

Chronicle of economic events 2005

January

The personal income tax paid to the Treasury was cut by 1 per cent as of the beginning of the year, from 25.75 per cent to 24.75 per cent. This was done with Act no. 129/2004 that included a number of other amendments to tax legislation. The personal income tax will be cut by another 1 per cent as of the beginning of 2006 and by 2 per cent in 2007. The average municipal income tax collected under the PAYE system rose from 12.83 to 12.98 per cent as of the beginning of the year, for a total PAYE rate of 37.73 per cent in 2005, as against 38.58 per cent in 2004.

The net wealth tax on individuals and businesses will continue at an 0.6 per cent rate in 2005 on net assets at the end of 2004 in excess of 4,983,140 krónur for an individual and double that amount for a couple. This tax is being fully abolished as of 2006.

Child benefits were amended as follows (in krónur per year):

	2004	2005	2006	2007
For all children under the age of seven ¹	36,308	37,397	46,747	56,096
Children under the age of sixteen:				
First child.....	123,254	126,952	139,647	139,647
Each additional child.....	146,713	151,114	166,226	166,226
Benefits for single parents:				
First child.....	205,288	211,447	232,591	232,591
Each additional child.....	210,854	216,902	238,592	238,592
Income threshold for benefit curtailment:				
For couples.....	1,444,139	1,487,463	1,859,329	2,231,195
For a single parent.....	722,070	743,732	929,665	1,115,598
Curtailment of benefits:				
For one child.....	3%	3%	3%	2%
For two children.....	7%	7%	7%	6%
For three children or more.....	9%	9%	9%	8%

1. These benefits are not linked to income.

The personal income surtax is cut from 4 per cent in 2005, based on 2004-income, to 2 per cent in 2006, based on income in 2005. The 2005-tax is imposed on taxable income in 2004 in excess of 4,191,686 krónur for an individual and 8,383,272 krónur for a couple. As of 2006, the surtax will be abolished.

The special tax credit for seamen will be 768 krónur per day in 2005.

The interest rebate maximum in respect of homeowners' interest expenses incurred in buying their own home is set at 161,064 krónur in 2005, after taking into account that the paid-out rebate will be 95 per cent of the calculated entitlement. This percentage is being increased from 90 per cent in 2004. For a single parent the rebate maximum is 207,140 krónur and 266,353 krónur for a couple. The calculated rebate is subject to ceiling of debt, income and net wealth as follows: (1) They can not exceed 5.5 per cent of the remaining debt balance incurred in buying a home for one's own use. As of 2006, on interest expenses incurred in 2005, the ceiling will be reduced from 5.5 per cent to 5 per cent. (2) The maximum amount of interest payments that qualify for an interest rebate calculation is 494,782 krónur for an individual, 649,544 krónur for a

single parent and 804,304 for a couple. (3) Six per cent of taxable income is subtracted from the interest expense. (4) The rebates begin to be curtailed at a net worth threshold of 3,721,542 krónur for a single individual and 6,169,097 krónur for a couple and are eliminated altogether at a 60 per cent higher amount.

The per capita tax that raises revenue for the Elderly's Construction Fund, a fund that finances the construction and, in part, the operation of nursing homes and assisted care facilities for the elderly, is 5,738 krónur per person in 2005. The tax applies to all persons from the age of sixteen to seventy. Those with an annual income under 855,231 krónur in 2004 are exempt from the tax.

As of the beginning of the year, all social security and unemployment payments were raised by 3 per cent.

February

On February 10th, Standard & Poor's, the credit rating agency, raised its rating for the Republic of Iceland's debt in foreign currency from A+ to AA- with a stable outlook. In its commentary the agency observed: "The upgrade reflects significant and sustained improvements in the resilience and structure of the Icelandic banking sector, as well as the positive perspective for public finances, which should lead to a rapid decline in general government debt levels." The full text of the agency's report is reproduced on the Central Bank's website and may be accessed [here](#).

On February 18th, the Central Bank announced an 0.5 per cent increase in its policy rate, from 8.25 to 8.75 per cent, effective as of February 22nd. The Bank's press release may be accessed [here](#).

On February 28th, the Ministry of Finance and the Association of Academics (BHM) signed a pay agreement that covers 24 unions within the Association. The agreement is for the period beginning last February 1st up to April 30th 2008. The pay increases are identical with those that have been negotiated in the general labour market and are assessed at a cost increase of 19.83 per cent. The agreement calls for a single unified wage rate table for all the unions, which is a new feature. The table is without seniority increases and each government agency is expected to conclude an in-house agreement with all unions with employees within said agency. This makes all pay issues easier, both for the state as well as for its agencies. As an example, the University Hospital (Landspítali) has had to conclude fourteen different pay agreements with those unions that have employees in the hospital. By adopting a single wage rate table, the scope is opened for reducing the gender difference in pay that up to now has existed due to different wage rate tables. It has often been argued that the gender pay differences are due to different wage rate tables of unions that value the labour contribution of different professions. The single wage rate table thus constitutes an important step in eliminating pay differences that can not be explained by factors other than gender.

The total cost increase of 19.83 per cent includes special funds for the effort of eliminating gender-based pay differences. In addition, funds are appropriated for the first half of 2006 and 2007 for compensating the replacement of the present seniority increases. In order to ensure that the total cost will stay within the 19.83 per cent limit, the contracting parties commit themselves to jointly resolve the changes necessary. On behalf of the Ministry of Finance, a special team will be established to assist agencies in this task.

The consent of the Ministry of Finance to the agreement is predicated on the consent of all the unions represented by the Association of Academics covered by the agreement. The above agreement is not expected to upset the overall assumptions behind the fiscal budget.

March

On March 22nd the Central Bank announced that it would increase its policy interest rate by 0.25 per cent to 9 per cent as of March 29th. The Bank's report regarding the increase may be accessed [here](#).

May

On the 3rd of May, Statistics Iceland announced that it has amended the basis for calculating the interest cost in the housing component of the consumer price index. Previously, this item had been calculated as a moving average of interest rates over the past five years. As of May, the interest rate will be calculated on the basis of a moving average of the past twelve months. This change in the rate will mean that the consumer price index will be 0.45 per cent lower in May than it otherwise would have been. The full news release of Statistics Iceland may be accessed [here](#).

On May 11th, the Act no. 87/2004 on the diesel tax and the weight-distance tax was amended. The diesel tax was reduced by 4 krónur, from 45 to 41 krónur per litre. The reduction will be in effect from July 1st, when the tax comes into effect, until the end of the year. Including the value added tax, the retail price of diesel oil will be 5 krónur lower than it otherwise would have been. The goal of this temporary tax cut is to offset the rise in the world price of diesel oil in recent month. Diesel oil is at present unusually expensive in the world market in relation to petrol. This is expected to lead to a revenue loss for the Treasury of 160 million krónur this year.

June

The Central Bank announced on June 3rd that it would raise its policy rate by 0.5 percentage points to 9.5 per cent. The Bank's press release may be accessed [here](#).

July

On July 1st, the amended taxation of diesel fuel and diesel-powered vehicles took effect. The amended taxation was embodied in Act no. 87/2004 which was passed in May 2004 and is outlined in the Chronicle of Economic Events 2004 (see [here](#)). The Act was amended in May of this year (see above) when the diesel oil tax was temporarily reduced by 4 kr.

The Central Bank of Iceland has revised the currency weights in the basket that the Bank uses to calculate the exchange rate index of the króna. Weights are determined on the basis of Iceland's external trade in 2004. The last revision was made in July 2004. Revised currency weights and the changes from the previous weights are shown in this [table](#). The aim is for the basket to reflect as closely as possible the composition of Iceland's external trade in goods and services. Main changes from the previous basket are that the weight of the US dollar has increased by 1.19 percentage points and the weight of the euro has decreased by 1.23 percentage points. The increased weight of the dollar is mainly explained by its larger share in service imports. The decrease in the weight of the euro is largely due to a lower level of service imports, but the weight of goods imports declined as well.

Moody's Investors Service, the rating agency, confirmed Iceland's credit rating of Aaa on July 19th. This rating applies to all debt of Iceland's Treasury, both in foreign and domestic currency. The rating has remained unchanged since October 21st 2002 when it was upgraded from Aa3 which was assigned on July 30th 1997. Prior thereto, the rating of A1 was in effect from June 24th 1996. A summary of Moody's rating report is available [here](#).

August

On August 4th, Fitch Ratings confirmed the credit rating of Iceland's Treasury of AA- for its long term debt in foreign currency and AAA for its debt in Icelandic krónur. For short term foreign debt, a rating of F1+ was assigned. The press release of the rating agency may be found [here](#).

September

On September 6th, the Treasury formally sold Iceland Telecom to a private investor and was paid 67.7 billion krónur on the same day, 32.2 billion of which was in foreign currency and 32.5 billion in Icelandic krónur. On the same day, the Government decided how to allocate the proceeds. It decided that the foreign share of the sale proceeds would go towards reducing foreign Treasury debt. The remainder, 32.5 billion krónur would be used for various domestic investment projects, mainly in the years 2007-2012. The main elements of expenditure will be:

- Fifteen billion will be used for road construction in 2007-2010.
- Eighteen billion will be used to begin construction of a high-tech addition to the University Hospital in Reykjavik in 2008-2012.
- Three billion will go towards the purchase or lease of a coast guard vessel and aircraft.
- A fund used for supporting start-up companies will receive 2.5 billion in order to go into joint investment ventures with pension funds.
- The nation's communications network will be strengthened with a 2.5 billion appropriation.
- One billion krónur will be used to support housing for the mentally disabled.
- One billion krónur is appropriated for a new building that will house the manuscript collection of Árnastofnun, the institute that safeguards the manuscripts of the Icelandic sagas.

A more detailed outline and timing schedule of the Government's expenditure decision may be accessed in Icelandic [here](#).

The Central Bank announced on September 8th that it would increase its regular purchases of foreign currency in the domestic market from 2.5 million to 10 million US dollars a week as of September 12th. This is done because the Minister of Finance decided to increase repayments of the Treasury's foreign debt beyond the earlier repayment schedule.

On September 29th the Central Bank announced that it would increase its policy rate by 0.75 per cent to 10.25 per cent as of October 4th. The Bank has thereby raised its policy rate by 4.95 per cent from May 2004. The Bank news release may be accessed [here](#).

October

On October 3rd, Minister of Finance Árni M. Mathiesen presented the 2006 fiscal budget proposal. Revenue is projected at 327 billion krónur, expenditure 313 billion and the revenue surplus 14 billion. On the same date, the Ministry of Finance issued a [new economic forecast](#) for 2005-2007 along with a projection up to 2010.

Standard & Poor's, the credit rating agency, issued an updated credit rating for the Republic of Iceland on October 31st. The rating was unchanged from its earlier assessment last February. The long-term foreign currency rating remained at AA-, after having been raised last February from A+. The short-term local currency rating is A-1+, assigned in May 1998 and the long-term local currency rating is AA+. The full text of the report of Standard & Poor's is reproduced on the Central Bank's website and may be accessed [here](#).

November

The Confederation of Icelandic Employers and the Icelandic Confederation of Labour signed a revision of their earlier wage agreement on November 15th. The revision provides for a 0.65 per cent wage increase across the board in January 2007 and a one-time 26,000 krónur payment in December of this year. Furthermore, the minimum guaranteed wage increases to 108.000 krónur a month at the beginning of 2006 and to 110.000 krónur at the beginning of 2007. The full text of the agreement (in Icelandic) may be found [here](#).

In conjunction with the above agreement, the Government issued a policy statement of its intent to implement certain measures to facilitate the conclusion of the agreement. The Government's statement (in Icelandic) may be accessed [here](#). The main points of the Government's statement are as follows: (1) The Government intends to assist pension funds in equalising their burden of disability pensions. For this purpose, a sum equivalent to 0.25 per cent of the social security tax base will be appropriated and phased in over a period of three years, 0.15 per cent in 2007, 0.20 per cent in 2008 and 0.25 per cent in 2009. (2) Retraining of unskilled labour will be strengthened and training support will be extended to foreign labour in the country. The cost is estimated at 100 million krónur in 2006. (3) The Government intends to pass legislation on contractual labour hiring agencies before the Christmas recess of the Althingi this year. (4) The Government intends to amend unemployment compensation so as to relate compensation to income, which up to now has not been the case. Recipients will receive 70 per cent of their pay prior to losing their job for the first three months of unemployment, except for the first ten days when they will only receive basic compensation which will amount to 96,000 krónur a month. The income-related compensation can amount to a maximum of 180,000 krónur, which is equivalent to 70 per cent of close to 260,000 krónur in monthly income.

On November 29th the Althingi passed the 2005 supplementary budget bill. Revenue is estimated to increase by 102.2 billion krónur from the original budget to 408.6 billion and expenditure by 21 billion to 317.4 billion. The revenue surplus is estimated to amount to 91 billion of which 58.4 billion represents revenue over book value from the sale of Iceland Telecom. Excluding those proceeds, the revenue surplus is estimated at 33 billion which is equivalent to 3.4 per cent of the forecast nominal GDP for 2005.

December

On December 2nd, the Central Bank announced an increase of 0.25 per cent in its policy rate, to 10.5 per cent, effective as of December 6th. The Bank's news release may be accessed [here](#).

The 2006 fiscal budget was passed on December 7th. Revenue is estimated at 334.6 billion, increasing by 7.2 billion from the budget proposal, all due to a revision of revenue estimates in light of latest economic indicators. Expenditure is estimated at 315.1 billion, increasing by 1.9 billion from the budget proposal. The revenue surplus amounts to 19.5 billion and is estimated to be equivalent to 1.9 per cent of the forecast GDP for 2006. The fiscal budget proposal as well as the fiscal budget itself may be accessed on the Ministry's budget website [here](#).