Box 4

Newly concluded private sector wage agreements

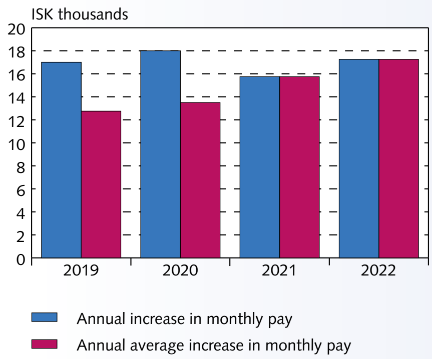
At the beginning of April, all member unions of the Federation of General and Special Workers and the Commercial Federation of Iceland signed new wage agreements with the Confederation of Icelandic Employers. The agreements extend to a large majority of private sector workers. They are based on fixed-amount pay rises resulting in a larger relative wage gain for the lowest wage earners. The negotiating parties assume that these agreements reflect a broad-based consensus on the remuneration policy the agreements entail, and that the contracts will provide a basis for those yet to be negotiated in private and public sectors alike. The new wage agreements will remain in effect for three years and seven months, with an expiry date of 1 November 2022. They were accompanied by a Government declaration on income tax, childbirth leave, child benefits, housing and pension affairs, social underbidding, economic policy, prices and indexation, simplification of the regulatory framework, and oversight (see Box 3 on Government measures).

Assumptions and review clauses

The wage agreements specify three contractual assumptions. First, real wages as reflected in the Statistics Iceland wage index must rise during the contract period. Second, interest rates must fall significantly before the first review of the contracts and must remain low throughout the contract period. Third, the authorities must honour the pledges they have given. The negotiating parties' committee on wages and assumptions will meet twice during the contract period – in September 2020 and September 2021 – to assess whether the assumptions have held.

Chart 1

Pay rises according to private sector wage agreements 2019-2022



Sources: Private sector wage agreements.

Back-loaded wage agreements ...

Table 1 shows the pay rises provided for in the agreements, in krónur, and the effective date of each. Monthly wages will increase annually by an average of 17,000 kr. during the term of the agreements, with pay scales rising more strongly beginning in 2020. In the first two years, pay rises will take effect in April; therefore, the average wage increase will be 12,750 kr. per month in 2019 and 13,500 kr. per month in 2020 (Chart 1). The wage hikes in the latter half of the contract period take effect at the beginning of the year, however, and the average monthly pay rise will therefore be larger in 2021 and 2022. In essence, then, the contracts are back-loaded, which is unusual, and as a result, there should be less incentive for labour unions to terminate them on grounds of a breach of premises.

Table 1 Wage increases for full-time position

Date	*Monthly wages (kr.)*	*Pay scales (kr.)*
1 April 2019	17,000	17,000
1 April 2020	18,000	24,000
1 January 2021	15,750	24,000
1 January 2022	17,250	25,000

Sources: Private sector wage agreements.

... with the potential for further pay rises

The contracts specify two types of wage supplements that could, under certain circumstances, lead to further wage increases. The pay scale supplement will be activated if the private sector wage index rises in excess of the proportional increase in the Federation of General and Special Workers' highest effective wage category during each reference period.[1] If the wage index rises more than this, the negotiating parties' committee on wages and assumptions shall rule on a fixed-amount pay rise to be calculated as the ratio of the excess rise to the aforementioned wage category. Because pay scales rise considerably more than monthly wages according to the contracts, it can be assumed that wage drift or pay rises among other private sector groups would have to be quite large in order to activate the provision.

The other wage supplement, called the output growth supplement, is a new feature of Icelandic wage negotiations. Under this provision, fixed-amount pay rises will be added to wages in accordance with developments in the growth rate of GDP per capita, as is shown in Table 2. This provision, aiming to link pay rises to productivity growth, is a positive step in wage negotiations because, in the long run, it is labour productivity that determines real wages.

Table 2 Output growth supplement

GDP per capita, year-on-year change (%)	*Supplement added to pay scale (kr.)*	*Supplement added to monthly wages (kr.)*
1.00 - 1.50%	3,000	2,250
1.51 - 2.00%	5,500	4,125
2.01 - 2.50%	8,000	6,000
2.51 - 3.00%	10,500	7,875
> 3.00%	13,000	9,750

Sources: Private sector wage agreements.

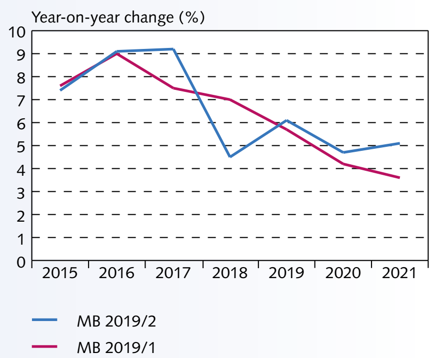
The output growth supplement is subject to limitations, however, as it is not based on conventional labour productivity measures such as GDP per hour worked. For example, streamlining working hours could deliver a productivity increase that does not trigger the supplement, whereas increased labour participation or an increase in the working-age population as a share of total population (i.e., due to migration) could trigger the supplement without reflecting a rise in productivity. Furthermore, the output growth supplement can result in pay increases only; that is, a decline in GDP per capita would not result in smaller pay rises. On the other hand, linking wage increases to a single measure will never be without drawbacks. In the final analysis, it is the task of the wage and assumption committee to determine the amount of the pay supplement and thereby evaluate these factors.

Impact on wage developments in the Central Bank's baseline forecast

The new wage agreements affect the Central Bank's assessment of the outlook for wage developments in the coming term. In addition, the new national accounts published in March led to a revision in recent wage developments (see Chapter VI). The pay rises negotiated in the new wage agreements are similar to those assumed in the February *Monetary Bulletin* forecast for this year. That forecast assumed that contracts would have a term of three years and would be relatively front-loaded. Because the new agreements are back-loaded, actual pay rises in the latter half of the contract period will be somewhat larger than was projected in the February fore-

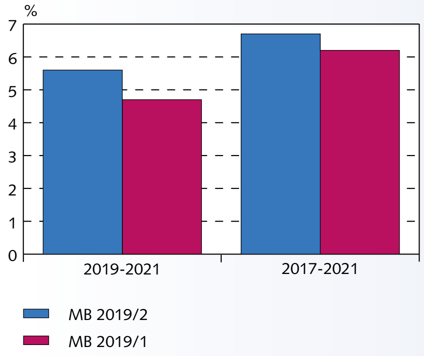
1. The Federation of General and Special Workers' highest effective wage category is category 17, with five years' work experience. The calculations are based on the private sector wage index, adjusted using a method recommended by a foreign expert, as is described in the report from the task force on public wage statistics. The reference period is from December to December of each year, beginning with December 2019 to December 2020, and the results shall be available in March of the following year.

Chart 2
Wages per hour 2015-2021



Source: Central Bank of Iceland.

Chart 3
Annual average increase in wages per hour



Source: Central Bank of Iceland.

cast (Chart 2). In addition to the negotiated pay rises, the current forecast assumes modest wage drift. It is now assumed that wages per hour will rise by 6.1% this year, as opposed to 5.7% in the February forecast. However, a large portion of this year's increase is due to base effects from last year, as the increase between the 2018 and 2019 averages would measure 2.6% even if wages remained unchanged at the Q4/2018 level until end-2019. Wages per hour are forecast to rise by 4.7% in 2020 and by another 5.1% in 2021, when pay rises will take effect at the beginning of the year. As a consequence, wages per hour will rise by a total of 17% this year and in the two years following, or by an average of 5.6% per annum. This is an increase of nearly 1 percentage point more than was assumed in the February forecast (Chart 3). On the other hand, the increase in wages over the period from 2017 through 2021, including the revision of previous figures on wages and related expenses, comes to an average of 6.7% per year, which is only 0.4 percentage points above the February forecast.

The Bank's current baseline forecast assumes that the output growth provision of the wage agreements will not be triggered, although it comes close towards the end of the forecast horizon. Clearly, both this and other aspects of the outlook for wage developments are subject to uncertainty. Public sector wage agreements are still pending, for instance, and it is difficult to evaluate the full impact of fixed-amount pay rises without adequate information on underlying wage distribution. Furthermore, wage drift could develop differently than is assumed here.