

Economic Survey May 2004

English summary

1. Short term forecast

The outlook for the Danish economy

The overall growth forecast for the Danish economy has not changed significantly since the December projection. But the uncertainty so far surrounding the timing of the turnaround has been markedly reduced and there are now clearer signs of progress in the economy. Private consumption has increased noticeably since the middle of 2003, and residential and fixed business investments show signs of progress. The decline in employment appears to have come to an end, and during the first months of 2004 there has been a small reduction in unemployment.

In mid-March the government announced the so-called Spring Package, which aims at supporting the expected rebound in economic activity thereby contributing to a decline in unemployment. The elements of the Spring Package are summarised in box 1.

Figure 1.1a. GDP-growth

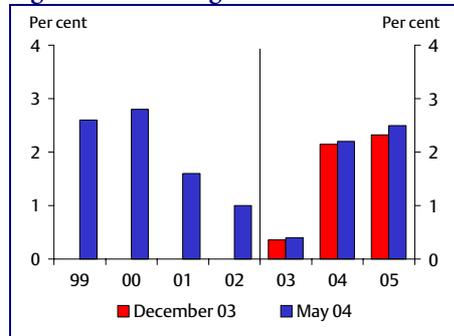
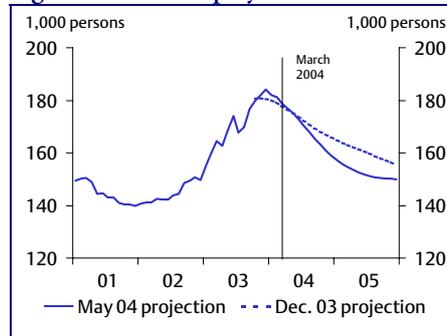


Figure 1.1b. Unemployment



Source: Statistics Denmark and own calculations.

The available indicators in combination with the stimulus stemming from the Spring Package quite clearly point to the moderate rebound seen at the end of 2003 gathering momentum in 2004. Following slow growth of 0.4 per cent in 2003, growth is thus expected to accelerate quite markedly in 2004 with growth reaching 2.2 per cent in 2004 and 2.5 per cent in 2005. This is 0.1 respectively 0.2 percentage points higher than the forecast in the *Economic Survey* from December 2003.

The pickup in growth in 2004 and 2005 is supported by low interest rates, strong growth in real disposable incomes owing among other things to reductions in income taxation and to a lesser extent increasing growth in foreign demand. Notwithstanding a gradual pickup in export growth in 2004 and 2005, the main driver behind GDP-growth is domestic demand and net foreign trade is expected to give a negative contribution to growth in 2004. The presumptions regarding developments in the international economy are described in a subsection below.

Table 1.1. Present forecast and the previous forecast in selected areas

	2003		2004		2005	
	Dec.	May	Dec.	May	Dec.	May
USA, GDP growth	2.8	3.1	3.8	4.2	3.3	3.2
Euro area, GDP growth	0.4	0.4	1.8	1.7	2.3	2.3
Trading partners, GDP growth	1.3	1.3	2.5	2.7	2.8	2.8
<i>Denmark:</i>						
GDP growth	0.4	0.4	2.1	2.2	2.3	2.5
Consumer prices	2.1	2.1	1.8	1.5	1.7	1.6
Hourly earnings, private sector	3.9	3.8	3.7	3.5	3.7	3.8
Unemployment rate	5.9	5.9	6.0	5.9	5.5	5.3

Note: GDP-growth among Denmark's trading partners is weighted according to their share in Danish exports.

Source: Statistics Denmark, EU-Commission, Ecwin, and own calculations.

Box 1. The Spring Package

The Spring Package can be said to contain 5 main elements. The effects of the Spring Package on key figures are summarised in table 1 below.

(1) The reductions in income taxation, which were decided in 2003 and were to be implemented gradually from 2004 through 2007, are moved forward and fully implemented already in 2004. This acceleration in the implementation will in itself increase disposable income in households by 4 billion kroner in 2004 and 2½ billion kroner in 2005.

(2) The so-called SP-payments, which are compulsory contributions to the Special Pensions fund, are suspended in 2004 and 2005. This will increase disposable income by about 4 billion kroner in each year.

Overall the tax reduction implemented at the beginning of the year together with the initiatives in the Spring Package will increase disposable income by approximately 15 billion kroner – or 1 per cent of GDP – in 2004 and a comparable amount in 2005.

(3) The remaining approximately 0.5 billion of 1 billion kroner set aside for social and health initiatives decided in connection with the agreement about income tax reductions will be fully allocated in 2004.

(4) There are a number of specific measures to move forward housing investments as well as move forward a number of public investment projects. This includes moving forward in time funds for public support for construction of private rental property. It is estimated that these investment initiatives will give a stimulus of 2½ billion kroner in each of the forecast years.

(5) There are a number of measures in the labour market, including an increase in the number of persons enrolled in active labour market policy (ALMP) schemes. This includes ¼ billion kroner in funds earmarked for training and re-schooling. The aim of these labour market measures is to counteract a potential deterioration of skills for those people who as a result of the downturn are now unemployed, thus acting to ensure that the foreseen employment growth will not be inhibited by a deficiency of qualified labour.

Table 1. The Spring Package's effect on key figures

	2004	2005
GDP-growth, percentage points	0.3	0.1
Households disposable income, per cent of GDP	0.6	0.6
Current account, per cent of GDP	-0.2	-0.3
Government net lending, per cent of GDP	0.1	0.4
Unemployment rate, per cent of labour force	-0.4 ¹⁾	-0.4
Of which due to increased employment	-0.2 ¹⁾	-0.3

1) This shows the estimated effect at the end of the year.

Source: Own calculations.

The expected pick-up in growth paves the road for employment growth moving into positive territory in 2004. Consequently, unemployment is expected to decline throughout 2004 and 2005. Towards the end of 2005 unemployment can reach a level which taking into consideration changes in the number of persons enrolled in active labour market policy programmes is comparable to the level seen at the end of 2001 and beginning of 2002, i.e. the lowest level of unemployment seen in almost 3 decades. Such a level of unemployment will most likely imply that the capacity constraints of the economy will be tested as unemployment would thus fall below the estimated structural level of unemployment, which in the medium term would support a stable evolution of wages and prices.

Domestic demand

Growth in real disposable income in households is set to increase from 2.6 per cent in 2003 to 4.2 per cent in 2004 and 1.3 per cent in 2005. The strong growth rate in 2004 is mainly due to reductions in income taxation and the suspension of the so-called SP-payments as well as the expected increase in employment. Income growth in 2005 decelerates somewhat compared to 2004 as the Spring Package implies that the full effect of the tax reductions takes place in 2004.

Figure 1.2a. Growth contributions

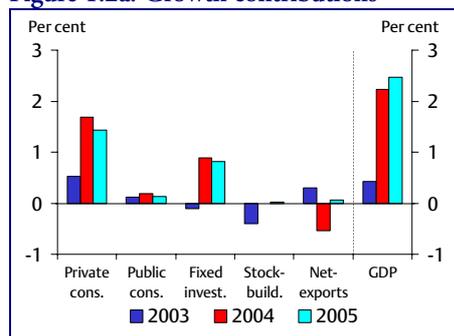
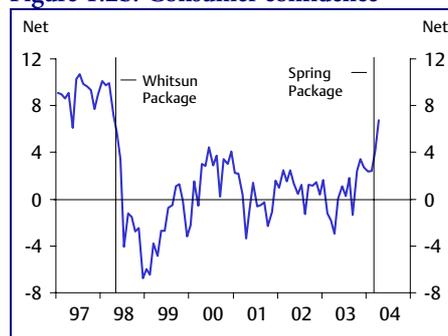


Figure 1.2b. Consumer confidence



Note: The so-called Whitsun Package was introduced in 1998 in order to curb growth in domestic demand and facilitate a soft landing in the Danish economy.

Source: Statistics Denmark and own calculations.

Following five years of low growth, growth in private consumption is expected to accelerate from 1.1 per cent in 2003 to 3.6 per cent in 2004

and 3.0 per cent in 2005, *cf. table 1.2*. Car sales, which have declined considerably over the last five years and fell by 14 per cent in 2003, are set to increase by 20 per cent in 2004 and 8 per cent in 2005.

The fairly strong growth in private consumption is supported by the income tax cuts, a healthy savings position in the private sector, low interest rates, and the impact of new flexible borrowing opportunities for house owners. The financial position of Danish households appears to be quite healthy with total private savings and financial wealth at relatively high levels relative to GDP.

Compared to the survey from December the growth rate in private consumption has been revised upwards by 0.6 percentage points in 2004 and 0.5 percentage points in 2005. This revision can first and foremost be attributed to the acceleration of tax reductions and suspension of SP-payments due to the Spring Package.

Table 1.2. Use and supply of goods and services

	2002	2000	2001	2002	2003	2004	2005
	Bill.Dkr.	----- Real growth, per cent -----					
Private consumption	641.9	-0.7	-0.2	0.6	1.1	3.6	3.0
Public consumption	358.5	0.9	2.7	2.1	0.5	0.7	0.5
Public investment	24.2	7.7	10.6	-5.0	-3.7	8.3	2.0
Residential construction	61.1	7.7	-5.3	10.5	7.8	3.0	-2.0
Fixed business investment	197.4	6.6	6.9	4.2	-2.1	3.4	5.0
Stock building 1)	0.7	1.0	-0.7	0.0	-0.4	0.0	0.0
Total domestic demand	1283.8	2.4	1.0	1.9	0.1	2.9	2.5
Exports of goods and services	602.7	13.5	4.4	4.8	0.3	2.8	5.1
Of which manufactures	294.4	15.0	5.0	5.3	-1.2	4.0	5.2
Imports of goods and services	525.8	13.5	3.5	7.3	-0.4	4.3	5.4
Of which goods	390.5	11.8	3.3	6.6	-1.5	5.4	5.1
Gross domestic product	1360.7	2.8	1.6	1.0	0.4	2.2	2.5
GDP at factor costs	1163.5	3.4	1.7	0.9	0.4	1.9	2.5
Of which in private non- agricultural sector	771.1	3.7	2.6	0.9	0.3	2.1	2.8
GDP per capita (1.000 Dkr.)	253.1	2.5	1.2	0.7	0.2	2.1	2.3

1) The percentages indicate the volume changes in stock building in per cent of volume GDP in the preceding year, both in 1995-prices.

Source: Statistics Denmark and own calculations.

Growth in real public consumption is assumed to be 0.7 per cent in 2004 and 0.5 per cent in 2005, which is in line with the targets in the medium

term fiscal strategy. In 2003 growth in real public consumption was 0.5 per cent, which must be seen in the context the growth rate in 2002 being above the 1 per cent target from the medium term fiscal strategy. Public investment is projected to increase by 8.3 per cent in 2004 and 2 per cent in 2005 following a decline in 2002 and 2003.

Residential investments are expected to rise by 3 per cent in 2004 following strong increases in both 2002 and 2003. Residential investments are being spurred by low interest rates, strong house prices, and higher real disposable incomes. Political initiatives to bring forward investments in municipal housing have contributed to investment growth in 2003 and will also contribute to growth in 2004. Following the fairly high level of investment in 2003 and 2004, residential investment is expected to decrease by 2 per cent in 2005.

The price of owner-occupied single-family houses, which have risen quite strongly in recent years, is expected to accelerate from 3¼ per cent in 2003 to 4½ per cent in 2004. In addition to low interest rates the increase in 2004 is partly related to the emergence of a new flexible type of mortgage loans where repayments on the principal can be postponed for 10 years. In 2005 growth in property prices is expected to moderate to 2½ per cent partly reflecting the assumed increase in interest rates.

Business investments fell by 2.1 per cent in 2003. This largely reflects a decline up until the 1st half of the year with businesses holding back investment in light of the general downturn in the economy. In the 2nd half of 2003 business investment rebounded strongly and fairly strong growth in business investments is expected to continue in 2004 and 2005.

Following a decrease in inventory investments of 0.4 per cent of GDP in 2002, the contribution to GDP-growth from inventory investments is presumed to be zero in 2004 and 2005.

International trade and the current account

Largely as a result of the international slowdown exports of goods and services grew by merely 0.3 per cent in 2003. Exports are expected to pick up again with 2.8 per cent growth in 2004 increasing to 5.1 per cent growth in 2005. This first and foremost reflects the expected pickup of

growth in the international economy where the rebound in the euro area is projected to lag somewhat behind that of the US and Asia. For 2004 this a downward revision of export growth of 1.1 percentage points relative to the December forecast reflecting a weak performance in recent months.

Imports fell by 0.4 per cent in 2003 sharply down from a 7.3 per cent growth rate in 2002. As domestic demand picks up in 2004 and 2005 growth in imports is expected to pick up as well reaching 4.3 per cent in 2004 and 5.4 per cent in 2005. This is an upward revision of 0.5 and 1.3 percentage points respectively compared to the estimate from the Economic Survey from December 2003, which primarily reflect the upward revision of growth in domestic demand.

The surplus on the current account, which was about 3 percent of GDP in 2003, is expected to remain roughly unchanged at this level throughout the projection period. As a result of the surplus net foreign liabilities should be reduced from 15 per cent of GDP by the end of 2003 to $6\frac{3}{4}$ per cent of GDP by the end of 2005 – save for any future price corrections in gross assets and liabilities.

Employment, unemployment and labour force

Employment has decreased by 5,000 persons in 2002 and 23,000 persons in 2003 according to the National Accounts. This corresponds to a decline of 0.2 per cent in 2002 and 0.8 percent in 2003. However, employment was roughly unchanged during the latter part of 2003 according to the National Accounts¹. Various other employment statistics confirm the impression that the decline in employment stopped towards the end of 2003.

Employment growth in the private sector usually tracks production growth with a minor lag. There is not a unique pattern but usually the lag is about two quarters before renewed production growth feeds into

¹ The employment statistics in the National Accounts are currently undergoing fairly significant changes, including the incorporation of new data sources. These changes, including certain difficulties with the incorporation of new data sources, have created some uncertainty regarding the development in employment during the last couple of years.

employment growth. Against this background positive employment growth in 2004 and 2005 is expected.

Growth in private sector employment is expected to reach 8,000 persons in 2004 and accelerate to 19,000 persons in 2005, *cf. table 1.3*. This is a small upward revision compared to the December forecast and this chiefly reflects the now somewhat stronger growth expectations.

Public employment is set to increase by 3,000 persons in both 2004 and 2005. This is unchanged compared to the December forecast.

Indicators for developments in the labour market largely support the expectation from the December projection that labour market conditions are set to improve in 2004 and 2005. Indicators for business confidence have improved, including sub-indices for employment expectations, *cf. figure 1.3*. Unemployment has declined during the first months of 2004 – also when taking into account the effect of an increased number of people enrolled in active labour market policy (ALMP) schemes. In addition, the Spring Package announced mid-March aims at supporting the economic upturn thereby contributing to a further reduction in unemployment.

Figure 1.3a. Employment

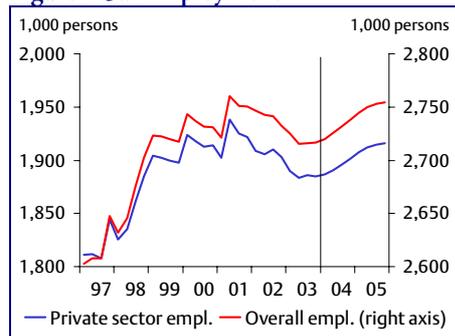
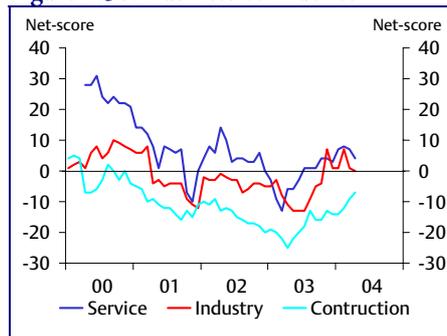


Figure 1.3b. Business confidence



Source: Statistics Denmark and own calculations.

The labour force measured by employment plus unemployment has been decreasing or approximately unchanged during 2002 and up until the third quarter of 2003, but according to the latest figures – which are subject to future revisions – the labour force increased markedly in the 4th quarter of 2003. Against this background it is estimated that the

labour force will increase by 11,000 persons in 2004 and 3,000 persons in 2005.

The labour force is thus expected to increase despite the fact that demographic developments in themselves are reducing the labour force, i.e. despite a negative demographic contribution. This is largely a result of reforms undertaken in the labour market that among other things act to increase the participation rate of people in the upper part of the working age population, i.e. people above approximately 55 years of age. Also, over the projection period a business cycle induced increase in the participation rate amongst especially the younger people of working age is expected to contribute somewhat to the increase in the labour force.

Table 1.3. Employment, labour force, and unemployment

	2002 level	Avg. 1980- 2002	2003		2004		2005	
			Dec.	May	Dec.	May	Dec.	May
			----- Change, 1,000 persons -----					
Private sector	1907	3	-35	-21	5	8	16	19
Public sector	834	6	0	-2	3	3	3	3
Total employment	2741	9	-35	-23	8	11	19	22
Labour force	2886	8	-10	3	12	11	6	3
Unemployment	145	-2	25	26	3	0	-13	-19

Note: There is a small data-break in the time series for employment from 1994 to 1995. Due to rounding the individual changes may not sum to the total.

Source: ADAM's databank and own calculations.

From June 2002 to March 2004 the number of unemployed has increased by 36,000 persons to 179,000 persons in March 2004. However, over the same period the number of people enrolled in active labour market policy (ALMP) schemes have decreased by approximately 12,000 persons. Thus looking at the number of unemployed and persons in ALMP schemes together there has been an increase of about 24,000 persons from June 2002 to March 2004.

The decline in unemployment is expected to continue throughout 2004 and 2005, *cf. table 1.3 and figure 1.4.*

The number of people in ALMP schemes is expected to increase fairly significantly during 2004 and this will contribute to bringing down the registered number of unemployed persons. Nonetheless, the number of

persons either unemployed or in ALMP schemes is expected to decline noticeably during 2004 and 2005.

Figure 1.4a. Unemployment

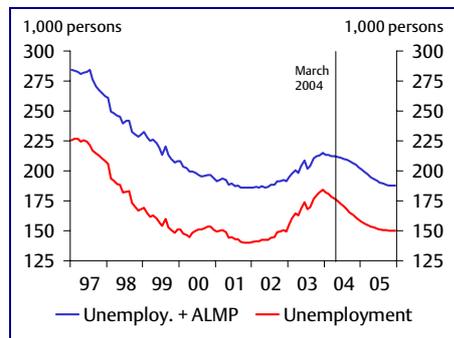
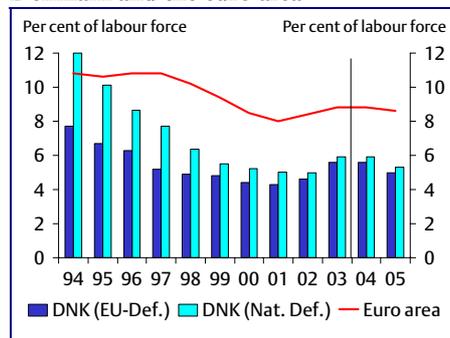


Figure 1.4b. Unemployment rates in Denmark and the euro area



Source: Statistics Denmark, EU-Commission, and own calculations.

Wage- and price inflation

Growth in hourly wages have been reduced from 4.2 percent in 2002 to 3.9 per cent in 2003 and are expected to decline further to 3.5 per cent in 2004, which is slightly less than expected in the December survey. In 2005 growth in hourly wages is expected to pick up slightly to 3.8 per cent, which reflects the outcome of recent wage negotiations as well as a higher pressure in the labour market during 2005.

Despite the decline in wage growth in 2003 and 2004 the hourly compensation of employees in Denmark will continue to grow faster than in most other EU-countries, which is only partially made up for by higher productivity growth. Also, competitiveness as measured by relative unit labour costs is eroded as a result of a weakening dollar vis-à-vis the euro (and thus the Danish krone). In the medium term a continued loss of competitiveness would most likely lead to loss of employment opportunities in the exporting industries.

Inflation as measured by the harmonised consumer price index is estimated to decline from 2.0 per cent in 2003 to 1.4 per cent in 2004 and 1.6 per cent in 2005. The Tax Freeze contributes to a slightly lower inflation rate during the forecast period due to the freeze of indirect taxes set in nominal terms. Also, the reduction of exercise duties on soft drinks, cigarettes and alcohol will reduce the rate of inflation by up to 0.2

percentage points in 2004. The forecasts for 2004 and 2005 are slightly lower than in the December survey.

Figure 1.5a. Wage increases in Denmark and abroad

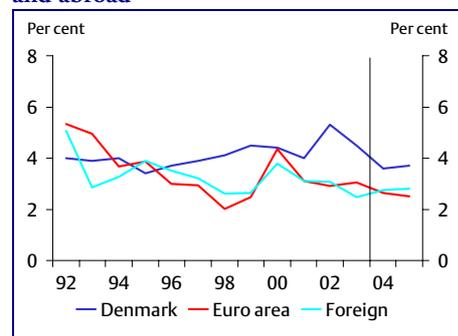
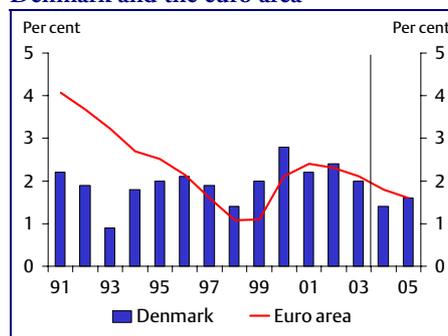


Figure 1.5b. Inflation (HICP) in Denmark and the euro area



Note: The foreign wage increases in figure 1.5a are weighed according to their share in the effective nominal exchange rate index for the krone.

Source: DA, EU-Commission, BLS, OECD and own calculations.

The Danish inflation rate continues to stay around the European Central Bank's medium term inflation target of below but close to 2 per cent. As a result of the fixed exchange rate vis-à-vis the euro, this medium term target effectively also applies to the Danish economy.

The international environment

The international economy is rebounding, driven by high growth in the US and Asia. The euro area, however, is lagging somewhat behind, and in the euro area a more gradual recovery is expected.

Growth in the US is primarily driven by strong domestic demand, which is supported by a considerable easing of monetary and fiscal policies over the last few years. The easing of monetary policy has resulted in negative short-term interest rates. In addition, there is a short-term stimulus from a considerable easing of fiscal policy where the structural fiscal balance has been reduced by up to 5 per cent of GDP from 2000 to 2004.

Up until recently job creation had been lower than seen during previous recoveries, however there are now also clearer signs of employment growth in the US economy. Also, business investments are picking up considerably. This among other things point to the recovery becoming increasingly self-sustaining. In the medium term the imbalances in the

US economy with large deficits on the current account and public finances could inhibit growth.

The forecast for growth in the US in 2004 has been revised upwards to 4.2 per cent in 2004, and in 2005 growth is expected to reach 3.2 per cent, cf. table 1.1. The outcome of the presidential elections in the US in November 2004 can influence economic policy in 2005, which increases the uncertainty surrounding the forecast for 2005.

A number of Asian countries pegging their currencies against the US dollar have benefited from the easy stance of monetary policy in the US. Also, the Japanese economy has performed well recently and fairly healthy growth is expected in 2004 and 2005. Thus developments in Asia should continue to contribute to the rebound in the international economy.

In the euro area the positive growth rates in the 3rd and 4th quarters of 2003 can in large part be attributed to higher exports. Growth in private consumption continues to be held back by low growth in real disposable incomes and continued uncertainty about prospects for employment. The rate of growth in the euro area is not yet sufficient to reduce the output-gap. However, the pace of growth is expected to gradually accelerate and the GDP figures for the 1st quarter of 2004 were encouraging.

The stance of monetary policy in the euro area is relatively easy whilst the fiscal policy stance is roughly neutral. However, the pace of reforms in labour and product markets remains slow. The reforms undertaken in recent years have primarily focused on increasing the fiscal sustainability of pension systems. The structural problems have most likely been an important factor in inhibiting a more significant drop in inflation thereby effectively blocking a more pronounced easing of monetary policy.

Growth in the euro area is expected to accelerate from 0.4 per cent in 2003 to 1.7 per cent in 2004 and 2.3 per cent in 2005. This forecast is more or less unchanged from the *Economic Survey* in December.

The rebound in the international economy has led to increased demand for raw materials, which have contributed to a strong price increases for raw materials. Also, oil prices have increased, though measured in euros rather than US dollars the price increases have been less pronounced. The

real price level of oil and other raw materials is still somewhat below the levels seen in the beginning of the 1980es. Still the increases could be a first indication that inflationary pressures will be increasing in the international economy following a period with fairly subdued price increases.

With the acceleration in growth in the US economy a certain monetary tightening must be expected in the US. The pace in the process can depend on how quickly the necessary adjustment of fiscal policy is going to happen. In the euro area it seems likely it will be some time before it would become necessary for ECB to increase interest rates, and should inflation subside e.g. as a result of a further appreciation of the euro then a further rate cut is possible.

Uncertainties in the projection

The primary uncertainties in the projection for the Danish economy are mostly associated with the risks in the international economy, including the uncertainty surrounding developments in long-term interest rates. There is a risk that long-term interest rates and risk premiums could increase if and when the Federal Reserve starts tightening monetary policy. This would be particularly relevant if the fiscal deficit in the US remains large and there is increasing uncertainty about the political will to begin fiscal consolidation.

Growth prospects for the German economy continue to be associated with some uncertainty. A delayed recovery in Germany, which is Denmark's most important export market, would hurt export growth.

On the domestic front, there is some uncertainty surrounding households' short-term response to the reduction in income taxes and the temporary suspension of the SP-payments. It is quite possible that the propensity to consume of these funds could be different from what has been incorporated into this projection. Strong consumer confidence could result in a high propensity to consume out of these funds. The suspension of SP-payments is temporary and households could choose to offset this suspension against other savings including other pension savings.

Table 1.4. Key figures of the Danish economy

	2000	2001	2002	2003	2004	2005
	----- Percentage changes from previous year -----					
Real GDP	2.8	1.6	1.0	0.4	2.2	2.5
Trade-weighted GDP abroad	3.7	1.3	1.5	1.3	2.7	2.8
Markets for Danish manufactures	13.1	0.1	1.4	4.1	6.9	7.7
International competitiveness	3.6	-2.2	-3.0	-5.3	-1.3	-0.7
Export of manufactures, volume	15.0	5.0	5.3	-1.2	4.0	5.2
Hourly wages	3.6	4.2	4.2	3.8	3.5	3.8
Consumer price index	2.9	2.4	2.4	2.1	1.5	1.7
Price index for single-family houses	6.5	5.9	3.7	3.3	4.5	2.5
Merchandise export prices	6.1	0.1	-1.2	0.2	-0.4	-0.1
Merchandise import prices	4.4	-1.2	-1.5	-1.8	-0.8	0.6
Merchandise terms of trade	1.7	1.3	0.3	2.0	0.3	-0.7
Productivity in private non-agricultural sector	0.8	2.5	2.3	1.8	1.5	1.9
Real disposable income of households ¹⁾ ...	2.1	2.4	0.3	1.7	5.1	2.7
<i>Labour market:</i>						
Labour force (thousands)	2,886	2,891	2,886	2,889	2,900	2,903
Employment (thousands)	2,736	2,746	2,741	2,718	2,729	2,750
Of which in private sector	1,914	1,922	1,907	1,886	1,893	1,912
in public sector	821	824	834	832	835	838
Percentage change in total employment ...	0.5	0.4	-0.2	-0.8	0.4	0.8
Unemployment (thousands)	150	145	145	171	171	152
Early retirements (thousands)	156	159	169	179	188	177
Persons on leave (thousands)	26	22	17	5	3	3
Unemployment rate (per cent)	5.2	5.0	5.0	5.9	5.9	5.3
Unemployment rate, EU-def. (per cent) ..	4.4	4.3	4.6	5.6	5.7	5.1
<i>Long term bond yields, exchange rate:</i>						
10-year government bonds	6.7	5.8	5.2	4.1	4.5	5.1
30-year mortgage credit bond	7.4	6.7	6.3	5.4	5.4	5.9
The effective krone rate (1980=100)	95.6	96.8	97.7	101.2	101.7	101.4
<i>Balance of payments:</i>						
Goods and services (bill. Dkr.)	76.2	85.5	76.9	91.7	90.5	91.2
Current account (bill. Dkr.)	18.6	40.5	27.6	40.5	42.1	44.8
Current account in per cent of GDP	1.5	3.1	2.0	2.9	2.9	3.0
Net foreign debt, ult. (bill. Dkr.)	218.0	229.0	241.0	210.0	155.4	99.3
Net foreign debt in per cent of GDP	17.0	17.3	17.7	15.0	10.7	6.6
<i>Public finances:</i>						
Government net lending (bill. Dkr.) ²⁾	32.5	37.5	21.2	16.7	18.1	26.1
Government net lending in per cent of GDP ²⁾	2.5	2.8	1.6	1.2	1.2	1.7
General government gross debt, ult. (bill. Dkr.)	641.3	633.2	642.8	625.5	618.0	602.7
General government gross debt ult. in per cent of GDP	50.1	47.8	47.2	44.8	42.6	39.8
Tax burden (per cent of GDP) ²⁾	49.6	49.9	48.9	49.1	48.9	48.4
Expenditures (per cent of GDP)	53.9	54.2	54.6	54.8	54.3	53.2

1) Adjusted for special factors concerning pension funds.

2) For the years 1999-2001 government net lending and the tax burden include the net savings respectively gross savings in the Special Pension fund (app. ½ per cent of GDP).

Source: Statistics Denmark and own calculations.

Table 1.5. A comparison, the present vs. the previous forecast

	2003		2004		2005	
	Dec.	May	Dec.	May	Dec.	May
Private consumption	1.2	1.1	3.0	3.6	2.5	3.0
Total government demand	-0.1	0.2	0.9	1.2	0.6	0.6
of which government consumption	0.1	0.5	0.7	0.7	0.5	0.5
of which government investment	-2.9	-3.7	3.2	8.3	2.0	2.0
Residential construction	8.5	7.8	2.5	3.0	-0.5	-2.0
Fixed business investment	-3.1	-2.1	1.0	3.4	3.1	5.0
Domestic demand exc. stock building ..	0.4	0.6	2.0	2.9	2.0	2.5
Changes in stock building ¹⁾	0.4	-0.4	0.0	0.0	0.0	0.0
Total domestic demand	0.8	0.1	2.0	2.9	2.0	2.5
Exports of goods and services	-0.4	0.3	3.9	2.8	4.6	5.1
Of which manufactures	-2.0	-1.2	5.0	4.0	5.3	5.2
Total demand	0.4	0.2	2.6	2.9	2.8	3.4
Imports of goods and services	0.6	-0.4	3.8	4.3	4.1	5.4
Of which goods ²⁾	2.9	-0.6	4.3	5.6	4.1	5.4
Gross domestic product	0.4	0.4	2.1	2.2	2.3	2.5
GDP at factor costs	0.6	0.4	1.9	1.9	2.4	2.5
Of which in non-agricultural sector ³⁾	0.5	0.3	2.0	2.1	2.7	2.8
Labour force	-10	3	12	11	6	3
Employment	-35	-23	8	11	18	21
of which in the private sector	-35	-21	5	8	16	19
of which in the public sector	0	-2	3	3	3	3
Unemployment	25	26	4	0	-13	-19

1) The volumes indicate volume changes in stock building in per cent of volume GDP in the preceding year.

2) Excluding energy, ships and planes.

Source: Statistics Denmark and own calculations.

Table 1.5. A comparison, the present vs. the previous forecast (continued)

	2003		2004		2005	
	Dec.	May	Dec.	May	Dec.	May
	----- Percentage changes from previous year -----					
Merchandise export prices	-0.5	0.2	0.0	-0.4	0.1	-0.1
Merchandise import prices	-1.8	-1.8	0.0	-0.8	0.9	0.6
Merchandise terms of trade	1.3	2.0	-0.1	0.3	-0.7	-0.7
Property prices, single-family houses	3.5	3.3	2.0	4.5	1.5	2.5
Consumer price index	2.1	2.1	1.8	1.5	1.7	1.7
Hourly earnings	3.9	3.8	3.7	3.5	3.7	3.8
Real disposable income, private sector ...	0.2	1.1	2.8	2.9	3.5	2.9
Real disposable income, households.....	1.6	2.6	3.2	4.2	2.2	1.3
Productivity in non-agricultural sector...	2.4	1.8	1.9	1.5	1.9	1.9
	----- Per cent -----					
Savings ratio in the private sector.....	27.7	29.7	27.6	29.2	28.3	29.1
10-year government bond	4.3	4.1	4.7	4.5	5.1	5.1
30-year government bond	5.5	5.4	5.6	5.4	5.9	5.9
	----- Bill. Dkr. -----					
Current account	37.0	42.2	44.0	42.1	51.0	44.8
Government net lending	18.5	16.7	20.7	18.1	21.5	26.1
Unemployment (thousands)	170	171	173	171	160	152
	----- Per cent -----					
GDP growth in OECD countries	1.3	1.3	2.5	2.7	2.8	2.8
International market growth	4.2	4.3	7.6	6.9	7.1	7.7
Dollar exchange rate (Dkr. per US\$) ...	6.6	6.5	6.3	6.2	6.3	6.3
Price of oil (Us-dollar per barrel)	28.5	28.4	26.5	31.1	25.0	28.9
Price of oil (Dkr. per barrel)	188.4	185.5	167.2	192.2	157.8	180.6

Source: Statistics Denmark and own calculations.

2. The fiscal stance and government finances

The slowdown in growth in the last 2 years and the increase in unemployment means that the outputgap has become negative and it is estimated to have reached $-1\frac{1}{4}$ per cent of GDP in 2003, *cf. figure 2.1*. This in combination with a sizable surplus on the current account and relatively healthy public finances creates room for a growth rate above potential growth and for positive growth contribution from fiscal policy. It is estimated that the outputgap is reduced in 2004 and becomes mildly positive in 2005.

Altogether the 2004 Fiscal Act, local council budgets, and the Spring Package (including the suspension of SP-payments) entail a fairly significant fiscal stimulus to the economy in 2004². The first-year impact on GDP from discretionary fiscal policy is estimated at 0.6 per cent of GDP in 2004. This growth stimulus first and foremost comes from the reductions in income taxation and to a lesser extent increased public investments. In addition the temporary suspension of SP-payments entails a contribution to growth of 0.1 percentage points in 2004³.

Figure 2.1a. Outputgap

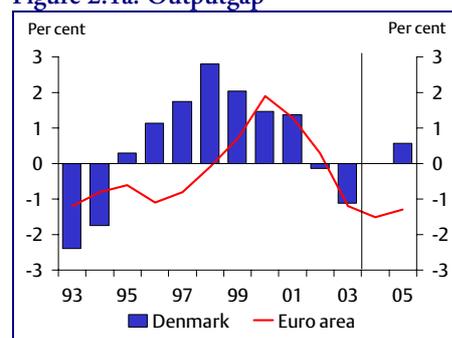
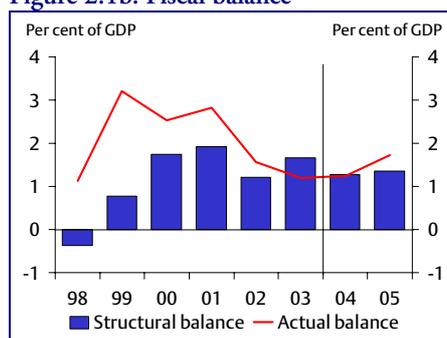


Figure 2.1b. Fiscal balance



Source: Statistics Denmark, EU-Commission and own calculations.

² A certain reduction of income taxation to be gradually implemented from 2004 through 2007 and lower indirect taxes (on spirits, cigarettes, soft drinks etc.) was decided in 2003. Also, the Tax Freeze, which implies a “nominal freeze” on a number of exercise duties etc. set in nominal terms and on property taxes continues in 2004.

³ As the Special Pensions fund is actuarially fair the SP-payments are not considered part of public revenues in the National Accounts. Hence the suspension of SP-payments is technically not considered as discretionary fiscal policy.

The general government surplus is expected to increase from 1.2 per cent of GDP in 2003 to 1.3 per cent of GDP in 2004 and 1.7 per cent of GDP in 2005. This gradual improvement predominantly reflects the combination of a reduction of the structural surplus in 2004 and the positive effects stemming from the improvement in the business cycle in 2004 and 2005.

It should be noted that the Spring Package in itself is expected to have an almost zero effect on public surpluses in 2004 and 2005 as the effect of moving forward of already decided tax reductions is counteracted by an increase in the tax base as a result of the temporary suspension of SP-payments. However, moving forward reductions in income taxation also entails moving forward the reduction of the structural surplus implied by the tax reductions.

General government gross debt (EMU definition) is projected to decline from 44.8 per cent of GDP at the end of 2003 to 39.8 per cent of GDP by the end of 2005, *cf. figure 2.2b*.

Figure 2.2a. General government surplus in EU countries in 2003

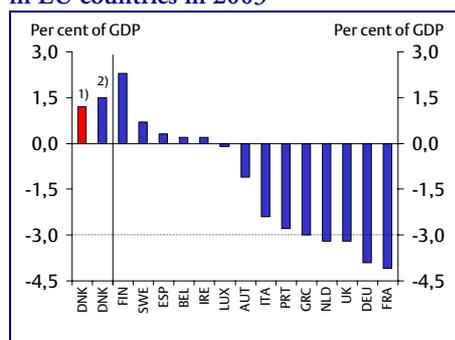
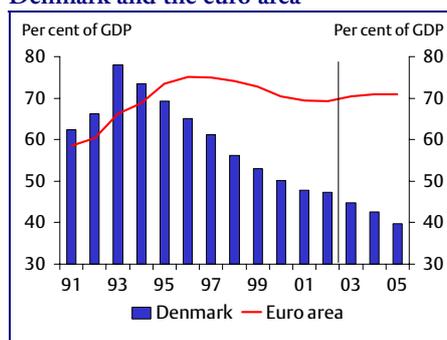


Figure 2.2b. Gross public debt ratio in Denmark and the euro area



Source: Statistics Denmark, EU-Commission, and own calculations.

In recent years the business cycle in the Danish economy has been roughly in phase with the euro area. The fairly strong rebound in the Danish economy in 2004 and 2005 can result in the interest rates, which are essentially “imported” from the euro area due to the fixed exchange rate vis-à-vis the euro, becoming on the low side relative to the business cycle position of the Danish economy.

The structural surplus is estimated to decline from 1.7 per cent of GDP in 2003 to 1.3 per cent of GDP in 2004. This primarily reflects the income tax reductions. With low growth in public consumption, lower interest payments and a continued tax freeze the structural balance is expected to reach 1.4 per cent of GDP in 2005.

Net of a technical contribution of 0.3 per cent of GDP from the suspension of SP-payments the structural balance in 2004 and 2005 is below the medium-term target interval of 1½ - 2½ per cent of GDP for the average surplus through to 2010⁴. This reflects the fiscal stimulus stemming from the reductions in income taxation. The structural balance is expected to increase in subsequent years due to continued limited growth in real public consumption, decreasing interest expenditures, and increasing structural employment. This ensures that the structural public balance over the period 2003 through 2010 will on average be within the target interval.

A cornerstone in the Danish medium term fiscal strategy is fiscal sustainability. Fiscal sustainability implies that the tax and expenditure policies in place in 2010 can be sustained subsequently without any need for policy adjustments to prevent public debt from rising beyond bounds⁵.

Fiscal policy is estimated to be sustainable given the stated targets and assumptions for employment, public services and taxes towards 2010. Two key targets are: (i) real public consumption growth of 0.5 per cent per year from 2005 to 2010, and (ii) new measures that can increase (structural) employment by about 2 per cent are needed. The government intends to improve the labour market attachment of immigrants, speed up students' flow through the education system, and reduce sick leave.

⁴ The temporary suspension of SP-payments in 2004 and 2005 will in itself improve the fiscal balance by around 0.3 per cent of GDP as the suspension increases taxable income in the private sector. The calculated structural balance is affected in a similar manner.

⁵ The sustainability of fiscal policy is based on specific policy targets and assumptions for employment, public-sector services and taxes towards 2010, whereas stylised "policy-neutral" assumptions are employed for the years following 2010.

An updated medium term projection as well as a discussion of the calculation of fiscal sustainability will be available in the forthcoming *Finansredegørelse 2004*.