

Box 3

Fiscal budget proposal for 2019

The fiscal budget proposal for 2019 was presented in September. Macroeconomic assumptions have changed marginally since the fiscal plan was submitted this spring, and a few revenue and expenditure items have been revised. Table 1 shows the Statistics Iceland forecast used as a basis for the budget proposal, together with revisions from the previous Statistics Iceland forecast, which was used as a basis for the fiscal plan. For comparison purposes, the forecast in *Monetary Bulletin* 2018/3 is also shown, as it was published at around the same time as the forecast on which the budget proposal was based.

Table 1 Macroeconomic assumptions in the 2019 fiscal budget proposal

	2019 (%)	Change since February (percentage points)	MB 2018/3 (%)
Private consumption	3.9	0.2	3.8
Public consumption	2.1	0.5	1.9
Gross capital formation	4.9	-0.2	6.1
Exports	2.7	-0.7	3.6
Imports	5.1	-0.2	6.2
Gross domestic product	2.7	-0.1	2.7
Consumer price index (CPI)	2.9	0.0	2.8
Exchange rate index	0.3	0.1	-0.9
Wage index	6.0	0.1	5.7

Sources: Fiscal budget proposal 2019, Central Bank of Iceland.

Various assumptions in the 2019 fiscal budget proposal

Wage assumptions: The 2018 National Budget assumed that wages would rise this year by 3.1%. Most wage increases took effect on 1 June 2018. The actual rise in wages will turn out larger, however, owing to the effects of several wage settlements that had not been concluded at the time the budget was prepared. These, plus updated annualised wage increases during the year, raise the wage assumptions for the 2019 budget proposal by 4.1 b.kr. State employees' wage agreements expire on 1 April 2019, and projected wage developments for that year are based on estimated results of those negotiations. The fiscal budget proposal assumes that a 3.4% increase as a result of the wage settlements will take effect on 1 April 2019. The weighted average wage increase for 2019 is estimated at 3.1%.

Price assumptions: The 2018 National Budget assumed that inflation would measure 2.9% during the year. Statistics Iceland has revised its forecast and now projects inflation at 2.7%. There is no precedent for lowering budgetary authorisations because of an overestimation of inflation in the Budget itself; instead, the overage is deducted from the next year's price level update. Statistics Iceland forecasts 2019 inflation at 2.9%, and the price level update for other operating expenditures therefore amounts to 2.7%, after adjusting for the deduction. Operating expenditures generally total about 20-30% of institutions' operating turnover.

Exchange rate assumptions: In the 2019 fiscal budget proposal, foreign-denominated expenditures are calculated based on the average exchange rate in July 2018, which is 1.4% above the exchange rate on which the 2018 National Budget was based. This causes a 500 m.kr. increase in institutions' budgetary authorisations.

Unemployment and social security benefits: The budget proposal assumes that benefits will increase by 3.4% on 1 January 2019. The total cost of these increases is 5.6 b.kr. Furthermore, a special 4 b.kr. increase in disability benefits is planned.

In all, changes to budgetary authorisations in the 2019 budget proposal – i.e., changes in wages, prices, and exchange rates, together with increased unemployment and social security benefits – amount to just over 25 b.kr. (see Table 2).

Table 2 Changes in wages, benefits, prices, and exchange rate in 2019

<i>Accrual basis</i>	
<i>Wage assumptions</i>	<i>B.kr.</i>
Wage increases in 2018 in excess of budgetary assumptions	4.1
Projected wage increases in 2019	9.9
Special resolutions included in 2015 and 2016 wage settlements	0.1
Total wage increases	14.1
Unemployment and social security benefits	5.6
General price level assumptions	5.1
Exchange rate assumptions	0.5
Total change in wages, benefits, price level, and exchange rate	25.3

Source: Fiscal budget proposal 2019.

Furthermore, it is assumed that changes in the tax system, both statutory (already passed into law) and non-statutory (not yet passed into law), will reduce revenues by just over 2 b.kr. (Table 3).

Table 3 Impact of tax changes on Treasury revenues in 2019

<i>Accrual basis</i>	
<i>Statutory changes</i>	<i>B.kr.</i>
Cancellation of discount on rental car excise tax	1.3
Third-pillar savings measure expires at mid-year	1.1
Total	2.4
<i>Non-statutory changes</i>	
Payroll tax reduction, 0.25 percentage points	-4.0
Additional increase in personal deduction and smaller increase in upper tax bracket limit	-1.7
Support for publishing of books in Icelandic	-0.8
Increase in carbon tax, 10%	0.6
Increase in additional income	0.5
Anti-tax fraud measures	1.0
Total	-4.5
Total changes, statutory and non-statutory	-2.1

Source: Fiscal budget proposal 2019.

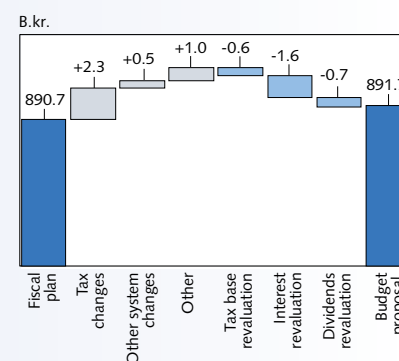
Deviations in budget proposal from the fiscal plan are minor

Based on the assumptions above, the difference between the fiscal budget proposal and the fiscal plan totals only 1 b.kr. on the revenues side and 500 m.kr. on the expenditures side. Both amounts represent increases relative to the fiscal plan. The fiscal budget proposal is therefore very similar to the fiscal plan as regards revenues, expenditures, and outcome.

Changes on the revenues side

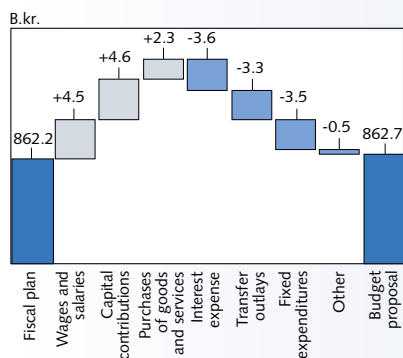
Chart 1 summarises the main changes in revenues from fiscal plan to budget proposal, by type. In the fiscal plan, plans for several changes to the tax system were announced for 2019. These plans changed somewhat by the time the budget proposal for the year was finalised. The planned reduction in income tax is now smaller, and child benefits are to increase. Additional revenues resulting

Chart 1
Change in expected revenue from fiscal plan to budget proposal 2019



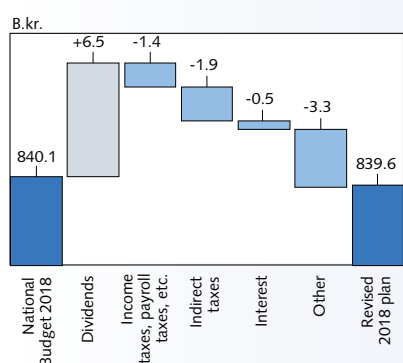
Source: 2019 fiscal budget proposal.

Chart 2
Change in expenditure from fiscal plan to 2019 budget proposal



Source: 2019 fiscal budget proposal.

Chart 3
Revision of revenue estimate from 2018 National Budget



Source: 2019 fiscal budget proposal.

from anti-tax fraud measures are assumed as well. These changes combined have a positive impact on Treasury revenues in the amount of 2.3 b.kr., plus a 500 m.kr. price level update of miscellaneous additional revenues. As is mentioned above, there was little cause to re-estimate tax bases due to economic assumptions, but this led to a revenue reduction of 0.6 b.kr. in comparison with the fiscal plan. Changes in special revenues are due mainly to a 1.6 b.kr. revocation of five funds' interest income on their balances with the Treasury and a 700 m.kr. reduction in planned dividends.

Changes on the expenditures side

The main changes in expenditures from fiscal plan to budget proposal for 2019 are shown in Chart 2. The two most important increases are wages and capital contributions. According to a revised estimate, Treasury interest expense will be reduced by 3.6 b.kr. relative to the fiscal plan. This is due to various offsetting upward and downward changes within the year. Investment will decline by 3.5 b.kr., and transfers will decline by 3.3 b.kr.

Revision of revenue estimate for 2018

In the National Budget for 2018, revenues were estimated at 840 b.kr. The outcome is expected to be in line with this (Chart 3). Even though tax revenues will fall by a total of 3.4 b.kr., and other reductions will total 3.8 b.kr., increased dividend payments from the State-owned commercial banks will offset the reduction in full.

Primary balance for 2019 in line with the fiscal plan but declines by 0.5% of GDP between years

The 2019 fiscal budget proposal assumes that the primary balance will be positive by 77.2 b.kr., as opposed to a surplus of 91.2 b.kr. in the 2018 National Budget. The primary surplus will decline year-on-year from 3.3% to 2.7% of GDP (Table 4). It is assumed that various measures on both revenues and expenditures sides will both raise and lower primary expenditures, as has been discussed previously. Primary income is projected at 880.5 b.kr., an increase of 53.2 b.kr. from the 2018 National Budget. The fiscal budget proposal assumes that primary expenditures will total 803.3 b.kr., up from 736.1 b.kr. in the 2018 National Budget, an increase of 67.2 b.kr. Excluding changes in wages, exchange rate, and price level, the real increase in primary expenditure is 42.9 b.kr. According to the budget proposal, the interest balance will improve by 10 b.kr. between years. The change is due largely to an 11.7 b.kr. reduction in interest expense. Of that total, charged Treasury interest expendi-

Table 4 Summarised outcome according to 2018 and 2019 fiscal budget proposals

	B.kr.		Change In b.kr.	% of GDP		Change in percentage points
	Budget proposal 2018	Budget proposal 2019		Budget proposal 2018	Budget proposal 2019	
National accounts basis						
Primary income	827.2	880.5	53.2	28.9	30.7	1.8
Primary expenditures	736.1	803.3	67.2	25.7	28.0	2.3
Primary balance	91.2	77.2	-14.0	3.2	2.7	-0.5
Interest income	12.9	11.2	-1.7	0.5	0.4	-0.1
Interest expense	71.2	59.4	-11.7	2.5	2.1	-0.4
Interest balance	-58.3	-48.2	10.0	-2.0	-1.7	0.4
Total revenues	840.1	891.7	51.6	29.4	31.1	1.7
Total expenditures	807.3	862.7	55.4	28.2	30.1	1.8
Overall balance	32.8	29.0	-3.8	1.1	1.0	-0.1

Source: Fiscal budget proposal 2019.

ture will decline by 10.4 b.kr., and calculated interest expense on unfunded pension obligations will decline by 1.3 b.kr. from the estimate in the 2018 National Budget. Including changes in the interest balance, the total Treasury outcome is projected to be positive by 29 b.kr., or 1% of GDP, which is in line with the fiscal plan approved by Parliament in March.

In estimating the fiscal stance, it is necessary to consider the degree to which the primary balance is affected by irregular revenue and expenditure changes and the degree to which the outcome simply reflects changes in overall economic activity. Chapter IV contains a more detailed analysis of the outcome after adjusting for these automatic stabilisers (see also Table 4 in Appendix 1).