

Economic Survey December 2004

English summary

1. Short term outlook

The economic expansion broadly follows the track laid out in the two latest Economic Surveys. Private consumption and housing investment have grown fairly rapidly supported by, in particular, income tax reductions as well as other initiatives in the so-called Spring Package¹. Exports and business investment have also shown solid growth. The acceleration in economic growth has led to a turnaround in the labour market. Employment has risen by about 17,000 persons during the first 3 quarters of 2004, boosted by private employment. Unemployment has declined by more than 10,000 persons since December 2003, *cf. figure 1.1b*.

Figure 1.1a. GDP-growth

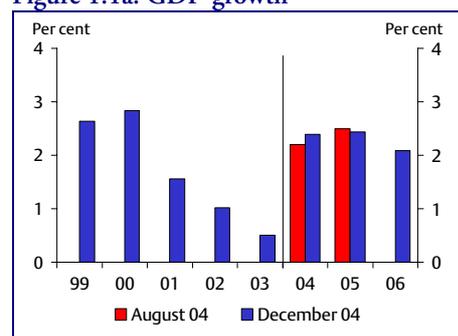
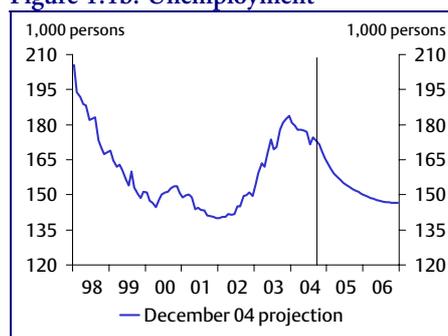


Figure 1.1b. Unemployment



Source: Statistics Denmark and own calculations.

GDP-growth is expected to pick up from 0.5 per cent in 2003 to 2.4 per cent in 2004 and 2005, *cf. figure 1.1a*. Apart from a supportive fiscal policy, including tax reductions, growth is driven by low interest rates and a rebound in foreign demand. In 2006, GDP-growth is expected to moderate slightly to 2.1 per cent, which is a little above the estimated potential

¹ For details on the Spring Package, see e.g. the Danish *Convergence Programme, 2004*.

growth. The growth estimate for 2004 is revised slightly upwards compared to the August survey, while projected growth in 2005 is marginally lower².

Table 1.1. Key forecast variables compared to the August projection

	2003	2004		2005		2006 Dec.
		Aug.	Dec.	Aug.	Dec.	
USA, GDP growth	3.0	4.3	4.4	3.3	3.0	2.9
Euro area, GDP growth	0.5	1.9	2.1	2.4	2.0	2.1
Trading partners, GDP growth	1.3	2.8	3.1	2.9	2.8	2.8
<i>Denmark:</i>						
GDP growth	0.5	2.2	2.4	2.5	2.4	2.1
Consumer prices	2.1	1.4	1.3	1.8	2.0	1.8
Hourly earnings, private sector	3.7	3.5	3.4	3.8	3.6	3.9
Unemployment rate	5.9	6.0	6.0	5.3	5.4	5.1

Note: GDP-growth among Denmark's trading partners is weighted according to their share in Danish exports.

Source: Statistics Denmark, EU-Commission, Ecwin, and own calculations.

The international environment and its impact on the Danish economy

Growth in the global economy this year appears to be higher than expected in the August survey. Strong global growth, especially driven by the United States and Asia, has contributed to higher oil prices. Further, oil prices have been lifted by supply side disturbances. Higher oil prices will presumably dampen global growth, and has already engendered some weakening in recent indicators, but the expansion is likely to continue.

In recent weeks, the dollar has depreciated further against the euro. The assumed dollar exchange rate is about 5 percent lower than in the August survey. In itself, this is likely to put moderate downward pressure on European growth. On the other hand, long-term interest rates have fallen significantly since the middle of the year in both the U.S. and the euro area. Alongside the recent euro strengthening, euro area-yields have decoupled from U.S. yields. The very low level of long-term interest rates in the euro area should support demand growth going forward.

² The projection has been finalized before the publication of the flash national accounts data for 2004Q3, which showed, in particular, higher private employment growth and lower GDP-growth than assumed in the projection. The flash data are not considered to notably change the assessment.

On balance the changes to the international environment since the August survey point to a small upward revision to GDP-growth in 2004 due to stronger export market growth, and to roughly unchanged growth in 2005. In 2005, lower interest rates in the euro area (and hence Denmark) tend to offset the negative growth impact of higher oil prices.

Key risks to the forecast concern oil price developments and the possibility of an extended decline of the dollar against the euro (and hence the Danish krone). Meanwhile, long-term yields especially in the U.S. could rebound against the background of sizeable fiscal deficits and the need to finance persistent current account deficits. While a renewed hike in oil prices would add to inflation and could not easily be countered by monetary policies, euro strength could induce lower interest rates in the euro area (and Denmark) compared to the gradual rise assumed.

Domestic demand

Household real disposable income (net of housing expenditures and certain other factors) is estimated to grow by 4 per cent in 2004. Income growth is boosted by lower income taxes and the suspension of the so-called Special Pension contributions in 2004 and 2005. Income growth is expected to decelerate in 2005, in part because previously-planned tax reductions have now been frontloaded to 2004. The suspension of SP-contributions is assumed to end in 2006, which acts to dampen disposable income growth.

Figure 1.2a. Growth contributions

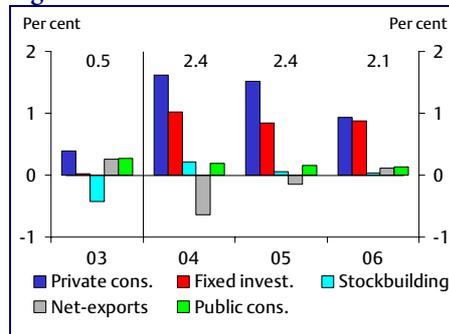
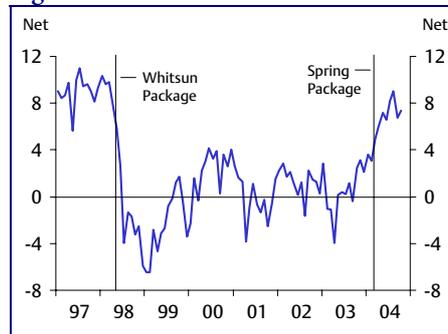


Figure 1.2b. Consumer confidence



Note: The so-called Whitsun Package was introduced in 1998 in order to curb growth in domestic demand.

Source: Statistics Denmark and own calculations.

Following five years of subdued growth, private consumption growth is picking up from 0.8 per cent in 2003 to 3.5 per cent in 2004 and 3.2 per cent in 2005, *cf. table 1.2*. The fairly strong growth in private consumption is supported by the income tax cuts, ample private savings, low interest rates, rising house prices and new flexible borrowing opportunities for house owners. Consumption growth is expected to remain strong in 2005 as private consumption gradually adjusts to the higher level for real disposable income in 2004. In 2006 private consumption growth is expected to decelerate somewhat to about 2 per cent reflecting, among other things, slower real income growth and a certain saturation effect for durable consumer goods, including cars.

Notwithstanding higher borrowing, the overall financial position of households appears quite healthy and total private savings are at a comparatively high level relative to GDP.

Table 1.2. Use and supply of goods and services

	2002	2000	2001	2002	2003	2004	2005
	Bill.Dkr.	----- Real growth, per cent -----					
Private consumption	641.9	-0.7	-0.2	0.6	0.8	3.6	3.0
Public consumption	358.5	0.9	2.7	2.1	1.0	0.3	0.5
Public investment	24.2	7.7	10.6	-5.0	-0.3	4.5	2.0
Residential construction	61.1	7.7	-5.3	10.5	5.2	3.0	-2.0
Fixed business investment	197.4	6.6	6.9	4.2	-1.1	3.4	5.0
Stock building ¹⁾	0.7	1.0	-0.7	0.0	-0.4	0.0	0.0
Total domestic demand	1,283.8	2.4	1.0	1.9	0.3	2.7	2.5
Exports of goods and services	602.7	13.5	4.4	4.8	0.0	3.1	5.1
Of which manufactures	294.4	15.0	5.0	5.3	-2.1	4.0	5.2
Imports of goods and services	525.8	13.5	3.5	7.3	-0.6	4.3	5.4
Of which goods	390.5	11.8	3.3	6.6	-1.9	5.2	5.1
Gross domestic product	1,360.7	2.8	1.6	1.0	0.5	2.2	2.5
GDP at factor costs	1,163.5	3.4	1.7	0.9	0.6	1.8	2.6
Of which in private non-agricultural sector	771.1	3.7	2.6	0.9	0.2	2.2	2.9
GDP per capita (1.000 Dkr.)	253.1	2.5	1.2	0.7	0.3	2.0	2.3

1) The percentages indicate the volume changes in stock building in per cent of volume GDP in the preceding year, both in 1995-prices.

Source: Statistics Denmark and own calculations.

Real public consumption is estimated to grow by 0.7 per cent in 2004 compared to an August projection of 0.3 per cent. The upward revision reflects, notably, preliminary data on local government consumption dur-

ing the first three quarters of 2004, and is underpinned by national accounts data for public employment growth through 2004Q3.

On the basis of the Fiscal Bill 2005, local government budgets, and the 2004 growth estimate for real public consumption, growth in real public consumption in 2005 corresponds to 0.6 per cent. Local government budgets show an overrun of 1½ billion Dkr. compared to the financial agreement of June 2004. The government has begun a dialogue with local governments about solutions that can provide for local government consumption in 2005 reflecting the agreement of June 2004.

Fiscal policy for 2006 is not yet determined. The projection technically assumes 0.5 per cent growth in public consumption in line with medium-term objectives.

Public investment is set to increase by 4.5 per cent in 2004 and 4.7 per cent in 2005. The relatively high growth reflects, in particular, the 2003-2004 initiatives to frontload public investment. Against this background, real public investment is assumed to grow by 1 per cent in 2006.

The strong growth in residential investment in 2002 and 2003 continues in 2004, where 5 per cent growth is expected. Low interest rate, strong house prices, and higher real disposable income contribute to quite strong growth in residential investments. Government initiatives, including initiatives in the Spring Package, to front-load investments in municipal housing also support investment growth in 2004. Though house prices should remain supportive, a certain decline in publicly supported housing construction results in an expected 2 per cent decline in residential investment in 2005. Residential investment growth of 1 per cent is expected in 2006 reflecting primarily higher private residential investments.

Price increases for owner-occupied single-family houses are expected to accelerate to above 6½ per cent this year and 5 per cent in 2005, which in both years is roughly 2 percentage points above the August projection. Low interest rates are an important factor behind the strong increase, and the forecast for interest rates has been lowered slightly compared to the August survey. Another likely factor could be the introduction of new flexible mortgage loans where repayments on the principal can be postponed for 10 years. Already one year after the introduction in late 2003

these loans constitute a sizeable share of outstanding mortgage loans. House price increases are expected to ease to about 3 per cent in 2006, mainly as a result of the assumed gradual increase in interest rates.

Business investment rebounded strongly in the second half of 2003. With an expected increase of 4 per cent, business investment has maintained momentum in 2004. The continued economic expansion is expected to further support business investment growth of around 4½-5 per cent in 2005 and 2006.

Following a decline in stockbuilding of 0.4 per cent of GDP in 2003, a positive contribution to GDP-growth from inventory investments of 0.2 percentage points in 2004 and 0.1 percentage point in 2005 is expected. In 2006 the contribution to GDP-growth from inventory investments is assumed to be zero.

International trade and the current account

The relatively high growth rate of GDP in 2004-06 is supported by fairly strong growth in exports following the pick-up in international demand. The real growth rate in exports is expected to be about 5½ per cent in both 2004 and 2005 and then moderate slightly to around 5 per cent in 2006.

The forecast for 2004 has been increased significantly since the last survey due to the upward revision of international growth in 2004 and data for the first part of 2004.

The upswing in private consumption and investment has boosted imports and the current outlook points to growth of around 7½ and 6 per cent in 2004 and 2005, respectively. Slower growth in domestic demand in 2006 contributes to a slight decline in the growth rate of imports in 2006.

Overall, net trade contributes negatively to GDP growth by 0.6 percentage points in 2004 and 0.1 percentage point in 2005 – a downward adjustment compared to the August survey of about 0.2 percentage points in both years. In 2006 a small positive growth contribution is expected.

Declining net exports in 2004 and 2005 are countered by improved terms of trade and the current account surplus is expected to be around 3

per cent of GDP in both years. In 2006, rising net exports imply a further expansion of the current account surplus to around 3.4 per cent of GDP.

Employment, unemployment and labour force

The available indicators show employment picking up. Employment is projected to grow by 20,000 persons and 10,000 persons in 2005 and 2006, respectively. This corresponds to an increase of 0.7 per cent in 2005 and 0.4 per cent in 2006.

National accounts data show an increase in employment of 6,000 persons in the 2nd quarter following a small increase in the 1st quarter. The preliminary national accounts for the 3rd quarter show quarterly employment growth of 7,000 persons³. In the 3rd quarter employment was up by 15,000 persons or 0.6 per cent compared to one year earlier.

The impression from the national accounts data is that employment, which fell during 2002 and 2003, has bottomed out and is now increasing. Other employment statistics are in accordance with this impression.

Table 1.3. Employment, labour force, and unemployment

	2002 level	1980- 2002	2003	2004		2005		2006	
				Aug.	Dec.	Aug.	Dec.	Dec.	
				----- Change, 1,000 persons -----					
Private sector	1,907	2	-22	9	-2	19	18	8	
Public sector	834	7	2	2	4	3	3	3	
Total employment ...	2,741	9	-21	12	2	21	20	10	
Labour force	2,886	7	5	16	6	1	1	2	
Unemployment	145	-2	26	4	4	-20	-20	-8	

Note: There is a small data-break in the time series for employment from 1994 to 1995. Due to rounding the individual changes may not sum to the total.

Source: ADAM's databank and own calculations.

For private sector employment a small decline of 2,000 persons on an annual basis is expected from 2003 to 2004, even though employment is increasing throughout 2004. In 2005 and 2006 private employment is expected to increase by 18,000 and 8,000 persons, respectively. Employment growth in 2004 is lower than in the August survey, which reflects a revision of the national accounts data for the 1st quarter. The preliminary

³ The forecasts were finalised before the publication of the flash national account data for the 3rd quarter of 2004. Editing of the Survey itself was completed on December 3.

national accounts for the 3rd quarter show private employment 13,000 persons or 0.6 per cent higher than the year before.

The increase in private employment follows an increase in output in 2004, which is expected to continue in 2005 and into 2006. Private sector output rose nearly 3 per cent year on year in the 2nd quarter of 2004, and the preliminary figures for the 3rd quarter show a 2.2 per cent increase. In 2006 growth in private sector production is expected to abate a little, which results in gradually lower employment growth.

Figure 1.3a. Employment

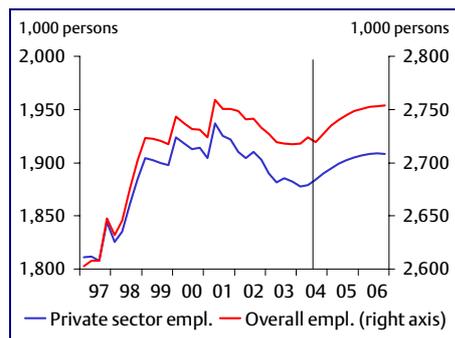
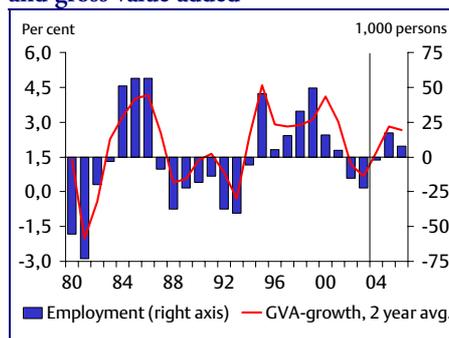


Figure 1.3b. Private sector employment and gross value added



Note: In figure 1.3b growth in gross value added in the private sector is shown as a 2-year moving average.

Source: Statistics Denmark and own calculations.

Survey indicators confirm the expectation of increasing employment. Business confidence in the service sector, which comprises the largest share of private employment, has improved slightly over the latest months. Expectations regarding future employment have also improved a little. During the last 18 months business confidence has improved for services, industry as well as the construction sector, *cf. figure 1.3b*.

The labour force is expected to grow by 6,000 persons or 0.2 per cent in 2004 following a roughly similar increase in 2003. The increase in 2004 is smaller than foreseen in the August survey, which reflects a revision in the employment data for the 1st quarter. A small increase in the labour force is presumed in 2005 and 2006.

The labour force is thus expected to grow despite demographic developments that tend to reduce the labour force. This may reflect labour mar-

ket reforms that have aimed, among other things, to increase participation among immigrants and the older part of the working age population. Also, a cyclical increase in the participation rate especially among younger people is expected as employment opportunities continue to improve.

On balance the effects of various labour market policy initiatives, including lower taxation and the decline in participation in pre-early retirement, largely offsets the underlying demographic trend towards a reduction in the labour force, *cf. table 1.4 and Finansredegørelse 2004*.

Table 1.4. Contributions to changes in the labour force, 2004-2006

	2004	2005	2006	2004-06
1. Demographic development	-8	-9	-10	-27
2. From labour market policy initiatives ...	12	9	3	24
Business cycle and other factors	2	2	9	12
Labour force.....	6	1	2	9

Note: Due to rounding the contributions do not necessarily sum to the overall change in the labour force. The contribution from labour market policy initiatives includes contributions from reform of retirement schemes, initiatives from “More people into employment”, and lower taxation of earned income. An effect from increased educational attainment of the labour force is also included.

Source: Own calculations.

Registered unemployment, which stood at 6.6 per cent of the labour force in December 2003, has decreased by 0.3 percentage points to 6.3 per cent in September 2004⁴, corresponding to a decline of just over 10,000 persons from 184,000 persons in December last year to just over 173,000 persons in September this year.

The decline in unemployment is expected to continue in 2005 and 2006. On an annual basis, the number of unemployed should decline from 175,000 persons in 2004 to 155,000 persons in 2005 and 148,000 persons in 2006. The projected numbers of unemployed for 2004 and 2005 are unchanged compared to the August survey.

⁴ According to the official monthly figures from Statistics Denmark. The labour force measurement used by Statistics Denmark to calculate the unemployment percentage differs slightly from the one employed in the ADAM model, and the unemployment percentage as calculated in the ADAM model is thus usually about 0.2 percentage points lower than the official figure from Statistics Denmark.

Initially, the decline in unemployment in 2004 can mostly be attributed to increased enrolment in active labour market policy (ALMP) schemes, following a substantial drop in ALMP enrolment during 2002 and 2003, and to a lesser extent increasing employment. In 2005 and 2006 the decline in unemployment comes from increasing employment.

When correcting for the number of persons enrolled in active labour market policy (ALMP) schemes, the number of unemployed in 2006 is expected to reach a level, which corresponds to the historically low level in 2001 and 2002.⁵ In 2005 and 2006 enrolment in ALMP schemes is projected to be on average about 5,000 persons below the level in 2002.

Figure 1.4a. Unemployment

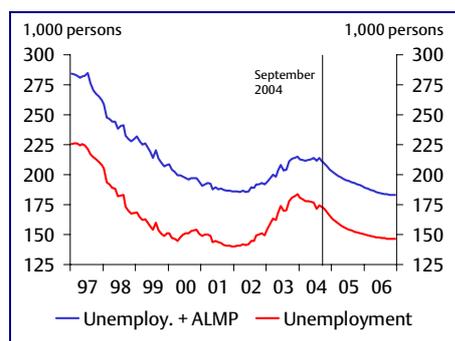
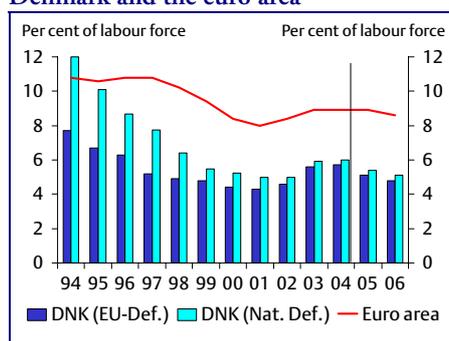


Figure 1.4b. Unemployment rates in Denmark and the euro area



Note: In figure 1.4b growth in gross value added in the private sector is shown as a 2-year moving average.

Source: Statistics Denmark and own calculations.

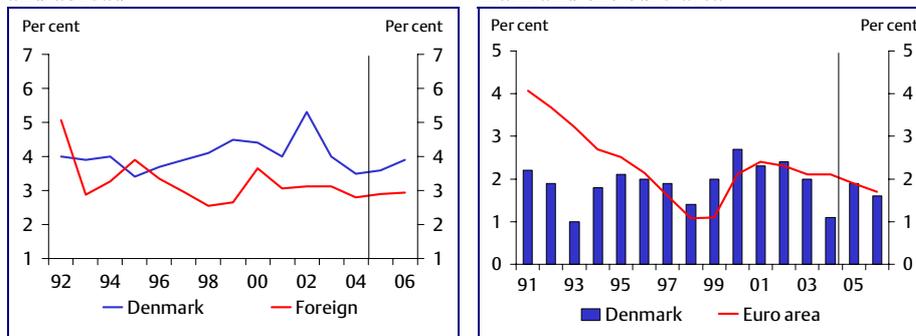
Wage- and price inflation

Growth in hourly wages is expected to decline from 3.7 per cent in 2003 to 3.5 per cent in 2004, with the latest data showing 2.9 percent annual growth in 2004Q3. A gradual pickup in wage growth is expected in 2005 and 2006 with a 3.6 per cent in 2005 and 3.9 per cent in 2006. The anticipated wage increases for 2004 and 2005 are marginally lower than envisaged in the August projection.

⁵ The number of people either unemployed or enrolled in ALMP schemes taken together may give a more appropriate picture of cyclical movements than the changes in registered unemployment alone – since an unemployed person who joins an ALMP scheme is not included in registered unemployment.

Despite a decline in wage growth in 2003 and 2004 hourly compensation of employees is forecast to continue to grow faster than in the euro area. Productivity is projected to grow faster as well, but not to the same extent. In addition, cost competitiveness has been eroded by the effective appreciation of the Danish krone, principally induced by the weakening of the dollar vis-à-vis the euro since 2001.

Figure 1.5a. Wage increases in Denmark and abroad **Figure 1.5b. Inflation (HICP) in Denmark and the euro area**



Note: The foreign increases in hourly wage costs in figure 1.5a are weighed according to their share in the effective nominal exchange rate index for the krone.

Source: DA, EU-Commission, BLS, OECD and own calculations.

Notwithstanding higher oil prices, inflation as measured by the harmonised consumer price index (HICP) has declined markedly in 2004 to an estimated 1.1 per cent compared to 2.0 per cent in 2003. This can be attributed in part to a reduction of excise duties on soft drinks, cigarettes and alcohol, which lowers the rate of inflation by almost 0.2 percentage points in 2004. Furthermore, import prices have been falling during 2002-04 giving rise to a moderation in goods prices.

Partly reflecting higher oil prices in recent months, inflation is projected to accelerate to 1.9 per cent in 2005, and with oil prices subsiding a slight deceleration in inflation to 1.7 per cent is envisaged in 2006. Also, the estimated output gap may close in 2005 indicating growing internal inflationary pressures.

The inflation rate continues to stay around the European Central Bank's medium term inflation target of below but close to 2 per cent.

Table 1.5. Key figures for the Danish economy

	2001	2002	2003	2004	2005	2006
	----- Percentage change from previous year -----					
Real GDP	1.6	1.0	0.5	2.4	2.4	2.1
Trade-weighted GDP abroad	1.3	1.5	1.3	3.1	2.8	2.8
Markets for Danish manufactures	0.1	1.4	4.1	7.8	7.3	7.0
International competitiveness	-2.2	-3.0	-4.9	-1.6	-1.4	-1.1
Export of manufactures, volume	5.0	5.3	-2.1	6.0	5.5	5.1
Hourly wages	4.2	4.2	3.7	3.4	3.6	3.9
Consumer price index	2.4	2.4	2.1	1.3	2.0	1.8
Price index for single-family houses	5.9	3.7	3.3	6.7	5.0	3.0
Merchandise export prices	0.1	-1.2	0.2	1.7	1.6	-0.6
Merchandise import prices	-1.2	-1.5	-1.8	1.1	1.1	-0.3
Merchandise terms of trade	1.3	0.3	2.1	0.6	0.4	-0.4
Productivity in private non-agricultural sector	2.5	2.2	1.6	2.6	1.7	1.8
Real disposable income of households ¹⁾	1.4	1.8	2.9	4.0	0.9	0.5
<i>Labour market:</i>						
Labour force (thousands)	2,891	2,886	2,891	2,897	2,898	2,900
Employment (thousands)	2,746	2,741	2,720	2,722	2,742	2,752
Of which in private sector	1,922	1,907	1,885	1,883	1,900	1,908
in public sector	824	834	836	840	842	845
Percentage change in total employment	0.4	-0.2	-0.8	0.1	0.7	0.4
Unemployment (thousands)	145	145	171	175	155	148
Early retirements (thousands)	159	169	179	186	175	160
Persons on leave (thousands)	22	17	5	4	3	3
Unemployment rate (per cent)	5.0	5.0	5.9	6.0	5.4	5.1
Unemployment rate, EU-def. (per cent)	4.3	4.6	5.6	5.7	5.1	4.8
<i>Long term bond yields, exchange rate:</i>						
10-year government bonds	5.1	5.1	4.3	4.5	5.0	5.2
30-year mortgage credit bond	6.7	6.3	5.4	5.3	5.8	6.3
The effective krone rate (1980=100)	96.8	97.7	101.2	102.2	102.8	102.8
<i>Balance of payments:</i>						
Goods and services (bill. Dkr.)	85.5	76.9	91.4	92.0	97.4	102.0
Current account (bill. Dkr.)	40.1	27.3	45.9	43.2	46.4	53.4
Current account in per cent of GDP	3.0	2.0	3.3	3.0	3.0	3.4
Net foreign debt, ult. (bill. Dkr.)	228.5	241.1	181.2	143.0	85.7	23.3
Net foreign debt in per cent of GDP	17.2	17.7	13.0	9.8	5.6	1.5
<i>Public finances:</i>						
Government net lending (bill. Dkr.) ²⁾	37.5	21.2	14.6	21.9	25.5	26.8
Government net lending, per cent of GDP ²⁾	2.8	1.6	1.0	1.5	1.7	1.7
General government gross debt, year-end, bill. Dkr.	633.2	642.8	624.8	607.4	590.6	581.7
General government gross debt, year-end, per cent of GDP	47.8	47.2	44.7	41.6	38.7	36.8
Tax burden (per cent of GDP) ²⁾	49.9	48.9	48.7	48.9	48.1	47.8
Expenditures (per cent of GDP)	54.2	54.6	54.9	54.3	53.0	52.4

1) Adjusted for special factors concerning pension funds.

2) For the years 1999-2001 government net lending and the tax burden include the net savings respectively gross savings in the Special Pension fund (app. ½ per cent of GDP).

Source: Statistics Denmark and own calculations.

Table 1.6. December projection and changes since August

	2004		2005		2006
	Aug.	Dec.	Aug.	Dec.	Dec.
	----- Real growth from previous year -----				
Private consumption	3.6	3.5	3.0	3.2	2.0
Total government demand.....	0.6	1.0	0.6	0.9	0.6
of which government consumption.....	0.3	0.7	0.5	0.6	0.5
of which government investment	4.5	4.5	2.0	4.7	1.0
Residential construction	3.0	5.0	-2.0	-2.0	1.0
Fixed business investment	3.4	4.0	5.0	4.8	4.4
Domestic demand exc. stock building.....	2.7	2.9	2.5	2.6	2.0
Changes in stock building ¹⁾	0.0	0.2	0.0	0.1	0.0
Total domestic demand	2.7	3.2	2.5	2.7	2.0
Exports of goods and services	3.1	5.6	5.1	5.4	4.9
Of which manufactures	4.0	5.9	5.2	5.5	5.1
Total demand	2.8	4.0	3.4	3.6	3.0
Imports of goods and services.....	4.3	7.6	5.4	6.1	5.0
Of which goods ²⁾	5.5	8.4	5.4	6.5	5.2
Gross domestic product	2.2	2.4	2.5	2.4	2.1
GDP at factor costs.....	1.8	2.2	2.6	2.3	2.0
Of which in non-agricultural sector ³⁾	2.2	2.4	2.9	2.7	2.4
	----- Change, 1,000 persons -----				
Labour force	16	6	1	1	2
Employment	11	2	21	20	10
of which in the private sector	9	-2	19	18	8
of which in the public sector	2	4	3	3	3
Unemployment.....	4	4	-20	-20	-7

1) The volumes indicate volume changes in stock building in per cent of volume GDP in the preceding year.

2) Excluding energy, ships and planes.

3) Excluding housing, sea transportation and imputed financial services. (Table continues).

Table 1.6. December projection and changes since August (continued)

	2004		2005		2006
	Aug.	Dec.	Aug.	Dec.	Dec.
-- Percentage changes from previous year --					
Merchandise export prices	0.6	1.7	0.3	1.6	-0.6
Merchandise import prices	-0.6	1.1	0.0	1.1	-0.3
Merchandise terms of trade	1.2	0.6	0.3	0.4	-0.3
Property prices, single-family houses	5.0	6.7	2.5	5.0	3.0
Consumer price index	1.4	1.3	1.8	2.0	1.8
Hourly earnings	3.5	3.4	3.8	3.6	3.9
Real disposable income, private sector	3.4	3.7	2.4	2.9	2.6
Real disposable income, households (ADAM)	4.4	4.0	0.7	0.9	0.5
Productivity in non-agricultural sector	1.6	2.6	2.0	1.7	1.8
----- Per cent -----					
Savings ratio in the private sector	29.5	29.8	29.1	29.6	30.0
10-year government bond	4.5	4.5	5.1	5.0	5.2
30-year government bond	5.5	5.3	5.9	5.8	6.3
----- Bill. Dkr. -----					
Current account	44.4	43.2	49.4	46.3	53.3
Government net lending	17.4	21.9	29.7	25.5	26.8
Unemployment (thousands)	175	175	155	155	148
----- Per cent -----					
GDP growth in OECD countries	2.8	3.1	2.9	2.8	2.8
International market growth	7.1	7.8	7.7	7.3	7.0
Dollar exchange rate (Dkr. per US dollar)	6.1	6.0	6.1	5.8	5.8
Price of oil (US dollar per barrel)	36.0	38.0	35.5	42.5	37.5
Price of oil (Dkr. per barrel)	218.9	228.6	216.6	245.7	216.8

Source: Statistics Denmark and own calculations.

2. The fiscal stance and government finances

Fiscal policy is estimated to boost activity growth by around 0.5 per cent of GDP in 2004. In addition, the temporary suspension of SP-contributions and a series of initiatives to stimulate housing investment each entail an estimated stimulus of 0.1 percent of GDP in 2004. Economic policy in 2004 thus gives a fairly sizeable contribution to increased job creation and reduced unemployment during the projection years.

Owing to fairly high growth through 2006, the output gap is expected to close and the projection implies that labour market pressures could begin to resurface.

Figure 2.1a. Outputgap

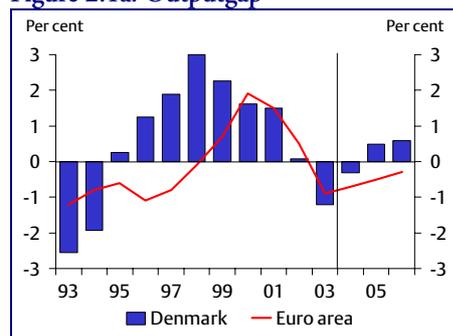
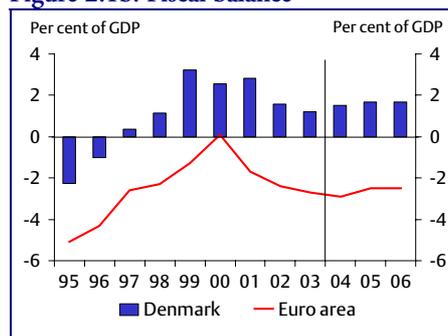


Figure 2.1b. Fiscal balance



Source: Statistics Denmark, EU-Commission, and own calculations.

Wage increases have declined as a result of the cyclically weak labour market during 2002 and 2003 and lower inflation. However, wage increases are still above those in the euro area. In principle, higher wage increases may be justified if matched by higher productivity growth also in the future. Wage competitiveness has been weakened by the appreciation of the effective exchange rate in the last few years.

Due to the fixed exchange rate against the euro, short-term (and long-term) interest rates in Denmark correspond to those in the euro area, albeit with a small risk premium. As a consequence of the stronger euro and still moderate growth prospects for the euro area, interest rate increases in the euro area are expected to be moderate. Interest rate developments through December 2004 are estimated to contribute positively to growth over the next two years, whilst a gradual increase in interest rates in 2005 and 2006 would pull in the opposite direction.

On the basis of the Fiscal Bill for 2005 and local government budgets, fiscal policy in 2005 is estimated to have a neutral impact on economic activity. This accords with the cyclical outlook given the degree of uncertainty that surrounds prospects for growth and unemployment as well as the uncertainty surrounding the estimate for structural unemployment.

Real government consumption is projected to grow by 0.7 per cent in 2004, up from 0.3 per cent in the August survey. The adjustment primarily reflects information on expenditures in local governments through the 3rd quarter. The national account data for public employment show an increase of 5.000 persons in the first 3 quarters of 2004 (year-on-year),

which supports the projected growth in public consumption. Hence it is presumed that the national accounts, which show near zero growth in real public consumption during 2004, underestimate the growth in public consumption, in particular growth in public wage costs.

Real public consumption growth for 2005 is estimated at 0.6 per cent based on the Fiscal Bill for 2005 and local government budgets. Local government budgets show an overrun of 1½ billion Dkr. compared to the financial agreement of June 2004. The government has begun a dialogue with local governments about solutions to provide for local government consumption in 2005 reflecting the agreement of June 2004.

Fiscal policy for 2006 has not been determined yet. In line with medium term objectives, fiscal policy in 2006 is presumed to entail real public consumption growth of 0.5 per cent as well as unchanged tax rates in accordance with the Tax Freeze.

The risk of capacity-induced price and wage pressures in 2005 or 2006 should be viewed in light of the Spring Package, which, to a degree, may dampen growth after 2005. The suspension of SP-contributions applies to 2004 and 2005. The tax reductions previously planned for 2006 and 2007 have now been implemented. Also, the activity profile of investment projects that have been brought forward will be declining.

The general government surplus is projected at 1.5 per cent of GDP in 2004 rising to 1.7 per cent of GDP in 2005 and 2006. The rise in the surplus primarily reflects stronger activity and declining unemployment.

The structural budget surplus is estimated at 1.4 per cent of GDP in 2004 and 1.6 per cent of GDP in 2005. The suspension of tax-deductible SP-contributions widens the tax base and boosts revenues by 0.3 per cent of GDP in both years. Based on the assumed fiscal policies, reintroduction of SP-contributions etc. a structural budget surplus of 1.3 per cent of GDP is estimated for 2006.

General government gross debt (EMU definition) is projected to decline from 44.7 per cent of GDP by the end of 2003 to 36.8 per cent of GDP by the end of 2006, *cf. figure 2.2b*.

Figure 2.2a. Growth in real public consumption

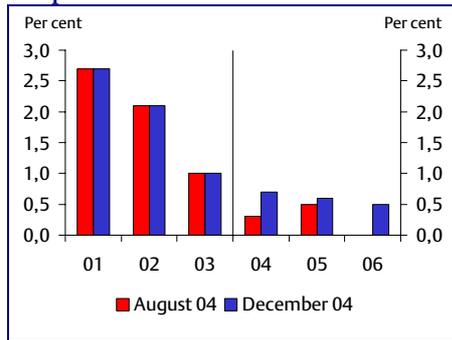
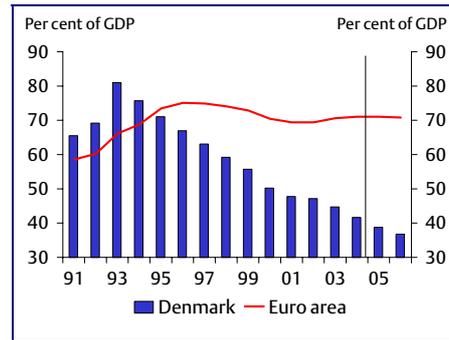


Figure 2.1b. Gross public debt ratio in Denmark and the euro area



Source: Statistics Denmark, EU-Commission, and own calculations.

The structural budget surplus, excluding the revenue effects of the suspension of SP-contributions in 2004 and 2005, is estimated at $1\frac{1}{4}$ per cent of GDP for the years 2004-06. This is close to the lower end of the medium-term target of an average surplus of $1\frac{1}{2}$ to $2\frac{1}{2}$ per cent of GDP through 2010. This reflects notably that the tax reductions in 2004 have been introduced sooner than the technically assumed reduction in taxation in the original 2010-plan dating from 2001.

The 2003 agreement on lowering taxes was designed so that the tax reductions were financed within the framework and assumptions of the original 2010-plan.

Given the medium-term targets for expenditure growth through 2010 and new initiatives to raise structural employment by 55-60,000 persons, the structural budget surplus is estimated at 1.6 per cent of GDP on average for 2003-2010. This is within the aforementioned interval.

With the updated projections and assumptions for the cyclical outlook and fiscal policies, the fiscal sustainability indicator amounts to -0.1 per cent of GDP, slightly revised from 0.0 per cent of GDP in the August projection. Assuming local government spending in 2005 in line with the June 2004 financial agreement, the sustainability indicator amounts to 0.0 per cent of GDP.