



MINISTRY OF FINANCE
AND ECONOMIC AFFAIRS

BUDGET PROPOSAL 2016 MEDIUM-TERM FISCAL PLAN 2016-2019

September 18th 2015

IRREGULAR ITEMS ON THE REVENUE SIDE

- » In some of the graphs and tables in the following presentation the figures have been adjusted for certain irregular, one-off and transitory items to bring to light the underlying evolution in the fiscal finances.

Revenue side:

Capital income tax paid by Treasury itself

Proceeds from sales of asset above book value

Reappraisal of financial assets

Temporary effects on tax revenue in relation to the household debt relief program and third-pillar savings withdrawals in 2015-2019

Part of the bank tax in 2014-2017 (levies on estates of fallen banks)

Part of the special FAT in 2014-2015 (levies on estates of fallen banks)

Special dividend to the Treasury due to the reduced equity in the CBI in 2014

Irregular dividends



IRREGULAR ITEMS ON THE EXPENDITURE SIDE

- » In some of the graphs and tables in the following presentation the figures have been adjusted for certain irregular, one-off and transitory items to bring to light the underlying evolution in the fiscal finances.

Expenditure side:

Capital income tax paid by Treasury itself

Tax write-offs

Liabilities of public employee's pension funds

Defaulted loans with state guarantees

Write-offs of outstanding claims

Depreciation of equity in funds and companys

Equity contributions to the Housing Financing Fund (HFF)

Expenses due to temporary debt relief for households in 2014-2017





1.

FISCAL OBJECTIVES AND PROSPECTS

BUDGET PROPOSAL
2016

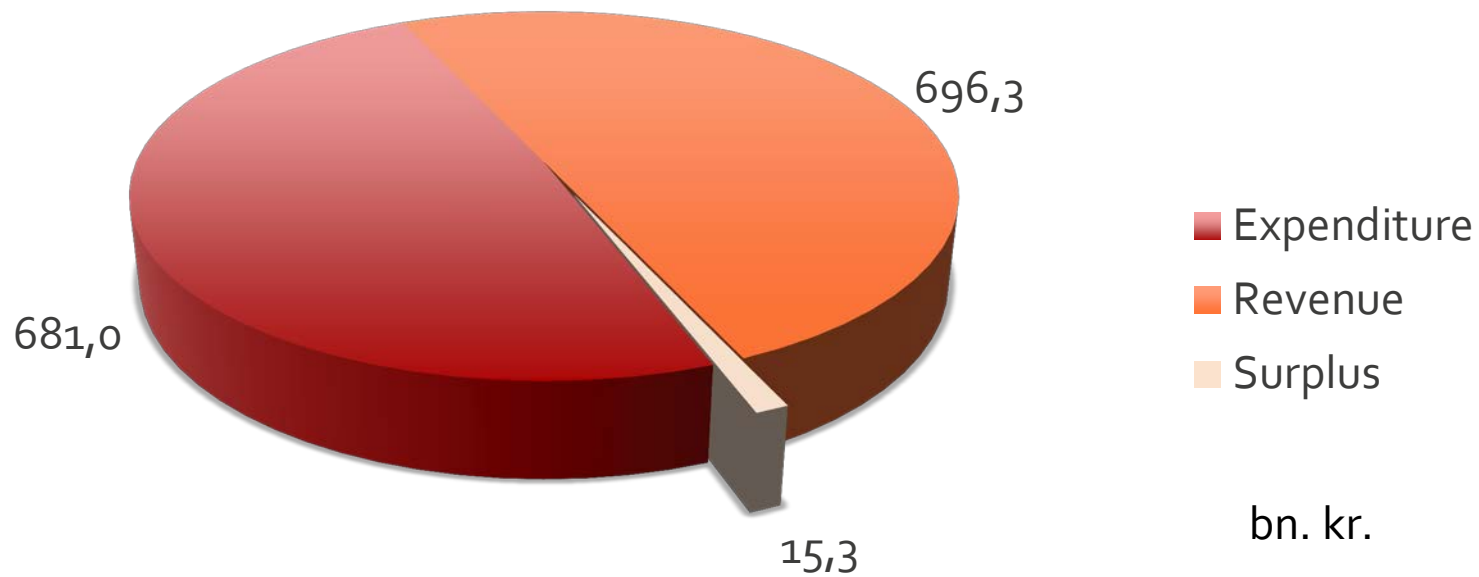
SPRING FISCAL PLAN 2016-2019 - MAIN TARGETS

	Targets
Total balance	Surplus should grow steadily over the period reaching at least 1% of GDP in 2018.
Revenue	Primary revenue* growth should not to exceed the growth of GDP until 2019.
Expenditure	Primary expenditure* should grow more slowly than GDP and somewhat slower than primary revenue and decrease by 1% of GDP until 2019.
Debt	Gross debt should decrease by 10% in nominal terms and by 15% as a percentage of GDP between the years 2015 and 2019.
Capital expenditure	Maintain the current level of capital expenditure at 1.2% of GDP until 2019.

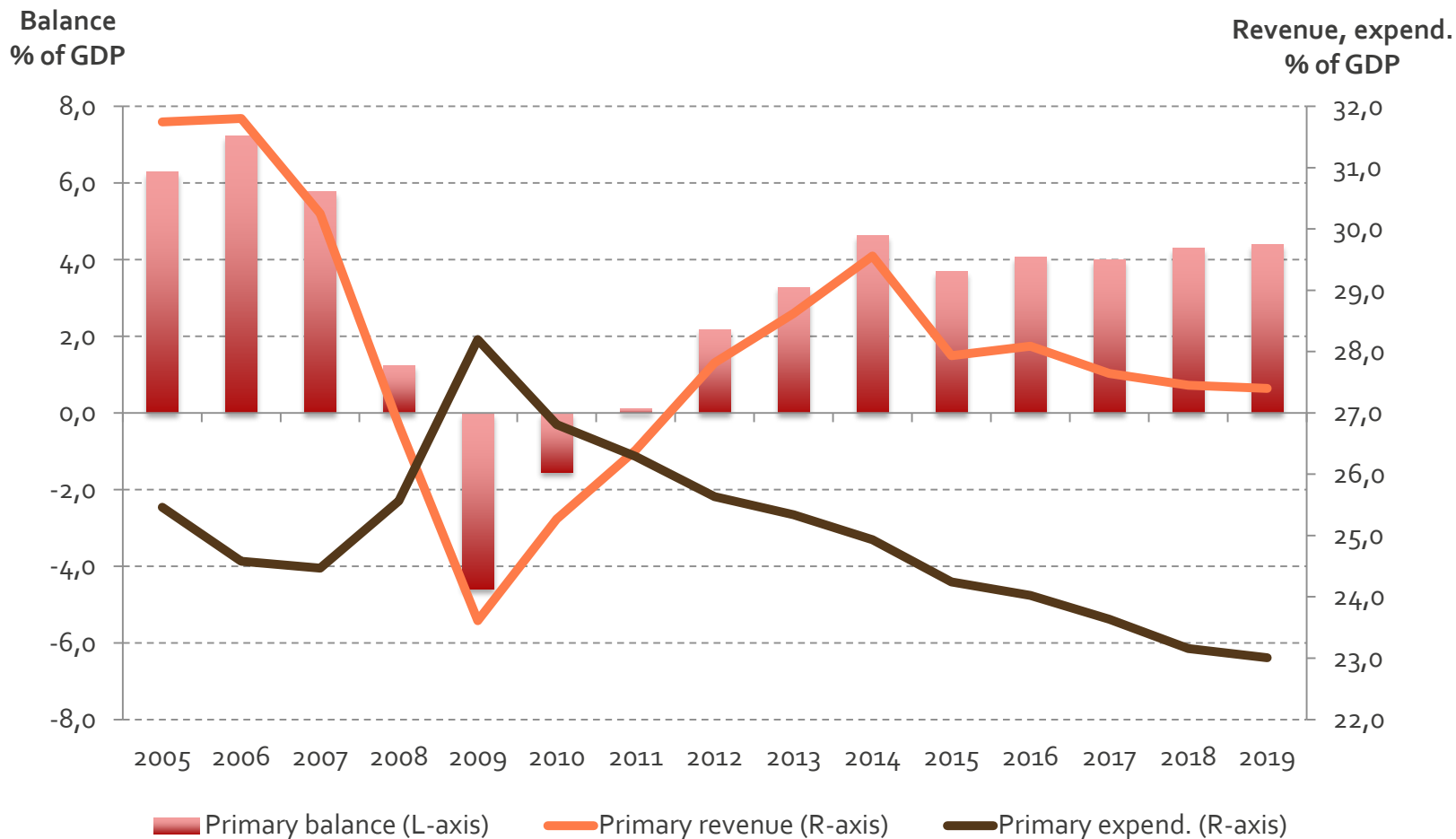
** excluding irregular and temporary items*



TREASURY OVERALL BALANCE 2016



TREASURY PRIMARY BALANCE 2005-2019*

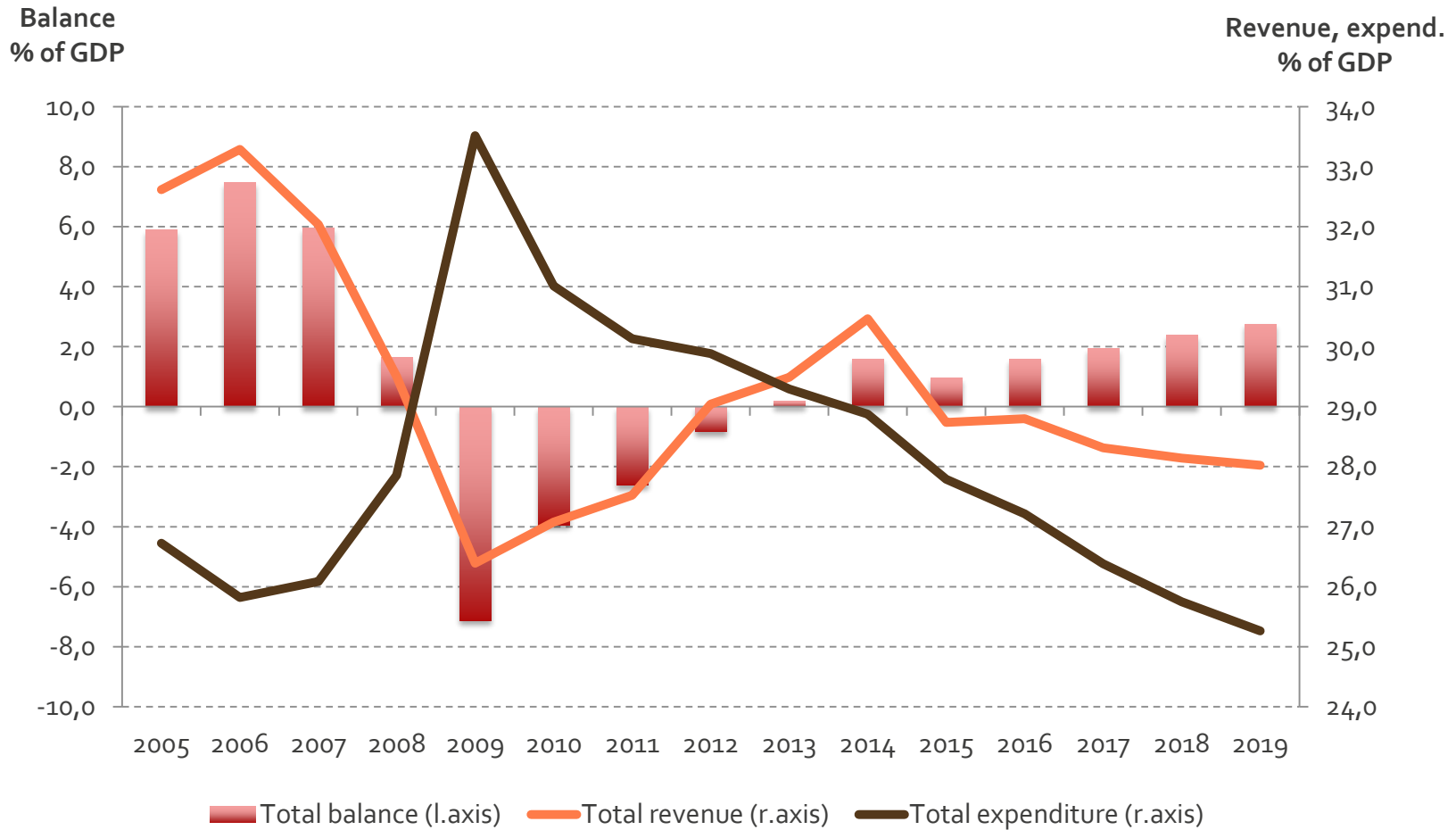


* excluding irregular items

Adjusted for the transfer of the services for disabled people from the state to local governments.



TREASURY OVERALL BALANCE 2005-2019*



* excluding irregular items

Adjusted for the transfer of the services for disabled people from the state to local governments.





2.

ECONOMIC PROSPECTS

BUDGET PROPOSAL
2016

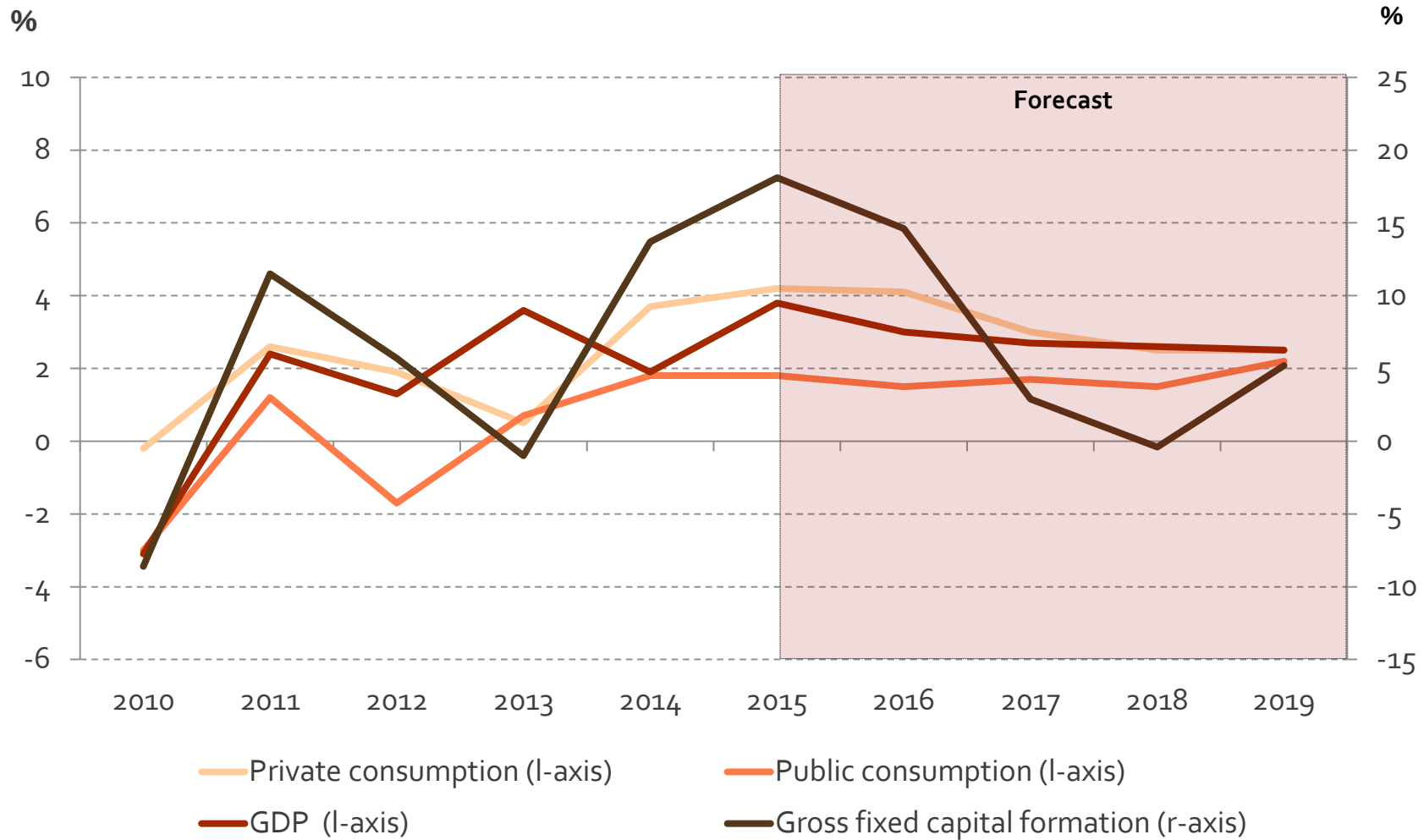
MAIN ECONOMIC ASSUMPTIONS FOR THE BUDGET

	2014	2015	2016	2017	2018	2019
Private consumption	3,7	4,2	4,1	3,0	2,5	2,5
Public consumption	1,8	1,8	1,5	1,7	1,5	2,2
Fixed capital	13,7	18,1	14,6	2,9	-0,4	5,2
Business sector	15,1	20,8	16,0	1,5	-3,0	4,2
Residential construction	14,9	20,3	19,3	12,2	9,4	8,7
Government services	7,5	2,5	1,5	-1,0	0,5	5,0
Domestic final expenditure	5,3	6,2	5,4	2,7	1,7	3,0
Exports	3,1	5,3	3,3	3,5	4,2	2,7
Imports	9,9	10,2	8,1	3,5	2,5	3,8
GDP	1,9	3,8	3,0	2,7	2,6	2,5
Inflation	2,0	2,0	4,5	4,1	3,2	2,6
Wages	5,6	7,5	8,0	6,0	5,0	5,0

* Economic forecast from Statistic Iceland, June 2015



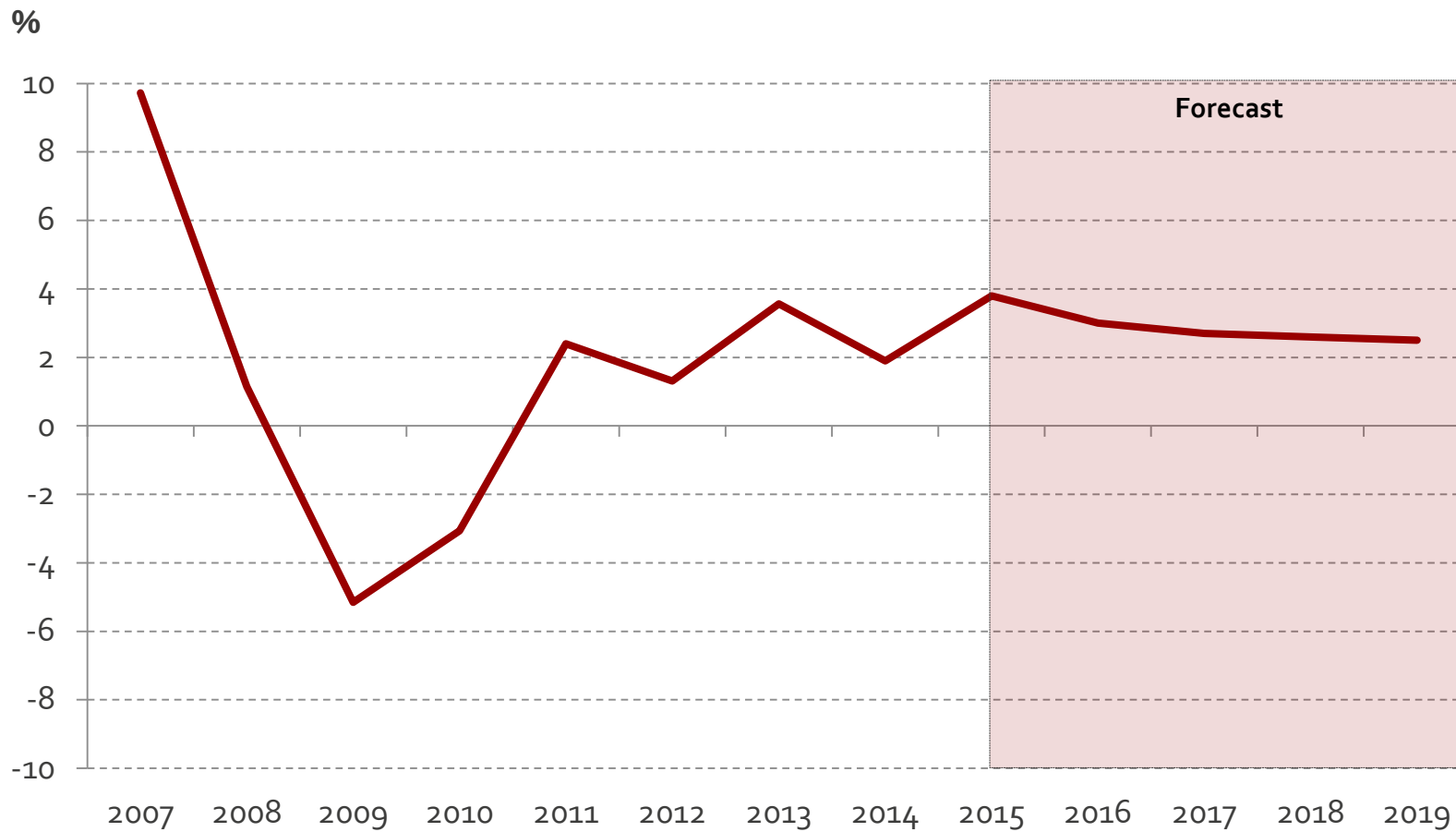
PROSPECTS FOR THE REAL ECONOMY



Source: Statistic Iceland



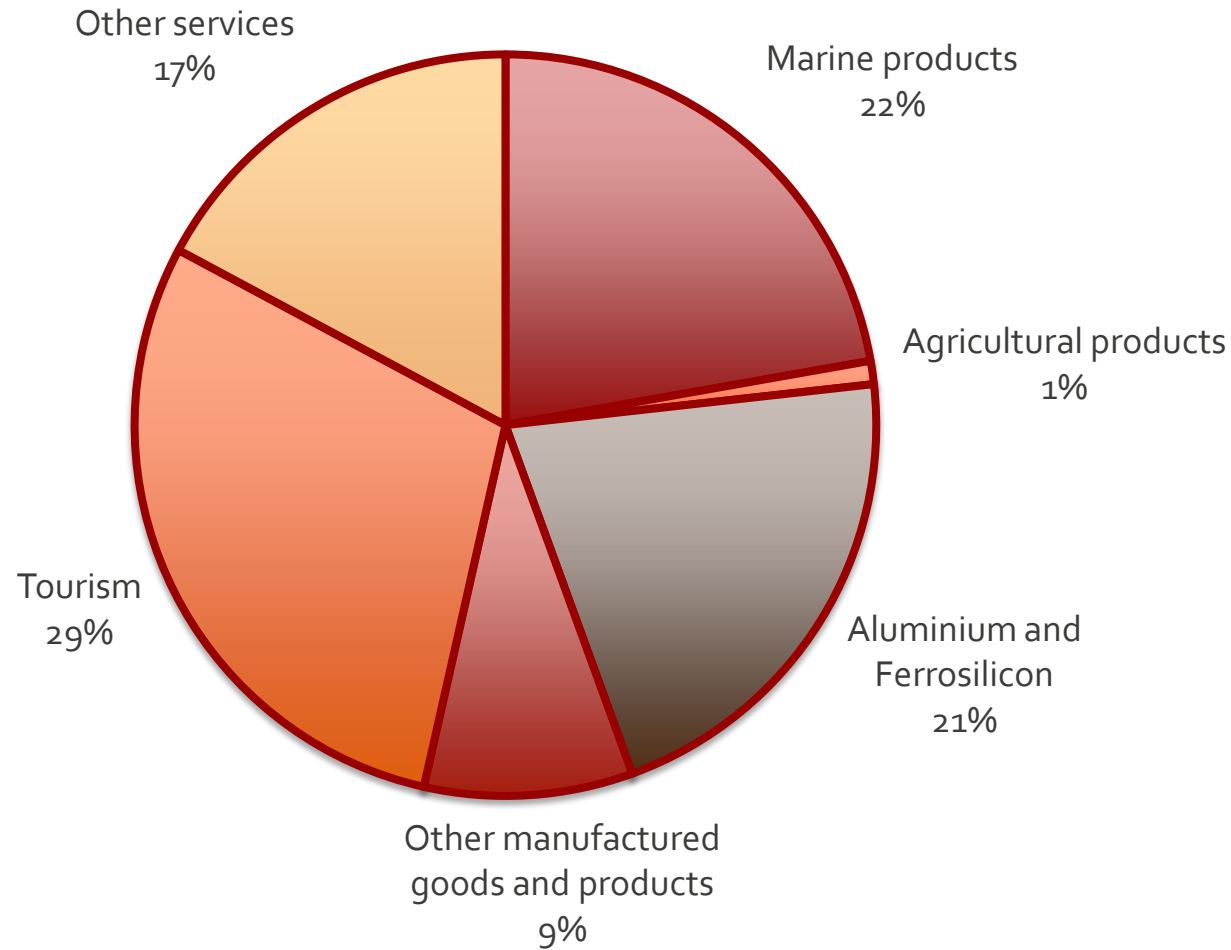
CONTINUOUS ECONOMIC GROWTH



Source: Statistic Iceland



A MORE DIVERSIFIED EXPORT SECTOR

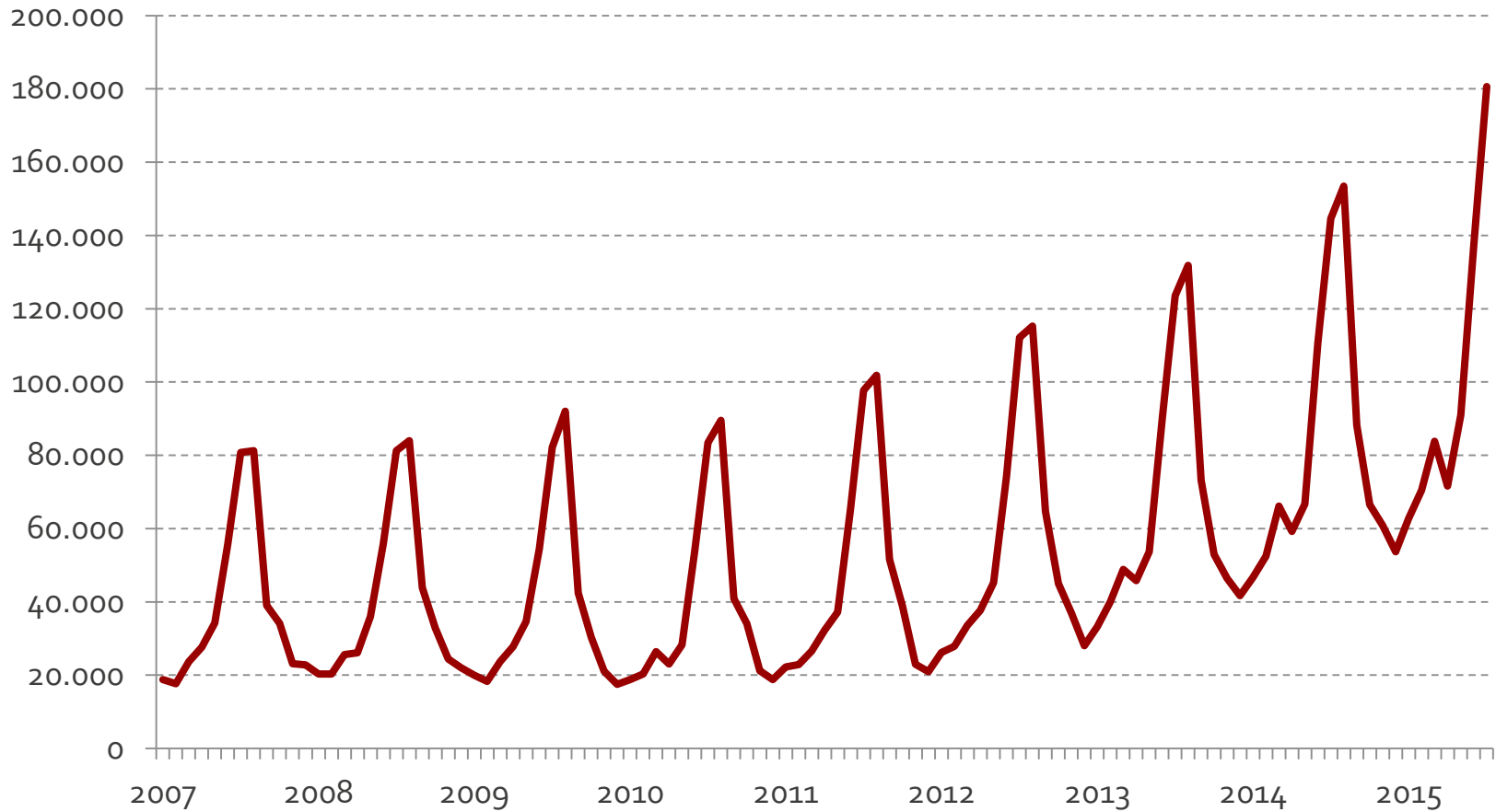


Source: Statistic Iceland



SURGE IN TOURISM

Monthly number of visitors

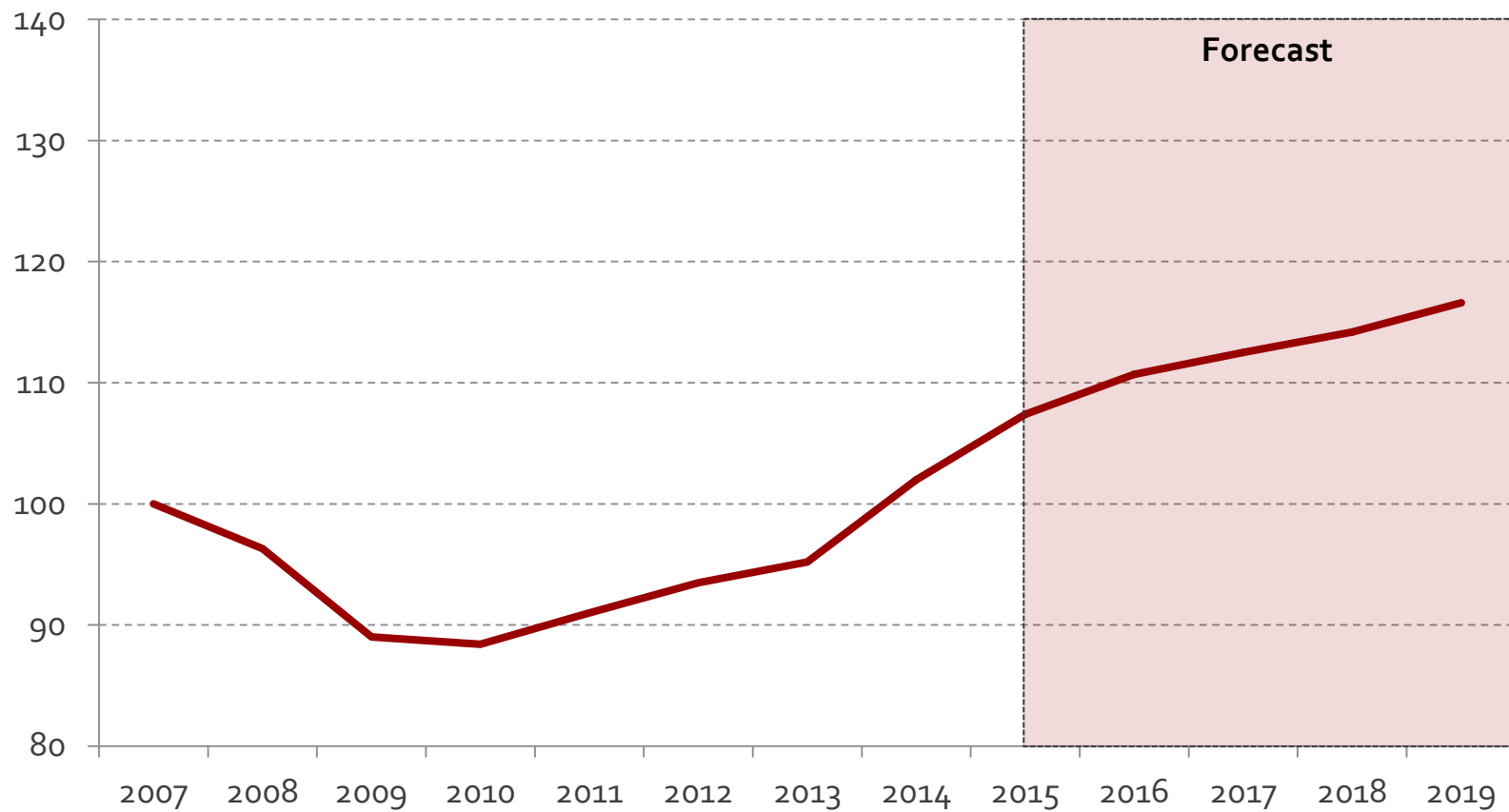


Source: Icelandic Tourist Board



REAL WAGES HAVE BEEN RISING STEADILY

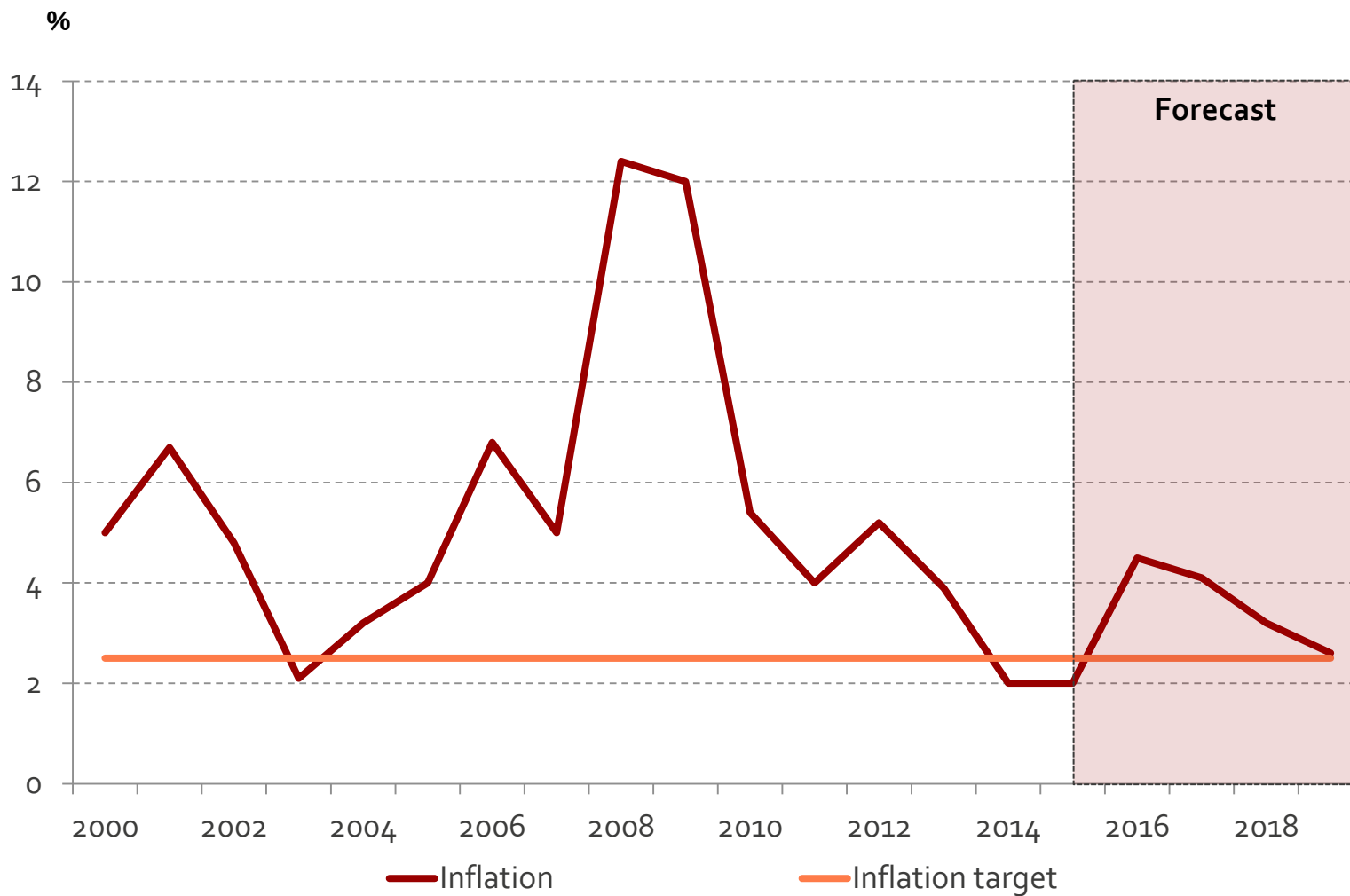
Index: 2007=100



Source: Statistic Iceland



INFLATION HAS BEEN LOW BUT IS RISING

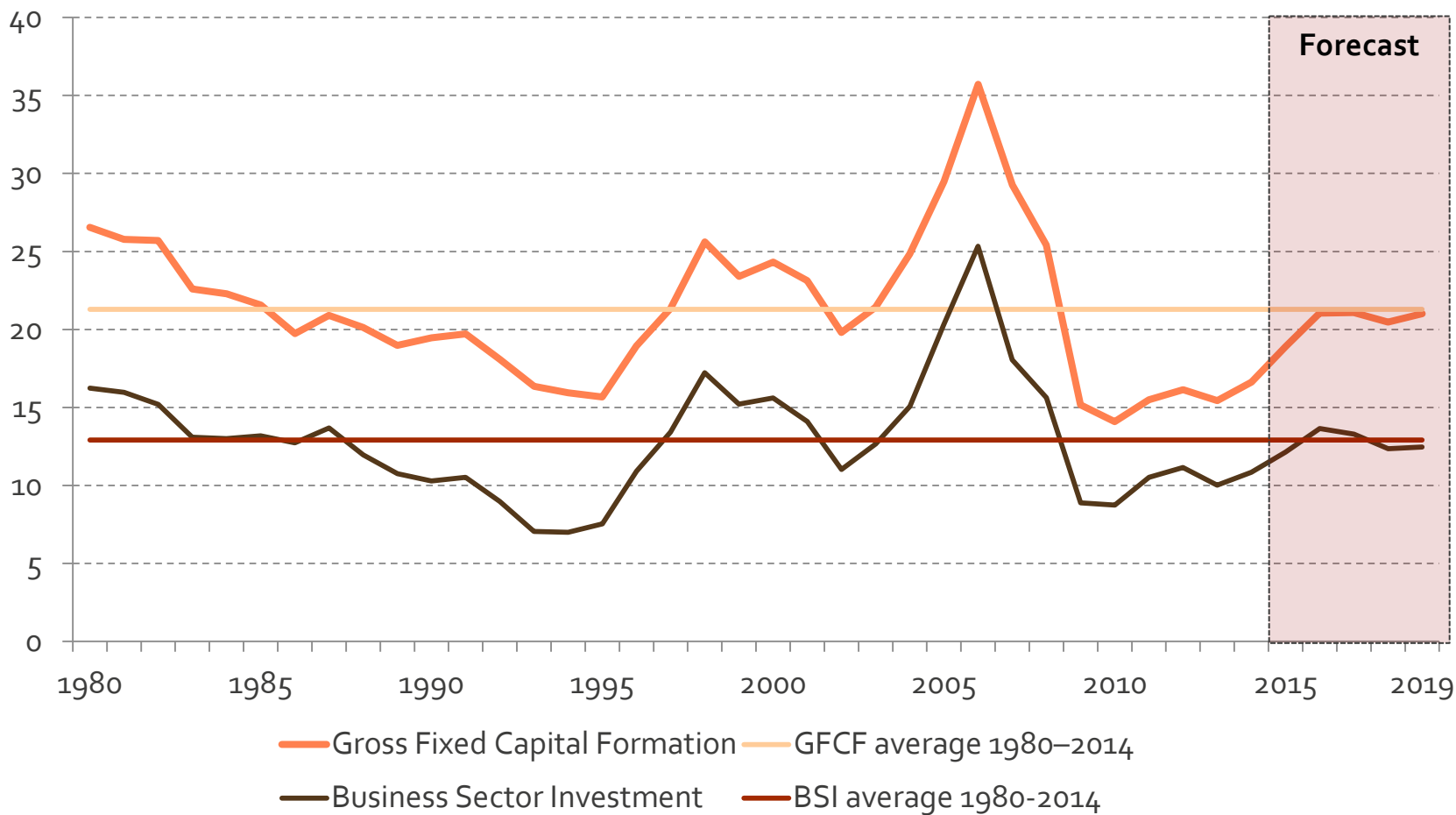


Source: Statistic Iceland



GROSS FIXED CAPITAL FORMATION

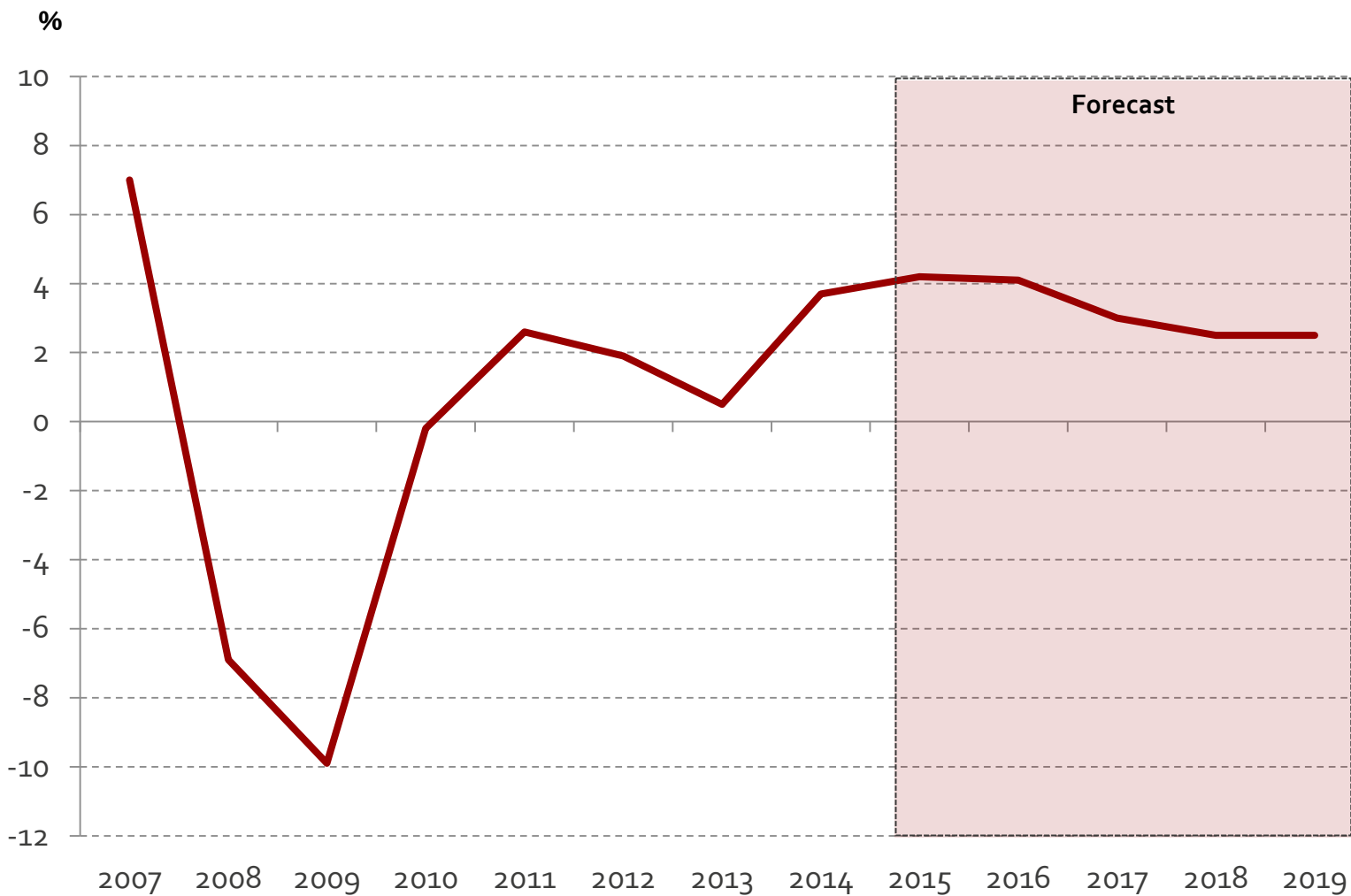
% of GDP



Source: Statistic Iceland



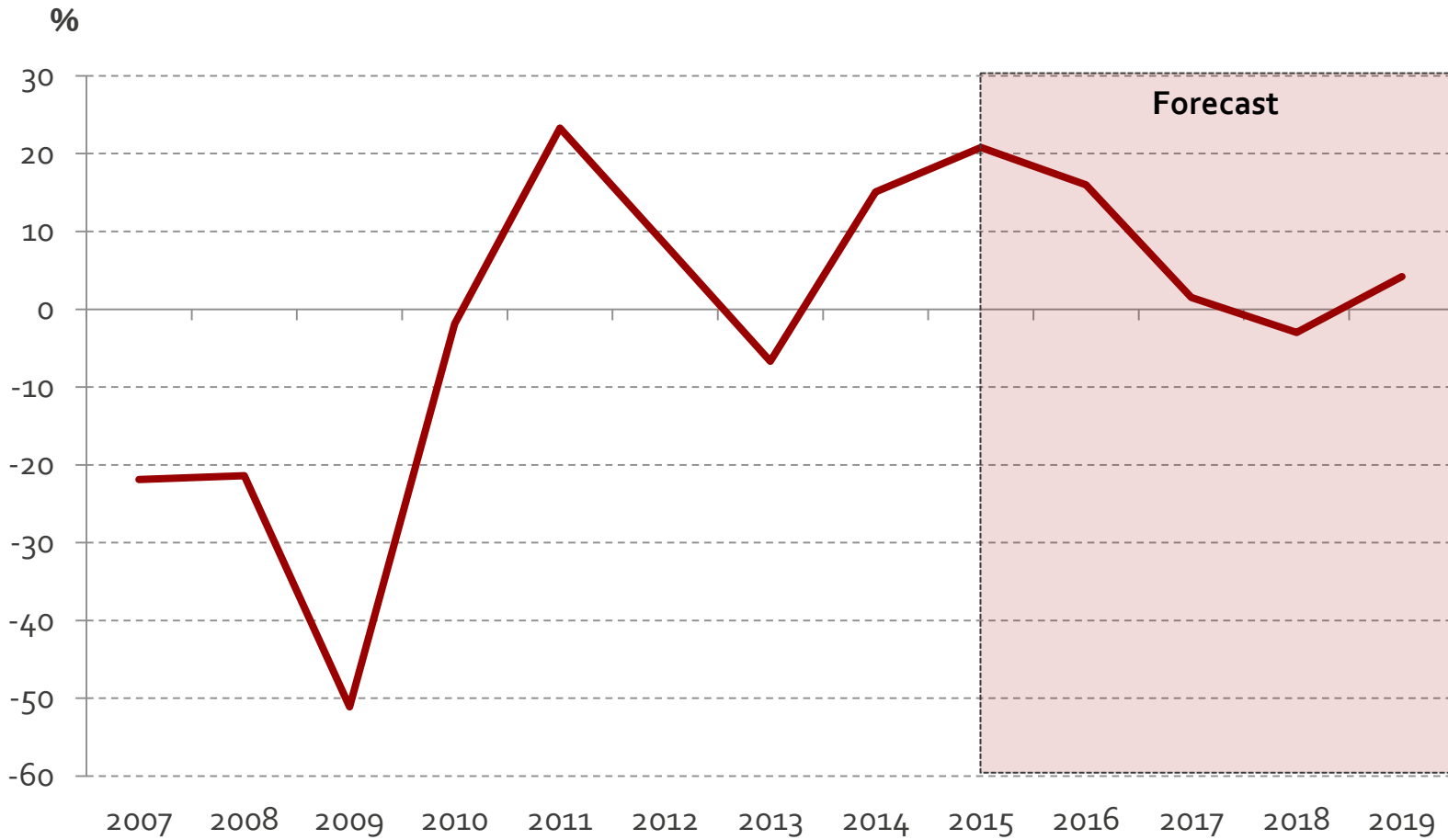
PRIVATE CONSUMPTION



Source: Statistic Iceland



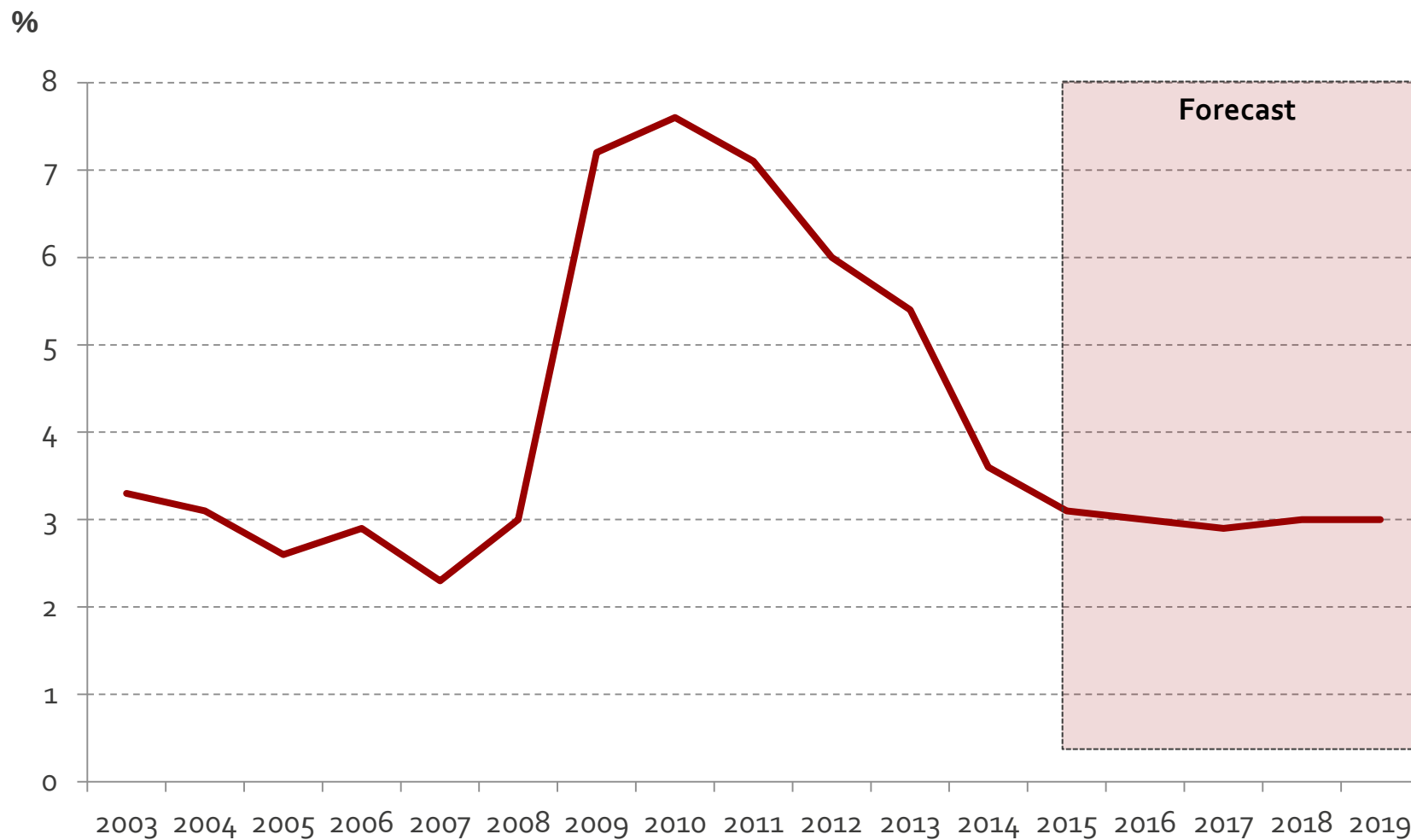
BUSINESS SECTOR INVESTMENT



Source: Statistic Iceland



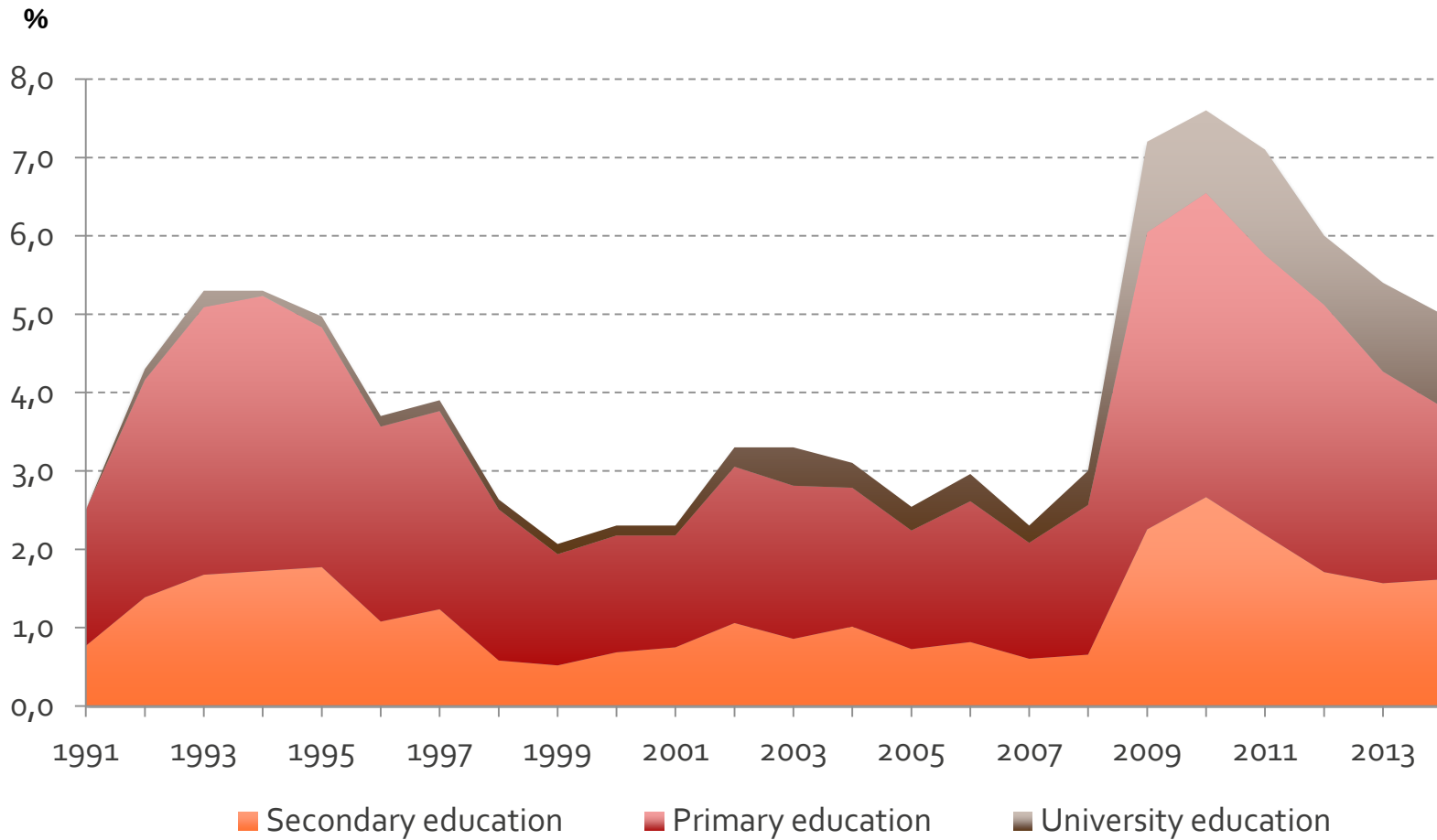
UNEMPLOYMENT



Source: Statistic Iceland



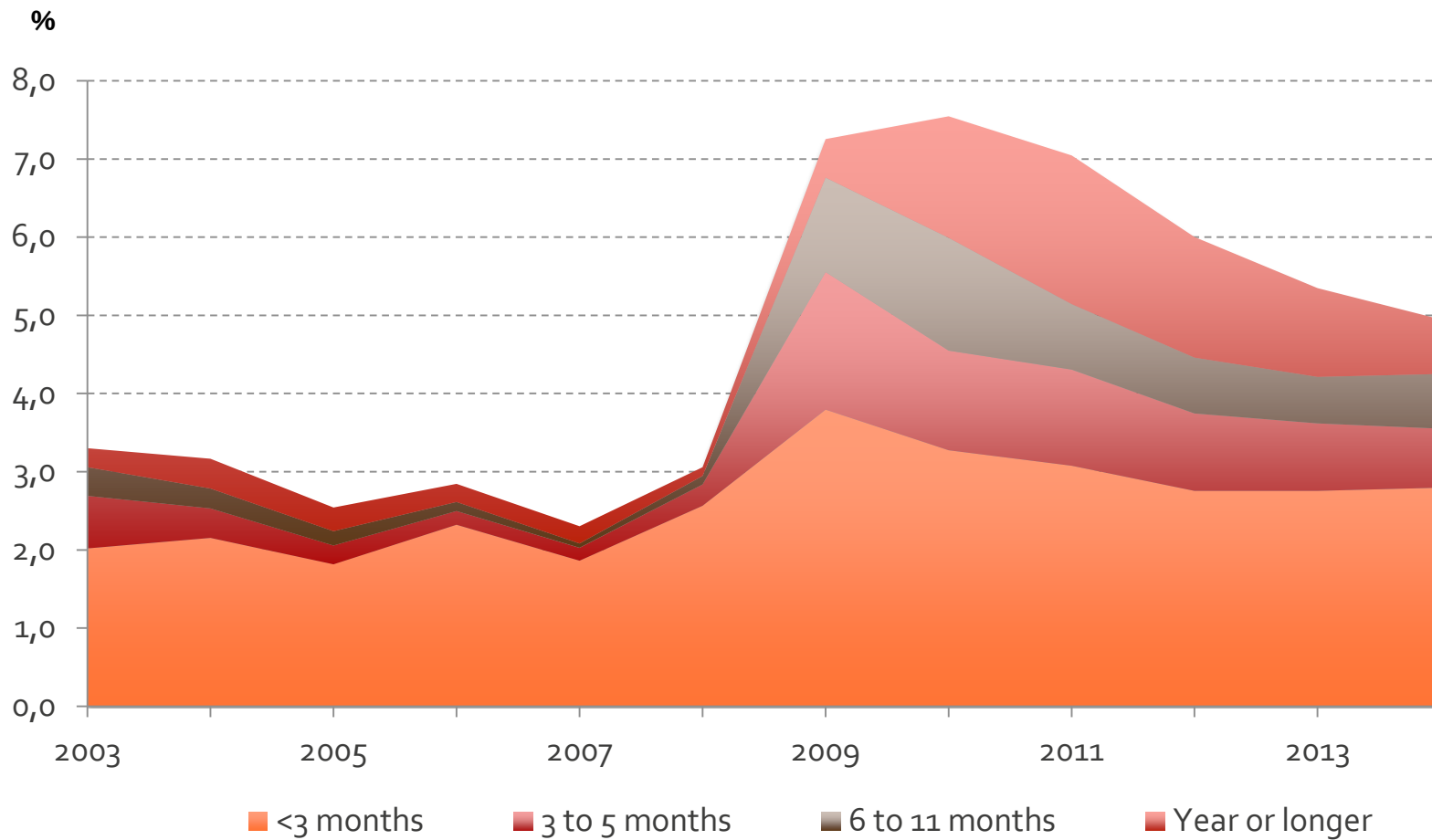
UNEMPLOYMENT BY EDUCATION



Source: Statistic Iceland



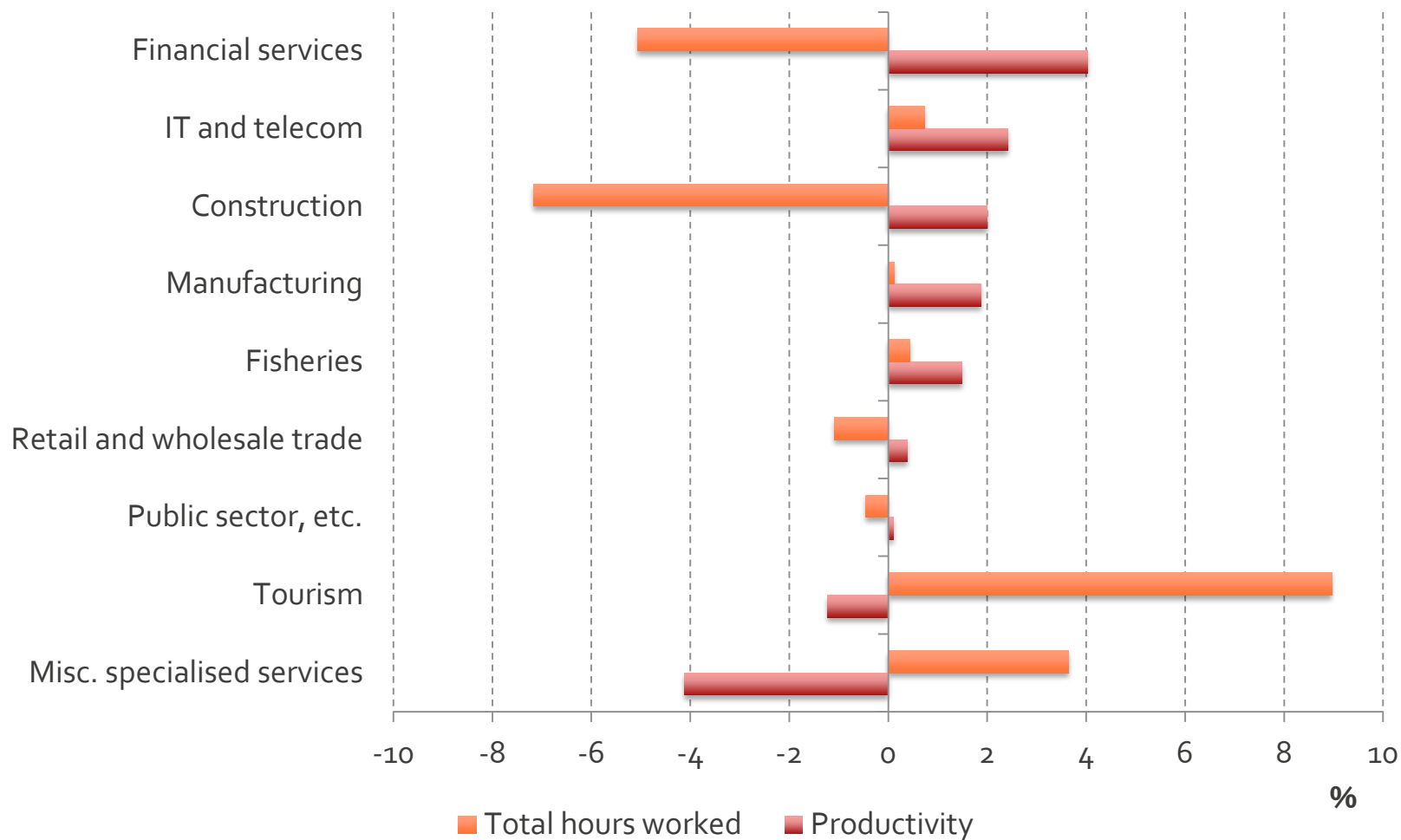
UNEMPLOYMENT BY DURATION



Source: Statistic Iceland



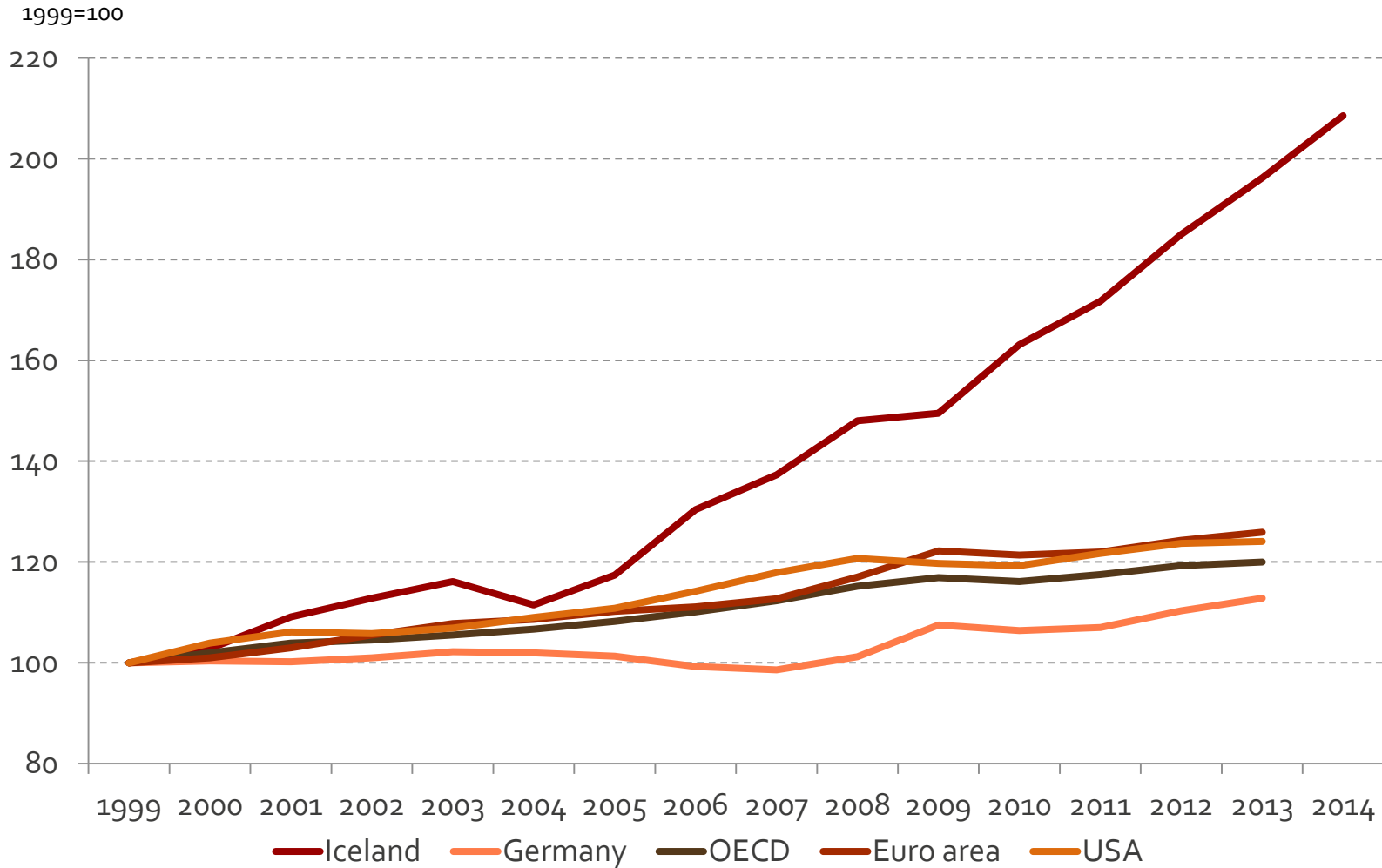
PRODUCTIVITY AND TOTAL HOURS WORKED, BY SECTOR 2009-2014



Source: Central Bank



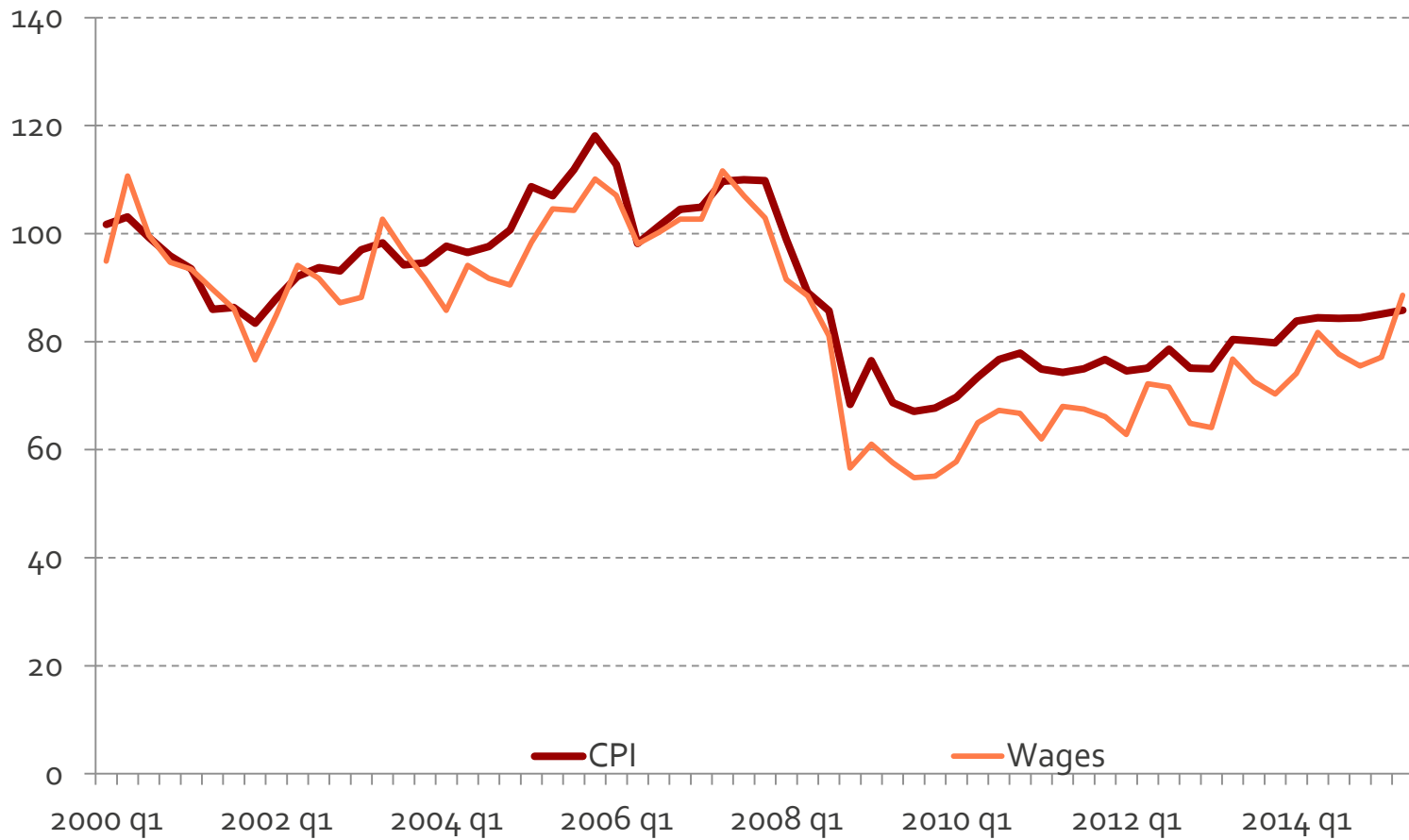
UNIT LABOUR COST



Source: Central Bank



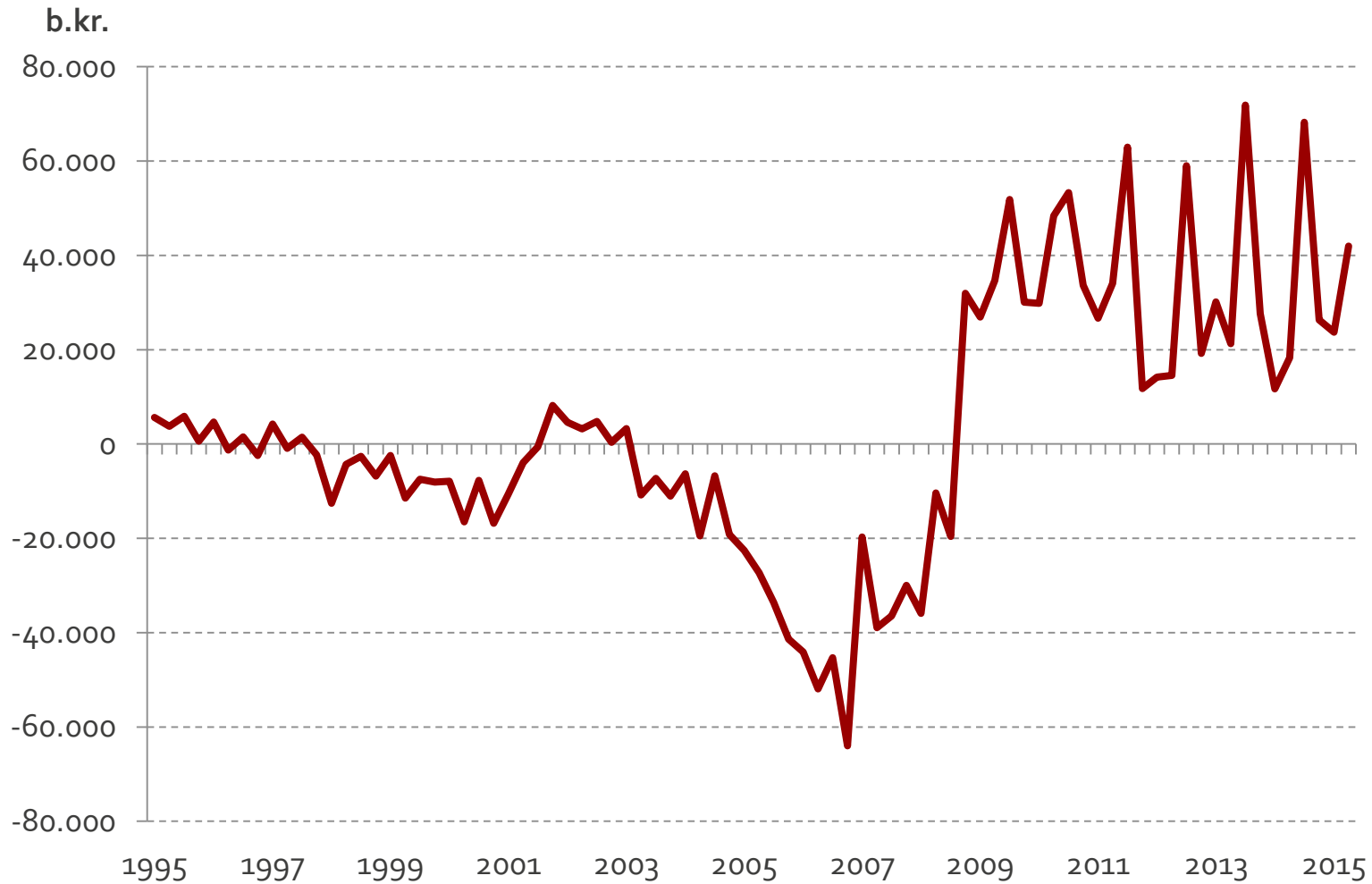
REAL EXCHANGE RATE



Source: Central Bank



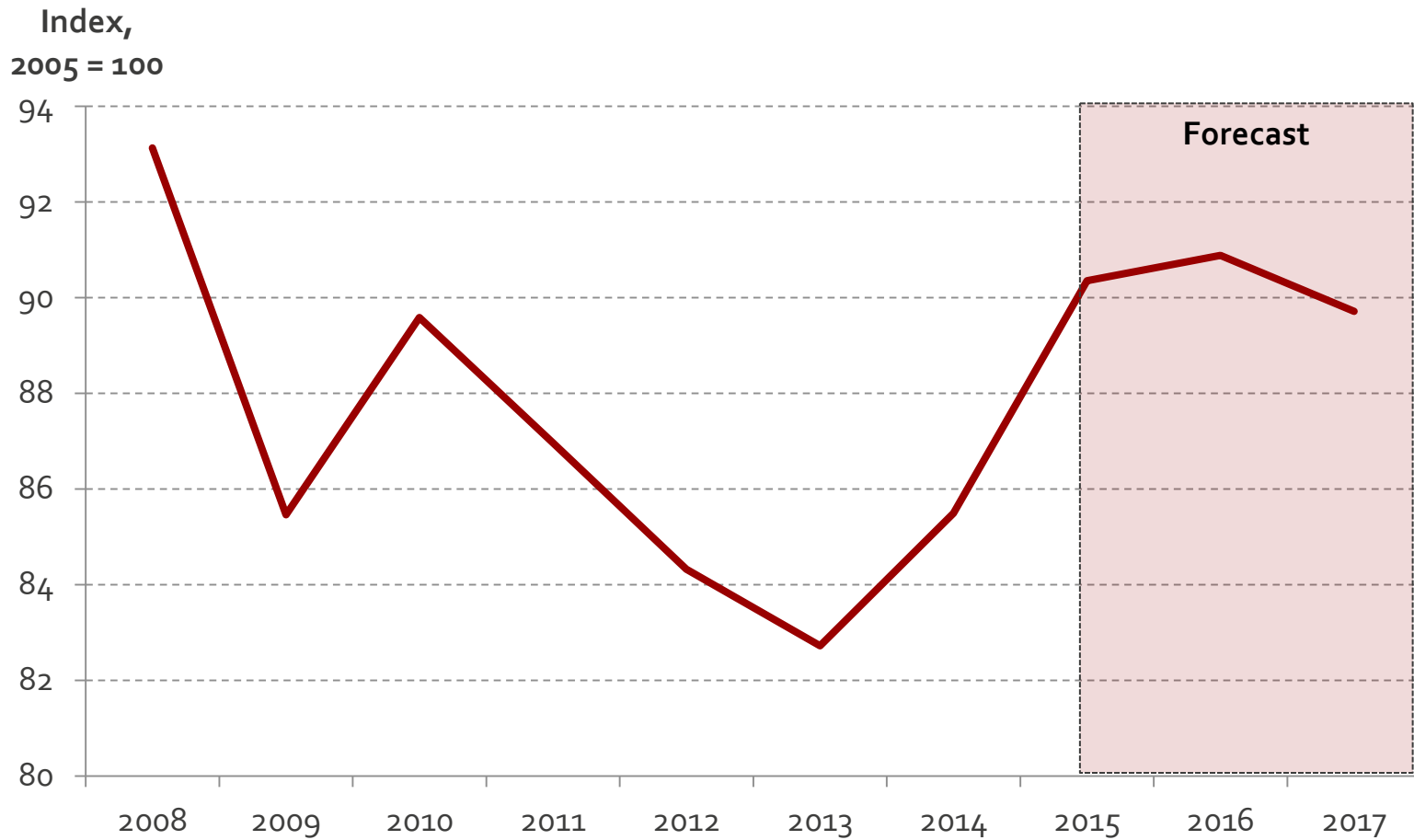
BALANCE OF TRADE IN GOODS AND SERVICES



Source: Statistic Iceland



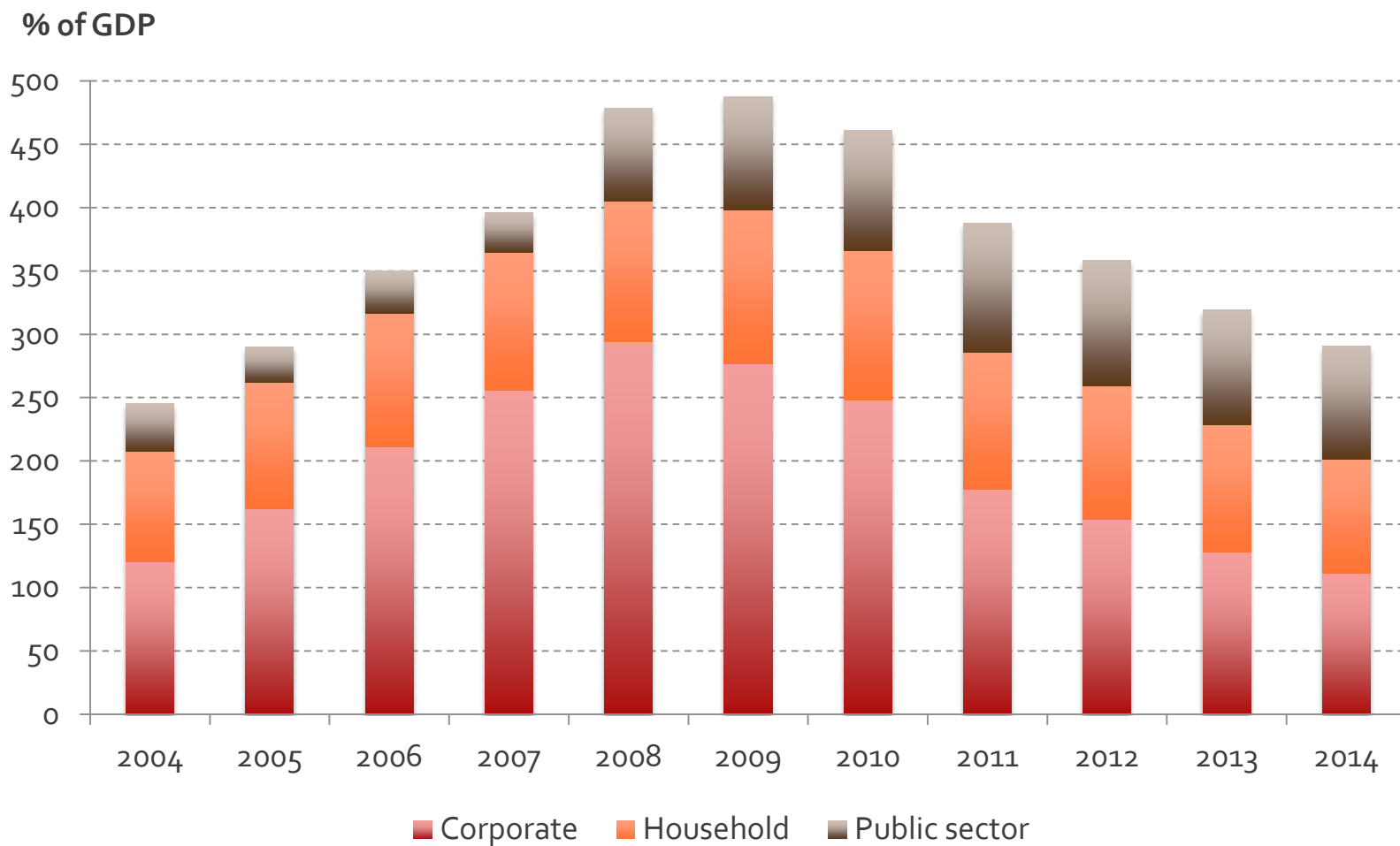
TERMS OF TRADE



Source: Central Bank



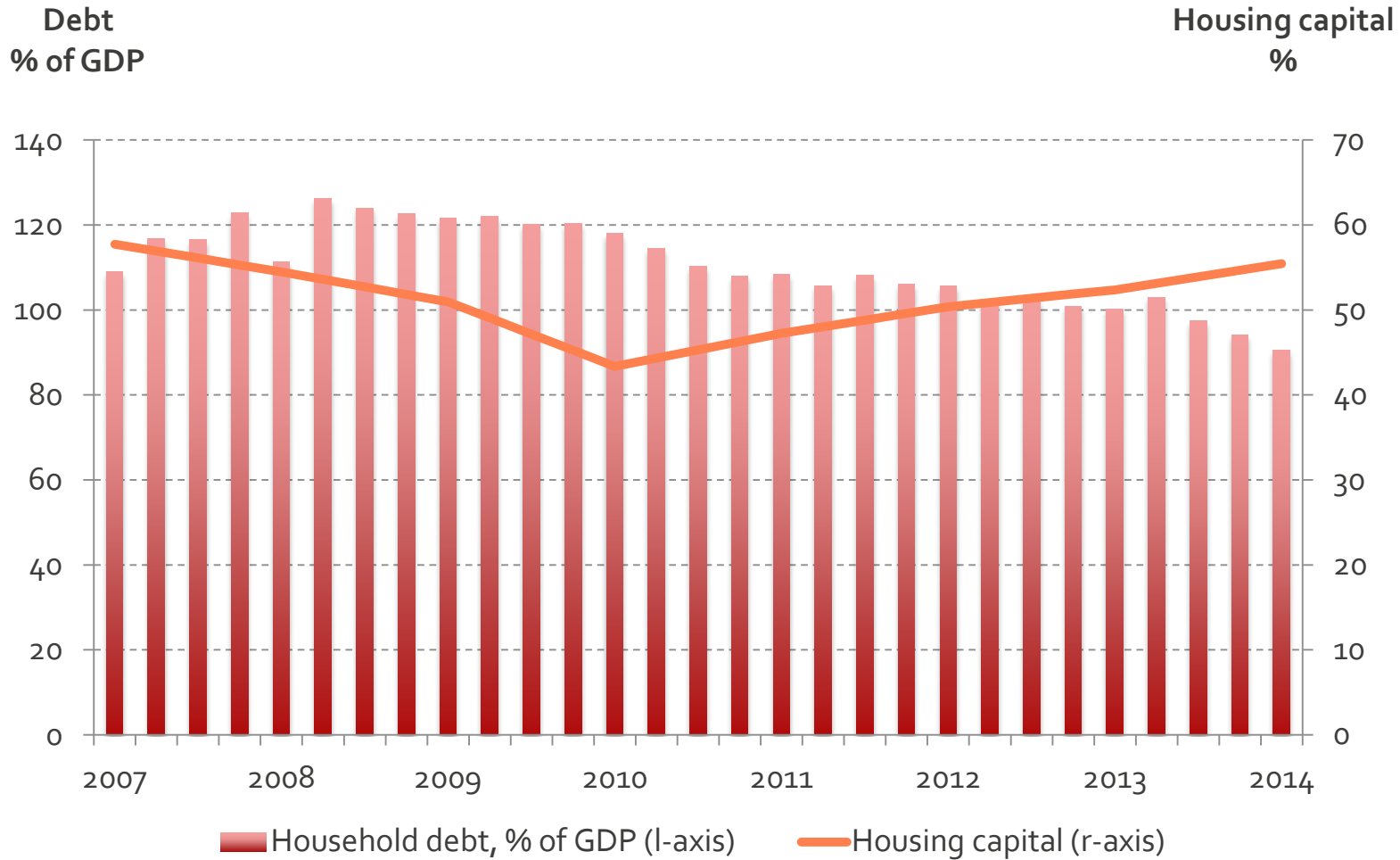
DEBT



Source: Central Bank



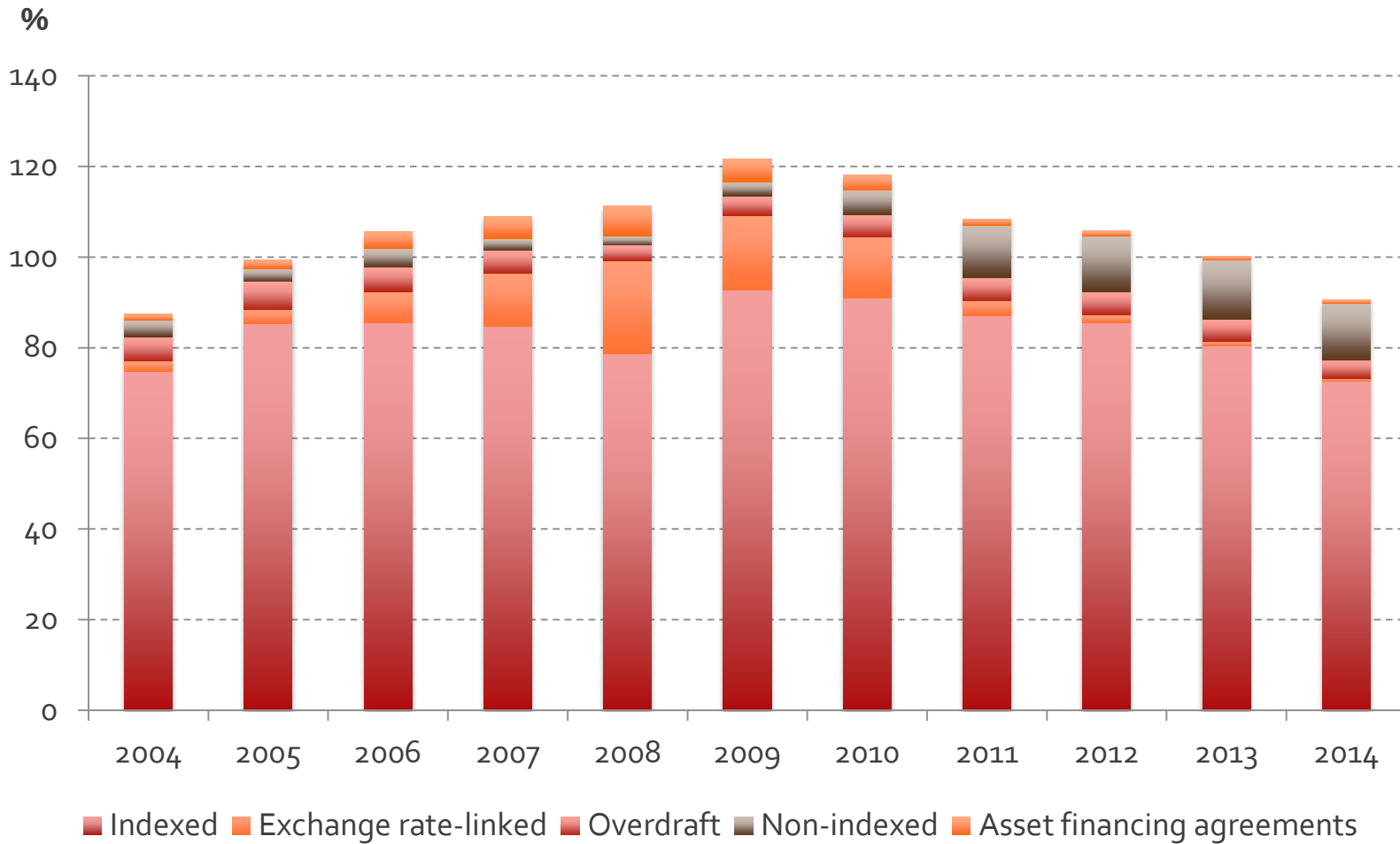
HOUSEHOLD DEBT



Source: Central Bank



HOUSEHOLD DEBT



Source: Central Bank





3.

FISCAL BALANCE

BUDGET PROPOSAL
2016

FISCAL OUTCOME 2014

- » The Treasury returned a surplus in the fiscal year 2014 for the first time in 7 years.

- » The surplus was 46,4 bn. kr. (2,3% of GDP) in the Treasury accounts or 8,4 bn. kr. greater than in the MoF prior estimate in the budget for 2015.
 - Expenditures turned out to be around 5 bn. lower than in the prior outcome projection
 - Mostly due to a reduction in pension liabilities by 5,2 bn.
 - Revenues were 3,4 bn. higher than projected
 - Thereof: tax revenues 6,8 bn. higher and asset sales 1 bn. higher while other current revenues were 4,5 bn. lower than projected

ESTIMATED FISCAL OUTCOME 2015

- » In the budget for 2015, a slight overall surplus was projected but a reassessment after the first half of the year indicates a better outcome.
 - Heading for 21 bn. kr. surplus instead of 3,5 bn. in the budget.
 - The improvement is largely due to favorable one-off revenue, mainly dividends from financial institutions, but also stems from lower interest expenditure.

- » Revenue increase by 26,4 bn. to 680,1 bn.
 - Thereof is a 14,2 bn. increase in tax revenue and a 12,2 bn. increase in other current revenue

- » Primary expenditure increases by 8,9 bn. to 659 bn.

- » Interest balance improves by ISK 5 bn. due to lower interest costs

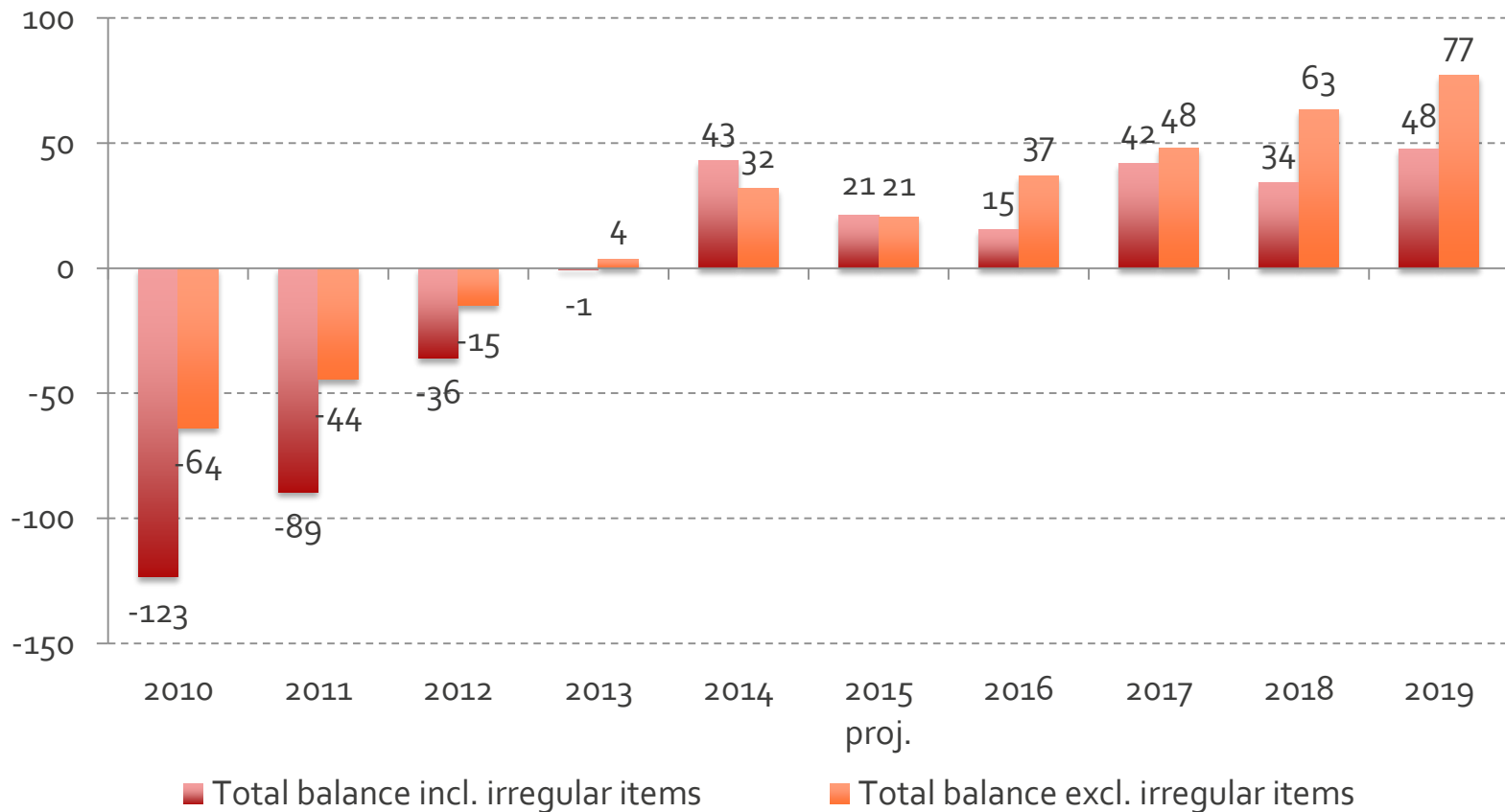
FISCAL OUTLOOK 2016-2019

- » Current fiscal outlook assumes restrained expenditure growth that will generate a growing surplus in the last three years of the fiscal plan
 - The outlook allows for some real growth both on the revenue side and the expenditure side until 2019, albeit somewhat slower than GDP growth.
 - The plan aims for continued expenditure restraint so that growth in primary expenditure will be moderate in real terms, or 1,3% annually on average which will accumulate to around 5% over the forecasting period. Thus, the target for primary expenditure, excluding irregular items, implies a reduction of 1,2% of VLF.
 - Target for the revenue side entails that the GDP ratio of primary revenue, excluding irregular items, will not rise over the period. Actually, it is projected to decrease by 0,5%.
 - In addition, interest expenditure are expected to fall by 1,3% of GDP over the period. This is based on proposed measures in the balance sheet as well as debt reduction by means of income stemming from the liberalization of capital controls.

TOTAL BALANCE 2010-2019*

INCLUDING AND EXCLUDING IRREGULAR ITEMS

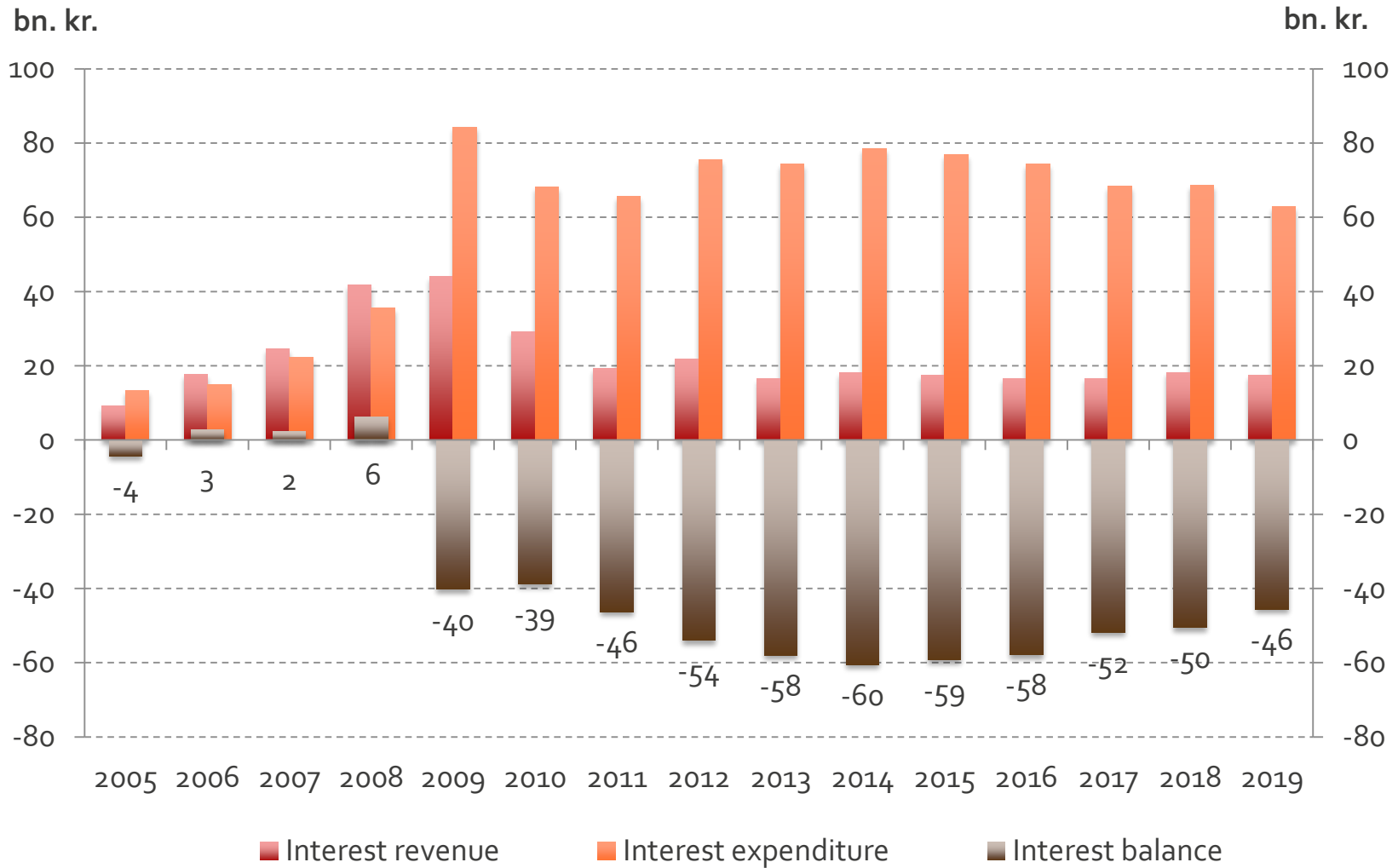
bn. kr.



*Balance in 2010 adjusted for the transfer of the services for disabled people from the state to local governments.



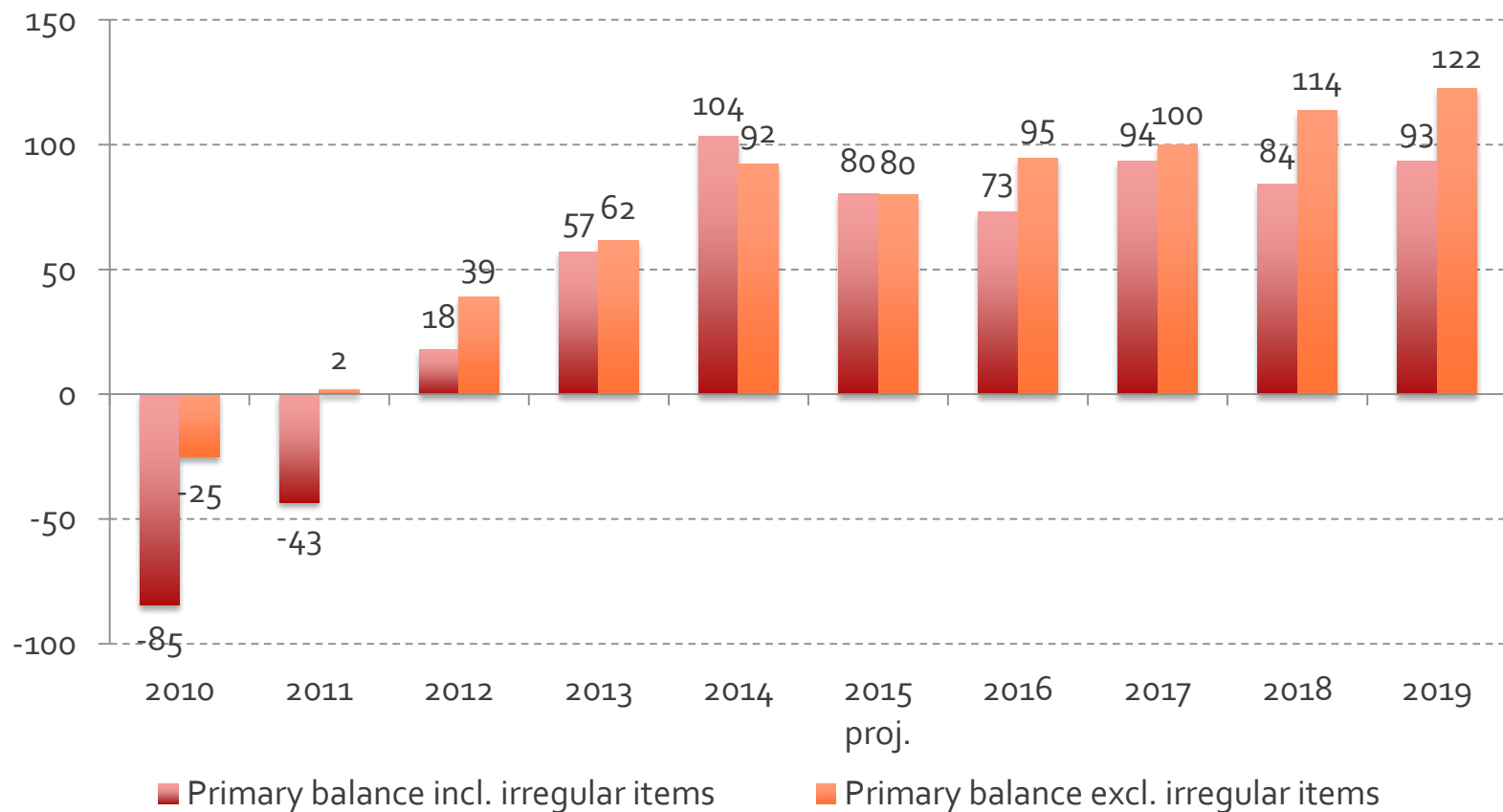
INTEREST BALANCE 2005-2019



PRIMARY BALANCE 2010-2019*

INCLUDING AND EXCLUDING IRREGULAR ITEMS

bn. kr.

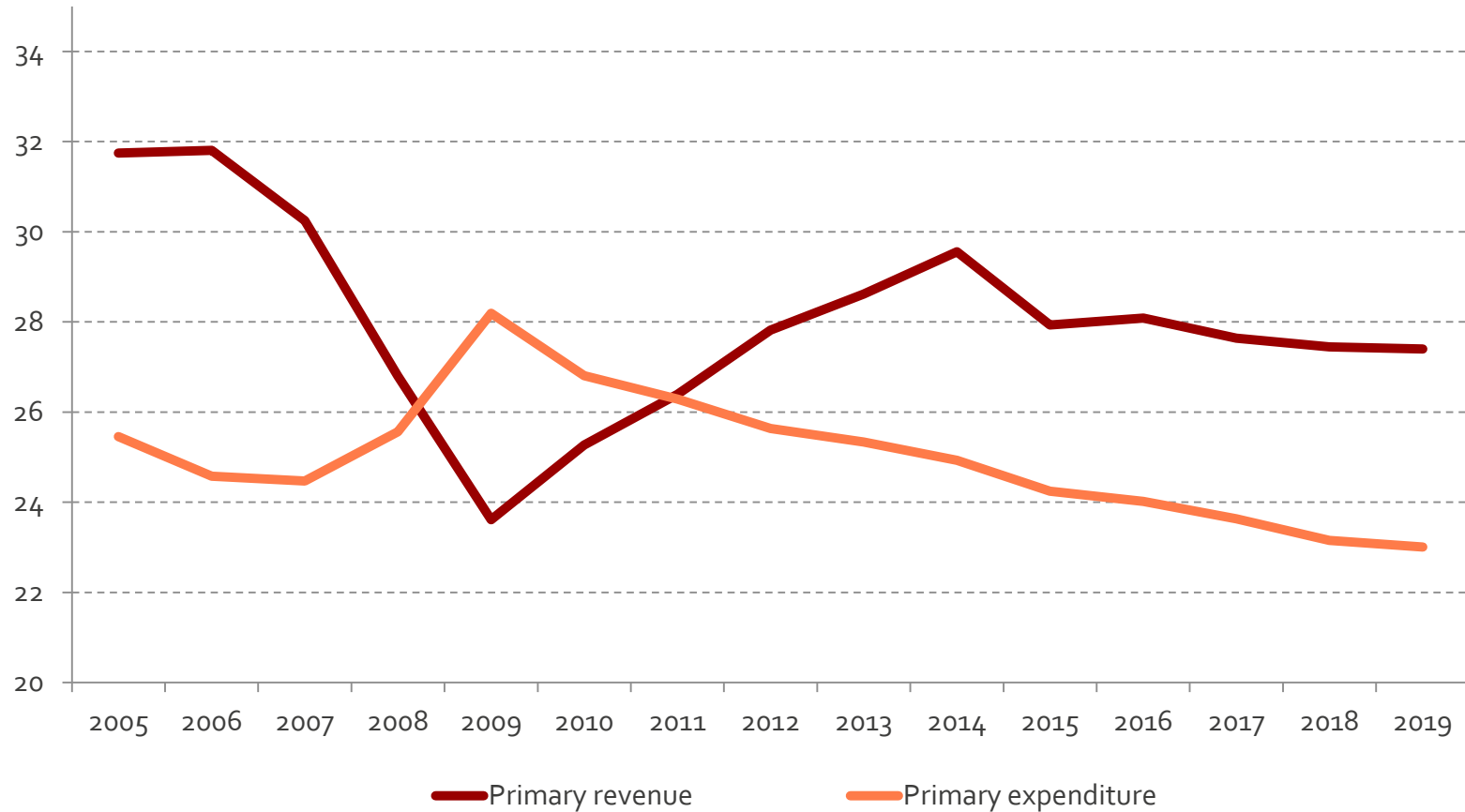


*Balance in 2010 adjusted for the transfer of the services for disabled people from the state to local governments.



PRIMARY REVENUE AND EXPENDITURE 2005-2019*

% of GDP



* Excluding irregular items





4.

REVENUE SIDE

BUDGET PROPOSAL
2016

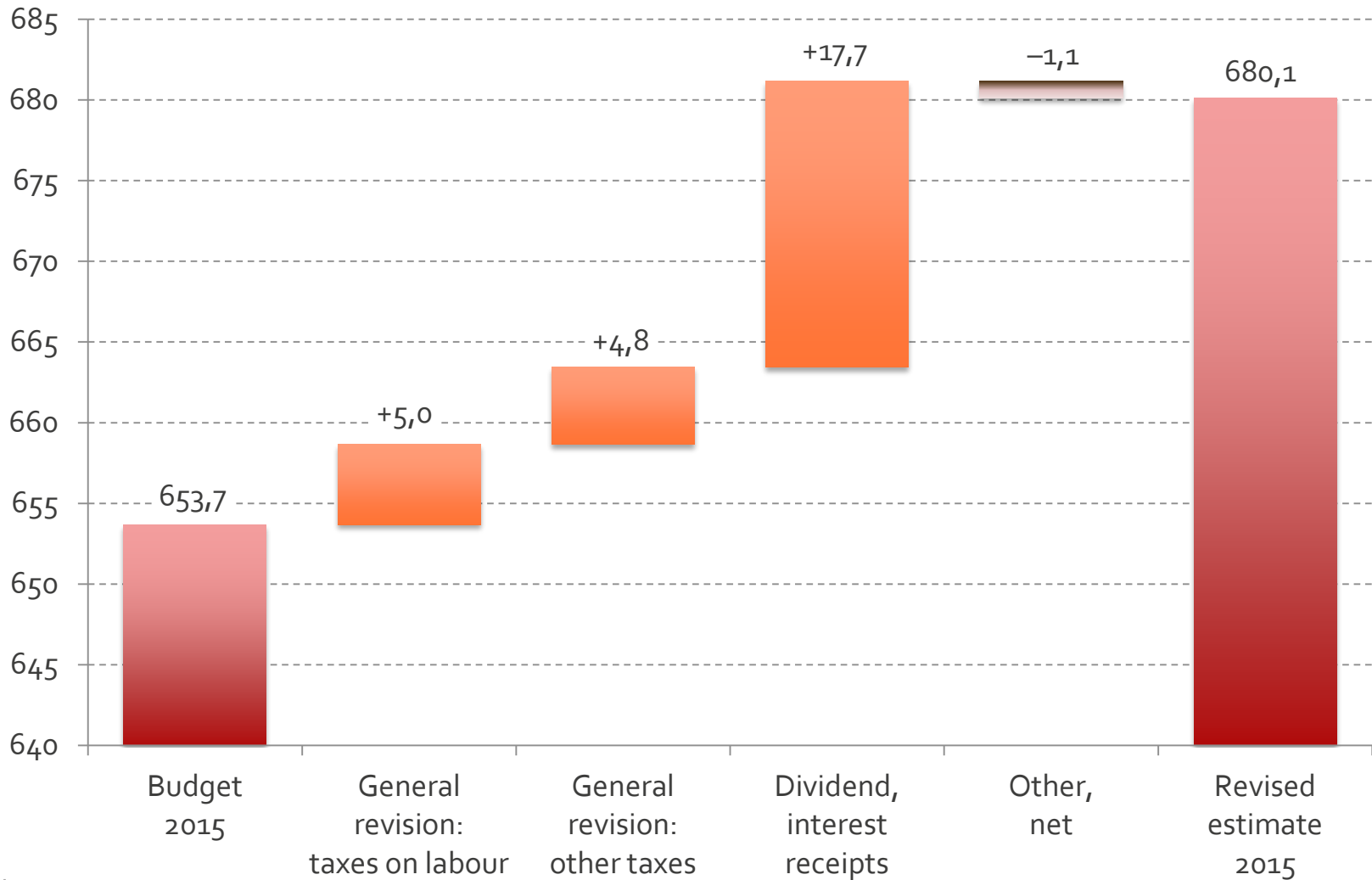
REVENUE ASSUMPTIONS 2016–2019

- Macroeconomic assumptions
 - » Macroeconomic projections from Statistics Iceland in early June for 2016-2019
 - » Reassessment of developments in tax bases in 2015 in light of changes in main premises and economic prospects
- Tax system reform
 - » Impact of earlier measures which become effective in 2016
 - » New measures effective in 2016–2017
 - » Personal income tax
 - » Import duties
 - » Excise on motor vehicles
 - » Taxation of alcohol
- Other specific assumptions and measures



REVISED REVENUE ESTIMATE FOR 2015 (A)

b.kr.



REVISED REVENUE ESTIMATE FOR 2015 (B)

B.kr.	Budget		Revised		Change	
	accrual	cash	accrual	cash	accrual	cash
Tax revenue incl. SSCs	600,1	578,3	614,3	597,3	14,2	19,1
Taxes on income and profits	222,2	211,4	238,0	231,8	15,8	20,4
Social security contributions (SSCs)	78,7	77,1	79,2	77,0	0,4	-0,1
Taxes on labour	6,8	6,8	7,1	7,0	0,2	0,2
Property taxes	7,0	7,0	7,2	7,5	0,2	0,5
Taxes on goods and services	248,8	239,5	248,0	239,3	-0,8	-0,2
Other taxes	36,6	36,6	34,8	34,8	-1,8	-1,8
Other revenue	50,6	49,0	62,8	62,8	12,2	13,8
Asses sales	0,8	0,8	0,8	0,8	0,0	0,0
Grants	2,1	2,1	2,2	2,2	0,0	0,0
Total revenue	653,7	630,2	680,1	663,1	26,4	32,9



REVENUE ESTIMATE 2016–2019: MAIN RESULTS

- Economic outlook for fairly strong growth ahead
- Tax policy aims for lower tax burden for households and reliance on more efficient indirect taxes
- Tax revenues (excl. irregular items) decline slightly in medium-term, from 26,5% in 2015 to 26,2% in 2019
- Tax reforms since 2013 result in 25 bn. kr. reduction (excl. bank tax) in tax revenue in 2016
 - » Households benefit most from reduced tax burden
- Total revenues (excl. irregular items) shrink from 28,7% in 2015 to 28,0% in 2019
- Total revenues shrink from 31,4% in 2015 to 28,2% in 2019 as large temporary items are lost



REVENUE ESTIMATE 2015–2019: OVERVIEW (A)

Accrual basis, billion kr. ¹	2015	2016	2017	2018	2019
Total revenue	680.1	696.3	731.0	748.8	787.4
Tax revenue	614.3	646.5	681.9	696.4	735.1
Primary revenue	662.6	679.7	714.3	730.5	770.0
Interest receipts	17.5	16.6	16.6	18.2	17.4
% of GDP					
Total revenue	31.4	29.9	29.3	28.3	28.2
Tax revenue	28.4	27.7	27.4	26.3	26.4
Primary revenue	30.6	29.2	28.7	27.6	27.6
Interest receipts	0.8	0.7	0.7	0.7	0.6

1. Irregular items are not excluded.



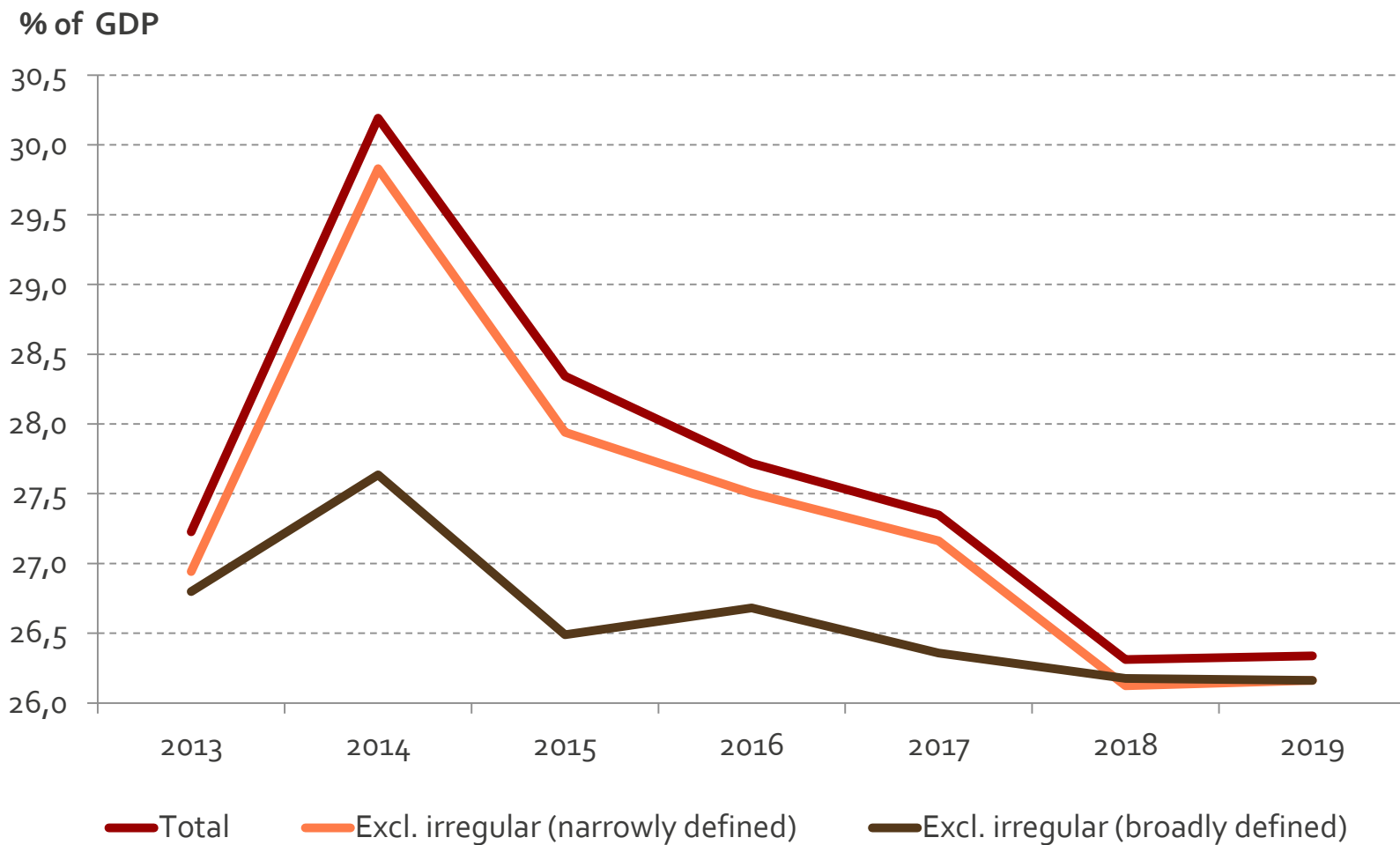
REVENUE ESTIMATE 2015–2019: OVERVIEW (B)

Excl. irregular items (broadly defined) ¹					
Accrual basis, billion kr. ¹	2015	2016	2017	2018	2019
Total revenue	622.6	671.3	705.5	744.4	781.7
Tax revenue	574.2	622.3	657.2	692.9	730.2
Primary revenue	605.1	654.7	688.8	726.2	764.3
% of GDP					
Total revenue	28.7	28.8	28.3	28.1	28.0
Tax revenue	26.5	26.7	26.4	26.2	26.2
Primary revenue	27.9	28.1	27.6	27.5	27.4

1. Irregular items are: capital income tax paid by Treasury itself, all proceeds from asset sales and revaluation of financial assets (narrow definition) and also the following items: temporary side effects on tax revenues from the Household Debt Reduction Programme 2015–2019; part of bank tax 2014–2017; part of special FAT 2014–2015; special dividend from reduction of CB capital 2014; part of Landsbanki dividend 2013–2015; temporary side effects from third-pillar pension savings withdrawals in 2015.

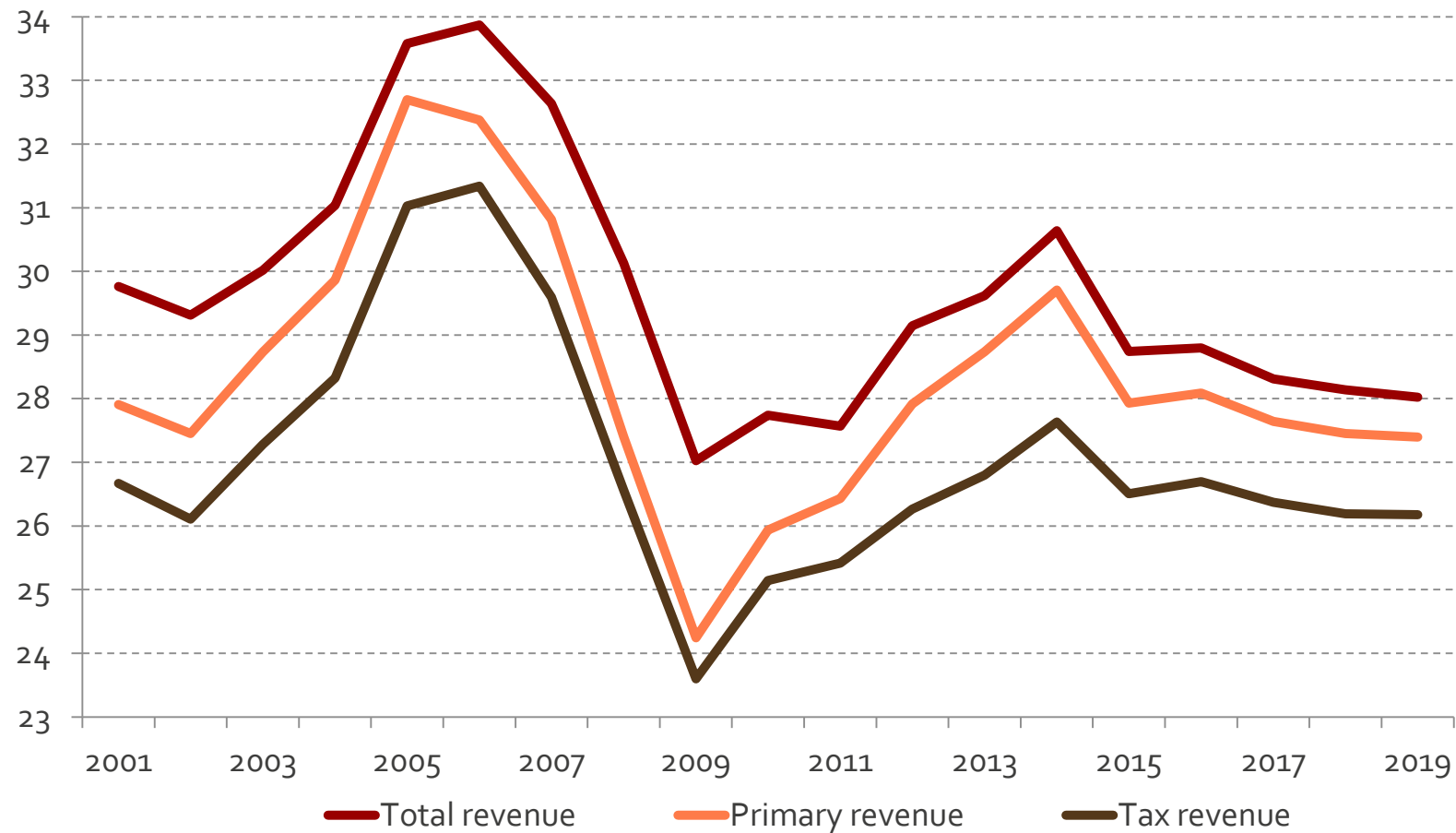


TREASURY TAX REVENUE 2013–2019



TREASURY REVENUE 2001–2019*

% of GDP

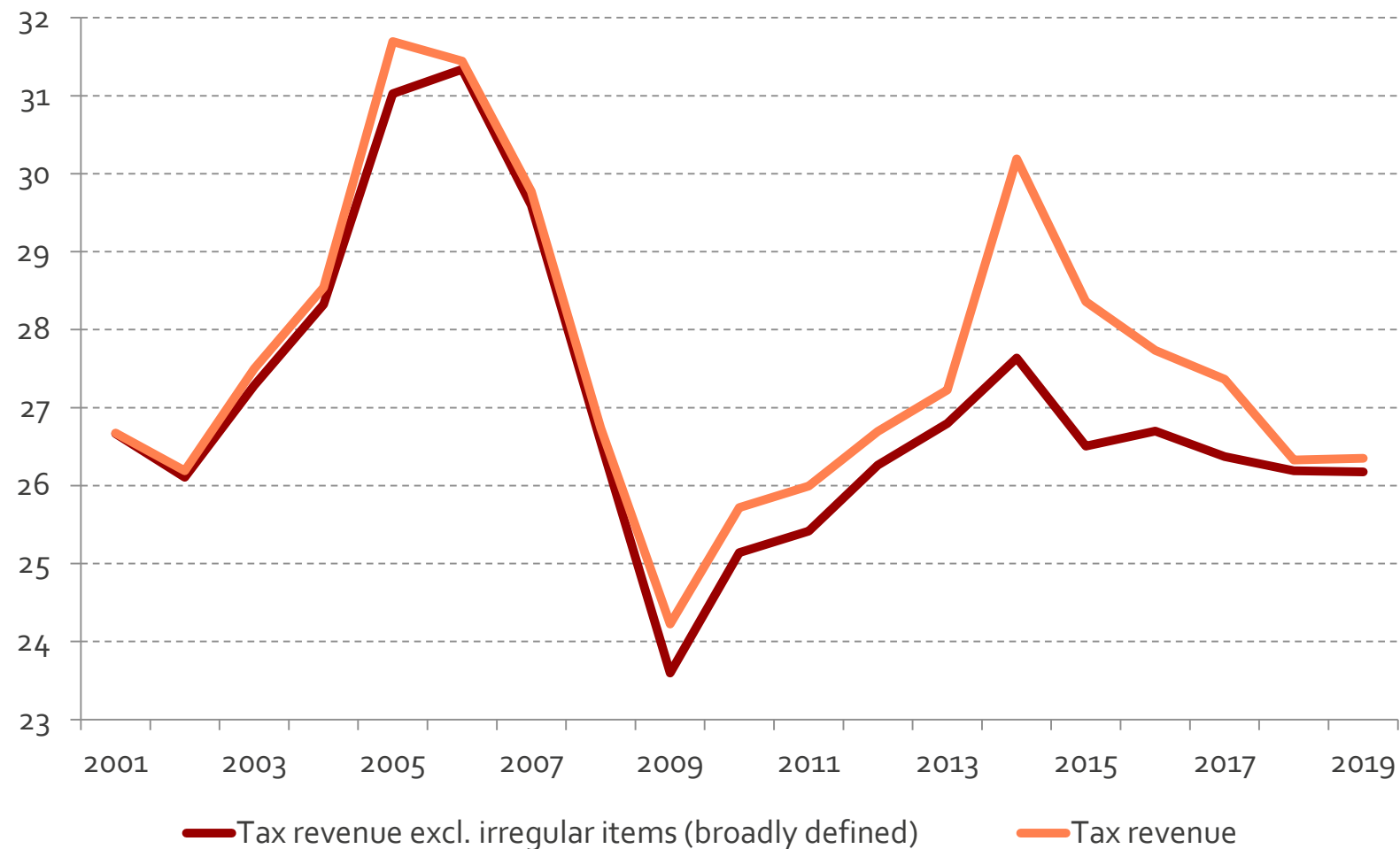


* Excluding irregular items.



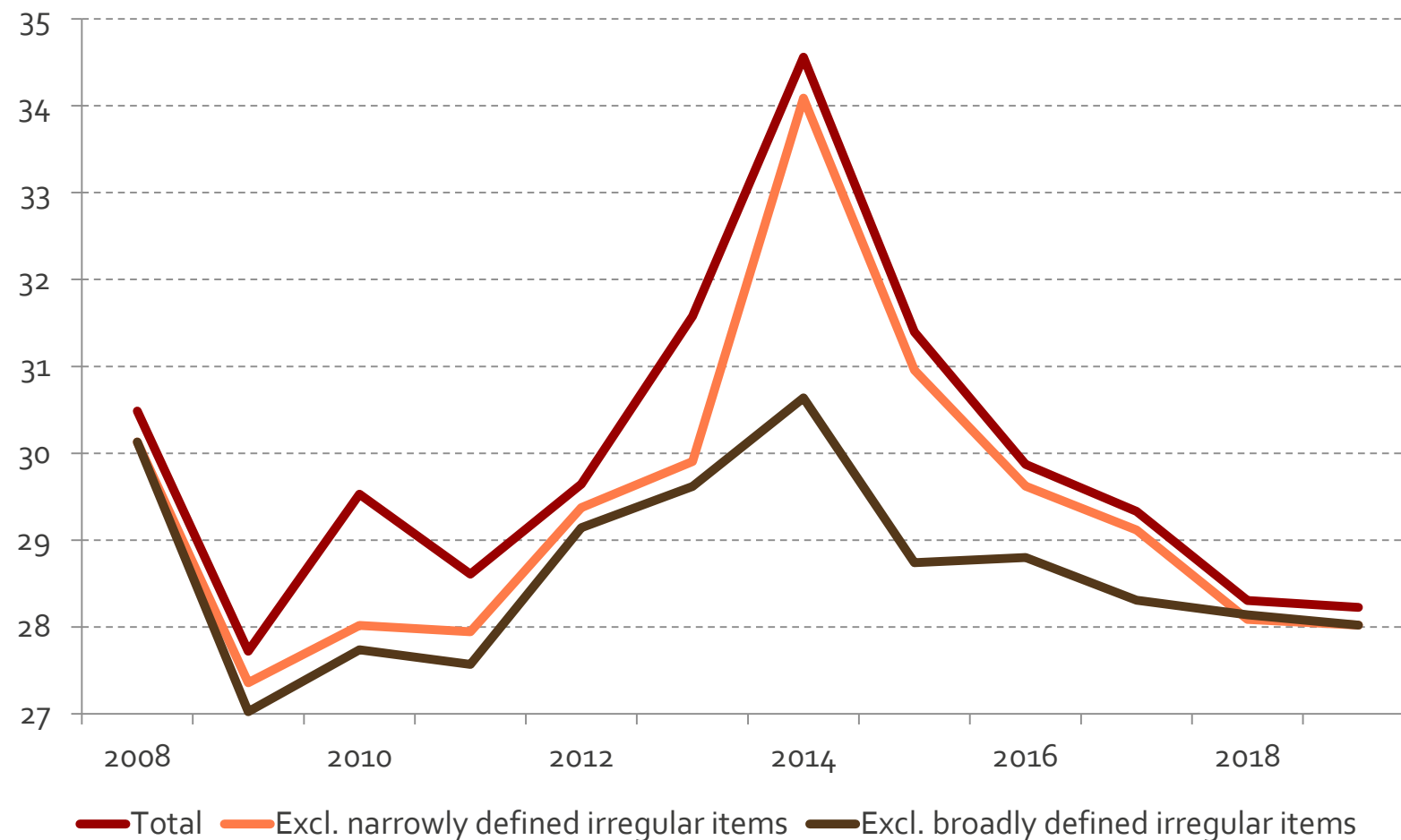
TREASURY TAX REVENUE 2001–2019

% of GDP

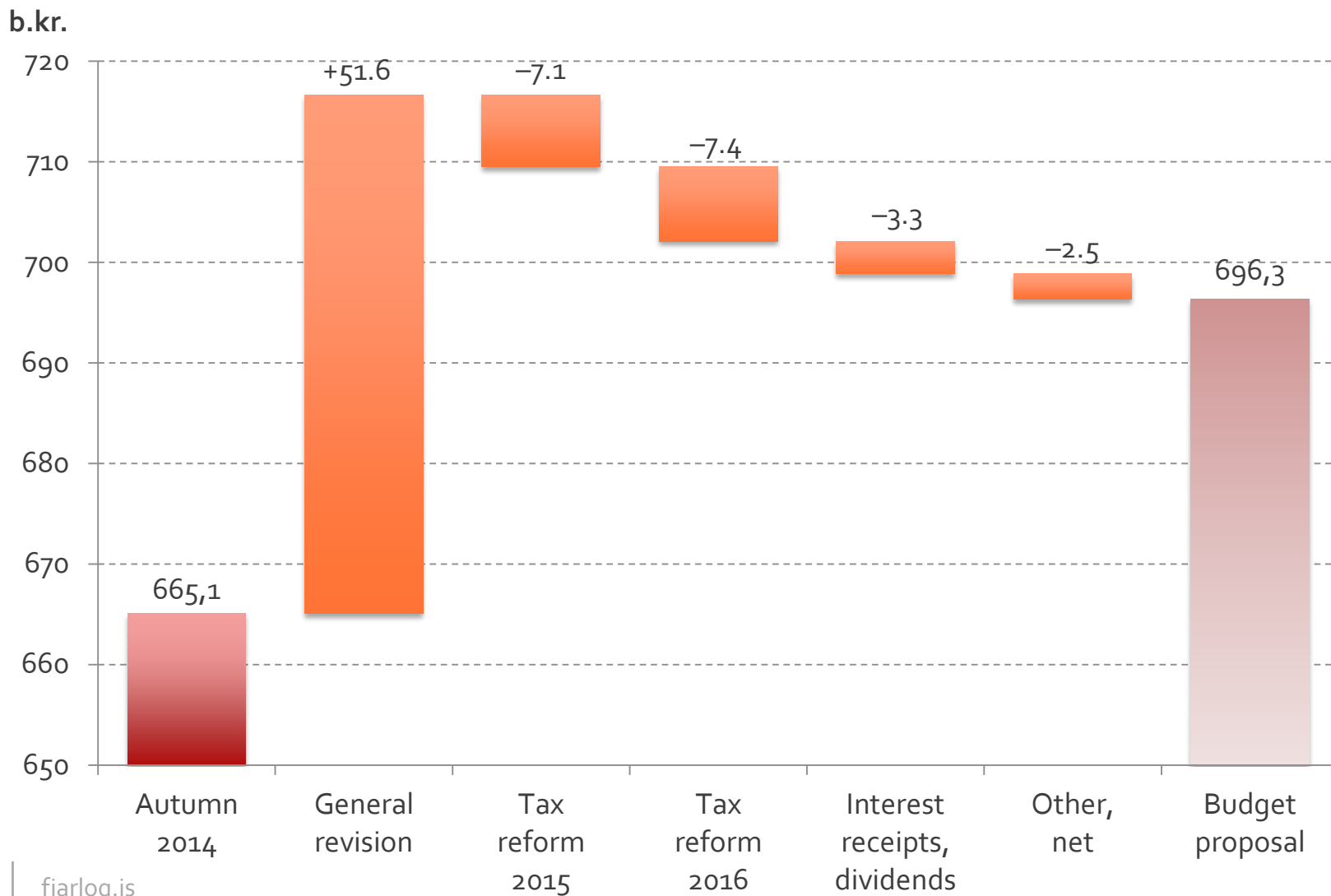


TREASURY TOTAL REVENUE 2008–2019

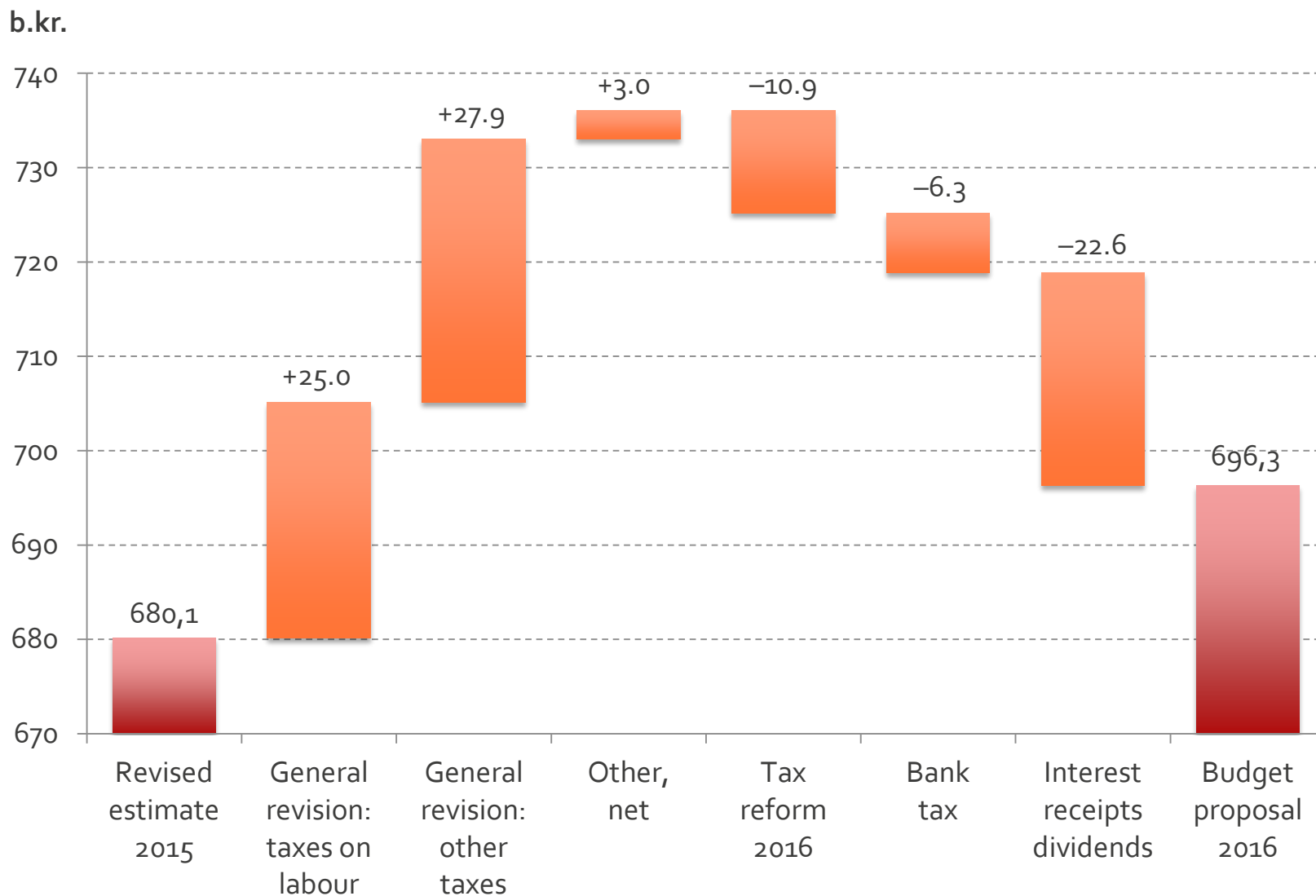
% of GDP



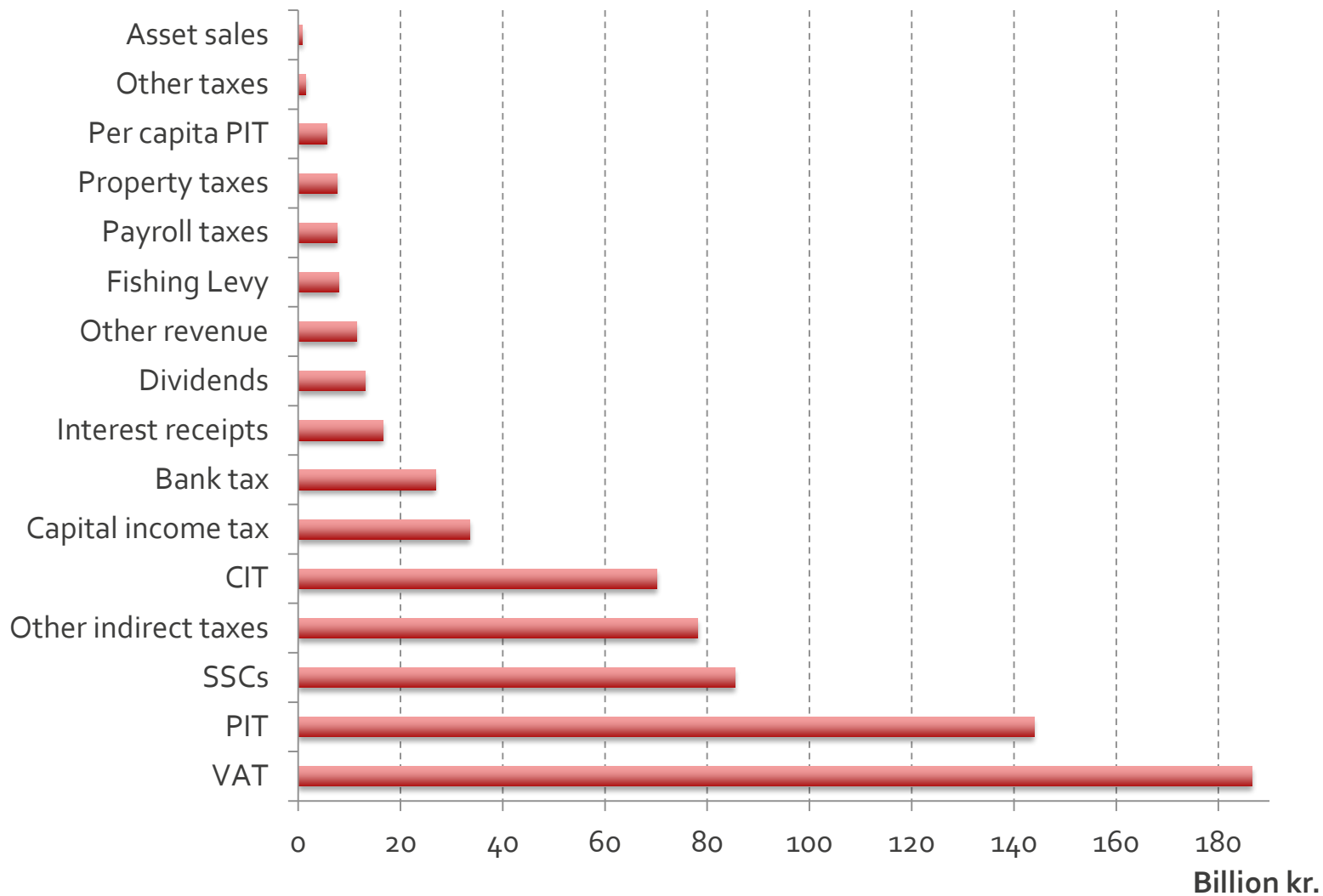
REVENUE ESTIMATE OF BUDGET PROPOSAL 2016: CHANGE FROM AUTUMN 2014



BUDGET PROPOSAL REVENUE ESTIMATE: NOMINAL CHANGE BETWEEN 2015 AND 2016



BUDGET PROPOSAL REVENUE ESTIMATE 2016: BREAKDOWN RANKED BY SIZE



Budget Proposal 2016



REVENUE DEVELOPMENTS 2014–2016 (A)

	Treasury Account	Budget	Revised budget	Budget proposal
Billion kr.	2014	2015	2015	2016
Total revenue	688.9	653.7	680.1	696.3
Tax revenue	601.8	600.1	614.3	646.5
Direct taxes	364.3	351.3	366.3	381.9
Indirect taxes	237.5	248.8	248.0	264.7
Interest receipts	18.6	18.2	17.5	16.6
Primary revenue	670.3	635.5	662.6	679.7
Irregular items	78.2	38.6	57.5	25.0
thereof tax items	50.9	37.8	40.1	24.2
Total revenue excl. irregular	610.7	615.1	622.6	671.3
Tax revenue excl. irregular	550.9	562.4	574.2	622.3



REVENUE DEVELOPMENTS 2014–2016 (B)

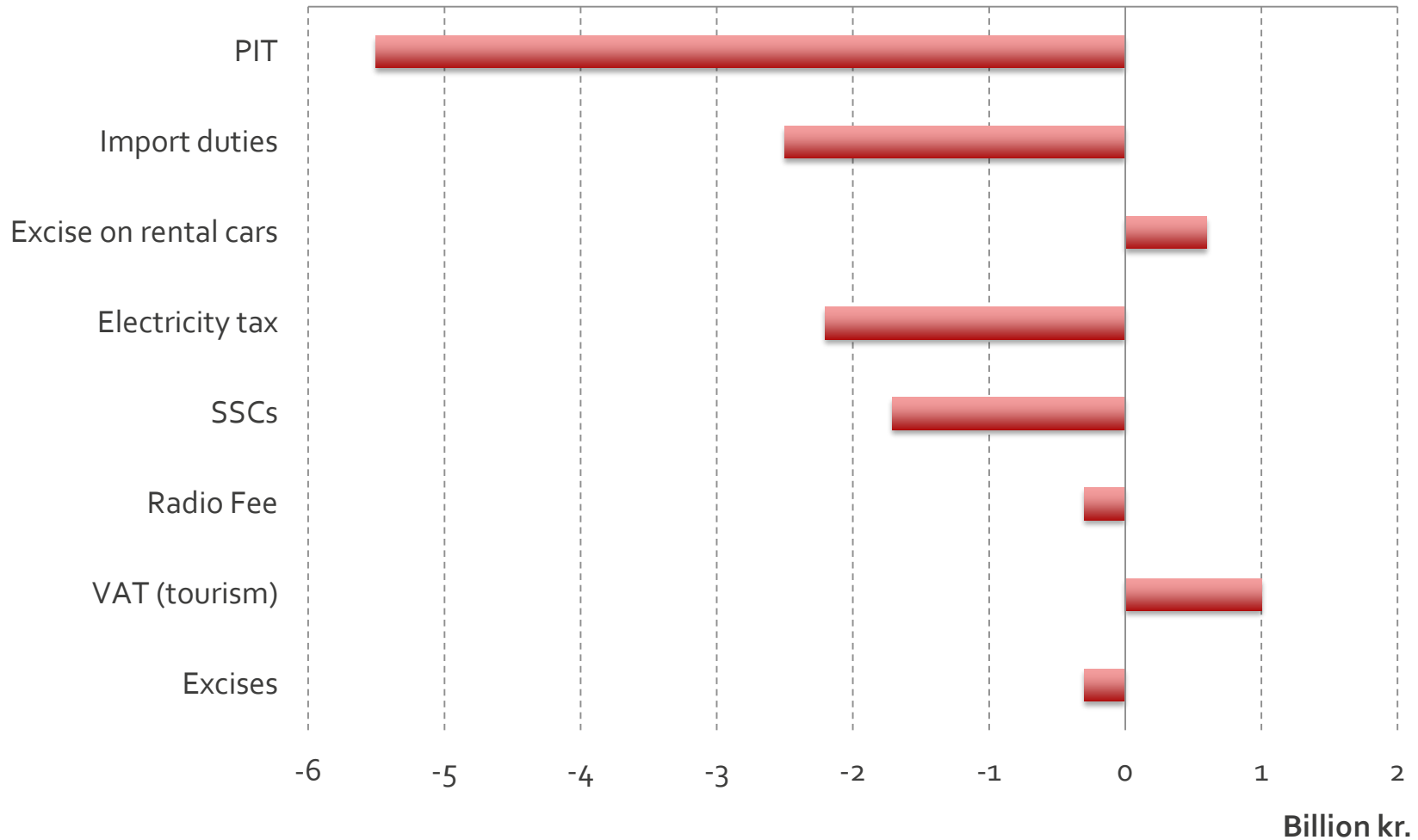
	Treasury Account	Budget	Revised budget	Budget proposal
% of GDP	2014	2015	2015	2016
Total revenue	34.6	30.7	31.4	29.9
Tax revenue	30.2	28.2	28.4	27.7
Direct taxes	18.3	16.5	16.9	16.4
Indirect taxes	11.9	11.7	11.4	11.4
Interest receipts	0.9	0.9	0.8	0.7
Primary revenue	33.6	29.8	30.6	29.2
Irregular items	3.9	1.8	2.7	1.1
thereof tax items	2.6	1.8	1.9	1.0
Total revenue excl. irregular	30.6	28.9	28.7	28.8
Tax revenue excl. irregular	27.6	26.4	26.5	26.7



NEW TAX REFORM PROPOSALS 2016–2017

- Reform of personal income tax (PIT) (two phases)
 - » Number of rates reduced from three to two
 - » Reduced tax burden for all income groups, most for middle groups
- Import duties in certain categories repealed
 - » All clothing and shoes in first phase
 - » All other, except food items, in second phase
- Tax relief for rental cars repealed in two phases
- Taxation of alcohol (revenue neutral in short-term)
 - » Reduced VAT rate; excise raised to offset lost VAT revenue
 - » Simplification for restaurants and improved compliance
- Effective tax rate on income from lease of residential housing reduced from 14% to 10%

TAX REFORMS IMPLEMENTED IN 2016



NEW TAX REFORM PROPOSALS 2016–2017: REVENUE IMPACT IN 2016–2019

Accrual basis, b.kr.	2016	2017	2018	2019
PIT	-5.5	-11.0	-11.0	-11.0
Import duties	-2.5	-5.7	-5.9	-6.1
Excises on rental cars	0.6	2.5	2.5	2.5
Capital income tax on lease income	.	-0.4	-0.4	-0.4
VAT (taxis)	.	0.1	0.1	0.1
Taxation of alcohol
Total	-7.4	-14.5	-14.7	-14.9



TAX REFORM SINCE 2013: REVENUE IMPACT IN 2016–2019

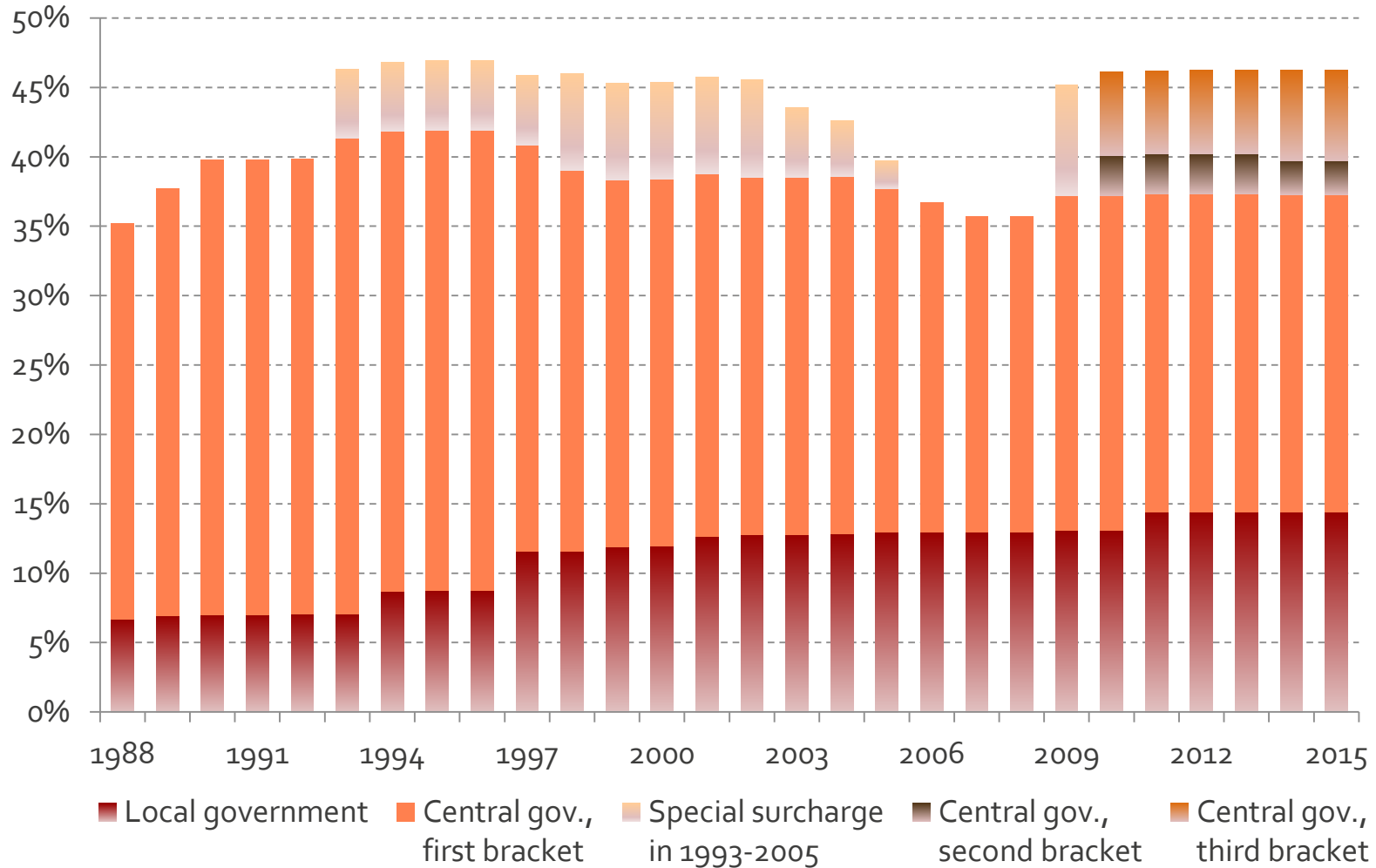
Billion kr.	2015	2016	2017	2018	2019
<i>Tax reform since autumn 2013</i>					
Tax reform in Parliament 2013/2014	21,4	12,5	11,8	-11,5	-10,8
thereof bank tax	32,1	25,7	26,0	3,1	3,3
Tax reform in Parliament 2014/2015	-4,8	-4,7	-4,3	-4,6	-5,0
Tax reform in budget proposal for 2016	-7,4	-14,5	-14,7	-14,9
Tax reform, total	16,7	0,4	-7,0	-30,8	-30,7
thereof bank tax	32,1	25,7	26,0	3,1	3,3
thereof other than bank tax	-15,4	-25,3	-33,0	-33,9	-34,0
<i>Earlier measures</i>					
Temporary provisions expire	-8,4	-10,8	-10,8	-10,8	-10,6
Tax reform and earlier measures	8,3	-10,5	-17,7	-41,5	-41,3
thereof other than bank tax	-23,8	-36,2	-43,7	-44,6	-44,6

Budget Proposal 2016

The total revenue impact in each year



THE PIT RATE STRUCTURE 1988–2015



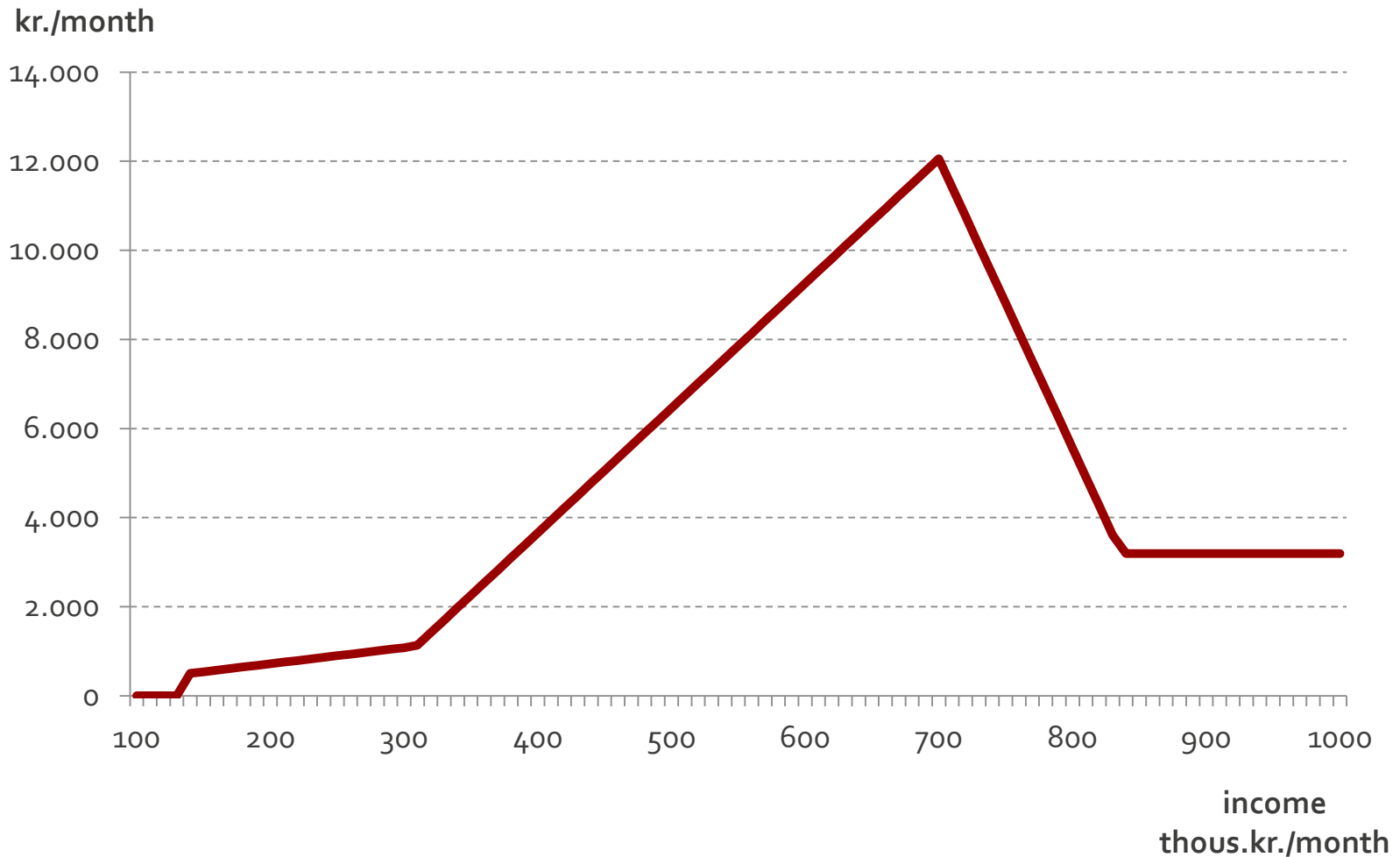
PIT REFORM IN 2016 AND 2017

	2015	2016	2017
<i>Central and local government PIT rates</i>			
Central government			
Bracket 1	22.86%	22.68%	22.50%
Bracket 2 (additional)	2.44%	1.22%	9.30%
Bracket 3 (additional)	6.50%	7.90%	-
Total.....	31.80%	31.80%	31.80%
Local government (average rate).....	14.44%	14.44%	14.44%
PIT rate total			
Bracket 1	37.30%	37.12%	36.94%
Bracket 2.....	39.74%	38.34%	46.24%
Bracket 3.....	46.24%	46.24%	-
<i>Bracket threshold per month (thous. kr.)</i>			
Lower.....	309.1	309.1	-
Upper.....	836.4	770.0	700.0

No change is assumed in the average tax rate for local government PIT which is 14.44% in 2015. Bracket thresholds, currently linked to the wage index, will continue to be indexed in the same way.

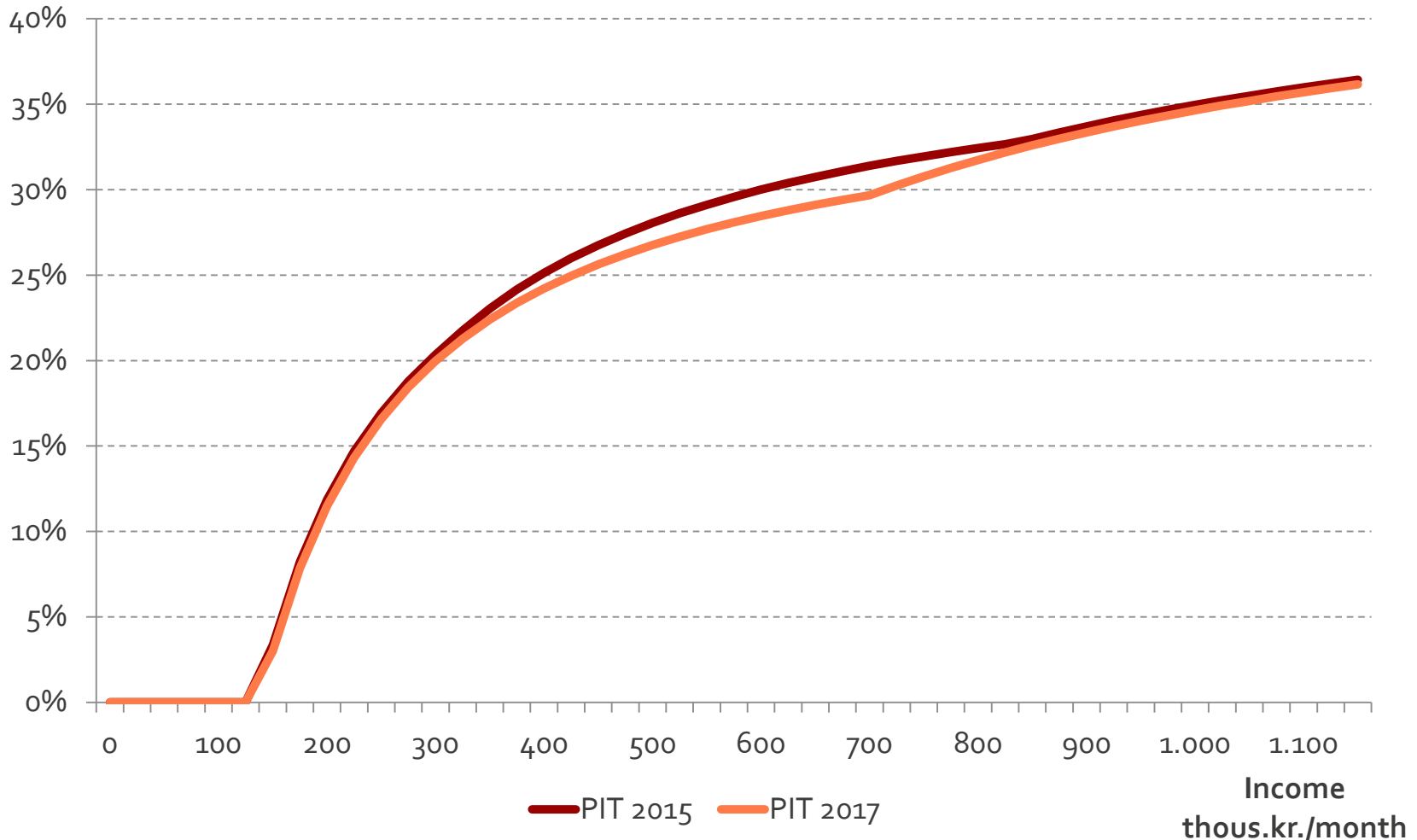


PIT REFORM: EFFECT ON DISPOSABLE INCOME 2017

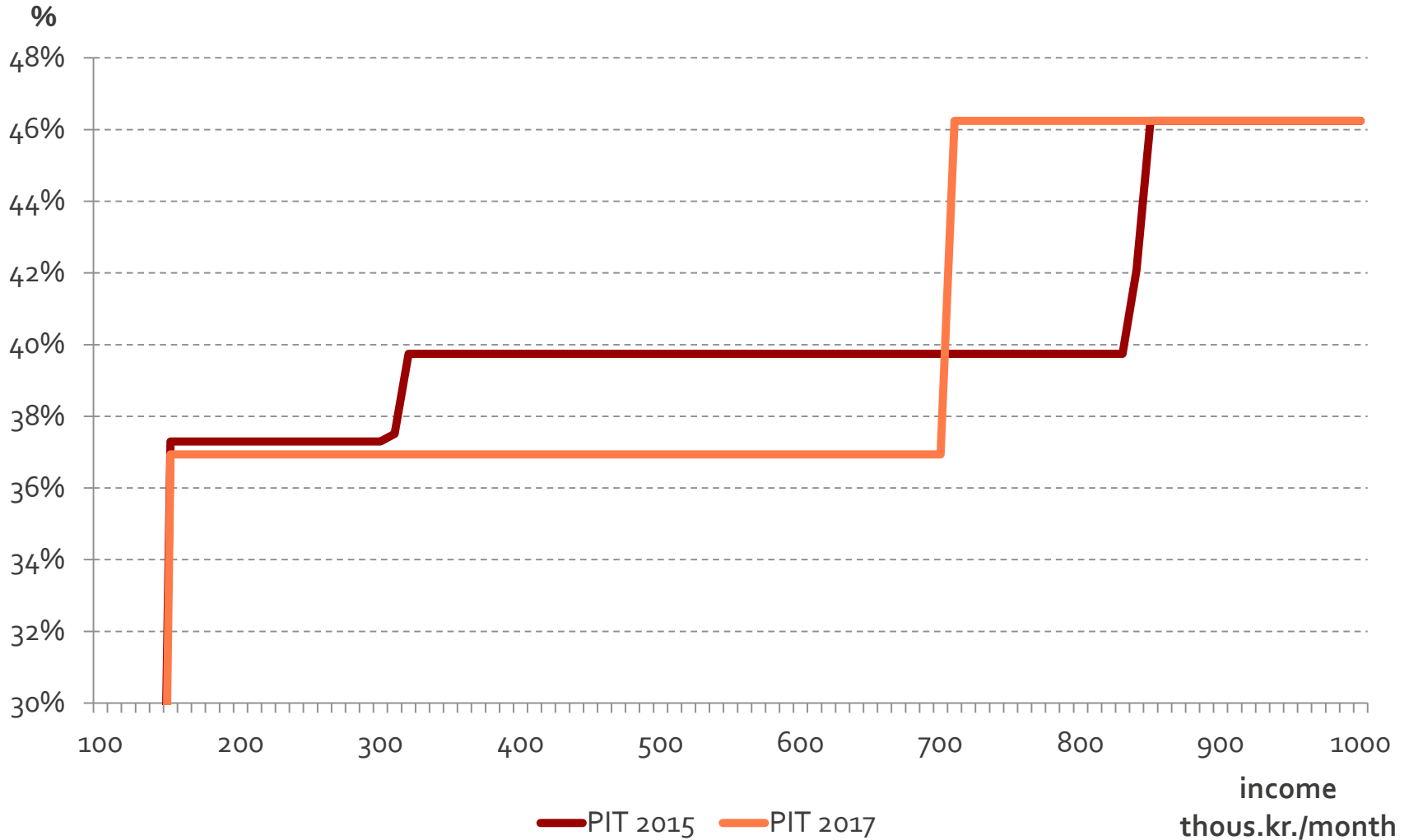


PIT BURDEN BEFORE AND AFTER THE REFORM

Tax burden



MARGINAL PIT RATES BEFORE AND AFTER THE REFORM



TAX EXEMPTION THRESHOLD PER MONTH 2007–2017*

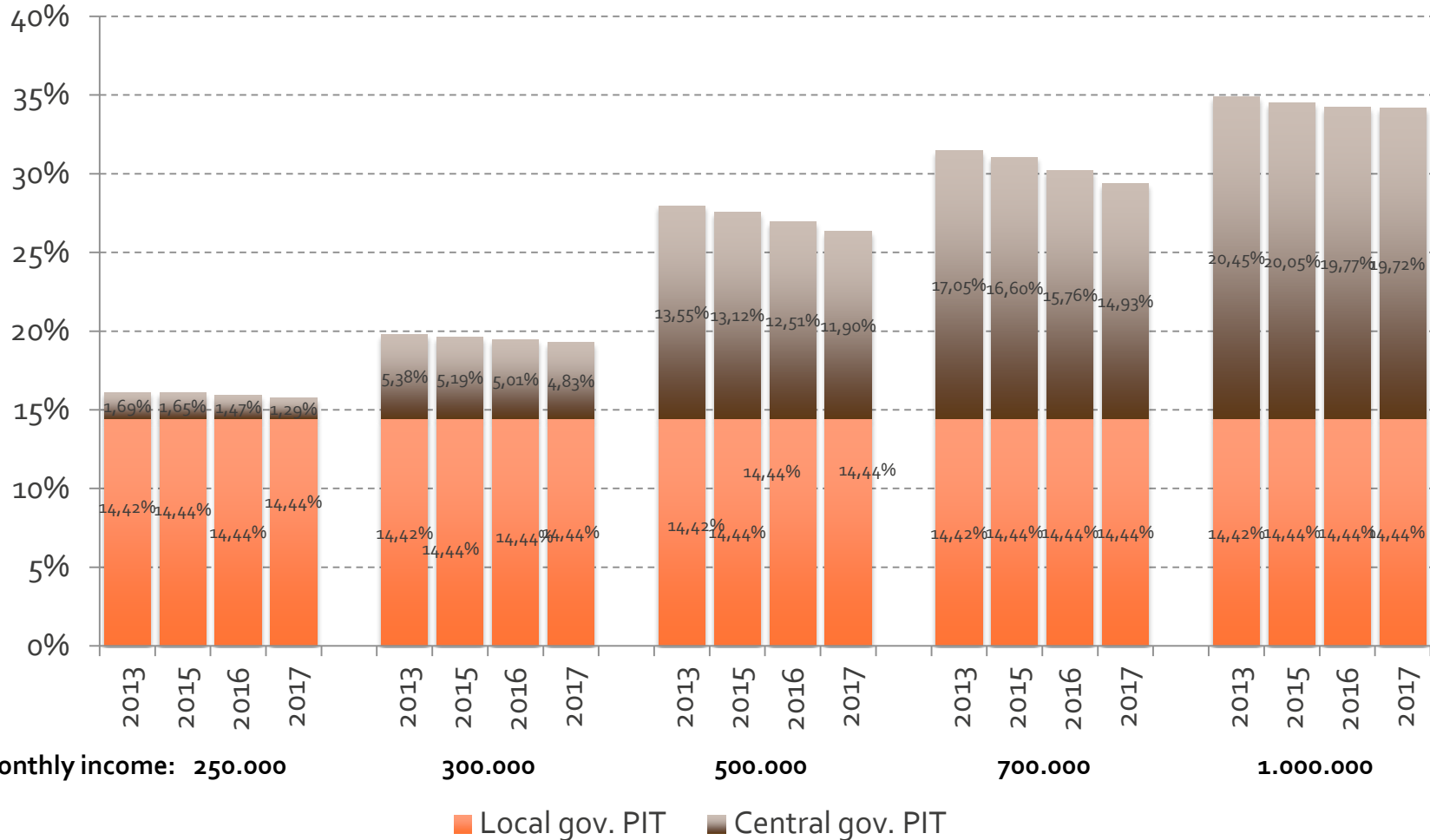


*At fixed 2015 prices. It is assumed that a 4% pension contribution is deducted before tax is calculated.



PERSONAL INCOME TAX BURDEN AND SHARE OF CENTRAL AND LOCAL GOVERNMENT 2013–2017

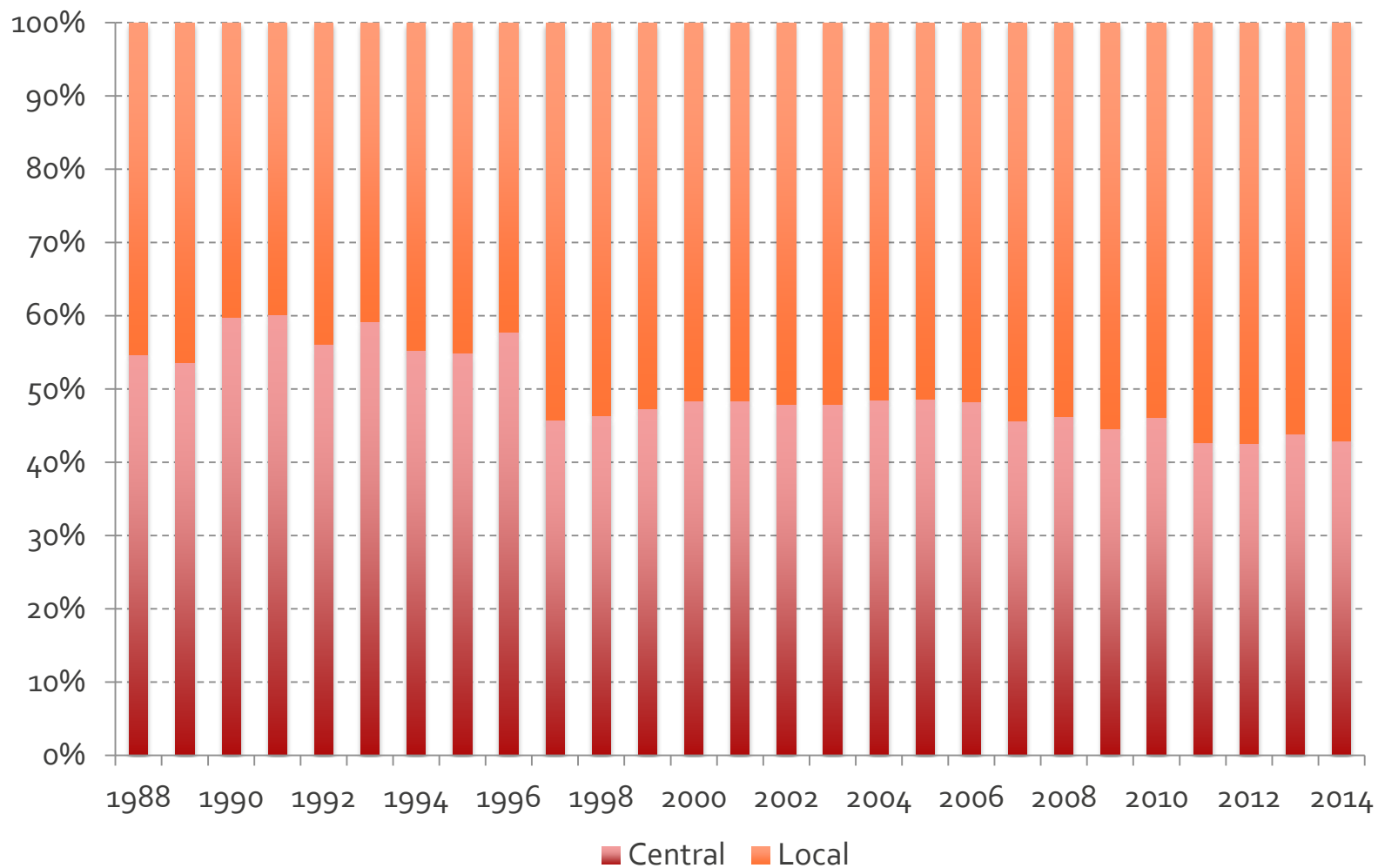
Tax burden per month



Budget Proposal 2016



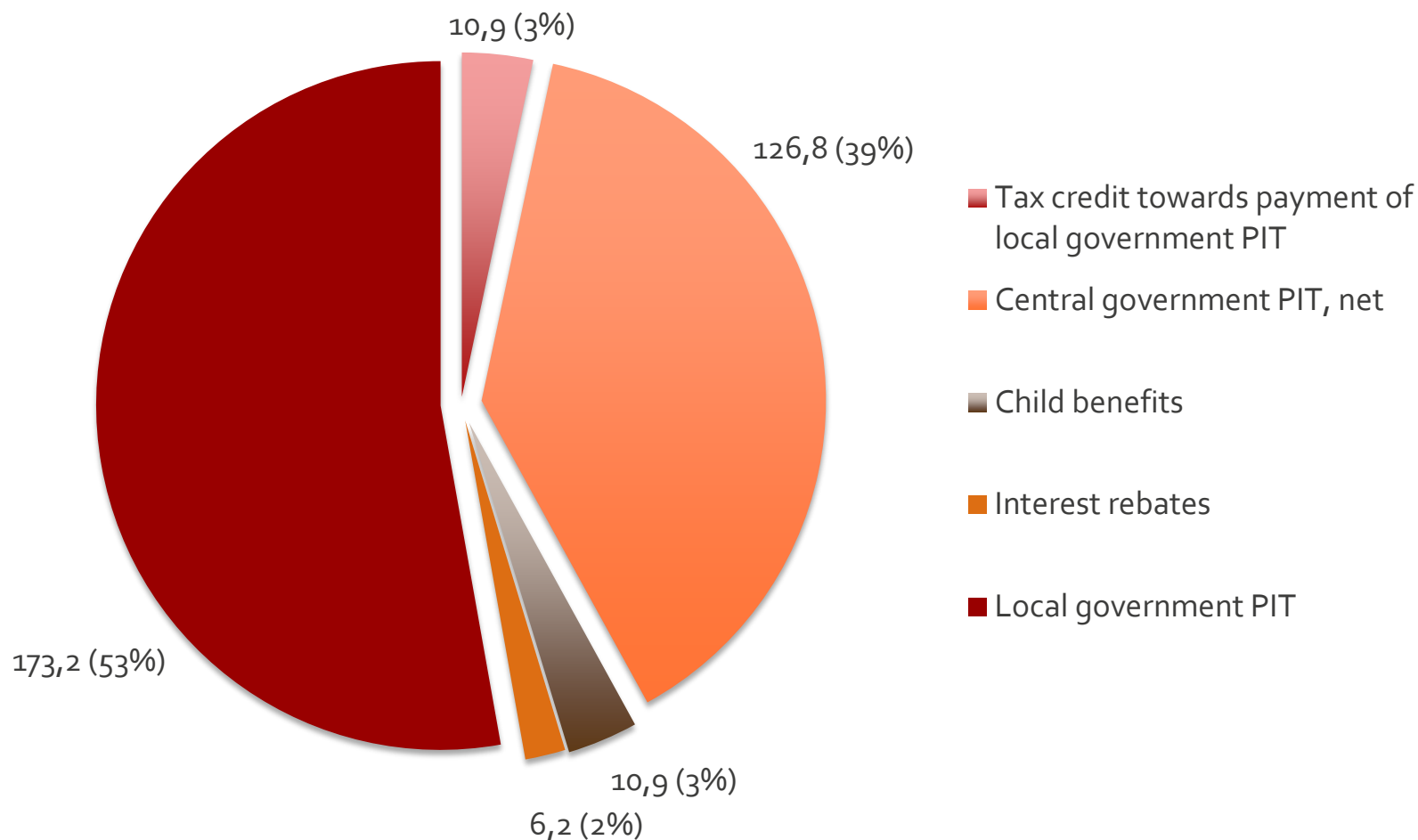
PIT TO CENTRAL AND LOCAL GOVERNMENT 1988–2014



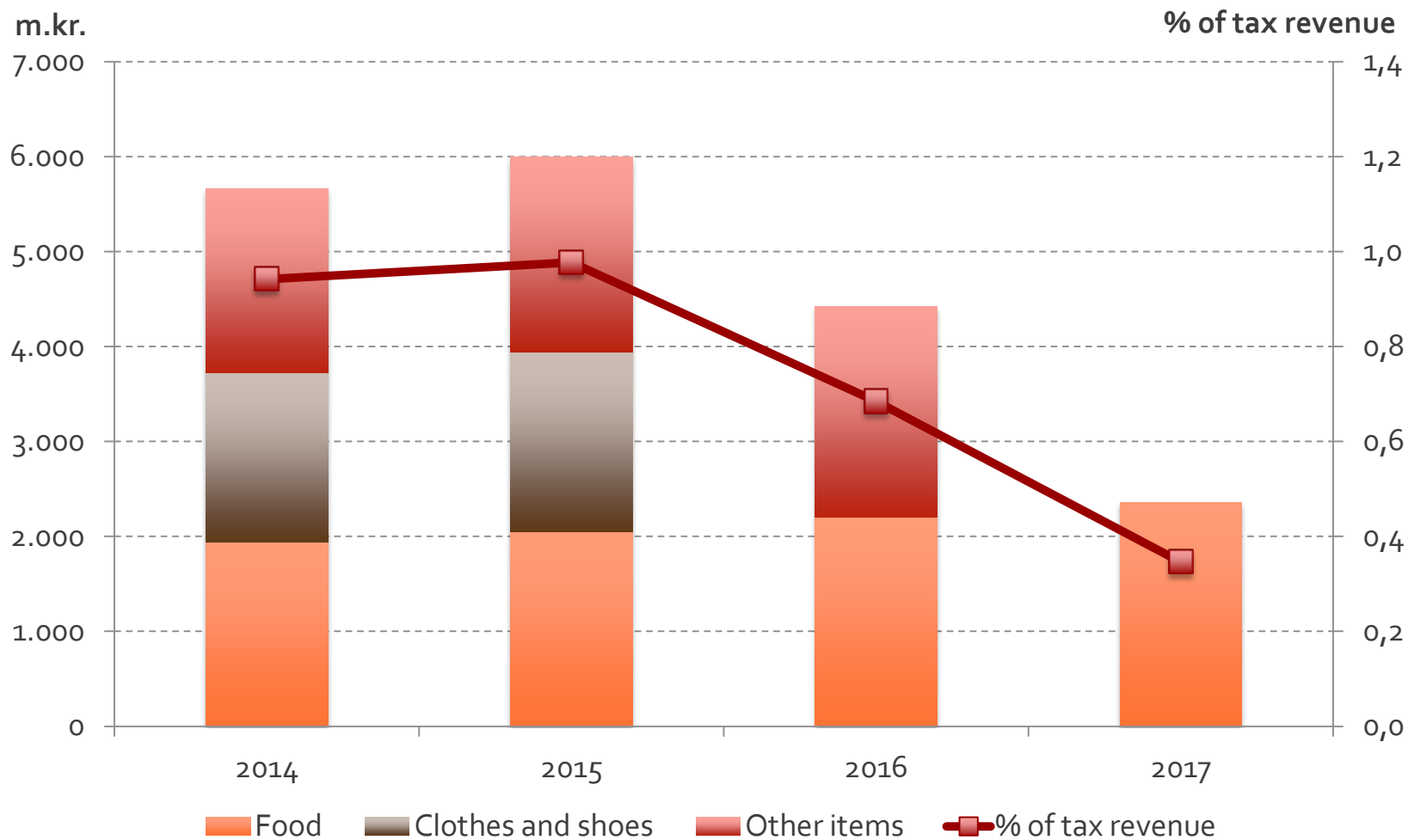
Budget Proposal 2016



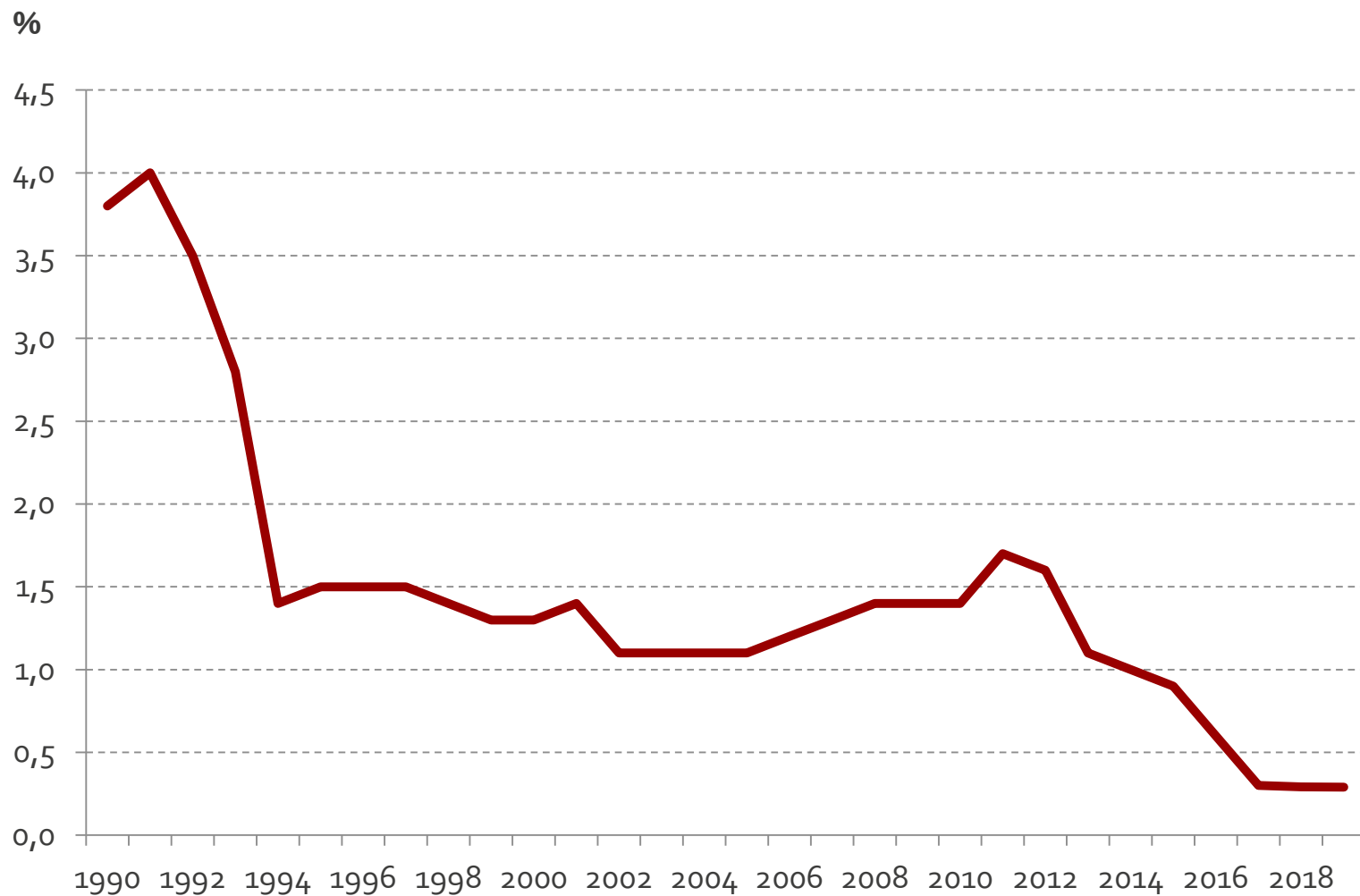
THE PIT SYSTEM IN 2016: NET IMPACT BY LEVEL OF GOVERNMENT (B.KR.)



IMPORT DUTIES: REVENUE COMPOSITION BY TYPE OF GOODS 2014–2017



IMPORT DUTIES: SHARE OF TOTAL REVENUE 1990–2019



IMPORT DUTIES REPEALED FROM CERTAIN GOODS

- 1 January 2016: Clothes and shoes
 - ✓ Most common rate is 15%
- 1 January 2017: All goods except food
 - ✓ Rates in the range 7.5% – 15%

Clothes – examples:

- Pants
- Jackets
- Shirts
- Sportswear
- Sports shoes
- Lingerie

Other goods – examples:

- School bags
- Household appliances, white and brown
- Fishing and hunting gear
- Cleaning and cosmetics
- Kitchenware
- Baby prams and strollers
- Goods for pets (not food)
- Car spare parts



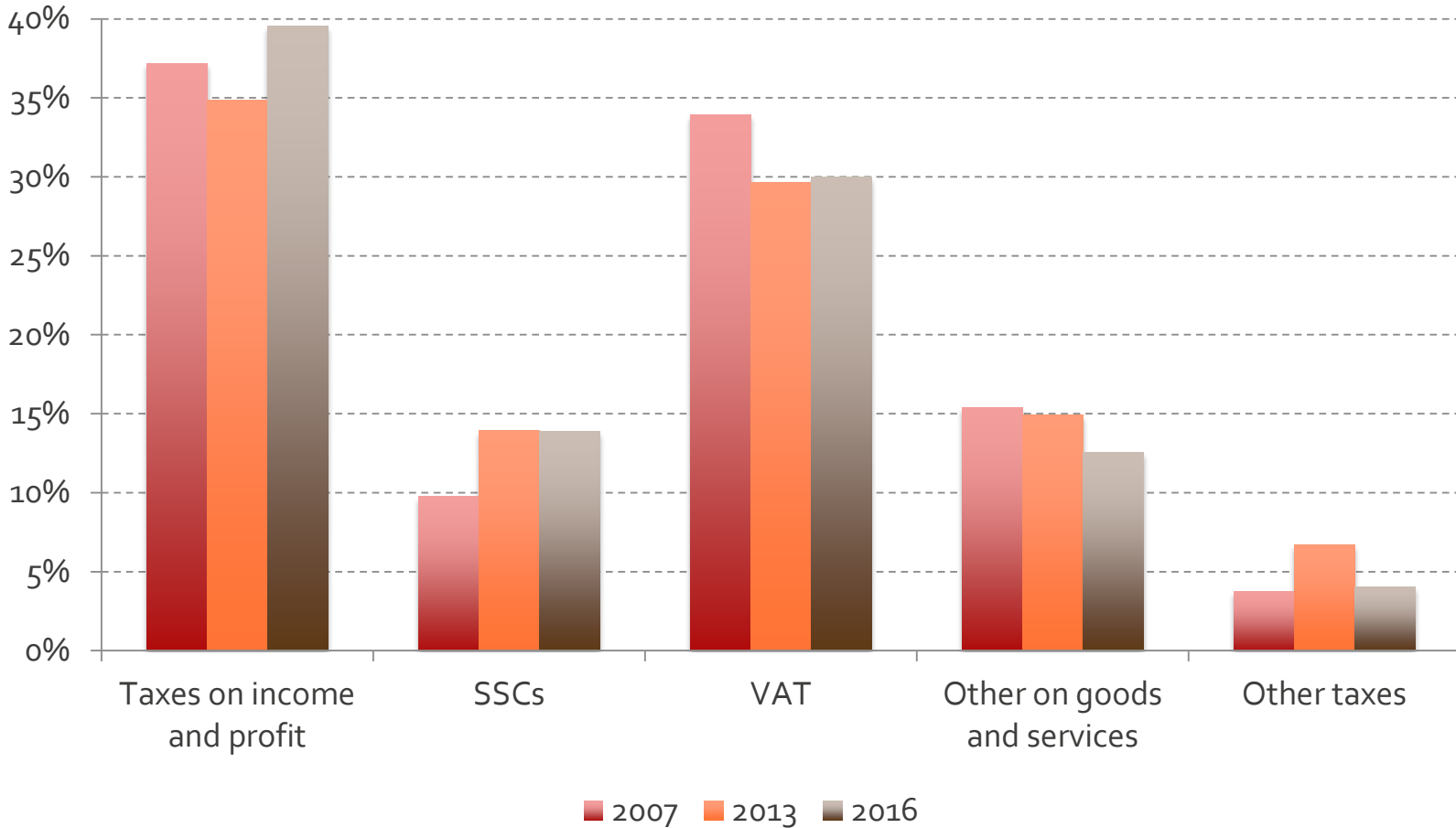
EXCISE ON MOTOR VEHICLES: RELIEF FOR RENTAL CARS (A)

- Car rental companies have since 2000 benefited from a reduced excise duty on rental cars – with a cap per car since 2011
- The relief will be reduced in 2016 and fully repealed in 2017
- The revenue yield is estimated 0.6 billion in 2016 and 2.5 billion in 2017 (side effect on VAT included)
- The original argument for this relief is no longer relevant; the market for car rentals has changed dramatically
- In 2011 the excise was reformed into a CO₂-based tax
- The cap amount was reduced in 2015 with a „promise“ to further reduce it



COMPOSITION OF TAX REVENUE IN 2007, 2013 AND 2016*

share of total tax revenue



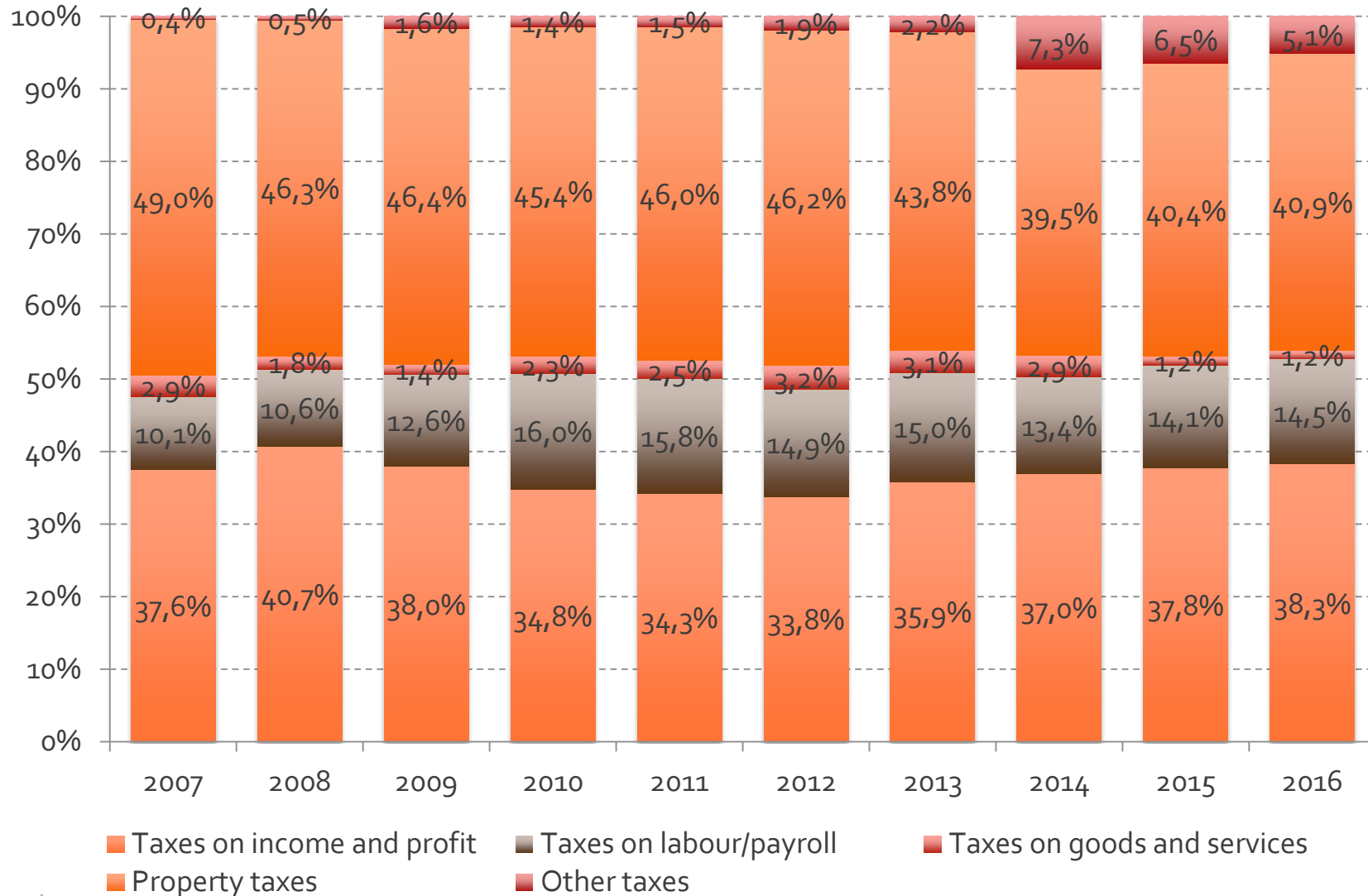
* Irregular items are excluded.



REVENUE FROM VAT 1998–2016



TAX REVENUE COMPOSITION 2007–2016





5.

EXPENDITURE SIDE

BUDGET PROPOSAL
2016

BUDGET FRAMEWORK 2016-2019

ISK bn.	Estimate 2016	Estimate 2017	Estimate 2018	Estimate 2019
Total expenditures	681,0	689,2	714,7	739,6
Irregular items				
Pension liabilities	12,4	13,9	14,4	14,9
Capital gains tax	5,0	4,6	5,0	4,9
Tax write-offs	13,0	13,8	14,1	15,0
Unemployment	13,3	13,9	14,3	14,8
Municipal Equalisation Fund	19,4	20,4	21,0	22,0
State guarantees	0,0	0,0	0,0	0,0
Write-offs of outstanding claims	0,1	0,1	0,1	0,1
Contributions to HFF	1,3	0,0	0,0	0,0
Amortization of indexed mortgages	15,5	0,0	0,0	0,0
Interest expenditures	74,4	68,4	68,7	62,9
Total irregular items	154,4	135,1	137,6	134,7
Expenditure frame	526,6	554,1	577,2	604,9

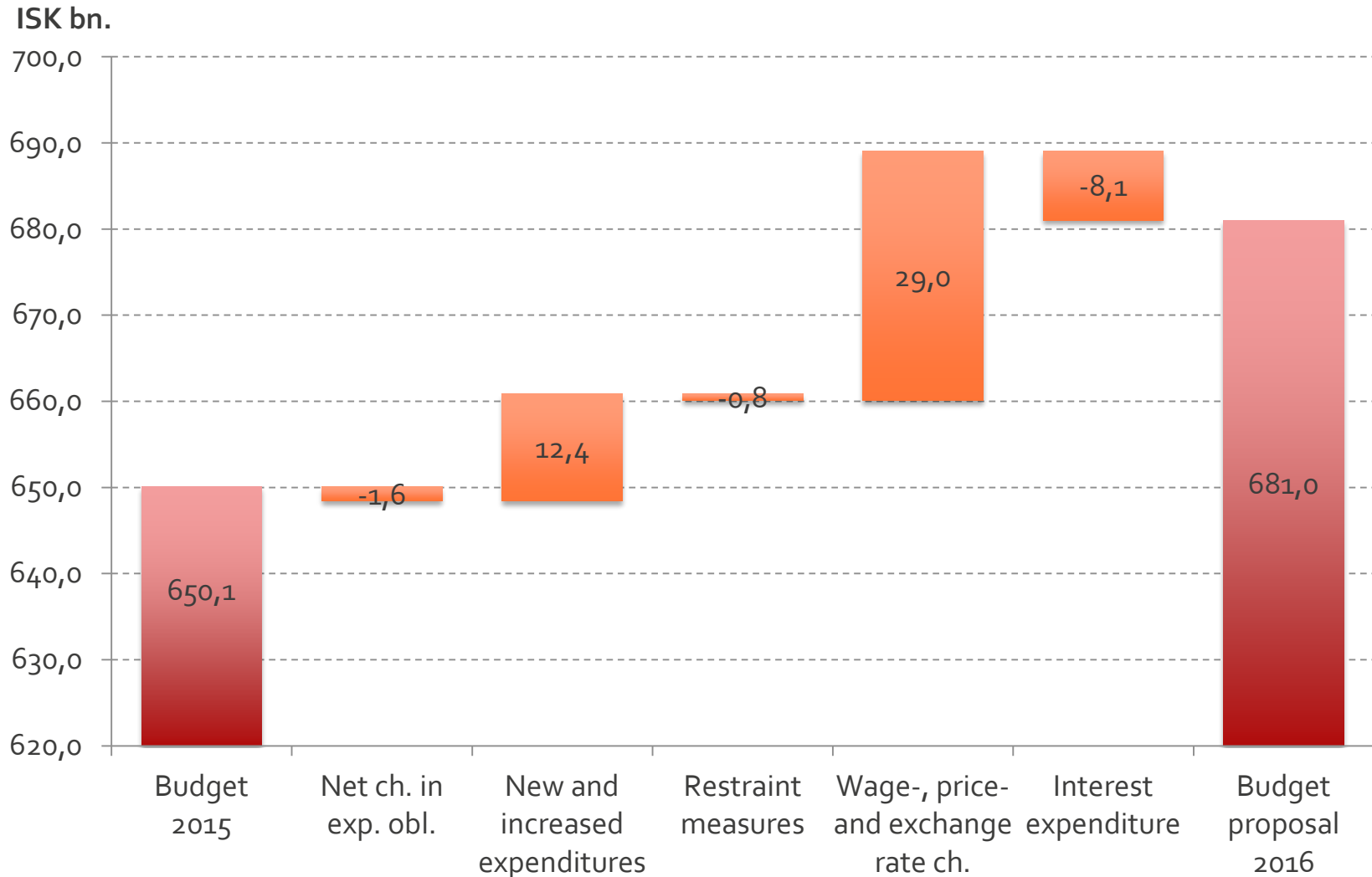
BUDGET FRAMES FOR MINISTRIES 2016*

ISK bn.	Budget 2015	Proposal 2016	ch. ISK bn.	ch. %
Budget frames				
The Presidency, Althingi and Supreme Court.....	4,3	4,4	0,1	2,7
Office of the Prime Minister.....	3,1	3,3	0,2	6,4
Ministry of Education, Science and Culture.....	72,9	75,1	2,2	3,0
Ministry for Foreign Affairs**.....	11,5	12,7	1,2	10,3
Ministry of Industries and Innovation.....	30,6	31,4	0,8	2,8
Ministry of the Interior**.....	58,1	59,5	1,3	2,3
Ministry of Welfare.....	253,6	262,4	8,8	3,5
Ministry of Finance and Economic Affairs.....	41,4	41,3	-0,1	-0,1
Ministry for the Environment and Natural Resources..	10,1	10,1	0,1	0,8
Total, excl. irregular items.....	485,6	500,2	14,6	3,0
Interest expenditures.....	82,5	74,4	-8,1	-9,8
Other irregular items.....	82,0	77,4	-4,6	-5,7
Total irregular items.....	164,5	151,8	-12,7	-7,7
Total, incl. irregular items.....	650,1	652,0	1,9	0,3

*excluding wage- and price changes in the 2016 budget proposal

** in the budget proposal a ISK 0.8 bn. are transferred from Ministry of Interior to the Ministry of Foreign Affairs in line with transfer of defense-related tasks between ministries.

EXPENDITURE CHANGES FROM 2015 BUDGET



Budget Proposal 2016



NEW AND INCREASED EXPENDITURES

	ISK bn.
Housing affairs – social housing and increased support to tenants	2.6
Increased contribution to Iceland Research Fund and Technology Development Fund	2.0
Increased contribution to various health care items	1.6
Building of recuperation residence and first phase in designing new treatment center for the National hospital	0.9
Increased contribution to education, such as project on strengthening literacy among children	0.5
Establishment of a new regional prosecutors office	0.5
Other	4.3
Total	12,4

**changes from 2015 budget*



NET CHANGES IN EXPENDITURE OBLIGATIONS IN BUDGET PROPOSAL 2016

	ISK bn.
Health insurance - excess expenditure in 2015, real growth and contractual expenditures.	2.7
Old age and disability insurance and welfare support payments – real growth	1.8
Government employee's pension fund liabilities	1.5
Expenditures financed with earmarked revenues	1.1
Contingency fund - increase due to nominal increase in turnover	1.0
Eliminated temporary contributions	-8.2
Household debt relief program - revaluation of capital requirement in relation to settlement with financial institutions	-2.9
HFF - lowering of precautionary contribution	-2.0
Interest cost rebate – lower expenditure due to lower debt and increased household income	-1.5
Other	-3.6
Total	-1.6

**changes from 2015 budget*

Budget Proposal 2016



WAGE AND PRICE ASSUMPTIONS

» Wage assumptions:

1. Reassessment of the wage assumptions in the 2015 budget, which come in full effect on the Treasury's wage cost on annual basis in 2016.
 - Based on collective agreements and the offer that the Treasury's negotiation committee have offered in the ongoing negotiations.
 - Weighted average wage increase for 2016 is 8.6%.

 2. Wage increases in 2016.
 - Based on collective agreements and the offer that the Treasury's negotiation committee have offered in the ongoing negotiations.
 - The wage assumption for 2016 is 5.5% wage increase which is the same increase as the increase in salary scales in the private sector in 2016. It is assumed that the increase will take effect on June 1st next year.
 - Weighted average wage increase for 2016 is 3.6% but when including an unallocated wage pot it is estimated that the increase will be 4.1% in 2016.
- » Cumulative effects on the Treasury's wage bill is 13.1% in 2016 but 15.1% permanently when taking into account the impact of wage increases in 2016 on annual basis.



WAGE AND PRICE ASSUMPTIONS

» Wage assumptions:

- In the budget proposal it has not been taken into account the outcome of the arbitration panel last August since the figures for the budget proposal were finalized in June.
- It is expected that the wage assumptions in the proposal will be reevaluated before finalizing the budget in December.

» Unemployment benefits and social security benefits:

- It is expected that the benefits will be raised by 9.4% from January 1st 2016.
- The raise takes into account the Statistics Iceland forecast of the wage index less wage drift, i.e. average salary scales both this year and next.



WAGE AND PRICE ASSUMPTIONS

» General price assumption:

- The general price assumption in the proposal is 3.79%.
- Taking into account the forecast of 4.5% increase in inflation between 2015 and 2016 but on the other hand adjusted for overestimation of the inflation in current year. The forecast for inflation between 2014 and 2015 is now 2% but the premises in the 2015 budget were 2.7%.

» Exchange rate assumptions:

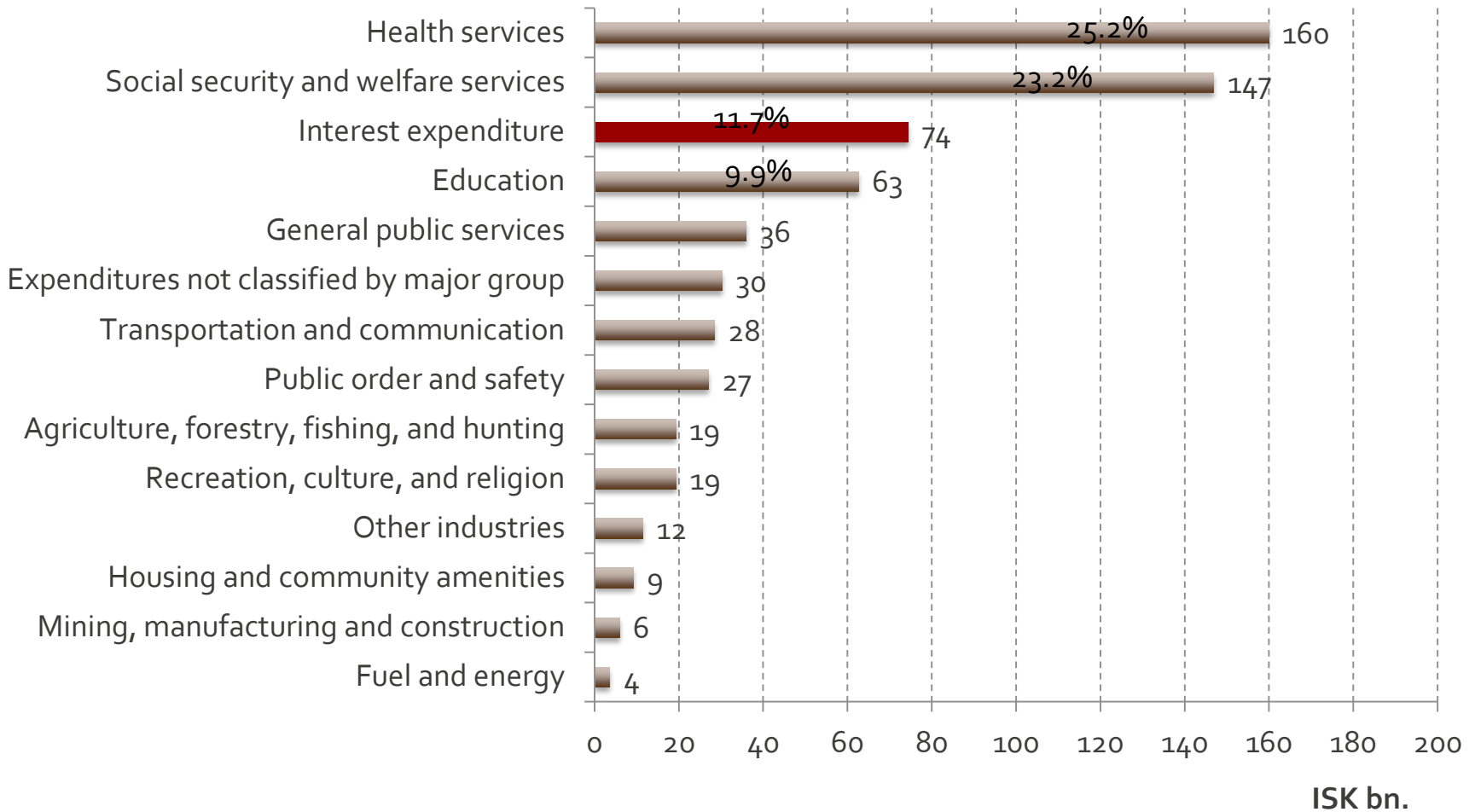
- Based on average exchange rate in June 2015.
- Similar rates as for the first six months of 2015.
- The exchange rate of the US dollar and the British pound has risen but the exchange rate for euro has decreased.

WAGE AND PRICE CHANGES IN 2015 AND 2016

- » Projected wage and price changes in the proposal are higher than ever in nominal terms or ISK 29 bn.
- » Thereof **ISK 8.6 bn.** are effects on annual basis by wage agreements that were made in 2014 and in the beginning of 2015 along with projection of wage increases for those unions that have not been negotiated with.
- » In the budget proposal it is assumed that average wage increases of public employees will be similar to those of the private market and not taking into account the effects of the decision of the arbitration panel last August since the figures for the proposal had been finalized.
- » In addition, wage and price changes for 2016 are estimated to be **ISK 20.4 bn.**



EXPENDITURES BY ECONOMIC FUNCTION*



**Irregular items other than interest expenditure are excluded*

Economic function according to COFOG (Classification of the Functions of Government)



MAIN EXPENDITURE CHANGES FROM 2015 BUDGET

- » Primary expenditure is estimated **ISK 606.6 bn.** in 2015 and increases by **ISK 39 bn.** from the 2015 budget in nominal prices (**1.7% of GDP**)
- » Total expenditure is expected to be **ISK 681 bn.** and increases by **ISK 30.9 bn.** from 2015 budget (**1.3% of GDP**)
- »
- » Excluding projected wage and price changes in 2016, the primary expenditure will increase by **ISK 10 bn. (0.4% of GDP)** and the total expenditures will increase by **ISK 1.9 bn. (0.1% of GDP)**

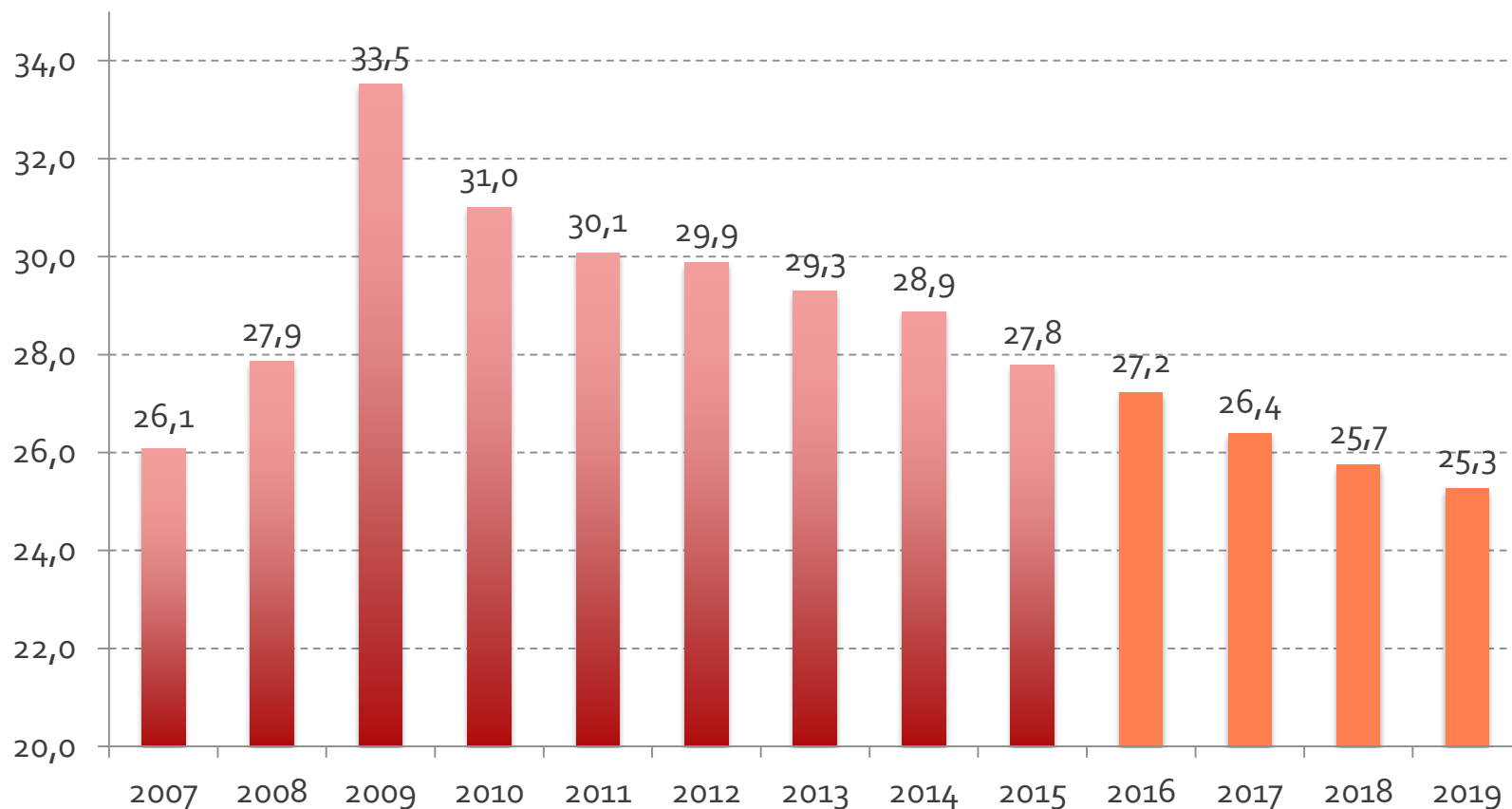
MAIN EXPENDITURE CHANGES FROM 2015 ESTIMATE

- » Primary expenditures are estimated **ISK 607 bn.** and increase by **ISK 4 mia.kr.** from the estimate for 2015 in nominal prices
- » Total expenditure are expected to be **ISK 681 bn.** and increase by **ISK 1.6 bn.** from the 2015 estimate.
- » Including projected wage and price changes in 2015 the primary expenditure will increase by **ISK 24.4 bn.** and the total expenditures will increase **ISK 22 bn.**



DECREASE IN TOTAL EXPENDITURE*

% of GDP

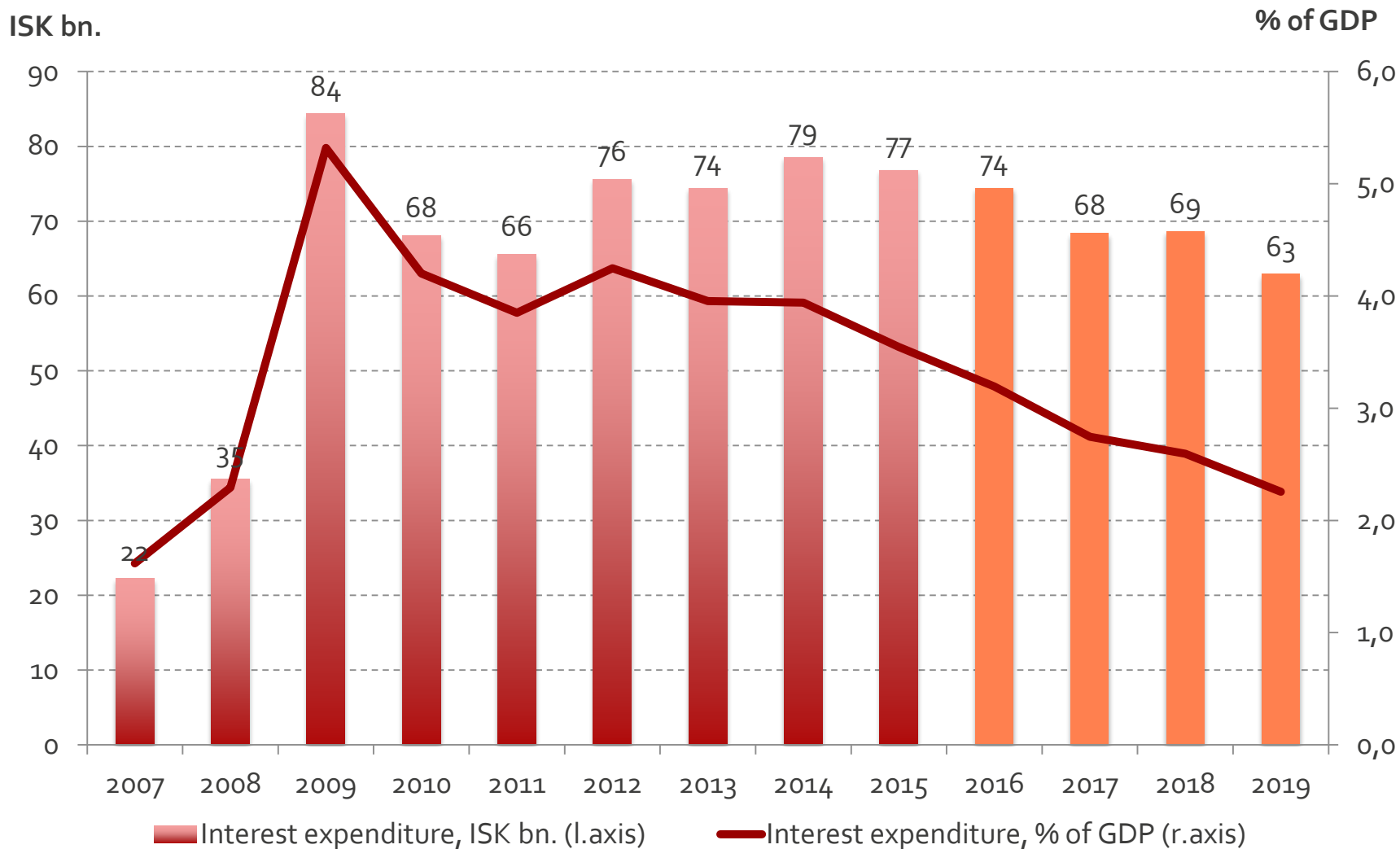


* Excluding irregular items

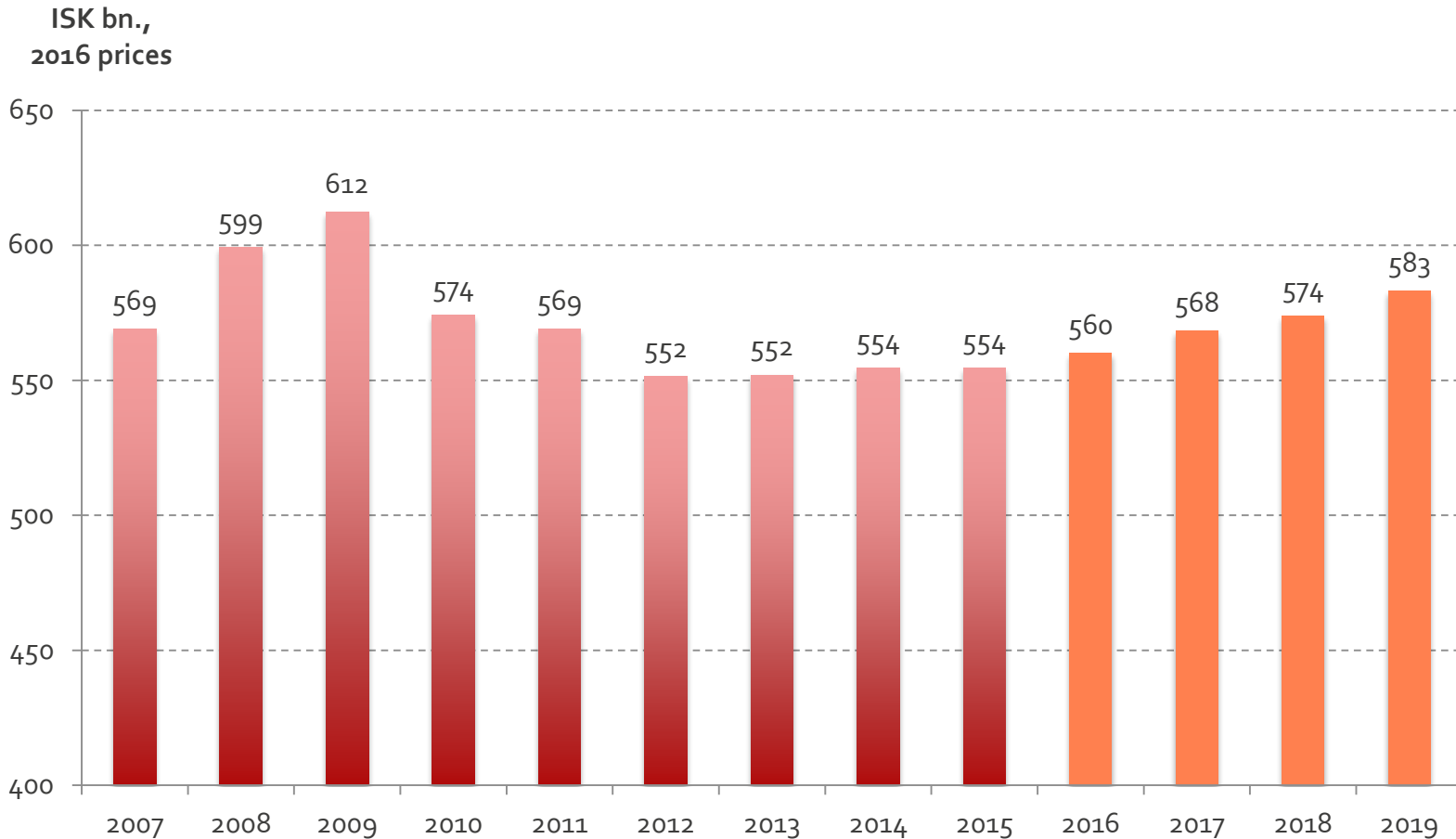
Adjusted for the transfer of services for disabled people from the state to local governments



TREASURY'S INTEREST EXPENDITURE 2007-2019



MODERATE GROWTH IN PRIMARY EXPENDITURE*



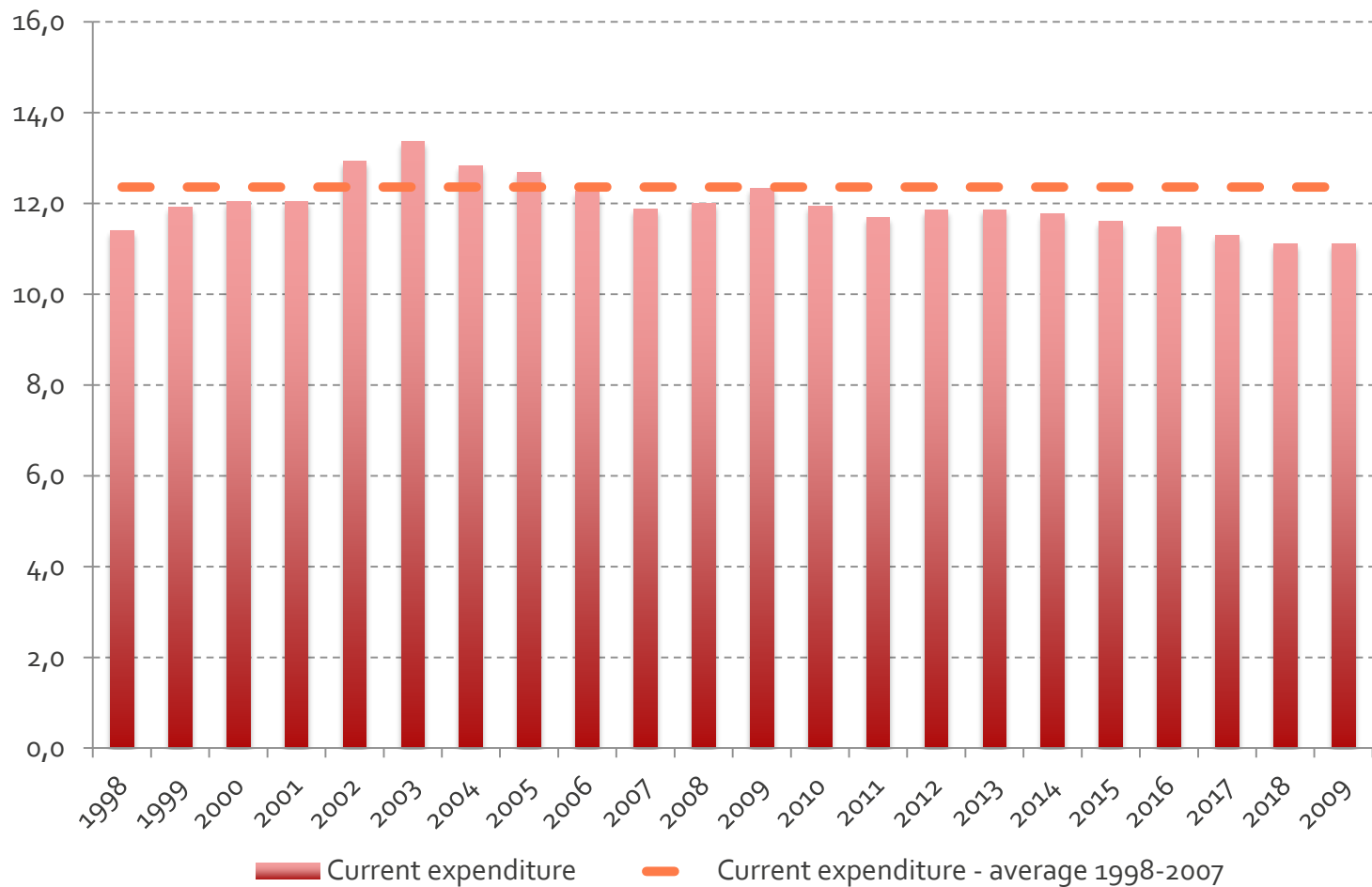
** in 2016 prices excluding irregular items*

Adjusted for the transfer of the services for disabled people from the state to local governments



TREASURY'S CURRENT EXPENDITURE 1998-2019*

% of GDP



* excluding irregular items



TREASURY'S TRANSFER PAYMENTS 1998-2019*

% of GDP

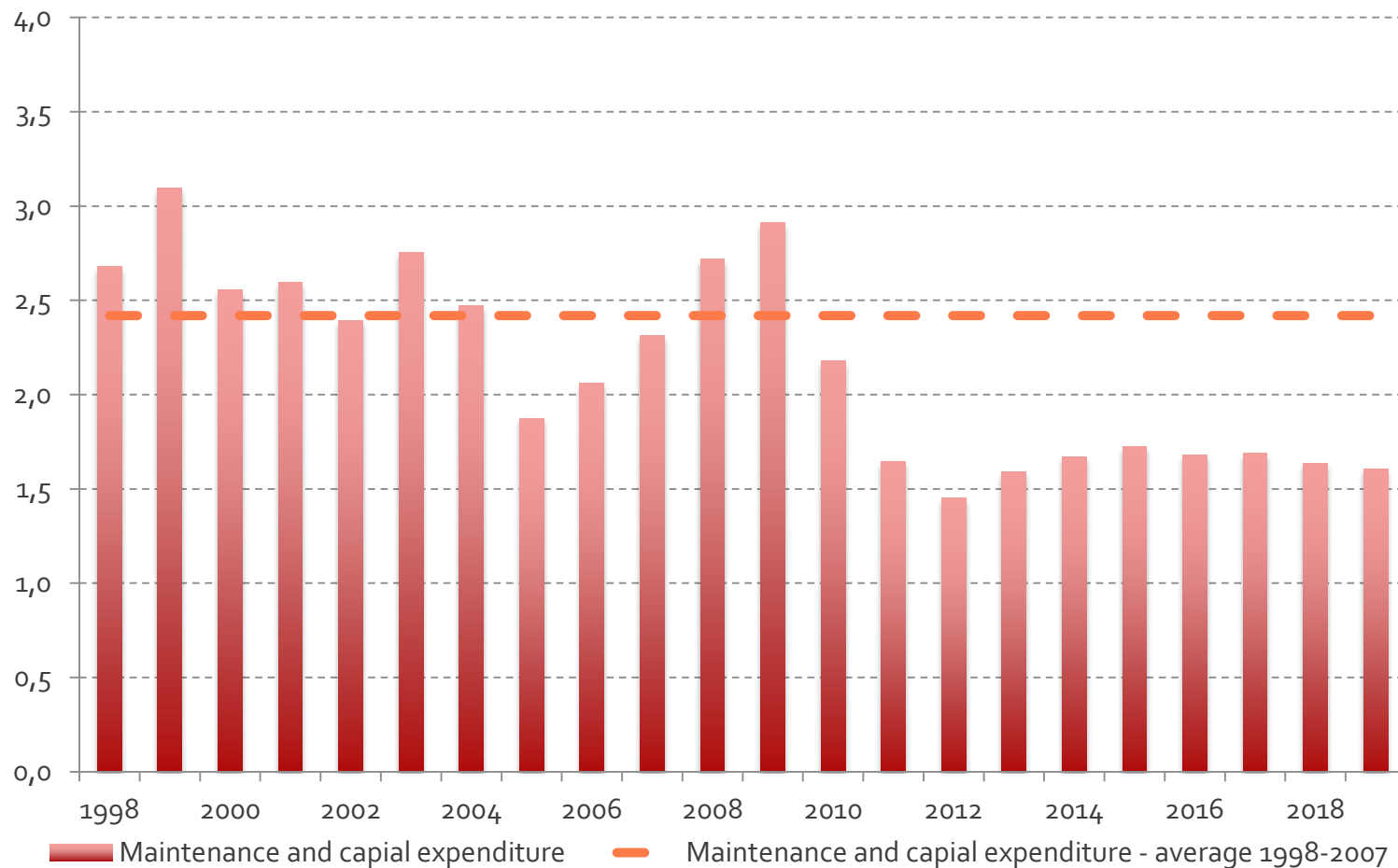


**excluding irregular items and unemployment benefits*



TREASURY'S MAINTENANCE AND CAPITAL EXPENDITURE 1998-2019*

% of GDP



* excluding irregular items





6.

FUNDING AND DEBT MANAGEMENT

BUDGET PROPOSAL
2016

STRATEGY ON CAPITAL ACCOUNT LIBERALIZATION

- Estimated Treasury revenues arising from the execution of the liberalization strategy amounts to ISK 450-850 bn.
- The funds that will accrue will firstly be used to offset the special tax on financial institutions ISK 40 bn.
- Other funds will be used to reduce public debt
- Steps will be thoroughly estimated as time progresses as decisions shall not risk economic or financial stability



STABILITY CONDITIONS / STABILITY TAX

- The effects of the tax are clear
- More uncertainty is around the stability conditions and possible outcome of the multi product auction
- In the fiscal plan it is expected to use the first part of the possible revenues to pay down the CB bond
- No other effects are taken into account
- More clarity is expected before the budget for 2016 is finalized

FUNDING AND DEBT MANAGEMENT

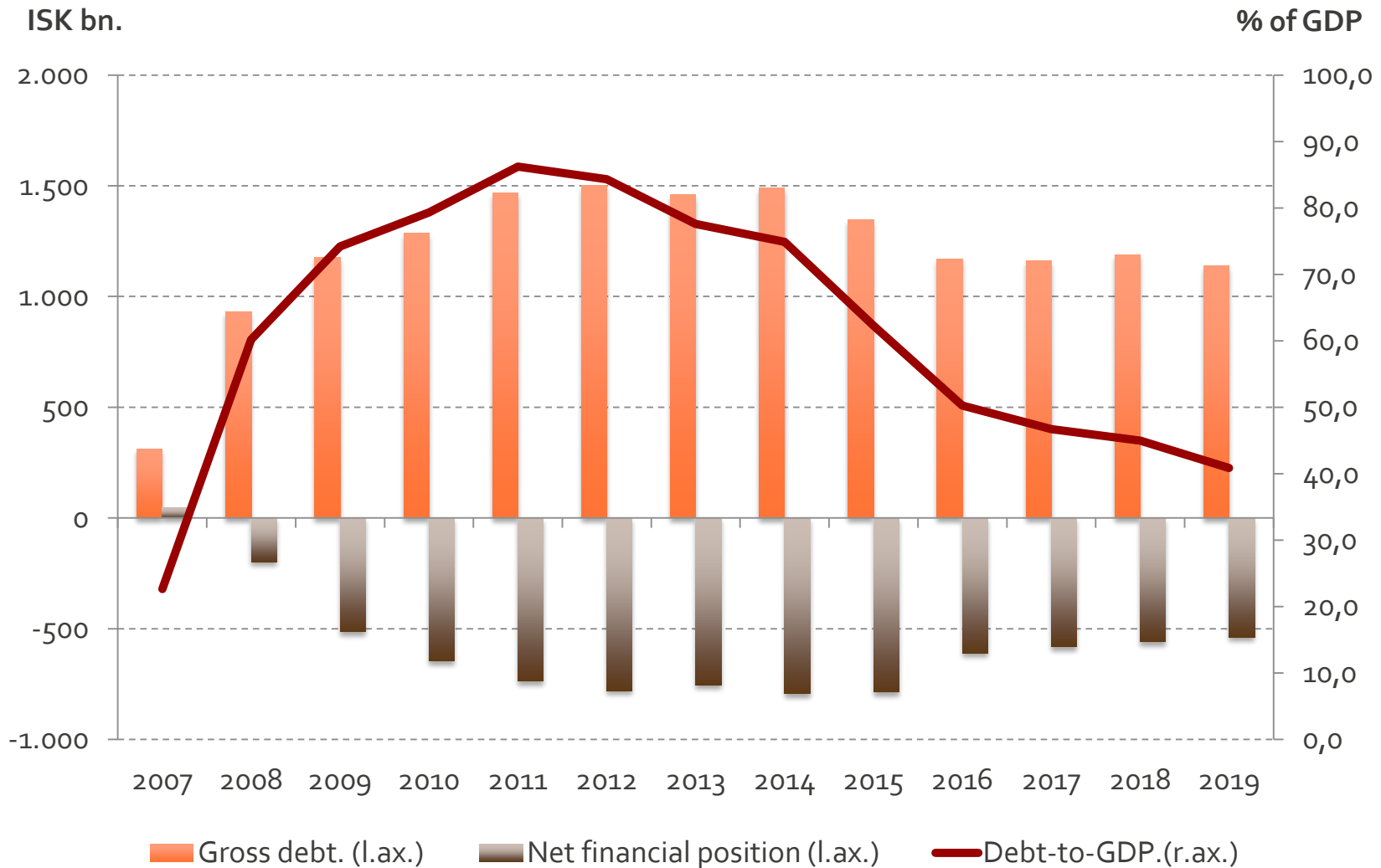
- Good progress have been made in debt management
- Polish loan was pre-paid in May – ISK 7.5 bn.
- Avens loan was paid up in July – ISK 28 bn.
- 50% of bond issuance in USD from 2011 was bought back this year – ISK 67 bn.
- These measures reduces debt-to-GDP ratio by ca. 5%

FUNDING AND DEBT MANAGEMENT

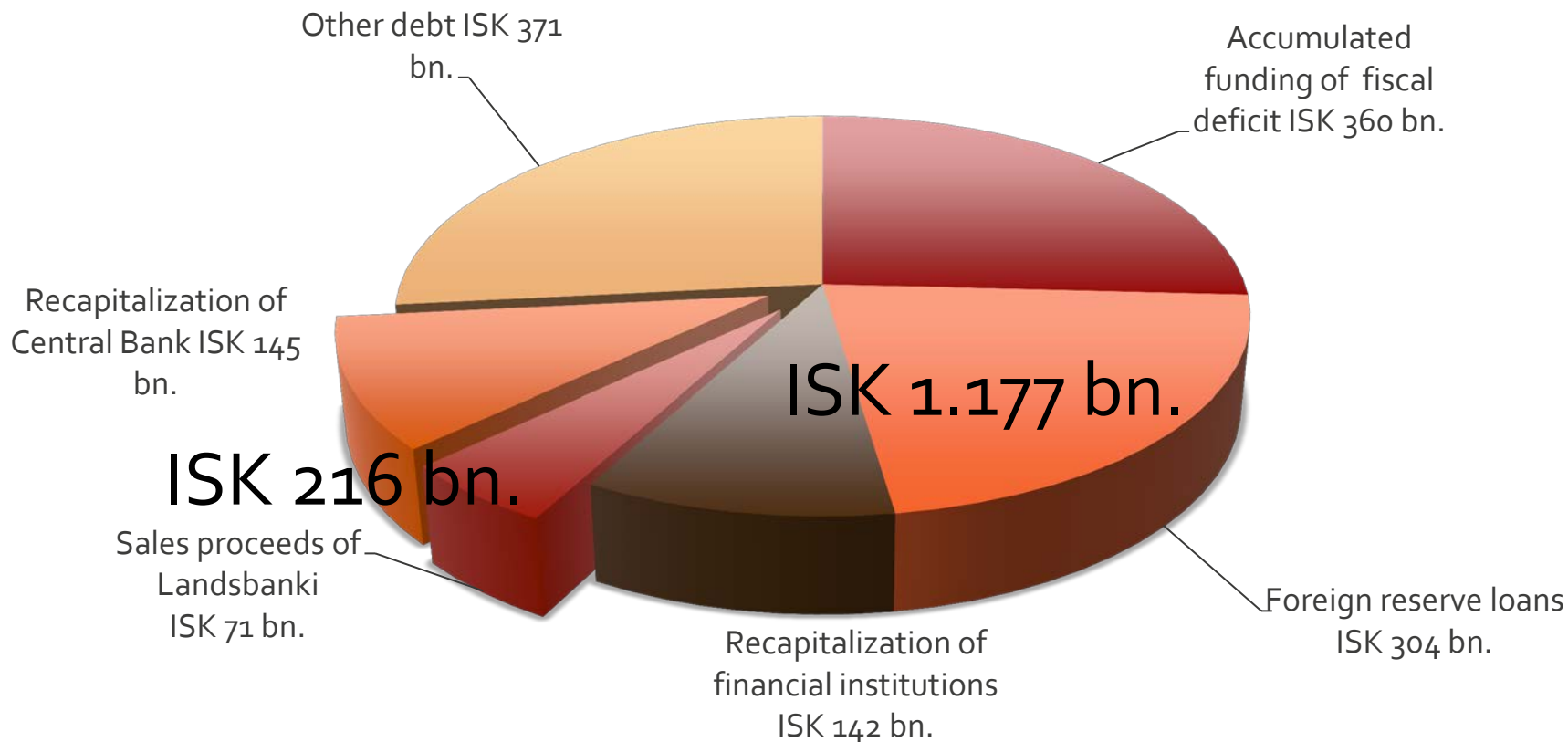
- Lower debt levels along with the strategy on lifting capital controls have had positive effects on ratings
- All of the major rating agencies, Moody's, S&P and Fitch upgraded Iceland by one notch this summer
- Successful liberalization of the capital controls will most likely result in further positive rating developments
- Improved rating → Lowered funding cost
- Lowered funding cost → Improved overall balance



GROSS DEBT AND NET FINANCIAL POSITION



REDUCTION OF TOTAL DEBT*



* Total debt is estimated at ISK 1.177 bn. at year-end 2016

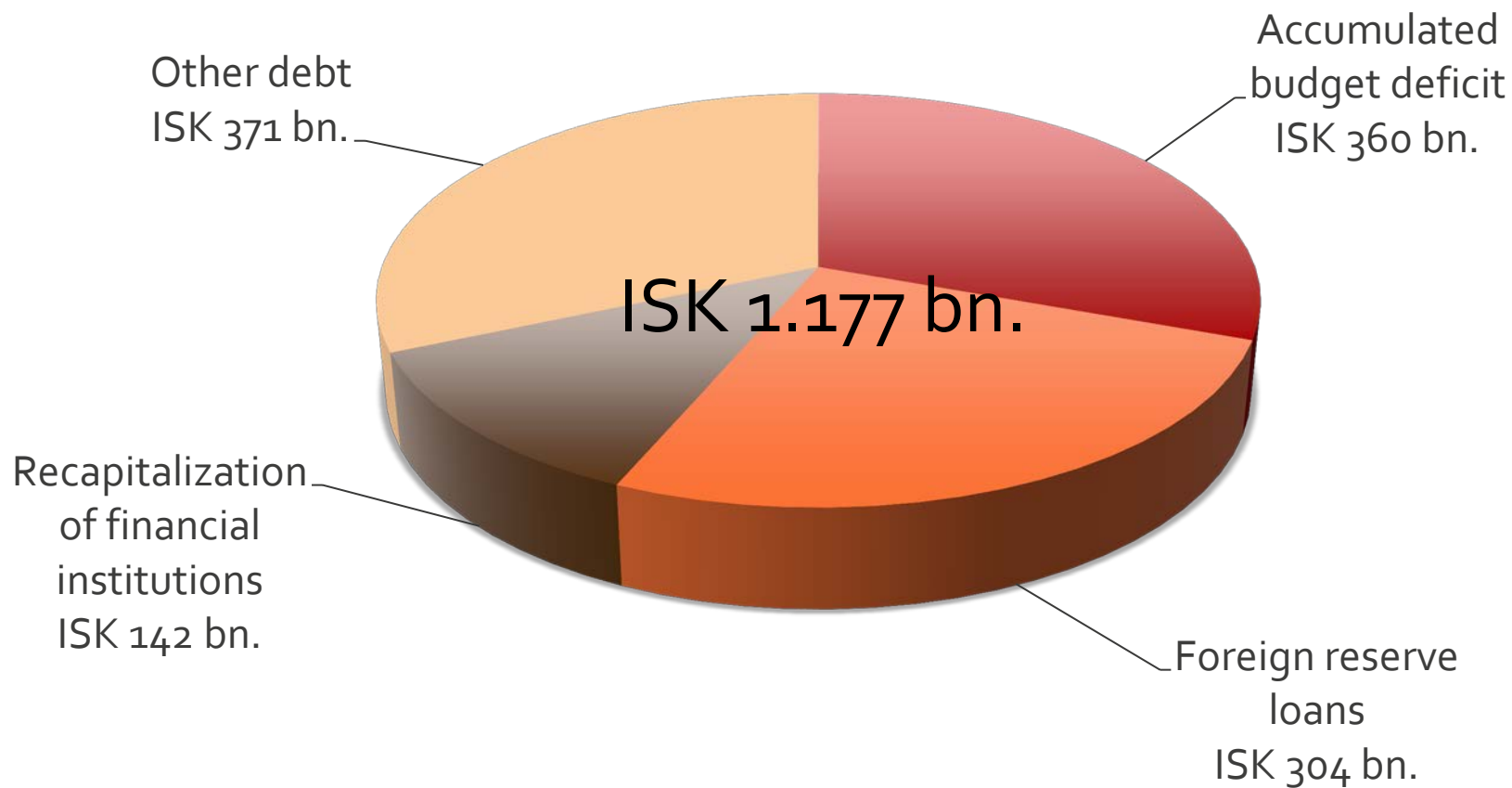


FUNDING AND DEBT MANAGEMENT

- Further debt reduction is forecasted in 2016
- Sale of 30% of Treasury's stake in Landsbanki will be sold and proceeds used to pay down related debt (RIKH 18)
- Central Bank bond will be paid up in first half of 2016
- The first part of stability contribution / tax will be used for that
- Debt-to-GDP is estimated at 50% at year end 2016



DEBT COMPOSITION AFTER MEASURES TAKEN*



* Estimated composition year-end 2016

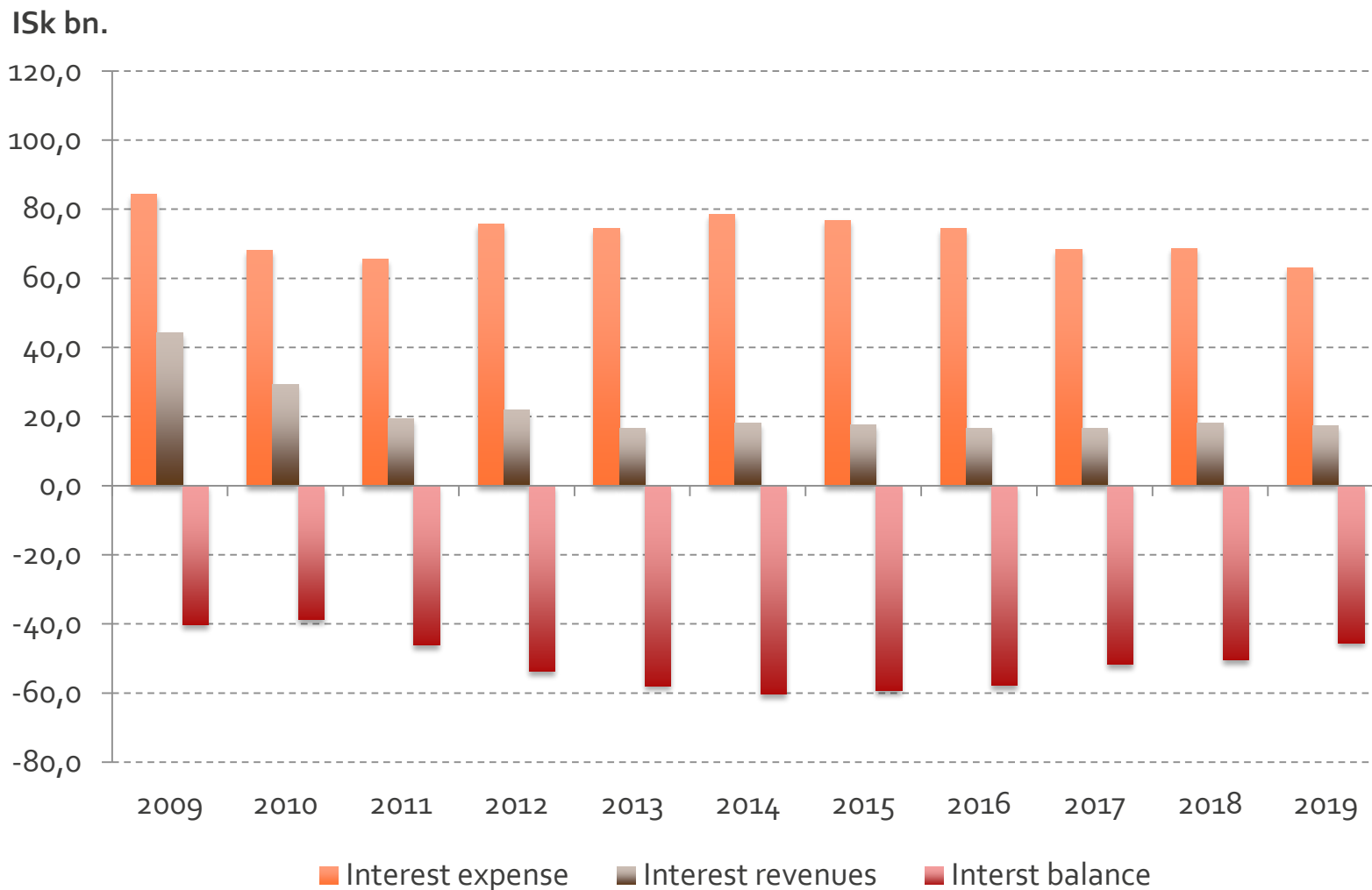


INTEREST BALANCE

- Lower interest expense improves the interest balance, interest income is more stable
- Interest balance is assumed to be negative by ISK 59 bn. or 2.7% of GDP at the end of 2015
- Forecasts assume rising interest rates, higher inflation and depreciation of the krona
- Interest balance deficit is projected at 2.1% of GDP at the end of 2017
- Further improvement is expected and in 2018 the interest balance deficit is forecasted at 1.9% of GDP and 1.6% of GDP at year-end 2019



INTEREST BALANCE 2009 - 2019

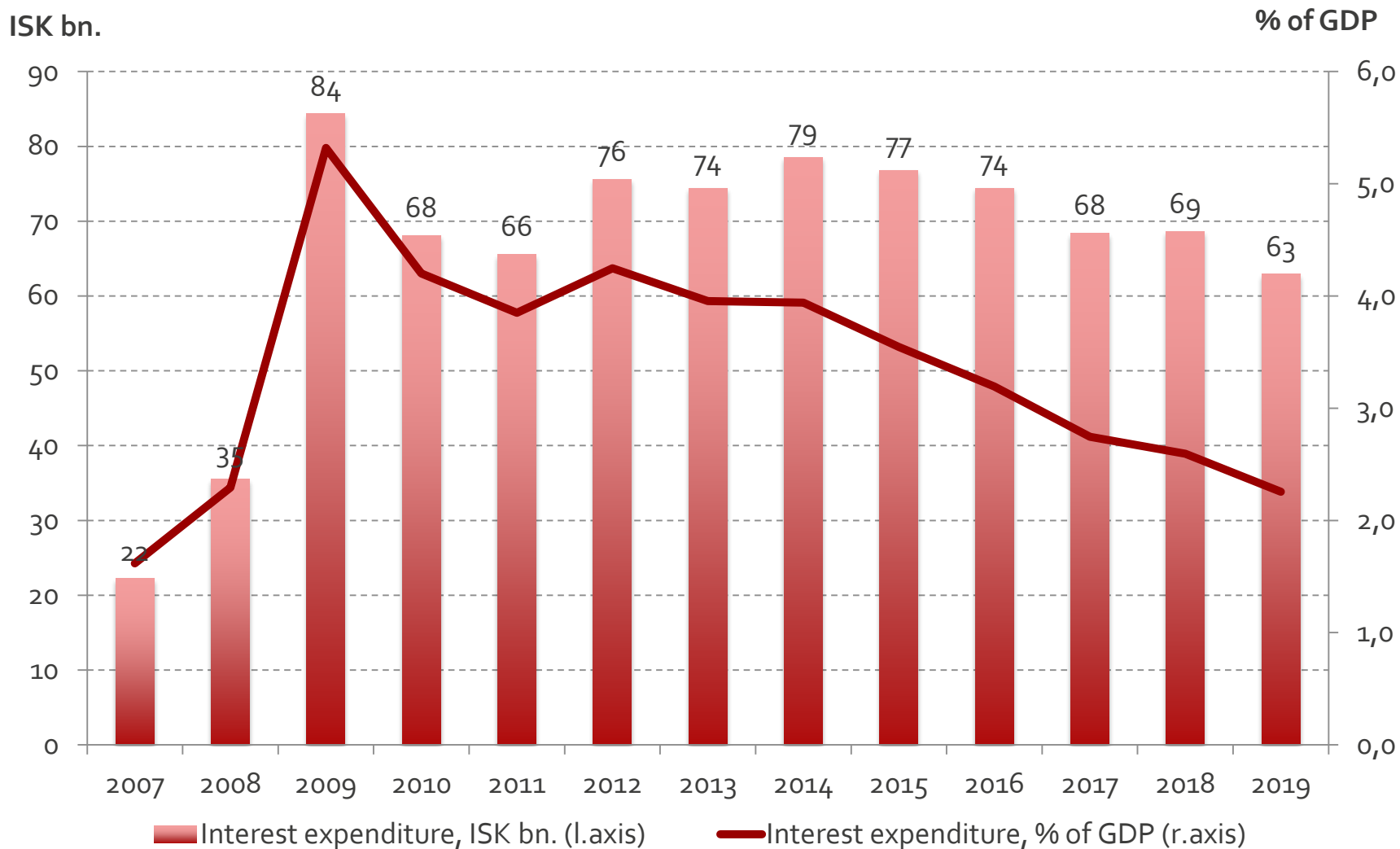


INTEREST EXPENDITURE

- Interest expense will be reduced in the next few years
- Interest expense in 2019 are around ISK 16 bn. lower than in 2014
- Pre-payment of debt and refinancing contribute to the majority of the reduction in interest expense
- Diminishing domestic issuance also contributes to lower expenses



TREASURY'S INTEREST EXPENDITURE 2007-2019



INTEREST REVENUES

- Interest revenues are interests from tax revenues, loans and deposits
- Interest revenues decreases because of pre-payment of Polish loan as well as Arion banki's payment on part of the subordinated loan Treasury granted
- Lower interest revenues are expected in relation to lower levels of deposits but is partly offset by higher policy rates
- Interest revenues are fairly stable during the forecast period

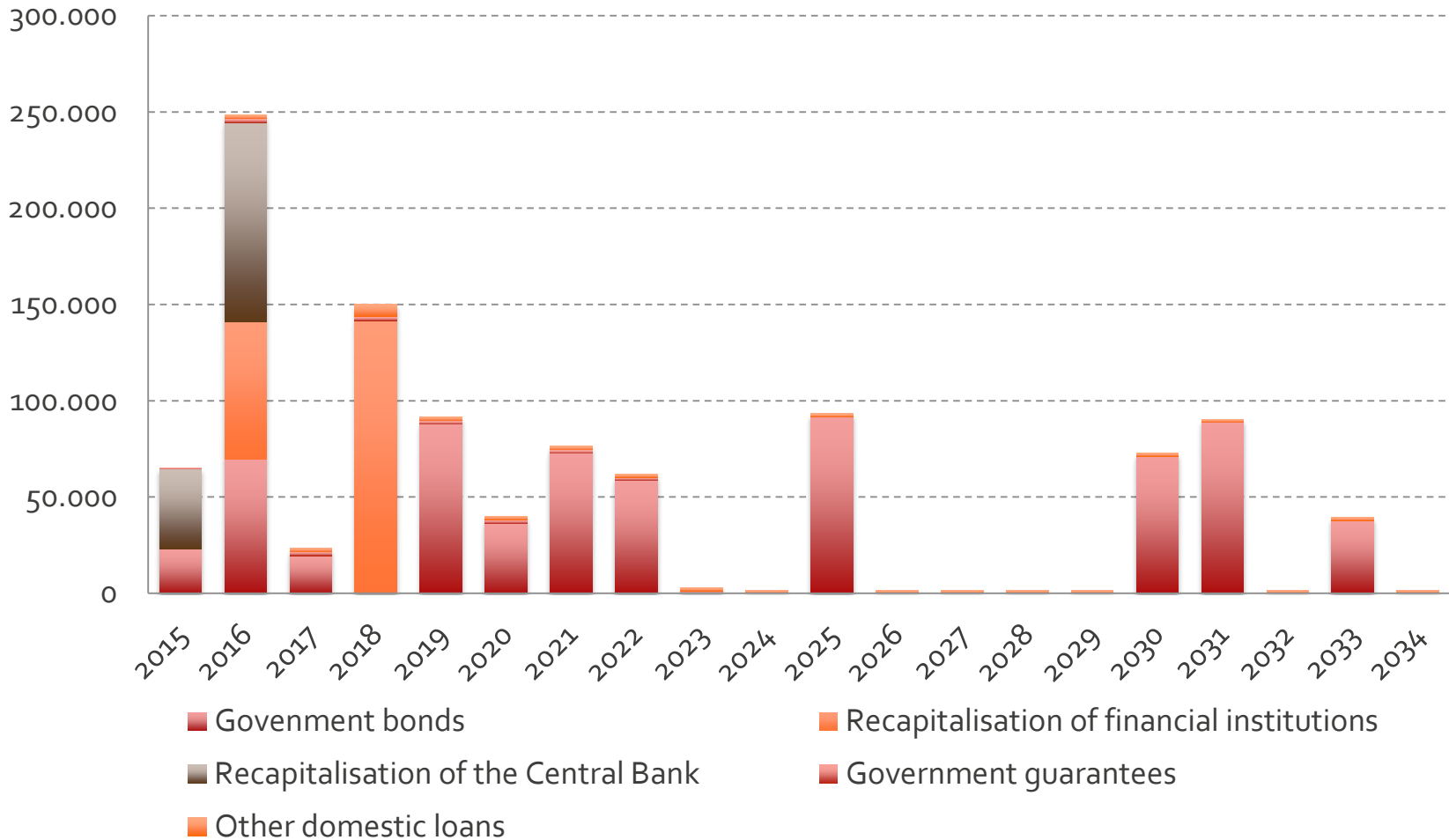
DOMESTIC DEBT MANAGEMENT STRATEGY

- » Medium Term Debt Management strategy describes the objectives of DM and guidelines followed and is reviewed and updated annually
- » The main objective is to ensure that financial needs and obligations are met with lowest possible cost that is consistent with a prudent risk policy
- » Efforts are made to have the maturity profile of securities issued as even as possible
- » The strategy is intended to encourage further development of efficient primary and secondary markets for domestic bonds
- » Principal guidelines relates to the maturity profile, benchmark series, degree of refinancing and maturity



REDEMPTION PROFILE – DOMESTIC DEBT

ISK million

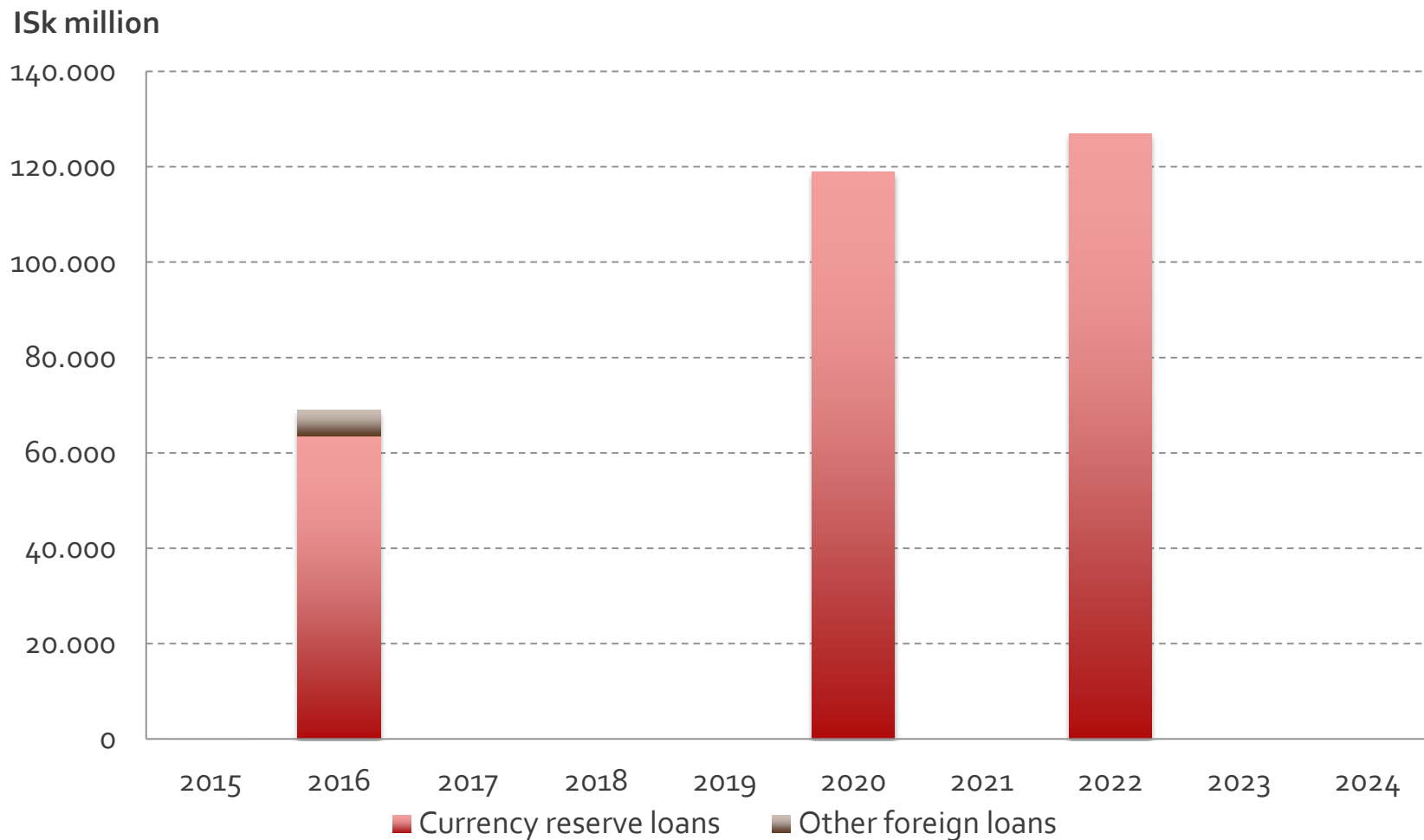


FOREIGN DEBT MANAGEMENT STRATEGY

- » Treasury borrows in foreign currencies primarily to strengthen the CB's foreign reserves
- » The strategy aims at maintaining access to international capital markets
- » Enhance the name recognition of the Republic as an issuer and appeal to a diverse group of investors
- » Regular issuance of securities in foreign markets is intended
- » Issuance of the Treasury lays the foundation for the access of domestic banks and firms to international capital markets
- » The necessity for international issuance is always carefully evaluated



REDEMPTION PROFILE – FOREIGN DEBT



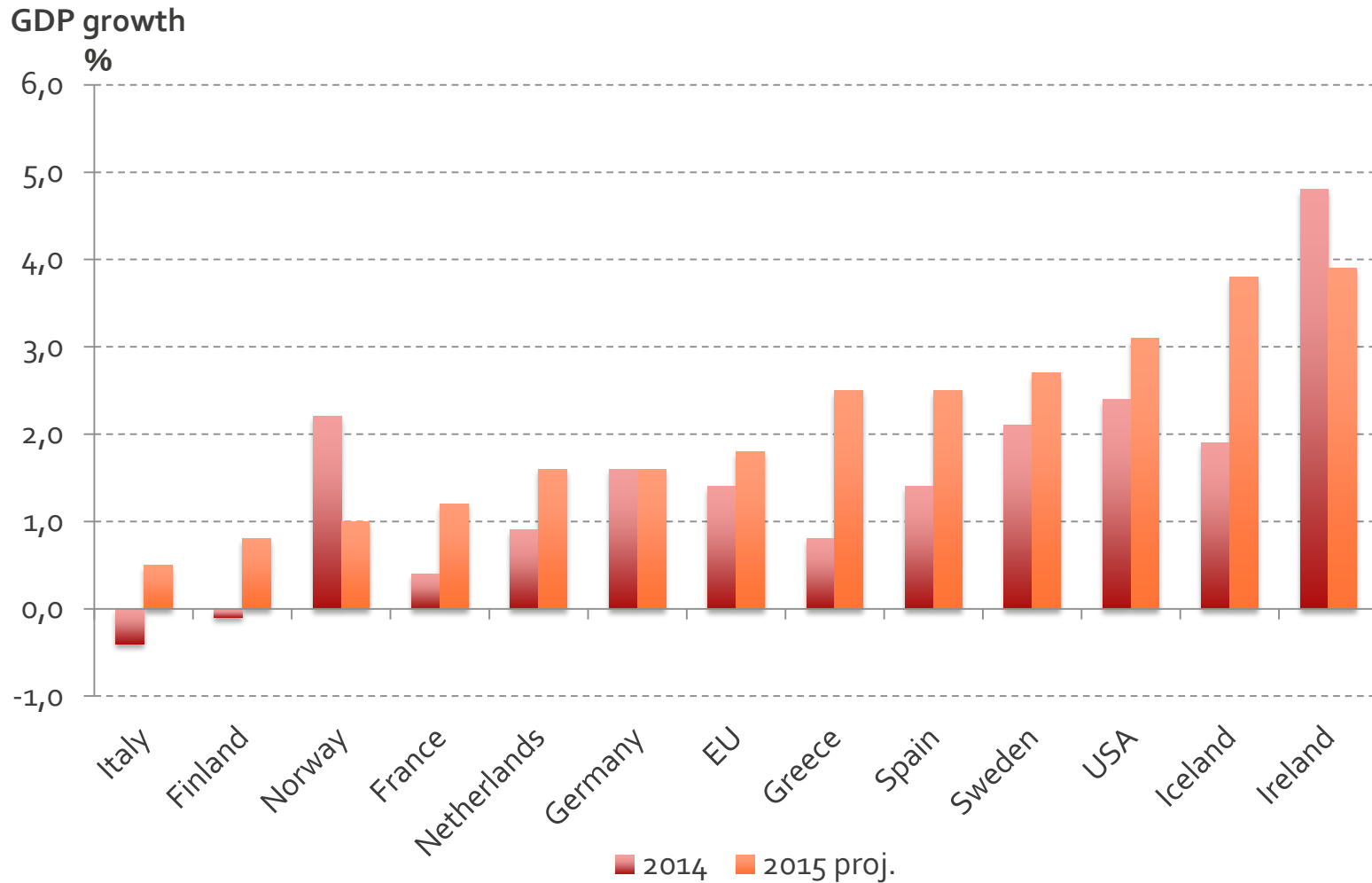


7.

ICELAND IN AN
INTERNATIONAL
COMPARISON

BUDGET PROPOSAL
2016

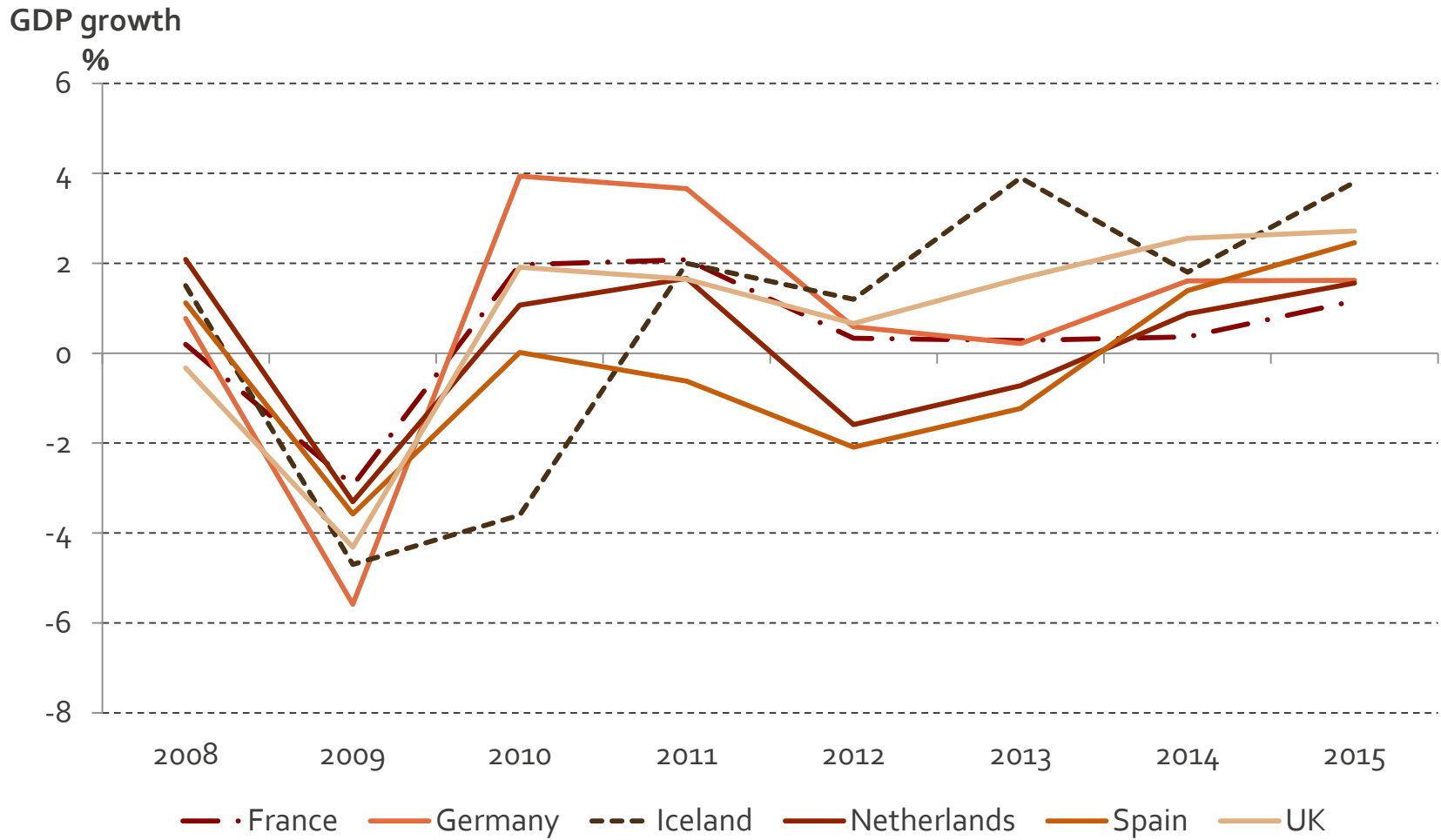
ECONOMIC GROWTH IN 2014 AND FORECAST FOR 2015



Source: IMF and Statistics Iceland



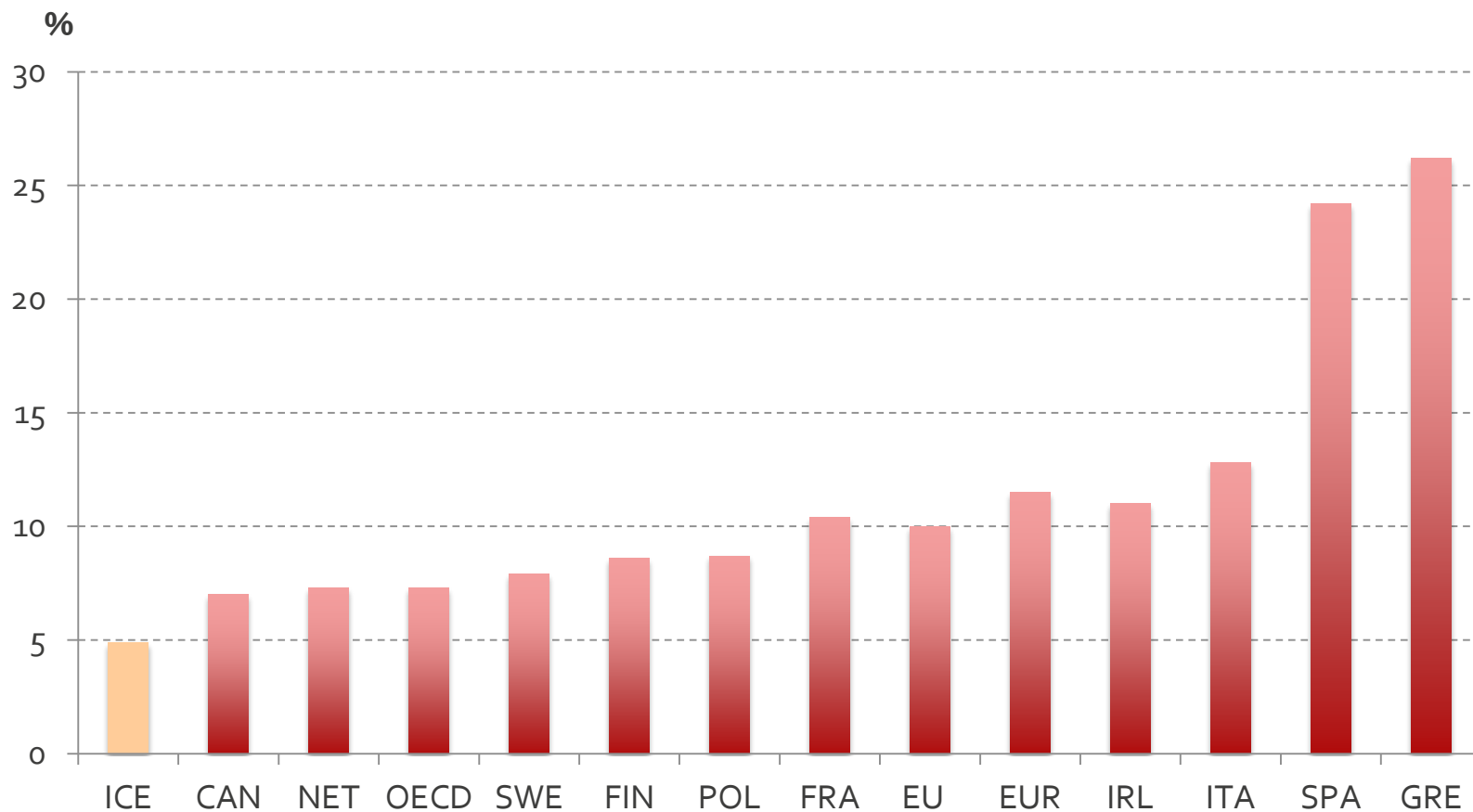
ECONOMIC GROWTH 2008-2015



Source: IMF



UNEMPLOYMENT IN OECD COUNTRIES 3Q2015

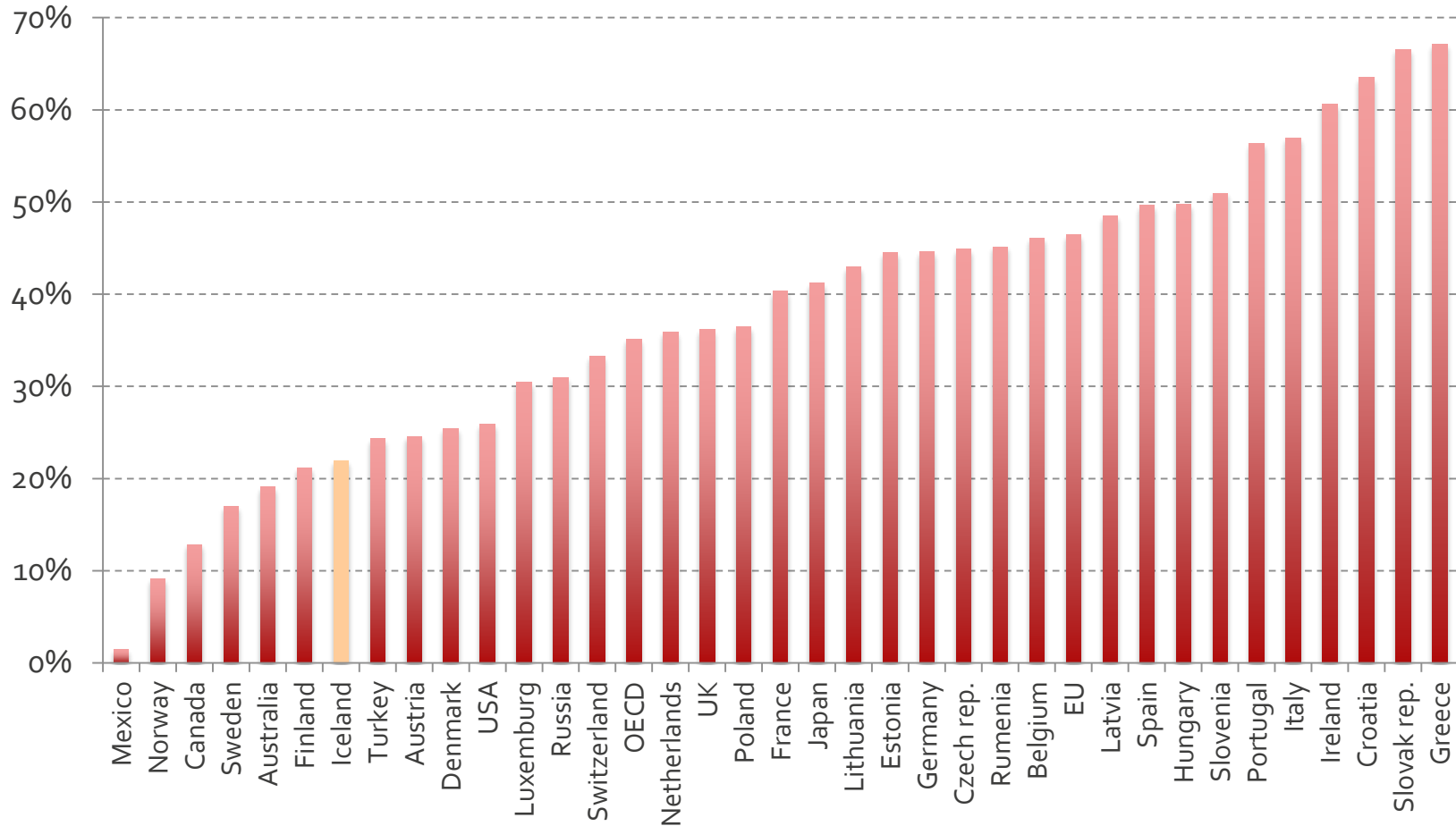


Source: OECD



LONG TERM UNEMPLOYMENT IN 2013

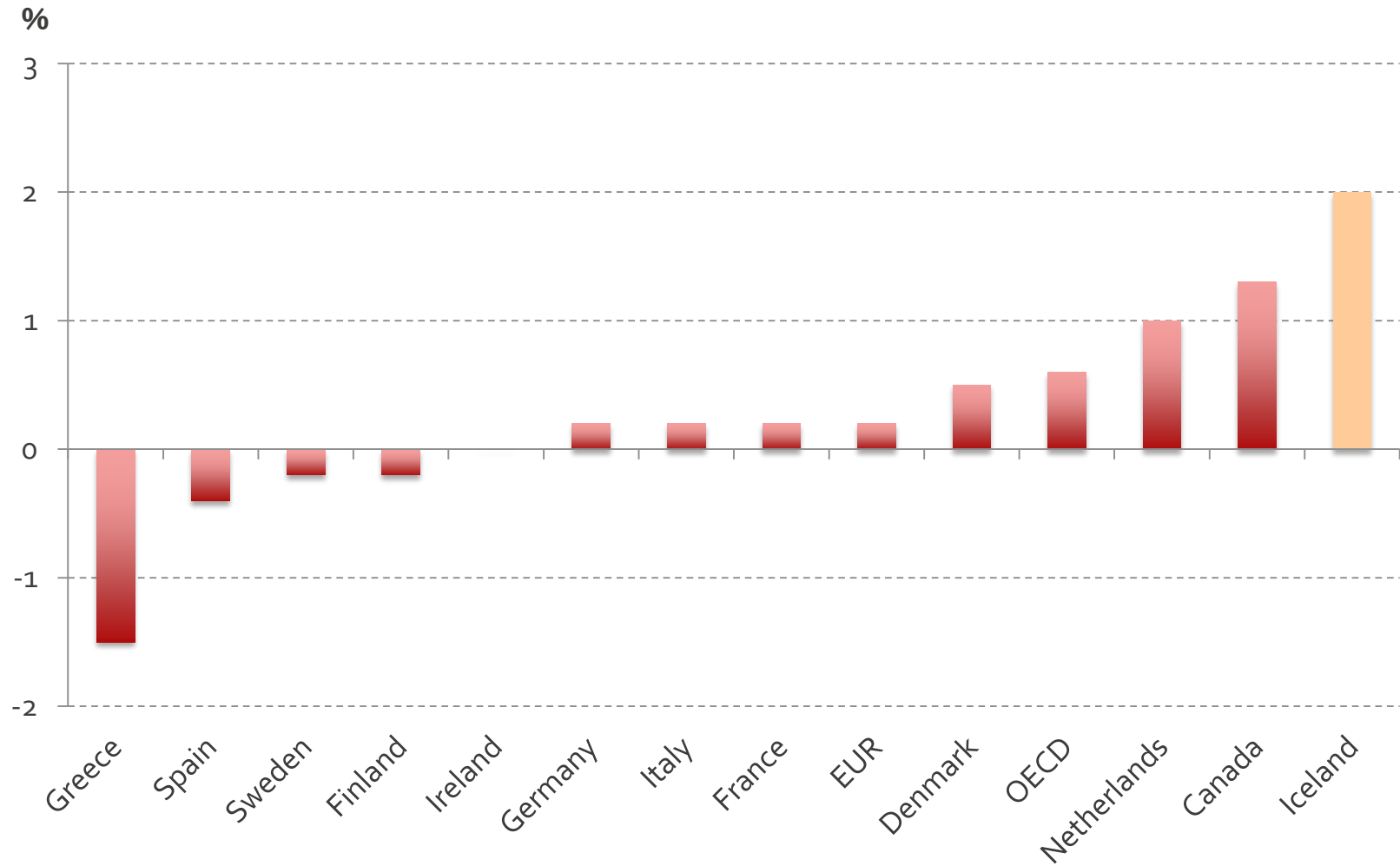
% of unemployed



Source: OECD, september 2015



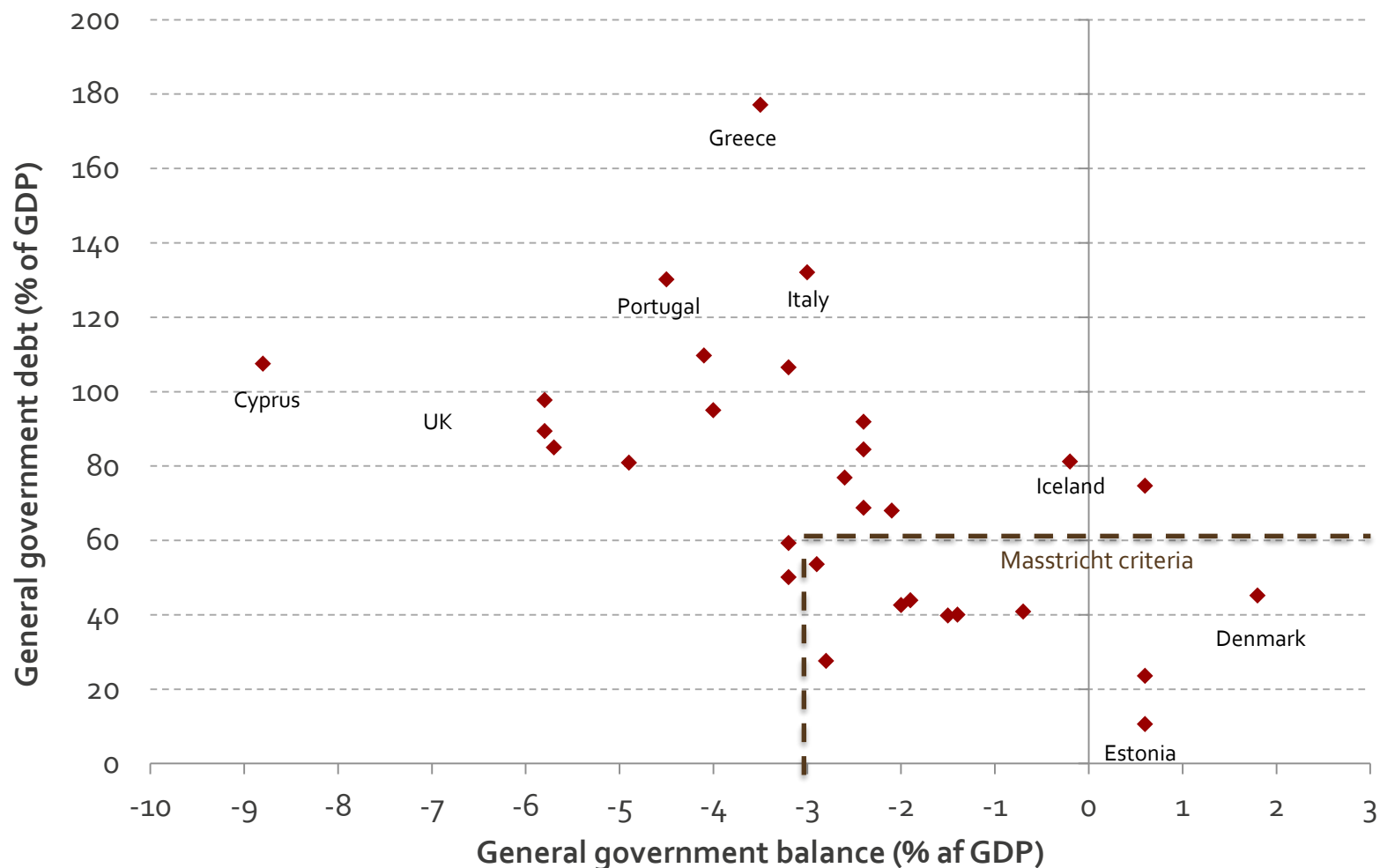
INFLATION IN 2015 IN OECD COUNTRIES



Source: OECD, August 2015



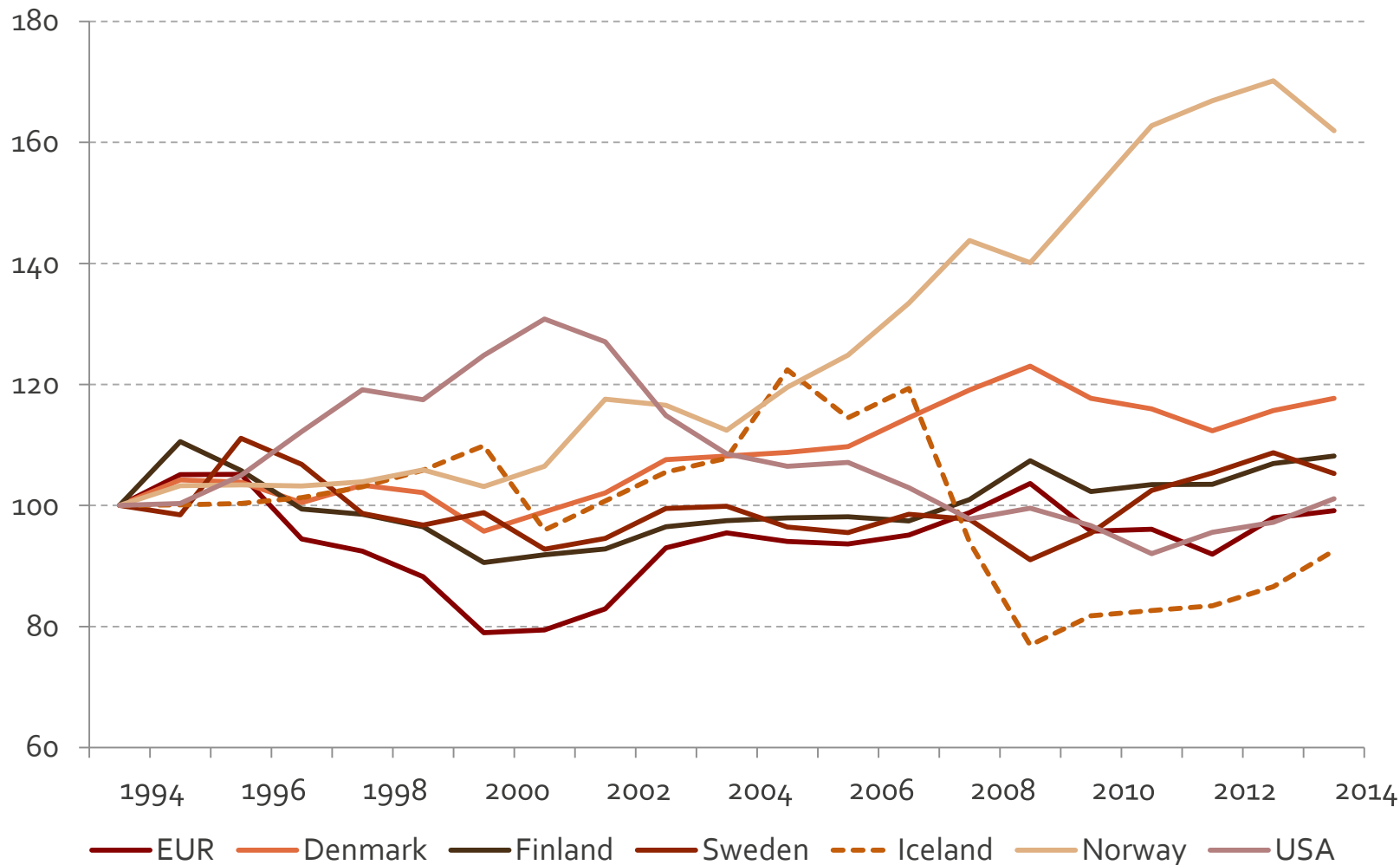
GENERAL GOVERNMENT DEBT AND FINANCES OF A FEW EUROPEAN COUNTRIES IN 2014, % OF GDP



Source: OECD, September 2015



REAL EFFECTIVE EXCHANGE RATE 1994 -2014: COMPARISON WITH OTHER COUNTRIES

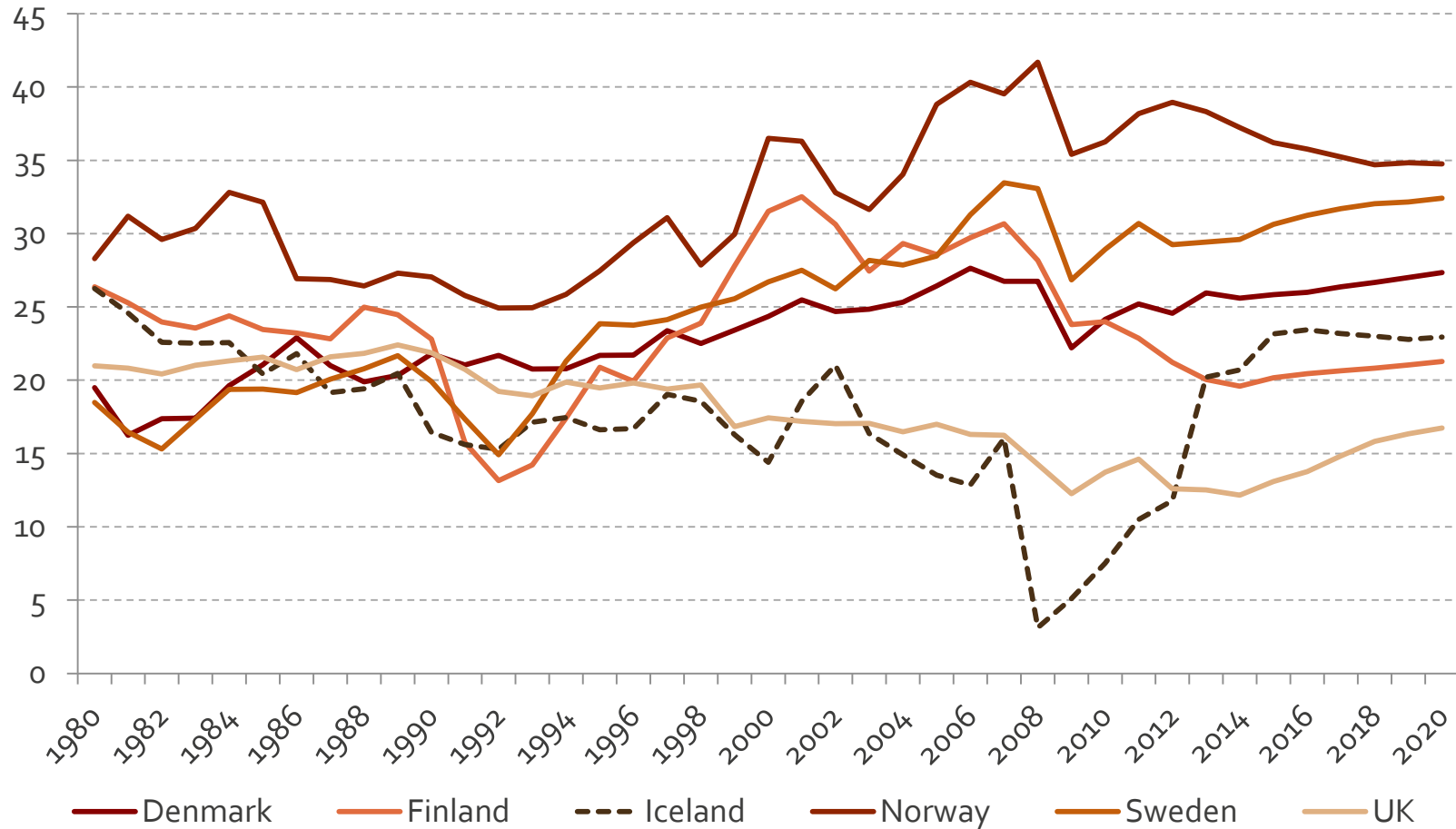


Source: Eurostat, September 2015



NATIONAL SAVINGS 1980-2020

% of GDP



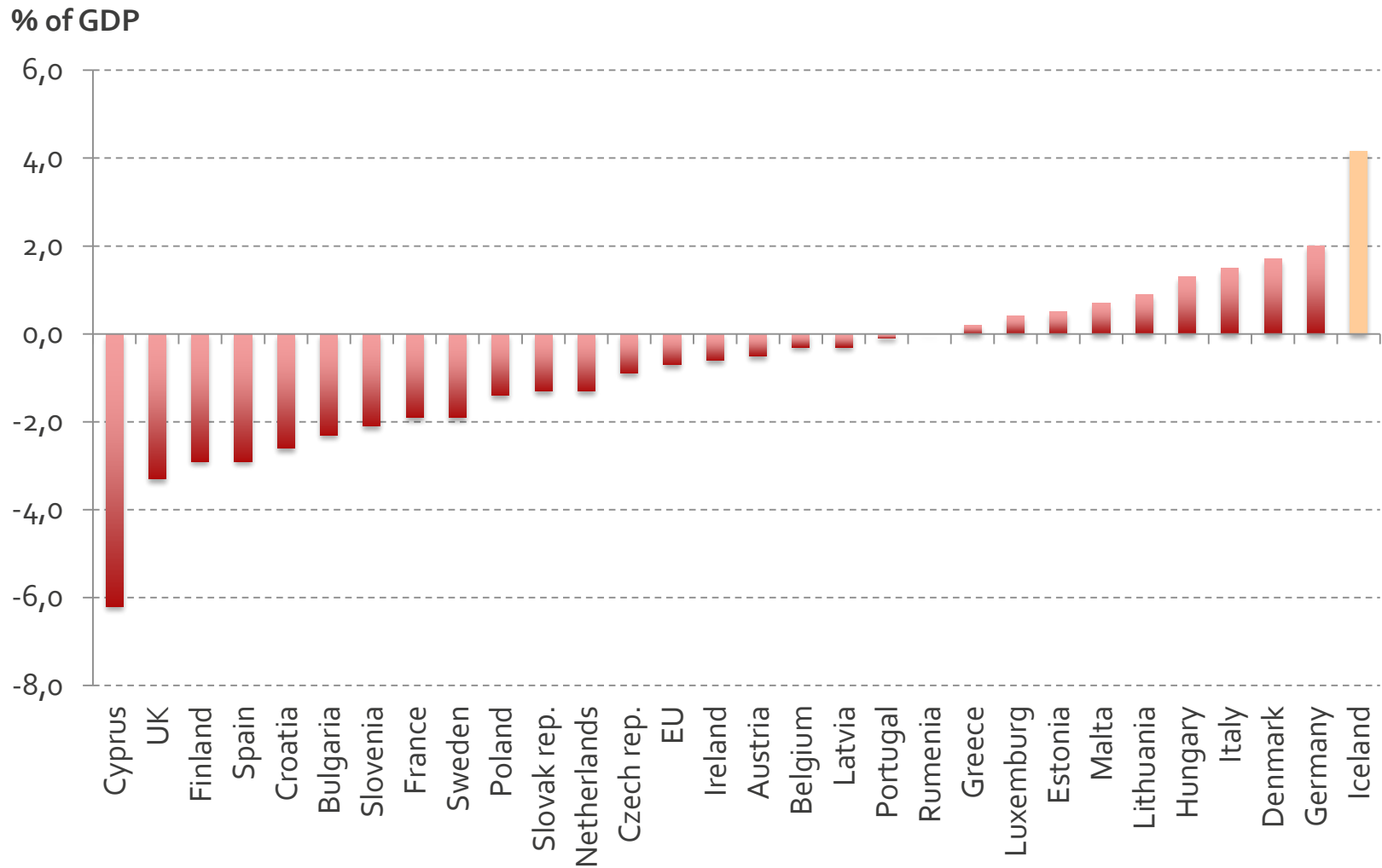
Budget Proposal 2016

Source: IMF, september 2015

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PRIMARY BALANCE – EU AND ICELAND 2014

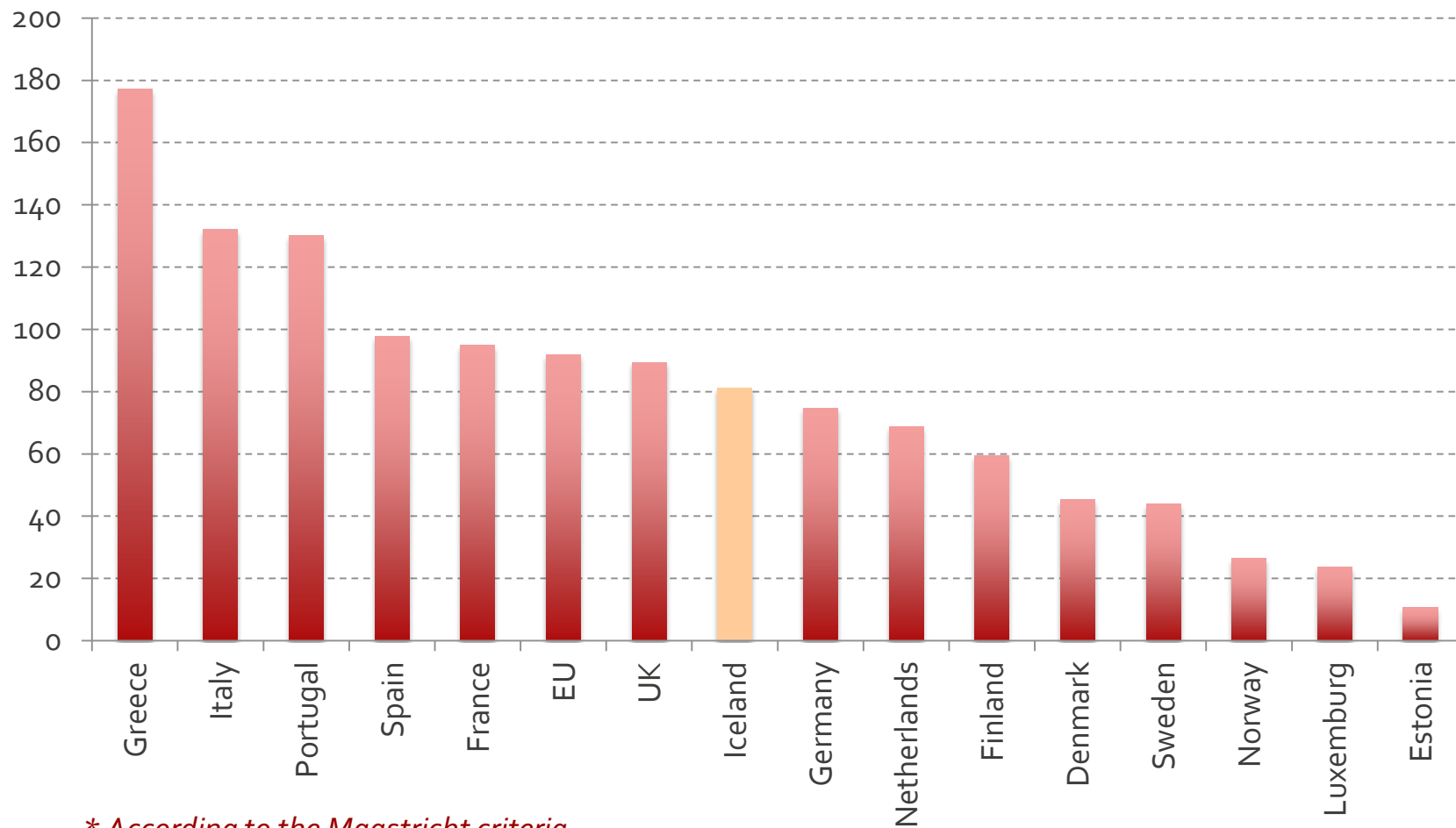


Source: Eurostat



GENERAL GOVERNMENT DEBT* – EU AND ICELAND 2014

% of GDP



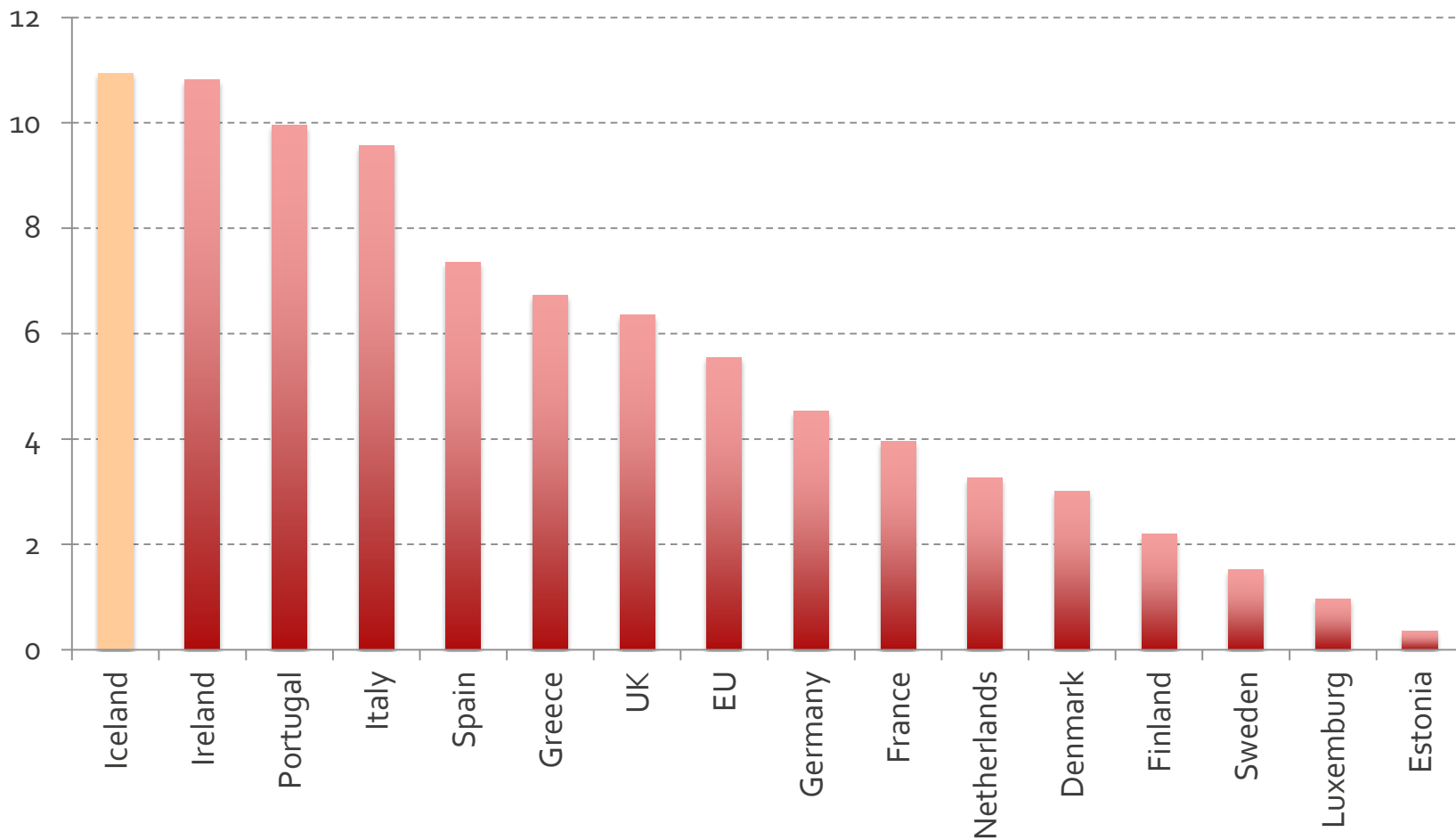
* According to the Maastricht criteria

Source: Eurostat



INTEREST EXPENTITURE OF THE GENERAL GOVERNMENT – EU AND ICELAND 2014

% of GDP



Source: Eurostat





8.

GENERAL GOVERNMENT AND MUNICIPALITIES

BUDGET PROPOSAL
2016

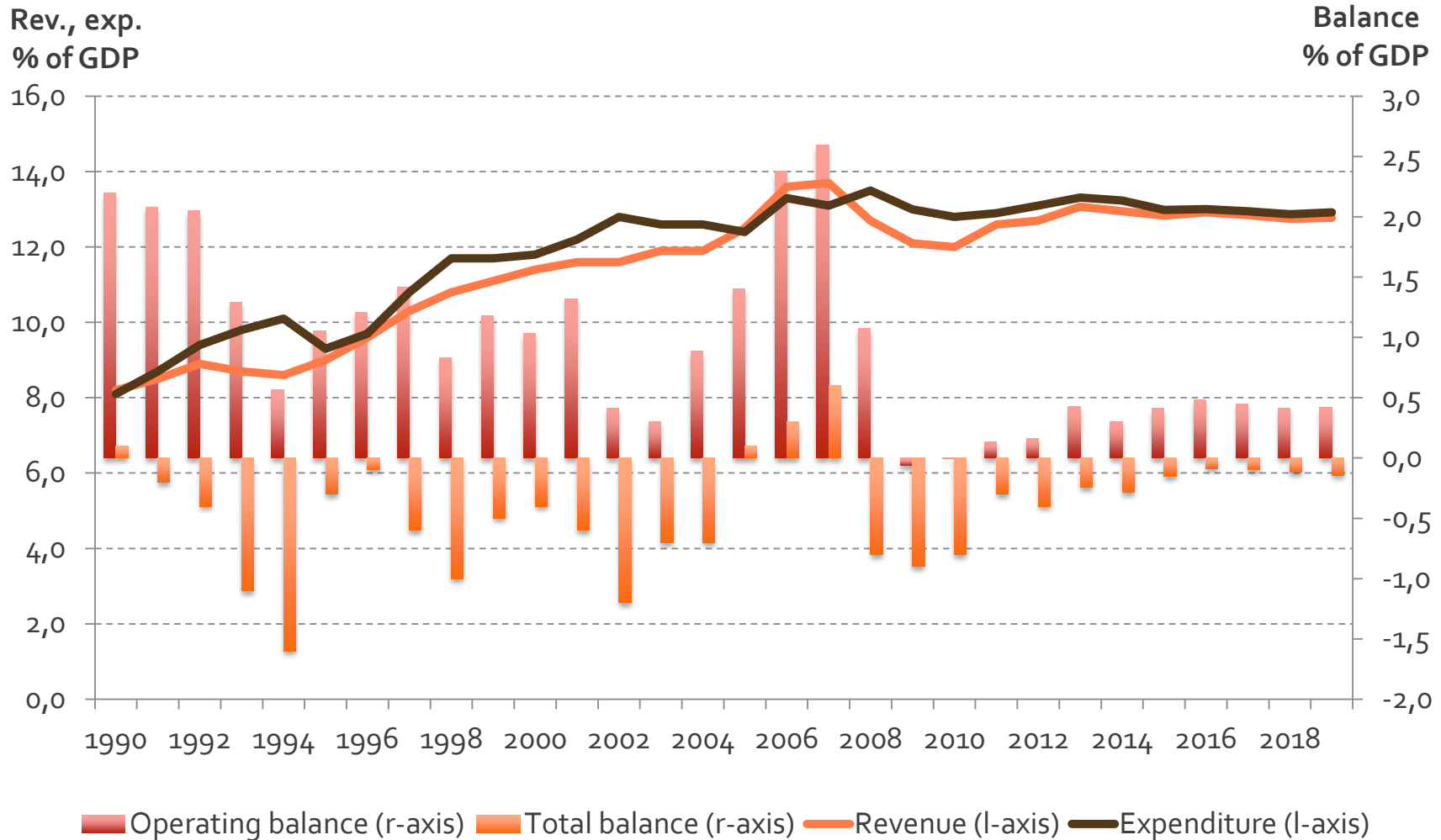
REVENUES OF MUNICIPALITIES 2014-2019

ISK bn.	Acc. 2014	Proj. 2015	Proj. 2016	Proj. 2017	Proj. 2018	Proj. 2019
Total revenue	258,1	278,0	301,2	320,3	337,3	356,4
Tax revenue	191,7	208,4	226,7	242,2	255,9	270,4
Tax on revenue and profits	157,9	171,9	187,4	200,4	211,7	223,8
Tax on assets	31,8	34,3	37,0	39,3	41,6	43,8
Tax on goods and services	2,0	2,2	2,4	2,5	2,6	2,8
Contributions	28,9	29,7	31,7	32,4	33,3	35,3
Other revenue	37,5	39,9	42,8	45,7	48,1	50,7
Revenue from assets	10,3	10,7	11,2	11,8	12,1	12,4
Sale of goods and services	26,3	28,3	30,6	32,8	34,8	37,0
Other revenue	0,9	0,9	1,0	1,1	1,1	1,2
Total revenue, % of GDP	12,9	12,8	12,9	12,9	12,8	12,8

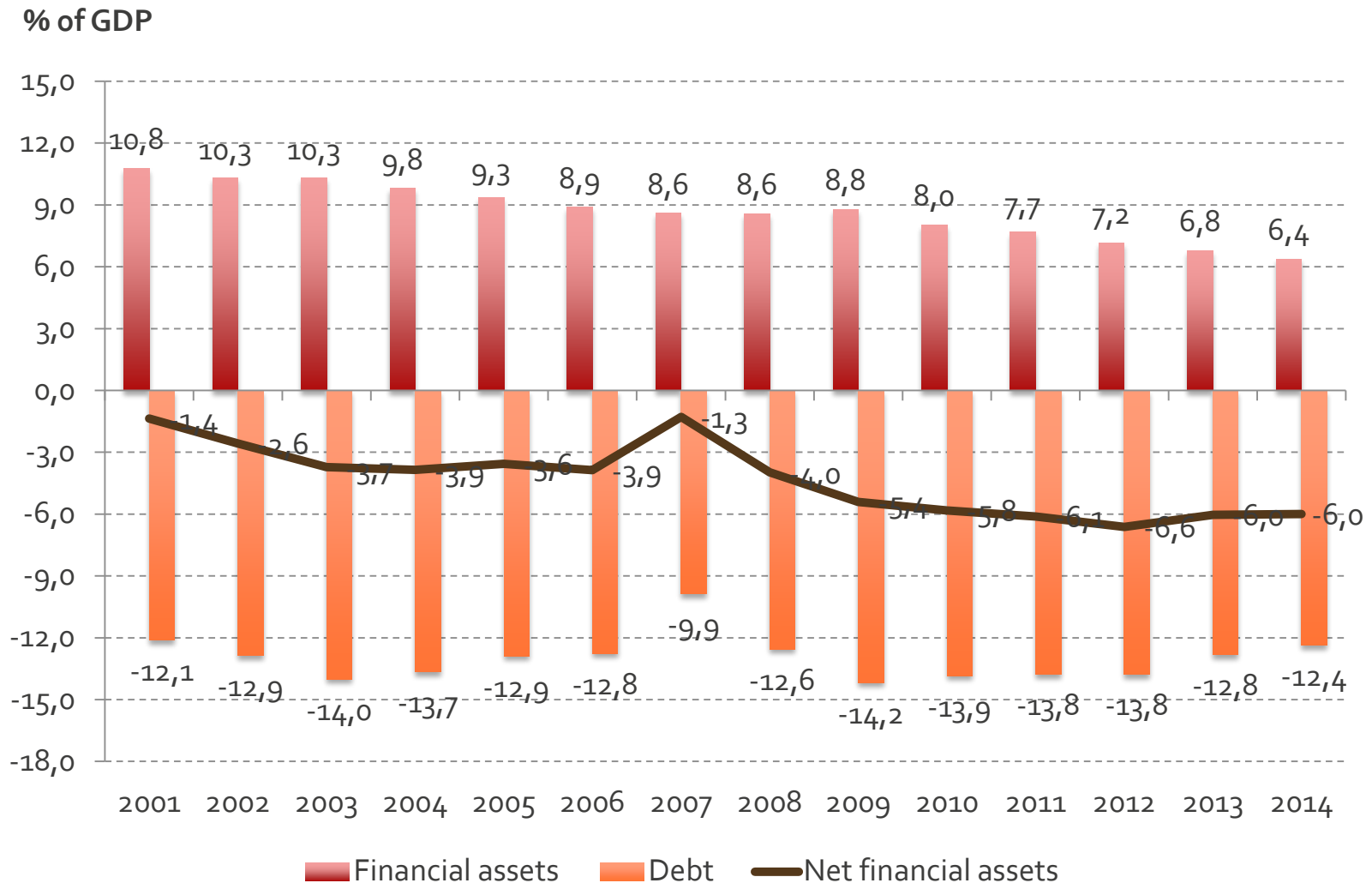
EXPENDITURES OF MUNICIPALITIES 2014-2019

ISK bn.	Acc. 2014	Proj. 2015	Proj. 2016	Proj. 2017	Proj. 2018	Proj. 2019
Total expenditure	263,8	281,3	303,2	322,7	340,5	360,4
Wages	205,7	220,3	238,3	255,1	270,0	286,0
Goods and services	7,9	8,1	8,3	8,4	8,6	8,6
Interest expenditures	27,7	29,4	31,7	33,6	35,3	37,1
Transfers and subsidies	22,4	23,5	24,9	25,7	26,6	28,7
Total expenditure, % of GDP ...	13,2	13,0	13,0	13,0	12,9	12,9

FINANCIAL BALANCE OF MUNICIPALITIES 1990-2019



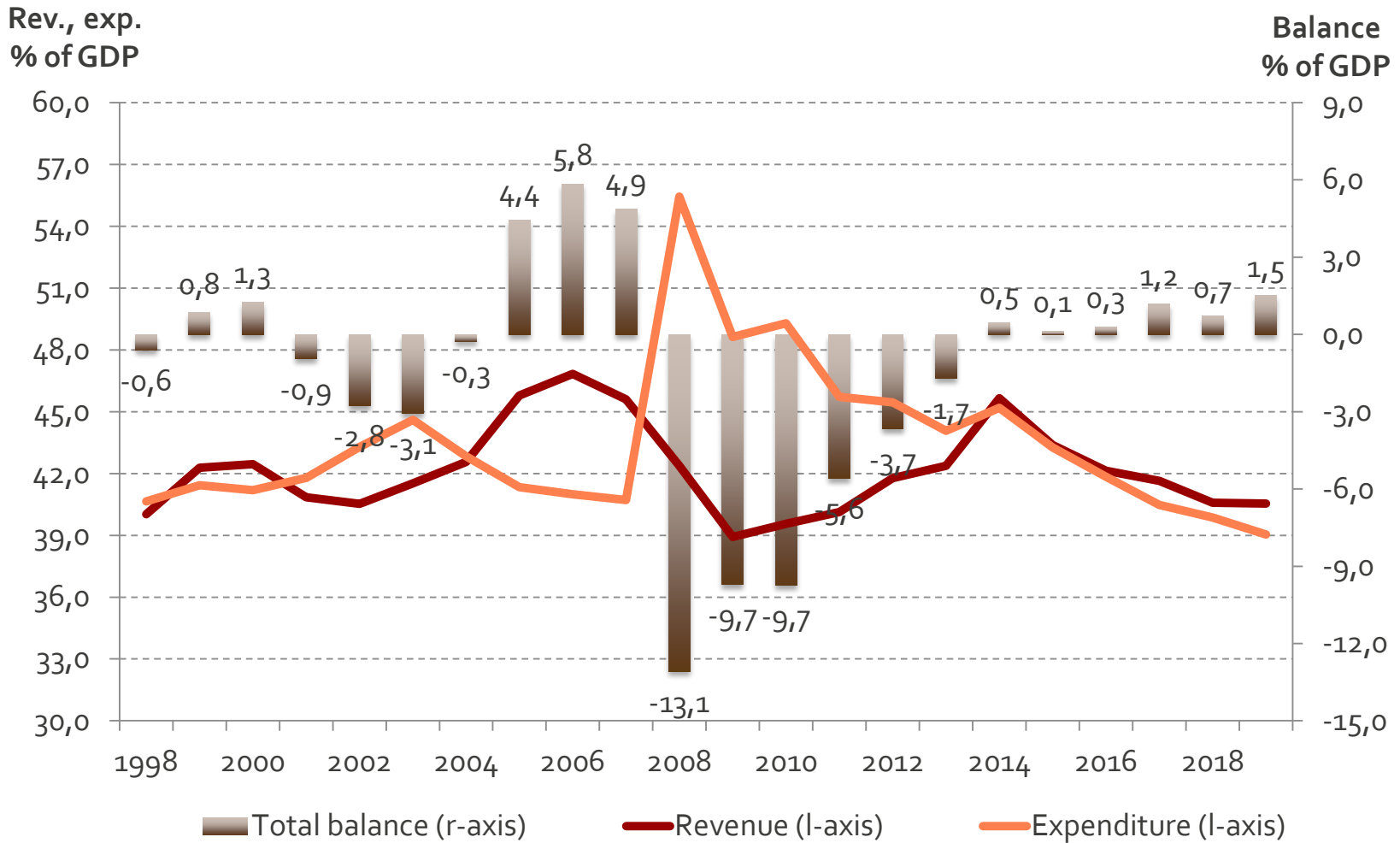
NET FINANCIAL ASSETS OF A-PART OF MUNICIPALITIES



GENERAL GOVERNMENT FINANCES 2014-2019

% of GDP	Acc. 2014	Proj. 2015	Proj. 2016	Proj. 2017	Proj. 2018	Proj. 2019
Total revenue	45,6	43,4	42,2	41,7	40,6	40,6
Tax revenue	35,3	33,4	33,1	32,8	31,8	31,9
Social security contribution	3,7	3,7	3,7	3,7	3,7	3,7
Contributions	0,1	0,1	0,1	0,1	0,1	0,1
Other revenue	6,6	6,2	5,3	5,1	5,0	4,9
Total expenditure	45,2	43,3	41,8	40,5	39,9	39,0
Operating expenditure	44,4	42,7	41,5	40,1	39,4	38,5
Investment expenditure	0,8	0,6	0,4	0,4	0,4	0,5
Investment	2,8	2,4	2,2	2,2	2,1	2,2
Depreciation	-2,0	-1,9	-1,8	-1,8	-1,7	-1,7
Total balance	0,5	0,1	0,3	1,2	0,7	1,5

GENERAL GOVERNMENT BALANCE 1998-2019





9.

FISCAL OUTLOOK
– OTHER ASPECTS

BUDGET PROPOSAL
2016

MAIN WEAKNESSES

- » Indebted Treasury and significant interest balance deficit
- » Expenditures as % of GDP are historically low and are projected to be restrained for the coming years
- » Liberalization of capital controls



MAIN STRENGTHS

- » Favorable demographics
- » Stable and positive economic prospects in the medium-term
- » Considerable assets that partly offset the debts of the Treasury
- » Fully funded private pension system
- » Renewable natural resources

