Economic Survey – May 2014

1.1 The current economic outlook

There are numerous signs that growth has returned to the Danish economy. Production is growing in large parts of the private sector, businesses and households have positive expectations for the future, and there have been notable improvements in the labour market. On average, there were 10,000 more persons employed in 2013 than the previous year, and the increase during last year was 22,000 persons. That is mainly due to job creation in the private sector. The higher employment is reflected in the unemployment rate, which fell to its lowest level in four years.

The basis for growth in the Danish economy generally has become stronger, and GDP growth is expected to increase to nearly 1½ per cent in 2014 and 2 per cent in 2015, *cf. figure 1.1*. The labour market will strengthen further, and employment is expected to grow by 16-17,000 persons a year, *cf. figure 1.2*.

The improved outlook should be seen in light of the fact that the recovery in the euro area has gotten hold, while other major Danish trading partners are already further into an upswing. Growth abroad allows for exports to once again become a main driver of the Danish economy. Exports are supported by an improvement of wage competitiveness since 2008. Meanwhile, a number of economic policy initiatives have been implemented aimed at supporting the competitiveness of businesses. The proposal for Growth Package 2014 follows a number of business-oriented initiatives aimed at improving the growth opportunities for companies and making it more attractive to invest in Danish jobs.

Figure 1.1
GDP in Denmark

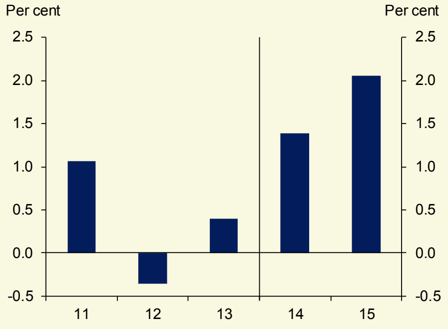
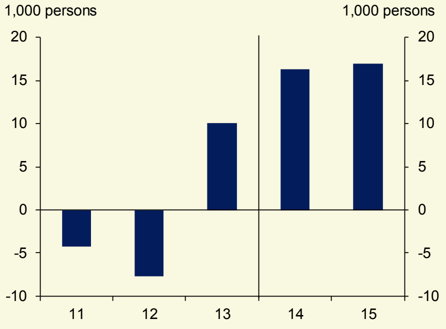


Figure 1.2
Growth in employment



Note.: Figure 1.2 has been adjusted for the lockout of teachers in 2013, which technically reduces the pub lic (and total) employment excl. leave by approx. 4,000 people in 2013.
Source: Statistics Denmark and own calculations.

Domestically, there are signs that consumer spending is on the rise again. In recent years households have held back on spending. For some, this has been a consequence of the general economic uncertainty. For others, it has been a necessary adjustment following a period of too high and partly debt financed consumption and housing investments. Consumption has now become better in tune with incomes, and there is room for it to grow roughly in line with rising incomes in the coming years.

The housing market is also improving. However, there are large regional differences, and house prices have mainly gone up in and around major cities. The adjustment following the unsustainably large house price increases in the run-up to 2007 thus appear to have taken place. This will also help to support private consumption.

Developments in the housing market and in the Danish economy more generally are supported by the continued very low interest rates. Fundamentally, this reflects an expansionary monetary policy in the euro area. However, it is also conditional on the credibility of the economic trajectory and public finances in Denmark, which, among other things, is reflected in the fact that Denmark has maintained its AAA-rating throughout the period following the financial crisis.

In recent years economic policy has been planned in order to support economic activity as much as possible within the fiscal policy framework resulting from the Budget Law, the EU recommendation and the EU fiscal compact. The need for fiscal stimulus will be reduced over the coming years as growth in the Danish economy picks up. However, fiscal policy will remain accommodative over the forecast period, in the sense that the level of public consumption and public investments are high both in a historical context and relative to the level, which is compatible with fiscal sustainability.

The actual public deficit was brought below 3 per cent of GDP in 2013 and is expected – in line with the assessment in the EU Commissions spring forecast – not to surpass 3 per cent in 2014 and 2015. In light of this, there is a prospect that Denmark can have the EU recommendation lifted at the ECOFIN meeting in late June. In accordance with the recommendation there has also been made structural budget improvements of 1½ per cent of GDP over the period 2011-13.

The potential for growth in production and employment is supported by a number of reforms implemented in recent years, which will contribute to increased labour supply and productivity. These include the tax reform of 2012, the growth plans for businesses with international competiveness and the initiatives in *Growth Plan DK.* The reforms strengthen the growth potential of the economy and will make a demand-driven recovery more robust.

1.2 The forecast

Improvement abroad is a prerequisite for growth in the Danish economy
There has been a clear improvement in the economic situation in the euro area. For the region as a whole, growth returned in the spring of 2013 after 1½ years of decline. The turnaround is mainly driven by growth in the German economy, but by the end of 2013 there was

also growth in most of the other euro area countries. The improvement in the economy of the crisis-ridden euro countries is also reflected in a considerable increase in the overall confidence in public finances. Together with the ECB's statement that the central bank is willing to intervene unlimited in favour of euro area government bonds, this has led to a marked narrowing of the yield spread to Germany since mid-2012, *cf. figure 1.3.*

Growth in the euro area is expected to gain strength this year and the next. That is due partly to the implementation of a number of structural reforms, and that the pace of fiscal tightening can gradually be reduced following recent years' budget consolidation. The accommodative monetary policy in the euro area is expected to be maintained over the forecast period.

Major Danish trading partners such as the UK and Sweden already experienced relatively high growth last year, and growth in the EU as a whole was somewhat higher than in the euro area. The recovery is also well advanced in other parts of the world economy. This includes the United States where a temporary slowdown in the beginning of the year due to hard winter weather does not change the overall impression of a robust underlying progress in the economy. The two-year budget agreement from December implies continued tight fiscal policy, but has, together with the suspension of the debt ceiling until 2015, reduced the uncertainty regarding the fiscal stance. The tapering of the Federal Reserve's asset purchase programme has begun and is expected to continue as capacity utilisation increases. At the same time, the Fed has signalled that interest rates will continue to be kept low so that the normalisation of interest rates does not inadvertently derail the recovery of the US economy.

The outlook for the emerging market economies is more mixed. Growth remains relatively high in China, while internal imbalances have led to capital outflows from Argentina, Brazil, South Africa, and Turkey. Overall, growth in the world economy is expected to gain momentum over the forecast period and will increasingly be driven by regions, particularly the EU, where trade intensity is high. This strengthens export market growth and thus the growth opportunities for Danish exports, *cf. figure 1.4.*

Figure 1.3
Long-term interest rates

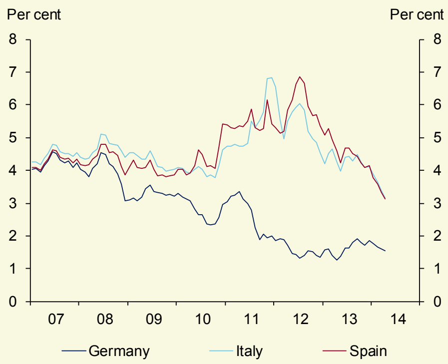
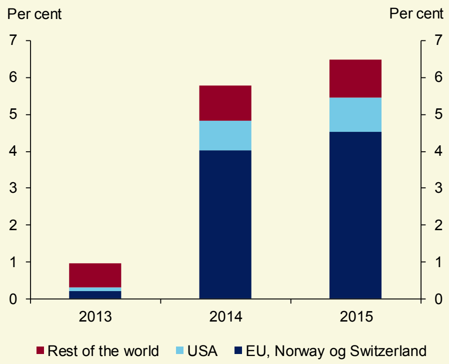


Figure 1.4
Export market growth



Source: IMF, Reuters EcoWin and own calculations.

Progress in the Danish economy

Domestically, there are also multiple and more certain indications of improvement. The modest growth of 0.4 per cent last year reflects a sharp decline in production in the North Sea, which reduced private sector production by ¾ percentage points. This blurs the picture of underlying momentum in the economy. When looking at the evolution of private GVA excluding mining and quarrying, growth was 1.1 per cent last year. Hence, growth in large parts of the private sector has been somewhat higher than what the GDP figure suggests*, cf. figur 1.5.* This year and the next production in the North Sea is only expected to contract slightly.

GDP growth should gradually increase to 1.4 per cent this year and 2.0 per cent in 2015. The improvement in the Danish economy should be viewed in light of progress abroad. Particularly in the euro area which accounts for around one third of Danish exports. Based on the international outlook, exports will once again become a major growth driver in 2014 along with accelerating growth in domestic demand, *cf. figur 1.6.*

The improvement contributes to a normalisation of the business cycle, however, over the forecast horizon production will continue to remain below the level of normal capacity utilisation. Historical experience also suggests that the recovery from a recession associated with a financial crisis takes longer. In the latest medium-term projection for the Danish economy from the Ministry of Finance it is technically assumed that the normalisation of the business cycle will be completed around 2019.

Figure 1.5
GDP in Denmark

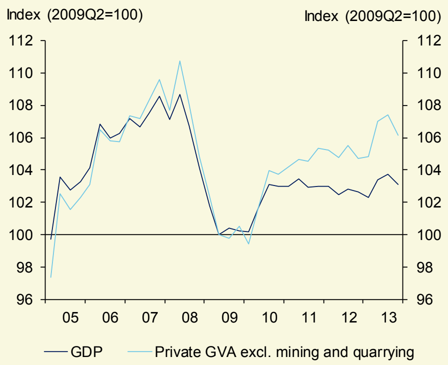
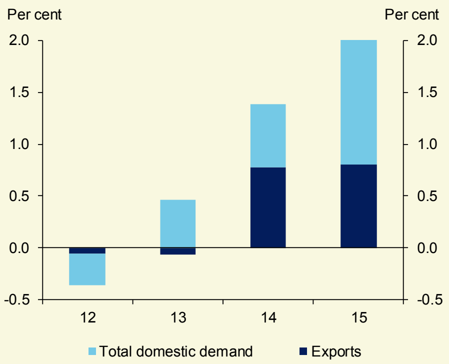


Figure 1.6
Drivers of GDP growth in Denmark



Note: The growth contributions in figure 1.6 are corrected for the import content of both exports and domestic demand.
Source: Statistics Denmark and own calculations.

Rebalancing strengthens the foundation for growth

The ability to latch on to the recovery abroad has been strengthened by an improvement in the competitiveness of Danish businesses since 2008. This mainly reflects a strengthening of productivity compared to other countries. In recent years, subdued wage growth has also helped, although there continues to be a backlog following years of higher wage growth in Denmark than abroad. The new collective wage agreements points towards continued subdued wage growth over the coming years. The forecast estimates private sector wage growth of around 2 per cent a year.

The improvement in exports is further supported by *Growth Plan DK* – including bringing forward a number of tax concessions in the Budget Bill of 2014 – which strengthens the competitiveness of Danish businesses through initiatives that reduce costs and increases productivity. In the beginning of May the government presented a proposal for *Growth Package 2014* which contains a number of new business-oriented initiatives to support businesses competitiveness further, *cf. box 1.1.*

Box 1.1
Growth Package 2014, Denmark all the way out of crisis – expanding businesses

Growth Package 2014 consists of 89 concrete initiatives, which can strengthen the competitiveness of businesses and expand the Danish economy by DKK 6 bn. in 2020. The initiatives are divided into four fields:

Easier and cheaper doing business
The relaxation of businesses' PSO-costs. Shorter processing times. Reduced administrative burdens and better business regulation.

Improved access to finance, creating more high-growth companies
Deductions for contributions to small businesses and easing of dividend taxation for companies. Extension of the growth lending scheme and the export lending scheme. More capital to high-growth businesses.

Lower prices for consumers and businesses
Efficiency in the utility sector will be improved by DKK 3.3 bn. in dialog with the sector. National special standards in construction are harmonised. Competition in the private service sector is strengthened.

More skilled employees and more advanced production
Strengthened international recruitment. Better adult education and training. More internships. Danish National Research Foundation is awarded DKK 3 bn. A better foundation for advanced manufacturing.

Improvements in export industries provide higher incomes and increased capacity utilisation, and hereby create the foundation for higher consumption and eventually investments in the private sector. In recent years growth in private domestic demand has been subdued, reflecting in particular the weakness in private consumption and in housing investments.

Since 2007 households have held back consumption in light of the generally uncertain economic outlook. For some, it has also been a necessary adjustment in consumption following a period of high, and in some cases unsustainable credit-financed consumption, which has created a subsequent need for consolidation. Since then consumption has been adjusted and overall private consumption is now below disposable incomes, *cf. figur 1.7.* For some households there may still be some need for consolidation, but generally private consumption is expected to grow in line with incomes. The relatively high consumer confidence makes such a trajectory more likely, *cf. figur 1.8.*

Figure 1.7
Consumption ratio

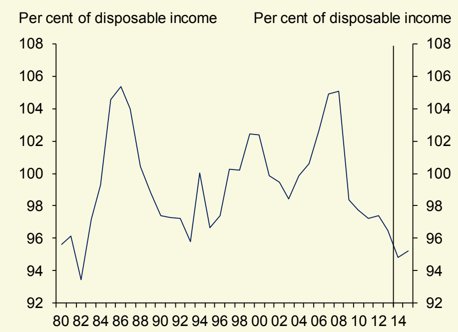
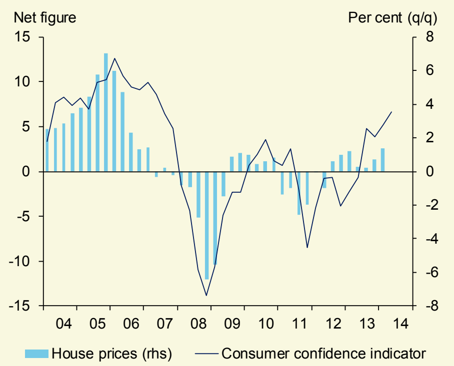


Figure 1.8
Consumer confidence and house prices



Note: The consumption ratio in figure 1.7 is calculated based on a measure of the consumption determining income, which is more narrowly defined than the household income in the National Accounts.
Source: Statistics Denmark and own calculations.

There are already signs that underlying private consumption is increasing. Excluding energy consumption and offsets of claims after the fall storms, consumer spending rose last year.[1] Rising employment and incomes will contribute to further growth in private consumption this year and next year. At the same time, real wages, and hereby consumption, are supported by relatively low inflation.

The housing market is also showing signs of progress as house prices grew by 2½ per cent last year after large declines in the preceding years. The rise in house prices is based on relatively few transactions, but the recovery in the housing market is also reflected in the the falling number of foreclosures from an already low level, and the delinquency rate on mortgages has dropped to the lowest level in five years. However, the improvement in the housing market covers considerable regional differences, and improvements are more prominent in and around the major cities. To some extent, this reflects structural differences in housing markets in different parts of the country. Municipalities with net population inflow generally have a more favourable development in the local housing market than municipalities with net population outflow.

[1] In the national accounts, insurance purchases are part of private consumption. In isolation, payout of insurance reduces the level and growth of private consumption in 2013 with around ½ per cent, whereas growth in private consumption is increased by a similar amount in 2014. Adjusted for this technical effect, private consumption I estimated to grow by almost ½ per cent in 2013 and a further 1¼ per cent in 2014. This is in line with the December survey.

The general improvement in the housing market suggests that the protracted adjustment from to the unsustainable house price increases towards 2007 is nearing its completion, and on average prices are expected to increase in 2014 and 2015 with the same order of magnitude as last year.

Household debt, which is particularly linked with mortgages, has received special attention by the EU as it has been viewed as a potential macroeconomic imbalance. The EU recognises that the level of debt is largely explained by country-specific structural factors, including the Danish mortgage system and the, in an international context, large pension funds. In the latest analysis of macroeconomic challenges, the EU also adheres to the fact that so far, households have been able to handle the adjustment of house prices since 2007. In addition, the conclusion of various stress tests and studies is that households will be resilient in the event of adverse shocks. Based on this, household debt can according to the European Commission, no longer be considered to be a macroeconomic imbalance that could pose a major risk to the real economy and financial stability under the EU procedure for macroeconomic imbalances.

Improvement in the labour market

The recovery of the Danish economy can also be observed in the labour market. Total employment (adjusted for the teacher lockout in 2013) grew by 10,000 persons from 2012 to 2013. This reflects an increase over the course of last year of 22,000 persons, which predominantly occurred in the private sector, mainly in private services. Increasing production is expected to lead to employment growing by 16-17,000 persons a year this year and the next, especially in the private sector, *cf. figur 1.9.*

The past year's increase in private sector employment must be viewed in light of the underlying output growth in the private sector, when production in the North Sea is excluded. North Sea production is relatively capital intensive and thus has less impact on employment than the rest of the private sector.

Figure 1.9
Private employment

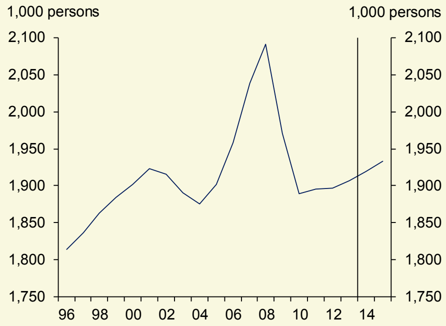
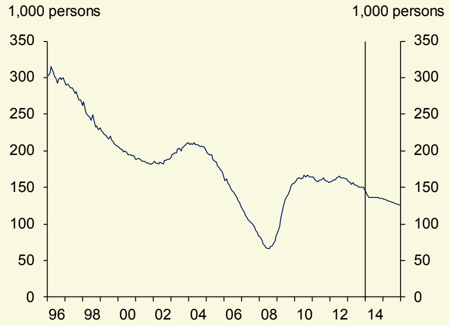


Figure 1.10
Gross unemployment



Source: Statistics Denmark and own calculations.

Despite the improvement in employment, there was a slight decrease in the total number of hours worked in 2013 as a result of a lower average working time. It should be seen in conjunction with a growing number of part-time jobs in the service sector, whereas employment (typically full-time) in manufacturing declined. Both average working time, number of hours worked, and the number of employees is expected to increase in line with the expected growth in the Danish economy in the coming years.

The increase in employment has contributed to bringing down the unemployment rate to the lowest level in four years, *cf. figure 1.10.* Unemployment has generally been declining since mid-2012 – both when looking at gross unemployment and the sample-based LFS unemployment. The reform of the cash benefit system, which came into force on January 1st this year, has technically reduced the number of young people receiving cash benefits that are included in gross unemployment. However, there are also signs that a greater proportion of the young cash benefit recipients find employment compared to previous years. As employment rises gross unemployment is expected to decline further through 2014 and 2015 to around 130,000 persons, or 4½ per cent of the labour force.

The growth outlook is unchanged from December

Selected key figures from the forecast can be found in table 1.1, while the annex tables also presents a comparison with the forecast from the *Economic Survey,* December 2013.

The assessment of the outlook for the Danish economy is largely unchanged. Over 2014 and 2015, growth is overall in line with the December forecast, and GDP is expected to reach the same level in 2015 as estimated in December. That reflects a marginal downward revision of the estimated GDP growth in 2014 to 1.4 per cent and an upward revision to 2.0 per cent in 2015.

The labour market has evolved more positively than expected in December. Against this backdrop, the forecast for employment has been revised upwards by 6,000 persons in both 2014 and 2015. The estimate for gross unemployment is revised downward by 10,000 persons in 2014 and 9,000 persons in 2015. The revision should be seen in light of both a better development in the labour market and as a technical adjustment due to the cash benefit reform.

The adjustments compared to the December survey are well within the margin of general uncertainty. Forecasts can basically be said to describe the same growth outlook for the economy if the concrete growth estimate does not vary more than ¼-½ percentage point. An assessment of the accuracy of a forecast must take this into account. In general the forecast for GDP growth in the *Economic Survey* fare well in comparision to other institutions, and in four out of five cases the *Economic Survey* is able to predict whether growth will slow or increase in strength in the following year, cf. section 5.1.

The growth outlook is still characterised by some uncertainty, although the risk profile has become more balanced. Risks are primarily related to developments in the euro area, where growth remains fragile. A change in sentiment – e.g. as an offshoot of a possible escalation of geopolitical tensions related to the situation in the Ukraine – can provide a setback to the recovery. In such a situation, the Danish economy culd be affected by means of general unrest in Europe, whereas the direct effect through trade with the countries involved in conflicts is minor.

Uncertainty is also associated with the recovery of domestic demand. It particularly relates to private consumption, which in spite of growing optimism continues to evolve subdued. Hence, some households may continue to have an outstanding need for consolidation, which keeps consumption down.

Alternative scenarios of the economic outlook are illustrated in *box 1.2.*

Box 1.2
Alternative scenarios

The projected improvement in the Danish economy should be seen in light of the recovery in the euro area, where confidence is on its way back, and the more general broader-based recovery in the global economy.

Growth abroad may turn out stronger than expected, allowing for more positive developments in the Danish export markets and in business investments. A weaker international tradjectory than assumed can on the other hand inhibit Danish export. Household and businesses expectations for the future will thus weaken and this will in turn slow down growth in domestic demand. The sensitivity to changes in assumptions is illustrated by two alternative scenarios.

- A positive scenario where developments abroad raise Danish export growth by 1 percentage point in 2014 and 2015 compared to the main scenario. At the same time the scale of Danish companies' investments is increased by 2 percentage points in both years to meet the expected increase in demand. This corresponds to a slightly faster recovery of the investment ratio towards its historical level as has been seen during previous recoveries.

- A negative scenario where export growth is assumed to be 1 percentage point lower in 2014 and 2015, for example due to a weaker implementation of structural reforms in the euro area or escalation of geopolitical uncertainty, which undermine confidence and expectations for growth and lead to lower real growth. Growth in Danish private consumption is assumed to be ½ percentage points lower in both years and business investments 1 percentage point lower in both years in this scenario, corresponding to a slower recovery of consumption and investment ratios against historical levels.

In the positive scenario the greater growth abroad and the higher level of investments will increase Danish GDP by about ¼ - ½ percentage points in both 2014 and 2015. Unemployment will also be lower and fall faster through both years. The public budget balance will improve as a result of higher revenues and lower expenditures derived from increased activity.

In the negative scenario GDP growth in Denmark will decline by about ¼ - ½ percentage points in both 2014 and 2015. At the same time unemployment will be higher and the public budget balance will deteriorate, *cf. table a.* This scenario does not take into account a possible fiscal response to meet requirements of the Stability and Growth Pact.

Table a

	Negative scenario		**Main scenario**		**Positive scenario**	
	2014	**2015**	**2014**	**2015**	**2014**	**2015**
Real GDP growth, per cent	1.0	1.7	1.4	2.0	1.7	2.4
Unemployment (per cent)	5.0	4.9	4.8	4.5	4.7	4.2
Public balance (per cent of GDP)	-1.6	-3.4	-1.4	-3.0	-1.3	-2.6

Table 1.1
Key figures

	2012	2013	2014	2015
Real percentage change from previous year				
Private consumption	-0.1	0.0	1.7	2.0
Public consumption	0.4	0.8	1.2	0.9
Public investments	7.7	0.5	0.7	-7.9
Residential investments	-8.0	-5.0	3.3	2.2
Fixed business investment	0.8	4.8	0.7	6.0
Stock building (per cent of GDP)	-0.3	0.2	0.0	0.0
Exports of goods and services	0.4	1.2	3.8	4.8
Imports of goods and services	0.9	1.7	4.3	4.9
GDP	-0.4	0.4	1.4	2.0
Level (per cent of GDP)				
General government fiscal balance	-3.9	-0.9	-1.4	-3.0
Current account	6.0	7.3	7.1	7.2
Level, 1,000 persons				
Gross unemployment (yearly average)	162	153	137	130
Labour force	2,847	2,852	2,857	2,867
Employment (excl. leave)	2,728	2,734	2,755	2,771
Employment (excl. teacher lockout)	2,728	2,738	2,755	2,771
Rate of change, per cent				
House prices (single family houses)	-3.4	2.6	2.5	2.5
Consumer prices	2.4	0.8	0.9	1.6
Hourly earnings, private sector (Danish Employers Federation statistics)	2.0	1.4	2.0	2.2

1.3 Fiscal policy and public finances

Following the downturn in 2008-09 fiscal policy has been planned in order to ensure sound public finances while supporting growth and employment as much as possible within the fiscal framework comprised by the Budget Law, Denmark's EU-recommendation and EU's fiscal compact. Moreover, monetary policy has been – and remains – highly accommodative resulting in low interest rates. The responsible fiscal policy contributes to maintaining confidence in the Danish economy and thereby the low interest rates that benefit growth and employment.

Fiscal policy and other measures since 2012 support the GDP level by approx. ¼ per cent of GDP in every year from 2012-14. Expenditure policy remains accommodative in the sense that public expenditures for public consumptions and public investments are high both in a historical perspective and compared to the level that can be sustainably financed.

As the economy gains more momentum, the accommodative fiscal policy will need to be gradually withdrawn and thereby approach the planned expenditure levels in 2020, which is in accordance with fiscal sustainability. It is important that fiscal expansions in times of low economic activity are offset by a fiscal tightening as the economy recovers.

In 2015, where GDP growth is expected to gain further momentum, a normalisation of the accommodative fiscal policy is assumed to be implemented, including a gradual adjustment down from the historically high public investment levels in 2012-14.

However, with an expected actual deficit of 3 per cent of GDP and a structural deficit of 0.4 per cent of GDP in 2015, fiscal policy is still close to the deficit limits following from the overall fiscal framework.

Prospect of having the EU-recommendation abrogated

In recent years Denmark's EU-recommendation has been a key concern when planning fiscal policy. Public finances are consolidated from 2010 to 2013 in accordance with the requirement in the recommendation of improving public finances in structural terms by 1½ per cent of GDP in 2011-13. Moreover, based on the latest forecast by the EU-Commission Denmark is expected to adhere to the key requirement in the recommendation of bringing the actual deficit sustainably below 3 per cent of GDP and is thus expected to have the recommendation abrogated by the end of June, *cf. box 1.3*.

Box 1.3
Denmark is expected to have its EU-recommendation abrogated

Denmark received a recommendation from the EU-Commission in 2010 based on expected excessive deficits on the general government fiscal balance. The key requirement in the recommendation is that the public deficit must be brought sustainably below 3 per cent of GDP by 2013 at the latest. As a starting point, the abrogation of the EU-recommendation therefor requires that public account figures from Statistics Denmark (verified by Eurostat) show that the public deficit has been brought below 3 per cent of GDP in 2013. Moreover, the actual deficit should be expected to remain below 3 per cent of GDP in 2014 and 2015 based on the spring 2014 forecast of the EU-Commission.

Statistics Denmark's preliminary accounts show a public deficit (on EDP-basis) of 0.8 per cent of GDP in 2013. Meanwhile, the EU-Commission estimate in the spring forecast that the actual deficit will amount to 1.4 per cent of GDP in 2014 and 2.7 per cent of GDP in 2015. Based hereon, Denmark is expected to adhere to the key requirement of the recommendation, which is decisive for having the recommendation repealed. A formal decision of the abrogation of Denmark's EU-recommendation is made on the ECOFIN-meeting (council composed of the member states' economics and finance minister) at the end of June.

In the current survey, the actual deficits are also expected to be brought below 3 per cent of GDP in accordance with the recommendation as the actual deficit based on the methodology of the EU-Commission (the so called EDP-basis[2]) is expected to amount to 1.3 per cent of GDP in 2014 and 2.9 per cent of GDP in 2015.

Based on national accounts, the actual deficit is expected to amount to 1.4 per cent of GDP in 2014 and 3.0 per cent of GDP in 2015. The increase of the deficit from 2014 to 2015 reflects that the deficits in 2013 and 2014 are reduced by a number of temporary revenues, mainly one-off revenues from a restructuring of the taxation of existing capital pensions. The one-off revenues amount to DKK 28½ billion in 2013 and are with considerable uncertainty estimated to amount to DKK 30 billion in 2014. Excluding the temporary revenues the actual deficit is very close or just above the 3 per cent of GDP limit in 2013 and 2014, *cf. figure 1.11.*

The sizeable actual deficits (excl. temporary revenues) in 2013-15 should be viewed in the context of the economic situation in general as public finances in Denmark are highly sensitive to cyclical conditions. Moreover, the development of public finances reflects that expenditure policy is accommodative, measured in levels, in all three years and that economic policy is planned in order to support activity because of low (compared to neutral) capacity utilisation in the Danish economy.

[2] The EU-Commission assesses the actual government balance on the EDP-basis, where EDP stands for "excessive deficit procedure". The key requirement in Denmark's EU-recommendation is thus associated to the actual government balance on EDP-basis. The difference between the actual balance on EDP-basis and the actual balance based on the Danish national accounts (which is the assessment used in the Economic Surveys and the Budget Outlooks) have historically been quite limited. The EDP-corrections have historically been in the order of +/- 0.1 or 0.2 per cent of GDP, *cf. Denmark's Convergence Program 2014.*

Figure 1.11
Actual public balance in 2013-2015 based on national accounts

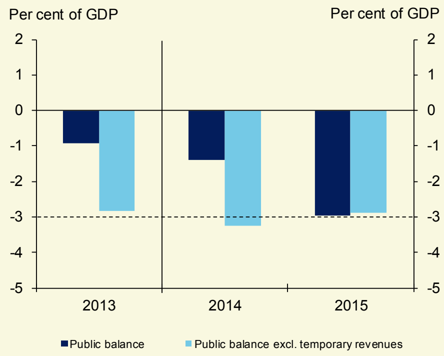
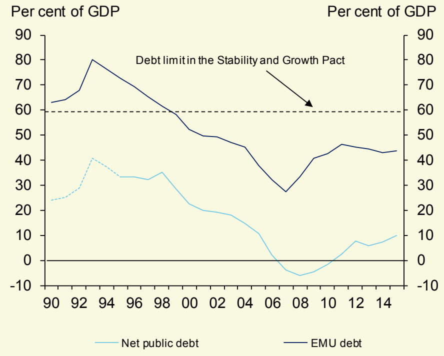


Figure 1.12
EMU-debt and net public debt



Note: In figure 1.11, the public balance excl. temporary revenues shows the balance net of the one-off revenues from the restructuring of existing capital pensions, 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 return, and advanced ordinary revenues from the taxation of capital pensions. In figure 1.12, the development of the net public debt from 1990 to 1995 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 2015 imply an increase in net public debt from approx. 6 per cent of GDP by the end of 2013 to approx. 10 per cent of GDP in 2015, *cf. figure 1.12*. However, gross public debt (EMU-definition) is expected to be reduced from approx. 44½ per cent of GDP by the end of 2013 to approx. 43½ per cent of GDP in 2015. This is partly due to a relocation of government assets, including a reduction of government's and the funds' deposit at the Central Bank (Danmarks Nationalbank) and the holdings of mortgage bonds by the Social Pension Fund (Den Sociale Pensionsfonds) towards 2015. As these holdings are not offset in the gross public debt (EMU-definition), a reduction of the holdings will – all else equal – imply a reduction of the EMU-debt. The EMU-debt maintains a wide safety margin relative to the EU-limit of 60 per cent of GDP in the Stability and Growth Pact.

Very small margin to the limit for structural deficits in 2015
According to the Budget Law, the annual structural deficits must not exceed ½ per cent of GDP unless exceptional circumstances are present. The limit for structural deficits binding for the estimated structural deficit in the budget proposal for a given fiscal year. However, this does not imply, that measures that will have a significant negative impact on the structural balance in the relevant year can be decided on after the budget proposal.

For the current fiscal year – 2014 – the structural deficit is estimated to 0.7 per cent of GDP and the structural deficit is thus increased by 0.2 per cent of GDP compared to the December survey. The revision of the estimated structural deficit in 2014 should be seen in light of the uncertainty associated with the estimation of the structural deficit, including forecast uncertainty of public expenditures and public revenues. However, fiscal policy in 2014 was planned within the framework of the Budget Law, and the structural deficit in 2014 was estimated to be in line with the Budget Law's limit for structural deficits both at the time of the budget proposal for 2014 and when an agreement of the budget for 2014 was reached. The revision of the estimated structural deficit in 2014 mainly reflects lower expected revenues from personal income taxes. Moreover, a new tax following the energy agreement of 2012 cannot as originally planned be implemented in 2014.

The structural deficit is estimated to 0.4 per cent of GDP in 2015. Thus, in regards to the forthcoming budget proposal for 2015 (will be presented in August) there is a very small margin to the deficit limit in the Budget Law, not at least because central government expenditures for income transfers covered by one of the expenditure ceilings are currently estimated to be lower than expected when the relevant sub-ceiling was set last year. If the expenditures for central government income transfers increase within or up to the level of the ceiling this will weaken, in isolation, the structural balance. Fiscal policy in 2015 is not finalised before the budget for 2015 has been adopted.

Fiscal policy still supports the Danish economy
The structural deficits in 2014 and 2015 reflect the expenditure policy, which is currently accommodative – and has been accommodative through the economic crisis – both in a historical perspective and compared to the level that can be sustainably financed going onwards, *cf. figure 1.13.* Expenditures for public consumption and public investments in 2014 and 2015 are respectively approx. ¾ and ½ per cent of structural GDP higher than the expenditure level in 2020, where expenditures are equal to their sustainably GDP-share. The accommodative expenditure policy is part of the overall fiscal policy and thereby also included in the development of the structural balance. All other things being equal, had expenditure policy been at the 2020-expenditure level, the structural balance would be improved by the difference between the planned expenditure level and the sustainable 2020-level, *cf. figure 1.14.*

However, the development of the structural balance does not only reflect expenditure policy, and the improvement of the structural balance in 2013 should e.g. be seen in light of phasing in of financing element in the *Spring Package 2.0 (2009),* the Fiscal Consolidation agreement (2010) and the Budget Bill for 2012. Moreover, the tax reform in 2012 implied advanced revenue from the taxation of pensions, which does, however, not affect economic activity. The reduction of the structural balance from 2013 to 2015 primarily reflects lower taxes, including reliefs in *Growth Plan DK* (2013) and advancements with the Budget for 2014.

Figure 1.13
Public consumption and public investments

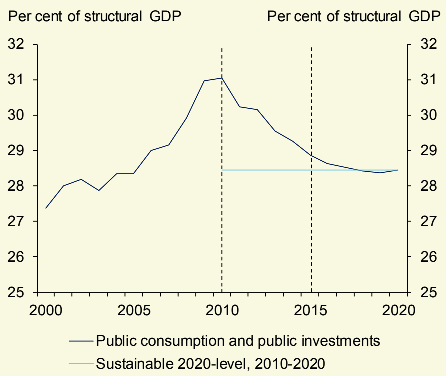
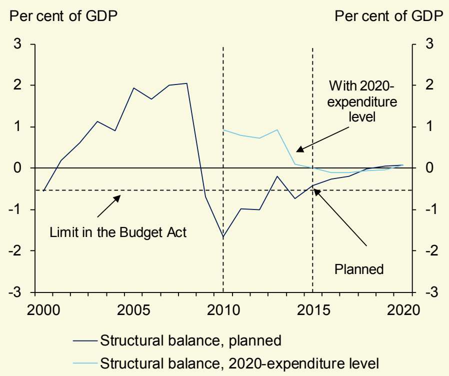


Figure 1.14
Structural public balance



Note: In figure 1.14 the "Structural balance, 2020-expenditure level" is calculated based on the planned structural balance and the deviation to the 2020-level for public consumption and public investments in each year.
Source: Statistics Denmark, Denmark's Convergence Program 2014 and own calculations.

The high consumption and investment levels through the economic crisis have been supporting the Danish economy, partly reflecting that a number of investments have been advanced to 2012-14. Compared to the accommodative level in 2011, fiscal policy and other measures from 2012 and onwards still support the GDP level in 2012-14 by approx. ¼ per cent of GDP yearly[3], *cf. table 1.2.* This mainly reflects a contribution from other investments, which concern initiatives that do not affect public finances. A declining and gradually negative contribution from fiscal policy in isolation (excl. other measures) reflects the accommodative starting point in 2011 and the following normalisation of expenditure levels.

[3] 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 investments are a result of political decisions but are not included in the effect of fiscal policy in the narrow definition.

Table 1.2
Effect on activity of fiscal policy and other economic policy measures from 2012 and onwards

Per cent of BNP	**2012**	**2013**	**2014**	**2015**
Total contribution to GDP level from fiscal policy and other measures since 2012	**0.3**	**0.2**	**0.2**	**-0.2**
Fiscal policy	0.2	-0.2	-0.2	-0.5
- hereof fiscal effect incl. multiannual effects	*0.1*	*-0.5*	*-0.3*	*-0.4*
- hereof other fiscal policy [1)]	*0.1*	*0.3*	*0.1*	*-0.1*
Other investments [2)]	0.1	0.3	0.4	0.3
Total contribution to GDP growth from fiscal policy and other measures since 2012	0.3	-0.1	0.1	-0.4

1) In other fiscal policy, an extra effect beyond what is captured by the 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 advanced activities in Fehmarnbelt agreed upon in Growth Plan DK.
Source: Statististics Denmark and own calculations.

The effect on activity in 2015 from fiscal policy and other measures from 2012 and onwards reflects the declining contributions from previous easing of fiscal policy and a gradual normalisation of the level of public investments towards a more sustainable level compared to high levels in 2012-14. Moreover, private investment have been advanced to 2013 and 2014 from 2015, e.g with the investment window and the HousingJobs scheme, which in isolation reduces the activity effect from fiscal policy in 2015. Fiscal policy in 2015 will be planned in connection with the agreements with municipalities and regions in June 2014 and the Budget for 2015 and this can accordingly differ from what is assumed in this *Economic Survey*.

The development in the contribution to activity from fiscal policy and other measures should be viewed in context with economic situation. As the economy gains momentum, the accommodative fiscal policy needs to be gradually normalised in order to have expenditure levels that approach the levels planned in 2020, which is in accordance with fiscal sustainability. It is important to ensure that fiscal policy is symmetrical so that fiscal expansions during times with low economic activity are subsequently offset by a fiscal tightening in periods with high economic activity, *cf. box 1.4.*

Moreover, the planned fiscal policy should be viewed alongside the monetary policy, which is still highly accommodative and interest rates very low. Thus, monetary policy contributes substantially to economic activity. The reduction in household net interest expenses alone has increased household disposable income from 2009 to 2013 by 5½ per cent. The current low interest rate level is connected to the sound fiscal policy framework in Denmark, which contributes to maintaining confidence in Danish economy and thereby the low interest rates that benefit growth and employment.

Box 1.4
Fiscal policy and stabilisation across business cycles

One of the central considerations when planning fiscal policy is to contribute to the stabilisation of the business cycle. As a main rule this implies that fiscal policy is accommodative (compared to a neutral and sustainable starting point), when the economy is considerably below the normal level and accordingly that fiscal policy is tight when there is a considerable capacity pressure in the economy, *cf. Finansredegørelse 2014.* When the fiscal response is fairly proportional to the output gap, the main rule imply – in different phases of the business cycle – that:

- In periods with *high business activity* (where capacity constraints are large and growing) fiscal policy should be tight measured in levels and tighten further if demand and the already positive output gap increases further.
- In a *downturn following a period with high activity* (where the output gap is initially positive, but declining) fiscal policy is tight measured in levels at the starting point but then gradually eased as the output gap is narrowed. This can increase the chances of a “soft landing”.
- In periods with *low business activity* fiscal policy should be accommodative measured in levels as the output gap is sizably negative. Continuous expansions of the negative output gap suggest a further easing of fiscal policy.
- At a *recovery following a period with low activity* fiscal policy is still accommodative measured in levels but gradually tightened as the negative output gap is narrowed. Thus, the first year fiscal effect is negative in a recovery phase while the overall fiscal policy still supports activity levels and employment.

Figure a
Stylised fiscal response in order to stabilise across business cycles

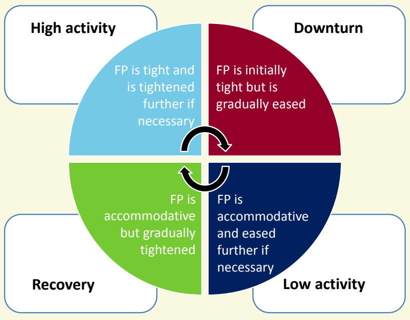
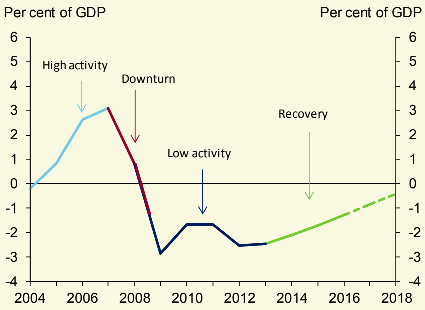


Figure b
Four phases of the business cycle illustrated by the Ministry of Finance estimates of the output gap.



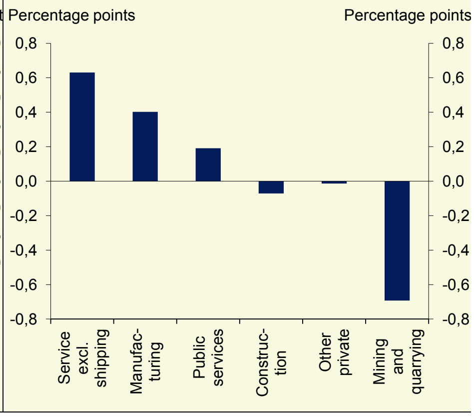
1.4 Manufacturing is important for the recovery

The manufacturing industry is playing a big part in lifting Denmark all the way out of the crisis. This is because of the industry's large sales to export markets and thus the potential for latching on to the recovery in the international economy. Even though the industry only accounted for one-tenth of both the total gross value added and employment in 2013, almost half of total Danish exports last year were industrial goods, *cf. figure 1.15.*

Manufacturing is also the industry in which growth in production was strongest last year. That reflects growth in exports of manufacturing goods of 2½ per cent. Despite its share in the total economy, manufacturing was thus one of the industries, which contributed most to the total growth in gross value added, *cf. figure 1.16*. Growth in the export-oriented industries creates higher income and increased capacity utilisation and is thereby creating a basis for private consumption and private investment to eventually start contributing to the recovery of the Danish economy.

Figure 1.13
Shares of the manufacturing industry, 2013

Figure 1.14
Contributions to GVA growth, 2013



Note: The share of manufacturing exports in total exports in figure 1.15 includes processed foods, which are estimated to constitute two thirds of the export of foods in 2013.
Source: Statistics Denmark and own calculations.

The manufacturing industry was hit hard by the crisis
The large exposure of the manufacturing industry to international developments meant that it was hit hard following the escalation of the financial crisis and the global economic downturn in 2008-09. Export markets shrank by 13 per cent in the two years, which strongly contributed to the fall in both GVA and employment in the sector of 15-20 per cent, *cf. figure 1.17*.

The fall in manufacturing exports also impacted the rest of the economy, in part due to decreased demand for subcontractors in other industries. Taking into account these additional effects on the economy as a whole, the fall in export markets during the two years is estimated by itself to have reduced employment by 70,000 persons.[4] This should be seen relative to the total fall in employment from 2008 to 2010 of 200,000 persons.

The size of the downturn in the Danish economy is therefore much related to the decrease in the demand for Danish industrial goods from abroad. The subsequent recovery was held back by the marked deterioration of wage competitiveness of Danish manufacturing firms that had occurred in the preceding eight years, due to both lower productivity growth relative to other countries and relatively higher wage increases, *cf. figure 1.19.* The weakened competitiveness was partly a result of the overheating of the Danish economy, which took place during the mid-2000's, which is another significant factor explaining the strength of the downturn.

Investments of manufacturing companies have also been reduced markedly following the downturn. In 2013, net investment in the sector amounted to ¾ per cent of GVA, following a couple of years where new investment was insufficient to replace the depreciation of the existing capital stock, *cf. figure 1.18.* The investment level is considerably lower than during 2007-08, which, however, was characterised by an extraordinarily high level of capacity utilisation and clear signs of overheating in the economy, which also applied to the manufacturing industry. The current lower level, in relative terms, reflects that capacity utilisation continues to be below the historical average.

Figure 1.15
GVA and employment in manufacturing

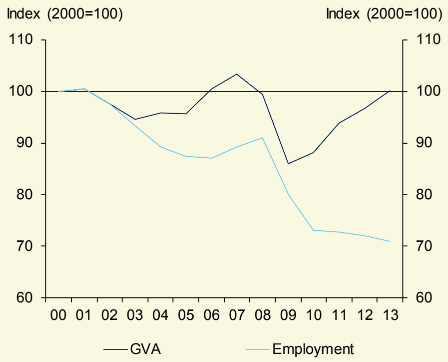
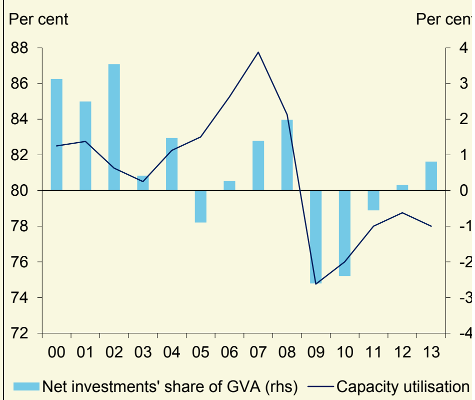


Figure 1.16
Capacity utilisation and investment ratio in the manufacturing industry



Source: Statistics Denmark and own calculations.

[4] Compared to a situation in which export market growth in 2008 and 2009 had amounted to the average annual growth of the preceding 15 years (7.0 per cent annually).

With such large sales to international markets it would have been difficult to counter the effects of the financial crisis followed by the euro area debt crisis on the manufacturing industry and the Danish economy more generally by traditional fiscal policy easing. Policies to support growth and employment have naturally mostly contributed to internal demand, and initiatives to support housing investment, *e.g.* the HousingJobs Scheme, and the initiation of major public construction has primarily supported employment in the construction industry.

On the other hand, the manufacturing industry has been much in focus of the part of economic policy that relates to strengthening competitiveness of Danish companies and thereby their opportunities to increase sales on both export- and domestic markets.

The recovery hinges on a competitive manufacturing industry
Just as the downturn in the international economy to a large extent rippled through the Danish economy through the manufacturing industry, the recovery of the Danish economy will to a large extent be related to the ability of Danish manufacturing companies to benefit from the external economic recovery. This will especially be dependent on their external competitiveness. The better competitiveness is, the faster the recovery.

International competitiveness has improved significantly since 2008, and about half of the previous losses has been made up for (measured by the change in relative unit labour costs), *cf. figure 1.19*. It reflects the adjustment of production resources in the industry, which has contributed to a significantly higher productivity growth in the industry. From 2009 to 2013, productivity grew on average by almost 5 per cent per year, which is more than in the main trading countries. At the same time, wage inflation declined markedly and has in recent years been lower than abroad.

The strengthening of wage competitiveness since 2008 has put the industry in a much better position. The new three-year collective wage agreements concluded in the spring, pave the way for further improvements in the coming years, to the extent that they are reflected in the wage determination in individual businesses and that the favorable productivity developments in the industry continues .

Meanwhile, implemented reforms and actions in *Growth Plan DK*, including tax incentives and a lower corporate tax rate, has increased industrial framework conditions in recent years. The business environment is further strengthened with the proposal of *Growth Package 2014,* which contains a number of new business-oriented programs that also supports the manufacturing sector, including the Strategy for Denmark as a production country.

With the recent reforms there has also been made great efforts to ensure that a recovery is supported by efficient labour market structures and will not be hampered by a lack of qualified labour. This includes the government's proposal for a reform of the employment effort, which will contribute to ensure that unemployed workers as quickly as possible obtain a lasting employment.

Figure 1.17
Wage competitiveness (accumulated relative unit labour costs incl. exchange rates)

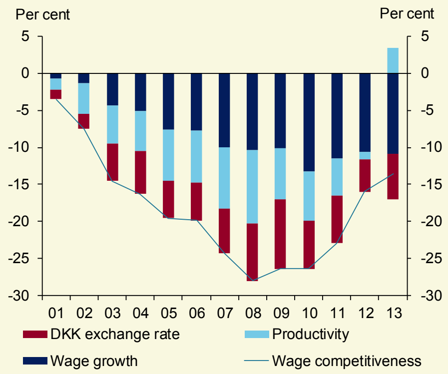
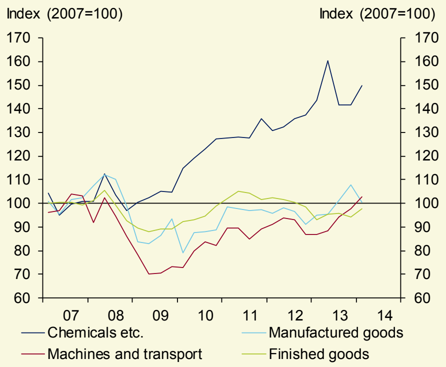


Figure 1.18
Exports of selected manufacturing product groups



Note: The calculation of wage competitiveness in 2013 is subject to considerable uncertainty, as it is preliminary and based on a narrower set of data.
Source: Statistics Denmark and own calculations.

Outlook for strong industrial exports

International economic growth and the strengthened competitiveness of manufacturing companies should overall give rise to an increase in industrial exports by 5¼ per cent this year and just over 6 per cent next year. This growth is expected to be more broadly-based across different manufacturing goods than has been the case in recent years where chemicals (mainly consisting of pharmaceutical products) has been the primary driver of Danish manufactured exports, *cf. figure 1.20*. That is partly because pharmaceutical exports have relatively little sensitivity to economic fluctuations.

Increased manufacturing production creates growth in other sectors and thus employment, while a very limited increase in manufacturing employment is expected. This should be seen in light of the trend decline in manufacturing employment, which has been going on over the past 40 years. Only the pharmaceutical industry has created jobs since the late 1980s, *cf. figure 1.21*.

The decline in manufacturing employment has taken place in other countries as well. This reflects a general trend of wealthier countries having higher levels of productivity in the manufacturing sector and domestic demand being more oriented towards services, *cf. figure 1.22*. The smaller share should also be viewed in light of the fact that manufacturing companies in wealthy countries increasingly outsource a number of service functions, such as cleaning, where employment formerly classified under manufacturing. What matters is not whether the employment is for one or the other type of industry, but that resources are used most effectively and maximizes value creation.

Figure 1.19
Manufacturing employment

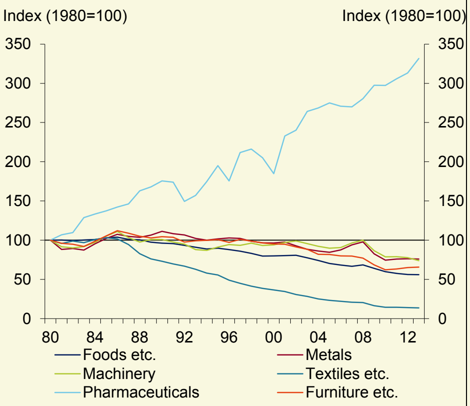
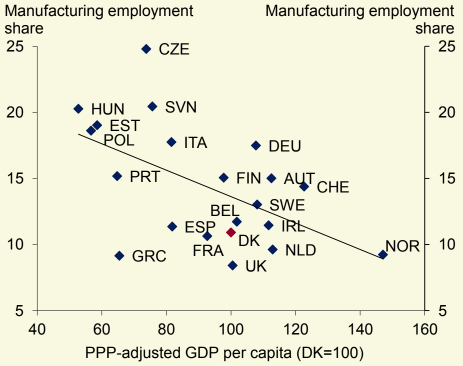


Figure 1.20
Manufacturing employment's share of total employment and the level of income, 2012



Source: Eurostat, OECD, Statistics Denmark and own calculations.

1.5 Appendix

Table 1.3
Key figures compared to the December Survey

	2013	2014		2015	
		Dec.	May	Dec.	May
Real growth, per cent					
Private consumption	0.0	1.3	1.7	1.6	2.0
Total public demand	0.8	1.6	1.2	-0.1	0.2
- public consumption	0.8	1.5	1.2	0.6	0.9
- public investment	0.5	2.1	0.7	-8.4	-7.9
Residential investments	-5.0	4.1	3.3	1.4	2.2
Fixed business investments	4.8	2.2	0.7	6.0	6.0
Final domestic demand	0.5	1.6	1.5	1.6	1.9
Stock building (per cent of GDP)	0.2	0.0	0.0	0.0	0.0
Total domestic demand	0.6	1.6	1.5	1.6	1.9
Exports of goods and services	1.2	3.7	3.8	4.7	4.8
- of which manufactures	2.6	4.8	5.2	6.1	6.1
Total demand	0.8	2.4	2.4	2.7	3.0
Imports of goods and services	1.7	3.9	4.3	4.5	4.9
- of which goods	4.1	4.2	4.1	5.2	4.2
GDP	0.4	1.6	1.4	1.9	2.0
Gross value added	0.4	1.6	1.7	1.8	1.8
- of which private sector	1.5	1.8	2.4	2.5	2.6
Change in 1,000 persons					
Labour force	5	15	5	9	11
Employment	6	17	20	16	17
- of which private sector	10	8	12	14	14
- of which public sector	-3	9	8	2	3
Employment excl. teacher lockout	10	13	16	16	17
- of which public sector	1	5	4	2	3
Gross unemployment (registered)	-9	-6	-16	-8	-7
Net unemployment (registered)	-1	-2	-16	-7	-6

Table 1.3 (continued)
Key figures compared to the December Survey

	2013	2014		2015	
		Dec.	May	Dec.	May
Growth, per cent					
Merchandise export prices	-0.5	1.1	0.8	1.5	1.5
Merchandise import prices	-2.2	0.8	0.3	2.0	1.5
Merchandise terms of trade	1.7	0.3	0.4	-0.4	0.0
House prices, single-family houses	2.6	2.5	2.5	2.0	2.5
Consumer prices	0.8	1.2	0.9	1.8	1.6
Hourly compensation	1.4	2.0	2.0	2.2	2.2
Real disposable income, private sector	0.5	3.7	2.1	4.9	5.2
Real disposable income of households[1)]	1.0	2.6	3.5	1.0	1.5
Productivity in a private non-agricultural sector	1.8	1.2	1.7	1.7	1.8
Per cent per year					
Interest rate 1-year adjustable rate loan	0.2	0.4	0.3	0.7	0.6
10-year government bonds	1.8	2.1	1.9	2.6	2.5
30-year mortgage credit bond	3.5	3.8	3.6	4.3	4.2
Balances					
Current account (bn DKK)	135.4	125.5	134.5	136.0	143.0
General government fiscal balance (bn DKK)	-17.2	-22.8	-26.7	-57.6	-58.4
Gross unemployment (thousands)	153	147	137	139	130
Gross unemployment (per cent)	5.4	5.1	4.8	4.8	4.5
Net unemployment (thousands)	118	115	102	108	96
Net unemployment (thousands)	4.1	4.0	3.6	3.8	3.3
External assumptions					
Trade-weighted GDP abroad, per cent	0.9	2.2	2.3	2.6	2.5
Export markets for Danish manufactures, per cent	1.0	5.4	5.8	6.5	6.5
Exchange rate, DKK per $	5.6	5.5	5.4	5.5	5.4
Oil price, $ per barrel	108.7	108.2	108.9	113.4	113.1
Oil price, DKK per barrel	610.9	600.2	589.1	629.0	610.3

1) Adjusted for various special items, *cf. section 4.1*.
Source: Statistics Denmark and own calculations