

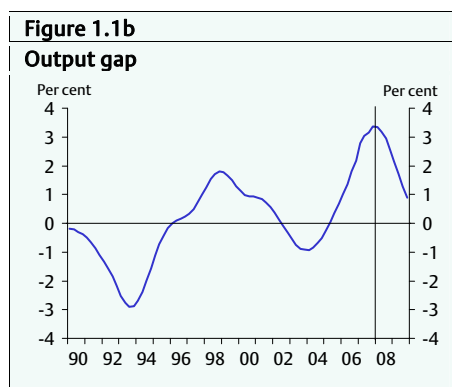
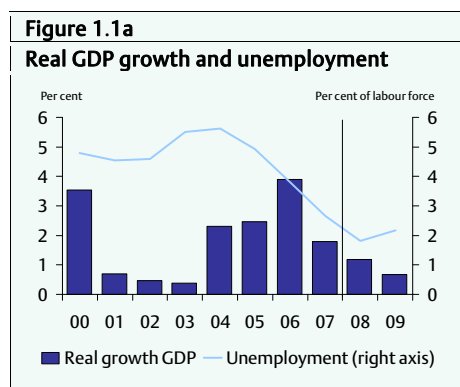
Economic Survey May 2008 – English Summary

Short term outlook

The Danish economy is in the late stages of a strong cyclical upturn. Despite surprisingly strong growth in domestic demand in late 2007, including 4½ per cent annual growth in private consumption, the current international financial turmoil and slowing global growth have improved the odds that the very tight conditions in the Danish labour market will ease.

Output growth in Denmark slowed in 2007 after strong expansion in recent years. In 2008 and 2009, growth is expected to slow further to 1¼ per cent and ¾ per cent, respectively. A downward adjustment in growth expectations since the February survey reflects a weakening housing market, reduced growth abroad, weakened competitiveness and higher inflation, with especially strong increases in energy prices. The slowdown in the pace of activity will lead to a small increase in the unemployment rate from the current historically low level of just below 2 per cent of the labour force, *cf. figure 1.1a*.

Capacity pressures and the risks of a more prolonged increase in inflation appear to have increased since the February survey, but the cooling-off of the Danish economy may occur earlier than previously expected due to the slowing international economy. Capacity pressures, as measured by the output gap, are expected to ease in the forecast period from almost 3½ per cent to 1 per cent of GDP, *cf. figure 1.1b*.

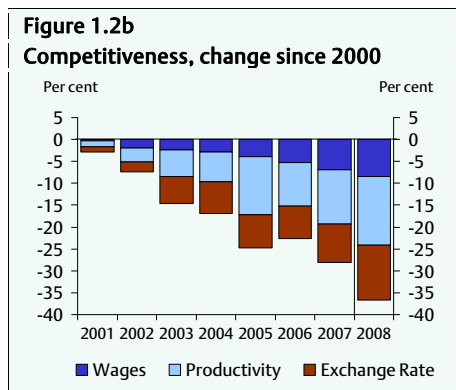
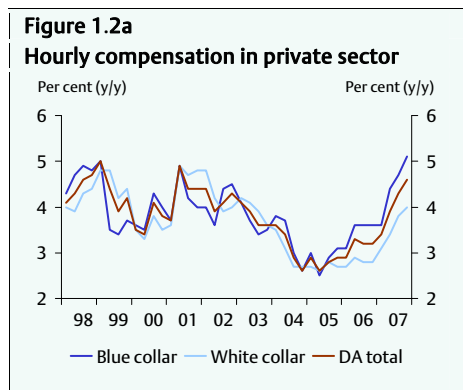


Source: Statistics Denmark and own estimates.

The expected slowdown in Danish economy is to be seen as a normalisation in a situation where there are clear signs of excessive capacity pressures. The reduction in unemployment has continued with undiminished strength and unemployment is now considerably below the estimated structural unemployment rate (the rate at which unemployment is considered consistent with stable wage and price developments).

Hourly earnings growth has thus accelerated, reaching 5 per cent for workers in the private sector by late 2007, cf. *figure 1.2a*. High earnings growth is also expected in the public sector over the next years. The renewed public sector wage contracts imply annual wage growth rising gradually towards 5½-6 per cent through 2008, after which growth in hourly earnings is expected to slow, with a profile which will to some extent depend on wage developments in the private sector.

Strong wage growth has contributed to the pronounced weakening in Danish competitiveness since 2000. Including developments in productivity and exchange rates, wage-competitiveness is estimated to have worsened by more than 35 per cent up to 2008, cf. *figure 1.2b*. Deteriorating competitiveness is causing market share losses for Danish producers, both in domestic and foreign markets. Labour costs in Danish manufacturing are now higher than in all other OECD-countries, except Norway.



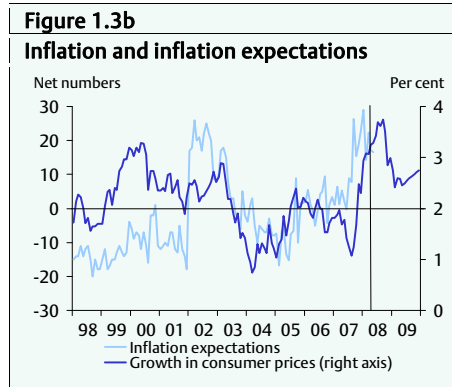
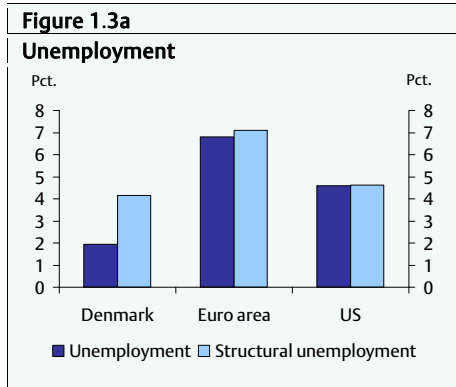
Note: DA-total in figure 1.2a refers to all positions covered by The Confederation of Danish Employers (DA).
 Source: DA, Statistics Denmark, ADAM and own calculations.

It is therefore important that total demand growth now abates, so that the pressure on wages and prices can be reduced. Even as output growth slows, the level of activity and demand for labour will be high for some time, and lessons from earlier upturns indicate that wage growth can stay high for some time after activity decelerates.

Weaker cyclical conditions in the coming years will not be a sign of crisis but imply a gradual normalisation of capacity pressures, required to secure a stable development in the Danish economy in the longer term. Due to extraordinarily low unemployment and very high capacity utilisation, the cyclical position of the Danish economy is quite different from the euro area or the United States, where the starting point around the turn of the year was a level of activity close to potential and capacity pressures close to neutral cf. *figure 1.3a*.

The risk of a more unbalanced development is dampened by initiatives that improve the availability of qualified labour, including from abroad. Labour market reforms and access to foreign labour have reduced wage pressures and extended the current

cyclical upswing. Reforms, with the recent Job Plan as the latest initiative, have allowed the unemployment rate to decline more before competitiveness pressures arise.



Note: In figure 1.3a unemployment for Denmark is for the first quarter of 2008, while the numbers for the euro area and the Unites States are for 2007.

Source: OECD, Statistics Denmark and own estimates.

Inflation has been on the rise and reached 3¼ per cent in March, mainly due to rising prices on food and energy, *cf. figure 1.3b*. Inflation is expected to reach almost 4 per cent this autumn and then to gradually fall back towards below 2 per cent, which by way of the stable exchange rate policy is the natural anchor for inflation expectations in Denmark.

The projected development in prices assumes that the currently high inflation rate does not affect wage settlements to a noticeable degree, and thus that a wage-price spiral is not set off, which would further reduce competitiveness and give rise to a more protracted rise in inflation and inflation expectations. Given agreed wage settlements and the expected outcome of local wage settlements, real wage growth is projected to be rather high towards 2010 in both the public and the private sector. The recent rise in inflation is to be seen against the background of low inflation the last few years. On average, inflation in the period 2003-09 is thus expected to be around 2 per cent.

	2007		2008		2009	
	Feb.	May ¹	Feb.	May	Feb.	May
Real growth²⁾, per cent						
Gross domestic product	1.9	1.8	1.4	1.2	1.0	0.7
Private consumption	2.2	2.5	2.0	2.6	1.4	1.3
Public consumption ³⁾	1.4	1.7	1.5	1.3	1.0	1.2
Export markets, manufactures	6.8	7.8	6.2	5.0	6.2	4.6
Per cent of GDP						
Public budget balance	4.5	4.5	3.8	4.1	2.8	2.9
Current external account	1.3	1.1	0.6	0.4	0.9	0.7
1,000 persons						
Increase in overall employment	44	51	5	17	-17	-17
Unemployment ⁴⁾	79	77	67	53	76	62
Per cent increase						
House prices, single-family house	3.0	4.5	0.0	-2.0	0.0	0.0
Consumer prices	1.7	1.7	2.6	3.3	2.4	2.6
Hourly compensation, private sector	4.6	4.1	4.8	4.9	4.7	4.8
Yield on 10-year government bonds	4.3	4.3	4.3	4.3	4.5	4.6
Oil price, \$ per barrel	72.4	72.8	88.5	104.8	85.2	104.1
Exchange rate, DKK per \$	5.4	5.4	5.1	4.8	5.1	4.7
Oil price, DKK per barrel	394.3	396.3	449.1	503.4	432.4	494.2
<p>1) The figures for 2007 are now based on statistics.</p> <p>2) The real growth rates of the macro variables are calculated using chain indices.</p> <p>3) Real growth of public consumption reflects growth in inputs, not improvements of output and is therefore not readily comparable to private consumption growth.</p> <p>4) The method, by which the unemployment rate is estimated, has been revised since the February survey. This has led to a downward revision in the number of unemployed by 14,000 persons. The numbers from the February survey has been adjusted, taking the revision into account.</p>						

Fiscal policy and public finances

The essential challenge for economic policies in Denmark right now is to avoid unnecessarily expansionary policies that would prevent an easing of capacity pressures in the time ahead. Even with very weak growth in total demand and rising unemployment, there will still be pressure on wages and competitiveness will deteriorate further for the next 1-2 years. This pressure on wages and competitiveness will be exacerbated if continued strong demand keeps unemployment at the current level, thereby increasing the risk of an even higher rise in unemployment in the slightly longer term.

The estimated demand impact of fiscal policy for 2008 has been reduced somewhat since the February survey. This is primarily due to lower growth both in public consumption and public investments, which is to be seen in light of higher growth in public spending in 2007.

In total, fiscal policy is now estimated to add a demand stimulus of 0.0 per cent of GDP in 2008. This impact has been scaled back from 0.2 per cent in the February survey. The added demand stimulus for 2007 and 2008 taken together is 0.1 per cent higher than in the February survey.

Public finance estimates for 2008 are based on the 2008 budget bill and imply that local and regional budgets for 2008 are adhered to. They also include the agreement on reduced taxation of labour income as well as the results of public sector wage bargaining, as they are currently available. Economic policy assumptions for 2009 are rooted in the 2015-plan and include the reintroduction of contributions to the Special Pension scheme (SP) in line with current legislation. The full set of fiscal priorities for 2009 will be determined in connection with the budget proposal for 2009 due to be released in August.

At this juncture it is essential that any new initiatives do not, on balance, increase demand further and that public expenditures do not exceed what has been planned. In order to avoid slippage in public spending, the government has put forward draft legislation to the effect that government grants to local authorities will be reduced if the local budgets are not respected. Legislation has also been put forward to strengthen expenditure discipline after 2009.

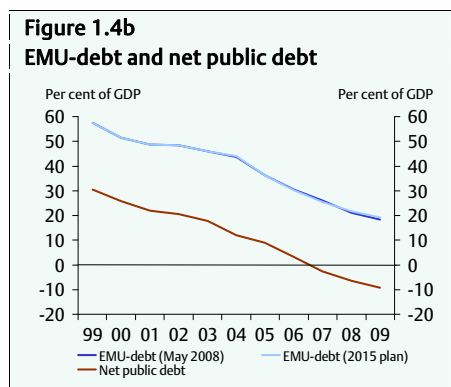
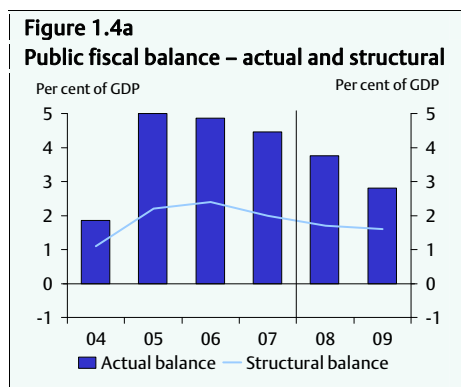
The demand impact from fiscal policy should be seen in conjunction with initiatives which may increase the labour supply over the next years and thereby soften labour market pressures. The 2006 Welfare Agreement, the 2008 Job Plan and the 2007 agreement on Lower tax on labour are estimated to raise labour supply by some 20-25,000 persons (full time equivalents) from 2007 to 2010.

Monetary conditions have been relatively easy given Danish cyclical conditions, since the cycle has been stronger in Denmark than in the euro area. Interest rates have risen from their very low levels in 2004 and 2005. Higher interest rates are dampening demand growth, particularly since they have curbed the very strong house price growth of recent years. While fiscal policy is expected to give neutral stimulus to demand in 2008, the rising interest rates are expected to slow activity in 2008. The expected negative contribution from interest rates has increased since the February survey due to higher lending rates associated with the financial turbulence.

The general government surplus reached 4.5 per cent of GDP in 2007, while the surpluses in 2008 and 2009 are estimated at 4.1 per cent and 2.9 per cent respectively, *cf. figure 1.4a*. The gradually declining government surplus is in accordance with the profiled range in the 2015-plan.

The high surpluses are underpinned by the current cyclical position with high employment, low unemployment and a relatively high level of private consumption. These are all factors contributing to the high surpluses, as the working of automatic stabilisers evens out economic fluctuations. High revenues from corporate taxation and oil and gas extraction in the North Sea also add to the current high surpluses.

Corrected for temporary factors, the structural surplus is estimated at 1.7 per cent of GDP in 2008, declining to 1.4 per cent in 2009. The surplus in 2009 is adjusted for the expiry of the suspension of SP-contributions by the end of 2008, which implies a reintroduction of payments to the compulsory pension savings scheme. The structural surplus is within the target interval in the 2015-plan, which calls for structural surpluses in the range of $3\frac{3}{4}$ - $1\frac{3}{4}$ per cent of GDP up until 2010.



Source: Statistics Denmark, own calculations and ‘Denmark 2015 – towards new goals’.

Capacity utilisation and wage developments

The pressure on the labour market appears to be even higher than assessed in the February survey. The estimated average unemployment rate in 2008 is 53,000 persons ($1\frac{3}{4}$ per cent of the labour force). The estimate has been lowered by 14,000 persons since the February survey. In 2009 the average unemployment rate is expected to increase by 10,000 persons, which is the same increase as expected in February. By the end of 2009 unemployment is expected to be around 70,000 persons.

Since 2005 the unemployment rate has been below the estimated structural unemployment rate, considered to be consistent with stable wage and price developments. The structural unemployment rate is estimated at $4\frac{1}{4}$ per cent of the labour force in 2007. Estimates of the structural unemployment rate are subject to uncertainty.

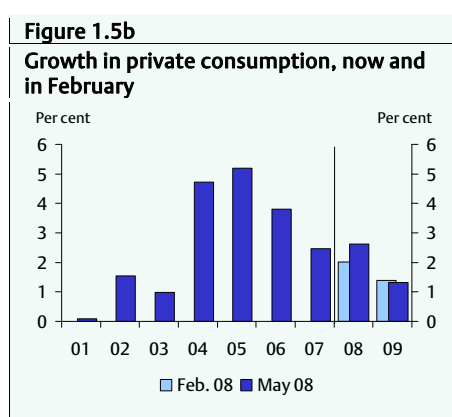
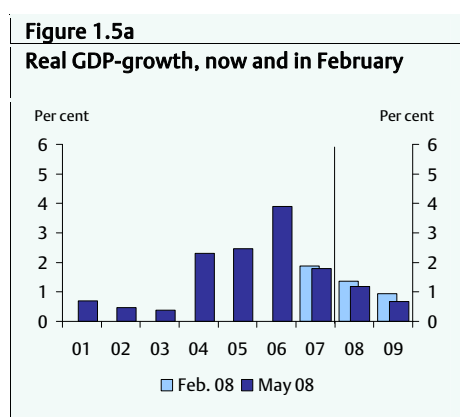
Initiatives in the Welfare Agreement are expected to reduce structural unemployment to $3\frac{3}{4}$ per cent in 2009. The expected moderate increase in unemployment starting in the summer of 2008 will, combined with the expected fall in structural unemploy-

ment rate, narrow the gap between the actual and the structural level of unemployment. This will accommodate a balanced development in the years to come.

Domestic developments

GDP growth is expected to be 1¼ per cent in 2008 and ¾ per cent in 2009. This is a continued slowdown from almost 4 per cent growth in 2006 and 1¾ per cent in 2007, *cf. figure 1.5a*. Combined with declining structural unemployment, this will lead to a reduction in the output gap, which nonetheless is expected to be positive in 2009.

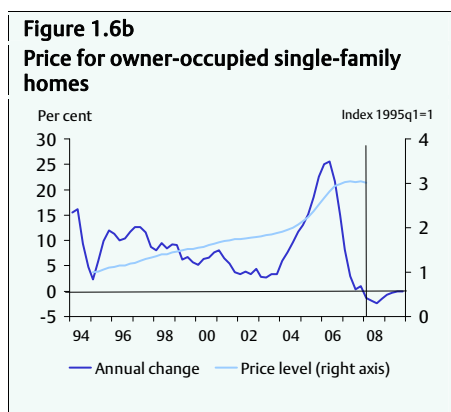
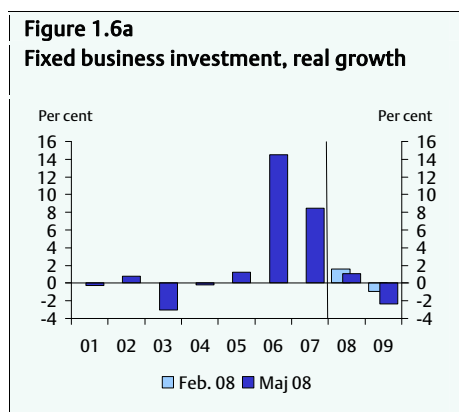
Growth in private consumption is estimated at 2.6 per cent in 2008, *cf. figure 1.5b*. This is slightly more than in 2007, when private consumption grew 2.5 pct. This reflects in part relatively high growth in the second half of 2007 and therefore carry-over effects in 2008. Estimated growth in 2008 is ½ percentage point higher than in the February survey. A slowdown in private consumption, to 1¼ per cent, is expected in 2009, owing in part to wealth effects from the weakening real estate market and other assets.



A clear slowdown is expected in fixed business investment due to generally lower growth in the economy and the international slowdown, *cf. figure 1.6a*. The pace is expected to ease to 1 per cent in 2008 and in 2009 growth is expected to turn negative at -2½ per cent. The slowdown is following a period of strong expansion with 8½ per cent growth in 2007 and 15 per cent in 2006.

After a marked slowdown in 2007, house prices are expected to fall by 2 per cent, for owner-occupied single-family homes, in 2008, *cf. figure 1.6b*. Nominal prices are expected to flatten in 2009, which corresponds to a small fall in real terms. The first half of 2006 house prices rose at well above 20 per cent on an annual basis, in part due to low interest rates and growing disposable incomes. Despite the expected price fall in 2008, the house price level is expected to stay relatively high. House owners' financial position is therefore relatively solid and house owners are considered to be well-bolstered for the ongoing slowdown. Reflecting the development on the house

market and rising construction costs, residential investments are expected to decline by 3-4 per cent in real terms both in 2008 and 2009.



Source: Statistics Denmark, Association of Danish Mortgage Banks (RKR) and own calculations.

International trade and the external current account

A slowdown in manufacturing exports is expected on the background of slowing growth on export markets. Real growth in manufacturing exports is estimated to 3½-4 per cent in 2008 and 2009, while export market growth is projected at 5 per cent in 2008 and 4½ per cent in 2009. The slowdown of manufacturing exports is due to the high level of capacity utilisation in the Danish economy and a quite substantial deterioration of Danish wage competitiveness, leading to losses in market shares. The deterioration in wage competitiveness is expected to be more pronounced in 2008, where a fairly high rise in wages will be followed by a relatively large appreciation of the real effective exchange rate of the krone.

Growth in exports of goods and services is expected to slow to 3 per cent in 2008 and 2 per cent in 2009. Growth is dragged down in both years by lower energy exports due to declining production of oil and gas in the North Sea. In 2009 the slowdown in growth in services exports is expected to be more pronounced than for the other export components. Slower expansion in total demand will lead to slower growth in imports, which is estimated at 4 per cent in 2008 and 1¾ per cent in 2009. In 2006 and 2007 imports grew 14 per cent and 5½ per cent, respectively, *cf. table 1.2.*

From a surplus of 4¼ per cent of GDP in 2005 and 1 per cent of GDP in 2007, the current account surplus is expected to fall further to ½ per cent of GDP in 2008. A small improvement is expected in 2009, to ¾ per cent of GDP. Compared to the February survey, the estimates of the current account surplus have been reduced by around ¼ per cent of GDP.

	2006	2004	2005	2006	2007	2008	2009
	Bill. DKK			Real growth, per cent			
Private consumption	841.0	4.7	5.2	3.8	2.5	2.6	1.3
Public consumption ²⁾	439.2	1.8	0.9	2.0	1.7	1.3	1.2
Public investment	31.3	13.2	3.1	16.5	-3.9	-2.5	0.8
Residential construction	118.6	11.9	18.7	12.2	4.5	-3.0	-4.0
Fixed business investment	239.4	-0.2	1.2	14.5	8.5	1.1	-2.3
Stock building ³⁾	7.3	0.6	-0.7	0.6	-0.4	0.1	0.0
Total domestic demand	1676.8	4.3	3.4	6.0	2.7	1.7	0.4
Exports of goods and services	884.4	2.8	8.3	9.0	3.7	2.9	2.1
of which manufactures	366.9	3.5	7.7	6.2	8.1	3.8	3.4
Total demand	2561.2	3.8	5.1	7.0	3.1	2.1	1.0
Imports of goods and services	864.9	7.7	11.3	14.1	5.6	3.9	1.7
of which goods	565.7	8.8	9.0	12.1	5.5	4.0	1.7
Gross domestic product	1696.2	2.3	2.5	3.9	1.8	1.2	0.7
Gross value added	1435.8	1.5	1.7	3.9	2.0	1.2	0.7
of which in private non-agricultural sector ⁴⁾	926.5	1.9	2.2	5.1	3.2	1.7	1.1
GDP per capita (1,000 DKK)	311.0	2.0	2.2	3.6	1.5	0.9	0.4

1) The real growth rates of the macro variables are calculated using chain indices.
2) Real growth of public consumption reflects growth in inputs, not improvements of output and is therefore not readily comparable to private consumption growth.
3) Contributions to GDP growth.
4) Excluding housing and shipping.
Source: Statistics Denmark and own calculations.

Employment, unemployment and the labour force

Employment increased by 50,000 persons in both 2006 and 2007. Employment growth is expected to slow in 2008 to 17,000 persons, *cf. table 1.3*. The expected increase in the annual average from 2007 to 2008 is due to a carry-over from relatively high growth in employment in the last quarters of 2007. The expected profile is flat in the first half of 2008, and falling slightly in the last half. In 2009 employment is expected to fall by 17,000 persons, reflecting the lower growth in activity.

Unemployment has come down to 53,000 persons in March 2008, and the unemployment rate is now less than 2 per cent of the work force. The expected moderate increase in employment in 2008, together with a small reduction in the labour force, will lead to a reduction in average unemployment from 77,000 in 2007 to 53,000 in 2008. The annual average covers a profile where unemployment is expected to fall until the summer of 2008 and then rise slightly through 2009, so the annual average in 2009 will rise to 63,000 persons.

	2006- level	Avg. 1990- 2006	2006	2007	2008		2009	
					Feb.	May	Feb.	May
	1,000 persons		Change, 1,000 persons					
Private sector	1,943	6	45	49	4	16	-18	-18
Public sector	824	3	0	1	1	1	1	1
Total employment	2,767	10	45	51	5	17	-17	-17
Labour force	2,876	0	13	19	-7	-8	-9	-7
Unemployment	109	-10	-32	-32	-12	-25	9	10

Source: ADAM and own calculations.

Unemployment numbers have been adjusted for a change in the measurement methodology compared to the estimates in the February survey. On average, changes to the statistical methodology has lowered the number of unemployed by some 14.000 persons (about ½ percentage point) – mainly by no longer counting those receiving holiday payments from unemployment insurance as unemployed.

Table 1.4						
Key figures for the Danish economy						
	2004	2005	2006	2007	2008	2009
Percentage change from previous year						
Real GDP	2.3	2.5	3.9	1.8	1.2	0.7
Trade-weighted GDP abroad	2.5	2.0	3.2	2.7	2.0	1.6
Markets for Danish manufactures	6.6	5.6	8.8	7.8	5.0	4.6
International competitiveness	-1.3	-1.1	-1.0	-2.6	-4.2	-1.9
Export of manufactures, volume	3.5	7.7	6.2	8.1	3.8	3.4
Hourly wages	2.8	3.6	3.6	4.1	4.9	4.8
Consumer price index	1.2	1.8	1.9	1.7	3.3	2.6
Price index for single-family houses	8.8	17.4	21.6	4.5	-2.0	0.0
Merchandise export prices	0.6	5.5	3.7	-0.7	4.3	2.2
Merchandise import prices	0.0	4.0	3.1	0.7	4.0	1.9
Merchandise terms of trade	0.6	1.4	0.5	-1.4	0.3	0.3
Productivity in private non-agricultural sector	2.3	2.4	2.2	-0.8	1.3	2.5
Real disposable income of households ¹⁾	4.1	1.0	2.9	1.4	2.0	2.7
Labour market						
Labour force (thousands)	2,858	2,863	2,876	2,895	2,887	2,880
Employment (thousands)	2,698	2,722	2,767	2,818	2,835	2,818
Of which in private sector	1,876	1,897	1,943	1,992	2,008	1,990
in public sector	822	825	824	826	827	828
Percentage change in total employment	-0.6	0.9	1.6	1.8	0.6	-0.6
Unemployment (thousands)	160.6	141.2	109.3	77.4	52.6	62.5
Early retirements 60-64 year (thous.)	124	130	138	142	142	138
Unemployment rate (per cent)	5.6	4.9	3.8	2.7	1.8	2.2
Unemployment rate. EU-def. (per cent)	5.5	4.8	3.9	3.7	2.5	3.0
Long term bond yields. exchange rate						
10-year government bonds	4.3	3.4	3.8	4.3	4.3	4.6
30-year mortgage credit bond	5.3	4.4	5.1	5.4	6.2	6.3
The effective krone rate (1980=100)	102.2	102.3	102.0	103.2	106.3	106.6
Balance of payments						
Goods and services (bill. DKK)	71.4	76.4	45.1	19.5	9.1	12.2
Current account (bill. DKK)	44.2	66.7	44.1	18.8	7.5	13.7
Current account (per cent of GDP)	3.0	4.3	2.7	1.1	0.4	0.7
Net foreign assets. ultimo (bill. DKK)	-77.6	54.1	-16.9	-62.1	-54.2	-40.2
Net foreign assets (per cent of GDP)	-5.3	3.5	-1.0	-3.7	-3.1	-2.2
Public finances						
Government net lending (bill. DKK)	27.3	77.4	79.9	75.6	72.4	53.0
Government net lending (per cent of GDP)	1.9	5.0	4.9	4.5	4.1	2.9
General government gross debt, year-end, (bill. DKK)	641.9	563.1	498.4	440.9	374.9	333.2
General government gross debt, year-end, (per cent of GDP)	43.8	36.4	30.4	26.0	21.2	18.2
Tax burden (per cent of GDP) ²⁾	49.2	50.9	49.3	48.9	48.7	47.4
Expenditures (per cent of GDP)	53.7	51.7	50.2	49.8	50.1	49.9

1) Adjusted for special factors concerning pension funds.

2) The increased tax burden in 2005 was not a result of changes in tax rules.