

The fiscal budget proposal for 2020 was introduced in Parliament in September. The macroeconomic assumptions behind the proposal are the same as those underlying the fiscal plan approved in June. Table 1 shows the forecast issued by Statistics Iceland in May, on which the estimates in the budget proposal are based. The forecast in *Monetary Bulletin 2019/2*, also published in May, is shown for comparison.¹

Table 1 Macroeconomic assumptions in the 2020 fiscal budget proposal

	<i>Statistics Iceland forecast (%)</i>	<i>MB 2019/2 (%)</i>
Private consumption	2.8	2.9
Public consumption	1.3	2.1
Gross capital formation	6.2	10.4
Exports	2.5	2.4
Imports	3.6	6.7
Gross domestic product	2.6	2.4
Consumer price index	3.2	2.7
Unemployment	3.8	3.8
Trade-weighted exchange rate index (TWI)	0.2	-0.2
General wage index	5.5	4.7

Sources: Statistics Iceland, Central Bank of Iceland.

Various assumptions in the 2020 fiscal budget proposal

Wage assumptions: The 2019 National Budget assumed a 3.1% weighted average wage increase, adjusted to reflect the fact that the increase applied only to seven months of the year. According to an assessment based on the private sector wage agreements made this past spring, Government employees' wages are assumed to rise by an estimated 4% year-on-year, on average. The revision of the wage assumptions for 2019 necessitates that wage expenses for 2020 be revised upwards by 2.6 b.kr. A weighted average increase of 3% is assumed for 2020. Expenditures stemming from wage increases during the year are estimated at 13.1 b.kr.

Price assumptions: The 2019 National Budget assumed that inflation would measure 2.9% during the year. The new budget proposal assumes that this assumption will be borne out; therefore, no adjustment in next year's indexation is required. As a result, the price update for other operating expenditures amounts to 3.2% for 2020, in line with the Statistics Iceland forecast. The cost of the price update is 6.6 b.kr.

Exchange rate assumptions: The exchange rate assumptions are based on the exchange rate of the króna on the first business day of August. The TWI is 1.7% higher than was assumed in the 2019 Budget. Institutions' budgetary authorisations will rise by 500 m.kr. as a result, owing mainly to foreign policy expenses and drug costs.

Unemployment and social security benefits: The budget proposal assumes that benefits will increase by 3.5% on 1 January 2020. The cost of this increase is estimated at 6.3 b.kr.

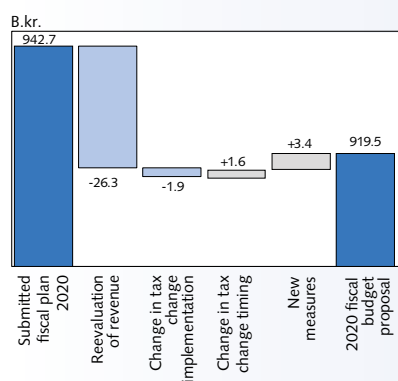
In all, the above-specified changes to budgetary authorisations in the 2020 budget proposal – changes in wages, benefits, prices,

1. The economic outlook for 2020 has deteriorated in the interim, and the Central Bank therefore assumes the GDP growth for the year will be weaker than in the May forecast (see Chapter IV).

Box 3

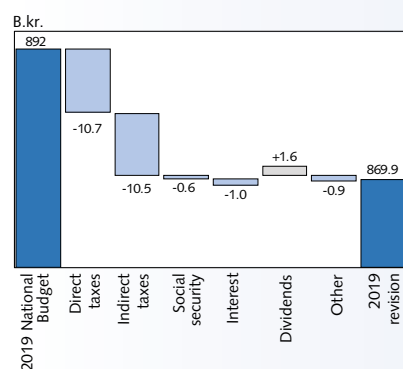
Fiscal budget proposal for 2020

Chart 1
Change in expected revenues from fiscal plan to 2020 budget proposal



Source: 2020 fiscal budget proposal.

Chart 2
Revision of revenues from 2019 National Budget to August 2019 revision



Source: 2020 fiscal budget proposal.

Table 2 Changes in wages, benefits, prices, and exchange rate in 2020

Accrual basis	
Wage assumptions	
	B.kr.
Wage increases in 2019 in excess of budgetary assumptions	2.6
Estimated wage increases 2020	10.5
Total wage increases	13.1
Unemployment and social security benefits	6.3
General price level assumptions	6.6
Exchange rate assumptions	0.5
Changes in wages, benefits, prices, and exchange rate	26.5

Source: Fiscal budget proposal 2020.

and exchange rates, as well as increased unemployment and social security benefits – amount to just over 26 b.kr. (see Table 2).

Furthermore, it is assumed that changes in the tax system, both statutory and non-statutory (not yet passed into law), will reduce next year's Government revenues by just over 5 b.kr. (Table 3).

Table 3 Impact of tax changes on Treasury revenues in 2020

Accrual basis	
Statutory changes	
	B.kr.
Payroll tax reduction, 0.25 percentage points	-4.0
Carbon tax increase, 10%	0.6
Total	-3.4
Non-statutory changes	
Changes in personal income tax	-5.5
New green taxes	1.5
Further support for energy switching	-0.2
Changes in taxation of motor vehicles and petrol	0.9
Fees charged to tourists	0.5
Anti-tax fraud measures	1.0
Total	-1.8
Total changes, statutory and non-statutory	-5.2

Source: Fiscal budget proposal 2020.

Changes on the revenues side

In the fiscal plan introduced in March, plans for several changes to the tax system were announced for 2020. Among them are a 0.25 percentage point reduction in the payroll tax, the first phase in a revision of the personal income tax system, a 10% increase in the carbon tax, and further anti-tax fraud measures. These plans have been incorporated into the fiscal budget proposal for 2020.

Chart 1 shows changes in the revenues side between the fiscal plan and the budget proposal. The re-estimation of the tax base led to a 26.3 b.kr. reduction in revenues, owing to changed economic assumptions for 2019 and 2020. Modifications in the design and timing of tax changes relative to the fiscal plan are more expensive by 300 m.kr., while new revenue measures will generate an additional 3.4 b.kr.

Revision of 2019 revenue estimates

In the 2019 National Budget, revenues were estimated at 892 b.kr.; however, they are now assumed to total just under 870 b.kr. (Chart 2). Tax revenues are estimated to decline by 21.2 b.kr., and other revenues by 0.9 b.kr.

Changes on the expenditures side

The main changes in 2019 expenditures from the 2019 National Budget to the 2020 budget proposal can be seen in Chart 3. The three most important increases are as follows: (1) committed expenditures for economic and structural changes, such as those relating to projected growth in the elderly and disabled population; (2) the estimated impact of changes in wages, prices, and the exchange rate; (3) an increase in Government expenditures relating to various categories and ministerial functions. Total expenditures for these three items will be 79 b.kr. more in 2019 than was assumed in the 2019 National Budget.

Small deviations between fiscal plan and budget proposal

Based on the assumptions above, total revenues are only 300 m.kr. higher than in the fiscal plan and total expenditures 700 m.kr. higher. The fiscal budget proposal is therefore very similar to the fiscal plan as regards revenues, expenditures, and outcome.

Primary surplus for 2020 in line with fiscal plan but narrows year-on-year

The 2020 fiscal budget proposal assumes that the primary balance will be positive by 48.4 b.kr., as compared with a surplus of 77.2 b.kr. in the 2019 National Budget. The primary surplus will therefore narrow by 1.1 percentage points of GDP between years, from 2.7% to 1.6% (Table 4). Various revenue and expenditure measures are assumed. Primary income is estimated at 910.1 b.kr., an increase of 29.6 b.kr. from the 2019 National Budget. The 2020 fiscal budget proposal assumes that primary expenditure will total 861.7 b.kr., as opposed to 803.3 b.kr. in the 2019 National Budget. Excluding changes in wages, exchange rate, and price level, the real increase in primary expenditure is 31.9 b.kr. According to the budget proposal, the interest balance is virtually unchanged between years. Including changes in the interest balance, the overall Treasury outcome is projected to be positive by 400 m.kr., which is in line with the fiscal strategy approved by Parliament in June.

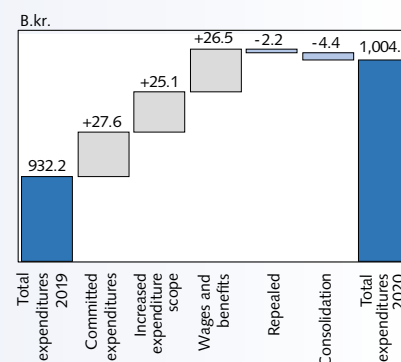
In estimating the fiscal stance, it is necessary to consider the degree to which the primary balance is affected by irregular revenue and expenditure changes and the degree to which the outcome simply reflects changes in overall economic activity. Chapter IV further analyses the outcome after adjusting for these automatic stabilisers, and Chapter I discusses the economic impact of the measures outlined in the budget proposal.

Table 4 Summary of fiscal outcome: 2019 National Budget and 2020 budget proposal

	B.kr.			% of GDP		Change in percentage points
	Budget 2019	Budget proposal 2020	Change In b.kr.	Budget 2019	Budget proposal 2020	
<i>National accounts basis</i>						
Primary revenues	880.5	910.1	29.6	30.7	29.6	-1.1
Primary expenditures	803.3	861.7	58.4	28.0	28.1	0.1
Primary balance	77.2	48.4	-28.8	2.7	1.6	-1.1
Interest income	11.2	9.3	-1.9	0.4	0.3	-0.1
Interest expense	59.4	57.4	-2.0	2.1	1.9	-0.2
Interest balance	-48.2	-48.0	0.2	-1.7	-1.7	0.0
Total revenues	891.7	919.5	27.8	31.1	30.0	-1.1
Total expenditures	862.7	919.1	56.4	30.1	29.9	-0.2
Overall balance	29.0	0.4	-28.6	1.0	0.0	-1.0

Source: Fiscal budget proposal 2020.

Chart 3
Change in total expenditures between 2019 and 2020, by type



Source: 2020 fiscal budget proposal.