

1. Summary

1.1 The current economic outlook

The Danish economy has experienced growth over the past two years, and the level of activity is nearing the level from before the recession in 2008-2009, *cf. figure 1.1*. The upturn is not very strong but has been strong enough to create a clear improvement in the labour market, with private sector employment rising by 66,000 persons since the trough in 2012, *cf. figure 1.2*. The reform efforts in recent years have created the basis for employment growth without leading to labour-market bottlenecks as happened during the pre-crisis overheating.

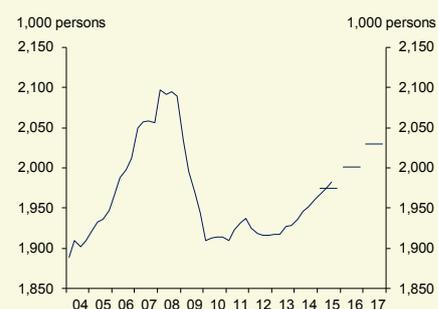
In combination with rising housing prices and improving real wages the improvement in the labour market has strengthened the economic position of households and thereby created a sound foundation for domestic demand. At the same time, the Danish economy continues to be supported by increased demand for exports from Denmark's main trading partners, with Danish companies in particular benefiting from increasing growth in the euro area and a low level of the effective Krone exchange rate.

GDP growth is expected to increase in the coming years, from 1.4 per cent in 2015 to 1.9 per cent in 2016 and 2.0 per cent in 2017. The increasing level of economic activity is also expected to result in an increase in private-sector employment of more than 80,000 persons in 2015-2017.

Figure 1.1
Growth in GDP since the spring of 2013



Figure 1.2
Which has contributed to increasing private sector employment



Note: In figure 1.1 the level of (quarterly) GDP has been annualized. Employment in figure 1.2 is calculated including persons on leave. The dark blue horizontal lines indicate the expected annual average.

Source: Statistics Denmark and own calculations.

Growth has become more broad-based than previously, as domestic demand increasingly extent contributes to economic growth in Denmark. Private consumption has increased in 2015 as a result of the strengthening of the economic situation of households due to increasing income and the progress in both the labour market and the housing market. Furthermore, continued low inflation implies real income growth despite relatively moderate nominal wage increases. Going forward, continued employment growth and increasing housing prices should result in a further lift in private consumption. Increasing housing equity will furthermore give households the opportunity to increase borrowing. Consumption is therefore expected to grow a little faster than income, *cf. figure 1.3*.

Investment is also expected to rise – supported by low interest rates and higher demand for the products of Danish companies. As capacity utilization increases, companies will have a need for investing in new equipment and structures.

Increasing demand will not only come from Danish consumers and companies, but also from abroad. In particular, the positive development in Europe is expected to improve the market for the exports of Danish companies. Compared with countries outside the euro area, Danish competitiveness has been strengthened due to the weak Euro and Krone exchange rate.

The economic upturn leads to a narrowing of the output gap over the forecast horizon, with an estimated output gap of -0.7 per cent of GDP in 2017 compared to -1.8 per cent in 2014, *cf. figure 1.4*. As the output closes, a tightening of economic policy is required. Currently, monetary policy is very accommodative, and it is expected to remain accommodative over the forecast horizon. This increases the need for a gradual tightening of fiscal policy from the current accommodative level, in order to bring fiscal policy in line with the business cycle and ensuring that fiscal balance is achieved in 2020. The tightening of fiscal policy reduces the structural deficit from 0.7 per cent of GDP in 2015 to 0.4 per cent of GDP in 2016 and 2017.

Figure 1.3
Consumption growth in line with income growth

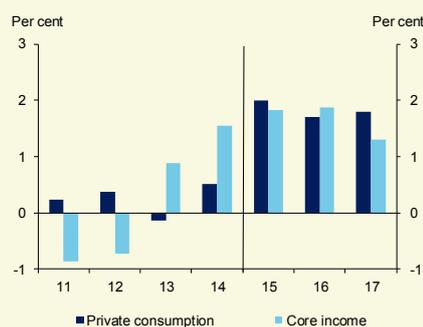
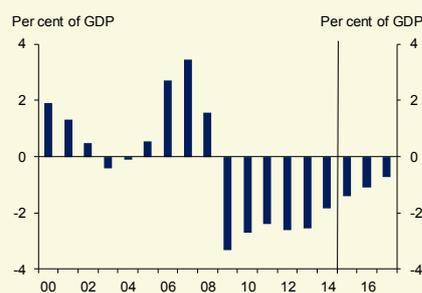


Figure 1.4
Gradual closing of the output gap



Note: Income in figure 1.2 is core income, which consists of wage income and transfers. Estimation of the output gap is subject to uncertainty.

Source: Statistics Denmark and own calculations.

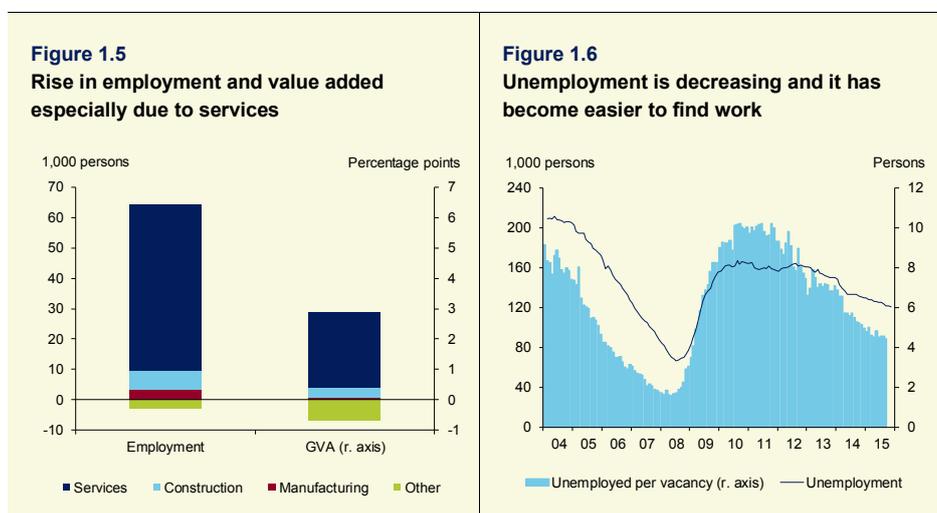
1.2 The Forecast

Stronger domestic demand

In the forecast period Danish companies and consumers are expected to increase their demand for goods and services. The growing domestic demand should especially be seen in connection with the strong developments in the labour market, which supports increasing income and reduces unemployment risk. Since the turnaround in late 2012, employment has increased by 62,000 persons. In particular, employment has risen in private services, *cf. figure 1.5*. This reflects the fact that these industries have driven economic growth in recent years, and that services is relatively more labour intensive.

The progress in the labour market is also reflected in 44,000 fewer unemployed persons since unemployment peaked in 2012, *cf. figure 1.6*. Falling unemployment has gone hand in hand with a rising number of vacant positions, and hence it has become easier to find work. Thus, there is now less than half as many unemployed persons per vacancy as in 2010-2011 when the competition for vacant positions was strongest, *cf. figure 1.6*.

The positive trend in the labour market is expected to continue, and employment growth of more than 80,000 persons is expected over the period 2015-2017. The room for employment growth in the coming years is in large part due to a rise in the structural employment level. This is especially due to a higher early retirement age as a consequence of the retirement reform, which contributes to more persons choosing to remain in the labour market for a longer period of time. This means that the capacity in the Danish economy expands so that the economic upswing is not halted by labour shortages.



Note: Figure 1.5 covers the period from the 4th quarter 2012 to the 3rd quarter of 2015. In figure 1.5 other industries consists of public administration, utilities, mining and quarrying and agriculture. Gross unemployment is shown in figure 1.6.

Source: Statistics Denmark, jobindsats.dk and own calculations.

The development in the housing market is also positive with increasing prices and turnover in large parts of the country. This reflects an improvement in the economic situation of many families as a result of income growth, rising employment and the very low level of interest rates, *cf. figure 1.7*.

The large drop in interest rates at the beginning of the year led to strong house-price increases in the major urban areas, and even a noticeable increase in long-term interest rates in the second part of the year has not prevented further increases in housing prices, although the rate of increases has slowed recently, *cf. figure 1.8*. For the forecast horizon further increases in housing prices are expected, albeit at a more muted pace than in 2015.

The low level of interest rates has led to many households converting their mortgages shifting from mortgages with frequent interest rate adjustments to fixed-rate mortgages, thereby protecting themselves against future increases in interest rates. This contributes to reducing the sensitivity to fluctuations in interest rates for both individual families and the Danish economy as a whole.

Figure 1.7
Significant fluctuations in long-term interest rates during the year

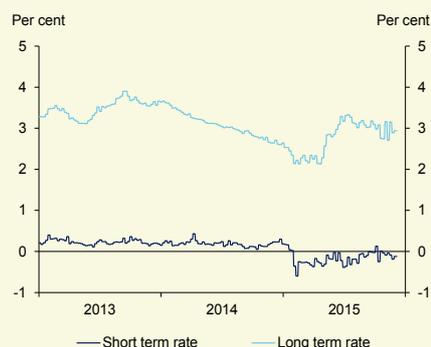


Figure 1.8
The pace of increases in housing prices has slowed in the second half of the year



Note: In figure 1.7 the short- and long-term interest mortgage rate is based on the effective interest rate on newly issued mortgage bonds, which forms the basis for respectively the high-frequency interest rate adjustment and the 30-year fixed rate mortgage loans. In figure 1.8 the cash price indices from Statistics Denmark, which are not seasonally adjusted, have been used.

Source: Thomson Reuters Eikon, Statistics Denmark and own calculations.

Inflation in Denmark is low, *cf. figure 1.9*. This is due to both low oil prices and idle resources remaining in the Danish economy. The modest level of prices increases contributes to strengthening the purchasing power of Danish consumers and thereby supports private consumption.

As a whole, the positive development in the labour market, combined with rising house prices, gradual wage increases and low inflation is supporting the economic position of households. This provides many Danes with an option to increase their consumption following a

number of years of consolidation after the overheating and the financial crisis. At the same time, housing equity is increasing for many property owners as a result of increasing housing prices. This creates room for households to increase their consumption more than increasing income would indicate. However, contrary to the period of overheating in the 2000's there is currently no expectation of a strong increase in debt-financed consumer spending.

Increasing demand from both Denmark and abroad has led to increasing capacity utilisation and a narrowing of the output gap. This increases the need for an expansion in the stock of capital, and the outlook is thus for increasing investment in equipment in the coming years, *cf. figure 1.10*. Investment in housing is also expected to pick up, especially driven by new construction, which has become more attractive as a result of increasing housing prices and a continued low level of interest rates.

Figure 1.9
Falling energy prices lowers inflation

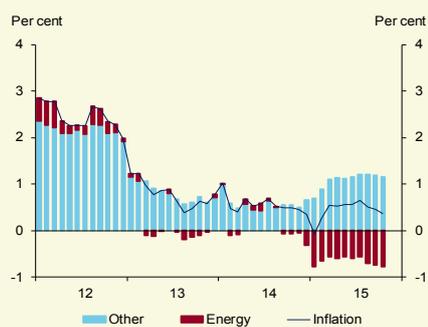
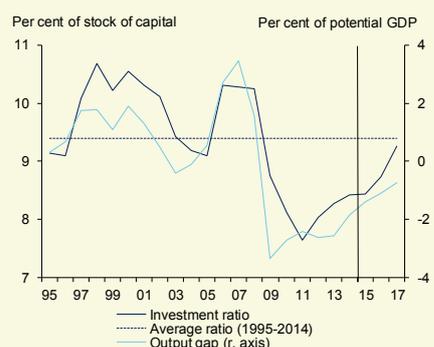


Figure 1.10
Increasing investment in line with increasing capacity utilization



Note: The investment rate is investment as a share of the total stock of capital. Capacity utilization is measured by the output gap. The estimation of the output gap is subject to uncertainty.

Source: Statistics Denmark and own calculations.

The conditions are in place for domestic demand to increase throughout the forecast period, and the economic upturn has generally become more robust despite weak demand in the second and third quarter of 2015. A stronger-than-expected increase in domestic demand is seen as more likely than a drop in growth in light of continued accommodative economic policy.

The accommodative monetary policy is associated with a risk of imbalances developing, given that interest rates are only expected to increase very slowly from the very low current level. The outlook for mortgage rates to remain low implies that they will not act as a brake on the strong progress in the housing market. Should domestic demand increase faster than expected, this could in combination with low interest rates lead to stronger-than-projected increases in housing prices. Such a scenario could lead to a need for tighter regulation in order to prevent overheating in the housing market.

Currently, there are no general labour-market bottlenecks or wide-spread recruitment problems. Labour-market capacity pressures have been increasing from a very low level in recent years, and despite an upward tick in recent quarters the rate of wage increases remains moderate. The assessment is still that idle resources remain in the labour market and that there is room for employment growth in the coming years, cf. section 1.4. Should the employment gap close more quickly than expected, labour market pressures will increase. This could imply a need for fiscal policy to be tightened more quickly.

International economic progress contributes to Danish export growth

The upturn in the Danish economy is greatly helped by international economic progress, and exports should continue to provide a significant contribution to growth over the forecast horizon, cf. figure 1.11. Export growth is especially driven by the entrenched growth in close trading-partner countries such as Sweden, United Kingdom and the euro area, cf. figure 1.12. Farther away, for the emerging-market economies the picture is less positive, with slower growth in China and recessions in Brazil and Russia.

As Danish exports to a large extent is sold to nearby countries, the slower momentum in emerging market economies is not expected to seriously dampen growth in Danish exports. However, there could be indirect effects if the decrease in growth impacts global financial markets negatively.

Figure 1.11
Progress has become more broad-based at home...

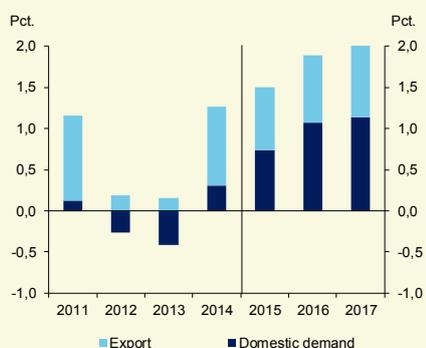
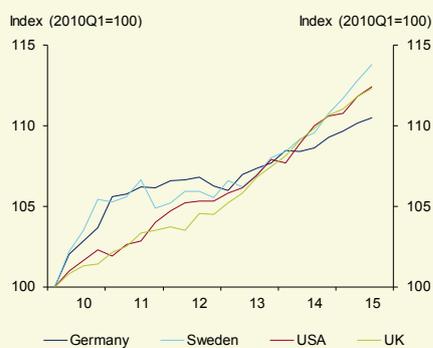


Figure 1.12
... and supported by growth in Denmark's largest export markets



Note: In figure 1.11 a correction has been made for the import content of exports and domestic demand.
Source: Thomson Reuters Eikon and own calculations.

The euro-area economy has continued to expand in 2015, and GDP grew by 1.6 per cent from the third quarter of 2014 to the third quarter of 2015. Furthermore, the labour market is improving with decreasing unemployment and rising employment. The upturn in the euro area is supported by a number of factors, including a continued low level of oil prices, very accommodative monetary policy, a weaker euro exchange rate and a transition from a relatively tight fiscal policy to a more neutral stance.

While euro-area growth is expected to increase in the coming years, the outlook for inflation remains very subdued. This should be seen in light of idle resources remaining, including high levels of unemployment in many countries. Thus, the European Central Bank is still a long way from beginning the normalization of monetary policy. Hence, growth is not expected to be dampened by rising short-term rates.

In the United States monetary policy tightening is expected soon – as opposed to the euro area. The economic recovery is further along and the latest figures show that unemployment is back at the pre-crisis level. The growing divergence in monetary policy between the euro area and the United States has contributed to a weakening of the euro against the dollar, and also the krone through the fixed-exchange-rate policy. This supports Danish competitiveness and, hence, exports.

Among the emerging-market economies, the growth outlook has weakened in recent years. There has been uncertainty about the Chinese economy which is transitioning from investment-led growth to more consumption-led growth. Weaker Chinese growth has contributed to depressing global demand for commodities and consequently exports for a number of economies which are particularly dependent on global commodity prices.

Risks for the international economy are balanced, but the picture is quite mixed. On the positive side, there has been a general tendency for euro-area growth to become more robust during 2015, and financial conditions have improved at the same time. This increases the likelihood for European growth to surprise on the upside, and at the same time the risk of renewed uncertainty about Southern Europe is limited.

On the negative side, there is increased uncertainty about emerging-market economies. Many countries are facing significant challenges both in the short run as well as in the longer run. In the short run, emerging market economies are challenged by sharp decreases in commodities prices and monetary-policy tightening in the United States. When, and how fast, US interest rates rise will crucially impact international capital flows as well as the stability of financial markets and interest rates across the globe. In the longer term, the challenge is to create sustainable growth which is less dependent on foreign capital and commodity market developments.

Uncertainty about the economic outlook

The expectation for increasing economic activity in Denmark should be viewed in light of higher domestic demand and continued growth in Danish export markets which will lead to further increases in exports.

Economic growth in Denmark could be higher than projected. Rising housing prices and progress in the labour market increases the confidence of households and consequently their propensity to consume. This effect could prove to be stronger than assumed in the forecast and thereby provide a greater-than-expected lift in private consumption. This could e.g. be due to greater optimism of households leading them to converting rising housing equity into consumption and housing investment.

However, global economic growth could prove to be weaker than expected, e.g. due to a weakening in a number of emerging-market economies, including China. Total export-market growth could be lower, if the uncertainty surrounding the emerging-market economies turns out to be greater than expected. This should also be seen in the light of the spillovers on Europe and the United States through effects on trade, financial markets and confidence. The uncertainty surrounding the outlook has been illustrated by comparing the main scenario with two alternative scenarios:

- A *positive scenario*, where private consumption growth is stronger than projected, due to households converting increasing housing equity to consumption. Specifically, consumption growth increases by ½ percentage points compared to the main scenario in both 2016 and 2017. At the same time housing investment is increased by respectively 2 and 3 percentage points in 2016 and 2017, respectively.
- A *negative scenario*, where export market growth is assumed to be 1¼ percentage points lower in both 2016 and 2017 due to uncertainty surrounding emerging market economies and the spillover effects on the advanced economies. As a result of the lower growth and increasing uncertainty private-sector investment is 1½ percentage points lower than assumed in the main scenario.

In the positive scenario GDP-growth is 0.3 percentage points higher in both 2016 and 2017, cf. *table 1.1*. Higher growth leads to an improvement in the government deficit and a greater fall in unemployment. In the negative scenario GDP growth is lowered by 0.3 and 0.4 percentage points in 2016 and 2017, respectively. The somewhat larger growth reduction in 2017 is due to spillover effects from 2016. Weaker external demand growth and a lower investment level leads to a small increase in unemployment and a deterioration in the government deficit.

Table 1.1
Alternative scenarios

	Negative scenario		Main scenario		Positive scenario	
	2016	2017	2016	2017	2016	2017
Real GDP growth (per cent)	1.6	1.6	1.9	2.0	2.2	2.3
Unemployment (per cent)	4.3	4.3	4.2	4.0	4.1	3.7
Government budget balance (per cent of GDP)	-2.9	-2.3	-2.8	-2.0	-2.6	-1.6

Source: Own calculations.

Selected key indicators for the forecast are collected in *table 1.2*, while the annex tables contain a comparison with the projections in the updated outlook from September 2015. In comparison with the resubmission of the proposed budget bill for 2016 in September a technical adjustment was made to the forecast in *Economic Survey*, August 2015. The technical adjustment comprised new information on oil prices and interest rates as well as the national accounts data for the second quarter. In addition, there were adjustments due to the budget

bill for 2016. All in all, the new information did not lead to a change in the September growth forecast for 2015 and 2016 compared with the forecast in *Economic Survey*, August 2015.

Table 1.2
Selected indicators

	2014	2015	2016	2017
Real growth, per cent				
Private consumption	0.5	2.0	1.7	1.8
Government consumption	0.2	0.8	0.8	0.0
Government investment	7.4	1.2	-6.9	-0.1
Housing investment	3.1	-1.5	5.0	5.0
Business investment	1.8	1.7	4.7	7.1
Inventory investment (per cent of GDP)	0.3	-0.3	0.3	0.2
Exports of goods and services	3.1	2.1	4.3	4.7
Imports of goods and services	3.3	1.4	4.6	5.6
GDP	1.3	1.4	1.9	2.0
Level, per cent of GDP				
Actual government budget balance	1.5	-2.0	-2.8	-2.0
Structural government budget balance	-0.9	-0.7	-0.4	-0.4
Current account balance	7.7	7.8	8.7	8.5
Level, 1,000 persons				
Unemployment, gross (annual average)	134	124	118	113
Employment (incl. leave), total	2,683	2,711	2,740	2,767
Labour force, total	2,789	2,815	2,838	2,861
Per cent change				
Housing prices (single family homes)	3.4	6.3	4.0	4.0
Consumer price index	0.6	0.5	1.1	1.7
Hourly earnings in the private sector (DA's Struktur-Statistik)	1.2	2.0	2.3	2.6

1.3 Fiscal policy and public finances

From a situation where the fiscal room for manoeuvre has been fully utilized in order to support the economy during the recession, the budget bill for 2016 provides a margin of 0.1 percent of GDP to the structural deficit limit of the Budget Law. Thus, fiscal policy is aligned with the upswing in the Danish economy characterized by increasing GDP growth and employment. At the same time, monetary policy remains very accommodative, which increases the need for a gradual tightening of fiscal policy, such that overall economic policies supports a sustainable recovery.

In coming years, the fiscal room for manoeuvre is tight since public deficits should be gradually reduced towards the structural balance target in 2020. New reforms which increase private employment could dampen future labour-market pressures and increase the fiscal room for manoeuvre. At the same time, prioritization can create fiscal space for further resources aimed at high-priority areas and initiatives, including core welfare services.

Table 1.3
Key fiscal policy figures

	2015	2016	2017
Structural budget balance, per cent of structural GDP	-0.7	-0.4	-0.4
Actual budget balance, per cent of BNP	-2.0	-2.8	-2.0
Public consumption real growth, per cent	0.8	0.8	0.0
One-year fiscal effect, per cent of GDP ¹	0.0	-0.1	-0.2

1) The one-year fiscal effect is an estimate of the effect on overall economy activity due to changes in fiscal policy from one year and to the next. Thus a negative number indicates a fiscal tightening compared to the year ahead.

Source: Owh calculations.

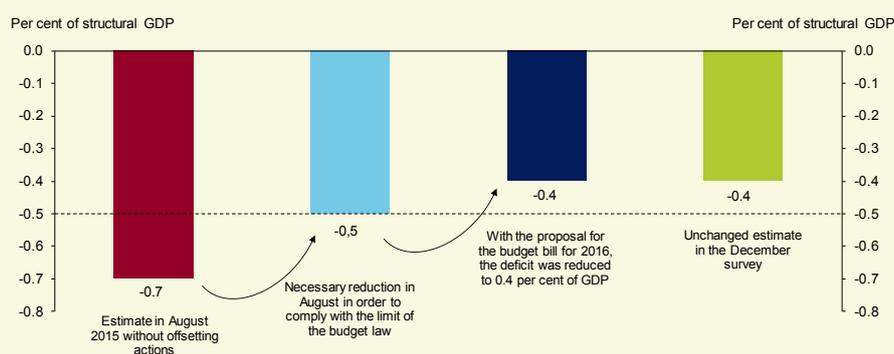
Budget bill for 2016 strengthens public finances

When assessing the Danish economy and public finances in August 2015, new statistical information implied that the room for manoeuvre in expenditure policies had to be reduced by DKK 3 bn. in 2016 in order to comply with the Budget Law structural deficit limit of 0.5 per cent of GDP, *cf. figure 1.13 and box 1.1 in Economic Survey, August 2015*. The government's budget proposal for 2016 put forward in September included a further fiscal improvement in order to ensure a margin against the Budget Law deficit limit. Thus, the structural budget deficit was estimated at 0.4 per cent of GDP in 2016, *cf. Opdateret 2020-forløb, September 2015 (only available in Danish at www.fm.dk)*.

The agreement on the budget bill for 2016 reached in November is fully financed and maintains the strengthening of public finances included in the budget proposal. Thus, on a fully updated basis the estimated structural budget deficit remains unchanged at 0.4 per cent of GDP in 2016. In the coming years, it is key that fiscal policy is gradually tightened compared to the accommodative starting point. This reflects both considerations regarding the econom-

ic recovery and the need to incrementally increase the distance to the Budget Law deficit limit. In total, the structural budget balance has to be improved by 0.4 per cent of GDP in 2017-2020 in order to comply with the balance target in 2020, *cf. section below concerning tight fiscal space in 2017*.

Figure 1.13
Estimates for structural budget balance in 2016 since August Economic Survey



Source: Economic Survey, August 2015, Opdateret 2020-forløb, September 2015 (only available in Danish) and own calculations.

The structural budget deficit in 2016 *inter alia* reflects that the starting point for fiscal policy is accommodative in spite of the consolidation of public finances. For instance, the current level of public investment remains high by historical standards. The accommodative fiscal starting point is due to fact that fiscal policy in later years has been planned in order to support the Danish economy as much as possible in wake of the economic crisis.

The Danish economy has been in progress for two years now. The recovery is moderate but the basis for further growth in the coming years is solid. Hence, it is key that fiscal policy is adjusted to the new cyclical situation – i.e. tightened relative to the accommodative starting point. And it is a basic requirement for sound public finances that fiscal easing during a recession is offset by a corresponding tightening when the economy recovers.

The so-called one-year fiscal effect – a calculated measure of whether fiscal policy is loosened or tightened in a given year *relative to the year before* – is estimated at -0.1 per cent of GDP in 2016 based on the planned fiscal policy for 2016 and other assumptions. In 2017 the one-year fiscal effect is technically estimated at -0.2 per cent of GDP, corresponding to a further fiscal tightening. In the current forecast, growth is expected to gain further momentum in 2016 and 2017. On this basis capacity utilization increases while employment and production is expected to move gradually towards the structural levels in the coming years, *cf. figure 1.14*. Thus, fiscal policy is on a general level aligned with the cyclical development.

The tightening of fiscal policy should also be seen in light of the fact that monetary policy is expected to remain very accommodative in coming years, thereby supporting domestic demand. All else equal this increases the call for a gradual tightening of fiscal policy as the

output and employment gap closes. It is key that economic policy as a whole is aligned with the business cycle, thereby reducing the risk of overheating.

Figure 1.14
Gradually fewer idle resources in the economy in coming years...

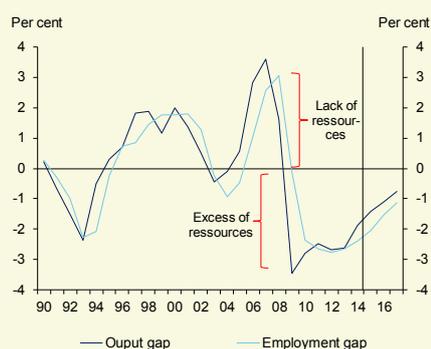
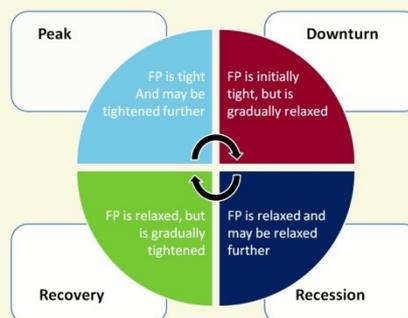


Figure 1.15
... prompt a gradual tightening of fiscal policy



Note: Figure 1.15 shows a stylized fiscal policy reaction in order to stabilize cyclical fluctuations. Fiscal policy is planned on the basis of a variety of different purposes and trade-offs. In particular, cyclical stabilization through active fiscal policies can play an important role when major economic imbalances are present.

Source: Statistics Denmark and own calculations.

Outlook for actual budget deficits in compliance with EU limit

The actual budget balance is very sensitive to the cyclical situation and can furthermore be affected significantly by temporary fluctuations in financial markets, oil prices etc. Hence, fiscal policy is primarily planned on the basis of the structural balance which is adjusted for such temporary factors.

However, it is also important that the actual balance comply with the framework due to EU's Stability and Growth Pact.¹ Thus, the Budget Law structural deficit limit is set at 0.5 per cent of GDP in order to support compliance with the EU rules for the actual budget balance. Throughout the forecast period the actual budget deficits are expected to comply with the 3 per cent of GDP limit of the Stability and Growth Pact, cf. figure 1.16.

Currently, an actual budget deficit of 2.0 per cent of GDP is estimated for 2015, which is considerably lower than expected in September, where the deficit was estimated at 3.0 per cent of GDP. The improvement of the actual balance for 2015 compared to the September estimate mainly reflects two factors. Firstly, the one-off revenues from the restructuring of

¹ Non-compliance with the EU limit for actual budget deficits will lead to a new EU recommendation in order to bring the deficit below 3 per cent of GDP within a given deadline and implement annual structural budget improvements of at least 0.5 per cent during the period covered by the recommendation. This applies unless EU finds that non-compliance is limited and temporary.

capital pensions have proven larger than expected.² Based on the actual payments so far in 2015 the tax revenues from restructuring of capital pensions and LD funds is expected at DKK 27 bn. (corresponding to 1.4 per cent of GDP) compared to the original estimate of DKK 15 bn. Secondly, the estimated revenues from the rather volatile pension-yield tax is revised upward by almost DKK 10 bn. as a result of developments in financial markets in recent months. In the opposite direction pulls higher depreciation and amortization of public arrears due to changes in the accounting principles concerning debt to the public sector and the problems with the Joint Collection System (in Danish: Et Fælles Inddrivelsessystem, EFI), *cf. box 1.1.*

Despite marked growth in both GDP and employment during 2016 an actual budget deficit of 2.8 per cent of GDP next year is estimated, implying a very small margin against the EU deficit limit. The increasing actual budget deficit from 2015 to 2016 partly reflects that the one-off revenues from restructuring of capital pensions etc. mentioned above reduces the actual deficit significantly in 2015. In 2017, where the economy is forecast to grow even further, the actual deficit is estimated to be reduced to 2.0 per cent of GDP.

² As part of the pension package from October 2014 the restructuring period was prolonged also covering 2015 (and not only 2013-14).

Figure 1.16
Actual budget balance comply with deficit limit of Stability and Growth Pact

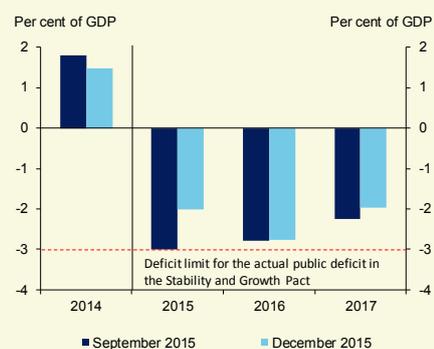
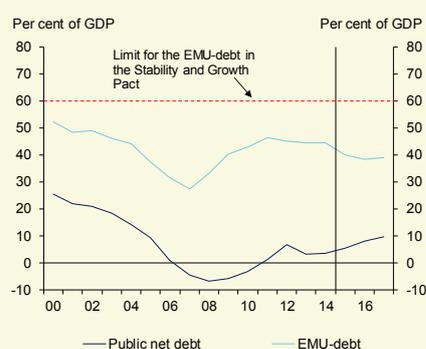


Figure 1.17
Public gross (EMU) and net debt remain at low levels



Source: Statistics Denmark, Opdateret 2020-forløb, September 2015 (only available in Danish) and own calculations.

Due to the budget deficits in 2015-2017, public net debt is estimated at a relatively moderate level around 10 per cent of GDP by the end of 2017, *cf. figure 1.17*. Furthermore, public gross debt (EMU definition) is estimated at approx. 38-39 per cent of GDP in 2015-2017 compared to somewhat above 45 per cent of GDP in 2014. Thus, a broad safety margin is maintained against the 60 per cent of GDP limit which is a part of the Stability and Growth Pact. The decline in gross debt (EMU definition) from 2014 to 2015-2017 among other reflects the decision to stop the issuance of central government bonds for the period 30 January to 7 October 2015.

Box 1.1**Ekstraordinary depreciations of tax arrears**

Extraordinary depreciations of tax arrears have been incorporated in the December *Economic Survey*. This is due to two particular circumstances:

1. **Depreciations:** An extraordinary depreciation of tax arrears amounting to DKK 15 bn. in 2015 has been incorporated. This depreciation is distributed evenly across the years 2013, 2014 and 2015 equal to DKK 5 bn. per year, *cf. table a.*¹ This must be seen in the context of a change in conduct concerning public tax arrears in the national accounts. Looking forward, the tax arrears to be paid by citizens and corporations will be decided on the basis of the amount assessed to be realistically collectable. This depreciation is thus not to be attributed to the present challenges regarding the tax collection system "Et Fælles Inddrivelsessystem".

Further depreciations: A further depreciation of approximately DKK 2½ bn. in 2015 is expected. This is due to the assessed legal enforceability of the arrears. The depreciation is distributed equally among the years 2013, 2014 and 2015. Additionally, depreciations due to the challenges regarding the tax collection system "Et fælles Inddrivelsessystem" will also occur. It is projected to amount to approximately DKK 2 bn. DKK in 2016, which will be distributed equally over the years 2014, 2015 and 2016.

Table a**Estimated effect of depreciations of tax arrears on the general government budget balance**

DKK bn.	2013	2014	2015	2016	Alt
Total effect on the general government budget balance	-6	-6¾	-6¾	-¾	-20
To be ascribed to the depreciation in 2015	5	5	5	-	-15
To be ascribed to the further depreciation in 2015	-¾ ²⁾	-¾ ²⁾	-¾	-	-2½
To be ascribed to the depreciation in 2016	-	-¾ ²⁾	-¾	-¾	-2
Total effect on general government budget balance, per cent of GDP	-0.3	-0.3	-0.3	-0.0	-1,0

Note: Due to numbers being rounded up or down, the individual values might not sum with the totals.

- 1) Statistics Denmark have with regards to the November version of the national accounts statistics for the public finances incorporated extraordinary depreciations of tax arrears in 2013 and 2014. The estimated effect in 2015 is incorporated in the december assesment and will in the spring 2016 be included in the Statistics Denmark March version of the public finances.
- 2) The general government budget pabalce in 2013 and 2014 presently draws on the depreciations made by Statistics Denmark in the national account numbers of 2013 and 2014 (November-version), i.e. a depreciation of DKK 5 bn. in both years. It is expected that Statistics Denmark will correct the historical national account numbers of 2013 and 2014 in the forthcoming versions of the national account statistics for the public finances.

Source: Statistics Denmark, The Danish Ministry of Taxation and own calculations

Limited fiscal room in 2017

In the coming years fiscal policy should be planned so that it is aligned with the business cycle and that the objective of balance between public revenue and expenditure in 2020 is achieved. The structural budget balance target in 2020 is reconciled with the overall objective of long-term fiscal sustainability – i.e. in popular terms, that current generations do not impose a burden on future generations. Fiscal sustainability implies that economic policies can remain unchanged after 2020, while maintaining a stable trend in public debt. Furthermore public finances close to structural balance provide fiscal room in case a new economic downturn.

Based on the latest medium-term projection for the Danish economy (from September 2015) the structural deficit was estimated at 0.4 per cent of GDP in 2017 followed by a gradual improvement towards the structural balance target in 2020. In the present December Economic Survey, the forecast period covers 2017 for the first time.

New information etc. concerning public finances since September implies a weakening of the structural balance in 2017. In case of no offsetting measures the structural budget deficit for 2017 would increase to 0.5 per cent of GDP, i.e. corresponding to the Budget Law limit. In order to ensure a continued margin against the Budget Law limit a technical reduction of public consumption expenditure amounting to DKK 2 bn. in 2017 has been incorporated, reducing the structural deficit to 0.4 per cent of GDP, corresponding to the deficit in the latest medium-term projection. Despite this reduction public consumption (as share of structural GDP) in 2017 will remain at a high level by historical standards, *cf. figure 1.19*.

The underlying deterioration of public finances compared to the September projection among other reflects a weakening of structural North Sea revenues by 0.1 per cent of GDP in 2017 due to the latest forecast (from November 2015) on long-term oil price developments by the International Energy Agency. Although estimates for the structural balance are associated with uncertainty, e.g. from one forecast/projection to the next due to new information etc., the structural balance represents a much more robust measure for the underlying position of public finances than the actual budget balance.

The adjustment towards structural balance in 2020 requires inter alia that the currently accommodative fiscal policy is normalized as planned. This applies especially to public investment, which has been historically high in later years in order to support economic activity during the recession. Based on technical assumptions the level of public investment (excl. research and development) is forecast to remain almost unchanged at 2½ per cent of GDP in 2016 and 2017.

Figure 1.18
Weaker structural balance in 2017 is offset

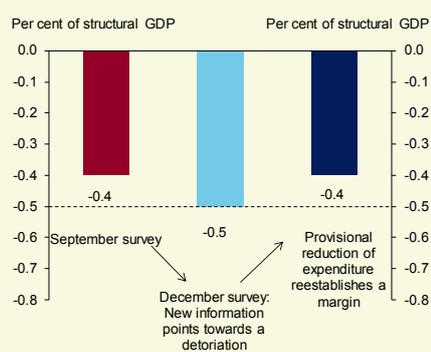
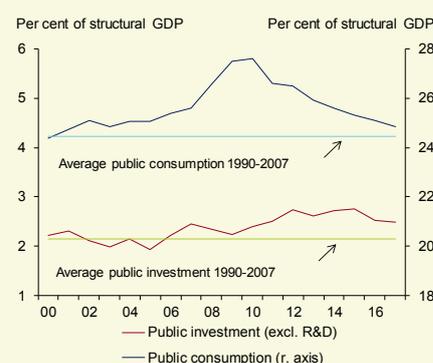


Figure 1.19
Public expenditure levels remain high in historical perspective



Note: Figure 1.19 shows public investment excl. research and development expenditures, which are projected separately. Average expenditure levels are shown for the period before the global downturn in 2008.

Source: Opdateret 2020-forløb, September 2015 (only available in Danish) and own calculations.

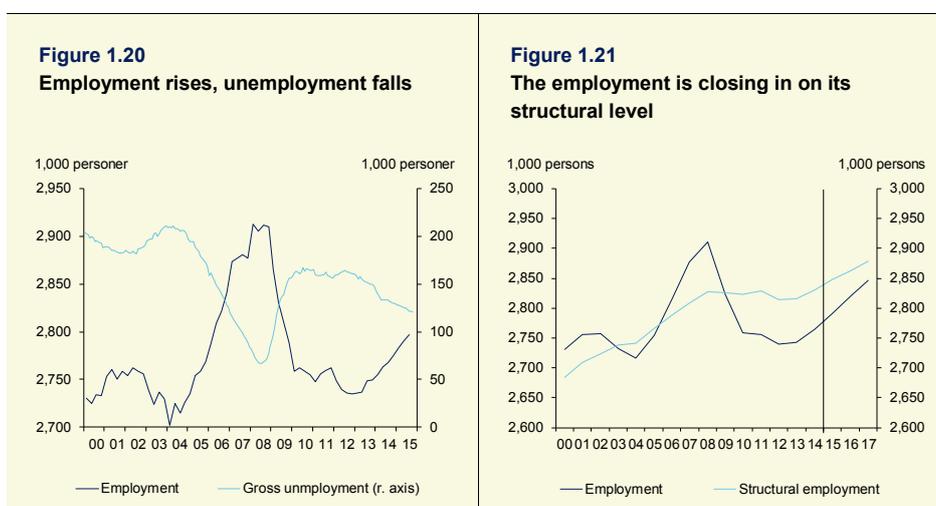
However, it is estimated that planned public investment is DKK 5 bn. higher than the technically assumed level for 2017. The government and the parties (Dansk Folkeparti, Liberal Alliance and Det Konservative Folkeparti) behind the budget bill for 2016 has agreed that there is a need to adjust public investment in order to bring them in line with the funded level included in the medium-term projections for the Danish economy. By the spring of 2016 the government will present specific adjustment proposals concerning public investment.

During the course of 2016 fiscal policy for 2017 will be specified in greater detail namely by the annual agreements on the economy of municipalities and regions and the central government budget bill for 2017. The planning of fiscal policy for 2017 will be set within the framework of the Budget Law framework – including the fixed expenditure ceilings – and will be based on the specific initiatives concerning public investment and updated overall assessments of public finances in 2017.

1.4 Spare capacity remaining in the labour market

The labour market is improving significantly with rising employment and falling unemployment, *cf. figure 1.20*. The assessment is that the improvement will continue in the coming years. As employment rises and unemployment keeps falling, risks might arise of upward wage pressures and growing shortages of specific types of labour if the workforce is not sufficiently large and well qualified. This happened during the economic boom in the years leading up to the financial crisis, where bottlenecks and capacity pressures led to unsustainably high increases in wages and, consequently, a loss of wage competitiveness.

The current situation is far from the one which characterized the labour market during the period of overheating. There is still idle capacity which is apparent from the level of employment being significantly lower than its structural level. The level of idle resources in the workforce will gradually be narrowed over the coming years, corresponding to a decreasing gap between actual and structural employment, *cf. figure 1.21*. This is expected to happen without general tendencies to bottlenecks appearing within the labour market – in large part because of implemented reforms, which increases the structural level of employment, thus securing long-term advancement in prosperity and growth in employment. This, however, does not rule out the possibility of labour shortages in specific industries or certain parts of the country, especially for specially qualified labour.



Source: Statistics Denmark and own calculations.

The assessment of the capacity pressure within the labour market is a central input for the conduct of fiscal policy, adapting it to the business cycle. There are currently vacant resources within the economy, and fiscal policy is expansionary measured in levels, among other things due to a high level of government initiated investments. However, a tightening of fiscal policy has been initiated, and the structural budget deficit is expected to be 0.4 per cent of GDP in 2016, *cf. section 1.3*. As the business cycle normalizes over the coming years the level of idle resources diminishes. It is thus appropriate that fiscal policy is tightened further, to avoid an overly rapid increase in demand for labour relative to the overall labour supply.

There are currently no signs of general bottlenecks. One indication is that companies generally have no problems hiring more workers. The number of futile recruitments has risen marginally since 2012 but is still at a low level, *cf. figure 1.22*.

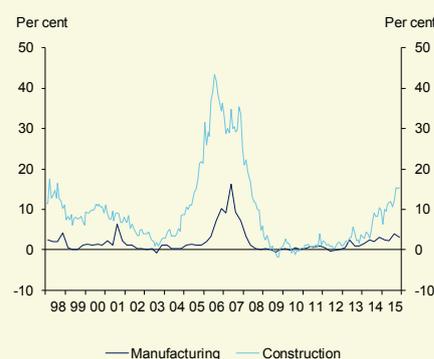
Equivalently, only few companies in manufacturing and construction report constraints on production due to labour shortage, *cf. figure 1.23*. The indicator has risen within construction since the middle of 2014, after years of low activity and virtually no labour shortage, but the extent of the shortage is far lower than during the 2000's. Construction is sensitive to the business cycle and demands special consideration, *cf. box 5.2* in section 5.2. This implies,

among others, that large business-cycle related changes to construction employment can have consequences in other industries, e.g. in services and manufacturing if rapid wage increases in construction lead to higher prices.

Figure 1.22
Still few failed recruitments



Figure 1.23
Fewer companies report constraints on production due to a shortage of labour



Note: The number of failed recruitments in figure 1.22 is based on a survey 14,000 companies in Denmark. The labour shortage indicator shown in figure 1.23 is based on the business cycle indicators which has a data-break in 2004.

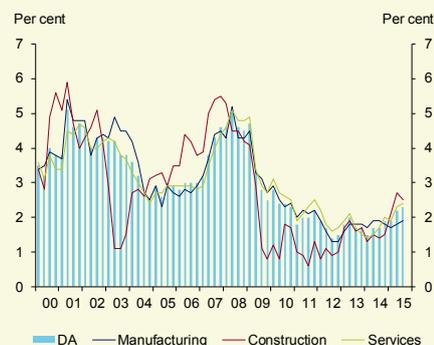
Source: Danish Agency for Labour Market and Recruitment and Statistics Denmark.

At the same time wage increases are fairly moderate across industries. Within the employer association area, the rate of wage increases have risen a little recently but is currently around approximately 2¼ per cent, which is fairly moderate in a historical perspective, *cf. figure 1.24*. This indicates that companies can attract the necessary labour without wages being pushed to unsustainable levels. However, in construction the rate of wage increases is somewhat higher than for the private sector, and the rate of increases has been rising since the end of 2014.

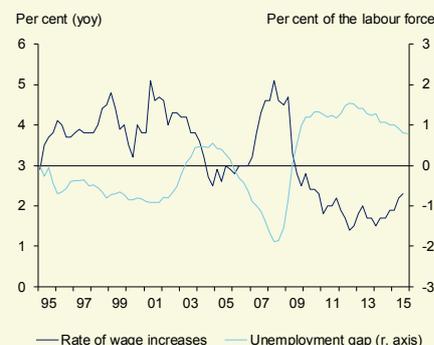
The moderate wage increases should be seen in the light of an unemployment level that still exceeds the estimated structural level of unemployment, corresponding to available labour resources - and that the unemployment gap is positive. The positive unemployment gap has narrowed over the last years, but unemployment can still decrease without leading to significant upward pressure on wages, *cf. figure 1.25*.

The overall impression from the indicators is that there is still available capacity in the labour market. The indicators have gradually moved upwards since 2013 from the very low levels during the crisis. This is a normal for an economy which is recovering from a downturn.

Figure 1.24
Wage increases continue to be moderate...



Figur 1.25
... reflecting a positive unemployment gap



Note: The rate of wage increases is hourly compensation excl. nuisance bonus.

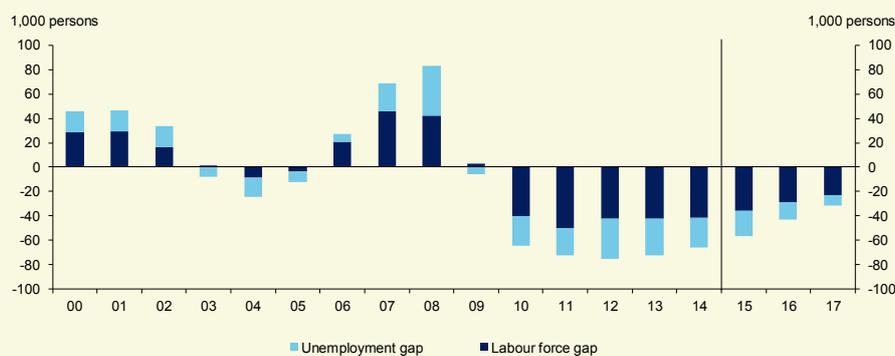
Source: DA, Statistics Denmark and own calculations.

In addition to the unemployed there are also available people outside the labour force that can enter the labour market as the business cycle improves. Employment increased by 62.000 persons from fourth quarter 2012 to third quarter of 2015. Of this increase, around one third came from an expansion of the labour force, while the rest can be attributed to a decrease in unemployment. More and more people have entered the labour market, especially over the past year, and this development is expected to continue in the coming years.

The extent of available resources in the labour market is summarized in the employment gap, which measures the difference between the actual employment and the employment level in a neutral business-cycle situation, the so-called structural employment level. The employment gap accounts for both the number of unemployed, i.e. the unemployment gap, and the number of people in the labour force, i.e. the labour-force gap.

Currently, the labour-force gap accounts for around two thirds of the employment gap, while the remaining third is due to the unemployment gap, *cf. figure 1.26*. The labour-force gap reflects variations in the labour force that stems from business cycles. These can be e.g. not-employment-ready cash-benefit recipients, students without part-time employment or young people enrolling at school or university instead of working because of poor job possibilities, with all having in common that they would be employed in a normal business-cycle situation.

Figure 1.26
The largest share of the employment gap is due to the labour force gap



Note: The unemployment gap is calculated for net unemployment.

Source: Statistics Denmark and own calculations.

In recent years, the labour force gap has increasingly consisted of students, who are currently out of the labour force but are expected to be employed or searching for a job in a normal business cycle situation. The number of students in the labour force gap has increased steadily from approximately 7,000 persons in 2010 to around 27,000 in 2015, *cf. figure 1.27*. This follows, among others, from an increase in the number of students since 2007. It is estimated that there was almost 500,000 students (17 years or above) in 2015. Of these, it is estimated that around one half were employed alongside studying, *cf. figure 1.28*. This is a significantly lower share compared to the years before 2007, where up to three fourths of the students were employed. Thus, there is significant potential for increasing the labour force through an increase in the share of students in employment.

The large increase in students since 2007 must also be viewed in the context of the economic downturn, which has likely caused many to seek education rather than searching for a job. This will, viewed in isolation, decrease the number of students when the economic situation improves over the coming years, though this effect is likely mitigated by a general tendency to a higher educational level.

Both the unemployed and students have a relatively weak connection to the labour market. Combined, the two groups account for more than 90 per cent of the employment gap of 56,000 persons in 2015. The negative employment gap implies an expectation that employment will increase in the coming years from the business-cycle upturn alone. The business cycle normalization is expected to be completed – and the employment gap reduced to zero – in 2019.

Figure 1.27
Many students are a part of the employment gap...

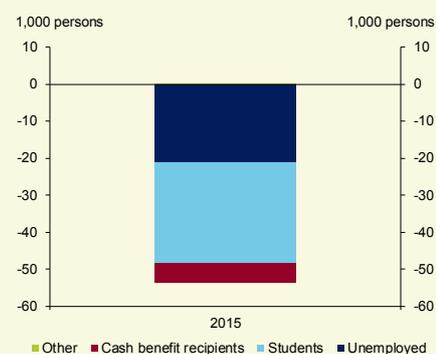
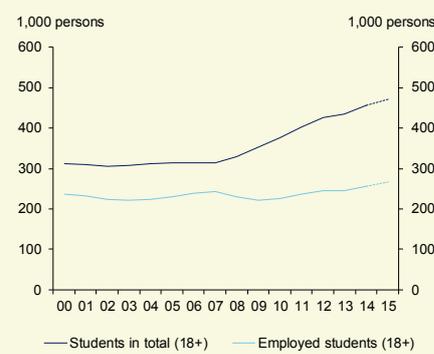


Figure 1.28
... due to the fact that many have begun studying



Note: In figure 1.27 cash benefit recipients comprises cash benefit recipients that are not employment ready, while employment-ready benefit recipients are counted as unemployed or in activation. The category other includes e.g. sickness benefit recipients. The employment gap is calculated as a number of persons, and students are naturally not expected to hold a full-time job.

Source: Statistics Denmark and own calculations.

Simultaneously with the business-cycle related increase in employment over the coming years, the structural level of employment is expected to increase. The estimated structural employment is expected to increase with 50,000 persons from 2014 to 2017.

This reflects *inter alia* a number of reforms, especially the retirement reform. This implies that the early retirement age is gradually increased, and the lowest possible retirement age is currently 61 years. The increase in the retirement age has significantly increased the degree of employment among those who are 60 or 61 years old, *cf. figure 1.29*. This indicates that the reform supports an overall increase in employment. The tendency is expected to expand as the early-retirement age is gradually increased to 62 years in 2017.

Additionally, there is an increase in the retirement age that follows from the *Welfare agreement* from 2006, which was moved forward as a part of the retirement reform. This implies that the retirement age is raised with half a year pro annum from 2019 to 2022 to 67 years corresponding to the retirement age in 2004. In combination with the increase of the age of eligibility for early retirement, it helps to increase structural employment by 71,000 persons by 2020 with an increase especially seen for skilled workers, *cf. figure 1.30*.

Figure 1.29
The higher early retirement age contributes to a higher participation rate

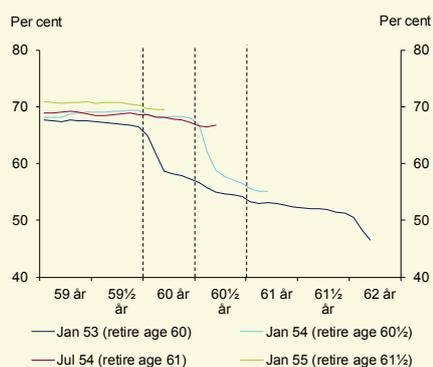
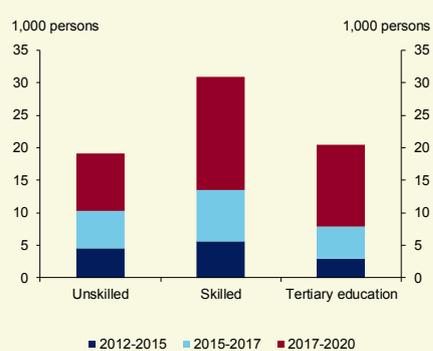


Figure 1.30
The retirement reform increases structural employment



Note: Figure 1.29 shows the share of a cohort which are wage earners during a month. All wage earners during a month are counted as employed regardless of the amount of work.

Source: Statistics Denmark, law-model database and own calculations.

The gradual increase in the structural employment over the coming years creates a foundation for a sustainable upturn in the Danish economy, with room for a significant increase in employment without leading to labour market bottlenecks, unsustainably high wage increases and a worsening of the wage competitiveness.

1.5 Annex table

Table 1.3
Key figures compared to the September survey for 2015 and 2016 and projections for 2017

	2015		2016		2017
	Sep.	Dec.	Sep.	Dec.	Dec.
Real change, per cent					
Private consumption	1.4	2.0	1.5	1.7	1.8
Total government demand	1.0	0.9	-0.4	-0.2	0.0
- of which government consumption	1.2	0.8	0.3	0.8	0.0
- of which government investment	-0.7	1.2	-4.8	-6.9	-0.1
Housing investment	2.0	-1.5	7.0	5.0	5.0
Business fixed investment	3.1	1.7	6.9	4.7	7.1
Total final domestic demand	1.4	1.3	1.8	1.6	1.9
Stock building, per cent of GDP	-0.1	-0.3	0.2	0.3	0.2
Total domestic demand	1.3	1.0	2.0	1.9	2.2
Exports	4.0	2.1	5.0	4.3	4.7
- of which manufacturing exports	5.0	4.7	5.5	5.3	5.3
Total demand	2.3	1.4	3.1	2.8	3.1
Imports	4.1	1.4	5.5	4.6	5.6
- of which imports of goods	3.2	2.4	5.2	4.7	5.5
GDP	1.5	1.4	1.9	1.9	2.0
Gross value added	1.6	1.4	1.9	1.9	2.0
- of which private non-agricultural sector	2.4	2.2	2.7	2.4	2.6
Change in 1,000 persons					
Labour force	20	20	19	24	22
Employment	24	26	24	29	27
- of which private sector	23	26	23	27	28
- of which public sector	1	0	1	2	-1
Gross unemployment	-6	-10	-6	-6	-5
Net unemployment	-6	-3	-6	-6	-4

Tabel 1.3 (fortsat)
Key figures compared to the September survey for 2015 and 2016 and projections for 2017

	2015		2016		2017
	Sep.	Dec.	Sep.	Dec.	Dec.
Change, per cent					
Merchandise export prices	-0.3	0.2	2.0	1.5	2.0
Merchandise import prices	-1.3	-0.6	2.1	0.6	1.9
Merchandise terms of trade	1.0	0.8	-0.1	0.9	0.1
House prices (single-family houses)	6.5	6.3	4.0	4.0	4.0
Consumer prices	0.7	0.5	1.5	1.1	1.7
Hourly compensation in the private sector	1.7	2.0	2.2	2.3	2.6
Real disposable income, private sector	10.3	7.1	2.5	4.9	1.8
Real disposable income, households ¹⁾	3.0	2.8	1.5	1.6	1.3
Productivity in the private non-agricultural sector	0.9	0.5	1.4	0.9	1.1
Per cent per year					
Interest rate, 1-year rate loan	-0.1	-0.1	0.1	0.0	0.2
Interest rate, 10-year government bond	0.8	0.7	1.3	1.1	1.3
Interest rate, 30-year mortgage credit bonds	2.7	2.7	3.3	3.1	3.2
Balances					
Current account (DKK bn.)	141	155	154	179	181
General government net lending (DKK bn.)	-59.6	-39.8	-56.6	-56.6	-41.8
Gross unemployment (thousands)	128	124	123	118	113
Gross unemployment (per cent)	4.6	4.4	4.3	4.2	4.0
Net unemployment (thousands)	101	104	94	98	94
Net unemployment (per cent)	3.6	3.7	3.3	3.5	3.3
External assumptions					
Trade weighted GDP abroad, per cent change	2.2	2.1	2.4	2.3	2.4
Export market growth (manufactures), per cent	5.3	5.4	5.9	5.8	6.1
Exchange rate (DKK per USD)	6.7	6.7	6.7	7.0	7.0
Oliepris, USD per barrel	54.2	52.9	58.3	49.5	57.7
Oliepris, DKK per barrel	363	356	389	344	401

1) Adjusted income, *cf. section 4.1.*
 Source: Statistics Denmark and own calculations.