Economic Survey – December 2013

1.1 The current economic outlook

The recovery of the Danish economy has gained momentum during 2013. It is not going fast, but the improvement is becoming more and more apparent. Over the past year both production, employment, and business confidence has increased throughout large parts of the Danish corporate sector, where gross value added is now approaching the level from before the downturn in 2008-09, *cf. figure 1.1.*

Over the coming years growth is expected to gain momentum in line with increasing demand from Danish exports markets. There is growing evidence that the debt crisis in the euro area is waning, and the euro area as a whole is once again moving forward. At the same time, the recovery is now fairly robust in other parts of the world economy, including in major Danish export markets, such as the USA and the UK.

The progress abroad along with low interest rates and the initiatives in e.g. *Growth Plan DK*, provide the foundation for a greater willingness to consume and invest domestically. In recent years both businesses and households have been very cautious, but a change in sentiment has occured. Optimism is expected to spread further as the recovery in the world economy becomes entrenched, and the uncertainty regarding economic developments is reduced.

Figure 1.1
GDP in Denmark

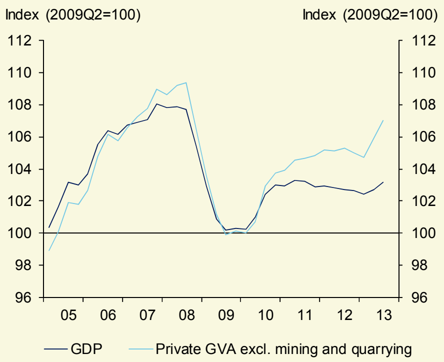
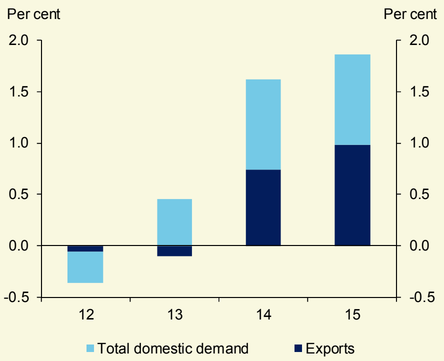


Figure 1.2
Drivers of GDP growth in Denmark



Note: Figure 1.1 shows a two-quarter moving average. The growth contributions in figure 1.2 are corrected for the import content of both exports and domestic demand.
Source: Statistics Denmark and own calculations.

GDP growth is expected to increase from 0.4 per cent in 2013 to 1.6 per cent and 1.9 per cent in 2014 and 2015 respectively. Exports and domestic demand contribute about evenly to growth in 2014 and 2015, *cf. figure 1.2.* GDP growth continues to be dampened by declining production in the North Sea, and a somewhat stronger growth is expected in gross value added in the private sector excl. mining and quarrying of 1.2 per cent this year, 1.8 per cent next year, and 2.4 per cent in 2015.

Danish economic growth is aided by the partial recovery of wage competitiveness in recent years. Together with *Growth Plan DK* – including the advancing of a number of tax reductions with the agreement on the Budget for 2014 – and the investment window that will strengthen the ability of Danish companies to transform an international recovery into growth and employment in Denmark. In a longer perspective, long term reforms contribute to preventing that a recovery is not hampered by a tight labour market.

Growth is also supported by a recovery in the housing market. Sharp price declines in the wake of the housing bubble in the mid-00s left a considerable need for economic consolidation in many households. This has contributed to dampen private consumption. With the prospect of gradually rising house prices and on the basis of a significant improvement in consumer confidence over the past six months, private consumption is expected to follow the rise in income over the coming years.

The increase in demand both at home and abroad will increase the need for investments among businesses. Business investments have been extraordinarily low in recent years. Along with a large corporate savings surplus it leaves a significant potential for investment growth in line with increasing capacity utilisation.

Employment is rising, and growth is expected to be strong enough to bring along further improvement. It is expected that overall employment (adjusted for the lockout of teachers in 2013) will increase by 8,000 persons (0.3 per cent) this year, 13,000 persons (0.5 per cent) next year, and 16,000 persons (0.6 per cent) in 2015, *cf. figure 1.3.* This reflects both higher private and public employment.

The economy is expected to continue to be supported by very low interest rates over the coming years. Furthermore, economic activity is underpinned by fiscal policy and other economic policy measures corresponding to an increase in the GDP level of around ½ per cent of GDP in 2014. Based on technical assumptions, fiscal policy and additional measures are expected to be approximately neutral for the level of activity in 2015. This should be viewed in a context of accelerating growth in GDP and employment in 2015. Fiscal policy for 2015 is not determined until the budget for 2015 is finalised.

Credibility of public finances is an essential precondition for a continued economic recovery. In recent years, a number of reforms have been undertaken in order to ensure sound public finances and strengthen confidence in the Danish economy. A number of initiatives aimed at structural improvements, including the tax reform of 2012 and the agreements on *Growth Plan DK*, will provide a lasting contribution to economic growth. At the same time the planned and the assumed economic policy in the forecast, including the agreement on the Budget for

2014, implies that the public deficit will remain within the limits established in the Budget Act and EU regulations, including the 3 per cent of GDP limit, *cf. figure 1.4.*

Figure 1.3
Growth in employment

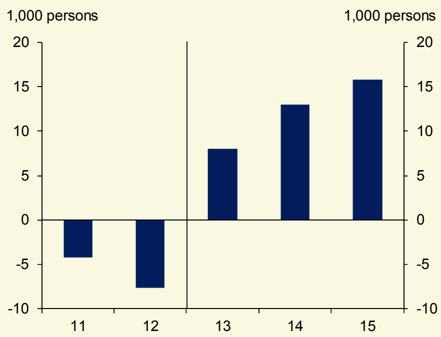
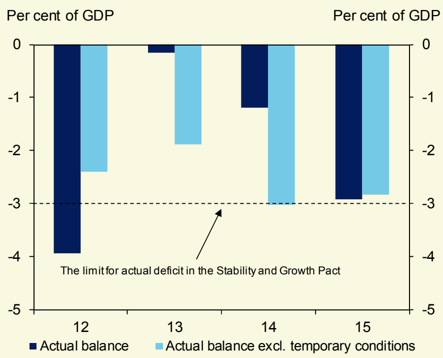


Figure 1.4
Government balance



Note: The calculation of total employment in figure 1.3 is including locked out teachers in 2013.
Source: Statistics Denmark and own calculations.

The forecast assumes that the recovery of the international economy is not derailed again by turmoil in financial markets and unsolved structural problems in major economies. Growth in the Danish economy can become stronger, for example, if the recovery abroad turns out to be stronger than expected, or if domestic consumption and investment appetite increases more than assumed.

1.2 The forecast

Economic developments in Denmark are closely linked to developments abroad. During the autumn, there has been growing evidence of improvements in the countries that have the closest trade links with Denmark. This chiefly concerns the euro area, which accounts for around one third of Danish exports. Following a year and a half of decline, GDP grew in both the second and third quarter, and confidence indicators suggest that growth has continued towards the end of the year, *cf. figure 1.5.* Until now however, growth in the euro area remains subdued. Nevertheless, a turnaround finally seems to be under way, and in 2014 and 2015 progress is expected again.

Germany, in particular, is driving the progress in the euro area, but there are also positive signs in other countries. Spain experienced economic growth – albeit modest – in the third quarter for the first time in more than two years, and in Italy, the decline in GDP of 0.1 per cent was the smallest in two years. The improvement also reflects the fact that confidence in public finances in the debt-ridden euro area countries is returning. For example, the yield on government bonds in both Spain and Italy has fallen considerably against Germany since mid-2012, *cf. figure 1.6.*

Figure 1.5
GDP and business confidence in the euro area

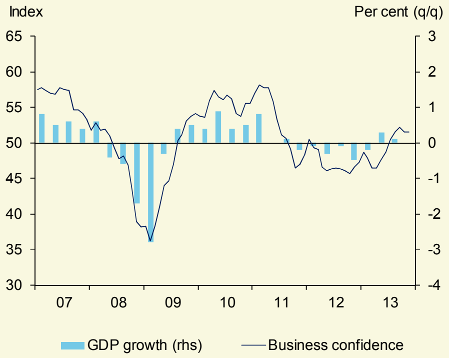
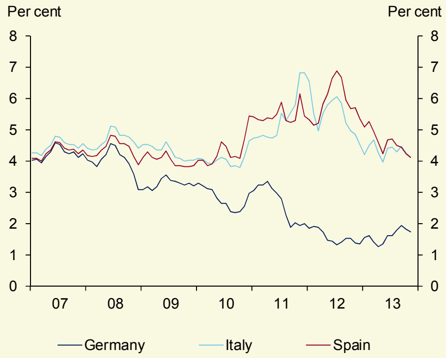


Figure 1.6
Long-term interest rates



Source: Eurostat, Reuters EcoWin and own calculations.

The turnaround in the euro area is supported by a continued accommodative monetary policy stance. In November, the ECB lowered the leading interest rate by a quarter of a percentage point. The reduction reflects the currently very low inflation rate and that inflationary pressure is expected to remain modest for a period of time. In addition, fiscal consolidation during recent years has strengthened the underlying balance of public finances and reduced the vulnerability to fluctuations in financial markets.

Outside the euro area the recovery appears to be well under way among Denmark's main trading partners, including the UK and the USA. In the UK the improvement is broad-based, with GDP in the third quarter around 1½ per cent higher than in the same quarter a year earlier. In the USA, growth has become rather robust, and it did not slow in response to neither the fiscal tightening nor the uncertainty, which followed from the process surrounding the increase of the debt ceiling and the approval of a federal budget during the fall. In the USA, growth is also supported by a very expansionary monetary policy. There has been quite some speculation as to when the tapering of the Federal Reserve's bond buying program would start, and long-term interest rates have risen somewhat over the course of 2013. However, policy rates in the USA are expected to be raised no earlier than 2015.

In other parts of the world economy the picture is more mixed. In Japan, an aggressive economic policy has supported growth throughout 2013, although the effects hereof are expected to eventually wear off. A more sustainable growth path depends on the implementation of structural reforms, which represents the third leg of the Japanese government's economic strategy. The pace of emerging markets growth has slowed lately. This particularly applies to the emerging market economies that have large external financing needs, and which have seen capital outflows and pressure on the currency, including Brazil and India. The changes in capital flows and exchange rates should be viewed in light of the increase in US long-term interest rates, but is also a more fundamental expression of doubt regarding the growth potential of the countries in question. An exception to this picture is China, where growth through 2013 has gone up a bit and is expected to remain around 8 per cent in the coming years.

Figure 1.7
Export market growth

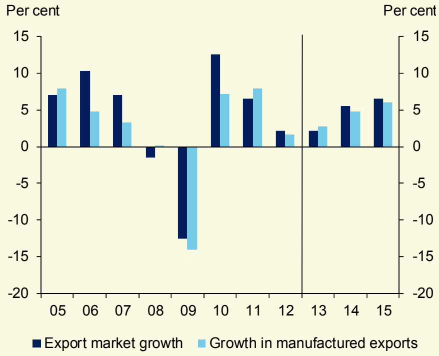
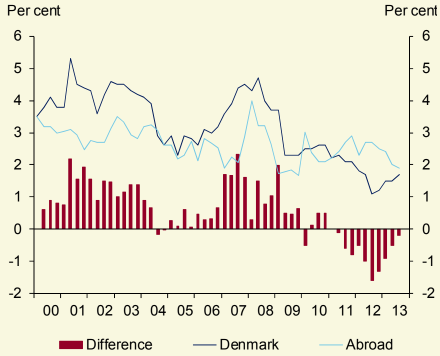


Figure 1.8
Increase in wages in Denmark and abroad



Source: Eurostat, Reuters EcoWin and own calculations.

Overall, the recovery abroad is expected to imply a significantly higher Danish export market growth over the coming years, following two years of very weak growth on export markets for Danish manufactured goods, *cf. figure 1.7.* At the same time, an increase in world trade will help pull up service exports. Against this backdrop, growth in total exports is expected at 3¾ and 4¾ per cent in 2014 and 2015.

The increase in exports is underpinned by *Growth Plan DK* – including the advancing of a number of tax reductions with the agreement on the Budget for 2014 – which strengthens the competitiveness of Danish businesses. The growth in exports is also supported by relatively modest nominal wage increases in Denmark over recent years, which on its own has increased wage competitiveness. However, there is still a backlog from previous years, where wage growth was significantly higher than abroad in the period 2000-08, *cf. figure 1.8.*

Domestic demand has been very subdued this year. This especially reflects the weak development in private consumption and housing investments. Households continue to be hesitant with consumption and investment spending despite increases in disposable real incomes due to tax cuts and declining interest rate expenses.

The outlook for consumer spending is brighter for 2014 and 2015. Over the summer, there has been a clear change in sentiment, and consumer confidence is now slightly above the historical average, *cf. figure 1.9.* This usually signals growth in consumption. At the same time, households are now expecting unemployment to decline over the coming year. The change in sentiment is also reflected in some improvement in the housing market.

Figure 1.9
Consumer confidence and house prices

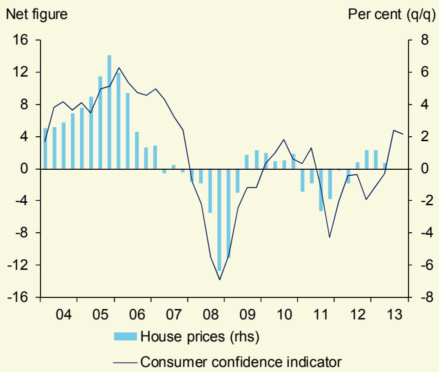
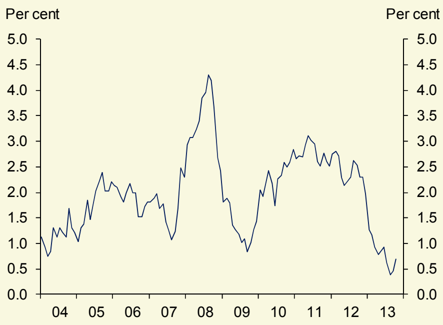


Figure 1.10
Consumer prices



Source: Statistics Denmark and own calculations.

Private consumption is also supported by low inflation, which provides real wage growth. During 2013 inflation has dropped to historically low levels after several years with fairly high price increases considering the business cycle stance, *cf. figure 1.10.* As employment, income, and confidence are expected to increase over the coming years, so is private consumption in line with income growth. The consumption ratio is, however, expected to remain low in a historical perspective, *cf. figure 1.11.* This reflects that some households still need to consolidate their finances further.

Since the downturn in 2008-09 companies have been very hesitant about investing, *cf. figure 1.12.* This partly reflects low capacity utilisation. The investment window that runs to the end of the year and government construction investments, etc., have supported investments in 2013. The coming years total business investments will continue to be supported by publicly initiated private investments. However, growth in investments will increasingly be driven by the prospect of growing demand both in domestic and exports markets. Along with increasing capacity utilisation in Danish companies, this will create a need for larger and newer production facilities. Large savings in businesses and low interest rates provide good opportunities for investment growth.

The expansion of exports and private domestic demand will drive up growth in overall demand to 2½ per cent next year and 2¾ per cent in 2015. A significant part of the increase in demand will be countered by higher imports, however, it does allow room for growth in GDP of 1.6 and 1.9 per cent respectively over the coming two years. This implies a relatively modest increase in growth when compared to previous turnarounds. This reflects, among other things, that progress in the euro area is only expected to manifest itself gradually. In addition, growth in overall production is dampened by declining production in the North Sea.

Figure 1.11
Consumption ratio

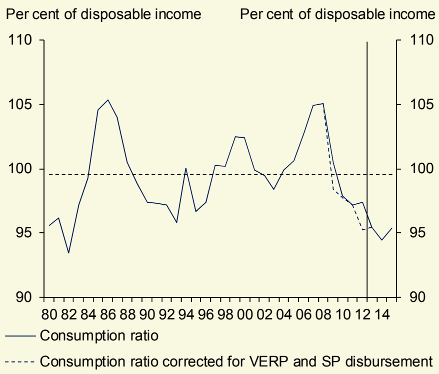
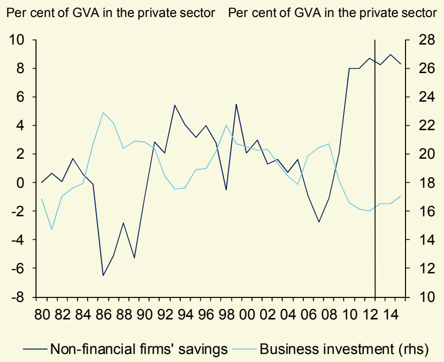


Figure 1.12
Business investment and savings



Note: The consumption ratio in figure 1.11 is calculated based on a measure of the consumption determining income, which is more narrowly defined than the household income in the National Accounts. The dashed line in the figure shows the average consumption ratio in the period 1980-2012. The consumption ratio can be over 100, e.g. if the household's choose to mortgage increasing housing assets. VERP in figure 1.11 is the voluntary early retirement pension and SP is the special savings scheme.
Source: Statistics Denmark and own calculations.

The recovery in the Danish economy can already be seen in the labour market. Private sector employment is estimated to have grown by 8,000 persons (0.4 per cent) this year, and the improvement is expected to continue in 2014 and 2015 as economic activity grows, *cf. figure 1.13.* This year's improvement in employment reflects the fact that production in those parts of the Danish business sector that matters the most for private employment has been somewhat higher than total GDP growth. This is also expected to be the case over the next few years. The prospect of employment growth should also be viewed in light of past reforms and a relatively flexible and efficient labour market.

The improvement in the labour market is also reflected in the unemployment rate, which has been declining since mid-2012. Going forward, employment growth will contribute to a further decline in the unemployment rate. By the end of 2015 gross unemployment is expected to be down to a level of 135,000 persons (around 4.7 per cent of the labour force), roughly equivalent to the level in 2006, *cf. figure 1.14.*

Selected figures from the forecast can be found in table 1.1, while table 1.4 presents a comparison with the assessment in *Economic Survey,* August 2013.

The projection of GDP growth in 2013 has been revised upward from 0.2 per cent to 0.4 per cent compared to the August forecast. This is due to the fact that the first half of the year has been slightly better than expected in August, mainly due to higher export growth. The growth outlook for next year is largely unchanged compared to the assessment in August, although growth in domestic demand and imports is expected to be somewhat stronger. The forecast includes estimates for 2015 for the first time.

Figure 1.13
Private employment

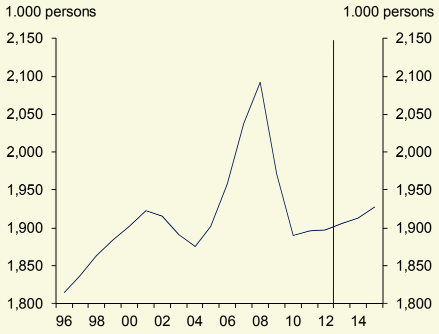
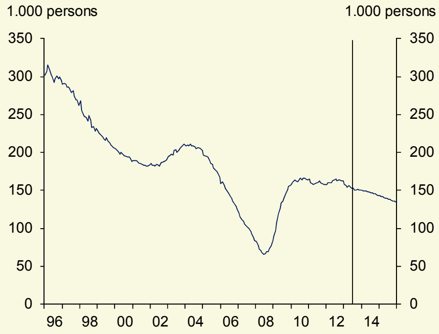


Figure 1.14
Gross unemployment



Source: Statistics Denmark and own calculations.

Growth prospects are still characterised by some uncertainty, although the risk profile has become more balanced. Risks are primarily related to developments in the euro area, where growth continues to be fragile. If, for example, doubt arises about the continued progress of the implementation of reforms aimed at strengthening economic structures and public finances in the vulnerable countries, it can set back economic growth. If for instance export market growth is 2 percentage points lower in both 2014 and 2015 than assumed in the main scenario, growth in Denmark will be around ½ percentage point lower in both years due to lower demand. The strength of the global recovery may, however, also provide a positive surprise. There is also uncertainty associated with the recovery in domestic demand, in particular private consumption, which despite growing optimism continues to be subdued.

It is assumed that domestic fiscal policy continues to be planned and implemented within the framework of a sustainable economic policy, including the requirements in the Budget Act. Foreign confidence in the Danish economy has been crucial to keeping interest rates at a low level. It has helped to stabilise the housing market, led to lower net interest expenses for households, and contributed to government debt growing less than would otherwise have been the case.

Table 1.1
Key figures

	2012	2013	2014	2015
Real percentage change from previous year				
Private consumption	-0.1	0.5	1.3	1.6
Public consumption	0.4	0.3	1.5	0.6
Public investments	7.7	-2.3	2.1	-8.4
Residential investments	-8.0	-3.5	4.1	1.4
Fixed business investment	0.8	5.8	2.2	6.0
Stock building (per cent of GDP)	-0.3	0.4	0.0	0.0
Exports of goods and services	0.4	0.7	3.7	4.7
Imports of goods and services	0.9	2.1	3.9	4.5
GDP	-0.4	0.4	1.6	1.9
Level (per cent of GDP)				
General government fiscal balance	-3.9	-0.2	-1.2	-2.9
Current account	6.0	6.2	6.6	6.9
Level, 1,000 persons				
Gross unemployment (yearly average)	162	153	147	139
Employment (excl. leave)	2,728	2,732	2,749	2,765
Employment (excl. teacher lockout)	2,728	2,736	2,749	2,765
Labour force	2,847	2,849	2,864	2,873
Rate of change, per cent				
House prices (single family houses)	-3.4	2.5	2.5	2.0
Consumer prices	2.4	0.8	1.2	1.8
Hourly earnings, private sector (Danish Employers Federation statistics)	2.0	1.8	2.0	2.2

1.3 Fiscal policy and public finances

Fiscal policy is planned in order to ensure sound public finances while supporting growth and employment as much as possible within the framework of the Budget Act. Within this framework the agreement on the Budget for 2014, among other things, advance the improvements of corporate conditions and the increase in the earned income tax credit.

The direct impact of fiscal policy and other economic policy measures from 2012 and onwards are estimated to support the GDP level by just under 0.5 per cent of GDP in 2014. Private sector employment in 2014 is estimated to be 13,500 persons higher compared to a situation where fiscal policy and other economic policy had been neutral during the same period. Moreover, monetary policy remains highly accommodative resulting in low interest rates. The low interest rates contribute to private economic activity. Household net interest expenses alone are reduced by half since 2009 compared to household disposable income.

Denmark's EU-recommendation has been a key concern in the fiscal framework in recent years. Public finances are consolidated from 2010 to 2013 in accordance with the requirement in the recommendation of improving public finances in structural terms by 1½ per cent of GDP in 2011-13. Moreover, the forecast of the actual balance implies that it is expected that Denmark will adhere to the key requirement in the recommendations of bringing the actual deficit sustainably below 3 per cent of GDP by 2013.

The actual deficits in 2013-15 are thus estimated to be lower than the 3 per cent of GDP limit. In 2013 and 2014 the actual deficits are positively affected by temporary revenues from the restructuring of taxation of existing capital pensions. In 2015, where the temporary revenues from the restructuring subside, the deficit is also expected to remain below 3 per cent of GDP. In the EU-Commission's fall 2013 forecast the deficits are likewise expected to comply with the 3 per cent of GDP limit in the Stability and Growth Pact. Denmark can have its recommendation repealed in 2014 if actual numbers for 2013 and the EU-Commission's spring 2014 forecast also estimate the deficits in 2013-15 to be below 3 per cent of GDP.

Fiscal policy remains accommodative as public consumption and investment expenditures are approx. ¾ per cent of GDP higher than the expenditure levels that can be sustainably financed *cf. Economic Survey,* August 2013. Going towards 2020, the expenditure levels (measured as share of structural GDP) will have to be reduced in order to secure, that public service and other expenditures can be financed in the long run.

The assessment of public finances in 2014 is based on the Budget for 2014, municipalities' and regions' budget for 2014, etc. The estimate of the public balance in 2015 is based on the economic outlook, the impact of political agreements and technical assumptions.

The development of public finances and the EU-recommendation

The actual deficit is expected to amount to 0.2 per cent of GDP in 2013 and 1.2 per cent of GDP in 2014, *cf. table 1.2.* Hence, in both years the deficit is expected to remain well below the 3 per cent of GDP-limit in the Stability and Growth Pact. In both years the public balance is positively affected by one-off revenues from a restructuring of the taxation of existing capital pensions.

The one-off revenues from the restructuring of the taxation of capital pensions are expected to amount to DKK 25 billion (1.3 per cent of GDP) in 2013 and DKK 30 billion (1.6 per cent of GDP) in 2014. The estimated one-off revenues are adjusted upwards compared to the August Survey, where the one-off revenues were assumed to amount to 20 DKK billion (1.1 per cent of GDP) in both years. Moreover, actual public deficits in 2013 and 2014 are reduced by a number of other temporary revenues. Adjusted for the total temporary revenues, the actual deficit will be 1.9 per cent of GDP in 2013 and 3.0 per cent of GDP in 2014.

Table 1.2
Public balance in 2013-15

Per cent of GDP	2013	2014	2015
Public balance	-0.2	-1.2	-2.9
Public balance excl. temporary revenues[1)]	-1.9	-3.0	-2.8

1) Temporary revenues consist of one-off revenues from the restructuring of the taxation of existing capital pensions, revenues from a reallocation in the pension sector from schemes with a guaranteed yield in each year to scheme in which each year's yield reflects market returns and advanced ordinary revenues from the taxation of capital pensions.

Source: Own calculations.

In 2015, the actual fiscal balance is no longer influenced by one-off revenues from the restructuring of the taxation of existing capital pensions. Moreover, the ordinary revenue from taxation of capital pension is expected to be temporarily reduced by around DKK 1½ billion (0.1 per cent of GDP) due to advanced revenues in 2013 and 2014. Based on this, the actual deficit will increase compared to the deficits in 2013 and 2014 and is expected to amount to 2.9 per cent of GDP in 2015, *cf. figure 1.15*.

The expected development of the actual fiscal balance implies that there is prospect of having Denmark's EU-recommendation repealed in 2014. The actual deficits must be brought sustainably below 3 per cent of GDP by 2013 according to the EU-Commissions assessment in order for the recommendation to be repealed. Therefore it is a key requirement, that the Commission in their spring 2014 forecast estimates, that the actual deficits in 2014 and 2015 remain below 3 per cent of GDP. In their fall 2013 forecast the EU-Commission estimated an actual deficit of 1.7 per cent of GDP in 2014 and 2.7 per cent of GDP in 2015.[1]

Thus, both in the EU-Commission's fall 2013 forecast and in the December Survey the actual deficit in 2015 is expected to remain below – but quite close to – the 3 per cent of GDP limit in the Stability and Growth Pact.

[1] The EU-Commission's figures for the actual balance is on EDP-basis, which differs marginally from the balance based on the Danish National Accounts, *cf. Denmark's Convergence Programme 2013*.

It should be noted that the developments of the actual fiscal balance in general is highly sensitive to the economic outlook. Moreover, the public revenue from the pension yield tax has been higher than the structural level in 2013 and 2014. The revenue from the pension yield tax is expected to be reduced by 0.3 per cent of GDP from 2014 to 2015, inter alia, due to the development of interest rates.

The fiscal deficits leading up to 2015 imply an increase in net public debt from around 7½ per cent of GDP by the end of 2012 to just above 11 per cent of GDP in 2015, *cf. figure 1.16.* However, gross public debt (EMU-definition) is expected to be reduced from 45½ per cent of GDP by the end of 2012 to around 43¾ per cent of GDP in 2015. This is among other things a result of a relocation of state assets, including a reduction of the government's deposit at the Central Bank (Danmarks Nationalbank) and the holdings of mortgage credit bonds by the Social Pension Fund (Den Sociale Pensionsfond) leading up to 2015. As these holdings are not offset in the gross public debt (EMU-definition), a reduction of the holdings will – all else equal – imply a reduction of the EMU-debt. The EMU-debt maintains a wide safety margin relative to the EU-limit of 60 per cent of GDP in the Stability and Growth Pact.

Figure 1.15
The development of the actual fiscal balance

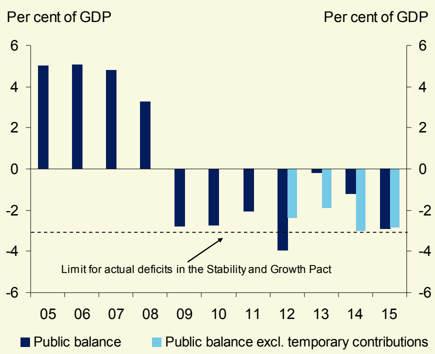
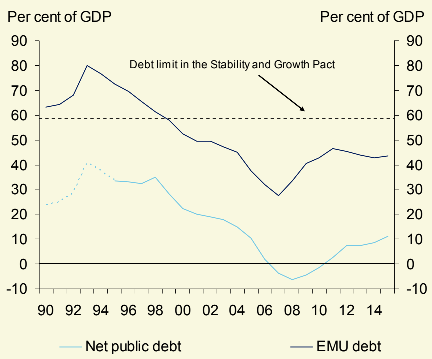


Figure 1.16
EMU-debt and net public debt



Note: In figure 1.15 the public balance shows the public balance net of the impact of repayment of VERP-contributions in 2012 and the temporary revenues in 2013-15, *cf. table 1.2*. In figure 1.16, the development of the net public debt from 1990 to 1995 corresponds to the EMU debt since official figures of net public debt are not available before 1995.
Source: Statistics Denmark and own calculations

Structural balance and the limit for structural deficits in the Budget Act

According to the Budget Act, the annual structural deficits must not exceed ½ per cent of GDP. The law requirement is aimed at the estimated structural deficit based on the budget proposal for the coming year. On grounds of the underlying considerations of the law requirements, this does not imply, that measures that will have a significant negative impact on the structural balance in the relevant year can be decided on after the budget proposal.

The structural deficit in 2014 is estimated to be 0.5 per cent of GDP in the December Survey, *cf. figure 1.17*. Compared to the budget bill proposal, the Budget for 2014 is estimated to have a roughly neutral impact on the structural balance, since a fiscal room for manoeuvre of DKK 0.8 billion from technical amendments to the budget has been disposed of.

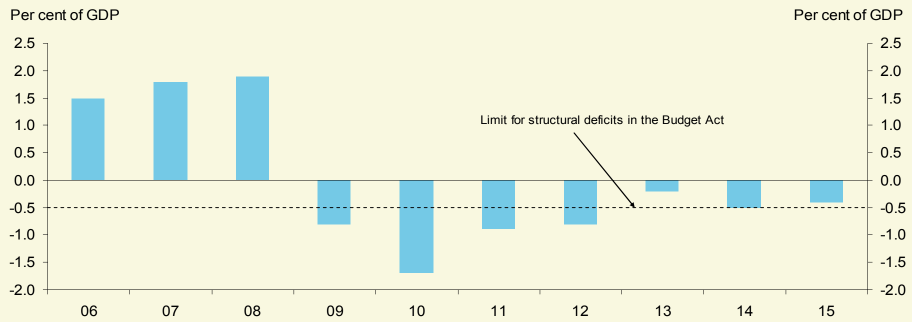
Based on the budget proposal the structural deficit in 2014 was estimated to 0.4 per cent of GDP in the August Survey. In connection to the budget proposal, the importance of having a safety margin to the limit for structural deficits in the Budget Act was emphasised, since there is uncertainty associated with the estimates of the structural balance.

The slight upward adjustment of the structural deficit in 2014 compared to the August estimate should be seen in light of this uncertainty. The updated estimates of the structural balance are based on revised estimates of public finances. This includes, inter alia, adjusted estimates for tax revenues that affect the structural balance and lower calculated structural revenues from the North Sea based on a new long-term projection for oil prices from the International Energy Agency (IEA) and a lower expected dollar exchange rate.

On that basis, planned fiscal policy in 2014 is assessed to be in compliance with the limit for structural deficits in the Budget Act both at the time of the budget proposal in August and when the agreement of the Budget was reached. The room for manoeuvre in fiscal policy is fully used with the Budget for 2014.

The structural deficit is estimated to 0.4 per cent of GDP in 2015. Thus, there is a relatively small margin to the deficit limit in the Budget Act going toward the budget proposal for 2015. Fiscal policy in 2015 will be planned when the Budget for 2015 is finalised.

Figure 1.17
Estimated movement of the structural balance



Source: Statistics Denmark and own calculations.

Structural deficits that adhere to the limit for structural deficits in the Budget Act reduces the risk of having the actual deficits that exceed the 3 per cent of GDP limit in the Stability and Growth Pact during normal economic downturns.

Central government operating expenditures in 2014 are budgeted to be equivalent to the relevant sub ceiling, *cf. Budget Outlook 3,* December 2013. Higher expenditure covered by the sub ceiling will therefore have to be offset by lower costs or by the reserve for unforeseen expenditures on the Budget for 2014. The expenditures for state income transfers in 2014 are budgeted below the relevant sub ceiling. Based on the current assumptions, the expenditures are also expected to be below the sub ceiling in 2015. If the expenditures for state income transfers covered by the sub ceiling are increased within or up to the level of the ceiling, it will in isolation weaken the structural balance.

Effects on activity from fiscal policy and other policy measures

Fiscal policy and other economic policy measures from 2012 and onwards are estimated to support economic activity in both 2013 and 2014 equivalent to 0.2 per cent of GDP in 2013 and 0.4 per cent of GDP in 2014 (measured by the multiannual fiscal effects), *cf. figure 1.18.*

The positive contribution to GDP-levels can be attributed to a positive contribution to activity from other investments, *cf. figure 1.19.* Other investments are investments undertaken by public companies, etc., which are recorded as private investments and therefore not included in the public balance in the National Accounts. The investments are a result of political decisions but are not included in the effect of fiscal policy in the narrow definition.

Figure 1.18
GDP level with and without fiscal policy and other measures

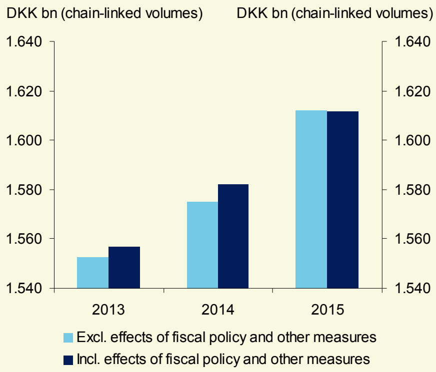
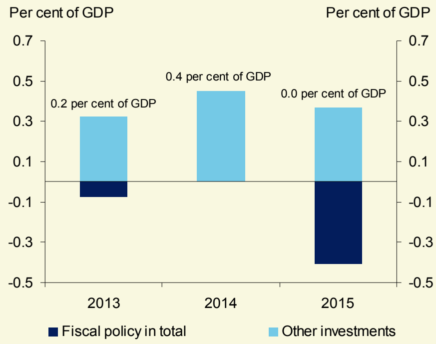


Figure 1.19
Effect on GDP level of fiscal policy and other measures from 2012 and onwards



Note: Figure 1.19 shows the effect on the GDP level of public budgets (measured by the multiannual fiscal effect), other fiscal measures and other investments.
Source: Statistics Denmark and own calculations.

Fiscal policy in 2015 is planned in connection with the agreements with municipalities and regions in June 2014, the budget proposal in August and the Budget for 2015. Based on technical assumptions, fiscal policy and other policy measures are estimated to be roughly neutral for the GDP level in 2015. Fiscal policy is assumed to contribute negatively to activity while the contribution from other investments is expected to be positive. The negative contribution to activity from fiscal policy in 2015 is among other things due to an assumed gradual decline in public investments towards a level that can be sustainably financed going forward. The positive contribution to activity from other investments is largely a result of investments following the energy agreement (2012).

The declining contribution to activity from 2014 to 2015 from fiscal policy and other measures should be viewed in context of an expected increase in GDP growth in the years to come.

The contribution to the GDP level in 2013 from fiscal policy and other economic policy measures since 2012 is adjusted downwards by 0.2 per cent of GDP compared to the August Survey, *cf. table 1.3.* This partly reflects a downward adjustment of public consumption by DKK 5 billion in 2013 based on preliminary actual numbers while public investments are expected to be DKK 2 billion higher compared to the August Survey. The total contribution to activity of 0.4 per cent of GDP in 2014 remains overall unchanged from the estimated effect in August.

Table 1.3
Effect on activity of fiscal policy and other economic policy measures from 2012 and onwards

	2013		2014		2015
Per cent of GDP	**Aug.**	**Dec.**	**Aug.**	**Dec.**	**Dec.**
Fiscal policy in total	0.1	-0.1	0,0	0.0	-0.4
- hereof fiscal effect incl. multiannual effects	*-0.2*	*-0.4*	*-0.1*	*-0.1*	*-0.3*
- hereof other fiscal policy [1)]	*0.3*	*0.3*	*0.1*	*0.1*	*-0.1*
Other investments [2)]	0.3	0.3	0.4	0.4	0.4
Fiscal policy and other measures (GDP level)	**0.4**	**0.2**	**0.4**	**0.4**	**0.0**
Growth-contribution from fiscal policy and other measures	0.1	0.0	0.0	0.2	-0.5

1) In other fiscal policy, an extra effect beyond what is captured by direct budget impact included in the calculation of the fiscal effect is added for the investment window, the HousingJobs scheme, and the corporate tax rate reduction in *Growth Plan DK*. Cf. *Vækstplan DK – Teknisk baggrundsrapport* for further information of the effects of the HousingJobs scheme and the corporate tax rate reduction.
2) Other investments cover investments following the energy agreement, the housing agreement, investments in social housing, climate-related investments in the wastewater sector (*cf. agreement on local governments' economy for 2013*), and advanced activities in Fehmarn Belt agreed upon in *Growth Plan DK*.
Source: Statistics Denmark and own calculations.

Fiscal policy and other economic policy measures are estimated to raise private sector employment by approx. 12,500 persons (0.7 per cent) in 2013 and 13,500 persons (0.7 per cent) in 2014. The contribution to private sector employment is adjusted downwards compared to the August Survey which partly reflects a lower multiannual contribution from public sector purchase of goods in the private sector and from income transfers to the private sector. Compared to the budget bill proposal for 2014, the Budget for 2014 is estimated to be roughly neutral for employment in 2014.

Including the adjustment in public sector employment compared to 2011 (after large prior increases in public sector employment) the impact on total employment is estimated to be roughly neutral in 2013. In 2014 the total impact on employment from fiscal policy and other measures is estimated to amount to just below 10,000 persons (0.4 per cent), while the impact was estimated to approx. 7,000 persons (0.3 per cent) in the August Survey. The larger impact on total employment is due to a greater contribution from public sector employment, while the contribution from private sector employment as mentioned is revised downwards. Fiscal policy in 2015 is as mentioned planned when the Budget for 2015 is finalised.

The planned fiscal policy should be viewed in the context of a highly accommodative monetary policy stance and very low interest rates. The expansionary monetary policy contributes substantially to economic activity. The responsible fiscal policy that adheres to the requirements of the Denmark's EU-recommendation and the requirements of the Budget Act contributes to maintaining confidence in Danish economy and thereby the low interest rates that benefit growth and employment.

1.4 Why has growth in Sweden been stronger than in Denmark?

Denmark and Sweden are closely connected and very similar, also in economic terms. Both countries are small, rich welfare states with significant trade with the outside world, and therefore both countries were hit hard by the global economic downturn in 2008-09.

Following the setback, economic developments have been very different in Denmark and Sweden. Since the trough of the business cycle in 2009 Danish GDP has increased by barely 3 per cent, while Swedish GDP in comparison has grown by well over 12 per cent, *cf. figure 1.20*.[2] This big difference reflects two aspects: First, there has been differences in the cyclical recovery from the crisis. Second, the underlying (structural) growth has been higher in Sweden than in Denmark before and after the crisis hit, *cf. figure 1.21*.

The GDP growth differential since 2009 reflects a greater pick-up in both Swedish exports and domestic demand, and in particular a larger increase in private consumption. Export growth in Sweden has been almost twice as high as in Denmark since 2009 (19 per cent compared to about 10½ per cent), while private consumption grew by 7½ per cent compared to just over ½ per cent in Denmark.

[2] A comparison of the development in the private sector excl. mining and quarrying, which employs 99.8 per cent of the private sector employees in Denmark, gives a similar picture. In Denmark GVA excl. mining and quarrying increased by around 4½ per cent compared to 14 per cent in Sweden from 2009 to 2012 (annual levels). If the (approximate) evolution in the terms of trade is taken into account, the increase in Danish real GDP is 2.8 per cent compared to almost 10½ per cent in Sweden (annual levels). In current prices Danish GDP has grown by about 9 per cent compared to 14¼ per cent in Sweden (annual levels).

Figure 1.20
GDP

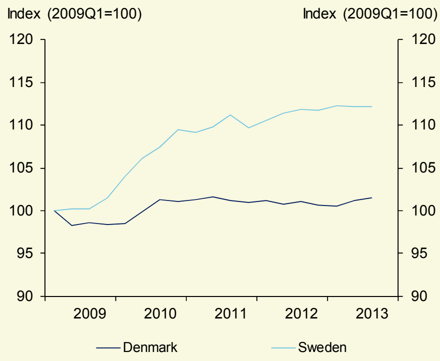
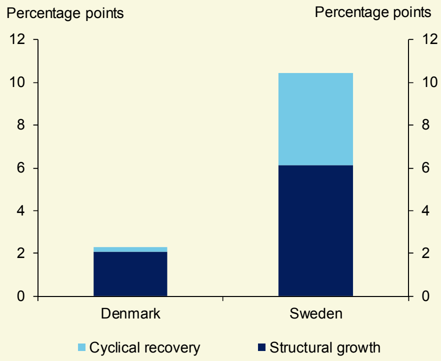


Figure 1.21
Contribution to GDP growth 2009-12



Note: The structural contribution to GDP growth is calculated on the basis of potential GDP using the EU Commission, Autumn Forecast. The calculations yield the same result when using the Ministry of Finance's method.
Source: Eurostat and own calculations.

The difference reflects the fact that the Danish economy to a greater extent than the Swedish was overheated in the years leading up to the crisis and was challenged by a housing bubble and weakening wage competitiveness. The unwinding of such imbalances can put a damper on the economy for a relatively long period of time. This is an essential part of the explanation for the relatively weaker growth in Denmark.

In Denmark easy credit conditions, overly optimistic expectations, and rising house prices went hand in hand with strong growth in private consumption and residential investments in the years leading up to the crisis. In Sweden credit growth was more muted and house price increases were not as strong, and when the crisis occurred the Swedish housing market was in a better balance than the Danish.[3] While the Danish house prices dropped sharply in 2008, the Swedish house prices have increased overall since 2007, *cf. figure 1.22*. The drop in house prices and the accompanying increase in uncertainty have contributed to create a need for consolidation among Danish households, and as a consequence to put a damper on consumption spending. Something similar has not happened in Sweden.

The more favorable development in Swedish exports since 2009 should be seen in light of the weakening of Danish wage competitiveness up through the 2000's, when wages rose more than labour productivity. In comparison Sweden has managed to improve wage competitiveness over the past 10-15 years, *cf. figure 1.23*.

[3] Cf. Bergman, U.M., B.T. Sillemann, and P.B. Sørensen (2014), "House Prices in Denmark and Sweden," in Andersen, T.M., U.M. Bergman and S.E.H. Jensen, eds., Reform Capacity and Macroeconomic Performance in the Nordic Countries, Oxford University Press, forthcoming in 2014.

Figure 1.22
House prices

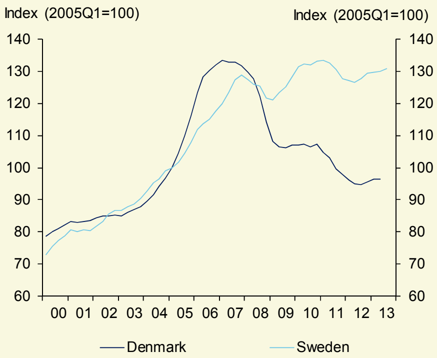
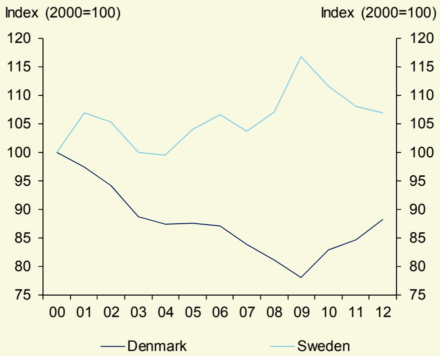


Figure 1.23
Wage competitiveness measured by relative unit labour costs



Note: The development in house prices is measured in real terms i.e. adjusted for consumer price developments. The relative unit labour cost take into account the structure of competition in export and import markets. Unit labour costs are inverted and for the whole economy, so an increase in the index corresponds to an improvement of the competitive position.
Source: Eurostat and OECD.

In addition, the export composition and exchange rate developments have played a role in the recovery of Swedish exports. Swedish exports consist to a greater extent of capital goods and were therefore relatively hard hit by the downturn in the international economy. On the other hand, the Swedish exporting companies have subsequently benefited from an increasing appetite for investment, especially from Germany and China. In addition, the floating exchange rate gave Sweden a temporary competitive advantage as the depreciation of the Swedish krona made Swedish goods relatively cheaper. However, this has been mirrored by a less favorable development in exports measured in current prices since 2009, and thus a smaller contribution from exports to wealth growth in Sweden than in Denmark.[4]

The stronger growth in Sweden is not due to a more expansionary fiscal policy in the aftermath of the crisis, since fiscal policy in general has been more expansionary in Denmark than in Sweden. This is also reflected in the structural balance. In Denmark the structural balance has been reduced by 4¼ percentage points of GDP since 2008 in comparison with a 1¼ percentage point reduction in Sweden, *cf. 1.24*.

In summary, a main reason for the stronger growth in Sweden than in Denmark since 2009 has been a more rapid cyclical recovery. This reflects the fact that the Swedish economy did not face the same imbalances in the private sector when the downturn hit. As a consequence

[4] Measured in current prices aggregate Danish exports grew by 26 per cent from 2009 to 2012 compared to a 16 per cent increase in Swedish exports.

Swedish GDP is now only about 2¼ percent from its potential level, while Danish GDP is still lagging a fair bit behind, *cf. figure 1.25*.

Figure 1.24
Total change in underlying balance 2008-12

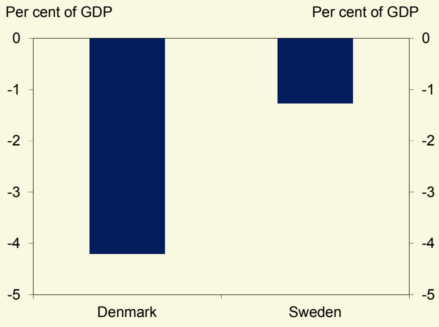
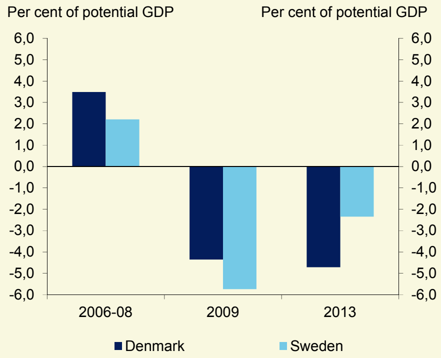


Figure 1.15
Difference between actual and potential GDP (output gap)



Note: Figure 1.24 shows the sum of yearly changes in 2009, 2010, 2011 and 2012. The underlying structural balance is calculated using the Ministry of Finance's method for Denmark and in the case of Sweden using the EU Commission, Autumn Forecast. Calculations of the underlying structural balance are generally uncertain. Figure 1.25 is based on the EU-Commission Autumn Forecast.
Source: Eurostat, Statistics Denmark and own calculations.

In the long run, the ability to generate income is essential for developments in economic prosperity. Also in this respect Denmark is lagging behind Sweden. Between 1995 and 2012 Swedish gross national income (GNI) per capita (measured in current prices and adjusted for purchasing power differences) has increased by 14 percentage points more than Danish GNI per capita. This corresponds to an average of approximately ½ percentage point per year, *cf. figure 1.26*. The reason is that production (real GDP) per capita has grown faster in Sweden than in Denmark.[5] A more favorable development in the Danish terms of trade[6] and higher capital income from abroad has, thus, not been enough to offset the lower growth in real GDP.

[5] Changes in the respective output gaps over the period can explain almost 0.3 percentage points of the difference in the development in GDP per capita in Sweden and Denmark. The remaining (structural) difference in GDP growth per capita is about 1 percentage point.
[6] Terms of trade effects are included in "Consumer prices" in figure 1.26. For Denmark, the terms of trade seen in isolation have contributed 0.2 percentage points annually to growth in GNI per capita. In Sweden the terms of trade have subtracted almost 0.3 percentage points. The remaining contribution from "Consumer prices" is the sum of the GNI deflator and the PPP factor. The GNI deflator has on average contributed 2.4 percentage points annually in both Denmark and Sweden over the period, while the contribution from the PPP factor on average amounted to around 0.5 percentage points for Denmark and almost -0.6 percentage points for Sweden annually.

The higher GDP growth in Sweden predominantly reflects higher labour productivity growth (measured as GDP per hour worked). On average, labour productivity has contributed 0.9 percentage points to annual GDP growth in Denmark compared to an average contribution of 1.9 percentage points in Sweden, *cf. figure 1.27*.

Figure 1.16

Average annual growth in GNI per capita from 1995 to 2012

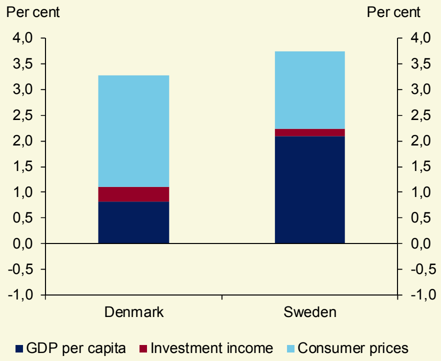
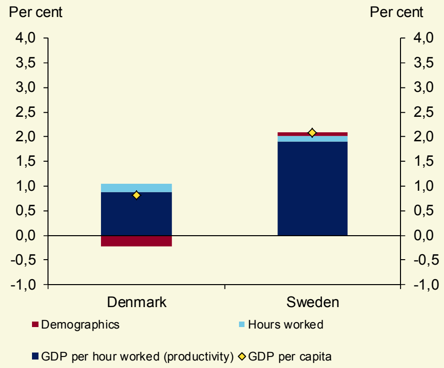


Figure 1.17

Average annual growth in GDP per capita from 1995 to 2012



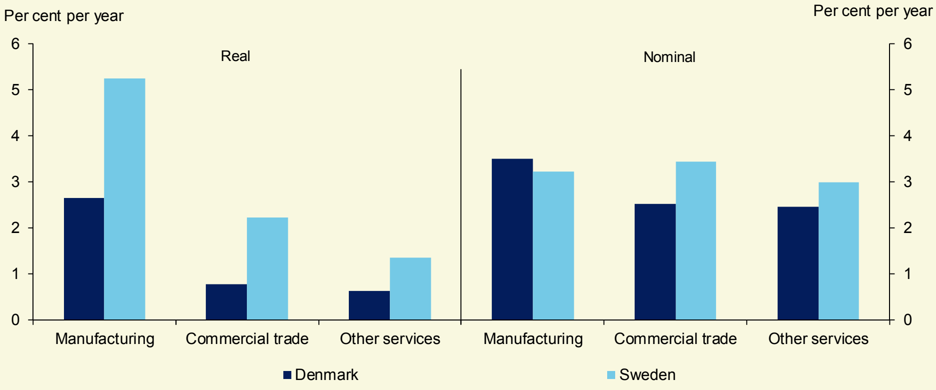
Note: In figure 1.26 GNI per capita is measured in current prices and adjusted for purchasing power (PPP) differences. "Consumer prices" are determined as the sum of the contributions from the terms of trade, the GNI deflator, and the PPP factor. The contribution from the terms of trade is calculated as in Danmarks Nationalbank, *Monetary review 1st quarter 2012*, Part 2 "Productivity development in Denmark". Investment income is calculated residually in order for the contributions from GDP per capita, the terms of trade, and investment income to sum to real GNI per capita. In figure 1.27 "hours worked" is the contribution from hours worked per person of working age, i.e. the sum of the contributions from working hours per employed and the employment rate. Demographics indicate the change in the ratio of people of working age relative to the total population over the period.

Source: Eurostat, Danmarks Nationalbank og egne beregninger.

The higher labour productivity growth in Sweden since 1995 can be attributed to a more favorable development both within the manufacturing sector and within the services sector (including trade and other services), *cf. figure 1.28*. Danish manufacturing companies – as opposed to Swedish – specialise in industries with increasing relative prices, and this has offset the lower labour productivity growth within the sector. The same has not been the case within the services sector. Therefore, the Productivity Commission has identified the domestically oriented part of the services sector as the biggest challenge in terms of raising labour productivity growth within the private sector in Denmark.

Effective competition promotes dynamism and efficiency and therefore contributes to increasing productivity. There are signs that part of the productivity growth differential between Sweden and Denmark is due to weaker competition in some parts of the Danish economy. Weak competition can be reflected in higher prices, and the Danish consumer prices are higher than in other comparable countries, including Sweden, *cf. figure 1.29*. This is particularly evident within the services sector, which is not exposed to international competition to the same extent as e.g. the manufacturing sector.

Figure 1.18
Average annual growth in productivity (real and nominal) in manufacturing and services from 1995 to2012



Note: Real and nominal productivity growth is calculated as the growth in real, respectively nominal gross value added per hour worked. Trade, etc. covers *trade, transport, hotels* and *restaurants*. Other services covers *information and communication, finance and insurance, real estate and leasing of commercial real estate, business and culture, leisure, etc.*
Source: Eurostat.

The weaker competition and lower productivity growth in Denmark in comparison with comparable countries can, among other things, be explained by a lower degree of openness to the outside world, cf. the Productivity Commission (2013) and the OECD.[7] This can be due to unnecessary regulation that impedes the access of foreign companies to the Danish markets. Better access for foreign companies to the domestic market can lead to efficiency gains by promoting the adoption of new technology and encouraging established businesses to streamline. This is a mirror image of how access to world markets can lead to efficiency gains for domestic companies by providing better opportunities for economies of scale and greater returns to innovation. In general there is no evidence that markets are more regulated in Denmark than in Sweden, however in parts of the services sector – especially within retail – the degree of regulation is significantly higher in Denmark, *cf. figure 1.30*.

[7] *Analyserapport 2: Konkurrence, internationalisering og regulering*, www.produktivitetskommisionen.dk.

Figure 1.19
Price differences compared to the average in seven comparable EU countries (2007)

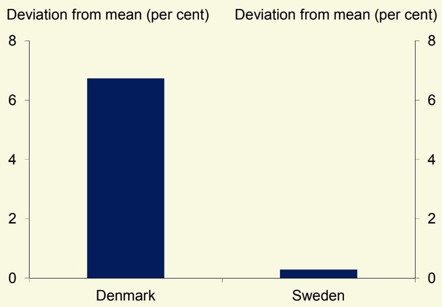
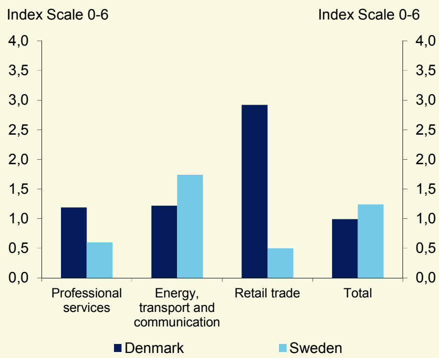


Figure 1.30
Product Market Regulation (2008)



Note: Figure 1.29 shows consumer prices in seven EU countries adjusted for VAT, taxes and wealth inequalities. The seven EU countries are Belgium, Denmark, Finland, France, Italy, Holland and Germany. Figures are from 2007 since the figures for Sweden from 2008 and onwards are not calculated due to large exchange rate fluctuations; cf. the Government (2013): *Denmark at work, survey on growth and competitiveness 2013,* www.evm.dk. As of 2007, Denmark has the highest price among the relevant countries in the years 2008-12. The columns in figure 1.30 show the values of the OECD Product Market Regulation indicator. A higher index indicates a higher degree of regulation in the sector.
Source: Danish Competition and Consumer Authority, Eurostat, OECD and own calculations.

In addition, the fact that the private sector in Denmark only employs a relatively small share of highly educated employees – below the OECD average – may also have contributed to relatively weaker private sector productivity growth, *cf. figure 1.31*. In addition to raising the productivity of the individual, a higher level of education can lead to an increase in the general level of knowledge and, thus, in that way affects the productivity of the business or in the community.

Developments in the respective labour markets – as opposed to productivity growth – are not a central part of the explanation for the different development in the levels of economic prosperity in Denmark and Sweden. Both Sweden and Denmark have implemented labour market reforms, and both labour markets are characterised by being relatively well-functioning and flexible. As a consequence both countries have, in an international context, a relatively high level of employment, low unemployment, and a high job turnover, *cf. figure 1.32*.

In the spring of 2014, The Productivity Commission will make its recommendations on how productivity growth in Denmark can be lifted.

Figure 1.31
Highly educated among employees in the private sector (2012)

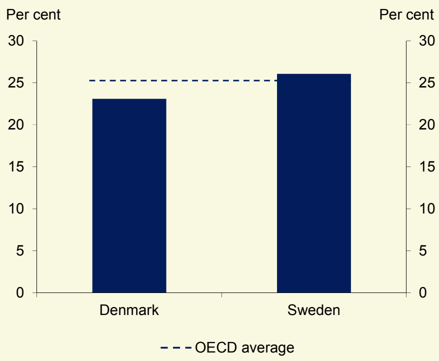
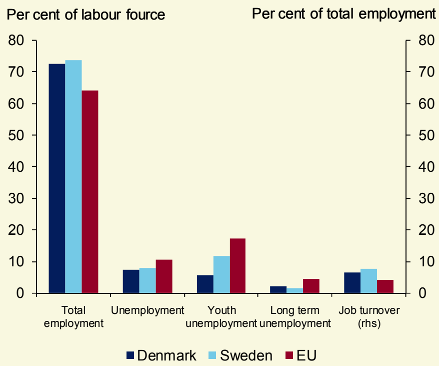


Figure 1.32
Labour market indicators in Sweden and Denmark (2012)



Note: In figure 1.31 figures for the OECD only cover European OECD countries. In figure 1.32 employment is measured as the share of people of working age. Youth unemployment is excl. students. The EU is an average for countries in the EU27.

Source: The Government (2013): *Denmark at work, survey on growth and competitiveness 2013,* www.evm.dk, Eurostat and own calculations.

1.5 Appendix

Table 1.4
Key figures compared to the August Survey

	2013		2014		2015
	Aug.	**Dec.**	**Aug.**	**Dec.**	**Dec.**
Real growth, per cent					
Private consumption	0.4	0.5	1.2	1.3	1.6
Total public demand	-0.2	0.1	0.9	1.6	-0.1
- public consumption	0.6	0.3	0.5	1.5	0.6
- public investment	-10.2	-2.3	6.8	2.1	-8.4
Residential investments	-3.5	-3.5	3.3	4.1	1.4
Fixed business investments	6.4	5.8	1.8	2.2	6.0
Final domestic demand	0.7	0.7	1.3	1.6	1.6
Stock building (per cent of GDP)	0.4	0.4	0.0	0.0	0.0
Total domestic demand	1.0	1.0	1.3	1.6	1.6
Exports of goods and services	0.2	0.7	3.7	3.7	4.7
- of which manufactures	1.5	2.7	4.8	4.8	6.1
Total demand	0.7	0.9	2.2	2.4	2.7
Imports of goods and services	1.7	2.1	3.3	3.9	4.5
- of which goods	3.0	5.0	3.1	4.2	5.2
GDP	0.2	0.4	1.6	1.6	1.9
Gross value added	0.1	0.5	1.6	1.6	1.8
- of which private sector	0.7	1.7	2.2	1.8	2.5
Change in 1,000 persons					
Labour force	-8	2	9	15	9
Employment	-6	4	9	17	16
- of which private sector	-6	8	7	8	14
- of which public sector	0	-4	2	9	2
Employment excl. teacher lockout	-6	8	9	13	16
- of which public sector	-	0	-	5	2
Gross unemployment (registered)	-8	-9	-6	-6	-8
Net unemployment (registered)	-2	-2	-1	-2	-7

Table 1.4 (continued)
Key figures compared to the August Survey

	2013		2014		2015
	Aug.	Dec.	Aug.	Dec.	Dec.
Growth, per cent					
Merchandise export prices	0.1	0.0	2.0	1.1	1.5
Merchandise import prices	-0.7	-1.3	1.9	0.8	2.0
Merchandise terms of trade	0.8	1.4	0.1	0.3	-0.4
House prices, single-family houses	3.0	2.5	2.5	2.5	2.0
Consumer prices	1.0	0.8	1.5	1.2	1.8
Hourly compensation	1.8	1.8	2.0	2.0	2.2
Real disposable income, private sector	-0.5	-1.4	2.5	3.7	4.9
Real disposable income of households[1)]	2.1	2.1	2.1	2.6	1.0
Productivity in a private non-agricultural sector	1.1	1.3	1.6	1.2	1.7
Per cent per year					
Interest rate 1-year adjustable rate loan	0.3	0.2	0.6	0.4	0.7
10-year government bonds	1.7	1.8	2.1	2.1	2.6
30-year mortgage credit bond	3.4	3.5	3.8	3.8	4.3
Balances					
Current account (bn DKK)	100.4	116.1	108.4	125.5	136.0
General government fiscal balance (bn DKK)	-31.2	-3.0	-38.5	-22.8	-57.7
Gross unemployment (thousands)	154	153	148	147	139
Gross unemployment (per cent)	5.4	5.4	5.2	5.1	4.8
Net unemployment (thousands)	116	117	115	115	108
Net unemployment (per cent)	4.1	4.1	4.1	4.0	3.8
External assumptions					
Trade-weighted GDP abroad, per cent	1.1	1.0	2.3	2.2	2.6
Export markets for Danish manufactures, per cent	2.3	2.2	5.6	5.4	6.5
Exchange rate, DKK per $	5.7	5.6	5.7	5.5	5.5
Oil price, $ per barrel	108.2	108.4	116.9	108.2	113.4
Oil price, DKK per barrel	613.5	609.5	660.6	600.2	629.0

1) Adjusted for various special items.
Source: Statistics Denmark and own calculations