Government statement on targeted actions to eliminate price-level indexing

The government's manifesto of 30 November 2017 states that the government intends to initiate concerted actions with the social partners to ensure that collective wage bargaining contracts result in real benefits for workers and society. It is noted that peace in the labour market is a prerequisite for promoting price stability and balance, thereby creating economic conditions for lower interest rates and improved living standards.

The manifesto also says: "The government will target actions during the electoral term towards abolishing the indexation of mortgage loans; at the same time, counterbalancing measures will be taken to safeguard the opportunities for young people and low-income groups to acquire housing. Special priority will be given to maintaining economic stability. Furthermore, the government intends to create incentives and support to enable households who so wish to convert from indexed mortgage loans to non-indexed mortgage loans.

Property prices are one component of the consumer price index in Iceland, and the substantial property-price rise in recent years has had the result that the principal amounts of indexed mortgage loans have increased more than they would otherwise have done. The government will initiate an examination of how real estate can be removed from the measure of the consumer price index."

The Living Standards Agreement of the Confederation of Icelandic Employers and the Icelandic Confederation of Labour states as a principal goal to promote a reduction in interest rates for the benefit of households and the economy. In the opinion of the parties, the agreement provides scope for a reduction in interest rates, which will increase the disposable income of households and make it easier for enterprises to pay the wages provided for in the agreement.

The government and social partners are in agreement on the importance of reducing the weight of indexation. The increased stability resulting from the improved interaction of the principal aspects of economic management and the labour market may enable the development of a loan market closer to the form in the other Nordic countries, where interest rates are lower and loans are generally non-indexed. During the effective term of the collective agreement targeted measures will be taken to end the indexation of loans.

The government will initiate the following actions to abolish indexation:

1. With effect from the beginning of 2020 it will not be permitted to offer indexed annuity loans with a term of over 25 years except on certain conditions. The reason for this is primarily the disadvantage of annuity loans that index adjustments are added to the principal of the loan and their payment postponed, so that the owner's equity grows more slowly and the likelihood of negative equity increases.

2. With effect from the beginning of 2020 the minimum term for index-linked consumer loans will be extended from five to ten years. This will prevent the index-linking of all, or most, types of consumer loans, i.e. apart from housing loans.

3. With effect from 2020 the consumer price index without the inclusion of housing will become the basis for calculation of indexing of consumer loans in the Act on interest and indexation.

4. Before the end of June 2020 a study will have been concluded on the methodology of computing the consumer price index based on international benchmarks in consultancy with experts from overseas. Among other things, the study will focus on the housing factor and what is known as the "index bias", i.e. the potential over-estimation of the consumer price index due to a systemic measuring error.

5. Before the end of 2020 a decision should be available on further restrictions on the offering of index-linked annuity loans, subject to conditions relating to stability and interest rates. In this context a special examination will be made of the payment burden of low-income groups and their means of financing their purchases of housing. Index-linked annuity loans could then be restricted to a term of 20 years or less, or a maximum mortgage ratio could be imposed on index-linked annuity loans. Mortgage ratios could change depending on the state of the economy and differ depending on the arrangement of payments, i.e. annuities or fixed payments or by maturity.

6. A study will be made of increased economic incentives to take non-indexed loans, e.g. in the form of mortgage ratios, tax-free private pension savings and specified additional pension savings, or interest subsidies could extend only to interest and not to index level adjustments.

7. Means will be sought of limiting automatic price level increases of goods and services and short-term contracts. Automatic increases of this kind fuel inflation, thereby increasing index-linked debts directly and non-indexed debt indirectly. According to a survey conducted in 2015, about half of domestic contracts and supplies are linked to indices. A study will be conducted of establishing conditions for price adjustments in contractual relationships that will ensure disclosure obligations on sellers and restrict maturities, thereby improving consumer protection.