

Chronicle of economic events

2004

January

The PAYE tax rate remained nearly unchanged from the year before at 38.58 per cent compared with 38.54 per cent in 2003. The Treasury's share remained unchanged at 25.75 per cent and the average municipal income tax collected under the PAYE system increased by 0.03 per cent to 12.83 per cent. The annual tax-free income threshold was increased from 835,019 to 855,895 krónur.

All reference thresholds for income tax, net wealth tax, child benefits and interest rebates were raised by 2.5 per cent at the beginning of the year. The ceiling on interest payments that qualify for the interest rebate is being reduced to from 7 per cent to 5.5 per cent of debt in order to reduce the incentives to increase household debt. This will take effect from the beginning of 2005. For 2004, the interest rebates will be cut by 10 per cent. The tax provisions for international trading companies with a venue in Iceland will be abolished as of the beginning of 2008. The International Trading Company Act, no. 31/1999, will be abolished as of the same date. The personal income surtax was extended for the next two years but during that period it will be reduced in stages until it is eliminated at the end of 2005. The surtax will be reduced to 4 per cent on 2004-income and to 2 per cent on 2005-income.

Social security and unemployment benefits increased by 3 per cent as of the beginning of the year.

As of the beginning of 2004, the employer option of deducting the 0.4 percentage points of the social security tax in order to apply it as a counter-contribution to an employee's saving of 4 per cent of wages in a supplementary pension scheme was abolished. This incentive was first introduced at the beginning of 1999 when employers could deduct 0.2 percentage points for such a purpose. The deduction was increased to 0.4 per cent in May 2000. Since then, such employer counter-contributions had become a part of wage agreements in most cases. It was no longer felt that such a tax incentive was needed.

On January 15th, the Ministry of Finance published its revised economic forecast from last autumn. One of the main conclusions was that economic growth in 2003 was estimated to have been 2½ per cent, which is ¾ per cent higher than previously forecast. Growth in 2004 was expected to be 3 per cent, ½ per cent lower than had been forecast last autumn, inflation 2½ per cent and unemployment 3 per cent.

March

On March 7th, SA – the Confederation of Icelandic Employers – signed a four-year wage agreement with two groups of blue-collar labour unions (Starfsgreinasambandið and Flóabandalagið) that cover the bulk of unskilled and skilled labourers in the country. The agreement has thereby become a leading indicator for wage developments for the rest of the country, even if several important employee groups, such as commerce employees, seamen and public employees, are not parties to the agreement.

The agreement will lead to an estimated 15 per cent increase in wage costs over the four-year period, as assessed by the collective bargaining parties. All wage rates will increase by ¾ per cent immediately, in addition to a 1 per cent increase in wage costs due to the adoption of a new wage rate table. Wage rates will increase by 3 per cent at the beginning of 2005 and by a further 2½ per cent in 2006, at which time wage costs are expected to increase also by 1 per cent due to the adoption of a new wage rate table when bonus and extra emoluments will be integrated into basic wage rates. Finally, wage rates will increase by ¼ per cent in 2007. Minimum wages will be 100,000 krónur a month from the time of the agreement's signature and increase thereafter in line with other wages.

The contribution of employers to pension funds will increase from 6 per cent to 7 per cent of wages as of the beginning of next year. The obligation of employers to pay 1 per cent into individual retirement accounts – regardless of whether the employee puts savings into such an account or not – will be abolished at the same time. The employer will continue as before to pay 2 per cent into the individual retirement account of an employee to match the employee's 2 per cent contribution. The employer's contribution to common pension funds will increase to 8 per cent as of the beginning of 2007. The cost of these employer pension fund contributions are estimated at 1.1 per cent.

In connection with the wage agreements, the Government declared that it will increase unemployment benefits by 9,000 krónur a month, from 79,767 to 88,767 krónur, as of March 1st. Such benefits will increase thereafter in line with the agreed increase in wage rates, i.e., 3, 2½ and 2¼ per cent as of the beginning of 2005, 2006 and 2007, respectively. The Government also promised that the arrangement to pay for employee retraining schemes that have been in effect since 2000 will be extended to the end of 2007. Such payments will come out of the Unemployment Insurance Fund and will be paid to the retraining schemes of the labour unions in accordance with the proposals of employers and labour unions that are parties to the wage agreement. The Government also declared that it is ready to enter into discussions with employers and the labour unions on pension issues through a special committee that will inquire into the division of labour between pension funds and the social security system. Finally, the Government will reduce the social security tax by 0.45 per cent as of the beginning of 2007 with the stipulation that employers will increase their contribution to common pension funds to 8 per cent at the same time.

The Ministry of Finance estimates that the cost to the Treasury of the wage agreements will amount to 2.7-2.8 billion krónur a year, once all provisions of the Government's commitments have come into effect in the course of the agreement period.

A new Inheritance Tax Act was passed by the Althingi on March 23rd, replacing the earlier Act dating from 1984. The main change from the previous legislation is that henceforth, the inheritance tax rate will be 5 per cent across the board, whereas before the tax differed according to the relation of the inheritor to the deceased. No tax will be paid on the first million krónur of the inherited estate. As regards the valuation of assets, all securities will henceforth be counted at market value. For market securities, the official bid price at the close of markets on the last trading day before the death of person leaving the estate will apply. For other stocks, the equity book value in accordance with the latest audited annual or periodic accounts will apply. In earlier legislation, the nominal value of securities applied for valuation purposes.

On March 28th it was announced that Columbia Ventures Corporation (CVC), the owner of the Norðurál aluminium plant at Grundartangi, had sold the plant to Century Aluminum Company, a US concern.

April

On April 1st it was announced that domestic Treasury bonds, Housing bonds and Housing Authority bonds have become eligible for settlement and custody in Clearstream Banking. The new facility will make it easier for foreign investors to invest in such bonds.

On April 4th, new wage agreement was concluded between Commercial Workers' Union of Reykjavík and the National Association of Commercial Workers on one hand and the Federation of Trade, representing import/export wholesalers, on the other. The new agreement calls for a strengthening of the so-called market-determined wage structure and provides for a 120,000 krónur minimum wage before the beginning of 2007. Employees earning less than 200,000 krónur a month are provided with a 5,000 krónur annual wage increase. The counter-contribution of employers to pension funds will increase to 8 per cent by 2007 and the accident insurance of employees will be reviewed. Employees will have the option of a 30-day annual holiday. The contract is for an indefinite time period. A notice of termination may be lodged by either party every two years, six months in advance.

On April 5th an agreement was signed between the Treasury and the City of Reykjavík on the settlement of pension fund obligations regarding those institutions and agencies that the two parties have been running in joint partnership. The net settlement, based on year-end 2002 data, entailed that the Treasury paid a total of 3.4 billion krónur to the City in the form of government savings bonds issued on April 6th 2004. The settlement does not affect Treasury finances for 2004 since the said obligations have already been expensed in Treasury accounts.

On April 8th, a wage agreement was concluded between the Ministry of Finance and a group of unions representing some 1,400 blue-collar central government employees. The agreement provides for identical raises during the contract period running up to the end of 2007 as in the agreement of the Employer Confederation of March 7th (see above). In addition, an ½ per cent increase will take place at the beginning of 2008. The agreement expires at the end of March of that year. In addition, it was agreed that the government contribution to employee pension funds would increase in stages over the contract period by 5.5 percentage points to 11.5 per cent of wages, as the government pays for its other employees.

On April 17th a contract was signed between Norðurál, the aluminium producer, as buyer, and Reykjavík Energy (Orkuveita Reykjavíkur) and the Suðurnes Regional Heating Company (Hitaveita Suðurnesja) as providers of geothermally produced electricity. The contract will enable Norðurál to double the annual production capacity of its plant at Grundartangi to 180 thous. tonnes. The National Power Company (Landsvirkjun) will provide the capacity for transmitting power from source to buyer. Reykjavík Energy intends to erect geothermally-driven generators at Hellisheiði, near Reykjavík, producing 80 MW. In addition it intends to expand its current power facility at Nesjavellir. The Suðurnes Regional Heating Company intends to erect a 80-100 MW power facility at it Svartsengi site on the Reykjanes peninsula. The investment in power generation and transmission is estimated at about 20 billion krónur and the expansion of the aluminium smelter is expected to cost 23 billion. Based on average aluminium prices in the world market and the present exchange rate, the expansion would generate new exports of 12 billion krónur a year. The contract is for 20 years with the possibility of an extension by a further 10 years.

Landsvirkjun will provide power transmission through an exchange of power capacity with the Reykjavík Energy and Suðurnes Regional Heating Company. Landsvirkjun will provide 100-150 MW of power with a new line from its Sultartangi facility in the Þjórsá river basin to the Norðurál plant in Hvalfjörður. In exchange, the two providers of power will feed their power deliveries into the general Landsvirkjun grid in the south-western part of the country. Landsvirkjun expects to invest 6.6 billion krónur in the power transmission project.

A number of wage agreements were signed in late April by the Confederation of Icelandic Employers and a range of unions in commerce and blue-collar trades, including retail employees, construction workers, metal workers, vehicle repairmen, hotel and restaurant workers. All the agreements are broadly in concert with the agreements signed on March 7th and that the contract period runs until the end of 2007.

A new law was passed by the Althingi on April 29th authorising the Minister of Finance to agree to an increase in the loan facility of the Nordic Investment Bank for projects outside the Nordic area from 3.3 billion to 4.0 billion euros as of July 1st 2004. The owners' surety for this facility remains unchanged, at 1.8 billion euros.

May

On May 6th, the Ministry of Finance published its new economic forecast for 2004 and 2005 including prospects up to 2010. The main conclusion was that the economic upswing is expected to continue in upcoming years. The main explanation for the solid growth prospects was on the one hand a large increase in investment in power-intensive industry and on the other hand a continuation of strong private consumption growth. Growth in 2004 was expected to be 4½ per cent, inflation 2½ per cent and unemployment 3 per cent.

On May 6th the Central Bank decided to raise base rate by 0.2 percentage points to 5.5%, effective at the next auction of repurchase contracts on May 11, 2004.

On May 19th, Fitch Ratings, confirmed Iceland's rating of AA- for foreign long-term debt, AAA for long-term debt in domestic currency and F1+ for short-term foreign debt. The economic outlook was viewed as stable.

On May 28th the Althingi passed a law imposing a tax on diesel oil and a new structure of a weight-distance tax. The main element of the new law, replacing an earlier law dating from 1987, is that a tax of 45 krónur per litre will be imposed on diesel fuel for motor vehicles. Diesel fuel for other purposes will be exempt from the tax and dyed so as to prevent it from being used as motor fuel. A weight distance tax will be imposed on all vehicles in excess of 10 tonnes other than passenger buses. The imposition of the diesel fuel tax replaces an earlier system where there was not excise tax on diesel fuel, whereas all diesel-powered vehicles had to pay a weight-distance tax or a variety thereof.

June

On June 1st the Central Bank announced an increase in its base rate of 0.25 per cent to 5.75 per cent, effective as of June 8th.

On June 7th, Moody's Investor Service, the rating agency, confirmed its Aaa/P1 rating of Iceland with a stable outlook.

The Ministry of Fisheries issued a regulation on June 15th regarding the maximum allowable fish catch in the 2004-2005 fisheries year which begins on September 1st. The catch is in all main aspects in accordance with the recommendation of the Marine Research Institute and for main species is as follows:

Maximum allowable catch

'000 tonnes

	2003-04	2004-05
Cod	209	205
Haddock	75	90
Saithe	50	70
Redfish	57	57
Greenland halibut	23	15
Herring	110	110
Shrimp	21	20

On the same day the Ministry of Fisheries announced an increased in the catch limit for blue whiting of 2004 of 220 thous tonnes to a total of 713 thous. tonne.

July

On July 1st the Central Bank announced an increase in its base rate of 0.5 per cent to 6.25 per cent as of July 6th.

The weights of the Central Bank's exchange rate index were revised on the basis of exchange rates on July 16th. The weight of Europe increased by 2.94 per cent to 73.64 per cent, that of America declined by 2.91 per cent to 22.91 per cent and the weight of Japan declined by 0.03 per cent to 3.45 per cent.

September

On September 17th the Central Bank announced that it would raise its policy rate by 0.5 per cent to 6.75 per cent as of September 21st.

October

The fiscal budget proposal for 2005 was presented to the Althingi at the beginning of the month. Total revenue is estimated at 305.8 billion, expenditure at 294.6 billion and the revenue surplus at 11.2 billion krónur.

A mission of the International Monetary Fund was in Iceland for discussions on the economy during October 20th-25th. The mission issued a closing statement at the end of its visit which may be accessed [here](#).

The Central Bank announced on October 29th that it would raise its policy interest rate by 0.5 per cent to 7.25 per cent as of November 1st.

A wage agreement between fishing boat operators and fishermen was signed on October 30th. The agreement calls for a 17.6 per cent increase in guaranteed pay over the contract period which lasts until 2008.

November

On November 3rd, Norðurál, the aluminium producer announced its decision to increase its proposed expansion of production capacity by 32,000 tonnes. The total production capacity of the company's plant in Hvalfjörður will thus reach 212,000 tonnes a year by the autumn of 2006, making the plant the largest in the country. Sales of electric power to the company will thus increase by 54 MW and will be provided by Reykjavík Energy and the Sudurnes Regional Heating Corporation. A further expansion of 8,000 tonnes is contemplated for the latter half of 2006, calling for a further increase in power supply of 15 MW, which still are subject to negotiation. Furthermore, Reykjavík Energy and Norðurál have decided to explore the possibility for a further 40,000 tonne expansion of the aluminium plant to a total annual production capacity of 260,000 tonnes.

On November 17th a pay agreement was reached between municipalities and elementary school teachers, following a teachers' strike that had lasted since September 20th, save for a few days at the beginning of November, when a proposal by the Government Mediator was being put to a vote and rejected. Following the rejection the strike resumed. Since the disputing parties seemed no closer to agreement the Government stepped in and passed a law on November 14th that cancelled the strike and placed the dispute into the hands of an arbitration panel, should the disputing parties prove unable to reach agreement by November 19th. As it turned out, agreement was reached before the deadline.

The main elements of the agreement are as follows: Salaries increase 5.5 per cent as of October 1st 2004, 3.0 per cent on January 1st 2005, 9.27 per cent on August 1st 2005 (an increase equivalent to three pay grades that are transferred from a previously existing pool of funds that was at the disposal of school principals). Salaries increase also by 2.5 per cent at the beginning of 2006 and 2.25 per cent at the beginning of 2007 and 2008. Teachers will also receive a one-time payment of 130,000 krónur immediately and a further 75,000 krónur on July 1st 2005. Teaching duties will be reduced by one teaching hour as of August 1st 2005 and further by one teaching hour as of August 1st 2007. The agreement will expire at the latest at the end of May 2008.

December

At the beginning of December, a wage agreement was reached between banks and other financial institutions on one hand and the union of bank and financial employees. The union represents mostly clerical employees in the financial sector. The main elements of the agreement were as follows: Pay increases by 5.25 per cent, retroactive to October 1st 2004. All lower-paid employees (pay grade 163 and below, covering approximately 2,400 persons) will get an extra pay grade as of the beginning of 2005, equivalent to a 3.4 per cent increase. All employees will receive a pay increase of 3.75 per cent, 3 per cent and 2.25 per cent at the beginning of the years 2006-2008, respectively. The cumulative pay increase over the agreement period works out to 18.91 per cent for employees in pay grade 163 and below and to 15 per cent for others.

The Central Bank base rate is raised by 1 percentage point to 8.25 per cent as of December 7th. The Bank has thereby increased its base rate by 2.95 per cent since May of this year.