

Economic Survey – August 2014

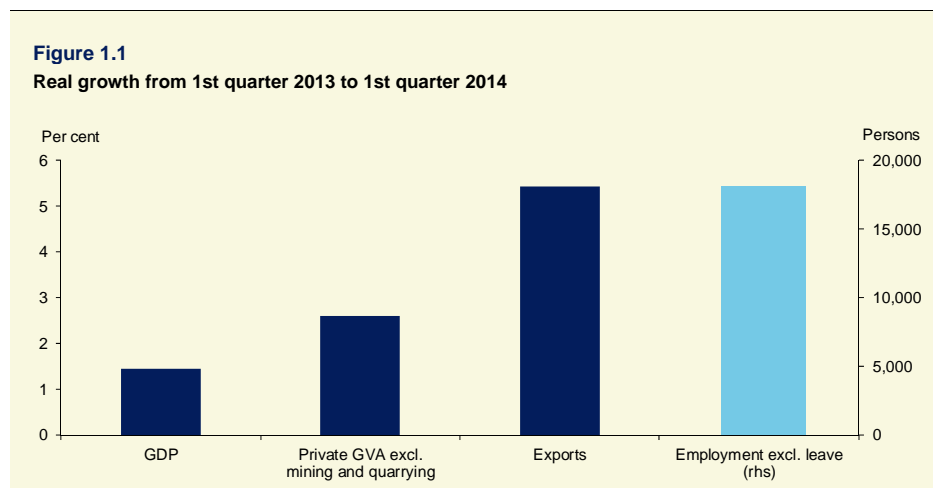
1.1 The current economic outlook

The recovery of the Danish economy has continued into 2014. Demand, production, and employment have grown and hence Danish businesses and households are well on their way out of the crisis following the global downturn in 2008-09.

Exports have been a key driver during the past year. Higher demand among Denmark's main trading partners has supported production (GVA) in the private sector (excluding mining and quarrying) by around 2½ per cent in the first quarter compared to a year earlier, *cf. figure 1.1*. Hence, production is now back at the same level as in 2007.

Growth in the overall economy (GDP) has been more modest – kept down by a slowdown in production in the North Sea. However, it cannot conceal the fact that the recovery in demand and production is well under way following the standstill in 2011-12, when the debt crisis in the euro area impeded both the Danish and the international economy.

The labour market has improved as well. Employment has risen by almost 20,000 persons over the past year. This is primarily due to job creation in the private service sector. There has also been more vacancies and unemployment has fallen. This has contributed to a very significant strengthening of sentiment among Danish families since last summer.



Source: Statistics Denmark and own calculations.

The foundation for further progress seems to be present, and GDP growth is expected to be almost 1½ per cent this year and rise further to 2 per cent next year. This is in line with the

latest assessment in *Economic Survey*, May 2014, reflecting that the overall economic outlook has not changed significantly in recent months. The forecast implies a relatively slow recovery of the economy, with sufficient idle resources in the labour market to ensure a sustainable increase in employment of 21,000 and 22,000 persons in 2014 and 2015 respectively.

A well-functioning labour market and a responsible economic policy, which ensures the credibility of public finances, are essential to the economic recovery and the speed at which the business cycle is normalised. In recent years, a number of initiatives aimed at both supporting economic activity and strengthening the foundation for growth going forward have been implemented. The reforms contribute to, amongst other things, increasing the labour force and productivity, and support the potential for a sustained recovery of the Danish economy. This was also the purpose of the agreement on the *Growth Package 2014* from July.

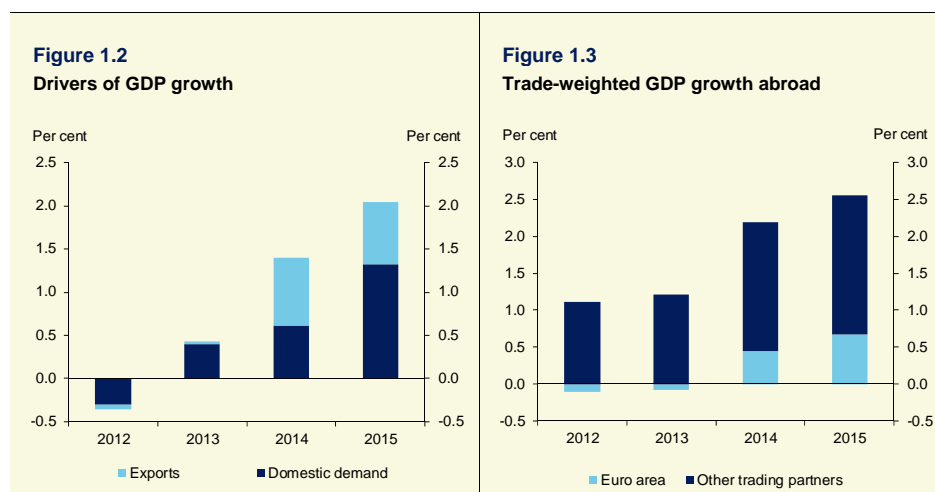
In the wake of the downturn in 2008-09 fiscal policy has been conducted with the aim of ensuring sound public finances while supporting growth and employment as much as possible within the fiscal framework comprised by the Budget Law, the EU recommendation and the EU Fiscal Compact. Denmark has been abrogated from the EU procedure for excessive government deficits, and fiscal policy will continue to be planned in accordance with the Danish Budget Law and EU regulations.

In 2015, when the Danish economy is still some way from having reached full speed, the room to manoeuvre is exploited fully. The structural deficit is expected to correspond to the limit in the Budget Law, and the actual deficit is estimated at the limit in the Stability and Growth Pact. As the economic recovery gains momentum over the coming years, there will be a need to gradually normalise the currently supportive fiscal policy stance and approach government spending levels that are consistent with fiscal sustainability.

It is important for the credibility of the economic policy that loosening of fiscal policy during a downturn is subsequently offset by fiscal tightening, as economic conditions improve. The normalisation of the expansionary fiscal policy should also be viewed in light of the very accommodative monetary policy stance, which implies extraordinarily low mortgage rates.

1.2 The forecast

The expected growth in the Danish economy is primarily driven by rising exports as growth on export markets is strengthening. Private domestic demand also contributes, but it is not expected to gain momentum until somewhat later, as exports pull up employment, capacity utilisation, and incomes, *cf. figure 1.2*.



Note: In figure 1.3, the trade-weighted GDP is divided into contributions from the euro area and from the rest of Denmark's primary trading partners.

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

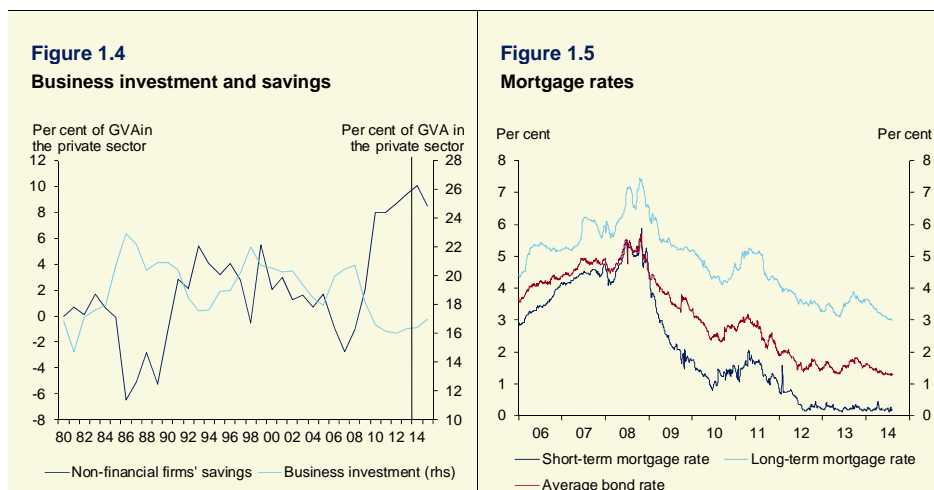
Among major Danish trading partners the recovery is further along, including in the United States, the United Kingdom, and Sweden, and the expansion in these countries seems to be continuing. In the United States, growth is back on track following a temporary slowdown in the beginning of the year due to unusually severe winter weather and a large reduction in inventories. In the United Kingdom the recovery continues unabated. Conversely, the Swedish economy seems to have lost some speed in the first half of the year, however, in the wake of very strong growth towards the end of last year.

Improvements are also present in the euro area, where the recovery continues. Growth is primarily driven by Germany, but Spain has also gained strength in 2014. Other euro area countries, including Italy and France, are finding it harder to restore growth. Although the improvement is modest, the overall impression is that economic conditions in the euro area are improving. Indicators for consumer and business sentiment suggest that the stagnation in the second quarter will be followed by increasing activity in the second half of 2014, when growth in the German economy is also expected to return. The recovery in the euro area is also reflected in unemployment, which seems to have peaked, although it remains at a very high level in many countries. The structural reforms undertaken in recent years and the correction of imbalances have contributed to raising growth potential in the euro area in coming years.

Overall the outlook for the international economy implies that growth in trade-weighted GDP of Denmark's main trading partners is expected to increase from 1.1 per cent in 2013 to 2.2 per cent in 2014 and 2.6 per cent in 2015, *cf. figure 1.3*.

Export growth is supported by improved wage competitiveness since 2008. Domestic wage increases continue to be more moderate than abroad, and in the latest collective bargaining in the private sector modest wage increases were agreed upon. Meanwhile, the competitiveness of Danish businesses is helped along by the tax cuts that are a part of *Growth Plan DK*

and the new growth initiatives in *Growth Package 2014*, which were agreed upon this summer.



Source: Statistics Denmark, The Association of Danish Mortgage Banks, Reuters EcoWin, and own calculations.

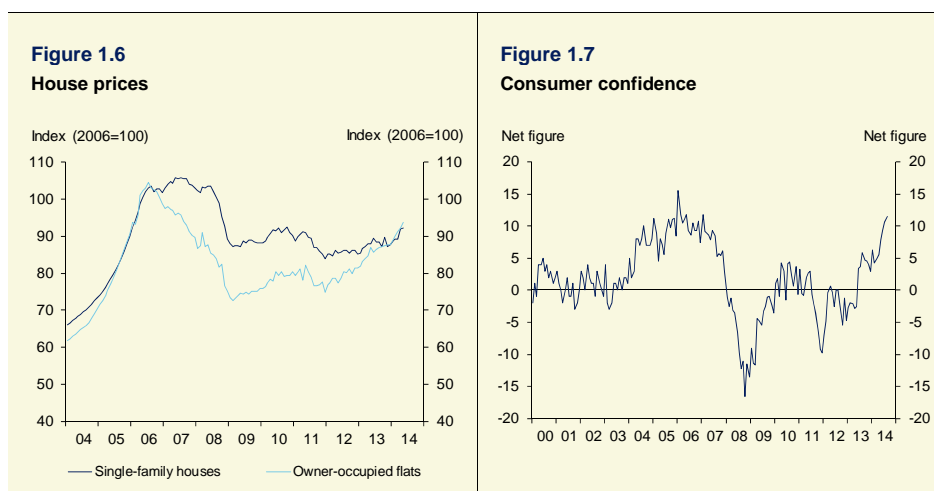
Exports support domestic production and business investments. Business investments have fallen to very low levels during the crisis, *cf. figure 1.4*. As capacity utilisation picks up, the need for new investments increases. In recent years, businesses have built up large savings, providing a significant potential for increasing investments, which are also supported by the continued low interest rates.

Interest rates have trended downward in 2014, partly because of further monetary policy easing in the euro area, which also implies that interest rates are expected to remain low for an extended period. This is also reflected in Danish interest rates, including mortgage rates, which are at historical lows, *cf. figure 1.5*.

The low mortgage rates contribute to strengthening the housing market, which continues to improve with rising prices on both houses and flats, *cf. figure 1.6*. Housing prices have particularly risen in and around the major cities, but there are emerging signs that price gains have begun to spread across the country. Large price increases are particularly seen in the market for owner occupied flats in Copenhagen. However, sales activity remains fairly low – both in Copenhagen and in the rest of the country – and there are no signs that prices in the capital are out of sync with fundamentals, such as the significant population growth.

Private consumption has been relatively subdued through the first half of 2014, partly because of low energy consumption due to a mild winter and a drop in car sales in the second quarter (albeit from a very high level). By contrast, consumer confidence has risen further over recent months and has reached the 2007-level, *cf. figure 1.7*. Consumption is currently low relative to disposable income, and households seem to consolidate their economy to a great extent. This, in turn, strengthens the possibility of a more sustainable recovery of con-

sumption later on. Private consumption is expected to gradually gain speed and grow roughly in line with real disposable incomes. Real disposable incomes will increase this year and the next, partly due to higher employment. Progress in the housing market will also eventually support private consumption and housing investments.

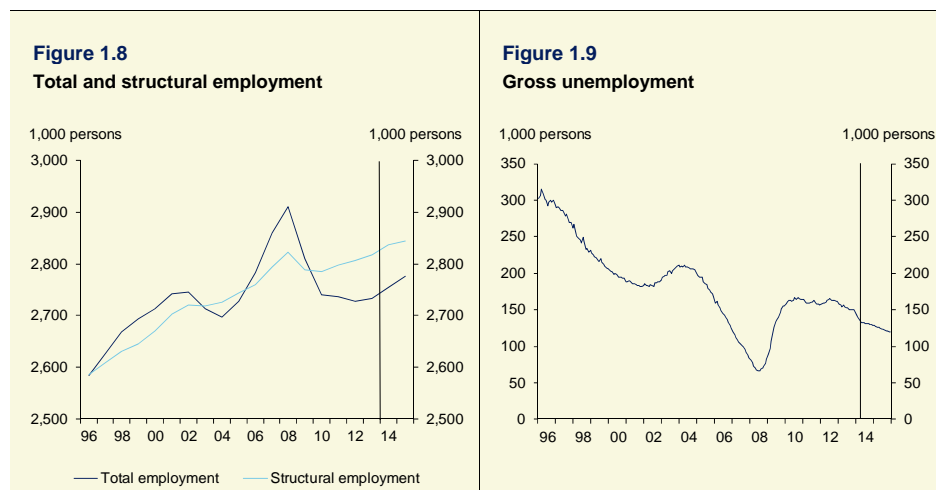


Source: Statistics Denmark and own calculations.

A very low inflation rate supports the current consumption possibilities of households. Inflation next year will be subdued by the rollback of the energy supply tax following the agreement on *Growth Package 2014*. The rollback is financed by an increase in the tax rate on the lower tax bracket and a reduction of the green check. Overall, the restructuring will only have a modest impact on household consumption possibilities.

In the labour market, employment has increased by almost 20,000 persons since the beginning of 2013. Notably younger and older persons have gained employment, cf. section 1.4. Employment is expected to rise further this year and next, particularly in the private sector. The annual growth in private sector employment is expected to be 17,000 and 19,000 persons in 2014 and 2015 respectively. At the same time, an increase in public sector employment is expected, leading to a total increase in employment of 21,000 and 22,000 persons in 2014 and 2015 respectively.

Consequently, employment is now back at the 2006-level – before the overheating of the Danish economy, cf. figure 1.8. In recent years, a number of reforms that increase the labour supply and future growth potential have been agreed upon. The reforms contribute to a well-functioning labour market, allowing for employment to increase over the coming years without causing shortages in the labour market as was seen in the years prior to the downturn in 2008-09.



Source: Statistics Denmark and own calculations.

Unemployment has continued to decline, and overall gross unemployment has been reduced by around 14,000 persons over the first half of 2014. This is partly due to the implementation of the cash benefit reform, which due to technical factors leads to a considerable reduction in the number of young cash benefit recipients registered in the statistics. However, the decline also reflects increased employment. The annual level for gross unemployment is expected to fall further to 126,000 persons in 2015 (4.4 per cent of the labour force) due to the continued improvement in employment, *cf. figure 1.9*.

The overall growth outlook is unchanged from the May forecast

Selected key figures from the forecast can be found in table 1.1, while the annex table present a comparison with the forecast from the *Economic Survey*, May 2014.

Overall, the assessment of the outlook for the Danish economy is unchanged compared to the *Economic Survey*, May 2014. Following a strong start of the year, indicators point to some moderation in demand and production towards the summer, which partly reflects developments in a number of key export markets. However, the overall impression is that the development in the first half of the year has been in line with the projection in the May survey.

The conditions for continued growth through the rest of the year and in 2015 are not assessed to have changed significantly. Forward-looking sentiment indicators generally point towards increasing activity both in Denmark and abroad, and no new factors have emerged to change the outlook for 2015. Accordingly, the overall GDP growth forecast has been maintained, minor adjustments have been made to the composition of demand. Growth in private consumption is estimated to be slightly lower this year, while expectations for investments and exports in particular have been adjusted upwards. This reflects new information about developments during the year to date.

Labour market developments have been slightly better than anticipated, and the annual growth of private employment has been revised upwards by around 5,000 persons in both

2014 and 2015 compared to the assessment in May. Correspondingly, unemployment is expected to fall slightly more than anticipated.

Since the assessment in May no substantial changes to the outlook have occurred. The recovery in the euro area continues, but remains fragile. If growth turns out weaker than expected, it could affect the Danish economy.

The geopolitical tensions related to the situation in Ukraine have increased in recent months. Stricter sanctions towards Russia have been implemented, and Russia has introduced counter-sanctions, which will affect Danish food exports. The impact on overall Danish exports and the growth outlook as a whole is limited. However, a further escalation of the situation could have consequences for the Danish economy, including through increased uncertainty.

The uncertainty associated with the forecast is not solely on the downside. The estimate of growth in domestic demand is fairly cautious and may turn out stronger. This should be seen in light of a significant potential for growth, notably in business investments.¹

New national accounts will not affect the assessment of the cyclical stance and growth prospects

On 15 September 2014, Statistics Denmark will publish new national accounts following the main revision, which implements new common European standards. The new national accounts also include a revision of sources and methods. Preliminary figures suggest that the level for nominal GDP will be revised upwards in the new national accounts. Statistics Denmark has yet to provide information about how the main revision will affect real GDP as a whole and hence real GDP growth.

In conjunction with the revision, a new input-output-based assessment of real growth in the public sector is also implemented. The assessment is based on developments in volume indicators. Preliminary calculations suggest that the growth in real public consumption and hereby real growth in GDP will be higher in the revised national accounts. All things being equal, neither the level of public revenue or expenditure are affected by the new measure of public consumption. This also includes the expenditure ceilings that constitute the upper limit on public spending.

The main revision of the national accounts is not expected to give cause to a significantly different view on the current state of the Danish economy or the recovery. This is because the national accounts revision does not in itself contain new information on the amount of spare capacity in the Danish economy.

¹ *Economic Survey*, May 2014, includes model-based alternative scenarios for the economic prospects under different assumptions about growth in foreign and domestic demand.

Table 1.1
Key figures

	2012	2013	2014	2015
Percentage change from previous year				
Private consumption	-0.1	0.1	1.3	2.1
Public consumption	0.4	0.7	1.3	0.8
Public investment	7.7	-0.7	1.8	-4.6
Residential construction	-8.0	-5.0	3.3	2.5
Fixed business investments	0.8	4.7	1.5	6.0
Stock building (per cent of GDP)	-0.3	0.2	0.0	0.1
Exports of goods and services	0.4	1.0	4.3	4.8
Imports of goods and services	0.9	1.4	4.8	5.3
GDP	-0.4	0.4	1.4	2.0
Level (per cent of GDP)				
General government fiscal balance	-3.9	-0.9	-1.2	-3.0
Current account	6.0	7.3	7.2	7.1
Level, 1,000 persons				
Gross unemployment (annual average)	162	153	135	126
Labour force	2,847	2,847	2,859	2,873
Employment (excl. leave)	2,728	2,730	2,755	2,777
Employment (excl. teacher lockout)	2,728	2,734	2,755	2,777
Rate of change, per cent				
House prices (single-family house)	-3.4	2.7	3.0	3.0
Consumer prices	2.4	0.8	0.8	1.2
Hourly earnings, private sector (Danish Employers Federation statistics)	2.0	1.4	1.8	2.2

1.3 Fiscal policy and public finances

While there are clearer signs of renewed growth in the economy, there are still available resources and a considerable output gap. With the budget proposal for 2015 fiscal policy is therefore planned to fully utilise the room for manoeuvre with deficits that equal the limits in the Danish Budget Law and the Stability and Growth Pact. Thus, the structural deficit is estimated to amount to ½ per cent of GDP in 2015 and the actual deficit is estimated to 3 per cent of GDP.

Expenditures for public consumption and public investments remain high in 2015 – both in a historical perspective and compared to the level that can be sustainably financed. Moreover, monetary policy is highly accommodative and mortgage interest rates very low.

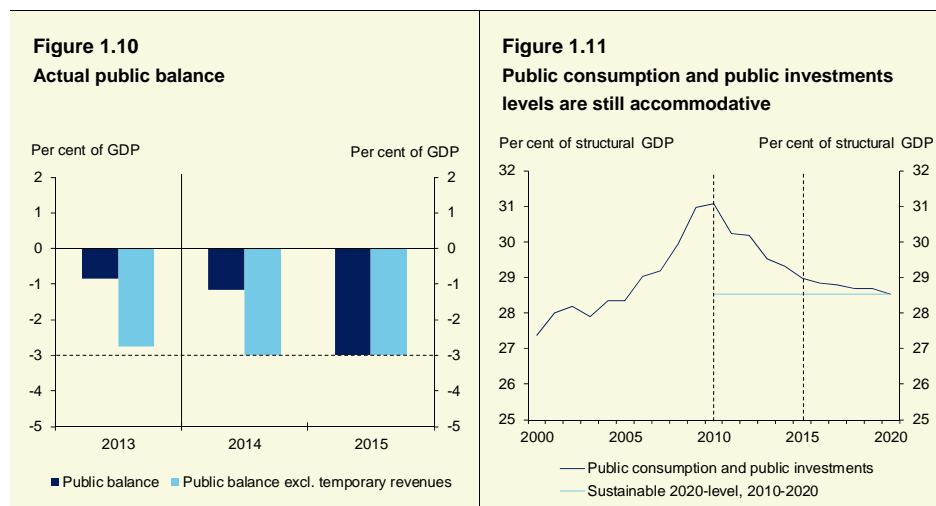
As the economy gains momentum in coming years, progress towards the medium-term target of at least structural balance in 2020 – which is consistent with fiscal sustainability – is needed. The adjustment towards structural balance in 2020 is supported by a new fiscal policy regime with four-year binding expenditure ceilings. In conjunction with the budget proposal for 2015, a bill setting the expenditure ceilings for 2018 is introduced. The expenditure ceilings for 2018 are set based on an updated macroeconomic projection towards 2020. The medium term scenario meets the target of at least structural balance in 2020 and fiscal sustainability and adheres to the limit for structural deficits in the Danish Budget Law.

Fiscal policy and public finances in 2014-15

Following the downturn in 2008-09 fiscal policy has been planned in order to support economic activity as much as possible within the fiscal framework of the Danish Budget Law (2012) and EU requirements. In 2015 the fiscal room for manoeuvre is also fully utilised with an estimated structural deficit of ½ per cent of GDP corresponding to the limit in the Budget Law. A main priority of the budget proposal for 2015 is that public consumption can grow by 0.8 per cent and that public investments remain high. The effort towards increasing productivity and wealth is continued with *Growth Package 2014* (from July 2014), which is fully financed.

The actual deficit is estimated to be 3.0 per cent of GDP in 2015 corresponding to the limit for actual deficits in EU's Stability and Growth Pact. Excluding temporary revenues – primarily from one-off revenues from a restructuring of the taxation of capital pensions – the deficit was close to the 3 per cent limit in 2013 and is estimated to remain so in 2014, *cf. figure 1.10*.

The public deficits also reflect that expenditure policy has been accommodative in a number of years both in a historical perspective and compared to the level that can be sustainably financed, *cf. figure 1.11*. The high consumption and investment levels through the economic crisis have been supporting economic activity. The high level of public investments reflects, among other things, that a number of public investments have been advanced to 2012-14.



Note: In figure 1.10, the public balance excl. temporary revenues shows the balance net of one-off revenues from the one-off revenues from the restructuring of existing capital pensions, revenues from a reallocation in the pension sector from schemes with a guaranteed yield in each year to schemes in which each year's yield reflect market return, and advanced ordinary revenues from the taxation of capital pensions.

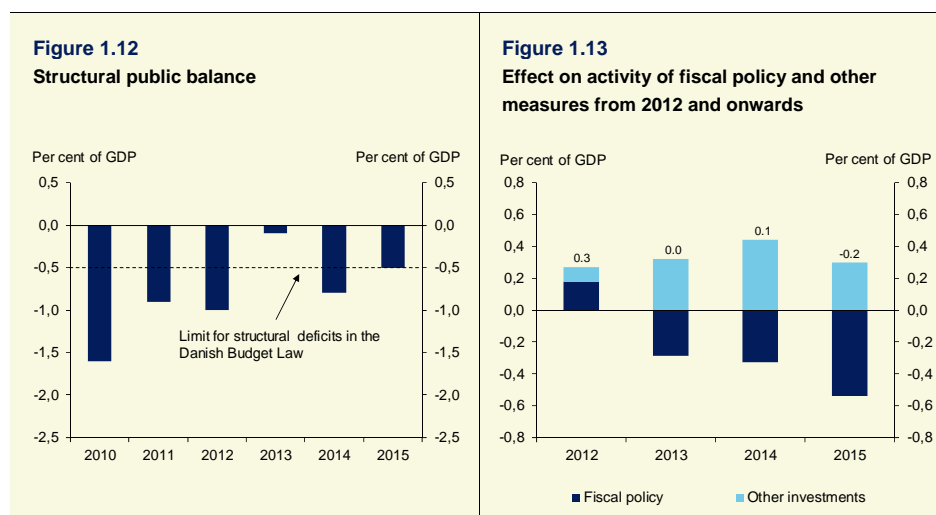
Source: Statistics Denmark and own calculations.

The structural deficit is estimated to amount to 0.5 per cent of GDP in 2015 corresponding to the limit in the Budget Law. The structural balance is estimated to improve from 2014 to 2015, as the structural deficit in 2014 is revised upwards to 0.8 per cent of GDP, *cf. figure 1.12*. Fiscal policy in 2014 was planned in accordance with the requirements of the Budget Law both at the time of the budget proposal for 2014 and when the Budget bill for 2014 was passed. The subsequent upward revisions of the structural deficit in 2014 mainly reflect a downward revision of revenues from personal income taxes due to higher tax deductions for pension payments and lower taxable pension pay outs than expected when fiscal policy for 2014 was planned, *cf. Economic Survey, May 2014*. The new information is included in the estimated structural deficit for 2015.

Compared to the accommodative level in 2011, fiscal policy and other economic policy measures still support the GDP level in 2014 by 0.1 per cent of GDP, *cf. figure 1.13*. The positive contribution reflects that a number of political initiatives supporting activity without directly affecting public finances have been implemented. In 2014 these measures cancel out the impact from the consolidation of public finances from 2010 to 2013 in order to meet the requirements of Denmark's EU-recommendation, which was abrogated in June 2014.

The impact of the implemented fiscal policy expansions – including advanced public investments – subsidies in 2015, when GDP growth is expected to increase to 2 per cent. Compared to the accommodative level in 2011, fiscal policy and other economic policy measures that have been implemented since 2012 have a moderating impact in 2015. Overall, the gradual withdrawal of the accommodative fiscal policy is assessed to be aligned with increased growth prospects and continuously low interest rates. The accommodative monetary

policy contributes substantially to economic activity. The drop in interest rates since 2011 is estimated with uncertainty to support the GDP level by up to 1½ per cent. In total, fiscal policy and the low interest rates continue to contribute to economic activity in 2015 compared to the accommodative level in 2011.



Note: In figure 1.13, other investments cover private investments following the energy agreement, political agreed increases and advancements of investments in social housing, climate-related investments in the waste water sector (*cf. agreement on local governments' economy for 2013*) and advanced activities in Fehmarn Belt agreed upon in *Growth Plan DK*.

Source: Statistics Denmark, 2020-projection, August 2014, and own calculations.

The ongoing normalisation of fiscal policy has to be continued as the economy gains further momentum and gradually recovers in order to reduce public deficits and make progress towards the medium term target of at least structural balance in 2020. The Danish economy is currently in a phase of a recovery following a period with low business activity. Therefore it is important that fiscal policy becomes less accommodative in the coming years, i.e. is gradually tightened. This can allow for a more sustainable upswing and reduce the risk of overheating of the economy as e.g. in the 00'ies.

Medium term scenario towards 2020 and expenditure ceilings for 2018

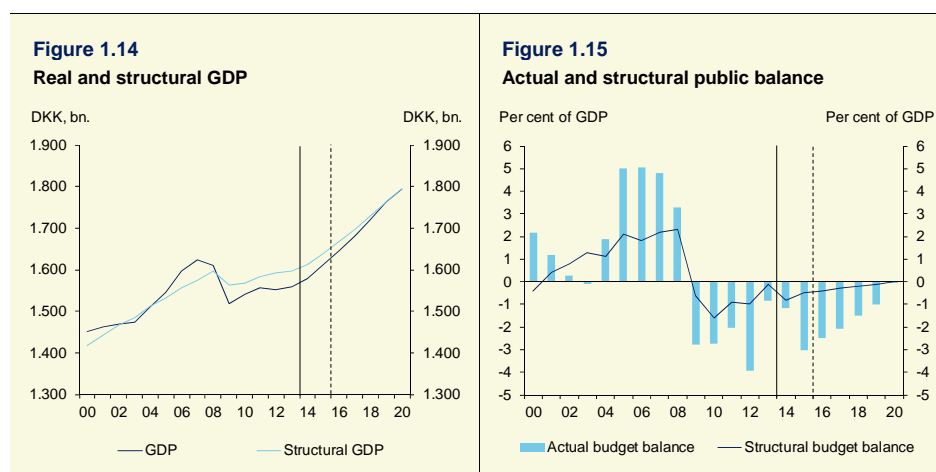
The Danish Budget Law (2012) introduces four-year binding expenditure ceilings for central government, municipalities and regions with effect from 2014. The expenditure ceilings are to underpin that public finances develop in accordance with the medium term targets for public finances, including fiscal sustainability and at least structural balance in 2020.

The expenditure ceilings are set based on a medium term projection for the Danish economy, which adheres to the Budget Law's limit for structural deficits of ½ per cent of GDP and meets the medium target of at least structural balance in 2020. The subsequent annual budget agreements and agreements with local governments and regions must be in compliance with the adopted expenditure ceilings and other requirements in the Budget Law. When determining the expenditure ceilings towards 2020 the aim is to ensure a gradual decline of

the structural deficit from estimated ½ per cent of GDP in 2015 towards structural balance in 2020.

At a general level, expenditure ceilings are set for two types of expenditure types, respectively for *operating costs*, which are primarily controlled by appropriations and for *income transfers*, which are statutory and affected by the number of recipients etc.

The expenditure ceilings for 2018 are determined based on the updated medium term scenario towards 2020. The scenario meets the fiscal targets and, in accordance with the precautionary principle, only reforms and initiatives that have a majority in the Danish Parliament are taken into account. Compared to the medium term scenario presented in *Denmark's Convergence Programme 2014*, the impact of *Growth Package 2014*, the recently agreed-upon employment reform, and the new short term projection have been taken into account. The updated 2020-projection implies that the economy gradually recovers towards 2019, cf. *figure 1.14*, and that fiscal policy is gradually normalised in order to meet the target of at least structural balance in 2020, cf. *figure 1.15*.



Source: Statistics Denmark, 2020-projection, August 2014, and own calculations.

Based on the medium term projection, real public consumption can grow annually by 0.6 per cent on average up until 2020, cf. *table 1.2*. This amounts to a total real growth of public consumption (excl. depreciations) of DKK 20 bn. from 2014 to 2020. Together with the projection of a number of other operating costs, the real growth of public consumption implies that the expenditure ceilings for operating costs in central government, local governments, and regions can grow by approx. 0.6 per cent in 2018, cf. *box 1.1*.

Table 1.2
Selected key figures for the Danish economy from the updated 2020-projection

	Short-term forecast		Medium-term scenario	
	2014	2015	2016-19 ¹⁾	2020
GDP growth, per cent	1.4	2.0	2.3	1.9
Growth in employment, per cent	0.8	0.8	1.2	0.6
Registered gross unemployment, per cent of labour force	4.7	4.4	3.6	3.3
Real growth of public consumption, per cent	1.3	0.8	0.6	0.6

1) Average for the four years.

Source: 2020-projection, August 2014 and own calculations.

Box 1.1

Ceilings for operating costs in 2018: Still room for a real growth of public consumption of 0.6 per cent

The operating costs covered by expenditure ceilings in central governments, local governments, and regions include a wide range of public expenditures in areas such as social services and health care. Therefore the expenditures covered by the ceilings for operating costs mainly consist of expenditures that are categorised as public consumption in the national accounts. The ceilings for operating costs also include a number of other expenditure types such as corporate subsidies, EU-contributions, and official development assistance.

In the medium term projection, which the expenditure ceilings for 2018 are based on, there is room for real growth of public consumption of 0.6 per cent of GDP in 2018. The ceilings for operating cost can in total grow by 0.6 per cent compared to the ceilings in 2017, *cf. table a*.

The available growth of operating costs is as a starting point placed under the sub-ceiling for central government. This was also the case when the expenditure ceilings for 2014-17 were determined. In connection with the yearly negotiations with local governments and regions of next year's budget it is possible to allocate resources to local governments and regions via cost-neutral reallocation within the established ceilings.

Table a
Expenditure ceilings for operating costs, 2015-2018

	2015	2016	2017	2018
DKK bn., 2015 prices				
Central government sub ceiling for operating costs	191.0	192.5	196.4	199.9
Local government expenditure ceiling	234.7	234.7	234.7	234.7
Regional sub ceiling for health expenditures	104.7	104.7	104.7	104.7
Regional sub ceiling for development expenditures	3.0	3.0	3.0	3.0
Total operating costs covered by expenditure ceilings	533.4	534.9	538.8	542.3

Source: Budget Proposal for 2015, 2020-projection, August 2014 and own calculations.

The expenditure ceilings for central government income transfers include the share of expenditures covered by central government for a number of income transfers, including the public old age pensions scheme, sickness benefits, voluntary early retirement pay scheme, and the anticipatory pension scheme. Unemployment related expenditures such as unemployment benefits, which are highly cyclical, are not covered by the ceilings in order to allow for automatic stabilisers to work.

In 2014-17 central government expenditures for income transfers covered by the ceiling are currently estimated to be DKK 3 to 5 bn. (equalling approx. 1-2 per cent of the expenditures covered by the ceiling) lower than the current sub-ceiling (excl. the buffer reserved for fluctuations). The downward revision of the expenditures for income transfers covered by the ceilings reflects, i.a., lower estimated expenditures for old age pensions, anticipatory pensions, and voluntary early retirement. The expenditures covered by the ceiling for income transfers is expected to decline from 2017 to 2018, reflecting the reform of retirement age, which increases the age for early retirement to 62½ years in 2018, and the impact of other reforms including lower indexation of public income transfers in the tax reform from June 2012.

The lower estimated expenditures for income transfers reflect that there is uncertainty associated with the projection of the statutory benefits. Therefore, the central government sub-ceiling for income transfers in 2018 contains a larger reserve for unforeseen expenditures, *cf. box 1.2*. This is in accordance with the Budget Law, which states that a reserve for unforeseen expenditures under the central government sub-ceiling for income transfers should gradually be build. The designated fluctuation buffer under the sub-ceiling for central government income transfers cannot be reallocated to the expenditure ceilings for operating costs.

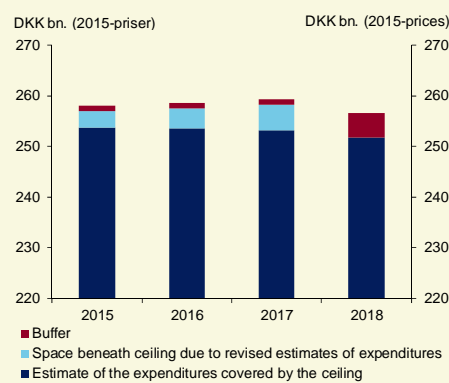
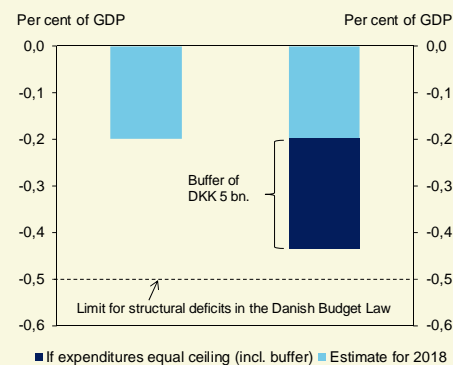
The medium term scenario and relevant considerations of the size of the designated fluctuation buffer etc. are described in further detail in a documentation paper (*Opdateret 2020-forløb: Grundlag for udgiftslofter for 2018*, available in Danish on www.fm.dk). The concrete determination of the expenditure ceilings for 2018 is described in further detail in *Dokumentation for fastsættelse af udgiftslofter for 2018* (available in Danish on www.fm.dk).

Box 1.2**Sub-ceiling for income transfers in 2018: Larger reserve for unforeseen expenditures**

The sub-ceiling for income transfers is set in accordance with the medium term scenario. As a starting point the ceiling corresponds to the budgeting in 2018 of the central government's share of expenditures for the income transfers covered by the ceiling on the budget proposal for 2015. A designated buffer for fluctuations is added. The buffer reflects that income transfers are statutory and that the budgeting is subject to uncertainty due to, i.a., fluctuations in the number of recipients.

The fluctuation buffer was set to DKK 1 bn. when the expenditure ceilings for 2014-17 were set (corresponding to approx. 0.4 per cent of the expenditures covered by the ceiling). The Budget Law states that the reserve for unforeseen expenditures should gradually be increased. The uncertainty is e.g. evident from the current estimates of the expenditures covered by the ceiling for income transfers, which are revised downward by approx. 2 per cent compared to the established ceiling, *cf. figure a*. Based hereon, the fluctuation buffer is increased to DKK 5 bn. in 2018 corresponding to approx. 2 per cent of the expenditures covered by the ceiling for income transfers. The designated fluctuation buffer cannot be reallocated to the expenditure ceilings for operating costs.

In the updated medium term scenario, which includes the estimated expenditures for income transfers etc., the structural deficit is estimated to approx. 0.2 per cent of GDP in 2018, *cf. figure b*. If the expenditures covered by the ceiling exceed the current estimate – and thereby utilise the designated fluctuations buffer – it will as a starting point imply a similar weakening of the structural balance (although there is not necessarily a one-to-one relationship between the expenditures covered by the ceiling and the impact of the structural balance). On the current basis, a full utilisation of the fluctuation buffer in 2018 will as a starting point be in adherence with the Budget Law's limit for structural deficits of ½ per cent of GDP.

Figure a**Expenditure ceilings for income****Figure b****Structural budget balance in 2018**

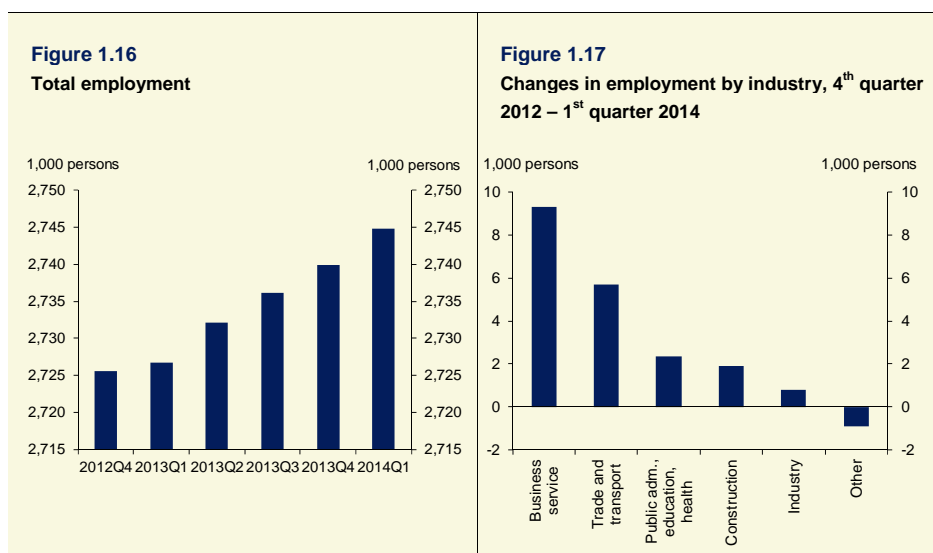
Note: In figure a, the estimate of the expenditures covered by the expenditure ceiling for income transfers in 2015-18 is based on the budget proposal for 2015 corrected for a cyclical change in expenditures for student grants and a separate estimate of the expenditures for family allowance, which is not budgeted multiannually.

Source: Budget Proposal for 2015, 2020-projection, August 2014 and own calculations.

1.4 More job creation

The labour market has improved over the past year and a half. Employment has increased for five consecutive quarters by an accumulated 19,000 persons overall, *cf. figure 1.16*. That is the longest period of employment growth since the onset of the crisis. At the same time unemployment has declined. This applies to both the register based gross unemployment and the survey based LFS-unemployment, as both measures have declined for the past couple of years.

The increase in employment has mainly taken place within the private service sector, in particular within *business services* and *trade and transportation*, *cf. figure 1.17*. *Business services* cover a wide variety of activities ranging from legal services and architectural services to cleaning. Employment has also increased within *public administration, health, and education*, which covers both the public and the private sector.



Note: In figure 1.16 there is an estimated adjustment for the teacher lockout, which reduced the employment by around 16,000 persons in the second quarter 2013. Other industries in figure 1.17 include agriculture, utilities, mining and quarrying, culture, leisure, and other services as well as finance and insurance. The decline in employment during the period can mainly be attributed to lower employment in finance and insurance.

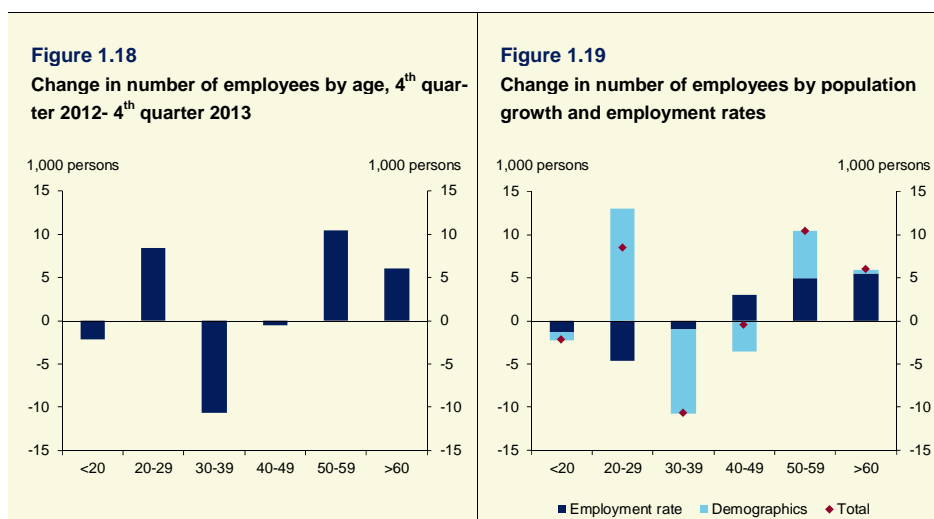
Source: Statistics Denmark and own calculations.

Employment has increased particularly among persons below 30 and above 50 years of age, *cf. figure 1.18*. This is evident from Statistics Denmark's register of wage earner employment at the individual level, which contains information up to and including the fourth quarter of

2013.² Employment among 20-29 year olds has increased by 8,000 persons during the course of 2013, while the increase for people above 50 has been of some 16,000 persons. At the same time there has been a decline in the employment for people in their thirties.

Parts of these changes are solely due to demographic developments. For example, the fall in employment among 30-39 year olds was predominantly due to a decline in the size of the population within this age group. The employment rate – that is, the share of the 30-39 year olds, who are employed – was largely unchanged, *cf. figure 1.19*. Conversely, there was a significantly larger number of persons aged 20-29, and that is the reason why employment among 20-29 year olds has increased.

Changes in employment rates are of particular interest, because this is an indicator of the labour market attachment of the population. Thus, the unchanged employment rate among 30-39 year olds illustrates that persons within this age group are employed to the same extent as a year earlier. This, however, is not the case for persons aged less than 30 and older than 50 years. The young persons are employed to a lesser extent, while the above 50 year olds increasingly participate in the labour market.

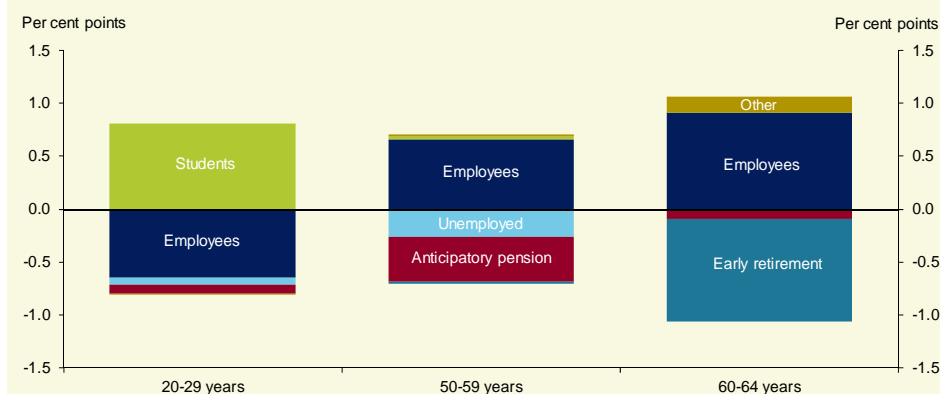


Note: In addition, approximately 1,000 more employees who do not live in Denmark.

Source: Statistics Denmark, Law Model, and own calculations.

² Statistics Denmark's register of wage earner employment shows an increase in wage earners by 12,500 persons from the fourth quarter of 2012 to the fourth quarter 2013. According to the register the increase in wage earner employment has been slightly smaller than the increase in the national accounts. The difference is a consequence of the two statistics being based on different sources and having different definitions. Historically the development in the national accounts and in the register of wage earner employment has been very consistent, albeit the levels differ. It should be noted that the register of wage earner employment also differs from Statistics Denmark's accounts of employment for wage earners, which measures the development in full-time employment.

Figure 1.20
Change in labor market rates for selected age groups, 4th quarter 2012 – 4th quarter 2013



Note: Persons, which in a given month are registered with paid hours equal to at least 1.5 hours per week in the register of employment for employees, are categorised as employees. Employees cover both ordinary employment and supported employment, including wage subsidies, flexi-job, light jobs, etc. Persons who are not categorised as employees are classified by labour status in the last full week of the month according to DREAM. Persons who appear both as employees and benefit recipients (eg. early retirement, unemployment benefits, or anticipatory pension) will thus be classified as employees. Other covers for instance pensioners and self-employed.

Source: Law Model, DREAM-registry, and own calculations.

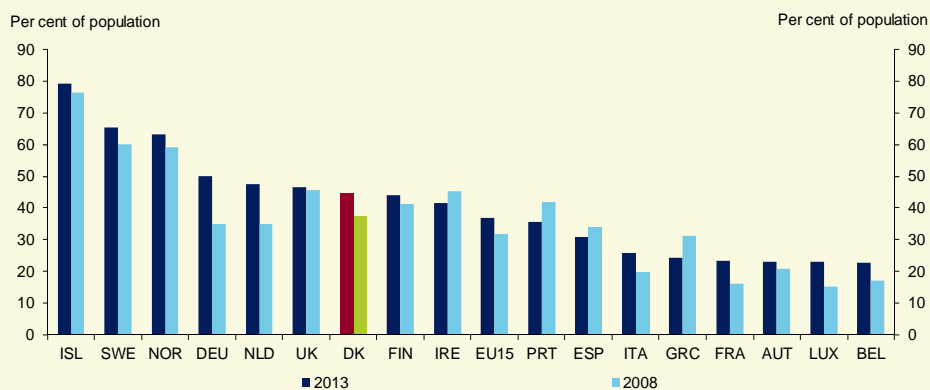
The smaller share of young persons with a job reflects that people within this age group to a greater extent are in an education programme and work less, *cf. figure 1.20*.

On the contrary, the increase in employment among persons above the age of 50 reflects an increase in the share of this age group, who are employed. Hence, the employment rate has increased for the 50-59 year olds as well as the above 60 year olds, *cf. figure 1.19*.

For the 50-59 year olds the increase in the employment rate is matched by a decrease in the share of the age group that receives anticipatory pensions, unemployment benefits, and cash benefits. The latter should be viewed in the context that unemployed persons within the unemployment benefit system, who have less than five years remaining until the early retirement age, are entitled to a senior job when their unemployment benefit eligibility expires.

The increase in the employment rate for the 60-64 year olds can be explained almost entirely by the fact that more persons within this age group have remained in the labour market rather than retire early. This is a continuation of the trend of recent years, when the labour force participation rate has increased for persons above the age of 60. This development should be viewed in context of increasing life expectancy, better health, and the political reforms that have been implemented. However, the same trend can be seen in many other countries, and Danish employment and participation rates for this age group remain below those in a number of other countries, in particular the other Nordic countries, *cf. figure 1.21*.

Figure 1.21
Employment rate (LFS) for 60-64 year olds in the EU15, Iceland and Norway



Note: The figure shows the interview based labour force survey and is subject to associated sampling errors.

Source: Eurostats Labour Force Survey (LFS).

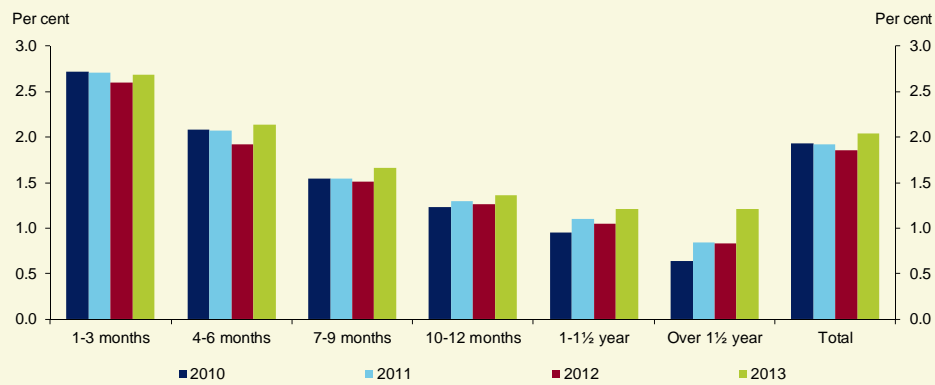
Underlying the change in the number of employed are large gross flows in and out of employment and between jobs. Over the course of a year a significant number of people change jobs, some retire, and others graduate or enter into training, or something else. These flows are summarised by the so-called job mobility, which measures how many people get a new job during a certain period. Generally, job mobility is high in Denmark. This has also been the case during recent year's weak business cycle. In 2013 alone, more than 500,000³ persons – almost 20 per cent of total employment – found a new job, of which some were previously unemployed.

When there is a general tendency for large flows, both between jobs and in and out of employment, it is easier for the unemployed to gain employment, as many new job openings arise. In 2013, a larger proportion of the gross unemployed found a job than in previous years, *cf. figure 1.22*. This was the case both for gross unemployed, with short and longer unemployment spells, but particularly for unemployed persons, who have experienced more than 1½ years of unemployment. This trend reflects improvements in the overall state of the Danish economy, but should also be viewed in light of the unemployment benefit reform, the cash insurance reform, and probably also the senior job scheme.

³ Based on a Labour Force Survey of how many persons have had their job for less than a year.

Figure 1.22

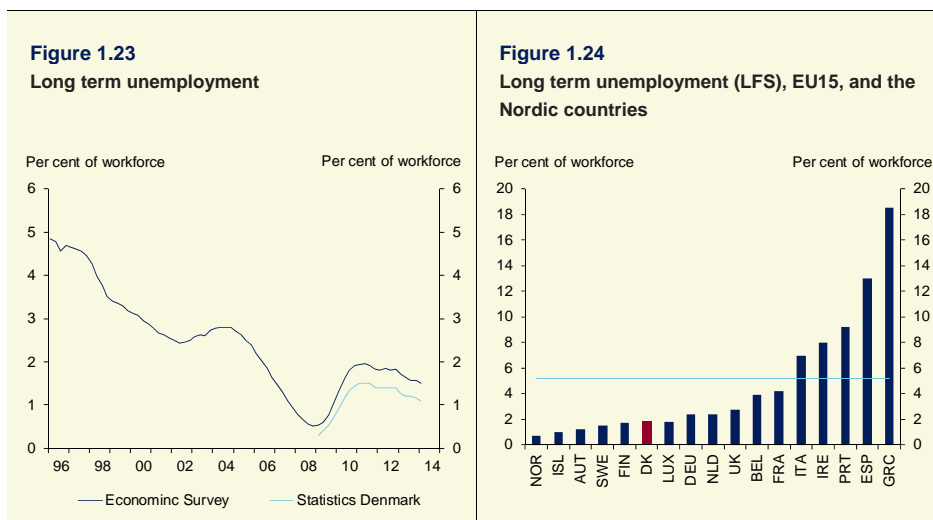
Departure rate from gross unemployment to employment, broken down by duration of unemployment



Note: The length of the unemployment periods are calculated based on a departure criterion of four consecutive weeks of employment.

Source: DREAM-database and own calculations.

The flow from unemployment to employment has helped to reduce long-term unemployment further, *cf. figure 1.23*. Today, long-term unemployment constitutes around 1½ per cent of the total labour force. Generally, Danish long-term unemployment is relatively low, both from a historical perspective and compared to other countries, *cf. figure 1.24*.

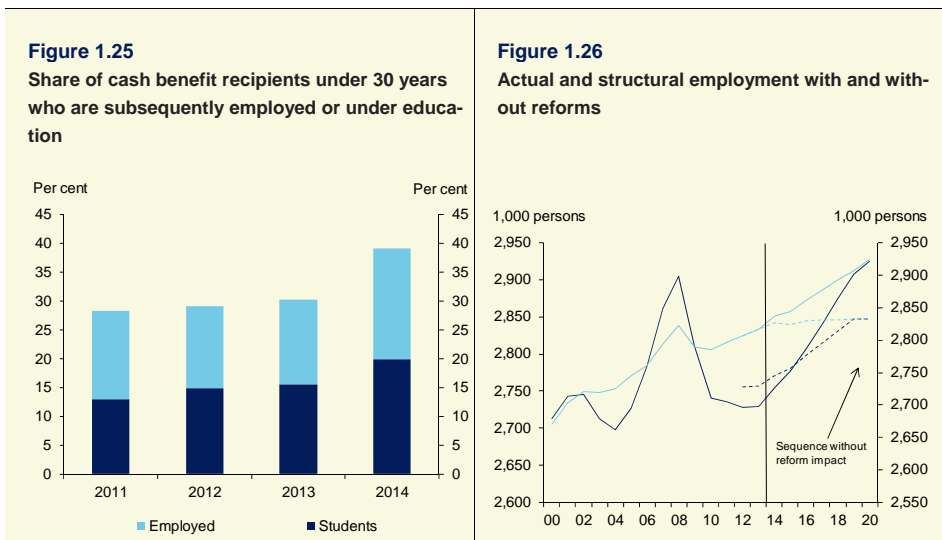


Note: Long term unemployment in the Economic Survey is calculated as persons who have received unemployment benefits, cash benefits, holiday pay, or participated in activation of at least 80 per cent of the time within the last 12 months. Statistics Denmark uses a different definition cf. *Economic Survey*, May 2014. The long term unemployment in figure 1.24 is based on the interview based labour force survey (LFS) and is not comparable with the long term unemployment based on register data. The blue line indicates the average for the EU15.

Source: Statistics Denmark, Eurostat, and own calculations.

As economic conditions improve further, employment opportunities will also increase, and it will help reduce both general unemployment and long-term unemployment going forward. The cash benefit reform will also contribute to increased youth employment. There are already indications that more young cash benefit recipients have either gained employment or entered education as a result of the reform. Approximately 40 per cent of the young cash benefit recipients, who were unemployed by the end of 2013, had either found a job or had started training/education (eligible for a state education grant) by April 2014, cf. figure 1.25. That is around 10 percentage points more than in previous years, indicating that the reform has contributed to increasing employment and training activity among young persons. This helps to reduce unemployment and to improve the ability for young people to gain a foothold in the labour market.

The cash benefit reform trails a series of reforms that have been undertaken in recent years in order to assure a well-functioning labour market and increase the labour supply, cf. figure 1.26. These include the reform of the retirement age, the tax reform from 2012, and most recently, the employment reform from 2014. The reforms form the basis for a sustainable recovery of the Danish economy towards 2020 and help to ensure that wage competitiveness does not deteriorate as a result of labour shortage and wage pressure.



Note: Figure 1.25 shows the percentage of employable cash benefit recipients aged 16-29 by December the previous year, who have entered into employment or education prior to week 17 (April) in the current year.

Source: Statistics Denmark, the DREAM database, Ministry of Finance, and own calculations

1.5 Appendix

Table 1.3
Key figures compared to the May Survey

	2013	2014		2015	
		May	Aug.	May	Aug.
Real growth, per cent					
Private consumption	0.1	1.7	1.3	2.0	2.1
Total public demand	0.6	1.2	1.4	0.2	0.4
- public consumption	0.7	1.2	1.3	0.9	0.8
- public investment	-0.7	0.7	1.8	-7.9	-4.6
Residential investments	-5.0	3.3	3.3	2.2	2.5
Fixed business investments	4.7	0.7	1.5	6.0	6.0
Final domestic demand	0.4	1.5	1.4	1.9	2.0
Stock building (per cent of GDP)	0.2	0.0	0.0	0.0	0.1
Total domestic demand	0.6	1.5	1.5	1.9	2.1
Exports of goods and services	1.0	3.8	4.3	4.8	4.8
- of which manufactures	1.6	5.2	5.2	6.1	6.1
Total demand	0.7	2.4	2.5	3.0	3.1
Imports of goods and services	1.4	4.3	4.8	4.9	5.3
- of which goods	3.4	4.1	3.9	4.2	4.9
GDP	0.4	1.4	1.4	2.0	2.0
Gross value added	0.5	1.7	1.7	1.8	1.8
- of which private sector	1.7	2.4	2.3	2.6	2.6
Change in 1,000 persons					
Labour force	1	5	12	11	14
Employment	2	20	25	17	22
- of which private sector	7	12	17	14	19
- of which public sector	-5	8	8	3	3
Employment excl. teacher lockout	6	16	21	17	22
- of which public sector	-1	4	4	3	3
Gross unemployment (registered)	-9	-16	-18	-7	-9
Net unemployment (registered)	-1	-16	-14	-6	-8

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

	2013	2014		2015	
		May	Aug.	May	Aug.
Growth, per cent					
Merchandise export prices	-0.5	0.8	0.3	1.5	1.3
Merchandise import prices	-2.2	0.3	0.0	1.5	1.4
Merchandise terms of trade	1.7	0.4	0.2	0.0	-0.1
House prices, single-family houses	2.7	2.5	3.0	2.5	3.0
Consumer prices	0.8	0.9	0.8	1.6	1.2
Hourly compensation	1.4	2.0	1.8	2.2	2.2
Real disposable income, private sector	0.5	2.1	1.6	5.2	5.9
Real disposable income of households ¹⁾	1.0	3.5	3.7	1.5	1.2
Productivity in a private non-agricultural sector	3.1	1.7	1.4	1.8	1.4
Per cent per year					
Interest rate 1-year adjustable rate loan	0.2	0.3	0.2	0.6	0.4
10-year government bonds	1.8	1.9	1.7	2.5	2.0
30-year mortgage credit bond	3.5	3.6	3.3	4.2	3.7
Balances					
Current account (bn DKK)	136.0	134.5	136.3	143.0	140.2
General government fiscal balance (bn DKK)	-15.8	-26.7	-22.1	-58.4	-59.9
Gross unemployment (thousands)	153	137	135	130	126
Gross unemployment (per cent)	5.4	4.8	4.7	4.5	4.4
Net unemployment (thousands)	118	102	104	96	96
Net unemployment (per cent)	4.1	3.6	3.6	3.3	3.3
External assumptions					
Trade-weighted GDP abroad, per cent	1.1	2.3	2.2	2.5	2.6
Export markets for Danish manufactures, per cent	1.0	5.8	5.5	6.5	6.4
Exchange rate, DKK per \$	5.6	5.4	5.4	5.4	5.5
Oil price, \$ per barrel	108.6	108.9	108.3	113.1	110.9
Oil price, DKK per barrel	610.2	589.1	594.1	610.3	613.4

Source: Statistics Denmark and own calculations.