

Fiscal budget proposal for 2023

The fiscal budget proposal for 2023 was introduced before Parliament in September. Treasury revenues will increase next year by just over 163 b.kr. relative to the 2022 National Budget, while expenditures will rise by just under 68 b.kr. The fiscal deficit will be 89 b.kr., or 97.4 b.kr. less than in the National Budget for 2022. The deficit on the interest balance increases by nearly 9 b.kr. year-on-year, to 63½ b.kr., whereas the deficit on the primary balance shrinks by 106 b.kr. relative to his year's National Budget, to 25½ b.kr. The fiscal deficit for the year is equivalent to 2.3% of GDP, according to the budget proposal, or 2.9 percentage points less than in the 2022 Budget (Table 1).

Table 1 Summary of fiscal outcome: 2022 Budget and 2023 budget proposal

<i>National accounts basis</i>	<i>B.kr.</i>		
	<i>Budget 2022</i>	<i>Budget proposal 2023</i>	<i>Change in b.kr.</i>
Primary income	939.5	1,099.8	160.2
Primary expenditures	1,071	1,125.2	54.1
Primary balance	-131.5	-25.4	106.1
Interest income	12.4	17.5	5.0
Interest expense	67.3	81.1	13.8
Interest balance	-54.9	-63.6	-8.7
Total revenues	952.0	1,117.2	165.3
Total expenditures	1,138.3	1,206.2	67.9
Overall balance	-186.4	-89.0	97.4

<i>National accounts basis</i>	<i>% of GDP</i>		
	<i>Budget 2022</i>	<i>Budget proposal 2023</i>	<i>Change in %</i>
Primary income	26.4	28.5	2.1
Primary expenditures	30.0	29.1	-0.9
Primary balance	-3.7	-0.7	3.0
Interest income	0.3	0.5	0.1
Interest expense	1.9	2.1	0.2
Interest balance	-1.5	-1.6	-0.1
Total revenues	26.7	28.9	2.2
Total expenditures	31.9	31.2	-0.7
Overall balance	-5.2	-2.3	2.9

Source: Fiscal budget proposal 2023.

The macroeconomic assumptions in the budget proposal are based on Statistics Iceland's June 2022 forecast. Table 2 compares the Statistics Iceland's forecast and the estimates in the budget proposal to the Central Bank forecast from roughly the same time (*Monetary Bulletin 2022/2*, published in May). The macroeconomic outlook has changed

somewhat since then, and according to the Bank's new baseline forecast, GDP growth will be stronger and inflation higher in 2023 than was forecast in May (see Chapters III and V).

Table 2 Macroeconomic assumptions in the 2023 fiscal budget proposal

	Statistics Iceland forecast (%)	MB 2022/2 (%)
Private consumption	2.6	3.0
Public consumption	1.1	1.7
Investment	-0.3	-0.5
Exports	6.2	5.2
Imports	3.8	3.5
Gross domestic product	2.7	2.6
Consumer price index	4.9	5.0
Unemployment	3.7	4.2
Trade-weighted exchange rate index	-1.5	1.4
General wage index	5.2	5.7

The table shows year-on-year changes except for unemployment, which is expressed as a share of the labour force.

Sources: Fiscal budget proposal 2023, Statistics Iceland, Central Bank of Iceland.

Various assumptions in the 2023 fiscal budget proposal

- Wage assumptions:** Typically, wage assumptions are based on current wage agreements. Because wage agreements for next year are not yet in place, the assumptions are based instead of those in the fiscal plan concerning real wage growth for public employees. Budgetary costs stemming from wage increases are estimated at 19.1 b.kr., including 5.1 b.kr. due to a revision of previous years' wage assumptions.

Price assumptions: The general rise in operating expenditures is based on Statistics Iceland's inflation forecast. Inflation is estimated at 7.5% for 2022, an increase of 4.2 percentage points relative to the assumptions underlying the 2022 fiscal budget, but it is projected to decline to 4.9% in 2023. Because of higher inflation, expenditures will be 9.6 b.kr. higher in 2022 and over 11 b.kr. higher in 2023. On the whole, increased expenditures in the amount of 20.7 b.kr. can be attributed to assumptions about price movements.
- Exchange rate assumptions:** The fiscal budget proposal assumes an exchange rate equal to the July 2022 average, which entails a 5.8% year-on-year appreciation of the króna. This leads to a 3 b.kr. reduction in expenditures, owing mainly to foreign policy expenses and drug costs.
- Unemployment and social security benefits:** Social security benefits rise by 6% in 2023, in addition to the 3% increase in June 2022. Unemployment benefits rise in line with inflation, or 4.9%. The cost of this increase in benefits is estimated at 19.1 b.kr.

In all, the above-specified changes to budgetary authorisations in the 2023 budget proposal – changes in wages, benefits, prices, and exchange rates – amount to 52.6 b.kr. (Table 3).

Table 3 Changes in wages, benefits, prices, and exchange rate in 2023

Accrual basis

Effect on expenditures b.kr.

Wage assumptions

Wage increases in 2022 in excess of budgetary assumptions	5.1
Estimated wage increases 2023	14
Total wage increases	19.1
Unemployment and social security benefits	19.1
General price level assumptions	20.1
Exchange rate assumptions	-3.0
Changes in wages, benefits, prices, and exchange rate	52.6

Source: Fiscal budget proposal 2023.

Several tax system changes will be introduced next year. It is assumed that statutory changes in the tax system will reduce Treasury revenues by 3.6 b.kr. in 2023, owing to the increased number of fully electric motor vehicles benefiting from value-added tax concessions. On the other hand are changes not yet passed into law, which deliver additional revenues of just over 14 b.kr., mainly including increased fees based on assumed changes in the price level and changes in motor vehicle excise taxes and motor vehicle taxes. In all, the changes will deliver 10.5 b.kr. in additional revenues in 2023 (Table 4).

Table 4 Impact of tax changes on Treasury revenues in 2023

Accrual basis

Revenues b.kr.

Statutory changes

Increased number of electric cars enjoying VAT concessions	-3.6
Non-statutory changes	
Changes in motor vehicle excise taxes	2.7
Changes in motor vehicle tax	2.2
Alternate airport fee	1.4
Change in value fee for sea-farmed fish	0.5
Increase in fees due to inflation	6.4
Other changes	0.8
Total changes, statutory and non-statutory	10.5

Source: Fiscal budget proposal 2023.

In addition to the above-specified changes, next year's Treasury revenues will be affected by previous tax changes. These include measures that will be partially implemented this year and temporary measures that will expire this year, such as the increased VAT reimbursement scheme under the "Back to Work" initiative in H2/2022. These effects will

boost Treasury revenues will increase by 13.4 b.kr. in 2023. Total tax revenues will therefore rise by a combined 23.9 b.kr. in 2023 because of tax changes (Chart 1).

Revision of 2022 revenue estimates

The revenue estimates for the current year have changed considerably relative to the National Budget, owing both to increased income tax revenues totalling just over 50 b.kr. (reflecting stronger-than-expected economic activity) and to increased dividend payments totalling just over 14 b.kr. Furthermore, payroll taxes will be 11 b.kr. higher than was provided for in the Budget. On the whole, revenues for the year are projected to be 78.6 b.kr. more than in the National Budget.

Changes on the revenues side for 2023

According to the budget proposal, Treasury revenues in 2023 will total 1,117 b.kr. and are virtually unchanged relative to the fiscal plan. There are several changes in individual sub-components, but these largely offset one another. The main changes are in estimated consumption taxes, which are 4.6 b.kr. higher in the budget proposal than in the fiscal plan, and income taxes, which generate 3.2 b.kr. less in revenues.

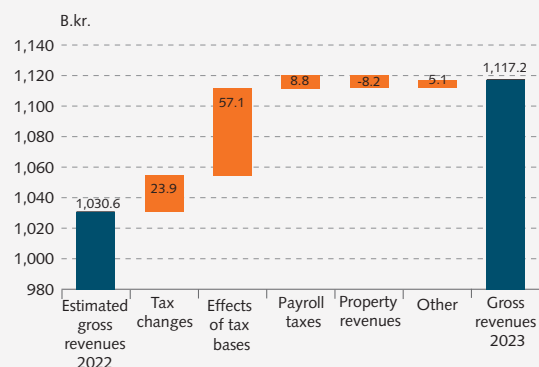
As can be seen in Chart 1, year-2023 revenues will rise by nearly 87 b.kr. over and above the estimate for 2022. This is due in large part to stronger economic activity and its effect on the Treasury's tax revenues.

Changes on the expenditures side for 2023

In 2023, expenditures will increase by nearly 68 b.kr. compared to the 2022 National Budget and will amount to 1,206 b.kr. Increases on the expenditures side stem from the effects of wage and price level adjustments and committed expenditures – due to growth in the elderly and disabled population, higher interest expense, and other factors – in addition to increased scope for new projects. Temporary budgetary allocations, particularly those related to the COVID-19 pandemic, will be discontinued, however, and consolidation targets are also expected to reduce expenditures.

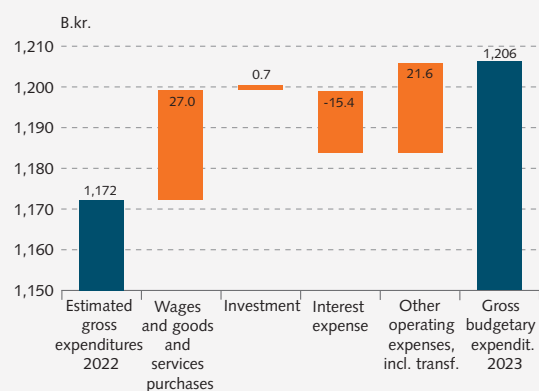
Substantial changes in economic developments affected Treasury expenditures in 2022, which are estimated to be 34 b.kr. over the 2022 Budget, owing in particular to increased interest expenditures. According to the budget proposal, expenditures will increase by nearly 34 b.kr. next year relative to the estimated 2022 level. Chart 2 shows that reduced interest expenditure only partly offsets the increase in other expenditures in 2023.

Chart 1
Revenue changes relative to 2022 estimates



Sources: Fiscal budget proposal for 2023, Ministry of Finance and Economic Affairs.

Chart 2
Expenditure changes relative to 2022 estimates



Source: Fiscal budget proposal for 2023.

Year-2022 deficit smaller than was assumed in the fiscal plan

In the fiscal plan approved last summer, it was assumed that the Treasury outcome would be negative by nearly 158 b.kr. in 2022, whereas the updated plan estimates the deficit at 142 b.kr. The difference stems mainly from higher projected tax revenues and dividend payments during the year. Offsetting this, interest expense and wage costs are higher in the new plan, but when all factors are accounted for, the primary deficit will be 25 b.kr. smaller and the overall deficit nearly 16 b.kr. smaller than in the original fiscal plan.

Fiscal deficit below fiscal policy benchmark

The income balance in the 2023 fiscal budget proposal is negative by 89 b.kr., or 6.5 b.kr. more than the deficit provided for in the fiscal plan this summer. As was the case for 2022, the change is due mainly to higher interest expense and wage costs.

The interest balance weighs heavily in the Treasury outcome, as it has in recent years, and according to the budget proposal, it is negative by 63.6 b.kr. The deficit on the primary balance will be 25.4 b.kr. in 2023, or just under a third of the overall deficit for the year. As a share of projected year-2023 GDP, the overall deficit on Treasury revenues will be 2.3%, while the deficit on the primary balance will be 0.7%. The deficit has therefore shrunk from its 2021 peak of 8.1%.

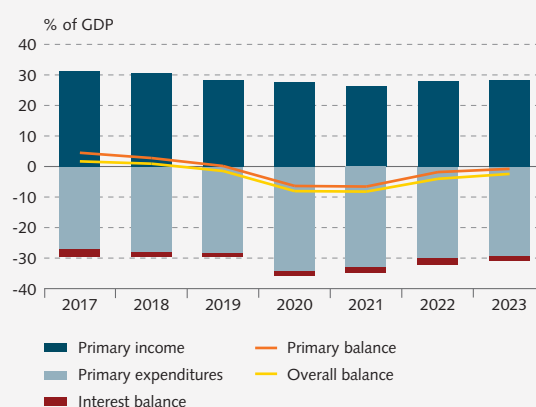
As is noted above, the deficit on Treasury revenues according to the budget proposal is larger than was provided for in the fiscal plan. However, next year's deficit will be considerably below the benchmark according to the Fiscal Policy Statement for 2022-2026, which was approved by Parliament in February 2022. Chapter III contains a more detailed discussion of the cyclically adjusted Treasury outcome.

Fiscal deficit larger than before the pandemic

According to the plan for 2022, Part A1 Treasury revenues will amount to 28.5% of GDP and primary income will total 28%. In 2023, overall revenues will come to 28.9% of GDP and primary income 28.5%. The ratios for 2022 and 2023 are slightly lower than before the pandemic struck.

Overall expenditures will amount to 32.4% of GDP this year and primary expenditures 29.7%, but in 2023 these ratios will decline to 31.2% and 29.1%, respectively, according to the budget proposal. These are somewhat higher ratios than during the years immediately preceding the pandemic. The Treasury performance will therefore be considerably more negative than during the pre-pandemic period. As

Chart 3
Part A1 Treasury outcome 2017-2023



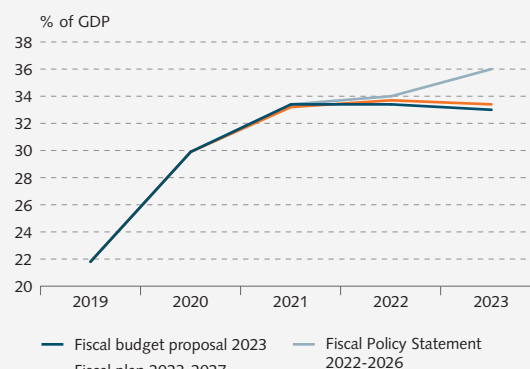
Sources: Fiscal budget proposal for 2023, Ministry of Finance and Economic Affairs.

Chart 3 shows, this is due mainly to a larger deficit on the primary balance. Even though Treasury debt has increased in recent years, it is not assumed that the deficit on the interest balance will be larger in 2023 than before the onset of the pandemic.

Debt-to-GDP ratio projected to stop rising earlier than previously assumed

Treasury debt has increased because of deficit operations during the pandemic. In terms of the debt rule provided for in the Act on Public Finances, the debt-to-GDP ratio is estimated to have risen from 21.8% in 2019 to 33.4% in 2021 (Chart 4). According to the estimate in the budget proposal, the ratio will remain unchanged between 2021 and 2022 but then fall to 33% in 2023. For next year, this represents a marginal change relative to the fiscal plan for 2023-2027, which assumed that the debt ratio would fall in 2023 and then rise again until 2025, peaking at 34.5% of GDP. By the same token, the debt ratio for 2023 is about 3 percentage points lower than in the Fiscal Policy Statement for 2022-2026. This is also considerably below the post-crisis peak of 58½% of GDP, reached in 2009.

Chart 4
Treasury debt according to debt rule¹



1. Part A1 Treasury debt according to the debt rule is total debt less pension obligations, accounts payable, cash balances, and bank deposits.
Sources: Fiscal budget proposal for 2023, Fiscal Policy Statement 2022-2026, Ministry of Finance and Economic Affairs.