

## 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 <sup>1</sup> .....	36,308	37,397	46,747	56,096
<b>Children under the age of sixteen:</b>				
First child.....	123,254	126,952	139,647	139,647
Each additional child.....	146,713	151,114	166,226	166,226
<b>Benefits for single parents:</b>				
First child.....	205,288	211,447	232,591	232,591
Each additional child.....	210,854	216,902	238,592	238,592
<b>Income threshold for benefit curtailment:</b>				
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
<b>Curtailment of benefits:</b>				
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 10<sup>th</sup>, 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."

On February 18<sup>th</sup>, 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 22<sup>nd</sup>.

On February 28<sup>th</sup>, 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 1<sup>st</sup> up to April 30<sup>th</sup> 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 22<sup>nd</sup> the Central Bank announced that it would increase its policy interest rate by 0.25 per cent to 9 per cent as of March 29<sup>th</sup>. The Bank's report regarding the increase may be accessed [here](#).

## **May**

On the 3<sup>rd</sup> 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 11<sup>th</sup>, 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 1<sup>st</sup>, 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 3<sup>rd</sup> 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 1<sup>st</sup>, 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 the accompanying [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 19<sup>th</sup>. This rating applies to all debt of Iceland's Treasury, both in foreign and domestic currency. The rating has remained unchanged since October 21<sup>st</sup> 2002 when it was upgraded from Aa3 which was assigned on July 30<sup>th</sup> 1997. Prior thereto, the rating of A1 was in effect from June 24<sup>th</sup> 1996. Moody's rating report may be accessed on its [website](#) and a summary in Icelandic is available [here](#).

## August

On August 4<sup>th</sup>, 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](#) and an Icelandic summary is available [here](#).

## September

On September 6<sup>th</sup>, 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](#).