Tourism in Iceland

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In recent years, the tourism industry has made its mark on Iceland’s economy and society as a whole. After the rapid-fire growth of the past few years, it has become one of the country’s most important economic sectors. This strong growth is expected to continue in 2016. But with it come a number of challenges: to preserve the natural surroundings that are such an important part of Iceland’s appeal and to build up the infrastructure needed to maintain Iceland’s worldwide competitiveness as a travel destination.

Iceland’s ratio of tourists to inhabitants is among the highest in the world. The number of tourists per unit of land area is comparatively low, however. This gives rise to questions about the tolerance limits of the tourism sector as regards nature conservation and infrastructure. Analysis of these factors reveals that infrastructure development has not kept pace with the extraordinary growth in the number of tourist arrivals in Iceland. This discrepancy represents an opportunity to distribute tourists more evenly around the country, smooth out seasonal peaks and troughs, and in so doing, better utilise existing investments. It is also important to address issues relating to safety and nature conservation, with particular attention to the density of visitor traffic at some of Iceland’s most appealing sites.

Tourism is now one of the cornerstones of foreign currency revenue generation in Iceland and, with the rapid growth of the past few years, has strengthened the economy and contributed to increased long-term stability. The sector has also been the mainstay of job creation during the recent upswing, thereby playing a large part in reducing the unemployment that was such a problem a few years ago.

Tourism is closely intertwined with other sectors of the economy, as tourists purchase not only flights and accommodation but other goods and services as well. The sector is closely linked to general trade and services in Iceland and affects domestic production and investment. The growth of the tourism industry is therefore rooted in broad-based cooperation across economic sectors. This is one of its main strengths, but at the same time it complicates statistical analysis of the scope of the sector.

Íslandsbanki has now published its Icelandic Tourism Industry report for the second time. This time the report is published in both Icelandic and English, with the aim of giving domestic and foreign readers insight into developments and prospects in the sector. With this publication, Íslandsbanki wishes to contribute to the provision of information about the status of the tourism industry. We hope the report will prove a useful and informative supplement to the extensive coverage the sector has so deservedly has received.

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Íslandsbanki and tourism

Íslandsbanki offers comprehensive financial services to individuals, households, firms, and institutional investors. For years, the Corporate Banking Division has maintained teams that specialise in fisheries, energy, real estate, and municipal affairs. Íslandsbanki now has a tourism team and a tourism council whose members represent various departments within the Bank.

In recent years, many of Iceland’s largest and strongest tourism operators have been among Íslandsbanki’s clients. The Bank has strengthened its position in the Icelandic tourism sector, and in the past two years 25% of its new loans have been to tourism companies. As of year-end 2015, loans to companies engaged in tourism accounted for 17% of the Bank’s corporate loan portfolio.

At present, over 500 tourism companies are Íslandsbanki clients; thus it is clear that tourism as an economic sector is extremely important to the Bank. Íslandsbanki employees therefore make every effort to provide tourism companies with the best banking services in Iceland.

Figure 1. Íslandsbanki corporate loan portfolio, by sector 2015

Source: Íslandsbanki
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Summary

- Islandsbanki Research forecasts a 29% increase in the number of tourists visiting Iceland in 2016. In comparison, the World Tourism Organization forecasts a 4% increase in tourist numbers worldwide. If our forecast materialises, over 1.6 million tourists will travel to Iceland via Keflavík Airport during the year.

- If our forecast is borne out, tourists will outnumber the population of Iceland by a ratio of nearly five to one in 2016. After accounting for the average length of stay, this means that there will be nearly 30,000 tourists in Iceland each day of the year. The ratio of tourists to inhabitants is one of the highest in the world.

- In spite of the high ratio of tourists to inhabitants, the number of tourists relative to geographic area is rather low in international context. According to our forecast, the number of tourists visiting Iceland in 2016 will be about 16 per square kilometre. This is below the OECD average of 18 and well below the EU average of 103.

- International tourists worldwide totalled 1,184 million in 2015, and about 0.1% of them visited Iceland, or one out of every thousand. In international context, Iceland’s tourism sector is not large, and there are certainly opportunities for further growth in spite of the recent increase in historical terms.

- Seasonal fluctuations in tourist visits have diminished. The share of tourists visiting Iceland in June, July, and August peaked at just under 50% in 2010. Since then, it has fallen markedly and is now about 40%. The countries that have reduced this seasonality the most are the UK and Japan, as only 15% of Japanese tourists and 18% of British tourists come in June, July, and August.

- Most tourists come from the US and the UK, and a larger proportion of travellers from these countries choose Iceland as a destination. Just over 1.9% of the Americans who travelled to Europe came to Iceland during the first 10 months of 2015, as opposed to 0.5% in 2010. Roughly 0.41% of British travellers who went to Europe in the first 10 months of 2015 came to Iceland, up from 0.14% in 2010. Iceland has therefore lured market share away from other destinations among British and American tourists over this period.

- About 90% of all tourists who come to Iceland arrive and depart via Keflavík Airport. As a result, the airport and the available flights to Iceland are a major contributor to the upswing in Icelandic tourism. According to information from Isavia, seven airlines offered scheduled flights to Iceland in 2009, while 25 airlines plan scheduled flights to Keflavík Airport at some point in 2016.

- We expect tourism to generate nearly ISK 428bn in export revenues and to account for around 34% of total export revenues in 2016, as opposed to 18% in 2010.

- Foreign travellers’ total payment card turnover in Iceland amounted to ISK 154.4bn in 2015, an average of just under ISK 13bn per month, an increase of ISK 40.4bn during the year, or 35.4%. Card turnover per tourist had been contracting ever since 2010, but in 2015 it turned around, growing from ISK 117,700 in 2014 to ISK 122,400 in 2015.

- More than one in three jobs created in the Icelandic economy during the period 2010-2015 is attributable to the tourism industry. This does not include the jobs created in other tourism-related sectors: car rental, retail trade, entertainment, culture, recreation, and other services. It can be estimated that more than one in ten employed persons in Iceland work in tourism and related sectors.

- According to the World Economic Forum, Iceland ranks 18th in a field of 141 countries in terms of the world’s most competitive tourism destinations. Its strengths include its human capital, the openness of the country and connectedness to airline routes, and its tourism infrastructure. Other advantages are its safety and cleanliness. Factors that somewhat cut into the competitiveness of Icelandic tourism include a shortage of cultural activities and high prices.

- Although foreign tourists have long been important for the Icelandic hotel and guesthouse sector, their importance has soared in the recent past. During the period from 1998 through 2010, nearly 69% of sold bed-nights were sold to foreign nationals and the other 31% to Icelandic nationals. In 2015, the percentage sold to foreign nationals was 85%, an increase of 13 percentage points since 2010. Icelandic nationals therefore account for 15% at present and have declined by half since 2010.

- In international context, however, such a large percentage of bed-nights sold to foreign nationals is uncommon. In all of the EU countries combined, for example, less than half of sold bed-nights (46%) are sold to foreign nationals.

- A total of 6.67 million bed-nights were sold nationwide in Iceland in 2015, an increase of 21.5% from the previous year. In the first 10 months of 2015, the number of bed-nights sold was up 21% year-on-year and, according to data from Eurostat, Iceland was the only country to see an increase of more than 20%. For example, growth in sold bed-nights in all EU countries combined measured 3% over the same period.
We estimate that listed bed-nights constitute about 68% of total overnight stays by foreign nationals in 2015, with the remaining 32% classified as unlisted bed-nights. Such unlisted bed-nights could be due to accommodations through the sharing economy, including stays in privately owned housing, stays with friends or relatives, and so on.

The increased weight of foreign nationals in overnight accommodation is driven by regional Iceland. Examining the greater Reykjavik area reveals that the share of bed-nights sold to foreign nationals has remained relatively stable at around 89% since 2010. There has been substantial growth in guest accommodation sold to foreigners in West Iceland, Northwest Iceland, and the West Fjords, however, with the percentage of bed-nights sold to foreigners rising by 30, 24, and 19 percentage points, respectively, since 2010.

Of the 6.67 million bed-nights sold nationwide in 2015, 2.82 million, or 42%, were in the capital area. In regional Iceland, there were 3.85 million bed-nights sold, or 58% of the nationwide total.

In 2015, hotels accounted for 2.96 million sold bed-nights, an increase of nearly 850,000, or 28.1%, year-on-year. Bed-nights sold to Icelanders declined by just over 6,500 in 2015, while sales to foreign nationals increased by 655,000. It is clear, then, that foreign tourists account entirely for the growth in the hotel market in 2015.

The number of available hotel rooms has never grown as strongly in a single year as it did in 2015. According to Statistics Iceland, 872 new rooms were added during the year, most of them due to the opening of Foss Hotel Reykjavik, the Kea hotels, Hótel Skuggi, and Hótel Storm. The number of rooms available in the greater Reykjavik area rose by 26.3% in 2015, the largest increase ever recorded. In spite of this extraordinary historical growth in hotel rooms, the number of tourists grew proportionally more in 2015, or by 30.2%, and the hotel room occupancy rate rose from 77.6% to 78.8% as a result.

Among capital cities in the Nordic region, the proportional increase in hotel room offerings was greatest in Reykjavik in 2015.

In 2016, an estimated 290 new hotel rooms will be available, an increase of 5.8% in the total supply. As a result, it is likely that for yet another year, the increase in supply will not keep pace with demand. We estimate that more than 1,400 additional hotel rooms are needed to meet this rise in tourist numbers and maintain the same occupancy rate. Therefore, two things will happen: the occupancy rate will rise in 2016, and a larger percentage of tourists will seek out non-hotel accommodation.

It is estimated that through 2019, a total of 2,450 new hotel rooms will be built, at a total investment of over ISK 55bn. Hotel-related investment in 2016 is estimated at ISK 20.2bn, or 7.5% of projected business investment for the year.

In 2015, the average price for hotel accommodation in Reykjavik (EUR 119) was higher than in Copenhagen (EUR 112) and Oslo (EUR 107) but similar to that in Stockholm (EUR 120). This is because the average price per room has risen much more in Reykjavik than in the other cities since 2011, or by 49%.

In addition, among Nordic capitals, revenue per available room (RevPAR) has risen most in Reykjavik since 2011, or 83%. RevPAR in Reykjavik has risen from the lowest in the Nordic region in 2011 to the highest. RevPAR is the metric that is most used to estimate the profitability of hotel operations.

As of end-November 2015, a total of 2,681 properties in Reykjavik were listed on Airbnb, as opposed to 1,188 in December 2014, an increase of 126% in less than a year.

We estimate that, over the twelve-month period beginning in November 2014, roughly 358,000 bed-nights in the greater Reykjavik area have been sold through Airbnb. In comparison, 1,782,000 hotel bed-nights were sold in the capital area over the same period. Bed-nights sold through Airbnb therefore equal about 20% of hotel bed-nights sold in greater Reykjavik.

Most bed-nights sold through Airbnb were sold in August, or 63,200. In comparison, 189,000 bed-nights were sold in capital area hotels in August 2015; therefore, the number of bed-nights sold via Airbnb was about a third of the number sold in hotels during the same month.

In October 2015, the number of bed-nights sold via Airbnb was up by about 22,000 year-on-year. The increase measured 225% and the number of sold bed-nights in October 2015 was more than three times greater. Over the same period, the increase in hotel bed-nights in the greater Reykjavik area measured 29%. These figures highlight the explosion that has taken place in the sharing economy.

During the twelve-month period beginning in November 2014, total revenues derived from Airbnb-listed accommodation in Reykjavik amounted to ISK 2.22bn. Capital area hotels’ revenues over the same period totalled ISK 14.5bn. Revenues generated via Airbnb over those twelve months therefore totalled just over 15% of hotel revenues for the same period. Over the four months beginning in June 2015, revenues from Airbnb listings totalled ISK 1.35bn, or 61% of total revenues for a twelve-month period. In comparison, capital area hotels’ revenues for the four months from June 2015 onwards amounted to 51% of total revenues for a twelve-month period. Therefore, seasonality is more of a factor in the Airbnb market than in the hotel market.
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- The average length of stay among Airbnb guests in Reykjavík is 3.3 nights, and stays are longer over the colder months of the year. This accords with the results of the survey conducted by the Icelandic Tourist Board among foreign visitors to Iceland, which indicate that 40.4% of tourists stay 3-4 nights in the greater Reykjavík area.

- The rental car fleet grew by a full 26% between 2014 and 2015, while the number of tourists visiting the country increased 30%. There had been a pent-up need to expand the fleet, as it had grown by only 7% between 2013 and 2014, while the number of tourists grew by 24%.

- Between 2003 and 2014, the number of operating permits for car rental agencies trebled, from 51 to 151. In 2015 growth was virtually flat, with only one new agency obtaining a licence. It appears that this was due to thinning in the sector; i.e., inactive licence holders left the market and new ones came in to take their place.

- The number of tourists visiting Iceland is expected to grow by 29% in 2016, and it is clear that the number of active car rental agencies will rise during the year.

- From 2006 to 2014, the number of rental vehicles rose from 4,756 to 12,179. For 2015 the fleet size was forecast at 14,000, but the actual number was 15,401. Expansion is expected to continue, with the fleet size projected to peak in 2016 at 18,500, a 20% increase year-on-year.

- The car rental fleet has grown faster than the general private vehicle fleet in Iceland. Rental vehicles accounted for 2.4% of the total fleet in Iceland in 2006 and 6.8% in 2015. If forecasts materialise, this proportion will rise to as much as 8% in 2016.

- In 2015, the 20 largest rental agencies owned some 85% of the total rental car fleet, about the same as in 2014. Most agencies appear to have expanded their fleet to accommodate the growth in the market as a whole.

- The car rental fleet is relatively young: 87% of vehicles are five years old or younger, and 64% are only a year or two old. In comparison, only an estimated 13-15% of the country’s total fleet of private vehicles are five years old or younger.

- Over the period from 2010 through 2014, rental cars have accounted for about 42% of all new cars sold in Iceland. They accounted for 43% in 2015, when some 6,600 of the 15,300 private cars sold were to rental agencies. This ratio is expected to remain broadly unchanged in 2016, with rental vehicles accounting for 7,500 of 17,500 cars sold.

- Turnover among car rental agencies has grown rapidly, in line with increased activity in the sector. In 2008, the sector’s total turnover was ISK 7.5bn, whereas in 2015 it had grown to ISK 33bn. It is estimated that as many as 900 people are directly employed in the car rental sector.
• The average price of new rental cars was about ISK 3m in 2015; therefore, the sector’s direct investment in motor vehicles totalled about ISK 19.5bn exclusive of VAT during the year. Based on projected car sales in 2016, it can be assumed that the rental sector’s direct investment in vehicles will total ISK 22.5bn this year. This figure does not include a vast number of other related purchases, such as tyres, spare parts, petrol, and investment in housing.

• The increased importance of tourism in the Icelandic economy has diversified both the country’s foreign exchange revenues and the general economy. This should enhance economic stability in the long run. On the other hand, increased activity in the tourism industry has made the Icelandic economy more vulnerable to shocks to the sector. Such shocks could take many forms, including natural disasters and economic downturns or crises.

• Natural disasters can be a double-edged sword for the tourism sector, as was the case with the Eyjafjallajökull eruption early in 2010. The eruption caused a contraction in tourism at first but then helped to trigger the surge that has occurred since. Because of Iceland’s geographical location, its tourism industry depends largely on air traffic. About 90% of tourists who visited Iceland in 2015 came by air. As a result, Iceland’s tourism sector is more vulnerable to interruptions in air traffic than that in many other economies where tourism is based on a range of transportation options. Iceland’s status as an active volcanic island therefore represents a certain risk for tourism.

• The global economic recession in 2008 is a recent example showing clearly how a worldwide economic downturn can affect tourist numbers and the tourism industry in general. For instance, global GDP growth was flat in 2009, and there was a 4.0% contraction in the number of tourists at the same time. In Iceland, there was weak growth in tourist numbers in 2008, followed by a contraction in both 2009 and 2010. The contraction came on the heels of relatively swift growth in the number of travellers to Iceland during the pre-2008 upswing, much of it due to business travel.

• The real exchange rate of the ISK has risen considerably during the recent tourism boom. This has eroded the Icelandic tourism industry’s competitive position in terms of prices. Research shows that changes in the real exchange rate of a tourist’s home country often have as much impact as changes in the real exchange rate of the destination country. This can be seen, for instance, in the surge in the number of Icelanders travelling abroad during the recent rise in the real exchange rate of the ISK. Furthermore, growth in tourist visits to Iceland has been greatest among people from economies with a rising real exchange rate, especially the US and the UK. Tourists from the eurozone have increased in number as well, but to a much lesser degree.
Tourism: large and growing rapidly

Yet another record year is underway for Icelandic tourism. We expect the sector to break records in foreign exchange revenue generation, size relative to the economy, and number of tourists visiting Iceland, to name just a few categories. The burgeoning of tourism has strongly affected the Icelandic economy, playing an important role in the upswing of the past few years and making its mark on Icelandic society as a whole. The scope of the sector is obvious to all, as the ratio of tourists to inhabitants is one of the highest in the world at present and appears set to rise even higher. Iceland has a strong competitive position as a tourist destination, but the challenge is to follow up on its popularity with infrastructure development, including hotels and recreational facilities, and to make better use of existing investments. The steep increase in flights to Iceland has made the growth of the sector possible, and the outlook is for a significant rise in flight offerings this year. In our opinion, tourism will grow even stronger in 2016, both as one of the pillars of the Icelandic economy and as the country’s largest source of foreign currency.

We forecast a 29% rise in tourist visits in 2016

Íslandsbanki Research forecasts a 29% increase in the number of tourists visiting Iceland in 2016. In comparison, the World Tourism Organization forecast a 4% increase in tourist numbers worldwide. If our forecast materialises, over 1.6 million tourists will travel to Iceland via Keflavik Airport (KEF) during the year. The forecast is based on currently available figures on the number of foreign tourists plus information from Isavia concerning expected air traffic over the coming year, which indicates a strong increase in air traffic through KEF. The expected increase in available flights in 2016 is much larger than the actual increase in 2015. On the other hand, Isavia projects a rise in the ratio of through passengers to total passengers landing at KEF in 2016; i.e., a smaller percentage of total passengers will actually enter the country.

Record-breaking years – one after the other

According to figures from the Icelandic Tourist Board, 1,262,000 tourists departed from Iceland via KEF in 2015, a year-on-year increase of just over 30%. This does not include travellers arriving with cruise ships and the Norræna ferry, nor does it include those travelling to other harbours or airports. According to the World Tourism Organization, global tourism grew by about 4.4% in 2015 and by an average of 3.5% per year over the period from 2005-2014. Since 2010, however, annual growth in tourist visits to Iceland has averaged 22.4%, dwarfing worldwide growth rates.

Figure 2. Number of visitors travelling through KEF (thousands)

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<td>2016F</td>
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Source: Icelandic Tourist Board, ISB Research
Seasonal peaks continue to even out

Iceland’s tourism industry has been characterised by seasonal peaks and troughs, with most tourists arriving in June, July, and August. The share of tourists visiting during these three months peaked at just under 50% in 2010. Since then, it has fallen markedly and is now about 40.2%. Since 2010, the increase in tourist numbers has been proportionally strongest in November and December, with year-on-year growth exceeding 30% during these two months. Over the same period, year-on-year growth has been weakest over the summer months, at 16-20%. Stakeholders in the tourism industry have therefore been highly successful in marketing Iceland as a year-round destination. A number of scheduled events and favourable off-peak airfares have also fostered this development, which has solidified the operational foundations for businesses in tourism-related fields. Íslandsbanki Research forecasts that this trend will continue in 2016, with seasonality diminishing still further.

The countries that have supported this trend the most are the UK and Japan. Travellers from these two countries stand out in that most of them visit Iceland outside the peak season. As is stated above, over 40% of all tourists visit in June, July, and August, whereas only 15% of Japanese and 18% of British tourists come during those months. This smoothing of seasonal fluctuations is very important to the sector, and increased visits from these two countries have supported that trend.
Americans outnumber the British

Over the thirteen years that the Icelandic Tourist Board has measured tourist numbers by nationality, visitors from the UK have been the largest group eleven times. In the other two instances, Americans have been the leaders: in 2011 and again in 2015. This is due to a surge in visitors from the US, who grew in number by 90,700, or nearly 60% year-on-year. The number of travellers from the US and UK has soared since 2010. For example, the number of British and American visitors to Iceland in 2015 alone exceeds the total number of tourists from all countries in 2010 by a full 25,000. The total number of tourists has risen by more than 800,000 since 2010, and the US and UK account for 372,000 of them, or nearly half. The catch-all category “Other” was the third-largest group, according to Icelandic Tourist Board data. The Icelandic Tourist Board database does not contain more detailed information on that group; therefore, it is uncertain what countries are represented there. As a result, analysis of the increased diversity among visitors to Iceland is limited in this respect. Greater diversification of nationalities is a positive development in tourism. Broadening the base of tourists in this way better prepares the sector to withstand shocks such as terrorist attacks or economic downturns that could strike specific countries or regions. Such shocks can have an enormous impact on tourism, as is discussed more fully in the section “Shocks in tourism”.

Nearly 30,000 tourists per day

Tourists outnumbered inhabitants by nearly 4:1 in 2015, and if our forecast is borne out, the ratio of tourists to inhabitants will approach 5:1 in 2016. After accounting for the average length of stay, this means that there will be nearly 30,000 tourists in Iceland each day of the year. As a result, they account for 8.3% of the combined total population of year-round residents plus tourists. This ratio has often been used as an indicator of the size of the tourism sector in various countries. By this criterion, Iceland ranks seventh, between Monaco and Malta. The countries above Iceland on the list are small ones, including the Vatican (#1), Andorra (2), and the Bahamas (5). No large countries have a tourist-to-inhabitant ratio as high as Iceland’s. For example, in Spain, the ratio is 2.2%; in France, 2.0%; and in Italy, 1.3%. Smaller countries have somewhat higher ratios, however: Estonia, 4.0%; Austria, 3.8%; Ireland, 3.7%, and Denmark, 2.5%. It should be noted that...
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because these are average year-round figures, the ratio is much higher during the summer. Therefore, we estimate that tourists will account for over 18% of all inhabitants in Iceland this summer.

Few tourists per square km

Even though the number of tourists in Iceland is large relative to the population and the ratio described above is high, the country is large and therefore not overfilled with tourists relative to land area. Actually, the number of tourists per unit of land area is rather small. According to our forecast, the number of tourists visiting Iceland in 2016 will be about 16.2 per square kilometre. This is slightly below the OECD average of 17.6 and far below the EU average of 102.6. It is worth noting that the countries ranking on either side of Iceland in terms of the tourist-to-inhabitant ratio – i.e., Monaco and Malta – have a much higher tourist-to-land area ratio than Iceland does. Monaco’s is 164,000 per square kilometre and Malta’s 4,943. Therefore, Iceland’s vast wilderness areas are still far from being as overstuffed with tourists as are most other countries with equally large tourism sectors. It can be said, then, that there is still considerable scope for growth in Icelandic tourism, although some sites within the country may be approaching the saturation point in terms of tourist traffic.

Figure 8. Ratio of tourists to total inhabitants, yearly average

Source: World Bank, ÍSB Research

Figure 9. Number of tourists per km²

Source: World Bank, ÍSB Research
One of every thousand tourists worldwide comes to Iceland

According to the World Tourism Organization, there were 1,184 million tourists worldwide in 2015, an increase of 4.4% year-on-year. Only 0.1% of those tourists – or one in a thousand – visited Iceland.

Figure 11 shows the most popular travel destinations in 2013, together with other selected destinations. The figure highlights how few travellers come to Iceland relative to the global total. In terms of the number of visitors, Iceland as a destination ranks 110th among the countries for whom information could be obtained from the World Bank, yet it ranks 176th in terms of population. It should be borne in mind that at present there are 196 independent countries in the world. When population is factored in, however, the picture changes radically, as can be seen in Figure XX. Tourists outnumbered the population of Iceland by 2.4:1 in 2013 and, if our forecast materialises, they will outnumber inhabitants by nearly 5:1 in 2016. Iceland is therefore at the top of the list in comparison with these same countries and in Figure 10, after accounting for population.

visitors, Iceland as a destination ranks 110th among the countries for whom information could be obtained from the World Bank, yet it ranks 176th in terms of population. It should be borne in mind that at present there are 196 independent countries in the world. When population is factored in, however, the picture changes radically, as can be seen in Figure XX. Tourists outnumbered the population of Iceland by 2.4:1 in 2013 and, if our forecast materialises, they will outnumber inhabitants by nearly 5:1 in 2016. Iceland is therefore at the top of the list in comparison with these same countries and in Figure XX, after accounting for population.

Figure 10. Number of tourists, by destination

Source: World Bank, Icelandic Tourist Board, Statistics Iceland

Figure 11. Number of tourists per inhabitant

Source: World Bank, Icelandic Tourist Board, Statistics Iceland
Iceland’s growing popularity among US and UK tourists

In this context, examining the two countries that produce the most visitors to Iceland – the US and the UK – reveals that, among overseas travellers, the percentage who visit Iceland has grown by leaps and bounds. Of Americans who travelled abroad in the first 10 months of 2015, 0.8% came to Iceland, as opposed to 0.2% in 2010. Of the Americans who travelled to Europe, just over 1.9% came to Iceland during the first 10 months of 2015, up from 0.5% in 2010. The share has therefore increased by 1.5 percentage points over this five-year period.

Of British nationals who travelled abroad in the first 10 months of 2015, 0.33% came to Iceland, up from 0.11% in 2010. Of British travellers who went to Europe in the first 10 months of 2015, roughly 0.41% came to Iceland, as compared with 0.14% in 2010.

It is noteworthy that of those who travel to Europe, the percentage of Americans who visit Iceland is considerably larger than the percentage of British nationals. Just over 1.9% of Americans who travelled to Europe came to Iceland, as opposed to only 0.4% of Europe-bound travellers from the UK. If American and British nationals travelled equally much, the number of American travellers should be much larger, as the population of the US is nearly five times that of the UK. But this is not the case, as American tourists outnumbered British tourists to Iceland by only 1,800 in 2015. The reason for this is that British people travel much more than Americans do. In 2014, British nationals travelled abroad 60 million times, the equivalent of at least one trip per person for 90% of the total population. On the other hand, Americans travelled abroad 30.8 million times, which is the equivalent of at least one trip per person for 10% of the total population.
Increased airline offerings: the key to the tourism boom

About 90% of all tourists who come to Iceland arrive and depart via Keflavík Airport. As a result, the airport and the available flights to Iceland are a major determinant of the upswing in Icelandic tourism. Increased offerings and the more favourable airfares that have resulted from increased competition in flights to Iceland have made it easier for foreign tourists to visit the country.

According to information from Isavia, seven airlines offered scheduled flights to Iceland in 2009, whereas 25 airlines plan scheduled flights to Keflavík Airport at some point in 2016. In addition to this are the regular chartered flights on behalf of Icelandic and foreign travel agencies and flights via other domestic airports in Akureyri, Egilsstaðir, and Reykjavík.

The frequency of flights to Iceland via KEF grew by 17% per year from 2010 through 2015. Over the same period, the number of tourists visiting the country grew by over 22% per year. This indicates that larger planes are coming to Iceland and that seat utilisation rates are rising. This assumption is supported by figures from Icelandair and IATA. As Figure 15 shows, Icelandair’s seat utilisation rate has risen considerably since 2010. European and other international airlines have also seen utilisation rates rise over this period.

Strong impact from foreign airlines

Foreign airlines’ decision to begin offering flights to Iceland has made a strong impact on tourism. In 2012, EasyJet began scheduled flights to Iceland 10 months of the year. That year the number of British visitors rose by 27,000, or 40%, whereas the increase in the previous year was just over 7,000, or 12%. In 2013, EasyJet began flying to Iceland year-round, and the frequency of flights from the UK to KEF rose by 67% that year. At the same time, the number of British visitors rose by 42,500, or about 45%. This is the largest increase in British tourists in the history of Icelandic Tourist Board figures, and the increase in air traffic between the UK and Iceland is also the largest since the onset of the tourism boom in 2010.

This pattern can also be seen among German and American tourists. In 2011, Delta Airlines began scheduled flights to Iceland four months of the year: June, July, August, and September. The number of American visitors to the country grew by more than 60% year-on-year over these four months, and growth for the year as a whole measured almost 52%. In 2012 through 2014, US airlines increased the frequency of flights to Iceland, flying to KEF 51% more often in 2014 than in 2012. The number of Americans visiting the country grew by 60% over the same period. In 2015, Delta Airlines added the month of March to its flight roster, and US airlines’ total flight offerings to KEF grew by 49%. The increase in US-bound flights by domestic airlines WOW and Icelandair has also been a major factor in the increased number of American tourists visiting Iceland. In 2015, the number of Americans visiting Iceland grew by nearly 60%. As a result of this surge in the number of Americans travelling to Iceland, most tourists in Iceland now come from the US.

In 2015, Air Berlin lengthened its schedule of flights to Iceland to nine months of the year, as opposed to five in 2014. Over the four additional months, 25% more German tourists came to Iceland than in those same months in 2014, and over the year as a whole, the number of visits by German tourists rose by more than 20%. Flight offerings from Germany to KEF have increased by 17% per year since 2010 and the number of German tourists by 14%.
Figure 16 shows flight offerings to KEF, classified by country. The US, the UK, and Germany are at the top of the list in terms of total offerings, and most tourists come from these countries. Figure 17 shows annual growth in flight offerings and number of visitors in the eight countries that produce the most travellers to Iceland. As the figure illustrates clearly, there is a strong connection between increased flight availability and increased tourist numbers. Seat utilisation and aircraft size, together with the nationality composition of passengers on each flight, affect this relationship and cause deviations in some instances. For example, this is why the increase in visitors from the US and the UK exceeds the increase in flight availability from those countries.
KEF Airport: increased investment need

The exponential growth in Iceland’s tourism sector has increased the need to invest in KEF Airport, and substantial investment is indeed planned for the coming term. Isavia projects that by 2040, nearly 14 million passengers could travel through KEF, which translates to an annual increase of 4.3% for the next 25 years. In comparison, the airport welcomed nearly 5 million passengers in 2015, an increase of just over 25% year-on-year. Isavia’s projections therefore assume a much more modest growth rate than has been seen recently.

Figure 18 shows the largest airports in the world, by number of passengers, together with KEF. The figure illustrates clearly how small KEF is in this context. Nevertheless, Keflavik stands out in that the increase in the number of passengers travelling through KEF far exceeds the increase at the largest airports.
Tourism generates over a third of FX revenues

In recent years, tourism has grown into one of the cornerstones of foreign currency generation in Iceland. As has always been the case, Iceland’s main export sectors are based on natural resource utilisation, but they are now more diverse than before. Lack of diversity in generation of FX revenues was long a procyclical element of the Icelandic economy. Tourism has added some of the diversity that was lacking, which should create greater stability in the future. The growth of the tourism sector has also connected Iceland more closely to economic developments in tourists’ countries of origin. In this respect, the Icelandic economy is more closely linked to neighbouring economies.

Year-2015 revenues from goods and services exports are estimated at ISK 1,191bn, an increase of 9% year-on-year. Tourism generated ISK 368bn in foreign-denominated revenues during the year, or 31% of the total from all goods and services exports. We estimate that total export revenues will grow by just over 5% this year, to about ISK 1,254bn. We expect tourism to generate nearly ISK 428bn and to account for around 34% of total export revenues in 2016. Tourism would then increase in terms of its share in total export revenues, further strengthening its position as Iceland’s leading export sector.

Tourism’s share of Iceland’s export revenues has been growing in recent years; for example, it was 18% in 2010. In view of this rapid growth and the fact that tourism now generates considerably more foreign currency than other sectors, it is appropriate to highlight the importance of fostering the growth of other FX revenue-generating sectors to ensure that diversity is maintained. Otherwise, there is the risk that, with continued rapid growth in tourism, FX revenue generation will grow more homogeneous, making the economy more vulnerable to shocks in the tourism industry.
Spending per visitor rises in 2015

Foreign travellers’ total payment card turnover in Iceland amounted to ISK 154.4bn in 2015, an average of just under ISK 13bn per month. Foreign nationals’ card turnover grew by ISK 40.4bn in 2015, or 35.4%, as opposed to 22% in 2014 and 17% in 2013. This strong increase in card turnover among foreign nationals has strengthened the ISK, and it is clear that this effect has grown stronger year by year. In this context, however, it is also necessary to consider Icelanders’ card turnover abroad, which totalled ISK 34.3bn in 2015. Therefore, foreign nationals’ purchases of Icelandic krónur net of Icelanders’ purchases of foreign currency (the card turnover balance) amounted to ISK 120.1bn in 2015. By way of comparison, it is interesting to note that in 2007, the pre-crisis peak of private consumption, the card turnover balance was negative by over ISK 54bn.

Examining card turnover per tourist reveals a decline beginning in 2012, as growth in the number of tourists outpaced foreign card turnover from 2012 through 2014. Things changed in 2015, however, when the number of tourists rose by 30.2% and foreign nationals’ card turnover by 35.4%, a difference of 5.2 percentage points. The result is therefore that card turnover per tourist rose from ISK 117,700 in 2014 to ISK 122,400 in 2015, which means that each tourist spent an average of over ISK 122,000 while in Iceland. Figure 23 breaks this amount down by spending category.

### Figure 21. Card turnover of tourists

<table>
<thead>
<tr>
<th>Year</th>
<th>Card Turnover</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>80</td>
</tr>
<tr>
<td>2013</td>
<td>93</td>
</tr>
<tr>
<td>2014</td>
<td>114</td>
</tr>
<tr>
<td>2015</td>
<td>154</td>
</tr>
</tbody>
</table>

Source: Centre for Retail Studies

### Figure 22. Card turnover balance (ISK bn)

<table>
<thead>
<tr>
<th>Year</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>-54</td>
</tr>
<tr>
<td>2012</td>
<td>48</td>
</tr>
<tr>
<td>2013</td>
<td>62</td>
</tr>
<tr>
<td>2014</td>
<td>82</td>
</tr>
<tr>
<td>2015</td>
<td>120</td>
</tr>
</tbody>
</table>

Source: Centre for Retail Studies, Central Bank of Iceland

### Figure 23. Average payment card turnover per tourist, 2015

- **Culture and recreation**
  - Turnover: 2,881
  - % share: 2.4%

- **Petrol, car repair and maintenance**
  - Turnover: 5,129
  - % share: 4.2%

- **Other**
  - Turnover: 6,738
  - % share: 5.5%

- **Cash withdrawals**
  - Turnover: 11,186
  - % share: 9.1%

- **Restaurant**
  - Turnover: 13,654
  - % share: 11.2%

- **Car rental and other transport**
  - Turnover: 15,097
  - % share: 12.3%

- **Accommodation**
  - Turnover: 24,310
  - % share: 19.9%

- **Retail trade**
  - Turnover: 18,012
  - % share: 14.7%

- **Misc. tourism services**
  - Turnover: 25,359
  - % share: 20.70%
Most spent on organised tours; car rentals growing rapidly

Foreign tourists’ did most of their card-based spending on miscellaneous tourism services in 2015. Under this category are organised tours such as whale watching, guided distance coach tours, hikes, and other such trips. This category of card turnover, which totalled ISK 32bn in 2015, has grown most since 2012, or by 51%. The second-strongest turnover category in 2015 was accommodation, at ISK 30.7bn, some 99.4% of it due to hotel stays. The category that includes car rental has also grown strongly. Car rentals now account for 99% of turnover under this item, which has grown by about 37% per year since 2012.

It should be noted that only card turnover through Icelandic acquirers is included here. Among the items not included are cash payments made by tourists who buy foreign currency before arriving in Iceland, package tours bought through foreign travel agencies, and services purchased through other foreign booking agencies. In this context, of those tourists who were asked about their bookings, only 9.6% said they booked package tours through Icelandic travel agencies. It is clear, then, that payment card turnover figures underestimate total spending by foreign visitors during their stay in Iceland.

**Figure 24. Tourists’ card turnover, by spending category (ISK bn, at 2015 price level)**

Source: Icelandic Centre for Retail Studies, Icelandic Tourist Board
Rapid job creation in tourism

Alongside the past few years’ exponential growth in tourist numbers and tourism-generated foreign exchange revenues, the number of jobs in the sector has grown substantially. The expansion of the tourism sector has been responsible for much of the job creation taking place since Iceland’s post-crisis economic recovery began in 2010. The number of jobs in the general economy rose by 16,300 between 2010 and 2015, and 5,400 of them are in tourism: air transport, travel agencies, and hotel and restaurant services. Therefore, more than one in three jobs created in the Icelandic economy over this period is attributable to the tourism industry. This does not include the jobs created in other tourism-related sectors: car rental, retail trade, entertainment, culture, recreation, and other services.

In the above-mentioned segments of tourism alone – air transport, travel agencies, and hotel and restaurant services – there were 10,800 jobs in 2008, or 6.0% of the total number of employed persons in the economy at the time. The number of tourism workers has risen since then, as has the share of the total: in 2015, there were 17,100 people working in tourism, or 9.3% of the total number of employed persons. The number of people employed in tourism can be expected to rise still further this year, and the sector’s share of the total number of working persons can be expected to increase likewise. As has been pointed out, the scope of the tourism industry is doubtless underestimated in these figures, as they do not include related activities. It is safe to estimate, then, that more than one of every 10 working people in Iceland are employed in tourism and related activities. Clearly, the tourism sector has become one of the largest segments of the Icelandic labour market.

Advertising value of the internet and social media

There is little doubt that the internet and social media have played an important role in the tourism boom of the past few years. The large number of people who come to Iceland then advertise the country informally on social media, with commentary and photos from their travels. In proportional terms, the power of social media is greater...
in the case of Iceland because tourists outnumber inhabitants by a much larger margin than in most other countries. The rise of social media concurrent with the recent upsurge in tourism has been extremely favourable, as it is relatively much more costly for a small economy to advertise itself through conventional channels than it is for larger countries. As a result, it can be said with some certainty that the recent growth in tourist numbers in Iceland is due in part to the simultaneous explosion in the use of social media.

The Eyjafjallajökull eruption in 2010 is a good example of the power of advertising, as the eruption drew enormous attention and has played a starring role in putting Iceland on the map as a travel destination. In Figure 27, which illustrates the interest in “Iceland” as an internet search string as compared with other search strings, it can be seen that interest was greatest around the time of the Eyjafjallajökull eruption. Interest also spiked around the time of the eruptions at Grímsvötn (2011) and Bárðarbunga (2014/2015). Interest in Iceland therefore appears to be affected by volcanic activity. Although it is impossible to assert that there is a cause-and-effect relationship between the popularity of “Iceland” as a search string and the upswing in the tourism sector, there are signs that Iceland is increasingly talked about, which increases the likelihood that interest in travelling to the country will be kindled.

Alongside Iceland’s growing popularity as a travel destination, world-famous people have visited the country in increasing numbers. Such visits generate enormous attention on social media and tend to be a valuable advertisement for Iceland. Furthermore, large film producers have considered Iceland as a shooting location because of its natural beauty and the tax concessions available to them, and this, too, has attracted attention to the country and its people. Stars such as Justin Timberlake, Beyoncé, Tom Cruise, and Justin Bieber have drawn considerable attention with their travels to Iceland. It is difficult to quantify the advertising value of such visits, but it is significant.

In 18th place among the world’s most competitive tourist destinations

Iceland ranks 18th out of 141 countries on the list of the world’s most competitive travel destinations, according to a report published by the World Economic Forum last year. Figure 28 shows the top 30 countries and a few from further down the list.

As regards tourism, Iceland’s strengths include its human capital and its labour market, the openness of the country and connectedness to airline routes, and its tourism infrastructure. Other advantages are the safety and cleanliness of the country. And it comes as no surprise that Iceland’s natural beauty should be considered a strength in terms of its appeal as a travel destination.

One factor that somewhat cuts into the competitiveness of Icelandic tourism is the shortage of cultural activities. Another negative factor is the price level, where Iceland ranks 128th. Less developed countries rank highest in terms of price level, while more developed countries place further down. This is normal, of course, and actually a plus for inhabitants that Iceland should not be further up on this part of the list. Countries ranking below Iceland in terms of price competitiveness include Norway, Denmark, Sweden, Italy, United Kingdom, Switzerland, and France.
Substantial investment in tourism

The rise in foreign visitors has transformed the environment in which the tourism industry operates. Large-scale investment has been needed in the sector in order to provide the best possible service to a growing number of people. For example, accommodation services have more than doubled in scale, and car rental business has grown similarly, as have most of the goods and services connected in one way or another to tourism. If our forecast of tourist numbers is borne out, this trend will continue in 2016, and the industry will continue to solidify its position as one of Iceland’s key economic sectors.

Increased impact of foreign tourists on accommodation services

Although foreign tourists have long been important for the Icelandic hotel and guesthouse sector, their importance has soared in the recent past. During the period from 1998 through 2010, nearly 69% of sold bed-nights were sold to foreign nationals and the other 31% to Icelandic nationals. Figure 29 depicts the rise in sold bed-nights from 2010 through 2015. In 2015, the percentage sold to foreign nationals was 85%, an increase of 13 percentage points since 2010. Icelandic nationals therefore account for 15% at present and have declined by half since 2010.

In international context, however, such a large percentage of bed-nights sold to foreign nationals is uncommon. Actually, in all of the EU countries combined, less than half of bed-nights (46%) are sold to foreign nationals. Therefore, within the EU, domestic customers have more of an impact than foreign nationals do. This underlines the uniqueness of the Icelandic tourism industry in this respect and the importance of foreign guests to the sector.

Figure 29. Bed-nights - nationwide total and total per tourist

Figure 30. Proportion of bed-nights sold to foreign nationals
Growth of accommodation services in Iceland unparalleled elsewhere

A total of 6.67 million bed-nights were sold nationwide in Iceland in 2015, an increase of 21.5% from the previous year. Examining this growth rate in international context shows how strong it is. In the first 10 months of 2015, the number of bed-nights sold was up 21% year-on-year, and according to data from Eurostat, Iceland was the only country to see an increase of more than 20%. For example, the increase in sold bed-nights in all EU countries combined was 3% during the same period. Belgium and Romania come closest to Iceland in terms of growth in the number of sold bed-nights over this period. Examining Eurostat figures on bed-nights over a longer period of time shows even more clearly how unusual developments in Iceland are. In fact, Iceland is virtually unrivalled among major European countries in this regard. The number of bed-nights has risen by nearly 3.67 million since 2010, or 122%, which translates to an annual growth rate of 17.3%. Annual growth in bed-nights sold to Icelanders measures 3% and sales to foreign nationals 17%. In comparison, however, the number of tourists visiting the country has grown by 22.4% per year since 2010. The fact that tourists numbers have outpaced bed-nights sold to foreign nationals indicates that travellers are either shortening their stay or using unlisted accommodation not included in Statistics Iceland figures. Such unlisted bed-nights could be due to accommodations through the sharing economy, including stays in privately owned housing, stays with friends or relatives, and so on. Furthermore, the number of bed-nights per tourist has declined since 2010. Non-hotel accommodation growing rapidly; a third of overnight stays in “unlisted” accommodation

The Icelandic Tourist Board has surveyed foreign tourists’ length of stay over a period of several years. Based on these surveys, the average length of stay in Iceland is 6.6 nights. Multiplying this figure by the number of tourists who come each year gives an estimated total number of foreign travellers’ bed-nights in Iceland, and from this it is possible to estimate the number of unlisted bed-nights. We estimate that listed bed-nights accounted for about 68% of total overnight stays by foreign nationals in 2015, with the remaining 32% classified as unlisted bed-nights. Over the period from 2010 through 2015, the share of unlisted bed-nights has grown most, or by nearly 3%, followed by other types of accommodation, which have increased by just over 2%. Hotels’ share of the total has contracted by nearly 5% over the same period. With the rapid growth of the sharing economy, unlisted accommodation has perhaps become a more appealing option than it was previously. It is in part because of this that the share of unlisted accommodation has grown. According to a Bifröst University study of apartment accommodation in the tourism industry, some 80-90% of such accommodation options in Reykjavík are unlicensed and therefore not covered by Statistics Iceland figures. The sharing economy is discussed more fully in Section “Accommodation through the sharing economy growing rapidly”.
Regional Iceland gains ground

The increased weight of foreign nationals in overnight accommodation is driven by regional Iceland, as can be seen rather clearly in Figure 33. Examining the greater Reykjavík area reveals that since 2010, the share of bed-nights sold to foreign nationals has remained relatively stable at around 89%. It was also around this level during the pre-crisis years, indicating that the share of bed-nights sold to foreigners has long been high in greater Reykjavík.

In regional Iceland, the areas closest to greater Reykjavík generally sell a larger share of bed-nights to foreign nationals than those further away. The Suðurnes peninsula has a relatively large share in comparison with other areas, selling 80% of bed-nights to foreigners in 2015. South Iceland is next, at 77%, an increase of 25 percentage points since 2000. The share of guest accommodation sold to foreigners in West Iceland, Northwest Iceland, and the West Fjords has soared in the recent term, with the percentage of bed-nights sold to foreign nationals rising by 30, 24, and 19 percentage points, respectively, since 2010. In West Iceland, Northwest Iceland, and the West Fjords, the share has risen above 50% only recently (either in 2011 or in 2012); therefore, until then, more than half of bed-nights in these areas were sold to Icelanders. The increased impact of foreign tourists on regional Iceland is therefore obvious.

Seasonality still a problem in regional Iceland

Figure 34 shows the distribution of sold bed-nights by season and region. Of the 6.67 million bed-nights sold nationwide in 2015, 2.82 million, or 42%, were in the capital area. In regional Iceland, there were 3.85 million bed-nights sold, or 58% of the nationwide total. About 55% of all bed-nights sold nationwide were in June, July, and August, and the share of accommodation sold during these three months is much higher in regional Iceland than in the greater Reykjavík area.

For example, 70% of all bed-nights in regional Iceland were sold during these three months, as opposed to 33% in greater Reykjavík. If bed-nights were distributed equally over the year, the three summer months would account for 25%, but because most people travel during these months, it is natural that they should weigh more heavily than others. Seasonality is therefore not a problem in the greater Reykjavík area.

Outside the capital area, however, it is. Progress has been made, and the share of bed-nights in the peak summer season has fallen from 78% in 2010 to 70%, but this is not enough. Seasonal fluctuations are greatest in the West Fjords, East Iceland, and Northwest Iceland, where the share of bed-nights sold in June, July, and August lies in the 78-82% range.

1 Figures on sold bed-nights for all guest accommodation locations by month in 2015 were not available from Statistics Iceland at the time this report was written. As a result, the seasonal distribution is assumed to have been the same in 2015 as in 2014. It can therefore be assumed that seasonal fluctuations were less pronounced in 2015 than is indicated in Figure 34.
Less seasonal volatility and higher occupancy rates closer to the capital

South Iceland has the largest number of sold bed-nights, at 1.2 million, or 18% of the nationwide total for 2015. Northeast Iceland and East Iceland rank second and third, with 13% and 9%, respectively.

Data on occupancy for all types of accommodation in 2015 were not available at the time this report was written; therefore, hotel occupancy figures are used as a reference. The data show clearly that the regions with the highest occupancy rates are also those with the smallest seasonal fluctuations: greater Reykjavík and the Suðurnes peninsula. In the capital area, the hotel occupancy rate was 78.8%, as opposed to 64.5% for the Suðurnes peninsula. Occupancy has also increased most in these regions since 2010: by 23.5 percentage points in greater Reykjavík and by 24.2 points in the Suðurnes peninsula. Occupancy rates are lower in the regions with greater seasonal fluctuations; i.e., West Iceland, the West Fjords, North Iceland, and East Iceland.

Figures on sold bed-nights for all guest accommodation locations by month in 2015 were not available from Examining occupancy by months in 2010 and 2015 shows how rates have risen in all regions. Over the summer months, the increase has been largest in the Suðurnes peninsula and smallest in North Iceland. In other months, occupancy has improved most in the greater Reykjavík area and the Suðurnes peninsula, and least in East Iceland and North Iceland.

The number of tourists visiting the country has long had a decisive impact on both the hotel market and the market for other accommodation, but in the past five years, that impact has grown noticeably stronger, and the market has grown at a speed previously unheard of. Statistics Iceland’s figures on sold bed-nights show that, during the period from 2000 through 2010, just over 79% of bed-nights were sold to foreign nationals. In 2011 this percentage began to rise, and by 2015, foreign guests accounted for nearly 89% of all bed-nights sold. In 2015, hotels accounted for 2.96 million
sold bed-nights, an increase of nearly 650,000, or 28.1%, year- 
on-year. Bed-nights sold to Icelanders declined by just over 6,500 
in 2015, while sales to foreign nationals increased by 655,000. It is clear, then, that foreign tourists account entirely for growth 
in the hotel market in 2015. These figures show incontrovertibly how the growth of the hotel market is driven by the rise in tourist 
visits to Iceland.

The number of sold hotel bed-nights per tourist declined in 
2011, 2013, 2014, and 2015; therefore, tourists are increasingly 
using other forms of accommodation. This accords with the 
developments portrayed in Figure 32, which shows that hotels’ 
share of total bed-nights declined during these same years.
The capital area hotel market

The number of available hotel rooms has never grown as strongly in a single year as it did in 2015. According to Statistics Iceland, 872 new rooms were added during the year, most of them due to the opening of Foss Hotel Reykjavík, the Kea hotels, Hótel Skuggi, and Hôtel Storm. The company Míðbæjarhótel opened Hótel Míðgarður, and Hôtel Vellir opened in Hafnarfjörður. Several hotels began building, adding on new rooms, among them Hótel Klettur and Hótel Marina. The number of rooms available in the greater Reykjavík area rose by 26.3% in 2015, the largest increase ever recorded. In spite of this extraordinary historical growth in hotel rooms, the number of tourists grew proportionally more in 2015, or by 30.2%, and the hotel room occupancy rate rose from 77.6% to 78.8% as a result.

Seasonal peaks in occupancy continue to even out

Seasonal fluctuations in foreign tourists’ visits to Iceland have begun to even out, and the impact on hotel room occupancy has been positive. This makes investment in the hotel market more profitable than it would be otherwise. But considerable seasonality remains, particularly in hotels outside the greater Reykjavík area. There is good cause to ponder possible ways to smooth out the seasonal peaks and troughs so that investments will be better utilised.

Historically, the hotel market has been subject to considerable seasonal volatility. Occupancy rates have risen as high as 90% in summer and fallen as low as 30% in winter. In the past four years, occupancy has improved greatly over the winter months. There are examples of capital area hotels that are nearing tolerance limits for most of the year.

Investment in the hotel sector has grown strongly in recent years, in tandem with increased demand. But investing in hotel construction is time-consuming, and supply responds to changes in demand with a certain lag. As can be seen, occupancy rates during the winter – such as February and March – are now similar to peak summertime rates. This is a radical change from the previous situation. In March 2010, for instance, the occupancy rate was 53%, while in March 2015 it was 84.8%.

It takes a longer time to bring an idea for a hotel to fruition than it does to realise the idea of taking a holiday. It is partly because of this that excess demand for accommodation has developed – demand that has been met by the sharing economy, among other things. The sharing economy has functioned to an extent as a countercyclical agent, absorbing the enormous number of tourists who have come to Iceland in the recent past.

The number of hotel rooms increased by 217 in 2014 and by 874 in 2015. The number of bed-nights sold in the greater Reykjavík area grew commensurably. Occupancy rates remain high, rising above 90% during the summer.
Are there enough hotels in the capital area?

In order to assess whether the supply of hotel rooms will rise in line with demand, it is necessary to pair the number of new rooms being planned (change in supply) with the estimated increase in tourists (change in demand). If our forecast materialises, over 1.6 million tourists will come to Iceland in 2016, an increase of 29% year-on-year. On the other hand, an estimated 290 new hotel rooms will be available in 2016, an increase of 5.8% in the total supply. As a result, it is likely that for yet another year, the increase in supply will not keep pace with demand. Therefore, two things will happen: the occupancy rate will rise in 2016, and a larger percentage of tourists will seek out non-hotel accommodation.

The figure 42 shows the number of new hotel rooms that are projected to become available in the next few years. The estimate is based on press releases and conversations with operators in the hotel market. It is estimated that through 2019, a total of 2,450 new hotel rooms will be built, provided that all planned projects are completed. The total investment for these projects is more than ISK 55bn. It should be borne in mind that these hotel rooms are at various stages of construction, and it is not at all certain that all of them will be built, as this requires that planning authorities approve changes in zoning where necessary and that financing be obtained. About 298 new hotel rooms are scheduled to become available in 2016, or 66% fewer than became available in 2015. Hotel-related investment in 2016 is estimated at ISK 20.2bn, or 7.5% of projected business investment for the year.
Pressure for new hotels likely to increase

We expect the number of tourists visiting Iceland this year to outpace the rise in the number of new hotel rooms. We estimate that 1,397 new rooms are needed in order to absorb this increased demand and maintain unchanged occupancy rates; however, as is mentioned above, only 298 new rooms are expected this year. This indicates that construction will satisfy only 21% of the demand. For simplification purposes, no consideration is given to other forms of accommodation; furthermore, it is assumed that foreign tourists’ travel habits will remain unchanged in all other respects. This will doubtless lead to a rise in hotel occupancy rates and to increased demand for other types of accommodation. For example, it will stimulate growth in the sharing economy and put even greater pressure on house prices in the areas most frequented by tourists.

Occupancy rates at greater Reykjavík hotels have been very favourable in the recent term. If the aforementioned forecast materialises, hotel occupancy will rise to a historical peak in 2016. A large number of hotel rooms are planned for the capital area in the next four years, and developments in the number of tourist visits to Iceland over that period will remain the major determinant of whether it is financially sound to build at any given time.

Figure 45. Number of new rooms needed to meet the increase in tourists in 2016

- **Number of rooms needed in 2016**: 1,014 rooms
- **Increase in tourists 2016**: 365,962 people
- **Sold bed-nights per tourist**: 1.35 nights
- **New rooms on the market in 2016**: 298 rooms
- **Unchanged occupancy since 2015**: 78.71% occupancy
- **Average number of beds per room**: 2.09 beds
- **Bed-nights per room per year**: 365 nights
- **Number needed in 2016 to maintain year-2015 occupancy rate**: 716 rooms
- **Supply of bed-nights needed to maintain this occupancy rate**: 627,652 nights per year
- **Supply of bed-nights needed to satisfy increased demand**: 494,049 nights per year

Source: Statistics Iceland, ÍSB Research
Where is the capital area hotel market headed in coming years?

In order to estimate the next few years’ developments in the capital area hotel market more accurately, three scenarios are used, based on differing assumptions concerning developments in key factors. Scenario I assumes that the rise in tourist numbers will remain strong but that the proportional growth rate will ease somewhat in coming years. This scenario provides for the construction of 2,450 new hotel rooms over the next four years. Scenario II assumes that the number of tourists will decline in 2017, which could occur if the tourism sector sustains some sort of shock, such as a natural disaster or an economic downturn. Scenario III assumes that growth in the number of tourist visits will slow markedly in coming years, much more so than is assumed in Scenario I.

Given the accumulated increase in both hotel rooms and tourist visits since 2003, according to Scenario I, the number of tourists will rise well in excess of the supply of hotel rooms. According to Scenario III, the increase in these two variables is better aligned.

In view of the uncertainty about growth in tourist numbers in coming years, it is interesting to examine the hotel market’s sensitivity to tourist numbers. According to Scenario I, occupancy and average hotel room prices will continue to rise for the next two years and then decline in 2019. Under this scenario, the supply of hotel rooms will not satisfy demand; therefore, tourists will continue to seek out other types of accommodation. Scenario I assumes that for all years, hotel occupancy rates in the capital area will remain high, average prices will be high, and the sharing economy will grow.

According to Scenario II, it is assumed that investors will respond by cutting back on hotel investment. It can also be assumed that average hotel prices will fall in tandem with declining occupancy rates, making hotel accommodation a more competitive option for tourists than it would otherwise be. The market would adjust to circumstances to a large degree, thereby cushioning against the contraction in tourist numbers. According to Scenario III, hotel occupancy rates can be expected to reach equilibrium at around 75%, assuming that all hotels currently planned are built.

Figure 46. Scenario I - Accumulated growth in tourists and hotel rooms from 2003

Figure 47. Scenario II - Accumulated growth in tourists and hotel rooms from 2003

Scenario I - Strong growth

<table>
<thead>
<tr>
<th>Year</th>
<th>Rise in number of tourists %</th>
<th>Rise in number of tourists</th>
<th>Rise in number of hotel rooms</th>
<th>Tourists per room</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>29%</td>
<td>365,962</td>
<td>298</td>
<td>1,228</td>
</tr>
<tr>
<td>2017</td>
<td>25%</td>
<td>406,975</td>
<td>544</td>
<td>748</td>
</tr>
<tr>
<td>2018</td>
<td>20%</td>
<td>406,975</td>
<td>798</td>
<td>510</td>
</tr>
<tr>
<td>2019</td>
<td>15%</td>
<td>366,278</td>
<td>810</td>
<td>452</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>1,546,190</td>
<td>2,450</td>
<td>631</td>
</tr>
</tbody>
</table>

Figure 48. Scenario I - number of new rooms and occupancy rates

Figure 49. Scenario I - estimated impact of changes in occupancy and average daily rate on hotel revenues
Scenario II - Contraction

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Rise in number of tourists (%)</th>
<th>Rise in number of tourists</th>
<th>Rise in no. of hotel rooms</th>
<th>Tourists per room</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>29%</td>
<td>346,053</td>
<td>298</td>
<td>1,158</td>
</tr>
<tr>
<td>2017</td>
<td>-5%</td>
<td>-341,859</td>
<td>544</td>
<td>(628)</td>
</tr>
<tr>
<td>2018</td>
<td>4%</td>
<td>-6,186</td>
<td>798</td>
<td>(8)</td>
</tr>
<tr>
<td>2019</td>
<td>4%</td>
<td>70,993</td>
<td>100</td>
<td>740</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td>1,740</td>
<td></td>
</tr>
</tbody>
</table>

Figure 50. Scenario II – number of new hotel rooms and occupancy

Source: Statistics Iceland, Icelandic Tourist Board, ÍSB Research

Scenario III - Modest growth

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Rise in number of tourists (%)</th>
<th>Rise in number of tourists</th>
<th>Rise in no. of hotel rooms</th>
<th>Tourists per room</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>29%</td>
<td>365,962</td>
<td>298</td>
<td>1,228</td>
</tr>
<tr>
<td>2017</td>
<td>15%</td>
<td>244,185</td>
<td>544</td>
<td>449</td>
</tr>
<tr>
<td>2018</td>
<td>10%</td>
<td>187,209</td>
<td>798</td>
<td>235</td>
</tr>
<tr>
<td>2019</td>
<td>4%</td>
<td>82,372</td>
<td>810</td>
<td>102</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>879,727</td>
<td>2,450</td>
<td></td>
</tr>
</tbody>
</table>

Figure 52. Scenario III – number of new hotel rooms per year and relationship to occupancy

Source: Statistics Iceland, Icelandic Tourist Board, ÍSB Research

Figure 51. Scenario II - estimated impact of changes in occupancy and average daily rate on hotel revenues

Source: Statistics Iceland, Icelandic Tourist Board, ÍSB Research

Figure 53. Scenario III - estimated impact of changes in occupancy and average daily rate on hotel revenues

Source: Statistics Iceland, Icelandic Tourist Board, ÍSB Research
Tourism in Iceland

The historical relationship between average price and occupancy

Examining the relationship between occupancy and average price of hotel rooms in the greater Reykjavík area as shown in historical data reveals a strong correlation between changes in occupancy and average price. When occupancy rates lie in the 30-60% range, average prices remain broadly unchanged. If occupancy ranges between 60% and 80%, however, there is a strong correlation between changes in occupancy and average price. In this range, a change of +/− 1% in occupancy is generally associated with a rise/fall in average price of about ISK 330 (EUR 2.3). When occupancy rates fall, hotel operators have a tendency to lower prices in order to bring them back up. By the same token, there is a tendency to raise prices when occupancy rises. In Stockholm, Copenhagen, and Oslo, changes in occupancy have a less marked impact on average prices. In Stockholm, average prices change by EUR 0.5 for each percentage point change in occupancy. In Copenhagen, average prices change by EUR 0.6, and in Oslo they change by EUR 0.3.

The relationship between hotel occupancy and average prices in Nordic capitals

As Figure 55 indicates, the relationship between occupancy and average room rates is weaker in other Nordic capitals than in Reykjavík. This suggests that price steering is more effective in Iceland, which could be because seasonal fluctuations are more pronounced and there is a greater need to reduce prices during off-peak periods and raise them again during the peak season. The hotel market in Reykjavík is therefore more volatile than that in other Nordic capitals. Furthermore, a larger proportion of Nordic hotel guests are domestic customers and a larger proportion are business travellers and conference attendees, whose travel is not as subject to seasonal fluctuation as tourist travel is.

Figure 54 illustrates the relationship between occupancy and average room rates in the greater Reykjavík hotel market. The interaction between these two variables grows more sensitive when occupancy rates are high; therefore, changes in occupancy affect average prices more strongly when the occupancy rate is high than when it is low.

International comparison

Eurostat compiles figures on sold hotel bed-nights in EU countries. In comparison with 28 countries in the EU, Iceland stands out with a larger proportional month-on-month increase in sold bed-nights on an annualised basis.

According to Eurostat data for 2014, among the Nordic countries, seasonal variability in sold bed-nights is greatest in Iceland. In the greater Reykjavík area, seasonal fluctuations in occupancy have diminished since 2011, whereas they have remained broadly unchanged over the same period in the other Nordic capitals.

Figure 54. Relationship between occupancy and average daily rate (ADR) in Nordic capitals, in EUR

Source: Statistics Iceland, Benchmarking Alliance, ISB Research
Figure 55. Month-on-month % change in sold bed-nights, 2009-2015

Figure 56. Seasonal fluctuations in hotel occupancy rates, 2011

Figure 57. Seasonal fluctuations in hotel occupancy rates, 2015

Figure 58. Seasonal fluctuations in sold bed-nights, 2014
Data from Benchmarking Alliance show that, among Nordic capitals, the increase in available hotel rooms in 2015 was greatest by far in Reykjavík. The second-largest spike in hotel room availability was in Copenhagen during the period 2011-2012.

The average price, or average daily rate (ADR), has risen more in Reykjavík than in the other capital cities in recent years. The ADR in Reykjavík has risen from EUR 80 to EUR 119 since 2011, or by 49%. At the same time, hotel occupancy in Reykjavík has risen from 63.8% to an average of 78.8%, or 15 percentage points.

Average hotel room prices fluctuate more in Reykjavík than in the other Nordic capitals. As is mentioned above, this highlights the more pronounced seasonality and price steering in the Icelandic hotel market than in the other Nordic markets. The average off-peak price was around EUR 60 in 2011 and is now in the EUR 80-100 range. Over the same period, the average peak price has risen from approximately EUR 110 to EUR 167. The peak season ADR in Reykjavík is therefore considerably higher than that in other Nordic capitals.

### Table 1. Average daily rate (ADR), Reykjavík hotels

<table>
<thead>
<tr>
<th></th>
<th>2011</th>
<th>2015</th>
<th>% change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rooms</td>
<td>100</td>
<td>100</td>
<td>0</td>
</tr>
<tr>
<td>ADR in EUR</td>
<td>80</td>
<td>119</td>
<td>49</td>
</tr>
<tr>
<td>Average occupancy</td>
<td>63.8%</td>
<td>78.8%</td>
<td>23</td>
</tr>
<tr>
<td>Exchange rate</td>
<td>153</td>
<td>140</td>
<td>-8</td>
</tr>
<tr>
<td>Bed-nights sold</td>
<td>23,290</td>
<td>28,747</td>
<td>23</td>
</tr>
<tr>
<td>Accommodation revenues in EUR</td>
<td>1,863,193</td>
<td>3,420,951</td>
<td>84</td>
</tr>
<tr>
<td>Accommodation revenues in ISK</td>
<td>285,068,579</td>
<td>478,933,084</td>
<td>68</td>
</tr>
</tbody>
</table>

Source: Statistics Iceland, Central Bank of Iceland, Benchmarking Alliance
Average occupancy in Reykjavík hotels has risen in recent years and is now close to 80%. It has risen sharply in Copenhagen as well and is now similar to that in Reykjavík.

Comparing revenue per available room (revPAR) across Nordic capitals reveals that revPAR has risen most in Reykjavík since 2011, or by 83%. RevPAR in Reykjavík has risen from the lowest in the Nordic region in 2011 to the highest. In Copenhagen it has risen by 39% since 2011, while in Stockholm it has grown only marginally and in Oslo it has declined slightly. RevPAR is the metric that is most used to estimate the profitability of hotel operations.
Accommodation through the sharing economy growing rapidly

The increase in tourist numbers has created increased demand for hotel rooms and other types of accommodation. Some of the demand for accommodation is met with space in residential housing, which is offered through the sharing economy. Because investment in hotels and guesthouses has not kept pace with the growth in visitor numbers – particularly in the most popular destinations, such as greater Reykjavík – there has been scope for strong growth in the sharing economy in the recent term.

Accommodation listings on Airbnb up 126% in less than a year

As of end-November 2015, a total of 2,681 properties in Reykjavík were listed on Airbnb, as opposed to 1,188 in December 2014, an increase of 126% in less than a year. Of the 2,681 accommodations listed in November, 1,944 were classified as active. Active listings are categorised as is shown in Table 2. Most spaces on offer are defined as one-room flats, followed by single rooms. In the latter case, the renter does not have private use of the flat but rents a single room within it. Only 34 properties are defined as a common area, such as a sofa-bed in the living room. More than three out of four listings are two-room flats or single rooms. Figure 65, which shows the location of most of the listings, indicates that the majority are in downtown Reykjavík and neighbourhoods nearby.

Bed-nights sold through Airbnb about 20% of sold hotel bed-nights

Over the twelve-month period beginning in November 2014, a total of 89,500 nights were sold through Airbnb in properties listed in Reykjavík. If it is assumed that the number of guests was in line with the permissible maximum in each instance, the number of bed-nights sold over this twelve-month period is estimated at 357,600. In comparison, 1,782,000 hotel bed-nights were sold in the capital area over the same period. Bed-nights sold through Airbnb therefore equal about 20% of hotel bed-nights sold in greater Reykjavík. Figure 64 shows the distribution of sold bed-nights over the period from October 2014 through November 2015, by month.

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2 Flats are defined as active or inactive by Airbnb Data Analytics (Airdna) in accordance with specific criteria, including when the listing was last updated, when the flat was last listed as available for rent and when it was last rented out, and how quickly customers’ queries are answered. A flat is defined as inactive if it no longer appears on the website, if information on availability dates has not been updated for two months, or if the landlord’s response to queries is poorer than 20% over a specified period.

3 A bed-night is defined by Statistics Iceland as follows: each guest who stays overnight is counted each night he/she is present.
33% of peak season bed-nights sold via Airbnb

Over the twelve-month period beginning in November 2014, the most bed-nights sold through Airbnb were in August, or 63,200. In comparison, 189,000 bed-nights were sold in capital area hotels in August 2015; therefore, the number of bed-nights sold via Airbnb was about a third of those sold in hotels during the same month. The ratio of Airbnb bed-nights to hotel bed-nights is therefore higher during the peak season. This is hardly surprising, given that about half of all tourists come to Iceland at that time. Hotel occupancy is also highest during the peak season, making it difficult for hotels to meet demand. This stimulates demand for other types of accommodation, including residential housing via Airbnb.

In 2015, about 60% of all bed-nights sold through Airbnb were sold during the four-month period beginning in June. The occupancy ratio of Airbnb spaces is also the highest over this four-month period. Occupancy during the period shown in Figure 66 peaked in August 2015 at 69%.

*The occupancy rate is the number of days a guest space is rented out over a given period divided by the number of days it was advertised for rent over the same period.*

Figure 65. Location of Airbnb listings in greater Reykjavík

Source: Airdna
Sold bed-nights more than trebled in October 2015

In October 2015, the number of bed-nights sold [via Airbnb] was up by about 22,000 year-on-year. The increase measured 225% and the number of sold bed-nights more than trebled. Occupancy rates rose by some 10 percentage points year-on-year in October 2015. During that same month, the increase in bed-nights sold in greater Reykjavík hotels measured 29% year-on-year. The sharing economy is therefore growing more rapidly in the capital area than the hotel sector is.

Total Airbnb revenues about 15% of hotel revenues

During the twelve-month period beginning in November 2014, total revenues deriving from Airbnb-listed accommodation in Reykjavík amounted to ISK 2.22bn. Capital area hotels’ revenues over the same period totalled ISK 14.5bn. Revenues generated via Airbnb over those twelve months therefore totalled just over 15% of hotel revenues for the same period. Bed-nights sold through Airbnb amount to about 33% of sold hotel bed-nights over the same period. It is therefore clear that each bed-night sold through Airbnb generates less revenue. Revenue per sold Airbnb bed-night can be seen in Figure 67.

Over the four months beginning in June 2015, revenues from Airbnb listings totalled ISK 1.35bn, or 61% of total revenues for the twelve-month period. In comparison, capital area hotels’ revenues from June 2015 onwards amounted to 51% of total revenues for the same twelve-month period. Therefore, seasonality is more of a factor in the Airbnb market than in the hotel market.

In October 2015, total revenues through Airbnb rose by ISK 115m year-on-year, or 202%. Revenues have therefore grown proportionally less than bed-nights over the same period, as each night was less expensive, on average, in October 2015 than in the same month in 2014. Therefore, revenues more than trebled over this period without any price increases, and growth is driven entirely by an increase in the number of visitors, indicating how rapidly this market has expanded.

Average length of stay via Airbnb 3.3 nights

The average length of stay among Airbnb guests is 3.3 nights, and stays are generally longer during the colder months of the year. This accords with the results of the survey conducted by the Icelandic Tourist Board among foreign visitors to Iceland, which indicate that 40.4% of tourists stay 3-4 nights in the greater Reykjavík area.

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1 Based on the USD/ISK exchange rate as of 21 January 2016.
The car rental market

The car rental market has expanded rapidly in recent years, as private cars are one of tourists’ main means of transport in Iceland, and the rental fleet must keep pace with the rise in tourist visits. The fleet does not necessarily expand in line with the number of tourists in any given year, but the two variables do track one another over longer periods of time. If there is a discrepancy between the number of tourists and the size of the fleet at any given time, rental agencies have other ways of adapting; for instance, by increasing car utilisation, although this is possible only to a degree and is not desirable for long periods.

Actually, it can be considered normal that growth in tourist numbers and expansion of the rental fleet should not correlate in real time, as expanding the rental car fleet is an expensive investment. Such an investment must be well prepared and financed, and in the past five years, forecasts of year-on-year growth in tourist numbers have been such that market agents have probably been cautious so as to avoid overinvestment based on unrealistic expectations. This may be about to change, however. In this context, it is worth mentioning that while the rental fleet expanded relatively little between 2013 and 2014 (by 7%, as opposed to a 24% increase in tourist numbers), it jumped between 2014 and 2015, almost keeping pace with the rise in tourist visits (26% versus 30%). This is probably due to both expansion and renewal, as the need for both had probably become acute by that time. Furthermore, the experience of the past five years has shown that forecasts of growth in tourist numbers have been realistic – relatively modest, if anything – so that operators have begun to trust that the forecasts will materialise and have been willing to invest accordingly.

But tourists are not car rental agencies’ only customers, as the market for rental to Icelanders is also growing. Such cases often involve long-term leasing to firms, institutions, and individuals, although there is some short-term rental as well. This is more often the case with larger rental agencies, as most of the smaller ones rely almost entirely on the tourist market. Car rentals’ revenue flows fluctuate in line with this; i.e., there is still a marked seasonal pattern among all rental agencies, although it is less pronounced for operators that also rent to Icelanders. Fortunately, however, tourist traffic has grown more even throughout the year, and wintertime car rental has become more common than it used to be. As a result, revenue flows in the car rental market are less subject to seasonal peaks and are more tenable on an annual basis.

The years since 2009 have been volatile ones for operators in the rental car market, largely because of natural disasters and changes in the regulatory framework. Clearly, the Eyjafjallajökull eruption in 2010 affected car rental agencies as it did others. The initial impact was negative, but later on the advertising value of the eruption appears to have compensated for it. Another eruption took place in Grímsvötn in 2011, and that same year the bridge over the Múlakvísl river collapsed during a sub-glacial outburst flood, destroying a part of Route 1, the so-called Ring Road that many tourists travel in rented vehicles. As regards the regulatory environment, since 2010 there have been a virtually uninterrupted series of amendments made to the laws and regulations governing car rental operations. For the most part, the changes centre on reduced excise taxes on new vehicles purchased by rental agencies, but the amount of the tax reduction has been raised and lowered by turns, fees qualifying agencies for the excise tax reduction have been introduced, and so on. Amendments to the Government’s fiscal budget proposal for 2016 were announced, capping the excise tax reduction at ISK 500,000 per new car purchased, whereas the previous maximum had ranged up to ISK 1,250,000. The licensing fees entitling agencies to the excise tax relief ranged from ISK 1,750,000 to ISK 6,750,000, but have now been abolished, two years after they were imposed. But it should be noted that the tax concession providing for reduced excise taxes on new cars is subject to numerous and stringent conditions, including requirements concerning ownership and use of the vehicles concerned. Furthermore, this does not mean that rental agencies pay no excise tax on the vehicles they purchase. On the contrary: they pay some tax on most of the cars they buy.

Active car rental agencies on the rise

The number of operating permits issued to car rental agencies trebled between 2003 and 2014, rising from 51 to 151. This correlates almost exactly with the rise in tourist visits, which has also trebled over the same period. It therefore appears that there is a strong correlation between the two variables in the long run, although in individual years there are discrepancies that could stem, for instance, from expectations of strong tourist traffic – as in 2010, for example – and a rise in the number of operators seeking to serve that market.

Given this correlation, it would have been appropriate to expect a significant increase in operating licenses in 2015, as tourist numbers were projected to grow and new car rental agencies could be expected to open their doors. But the number of agencies was virtually unchanged between 2014 and 2015, rising from 151 to 152. The number of licence holders was therefore broadly unchanged since 2013, when there were 149 licensed car rental agencies.
These numbers do not necessarily tell the whole story, however, as not all licence holders are active in the market. Therefore, it is useful to determine how many licence holders actually have rental cars registered to them and to compare these data between 2014 and 2015. This gives an indication of the change in the number of verifiably active operators in the market. Such an examination reveals that of the 152 entities licensed to operate car rental agencies in 2015, only 111 have at least one vehicle registered to them according to the motor vehicle register. Of those, only 49-62 have operations of any size, with 10-20 vehicles registered in their names.

Figure 70 shows the number of operators with one or more cars, 10 or more, 20 or more, and 50 or more, together with a comparison between 2014 and 2015. Furthermore, this could explain why there was virtually no increase in the number of licence holders between 2014 and 2015, in spite of the rise in tourist numbers. It could be that there was some thinning in the sector, with inactive licence holders dropping out of the market and new ones taking their place.

The number of tourists visiting Iceland is projected to rise by 29% between 2015 and 2016, and it is not unlikely that the number of car rental agencies will rise as well. Whether this affects the number of issued licences is unclear, however, because as is mentioned above, inactive operators could drop out and be replaced by new ones. It is quite likely, though that the number of active rental agencies will rise during the year.
The rental car fleet

Strong growth in rental fleet in 2015

An estimated 4,756 rental cars were on the road in Iceland during the peak season in 2006. The number began to grow rapidly after 2009, and by 2014 there were 12,179 rented vehicles on the road. The rental fleet was forecast to grow to just over 14,000 but actually expanded to 15,401 as of 13 August 2015. This equates to a 26% increase year-on-year, versus a 30% increase in the number of foreign tourists travelling through Keflavík Airport.

As is mentioned above, this jump between 2014 and 2015 is apparently due to an accumulated need for expansion and renewal. Given the developments in tourist numbers over the past few years, the rental fleet would have needed to grow faster and be renewed more at certain points in time – between 2013 and 2014, for instance – but because this was not done, there was greater strain on the cars, owing to increased mileage driven and higher utilisation rates. As a result, rental agencies were forced to expand more between 2014 and 2015 in order to maintain their fleet and provide service to the increased number of customers.

It is assumed that the fleet will expand by about 20% in 2016, to a peak of nearly 18,500 vehicles during the summer. The number of tourists visiting Iceland is expected to rise by 29%. If these forecasts materialise, the number of tourists and the rental car fleet will both have quadrupled since 2006.

The rental car fleet has grown more rapidly than the nationwide fleet of private vehicles; therefore, the number of rental cars relative to the total passenger car fleet has risen somewhat in recent years. Rental cars accounted for 2.4% of all passenger vehicles in Iceland in 2006 and 6.8% in 2015. Rental cars as a share of all passenger cars had therefore nearly trebled over this period. If the size of the rental fleet develops as forecast in 2016 and the total nationwide passenger vehicle fleet grows as it has in recent years, the ratio of rental cars to the total fleet will rise still further, to about 7.5-8.0%. This is close to our estimate (8.3%) of the ratio of tourists to total inhabitants at any given time.

It is still cause for concern that listings of rental agencies’ cars in the motor vehicle register are often incorrect. A large number of cars are listed in the motor vehicle register as belonging to rental agencies, although they actually are not rentals. This includes cars that were once part of the rental fleet but, upon being sold, have not been transferred from the rental register to the private vehicle register. Official data show 18,290 rental cars as of 13 August 2015, but of that total, 2,077 are registered to individuals and another 812 are clearly not rentals even though they are registered to legal entities. The result is therefore that there were 15,401 correctly registered rental cars and 2,889 incorrectly registered.

![Figure 71. Number of registered rental vehicles](source: Icelandic Transport Authority)

**Table 2. Proportion of rental vehicles to total passenger vehicle fleet**

<table>
<thead>
<tr>
<th>Model</th>
<th>Rentals</th>
<th>Total</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>4,756</td>
<td>197,305</td>
<td>2.4%</td>
</tr>
<tr>
<td>2007</td>
<td>4,843</td>
<td>207,513</td>
<td>2.3%</td>
</tr>
<tr>
<td>2008</td>
<td>5,649</td>
<td>209,740</td>
<td>2.7%</td>
</tr>
<tr>
<td>2009</td>
<td>5,736</td>
<td>205,338</td>
<td>2.8%</td>
</tr>
<tr>
<td>2010</td>
<td>6,572</td>
<td>204,736</td>
<td>3.2%</td>
</tr>
<tr>
<td>2011</td>
<td>7,888</td>
<td>206,112</td>
<td>3.8%</td>
</tr>
<tr>
<td>2012</td>
<td>9,641</td>
<td>210,070</td>
<td>4.6%</td>
</tr>
<tr>
<td>2013</td>
<td>11,418</td>
<td>213,113</td>
<td>5.4%</td>
</tr>
<tr>
<td>2014</td>
<td>12,179</td>
<td>217,454</td>
<td>5.6%</td>
</tr>
<tr>
<td>2015</td>
<td>15,401</td>
<td>226,321</td>
<td>6.8%</td>
</tr>
</tbody>
</table>

Source: Icelandic Transport Authority, Statistics Iceland
The twenty largest agencies own 85% of the rental fleet

In our last Tourism Industry Report, we included a list of the number of vehicles owned by the 10 largest agencies in the market in 2014. For 2015, this list has now been expanded to include the 20 largest operators and a comparison between 2014 and 2015. The survey shows that of the 15,401 rental cars in the fleet, 13,076, or 84.9%, are owned by the 20 largest operators in the market, up slightly from 2014, when 84.5% of the fleet was owned by the largest operators. The share owned by the very largest rental agencies appears to have declined between years, but by a hardly discernible margin. On the whole, most agencies appear to be growing in line with the overall year-on-year growth in the fleet. However, this is not necessarily an accurate indicator of market share, which also depends on many other factors, including fleet utilisation.

These figures do not include agencies that list their cars anonymously in the motor vehicle register, which means that batch runs from the register, like that used for this study, do not name them as owners or operators of the vehicles concerned. A total of 757 cars are registered anonymously, but most of them belong to a single rental agency and the others belong to a number of smaller agencies.

### Table 4. Distribution of the car rental fleet among the 20 largest rental agencies

<table>
<thead>
<tr>
<th>Name of rental agency</th>
<th>Number 2014</th>
<th>Share of total</th>
<th>Number 2015</th>
<th>Share of total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bílaleiga Akureyrar / Europcar</td>
<td>3,333</td>
<td>27.40%</td>
<td>3,842</td>
<td>24.90%</td>
</tr>
<tr>
<td>Avis / Budget</td>
<td>1,781</td>
<td>14.60%</td>
<td>2,063</td>
<td>13.40%</td>
</tr>
<tr>
<td>Hertz</td>
<td>1,455</td>
<td>11.90%</td>
<td>1,778</td>
<td>11.50%</td>
</tr>
<tr>
<td>Sixt</td>
<td>687</td>
<td>5.60%</td>
<td>1,049</td>
<td>6.80%</td>
</tr>
<tr>
<td>Dollar / Thrifty</td>
<td>587</td>
<td>4.80%</td>
<td>758</td>
<td>4.90%</td>
</tr>
<tr>
<td>Blue Car Rental</td>
<td>272</td>
<td>2.20%</td>
<td>495</td>
<td>3.20%</td>
</tr>
<tr>
<td>Bílaleiga Reykjavikur</td>
<td>319</td>
<td>2.60%</td>
<td>406</td>
<td>2.60%</td>
</tr>
<tr>
<td>Procar</td>
<td>305</td>
<td>2.50%</td>
<td>397</td>
<td>2.60%</td>
</tr>
<tr>
<td>Green Motion Iceland</td>
<td>159</td>
<td>1.30%</td>
<td>395</td>
<td>2.60%</td>
</tr>
<tr>
<td>Enterprise / Red</td>
<td>127</td>
<td>1.00%</td>
<td>305</td>
<td>2.00%</td>
</tr>
<tr>
<td>SAD Cars</td>
<td>207</td>
<td>1.70%</td>
<td>273</td>
<td>1.80%</td>
</tr>
<tr>
<td>Rent Nordic</td>
<td>224</td>
<td>1.80%</td>
<td>270</td>
<td>1.80%</td>
</tr>
<tr>
<td>CC bílaleiga</td>
<td>192</td>
<td>1.60%</td>
<td>229</td>
<td>1.50%</td>
</tr>
<tr>
<td>Route 1 Car Rental</td>
<td>120</td>
<td>1.00%</td>
<td>134</td>
<td>0.90%</td>
</tr>
<tr>
<td>SS bílaleiga</td>
<td>128</td>
<td>1.10%</td>
<td>134</td>
<td>0.90%</td>
</tr>
<tr>
<td>Átak</td>
<td>100</td>
<td>0.80%</td>
<td>123</td>
<td>0.80%</td>
</tr>
<tr>
<td>Hasso Iceland</td>
<td>69</td>
<td>0.60%</td>
<td>120</td>
<td>0.80%</td>
</tr>
<tr>
<td>Lagoon Car Rental</td>
<td>0</td>
<td>0.00%</td>
<td>115</td>
<td>0.70%</td>
</tr>
<tr>
<td>KúKú Campers</td>
<td>85</td>
<td>0.70%</td>
<td>110</td>
<td>0.70%</td>
</tr>
<tr>
<td>Icerental 4x4</td>
<td>45</td>
<td>0.40%</td>
<td>80</td>
<td>0.50%</td>
</tr>
<tr>
<td></td>
<td>13,076</td>
<td>84.90%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Icelandic Transport Authority
**Rental fleet dominated by recent-model cars**

On average, 50% of the vehicles owned by Iceland’s 10 largest rental agencies were new in summer 2015, although the pace at which agencies in this group renewed certainly varied – some had over 70% new cars and others closer to 30%.

On the whole, Iceland’s nationwide rental fleet is relatively new, although some of the cars are rather old. About 64% of the total fleet consisted of one- to two-year-old cars in summer 2015, and 87% were five years old or less. The other 13% of the rental fleet – 2,064 vehicles – were more than five years old, and 958 of these (6% of the fleet) were more than 10 years old.

Of the entire fleet of passenger cars in the country, however, only 13-15% are five years old or less.

Car rental agencies are under no restrictions as regards the age of their vehicles. It is only required that the cars be in good condition and meet the demands generally made of them. The vehicles must be listed as rentals in the motor vehicle register and must undergo an annual inspection, as all cars do, but they are not subject to any more monitoring than other vehicles.

**Table 5. Age distribution of rental car fleet**

<table>
<thead>
<tr>
<th>Model</th>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>6,027</td>
<td>39.1%</td>
</tr>
<tr>
<td>2014</td>
<td>3,898</td>
<td>25.3%</td>
</tr>
<tr>
<td>2013</td>
<td>1,659</td>
<td>10.8%</td>
</tr>
<tr>
<td>2012</td>
<td>1,234</td>
<td>8.0%</td>
</tr>
<tr>
<td>2011</td>
<td>519</td>
<td>3.4%</td>
</tr>
<tr>
<td>2010</td>
<td>321</td>
<td>2.1%</td>
</tr>
<tr>
<td>2009</td>
<td>95</td>
<td>0.6%</td>
</tr>
<tr>
<td>2008</td>
<td>231</td>
<td>1.5%</td>
</tr>
<tr>
<td>2007</td>
<td>267</td>
<td>1.7%</td>
</tr>
<tr>
<td>2006</td>
<td>192</td>
<td>1.2%</td>
</tr>
<tr>
<td>2005</td>
<td>246</td>
<td>1.6%</td>
</tr>
<tr>
<td>2004</td>
<td>159</td>
<td>1.0%</td>
</tr>
<tr>
<td>2003</td>
<td>120</td>
<td>0.8%</td>
</tr>
<tr>
<td>2002</td>
<td>74</td>
<td>0.5%</td>
</tr>
<tr>
<td>2001</td>
<td>77</td>
<td>0.5%</td>
</tr>
<tr>
<td>2000 and older</td>
<td>282</td>
<td>1.8%</td>
</tr>
<tr>
<td></td>
<td>15,401</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

Source: Icelandic Transport Authority
Most common makes

Iceland’s rental car fleet includes a number of makes, although a few of them constitute the majority. Agencies own at least 1,000 each of the six most common makes.

If these makes are traced to the dealerships that sell them, it is possible to determine roughly how much of the rental fleet each dealership supplies. It should be noted, though, that the figures do not indicate each dealership’s share in new car sales to rental agencies but only the number of vehicles from each dealership that are part of the rental car fleet at a given point in time. Furthermore, some imports circumvent domestic dealers; therefore, not all vehicles have entered the market via direct sale from the dealership in question, which account for a combined 63.7% of the total fleet.

<table>
<thead>
<tr>
<th>Type</th>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>TOYOTA</td>
<td>2,441</td>
<td>15.8%</td>
</tr>
<tr>
<td>SUZUKI</td>
<td>2,096</td>
<td>13.6%</td>
</tr>
<tr>
<td>HYUNDAI</td>
<td>1,587</td>
<td>10.3%</td>
</tr>
<tr>
<td>VOLKSWAGEN</td>
<td>1,417</td>
<td>9.2%</td>
</tr>
<tr>
<td>SKODA</td>
<td>1,157</td>
<td>7.5%</td>
</tr>
<tr>
<td>KIA</td>
<td>1,117</td>
<td>7.3%</td>
</tr>
<tr>
<td>FORD</td>
<td>770</td>
<td>5.0%</td>
</tr>
<tr>
<td>CHEVROLET</td>
<td>719</td>
<td>4.7%</td>
</tr>
<tr>
<td>NISSAN</td>
<td>703</td>
<td>4.6%</td>
</tr>
<tr>
<td>RENAULT</td>
<td>472</td>
<td>3.1%</td>
</tr>
<tr>
<td>DACIA</td>
<td>359</td>
<td>2.3%</td>
</tr>
<tr>
<td>OPEL</td>
<td>328</td>
<td>2.1%</td>
</tr>
<tr>
<td>MITSUBISHI</td>
<td>206</td>
<td>1.3%</td>
</tr>
<tr>
<td>MERCEDES-BENZ</td>
<td>209</td>
<td>1.4%</td>
</tr>
<tr>
<td>SUBARU</td>
<td>184</td>
<td>1.2%</td>
</tr>
<tr>
<td>JEEP</td>
<td>182</td>
<td>1.2%</td>
</tr>
<tr>
<td>MAZDA</td>
<td>171</td>
<td>1.1%</td>
</tr>
<tr>
<td>CITROEN</td>
<td>156</td>
<td>1.0%</td>
</tr>
<tr>
<td>HONDA</td>
<td>150</td>
<td>1.0%</td>
</tr>
<tr>
<td>PEUGEOT</td>
<td>116</td>
<td>0.8%</td>
</tr>
<tr>
<td>LAND ROVER</td>
<td>192</td>
<td>1.2%</td>
</tr>
<tr>
<td>DODGE</td>
<td>103</td>
<td>0.7%</td>
</tr>
<tr>
<td>AUDI</td>
<td>102</td>
<td>0.7%</td>
</tr>
<tr>
<td>SSANGYONG</td>
<td>55</td>
<td>0.4%</td>
</tr>
<tr>
<td>VOLVO</td>
<td>55</td>
<td>0.4%</td>
</tr>
<tr>
<td>Other</td>
<td>354</td>
<td>2.3%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>15,401</strong></td>
<td><strong>100.0%</strong></td>
</tr>
</tbody>
</table>

Conventional energy sources still dominant

According to our last Tourism Industry Report, the Icelandic rental car fleet was powered by conventional energy sources; i.e., 99.9% of vehicles were petrol- or diesel-powered. This has changed very little between years, and nearly all rental cars are equipped with petrol and diesel engines, although diesel vehicles have gained slightly at the expense of petrol vehicles.

It is unsurprising that rental cars should rely on conventional energy sources, as there is little incentive for agencies to shift from fossil fuels to alternative energy sources such as electricity or methane. One of the main hindrances is the lack of charging and filling stations for electric or methane-powered cars, particularly in regional Iceland; furthermore, there is no financial incentive for agencies to shift from conventional to alternative fuels.
This does not mean the fleet is not growing more environment-friendly, however. Diesel and petrol engine technology has been advancing rapidly in recent years, and cars are now more fuel-efficient and emit less CO2 than before. Examining average CO2 emissions by vehicle age (year of model) reveals a continuous decline in emissions as cars grow younger. Average emissions from the entire fleet are 150g of CO2, with one- to three-year-old cars well below that average. This average level of emissions would place the fleet as a whole in CO2 emissions category E as defined by the authorities.

### Investment, turnover, and labour force

Car rental agencies are extremely investment-intensive, as they rely entirely on the purchase and regular replacement of their fleet. As regards purchase patterns, agencies are shifting towards buying cars more evenly throughout the year, owing in large part to improved seasonal distribution of tourist visits to the country. The spring remains a peak buying time, however, while sales of used rental cars usually take place in autumn and winter.

### ISK 22bn in vehicle purchases in 2016

Iceland’s ratio of rental cars to sold new cars ranged from 5-25% from 1999 through 2009 and then jumped in 2010, and from 2010 through 2015 rentals accounted for 42% of sold new cars. In 2015 the ratio rose slightly, to 43%. The outlook for 2016 is for this pattern to continue, with rental cars accounting for about 43% of sold new vehicles.

### Table 7. Rental car emissions on the decline

<table>
<thead>
<tr>
<th>Model</th>
<th>Average CO2 emissions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998</td>
<td>233</td>
</tr>
<tr>
<td>1999</td>
<td>201</td>
</tr>
<tr>
<td>2000</td>
<td>218</td>
</tr>
<tr>
<td>2001</td>
<td>210</td>
</tr>
<tr>
<td>2002</td>
<td>212</td>
</tr>
<tr>
<td>2003</td>
<td>228</td>
</tr>
<tr>
<td>2004</td>
<td>212</td>
</tr>
<tr>
<td>2005</td>
<td>210</td>
</tr>
<tr>
<td>2006</td>
<td>197</td>
</tr>
<tr>
<td>2007</td>
<td>205</td>
</tr>
<tr>
<td>2008</td>
<td>200</td>
</tr>
<tr>
<td>2009</td>
<td>167</td>
</tr>
<tr>
<td>2010</td>
<td>177</td>
</tr>
<tr>
<td>2011</td>
<td>169</td>
</tr>
<tr>
<td>2012</td>
<td>154</td>
</tr>
<tr>
<td>2013</td>
<td>150</td>
</tr>
<tr>
<td>2014</td>
<td>143</td>
</tr>
<tr>
<td>2015</td>
<td>140</td>
</tr>
</tbody>
</table>

**Source:** Icelandic Transport Authority

### Figure 74. Number of vehicles sold and rental cars as percentage of total sold

[Graph showing percentage of vehicles sold by year for Individuals and firms and Car rental agencies, with labels and data points indicated.]
About 15,300 new passenger cars were sold in 2015, about 6,600 of them to rental agencies. In 2016, car sales are estimated at 17,500, including about 7,500, or just under 43%, sold to rental agencies. This does not include imports that circumvent domestic car dealers and are registered in Iceland as used cars. In 2015, for instance, some 1,250 vehicles, including 350 rental cars, entered the market in this way.

The average price for a new rental car in 2015 was just under ISK 3m exclusive of value-added tax, which means that rental agencies invested roughly ISK 19.5bn in motor vehicles last year, a rather large percentage of total turnover in the sector. Sales projections for 2016 indicate that rental agencies’ investment in cars will approach ISK 22.5bn, or 8.4% of total business investment for the year, according to our forecast. This figure represents only direct investment in the fleet itself. Other investments include tyres, spare parts, fuel, and the housing and other facilities needed for a growing fleet and operations. Car rentals are subject to the highest value-added tax rate, and all things considered, the sector generates substantial direct and indirect revenues for the Treasury.

Turnover has quadrupled since 2008

Turnover in the car rental sector has risen sharply in recent years, in line with growth in overall activity. According to figures from Statistics Iceland, turnover has quadrupled since 2008, to ISK 33bn in 2015.

About 900 employed in the rental sector

It is difficult to determine exactly how many people are directly employed in the car rental sector, as itemised records of this type are not maintained. It is safe to say, however, that the number of people employed in the sector has grown in line with the level of activity and rises to seasonal peaks during the summer. It is estimated that as many as 900 people currently work in the car rental business.

Prospects are good

As is described above, the rental car business has grown by leaps and bounds in recent years, as has the tourism industry as a whole, and there have inevitably been growing pains as well. Today, however, many car rental companies are financially strong and enjoy economies of scale to a greater degree than before. Until now there have been few mergers in the sector; instead, each operator has been able to expand alongside the market, although this is not always easy in such an investment-intensive business. Mergers are unlikely to occur in the market until the long-term equilibrium number of tourists can be determined.

In the immediate future, the outlook for the car rental market appears strong. If forecasts concerning tourist numbers are borne out, demand for rental vehicles will be strong enough that there will be sufficient need for an expanding fleet – and perhaps more than enough work on hand for operators, as they undertake the investment needed to expand their fleet and acquire the necessary facilities for it.

The main foreseeable risks, perhaps, relate to the resale of used rental cars in the general market. It is difficult to project where the threshold lies; i.e., when the fleet has grown large enough that the domestic market ceases to absorb the number of cars that must be sold off each year to accommodate renewal. As yet, however, there are no signs that this threshold will be reached in the near future. If the tourism industry sustains a major shock – such as a natural disaster or an economic contraction – that causes a steep drop in tourist visits, car rental agencies could suffer just as other operators in the sector would, but it is difficult to say how much change must take place in order for the entire tourism industry to suffer. Car rental activities rely on large-scale investment, and if business is too weak to sustain that investment for a period of time, rental agencies could face difficulties. On the other hand, it should be noted that operators in the sector have grown financially stronger in recent years and are better able to withstand shocks, and they should be able to adapt to change in a relatively short time.

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1 Figures are based on industry classification 77.11 and preliminary figures for January-October 2015, plus estimates for November-December 2015, exclusive of VAT.
Shocks to the tourism industry

Iceland’s tourism industry has grown faster in recent years than most other sectors of the economy. Tourism has driven a large part of the economic recovery that began in 2010 and has grown commensurably in its importance to the economy. This increase in importance can be seen in a number of ways, not least in the generation of foreign currency, where tourism is now the country’s leading sector. The industry’s ability to generate foreign currency is much greater than in most other economies. Tourism has also grown markedly in its importance to the labour market, as the sector is relatively labour-intensive. It has therefore played a large part in reversing the post-crisis spike in unemployment.

The increased importance of tourism to the Icelandic economy has diversified both the country’s foreign exchange revenues and the general economy. This should enhance economic stability in the long run. On the other hand, increased activity in the tourism industry has made the Icelandic economy more vulnerable to shocks to the sector. Such shocks could take many forms, including natural disasters and economic downturns or crises. Other examples are geopolitical shocks and terrorist attacks. Research on the impact of terrorist attacks shows that the effects are quite localised and temporary, and that the tourism industry’s recovery time from such attacks is growing shorter. There are several recent examples of this in neighbouring countries. In Iceland, however, experience is concentrated in economic shocks and natural disasters. In general, shocks to the tourism industry teach the lesson that the sector must always be prepared for them and that development should be carried out so as to distribute the risk of shocks as widely as possible.

Tourism sensitive to the business cycle

The global economic recession in 2008 is a recent example showing clearly how a worldwide economic downturn can affect tourist numbers and the tourism industry in general. After more than 6.5% growth in the number of international travellers and 5.7% global GDP growth in 2007, growth in tourism measured only 1.9% and GDP growth only 3.1% in 2008. GDP growth was broadly flat in 2009, and the number of travellers declined by 4.0%. The contraction was greater in the number of travellers to developed economies, particularly the US and Europe, where the banking crisis made the most impact. It surfaced in all segments of tourism, but particularly in business travel.

In line with increased global GDP growth, tourist numbers began to rise again in 2010. The number of travellers grew by 6.6% and GDP growth measured 5.4%. In Iceland, there was weak growth in tourist numbers in 2008, followed by a contraction in both 2009 and 2010. The contraction came on the heels of relatively swift growth in the number of travellers to Iceland during the pre-2008 upswing, much of it due to business travel.

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The global economic outlook has been deteriorating in the recent past. For example, according to the International Monetary Fund’s (IMF) January forecast, GDP growth will be 0.2 percentage points weaker in 2016 and 2017 than was assumed in the Fund’s October forecast. Nonetheless, the IMF projects that GDP growth will pick up, measuring 3.4% this year and 3.6% next year, up from 3.1% in 2015. Furthermore, the World Tourism Organization forecasts 4.4% growth in the number of international travellers this year. Among the economies that produce the most visitors to Iceland, the IMF expects the US economy to grow somewhat more rapidly this year and next year than in 2015. The Fund expects GDP growth to be broadly unchanged year-on-year in the UK and slightly stronger in Germany. On the whole, the IMF forecast indicates that GDP growth in the home countries of the majority of Iceland’s tourists will remain relatively unchanged year-on-year or pick up slightly in comparison to 2015. Alongside this, oil prices have fallen steeply in the recent term. Lower oil prices have created the scope for reduced airfares and tend to increase households’ purchasing power by lowering their petrol and oil costs. This functions as a spur to travel.

The interplay between global economic developments and tourism in Iceland underlines the importance of developing a tourism sector based on a broad spectrum of visitors from a number of different economies. This will reduce the likelihood that an economic shock in one economy will wreak havoc on the Icelandic tourism sector.

Currency exchange rates: a major determinant of travel patterns

Tourism is strongly affected by developments in the real exchange rate. The impact can be felt in the number of travellers, the length of their stay, and their spending while at their destination. The real exchange rate of the ISK has risen considerably during the tourism upswing of recent years. In terms of relative consumer prices, in Q4/2015 the real exchange rate of the ISK was 37% above its post-crisis trough in 2008. Since then, the rise in the real exchange rate has doubtless cut into the number of tourists visiting Iceland, particularly those who are most price-sensitive. Nevertheless, the number of tourists visiting Iceland has grown enormously at the same time as the real exchange rate has been rising.

The effect of the real exchange rate on tourists’ travels and spending is more complex than would first appear. Research carried out by the IMF shows that changes in the real exchange rate of a tourist’s home country often have as much impact as changes in the real exchange rate of the destination country. This can be seen, for instance, in the surge in the number of Icelanders travelling abroad during the recent rise in the real exchange rate of the ISK. For example, Icelanders’ overseas travel has increased by 77% since 2009, yet the real exchange rate has been rising over that period. Furthermore, growth in tourist visits to Iceland has been greatest among people from economies with a rising real exchange rate, including the US and the UK, where the real exchange rate of the domestic currency has been on the rise. Tourists from the eurozone have increased in number as well, but to a much lesser degree.
In addition, the euro has been depreciating against the US dollar, and many American tourists stop over in Iceland on their way to the eurozone. In those cases, it is possible that the decline in the euro vis-à-vis the dollar is the determining factor and the rise in the real exchange rate of the ISK is less important. In this context, research shows that the number of tourists and their length of stay is less sensitive to fluctuations in the real exchange rate in small economies than in larger ones. This probably applies in cases where American travellers to Europe schedule a stopover in Iceland.

Actually, a number of important economic factors apart from the real exchange rate in the home country are at work here: alongside the rise in the real exchange rate, the overall economy and households’ position in the home country are usually improving. Icelandic households’ financial position has improved markedly since 2009, and not only from the standpoint of the factors measured by the real exchange rate, but also as regards assets, household debt, unemployment, and labour participation. Improvements in these areas have enabled a larger number of Icelanders to travel overseas. The same can be said of both British and American households, albeit to varying degrees.

The growth of the Icelandic tourism sector makes the domestic economy more sensitive to economic developments in tourists’ home economies. For instance, the upswing in the US and UK doubtless plays a part in the recent tourism boom in Iceland. By the same token, a downturn in these countries could have a strong impact on Icelandic tourism and could affect the Icelandic economy more than has been seen previously.

The rise in the number of American and British tourists visiting Iceland in recent years is larger than can be explained by economic developments, including the real exchange rate. A total of 243,000 American tourists came to Iceland in 2015, as opposed to 40,000 in 2008. This is a nearly 500% increase, whereas the real exchange rate of the US dollar has risen by about 23% over the same period. The increase in flight availability and destinations in air travel between Iceland and both the US and other countries is certainly a major factor. Furthermore, Iceland has been widely advertised abroad, including in the US. For example, the proportion of Americans who fly to Europe has risen from 0.3% in 2008 to 1.9% in 2015. In a manner of speaking, Iceland as a travel destination has increased its market share in Americans’ travel to Europe over this period, which has seen an across-the-board rise in European travel by Americans. As a result, it unlikely that the Icelandic tourism sector would collapse if the US economy should weaken or if the real exchange rate of the US dollar should fall because of a depreciation against the euro. That said, such a development would affect the flow of American travellers to Iceland and, given the large proportion of Americans among tourists in Iceland – nearly one in five in 2015 – would affect the sector. The same applies to the UK: if the UK economy should deteriorate and the real exchange rate of the pound sterling should fall, the number of British travellers to Iceland would be affected, as would the revenues they generate. British nationals were the second-largest group of foreign visitors to Iceland in 2015, at 19% of all tourists.
Natural disasters: both a blessing and a curse

Because of Iceland’s geographical location, its tourism sector depends largely on air traffic. About 89% of tourists who visited Iceland in 2015 came by air. The vast majority of this air traffic is routed through Keflavík Airport. A large proportion of tourism revenues also come from transporting passengers between Europe and the United States, with an intermediate stop at KEF. As a result, Iceland’s tourism sector is more vulnerable to interruptions in air traffic than that in many other economies where tourism is based on a range of transportation options. Iceland is situated on a hot spot on the divergent boundary between two tectonic plates on the Mid-Atlantic Ridge, where two large plates are moving away from one another. This makes the country an active volcanic island. As a result, Iceland is by nature a threat to air traffic. The volcanic eruption at Eyjafjallajökull in the first half of 2010 is a reminder of this and a recent example of the impact of such natural phenomena on air traffic and tourism, both in Iceland and elsewhere.

The Eyjafjallajökull eruption caused a 1.1% contraction in tourist visits to Iceland in 2010, whereas international travel worldwide grew by 6.6%. The decline was most pronounced during the peak of the eruption, in April and May 2010, when tourist numbers were down 17.6% on an annualised basis. During this period, a portion of Iceland’s air traffic was re-routed from KEF to other airports, including Akureyri and Egilsstaðir. A number of international airlines were affected by the eruption. Of airlines headquartered in Iceland, Icelandair estimates that it lost 20% of scheduled flights and was forced to reschedule 180 flights. Iceland Express estimates that it lost 100 flights as a result.

The tourism industry did not record positive growth again until the end of 2010. The following year saw a virtual tidal wave, however, with visitor numbers up 15.7%, far in excess of the rise in tourism worldwide and the largest increase seen in Iceland in a quarter-century. The eruption had drawn international attention and advertised Iceland and its natural environment as an interesting travel destination. In this sense, the Eyjafjallajökull eruption marked the beginning of the tourism boom that is unparalleled in Icelandic history and has made tourism the important economic sector that it is today. Other factors have certainly contributed to this development, but experience has shown that natural disasters such as the Eyjafjallajökull eruption can be both a curse and a blessing for the tourism industry.
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