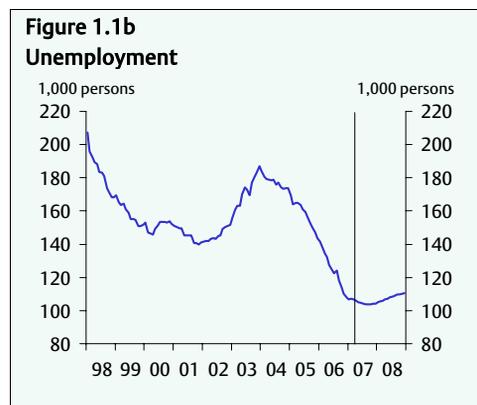
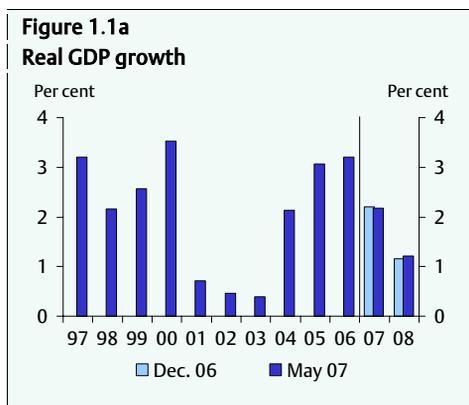


## Economic Survey May 2007 – English Summary

### Short term outlook

The Danish economy has now achieved very high levels of capacity utilization and employment after three years of strong growth. Unemployment has fallen sharply offering new employment opportunities for individuals at the fringes of the labour market, e.g. immigrants. Both real disposable incomes and wealth have risen strongly, paving the way for a 12 per cent real increase in private consumption between 2003 and 2006.

Due to the already low levels of unemployment and to underlying demographic trends, the scope for further growth is now more limited. GDP growth is expected to slow from more than 3 per cent in 2005 and 2006 to 2¼ per cent in 2007 and 1¼ per cent in 2008.



The GDP forecast is based on slowing growth in consumption and investment towards 2008, especially due to increasing interest rates, weaker growth in household incomes and a cooling of the real estate market. This slowdown in demand growth is a welcome development given the tight supply side conditions.

The forecast is roughly unchanged compared to the December forecast, although the probability of a renewed pick-up in demand seems to have increased. The centralized wage bargaining process which has recently been completed - in combination with the tight labour market - is likely to lead to somewhat higher wage increases in the forecast period. This could boost domestic demand in the short run, whereas adverse effects on exports will occur more gradually.

Export demand is likely to be strong, due to continued growth in the world economy of around 5 per cent p.a. Furthermore, the growth pattern has changed. Growth in

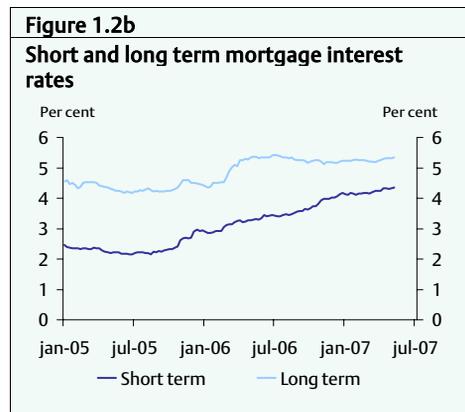
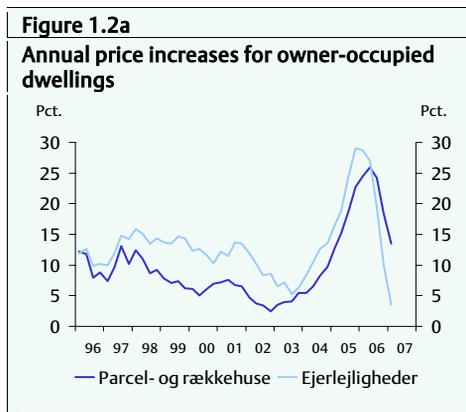
Europe, particularly Germany, is now stronger, boosting demand facing Danish exporters while growth in the US has been reduced.

<b>Table 1.1</b>						
<b>Key figures compared to the December projection</b>						
	<b>2006</b>		<b>2007</b>		<b>2008</b>	
	<b>Dec.</b>	<b>May</b>	<b>Dec.</b>	<b>May</b>	<b>Dec.</b>	<b>May</b>
<b>Real growth<sup>1)</sup>, per cent</b>						
Gross domestic product	3.3	3.2	2.2	2.2	1.2	1.2
Private consumption	4.2	3.4	2.2	2.4	1.2	1.2
Public consumption <sup>2)</sup>	1.1	1.2	1.3	1.3	1.1	1.1
Export markets, manufactures	8.2	7.3	5.9	7.8	7.1	7.1
<b>Per cent of GDP</b>						
Public budget balance	3.4	4.2	3.3	4.2	3.3	3.3
Current external account	2.3	2.4	2.0	2.4	1.6	1.7
<b>1,000 persons</b>						
Unemployment	125.0	124.4	112.0	105.0	112.0	108.0
<b>Per cent increase</b>						
House prices, single-family house	21.0	20.6	6.0	4.0	2.0	2.0
Consumer prices	1.9	1.9	1.9	1.9	2.4	2.4
Hourly compensation, private sector	3.8	3.6	4.3	4.6	4.6	4.6
Yield on 10-year government bonds	3.8	3.8	4.2	4.2	4.5	4.5
Oil price, \$ per barrel	65.0	64.9	64.0	65.0	63.0	63.0
Exchange rate, Dkr. per \$	5.9	5.9	5.8	5.6	5.5	5.5
Oil price, Dkr. per barrel	381.4	385.7	372.2	361.4	347.8	347.8
1)	The real growth rates of the macro variables are now calculated using chain indices. In the December survey, 2000-prices were used.					
2)	Real growth of public consumption reflects growth in inputs, not improvements of output and is therefore not readily comparable to private consumption growth.					

To a large extent, the strong domestic demand has been met by foreign supply. Imports have risen markedly. This has taken some pressure off the domestic labour market, but it has also led to a deterioration of the balance of payments of 1½ per cent of GDP over the last twelve month period. This is somewhat more than expected. The balance of payments surplus is expected to be maintained in the forecast period due to strong growth in the world economy and continuing high revenues from oil exports and sea freight – sectors that are largely unaffected by the tight labour market situation in Denmark.

An important prerequisite for the economy to slow down, as projected, is moderate price developments in the real estate market. The significant increases seen until mid 2006 have fuelled consumption growth and housing investment. Since then, the market has cooled off and prices are expected to increase more or less in line with consumer prices until 2008. The very limited increase is partly due to rising short term interest rates.

Real estate prices may temporarily fall, particularly in larger cities where the increases have been greatest in recent years. There is, however, no reason to expect major corrections. In general, the financial situation of owner-occupants appears healthy. Increasing labour income, low debt to equity ratios, low unemployment and readily available mortgage financing are likely to keep the real estate market stable.

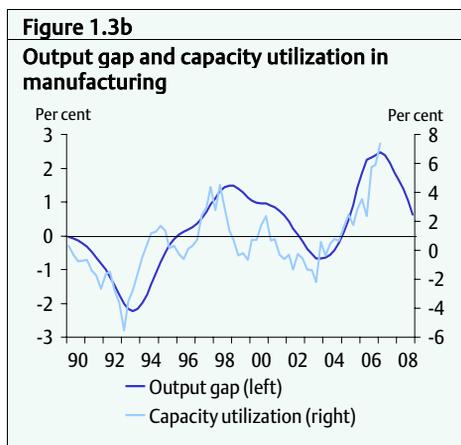


### Capacity utilization and wage developments

Registered unemployment has fallen by 80.000 persons since December 2003 and reached 106.600 in March 2007. At 3¾ per cent of the labour force (national concept), this is the lowest level since 1974. Unemployment is lower than in almost all other OECD-countries.

The very low rate of unemployment has led to labour shortages in parts of the private sector and the public services sector. Labour shortages in the construction sector were at their highest in the autumn of 2006. They have since eased a bit, but continue to be significant. In manufacturing the shortages only began during 2006 but have since then become more acute, reaching a historical peak in March 2007. Capacity utilization also remains high in manufacturing.

The favourable employment opportunities have prompted more people to join the labour force, including individuals at the fringes of the labour market, who previously had difficulty finding jobs, e.g. immigrants. From 2005 to 2006 employment grew by 50.000 persons and the labour force grew by 20.000.



Note: In figure 1.3b the light blue graph shows deviations from the historical average (seasonally adjusted)

Apart from higher labour force participation of young people and immigrants, the larger labour force also reflects an increased influx of foreign labour from Eastern Europe and commuters from Sweden and Germany. The largest part of the increase, however, seems to reflect cyclical factors. It is not unusual, that about one third of an increase in employment in an upturn is accounted for by increases in the labour force.

**Table 1.2**  
**Indicators of the foreign labour force**

	Commuters from Sweden	Commuters from Germany	Employees from new EU Member States	Total
	----- thousands -----			
1 January 2004	6.5			6.5
1 January 2005	10.6		1.6	12.3
1 January 2006	13.9	9.3	4.0	27.2
1 January 2007	20.9	5.5	5.5	37.0
9 May 2007	23.0	10.4	10.4	44.8

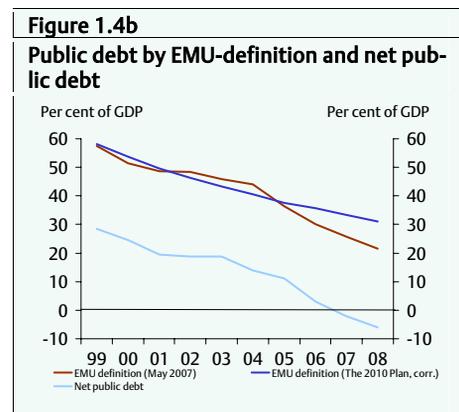
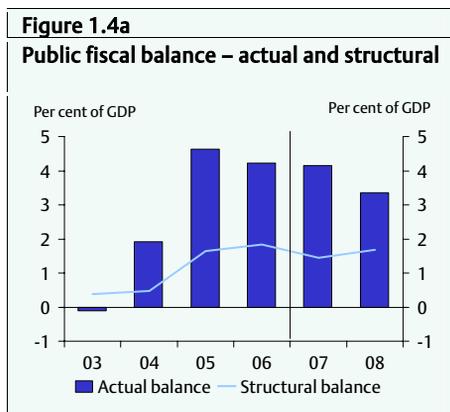
The recently completed three-year wage settlements in the private sector will imply larger wage increases than in the previous settlement. This is particularly so for the sectors in which most bargaining takes place centrally, as opposed to other sectors where the centralized settlement concerns minimum wage levels while the size of the actual wages is negotiated at the plant level. In the former sectors wage rate increases are roughly twice as high as in the last settlement. Such increases could also have an impact on wage expectations in other sectors leading to significant wage increases at the firm level.

Hourly wages in the private sector are thus projected to rise by 4.6 per cent in both 2007 and 2008. This is 0.3 percentage points more than assumed in the December survey (before the wage settlement). Even though wages are also expected to grow faster in other countries, including Germany, wage competitiveness is expected to deteriorate, as it has since 2000. The higher trade weighted value of the DKK, particularly due to the weaker US-dollar, also tend to hamper wage competitiveness. The structural level of unemployment is estimated at some 5-5½ per cent of the labour force. It is expected that structural reform will help to reduce the structural unemployment level to less than 5 percent in 2008.

## Public finances

The overall public sector fiscal balance stands at 4.2 per cent of GDP in 2006, only slightly less than the record level of 4.6 per cent in 2005. Low unemployment and high domestic demand are likely to ensure a surplus of a similar size in 2007. In 2008 the surplus is projected to diminish to 3½ per cent of GDP due to a less buoyant economy and the reintroduction of the mandatory, but tax deductible, contributions to the so called Special Pensions Scheme as from 2008.

To a significant extent, the large surpluses in recent years reflect transitory effects, including high capacity utilisation, high tax revenues from North Sea resource extraction and favourable demographic developments with relatively large generations active on the labour market. As these effects gradually fall away, public finances are expected to deteriorate.



Note: According to the original 2010 Plan, debt by the EMU definition would have been reduced from 48 per cent of GDP in 2000 to 27½ per cent in 2008. The present estimate is 21½ per cent in 2008. The figures in the original plan are not readily comparable to the present ones. A number of technical adjustments have been carried out since the publication of the 2010 Plan. These adjustments increase debt in absolute figures, but have no effect on the actual sustainability of public finances. In the chart, the figures from the 2010 Plan are adjusted in order to achieve comparability.

Public finances are more volatile in Denmark than in most other countries. In 2003, at the end of the last short lived slump in the economy, the fiscal balance exhibited a small deficit. Just two years later, a record surplus was achieved. This was due in part to a strong revenue increase from the taxation of private pension schemes, related to very high returns in a favourable stock market. High revenues from the North Sea oil and gas extraction, strong consumption growth and falling unemployment have also contributed.

Correcting for temporary factors, including the strong business cycle, the structural budget balance is estimated at just below 1½ percent of GDP in 2004-2008 on average, which is in the upper end of the target range (which is between ½ and 1½ percent of GDP). The fact that the actual surpluses are somewhat higher also shows, that automatic stabilizers help to reduce pressures.

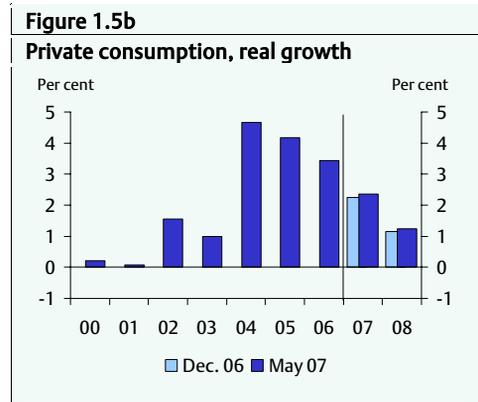
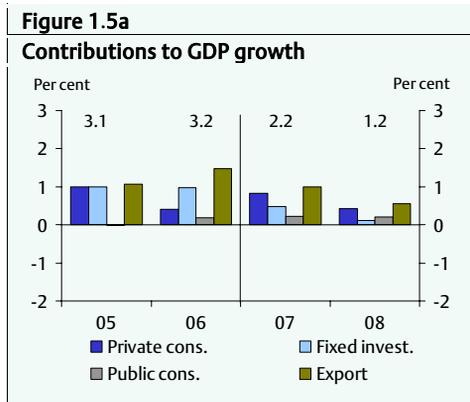
Along with the reforms of the retirement system, the strong reduction of public debt has made public finances largely sustainable, even in the face of a significant increase in the number of elderly. The latest Convergence Programme from November 2006 concludes for the first time, that the projected expenditure increases are manageable without significant changes to taxation, transfers or public service provision. Such a scenario, however, requires that the large current surpluses are used exclusively to reduce debt. The lower interest payments – and the reform of the early retirement system - will contribute to provide the necessary leeway for extra ageing related expenditures.

Owing to the large surpluses in recent years, net public debt is expected to reach zero, leaving the public sector with positive net assets by the end of this year or next year. The book value of government financial assets including government stakes in corporate companies will thus exceed total government debt.

### **Domestic developments**

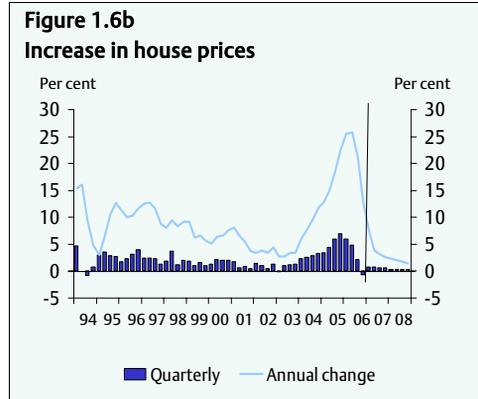
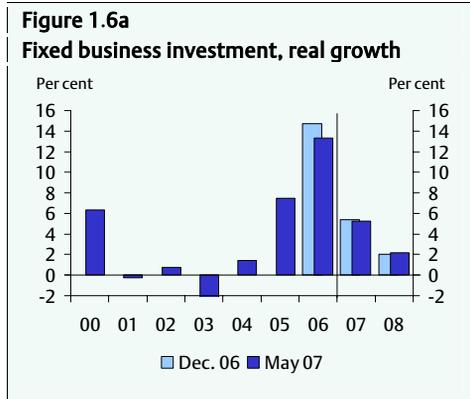
GDP growth has exceeded 3 per cent in both 2005 and 2006 and is now forecast at 2¼ per cent and 1¼ per cent in the 2007 and 2008, respectively, *cf. figure 1.5a.*

After three years of growth of around 4 per cent annually, private consumption is expected to increase by 2.4 per cent in 2007 and by 1.2 per cent in 2008 due to rising interest rates and smaller wealth effects from the real estate market, *cf. figure 1.5b.*



Note: The contributions to GDP growth are calculated by the input-output based method, cf. box 1 in English summary December 2006.

Fixed business investment grew by 13.3 per cent in 2006. The growth in fixed business investment is expected to fall and is forecast at 5.3 per cent in 2007 and 2.2 per cent in 2008 as the interest rates are rising, the investment to production ratio has reached a rather high level, and capacity constraints are expected to gradually abate, cf. figure 1.6a. The changes to corporate taxation, including among other things a reduction in the corporate tax rate from 28 to 25 per cent, are expected to have only a minor impact on investments during the forecast period.



Prices of owner-occupied single-family homes increased markedly through 2005 and the first half of 2006 at well above 20 per cent on an annual basis, in part due to persistently low interest rates and growing disposable incomes. The brisk house price increases have come to a necessary stop and the forecast for price increases for owner-occupied single-family homes is 4 per cent in 2007 and 2 per cent in 2008, cf. figure 1.6b.

After strong growth of 11-12 per cent on average over the years 2003 to 2005, the rise in residential investment slowed to 8 per cent in 2006, *cf. table 1.2*. Rising interest rates and higher construction costs, and the lower house-price increases, are expected to further reduce residential construction growth in 2007 and 2008.

In 2006 the growth rate of real public consumption was 1.2 per cent. A slightly higher growth rate of 1.3 per cent is projected for 2007. For 2008 the figure is 1.1 per cent. These figures are roughly the same as in Denmark's *Convergence Programme for 2006* and as in the December 2006 edition of the economic survey.

### **International trade and the current account**

Manufacturing exports increased strongly in 2006 as export markets grew strongly and the Danish krone depreciated slightly. In 2007 and 2008 manufacturing export growth is projected to abate to 4.4 and 3.6 per cent, mainly due to some loss of wage competitiveness as Danish wage rate increases are set to exceed those of Denmark's main trading partners.

Total exports grew even faster in 2006 as services exports rose by 17 per cent mostly due to a large merger in 2005 in the shipping industry. For 2007 and 2008, a growth in total exports of 4.8 and 2.8 per cent are expected since the increase in services exports will slow down and also reflecting a gradual reduction in production of oil and gas in the North Sea.

Total demand grew by exceptionally 6.5 per cent in 2006, the strongest growth since 1994. As growth in both domestic demand and exports are expected to slowdown total demand is forecast to grow by 3.4 and 1.7 in 2007 and 2008, respectively.

Imports grew by 14 per cent in real terms in 2006 partly due to capacity constraints and partly reflecting the strong expansion of the merchant fleet. In 2007, imports of goods and services are expected to increase by 5.8 per cent and slow even further in 2008, as growth in total demand is expected to recede.

**Table 1.3****Use and supply of goods and services<sup>1)</sup>**

	2006	2003	2004	2005	2006	2007	2008
	Bill. kr.						
				Real growth, per cent			
Private consumption	796.0	1.0	4.7	4.2	3.4	2.4	1.2
Public consumption <sup>2)</sup>	418.3	0.7	1.6	1.1	1.2	1.3	1.1
Public investment	30.2	-7.8	12.6	3.0	6.6	-7.8	1.0
Residential construction	104.7	11.8	14.4	16.7	8.1	6.0	1.0
Fixed business investment	230.5	-2.9	1.7	7.6	13.3	5.3	2.2
Stock building <sup>3)</sup>	10.3	-0.5	0.1	-0.1	0.4	0.0	0.0
<b>Total domestic demand</b>	1590.1	<b>0.2</b>	<b>4.1</b>	<b>4.3</b>	<b>4.9</b>	<b>2.6</b>	<b>1.3</b>
Exports of goods and services	849.4	-1.0	2.2	7.3	9.6	4.8	2.6
of which manufactures	344.7	-2.6	2.0	7.4	7.7	4.4	3.6
<b>Total demand</b>	2439.5	-0.2	3.5	5.3	6.5	3.4	1.7
Imports of goods and services	801.9	-1.6	7.0	10.8	14.0	5.8	2.8
of which goods	531.5	-2.2	8.1	8.1	12.9	4.7	2.6
Net exports <sup>3)</sup>	47.5	0.2	-1.9	-1.3	-1.9	-0.5	-0.1
<b>Gross domestic product</b>	1637.6	<b>0.4</b>	<b>2.1</b>	<b>3.1</b>	<b>3.2</b>	<b>2.2</b>	<b>1.2</b>
Gross value added	1385.9	0.4	1.3	2.6	3.2	2.3	1.2
of which in private non-agricultural sector <sup>4)</sup>	885.8	0.7	1.3	3.3	4.0	2.9	1.5
GDP per capita (1.000 Dkr.)	301.3	0.1	1.9	2.8	2.9	1.9	1.0

3) The real growth rates of the macro variables are now calculated using chain indices. In the December survey, 2000-prices were used.

4) Real growth of public consumption reflects growth in inputs, not improvements of output and is therefore not readily comparable to private consumption growth.

5) Contributions to GDP growth

6) Excluding housing and shipping

Source: Statistics Denmark and own calculations.

The external current account has deteriorated markedly from a surplus in 2005 of 3.8 per cent of GDP to an expected level of 1.7 per cent of GDP in 2007, and remain almost unchanged in 2008.

Denmark's net foreign asset position turned positive in late 2005 but due to valuation effects was reversed in 2006. By 2008 Denmark is again expected to be a net lender. The net foreign asset position is projected at 1.4 per cent of GDP by the end of 2008.

### Employment, unemployment and labour force

Employment growth amounted to 1.9 per cent in 2006 and reached a record level at the beginning of 2007, giving rise to a very weak productivity performance. Hence, employment is forecast to stay more or less at the present level as productivity growth returns to more normal levels.

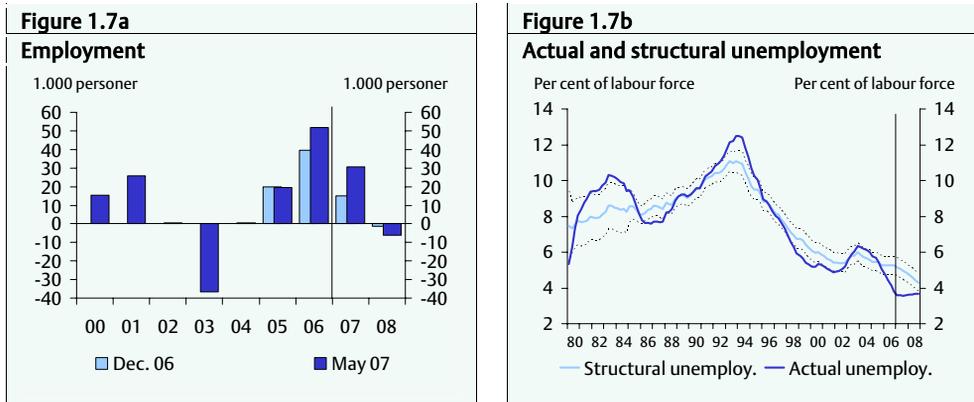
Employment in 2007 is expected to be 31,000 persons above the 2006 average, corresponding to a growth rate of 1.1 per cent. For 2008, employment is projected to fall slightly, *cf. figure 1.7a* and *table 1.4*. Total employment growth is driven by higher private sector employment while public sector employment is assumed to remain almost unchanged.

<b>Table 1.4</b>								
<b>Employment, labour force and unemployment</b>								
	<b>2005 level</b>	<b>Avg. 1990-2005</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>		<b>2008</b>	
					<b>Dec.</b>	<b>Maj</b>	<b>Dec.</b>	<b>Maj</b>
	<b>1.000 persons</b>		<b>Change, thousands</b>					
Private sector	1908	8	22	53	39	30	14	-7
Public sector	818	3	-3	-2	0	1	1	1
Total employment	2726	11	19	52	39	31	15	-6
Labour force	2884	2	1	19	7	11	2	-3
Unemployment	157	-9	-19	-33	-32	-19	-13	3

The labour force has increased recently as more young people are now seeking employment and as the inflow of foreign labour seems to have risen. The labour force is projected to remain more or less constant in the forecast period. Demographic developments impact negatively on labour force growth while positive contributions are expected from the cyclical upswing in labour force participation together with the impact of various labour market reforms.

Unemployment has come down from 176,000 persons in 2004 (6.1 per cent of the labour force, national definition; 5.5 per cent, Eurostat definition) to 125,000 persons in 2006 and fall further to 105,000 persons in 2007 (3.6 per cent of the labour force; 3.3 per cent, Eurostat definition). For 2008, a small increase of 3,000 persons is expected. Unemployment in 2008 will be affected downwards by an increased activation effort which is an element of the Welfare Agreement.

The projection implies that unemployment will stay below the estimated structural level of unemployment throughout the projection period leading to labour market pressures and affecting wage growth. However, The Welfare Agreement is expected to reduce structural unemployment somewhat, *cf. figure 1.7b*.



### Wage and price inflation

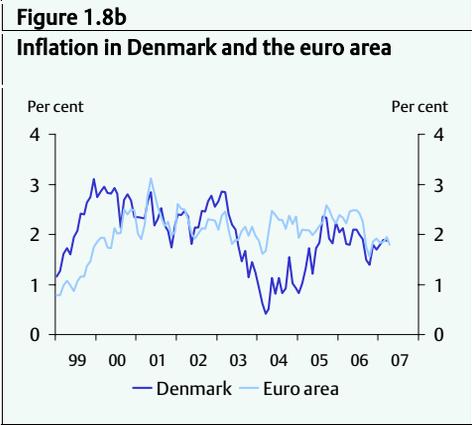
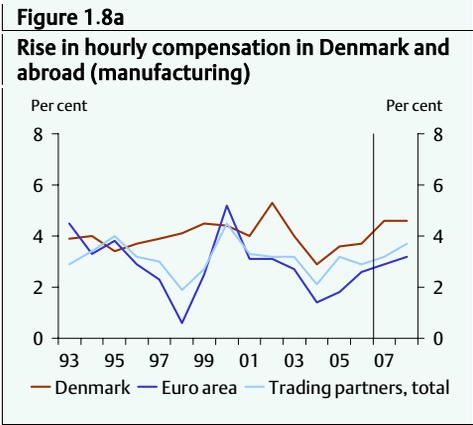
Wages in the non-financial, non-farm private sector increased by 3.6 per cent in 2006. In the construction sector, wage growth reached 4.7 per cent. Wage pressures have been building up and based on the recent centralized wage settlements wage increases in 2007 and 2008 are forecast to reach 4.6 per cent.

The gap between hourly compensation of employees in the manufacturing sector in Denmark and the main trading partners is expected to widen, reversing the trend in recent years, *cf. figure 1.8a*.

Consequently, wage competitiveness is expected to deteriorate somewhat and an assumed appreciation of the effective exchange rate adds to the widening wage differential.

The inflation rate has fluctuated around 2 per cent since mid-2005 after picking up from a historically low level in 2004, *cf. figure 1.8b*. Inflation remains slightly below inflation in the euro area. Oil price increases have had a larger impact on inflation in the euro area than in Denmark, and core inflation in Denmark is also slightly below core inflation in the euro area.

The inflation rate is forecast at 1.9 per cent in 2007 and 2.4 per cent in 2008. The projected increase in inflation in 2008 compared to 2007 is due to price increases for services reflecting that higher wages increase costs. Oil prices are assumed to stay at around 65 \$ per barrel in the coming years, roughly in line with both market expectations and the medium to long term reference scenario of the International Energy Agency (IEA). Inflation excluding energy is expected to increase from 1.6 per cent in 2006 to 2.7 per cent in 2008.



A number of policies will dampen inflation: the nominal tax freeze for excise duties, lower parental co-payment for day care institutions and a recent political agreement on registration fees for motor vehicles.

**Table 1.5****Key figures for the Danish economy**

	2003	2004	2005	2006	2007	2008
<b>Percentage change from previous year</b>						
Real GDP	0.4	2.1	3.1	3.2	2.2	1.2
Trade-weighted GDP abroad	1.3	3.0	2.2	3.8	2.9	3.2
Markets for Danish manufactures	3.9	6.1	5.5	7.3	7.8	7.1
International competitiveness	-4.2	-1.8	-0.5	-0.8	-2.5	-0.9
Export of manufactures, volume	-2.6	2.0	7.4	7.7	4.4	3.6
Hourly wages	3.7	2.8	3.6	3.6	4.6	4.6
Consumer price index	2.1	1.2	1.8	1.9	1.9	2.4
Price index for single-family houses	3.1	8.8	17.4	20.6	4.0	2.0
Merchandise export prices	-0.7	1.4	5.4	2.7	1.4	1.3
Merchandise import prices	-1.5	1.0	3.9	2.8	1.1	1.1
Merchandise terms of trade	0.8	0.4	1.4	-0.2	0.2	0.2
Productivity in private non-agricultural sector	2.7	0.8	1.0	0.7	1.4	2.3
Real disposable income of households <sup>1)</sup>	3.1	3.8	1.8	2.9	1.8	0.9
<b>Labour market:</b>						
Labour force (thousands)	2,877	2,883	2,884	2,902	2,914	2,911
Employment (thousands)	2,706	2,707	2,726	2,778	2,808	2,802
Of which in private sector	1,886	1,886	1,908	1,961	1,991	1,984
in public sector	820	821	818	816	817	818
Percentage change in total employment	-1.3	0.0	0.7	1.9	1.1	-0.2
Unemployment (thousands)	171	176	157	124	105	108
Early retirements 60-64 year (thous.)	105	111	118	125	145	145
Unemployment rate (per cent)	5.9	6.1	5.5	4.3	3.6	3.7
Unemployment rate, EU-def. (per cent)	5.4	5.5	4.8	3.9	3.3	3.4
<b>Long term bond yields, exchange rate:</b>						
10-year government bonds	4.3	4.3	3.4	3.8	4.2	4.5
30-year mortgage credit bond	5.4	5.3	4.4	5.1	5.4	5.6
The effective krone rate (1980=100)	101.2	102.2	101.6	101.6	102.9	103.0
<b>Balance of payments:</b>						
Goods and services (bill. Dkr.)	87.5	72.0	73.4	47.5	37.8	37.5
Current account (bill. Dkr.)	48.3	44.7	58.7	39.4	28.5	28.9
Current account in per cent of GDP	3.4	3.1	3.8	2.4	1.7	1.6
Net foreign assets, ultimo (bill. Dkr.)	-170.3	-92.7	20.2	-34.0	-5.0	24.0
Net foreign assets in per cent of GDP	-12.2	-6.4	1.3	-2.1	-0.3	1.4
<b>Public finances:</b>						
Government net lending (bill. Dkr.) <sup>2)</sup>	-1.4	27.9	71.8	69.1	71.0	59.3
Government net lending per cent of GDP <sup>2)</sup>	-0.1	1.9	4.6	4.2	4.2	3.3
General government gross debt, year-end, bill. Dkr.	641.7	641.9	563.1	494.5	440.8	382.7
General government gross debt, year-end, per cent of GDP	45.8	44.0	36.3	30.2	25.8	21.6
Tax burden (per cent of GDP) <sup>1)</sup>	48.1	49.4	50.4	48.8	48.0	47.2
Expenditures (per cent of GDP)	54.2	53.9	51.7	50.2	49.2	49.1

1) Adjusted for special factors concerning pension funds.

2) Excluding the labour market supplementary pension scheme ATP.