Economic Survey – August 2013

1.1 The current economic outlook

Optimism and belief in progress is spreading both in Denmark and abroad, *cf. figure 1.1.* This points to higher demand in the times ahead, both from Danish consumers and businesses and from abroad. This strengthens the possibility of a turnaround in the Danish economy in the second half of 2013. The timing and strength of the turnaround will largely depend on developments abroad.

The Government's policy supports a turnaround in the Danish economy. The tax reform from 2012 and the HousingJobs Scheme expands the room in consumers' budgets – along with the low interest rates that are supported by the credibility of the economic policy. At the same time the agreements on *Growth Plan DK* and the investment window strengthen the possibilities of Danish businesses of transforming the international recovery into growth and employment in Denmark. Looking further into the future the long-term reforms ensure that future welfare can be financed without tax increases, and that a recovery is not held back by a tight and rigid labour market.

The expectation of a gradual improvement abroad is supported by the apparent stabilisation of the real economy in Europe in the wake of the many measures implemented to contain the sovereign debt crisis. In the 2nd quarter, GDP in the Euro Area rose for the first time since 2011, *cf. figure 1.2.* In other parts of the world economy the recovery is well under way.

Figure 1.1
Consumer confidence

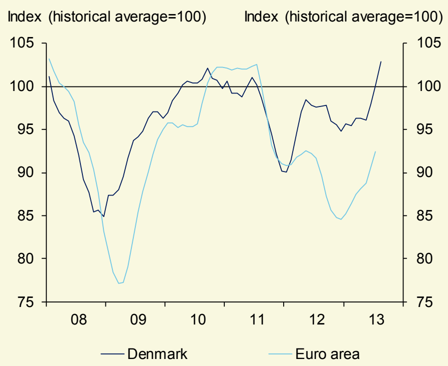
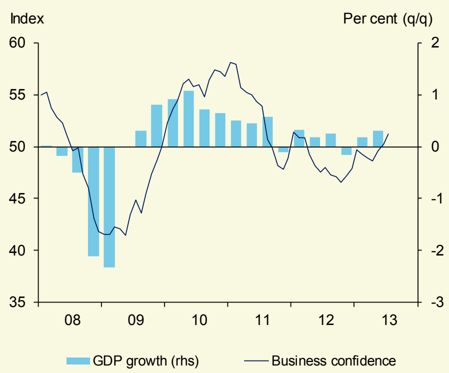


Figure 1.2
GDP and business confidence, euro area



Note: Figure 1.1 shows a 3-month moving average. In figure 1.2 the business confidence is measured by the PMI Index in manufacturing. A value higher than 50 indicates an improvement in activity.
Source: Reuters EcoWin, The EU Commission, Statistics Denmark, and own calculations.

Figure 1.3
GDP growth

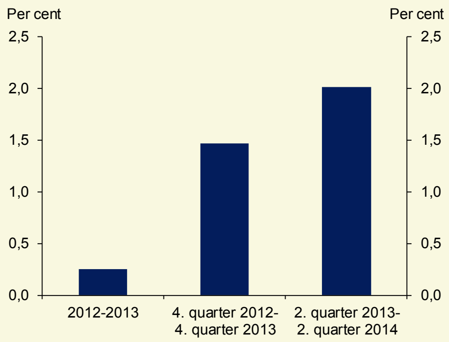
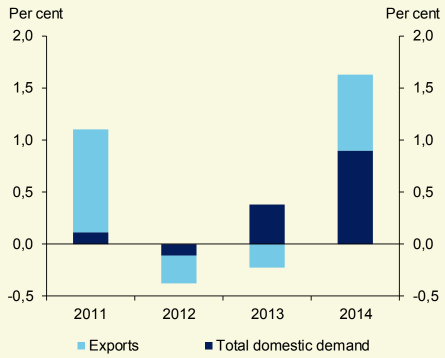


Figure 1.4
Drivers of GDP growth in Denmark



Note: The growth contributions in figure 1.4 are corrected for the import content of both exports and domestic demand.
Source: Statistics Denmark and own calculations.

In Denmark, GDP is estimated to grow 0.2 per cent this year and 1.6 per cent next year. The very modest growth rate for 2013 is a consequence of the significant drop in GDP at the end of last year and the continued sluggish – and weaker than expected in the May forecast – development in the first part of the year. However, the expectations of progress in the second half of the year remain unchanged, and in the fourth quarter GDP is expected to be around 1½ per cent higher than a year before, *cf. figure 1.3*.

This year domestic demand is the main driver of economic growth, *cf. figure 1.4*. This primarily reflects higher business investments. At the same time the basis for private consumption growth is strengthened. Inflation has fallen markedly this year, and disposable incomes increase as a result of tax cuts and lower interest rates. Greater optimism among consumers suggests that lack of confidence in the economic situation will not hold back private consumption. The improved sentiment is supported by, amongst other things, rising house prices and expectations of falling unemployment.

The recovery abroad implies that exports will gradually return as a key driver of the Danish economy. In 2014 exports are once again expected to provide a significant contribution to GDP growth. That will make the progress in the Danish economy more self-sustaining.

The expected growth in the Danish economy is estimated to be sufficient to ensure gradually rising employment and falling unemployment in the forecast period. The labour market has been characterised by stability since 2010 in spite of the weak business cycle. This should be seen in light of the fact that there has been room for manoeuvre in the economic policy to support the labour market.

The overall economic policy has been planned so as to support activity and employment as much as possible within the fiscal framework comprising the Budget Law, the EU-recommendation and the EU's fiscal compact. The fiscal policy should also be seen in conjunction with the extraordinarily accommodative monetary policy stance. Overall the fiscal policy and other measures are expected to support GDP by nearly ½ a percentage point in both 2013 and 2014. Based on the budget proposal for 2014 the structural public deficit is estimated at 0.4 per cent in 2014. Hence, the budget proposal for 2014 is close to the structural deficit limit according to the Budget Law of ½ per cent of GDP.

Compliance with the fiscal obligations supports the credibility of economic policy and thus the currently low interest rates at the benefit of households, businesses, and job creation. Regarding the repeal of Denmark's EU-recommendation, it is also an important consideration that the fiscal policy does not contribute to increased deficits in coming years. This should be seen in light of the risk that the actual public deficit may come close to the EU-limit of 3 per cent of GDP in 2015, as this year there will no longer be an extraordinary income from the restructuring of the taxation of existing capital pensions.

The planned level of of public expenditure for consumption and investments in 2014 is already high in a historical perspective and around ¾ per cent of GDP above the "neutral" level, both in a cyclical sence and in terms of long-term fiscal sustainability, *cf. section 1.3.*

Growth prospects are still subject to some uncertainty, although the risk profile has become more balanced. The international recovery – particularly in Europe – is still in its infancy, and sudden mood shifts and market reactions can slow down the progress. On the positive side monetary policy remains very accommodative and there has been a significant financial stabilisation in the southern European countries.

The forecast implies a relatively slow improvement in growth from the second half of this year compared with previous turnarounds. The increase may be larger, for example, if the improvement in growth abroad comes earlier and with more power, or if the appetite for consumption and investments in the domestic economy increases more strongly than expected after years of restraint.

1.2 The forecast

A recovery abroad is of great importance to the Danish economy. In the euro area there are signs that confidence among businesses and consumers is returning. Likewise, there has been a gradual stabilisation of the real economy in the first half of the year and a rebound is expected to gradually manifest itself in the second half of the year, *cf. figure 1.5.*

The recovery in Europe should chiefly be seen against a backdrop of the continued crisis response and the expansionary monetary policy stance, which has contributed to calming financial markets. A steady development in financial markets is a precondition for the return of confidence in economic prospects. It is therefore a positive sign that the indebted countries' interest rate spreads against Germany have been affected only to a limited extend by new periods of uncertainty about the reform progress in the individual countries. At the same time, the interest rate spreads have narrowed considerably and returned to the levels from before the sovereign debt crisis escalated, *cf. figure 1.6.*

Figure 1.5
Real GDP

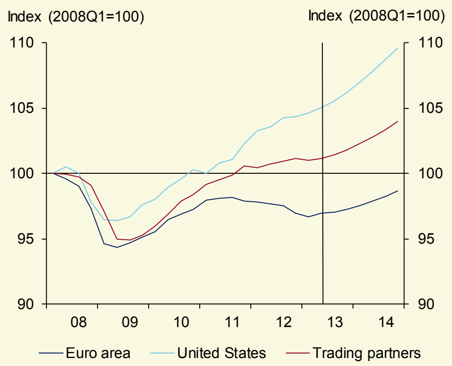
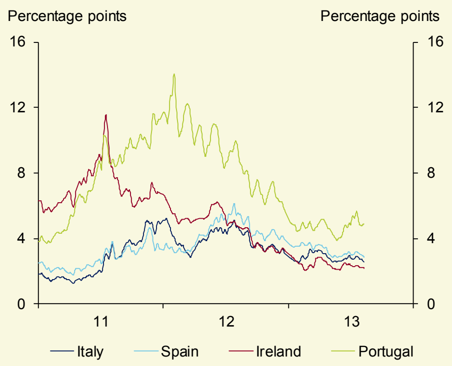


Figure 1.6
Interest rate spread to Germany



Note: In figure 1.5 the GDP of Denmark's trading partners is weighted on the basis of the proportion of total Danish exports to the countries.
Source: Reuters EcoWin, OECD, *Economic Outlook 93* and own calculations.

An improvement in the euro area is also reflected in the fact that the rise in unemployment has stopped lately. However, unemployment remains high at a level higher than 12 per cent of the labour force. Hence, signs of progress in Europe remain uncertain, and in a number of countries demand will, all else equal, be constrained by the fiscal consolidation and the adjustments in credit policy, which is a fundamental prerequisite for creating a sustainable recovery and prevent new financial turmoil.

Outside Europe the signs of recovery in the international economy are more pronounced. This is partly due to developments in the USA and Japan. In the USA, GDP grew by 2.8 per cent last year, and the progress has continued in the first half of 2013. The upswing is largely driven by private consumption and investments, and there has been a significant increase in job creation. In Japan, the effects of an aggressive economic policy (Abenomics) are – for now – manifested in economic progress. Whether that will sustain depends on the handling of major structural challenges for the Japanese economy, including the reduction of the public debt. The growth in the advanced economies compensates for slowing pace of growth in emerging market economies, including China, lately. However, the emerging markets are still a main driver of global growth.

The recovery abroad is expected to lead to an increase in export market growth for industrial goods, especially in 2014. In 2013, a weak first half of the year implies that export market growth over the year as a whole is expected to be a modest 2.3 per cent, while the continued improvement will lead to growth of 5.6 per cent in 2014, *cf. figure 1.7.* Against this backdrop, exports are expected to increase 0.2 per cent this year and 3.7 per cent next year.

The recovery is helped along by the agreements on *Growth Plan DK*, which strengthen the competitiveness of Danish businesses, so they can better latch on to an upswing abroad.

Figure 1.7
Export market growth and industrial exports

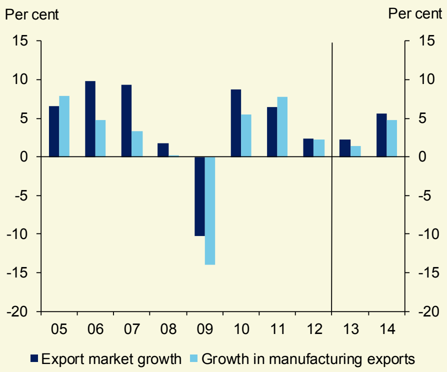
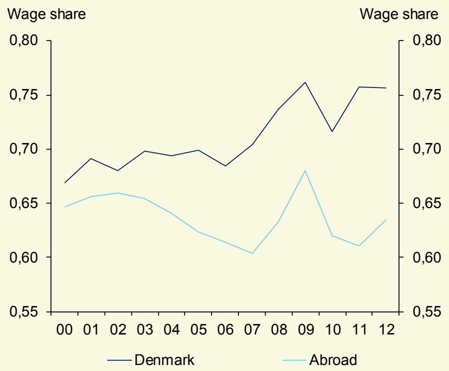


Figure 1.8
Wage share in Denmark and abroad



Note: Figure 1.8 illustrates the wage share in manufacturing (excl. energy supply).
Source: Statistics Denmark, OECD, *Economic Outlook 93* and own calculations.

In recent years there has been a considerable improvement of the wage competitiveness of the Danish manufacturing sector, but there is still a considerable backlog from previous years. One reason for this is substantially higher wage growth in Denmark than abroad in the period from 2000 to 2010. This is also reflected by the fact that the wage share of value added in manufacturing has increased relatively to abroad, *cf. figure 1.8.*

The prospects of higher sales in export markets increases the need for investments in new production facilities. Since the downturn in 2008-09, business investments have been low, and companies have been saving, *cf. figure 1.9.*

Figure 1.9
Business investment and savings

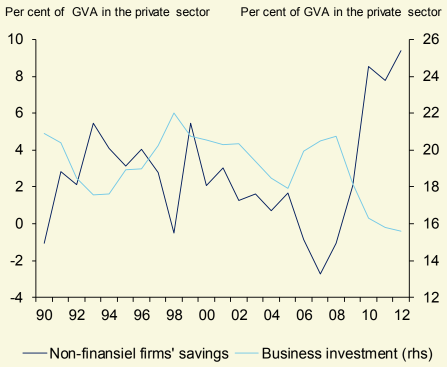
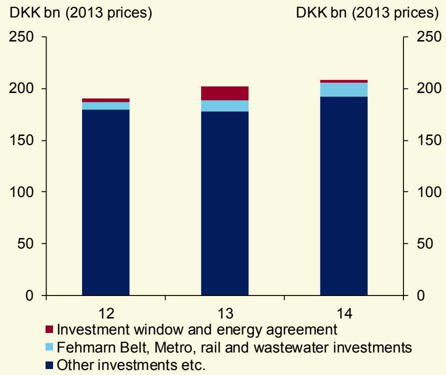


Figure 1.10
Business investments



Source: Statistics Denmark and own calculations.

The investment window that runs until the end of this year provides, along with low interest rates, a significant incentive to increase investments in production equipment this year. At the same time, construction investments are supported by public-initiated investments including in railways and in investments derived from the energy agreement, *cf. figure 1.10.* Overall, business investments are expected to increase significantly in 2013.

Following substantial weakness in private consumption since 2008, there is now the possibility of a stronger expansion. Household budgets are supported by economic policy, as the tax reform from 2012, in isolation, increases incomes. Furthermore, households net interest expenses are expected to decline further this year. Discretionary tax reductions and falling interest rates have ensured a rise in disposable incomes since the downturn of 2008-09, hereby supporting private consumption, *cf. figure 1.11.* Inflation has fallen to historically low levels, *cf. figure 1.12.* Thus, purchasing power is only eroded by price developments to a very limited extend.

The expectation of a gradual recovery in private consumption is supported by a substantial improvement of consumer confidence over the past months, and the indicator is now positive and above the historical average. At the same time, developments in the labour market are stable, and households are expecting declining unemployment over the coming year. The overall sentiment is also affected by more positive developments in the housing market, where progress – initially – is showing in rising house prices, *cf. figure 1.13.* However, the number of home sales remains low and will have to increase significantly before the housing market can be said to have recovered from fall in prices in past years. Low interest rates are critical to a continued stabilisation of the housing market.

Figure 1.11
Contribution to real disposable income since 2008 (accumulated)

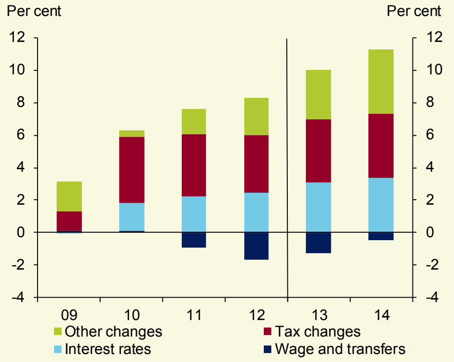
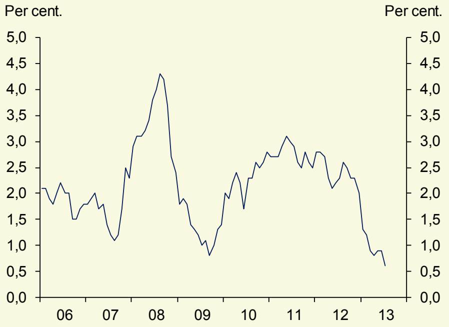


Figure 1.12
Consumer price inflation



Note: In figur 1.11 other changes covers for instance payments from pensions, dividends, and income from self-employment.
Source: Statistics Denmark and own calculations.

Developments in consumption, investments, and exports in the first months of 2013 means that the overall expectation of GDP growth in 2013 as a whole is relatively modest at 0.2 per cent, while accelerating progress in the second half of the year contributes to an estimated annual growth in 2014 of 1.6 per cent.

The expected growth in the Danish economy implies that the labour market may recover gradually and employment rise. Over the period since 2010 private employment has been remarkably stable considering the weak cyclical stance, *cf. figure 1.14.* It should be seen in light of past reforms, great flexibility in the labour market, and the fact that there has been room for manoeuvre in economic policy to support the labour market. But it also reflects that the increase in production in a number of industries, which account for around 95 per cent of private sector employment, has been somewhat higher than overall GDP growth*, cf. figure 1.15*. This is also expected to be the case in 2013 and 2014.

Gross unemployment has fallen by nearly 10,000 persons since the end of 2012, *cf. figure 1.16.* This is partly due to the phasing-in of the unemployment benefit reform and thus of circumstances that are not closely linked to overall employment possibilities. The *Agreement on Temporary Labour Market Allowance* implies that the special education allowance will be extended to the end of 2013, and that a new temporary labour market grant is introduced per 1 January 2014. In isolation, the agreement pulls up slightly registered unemployment in the second half of 2013 and in 2014. This is because the new phasing-in implies that a large group of recipients of unemployment benefits can get an extended benefit period. The agreement does not affect the assessment of the outlook for employment or the benefit reform's positive effects on structural unemployment.

Compared to 2012, unemployment is expected to have fallen by around 14,000 persons, to an annual average of 148,000 persons in 2014.

Figure 1.13
House prices

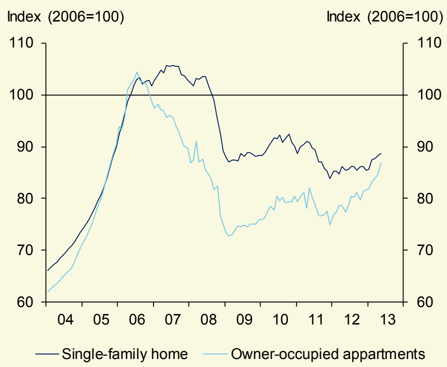
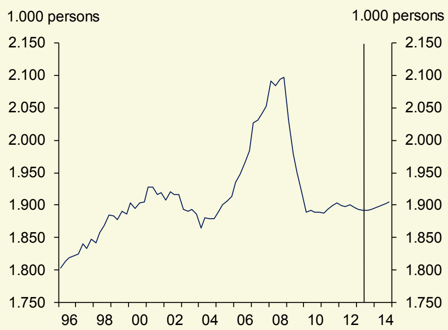


Figure 1.14
Private employment



Note: In figure 1.13 the development until 2006 is based on quarterly figures for houseprices.
Source: Statistics Denmark and own calculations.

Figure 1.15
Growth in GDP and GVA in businesses with 95 per cent of private employment

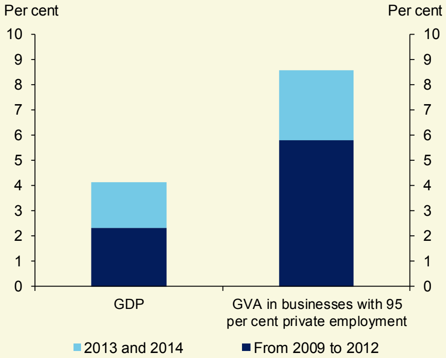
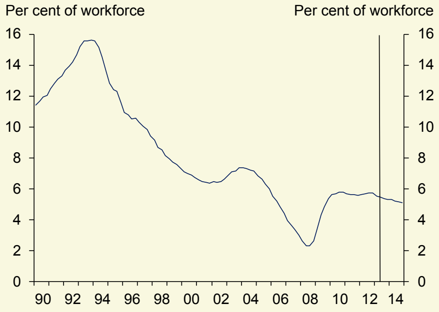


Figure 1.16
Gross unemployment



Note: In figure 1.15 private sector GVA is shown excluding mining, quarrying and financial services.
Source: Statistics Denmark and own calculations.

Selected key figures of the forecast are presented in table 1.1, while table 1.4 (in the annex to the summary) is a comparison with the assessment in *Economic Outlook*, May 2013. Compared to the May forecast, GDP growth in 2013 is revised down from 0.5 per cent to 0.2 per cent. This is due to developments in the first half of 2013 being weaker than expected. This particularly holds for export growth, which according to the latest national accounts was somewhat weaker in 2012 and the beginning of 2013 compared to what was expected in May. On the other hand, the outlook for the second half of 2013 and 2014 is unchanged from the May assessment.

The forecast assumes that a recovery in the euro area will gradually manifest itself in the second half of the year. If the recovery is weakened, it will also have a negative impact on Denmark, and may imply that the expected improvement of the Danish economy will only arrive later, and at a slower pace, *cf. box 1.1*. Compared to previous turnarounds of the Danish economy, the forecast assumes a relatively slow increase in growth in the second half of the year. Thus, it is also possible that the progress of the Danish economy will be stronger, e.g. if exports and private consumption evolves more positively than assumed.

It is assumed that domestic economic policy will continue to be planned and implemented within a framework of sustainable economic policy, including the requirements in the Budget Law. International confidence in the Danish economy has been crucial in keeping interest rates at a low level. This has, among other things, contributed to the stabilisation of the housing market, lower net interest expenses for households, and helped to ensure that the government's debt grew less than what would otherwise have been the case.

Box 1.1

Alternative scenarios

The forecast is based, among other things, on the assumption of a gradual recovery in the euro area through 2013, and that the recovery of the rest of the world economy continues. The Danish economic outlook is still characterised by uncertainty, even though it has receded somewhat over the past years.

On the negative side, there may be bumps in the road for the European recovery, which, in the short term, would dampen European growth compared to the assumed. This will imply lower exports market growth. For illustration purposes a negative scenario has been constructed, where the exports market growth is assumed to be 1 percentage point lower in 2013 and 1½ percentage point lower in 2014, as a result of the delayed recovery of growth abroad. In this scenario Danish GDP growth is lowered by around ¼ percentage points in 2013 and ½ percentage point in 2014, *cf. table a*. At the same time, the budget balance is worsened.

On the positive side, there is also a possibility that greater optimism and rising house prices will lead to higher domestic investment and consumption ratios. In such a scenario, it is assumed that business investments will increase by 3 percentage points more in both 2013 and 2014 than in the main scenario. This corresponds to a faster recovery of the investment ratio towards its historical level than seen during previous recoveries. In this scenario private consumption is expected to increase by ¼ and ½ percentage points more in each year respectively, compared to the main scenario. Overall, this will increase growth in Danish GDP by ¼ percentage points in both 2013 and 2014. Meanwhile unemployment will fall through both years, and the public budget balance will improve.

Even in the more positive scenario, annual growth in 2013 will be subdued due to the weak development over the end of 2012 and into 2013.

Table a

	Negative scenario: Slower european recovery		Main scenario: Starting recovery in the second half of 2013		Positive scenario: Increasing consumption and investment	
	2013	**2014**	**2013**	**2014**	**2013**	**2014**
Real GDP growth, per cent	0.0	1.2	0.2	1.6	0.4	1.9
Unemployment (1,000 persons)	156	156	154	148	153	143
Public balance, per cent	-1.8	-2.3	-1.7	-2.0	-1.6	-1.8

Source: Own calculations in the macro-econometric ADAM model etc.

Table 1.1
Key figures

	2011	2012	2013	2014
Percentage change from previous year				
Private consumption	-0.5	0.5	0.4	1.2
Public consumption	-1.5	0.7	0.6	0.5
Public investment	4.2	10.7	-10.2	6.8
Residential construction	14.6	-8.6	-3.5	3.3
Fixed business investments	-0.7	0.0	6.4	1.8
Stock building (per cent of GDP)	0.5	-0.4	0.4	0.0
Exports of goods and services	6.5	0.2	0.2	3.7
Imports of goods and services	5.6	1.0	1.7	3.3
GDP	1.1	-0.4	0.2	1.6
Balances (per cent of GDP)				
General government fiscal balance	-2.0	-4.2	-1.7	-2.0
Current account	5.6	5.8	5.4	5.7
Balances, 1,000 persons				
Gross unemployment (yearly average)	160	162	154	148
Employment (excl. leave)	2,736	2,729	2,724	2,733
Labour force	2,845	2,848	2,840	2,848
Rate of change, per cent				
House prices, single-family house	-2.7	-3.3	3.0	2.5
Consumer prices	2.8	2.4	1.0	1.5
Hourly earnings, private sector (Danish Employers Federation statistics)	1.2	2.0	1.8	2.0

1.3 Fiscal policy and public finances

Economic policy is planned in order to support growth and employment within the framework of sound fiscal policy. The budget proposal for 2014 takes advantage of the possibilities that lie within the fiscal framework by, inter alia, having a structural deficit close to the limit for the structural deficit in the Budget Act. The direct impact of fiscal policy and other economic policy measures from 2012 and onwards are estimated to support the GDP level by just under ½ per cent in both 2013 and 2014. Moreover, monetary policy remains exceptionally accommodative and interest rates are low.

I these years, it is a fundamental premise for fiscal and expenditure policy that Denmark adhere to the Budget Act and comply with the EU-recommendation to reduce the excessive government deficits (in terms of the EU-Treaty).

In June 2013, the Danish Parliament adopted expenditure ceilings for the central government, local governments and the regions. The adopted ceilings cover the years 2014-17 and mark a regime change in expenditure policy aimed at permanently sustaining the improved control with public expenditures achieved in the past few years. The expenditure ceilings are to ensure that the past tendency for budget overruns can be avoided. Budget overruns have been a main issue in fiscal policy in Denmark during the last two decades.

A stable and predictable fiscal framework is important for the credibility of the economic policy and for appropriate planning of expenditure policy. Confidence in fiscal policy and the fiscal framework supports the currently low interest rates at the benefit of households, businesses and job creation.

The main requirement for the repeal of Denmark's EU-recommendation in the spring of 2014 is that the actual deficit must be brought sustainably below 3 per cent of GDP no later than by 2013. As a starting point, this requires that the European Commission in its spring forecast 2014 estimates the deficit in 2014 and 2015 to be below 3 per cent of GDP. In *Convergence Programme Denmark 2013* the actual deficit in 2015 was estimated to be around 2.9 per cent of GDP, i.e. close to the limit of the Stability and Growth Pact. Against this backdrop, it is important for the repeal of the EU-recommendation, that fiscal policy is not eased compared to this projection in the next few years. A loosening of fiscal policy will increase the actual deficit and thus increase the risk of exceeding the 3 per cent of GDP limit.

The estimated structural deficit is 0.4 per cent of GDP in 2014, when it is assumed that the expenditures for income transfers in the budget proposal for 2014 is 0.1 per cent of GDP below the specified sub-ceiling for income transfers. Hence, the budget proposal is close to the limit for the structural deficits in the Budget Act of ½ per cent of GDP.

The planned fiscal policy for 2014 reflects the numerous initiatives implemented since 2011 aimed at supporting employment. Overall, fiscal policy and other initiatives are estimated to increase private employment by almost 15,000 persons in 2014. Since the start of the financial crisis, fiscal policy has been loosened by around 1¼ per cent of GDP (measured by the direct revenues from 2009 to 2014 included in the calculation of the fiscal effect), including increased public consumption and investments.

The planned public investments and consumption in 2014 are thus high in both a historical and future perspective. Public consumption and investments are estimated to amount to 29.3 per cent of structural GDP in 2014 (27.1 per cent for consumption and 2¼ per cent for investments respectively).[1] This is higher than in all the years prior to the financial crisis.

Furthermore, public expenditures in 2014 are around ¾ per cent of GDP higher than the 2020-level in the latest medium-term projection, where expenditures' share of GDP is in line with a sustainable fiscal policy, *cf. Convergence Programme Denmark 2013*. A sustainable fiscal policy thus requires a gradual decline in expenditures' share of GDP in the years to come. This will partly be accomplished through a moderate and balanced growth in public consumption and through a normalisation of public investments towards 2020.

Public finances in 2012-2014

Statistics Denmark has estimated the public deficit in 2012 at DKK 77½ billion (4.2 per cent of GDP). The public deficit in 2012 partly reflects that the reimbursements of contributions to the voluntary early retirement pension (VERP) amounted to a one-off expenditure of DKK 28½ billion corresponding to around 1½ per cent of GDP. On the other hand, the revenue from the pension yield tax was well above its estimated structural level in 2012. The public deficit in 2012 is higher compared to the expected deficit in the May Survey as a result of higher public consumption and investment expenditures according to Statistics Denmark's revised account of public finances for 2012.

In 2013, the deficit of the actual fiscal balance is expected to be reduced to around DKK 31¼ billion (1.7 per cent of GDP), *cf. table 1.2*. This partly reflects temporary revenue from restructuring of existing capital pensions that are assumed to amount to DKK 20 billion in both 2013 and 2014. Moreover, the pension yield tax contributes with expected revenue of around DKK 38½ billion in 2013, which – as in 2012 – is significantly above the structural level.

The assessment of public finances in 2014 is based on the budget proposal for 2014, the agreements on local governments' and regions' economy in 2014, *Agreement on a Temporary Labour Market Allowance* and *Agreements on Growth Plan DK*, including the agreements on a cash benefit reform and a reform of study grants etc. The planned expenditure policy in 2014 is in compliance with the agreed expenditure ceilings for 2014-17.

The public deficit for 2014 is estimated at around 2 per cent of GDP including the temporary revenue from the restructuring of the taxation of capital pensions, etc. The public deficit has been adjusted upwards by around DKK 7½ billion compared to the May Survey partly due to higher public investments and reduced estimates of tax revenues, etc.

[1] The structural GDP level is above the actual GDP level, and hence the consumption and investment shares of structural GDP are lower than the shares of actual GDP in 2014.

Table 1.2
Public and structural budget balance, 2010-2014

Per cent of GDP	2010	2011	2012	2013	2014
Public balance	-2.7	-2.0	-4.2	-1.7	-2.0
Public balance excl. temporary revenues[1)]	-2.7	-2.0	-4.2	-2.9	-3.2
Structural balance	-1.7	-0.8	-1.1	-0.2	-0.4

1) Temporary revenues related to revenues from the restructuring of the taxation of the capital pensions and revenues from a reallocation in the pension sector from schemes with a guaranteed yield in each year to schemes in which each year's yield reflects market returns.

Source: Own calculations.

There is extra uncertainty associated with the estimates of the public fiscal balance in 2013 and 2014 linked to the assumed revenues from the restructuring of the taxation of existing capital pensions. The temporary revenues from the restructuring are, with considerable uncertainty, estimated to be DKK 40 billion in total, which is assumed to be equally distributed between 2013 and 2014. Adjusted for the temporary revenues from the restructuring of the taxation of capital pensions etc., the actual public deficit will be 2.9 per cent of GDP in 2013 and 3.2 per cent of GDP in 2014, *cf. figure 1.17*.

In 2015, the actual fiscal balance is no longer influenced by the temporary revenues from the restructuring of the taxation of capital pensions. The actual fiscal balance is also highly sensitive to the cyclical stance. In addition, revenues from the pension yield tax are, at some point, expected to decrease substantially as a recovery of the international business cycle leads to a normalisation of monetary policy and thereby higher interest rates. For example, an increase in interest rates by ½ percentage points is likely to reduce the estimated revenues from the pension yield tax by around DKK 12 billion or 0.6 per cent of GDP (calculation based on 2014-assumptions).

Partly due to the large uncertainty associated with the actual fiscal deficit, fiscal policy in Denmark is planned based on the structural deficit. In the current situation it is, however, an important concern that fiscal policy does not contribute to increased actual deficits over the next few years in relations to the 3 per cent of GDP EU-limit in the Stability and Growth Pact.

Figure 1.17
Public balance with and without temporary expenditures and revenues

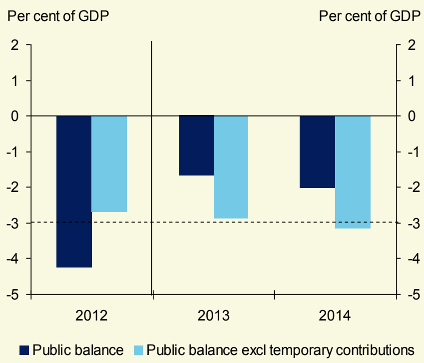
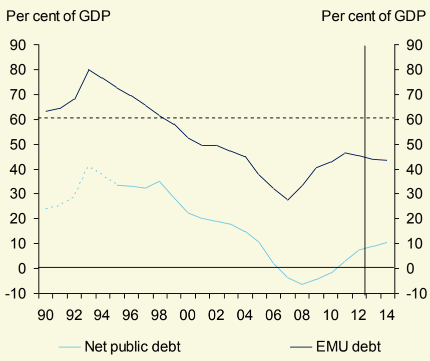


Figure 1.18
EMU debt and net public debt



Note: Figure 1.17 shows the public balance net of the impact of repayment of VERP-contributions in 2012 and the temporary revenues from restructuring the taxation of pension schemes and reallocation in the pension sector in 2013 and 2014. In figure 1.18, from 1990 to 1995 the development of the net public debt corresponds to the EMU debt, since official figures of net public debt are not available before 1995.
Source: Statistics Denmark and own calculations.

The fiscal deficits towards 2014 imply an increase in net public debt from around 3 per cent of GDP by the end of 2011 to around 10½ per cent of GDP in 2014, *cf. figure 1.18*. However, gross public debt (EMU definition) is expected to be reduced from 46½ per cent of GDP by the end of 2011 to around 43½ per cent of GDP by the end of 2014. This is among other things a result of the fact that a part of the government's funding need is covered by a reduction of the government's deposits at the Central Bank (Danmarks Nationalbank). The reduction of the government's deposit reflects that, in earlier years, more bonds have been issued than needed for funding, whereby the government's deposits have been built up. The EMU debt maintains a wide safety margin relative to the EU limit of 60 per cent of GDP in Stability and Growth Pact.

Figure 1.19
Public and structural balance

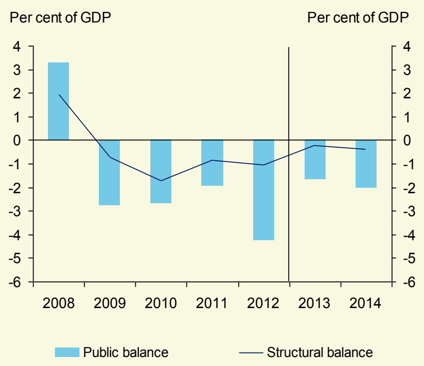
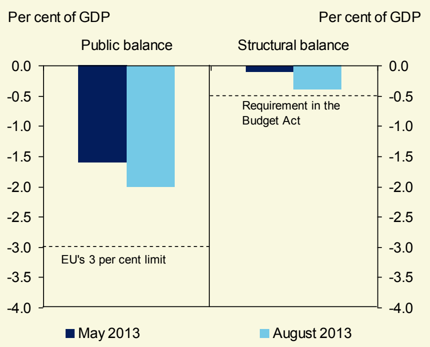


Figure 1.20
Changes to budget balance estimates for 2014



Source: Statistics Denmark and own calculations.

The structural deficit in 2014 of around 0.4 per cent of GDP is estimated based on the budget proposal for 2014, where the expenditures for state income transfers is around DKK 1.7 billion (almost 0.1 per cent of GDP) below the specified sub-ceiling. If the expenditures for income transfers, which, among other things, are sensitive to the number of recipients, are increased up to the specified sub-ceiling, the public deficit will increase in both actual and structural terms.

The estimated structural deficit increases from 0.2 per cent of GDP in 2013 to 0.4 per cent in 2014. This partly reflects higher public investments in 2014. Almost all of the increase in the structural deficit from 2013 to 2014 can be attributed to fiscal policy (when this is measured by direct revenues, which are included in the fiscal effect calculation).

Compared to the May Survey, the estimated structural deficit in 2014 is revised upwards by around ¼ per cent of GDP. This partly reflects that the expenditures for public investments are increased by DKK 2¼ billion due to the agreement on the regions' economy for 2014, increased state investments in road infrastructure, and the DKK 1 billion additional public investments on the budget proposal for 2014. The remaining adjustment since May reflects updated estimates in particular for personal income taxes, subsidies and public sector net interest expenditures.

Effects of the planned fiscal policy and other economic policy measures on activity

Fiscal policy and other economic policy measures from 2012 and onwards are estimated to support economic activity in both 2013 and 2014 equivalent to 0.4 per cent of GDP in both years (measured by the multiannual fiscal effects), *cf. figure 1.21.*

A gradually declining contribution from fiscal policy is offset by an increased contribution to economic activity from other investments from 2012 to 2014, *cf. figure 1.22.* Other investments are investments undertaken by public companies, etc., which are recorded as private investments and therefore not included in the public balance in the national accounts. The declining contribution from fiscal policy is measured by the multiannual fiscal effects and specific estimates for the investment window, HousingJobs scheme and the lowering of the corporate tax rate in *Agreements on Growth Plan DK.* [2]

Figure 1.21
GDP level with and without economic policy

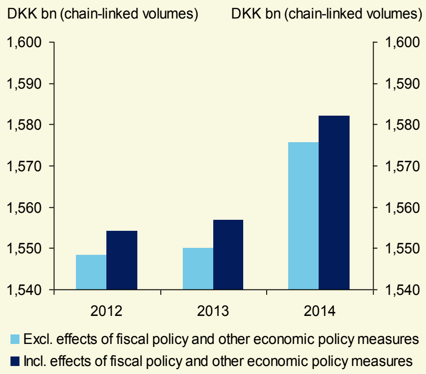
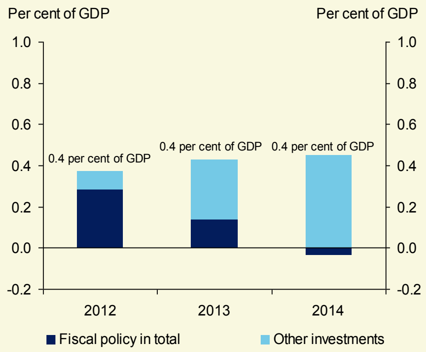


Figure 1.22
Effect on GDP level of fiscal policy and other economic policy measures from 2012 and onwards



Note: Figure 1.21 shows the effect on the GDP level of public budgets (measured by the multiannual fiscal effect), other fiscal measures and other investments.
Source: Statistics Denmark and own calculations.

The contribution to the GDP level in 2014 from fiscal policy and other economic policy measures adopted in 2012-14 has been revised upwards by 0.1 per cent of GDP since the May survey, *cf. table 1.3.* This is partly due to increased public investments in 2014 as a result of the agreement on the regions' economy for 2014, increased state investments in road infrastructure, and the DKK 1 billion of additional public investments on the budget proposal for 2014.

[2] The impact of those fiscal measures is only to a limited extent captured in the traditional fiscal effect calculation.

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

	2012		2013		2014	
Per cent of GDP	**May**	**Aug.**	**May**	**Aug.**	**May**	**Aug.**
Fiscal effect including multiannual effects (GDP level)	0.0	0.2	-0.2	-0.2	-0.2	-0.1
Other fiscal policy[1)] (investment window etc.)	0.1	0.1	0.3	0.3	0.1	0.1
Fiscal policy in total	**0.1**	**0.3**	**0.1**	**0.1**	**-0.2**	**0.0**
Other investments[2)]	0.1	0.1	0.4	0.3	0.5	0.4
Fiscal policy and other measures (GDP level)	**0.2**	**0.4**	**0.5**	**0.4**	**0.3**	**0.4**
- fiscal policy and other measures (growth contribution)	0.2	0.4	0.3	0.1	-0.2	0.0

Note: The estimated contributions to activity from the investment window, HousingJobs scheme and the lowering of the corporate tax rate in *Agreements on Growth Plan DK* are included in table 1.3 under "other fiscal policy", while they were partly placed under "other investment measures etc." in the May Survey.

1) In other fiscal policy, an extra effect beyond what is captured by direct budget impact included in the calculation of the fiscal effect is added for the investment window, the HousingJobs scheme and the corporate tax rate reduction in *Growth Plan DK*. Cf. *Vækstplan DK – Teknisk baggrundsrapport* for further information of the effects of the HousingJobs scheme and the corporate tax rate reduction.

2) Other investments cover investments following the energy agreement, the housing agreement, investments in social housing, climate-related investments in the wastewater sector (*cf. agreement on local governments' economy for 2013*) and preponed activities in Fehmarn Belt agreed upon in *Growth Plan DK*. The slightly lower contribution to activity from other investments in 2013 compared to the May Survey reflects a delay in the investments associated with the energy agreement. There is a considerable amount of uncertainty related both to the impact on investments of the energy agreement and timing of the investments following the agreement.

Source: Statistics Denmark and own calculations.

Fiscal policy and other economic policy measures are roughly neutral for GDP growth in 2014, as the estimated contribution to activity in 2014 match the contribution in 2013. This includes that the effect of the investment window expires in 2014 while the contribution to activity from other investments gathers strength in 2014, *cf. box 1.2*. The fiscal effect (not including multiannual effects) in 2014 is estimated to be 0.1 per cent of GDP.

Economic policy in 2012-14 supports employment in 2013 and 2014. Fiscal policy and other economic policy measures are estimated to raise private sector employment by almost 15,000 persons in both 2013 and 2014. Including an adjustment in public sector employment compared to 2011 (after large prior increases in public sector employment) the impact on total employment amounts to around 5,000 persons in 2013 and 7,000 persons in 2014.

The planned fiscal policy should be viewed in the context of an exceptionally accommodative monetary policy stance and very low interest rates. The expansionary monetary policy contributes substantially to economic activity. The responsible and credible fiscal policy that is in compliance with both the Budget Act and the EU-recommendation contributes to maintaining confidence in economic policy and hereby the low interest rates that benefit growth and employment.

Box 1.2
Other investments support activity in 2014

In 2014, fiscal policy and other economic policy measures from 2012-2014 support GDP level by 0.4 per cent. This includes an estimated contribution to activity from other investments of 0.4 per cent of GDP in 2014.

Other investments reflects, among other things, the advancement and increase of investments in renovations of social housing, the advancement of activities in Fehmarn Belt and increased investment in renewable energy and energy efficiency.

There is uncertainty concerning the effects on activity of both fiscal policy and the mentioned other investments, but the uncertainty is in general larger for the latter. One reason is that the investments are made by companies outside the public sector and there is uncertainty linked to how the investments would proceed in the absence of the political agreements and decisions. However, in general a more comprehensive picture of the effects of economic policy measures is obtained when estimates of other investments are included.

The pursued economic policy thereby takes advantage of the possibilities – that lies beyond the traditional means of fiscal policy – to support economic activity.

A perspective on expenditure and fiscal policy in 2014

The Budget Act and the expenditure ceilings that were adopted by a large majority of Parliament are decisive steps towards maintaining the improved expenditure control obtained in recent years on a long-term basis – and thereby helping to avoid the recurrent budget overruns that characterised Danish fiscal policy for a number of years. OECD, EU and the Danish Economic Councils have on several occasions over the past 10-15 years pointed out that the stabilising effect of fiscal policy was weakened by a persistent trend of expenditures surpassing the planed level, which, moreover, posed a serious threat to the sustainability of fiscal policy.

Local governments, regions and central government have taken important steps in order to regain control of expenditures after significant budget overruns in the years 2009-2010 (amongst others). To ensure a continuously high level of credibility in fiscal and expenditure policy in Denmark, it is essential that recent years' improved control of public expenditures is not compromised. Denmark's public consumption expenditures are already the highest among the developed countries (measured as share of GDP).

The planned public consumption in 2014 is high both in a historical perspective and in comparison to the level of expenditures that can be sustainably financed from 2020 (given the planned tax policy and the reforms, which have been adopted). Public consumption expenditures are equivalent to around 27 per cent of structural GDP in 2014, *cf. figure 1.23*. The expenditure share is gradually reduced to 26½ per cent of GDP towards 2020, partly due to a balanced real growth (on average approx. 0.6 per cent per year) and reforms that increase GDP, *cf. Convergence Programme Denmark 2013.*

Even if it was possible to increase short run consumption expenditures without compromising the improved expenditure control and compliance with EU requirements, rapid expenditure increases would imbed the risk of inappropriate use of resources and require subsequent tightening. The annual expenditure growth would have to be reduced compared to the planned expenditure growth, which would leave only limited room for new priorities and ongoing expenditure requirements, including the effects of growth in the number of users of public benefits, which are estimates to follow the trend in population growth.

Moreover, the planned public investments in 2014 are at such a high level that it is only surpassed by the level in 2012, *cf. figure 1.24*. The high level of investments in recent years implies that many projects are already under way. In addition, the higher the investments in the short run, the steeper the required slowdown towards 2020 – a period where there might already be prospects of increased interest rates and less expansionary monetary policy.

Figure 1.23
Public consumption

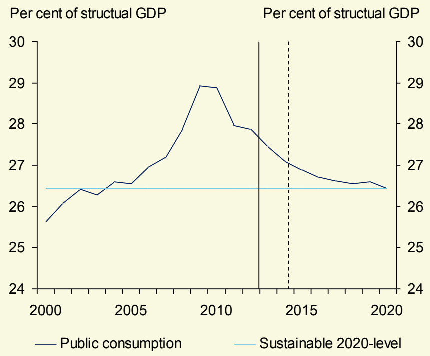
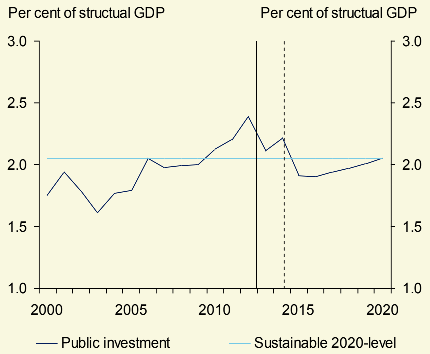


Figure 1.24
Public investments



Note: Towards 2014, the figures are based on *Economic Survey,* August 2013. From 2015-2020 the figures are based on *Convergence Programme Denmark 2013.*
Source: Statistics Denmark and own calculations.

The current combination of an extraordinarily accommodative monetary policy stance and a fiscal policy that imply a structural deficit close to ½ per cent of GDP should be viewed in the context of the cyclical stance and the need for continued moderate wage increases to strengthen competiveness and restore the earnings potential of investments in Denmark. The so-called output gap – which expresses the difference between the actual and structural production – is estimated at around -2 ¾ per cent of GDP in 2014. This level of the output gap is in line with the output gap during previous economic downturns in the early 1980s and 1990s. To the contrary, unemployment is not high in historical perspective. Gross unemployment is currently around 5½ per cent of the labour force, which is significantly lower than in for example 1980-82 and 1992-93. At the same time, unemployment of for example skilled metal and construction workers (with unemployment insurance) has dropped from around 10 per cent in 2010 to currently around 6 per cent.

While unemployment has increased less compared to previous downturns, the labour market participation rate has fallen significantly. This is partly caused by an increase in the number of people in education. Likewise, the number of, amongst others, cash-benefits recipients outside the labour force has increased. There is uncertainty related to what extent and how quickly groups outside the labour force are available for employment when the economy recovers.

Business investments have remained low for a number of years and the production facilities are reduced. Hereby, the estimated output gap may overstate the amount of idle resources available in the short term. The planning of the fiscal policy must therefore be viewed in the context of the current capacity utilisation as well as a number of other factors including the expansionary monetary policy, the prospect of increased growth both in Denmark and abroad, as well as the size of the fiscal challenges that lie ahead, and uncertainty about the extent of available resources.

1.4 Challenges for the Danish economy in light of nye labour market statistics

In June, Statistics Denmark carried out a comprehensive revision of the national accounts, which reduced total work effort of the population by what corresponds to 140,000 full-time employees. This alters the general picture of the Danish labour market slightly but does not require changes to economic policy.

Economic policy aims at dealing with the main challenges for the Danish economy. These are, firstly, recovering from the global financial crisis that struck Denmark hard. Secondly, increasing growth potential in the medium term and making better use of the opportunities that globalisation presents. And thirdly, maintaining sound public finances, thereby contributing to low interest rates and good conditions for growth going forward. Longer term growth challenges relate particularly to increasing labour supply and underpinning productivity growth, which has been misaligned with wage developments in the past. These are therefore the key objectives in the government's long-term reform path towards 2020, *cf. Denmark at Work* and *Growth Plan DK.*

Figure 1.25
Revision of employment (excluding leave)

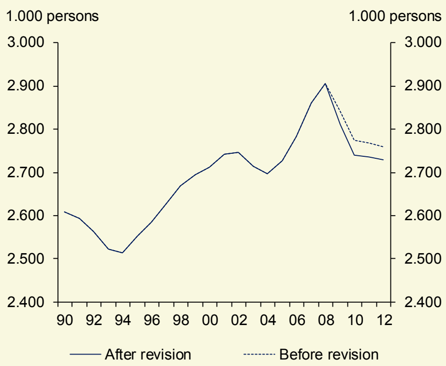
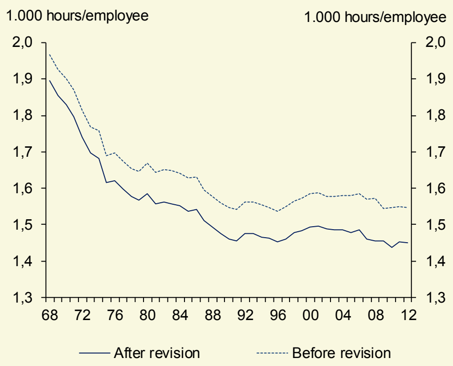


Figure 1.26
Revision of hours worked per employee



Anm.: Revivions of employment in the national accounts are more limited than the revisions in hours worked. As shown in figure 1.25 employment is therefore preliminary only revised in the years 2009-11, so the development corresponds to the development in the revised ATR. Total hours worked – and thus the average number of hours worked per employee in figure 1.26 – is revised throughout the period back to 1966.

Kilde: Statistics Denmark.

National accounts are revised frequently as a result of improved statistical sources, changing regulation etc. The revisions, however, rarely alter the perception of general trends. In the most recent national accounts revisions were made to hours worked, wages and employment, and the changes to hours worked were relatively large. This means, for instance, that hours worked per employee is now somewhat lower than estimated before, and that the level of productivity is correspondingly higher.

It does not, however, change the main economic challenges facing Denmark. The total work effort is still mediocre compared to other OECD countries, and productivity growth has been low over the past almost 20 years. Therefore the endeavour to significantly improve the framework for growth and job creation in Denmark remains a necessity.

The revision of the national accounts is linked to a revision of the working time accounts (ATR), which is the main source in the national accounts for estimating employment, wages and hours worked. The quality of the ATR, and thus the main source for labour market statistics in the national accounts, has been improved with a transition to new primary sources, particularly the so-called e-Income register.

According to the new information, the total number of hours worked in the Danish economy was overestimated. Hours worked in the national accounts are therefore revised downwards significantly, on average by about 5 per cent a year over the period since 1966, equalling almost 140,000 full-time employees. The downward revision only to a limited extent reflects fewer employed persons, *cf. figure 1.25.* The revised figures thus especially point to a lower average working time per employed than previously assumed, *cf. figure 1.26.* Every employed person worked 6½ per cent less in 2012 – roughly two hours a week – than previously assessed.

Figure 1.27
Hours worked per employed

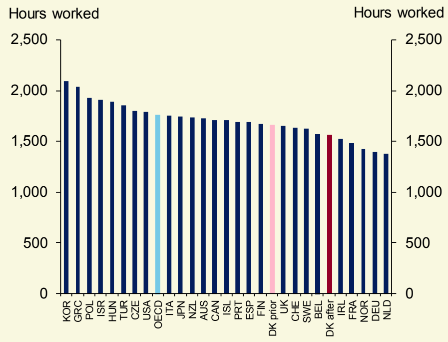
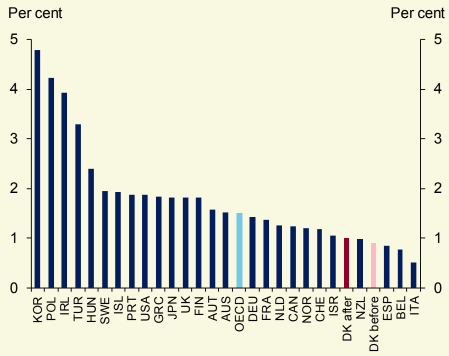


Figure 1.28
Average annual productivity growth 1995-2011



Note: "DK before" and DK after" refer to the figures for Denmark before and after the revision of the national accounts. "OECD" refers to the average for OECD countries. Figure 1.27 shows the average hours worked per employed, based primarily on information from national accounts. Due to cross country differences in data sources and methodology in the assessment of hours worked in the national accounts, the level for Denmark probably tends to be underestimated relative to other countries. Figure 1.28 excludes Estonia, Mexico, Slovakia, and Slovenia since data is not available for the entire period for those four countries. Productivity is calculated as GDP divided by hours worked.
Source: OECD and own calculations.

Even before the revision, Denmark was among the countries with the lowest working time per employed, *cf. figure 1.27.* The government has introduced a number of reforms that strengthen the individual's incentive to join the labour market and make an extra effort. The tax reform alone is estimated to increase employment by about 16,000 full-time persons, when it is fully implemented. The positive effects occur because the benefits from being in employment increase, and because taxes on the last krone earned are lowered, making it more profitable to increase working hours or to make an extra effort in other ways.

There are still people, though, who from an economic point of view gain only little by making an extra work effort. This is particularly true for many single parents, since this group often find that income-dependent benefits such as housing subsidies and subsidies for day care are reduced, if they make an extra effort and earn a higher income. This reduction may entail that the effective marginal tax rate is significantly higher than the marginal tax rate for e.g. tax payers in the highest tax bracket. Just under 30,000 full-time employed are estimated to have an effective marginal tax rate above 60 per cent and thus only gain relatively little by for instance increasing working hours. Of this group, 12,000 are single parents. With the *Agreement on a tax reform 2012*, the government has taken steps to improve the incentive for single parents to increase work effort through a higher employment allowance.

Figure 1.29
Hourly productivity by sectors before and after the revision, 1995-2012

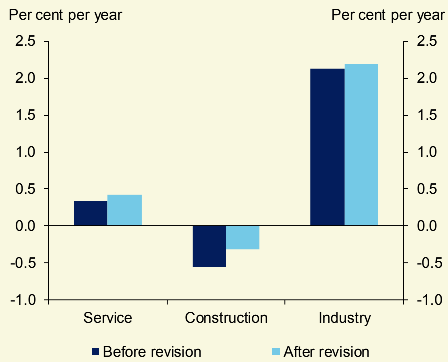
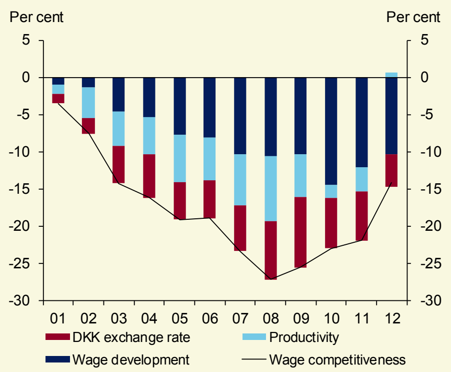


Figure 1.30
Wage competitiveness (accumulated)



Note: In figure 1.29 services exclude shipping and financial services. Unit labour cost in figure 1.30 is calculated as the relative development of the ratio of compensation and gross value added within manufacturing excluding energy in Denmark and abroad and adjusted for changes in the krone exchange rate. Abroad is weighted trade partners based on the weights in the effective krone rate. 2000-10 is based on data from OECD, while 2011-12 is based on data from OECD and Eurostat.
Source: OECD, Statistics Denmark and own calculations.

Total production in Denmark has not been revised as a result of the new data. The lower amount of hours worked therefore by definition implies that production per hour worked (productivity) is higher than previously assumed. However, this results only in a level shift in the period 1966-2013, and the new data does not change the fact that the Danish productivity growth has been low since the mid-90s both compared to previous periods and in an international context, *cf. figure 1.28*.

Productivity growth is the main driver of economic growth in the long term and therefore a prerequisite for developing the welfare state and retaining and creating productive and consequently well-paid jobs in Denmark. Accordingly, higher productivity growth is of great importance with regards to increasing welfare and prosperity. Therefore, enhancing Danish productivity growth is a key objective in *Growth Plan DK*.

Average annual productivity growth rates since 1995 has been low primarily because of low and negative productivity growth within the services and construction sectors[3] (0.5 and -0.4 per cent respectively), while average annual productivity growth in the industrial sector has amounted to 2.3 per cent, *cf. figure 1.29*. The services sector has a lower than average level

[3] Some uncertainty applies to the calculation of productivity growth in the construction sector and parts of the services sector, as the price index does not fully capture improvements in quality. The Productivity Commission demonstrates that productivity growth since 1995 within the services sector and measured in value terms has also been weaker in Denmark than in comparable countries.

of productivity, while at the same time taking up most of the hours worked in the private sector. Consequently, productivity within services must be lifted in order to truly enhance Danish growth potential. This is also one of the key conclusions made by the Productivity Commission.

Furthermore, the revised data does not change the fact that wage competitiveness within manufacturing still faces a challenge because relatively high Danish wage increases during the most part of the past decade were not matched by correspondingly higher productivity growth, *cf. figure 1.30.* In 2000-12 productivity growth in manufacturing did match the developments abroad, but the growth rate should have been even higher to offset the higher wage increases in Denmark. Since 2008, wage competitiveness in manufacturing has improved significantly, but more than half of the loss since 2000 still remains.

Altogether, the main challenges for the Danish economy in terms of the need to increase work effort, productivity growth and impaired wage competitiveness, still stand. The government's economic policy addresses these challenges by making it more attractive to work, invest, and do business in Denmark. These policies include the retirement reform, the reform of disability pension and flex jobs, reforms of cash benefits and student grants, as well as the tax reform. They also include initiatives to improve workforce qualifications and other initiatives in *The Agreements on Growth Plan DK*, which underpin higher productivity growth. In autumn 2013, the government will propose a reform of vocational education and training, and by the end of the year the Productivity Commission will present its recommendations as to how productivity growth can be lifted. This will contribute to better aligning wages and productivity, thus strengthening wage competitiveness so that Denmark better can explore the opportunities offered by globalisation and recover more quickly from the crisis.

1.5 Annex

Table 1.4
Key figures compared to the May survey

	2012	2013		2014	
		May	Aug.	May	Aug.
Real growth, per cent					
Privat forbrug	0.5	0.4	0.4	1.2	1.2
Total public demand	1.4	0.3	-0.3	0.6	1.0
- public consumption	0.7	0.9	0.6	0.6	0.5
- public investment	10.7	-7.4	-10.2	1.2	6.8
Residential construction	-8.6	0.3	-3.5	3.4	3.3
Fixed business investments	0.0	7.8	6.4	1.1	1.8
Final domestic demand	0.3	1.1	0.7	1.2	1.3
Stock building (per cent of GDP)	0.0	0.1	0.4	0.2	0.0
Total domestic demand	0.0	1.2	1.0	1.4	1.3
Exports of goods and services	0.2	0.9	0.2	3.7	3.7
- of which manufactures	2.3	2.2	1.5	4.8	4.8
Total demand	0.1	1.1	0.7	2.2	2.2
Imports of goods and services	1.0	2.2	1.7	3.3	3.3
- of which goods	1.4	3.0	3.0	3.1	3.1
GDP	-0.4	0.5	0.2	1.6	1.6
Gross value added	-0.3	0.3	0.1	1.6	1.6
- of which private sector	0.5	0.5	0.7	2.3	2.2
Change in 1,000 persons					
Labour force	3	4	-8	5	9
Employment	-7	-2	-6	10	9
- of which private sector	2	-5	-6	8	7
- of which public sector	-9	3	0	2	2
Gross unemployment (registered)	2	-8	-8	-9	-6
Net unemployment (registered)	10	5	-2	-5	-1

Table 1.4 (continued)
Key figures compared to the May survey

	2012	2013		2014	
		Maj	Aug.	Maj	Aug.
Growth, per cent					
Merchandise export prices	3.1	0.2	0.1	2.0	2.0
Merchandise import prices	2.7	0.2	-0.7	2.0	1.9
Merchandise terms of trade	0.4	0.0	0.8	0.0	0.1
House pricse, single-family house	-3.3	1.2	3.0	1.5	2.5
Consumer prices	2.4	1.1	1.0	1.5	1.5
Hourly compensation	2.0	1.7	1.8	2.0	2.0
Real disposable income, private sector	0.4	-0.9	-0.5	2.7	2.5
Real disposable income of households[1)]	0.0	1.1	2.1	2.2	2.0
Productivity in a private non-agricultural sector	0.9	0.7	1.1	1.8	1.6
Per cent per year					
Interest rate 1-year adjustable rate loan	0.5	0.3	0.3	0.6	0.6
10-year government bonds	1.4	1.6	1.7	1.9	2.1
30-year mortgage credit bond	3.7	3.4	3.4	3.7	3.8
Balances					
Current account (bn DKK)	105.0	85.2	100.4	93.0	108.4
General government fiscal balance (bn DKK)	-77.5	-23.0	-31.0	-31.1	-38.5
Gross unemployment (thousands)	162	154	154	145	148
Gross unemployment (per cent)	5.7	5.3	5.4	5.0	5.2
Net unemployment (thousands)	118	124	116	119	115
Net unemployment (per cent)	4.2	4.3	4.1	4.1	4.1
External assumptions					
Trade-weighted GDP abroad, per cent	1.0	1.2	1.1	2.2	2.3
Markets for Danish manufactures, per cent	2.4	2.6	2.3	5.5	5.6
Exchange rate, DKK per $	5.8	5.7	5.7	5.7	5.7
Oil price, $ per barrel	111.7	105.5	108.2	114.3	116.9
Oil price, DKK per barrel	646.8	600.5	613.5	651.7	660.6

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