Economic Survey August 2010 – English Summary

Short term outlook

The Danish economy has been expanding since the summer of 2009 after the sharp setback that followed the international financial crisis.[1] Growth over the last year has been driven by private and public consumption, public investments, as well as a slowdown in the reduction of inventories. In addition, exports showed healthy growth in the 1st half of this year.

GDP is expected to increase moderately in the remainder of 2010 and in 2011, and GDP growth is projected at 1½ per cent in 2010 and 1¾ per cent next year, following a 4¾ per cent drop in 2009, *cf. figure 1.1a.*

In 2010, private consumption is supported by considerable temporary tax cuts, very low interest rates and a very high (automatic) adjustment of public transfer rates. Exports are expected to grow in line with the gradual improvement among Denmark's trading partners, and GDP growth should be further supported by an end to the destocking cycle as well as a further planned increase in public investments as part of the stimulus measures. On the other hand, as in 2009, business and residential investments are expected to fall, albeit at a slowing rate.

Figure 1.1a
Real GDP growth

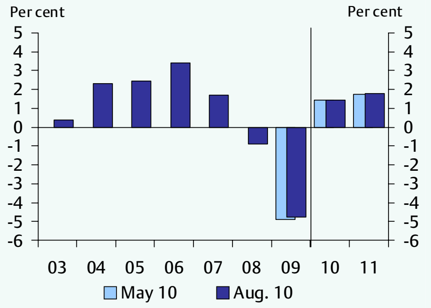
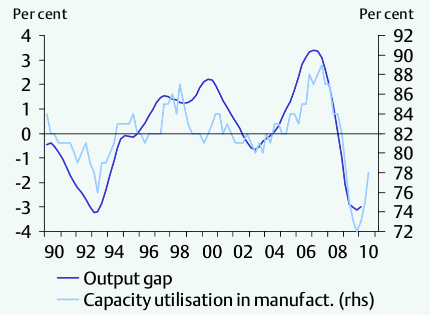


Figure 1.1b
Output gap and capacity utilisation in manufacturing



In 2011, growth is assumed to become more self-sustained. Private consumption is expected to continue growing due to a further increase in real incomes, while household savings are expected to remain largely stable at a high level. The positive effects on household incomes from a further drop in short term interest rates will more than compensate for the changes in personal taxation etc. under the Fiscal Consoli-

[1] According to the national accounts from Statistics Denmark GDP grew by 1.7 per cent in the 2nd quarter of 2010, and was 3.8 per cent higher than in the trough reached in the 2nd quarter of 2009. The forecast presented in the Economic Survey was finished before national accounts for the 2nd quarter 2010 were published.

dation Agreement. Fiscal consolidation contributes to keeping a low interest rate spread vis-à-vis Germany.

Business and residential investments are expected to rise again in 2011, after considerable reductions over the last couple of years, while exports are expected to gain further momentum. Public consumption is expected to grow moderately following an unchanged level this year. On the other hand, public investments are expected to start returning to a more normal level following the planned expansion in 2009 and 2010, while the destocking cycle is expected to abate.

The output gap is estimated to have become negative by the end of 2008 and reached a trough by the end of 2009, *cf. figure 1.1b*. Capacity utilization in manufacturing has been picking up quite significantly, and the output gap is expected to be reduced in the forecast period.

Table 1.1
Key figures compared to the May Survey

	2010		2011	
	May	August	May	August
Real growth, per cent				
Gross domestic product	1.4	1.4	1.7	1.8
Private consumption	2.4	2.5	2.4	2.2
Public consumption	0.8	0.0	0.0	0.6
Export markets, manufacturing	3.9	5.3	5.8	5.8
Per cent of GDP				
Public budget balance	-5.1	-4.6	-4.4	-4.4
Current external account	2.6	3.6	2.6	3.4
1,000 persons				
Employment (increase)	-73	-84	-5	2
Unemployment	130	121	135	125
Per cent increase				
House prices, single-family house	1.5	0.8	1.0	2.0
Consumer prices	2.3	2.2	1.8	1.7
Hourly compensation, private sector	2.0	2.2	2.1	2.4
Yield on 1-year adjustable mortgage	1.4	1.2	2.3	2.2
Yield on 10-year government bonds	3.6	3.2	4.0	3.6
Oil price, $ per barrel	84.1	77.0	89.6	80.6
Exchange rate, DKK per $	5.5	5.7	5.5	5.8
Oil price, DKK per barrel	461.7	439.1	495.0	465.1

Compared to the *Economic Survey*, May 2010 the estimated GDP growth in 2010 is unchanged, while the estimate for 2011 has been raised by 0.1 percentage point, *cf. table 1.1*. According to the revised (but still preliminary) national accounts GDP fell by 4.7 per cent in 2009, which is 0.2 percentage points less (lower fall) than the version of the national accounts that was available in May.

Unemployment has developed more favourable than expected and the estimates for both 2010 and 2011 have been revised down by around 10,000 persons to 121,000 and 125,000 persons respectively (registered unemployment), or some 4¼ per cent of the labour force. Including persons enrolled in activation measures, unemployment is estimated at 6.0 and 6.2 per cent of the labour force in 2010 and 2011, respectively, which is still quite low by historical standards. The unemployment gap is estimated to have closed in the autumn 2009, and since then unemployment has moved above the estimated structural level. The forecast imply that unemployment will be around ½ percentage point above the structural level by the end of 2011.

The gradual withdrawal of the fiscal easing that was introduced during the crisis will strengthen the structural fiscal balance from an estimated deficit of 1¾ per cent of GDP in 2010 to ¾ per cent of GDP in 2011. The structural deficits in 2010 and 2011 result from the expansionary measures made in 2009-2010. In the years before the crisis there was a structural surplus of around 2 per cent of GDP.

In light of the short-term prospects of the economy and the Budget for 2011, as well as other assumptions regarding economic policies, the fiscal deficit is estimated at DKK 80 bn in 2010 and DKK 79 bn in 2011 (4.6 and 4.4 per cent of GDP respectively). On the back of the crisis and the measures taken to support activity, gross public debt (EMU definition) is expected to rise from 27½ per cent of GDP by the end of 2007 to 44½ per cent in 2011. This is 22 per cent of GDP more than assumed in the 2015 Plan from 2007.

Fiscal policy

With the Fiscal Consolidation Agreement, specific measures have been decided in order to consolidate public finances in the years 2011 to 2013, fulfilling the EU recommendation that Denmark received in July, *cf. box 1.1*.

The Fiscal Consolidation Agreement contains a combination of reduced spending growth, higher taxation and a shortening of the unemployment benefit period, thereby reducing the risk of higher long-term unemployment as well as raising effective labour supply in the longer term. Thus, Denmark starts the consolidation in 2011, which is later than most other EU countries.

The Fiscal Consolidation Agreement signals the determination to restore sound public finances. The agreement may, together with the relatively good initial fiscal position, have contributed to the further fall in Danish interest rates on mortgages and on public debt since the latest turmoil in financial markets and to the Danish krone not coming under pressure. Denmark has – in contrast with most euro area countries – experienced declining interest spreads vis-à-vis Germany, *cf. figure 1.2a and b*.

Figure 1.2a
Interest rates on10-year government bonds have fallen since May

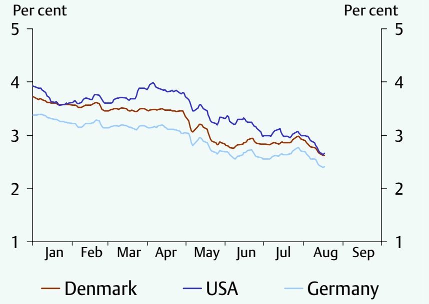
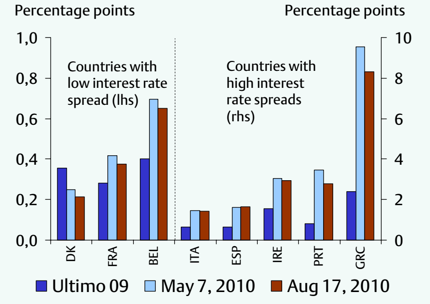


Figure 1.2b
Interest rate spreads vis-à-vis Germany (10-year government bonds)



Source: Reuters EcoWin.

In this vein, the Fiscal Consolidation Agreement also strengthens the fiscal room for manoeuvre going forward, and can be seen as one of several elements in a broad exit strategy that may increase the likelihood that an upswing – and the effects of the expansionary measures that have been implemented – is not dampened by rising risk premiums, interest rates or exchange rate pressures, *cf. box 1.2*.

Box 1.1
The EU Council's recommendation to Denmark

Denmark is now subject to EU's 'excessive deficit procedure' and received a recommendation from the EU Council of Economics and Finance Ministers (ECOFIN) in the middle of July to strengthen public finances. The Council recommends that Denmark:

- reduces the deficit below 3 per cent of GDP as soon as possible and no later than 2013
- implements the planned expansionary fiscal policy in 2010 and starts consolidation in 2011
- ensures average annual fiscal tightening of at least ½ per cent of GDP in 2011-2013
- implements effective measures within 6 months after the recommendation

The recommendation is in line with the expectations in *Denmark's Convergence Programme 2009* and in the Fiscal Consolidation Agreement.

The recommendation that Denmark implement effective measures within 6 months is met with the Fiscal Consolidation Agreement. The agreement consists of consolidation measures for a total of DKK 24 bn, thereby ensuring that the EU recommendation is adhered to.

The recommendation for Denmark is among the mildest of the 24 recommendations that have been given under the EU procedure. The consolidation required in other countries in order to fulfil the recommendations, are on average 3 times larger than in Denmark.

Fiscal policy in the years 2009-2011 is estimated to have a broadly neutral impact on demand growth in 2011 (measured by the multi-annual fiscal effect), even if the planned fiscal policy in 2011 in itself has a negative effect on activity, estimated at ½ per cent of GDP (at given interest rates). This should be seen in light of delayed positive effects on demand into 2011 from the expansionary measures in 2009 and especially in 2010.

The negative first year effect from fiscal policy in 2011 (of -½ per cent of GDP) primarily reflects a gradual normalisation of the level for public investments following the significant, planned growth in 2009 and especially in 2010, while planned real growth in public consumption is set at 0.6 per cent (primarily as part of the Fiscal Consolidation Agreement) compared to zero growth in May.

The negative effect on activity from fiscal policy in 2011 (the so called fiscal effect) is marginally lower than estimated in May. The new elements in the Fiscal Consolidation Agreement strengthen public finances by 0.2 per cent of GDP in 2011 compared to the May estimate, but does not affect the fiscal effect, because the increase in public consumption under the agreement is financed among others by savings on public transfers with smaller first-year effects on activity.

Box 1.2

Elements in a Danish exit strategy

Denmark has come relatively far in preparing an exit strategy following the substantial economic policy interventions during the crisis. Credible exit strategies increase the possibility that a recovery is not hampered by uncertainties regarding future economic conditions, higher interest rates or exchange rate pressures. It is, at the same time, an important objective that the financial sector again will be able to operate without government support, thereby reducing the public sector's exposure to risk and to bring fiscal policy back on a sustainable path. Credible exit strategies can ensure that the easing of monetary and fiscal policies work as intended, and also increases the room for manoeuvre going forward.

- The Fiscal Consolidation Agreement contains specific measures on consolidation of public finances up to 2013, fulfilling the EU recommendation Denmark received in July, *cf. box 1.1*. The agreement also increases labour supply due to the shortening of the unemployment benefit period and delivers in total around 85 per cent of the required new initiatives in order to reach the target of structural balance by 2015.
- A historically high foreign exchange reserve of around 20 per cent of GDP has been built up as a contingency against possible future pressures against the krone. The Danish government has large liquid deposits in the National Bank, and compared to other countries Denmark has a relatively limited need to refinance public debt over the next couple of years. This reduces the vulnerability towards financial turmoil.
- In order to ensure a smooth transfer from the general government guarantee scheme that expires September 30, 2010, credit institutions may sign individual government guarantees for unsecured loans with a maturity of up to 3 years until the end of 2010. With the law on handling troubled banks, a permanent model has been introduced for handling this issue providing the basis for a controlled exit, while the risk is borne by the involved private actors and the financial sector and therefore without expenditures for the government.

A final element is strengthening the conditions for higher long term growth after the crisis, partly building on the work done in the so-called Growth Forum.

Apart from the delayed effects from the expansionary policies in 2009 and 2010, fiscal policy in 2011 should be seen in light of the very expansionary monetary policy and the low long-term interest rates in Denmark. The falling interest rates give room to start consolidation, in part reflecting that the Danish economy is very sensitive to interest rate changes. The fall in interest rates since 2008 can increase GDP growth in 2011 by an estimated 1 per cent of GDP, which is significantly more than the negative contribution to activity from fiscal policy next year.[2]

The sensitivity towards interest rates in part reflects a high level of household debt with adjustable interest rates and also that housing demand is very sensitive to changes in short-term interest rates. Low interest rates also support financial stability, because the risks of losses in the financial sector are reduced and the number of foreclosures is dampened. On the other hand, Denmark will be vulnerable if interest rates rise sharply and it is therefore important – especially in the current financial climate – that economic policies are set in order preserve confidence in public finances and the fixed exchange rate regime. As it looks, monetary policy is not expected to be tightened until some time into 2011 and interest rates are expected to stay low throughout the forecast period.

Expansionary fiscal policy during the crisis and required consolidation from 2011

Expansionary fiscal measures constitute close to 4 per cent of GDP from 2008 to 2010 (measured by the direct revenues that enters into the estimation of the fiscal effect), *cf. figure 1.3a*. The expansionary fiscal policy has supported demand during the global setback and has dampened the rise in unemployment. Employment is estimated to be around 45,000 persons (1½ per cent) higher in 2010 than in the absence of expansionary measures since 2008.[3] The number does not include the initiatives to secure financial stability, which have prevented a deeper setback.

Figure1.3a

Fiscal expansion compared to 2008 (direct revenues 2009-2015)

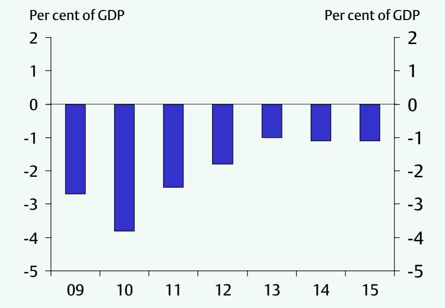
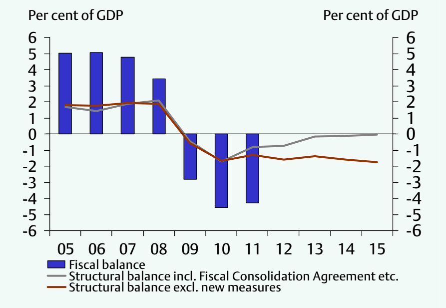


Figure1.3b

Fiscal and structural balance with and without consolidation, 2009-2015



Source: Statistics Denmark and own estimates.

[2] For example, the further fall in interest rates since May alone is estimated to be enough to compensate the effect on household income from the tax increase in the Fiscal Consolidation Agreement in 2011. Household real income is estimated to rise by 2½ per cent in 2011 despite the tax increase etc. in the Fiscal Consolidation Agreement and the implementation of the financing elements of the tax reform. Falling interest expenditures are estimated to increase household real incomes by 1½ per cent in 2010 and ¾ per cent in 2011.

[3] The calculation does not include potential effects on interest rates from fiscal policy.

The expansionary measures of 4 per cent of GDP include a planned increase of public investments in 2009 and 2010 (of around ½ per cent of GDP in direct revenue effect) and reduced taxation (of around 1¼ per cent of GDP). Moreover, public consumption is expected to rise by around 1¼ per cent of GDP over the two years. In addition, the disbursement of the Special Pension (SP) savings and of certain private pension savings schemes (which are not included in the fiscal effect calculations above, because they are private schemes) is, with some uncertainty, estimated to increase private consumption in both 2009 and 2010 by almost ½ per cent of GDP each year.

Approximately 2/3 of the fiscal easing (around 2½ per cent of GDP) is estimated to have occurred in 2009, i.e. immediately following or coinciding with the accelerating downturn and the sharp drop in GDP in the last quarter of 2008 and the first half of 2009. The fiscal expansion in 2009 includes real growth in public investments of around 12½ per cent and 3.4 per cent growth in public consumption, including growth in public employment by around 17,000 persons. Public investments have therefore grown less than planned, while public consumption grew significantly more than budgeted. Overall, public demand increased more than planned in 2009 and a larger share of the rise in expenditures was on public service. Based on the budgets for 2010 and the estimates for public consumption expenditures in the May survey, public consumption is assumed to be unchanged compared to 2009 and public investments are expected to grow further by around 25 per cent (in real terms).

The expansionary fiscal measures in Denmark in 2009 and 2010 have been larger than in all other OECD countries, as measured by the OECD's estimate of the change in the underlying primary balance, *cf. figure 1.4a*. According to the Economic Outlook 87 (OECD), Denmark's underlying primary balance is reduced by 3.8 per cent of GDP from 2008 to 2010, which is in line with the Ministry of Finance estimates. For comparison, when measured the same way, the fiscal easing in the USA corresponds to 2.9 per cent of GDP, and in the UK as well as the euro area to 2.4 per cent of GDP. In a number of countries with larger challenges, including Greece, Ireland, Iceland, Hungary and the Czech Republic, fiscal policy was tightened over the same period.

Across OECD countries there is a tendency that countries, which have eased their fiscal polices more, have had a smaller rise in output gaps from 2008 to 2010, but the tendency is not clear-cut. The effects of expansionary fiscal policies may be different in different countries, depending on the economy's openness, initial deficit and debt, and the interaction with interest rates and spreads. In addition, there are differences as to the concrete measures that have been implemented, and countries that have been hit harder by the crisis may have eased more, to the extent that they had the fiscal room.

Figure1.4a
Expansionary fiscal policy 2009-2010 and change in output gap from 2008 to 2010

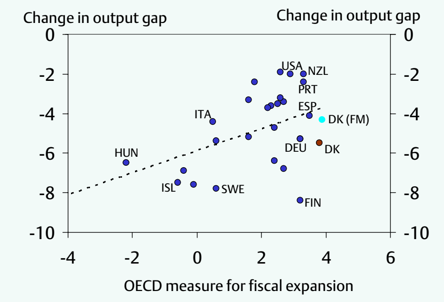
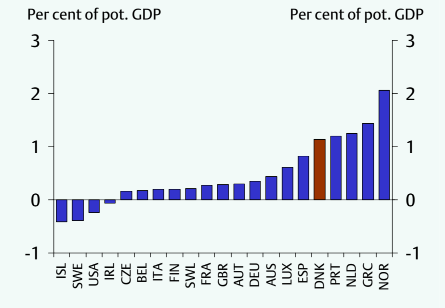


Figure1.4b
Growth in public consumption, share of cyclically adjusted GDP, 2008-2009



Source: OECD, Statistics Denmark and own estimates. Fiscal expansion in the OECD countries in figure 1.4a is calculated by the change in underlying primary balance according to the OECD. For DK(FM) own estimates have been used, also for the change in output gap.

The very expansionary policy in Denmark has been viable due to a relatively healthy fiscal starting point, when the crisis escalated. Denmark had the largest actual surpluses in the EU in 2005 to 2008 on average, and a structural budget surplus of just over 2 per cent of GDP in 2008, while many other countries had fiscal deficits, even at the peak of the last cycle.

The expansionary policy in Denmark comes on top of the adjustment to local government appropriations implying that municipalities and regions (which account for 70 per cent of public consumption expenditures) more or less are automatically shielded from cyclical effects through increased grants from the state when cyclical conditions weaken. In a number of other countries – for example the USA and Sweden – falling tax revenues may weaken the ability of municipalities, regions or provinces to keep unchanged expenditures, unless emergency grants from the central government are actively decided. In 2009, public consumption grew less in comparable Western countries than in Denmark, *cf. figure 1.4b.*

In some countries there are also built-in mechanisms that increase social contributions or taxes, when expenditures for unemployment benefits etc. increases. In countries with such procyclical budgetary mechanisms active crisis measures are therefore partly offset by automatic tightening. Hence, one of the reasons fiscal easing has been bigger in Denmark is that there is no particular automatic tightening when the cyclical conditions weaken.

Fiscal easing and the global crisis have weakened public finances in Western countries markedly, also structurally. The weakening has been larger in Denmark than in most countries, partly due to the large expansionary measures, and partly because the automatic stabilisers in Denmark are more powerful than in other OECD countries, *cf. figure 1.5a.* The fiscal surplus of 3½-5 per cent of GDP in the years up to 2008 turned to a deficit in 2009, which in 2010 is estimated at approximately 4½ per cent of GDP.

Figure1.5a

Weakening of fiscal and structural balance from 2008 to 2010 is largest in Denmark

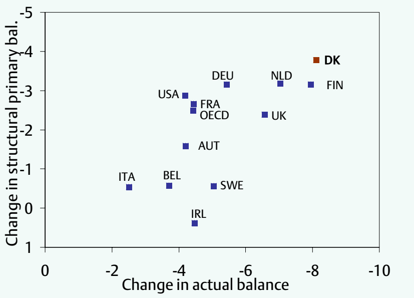
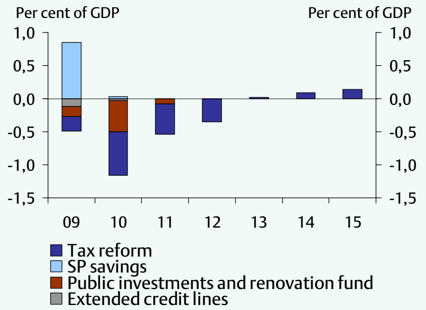


Figure1.5b

Temporary expansionary measures decided in 2009 and 2010



Due to fiscal easing, a structural surplus of just over 2 per cent of GDP in 2008 has turned into an estimated structural deficit of 1.7 per cent of GDP in 2010. Without the measures that have been decided in the Fiscal Consolidation Agreement, the structural deficit would continue towards 2015, *cf. figure 1.3b.*

A central objective in the various measures that have been adopted during the crisis – e.g. *Spring Package 2.0*, the increase in construction investments, the renovation fund, extended credit lines etc. – has been that easing measures should be temporary, thus avoiding a permanent weakening of public finances, *cf. figure. 1.5b.* For instance, the tax reform in Spring Package 2.0 is underfinanced in the first years, in order to support private consumption, but fully financed in the medium term (and not including the structural impact on labour supply etc.) and is estimated to eventually strengthen public finances by DKK 5½ bn (0.3 per cent of GDP) via increased labour supply etc. In the same vein, the high growth in public consumption in 2009 must be followed by a period where expenditure growth is kept at bay, in order to avoid a permanent weakening of the public finances.

Real growth in public consumption in 2009 was considerably higher than set out in the 2015 Plan, where real growth was planned at 1 per cent per year in 2009-2012 and ¾ per cent per year in 2013-2015. Consolidating public finances in 2011-2013, including the Fiscal Consolidation Agreement, implies that public spending growth is reduced up to 2013, *cf. figure 1.6a.* If real growth in 2014-2015 is kept in line with the assumptions in the Convergence Programme 2009 real public expenditures would still be higher in 2015 compared to the assumptions in the 2015 Plan, even though the funding base has been weakened by the crisis, *cf. figure 1.6b.*

Figure1.6a
Public consumption, real growth 2008-2015

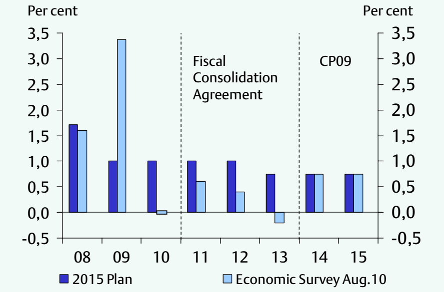
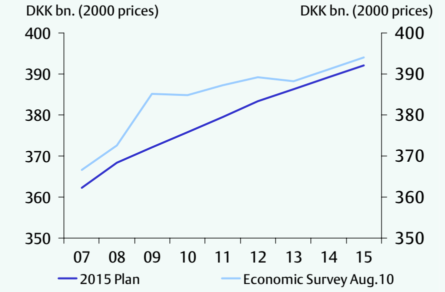


Figure1.6b
Public consumption (real growth), 2007-2015



Source: Statistics Denmark and own estimates.

The consolidation challenge in Denmark and in the EU

The primary challenge in most Western countries is now to create confidence in fiscal policies and to ensure a recovery of public finances. This should be seen in light that monetary policy is expected to stay very supportive for some time.

When the "debt-turmoil" in European financial markets escalated this spring, investors sought refuge in the safest assets, and government bond yields have fallen considerably in countries with high fiscal credibility, including e.g. Denmark and Germany, *cf. table 1.2*. Mortgage rates have also fallen, to the benefit of home owners and other borrowers. The planned consolidation of public finances helps to maintain fiscal credibility, and provides better opportunities for future, temporary fiscal policy measures, if needed, without weakening the credibility or increasing interest rates vis-à-vis Germany.

Most EU countries, including Denmark, have entered the EU procedure for excessive deficit procedures (EDP) and have received recommendations from the EU to reduce the deficits. The EU's budget rules aim to secure a) healthy public finances that contribute to lower financing costs to the benefit of investments and growth, b) more fiscal room for manoeuvre during setbacks, and c) to underpin stable inflation expectations and central bank independence.

The consolidation needs are reinforced by the fact that not only are current structural deficits large in many countries, but public finances are under increasing strain from aging populations. According to recent calculations from the European Commission, the permanent improvement of public finances required to ensure long-term sustainability is approximately 6½ per cent of GDP on average for the EU countries, and in many countries the challenge is considerably higher, *cf. figure 1.7a*. With some exceptions, the countries that currently are running the largest deficits, typically also have the largest challenges in the longer term, *cf. figure 1.7b*.

Table 1.2
Interest rate spread to Germany, 10 year government bonds

Basis points	Ultimo 2009	May 7 2010	Aug. 17 2010	Change since ultimo 2009	Change since May 7
Denmark	36	25	21	-14	-4
Netherlands	22	20	19	-3	-1
France	28	42	38	9	-4
Belgium	41	70	65	24	-5
Italy	65	147	142	77	-5
Spain	65	162	166	102	4
Ireland	154	305	294	140	-12
Portugal	79	347	278	198	-69
Greece	239	956	832	594	-124

Note: 100 basispoints equals 1 per cent.
Source: Reuters Ecowin.

Figure1.7a
Structural deficits in 2010

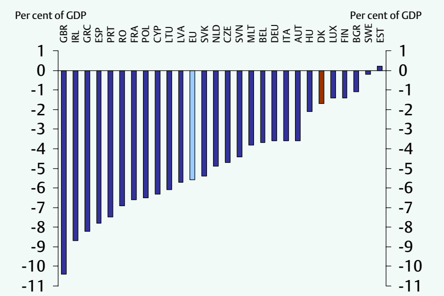
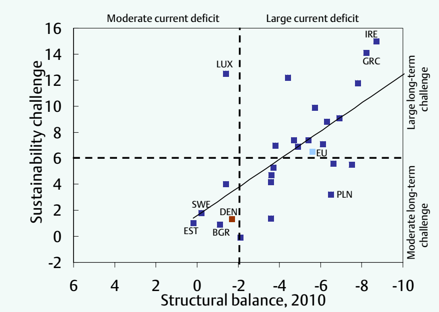


Figure1.7b
Structural deficit and sustainability challenge



Source: European Commission.

Denmark's EU recommendation and required fiscal consolidation

In the middle of July, Denmark received the recommendation from the Council of EU's Economics and Finance Ministers (ECOFIN) to consolidate public finances. The recommendation – as assumed in the Convergence Programme 2009 and the *Economic Survey*, May – requires that Denmark reduces the fiscal deficit to below 3 per cent of GDP in 2013 at the latest, and ensures an average annual fiscal tightening of at least ½ per cent of GDP in the years 2011-2013. The recommendation is one of the mildest among the 24 member states that have received a recommendation.

In *Denmark's Convergence Programme 2009 (CP09)* it is estimated, that fulfilling this recommendation requires budget measures of DKK 24 bn (just under € 3¼ bn), *cf. table 1.3*. This is to come from new initiatives, beyond the phasing-in of financing elements of the tax reform as well as the normalisation of public investments from the high level in 2010.

Table 1.3
Required consolidation measures to fulfil central targets (Convergence Programme 2009)

	Required consolidation measures
EU-recommendation 2011-2013	DKK 24 bn
Structural balance in 2015	DKK 31 bn

Note. The required measures for DKK 24 bn towards 2013 are estimated to strengthen the structural balance by some DKK 22 bn after effects on indirect tax revenue etc. The EU recommendation to strengthen the structural balance by 1½ per cent of GDP is estimated to require an improvement of 22 bn through new initiatives.

Fulfilling the EU recommendation up to 2013 is a major step to reach the key objective in the 2015 Plan of structural balance in 2015. Ensuring structural balance in 2015 requires new initiatives for a total of DKK 31 bn up to 2015.

The structural balance target in 2015 prevents continued debt accumulation and rising interest expenditures, which otherwise would weaken the ability to meet rising expenditures in notably health care, pensions, and elderly care as the number of elderly rises.

Figure1.8a
Fiscal and primary balance up to 2060

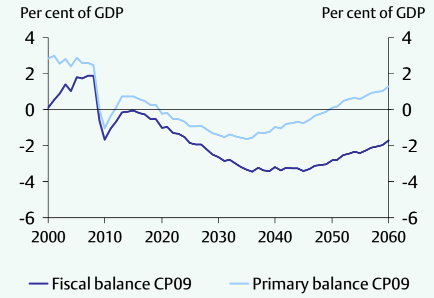
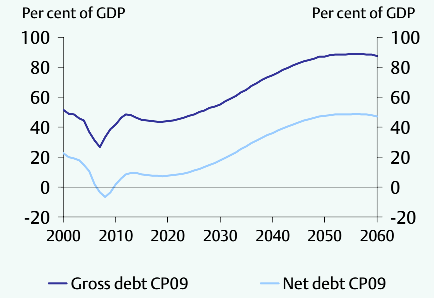


Figure1.8b
Gross debt (EMU definition) and net debt up to 2060



Source: Convergence Programme 2009.

Public finances are, however, subject to an underlying weakening after 2015, partly due to the demographic development with a rising share of elderly and fewer in the most active working ages and falling revenues from the North Sea activities in line with the depletion of the oil reserves. Even with fiscal balance in 2015, the deficit – based on technical assumptions regarding fiscal polices after 2015 – will be in the order of 3 per cent of GDP in 2030-2040, *cf. figure 1.8a and Denmark's Convergence Programme 2009.*

After 2040-2050 the deficit and net debt falls back again, primarily due to the positive effects of the retirement reform in the Welfare Agreement, *cf. figure 1.8b*. In addition, some reversal in the demography occurs when the smaller cohorts from the 1970s and 1980s are retiring and larger young cohorts enter the labour market. The projection is technically sustainable, as the sustainability indicator is estimated at 0.2 per cent of GDP, but the projection illustrates that there are significant fiscal challenges in the coming decades, even when structural balance is achieved in 2015.

Effects on activity from fiscal policy and interest rates

Of the total fiscal easing of approximately 4 per cent of GDP from 2008 to 2010, around one third is withdrawn in 2011 and another third is rolled back up to 2013 (measured by direct revenue effects).

Measured by the multiannual fiscal effects – that takes into account, that fiscal policy in a given year affects economic activity in the following years – fiscal policy in the years 2009-2011 is estimated to contribute approximately 2¼ per cent to the activity level in 2011, *cf. table 1.4*. Due to the consolidation of public finances the estimated contribution will gradually decline to an estimated ¾ per cent of GDP in 2015.

The dampening effects from fiscal consolidation on GDP growth are therefore expected to occur after 2011. These dampening contributions have been estimated to around ¼-½ percentage point per year in 2012-2015.

Table 1.4
Effects on economic activity from the economic policy etc. since 2008

	2009	2010	2011	2012	2013	2014	2015
Multi-annual fiscal effect (GDP level)	1.3	2.3	2.2	1.9	1.3	1.0	0.8
Disbursion of SP etc. (GDP level)	0.4	0.7	0.4	0.2	0.0	0.0	-0.1
Fiscal policy from 2009 and SP etc.	1.7	3.0	2.6	2.1	1.3	1.0	0.8
Changes in interest rates since 2008 (level)	0.5	2.0	3.2	2.7	1.9	1.1	0.3
Total effect (level)	2.1	4.9	5.8	4.8	3.2	2.1	1.1
Growth contribution	2.1	2.8	0.9	-1.0	-1.6	-1.2	-1.0
of this, one-year fiscal effect (growth contribution)	1.3	0.6	-0.5	-0.3	-0.3	0.1	0.0
Memo							
Average bond yield	3.8	2.9	3.7	4.1	4.4	4.7	5.0

Note: The multi-annual effects are calculated as the effects on activity from fiscal policies etc. from (and including) 2009. The calculation does not include potential effects on interest rates from fiscal policy. Due to rounding the total may differ from the sum of the contributions in the table.

The estimated effects from fiscal policy should be seen in light of the fall in interest rates since 2008. Fiscal policies, together with the fall in interest rates since 2008, are expected to contribute to activity growth in 2011 by around 0.9 per cent. This estimate includes the negative activity-impact due to the fiscal contraction in 2011. However, the multiannual effects of fiscal policy and interest rate changes are more uncertain than the first-year fiscal effect.

From 2011, monetary policy is expected to tighten gradually and interest rates are eventually expected to rise in line with a gradual normalisation of cyclical conditions in the euro area and abroad. The rising interest rates and the assumed fiscal consolidation may dampen economic growth by an estimated 1¼ per cent per year on average. The monetary policy tightening depends on cyclical developments and may occur at a faster pace if fiscal consolidation is not implemented in the countries.

Table 1.5
Employment effects from the economic policy etc. from 2009

1,000 persons	2009	2010	2011	2012	2013	2014	2015
Fiscal policy	23	45	52	48	32	20	10
SP and private pension accounts	4	10	10	7	2	-1	-3
Fiscal policy and SP etc.	**27**	**55**	**62**	**55**	**34**	**16**	**4**
Changes in interest rates since 2008 (level)	**6**	**31**	**60**	**68**	**57**	**35**	**12**
Total effect (level)	**33**	**86**	**122**	**123**	**91**	**54**	**19**

Note: The multiannual employment effects are calculated as the effects on activity from fiscal policies etc. and lower interest rates from (and including) 2009. The effects are subject to uncertainty.

The total employment effects from fiscal policy and lower interest rates are (with uncertainty) estimated to be in the order of 85,000 persons in 2010 and 120,000 persons in 2011. In line with the expected consolidation of fiscal policies and normalisation of interest rates, the estimated effect gradually declines to 15-20,000 persons in 2010, *cf. table 1.5*. This implies that the estimated contribution to activity and employment from the extraordinary and temporary monetary and fiscal measures in 2009 and 2010 is largely phased out by 2015.

Domestic demand

Due to temporary tax cuts, high annual adjustment of public transfer rates and the rather steep fall in interest rates, household *real disposable income*[4] is expected to grow by almost 6 per cent in 2010, despite the fall in the labour force and employment. The income growth is to a large extent a result of the economic policy. The estimated income growth in 2010 has been revised upwards by 1¼ per cent compared to the May Survey, especially due to lower interest rates. Real household incomes are expected to grow further in 2011 by 2½ per cent due to low interest rates and a stabilisation of the labour market.

The significant rise in household income, together with renewed growth in house hold wealth due to higher share prices and a moderate rise in prices of owner-

[4] The adjusted income for households.

occupied dwellings, is expected to lead to real growth in *private consumption* by 2½ per cent in 2010, continuing the growth in private consumption since the middle of 2009.

In 2011 private consumption is expected to continue growing by 2¼ per cent, since the increase in the savings rate is expected to stop. Compared to the May Survey, growth in private consumption has been revised slightly downwards. Estimated growth in households' real disposable incomes in 2011 has been adjusted downwards by ¼ percentage point.

The average household is quite well consolidated. The level of total *net assets* by the end of 2009 is in line with the level at the beginning of 2005, and the average "directly owned" net assets per household (calculated as assets in owner-occupied dwellings and financial net assets excluding pensions) is around DKK 900,000 (close to € 121,000). Including private pension savings average net assets are DKK 1.3 million (just under € 175,000).

The housing market stabilised in the second half of 2009 and the *price of single-family houses* are expected to rise moderately by ¾ per cent in 2010 and 2 per cent in 2011 after dropping by some 14 per cent in 2009, *cf. figure 1.9a.* In 2011, the level of wage-deflated housing prices will be close to the historical average and the level ten years ago.

Table1.6

Use and supply of goods and services

	2009	2006	2007	2008	2009	2010	2011
	DKK bn	Real growth, per cent					
Private consumption	817.6	3.6	2.4	-0.2	-4.6	2.5	2.2
Public consumption	496.4	2.8	1.3	1.6	3.4	0.0	0.6
Public investment	33.9	16.6	-3.3	-2.9	12.4	25.9	-13.5
Residential construction	83.6	9.6	3.4	-14.2	-18.1	-8.3	1.5
Fixed business investment	191.5	16.5	3.3	-0.1	-13.9	-8.2	5.0
Stock building (growth contr.)	-18.8	-0.3	-0.3	0.3	-2.0	1.0	0.4
Total domestic demand	1,603.7	5.2	1.9	-0.5	-6.2	1.4	2.0
Exports	785.2	9.0	2.2	2.4	-10.2	3.0	3.9
of which manufactures	329.9	4.7	3.1	1.3	-13.7	4.0	4.5
Total demand	2,388.9	6.5	2.0	0.5	-7.7	2.0	2.6
Imports	726.5	13.4	2.6	3.3	-13.2	3.2	4.4
of which goods	459.9	11.5	1.8	0.7	-15.0	3.0	4.0
Gross domestic product	1,662.4	3.4	1.7	-0.9	-4.7	1.4	1.8
Gross value added	1,426.6	3.2	1.8	-0.5	-4.0	1.3	1.8
of which in private non-agricultural sector	908.9	4.7	2.8	-1.0	-6.8	2.2	2.8
GDP per capita (DKK 1,000)	301.0	3.0	1.2	-1.5	-5.2	1.1	1.5

Announced foreclosures have been rising since the beginning of 2007, but the level is still low by historical standards and in recent months the increase has levelled off.

Residential investments are expected to fall by 8¼ per cent in 2010 in continuation of the double-digit drops in the two previous years, *cf. figure 1.9b*. The stabilisation in the housing market and low interest rates are expected to lead to moderate growth in residential investments by 1½ per cent in 2011.

In 2007, residential investments reached a historical high level of almost 7 per cent of GDP. Despite dropping significantly in recent years, the level of residential investment as a share of GDP is not lower than in years up to 2003, *cf. figure 1.10a*. The level of housing repairs is at a higher level now than back then, while the construction of new houses, which is particularly sensitive to cyclical conditions and house prices, is at a lower level.

Figure 1.9a
Price of single family houses

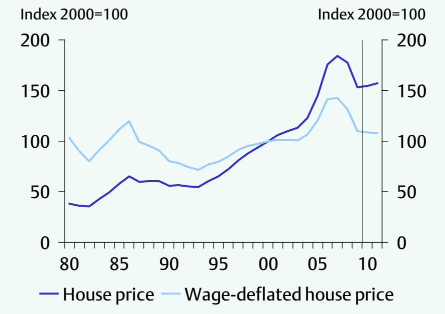
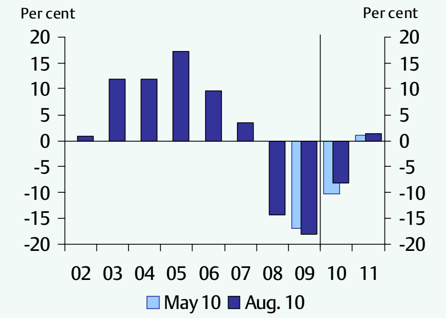


Figure 1.9b
Residential investments (real growth)



Fixed business investments are expected to contract by 8¼ per cent in 2010 after falling by 14 per cent in 2009, *cf. figure 1.10b*. The slowdown of the adjustment in investments is to be seen in light of a turnaround in production. In this vein, and due to continued low interest rates and a gradual normalisation of financial markets, business investments are expected to grow by just over 5 per cent in 2011. The estimated fall in business investments in 2010 has been revised from -3 per cent in the May Survey, primarily in light of the national account data for the 1st quarter.

Figure 1.10a
Residential investments and total investments in construction

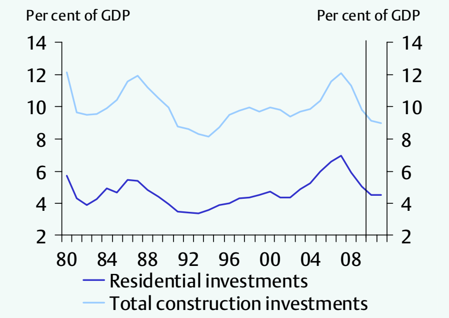
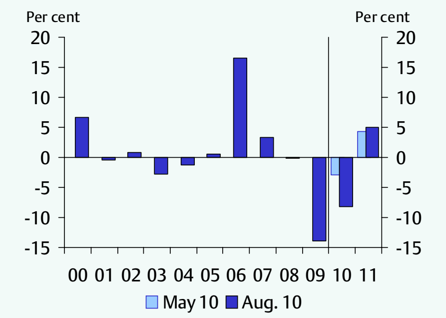


Figure 1.10b
Fixed business investments (real growth)



The reduction of inventories declined sharply in the second half of 2009, and growth contributions from the inventory cycle are expected to be quite significant in the short term. Inventories are expected to contribute to GDP growth by 1 per cent in 2010, following a very large negative contribution in 2009 of 2 per cent. In 2011, when stock building is expected to turn positive, the contribution to GDP growth is expected to decline to almost ½ per cent. The change in inventories, however, partly reflects changes in import inventories. Taking this into account, the actual contribution to GDP growth is somewhat less.

Public consumption expenditures are estimated to be constant (in real terms), down by ¾ percentage point compared to the May survey. This is due to a higher level than expected in 2009 – where real growth is now recorded at 3½ per cent, compared to an estimated 2½ per cent in the version of the National Accounts that was available in May. The estimated level of public consumption expenditures in current prices in 2010 is kept unchanged compared to the May survey.

In 2011, public consumption is expected to grow by just over ½ per cent due to the agreements made on the economy in municipalities and regions, as well as the proposed budget, including the *Fiscal Consolidation Agreement*. Public consumption in 2011 has been revised upwards by ½ percentage point compared to the May survey, and is financed inter alia by savings in public transfers by way of the Fiscal Consolidation Agreement.

Public investments are estimated to grow in real terms by 25 per cent in 2010 following an expansion of 12½ per cent in 2009. This reflects the growth supportive measures, which include strengthened maintenance of national roads, moving forward of maintainance of hospitals, and energy efficiency measures in national buildings.

In 2011, growth in public investments is technically -13½ per cent following the high planned level in 2010. Despite the assumed drop in 2011, the level of public investments will still be 22 per cent higher than in 2008.

The projections above imply that *total domestic demand* will grow by 1½ per cent in 2010 and 2 per cent in 2011, after falling by 6¼ per cent in 2009.

Foreign trade and the current external account

Global GDP growth is now expected at around 4½ per cent in 2010 and 4¼ per cent in 2011, which is ½ and ¼ percentage point higher than in the May survey.

In 2010 and 2011, high growth rates are expected especially in China and other Asian economies (except Japan). In Denmark's major export markets – such as the euro area and the rest of the EU – GDP is expected to grow by 1¼ per cent in 2010 and by 1¾ per cent in 2011 after a drop by more than 4 per cent in 2009.

Market growth for Danish manufactures is expected at around 5¼ per cent in 2010, rising to 5¾ per cent in 2011, after a drop of 10¾ per cent in 2009, *cf. table 1.5*. Export market growth has thus been revised upwards by 1½ percentage point compared to the May survey. This is to some extent due to the upward revision of GDP growth in Sweden in 2010 from 1¾ per cent in May to 3½ per cent.

Wage competitiveness – measured by the difference in wage growth in Denmark and in Danish export markets adjusted for exchange rate developments – is expected to improve considerably in 2010 due to the lower effective exchange rate, and then to stay almost unchanged in 2011 following a significant weakening in previous years. Wage growth is still expected to be slightly higher than abroad.

In light of developments in export markets and wage competitiveness, manufacturing exports are expected to rise by 4 per cent in 2010 and 4½ per cent in 2011, after an almost 14 per cent drop in 2009. The estimates imply a further loss of export market shares in both years, following a quite large loss of market shares in 2009. The estimated growth in manufacturing exports in 2010 has been revised upwards by 2 percentage units compared to the May survey.

Services and agricultural exports are also expected to grow in 2010 and 2011 after falling in 2009. Energy exports are estimated to fall by around 5-10 per cent in both years, as in 2008-09, reflecting lower energy production in the North Sea.

Total exports of goods and services are thus estimated to grow by 3 per cent in 2010 and 4 per cent in 2011 after falling by just over 10 per cent in 2009, *cf. figure 1.11a*. Compared to the May survey, estimated export growth in 2010 has been revised upwards by 1½ percentage point.

Figure1.11a
Exports of goods and services

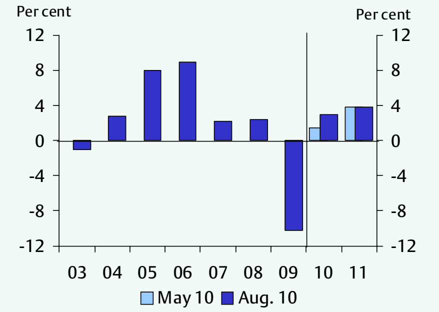
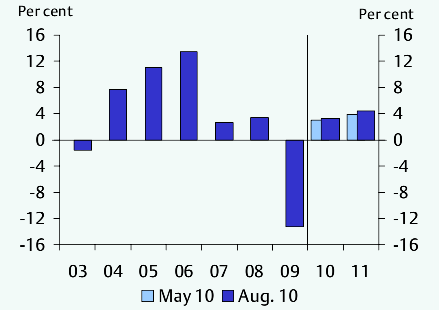


Figure1.11b
Imports of goods and services



Together with the estimates for domestic demand, the estimated export growth implies that *total* demand will grow by 2 per cent in 2010 and 2½ per cent in 2011, after falling 7¾ per cent in 2009.

The turnaround in demand is expected to imply that *imports* will grow by 3¼ per cent in 2010 and by 4½ per cent in 2011, after falling by just over 13 per cent in 2009, *cf. figure 1.11b*.

Terms of trade (goods and services) is expected to improve by ½ pct. in 2010 after a similar deterioration in 2009. In 2011, terms of trade are expected to be unchanged.

The current account surplus is expected at around DKK 62 bn (3½ per cent of GDP) in both 2010 and 2011, *cf. figure 1.12a*, following a surplus of close to DKK 66 bn in 2009. The estimates for 2010 and 2011 have been revised up by just over DKK 15 bn compared to the May survey due to higher export growth and improved terms of trade.

Figure1.12a
Current account

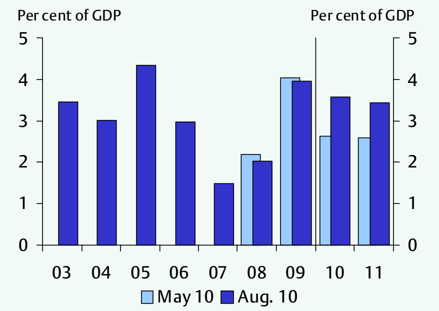
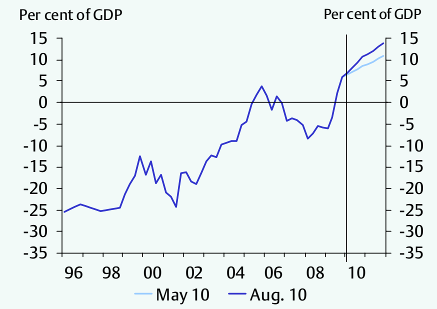


Figure1.12b
Denmark's net foreign assets



Due to the continued current account surplus, net foreign assets are expected to increase to DKK 245 bn (almost 14 per cent of GDP) by the end of 2011, compared to DKK 100 bn by the end of 2009, *cf. figure 1.12b*. The estimate is uncertain since revaluations can have a significant impact on the net debt numbers.

Labour market

Private employment fell by 110,000 persons (5¼ per cent of the labour force) in 2009 compared to 2008.[5]

The turnaround in production is eventually expected to bring the fall in employment to a halt. Due to the rather steep fall during 2009, private employment is expected to fall by 86,000 persons in 2010 compared to 2009. That is 8,000 more than estimated in the May survey. Since production has been growing since the 2nd quarter of 2009, this implies a quite strong recovery in *productivity* in 2010.

Private employment is expected to grow moderately in 2011, and the annual average is projected to be 1,000 persons higher than in 2010. Productivity growth is expected to be a bit higher than normal.

Public employment rose by around 17,000 persons in 2009.[6] Following the cyclical downturn it has become easier to recruit, and fewer public employees apply for vacancies in the private sector. In 2010 and 2011, public employment is assumed to rise by a couple of thousand persons each year, in line with the muted rise in public consumption.

Total employment is expected to fall by 84,000 persons in 2010 (around 3 per cent of the labour force) and a small increase of 2,000 persons is projected in 2011, *cf. figure 1.13a*.

The *labour force* fell by 46,000 persons or 1½ per cent in 2009. For 2010 as a whole, the labour force is estimated to fall by another 60,000 persons. This is 20,000 more than estimated in May.

The drop in the labour force in 2009-2010 amounts to a bit more than half of the fall in employment, which is a higher number than in earlier downturns. The significant fall in the labour force mainly reflects fewer foreign workers and commuters as well as increased influx into education among young people. Structurally, the labour force is reduced due to the demographic transition.

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[5] All numbers for employment and labour force are excluding persons on leave.
[6] The relatively large rise in public employment excluding leave in 2009 is to be seen in light of public sector strikes in the 2nd quarter of 2008 that led to lower estimates (by just over 5,000 persons) for public employment in the national accounts for 2008 as a whole.

Figure1.13a
Employment (annual change)

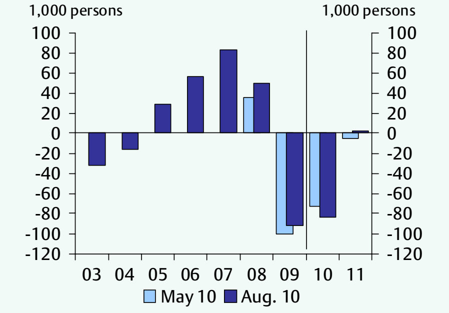
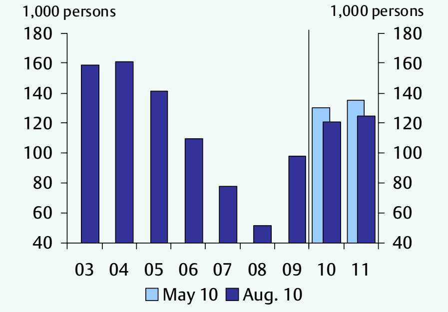


Figure1.13b
Unemployment



As for employment, the fall in the labour force is expected to come to an end during 2010, and in 2011 the improved cyclical condition is expected to lead to a rise in the labour force by 6,000 persons.

These estimates for employment and labour force (and the number of people in activation schemes) imply a rise in (registered) unemployment from 98,000 persons in 2009 to 121,000 persons in 2010 (4¼ per cent of the labour force), *cf. figure 1.13b*. Compared to the May survey the estimate for 2010 has been revised downwards by 9,000 persons. In 2011, a small rise in average unemployment to 125,000 persons (4.4 per cent of the labour force) is expected. Including people in activation schemes, gross unemployment is expected at 171,000 persons in 2010 (6.0 per cent of the labour force) and 177,000 persons in 2011 (6.2 per cent of the labour force).

Unemployment (registered) reached the estimated structural unemployment level in the autumn of 2009. Going forward, unemployment is set to stay above the structural level by the end of 2011, but closer to the structural level than estimated in May.

Wages and prices

In light of the new collective agreements and the available wage statistics *hourly wages* in the *private* sector are expected to increase by 2.2 per cent in 2010, compared to 3 per cent in 2009 and 4.6 per cent in 2008, *cf. figure 1.14a*[7]. In 2011 wage growth is expected to increase slightly to 2.4 per cent.

Compared to the May survey the estimated wage growth has been revised upward by 0.2 percentage points in 2010 and 0.3 percentage points in 2011. This reflects primarily the downward adjustment of unemployment, and higher capacity utilization in manufacturing than previously expected.

[7] Hourly wages excluding inconvenience premium according to StrukturStatistik from the Confederation of Danish Employers (DA).

The estimates imply that wage growth is still higher than in Danish export markets. The fall in the effective exchange rate, to some extent due to the rise in US dollars, leads to improved competitiveness, following a sizeable deterioration in previous years.

Figure 1.14a
Hourly wage growth

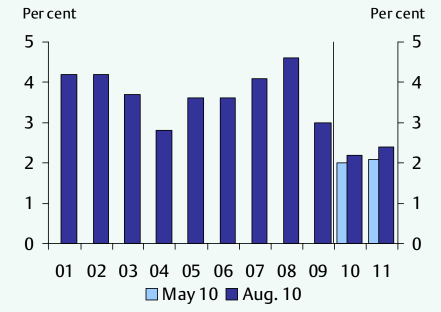
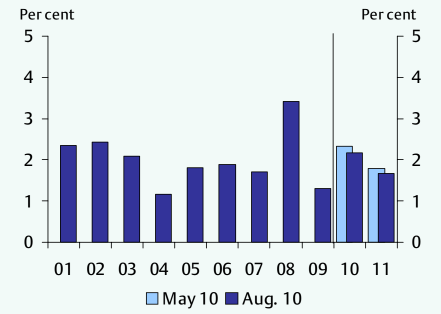


Figure 1.14b
Inflation



Public sector wage growth is expected at 3 per cent in 2010 in light of the collective agreements, following a wage increase of 5 per cent in 2009. In 2011 when collective agreements are to be renegotiated, wages have technically been assumed to rise by ½ per cent. This reflects the moderate wage growth in the private sector, which affect public sector wages with a certain lag through the so-called regulation-mechanism in public sector wage agreements.

C*onsumer price inflation* is estimated at 2.2 per cent in 2010, after 1.3 per cent in 2009, *cf. figure 1.14b*. Inflation has increased mainly due to higher energy prices and an increase in indirect taxes as part of the 2010 tax reform. In 2011 consumer prices are expected to rise by 1.7 per cent, partly due to lower contributions from indirect taxes and energy. Since June 2008, inflation has been higher in Denmark than in the euro area.

Compared to the May survey, the estimated inflation for both 2010 and 2011 has been revised downwards by 0.1 percentage point, primarily due a smaller rise in oil prices than expected.

Table 1.7

Key figures for the Danish economy

	2006	2007	2008	2009	2010	2011
Percentage change from previous year						
Real GDP	3.4	1.7	-0.9	-4.7	1.4	1.8
Trade-weighted GDP abroad	3.2	2.8	1.3	-0.4	1.8	2.1
Export markets, Danish manufactures	8.9	8.3	1.6	-10.7	5.3	5.8
International competitiveness	-1.4	-3.5	-3.7	-3.8	2.9	0.1
Export of manufactures, volume	4.7	3.1	1.3	-13.7	4.0	4.5
Hourly wages	3.6	4.1	4.6	3.0	2.2	2.4
Consumer price index	1.9	1.7	3.4	1.3	2.2	1.7
Price index for single-family houses	21.6	4.9	-3.7	-13.8	0.8	2.0
Merchandise export prices	4.4	1.9	6.9	-6.2	3.7	2.2
Merchandise import prices	3.5	2.8	6.5	-9.2	3.4	2.4
Merchandise terms of trade	0.8	-0.9	0.4	3.2	0.3	-0.2
Productivity, priv. non-agricult. sector	1.9	0.0	-3.3	-0.8	5.9	2.7
Real disposable income of households[1)]	3.0	0.0	0.1	0.9	5.9	2.5
Labour market						
Labour force (thousands)	2,893	2,944	2,968	2,921	2,861	2,867
Employment (thousands)	2,783	2,866	2,916	2,823	2,740	2,742
Of which in private sector	1,958	2,043	2,103	1,993	1,907	1,908
in public sector	826	823	813	830	833	834
Percentage change in total empl.	2.1	3.0	1.7	-3.2	-3.0	0.1
Unemployment (thousands)	109	78	52	98	121	125
Unemployment rate (per cent)	3.8	2.7	1.7	3.4	4.2	4.4
Unemployment rate. EU-def. (per cent)	3.9	3.8	3.3	6.0	7.2	7.2
Long term bond yields and exchange rate						
10-year government bonds	3.8	4.3	4.3	3.6	3.2	3.6
30-year mortgage credit bond	5.1	5.4	6.1	5.5	4.7	5.3
The effective krone rate (1980=100)	101.6	103.2	105.8	107.8	103.9	103.2
Balance of payments						
Goods and services (DKK bn)	51.9	41.3	46.7	58.7	65.2	64.9
Current account (DKK bn)	48.6	25.0	35.2	65.9	62.0	61.4
Current account (per cent of GDP)	3.0	1.5	2.0	4.0	3.6	3.4
Net foreign assets. ultimo (DKK bn)	-3.1	-90.2	-98.9	99.8	184.1	245.8
Net foreign assets (per cent of GDP)	-0.2	-5.3	-5.7	6.0	10.7	13.8
Public finances						
Government net lending (DKK bn)	82.3	80.6	59.8	-47.0	-80.1	-78.7
Government net lending (per cent of GDP)	5.0	4.8	3.4	-2.8	-4.6	-4.4
General government gross debt, year-end, (DKK bn)	523.4	462.8	593.8	688.1	740.8	805.4
General government gross debt, year-end, (per cent of GDP)	32.1	27.4	34.2	41.4	42.9	45.1
Tax burden (per cent of GDP)	49.8	49.1	48.3	48.2	47.5	46.5
Expenditures (per cent of GDP)	50.6	50.0	50.9	57.4	57.7	56.5

1) Incl. the SP-disbursement, incomes grew by 4.6 per cent in 2009.