

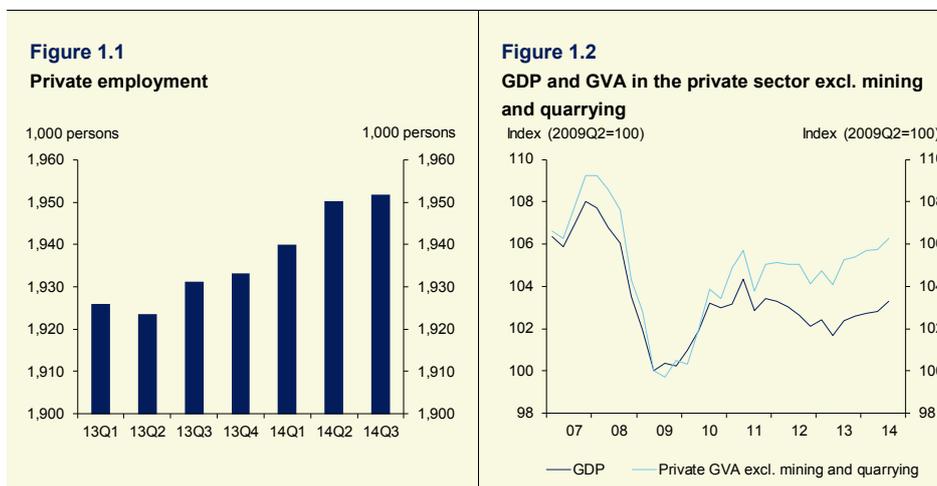
Economic Survey – December 2014

1.1 The current economic outlook

The Danish economy *is* improving, although growth through 2014 has been weaker than previously expected. The improvement is most evident in the labour market, where private sector employment has grown by nearly 30,000 persons since mid-2013, *cf. figure 1.1*. The increase reflects the fact that production in large parts of the private sector is rising faster than overall GDP-growth would imply, *cf. figure 1.2*. Meanwhile, unemployment has gone down, and fewer are affected by long-term unemployment.

Growth in Danish export markets slowed during 2014, which should be viewed in light of increased uncertainty about the underlying strength of progress in several euro area countries and geopolitical tensions. This has led the international organisations to downgrade the growth outlook.

The weaker growth in foreign demand has contributed to more subdued growth in Denmark, and Danish companies and households have been more hesitant to invest and consume. Against this backdrop, the growth estimate for the Danish economy has been revised down in the current projection compared to the assessment in *Economic Survey, August 2014*. GDP-growth is now estimated to be ¾ per cent in 2014 increasing to around 1½ per cent in 2015 and 2 per cent in 2016.



Note: Employment in figure 1.1 includes leave.
Source: Statistics Denmark and own calculations.

The preconditions for stronger growth are present in most of the euro area, and therefore growth is expected to increase as the current uncertainty subsides. The improvement is expected to be driven mainly by the German economy, which is fundamentally sound and has a robust labour market. Among other major trading partners, like the US and the UK, where growth is more robust, the current recovery is expected to continue.

Increasing growth abroad allows for exports to become a major driver for the Danish economy once again, and gradually domestic demand will also gain traction. Progress is mainly expected to take place in the private sector. Against this backdrop, employment is expected to increase by just over 60,000 persons in the period 2014-16.

The outlook for Danish growth also reflects that the adjustment in the Danish economy has come a long way following the overheating of the 00's and the global downturn in 2008-09. Competitiveness has strengthened notably in recent years, household finances have become better balanced, and the housing market is strengthening once again.

Furthermore, the government has implemented a series of reforms and growth initiatives that will support growth prospects. This applies to the labour market, where increasing labour supply and improved structures implies a greater potential for employment growth. Meanwhile, a number of business oriented initiatives have been undertaken, which improve the growth conditions for Danish companies.

The improvement is also supported by monetary policy, which has been eased further, implying an extended period of very low interest rates. Fiscal policy remains supportive in the sense that the level of public consumption and investments is relatively high both in a historical perspective, and compared to the level consistent with long-term fiscal sustainability.

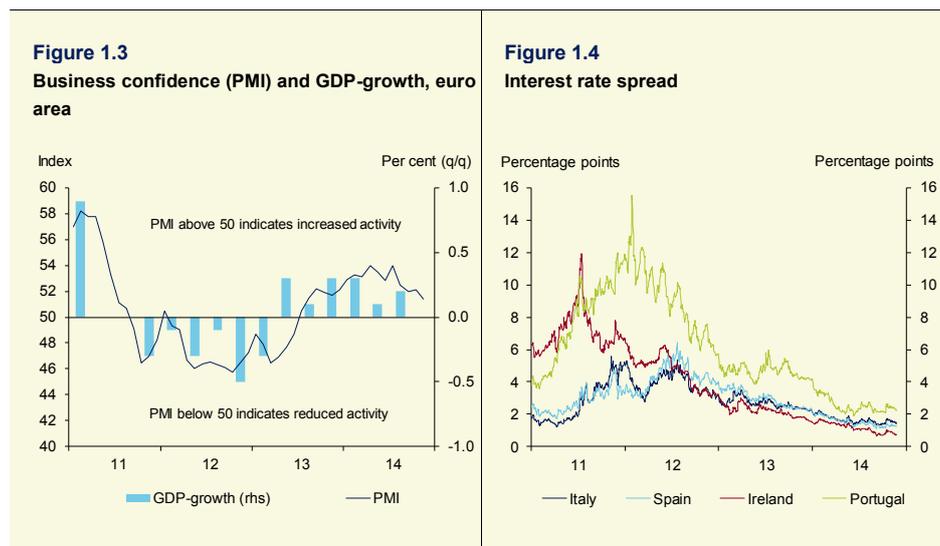
It is against this backdrop that the prospects of increasing growth over the coming years should be viewed. The risk environment has, however, turned more negative over the course of 2014, and uncertainty is mainly related to the euro area, where doubt remains regarding the underlying strength of the recovery in a number of countries. If the euro area – contrary to expectations – should move into an period of outright stagnation with weak growth and low inflation, this will spill over to the Danish economy. In this case, the road towards a normalisation of the business cycle will be prolonged, even though interest rates would also be expected to remain at record lows for longer under such a scenario. This could mitigate the impact on the Danish economy, which is likely to be more sensitive to interest rate changes than most other countries.

1.2 The forecast

Growth abroad is gradually expected to raise Danish exports

Over the course of 2014 there has been a moderation in euro area growth, following improvements through 2013. Uncertainty regarding the underlying strength of the recovery in several euro area countries may, together with geopolitical tensions, have contributed to a more uneven growth pattern, including through businesses having postponed investment decisions. However, sentiment indicators remain at a level that points to increasing activity in

the euro area as a whole, *cf. figure 1.3*. The German economy returned to growth in the third quarter after posting a decline in the second quarter. An improvement can also be traced in the vulnerable countries such as Greece, Portugal, and Spain. Developments have, however, been more sluggish in France and particularly in the Italian economy, which is characterised by stagnation and rising unemployment.



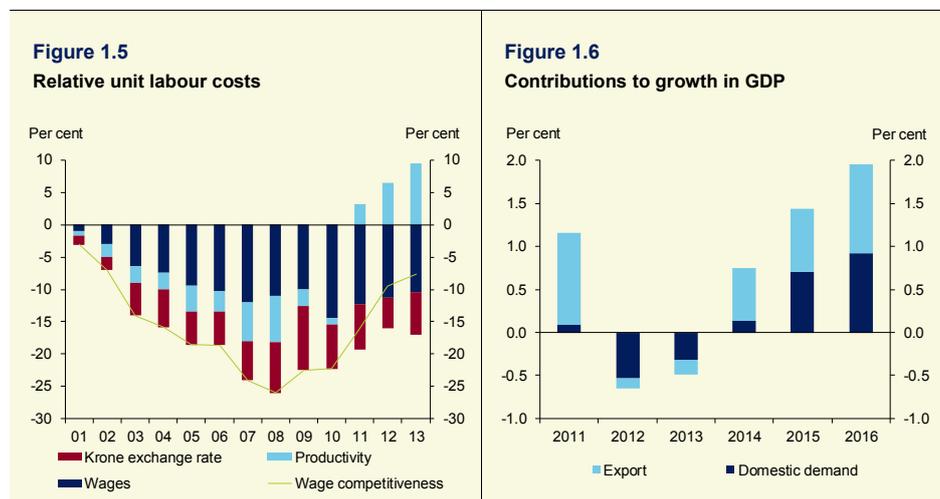
Note: In figure 1.3, business confidence is measured by the PMI-index.

Source: Reuters EconWin and own calculation.

The overall assessment by international organisations is that the recovery will continue in the euro area, though growth expectations have been revised downward. The potential for improvement is partly attributed to recent year's reform effort, fiscal consolidation, and the reestablishment of confidence in a number of the vulnerable euro area countries. This has contributed to the narrowing of interest rate spreads, *cf. figure 1.4*. The improvement in European financial markets was also emphasised by the ECB's health check of the largest euro area banks in the form of a stress test and the so-called asset quality review. With the exception of a few (notably Italian) banks, the study indicated that the vast majority of the banks are relatively healthy.

Monetary policy in the euro area has been eased further, with an interest rate cut in September, and will continue to support activity going forward. The rate cut should be seen in context of the fact that euro area inflation has gone further down to a very low level, partly due to the decline in oil prices over the later part of 2014. The low inflation contributes to raising real income, which will support consumption growth.

Other countries among Denmark's major trading partners have sustained a high level of growth throughout 2014. This includes the US, the UK and Sweden. Growth in these countries seems more robust, but the weaker development in the euro area and geopolitical tensions could have spill over effects here as well.



Note: In figure 1.6, exports are adjusted for import content and domestic demand. The reduced contribution to growth from domestic demand compared to the latest assessment in August is partially a consequence of the transition to the new national accounts, since a change in the calculation of insurance compensations following the storms late in 2013 have, in isolation, drawn down private consumption.

Source: Statistics Denmark and own calculations.

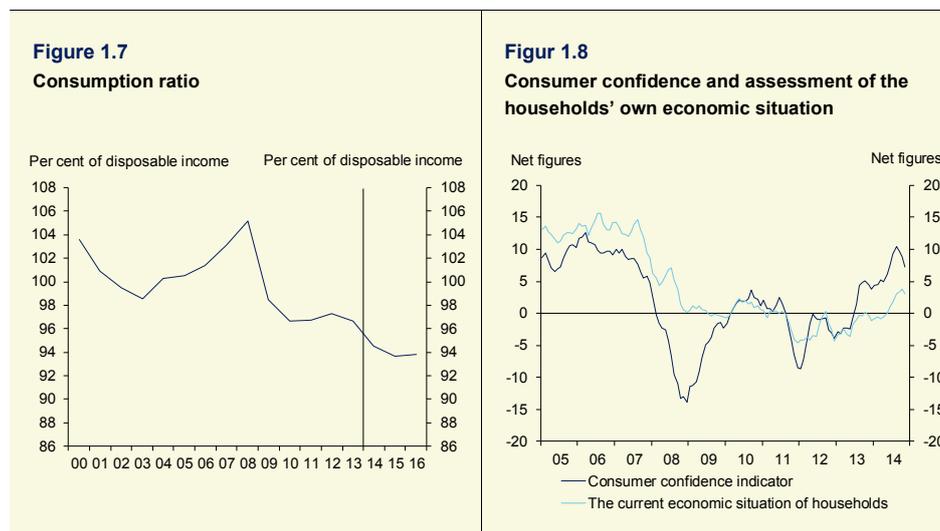
Danish exports are expected to increase in line with progress abroad. Export growth is supported by recent year's improvement in Danish competitiveness, partly as a result of several years with moderate wage increases and a significant strengthening of productivity, *cf. figure 1.5*. Decreasing wage shares in manufacturing confirm the impression of strengthened private sector competitiveness. Corporate competitiveness is also supported by the easing of tax burdens and other initiatives, which improve the business conditions. These include initiatives in the Growth Package 2014. Exports are expected to be a significant driver behind Danish growth gaining momentum over the coming years, *cf. figure 1.6*.

Growth in domestic demand

Domestic demand has increased in 2014, though not at the expected pace. This is mainly due to a weaker development in private consumption, where the consumption ratio remains at a very low level in a historical context, *cf. figure 1.7*. The trend in consumption has, however, been affected by the mild weather last winter, and if energy outlays are ignored, there have been signs of rising underlying consumption during 2014. Over the coming years, rising employment and increasing incomes could help lift consumption. Consumption growth is supported real wage gains as a result of very low inflation.

Furthermore, consumer confidence is at a relatively high level, and during 2014 there has been a significant improvement in households' assessment of their own economic situation, which has become positive for the first time in a long while, *cf. figure 1.8*. Progress in the la-

bour market and the rising house prices contribute to a more positive view on their own economy. Thus, households' assessment of their own economy is particularly up-beat in areas, where housing prices have gone up the most.



Note: In figure 1.7, the consumption ratio is consumption relative to the adjusted disposable income. In figure 1.8 a three month moving average is used.

Source: Statistics Denmark and own calculations.

In the forecast it is assumed that the consumption ratio remains at a relatively low level, and that consumption therefore only develops in line with incomes. However, consumption will be able to grow faster if low interest rates, increasing house prices, and a declining risk of unemployment leads to a higher consumption ratio.

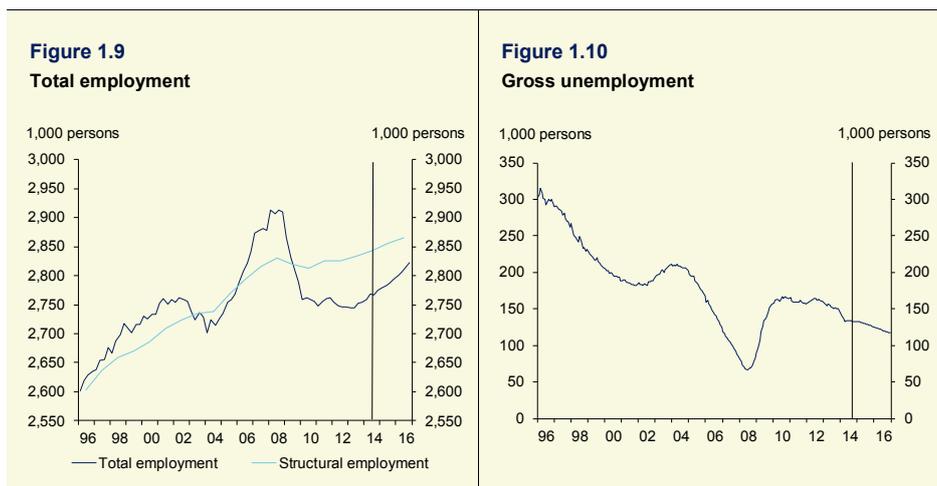
The level of investments has been extraordinarily low for some years and lower than the current depreciation of production capital. As demand rises, including from abroad, capacity utilisation will go up and companies are therefore expected to once again invest in new production facilities.

More jobs

Up until now, the most evident improvement in the Danish economy has been seen in the labour market, where employment has been rising over the past year and a half, *cf. figure 1.9*. The improvement has mainly taken place in the private sector, where employment rose by nearly 30,000 persons since mid-2013.

This is because there is a greater underlying production growth in large parts of the private sector than the development in GDP indicates. This is primarily attributed to declining production in the North Sea, which has pulled down overall growth in recent years. In the first three quarters of 2014 production in the private sector excluding mining and quarrying went up by 1.1 per cent compared to the same period the year before, while the corresponding increase in GDP was 0.7 per cent.

In the coming years the improvement in the Danish economy is projected to be strong enough to boost employment further. Growth is predominantly anticipated to take place in the private sector, where 15,000 and 25,000 more persons are expected to gain employment in 2015 and 2016 respectively. Based on the expected growth in public consumption, public sector employment is projected to grow by 4,000 persons in 2015 and be unchanged in 2016.



Note: Employment is presented including leave.

Source: Statistics Denmark and own calculations.

In recent years, a number of reforms have been made that contribute to a flexible labour market and raises the structural level of employment. This allows for an improvement in the business cycle stance to translate into more jobs and fewer unemployed, without giving rise to labour shortages.

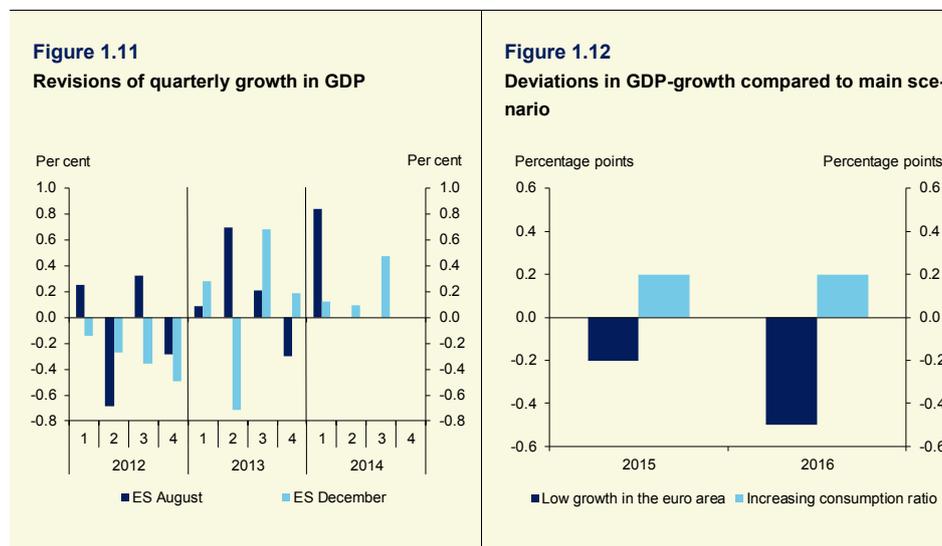
Overall, unemployment has gone down since mid-2012 and it is expected to fall further over the forecast period due to continued employment growth, cf. figure 1.10. Long-term unemployment has also been reduced over the period, and there is still a high level of job mobility in Denmark compared to other countries, despite recent year's weak economic growth. In 2013 alone, more than 500,000 persons found a new job, and part of them came from being unemployed. This testifies to the healthy structures of the Danish labour market, which also contributes to fewer persons on long-term public support, cf. section 1.4.

Uncertainty and alternative scenarios for the economic outlook

The forecast is based on an overall assessment of a wide range of indicators for the economic trajectory both at home and abroad. The forecast is naturally subject to uncertainty relating to both the data and the specific underlying assumptions, on which the forecast is based.

Since the last assessment in *Economic Survey*, August 2014, Statistics Denmark has published a new major revision of the national accounts. The new statistics paint a different picture of growth over the last year and a half than what formed the basis for the August assessment, cf. figure 1.11. It now shows that there has been positive growth for the past five

quarters. However, growth in the first half of 2014 has been more subdued than previous data indicated. This explains part of the downgrade of the growth outlook in this survey.



Note: The quarterly growth rates in figure 1.11 are based on the numbers from the national accounts at the time of the publication of this survey and the figures available for the August Survey.

Source: Statistics Denmark and own calculations.

The relatively weak growth through 2014 is linked with developments abroad, which have affected exports. Overall exports are also affected by the larger-than-expected decline in energy exports due to production halts in some North Sea fields earlier in the year. In addition, domestic demand has been weaker than expected.

Selected key figures from the forecast can be found in table 1.1, while the annex presents a comparison with the forecast from the *Economic Survey*, August 2014.

As a small open economy, the Danish economy is closely linked to developments abroad particularly in the euro area. Growth in the euro area is still regarded as fragile, which entails risk of a continued uneven growth trajectory and the potential for additional quarters of decline. This would also spill over to the Danish economy. The effect does not only work directly through exports, but can also be indirect, since lack of confidence in growth and uncertainty in itself can make Danish companies and households more hesitant and therefore postpone consumption and investments.

In case of low growth in the euro area, Danish economic growth will be reduced by around $\frac{1}{4}$ percentage point in 2015 and $\frac{1}{2}$ percentage point in 2016, cf. figure 1.12 and box 1.1. There is also scope for a more benign growth trajectory, if the recovery in Danish domestic demand turns out stronger.

Box 1.1**Alternative scenarios**

The development in the Danish economy is closely related to the one abroad. At the moment, developments in the euro area are particularly uncertain at the moment. Several factors can contribute to a more persistently weak development in domestic demand of the euro area, including high unemployment, high debt and limited underlying growth.

A continued weak development in the activity of the euro area could lead to lower inflation expectations and deterioration in financial market sentiment. On this background, the OECD's risk scenario in *Economic Outlook* No. 96 assumes risk premiums increase 1 percentage points and that equity prices are reduced by 10 per cent. The scenario implies that GDP growth in the euro area is reduced by ½ percentage point in 2015 and 1 percentage point in 2016. The development will affect trading partners through imports. However, growth in the OECD risk scenario will still be reasonable in the United States, United Kingdom and Sweden amongst others, and an outright confidence crisis does not emerge.

A more positive scenario is also possible, and may be related to a stronger growth in Danish domestic demand. The main scenario is founded on the assumption that the consumption rate is nearly unchanged from 2014. The demand could also develop faster if e.g. low interest rates, increasing house prices and decreasing unemployment risk leads to a higher consumption ratio.

The sensitivity to changed assumptions is illustrated by two different scenarios:

- Negative scenario: Low growth scenario in the euro area, where the growth is assumed to be ½ percentage point and 1 percentage point lower in 2015 and 2016 respectively, corresponding to OECD's risk scenario. It is assumed that the reduction in exports make Danish businesses more reluctant to invest, implying that growth in business investments is assumed to be 2½ percentage points lower in both years.
- Positive scenario: Faster recovery of domestic demand, where growth in private consumption is assumed to be ½ percentage point higher in both years. The scenario implies an increasing consumption ratio.

In the negative scenario, growth in GDP decreases by ¼ percentage point in 2015 and by ½ percentage point in 2016, cf. *table a*. The scenario implies higher unemployment and a worsening of the general government fiscal balance. A worsening of the general government fiscal balance reflects exclusively the consequences for the public expenditure and revenue caused by a change in activity. The positive scenario implies that the growth in GDP is about ¼ percentage point higher in both 2015 and 2016.

Table a

	Negative scenario		Main scenario		Positive scenario	
	2015	2016	2015	2016	2015	2016
Growth in real GDP, per cent	1,2	1,5	1,4	2,0	1,6	2,2
Unemployment, per cent	4,6	4,5	4,5	4,2	4,4	4,0
General government fiscal balance, per cent of GDP	-2,7	-3,0	-2,5	-2,6	-2,4	-2,3

Table 1.1
Key figures

	2013	2014	2015	2016
Percentage change from previous year				
Private consumption	0.0	0.1	1.5	1.6
Public consumption	-0.5	0.9	1.5	0.1
Public investment	0.3	3.1	0.6	-2.5
Residential construction	-5.0	4.5	2.5	5.5
Fixed business investments	3.8	2.4	3.2	6.8
Stock building (per cent of GDP)	-0.2	0.1	0.0	0.2
Exports of goods and services	0.8	2.2	4.0	4.7
Imports of goods and services	1.5	2.6	4.8	5.3
GDP	-0.5	0.7	1.4	2.0
Level (per cent of GDP)				
General government fiscal balance	-1.1	1.8	-2.5	-2.6
Current account	7.1	6.9	6.9	6.7
Level, 1,000 persons				
Gross unemployment (annual average)	153	135	130	123
Employment (incl. leave)	2,749	2,767	2,786	2,811
Labour force	2,889	2,892	2,907	2,925
Rate of change, per cent				
House prices (single-family house)	2.7	3.0	3.5	3.5
Consumer prices	0.8	0.6	0.8	1.5
Hourly earnings, private sector (Danish Employers Federation statistics)	1.4	1.7	1.9	2.4

1.3 Fiscal policy and public finances

Even though the Danish economy is improving, there are still unemployed resources and the output gap is estimated at approx. -2 per cent of GDP for 2015. Against this background, fiscal policy for 2015 is designed to support economic activity and employment as much as possible within the rules-based framework inter alia given by the Danish Budget Law. Within this framework, the agreement on the budget bill for 2015 e.g. allocates additional resources to the health care area.

The pension package from October 2014 has created a margin relative to the EU's 3 per cent of GDP limit regarding the actual budget deficit in 2015, without dampening economic activity. Furthermore the actual deficit for 2016 is expected to keep a similar distance vis-à-vis EU's deficit limit.

Public investment and consumption expenditures as a share of GDP are still high in a historical perspective and compared to the sustainable level going forward. The relatively high expenditure level in these years, when economic activity is below normal, has contributed to support the economy.

At the same time monetary policy in the euro area and in Denmark is highly expansionary, which also contributes to support activity in the EU and in Denmark.

As the economy gains further momentum a gradual normalization of the fiscal policy stance is needed. This is mainly achieved through the implementation of reforms and a gradual normalization of the current high level for public investment. In this manner, progress is made towards the required at least structural balance in 2020, which is consistent with fiscal sustainability.

Budget surplus in 2014 and a margin to EU's deficit limit in 2015

Currently the actual budget balance is expected to show a surplus of 1.8 per cent of GDP in 2014, which is an improvement of approx. 3 per cent of GDP compared to the August estimate. The upwards adjustment is primarily due to temporary factors. First, the one-off revenues stemming from the restructuring of capital pensions currently are estimated at DKK 58 bn, which is DKK 28 bn (almost 1½ per cent of GDP) higher than the August forecast. Second, revenues from the pension yield tax are currently estimated at DKK 57 bn, which is approx. DKK 25 bn (approx. 1¼ per cent of GDP) higher than expected in August. The higher revenues from the pension yield tax namely reflect lower interest rates in the second half of 2014 than markets had previously expected.

The increased one-off revenues in 2014 do not affect the structural budget balance and, as such have no impact on the fiscal room for manoeuvre. However, a part of the estimated budget improvement for 2014 is due to lower public consumption expenditures at both the central government and municipal level than assumed in August. This contributes to an improvement of the estimated structural budget balance in 2014 since the August Survey. The latest calculations entail a structural budget deficit of 0.5 per cent of GDP corresponding to the limit in the Budget Law.

For 2015 an actual budget deficit of 2.5 per cent of GDP is estimated. This implies a certain margin compared to EU's limit for the actual budget deficit of 3 per cent of GDP. The margin should primarily be seen in light of the pension package from October 2014, *cf. box 1.2*.

Box 1.2

The pension package increases the distance to EU's deficit limit in 2015

The draft budget bill for 2015 fully employed the available room for manoeuvre, which was reflected in a structural deficit of ½ per cent of GDP. At the same time the actual budget deficit was estimated at 3 per cent of GDP in 2015. After the presentation of the draft budget bill in August the flow of new economic indicators pointed in the direction of more dampened growth prospects. Thus the agreed on a pension package with the Red-Green Alliance (Enhedslisten) and the Socialist People's Party (Socialistisk Folkeparti) in October 2014. The pension package is estimated to improve the actual budget balance by approx. DKK 15 bn in 2015 corresponding to ¾ per cent of GDP without dampening economic activity. Despite the weaker growth prospects the improvement in 2015 contributes to a certain margin vis-à-vis EU's deficit limit of 3 per cent of GDP concerning the actual budget balance. This applies to both the current assessment and the EU Commission's latest forecast, *cf. table a*.

The pension package revenues partly stem from a prolongation of the period where it is possible to restructure capital pensions with a tax rebate to also include 2015 (and not only 2013-14). In addition, all persons over 60 years with savings in Lønmodtagernes Dyrtdidsfond (LD) are allowed to take out their savings in 2015 with a tax rebate. Similarly there is a possibility for persons over 60 years to choose to pay the tax with the rebate and let the savings continue in LD. Persons with LD savings, which turn 60 years in 2016 or later, has the same option, as long as the pay out or restructuring of savings takes place before the person turns 61 years. The pension package implies an advancement of future revenues with a tax rebate. Thus the revenues are of one-off nature and do not affect the structural budget balance in 2015.

Table a

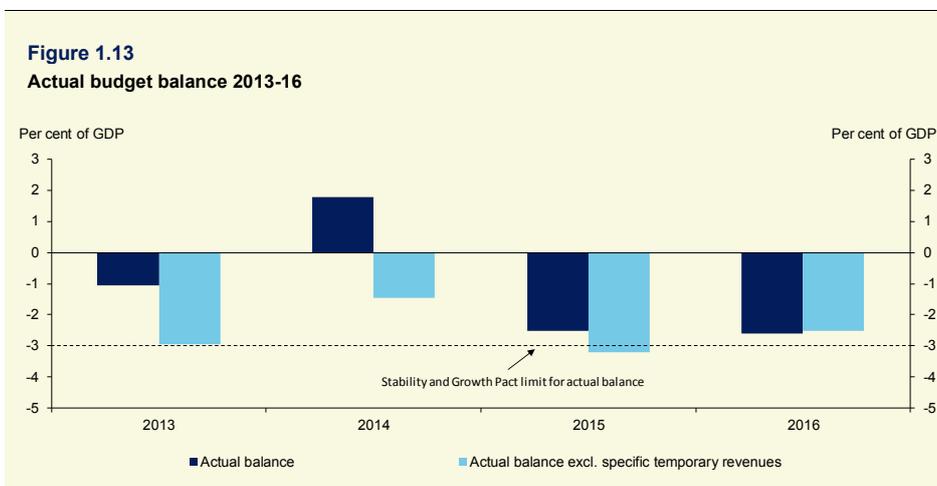
Actual budget balance estimates for 2015

	Economic Survey	EU Commission
Pct. of BNP		
Previous forecast	-3.0	-2.7
Latest forecast	-2.5	-2.3
- Hereof contribution from pension package	¾	¾
- Actual balance excl. pension package	Approx. -3¼	Approx. -3

Note: The EU Commission calculates the actual budget balance using EDP-principles, where EDP is short for "excessive deficit procedure", while the Economic Survey estimates follow national account principles. Thus minor technical differences in the calculation method might appear.

- 1) The pension package is expected to be approved by the Parliament (Folketinget) at the latest on 19 December 2014.

Source: The EU Commission's Spring and Autumn forecast 2014 and own calculations.



Anm.: The budget balance excl. particular temporary revenues are corrected for one-off revenues stemming from the restructuring of existing capital pensions, pay out and restructuring of savings in *Lønmodtagernes Dyrtdidsfond (L.D)*, a reallocation in the pension sector from schemes with guaranteed yield to schemes based on market return, and advanced ordinary revenues from the taxation of capital pensions.

Source: Statistics Denmark and own calculations.

The significant one-off revenues which improve the budget balance in 2013-2015 more or less lapse in 2016. Thus despite the expected progress in GDP and employment the actual budget deficit is estimated to remain largely unchanged from 2015 to 2016, *cf. figure 1.13*.

Due to the specific uncertainties connected to the assumed one-off revenues, the overall uncertainty with respect to the actual budget balance is especially large in the current juncture. However, it applies quite generally, that the actual budget balance in Denmark is very cyclically sensitive and can be affected quite strongly by temporary fluctuations in revenues from the pension yield tax etc., *cf. box 1.3*. In that perspective fiscal policy is primarily planned on the basis of the *structural* balance, which is adjusted for temporary factors affecting public finances. Thus, the structural budget balance is the key target for public finances in the Danish Budget Law.

However, in the current juncture characterized by significantly negative output and employment gaps it is still a separate consideration to keep the actual deficit within the limits of EU's Stability and Growth Pact. Exceeding the EU's deficit limit of 3 per cent of GDP would lead to a new recommendation to bring the actual budget deficit below 3 per cent of GDP within a given deadline, unless the breach were considered to be limited and temporary.

Box 1.3**Revised estimates for the actual budget balance 2013-2015**

A comparison of the estimated actual budget balance produced when presenting the draft budget bill for a given year and the current economic survey exhibits a upwards adjustment of the actual balance in 2013-15, cf. table a. For 2013 and 2014 the adjustment reflects higher one-off revenues from the restructuring of capital pensions with a tax rebate. Furthermore, with respect to 2014 the revenues from the pension yield tax have been revised markedly upwards. For 2015 the improvement partly reflects higher estimated revenues from the pension yield tax and partly the assumed impact of the pension package.

Besides the revisions of revenues from the pension yield tax and one-off revenues, the actual budget balance is affected by revised estimates for the remaining public revenues and expenditures, including the impact of revised estimates for activity and employment, oil prices etc. For instance the revenues from North Sea activities have been revised downwards for all three years 2013-15 compared to the estimates produced at the time of presenting the draft budget bills for the given years. The estimated North Sea revenues for a given year are affected by the expected oil price. Thus, a lower than expected oil price measured in USD – ceteris paribus – implies a decrease in North Sea revenues. Conversely a lower oil price could lead to higher economic activity, which to a certain extent can offset the direct weakening of public finances stemming from the lower North Sea revenues.

Table a**Actual budget balance estimates 2013-15**

	2013	2014	2015
DKK bn, current prices			
Actual balance – draft budget bill estimate	-37	-38	-60
Current forecast (December 2014)	-20	34	-50
Revision of estimates¹⁾	17	73	10
- <i>pension yield tax</i>	-1	31	5
- <i>change in one-off revenues²⁾</i>	24	38	15
- <i>North-Sea revenues</i>	-4	-5	-4
- <i>other factors</i>	-2	9	-5
Memo item: Total revision in per cent of GDP	0,9	3,8	0,5

Note: Estimates are rounded to the nearest DKK bn. The current forecast (Economic Survey – December 2014) is based on the revised national accounts (ESA2010) and the budget balance for 2013 is based on actual accounting figures.

- 1) Positive numbers indicate an improvement of the budget balance through higher public revenues or lower expenditures and vice versa concerning negative numbers.
- 2) Includes revisions of assumed one-off revenues stemming from the restructuring of capital pensions in 2013-15 and LD savings in 2015.

Source: Statistics Denmark and own calculations.

Thus, the limit for the structural budget deficit of ½ per cent of GDP stipulated in the Budget Law is set so it basically ensures that the actual deficit in a normal recession will comply with the limit of 3 per cent of GDP with high probability.¹

As part of the *Agreement on a tax reform (2012)* etc. it was agreed that one-off revenues should essentially be used to reduce public debt. Partly due to the current high one-off revenues public net debt is estimated to be close to zero by the end of 2014 (approx. 1 per cent of GDP). Given the forecasted budget deficits in 2015 and 2016 public net debt is estimated to remain at a still moderate level of 6 per cent of GDP by the end of 2016. Furthermore, public gross debt (EMU definition) is estimated at 42½ and 43 per cent of GDP in 2015 and 2016 respectively, thus keeping a broad safety margin to the requirement of the Stability and Growth Pact.

Fiscal room for manoeuvre fully utilized

Fiscal policy is planned and designed within the framework given by the structural budget deficit limit of ½ per cent of GDP stipulated in the Budget Law. The structural deficit limit of the Budget Law essentially applies when presenting the draft budget bill for a given fiscal year. Nevertheless, this does not imply a possibility (in the period following the presentation of the draft budget bill) to introduce discretionary measures that weaken the structural balance beyond the deficit limit.

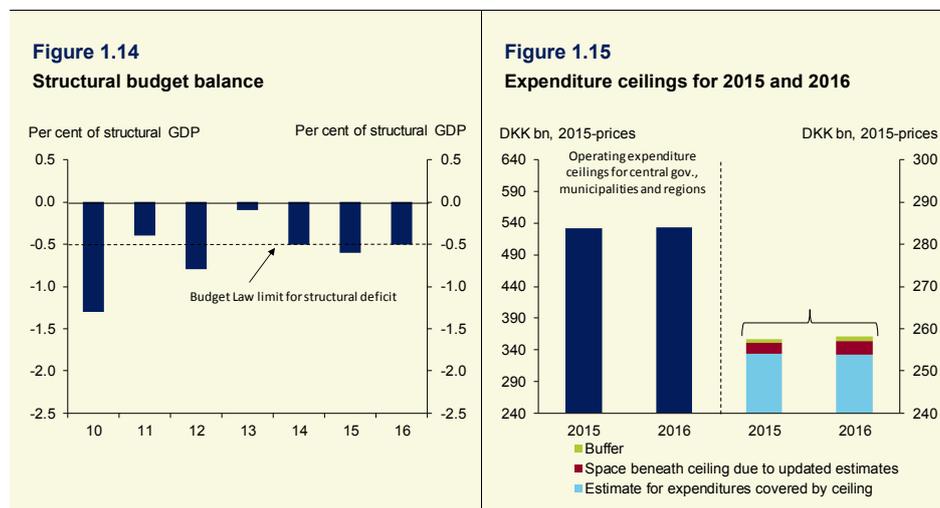
At the presentation of the draft budget bill for 2015 in August the structural budget deficit was estimated at 0.5 per cent of GDP. Currently the structural deficit for 2015 is calculated at 0.6 per cent of GDP, *cf. figure 1.14*. Among other things the higher structural deficit in 2015 reflects an upwards adjustment in expected refugee related income transfers. This adjustment reflects revised spending estimates, i.e. it is not caused by a change in rules or policy decisions. The agreement on the budget bill is fully financed and complies with the legislated expenditure ceilings.

Since the August Economic Survey new information about public finances has been incorporated, including the agreement on the budget bill for 2015 and the revision of national accounts (ESA2010). Based on the revised national accounts the methods for calculating the structural balance and the output gap etc. have been updated.

Based on technical assumptions concerning fiscal policy, the structural deficit is estimated at 0.5 per cent of GDP for 2016. The estimated structural balance for 2016 is based on the assumption that expenditure ceilings for the operating costs in central government, municipalities and regions, respectively, are fully utilized. Concerning the central government expenditure ceiling for income transfers the latest spending estimates are included, currently being approx. DKK 4 bn lower than the stipulated expenditure ceiling (incl. a buffer) for 2016, *cf.*

¹ The EU Commission's method for calculating the minimum requirement with respect to the medium term objective (MTO) for a given member state – based on the so called minimum benchmark – concretely implies, that the lower limit for the structural balance should be set, so that the probability of exceeding the actual budget deficit limit of 3 per cent of GDP in a normal recession amounts to 5 per cent, *cf. Finansredogørelse 2014* (available on www.fm.dk but only in Danish).

figure 1.15. If the spending on income transfers covered by the ceiling increases within or fully up to the stipulated limit, this would weaken the structural balance in 2016.



Source: Statistics Denmark, budget bill for 2015 and own calculations.

As growth in the Danish economy is expected to gain further momentum in the coming years, there will be a need to gradually increase the distance to the structural deficit limit stipulated in the Budget Law in order to make progress toward the required structural balance in 2020. Thus, public expenditures as share of GDP gradually have to adjust towards the spending levels that are consistent with fiscal sustainability.

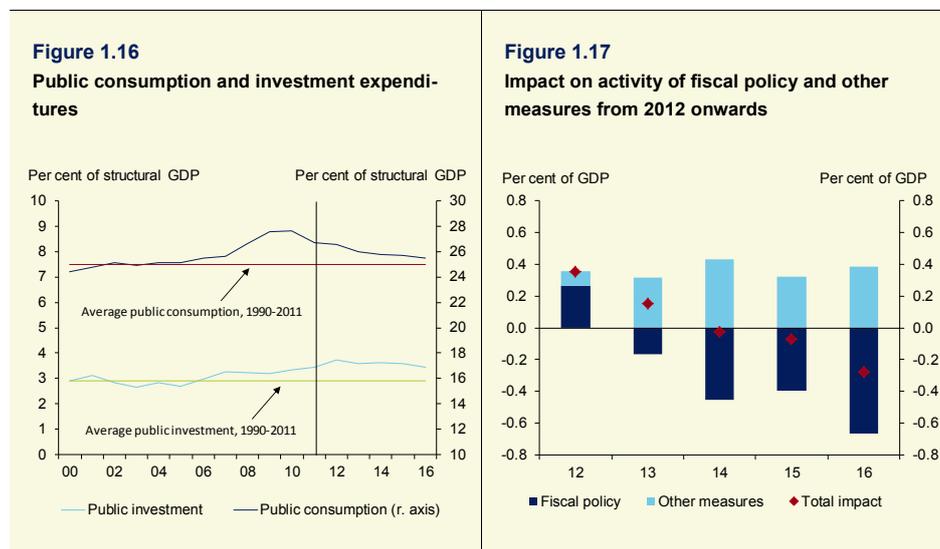
Fiscal policy is aligned with the business cycle

During the economic crisis the expenditure policy has been expansionary seen in a historical perspective, *cf. figure 1.16*. This is also true with regard to the planned policy for 2015, which is designed to support the economy as much as possible within the given fiscal policy framework.

The impact on economic activity due to the fiscal easing and other measures conducted from 2012 and onwards is estimated to decrease gradually, *cf. figure 1.17*. Thus, the impact on GDP is estimated to be approximately neutral in 2014 and somewhat dampening in 2015, where employment currently is forecasted to increase by almost 20,000 persons.

The calculated contributions to economic activity cover divergent contributions from fiscal policy and a number of other measures that are not part of public finances, respectively. The contribution from fiscal policy is estimated to be decreasing and negative from 2013 onwards. This reflects, that the impact on activity is calculated from an already expansionary starting point in 2011, and the need to consolidate public finances in the period 2011-2013 namely due to Denmark's EU-recommendation. Conversely a number of other politically initiated measures, which do not affect public finances directly, still support the Danish economy in the current years. These measures primarily reflect private investments following the energy

agreement and investments in social housing. Furthermore, the accommodative monetary policy characterized by low interest rates also contributes to support activity and employment.



Note: In figure 1.17, other investments cover private investments following the energy agreement, politically agreed increases and advancements of investments in social housing, climate-related investments in the waste water sector (*cf. agreement on the municipalities' economy for 2013*) and advanced activities in Fehmarn Belt (excl. land plants) agreed upon in *Growth Plan DK*.

Source: Statistics Denmark and own calculations.

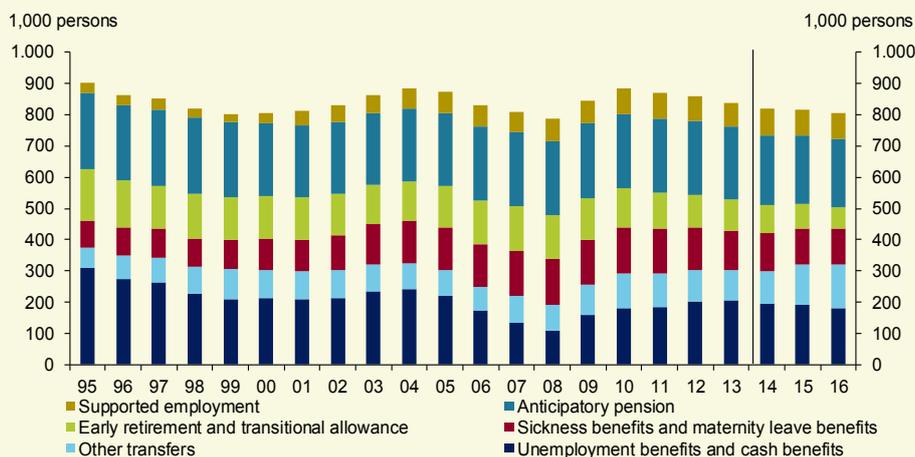
Fiscal policy for 2016 is determined in more detail in connection with the agreements on the economy of municipalities and regions and the budget bill for 2016. In 2016 GDP-growth is expected to gain further momentum and reach 2 per cent, while employment is expected to grow by approx. 25,000 persons. This takes into account, that the impact of previous easing decreases further, and that the total contribution to activity is dampened. This should be seen in light of the need to secure that fiscal policy is counter cyclical, i.e. the expected growth acceleration implies the need for a gradually less expansionary fiscal policy.

1.4 Fewer long-term recipients of public benefits

In recent years there has been a fairly large drop in the number of public benefit recipients in the age group of 16-64 year olds, excluding recipients of state education grants. From 2010 to 2013, the number of public benefit recipients has dropped by approximately 45,000 full-time equivalents, and the downward trend has continued into 2014, *cf. figure 1.18*.

The decline in the number of public benefit recipients reflects among other things that the ongoing recovery of the Danish economy has increased employment. In addition, more young people have started education, and the number of persons receiving early retirement benefits and anticipatory pensions has fallen.

Figure 1.18
Public benefit recipients



Note: The figure is based on full-time equivalents. Apart from state education grants, all types of transfers directed towards the age group 16-64 years are included, including supported employment. To ensure comparability, the numbers before 2007 are adjusted for the reduction in the retirement age from 67 to 65 years in 2004-2006.

Source: Statistics Denmark, DREAM and own calculations.

In 2013 there were 838,000 recipients of public benefits (full-time equivalents).² This number includes both short-term and long-term recipients. During 2013 nearly 1.4 million 16-64 year olds received public benefits (excluding state education grants) for a shorter or longer period of time.

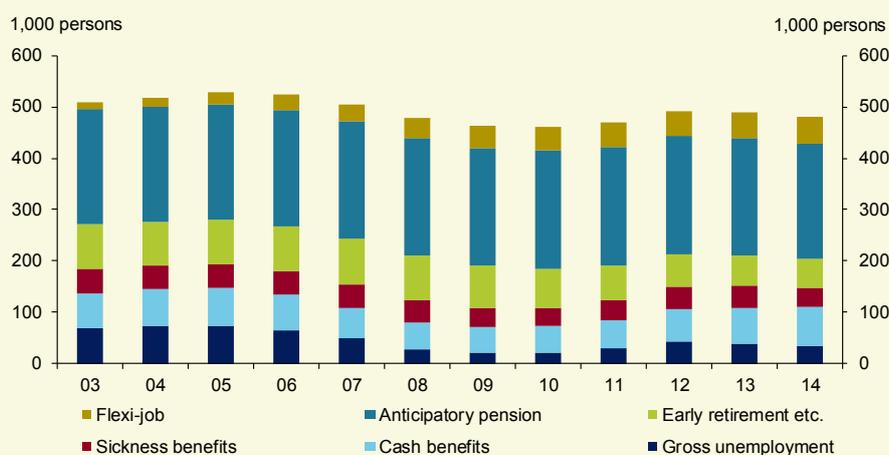
The remainder of this section will focus on people on *long-term public support*. The group is delimited to persons, who have received public benefits (excluding state education grants) for at least 80 per cent of the time within the previous three years.

As of mid-2014 there are approximately 475,000 18-64 year old long-term public benefit recipients. The majority of this group has withdrawn permanently from the labour market and receives either anticipatory pensions or early retirement benefits. However, there are also 141,000 gross unemployed, (other) cash benefit recipients, and recipients of sickness benefits, who have received public benefits for at 80 per cent of the time during the past three years.

² People in subsidised employment (the wage subsidy scheme, the flexi-job scheme, etc.) are included in this group even though they are only partially reliant on public benefits.

The number of long-term recipients of public benefits has declined over the past few years. Currently, the level is lower than nine to ten years ago, when about 530,000 received long-term public benefits. In the calculations, persons in the flexi-job scheme are included in the group of long-term public benefit recipients. Persons in the flexi-job scheme often have long-term employment. Therefore, the fall in the number of long-term recipients of public benefits over the past ten years is even larger if this group is excluded, *cf. figure 1.19*.

Figure 1.19
Long-term public benefit recipients divided by type of benefit



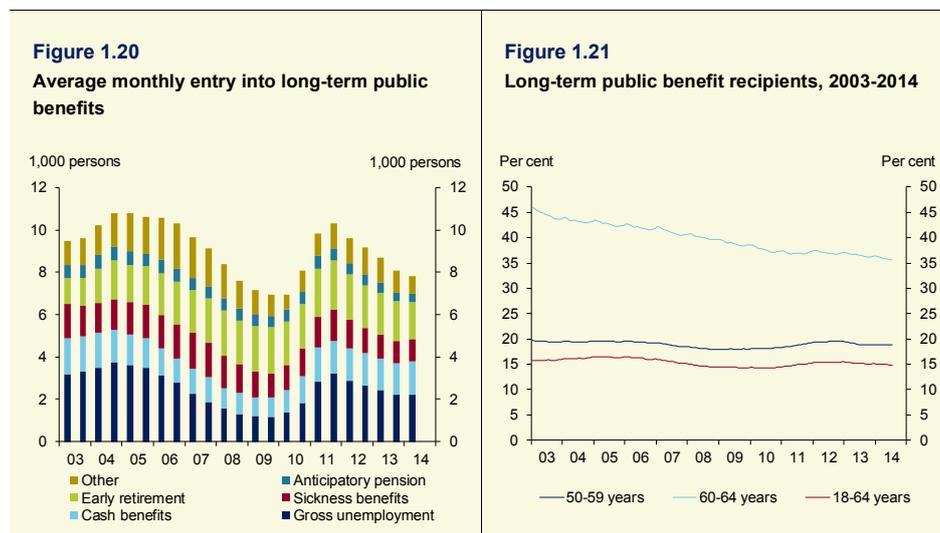
Note: Calculated as an average for the first six months of the year. The underlying monthly numbers are based on the labour market status in the final full week of each month. Persons registered to be on a temporary “leave” (up to 3 weeks) from receiving public benefits are considered to be public benefit recipients during this period. The division is based on the type of benefit received at the time of account. Due to the accounting period of 3 years, the fluctuations caused by the business cycle are somewhat delayed compared to the total number of public benefit recipients.

Source: Law Model and own calculations.

The number of long-term public benefit recipients fell significantly during the boom in the mid-2000's, and increased between 2010 and 2012 due to the economic crisis. In the past few years the number of long-term public benefit recipients has dropped again.

The significant decline since 2005 is mainly driven by a fall in the number of persons receiving early retirement benefits and the number of gross unemployed. This largely reflects the effects of the reforms that have contributed to lower structural unemployment. The decrease in the number of recipients of early retirement benefits partly reflects the 1998 reform of the early retirement scheme, which included an increase in the amount of self-financing, a (larger) deduction for private pension savings, in addition to a higher benefit rate and a reward scheme for those who postpone their transition to early retirement.

The decrease in the number of long-term public benefit recipients over the past few years is due to a decline in the entry to the group. This reflects, among other things, that fewer gross unemployed have moved into the group, *cf. figure 1.20*.



Note: Figure 1.20 shows the biannual average of the monthly entries (seasonally adjusted). Part of the fall for the 50-59 year olds in figure 1.21, probably reflects a transition to senior jobs for people who exhaust their unemployment benefit entitlement.

Source: Law Model and own calculations.

The share of long-term public benefit recipients has decreased for all age groups, in particular for the 60-64 year olds, *cf. figure 1.21*. This mainly reflects the fact that fewer people than before make use of the early retirement scheme, and that fewer people receive public benefits in the period up to the early retirement date than ten years ago. This reflects, among other things, the abolition of the transitional benefit scheme as well as special rules for the elderly in the unemployment benefit system.

The large decrease in the proportion of (long-term) public benefit recipients among the 60-64 year olds is mirrored in a relative large increase in the employment rate within this age group. Despite this increase, the employment rate among 60-64 year olds is still lower than in a number of other countries, including the other Nordic countries, *cf. Economic Survey*, August 2014.

There is no doubt that the structural improvements that have been made in the labour market over the past ten years have contributed to the decrease in the number of long-term public benefit recipients. The outlook towards 2020 is for a further decline – as the business cycle is normalised and the impact of the reforms of the early retirement system, the unemployment benefit system, the cash benefit system, and the anticipatory pension system gradually increases. For instance, there is evidence that the reform of the unemployment benefit system – despite not being fully phased in – is already contributing to reduce unemployment and increase employment, *cf. Danish Economy*, autumn 2014, The Danish Economic Council. Simi-

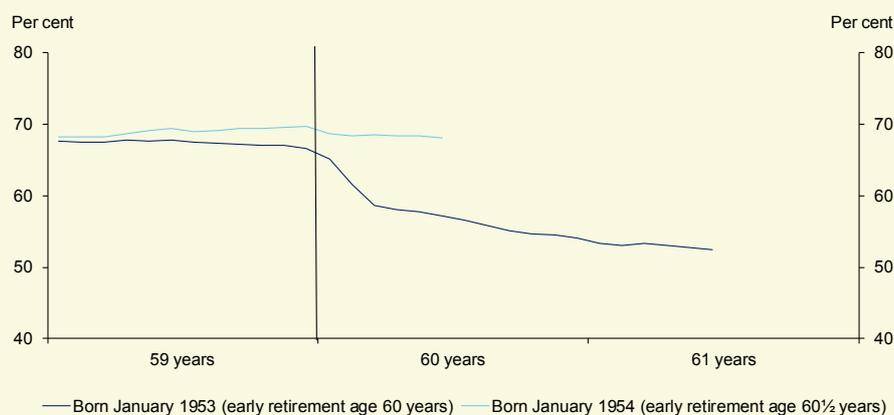
larly, the preliminary experiences with the impact of the reform of the cash benefit system indicate that more young people now enter into education or employment rather than remaining within the cash benefit system, *cf. Economic Survey*, August 2014. The impact of the reforms will increase over the coming years.

The retirement reform will also contribute to reduce the number of long-term recipients of public benefits in the years to come. The retirement reform is only starting to have an effect in 2014. The people who turned 60 in the first half of 2014 are the first to experience an increase in the early retirement age. They will not have the option to enter into early retirement until they turn 60½ years old.

The effect of the reform can already be seen. The persons, who are not eligible for early retirement before they turn 60½ years of age, remain in employment. Looking at the employment trends for the group in the months immediately after the 60th birthday shows that the employment rate remains roughly the same as just prior to this date. In contrast, the employment rate dropped sharply for older generations, who had an early retirement age of 60, when they turned 60, *cf. figure 1.22*.

Figure 1.22

Share of wage earners for two birth cohorts with different early retirement ages (60 and 60½ years respectively)



Note: All individuals with earned income in a given month are recorded as being employed regardless of the extent of their work.

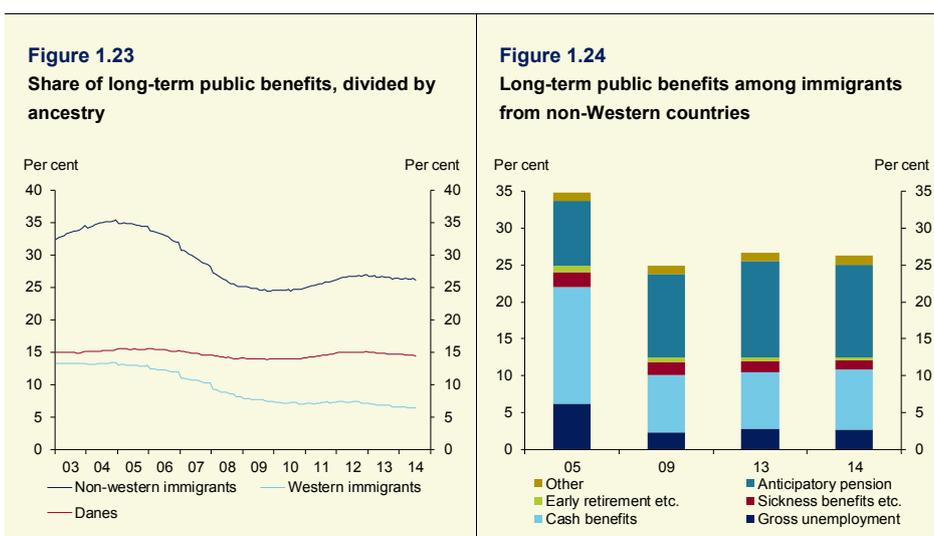
Source: Law Model and own calculations

Over the past ten years the share of long-term public benefit recipients declined most for immigrants, especially for immigrants from non-Western countries. From 2005 to 2014 the share of long-term public benefit recipients among non-Western immigrants dropped from 35 per cent to 26 per cent, *cf. figure 1.23*.

Despite the significant drop, the proportion of long-term public benefit recipients among non-Western immigrants is still almost twice as high as among Danes. This shows that there is a considerable potential for reducing the share of immigrants from non-Western countries dependent on long-term public benefits.

However, it is hardly realistic that the proportion can converge to a level comparable to the one among Danish-borne. This is, among other things, due to differences in educational composition, and because the group of non-Western immigrants includes refugees, who often have certain barriers that limit their ability to participate in the labour market, e.g. psychological problems.

The relatively sharp drop in the share of long-term public benefit recipients among immigrants from non-Western countries mainly reflects that the share of long-term gross unemployed and non-available cash benefit recipients has been reduced for this group in the period from 2005 to 2014. This reduction is particularly evident among persons under 30 years of age and among 30-39 year olds. By contrast there has been an increase in the share of long-term recipients of anticipatory pensions among immigrants from non-Western countries. This should be seen in the context of a gradual increase in the proportion of immigrants in older age groups, where the use of anticipatory pensions is more frequent, cf. figure 1.24.



Note: Descendants of immigrants are not included in Figure 1.23, as the age composition of this group differs significantly from the rest of the group. In Figure 1.24 the data is based on the first half of the year.

Source: Law Model and own calculations.

1.5 Appendix

Table 1.2
Key figures compared to the August Survey

	2014		2015		2016
	Aug.	Dec.	Aug.	Dec.	Dec.
Real growth, per cent					
Private consumption	1.3	0.1	2.1	1.5	1.6
Total public demand	1.4	1.2	0.4	1.4	-0.2
- public consumption	1.3	0.9	0.8	1.5	0.1
- public investment	1.8	3.1	-4.6	0.6	-2.5
Residential investments	3.3	4.5	2.5	2.5	5.5
Fixed business investments	1.5	2.4	6.0	3.2	6.8
Final domestic demand	1.4	0.8	2.0	1.7	1.9
Stock building (per cent of GDP)	0.0	0.1	0.1	0.0	0.2
Total domestic demand	1.5	0.9	2.1	1.7	2.1
Exports of goods and services	4.3	2.2	4.8	4.0	4.7
- of which manufactures	5.2	4.0	6.1	4.6	5.3
Total demand	2.5	1.4	3.1	2.5	3.1
Imports of goods and services	4.8	2.6	5.3	4.8	5.3
- of which goods	3.9	1.9	4.9	4.1	4.9
GDP	1.4	0.7	2.0	1.4	2.0
Gross value added	1.7	1.0	1.8	1.4	2.1
- of which private sector	2.3	1.7	2.6	1.7	2.9
Change in 1,000 persons					
Labour force	8	3	14	15	18
Employment ¹⁾	21	18	22	19	25
- of which private sector	17	21	19	15	25
- of which public sector	4	-3	3	4	0
Gross unemployment (registered)	-18	-18	-9	-5	-7
Net unemployment (registered)	-14	-11	-8	-3	-8

1) Employment is in *Economic Survey*, August 2014, calculated excl. leave, while in *Economic Survey*, December 2014 it is calculated incl. leave.

Table 1.2 (continued)
Key figures compared to the August Survey

	2014		2015		2016
	Aug.	Dec.	Aug.	Dec.	Dec.
Growth, per cent					
Merchandise export prices	0.3	-0.9	1.3	-0.3	1.7
Merchandise import prices	0.0	-1.1	1.4	-0.3	2.2
Merchandise terms of trade	0.2	0.2	-0.1	0.0	-0.5
House prices, single-family houses	3.0	3.0	3.0	3.5	3.5
Consumer prices	0.8	0.6	1.2	0.8	1.5
Hourly compensation	1.8	1.7	2.2	1.9	2.4
Real disposable income, private sector	1.6	-3.7	5.9	8.6	2.9
Real disposable income of households ²⁾	3.7	2.4	1.2	2.4	1.5
Productivity in a private non-agricultural sector	1.4	0.5	1.4	0.8	1.5
Per cent per year					
Interest rate 1-year adjustable rate loan	0.2	0.2	0.4	0.2	0.3
10-year government bonds	1.7	1.4	2.0	1.3	1.6
30-year mortgage credit bond	3.3	3.1	3.7	3.0	3.2
Balances					
Current account (bn DKK)	136.2	131.2	140.2	135.3	135.6
General government fiscal balance (bn DKK)	-22.1	34.2	-59.9	-49.7	-52.7
Gross unemployment (thousands)	135	135	126	130	123
Gross unemployment (per cent)	4.7	4.7	4.4	4.5	4.2
Net unemployment (thousands)	104	106	96	103	96
Net unemployment (per cent)	3.6	3.7	3.3	3.6	3.3
External assumptions					
Trade-weighted GDP abroad, per cent	2.2	2.0	2.6	2.2	2.4
Export markets for Danish manufactures, per cent	5.4	4.6	6.4	5.2	5.9
Exchange rate, DKK per \$	5.5	5.6	5.5	6.0	6.0
Oil price, \$ per barrel	108.3	101.0	110.9	88.0	97.2
Oil price, DKK per barrel	594.1	567.2	613.4	524.4	579.2

2) The adjusted income, see. Section 4.1.
Source: Statistics Denmark and own calculations.