

# Economic Survey August 2005 – English Summary

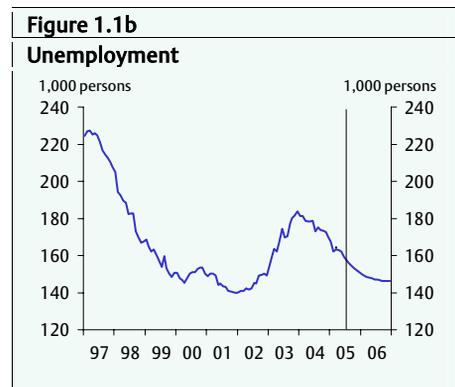
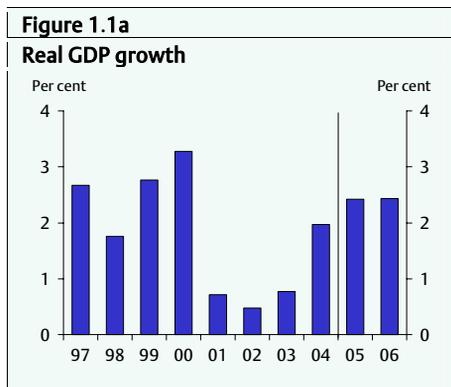
## 1. Short term outlook

Supported by fairly high international growth and a sustained upswing in domestic demand, real GDP is expected to grow by 2.4 per cent in both 2005 and 2006, *cf. figure 1.1a*. The forecast for the Danish economy has, taken as a whole, changed relatively little compared to the survey in May, *cf. table 1.1<sup>1</sup>*.

The expansion in 2004 and 2005 is mainly driven by private consumption. The pick up in household spending reflects low interest rates, rising house prices as well as income tax reductions and other initiatives in the Spring Package of March 2004. The fiscal expansion in 2004 has thus contributed to the revival of economic growth after a period of slow growth in 2001-2003.

Private investment and exports should gradually become more important growth drivers in 2005 and 2006, while the growth rate of private consumption is expected to recede. The upswing is therefore set to become more broad-based and better balanced in 2005 and 2006.

Against the background of above-trend GDP growth, the prospects for the Danish economy include falling unemployment, moderately increasing inflation, and continued surpluses on the public balance as well as the external current account. The planned fiscal policy stance is broadly neutral with respect to economic activity in 2005 and 2006, *cf. section 2*.



<sup>1</sup> Since May, Statistics Denmark has substantially revised the methods and data used in the national accounts, including a shift to chain-weighting. Data based on traditional fixed-price indices are still published (in electronic form), now with 2000 as the new base year. For recent years, the differences in growth rates (e.g., for real GDP and demand components) between the chain-weighted and the 2000-fixed price data are modest, *cf. box 1.2*. Unless otherwise stated, the real growth rates shown in this Survey are based on data in fixed 2000-prices.

The pick-up in activity has led to a turnaround in the labour market. Unemployment has declined by about 25,000 persons (0.8 percentage points) since December 2003, cf. figure 1.1b. The drop in unemployment is expected to continue throughout this year and into 2006. In 2006, unemployment is estimated to reach 147,000 persons (5.1 percent of the labour force, national definition). Overall, employment is expected to grow by about 30,000 persons (1 percent) during the forecast period.

**Table 1.1****Key figures compared to the May projection**

	2004		2005		2006	
	May	Aug.	May	Aug.	May	Aug.
<b>Real growth, per cent<sup>1</sup></b>						
Gross domestic product	2.4	2.0	2.4	2.4	2.2	2.4
Private consumption	4.3	3.9	3.7	3.6	2.3	2.5
Public consumption	0.7	2.0 <sup>2</sup>	0.6	0.3	0.5	0.5
Export market, manufactures	7.5	7.5	6.5	6.1	6.8	6.5
<b>Per cent of GDP</b>						
Public budget balance, new national accounts <sup>3)</sup>	1.2	1.1	1.7	2.5	1.0	1.9
Public budget balance, former national accounts <sup>3)</sup>	2.3	.	2.6	.	2.3	.
Current account	2.5	2.5	2.1	2.4	2.5	2.4
<b>1,000 persons</b>						
Unemployment	176		158		147	
<b>Growth, per cent</b>						
House prices, single-family house	7.9	9.1	9.0	13.0	6.0	7.0
Consumer prices	1.2		1.5		1.9	
Hourly compensation, priv sector	2.8		3.1		3.7	
<hr/>						
Yield on 10-year gov't bonds	4.3		3.8		4.4	
Oil price, \$ a barrel	38.2		50.5		58.5	
Exchange, rate dkr. per \$	6.0		5.7		5.8	
Oil price, dkr. per barrel	228.9		289.9		361.2	

1) Statistics Denmark has substantially revised the methods and data used in the national accounts, including a shift to chain-weighting, revised data for services trade, and reclassification of ATP, cf. note 3. The revisions have affected historical growth rates, public finances and other variables, cf. box 1.2.

2) Real public spending growth is 0.3 per cent in 2003, revised from 1.0 percent in May.

3) Excluding the labour market supplementary pension scheme ATP. The data from May are estimated.

4) Including the labour market supplementary pension scheme ATP.

Source: Statistics Denmark and Ministry of Finance

Public finances are expected to benefit from stronger activity, higher revenues from oil and gas production and high returns on pension savings. The suspension of Special Pension Savings contributions (of 1 percent of income) in 2004 and 2005 has been extended to 2006 and 2007, thus widening the tax base in those years compared to May assumptions.

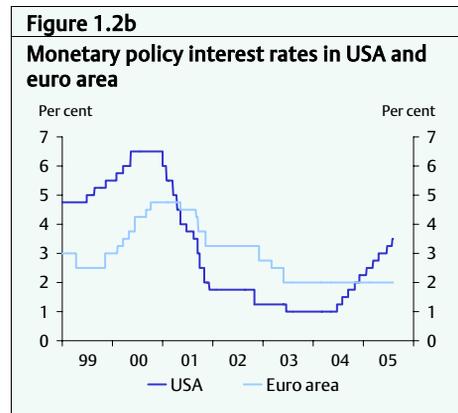
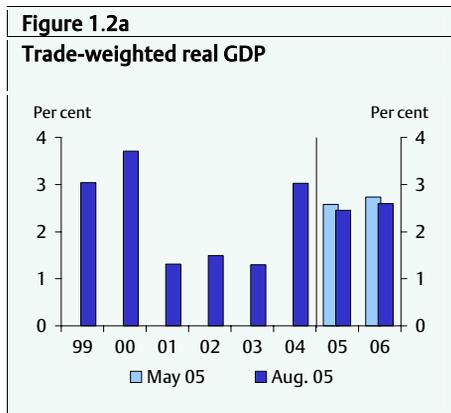
The budget surplus is projected to grow from 1.1 per cent of GDP in 2004 to 2.5 and 1.9 per cent of GDP in 2005 and 2006, respectively. The data are based on the new national accounts, in which, among other things, the labour market supplement-

tary pension scheme ATP has been reclassified from the public to the private sector, *cf. also table 1.1 and box 1.2*. The revised treatment of ATP has lowered the general government balance by around 1 per cent of GDP in the official statistics, *cf. also section 2*. The altered statistical treatment of ATP is technical and does not affect the assessment of fiscal policy challenges, nor the sustainability of public finances.

### The international environment and its impact on the Danish economy

Global growth remains fairly strong, with continued brisk expansion in North America and Asia. Growth has been more subdued in the euro area, yet forward-looking indicators seem to suggest that the long-awaited improvement in Germany could be about to materialize. Hence, although the growth rates in several EU countries are seen lower than in the May survey – in view, notably, of weaker data for the first half of the year and high oil prices – the outlook is still for a gradual pick-up in the euro area, sustained by low interest rates as well as recently improved export competitiveness. Projected growth for the United States remains more or less unchanged, as confirmed by incoming data, and with the dampening impact of higher oil prices offset, in particular, by lower long-term yields.

Overall, real GDP growth among Denmark's main trading partners has been revised down slightly (by 0.1 and 0.2 percentage points in 2005 and 2006, respectively), but the pace of activity is still expected to be rather healthy *cf. figure 1.2a*.

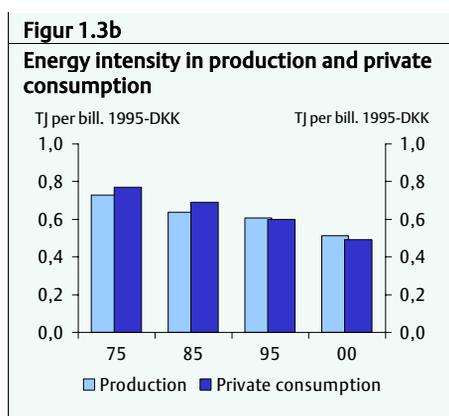
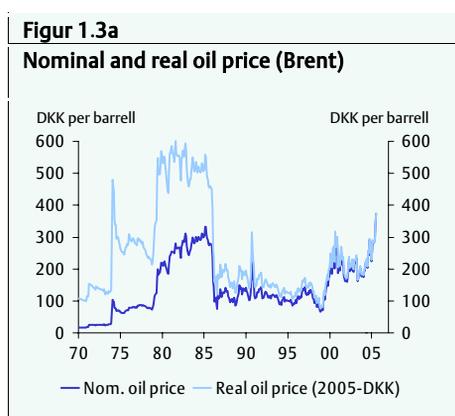


Interest rates in the euro area are a little lower than expected in the May survey. The ECB has maintained its key policy interest rate unchanged at a low level, reflecting relatively moderate inflation prospects and still-subdued economic growth, *cf. figure 1.2b*. An increase in short term interest rates, which had been expected earlier, is now assumed to take place in the second half of 2006. As a consequence of the fixed exchange rate policy vis-à-vis the euro, the key Danish policy rate has stayed close to the refinancing rate of the ECB.

In the USA, the federal funds target rate has been gradually raised during the last 12 months. So far, however, long term interest rates have been relatively immune to this increase and they are currently somewhat lower than anticipated. The gradual tightening of monetary policy towards a more neutral stance is expected to continue.

Oil prices have increased markedly since the May projection, *cf. figure 1.3a*. The assumed crude oil price (in DKK) is revised upward by 10 percent in 2005 and 25 percent in 2006. The hike in oil prices partly reflects buoyant growth in the world economy. Demand of a more speculative nature may also have played a role, partly reflecting the still-unsettled conditions in the Middle East. With most oil-producing countries currently close to capacity limits, oil supply may be relatively inelastic in the short-term. But crude oil prices are considerably above marginal production costs, which supports expectations of some decline in the medium-term.

In recent years, Denmark has been a net exporter of energy and higher oil prices tend to strengthen both the budget balance and the current account. Private consumption may be negatively affected, but the energy intensity in both production and private consumption is significantly lower than in previous periods with high oil prices, *cf. figure 1.3b*. Due also to the large component of excise duties in end-user energy prices, the impact of crude oil price changes on overall inflation is comparatively modest. Oil prices in real terms (i.e., relative to consumer prices) are still far lower than in the early 1980s, when the crude oil price corresponded to some 600 Dkr. or \$100 pr. barrel in today's terms, *cf. figure 1.3a*.



The dollar has appreciated somewhat against the euro over recent months, and hence the assumed dollar exchange rate for 2005 has been revised up from 5.75 Dkr. per dollar in May to 6 Dkr. in the current forecast. The somewhat stronger dollar has caused Danish (and euro-area) producers to recoup some of their earlier price competitiveness, but it may also imply slightly higher inflation.

On balance, the changes to the international environment since the May Survey point to a marginal downward revision to real GDP growth in 2005 and 2006 *cf. box 1.1*.

### Box 1.1

#### Estimated effects of revised external assumptions

Overall, the revisions to the assumptions concerning export market growth, oil prices, interest rates, import prices and competitors' export prices since May should have a marginal negative impact on activity growth in 2005 and 2006, *cf. table a*. The lower export market growth and higher oil prices pulls down GDP growth in both years, while lower assumed interest rates have a small positive effect on GDP in 2006.

#### Table a

##### Estimated effects on Danish GDP of changed assumptions

	2005	2006
<b>Percentage points</b>		
Export market growth <sup>1)</sup>	-0.1	-0.1
Foreign prices (excl. oil prices)	0.0	-0.0
Prices on energy <sup>2)</sup>	-0.0	-0.1
Foreign interest rates	0.0	0.1
<b>Total</b>	<b>-0.1</b>	<b>-0.0</b>

1) Including the effects of higher oil prices on export market growth

2) Excluding the effects of higher oil prices on export market growth.

Source: Own calculations on the macroeconomic model ADAM.

## Domestic developments

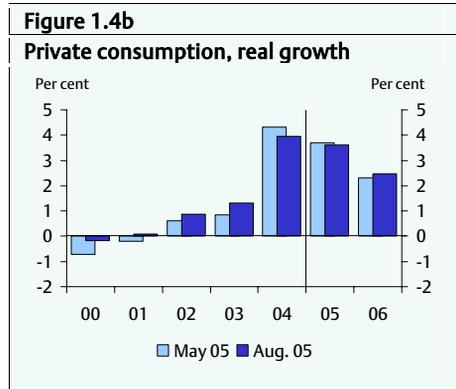
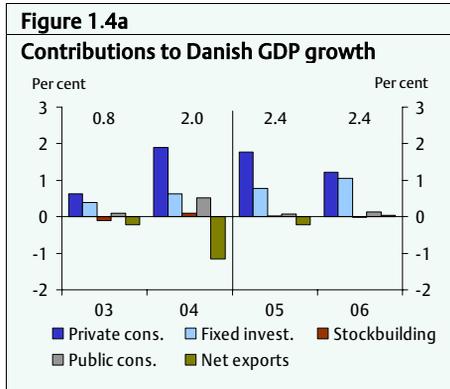
Against the background of fairly high international growth and a sustained upswing in domestic demand, the Danish economy is expected to grow at above-potential rates in both 2005 and 2006. With export growth projected to pick up and domestic demand growth abating somewhat, the recovery is expected to become broader-based and more balanced across sectors.

The strong growth in domestic demand in 2004 stemmed mainly from private consumption, which increased by 3.9 per cent, *cf. figure 1.4a*. This upswing in private consumption reflected strong growth in household real disposable income in 2004 boosted by income tax reductions and the suspension of contributions to the Special Pension Savings scheme (of 1 per cent of income; the scheme had been introduced in 1998 with a view to dampen demand and pre-empt overheating).

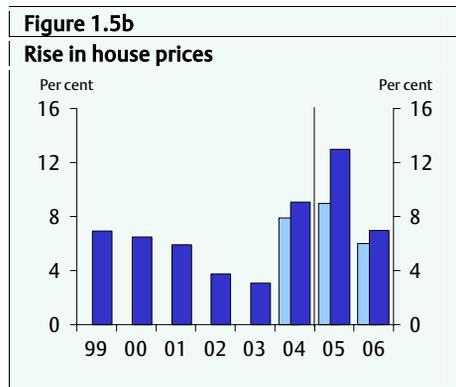
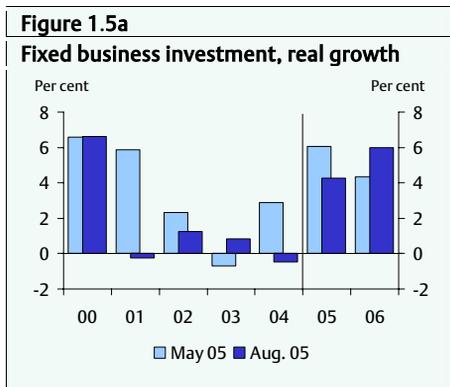
Recent trends in retail trade and car sales confirm that private consumption has continued to grow at a high pace in the first half of 2005. Overall, consumption growth is expected to remain strong at 3.6 per cent in 2005 as spending gradually adjust to the higher level of real disposable incomes, *cf. figure 1.4b*. In 2006, private consumption growth is expected to decelerate to 2.5 per cent, reflecting moderate growth in the real disposable income of households and a modest decline in the savings ratio.

The growth rate of consumption in 2005 is marginally lower than forecast in May, but the 2006 forecast has been revised upward by 0.2 percentage points following, in particular, the extended suspension of Special Pension Scheme contributions to cover the years 2006 and 2007.

The relatively strong growth in private consumption in 2004-2006 is underpinned by low interest rates, rising house prices and new loan types – including mortgage loans free of repayment on the principal for up to 10 years – for owners of real estate.



In the light of high and increasing capacity utilization and low interest rates, the growth rate of fixed business investments is expected to pick up. It is projected to reach 4 percent in 2005 and 6 percent in 2006 after several years of sluggish growth, cf. figure 1.5a.



House prices are still increasing fairly rapidly, in part due to persistently low interest rates. Reflecting developments in the first half of 2005, the price increases for owner-occupied single-family homes have been revised up to 13 per cent in 2005 (from 9 per cent in the May projection), cf. figure 1.5b. House price increases are still expected

to decelerate somewhat in 2006, to 7 percent, due to the assumed moderate increase in interest rates and slower growth in real disposable incomes.

After strong growth of around 10 per cent in both 2003 and 2004, residential investment is expected to decelerate in 2005 and 2006 with growth rates at 3 and 4 per cent, respectively, *cf. table 1.2*. The sustained growth in residential investment in 2005 and 2006 reflects a marked increase in private housing investments. The forecast for 2006 has been revised upward by 2 percentage points. This revision follows from the stimulus of lower interest rates and higher real estate prices.

In 2005 the real growth rate of public consumption is assumed to be 0.3 percent. The growth rate is about 0.3 percentage points lower than in the May survey, because the level of public consumption in 2004 has been revised up in the latest national accounts data. On the basis of the 2006 fiscal agreement with the municipalities and of the government's proposed fiscal bill for 2006, real public consumption growth is assumed to be 0.5 percent in 2006. This is in line with the medium term requirements in the 2010-framework.

Stock-building contributed 0.1 percentage point to GDP growth in 2004, and is expected to be neutral in terms of GDP growth in both 2005 and 2006.

**Table 1.2****Use and supply of goods and services**

	2004	2001	2002	2003	2004	2005	2006
	Bill.Dkr.						
				Real growth, per cent			
Private consumption	710.1	0.1	0.9	1.3	3.9	3.6	2.5
Public consumption	388.7	2.2	2.2	0.3	2.0	0.3	0.5
Public investment	25.8	11.4	-6.6	-6.8	11.6	2.7	1.0
Residential construction	73.4	-9.3	1.2	9.1	10.9	3.0	4.0
Fixed business investment	185.3	-0.3	1.3	0.8	-0.5	4.3	6.0
Stock building <sup>1)</sup>	3.7	-0.3	-0.2	-0.1	0.1	0.0	0.0
<b>Total domestic demand</b>	<b>1387.1</b>	<b>0.0</b>	<b>0.9</b>	<b>1.1</b>	<b>3.3</b>	<b>2.8</b>	<b>2.5</b>
Exports of goods and services	667.3	3.1	4.8	-0.9	3.3	3.9	4.6
Of which manufactures	297.5	4.3	5.7	-1.6	2.4	3.9	5.0
Imports of goods and services	594.0	1.9	6.5	-0.5	6.5	4.8	4.9
Of which goods	406.7	1.6	5.3	-2.2	7.0	6.0	5.7
Net exports	73.3	0.7	-0.4	-0.2	-1.2	-0.2	0.0
<b>Gross domestic product</b>	<b>1460.4</b>	<b>0.7</b>	<b>0.5</b>	<b>0.8</b>	<b>2.0</b>	<b>2.4</b>	<b>2.4</b>
Gross value added	1248.4	0.7	0.4	0.8	1.3	2.1	2.3
Of which in private non-agricultural sector	794.2	0.7	0.0	0.4	1.5	2.8	3.4
<b>GDP per capita (1,000 Dkr.)</b>	<b>270.4</b>	<b>0.4</b>	<b>0.2</b>	<b>0.5</b>	<b>1.8</b>	<b>2.3</b>	<b>2.3</b>

1) The percentages indicate the volume changes in stock building in per cent of volume GDP in the preceding year, both in 2000-prices.

Source: Statistics Denmark and own calculations.

Overall, the real growth rate of domestic demand is expected to moderate from 3.3 percent in 2004 to 2.8 and 2.5 per cent in 2005 and 2006, respectively. The strong rise in domestic demand in 2004-2006 should be seen in the light of previously low growth of just 0.6 percent on average in 2001-2003. Taken in isolation, the expected dampening of domestic demand growth in 2005 and 2006 reduces the risks of overheating and internally generated inflation pressures.

**Box 1.2****New and revised national accounts**

Statistics Denmark has in July published new and revised national account statistics for the Danish economy in line with the guidelines of the ENS-conventions. The official real growth rates for GDP and its components are now based on chain indexes.

Compared to real growth rates based on fixed prices (e.g. 1995 prices) price weight in a chain index are updated annually, so the real growth rate of for example private consumption is based on consumer prices from the year before. Real growth rates measured with chain indexes therefore use the most recent and relevant weight structure and hence gives a better "year-to-year" real growth estimate. Table a shows a comparison between real GDP growth in the new and old national account statistics. Note that the real growth projections presented in this survey are based on 2000 prices.

Besides the shift to chain indexes the national accounts are revised in the following areas:

- The labour market supplementary pension fund (ATP) has been moved from the public to the private sector. The revision reduced the public budget surplus considerably, cf. box 2.1.
- Revised treatment of imputed financial services (FISIM) raises the level of private and public consumption as well as GDP etc. The effect on real growth rates is however negligible.
- Upward revision of both exports and imports of services by 25-30 per cent. Net exports of services are unchanged.

**Table a****Real GDP-growth since 1990 according to new and old national account statistics**

Per cent	1990-2000 (avg.)	2001	2002	2003	2004	Forecasts	
						2005	2006
<i>New national accounts</i>							
Chain index	2.6	0.7	0.5	0.6	2.1	2.4	2.2
2000 prices	2.3	0.7	0.5	0.8	2.0	2.4	2.4
<i>Old national accounts</i>							
1995 prices	2.3	1.3	0.5	0.7	2.4	-	-

Source: Statistics Denmark and own calculations.

**International trade and the current account**

Export market growth is expected to be fairly strong, although held back somewhat by relatively weak activity in the euro area. In addition, export growth should be positively affected by the weakening of the euro against the dollar and other currencies, and thus of the effective exchange rate of the Danish kroner. Accordingly, wage competitiveness is expected to be unchanged in 2005 and 2006 after some deterioration in the preceding years. Export growth is projected at about 4 – 4½ per cent in 2005 and 2006.

Imports of goods and services are expected to grow slightly faster, at just below 5 per cent in 2005 and 2006, reflecting both the growth and composition of domestic demand.

Overall, the substantial negative contribution to GDP growth from net foreign trade in recent years is projected to decline to 0.2 percentage points in 2005 and roughly zero in 2006.

The current account surplus is expected to be about 2½ per cent of GDP in 2005 and 2006, which is roughly 1 percentage point less than in 2003. The reduction mainly reflects the relatively strong growth in domestic demand combined with a loss of export market shares.

### Employment, unemployment and labour force

The upswing in economic growth as of mid-2003 arrested the decline in employment, which took place in 2002 and 2003. Output recoveries typically affect employment with some delay, and employment increased by a modest 2.000 persons in 2004, *cf. figure 1.6a* (correspondingly, productivity increases were relatively high, as they typically are at the beginning of an economic expansion).

Relatively strong output growth in 2004 and 2005 is expected to lead to an increase in employment of 17.000 persons in 2005, *cf. table 1.3*. In 2006 an increase of a similar size is expected. For the most part the increase in both years reflects higher private sector employment. Public sector employment is assumed to increase by 3.000 persons from 2004 to 2006.

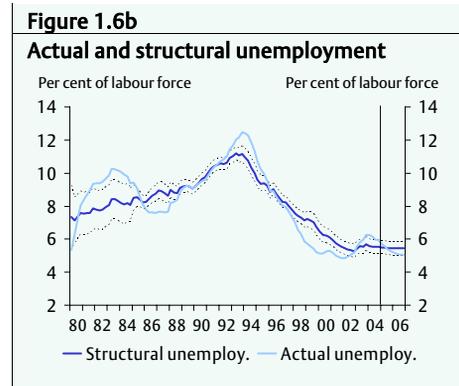
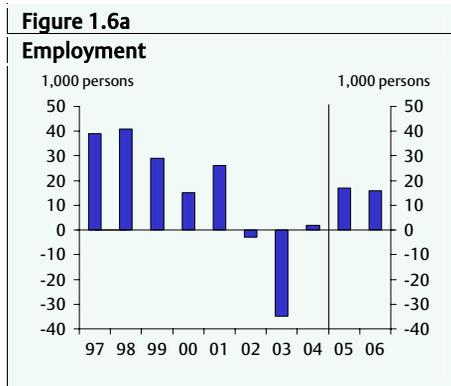
The outlook for the labour market is basically unchanged since the May survey.

<b>Table 1.3</b>								
<b>Employment, labour force, and unemployment</b>								
	2003 level	Avg. 1990- 2004	2003	2004	2005		2006	
					May	Aug.	May	Aug.
					<b>Change, 1000 persons</b>			
Private sector	1876	3	-30	1	15	15	11	14
Public sector	829	4	-5	1	2	2	2	2
Total employment	2705	7	-35	2	17	17	13	16
Labour force	2876	0	-9	8	-1	-1	1	5
Unemployment	171	-7	26	6	-18	-18	-11	-11

Rising employment should lead to a corresponding drop in unemployment as the labour force only changes slightly in 2005 and 2006. The level of unemployment is expected to decrease from 176.000 persons (6.1 percent of the labour force) in 2004 to

159.000 persons in 2005 and 147.000 persons in 2006 (5.1 percent of the labour force).

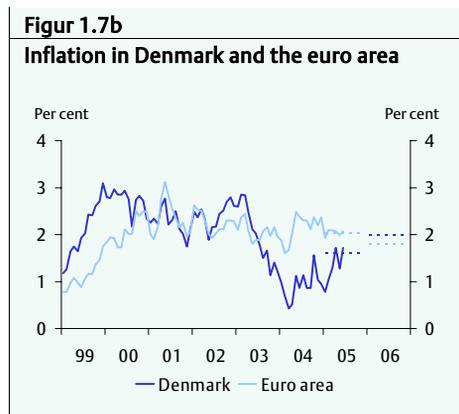
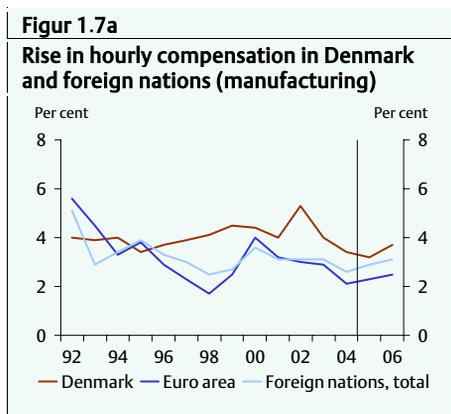
During 2005 and 2006, the unemployment rate is expected to fall below the estimated structural level of unemployment indicating that labour market pressures could begin to emerge, *cf. figure 1.6b*.



**Wage and price inflation**

The unemployment rate remained above the estimated structural level in 2003 and 2004, thus contributing to dampen hourly wage growth from 4.2 per cent in 2002 to 2.8 per cent in 2004. Labour market pressures are expected to emerge gradually during the forecast years and wage growth is expected to pick up to 3.2 per cent in 2005 and 3.7 per cent in 2006. The anticipated wage increases for 2005 are slightly higher than projected in May.

Hourly compensation of employees in the manufacturing sector continues to grow faster than for an average of trading partners, *cf. figure 1.7a*.



The inflation rate (HICP) has been historically low in 2004 and the beginning of 2005, *cf. figure 1.7b*. Low inflation owes partly to falling import prices in 2003 and 2004, which have more than offset the price increases on energy. Developments in the last months indicate that the impact of the decrease in import prices is gradually diminishing. Consequently inflation has picked up as the increasing energy prices are no longer offset and hence become more visible in the overall inflation rate.

For 2005 as a whole, inflation is expected to pick up from 0.9 per cent in 2004 to 1.6 per cent. Inflation is projected to rise to 2.0 per cent in 2006. The increase is mainly due to growing domestic inflation pressures, as output is expected to be above potential in 2006. The expected inflation rate is revised up by 0.2 percentage points in 2005 and 2006 mainly reflecting higher oil prices.

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

**Table 1.3****Key figures for the Danish economy**

	2001	2002	2003	2004	2005	2006
<b>Percentage change from previous year</b>						
Real GDP	0,7	0,5	0,8	2,0	2,4	2,4
Trade-weighted GDP abroad	1,3	1,5	1,3	3,0	2,5	2,6
Markets for Danish manufactures	0,1	1,4	4,1	7,5	6,1	6,5
International competitiveness	-2,2	-3,0	-4,2	-1,4	0,3	-0,2
Export of manufactures, volume	4,3	5,7	-1,6	2,4	3,9	5,0
Hourly wages	4,2	4,2	3,7	2,8	3,2	3,7
Consumer price index	2,4	2,4	2,1	1,2	1,7	2,1
Price index for single-family houses	5,9	3,8	3,1	9,1	13,0	7,0
Merchandise export prices	1,3	-1,9	-1,3	1,6	3,3	2,9
Merchandise import prices	0,3	-0,9	-1,2	1,5	3,1	3,0
Merchandise terms of trade	1,0	-1,0	-0,1	0,0	0,3	-0,1
Productivity in private non-agricultural sector	-0,3	0,8	2,5	2,9	1,9	2,4
Real disposable income of households <sup>1)</sup>	1,8	0,1	3,1	3,2	1,1	0,5
<b>Labour market:</b>						
Labour force (thousands)	2.888	2.884	2.876	2.883	2.882	2.886
Employment (thousands)	2.742	2.739	2.705	2.707	2.723	2.739
Of which in private sector	1.919	1.906	1.876	1.877	1.892	1.906
in public sector	824	834	829	830	831	833
Percentage change in total employment	0,9	-0,1	-1,3	0,1	0,6	0,6
Unemployment (thousands)	145	145	171	176	158	147
Early retirements (thousands)	159	165	175	180	168	152
Persons on leave (thousands)	24	17	5	3	3	3
Unemployment rate (per cent)	5,0	5,0	5,9	6,1	5,5	5,1
Unemployment rate, EU-def. (per cent)	4,3	4,6	5,6	5,4	4,8	4,4
<b>Long term bond yields, exchange rate:</b>						
10-year government bonds	5,1	5,1	4,3	4,3	3,5	3,9
30-year mortgage credit bond	6,7	6,3	5,4	5,3	4,4	4,7
The effective krone rate (1980=100)	96,8	97,7	101,2	102,2	101,5	101,0
<b>Balance of payments:</b>						
Goods and services (bill. Dkr.)	88,7	80,1	84,7	73,3	72,4	73,8
Current account (bill. Dkr.)	40,1	30,3	46,1	35,8	36,7	38,0
Current account in per cent of GDP	3,0	2,2	3,3	2,5	2,4	2,4
Net foreign debt, ult. (bill. Dkr.)	224,0	227,0	178,0	159,8	130,1	92,1
Net foreign debt in per cent of GDP	16,8	16,7	12,7	10,9	8,5	5,8
<b>Public finances:</b>						
Government net lending (bill. Dkr.) <sup>2)</sup>	15,9	3,6	-3,2	16,2	38,9	30,8
Government net lending per cent of GDP <sup>2)</sup>	1,2	0,3	-0,2	1,1	2,5	1,9
General government gross debt, year-end, bill. Dkr.	633,2	642,8	624,8	618,4	543,8	507,5
General government gross debt, year-end, per cent of GDP	47,4	47,2	44,6	42,3	35,6	31,8
Tax burden (per cent of GDP) <sup>2)</sup>	48,6	48,3	47,9	49,1	49,3	47,9
Expenditures (per cent of GDP)	53,5	54,1	54,1	54,1	52,5	51,6

1) Adjusted for special factors concerning pension funds.

2) Excluding the labour market supplementary pension scheme ATP.

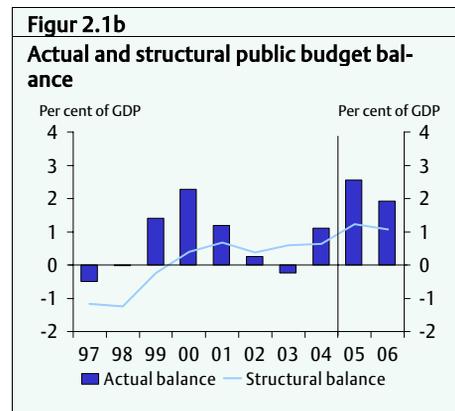
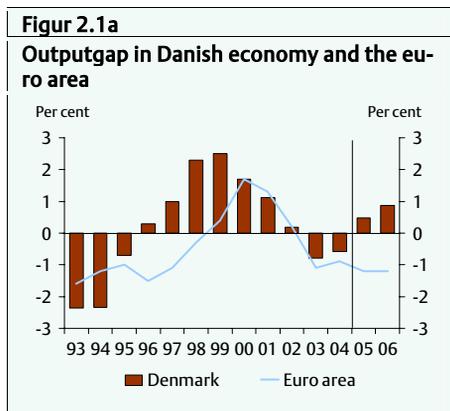
## 2. The fiscal stance and government finances

After a sizeable fiscal stimulus in 2004 the fiscal stance is estimated to have a broadly neutral impact on economic activity in 2005 and 2006.

This neutral stance should be seen in the light of the substantial growth stimulus from low interest rates and the lagged impact of the 2004 policy initiatives, while the unemployment rate is expected to decline to a level below the currently estimated structural rate.

The extended suspension of SP-contributions in 2006 and 2007, which is not included in the estimated fiscal stance since SP is statistically classified as a private scheme, is presumed to increase GDP by around 0.1 per cent in 2006.

Owing to above-potential growth in 2004 to 2006, output is projected to exceed currently estimated potential and labour market pressures can be expected pick up in the course of 2005 and 2006, *cf. figure 2.1a*. Due to the fixed exchange rate vis-à-vis the euro, the short-term (and long-term) interest rates in Denmark are closely tied to those of the euro area. The cyclical position of the Danish economy is stronger than in the euro area and the monetary stance of the ECB may turn out to be relatively easy in relation to Danish cyclical conditions.



The planned public expenditure growth in 2005 and 2006 is in line with medium-term goals of relatively low real growth in public consumption of around 0.5 per cent yearly to 2010.

In 2005 the level of public expenditure is assumed to be in line with budgets. Compared to the May survey, the assumed real growth rate of public consumption in 2005 has been revised down from 0.6 to 0.3 per cent, reflecting a higher level of expenditure in 2004. The higher expenditure level in 2004 reflects budget overruns in local governments. For 2003-2005 on average, the real growth rate in public consumption is more or less in line with the May forecast.

Based on revised national accounts, the projections for the public budget surplus are revised upwards considerably since the May forecast, *cf. box 2.1*. The surplus estimate for 2005 is revised up by 0.9 percentage points to 2.5 per cent of GDP while the surplus for 2006 is revised up by a similar amount to 1.9 per cent of GDP, *cf. box 2.1*.

**Box 2.1****Revisions to the public budget balance, 2002-2006**

Owing to revised national accounting methods, the new forecast for the public surplus is not directly comparable to the May forecast.

The main revision stems from the exclusion of the labour market supplementary pension fund (ATP) from the public sector. This lowers the public budget balance by around 1 per cent of GDP, *cf. table a*. Other revisions include a changed periodization of corporate taxes. As a result of the revisions, the May forecast for the public surplus would, based on the new national accounts, correspond to 1.7 per cent of GDP in 2005 and to 1.0 per cent of GDP in 2006, *cf. table a*.

Subsequent data releases and new projections for public revenues and expenditures point to a more favourable outlook for the public budget balance in 2005 and 2006. In 2005 the surplus is improved (excluding technical revisions) by 0.9 per cent of GDP compared to May. This follows mainly from increased tax revenues from pension returns (0.6 per cent of GDP) and larger North Sea oil and gas-related revenues (0.2 per cent of GDP). In 2006 the expected public surplus is revised up (excluding technical revisions) by 1 per cent of GDP. The improvement in the surplus in 2006 includes, among other things, increased North Sea and income tax revenues.

On the new basis, the surplus on the public budget balance is forecast at 2.5 and 1.9 per cent of GDP in 2005 and 2006, respectively.

**Table a****Public budget balance, 2002-2006**

	2002	2003	2004	2005	2006
<b>Per cent of GDP</b>					
<b>1. May (former national accounts)</b>	<b>1,6</b>	<b>1,0</b>	<b>2,3</b>	<b>2,6</b>	<b>2,3</b>
<i>Technical revisions</i>					
- reclassification of supplementary pension fund, ATP	-1,0	-1,1	-1,0	-0,9	-0,8
- corporate taxes (new periodization)	0,0	0,1	0,1	0,2	-0,3
- income taxes	-0,1	-0,1	-0,1	-0,1	-0,1
- other changes	-0,1	0,0	0,0	0,0	0,0
<b>2. Technical revisions, total</b>	<b>-1,2</b>	<b>-1,1</b>	<b>-1,1</b>	<b>-0,9</b>	<b>-1,3</b>
<b>3. May (new national accounts) 1+2</b>	<b>0,4</b>	<b>-0,1</b>	<b>1,2</b>	<b>1,7</b>	<b>1,0</b>
<i>New data/projections</i>					
- Tax on pension returns	0,0	-0,1	0,1	0,6	0,0
- North Sea oil and gas production revenues	0,0	0,0	0,2	0,2	0,5
- indirect taxes	0,0	0,0	0,1	0,1	0,2
- income taxes	0,0	-0,2	-0,3	0,1	0,4
- income transfers	0,0	0,0	0,0	0,0	-0,3
- other changes	-0,1	0,2	-0,1	-0,1	0,1
<b>4. New data/projections, total</b>	<b>-0,1</b>	<b>-0,1</b>	<b>-0,1</b>	<b>0,9</b>	<b>1,0</b>
<b>5. August (new national accounts) 3+4</b>	<b>0,3</b>	<b>-0,2</b>	<b>1,1</b>	<b>2,5</b>	<b>1,9</b>

Source: Statistics Denmark and own calculations

The structural budget surplus is estimated at 1.2 per cent of GDP in 2005 and 1.1 per cent of GDP in 2006. The structural surplus is consistent with the medium-term fiscal objective of an average surplus of  $\frac{1}{2}$  to  $1\frac{1}{2}$  per cent of GDP through 2010<sup>2</sup>.

According to the most recent medium-term projection (May Survey 2005) implying restrained expenditure growth (0.5 per cent annually in real terms) through 2010 and further policy initiatives to raise structural employment by some 60,000 persons (roughly 2 percent), the structural budget surplus is estimated at 1.0 per cent of GDP on average for 2003-2010.

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<sup>2</sup> The medium-term fiscal objective reflects the new national accounting system. The reclassification of ATP does not affect the assessment of fiscal sustainability. The 2010-framework for assessing long-term fiscal challenges is based on the fiscal variables of central and local governments, hence ATP is excluded in the calculations. The medium-term objective for the general government balance has been updated to reflect the new statistical basis and now corresponds to an average surplus of  $\frac{1}{2}$  to  $1\frac{1}{2}$  per cent of GDP through 2010.