

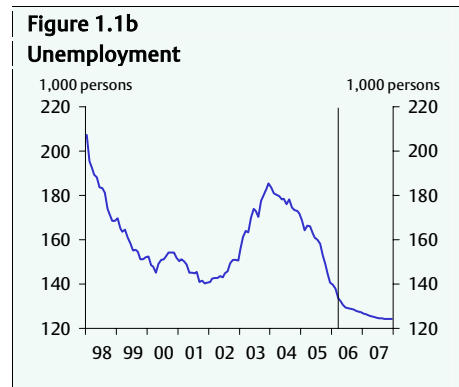
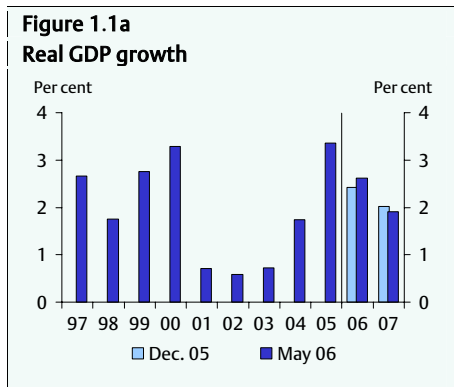
Economic Survey May 2006 – English Summary

1. Short term outlook

The upswing in the Danish economy became more broadly based in 2005 and exceeded expectations. Output growth reached 3.4 per cent, 0.6 percentage points more than expected in the December Survey, *cf. figure 1.1a*. This is the highest growth rate for eleven years.¹ Unemployment has declined by approximately 52,000 persons (1.9 percentage points of the labour force) since December 2003 to below 135,000 persons (4.8 percent on the national definition), a record low for more than thirty years. Employment grew by 0.7 per cent.

The upswing has been driven by low interest rates, buoyant house price increases, the impact on real disposable income of tax reductions in 2004 and strong international growth.

Despite solid domestic demand, the current account is in surplus and in late 2005, Denmark's net foreign asset position turned positive. The public budget surplus reached 4.0 per cent of GDP, the largest among the EU countries.



The brisk expansion in 2005 is expected to abate in 2006 and 2007. Growth is expected to continue at a solid, but slightly lower pace of 2.6 per cent in 2006 and a more modest 1.9 per cent in 2007. This is $\frac{1}{4}$ percentage points more than expected for 2006 in the December projection but slightly less for 2007, see figure 1.1a and *table 1.1*. The moderation in activity growth owes to high capacity utilization and rising, although still low, interest rates.

¹ In July 2005, Statistics Denmark substantially revised the methods and data used in the national accounts, including a shift to chain-weighting. Data based on traditional fixed-price indices are still published (in electronic form), now with 2000 as the new base year. For recent years, the differences in growth rates (e.g., for real GDP and demand components) between the chain-weighted and the 2000-fixed price data are modest. Unless otherwise stated, the real growth rates shown in this Survey are based on data in fixed 2000-prices.

Employment is expected to increase by 26,000 persons from 2005 to 2006, 1 per cent of total employment, and by further 6,000 persons from 2006 to 2007. The employment growth takes place in the private sector with zero growth expected for public employment.

Unemployment is expected to reach a record low of 125,000 persons in 2007 (4.3 per cent of the labour force, national definition; 3.7 per cent on the harmonized Eurostat definition), *cf. figure 1.1b*. This is lower than the estimated structural level of unemployment. Real wage growth is expected to pick up.

Table 1.1**Key figures compared to the December projection**

	2006		2007	
	Dec.	May	Dec.	May
Real growth, per cent				
Gross domestic product	2.4	2.6	2.0	1.9
Private consumption	2.4	2.5	1.9	1.8
Public consumption	0.3	0.5	0.5	0.5
Export market, manufactures	7.0	7.3	7.0	5.9
Per cent of GDP				
Public budget balance	2.3	2.8	2.1	2.9
Current account	3.1	2.3	3.4	2.5
1,000 persons				
Unemployment	143	131	140	125
Per cent increase				
House prices, single-family house	10.0	17.0	5.0	5.0
Consumer prices	2.0	2.0	1.6	1.8
Hourly compensation, private sector	3.5	3.4	4.0	4.2
Yield on 10-year government bonds	3.9	4.0	4.2	4.3
Oil price, \$ a barrel	57.0	70.0	48.5	63.0
Exchange rate Dkr. per \$	6.3	6.1	6.3	6.1
Oil price, Dkr. per barrel	360.2	427.2	306.5	382.7

Source: Statistics Denmark and Ministry of Finance

While the recovery was driven mainly by buoyant growth in private consumption early on, the recovery has gradually become better balanced, due to strong export growth and increasing investments, while private consumption growth is expected to recede in 2006 and 2007.

House prices increased rapidly in 2005 and through the first quarter of 2006, which has stimulated activity in construction of private dwellings, and labour shortages are building up.

Public finances are expected to benefit from stronger activity and higher revenues from oil and gas production. The suspension of Special Pension Savings contributions (of 1 per cent of income) in 2004 and 2005 has been extended to 2006 and 2007.

The budget surplus was 4.0 per cent of GDP in 2005 according to preliminary estimates from Statistics Denmark. The surplus is expected to fall back to 2.8 and 2.9 per cent of GDP in 2006 and 2007, respectively.²

On average the structural budget surplus is estimated at approximately 1.2 per cent of GDP in 2004 through 2007, i.e. in the high end of the operational target range, which is a surplus within ½-1½ per cent of GDP through 2010, *cf. Convergence Programme for Denmark 2005*.

Key vulnerabilities to the balanced development include global imbalances that may pose a risk to global growth. On the domestic side, the anticipated levelling out of house price increases and of the decline in unemployment may not materialize, and hence activity may continue at a stronger pace than expected. If, for example, house price increases continue at an unabated pace or the savings rate declines further, competitiveness could eventually deteriorate more significantly in the near future posing the risk of a larger subsequent adjustment.

The international environment and its impact on the Danish economy

Global growth remains strong with continued brisk expansion in the Americas, Asia, North Africa and the Middle East. Global growth has been revised upwards by 0.3 percentage points to 4.6 per cent in 2006 and by 0.1 percentage point in 2007 to 4.3 percent.

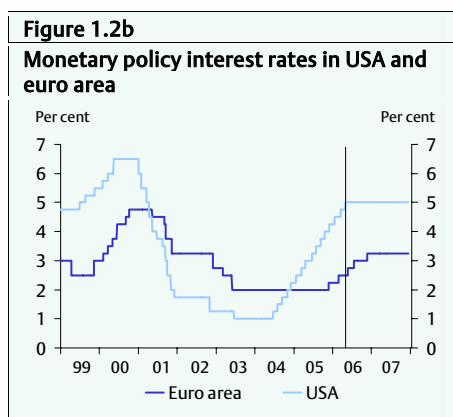
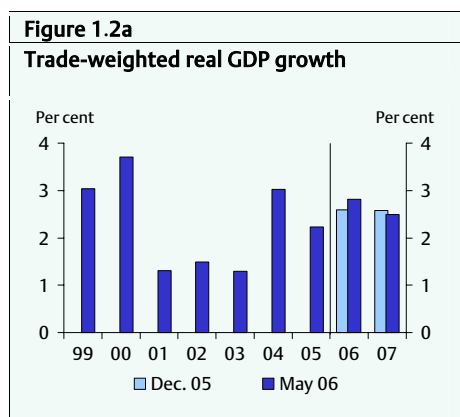
Although domestic demand remains subdued in several EU member countries, growth is expected to pick up somewhat in the EU in 2006 to 2.2 per cent and ease in 2007 to 1.8 per cent. The expected growth rate in the EU is driven by stronger domestic demand and solid export growth. In Germany, sharply rising industrial confidence suggests that GDP growth will pick up in 2006 supported by the economic reforms that were agreed upon in 2005. In some EU15 countries, growth is expected to be somewhat higher than expected in December, especially in Sweden, Germany, and the UK. In 2007, the planned increase in the German VAT rate is expected to restrain activity.

² The data are based on the new national accounts introduced in the summer of 2005, in which the labour market supplementary pension scheme ATP has been reclassified from the public to the private sector. The revised treatment of ATP has lowered the general government balance by around 1 per cent of GDP in the official statistics. The altered statistical treatment of ATP is purely technical and does not affect the assessment of fiscal policy challenges, nor the sustainability of public finances.

For the euro area, output is expected to increase by 2.1 and 1.8 per cent in 2006 and 2007, respectively, up from 1.3 per cent in 2005. The pick-up is sustained by still-low interest rates, increasing household wealth and buoyant export growth.

Projected growth for the United States in 2006 is roughly unchanged since the December survey. The expansion is expected to slow in 2006 and 2007 and to be slightly below potential growth in 2007, but still stronger than in the EU, due to increasing (short-term) interest rates and an expected increase in households' savings rate.

Overall, real GDP growth among Denmark's main trading partners has been revised upwards for 2006 by 0.2 percentage points but slightly downwards for 2007, *cf. figure 1.2a*.



The ECB has raised its key policy interest rate on two occasions by a total of $\frac{1}{2}$ percentage point, *cf. figure 1.2b*. The Danish key policy rate has been held close to the refinancing rate of the ECB as a consequence of the fixed exchange rate policy vis-à-vis the euro, although Denmark unilaterally increased the key policy interest rate by 10 basis points in February due to a temporary, but sizeable, capital outflow. Overall, however, the European policy rate remains very low, which should be seen in part on the backdrop of still-uncertain and modest economic growth prospects and relatively moderate underlying inflation pressures. It is projected that ECB will tighten monetary policy further to 3.25 percent during 2006.

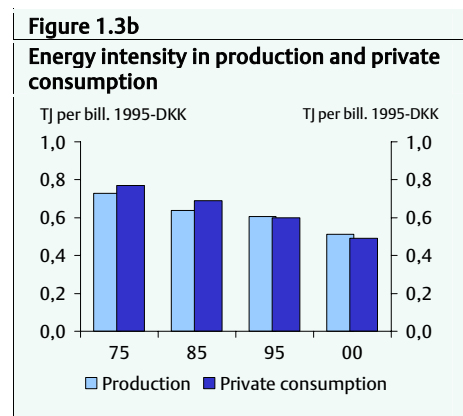
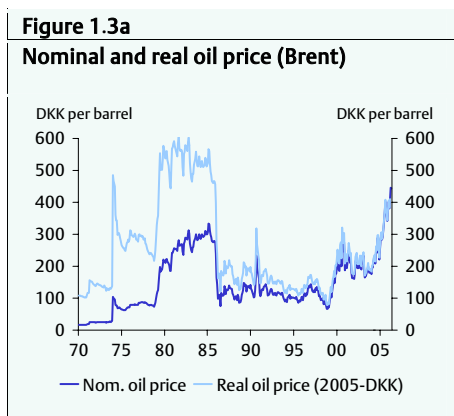
In the US, the federal funds target rate has been increased gradually since mid-2004. The gap between the actual interest rate and an estimated Taylor interest rate is closing, further suggesting that monetary policy is well in line with fundamentals. No further tightening of monetary policy is expected in the near future.

US 10-year bond yields have increased by 0.6 percentage points since the December survey. The increase is modest compared with the rise in short term interest rates.

Consequently, the yield curve has flattened. This may indicate market expectations of moderate future inflation. Forward interest rates have risen and the projection for the long interest rate have been adjusted upwards slightly by 0.1 percentage points.

Oil prices increased markedly by 60 per cent (in DKK) during 2005 and by 20 per cent since the beginning of 2006, cf. figure 1.3a. The price on oil in the future markets has followed the spot price, supposedly reflecting significant uncertainty over future capacity and the geopolitical situation. The expected average dollar-price of oil is adjusted upward relative to the December survey by about 20 per cent for 2006 and by around 25 per cent for 2007. The average crude oil price (in DKK) is expected to increase by 31 per cent from 2005 to 2006 to \$70 per barrel. For 2007 the oil price (Brent) is expected to decrease by 10 per cent to \$63 per barrel towards the International Energy Agency's forecast for a long term price of around \$40 per barrel.

In recent years, Denmark has been a net exporter of energy and higher oil prices tend to strengthen both the budget balance and the current account. Private consumption may be negatively affected, but the energy intensity in both production and private consumption is significantly lower than in previous periods with high oil prices, cf. figure 1.3b. Due also to the large component of excise duties in end-user energy prices, the impact of crude oil price changes on overall inflation is comparatively modest. Oil prices in real terms (i.e., relative to consumer prices) are still lower than in the early 1980s, when the crude oil price corresponded to some 600 Dkr. or \$100 pr. barrel in today's terms, cf. figure 1.3a.



The dollar has depreciated somewhat against the euro. The assumed dollar exchange rate has been revised downward in 2006 to 6.10 Dkr. in the current forecast (from 6.32 Dkr. per dollar in December).³

³ The actual exchange rate medio may is even lower.

On balance, the changes to the international environment since the December projection point to a marginal downward revision to real GDP growth in 2007, *cf. box 1.1*.

Box 1.1

Estimated effects of revised external assumptions

Overall, the revisions to the assumptions concerning export market growth, oil prices, interest rates, import prices and competitors' export prices since December have a neutral impact on activity growth in 2006 and a negative impact in 2007, *cf. table a*. Slightly stronger expected export market growth is projected to have a positive impact on GDP growth while higher oil prices (in Dkr.) and foreign interest rates pull down GDP growth in 2006. In 2007, higher interest rates have a negative impact.

Table a

Estimated effects on Danish GDP growth of changed assumptions

	2006	2007
Percentage points		
Export market growth ¹⁾	0.1	0.0
Foreign prices (excl. oil prices)	0.0	0.0
Prices on energy ²⁾	-0.1	0.0
Foreign interest rates	-0.1	-0.2
Total	0.0	-0.2

1) Including the effects of changes in oil prices on export market growth

2) Excluding the effects of changes in oil prices on export market growth.

Source: Own calculations on the macroeconomic model ADAM.

Domestic developments

Against the background of strong international growth and a sustained expansion in domestic demand, the Danish economy is expected to grow at above-potential rates in 2006-07. After picking up in 2005, export growth is projected to subside in 2006 and 2007 although manufacturing export growth is expected to remain solid in 2006.

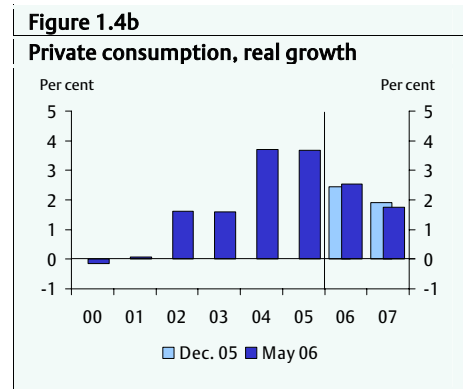
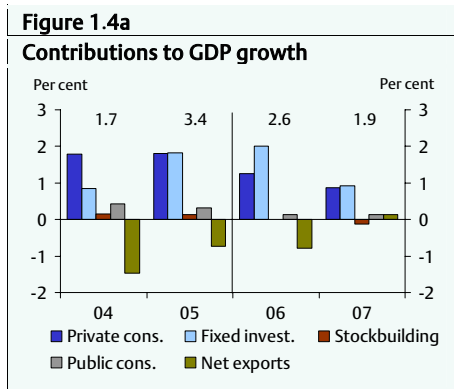
Domestic demand is expected to remain relatively solid in 2006 and to recede in 2007. Strong growth in domestic demand in 2004-2006 should be seen in the light of previously low growth of just 0.8 per cent on average in 2001-2003.

Persistent solid growth in private consumption reflects delayed effects of the income tax reductions and the suspension of contributions to the Special Pension Savings scheme as of 2004⁴ supported by low, albeit increasing, interest rates, strong growth in house prices, new loan types for owners of real estate – including interest-only mortgages – and the solid increase in employment.

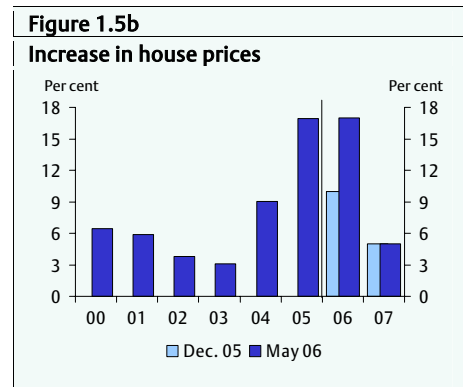
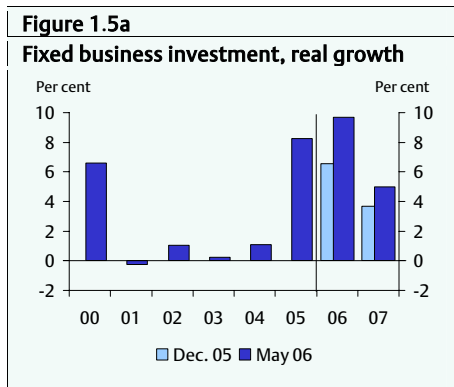
The growth in private consumption has been revised upwards slightly to 2.5 per cent in 2006 due to wealth effects from higher house prices, while increasing interest rates

⁴ 1 per cent of income; the scheme was introduced in 1998 with a view to dampen demand and pre-empt overheating

and oil prices dampen private consumption growth. In both 2004 and 2005 private consumption grew by 3.7 per cent in real terms. Private consumption growth has been revised down slightly to 1.8 percent in 2007, *cf. figure 1.4a* and *figure 4.1b*.



The growth rate of fixed business investments picked up markedly in 2005 after several years of sluggish growth and is expected to grow by about 10 per cent in 2006, *cf. figure 1.5a*. This is an upward revision relative to the December survey. Business investment is expected to be driven mainly by investments in machinery etc. that accelerated in 2005. A decline in the growth of fixed business investment is expected in 2007 due to mitigated activity growth and higher real interest rates.



House prices rose sharply in 2005 and the price increase for owner-occupied single-family homes reached almost 25 per cent on a yearly basis in the first quarter of 2006. This is in part due to persistently low interest rates and the growth in households' real disposable incomes. In consequence, the price increases for owner-occupied single-family homes have been revised up by 7 percentage points to 17 per cent in 2006, *cf. figure 1.5b*. House price increases are expected to decelerate into 2007 to 5 per cent due to the anticipated moderate increase in interest rates.

After strong growth of around 12 per cent on average over the years 2003 to 2005, residential investment growth is expected to moderate in 2006 and 2007 but with still solid growth rates at 8 and 5 per cent, respectively, *cf. table 1.2*. Strong growth reflects a marked increase in residential construction. The forecast has been revised upward by 5 and 2 percentage points for 2006 and 2007, respectively, owing to the stimulus of, notably, higher real estate prices.

Stock-building is expected to be unchanged in 2006 and contribute -0.1 percentage point to GDP growth in 2007.

	2005	2002	2003	2004	2005	2006	2007
	Bill. kr.	Real growth, per cent					
Private consumption	751.9	1.6	1.6	3.7	3.7	2.5	1.8
Public consumption	401.9	2.3	0.2	1.7	1.2	0.5	0.5
Public investment	27.2	-6.5	-7.2	12.4	2.9	9.6	-7.4
Residential construction	87.1	0.8	11.6	10.6	12.6	8.0	5.0
Fixed business investment	208.1	1.0	0.3	1.1	8.3	9.7	5.0
Stock building ¹⁾	2.0	0.3	-0.7	0.1	0.1	0.0	-0.1
Total domestic demand	1478.3	1.8	0.6	3.4	4.3	3.5	1.8
Exports of goods and services	754.8	4.6	-1.1	2.6	8.7	5.3	3.8
Of which manufactures	331.3	6.4	-2.1	2.9	8.9	7.8	5.3
Total demand	2233.0	2.7	0.0	3.1	5.8	4.1	2.5
Imports of goods and services	681.5	8.0	-1.7	6.4	11.1	7.2	3.7
Of which goods	459.3	7.0	-3.1	7.8	8.3	8.8	3.8
Net exports ¹⁾	73.3	-1.1	0.2	-1.5	-0.7	-0.8	0.1
Gross domestic product	1551.5	0.6	0.7	1.7	3.4	2.6	1.9
Gross value added	1317.3	0.4	0.7	1.1	2.9	2.6	1.9
Of which in private non-agricultural sector	828.7	-0.1	0.6	0.6	3.9	3.5	2.6
GDP per capita (1,000 Dkr.)	286.8	0.3	0.5	1.5	3.2	2.5	1.8

1) The percentages indicate the contribution to GDP growth in 2000-prices.
Source: Statistics Denmark and own calculations.

In 2005 the growth rate of real public consumption was 1.2 per cent. Real public consumption growth has been revised upwards for 2006 by 0,2 percentage points to 0.5 per cent in 2006. As a technical assumption real growth in public consumption is estimated at 0.5 per cent in 2007 as in the December projection.

International trade and the current account

Exports increased strongly in 2005⁵. Goods exports grew strongly, especially to the US and to a lesser extent to Sweden and the UK. Manufacturing exports increased

⁵ The statistical basis for overall exports and imports of goods and services is affected by technical factors concerning the services items.

by almost 9 per cent in 2005. In 2006 and 2007 manufacturing export growth is projected to abate somewhat to 7.8 and 5.3 per cent.

Export growth in 2005 has been positively affected by strong export market growth and a small depreciation of the effective exchange rate of the Danish krone. However, stronger wage increases in Denmark than in main trading partners will cause a loss of wage competitiveness in 2006 and 2007. The boycott of Danish export goods in some Middle East countries is estimated to have only a very modest effect on overall export growth.

Imports of goods and services also grew strongly in 2005 by 8.3 per cent. Goods imports are expected to grow at broadly the same pace in 2006 as in 2005, reflecting both the growth and composition of domestic demand, including strong investment growth. For 2007, import growth (for goods) is projected to subside to around 4 per cent, in line with receding demand growth.

Overall, net foreign trade is expected to contribute negatively to GDP growth in 2006 – by 0.8 per cent of GDP compared with -1.2 and -0.7 per cent in 2004 and 2005 – but is projected to contribute slightly positively in 2007.

Denmark's net foreign asset position turned positive in late 2005 and Denmark is now a net lender in the world economy. Despite strong domestic demand, the current account surplus is expected to remain significant at around 2½ per cent of GDP in 2006 and 2007, somewhat lower than in 2005. The current account may have improved structurally in recent years due to an improvement in the terms of trade and growing exports of maritime services and energy.

Employment, unemployment and labour force

After modest growth in 2004, employment growth amounted to 0.7 per cent in 2005. Employment is expected to increase by 26,000 persons in 2006 corresponding to 1 per cent of total employment and by 6,000 persons in 2007. For 2006, projected employment is adjusted upward by 12,000 persons and for 2007 by 3,000, *cf. figure 1.6a and table 1.3*. The more modest increase in employment projected for 2007 follows the anticipation of more moderate output growth.

Total employment growth is driven by higher private sector employment while public sector employment is assumed to remain unchanged.

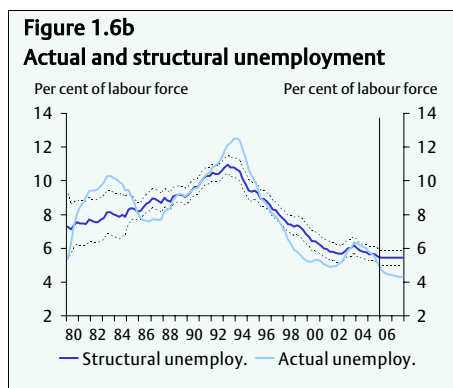
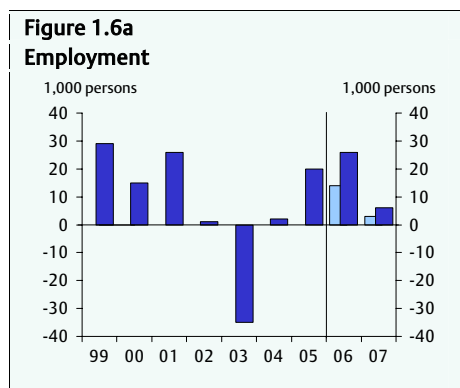
The labour force is projected to be stagnant. Demographic developments impact negatively on labour force growth while positive contributions are expected from the cyclical upswing in labour force participation together with the impact of various labour market reforms.

Consequently, unemployment is expected to decrease from 157,000 persons in 2005 (5.5 per cent of the labour force, national definition; 4.8 per cent Eurostat definition)

to 131,000 persons in 2006 and 125,000 persons in 2007 (4.3 per cent of the labour force; 3.7 per cent Eurostat definition). For 2007 the projection has been revised downwards by 15,000 persons due to a more rapid decline in unemployment since the December forecast.

	2005 level	Avg. 1991-2005	2005	2006		2007	
				Dec.	May	Dec.	May
				Change, 1,000 persons			
Private sector	1,917	5	24	13	26	2	6
Public sector	813	3	-4	2	0	2	0
Total employment	2,730	8	20	14	26	3	6
Labour force	2,887	0	1	0	0	0	0
Unemployment	157	-8	-19	-14	-26	-3	-6

In 2005 through 2007, the unemployment rate is expected to decline significantly and remain below the estimated structural level of unemployment indicating that labour market pressures could emerge, *cf. figure 1.6b*.



Wage and price inflation

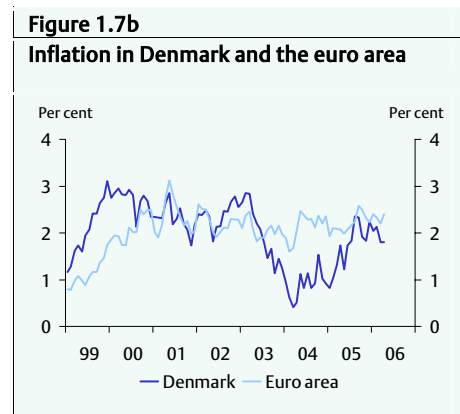
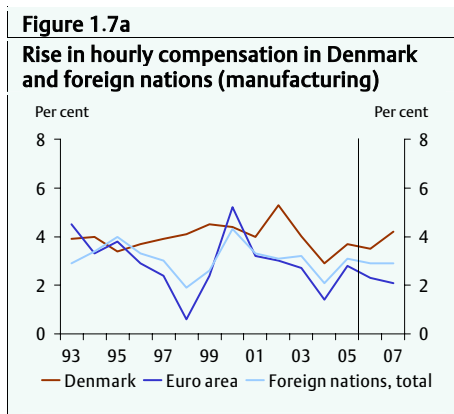
The unemployment rate was above the estimated structural level in 2003 and 2004 contributing to dampen hourly wage growth from 4.2 per cent in 2002 to 2.8 per cent in 2004.

Hourly wage growth was 3.6 per cent in 2005 indicating that wage pressures are building up, though some of the increase in wage growth may be explained by special factors, including statistical effects.

Low unemployment and increasing labour market shortages, notably in construction, is expected to lead to higher wage growth reaching 4.2 per cent in 2007, 0.2 percent-

age points more than expected in the December Survey. This reflects the larger drop in unemployment below the estimated structural level of unemployment, which is anticipated to lead to increased wage growth.

The gap between hourly compensation of employees in the manufacturing sector in Denmark and in the main trading partners has been closing somewhat, *cf. figure 1.7a*, and wage competitiveness was more or less unchanged in 2005 after several years of deteriorating wage competitiveness. Due to increasing wage growth in Denmark and more or less constant foreign wage growth, wage competitiveness is expected to deteriorate in 2006 and 2007 although an assumed depreciation of the effective exchange rate counteracts the widening of the wage differential.



The inflation rate was historically low in 2004 owing to negative contributions from food and other items, *cf. figure 1.7b*. Inflation picked up again in 2005 to 1.8 per cent due to, *inter alia*, increasing oil prices.

Table 1.4**Key figures for the Danish economy**

	2002	2003	2004	2005	2006	2007
Percentage change from previous year						
Real GDP	0.6	0.7	1.7	3.4	2.6	1.9
Trade-weighted GDP abroad	1.5	1.3	3.0	2.2	2.8	2.5
Markets for Danish manufactures	0.5	3.7	6.2	5.3	7.3	5.9
International competitiveness	-2.9	-4.2	-1.7	0.1	-0.2	-1.3
Export of manufactures, volume	6.4	-2.1	2.9	8.9	7.8	5.3
Hourly wages ¹⁾	4.2	3.7	2.8	3.6	3.4	4.2
Consumer price index	2.4	2.1	1.2	1.8	2.0	1.8
Price index for single-family houses	3.8	3.1	9.1	16.9	17.0	5.0
Merchandise export prices	-1.0	-1.1	1.1	4.6	4.0	0.5
Merchandise import prices	-2.5	-0.3	1.0	4.1	3.9	0.9
Merchandise terms of trade	1.4	-0.9	0.1	0.5	0.1	-0.4
Productivity in private non-agricultural sector	0.7	2.0	1.3	1.9	1.8	2.2
Real disposable income of households ²⁾	-0.2	3.7	2.6	1.8	1.9	2.5
Labour market:						
Labour force (thousands)	2,888	2,878	2,886	2,887	2,887	2,887
Employment (thousands)	2,743	2,708	2,710	2,730	2,756	2,762
Of which in private sector	1,910	1,886	1,893	1,917	1,943	1,949
in public sector	833	822	817	813	813	813
Percentage change in total employment	0.0	-1.3	0.1	0.7	1.0	0.2
Unemployment (thousands)	145	171	176	157	131	125
Early retirements 60-64 year (thous.)	114	120	127	135	142	149
Unemployment rate (per cent)	5.0	5.9	6.1	5.5	4.5	4.3
Unemployment rate, EU-def. (per cent)	4.6	5.4	5.5	4.8	3.9	3.7
Long term bond yields, exchange rate:						
10-year government bonds	5.1	4.3	4.3	3.4	4.0	4.3
30-year mortgage credit bond	6.3	5.4	5.3	4.4	5.4	5.6
The effective krone rate (1980=100)	97.7	101.2	102.2	101.6	101.3	101.3
Balance of payments:						
Goods and services (bill. Dkr.)	80.1	85.6	72.0	73.3	65.9	67.6
Current account (bill. Dkr.)	34.1	45.8	33.3	44.3	36.7	42.0
Current account in per cent of GDP	2.5	3.2	2.3	2.9	2.3	2.5
Net foreign assets, ultimo (bill. Dkr.)	-225,3	-170,3	-124,1	36,0	75,0	119,3
Net foreign assets in per cent of GDP	-16,4	-12,1	-8,5	2,3	4,6	7,1
Public finances:						
Government net lending (bill. Dkr.) ³⁾	3.2	-1.0	24.8	61.4	45.89	48.8
Government net lending per cent of GDP ²⁾	0.2	-0.1	1.7	4.0	2.8	2.9
General government gross debt, year-end, bill. Dkr.	643.1	625.2	624.9	556.4	467.5	411.9
General government gross debt, year-end, per cent of GDP	46.8	44.4	42.6	35.9	28.8	24.4
Tax burden (per cent of GDP) ²⁾	48.0	47.8	49.0	50.1	47.8	47.5
Expenditures (per cent of GDP)	53.8	53.8	53.7	51.8	50.6	49.9

1) The 2005 figure was published after finishing the forecast for 2006 and 2007.

2) Adjusted for special factors concerning pension funds.

3) Excluding the labour market supplementary pension scheme ATP.

The inflation rate is expected to rise to 2.0 per cent in 2006, unchanged from the December survey despite higher oil prices. For 2007 the projection is revised upward by 0.2 percentage points compared with the December Survey but the expectation is still for a slowdown in price increases to 1.8 per cent. The projected increase in inflation in 2006 is due to growing import and energy prices and domestic inflation pressures, as output is expected to be above potential. The upward revision for 2007 reflects that the assumed decrease in oil prices is now expected to occur more gradually than expected in the December projection. Inflation excl. energy increases from 1.6 per cent in 2006 to 2.2 per cent in 2007.

The nominal tax freeze for excise duties and lower parental co-payment for day care institutions with the additional lower rental increase and the gradual elimination of airport passenger duty agreed in connection with the fiscal bill for 2006, contribute to dampen inflation. Overall, the inflation rate continues to stay broadly in line with the European Central Bank's medium term inflation target of below but close to 2 per cent.

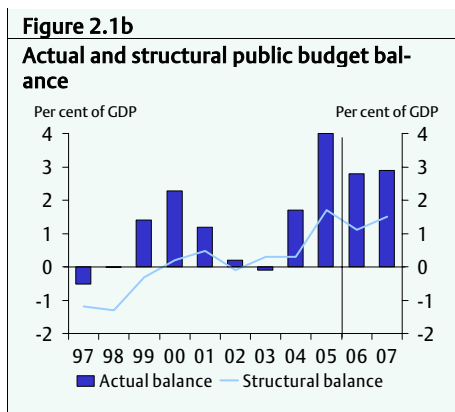
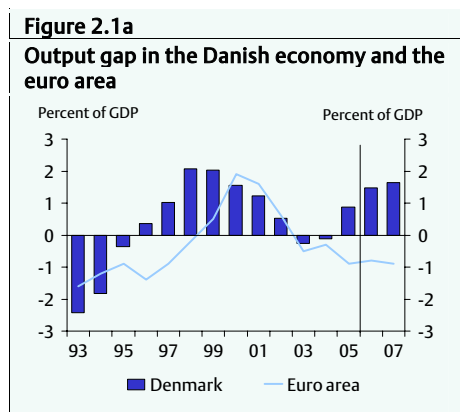
2. The fiscal stance and government finances

After a sizeable fiscal stimulus in 2004 fiscal policy – measured by the so-called first-year fiscal effect – is estimated to have a broadly neutral impact on economic activity in 2005 and 2006⁶. The fiscal stance in 2007 will be determined during 2006 in connection with the budget proposal for 2007.

The current neutral stance should be seen in the light of the substantial growth stimulus from still low interest rates and the lagged impact of the 2004 policy initiatives, while the unemployment rate is expected to decline further below the currently estimated structural rate.

Owing to above-potential growth in 2005 through 2007 labour market pressures are expected to pick up in the course of 2006 and 2007. Due to the fixed exchange rate vis-à-vis the euro, the short-term (and long-term) interest rates in Denmark are closely tied to those of the euro area. As the cyclical position of the Danish economy is ahead of the euro area, *cf. figure 2.1a*, the monetary stance of the ECB may turn out to be somewhat easy in relation to Danish cyclical conditions.

⁶ The extension of the suspension of SP-contributions in 2006 and 2007 is estimated to increase GDP, *ceteris paribus*, by around 0.1 per cent in 2006. SP is classified as a private scheme and hence changes to SP are not included in the estimated fiscal stance.



As a share of GDP, public consumption is expected to decrease by approximately 0.6 percentage points from 2005 to 2007. For 2006 real public consumption growth has been revised upwards by 0.2 percentage points to 0.5 per cent in 2006 especially due to higher expenditures for medicine, expenditures in connection with the reform of the municipalities and a changed timing of the military's purchase of rescue helicopters and other equipment. As a technical assumption real growth in public consumption is estimated at 0.5 per cent in 2007 as in the December projection.

The public budget surplus reached 4.0 per cent of GDP for 2005. This is 0.7 percentage points more than expected the December projection owing primarily to higher revenues from the tax on pension fund returns, which are of a temporary nature. For 2006 and 2007 the surplus is revised up by 0.6 and 0.8 percentage points, respectively compared with the December projection to 2.8 and 2.9 per cent of GDP. The decline in the surplus from 2005 to 2006 is mainly a result of lower revenues from the pension yield tax while higher energy prices increases government revenues. The slightly larger surplus in 2007 is due to, inter alia, higher revenues from the pension yield tax, *cf. figure 2.1b*.

On average the structural budget surplus is estimated at approximately 1.2 per cent of GDP in 2004 through 2007, i.e. in the high end of the operational target range, which is a surplus within $\frac{1}{2}$ - $1\frac{1}{2}$ per cent of GDP through 2010, *cf. Convergence Programme for Denmark 2005*.

In April, the government put forward a reform plan comprising a comprehensive set of proposals for, *e.g.*, later retirement, earlier study completion, immigration and labour market policies. The government's plan is based in part on the reports from the Welfare Commission, the Globalization Council, and the tripartite committee on life-long learning. The proposals should provide an increase in structural employment of 125.000 persons by 2025. Negotiations are presently proceeding.