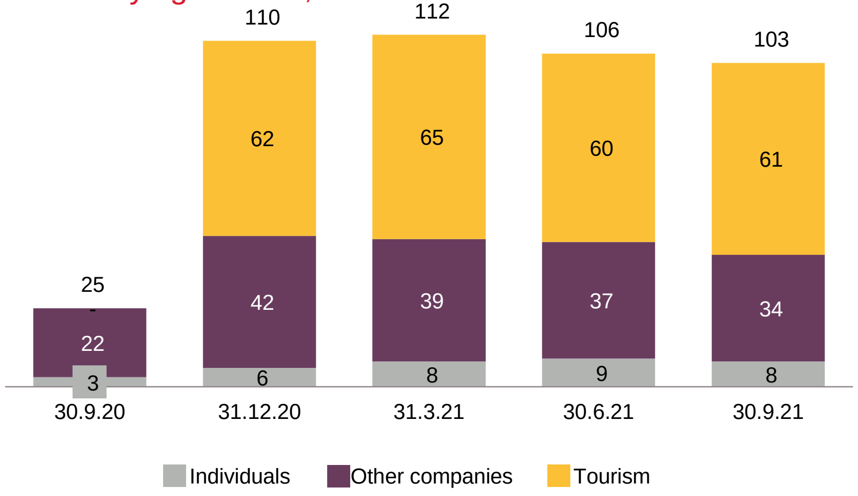
1. The average LTV can be calculated in different ways and therefore the definition is important for comparison to other banks. For mortgages to individuals, the weight is Íslandsbanki's total amount outstanding on the property and the LTV used is the maximum LTV of all Íslandsbanki's loans of the property. See more in the Pillar 3 Report. For other portfolios with more complex collateral agreements a generalised method is used.

COVID-19 moratoria over, more clarity on forbearance

Temporary moratorium uniformly executed and broadly applied during 2020 providing shelter for customers as they weathered the storm. Payments have resumed for 59% of loans in forbearance

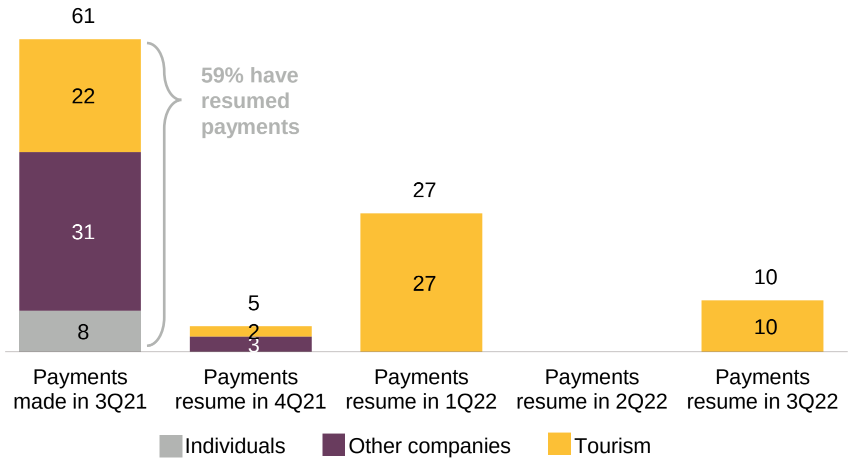
Performing loans with forbearance

Gross carrying amount, ISKbn



Indication on when payments resume after moratorium

Gross carrying amount, ISKbn



Further extension of moratorium

- The forbearance increase at end of 2020 mostly due to extension of COVID-19 moratoria to companies in the tourism sector
- Loans that have been granted extended moratoria primarily with collateral in residential or commercial real estate
- The definition of forbearance includes a 24-month probation period and therefore loans are classified with forbearance even after normal payments have resumed
- The fall in performing loans with forbearance is due to loans that are fully repaid

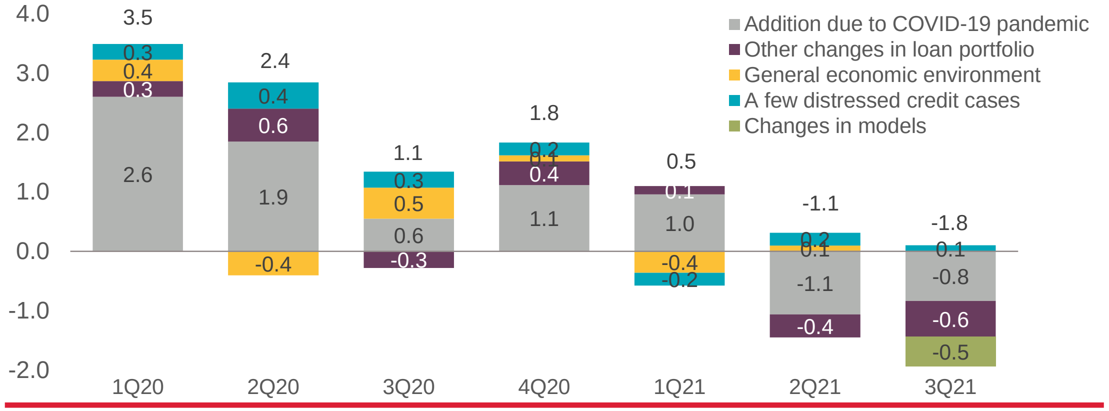
Clarity on when payments are expected to resume

- Loans amounting to ISK 103bn are classified as performing with forbearance, but ISK 61bn have already begun regular payments or 59%
- Performing loans with forbearance that have not yet started regular payments are almost exclusively in the tourism industry
- According to current schedule, additional ISK 27bn should resume regular payments again in the first quarter of next year
- Note that some customers might request further extension of moratoria when the current moratoria expires

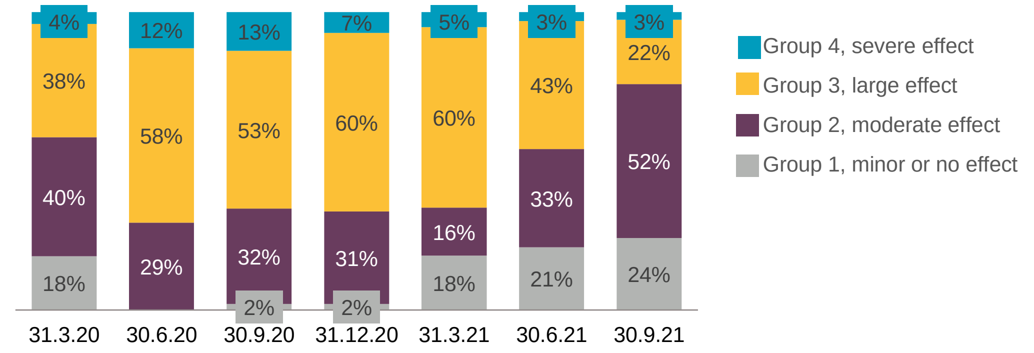
Majority of net impairments are COVID-19 related

Tourism sector hit hard and fully in Stage 2, overlay factors to account for uncertainty

Net impairment on financial assets
By period, ISKbn



Exposure to tourism by effect of COVID-19
A proportion of approximately ISK 100bn



Macroeconomic scenario applied to IFRS 9 model[1]
Baseline forecast assumes 1.3 million tourists in 2022

Change in economic indicators %	2020	2021	2022	2023	2024
Economic growth	(6.5)	4.2	3.6	3.0	2.4
Housing prices in Iceland	6.4	11.3	6.9	3.4	3.5
Purchasing power	3.5	3.6	1.4	1.9	1.6
ISK exchange rate index	11.1	(3.6)	(5.1)	(0.9)	0.0
Policy rate, Central Bank of Iceland	1.5	1.0	2.2	3.2	3.5
Inflation	2.8	4.4	3.0	2.5	2.4
Capital formation	(8.7)	7.5	2.3	2.0	3.5
thereof capital formation in industry	(14.2)	9.5	0.9	2.2	3.5

1. The table shows the assumptions used in the forward-looking IFRS 9 model, figures for 2020 were estimates while the other years are based on forecast.

Highlights

— Annualised cost of risk was -0.64% in 3Q21 and -0.30% in 9M21, compared to +0.91% for the full year 2020 and +0.44% for 3Q20. The average cost of risk in 2019 and 2020 excluding the effect of COVID-19 amounts to +0.35%

— The positive net impairment in 3Q21 is mostly due to an updated model for risk assessment of individuals (see next slide) and a brighter outlook for the tourism industry, reflected in a shift from impact group 3 to 2. The additional impairment allowance currently attributable to the tourism overlay and stage transfer is approximately ISK 2.8bn

— In addition to the baseline forecast, scaling factors are produced for an optimistic and pessimistic case. The probability weights of the scenarios were set to 15% (good), 50% (baseline), and 35% (bad) at end of 3Q, unchanged from end of 2Q21

— A shift of 5% weight from the baseline to the pessimistic scenario would increase the impairment allowance by ISK 0.6bn while a 5% shift from the baseline to the optimistic scenario would decrease the allowance by ISK 0.2bn

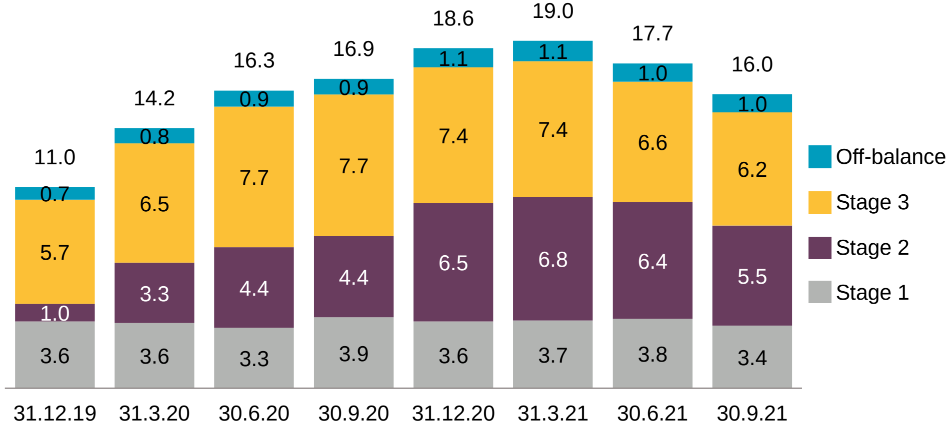
Impairment allowance sufficient, uncertainty accounted for

Exposures in Stage 2 continue to lower as COVID-19 pandemic recedes and Stage 3 has decreased

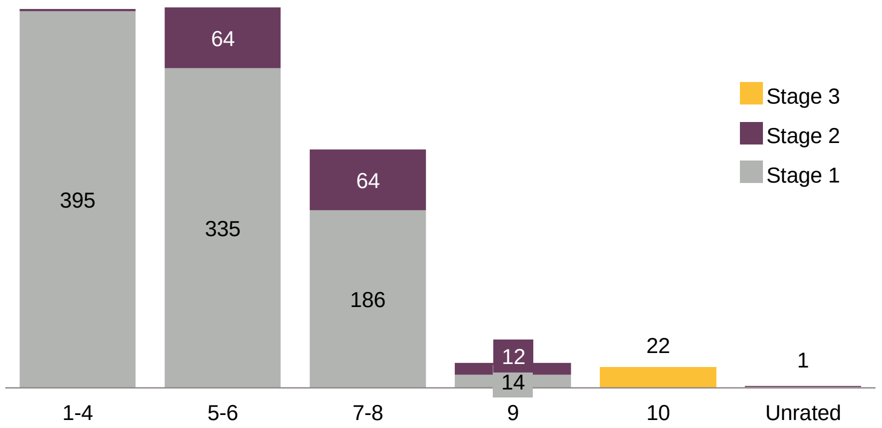
Highlights

- The distribution in risk classes and strong collateral ensures a modest credit risk profile
- A new risk assessment model for individuals was introduced in 3Q21. The new model utilises new information from the semi-automatic lending process for mortgages and leads to a general shift to better risk classes and an overall reduction in average probability of default
- Consequently, the expected credit loss and the impairment allowance for loans to individuals fell by ISK 0.5bn
- The impairment allowance account has risen by ISK 5.0bn since beginning of COVID-19 due to uncertainty, but the loss has not been, and might not be, realised
- The share of credit-impaired loans to customers was only 2.0% (gross) down from 2.9% at year-end, following full repayments of exposures in Stage 3

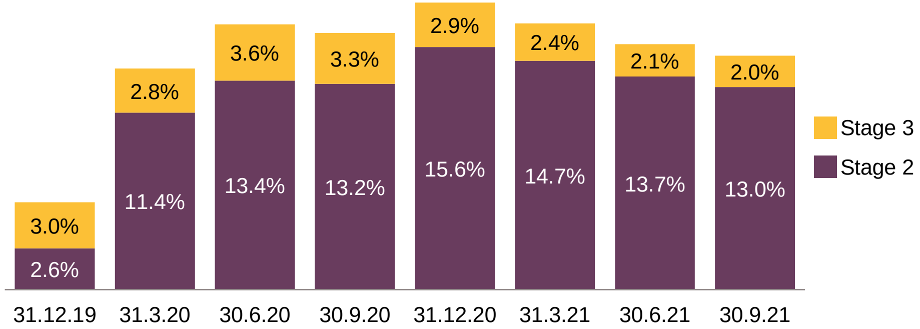
Loans to customers & off-balance sheet items
Impairment allowance account, ISKbn



Loans to customers: gross carrying amount
30.9.2021, risk class and impairment stage, ISKbn



Loans to customers: Stage 2 and 3
Development of gross carrying amount as ratio of total loans



Loans to customers: credit quality
30.9.2021, Break-down of loans to customers

	Gross carrying amount		Impairment allowance		Net carrying amount	
	(ISKbn)	% of total	(ISKbn)	RCR	(ISKbn)	% of total
Stage 1	932	85.0%	3.4	0.4%	928	85.8%
Stage 2	143	13.0%	5.5	3.8%	137	12.7%
Stage 3	22	2.0%	6.2	28.0%	16	1.5%
Total	**1,096**	**100.0%**	**15.1**	**1.4%**	**1,081**	**100.0%**

Diversified funding base

Deposits are largest source of funding

Highlights

- Deposits from customers contracted by 1.5% due to settlement following the Bank's IPO
- Deposits from retail and corporations are the Bank's main source of funding, comprising 43% of the Bank's total funding sources and 82% of the Bank's total deposit base at period end
- Subordinated loans increased due to and AT1 issue

Liabilities & Equity, ISKm	30.9.2021	30.6.21	Δ	Δ%	31.12.20	Δ	Δ%
Deposits from Central Bank and credit institutions	**20,409**	32,240	(11,831)	(36.7%)	39,758	(19,349)	(48.7%)
Deposits from customers	**754,442**	765,614	(11,172)	(1.5%)	679,455	74,987	11.0%
Derivative instruments and short positions	**10,869**	10,079	790	7.8%	6,936	3,933	56.7%
Debt issued and other borrowed funds	**397,672**	398,786	(1,114)	(0.3%)	387,274	10,398	2.7%
Subordinated loans	**36,923**	25,297	11,626	46.0%	27,194	9,729	35.8%
Tax liabilities	**6,256**	6,025	231	3.8%	5,450	806	14.8%
Other liabilities	**32,420**	18,464	13,956	75.6%	11,920	20,500	172.0%
Total Liabilities	**1,258,991**	1,256,505	2,486	0.2%	1,157,987	101,004	8.7%
Total Equity	**197,381**	190,355	7,026	3.7%	186,204	11,177	6.0%
Total Liabilities and Equity	**1,456,372**	**1,446,860**	**9,512**	**0.7%**	**1,344,191**	**112,181**	**8.3%**

Key ratios	30.9.2021	30.6.21	31.12.20
Customer loans to customer deposits ratio	**143%**	142%	148%
REA/total assets	**63.0%**	63.9%	69.4%
Liquidity coverage ratio (LCR)	**225%**	187%	196%
Net stable funding ratio (NSFR)	**121%**	122%	123%
CET 1 ratio[1]	**20.6%**	20.1%	20.1%
Tier 1 ratio[1]	**21.8%**	20.1%	20.1%
Total capital ratio[1]	**24.7%**	22.9%	23.0%
Leverage ratio[1]	**13.2%**	12.4%	13.6%

1. Including third quarter profit

Deposits are largest source of funding

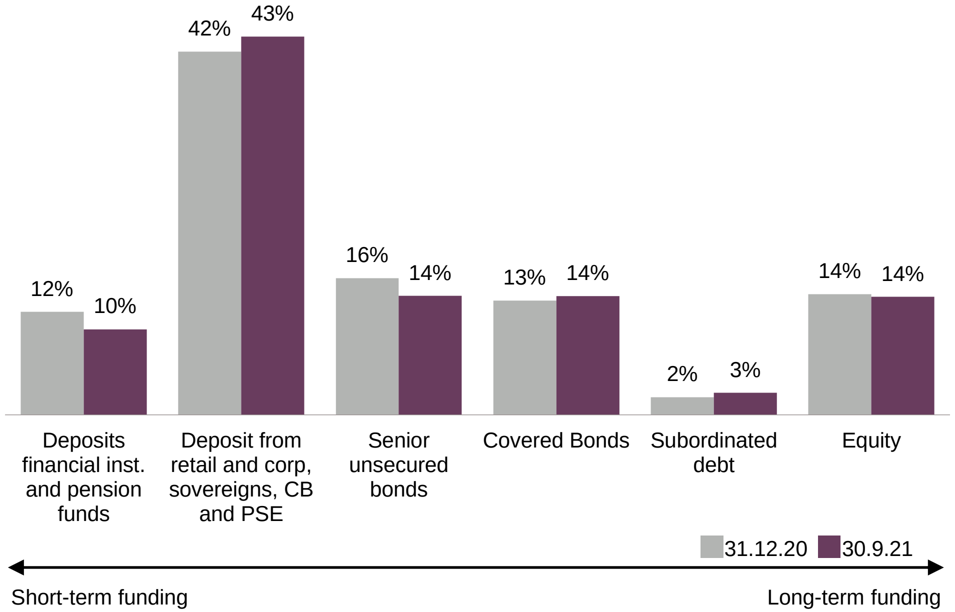
Steady deposit growth of 11% since year-end 2021 provides a solid funding base

Highlights

- Total reduction in deposits amounted to ISK 23bn in 3Q21
- A substantial part of the decrease in Corporations and sovereigns (ISK 50bn) is due the settlement of the ISB IPO as mentioned in the 1H21 financial results
- Term deposits are 20% of total deposits
- Deposit concentration is stable. 13% of the Bank's deposits belonged to the 10 largest depositors and 29% to the 100 largest depositors at 3Q21, compared to 16% and 31% respectively at YE20
- On 30.9.2021, 77% of deposits were in non-indexed ISK, 12% CPI-linked and 11% in foreign currencies

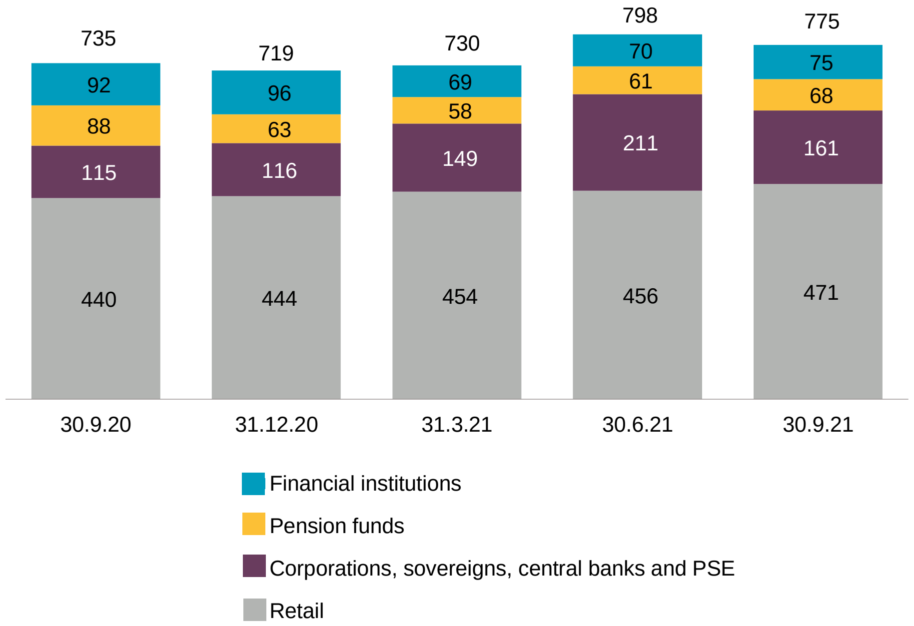
Funding sources

By type, % of total liabilities and equity



Deposits from customers and credit institutions

Development, by LCR category, ISKbn



Seasoned and diversified long-term funding programme

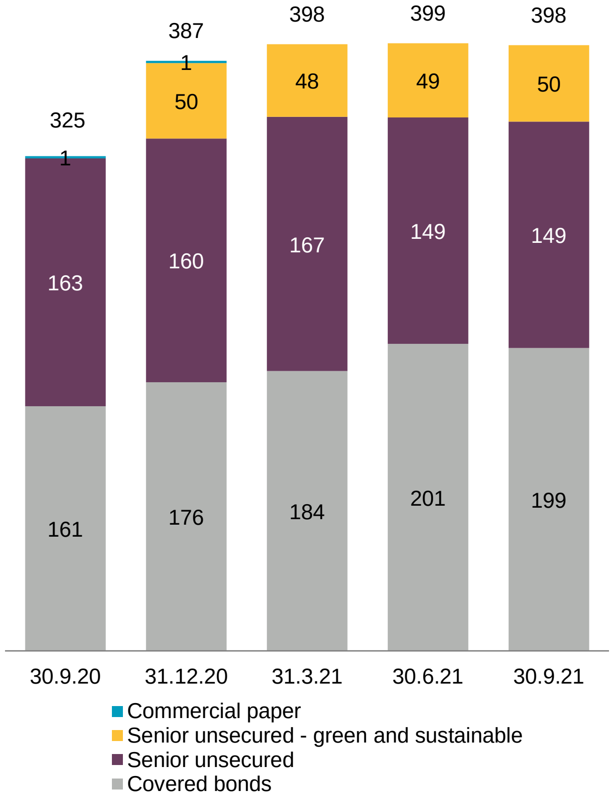
Limited wholesale funding activity in 3Q21

Highlights

- The Bank’s funding model is designed in a straightforward way to:
  - Limit refinancing and liquidity risks
  - Optimise cost of funding and use of proceeds
- The Bank continued its issuance of covered bonds during the quarter to fund the increase in mortgage lending. In 9M21the Bank sold ISK 32bn of outstanding series, thereof ISK 4bn in 3Q21

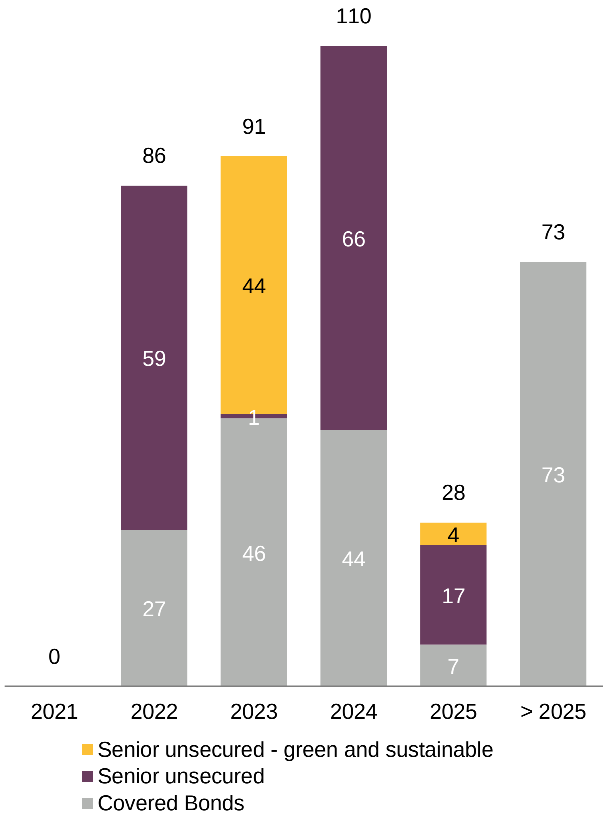
Sources of market borrowings

Book value, ISKbn



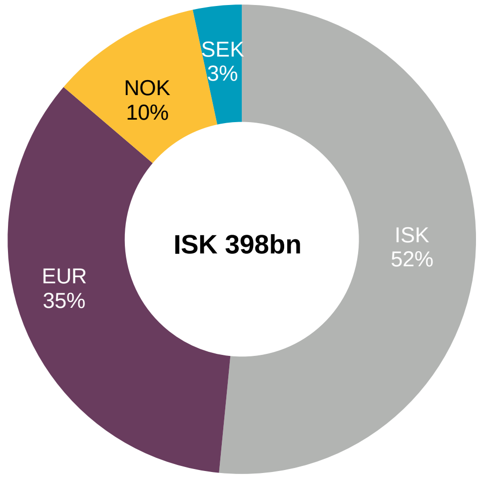
Contractual maturity profile of borrowings

30.9.2021, nominal value, ISKbn



Currency split of borrowings

30.9.2021



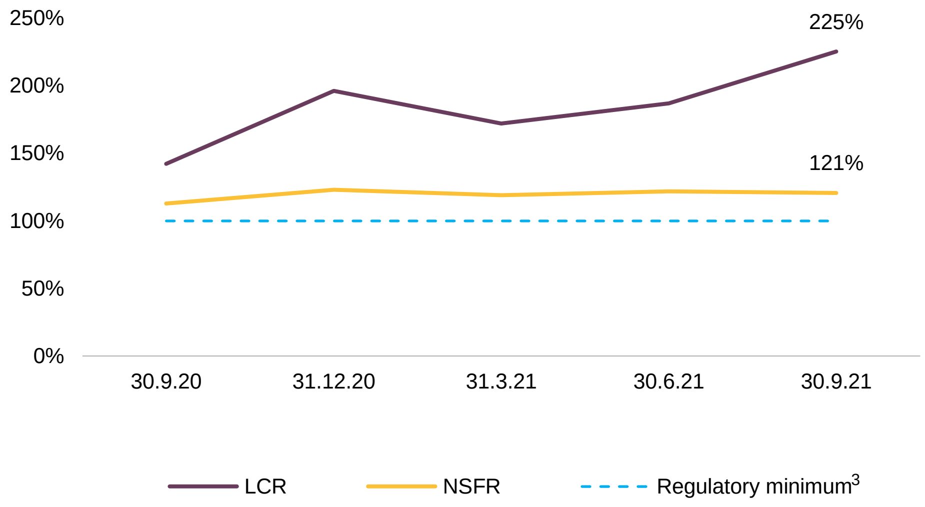
Sound liquidity management, meeting all requirements

Liquid assets of ISK 314bn are prudently managed, representing 22% of total assets

Highlights

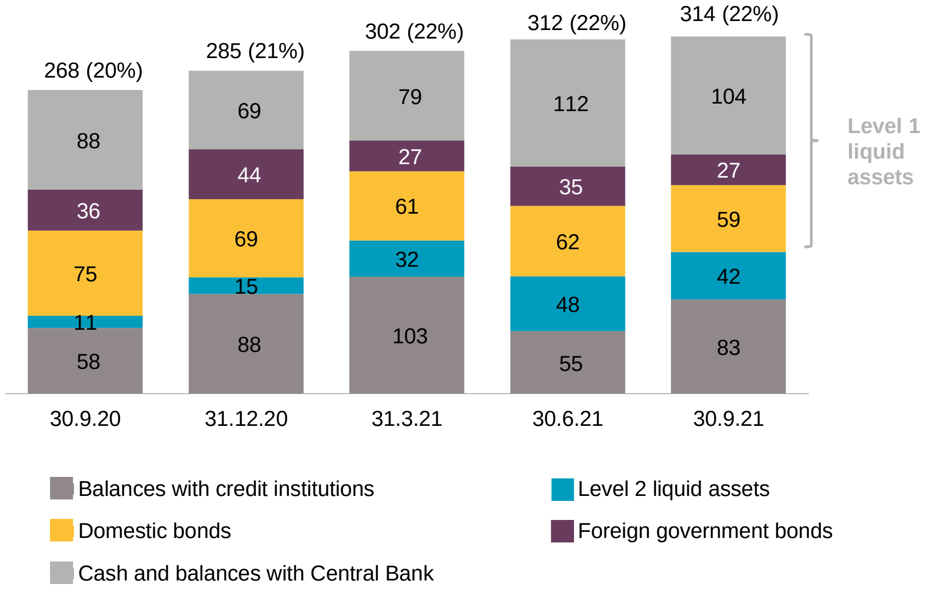
- The Icelandic Central Bank postponed a planned increase in the minimum requirements for LCR in ISK. The minimum requirements will therefore continue to be 30% for the year 2021 but will rise to 40% in 2022
- After the Central Bank decided to stop offering one-month term deposits, the Bank shifted ISK liquidity to Treasury bills, short-dated Treasury bonds and covered bonds to earn higher yield
- As the Bank's liquidity position remains strong across currencies and above requirements, the Bank may consider debt buybacks or exchanges of outstanding transactions during 2021

Liquidity Coverage Ratio[1] and Net Stable Funding Ratio[2]



Liquid assets

% of total assets, ISKbn



1.LCR in ISK was 124% at 30.9.21 compared to 95% at YE20. LCR in foreign currencies decreased to 384% at 30.9.21 from 463% YE20. 2. NSFR in foreign currencies was 166% at 30.9.21 compared to 179% at YE20. 3. Total NSFR minimum requirements took effect on 28.6.21.

Market risk well within appetite

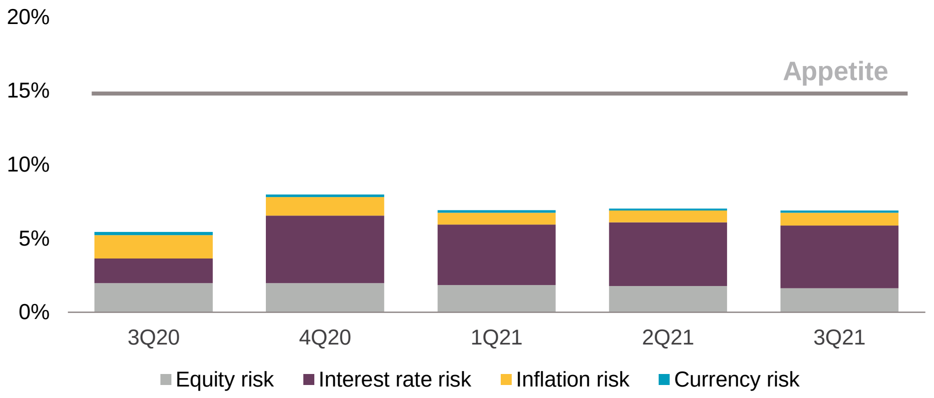
The Bank has a modest market risk profile

Highlights

- The Bank's market risk mainly derives from aggregate balance sheet imbalances in interest rate, inflation and currency positions as well as the Bank's liquidity portfolio managed by Treasury
- Equity risk originates in strategic investments and market making activities

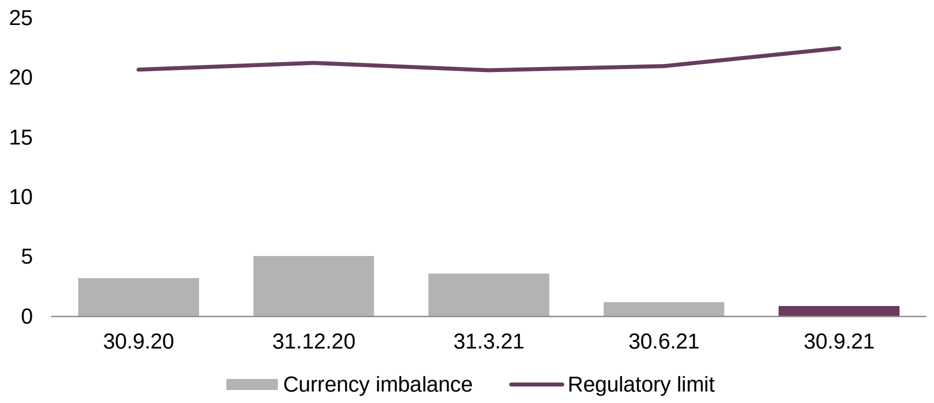
Market risk exposure and market risk appetite

Average positions per quarter, % of total capital base



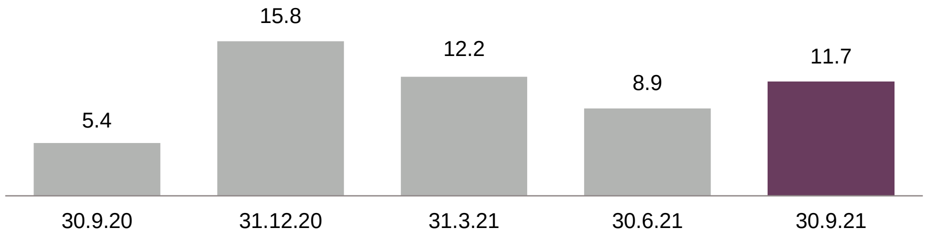
Currency imbalance, compared with regulatory limit

End of quarter, ISKbn



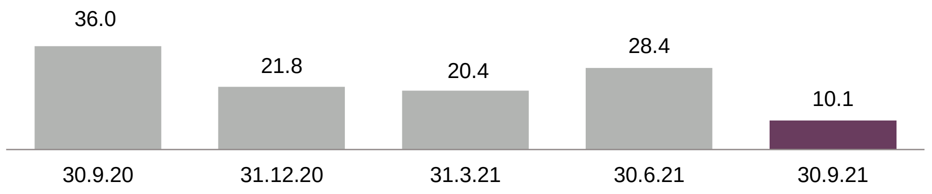
Interest rate risk in the banking book

Weighted average BPV, end of quarter, ISKm



Banking book inflation imbalance

End of quarter, ISKbn



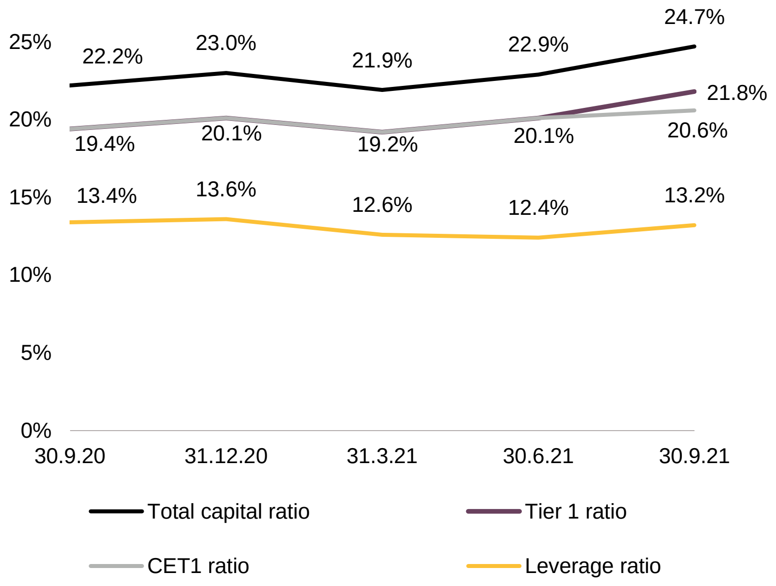
Sound capital position

High REA density and high leverage driven by CRD IV standardised approach

Highlights

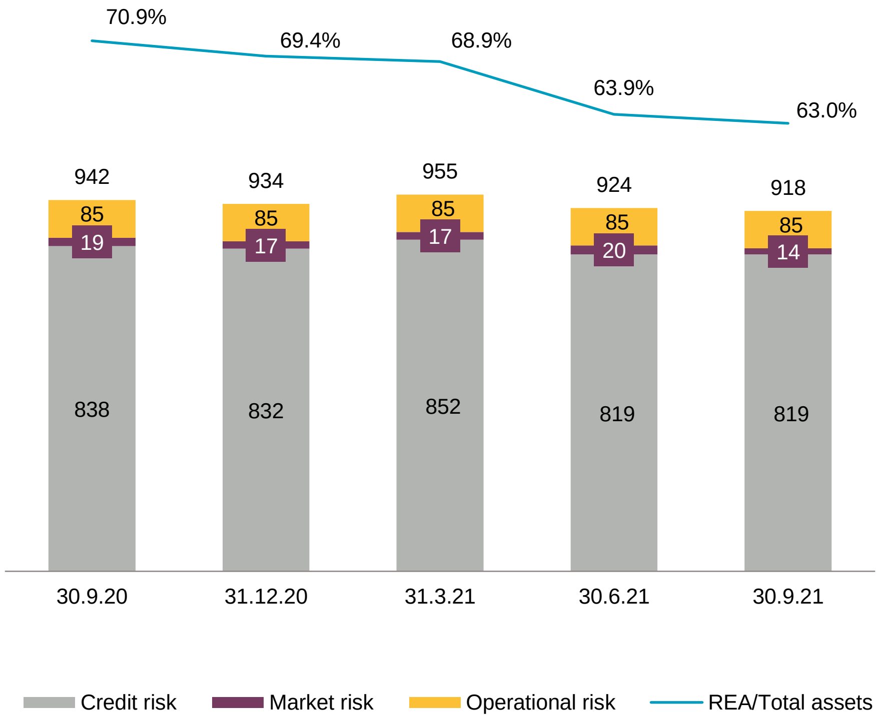
- A dividend payment in March and changes in IFRS 9 transitional rules in January lowered the CET1 capital by ISK 4.7bn. These two changes along with the profit in the period result in CET1 capital of ISK 189bn at the end of September (2020: ISK 188bn)
- Note that expected dividend, based on 50% of profit, has been deducted in the total capital ratio from 1Q21 onwards
- In September, the Bank issued Additional Tier 1 (AT1) notes amounting to SEK 750m or ISK 11bn
- The AT1 along with CET1 comprise the Tier 1 capital, totalling ISK 197bn at the end of September
- The implementation of EU regulation 2019/876 (CRR II) in Iceland led to a reduction in REA, contributing to a 60bp rise in the capital ratios. As a result, the ratio of REA/total assets fell sharply at end of June
- The most material effect was the amendment of the SME supporting factor, lowering the REA by ISK 35bn
- The Bank is currently reviewing the methodology for calculating REA for operational risk. Changing from the basic indicator approach to the standardised approach could reduce the REA and offer some relief in the Pillar 1 requirement

Capital ratios and leverage ratio[1]



Risk exposure amount (REA)

ISKbn



1. Including third quarter profit

Íslandsbanki’s capital ratios well above target

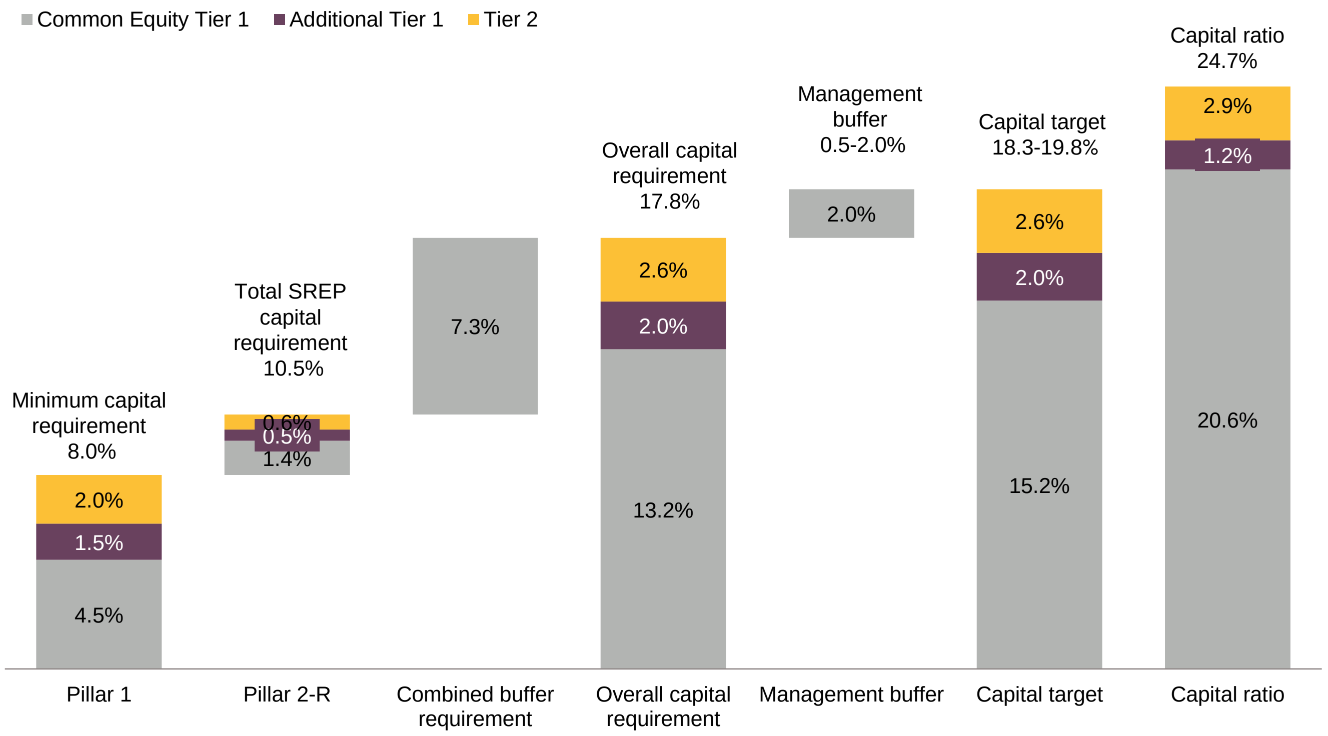
Excess capital of ISK >35bn including capital structure optimisation

Highlights

- The Pillar 2-R capital requirement has been revised, leading to an increase from 1.7% to 2.5%, in line with the Bank’s expectations of a temporary increase as a result of COVID-19
- The overall capital requirement is therefore 17.8% of REA
- Íslandsbanki's total capital target ratio is based on the overall regulatory requirement in addition to a 50-200bp management buffer and is therefore currently at 18.3–19.8%
- The Financial Stability Committee has announced an increase of the countercyclical capital buffer (CCB) from 0% to 2%, effective from September 2022
- The Bank’s long-term target range is 19.5-21.0% with a CET1 target of >16% and already assumes the increases of the CCB to 2% and a reversal of the COVID-19 effect on the Pillar 2-R
- Headroom for further AT1 issue is ISK 6bn

Current regulatory requirements and minimum capital target

30.9.2021, by capital composition



Excess capital based on long-term capital targets

ISK >35bn[1]

1. Based on long term capital targets. An increase in 3Q21 in excess of CET1 due to strong financial result and lower REA. Figure will fluctuate with the level of net profits and changes in REA

4. Q&A

5. Annex – About Íslandsbanki and financial overview

This is Íslandsbanki

Moving Iceland forward by empowering our customers to succeed

Vision and Values

Vision to be
#1 for service

Passion
Professionalism
Collaboration

The Bank

FTEs 730 number of FTEs at Íslandsbanki at period end

12 branches

ergo

Market share[1]

29% retail customers

38% SMEs

35% large companies

Sustainability 3Q21

Íslandsbanki became a supporter of Grænvangur, a collaboration forum on climate issues and green solutions

Íslandsbanki oversaw the sale of a social bond for Reykjavik University and green/blue bond for seafood company Brim

Íslandsbanki was recognised for Excellence in Corporate Governance for the eighth year in a row

Key Figures 3Q21

ROE	15.7%	LCR Group, all currencies	225%
Cost-to-income ratio	39.4%	NSFR Group, all currencies	121%
Total capital ratio	24.7%	Leverage ratio	13.2%
Tier 1 capital ratio	21.8%	Total assets	ISK 1,456bn

Ratings and certifications

S&P Global Ratings
BBB/A-2
Stable outlook

EQUAL PAY CERTIFICATE 2018 - 2021

EXEMPLARY IN CORPORATE GOVERNANCE

Digital milestones 3Q21

An English version of the app was released in September

Push notifications in app enables easy flow of relevant information to customers

Customers can now estimate their carbon footprint based on their spending profile via the app

1. Based on Gallup surveys regarding primary bank. 2021 average for retail customers and SMEs and 2020 average for large companies.

Financial overview

Key figures & ratios

		3Q21	3Q20	9M21	9M20	2020
PROFITABILITY	Profit for the period, ISKm	**7,587**	3,361	**16,633**	3,230	6,755
	Return on equity	**15.7%**	7.4%	**11.7%**	2.4%	3.7%
	Net interest margin (on total assets)	**2.4%**	2.5%	**2.4%**	2.6%	2.6%
	Cost-to-income ratio[1]	**39.4%**	46.7%	**46.6%**	55.3%	54.3%
	Cost of risk	**(0.64%)**	0.44%	**(0.30%)**	0.98%	0.91%

		30.9.21	30.6.21	31.3.21	31.12.20	30.9.20
BALANCE SHEET	Loans to customers, ISKm	**1,081,418**	1,089,723	1,029,415	1,006,717	970,309
	Total assets, ISKm	**1,456,372**	1,446,860	1,385,235	1,344,191	1,328,724
	Risk exposure amount, ISKm	**917,764**	924,375	954,712	933,521	942,339
	Deposits from customers, ISKm	**754,442**	765,614	698,575	679,455	698,610
	Customer loans to customer deposits ratio	**143%**	142%	147%	148%	139%
	Non-performing loans (NPL) ratio[2]	**2.0%**	2.1%	2.4%	2.9%	3.3%
LIQUIDITY	Liquidity coverage ratio (LCR), for all currencies	**225%**	187%	172%	196%	136%
	Net stable funding ratio (NSFR), for all currencies	**121%**	122%	119%	123%	113%
CAPITAL	Total equity, ISKm	**197,381**	190,355	185,471	186,204	182,509
	CET 1 ratio[3]	**20.6%**	20.1%	19.2%	20.1%	19.4%
	Tier 1 ratio[3]	**21.8%**	20.1%	19.2%	20.1%	19.4%
	Total capital ratio[3]	**24.7%**	22.9%	21.9%	23.0%	22.2%
	Leverage ratio[3]	**13.2%**	12.4%	12.6%	13.6%	13.4%

1.Calculated as (Administrative expenses + Contribution to the Depositors' and Investors' Guarantee Fund – One-off items) / (Total operating income – One-off items).
2. Stage 3, loans to customers, gross carrying amount.
3. Including third quarter profit.

Attractive and achievable financial targets

Clear path to ROE expansion, attractive capital return and optimisation

	Financial targets	3Q21	2Q21	2020	Guidance
Return on equity[1]	8-10% by 2023 >10% long-term	15.7% ✓	11.6% ✓	3.7%	— Based on average expected risk-free rates through the business cycle — The Bank has a clearly identified path to ROE improvements, supported by a clear action plan and economic recovery — **The Bank assumes the loan book will grow in line with nominal GDP on average through the business cycle**
Cost-to-income ratio[2]	<45% by 2023	39.4% ✓	49.9% ✓	54.3% ✓	— The Bank continues to invest in IT infrastructure and process efficiency to improve the C/I ratio in the medium to long-term — Costs to remain broadly flat over the next 3 years
CET1 capital ratio	>16%	20.6% ✓	20.1% ✓	20.1% ✓	— Based on current regulatory requirements and management buffer of 50-200bps, the CET1 target range is currently 13.7-15.2% — The target assumes that the countercyclical buffer increases from 0% to 2% which will take effect from September 2022 — **The Bank will start paying out a part of its excess capital in parallel with its ordinary dividend payable for the FY 2021 – the amount to be decided at that time**
Total capital ratio	18.3-19.8%	24.7% ✓	22.9% ✓	23.0% ✓	— Based on current regulatory requirements and management buffer of 50-200bps — Long term target range is 19.5-21.0%, assuming that the countercyclical buffer increases from 0% to 2%, which will take effect from September 2022, and the COVID-19 effects on the Pillar 2-R requirements is reversed — Íslandsbanki issued AT1 notes amounting to SEK 750m as part of its plan to optimise its capital structure. Further headroom for AT1 issuance remains ISK 6bn.
Dividend payout ratio	c. 50%			50% ✓	— Target for annual regular dividend — Excess capital to support further dividend payments, buybacks, and/or ROE enhancing growth — Additional capital return to approach capital targets over the medium term

1. ROE excluding one-off cost is 12.6% for 2Q21, one-off cost for 2Q21 is 627m. 2. Calculated as (Administrative expenses + Contribution to the Depositors' and Investors' Guarantee Fund – One-off items) / (Total operating income – One-off items). Target was updated in 1Q21 from the previous <55%

6. Annex – Icelandic economy update

Corona Crisis takes its leave, strong GDP growth takes the stage

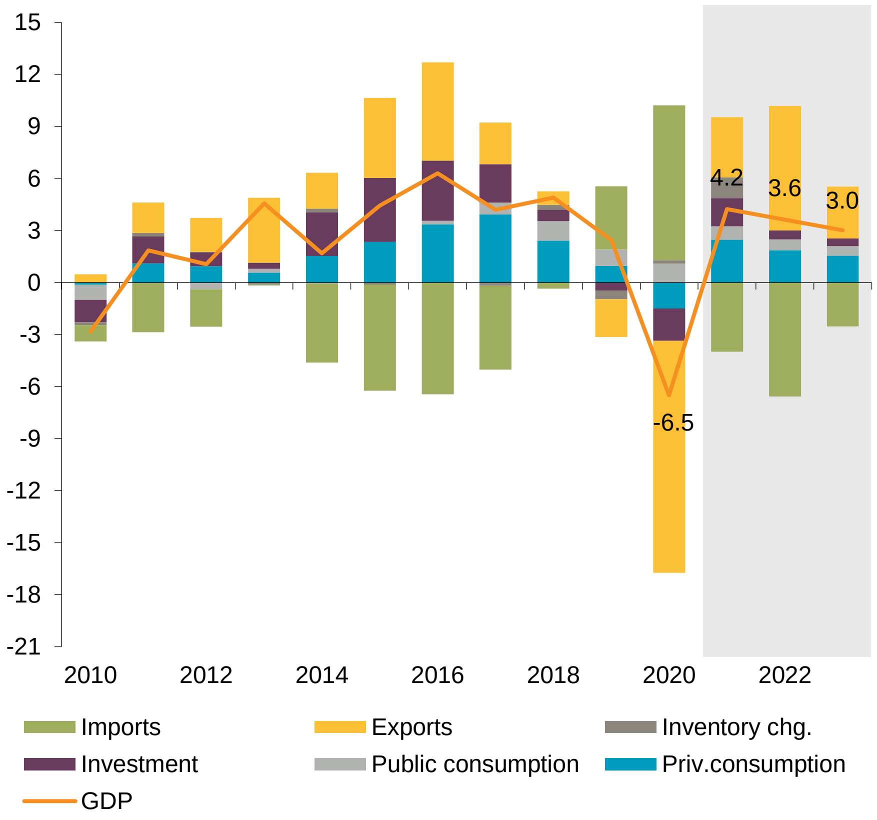
Domestic demand will rebound strongly this year, with export growth following in its wake

Highlights

- The COVID-19 pandemic has made its mark on 2021 worldwide, and in greater measure than previously hoped
- Nevertheless, the Icelandic economy has turned the page and begun a new growth phase, after contracting 6.5% in 2020
- The shift towards more favourable economic developments and short-term prospects is thanks to three main factors:
  - A strong pre-pandemic financial position among households, businesses, and the public sector
  - Successful public health measures
  - Successful economic policy action
- The outlook is for GDP growth to measure 4.2% in 2021, owing mainly to robust growth in domestic demand. Export growth has suffered a temporary setback, however
- For 2022, ÍSB Research forecasts 3.6% growth, as exports look set to grow rapidly and domestic demand to continue growing apace
- In 2023, the forecast is for 3.0% growth, as the impact of COVID-19 will be behind us and the economy will have begun to rebalance

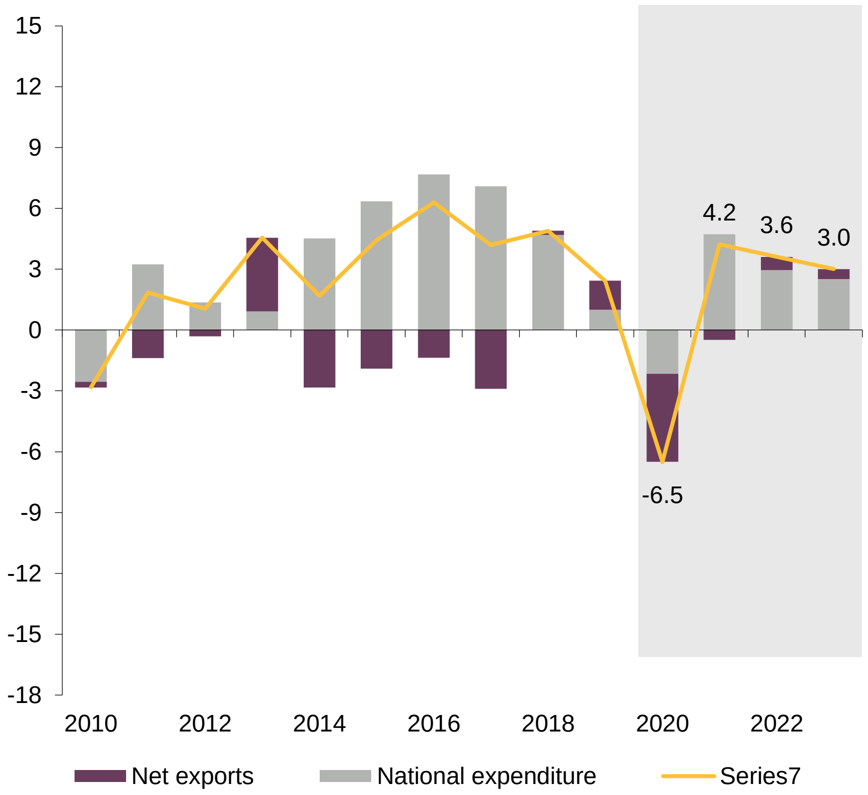
GDP and contribution of its subcomponents

Volume change from prior year, %



GDP, domestic demand, and external trade

Volume change from prior year, %



Sources: Statistics Iceland, ÍSB Research.

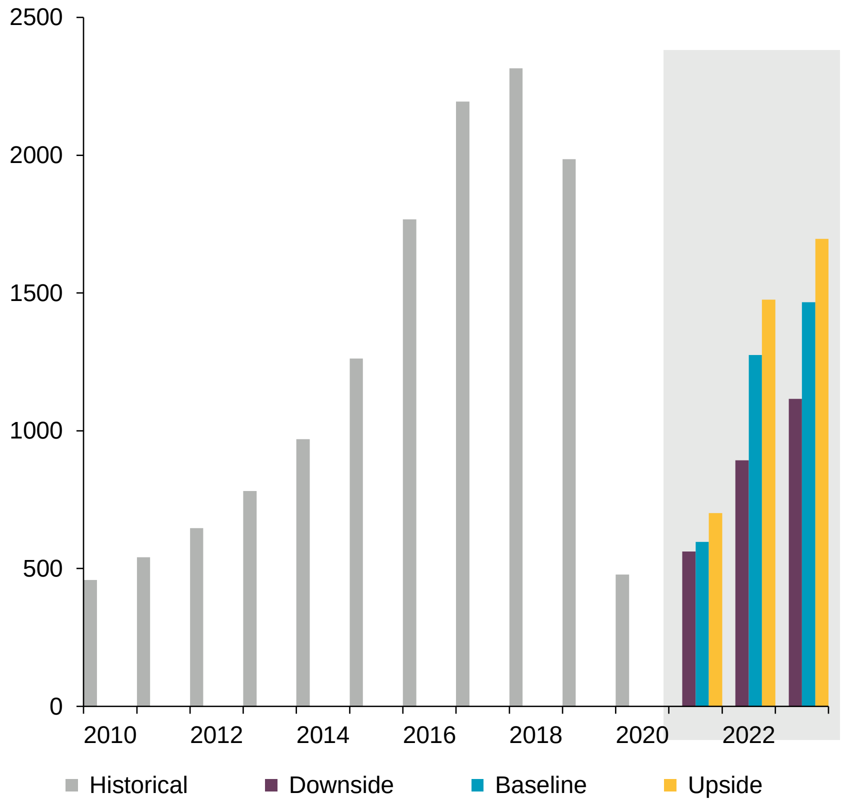
Temporary hitch in tourist numbers, but the future is bright

We project that tourist arrivals will total 600,000 this year and then more than double in 2022

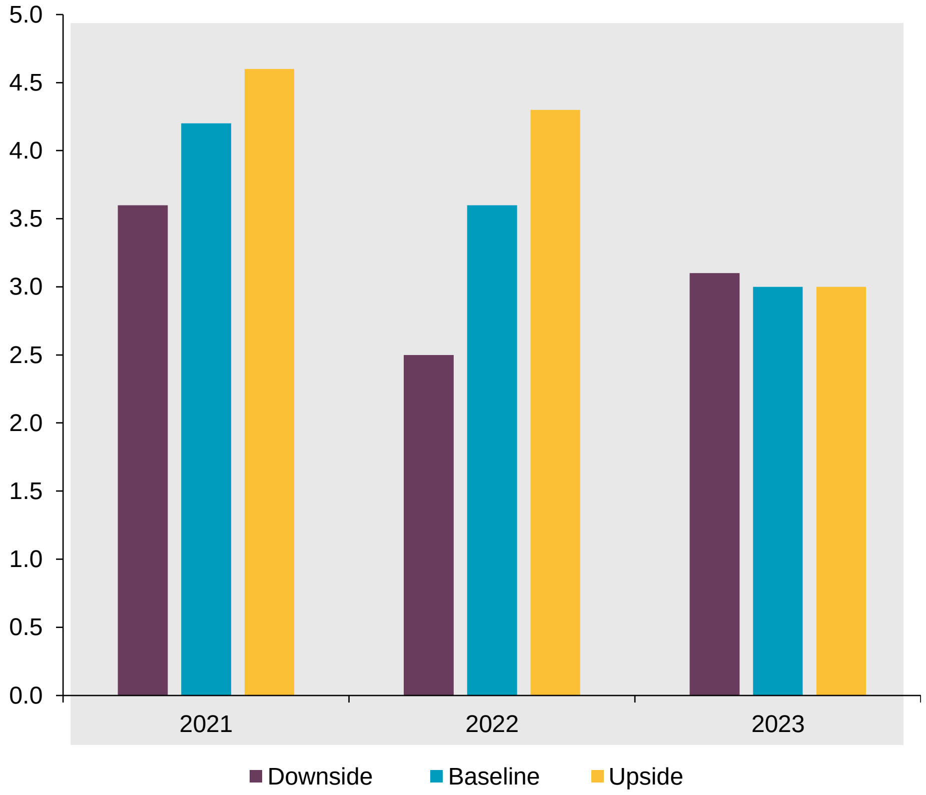
Highlights

- After a promising surge this summer, Q3 tourist arrivals are set to stumble as a result of the spread of the Delta variant of COVID-19 in Iceland and abroad
- Even so, Iceland is still widely viewed as a desirable post-pandemic travel destination. Tourists' swift response to the relaxation of border restrictions in 2020 and 2021 indicates keen interest in visiting Iceland
- ÍSB Research forecasts that roughly 600,000 tourists will visit Iceland this year, less than 1/3 of the 2019 total
- Tourist arrivals are projected at 1.3 million in 2022 and nearly 1.5 million in 2023
- ÍSB Research's alternative scenarios allow for 560,000-700,000 arrivals this year and 900,000-1,500,000 next year
- Developments in tourist arrivals will greatly affect economic developments in the coming term
- Higher tourist numbers mean, among other things, a more rapid ISK appreciation, lower inflation, a faster decline in unemployment, and stronger GDP growth in the coming term. The reverse applies if tourist numbers are lower than in the baseline forecast
- If the more optimistic forecast materialises, GDP will be 1.2% higher in 2023 than in the baseline, whereas it will be 1.7% lower if the more pessimistic scenario materialises

Number of foreign tourists, by year
Thousands



GDP growth
%



Sources: Icelandic Tourist Board, ÍSB Research.

Current account set to show a deficit in 2021, then revert to surplus

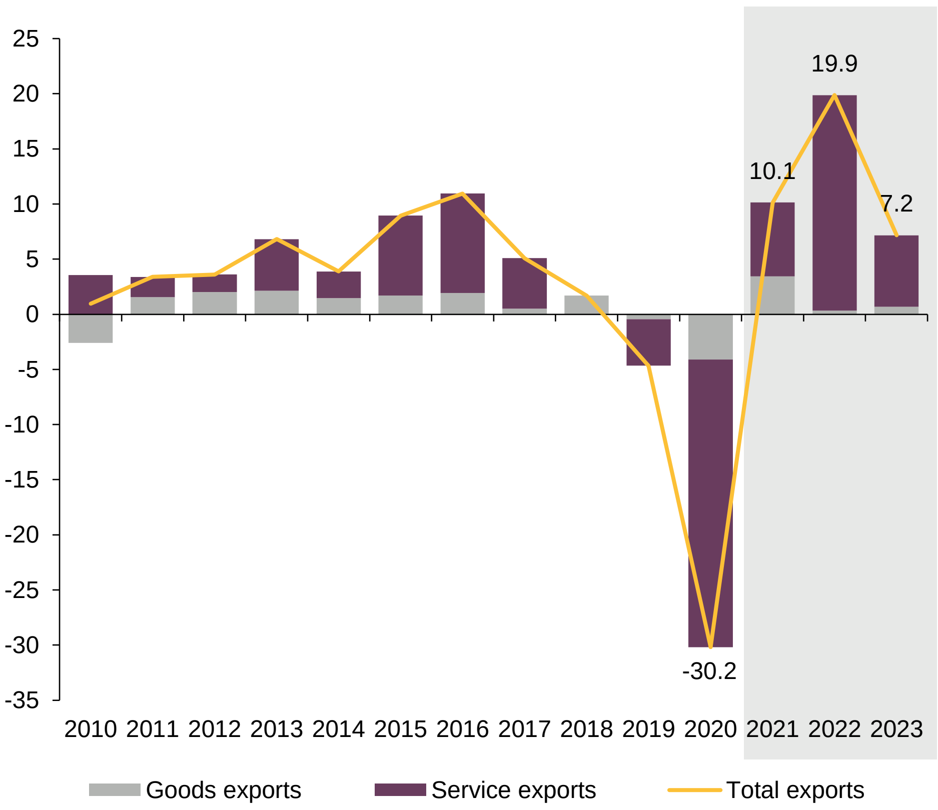
The short-lived deficit is due to domestic demand, which is a few steps ahead of the recovery of exports

Highlights

- Tourism, plus exports of intellectual property and other services, is the main driver of the more than 10% export growth forecast for this year. Added to this is modest growth in goods exports, particularly to include farmed fish, capelin, aluminium, and silicon metal
- A surge in tourist arrivals will deliver the lion's share of the forecasted 20% export growth in 2022 and just over 7% growth in 2023
- Furthermore, the outlook is for stronger exports, for instance, of capelin and farmed fish, aluminium and other industrial goods, and increasingly, intellectual property usage as well. Pulling in the opposite direction are weaker exports of groundfish, as a result of quota reductions
- Iceland recorded a current account surplus of just under 1% of GDP in 2020. The contraction in imports and the surplus on primary income offset the drop in exports
- The outlook is for a 1.4% current account deficit in 2021, in part because increased imports stemming from domestic demand weigh more heavily than growing exports
- Nevertheless, ÍSB Research forecasts that export growth will deliver current account surpluses measuring 2.4% of GDP in 2022 and 3.3% of GDP in 2023
- The country's net external assets are currently equivalent to over a third of GDP – a situation that could improve further over the forecast horizon, as external trade strengthens

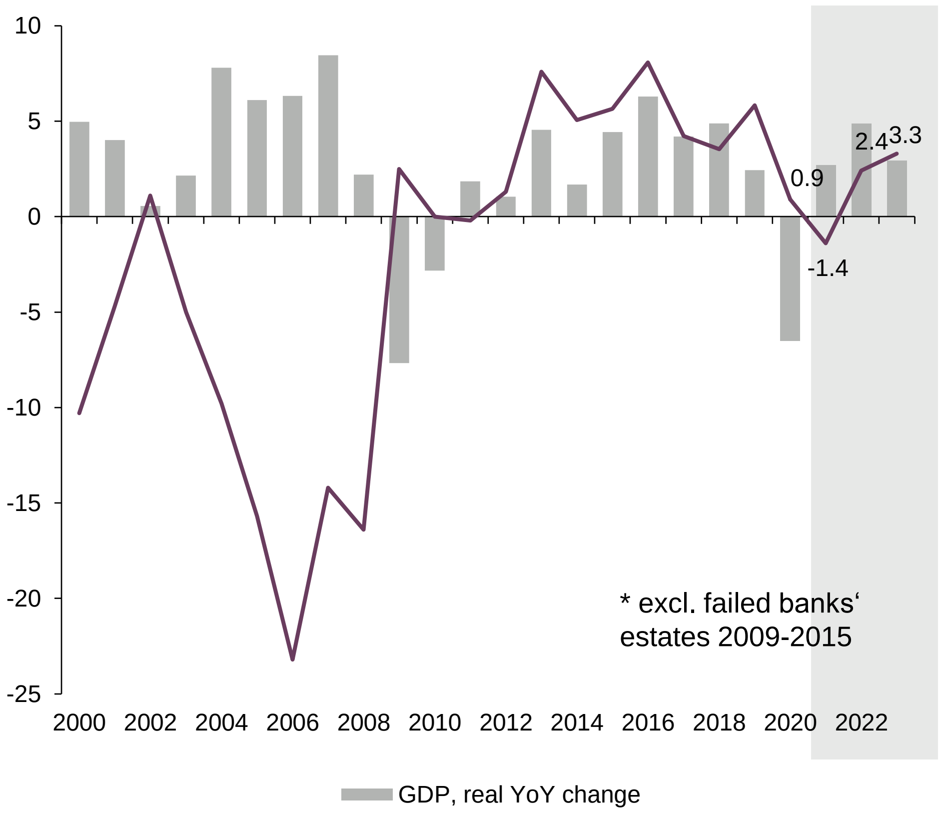
Exports and contribution from subcomponents

% change



Current account balance and GDP growth

% of GDP and % change YoY

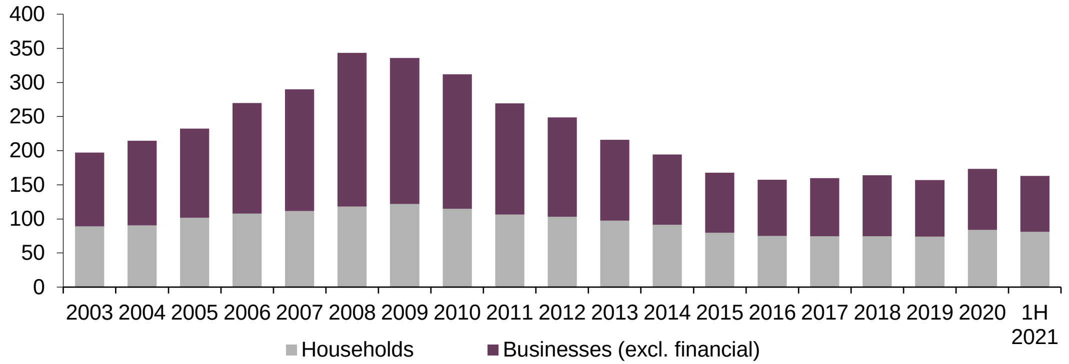


Source: Statistics Iceland, The Central Bank of Iceland, ISB Research

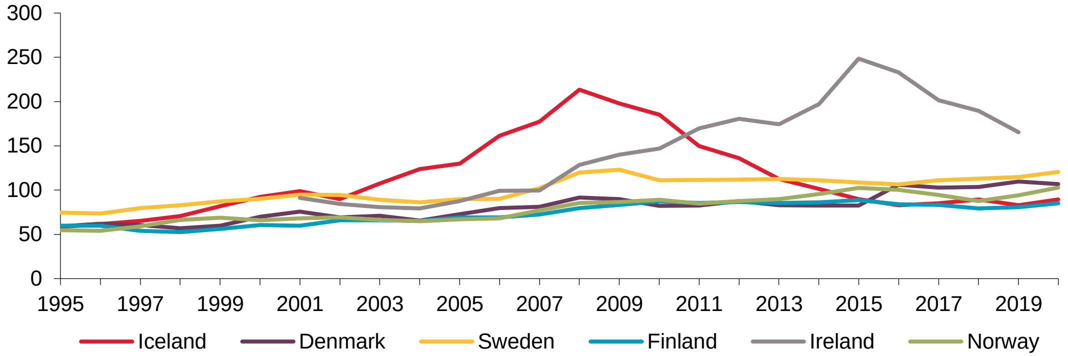
Domestic balance sheets remain healthy despite COVID-19

Economy-wide leverage remains moderate in comparison with peers and historical levels

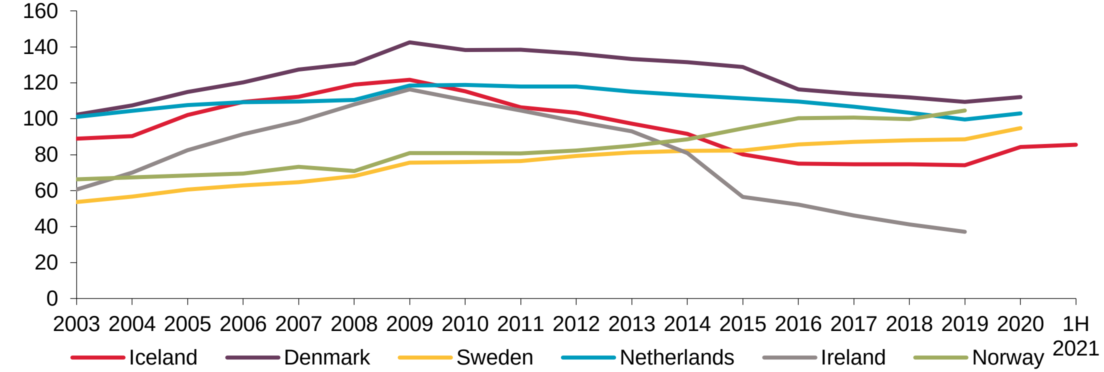
Private sector debt
% of GDP



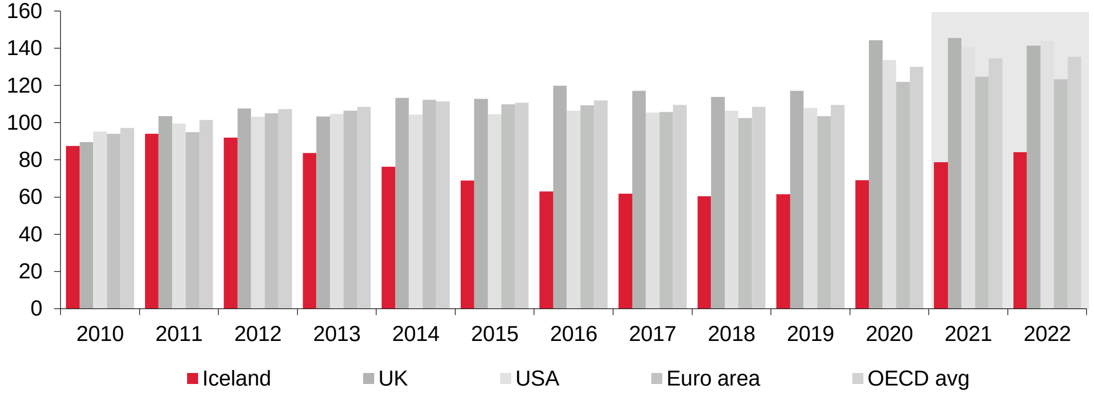
Corporate debt
% of GDP



Household debt
% of GDP



General government gross financial liabilities
% of GDP



Shaded areas indicate OECD forecasts.
Source: Central Bank of Iceland, Statistics Iceland, OECD and ISB Research.

28 October 2021

Investment growth stronger than expected in 2021

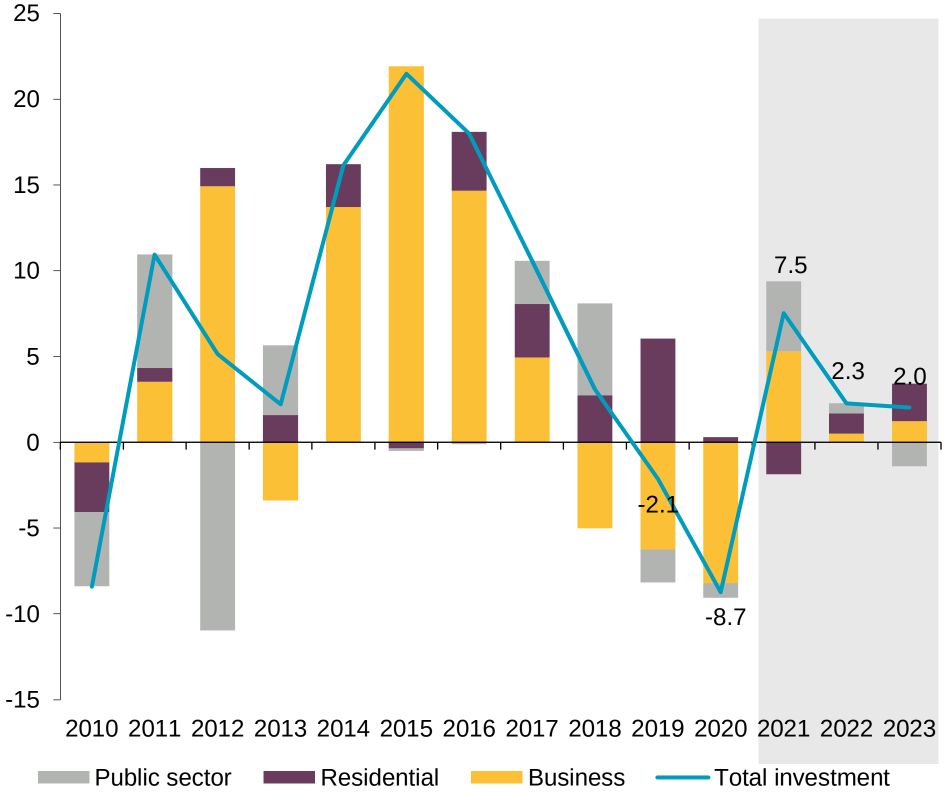
Reduced uncertainty and favourable financing conditions provide an incentive for increased corporate investment

Highlights

- Investment has sagged for two years running, declining by a combined 11%, after a period of robust growth early in the 2010s
- Investment growth measured just over 13% in H1/2021, fuelled by strong growth in public and business investment, whereas residential investment contracted. Most likely, this pattern will also characterise the year as a whole
- Executives' expectations concerning near-term economic conditions have improved markedly in recent quarters, hitting an all-time high around mid-year
- There is a fairly strong correlation between corporate sentiment and developments in business investment. The ongoing improvement in expectations therefore suggests that overall appetite for investment will grow
- Added to this, most firms are financially sound, and relatively favourable financing conditions should facilitate investment as pandemic-related uncertainty subsides
- ÍSB Research forecasts that total investment will increase by 7.5% in 2021
- For 2022, all key subcomponents of investment are forecast to gain strength, with total investment growing by 2.3%. In 2023, however, private investment – residential investment in particular – will be the main driver of the projected 2.0% growth rate, and public investment will contract year-on-year

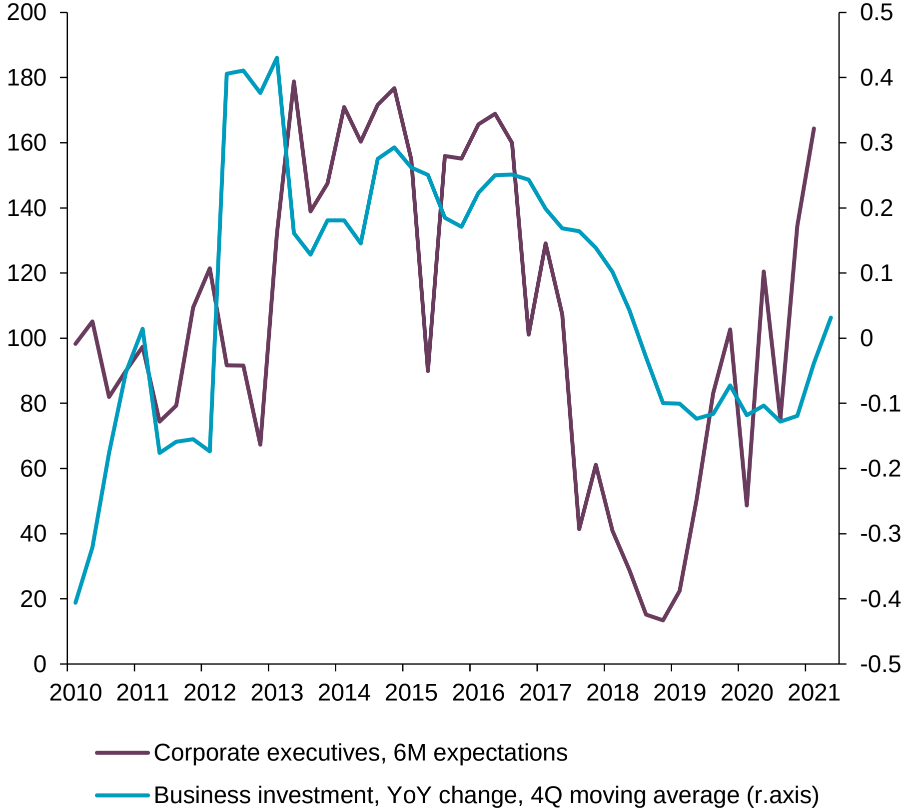
Investment, real change, and contribution of subcomponents

%



Executives' expectations and business investment

Index value (left) and % change year-on-year (right)



Source: Statistics Iceland, Gallup

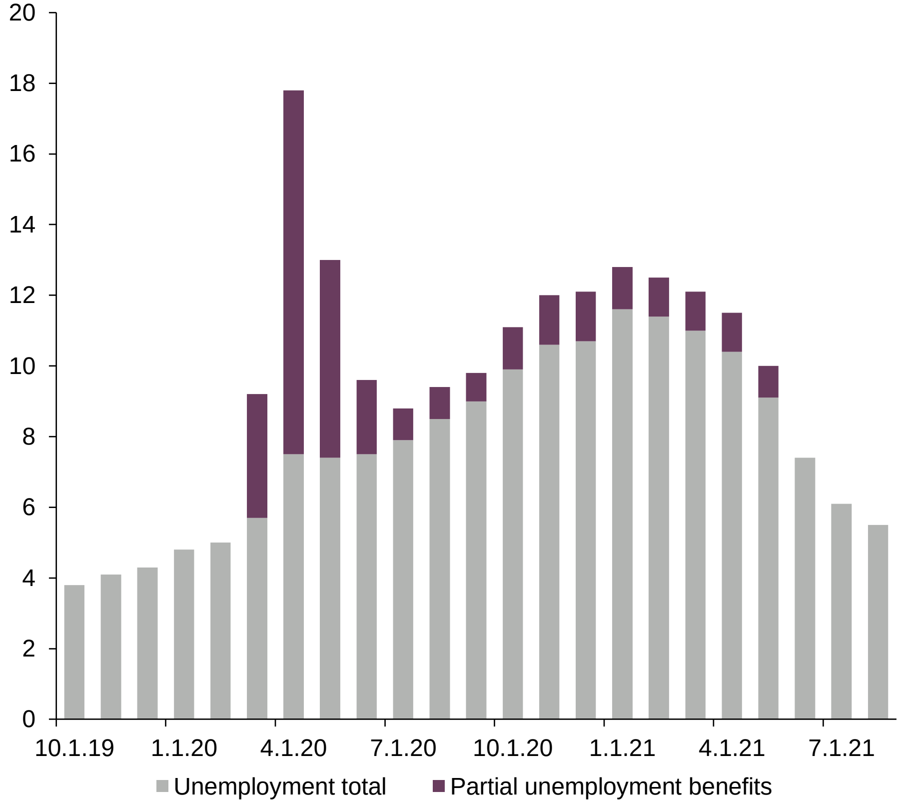
Unemployment falling rapidly

Jobless rate to return to the pre-pandemic level by 2023

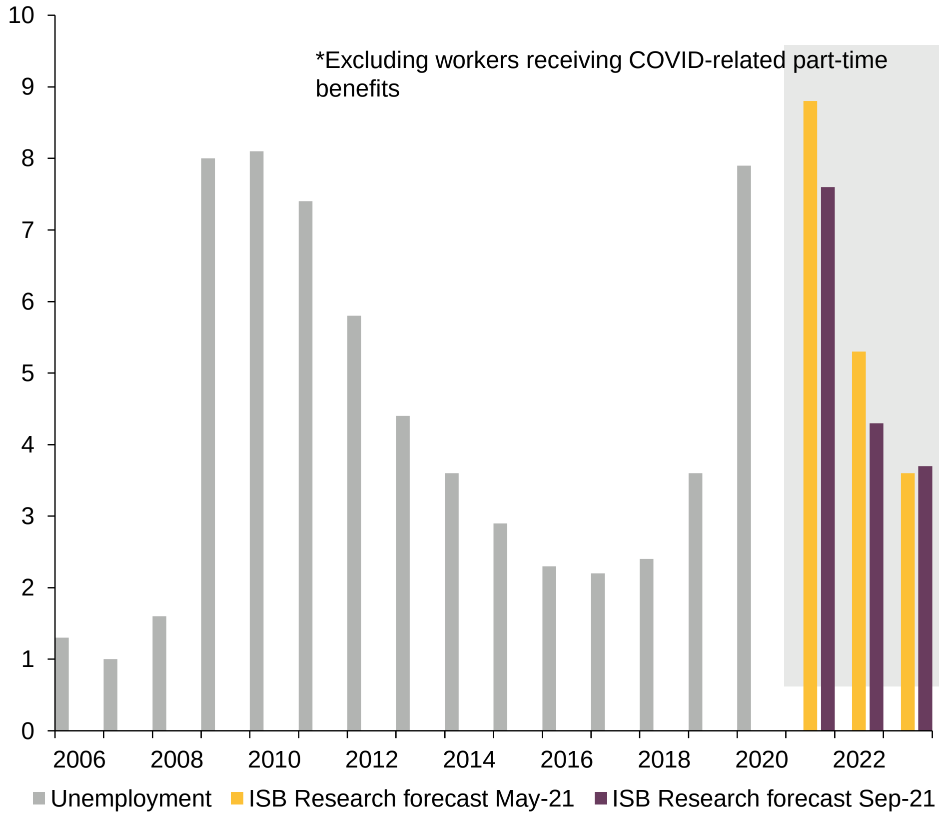
Highlights

- Unemployment soared in the wake of the pandemic, peaking at 12.8% in January 2021 (including workers receiving part-time benefits)
- The part-time benefits programme introduced after the pandemic started expired in May 2021. A total of 37,000 workers benefited from the programme
- Since it peaked, unemployment has been declining month by month, to 5.5% as of August
- It has therefore been cut nearly in half in 2021 to date
- ÍSB Research expects it to keep declining gradually in the coming term
- Unemployment to average 7.6% in 2021 and 4.3% in 2022. In 2023, it looks set to fall to 3.7%, very close to the pre-pandemic level

Unemployment
% of workforce, monthly average



Unemployment*
% of workforce, annual average



Private consumption growth ahead

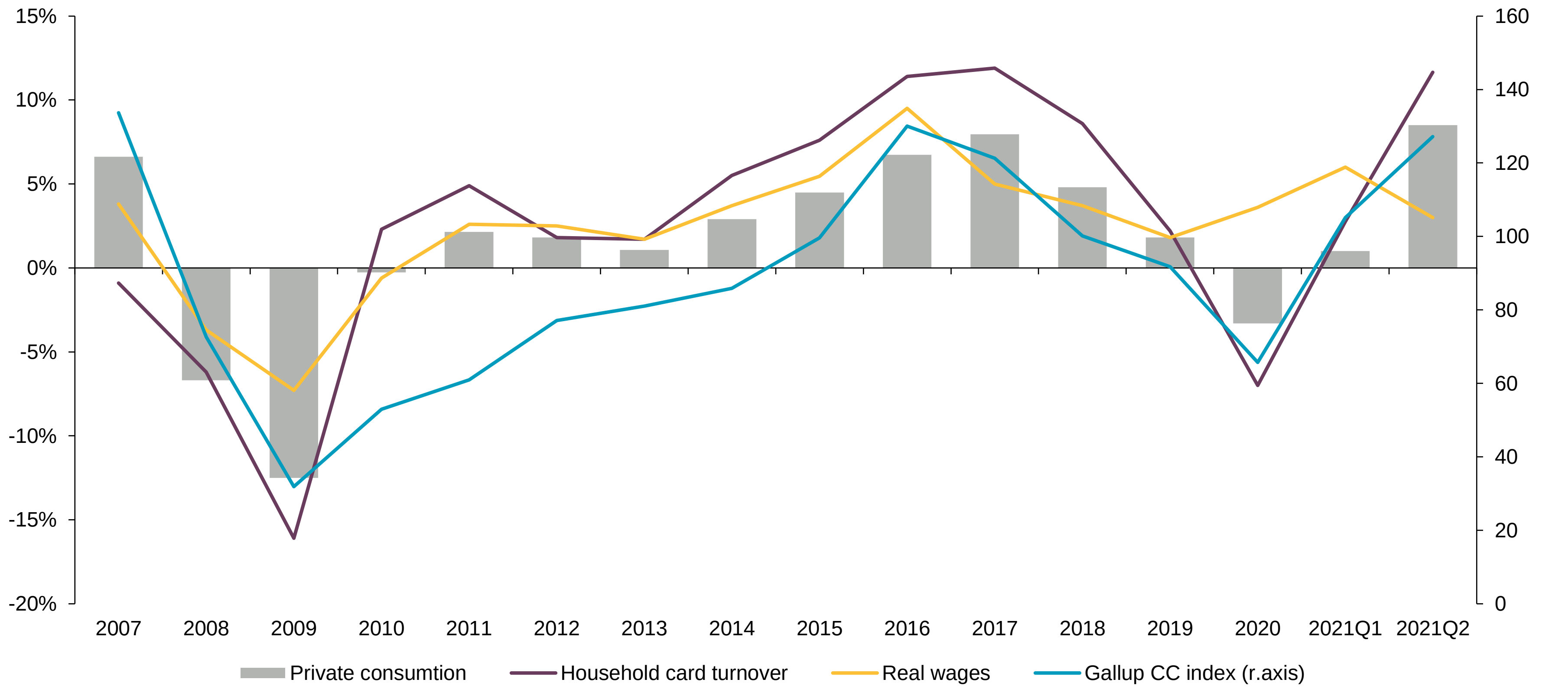
Consumers eager to spend after a bleak COVID year

Highlights

- Private consumption contracted by 3.3% in 2020. Consumption within Iceland generally held its ground, whereas consumption abroad and in the services sectors most affected by public health measures contracted sharply
- Private consumption grew 4.7% YoY in H1/2021
- Payment card turnover has increased YoY, both in Iceland and abroad
- Indicators such as the Gallup Consumer Confidence Index, real wages, and unemployment also suggest that private consumption will keep growing in the coming term
- Most households' asset position is sound, and household saving increased markedly during the pandemic
- Appetite for consumption seems strong among the general public, and private consumption has considerable growth potential after the pandemic
- ÍSB Research forecasts private consumption growth at just under 5% this year, just over 3.5% in 2022, and 3.0% in 2023

Private consumption and related indicators

% change year-on-year (left) and index value (right)



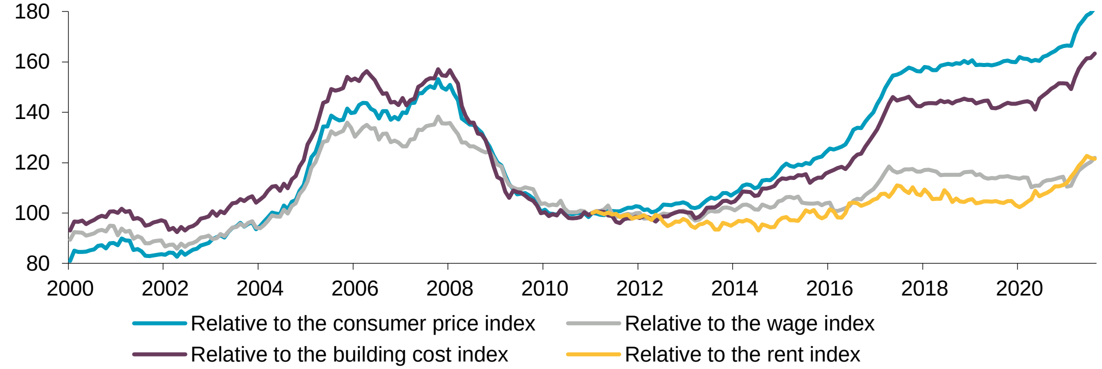
Sources: Central Bank of Iceland, Gallup, Statistics Iceland, ÍSB Research.

Housing markets lively despite pandemic

Commercial property prices are stable while residential house price rises have gained steam

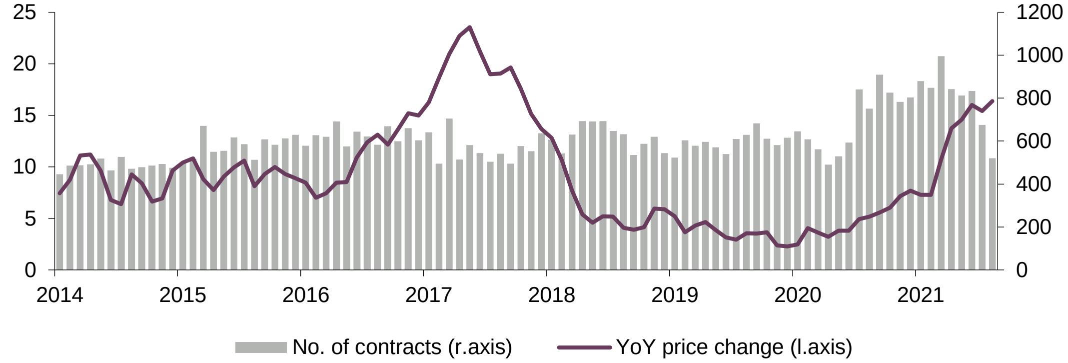
Capital area house prices relative to macroeconomic fundamentals

Index, January 2011=100



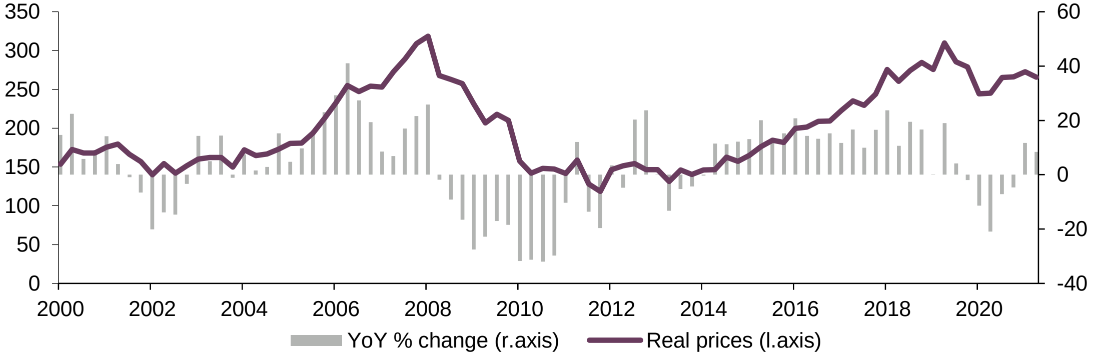
Residential house prices and turnover in greater Reykjavik

% change (l.axis) and number (r.axis)



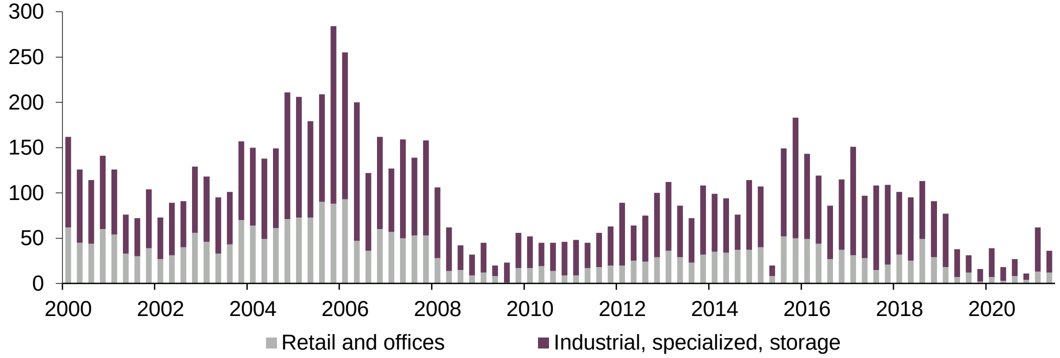
Commercial property real prices in greater Reykjavik

Index, 1995=100 (l.axis) and % change (r.axis)



Commercial real estate market activity

No. of registered purchase agreements



Source: The Central Bank of Iceland

ISK likely to strengthen when tourism rebounds

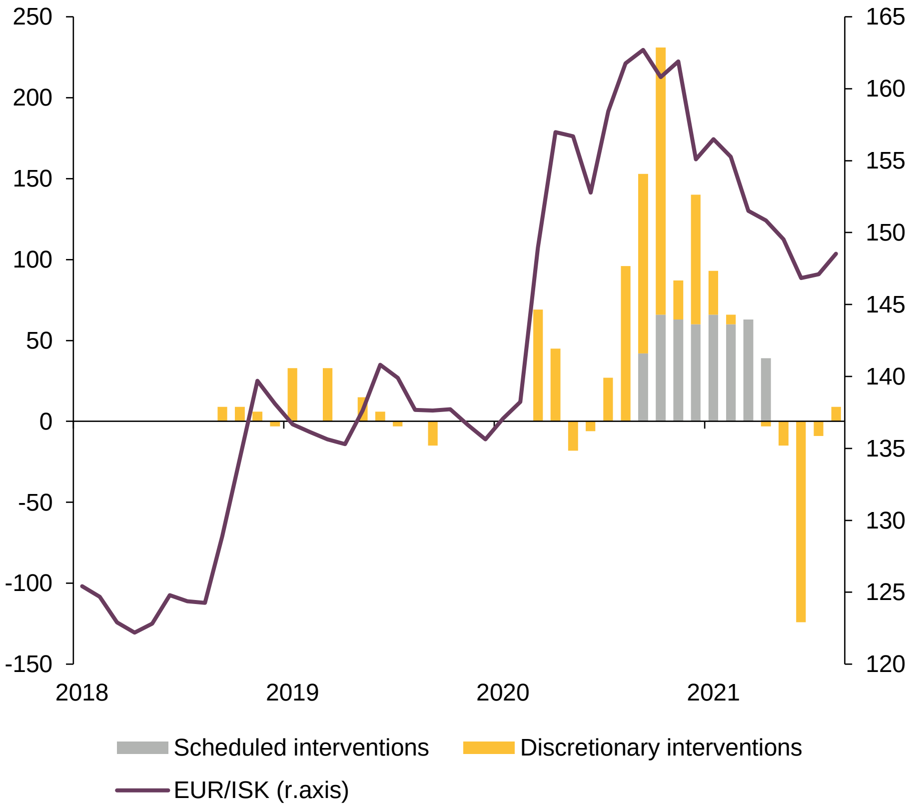
The Central Bank has mitigated exchange rate volatility via intervention since WOW Air collapsed

Highlights

- The ISK has fluctuated in line with the path of the pandemic in recent quarters. In 2020, it depreciated by nearly 10% against major currencies
- The CBI smoothed things out, however, using nearly EUR 830m from its reserves to mitigate short-term volatility and offset pressures due to non-residents' sales of domestic securities
- Even after these large FX sales, the CBI's reserves still exceed EUR 6bn, or just over 30% of GDP
- The ISK has appreciated by a just under 4% in 2021 to date. It strengthened in H1, but since mid-year it has sagged a bit, owing to unfavourable external trade, reduced investment flows, and expectations of delays in the recovery of tourism
- ÍSB Research forecasts that the ISK will appreciate over time. A surplus on the current account is in the offing, interest rates are on the rise, Iceland's IIP is strong, the growth outlook is good, and non-residents' securities holdings are relatively limited in historical terms
- Factors offsetting this include the pension funds' foreign investments in the coming term and possible CBI purchases of reserve assets
- According to the ÍSB Research forecast, the ISK will be approximately 10% stronger at the end of the forecast horizon than it was at the beginning of 2021

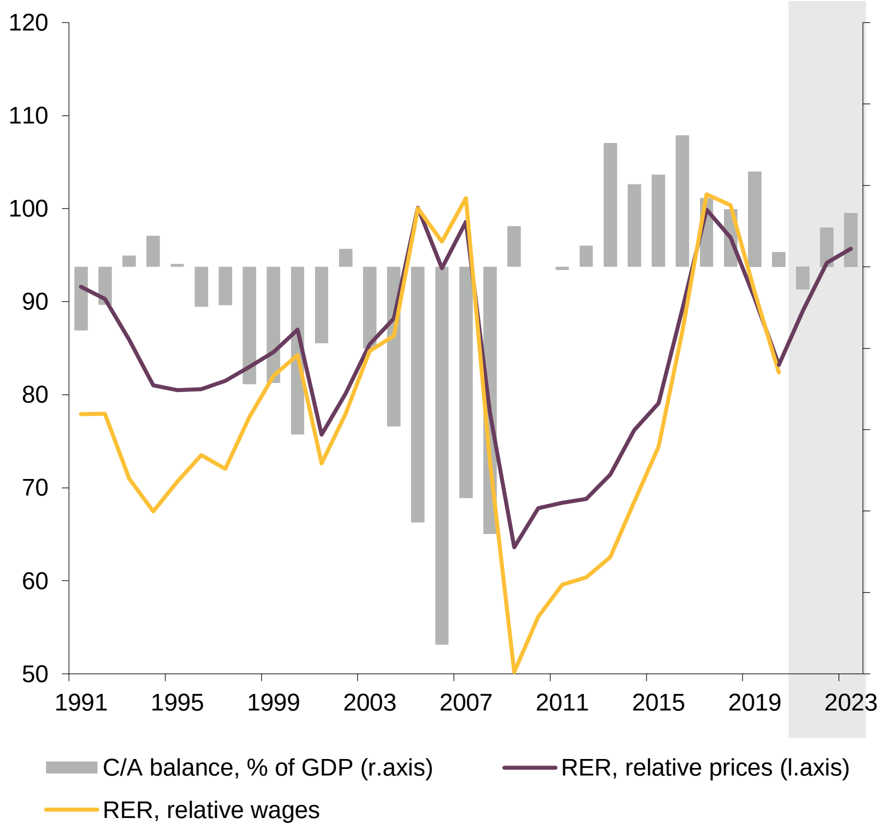
ISK exchange rate and CBI FX market intervention

EUR m (left) and EURISK (right)



Real exchange rate and current account balance

Index and % of GDP



Source: Statistics Iceland, The Central Bank of Iceland, ISB Rsearch

Inflation at target by late 2022

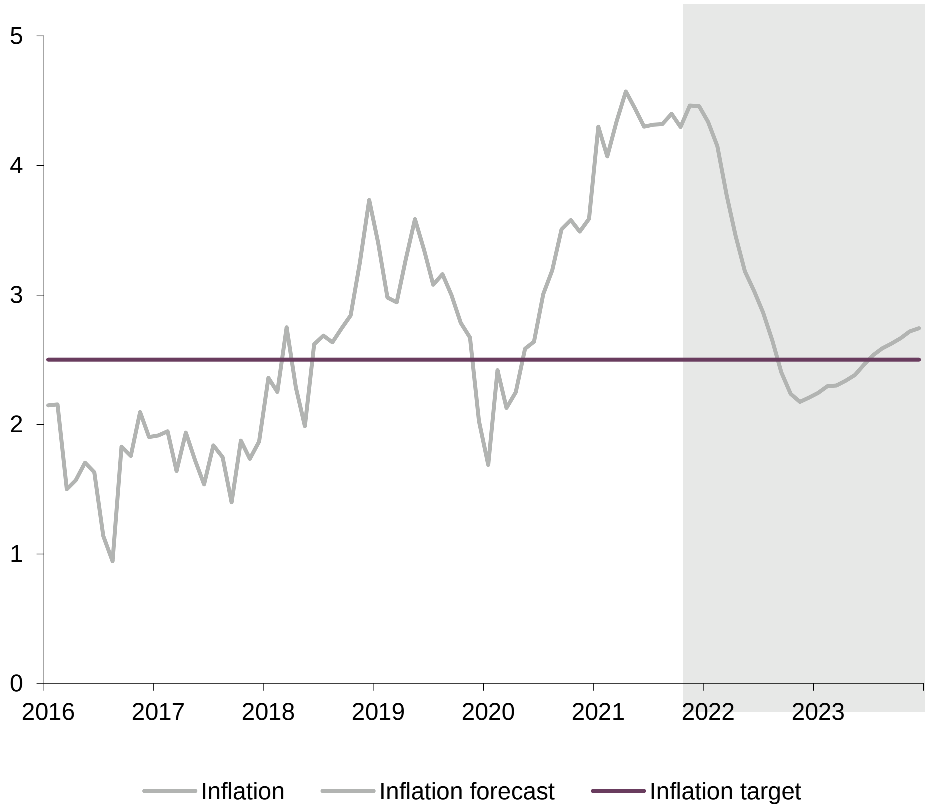
Inflation spiking in other countries as well

Highlights

- Inflation started rising in mid-2020, in the wake of the Corona Crisis and the depreciation of the ISK
- In August it measured 4.3%
- Inflation has proven more persistent than expected, but ultimately it will fall
- ÍSB Research expects it to remain somewhat above 4%, the upper deviation threshold of the CBI's target, and measure 4.4% at the year-end
- It will then subside slowly and steadily, aligning with the CBI's 2.5% target in Q4/2022
- Inflation expected to average 3.0% in 2022 and 2.5% in 2023
- Inflation has been on the rise in most Western countries since the pandemic struck
- The forecast assumes that the ISK will appreciate in coming quarters. On the other hand, inflationary pressures from wages and/or house prices could turn out stronger than anticipated
- Furthermore, imported inflation could turn out higher if price hikes abroad continue unabated

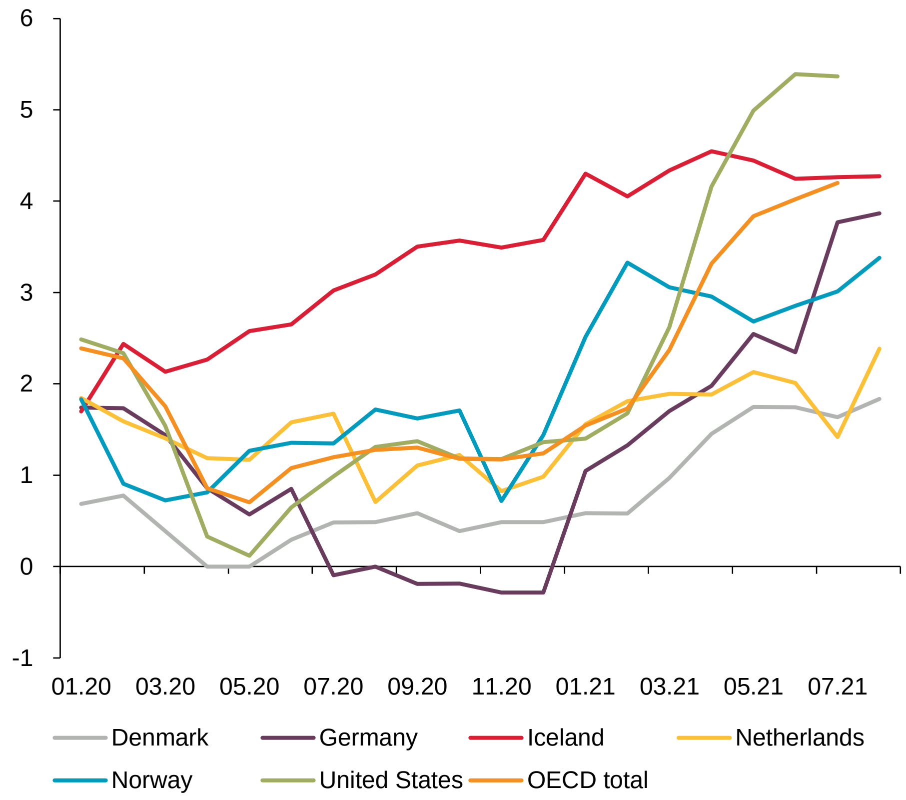
Inflation and the CBI inflation target

%



Headline inflation, by country

%



Source: Statistics Iceland, ISB Research, OECD

Policy rate on the rise

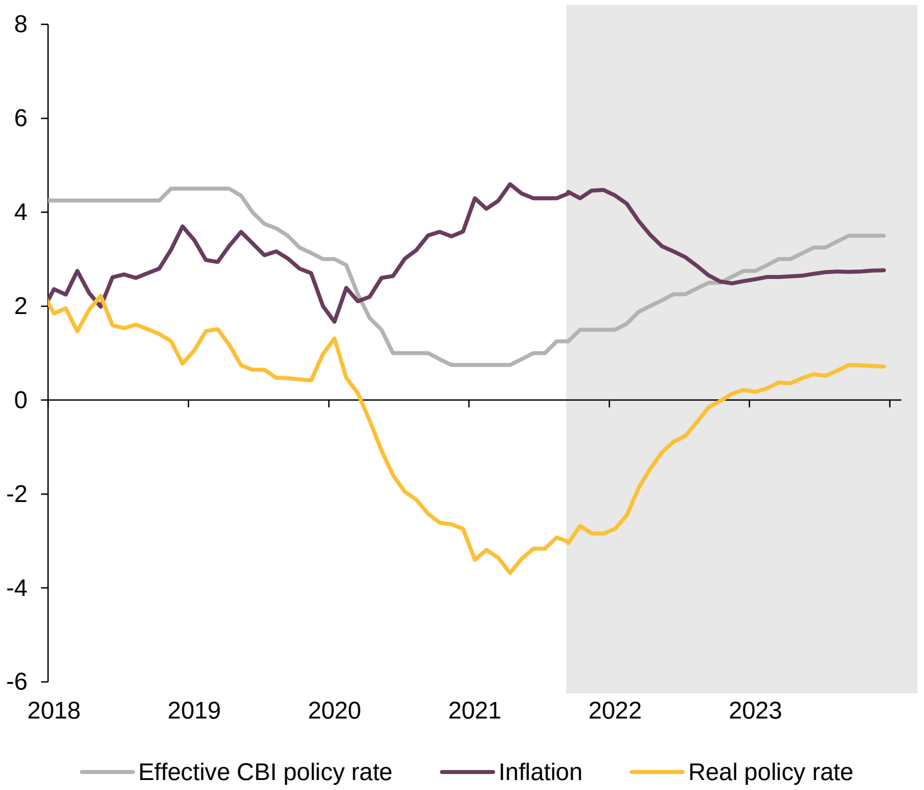
Long-term interest rates approaching equilibrium within the forecast horizon

Highlights

- The Central Bank of Iceland has hiked its policy rate 3 times in 2021, after reaching an all-time low of 0.75% in Q4 2020
- The policy rate is now 1.5%, its highest since May 2020
- ÍSB Research expects rates to stay at 1.5% throughout 2021, with the rate hike path resuming in 2022
- The policy rate is expected to reach 3.5% in Q3 2023
- Monetary tightening is probably already largely priced into long-term nominal rates while the real rate on CPI-linked treasury bonds remains held back by short-term inflation pressures
- Further ahead, long-term rates are expected to approach a medium-term equilibrium, which ISB Research estimates at around 4% for nominal rates and just over 1% for the real rate

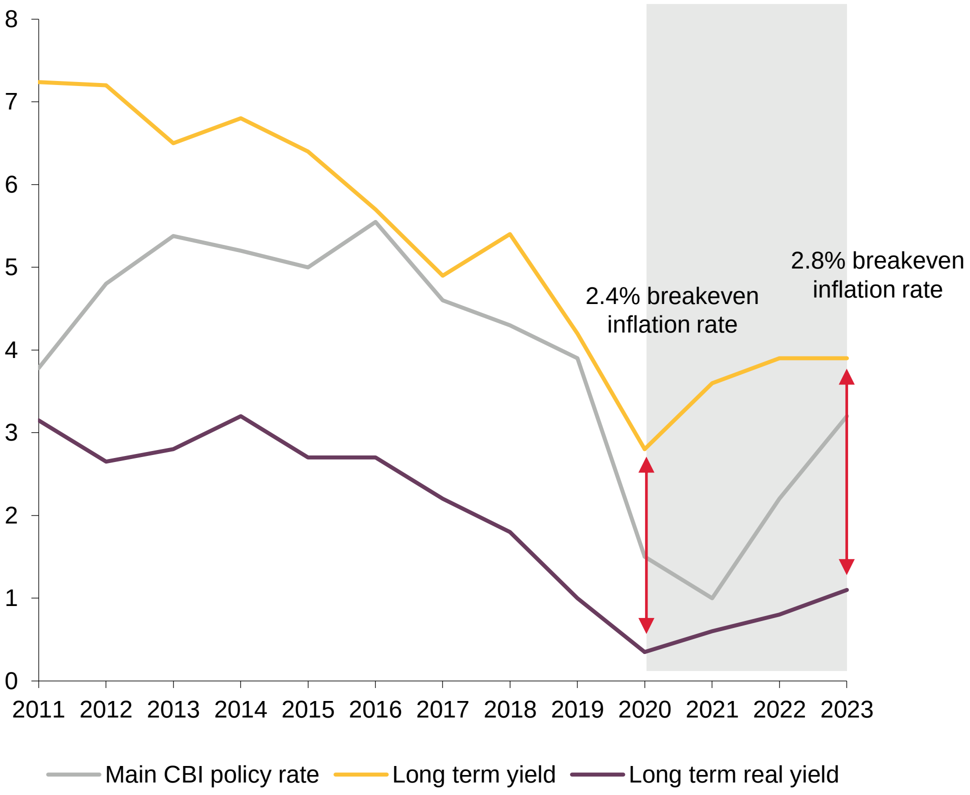
Policy rate and inflation

%



Interest rates

%

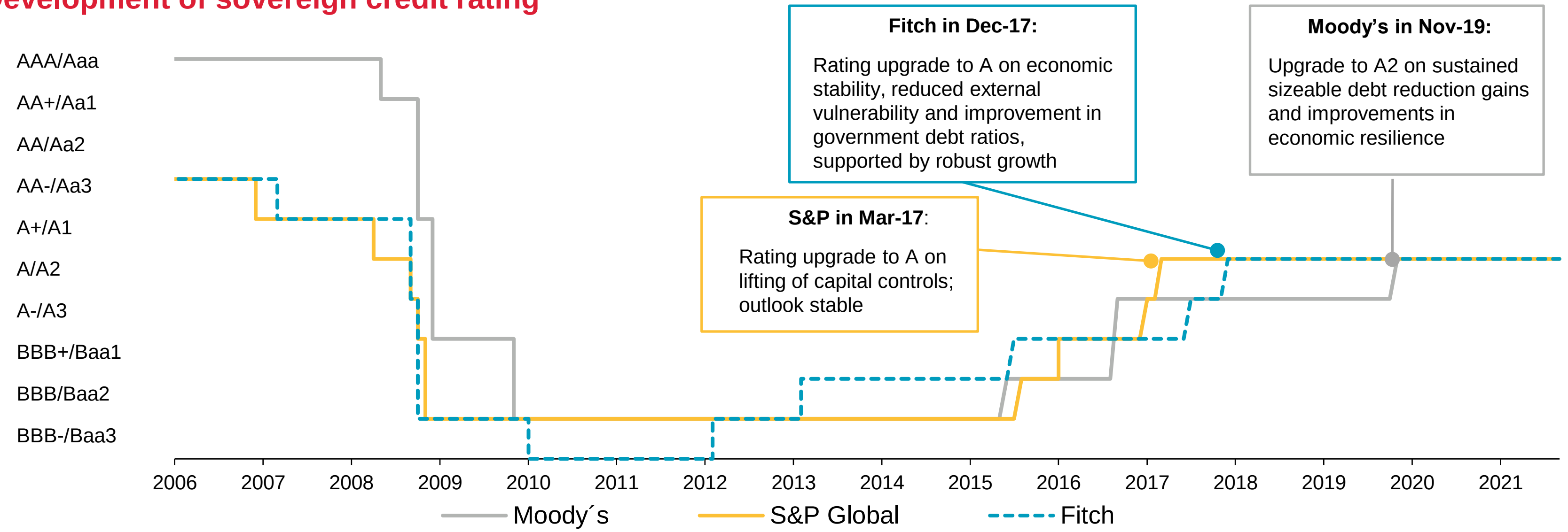


Sources: Central Bank of Iceland, Kodiak, Statistics Iceland, ÍSB Research.

Iceland’s credit rating has remained at A

Setbacks in the tourist sector have not affected the sovereign ratings

Development of sovereign credit rating



MOODY’S IN AUGUST 2021

- “Iceland's credit strengths include the economy's flexibility, wealth, competitiveness and favourable demographics, all of which support its long-term growth prospects and help it to absorb shocks.”
- “In our baseline scenario we expect the recovery to gather pace into next year, helped by the authorities' strong and swift policy action, high wealth buffers and stronger-than-expected resilience of Iceland's other key industries.

FITCH IN SEPTEMBER 2021

- Rating affirmed at A with a negative outlook
- “Iceland’s ‘A' rating is driven by its very high income per capita, very strong governance, human development and doing business indicators that are more consistent with those of 'AAA' and 'AA' rated countries”
- “The Negative Outlook reflects the uncertainty around the path of the public finances following the Covid-19 shock, which has left the public debt ratio substantially higher than pre-pandemic, and at risk of rising further over the medium term.”

S&P IN MAY 2021

- “The stable outlook indicates that Iceland's economy is likely to continue recovering in the second half of 2021. This should allow authorities to gradually roll back much of the fiscal and monetary policy support that limited the economic contraction and exchange rate volatility during the pandemic. This will limit the increase in public debt over the next few years.”

Source: Moody’s, S&P, Fitch Ratings and Central Bank of Iceland.

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28 October 2021

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