

Economic Survey August 2004

English summary

1. Short term outlook

The economic expansion appears to broadly follow the track laid out in the *May 2004 Economic Survey* and the projections for GDP growth in 2004 and 2005 remain unchanged, *cf. figure 1.1a*. Private consumption and investment have risen quite strongly and annualized GDP growth has exceeded trend growth since mid-2003 (with trend growth estimated at just below 2 per cent). Employment is rising and the upward trend in unemployment appears to have been reversed, *cf. figure 1.1b*. The stimulus package introduced in March 2004 – the so-called Spring Package – is not yet fully reflected in the available statistics but the package appears to have boosted consumer and business confidence¹.

Figure 1.1a. GDP-growth

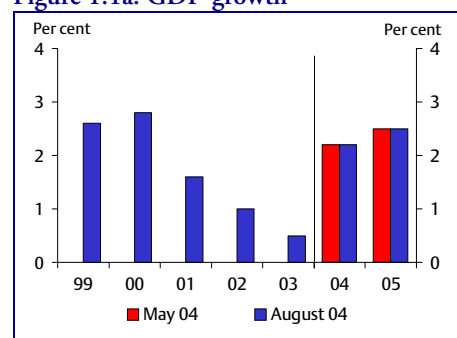
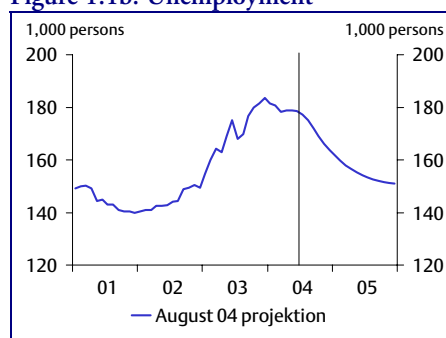


Figure 1.1b. Unemployment



Source: Statistics Denmark and own calculations.

Forward-looking indicators suggest that the rebound in activity may strengthen in the remainder of 2004 and continue in 2005. The

¹ The Spring Package brought forward to 2004 income tax cuts planned for 2005-07, suspended contributions to the Special Pension savings scheme (SP) of 1 percent of earnings for 2004 and 2005, moved forward public or publicly-supported investment projects, and stepped up active labour market measures, *see Economic Survey, May 2004*.

expansion is supported by low interest rates, strong growth in household disposable income owing in part to lower income taxes, and stronger foreign demand. Following growth of 0.5 per cent in 2003, activity is projected to expand by 2.2 per cent in 2004 and 2.5 per cent in 2005, *cf. table 1.1.*

While foreign demand is picking up, the key driver of the expansion is domestic demand. On net, external trade is expected to subtract from growth in 2004. High private sector savings and a substantial current account surplus provide substantial leeway for higher private spending.

The upswing in domestic demand is supported by fiscal stimulus. Fiscal measures, including the Spring Package, are estimated to boost activity by some 0.5 per cent of GDP in 2004. In addition, initiatives to promote housing investment and the temporary suspension of contributions to the Special Pensions savings scheme (technically not fiscal policy, since SP is actuarially fair and hence not part of public finances) each contribute an estimated 0.1 percentage point to activity growth in 2004.

Table 1.1. Key forecast variables compared to the May projection

	2003		2004		2005	
	May	Aug.	May	Aug.	May	Aug.
USA, GDP growth	3.1	3.0	4.2	4.3	3.2	3.3
Euro area, GDP growth	0.4	0.5	1.7	1.9	2.3	2.4
Trading partners, GDP growth	1.3	1.3	2.7	2.8	2.8	2.9
<i>Denmark:</i>						
GDP growth	0.4	0.5	2.2	2.2	2.5	2.5
Consumer prices	2.1	2.1	1.5	1.4	1.6	1.8
Hourly earnings, private sector	3.8	3.7	3.5	3.5	3.8	3.8
Unemployment rate	5.9	5.9	5.9	6.0	5.3	5.3

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.

Since May, the prices of oil and other raw materials have increased markedly, mainly driven by buoyant global demand. The hike in oil prices is estimated to have only a minor dampening effect on economic activity, *cf. box 1.* The dampening impact should be seen against generally stronger global activity, including clearer signs of a pick-up in the euro area. The *real* oil price in Danish kroner (deflated by the CPI) remains relatively low in a historical perspective. The moderate estimated effects

of higher oil prices partly reflect less energy intensive production than in the past.

Box 1. The impact of higher oil prices

The recent hike in crude oil prices is to a large extent caused by higher demand for oil following rapid activity growth particularly in the USA and Asia. Higher growth abroad supports Danish exports but the accompanying increase in oil prices dampens the boost to activity. To the extent higher crude oil prices are caused by uncertainty about the supply of oil, the dampening effects on activity are more clear-cut.

Seen in isolation, the hike in oil prices since the May forecast is estimated to reduce growth by about 0.1 percentage point in both 2004 and 2005, *cf. table a*. Since Denmark is a net exporter of oil and the government receives substantial tax revenue from North Sea oil and gas activities, higher oil prices improve the current account and the general government budget balance by respectively 3 and 3½ bill. Dkr. in 2005. Higher oil prices add some 0.2 percentage points to CPI inflation in 2004. The model simulation presumes that monetary policy at home and abroad remains unaltered, since higher crude oil prices are taken to impact inflation only temporarily.

Table a. The effect on the Danish economy of increasing oil prices

	2004	2005
Central scenario:		
GDP-growth, percentage points.....	-0.1	-0.1
Inflation, percentage points	0.2	0.0
Employment, 1,000 persons	-2	-4½
Current account, bill. Dkr.	1½	3
General government budget balance, bill. Dkr.	2½	3½
Scenario with oil prices of approx. 42 dollars:		
GDP-growth, percentage points.....	-0.2	-0.3
Inflation, percentage points	0.3	0.2
General government budget balance, bill. Dkr.	3	7

Notes: Assumptions regarding the impact on the international economy are based on the OECD Interlink standard multipliers. In the central scenario the oil price is assumed to fall to 38 dollars by the end of 2004 and to 33 dollars by the end of 2005, which leads to an annual average of 36 dollars in 2004 and 35,5 dollars in 2005. In the scenario with an oil price of approx. 42 dollars as of August, the annual averages are 37,4 dollars in 2004 and 42 dollars in 2005.

Source: OECD and own calculations.

If the oil price remains at around 42 dollars pr. barrel (Brent crude) through the remainder of 2004 and in 2005, and if the higher price is caused by supply side factors rather than stronger global demand, the effects can be estimated at approx. ¼ percentage point lower GDP-growth in 2004 and 2005, compared to the May assumptions. Inflation increases by roughly ¼ percentage point in each year while the general government balance improves by some 7 bill. Dkr. in 2005.

The pick-up in growth has been followed by rising employment in early 2004. Consequently, unemployment has started falling and the decline is expected to continue throughout 2004 and 2005. The timing and strength of the decline in unemployment depend, among other things, on prospective productivity growth, which is subject to considerable uncertainty. Towards the latter part of 2005 unemployment could fall to a level close to and perhaps slightly below the estimated structural level of unemployment, consistent with a stable evolution of wages and prices.

Domestic demand

Growth in household real disposable income (net of housing expenditures and other factors) is set to increase from 2.9 per cent in 2003 to 4.4 per cent in 2004. Income growth in 2004 is boosted by the reductions in income taxation and the suspension of SP-contributions. Disposable income growth is expected to moderate in 2005.

Figure 1.2a. Growth contributions

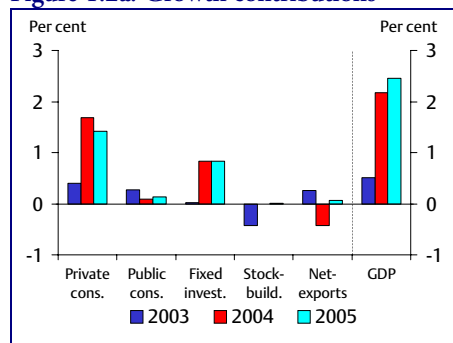
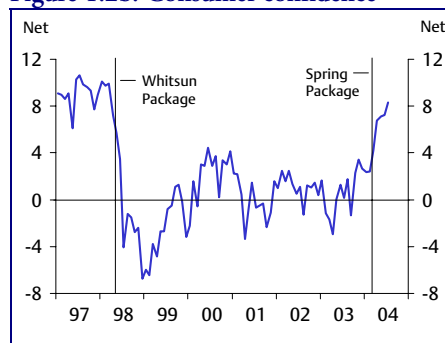


Figure 1.2b. Consumer confidence



Note: The so-called Whitsun Package was introduced in 1998 in order to curb growth in domestic demand and facilitate a soft landing in the Danish economy.

Source: Statistics Denmark and own calculations.

Following five years of subdued growth, private consumption growth is expected to accelerate from 0.8 per cent in 2003 to 3.6 per cent in 2004 and 3.0 per cent in 2005, *cf. table 1.2*. Compared to the May survey the growth rate in private consumption is unchanged in both years.

Car sales, which have declined considerably over the last five years and fell by 14 per cent in 2003, are set to increase by 20 per cent in 2004 and 8 per cent in 2005.

The fairly strong growth in private consumption is supported by the income tax cuts, healthy private savings, low interest rates, rising house prices and new flexible borrowing opportunities for house owners. In spite of higher borrowing, the overall financial position of households appears quite healthy and total private savings are at comparatively high levels 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 0.3 per cent in 2004 against a May estimate of 0.7 percent. The downward revision incorporates, among other things, an upward adjustment of real consumption growth in 2003 from 0.5 to 1.0 percent, *cf. section 2*. In 2005, real public consumption is set to increase by 0.5 per cent in line with medium term fiscal projections. Public investment is due to increase by 4.5 per cent in 2004 and 2 per cent in 2005 following declines in 2002 and 2003.

Residential investment is expected to rise by 3 per cent in 2004 on top of strong increases in both 2002 and 2003. Residential investment is spurred by low interest rates, strong house prices, and higher real disposable incomes. Government initiatives to front-load investments in municipal housing have contributed to investment growth in 2002 and 2003 and will also contribute to growth in 2004. Following high levels of investment in 2003 and 2004, residential investment is expected to ease back by 2 per cent in 2005.

The price of owner-occupied single-family houses is expected to rise by 5 per cent in 2004. In addition to low interest rates, the increase in 2004 is partly related to the introduction of new flexible mortgage loans where repayments on the principal can be postponed for up to 10 years. In 2005 growth in property prices is expected to ease to 2½ per cent, which partly reflects an assumed increase in interest rates.

Business investment fell by 1.1 per cent in 2003, largely reflecting a decline up until the first half of the year as businesses held back capital spending in light of the general downturn in the economy. In the second half of 2003, business investment rebounded strongly, and fairly strong growth in business investment is expected to continue in 2004 and 2005.

Following a decline in inventory investment of 0.4 per cent of GDP in 2003, the contribution to GDP-growth from inventories is presumed to be zero in 2004 and 2005.

International trade and the current account

Exports of goods and services exhibited zero growth in 2003. However, exports have started to pick up again in early 2004. Export growth is projected at 3.1 per cent in 2004 and 5.1 per cent in 2005. The pick-up in 2004 is a little stronger than the 2.8 per cent expected in the May Survey. The projected acceleration in exports is primarily due to faster market growth. Danish exporters are expected to lose market shares in 2004 and to a lesser extent in 2005, in part reflecting recent years' appreciation of the effective exchange rate. In addition, somewhat higher wage increases in Denmark than among trading partners are only partially offset by productivity developments.

Imports fell by 0.6 per cent in 2003. Reflecting the projected increase in primarily domestic demand, import growth is expected to reach 4.3 per cent in 2004 and 5.4 per cent in 2005. This is unchanged compared to the May forecast. In 2003 net exports contributed 0.3 percentage points to GDP growth. In 2004 net exports are set to contribute negatively to GDP growth, by -0.4 percentage points, increasing to 0.1 percentage point in 2005.

The trade balance (goods and services) is expected to equal 6.5 per cent of GDP in both 2004 and 2005, unchanged compared to 2003. Combined with falling net transfers abroad this allows for an increase in the current account surplus from 2.8 per cent of GDP in 2003 to 3.1 and 3.3 per cent of GDP in 2004 and 2005, respectively. Net foreign liabilities are projected to decline from 15½ per cent of GDP by the end of 2003 to 6½ per cent of GDP by the end of 2005.

Employment, unemployment and labour force

Employment, which decreased by 21,000 persons in 2003, is expected to increase by 11,000 persons in 2004 and 21,000 persons in 2005. This corresponds to an increase of 0.4 per cent in 2004 and 0.8 per cent in 2005.

The latest National Account data indicate that employment bottomed out in the latter part of 2003 and increased by 9,000 persons in the first quarter of 2004.² Various other employment statistics broadly confirm the impression that the decline in employment came to a halt in the latter part of 2003 and that employment is set to increase in 2004.

The growth in employment is driven by the private sector, where employment growth is expected to reach 9,000 persons in 2004 and accelerate to 19,000 persons in 2005, *cf. table 1.3*. This is essentially unchanged compared to the May projection. The gradual acceleration in employment growth partly reflects slightly stronger projected production growth in 2005 than in 2004, as well as a lag before production growth feeds into employment. The latest data indicate that production in the

² The employment statistics in the National Accounts are currently undergoing fairly significant changes, including the incorporation of new data sources, and the uncertainty surrounding the employment figures is thus greater than normal.

private sector increased fairly strongly in the 4th quarter of 2003 and 1st quarter of 2004.

Table 1.3. Employment, labour force, and unemployment

	2002 level	Avg. 1980-2002	2003		2004		2005	
			May	Aug.	May	Aug.	May	Aug.
			----- Change, 1,000 persons -----					
Private sector	1,907	2	-21	-22	8	9	19	19
Public sector	834	7	-2	2	3	2	3	3
Total employment	2,741	9	-23	-21	11	12	22	21
Labour force	2,886	7	3	5	11	16	3	1
Unemployment	145	-2	26	26	0	4	-19	-20

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.

Business confidence indicators support the expectation of increasing employment. Business confidence indicators for both industry and the service sector have been improving fairly consistently over the last months, and the indicators for employment expectations have strengthened, *cf. figure 1.3b*.

Figure 1.3a. Employment

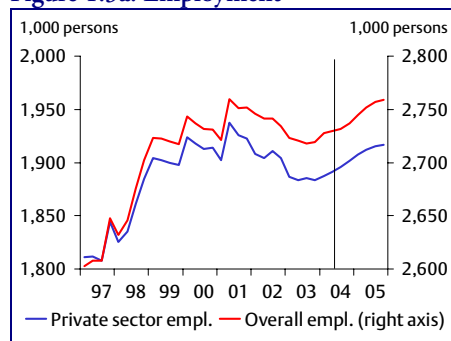
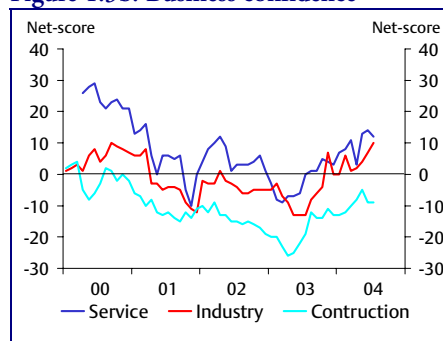


Figure 1.3b. Business confidence



Source: Statistics Denmark and own calculations.

The labour force is expected to grow by 16,000 persons or 0.5 per cent in 2004 following an increase of 5,000 persons or 0.2 per cent in 2003. According to the latest data the labour force grew strongly – by 18,000 persons combined – in the 4th quarter of 2003 and 1st quarter of 2004, which largely accounts for the projected increase in labour supply in

2004. Hence, in the remainder of 2004 and in 2005 the labour force is expected to remain broadly stable.

The estimated growth in the labour force in 2004 has been revised upward by about 0.2 per cent compared to the May projection.

The labour force is thus expected to grow despite demographic developments, which tend to reduce the labour force. This may reflect labour market reforms that have aimed, among other things, to increase participation rates 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 improve.

Registered unemployment, which stood at 6.6 per cent of the labour force in December 2003³, has decreased by 0.2 percentage point to 6.4 per cent in June 2004, corresponding to a decline of 5,000 persons. The decline in unemployment is expected to continue in the remainder of 2004 and throughout 2005, *cf. table 1.3 and figure 1.4.*

Figure 1.4a. Unemployment

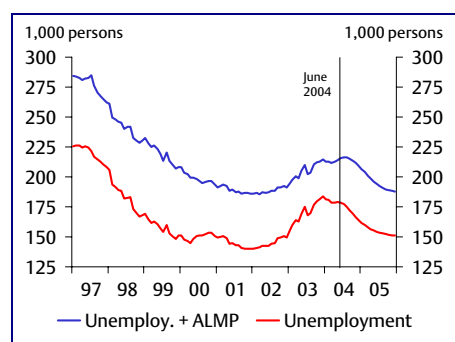
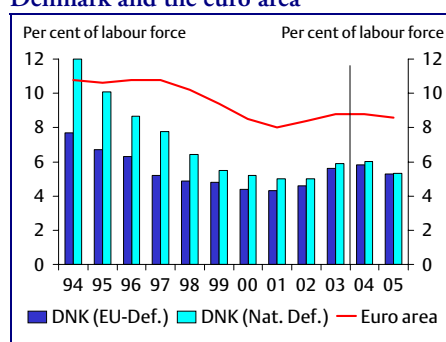


Figure 1.4b. Unemployment rates in Denmark and the euro area



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

Initially the decline in unemployment can mostly be attributed to more people participating in active labour market policy (ALMP) schemes,

³ 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.

however for the most part the decline throughout 2004 and 2005 is due to increased employment.

In terms of annual averages, unemployment has been revised up by 3-4,000 persons in 2004 and 2005. The upward revision corresponds to roughly 0.1 per cent of the labour force and reflects a less rapid decline in unemployment since the beginning of the year than expected in the May projection. The upward revision must be seen in view of an essentially unchanged estimate for employment growth.

Seen over the course of the business cycle the number of people either unemployed or enrolled in ALMP schemes taken together may give a more appropriate picture of the business cycle induced changes in unemployment than the changes in registered unemployment alone – since an unemployed person who joins an ALMP scheme is not included in registered unemployment. Through 2002 and 2003 the number of people either unemployed or in ALMP schemes increased by 29,000, corresponding to about 1 per cent of the labour force, whilst unemployment increased by 44,000 persons.

The number of people enrolled in ALMP schemes has increased since the beginning of 2004 and a further increase is expected in the remainder of the year, bringing the number of people in ALMP schemes back to almost the same level as in 2001. The number of persons either unemployed or in ALMP schemes is expected to decline noticeably during 2004 and 2005, albeit not quite as much as registered unemployment.

Wage- and price inflation

Growth in hourly wages has subsided from 4.2 percent in 2002 to 3.7 per cent in 2003 and is expected to ease to 3.5 per cent in 2004. In 2005 growth in hourly wages is expected to pick up slightly to 3.8 per cent, which reflects the profile of recent wage settlements as well as increasing pressures in the labour market during 2005. The projection is unchanged compared to the May forecast.

Despite the decline in wage growth in 2003 and 2004 hourly compensation of employees will continue to grow faster than in most other EU-countries. Productivity is projected to grow faster as well, but

not to the same extent. In addition, cost competitiveness has been eroded by the appreciation of the Danish krone, principally induced by the weakening of the dollar vis-à-vis the euro since 2001.

Figure 1.5b. Wage increases in Denmark and abroad

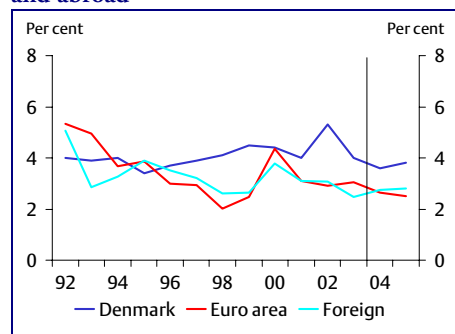
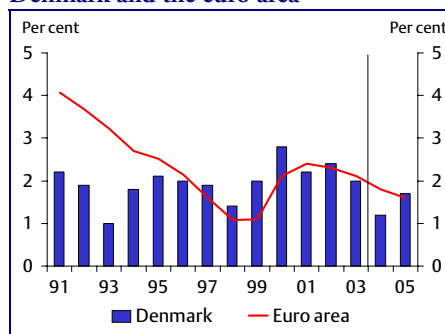


Figure 1.5b. Inflation (HICP) in Denmark and the euro area



Note: The foreign wage increases 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.

Inflation as measured by the harmonised consumer price index (HICP) is estimated to decline from 2.0 per cent in 2003 to 1.2 per cent in 2004 and then accelerate to 1.7 per cent in 2005. The Tax Freeze contributes to a slightly lower rate of inflation during the forecast period since excise duties specified in DKK are frozen in nominal terms. Also, the reduction of exercise duties on soft drinks, cigarettes and alcohol lowers the rate of inflation by almost 0.2 percentage points in 2004.

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

The international environment

Activity has been growing at a robust pace in the US and Asia, and there are now clearer signs of a recovery also in the euro area. The global expansion is supported by generally supportive monetary policies and, in some countries, lax fiscal policies. At least up until early summer, global activity has proven fairly resilient to rising oil prices and continued unrest notably in the Middle East. Business investment is expanding in most large economies, which points to a gradually more self-sustaining and broad-based global recovery.

Growth prospects for the US have been revised slightly upwards since May to 4.3 per cent in 2004, moderating to 3.3 per cent in 2005, cf. table 1.1. The U.S. expansion is broad-based with robust growth in consumption, investment and exports. Productivity growth remains strong at an annual 5.5 percent in the private non-farm business sector (first quarter of 2004). Low interest rates, rising profitability and improved competitiveness are key drivers of the recovery. Domestic demand has been propped up also by substantial fiscal easing since 2000. The structural fiscal balance has deteriorated by some 5 per cent of GDP from 2000 to 2004, much of which reflects discretionary tax reductions.

With the recovery seemingly on a firmer footing, the Federal Reserve has begun a gradual but moderate tightening of monetary policy, cf. figure 1.6b.

The unsustainably large fiscal and current account imbalances continue to point to medium-term adjustment needs in terms of public and private savings in the U.S. These adjustment needs may pose threats to the robustness of the upswing over the medium term, with potential spill-overs to the rest of the world through exchange rate or interest rate channels.

Figure 1.6a. GDP-growth in USA and the euro area

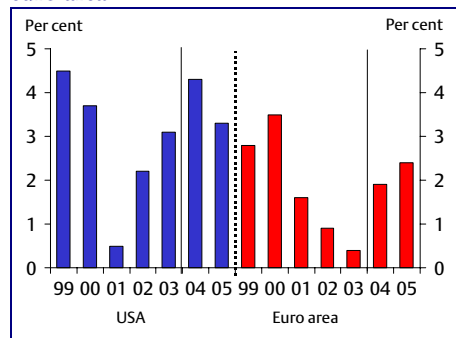
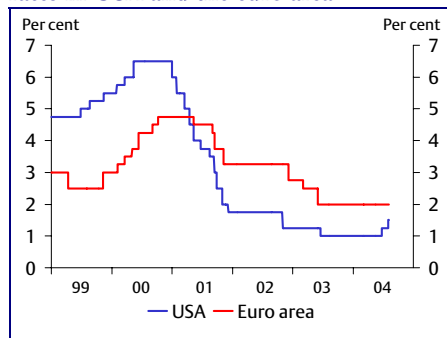


Figure 1.6b. Monetary policy interest rates in USA and the euro area



Source: Statistics Denmark and own calculations.

In the euro area, activity grew at or slightly above its trend rate in the first and second quarters of 2004. The pick-up in growth is mainly driven by higher exports, although private consumption also accelerated in the first

part of 2004 and investment has shown signs of recovering. The current low interest rates and external buoyancy should support a further acceleration in activity. Growth in the euro area is expected to pick up from 0.5 per cent in 2003 to 1.9 per cent in 2004 and 2.4 per cent in 2005. This forecast is a slight upward adjustment compared to the *Economic Survey* in May.

Headline inflation exceeds 2 percent, boosted by rising energy prices, but the medium-term outlook for inflation appears reasonably benign. In view of low wage increases, recent years' euro appreciation and the prospect of a relatively moderate upswing, monetary policy tightening is assumed not to take place before 2005.

With robust growth also in other economies, including the U.K., Japan and China, total export market growth for Danish industrial exports has been revised upwards by 0.2 percentage points to 7.1 percent in 2004 and remains unchanged at 7.7 percent in 2005.

Risks and uncertainties

Oil prices have risen sharply in August and are currently 10-20 percent above the 39 dollars pr. barrel (Brent) assumed for the remainder of 2004. The price increase partly reflects concerns about current or potential disruption of oil supplies. Sustained higher prices would likely have a moderate dampening effect on growth, cf. box 1. In July, OPEC raised the daily production quota by 2 million barrels, and futures prices are currently pointing towards oil prices in the vicinity of 35 dollars by end-2005 (the baseline assumes 35,5 dollars pr. barrel on average for 2005).

On the domestic front, an important uncertainty relates to the growth in private consumption, which in the light of behaviour during previous cyclical upswings could be substantially stronger than assumed. This upside potential also reflects the possibility that the income tax reductions in conjunction with low interest rates and new flexible borrowing opportunities could have more expansionary effects than assumed. On the other hand, rising interest rates could dampen demand more than expected, especially if it should become necessary for European central banks to raise policy rates more than assumed in order to forestall second-round wage effects of higher oil prices.

Table 1.4. Key figures of the Danish economy

	2000	2001	2002	2003	2004	2005
	----- Percentage changes from previous year -----					
Real GDP	2.8	1.6	1.0	0.5	2.2	2.5
Trade-weighted GDP abroad	3.7	1.3	1.5	1.3	2.8	2.9
Markets for Danish manufactures	13.1	0.1	1.4	4.1	7.1	7.7
International competitiveness	3.6	-2.2	-3.0	-4.9	-1.6	-0.9
Export of manufactures, volume	15.0	5.0	5.3	-2.1	4.0	5.2
Hourly wages	3.6	4.2	4.2	3.7	3.5	3.8
Consumer price index	2.9	2.4	2.4	2.1	1.4	1.8
Price index for single-family houses	6.5	5.9	3.7	3.3	5.0	2.5
Merchandise export prices	6.1	0.1	-1.2	0.2	0.6	0.3
Merchandise import prices	4.4	-1.2	-1.5	-1.8	-0.6	0.0
Merchandise terms of trade	1.7	1.3	0.3	2.1	1.2	0.3
Productivity in private non-agricultural sector	0.8	2.5	2.2	1.6	1.6	2.0
Real disposable income of households ¹⁾ ...	0.8	1.4	1.8	2.9	4.4	0.7
<i>Labour market:</i>						
Labour force (thousands)	2,886	2,891	2,886	2,891	2,907	2,908
Employment (thousands)	2,736	2,746	2,741	2,720	2,732	2,753
Of which in private sector	1,917	1,922	1,907	1,885	1,894	1,913
in public sector	819	824	834	836	838	840
Percentage change in total employment ...	0.5	0.4	-0.2	-0.8	0.4	0.8
Unemployment (thousands)	150	145	145	171	175	155
Early retirements (thousands)	156	159	169	179	188	177
Persons on leave (thousands)	26	22	17	5	3	3
Unemployment rate (per cent)	5.2	5.0	5.0	5.9	6.0	5.3
Unemployment rate, EU-def. (per cent) ..	4.4	4.3	4.6	5.6	5.7	5.1
<i>Long term bond yields, exchange rate:</i>						
10-year government bonds	5.7	5.1	5.1	4.3	4.5	5.1
30-year mortgage credit bond	7.4	6.7	6.3	5.4	5.5	5.9
The effective krone rate (1980=100)	95.6	96.8	97.7	101.2	102	101.9
<i>Balance of payments:</i>						
Goods and services (bill. Dkr.)	76.2	85.5	76.9	91.4	94.6	99.4
Current account (bill. Dkr.)	18.6	40.1	27.3	39.8	44.4	49.4
Current account in per cent of GDP	1.5	3.0	2.0	2.8	3.1	3.3
Net foreign debt, ult. (bill. Dkr.)	218	229	241	218	161.1	100.3
Net foreign debt in per cent of GDP	17	17.3	17.7	15.6	11.1	6.6
<i>Public finances:</i>						
Government net lending (bill. Dkr.) ²⁾	32.5	37.5	21.2	16.9	17.4	29.7
Government net lending in per cent of GDP ²⁾	2.5	2.8	1.6	1.2	1.2	2.0
General government gross debt, ult. (bill. Dkr.)	669	652.1	664.2	641.9	634.8	622.3
General government gross debt ult. in per cent of GDP	52.3	49.2	48.8	45.9	43.7	40.9
Tax burden (per cent of GDP) ²⁾	49.6	49.9	48.9	48.9	48.9	48.4
Expenditures (per cent of GDP)	53.9	54.2	54.6	54.9	54.4	53.0

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 1.5. A comparison, the present vs. the previous forecast

	2004		2005	
	May	Aug.	May	Aug.
Private consumption	3.6	3.6	3.0	3.0
Total government demand	1.2	0.6	0.6	0.6
of which government consumption	0.7	0.3	0.5	0.5
of which government investment	8.3	4.5	2.0	2.0
Residential construction	3.0	3.0	-2.0	-2.0
Fixed business investment	3.4	3.4	5.0	5.0
Domestic demand exc. stock building	2.9	2.7	2.5	2.5
Changes in stock building ¹⁾	0.0	0.0	0.0	0.0
Total domestic demand	2.9	2.7	2.5	2.5
Exports of goods and services	2.8	3.1	5.1	5.1
Of which manufactures	4.0	4.0	5.2	5.2
Total demand	2.9	2.8	3.4	3.4
Imports of goods and services	4.3	4.3	5.4	5.4
Of which goods ²⁾	5.6	5.5	5.4	5.4
Gross domestic product	2.2	2.2	2.5	2.5
GDP at factor costs	1.9	1.8	2.5	2.6
Of which in non-agricultural sector ³⁾	2.1	2.2	2.8	2.9
	--- Changes from previous year, 1,000 ---			
Labour force	11	16	3	1
Employment	11	11	21	21
of which in the private sector	8	9	19	19
of which in the public sector	3	2	3	3
Unemployment	0	4	-19	-20

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.

Source: Statistics Denmark and own calculations.

**Table 1.5. A comparison, the present vs. the previous forecast
(continued)**

	2004		2005	
	May	Aug.	May	Aug.
	---Percentage changes from previous year---			
Merchandise export prices	-0.4	0.6	-0.1	0.3
Merchandise import prices	-0.8	-0.6	0.6	0.0
Merchandise terms of trade	0.3	1.2	-0.7	0.3
Property prices, single-family houses	4.5	5.0	2.5	2.5
Consumer price index	1.5	1.4	1.7	1.8
Hourly earnings	3.5	3.5	3.8	3.8
Real disposable income, private sector.....	2.9	3.4	2.9	2.4
Real disposable income, households (ADAM)....	4.2	4.4	1.3	0.7
Productivity in non-agricultural sector.....	1.5	1.6	1.9	2.0
	----- Per cent-----			
Savings ratio in the private sector	29.2	29.5	29.1	29.1
10-year government bond	4.5	4.5	5.1	5.1
30-year government bond	5.4	5.5	5.9	5.9
	----- Bill, Dkr. -----			
Current account	42.1	44.4	44.8	49.4
Government net lending	18.1	17.4	26.1	29.7
Unemployment (thousands)	171	175	152	155
	----- Per cent-----			
GDP growth in OECD countries	2.7	2.8	2.8	2.9
International market growth	6.9	7.1	7.7	7.7
Dollar exchange rate (Dkr. per US dollar)	6.2	6.1	6.3	6.1
Price of oil (US-dollar per barrel)	31.1	36.0	28.9	35.5
Price of oil (Dkr. per barrel)	192.2	218.9	180.6	216.6

Source: Statistics Denmark and own calculations.

2. The fiscal stance and government finances

Fiscal policy is estimated to boost economic activity by around 0.5 per cent of GDP in 2004. In addition, the temporary suspension of SP-contributions and a series of government initiatives to stimulate housing investment each entail an estimated stimulus of 0.1 per cent of GDP in 2004.

The stance of policies in 2004 has been decided at a time of considerable slack in the economy. Subject to a margin of uncertainty, the output gap is estimated at about $-1\frac{1}{4}$ per cent of GDP in 2003, *cf. figure 2.1*. In the absence of fiscal policy stimulus and related measures, the estimated output gap would have been of a similar order of magnitude in 2004.

The proposal for the 2005 Fiscal Act and the local council agreements for 2005 entail a neutral fiscal stance in 2005. Overall, fiscal policy in 2005 is in line with the medium-term assumptions as outlined in the latest 2010-projections, *cf. Finansredøgørelse 2004*. The neutral fiscal stance is consistent with a level of unemployment, which could be close to and perhaps slightly below the estimated structural level in 2005.

Figure 2.1a. Outputgap

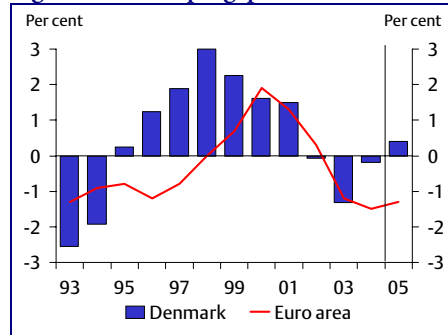
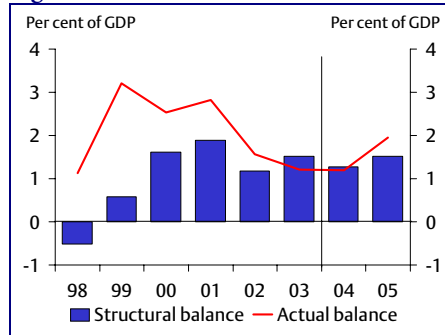


Figure 2.1b. Fiscal balance



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

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

The general government surplus is projected at 1.2 per cent of GDP in 2004 and 2.0 per cent of GDP in 2005. The improvement in 2005 primarily reflects the effects of improved cyclical conditions, i.e. rising activity and falling unemployment, on public finances. Higher revenues from the taxation of oil and gas activities also boost the surplus.

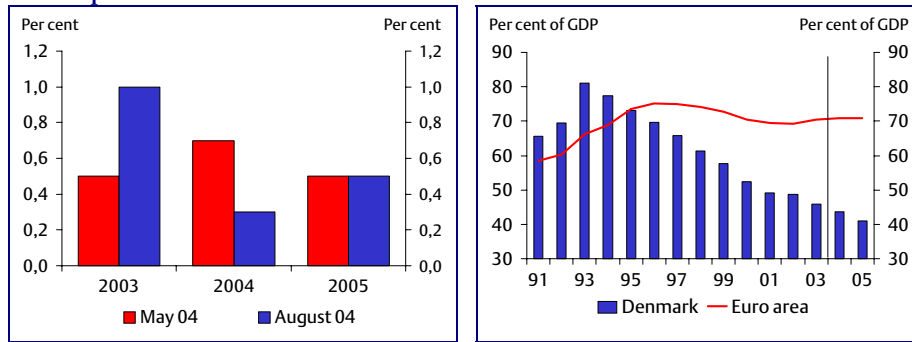
The Spring Package has a virtually neutral effect on the fiscal balance in 2004 and 2005 as the effect of moving forward already-planned tax reductions is counteracted by an increase in the tax base due to the suspension of SP-contributions. The package also has a virtually neutral impact on long-term fiscal sustainability since it essentially brings forward fiscal measures that had already been planned, and since the SP-suspension has broadly neutral implications for long-term fiscal sustainability.

The structural surplus is estimated at 1.2 per cent of GDP in 2004. With moderate growth in public consumption and lower interest payments the structural balance is expected to reach 1.5 per cent of GDP in 2005.

As a result of budget overruns in local governments, the growth in real public consumption in 2003 has been revised up from 0.5 per cent in the May forecast to 1 per cent, *cf. figure 2.2a*. In conjunction with an upward revision of nominal public consumption for 2004 – incorporating, among other things, a Supreme Court ruling on “flex-jobs” and changes to the price and wage assumptions for 2004 agreed in connection with the 2005 budget agreement between central and local governments – the growth rate in real public consumption in 2004 has been revised down from 0.7 per cent to 0.3 per cent.

Based on the proposed fiscal bill for the central government and the budget agreement with local councils, the growth rate in real public consumption is estimated to be 0.5 per cent in 2005 in line with medium term fiscal projections.

Figure 2.2a. Growth in public consumption **Figure 2.2b Gross public debt ratio in Denmark and the euro area.**

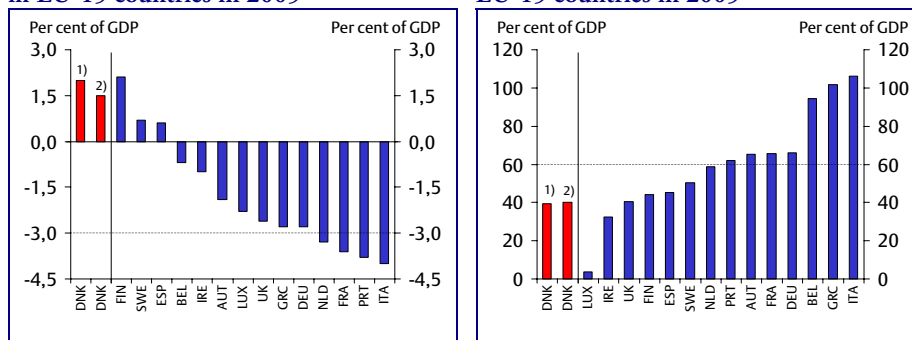


Source: Statistics Denmark, EU-Commission, and own calculations.

General government gross debt (EMU definition) is projected to decline from 45.9 per cent of GDP by the end of 2003 to 40.9 per cent of GDP by the end of 2005, *cf. figure 2.2b*.

According to the European Commission's latest forecasts, the Danish government surplus is projected to be the second largest among the EU countries in 2005, *cf. figure 2.3a*. In addition the government gross debt (EMU definition) is well below the 60 per cent of GDP bound of the Maastricht Treaty, *cf. figure 2.3b*.

Figure 2.3a. General government surplus in EU-15 countries in 2005 **Figure 2.3b. Gross public debt ratio in EU-15 countries in 2005**



- 1) Economic Survey, August 2004. National accounts definition.
- 2) EU commission, Economic Forecast, Spring 2004.

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

A cornerstone in the Danish medium term fiscal strategy is fiscal sustainability. Broadly speaking, fiscal sustainability implies that the current welfare systems and the expenditure policies planned through 2010 can be sustained subsequently without raising taxes, taking account of the longer-term fiscal implications of an ageing population⁴.

The estimated structural balance in 2004 and 2005 is close to the lower end of the medium-term target for an average surplus of 1½ - 2½ per cent of GDP through 2010. The structural surplus declined from 2003 to 2004, mainly reflecting the bringing-forward of income tax reductions for stabilization purposes. In the medium-term projections, the structural balance improves towards 2010 due to continued moderate growth in real public consumption, declining interest expenditures, and higher structural employment. The projections suggest that an average structural surplus of around 1.6 percent of GDP from 2003 to 2010 is required for fiscal policies to be sustainable. Hence, the required surplus in the latest 2010-projection is at the lower end of the target of 1½ - 2½ per cent of GDP. From the outset, the target has been specified as a range to take into account the uncertainties associated with the long-term sustainability calculations.

Fiscal policy is estimated to be sustainable given the stated targets and assumptions for employment, public services and taxes towards 2010. Two key targets are: (i) real public consumption growth of 0.5 percent per year from 2005 to 2010, and (ii) new measures that raise (structural) employment by about 2 per cent. The employment objective can be reached through a combination of, for instance, improved labour market attachment of immigrants, later average retirement age, and a faster flow through the education system.

An updated medium term projection as well as an in-depth discussion of the calculation of fiscal sustainability is available in *Finansredegørelse 2004*.

⁴ The sustainability of fiscal policy is based on specific policy targets and assumptions for employment, public-sector services and taxes through 2010. Stylised or “policy-neutral” assumptions are employed for the years following 2010.