

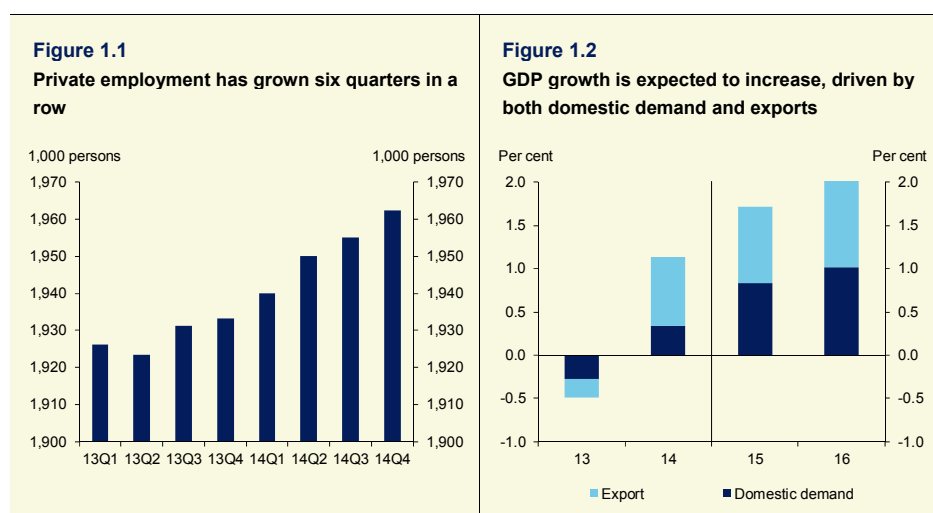
Economic Survey – May 2015

1.1 The Current Economic Outlook

The recovery of the Danish economy is well under way with increasing growth and employment. In 2014 the economy grew by 1.1 per cent after several years of weak growth. Progress has been evident in the labour market, and private-sector employment has increased by almost 40,000 persons since mid-2013, *cf. figure 1.1*. This reflects both a decrease in unemployment and an increasing labour force. Economic growth accelerated in particular in the second half of 2014. This is expected to continue, and domestic demand is now expected to be a major driving force, *cf. figure 1.2*.

The economy is also improving in the countries surrounding us, and a number of international organisations have revised up their outlook for the European economy. Conversely, there are signs of moderation in many of the major emerging market economies, yet, in total Danish export markets are improving. The progress is supported by expansionary monetary policy measures by The European Central Bank (ECB) and lower oil prices, among other things. In addition, the depreciation of the euro has improved the competitiveness of both Danish and European companies.

The tail winds from the fall in oil prices, interest rates, and the effective krone exchange rate also support growth in the Danish economy. This is a contributing factor to the upward revision of the growth estimate for the Danish economy in this forecast compared to the one published in *Economic Survey*, December 2014. GDP growth is now estimated to increase from 1.1 per cent in 2014 to 1.7 per cent in 2015 and 2 per cent in 2016.



Note: Employment includes leave. Exports are adjusted for import content and domestic demand.
Source: Statistics Denmark and own calculations.

Private consumption and investments are expected to boost domestic demand in the coming years. Danish consumers have come a long way in the economic consolidation after the overheating of the 2000's and the global economic downturn in 2008-09. They are now more optimistic about the future, and private consumption is on the rise – not financed by increased leverage as in the 2000's, but in line with income growth. Consumption is stimulated by a number of factors including increases in real wages and rising house prices.

The Danish economy will also benefit from growth abroad, which is expected to boost exports. This is largely due to the restoration of competitiveness in recent years following the years of overheating. Currently, Danish companies benefit from the weakening of the krone exchange rate against countries outside the euro area.

Additional labour will be needed to meet the increase in demand as exports grow, companies increase their investments, and households spend more money. This will reinforce the progress in the labour market and contribute to a positive spiral for Danish economy with employment growth, rising incomes, and increasing consumption and investment.

The reforms of recent years support the economy of both households and companies, and at the same time they improve the growth potential for the Danish economy. This helps to ensure a sustainable improvement in the labour market that is not stifled by bottlenecks and capacity pressures.

In recent years economic policy has been conducted with the purpose of supporting the economy as much as possible. In the coming years the expansionary monetary policy stance will stimulate demand, while fiscal policy will be rolled back from the current expansionary stance. Interest rates are expected to remain low for a number of years to come – even after 2016. Therefore, as the business cycle progresses the adjustment of economic policy must take the form of a continued normalisation of the current expansionary fiscal policy stance. This will help to ensure that the government deficit gradually converges towards the objective of structural balance in 2020.

The risks to the forecast are considered to be broadly balanced. Developments abroad are of particular importance to the forecast, and they will have a large impact on whether Danish growth turns out to be higher or lower than expected.

1.2 The Forecast

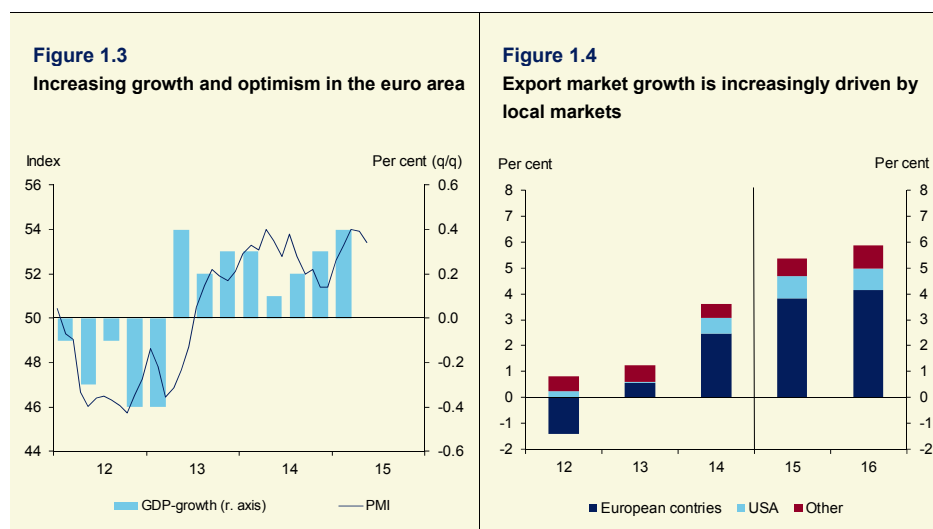
The Economic Recovery in Europe will drive up Exports

As a small open economy Denmark is heavily dependent on the developments in economies of our main trading partners. Therefore, the current improvements in the European growth prospects are welcome.

The recovery in the euro area has been hesitant in recent years, and during the autumn of 2014 there were once again signs of weakness and declining optimism, *cf. figure 1.3*. Since then the outlook has improved, and since the turn of the year there has been progress in most countries, particularly in Germany, Spain, and some of the countries in Eastern Europe. The economic growth is supported by the fact that many countries have achieved sufficient

progress in the process of consolidating public finances and implementing structural reforms for them to reduce the pace of consolidation. Improving labour market conditions and easier credit standards will also support growth over the forecast horizon.

It is to a great extent the progress in the neighbouring markets in Europe that is expected to boost Danish export market growth over the coming years, *cf. figure 1.4*. In the more distant emerging markets the pace of economic progress has gone down a bit, but for Danish exporters the depreciation of the krone exchange rate helps mitigate the effect of the lower growth rate.

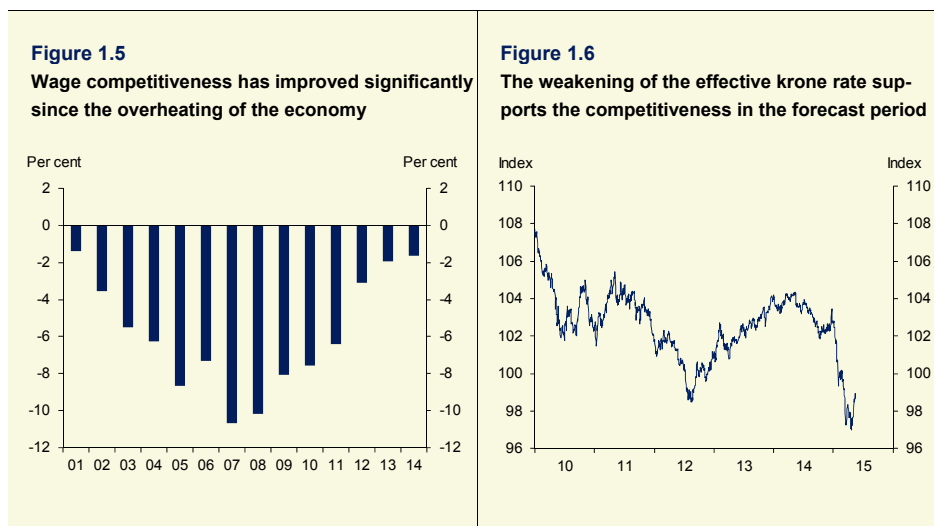


Note: In figure 1.3 a PMI-value over 50 indicates increasing growth. Export market growth is based on estimates for GDP growth for Denmark's main trading partners and the countries' historical relationship between GDP and imports of industrial goods. Countries are weighted by their share of Denmark's total industrial exports. "Other" covers those of Denmark's largest trading partners who are not covered by the other two categories.

Source: Reuters EcoWin and own calculations.

The gap between the monetary policy pursued in the euro area and in the United States is growing. The reason is that the business cycle in the US is at a considerably more advanced stage than in Europe. While the Federal Reserve is preparing for an interest rate hike, the ECB has chosen to ease monetary policy even further. This is the main driving force behind the weakening of the euro against the dollar. The depreciation implies – due to the fixed exchange rate regime towards the euro – that the krone has weakened correspondingly against the dollar. The weaker krone exchange rate has contributed to make Danish goods cheaper compared to goods from outside the euro area, including the US and the United Kingdom. The improvement in the competitiveness supports Danish exports.

The international organisations have revised up their growth prospects for the European economy since December. All countries in the euro area are expected to experience positive growth rates in both 2015 and 2016 (except for Cyprus in 2015).



Note: Figure 1.5 shows changes in the relative wage share of the entire export-oriented private sector accumulated since 2000. Competitiveness can also be calculated as relative unit labor costs in the industry. Both methods point to a substantial improvement in competitiveness since 2007-08. The effective exchange rate is a weighted average of the exchange rates of Denmark's largest trading partners.

Source: Reuters EcoWin, Statistics Denmark and own calculations.

Growth abroad will strengthen Danish exports, and this will provide a significant contribution to growth in the Danish economy over the coming years. Growth in the euro area is expected to boost the Danish export of services, in particular, such as engineering advice, consultancy support, and financial services etc. These types of services usually experience greater growth, when the nearby markets in Europe are doing well. The export of goods is also benefiting from the economic growth experienced by our closest trading partners, and particularly the export of industrial goods is expected to accelerate in the coming years.

The growth in exports is supported by the improvements in competitiveness achieved in recent years, *cf. figure 1.5*. This is mainly due to the fact that the large imbalances that were built up in the Danish labour market prior to the economic downturn in 2008-09 have gradually subsided. The improvement in competitiveness is a result of a number of things, incl. several years of moderate wage growth and a significant improvement in labour productivity in the industrial sector. Over the forecast horizon, wage competitiveness will improve even further due to a combination of a continuation of moderate wage developments and the current depreciation of the krone exchange rate, *cf. figure 1.6*. At the same time, a number of business-oriented initiatives, stemming from amongst others the agreements on *Growth Plan DK* and *Growth Package 2014*, have contributed to strengthen the growth conditions for companies.

Although economic growth promises to become more solid, there are still a number of risks to the economic outlook. In the euro area, there is still uncertainty regarding the economic future of Greece, and even though there are signs of progress, unemployment remains at a high

level in many European countries. The risk of a harder-than-expected slowdown in the Chinese economy also constitutes a source of uncertainty.

Domestic Demand is also Improving

After several years of modest growth there are now clear signs of progress in total private consumption. Increasing retail sales and credit-card turnover confirms the positive signs stemming from the improvements in consumer confidence over the past year, *cf. figure 1.7*.

The growth in private consumption reflects the fact that incomes and consumption are much more in line now. Thus, household finances have become more balanced compared to the years of strong credit-financed consumption growth during the overheating in the 2000's and the subsequent years of consolidation following the burst of the housing bubble. Some households still need to deleverage, but at the aggregate level the balance-sheet adjustment is well advanced.

Danish interest rates are at a very low level, *cf. figure 1.8*. This improves the situation of the households, and many homeowners consider the very low interest rates to be an opportunity to begin amortising the loans and refinancing into fixed-rate loans.

Figure 1.7
Consumer confidence shows growing optimism among Danes

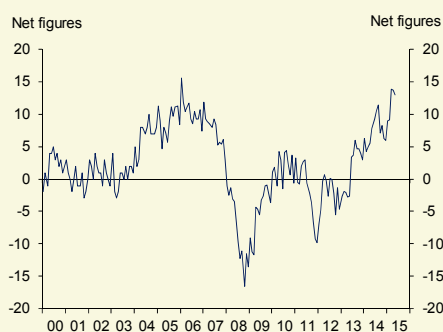
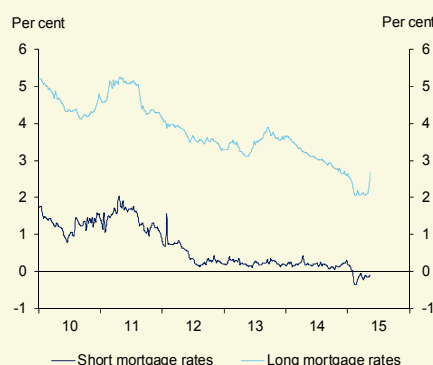


Figure 1.8
Danish bond yields are at a very low level



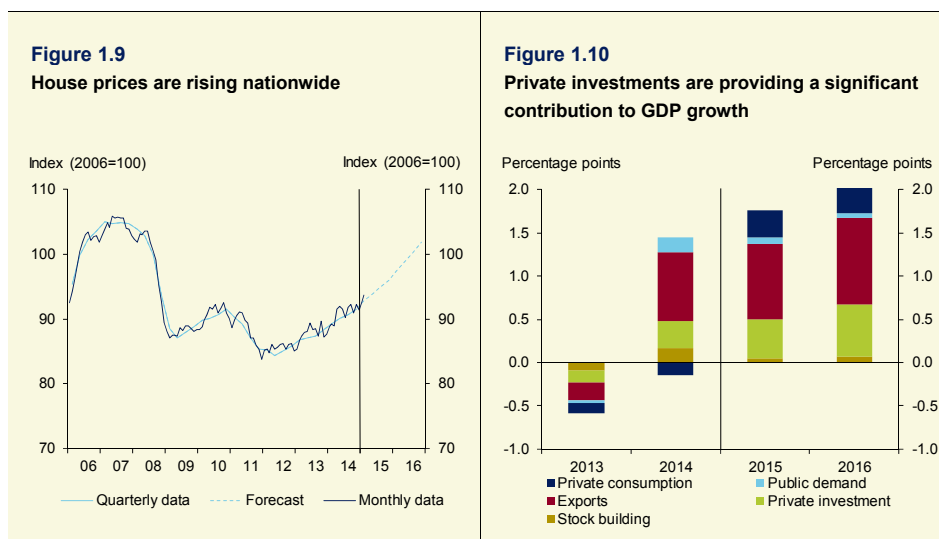
Note: In figure 1.8 short-term and long-term mortgage interest rates are based on the yield on newly issued bonds that underlie respectively, very short-term adjustable-rate mortgages and 30-year fixed rate mortgages.

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

The Danish housing market has experienced significant progress, although there are still regional differences. The progress is expected to strengthen over the coming years, driven by both the progress in the business cycle and the very low level of interest rates, which will contribute to an expected growth in house prices of 4½ percent both this year and next year, *cf. figure 1.9*. As a consequence house prices are expected to reach their pre-crisis level on a national basis towards the end of the forecast horizon.

The increasing house prices will contribute to the build-up of housing equity among many Danish home owners, which can be converted into consumption. This effect, however, is only expected to contribute at the end of the forecast horizon, when consumption is expected to grow a little faster than incomes.

As the progress in the housing market gets stronger it will become more attractive to build new homes in order to meet the increasing demand. Also, business investments are expected to increase over the forecast horizon following several years, where companies have been reluctant to invest. Investments are expected to grow in line with increasing demand and higher capacity utilisation. Very favourable financing conditions also stimulate increasing business investment. Overall, private investments are expected to provide a significant contribution to economic growth in Denmark over the coming years, *cf. figure 1.10*.



Note: Figure 1.9 holds data from Statistics Denmark's house price index. Growth contributions in figure 1.10 are adjusted for import content, calculated by the so-called input-output-based method.
Source: Statistics Denmark and own calculations.

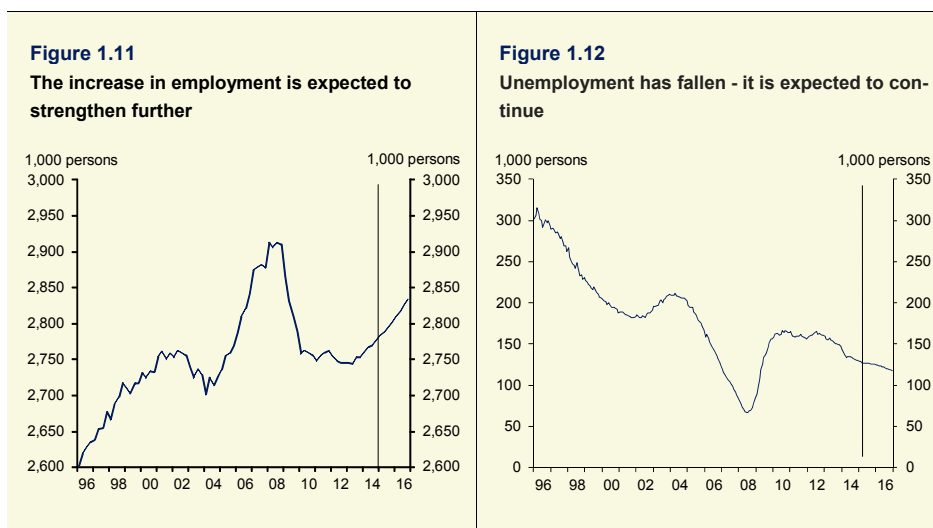
More People in Employment

The improvement in the labour market has gained momentum, and employment has increased continuously since mid-2013, *cf. figure 1.11*. More than 38,000 people have found work in the private sector from mid-2013 to the end of 2014, and the positive trend is expected to continue in the coming years.

The growth in employment reflects the increasing production in the most labour-intensive parts of the private sector that benefit particularly from higher domestic demand. Total employment is estimated to increase by 23,000 people in 2015 and 29,000 in 2016, *cf. figure 1.11*. The private sector is expected to account for the vast majority of the employment growth, equal to 20,000 people in 2015 and 28,000 people in 2016.

Employment growth has occurred across age groups, educational background, origin and geography, as the analysis in section 1.5 shows. It suggests that the recovery on the Danish labour market is broadly based.

The progression in employment reflects a labour force that has grown by 20,000 people since mid-2013, and an unemployment that has fallen significantly over the same time span, *cf. figure 1.12*. Thus, unemployment is now at 4.8 per cent of the labour force. The decline in unemployment should be seen in light of both the Cash Benefit Reform and a bigger demand for labour. The decline in unemployment is particularly evident for the groups that were affected relatively hard by the crisis, including the construction trades. Meanwhile, both long-term unemployment and youth unemployment has dropped. This confirms the impression that the structures on the Danish labour market has remained healthy, and that the crisis has not had a lasting impact on structural employment.

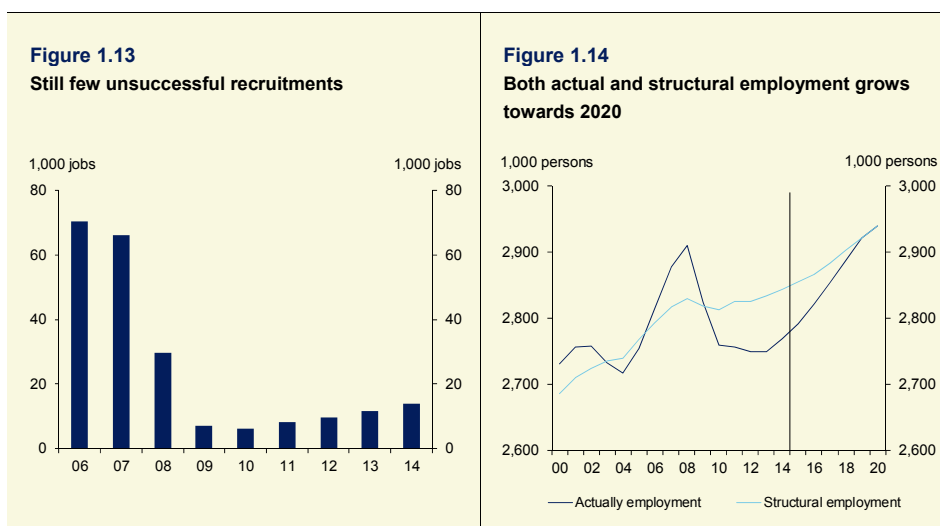


Note: Employment in figure 1.11 includes leave. Figure 1.12 shows the development of gross unemployment.

Source: Statistics Denmark and own calculations.

There are still available resources in the Danish economy, and employment growth is thus not considered to give rise to general bottlenecks in the labour market. Thus, Danish companies still have relatively few problems compared to the booming years in the 2000's, *cf. figure 1.13*.

At the same time, the reforms of the recent years imply an increase in structural employment which supports a sustainable development in the labour market, *cf. figure 1.14*. This allows the actual employment to rise significantly without causing bottlenecks and unsustainable wage increases. Overall, the normalisation of the business cycle, the underlying demographic development and the reforms are expected to increase private employment by about 180,000 people from 2013 to 2020. In terms of full-time persons this corresponds to almost 160,000 people getting a job in the private sector over the period.



Note: The number of unsuccessful recruitments is based on a survey including about 14,000 companies in Denmark. Structural employment in figure 1.14 originates from Denmark's Convergence Programme, 2015.

Source: Agency for Labour and Recruitment, Statistics Denmark and own calculations.

Uncertainty and Alternative Scenarios for the Economic Development

The expectation of stronger growth in the Danish economy should be seen as a reflection of the returning growth in the euro area and the prospects for an increasing foreign demand going forward.

The Danish economy is sensitive to the development abroad, including especially the euro area. Growth could be stronger than anticipated due to for instance a greater effect of the lower oil prices than expected and the new monetary policy measures by the ECB resulting in a more positive development in the Danish export markets and in business investments. At the same time this could induce a faster moving housing market and subsequently a higher propensity to consume. Overall, this could contribute to a faster growing economy than anticipated.

The strength of the European recovery could, however, also turn out weaker than expected, due to for instance a smaller effect of the lower oil prices and the ECB's quantitative easing. That would weaken growth in the Danish economy. Households' and businesses' expectations for the future would then also be expected to weaken, which would slow growth in domestic demand. The uncertainty is illustrated by comparing the baseline scenario with two alternative scenarios.

- A *positive scenario* with the development abroad implying an increase in the Danish export market growth by an additional 1 percentage point in 2015. At the same time, the investments of Danish companies are increased by 1½ percentage points in both 2015 and 2016 in order to meet an expected increase in demand. This corre-

sponds to a slightly faster recovery of the investment ratio towards its historical level, as it has been the case during previous turnarounds in the economy. The growth in private consumption is also assumed ½ percentage point higher in 2016.

- A *negative scenario* with an anticipated 1 percentage point lower export market growth in 2015 and 2016, caused by for instance a smaller effect from lower oil prices and the ECB's quantitative easing, which also weakens growth in domestic demand through weaker confidence. Growth in business investments is assumed to be 2 percentage points lower in both years, corresponding to a slower recovery of the investment ratio towards its historical level.

In the positive scenario, the bigger foreign growth and the higher investment level will increase growth in the Danish GDP by slightly more than 0.3 percentage points in both 2015 and 2016. Altogether, the economy will grow with 4¼ per cent over the two years which will be the strongest growth since 2006-07. At the same time, unemployment will fall faster through both years. The general government balance improves as a result of higher revenues and lower costs due to higher activity. In the negative scenario, GDP growth in Denmark declines by about 0.3 percentage points in both 2015 and 2016. At the same time, unemployment will be higher and the general government balance will deteriorate, *cf. table 1.1*.

Table 1.1
Alternative scenarios

	Negative scenario		Base scenario		Positive scenario	
	2015	2016	2015	2016	2015	2016
Growth in real GDP, per cent	1,4	1,7	1,7	2,0	2,1	2,3
Unemployment, per cent	4,7	4,6	4,6	4,3	4,4	4,0
General government fiscal balance, per cent of GDP	-1,5	-2,8	-1,3	-2,5	-1,2	-2,1

Source: Own calculations.

Developments in the housing market require special attention. On the one hand, it is natural with rising house prices, which also partially translate into consumption. On the other hand, a longer period of increasing house prices and very low interest rates increases the risk of future imbalances in the housing market. This could be caused by for instance self-fulfilling expectations of continuing rises in house prices or a sharp increase in credit growth. This could have negative consequences for economic stability if an abrupt correction of house prices came afterwards.

Selected key figures for the forecast can be found in table 1.2, while annex tables contain a comparison with the estimates from *Economic Survey*, December 2014.

Table 1.2
Key figures

	2013	2014	2015	2016
Real growth, per cent				
Private consumption	0.0	0.5	1.6	1.7
Public consumption	-0.5	1.4	0.8	0.4
Public investment	0.3	8.6	-1.9	-2.3
Residential construction	-5.0	6.5	4.0	7.0
Fixed business investments	3.8	1.2	3.5	7.1
Stock building (per cent of GDP)	-0.2	0.3	0.1	0.2
Exports of goods and services	0.8	2.6	4.2	4.9
Imports of goods and services	1.5	3.8	4.1	5.6
GDP	-0.5	1.1	1.7	2.0
Level (per cent of GDP)				
General government fiscal balance	-1.1	1.2	-1.3	-2.5
Current account	7.2	6.2	7.1	7.2
Level, 1,000 persons				
Gross unemployment (annual average)	153	135	128	121
Employment (incl. leave)	2,749	2,768	2,792	2,821
Labour force	2,887	2,891	2,909	2,932
Rate of change, per cent				
House prices (single-family house)	2.7	3.4	4.5	4.5
Consumer prices	0.8	0.6	0.8	1.5
Hourly earnings, private sector (Danish Employers Federation statistics)	1.4	1.2	1.9	2.3

1.3 Fiscal Policy and Public Finances

GDP growth is picking up and the amount of slack is being reduced considerably. A gradual normalisation of fiscal policy has been initiated after a period following the economic crisis when fiscal policy was conducted in order to support economic activity as much as possible. However, a very accommodative monetary policy implies that economic policy all in all still supports growth in domestic demand in 2015 and 2016.

A less accommodative fiscal policy in the coming years is in line with the need for a symmetric conduct of fiscal policy across the business cycle, and, hence, the fiscal support provided during periods of low economic activity should be gradually withdrawn as the economy regains momentum. Moreover, it is important that public deficits are gradually reduced towards the target of at least structural balance by 2020, which is consistent with fiscal sustainability.

For the coming fiscal year – 2016 – the structural deficit is estimated at 0.5 per cent of GDP equivalent to the deficit limit in the Danish Budget Law. This entails a small reduction from an estimated structural deficit of 0.6 per cent of GDP in 2015. Fiscal policy in 2015 was planned in accordance with the Budget Law with an estimated structural deficit of 0.5 per cent of GDP, when the budget proposal for 2015 was presented – but the estimated structural deficit has since increased, notably due to reduced revenues from North Sea activities. The structural deficit in 2016 reflects, in particular, that the level of public investments remains high even with an assumed degree of normalisation from the extraordinary high levels maintained in recent years. The actual budget deficit is estimated at 2.5 per cent of GDP in 2016, which implies a certain margin to the limit of 3 per cent of GDP in the EU's Stability and Growth Pact.

Denmark's net public debt is expected to remain at a moderate level of approx. 7½ per cent of GDP by the end of 2016. The gross public debt (EMU-definition) is estimated at approx. 39 per cent of GDP in 2016 and, thus, maintains a substantial safety margin to the EU-debt limit of 60 per cent of GDP.

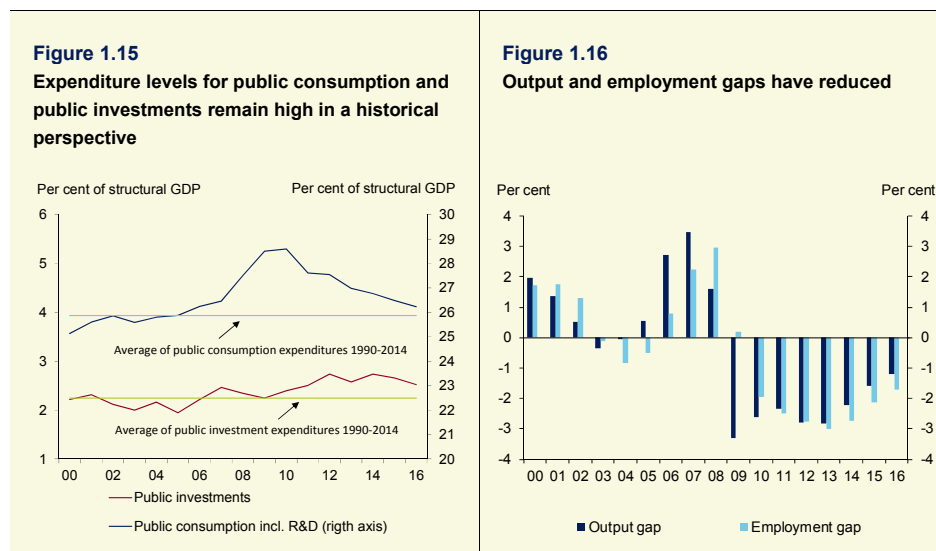
Fundamentally, public finances in Denmark are sound, which helps to ensure the high level of confidence in the Danish economy. Denmark is one of only nine countries in the world with the highest credit rating (AAA) from all the major credit ratings agencies.

Fiscal Policy should be Normalised in the Coming Years

In the wake of the global economic crisis, fiscal policy has been planned in order to support growth and employment as much as possible within the stability-oriented fiscal policy framework given by the Danish Budget Law, the medium-term plan towards 2020, and EU rules. Expenditure policy has been accommodative with high public investment levels, *cf. figure 1.15*.

The recovery of the Danish economy is well under way with a solid foundation for increased momentum in both GDP growth and employment. The output gap – which is an estimate of the difference between actual and potential output – is estimated to narrow from -3 per cent in 2013 to a little more than -1 per cent in 2016, *cf. figure 1.16*. Expenditure policy remains accommodative, but it is assumed that a normalisation of the level of public investment will commence. In 2016 the level of public investment is thus 0.3 per cent of GDP above the his-

torical average for 1990-2014, compared to 2015 where the public investment level is 0.4 per cent of GDP above the historical average.



Note: Public consumption in figure in 1.15 includes research and development expenditures which are correspondingly not included in the shown development of expenditures for public investments.

Source: Statistics Denmark and own calculation.

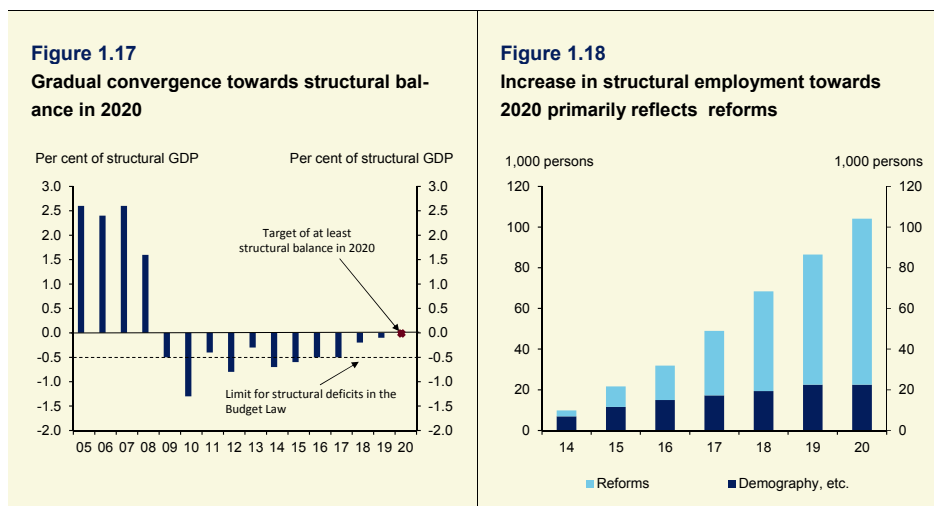
Based on technical assumptions concerning fiscal policy in 2016, the structural balance is estimated to improve from -0.6 per cent of GDP in 2015 to -0.5 per cent of GDP in 2016. Economic policy in 2016 will be finalised with the agreements on the economy for municipalities and regions, the budget proposal and the later negotiations on the fiscal bill for 2016.

Fiscal policy in 2015 was planned in accordance with the Danish Budget Law with a budget proposal in which the structural deficit was estimated at 0.5 per cent of GDP.¹ The later revision of the structural deficit in 2015 to 0.6 per cent of GDP reflects revised estimates of public finances, including the effect of lower oil prices on the structural revenues from the extraction of oil and gas in the North Sea.

The structural balance is projected to improve gradually from a deficit of 0.5 per cent of GDP in 2016 towards the target of at least structural balance in 2020, cf. figure 1.17. The development of public finances towards 2020 includes an annual growth in public consumption (and research and development expenditures) of approx. DKK 3 bn. amounting to an overall

¹ According to the Danish Budget Law the annual structural deficit must not exceed $\frac{1}{2}$ per cent of GDP. The law requirement is aimed at the estimated structural balance at the time of the budget proposal for the fiscal year in question. However, this does not mean, that measures weakening the structural deficit beyond the deficit limit can be decided upon after the budget proposal.

increase of approx. DKK 15 bn. from 2015 to 2020, *cf. Convergence Programme Denmark 2015*. The room for manoeuvre in fiscal policy towards 2020 primarily reflects the implementation of reforms that increase employment and raise potential output, *cf. figure 1.18*.



Source: Statistics Denmark, Convergence Programme Denmark 2015 and own calculations.

Impact on Activity is aligned with the Business Cycle

From an already accommodative starting point the impact on economic activity from fiscal policy and other measures from 2012 and onwards is estimated to decline gradually, *cf. figure 1.19*. The total impact on the level of GDP is estimated to be approximately neutral in 2014 and to be dampening in 2015 and 2016.

The development in the impact on economic activity from fiscal policy and other measures reflects the need to ensure that fiscal policy is countercyclical. The prospect of increased growth implies that fiscal policy should gradually become less accommodative, *cf. figure 1.20*. In 2015 and 2016 GDP growth is expected to amount to respectively 1.7 and 2.0 per cent. The one-year fiscal effect – a calculated measure of whether fiscal policy is expanded or tightened compared to the year before – is approximately zero in 2015 and estimated to -0.1 per cent of GDP in 2016, implying a small tightening of fiscal policy from 2015 to 2016. In addition, monetary policy is extraordinarily accommodative, contributing substantially to domestic demand. The accommodative monetary policy stance increases, *ceteris paribus*, the need for a gradual tightening of fiscal policy in the coming years in order to ensure that the overall economic policy is aligned with the business cycle.

Figure 1.19
Contribution to GDP level from fiscal policy and other measures from 2012 and onwards

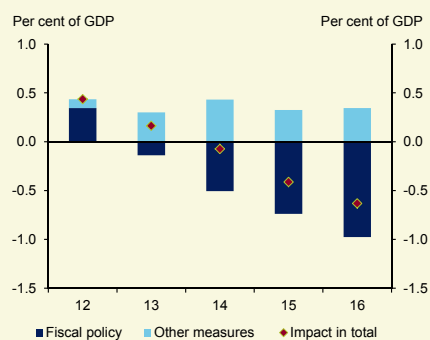
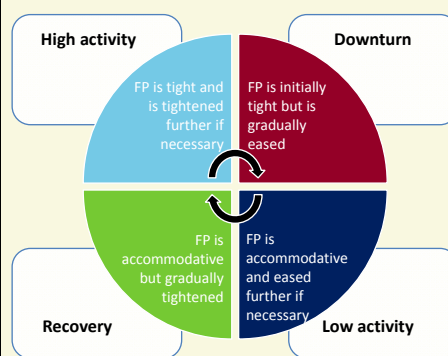


Figure 1.20
Stylised fiscal response with regards to the business cycle



Note: In figure 1.19 other measures cover politically initiated investments, which are however not included in the public balance in the national accounts and thus not included in the impact of fiscal policy in a narrow definition.

Source: Statistics Denmark and own calculations.

The level of public investments has been very high in recent years in a historic perspective, *cf. figure 1.15*, and it was decided to advance public investments in order to support the Danish economy in connection with for instance the “kick-start” (fiscal stimulus package). The assumed normalisation of public investment levels in the coming years is necessary in order to ensure progress toward the target of at least structural balance in 2020 and to ensure that fiscal policy is aligned with the economic situation, *cf. box 1.1*.

Box 1.1
Stabilisation policy via public investments

Public investments fundamentally serve the purpose of expanding and maintaining the capital stock in the public sector. The primary consideration is, thus, to ensure sound public investments with a reasonable social return and the timing of public investments should as a starting point be aligned with the need originating from the capital stock. However, the timing should also be viewed in the context of the cyclical state of the economy as there can be social gains associated with undertaking investments in periods, where there is spare capacity in the economy and a low price and wage pressure.

Both public investments and politically initiated investments in the private sector have quite a large impact on economic activity in the short run compared to other fiscal instruments, and they have, *ceteris paribus*, made a positive contribution to economic activity and employment during the economic crisis. This should be viewed in the context of an extraordinarily high public investment level in recent years due to both politically agreed increases in the level and the moving forward of planned investments to 2012-14.

Box 1.1 (continued)**Stabilisation via public investments**

However, there may also be a number of challenges linked to using public investments as an instrument to stabilise the volatility of the business cycle. The risk of delay for large investment projects may imply that the impact on economic activity is ultimately postponed to a time, when the economy has regained momentum. A gradual normalisation of public investment levels is presupposed in the coming years, where growth in the Danish economy is expected to increase further. It is important that this normalisation takes place as assumed, both in regard to stabilising the business cycle and to ensure a gradual convergence towards structural balance in 2020.

Source: *Finansredøgørelse 2014* and *En samlet strategi for offentlige investeringer (2014)* (in Danish only).

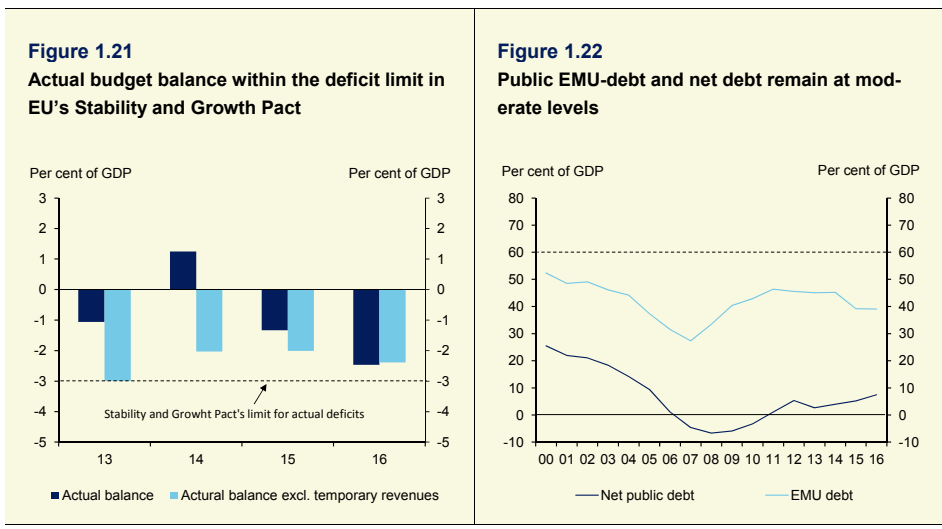
Estimated Actual Budget Balance and Margin to the EU's Deficit Limit

Fiscal policy is primarily conducted on the basis of the *structural budget balance*, which is corrected for temporary factors affecting public finances. Therefore, the structural balance is the key fiscal target in the Budget Law. The limit for structural deficits of ½ per cent of GDP in the Budget Law is, among other things, set to ensure that the actual deficit in a normal downturn will most likely comply with the limit for actual deficits of 3 per cent of GDP in EU's Stability and Growth Pact.

The actual budget balance is estimated to show a deficit of 1.3 per cent of GDP in 2015, which is a smaller deficit than the December estimate of 2.5 per cent of GDP. The improvement of the actual balance in 2015 primarily reflects higher temporary revenues from the pension yield tax, due to the development in interest rates and the increase in share prices. In addition, the actual deficit in 2015 is diminished by one-off revenues, which also affected the actual budget balance in 2013 and 2014, *cf. figure 1.21*.

In 2016 the actual deficit is estimated to amount to 2.5 per cent of GDP, even though GDP and employment are expected to increase. The larger actual deficit in 2016 compared to 2015 primarily reflects that one-off revenues affect 2015 but not 2016 and that the revenues from the pension yield tax are reduced from 2015 to 2016. The high revenue levels from the pension yield tax in recent years are expected to be followed by a period towards 2020 where the revenues in general will be below the structural level as interest rate levels are normalised. In isolation, this implies a weakening of the actual budget balance, *cf. box 1.2*.

With the estimated actual deficits in 2015 and 2016, net public debt is expected to remain at a moderate level of about 7½ per cent of GDP by the end of 2016, *cf. figure 1.22*. Gross public debt (EMU-definition) is estimated to amount to about 39¼ and 39 per cent of GDP in 2015 and 2016, compared to a level of 45¼ per cent of GDP in 2014. Thus, the EMU-debt thus keeps a wide safety margin to the debt limit of 60 per cent of GDP in the EU's Stability and Growth Pact. The decline in the EMU-debt from 2014 to 2015-16 reflects a number of things, including the decision taken on 31 January 2015 to stop the issuance of central government bonds until further notice and instead reduce government holdings at Danmarks Nationalbank.



Anm.: In figure 1.21 the actual balance excl. temporary revenues is corrected for one-off revenues from the restructuring of existing capital pensions, pay out and restructuring of saving in Lønmodtagernes Dyrtdsfond, revenues from a reallocation in the pension sector from schemes with a guaranteed yield each year to schemes in which each year's yield reflect market return, and advanced ordinary revenues from the taxation of capital pensions.

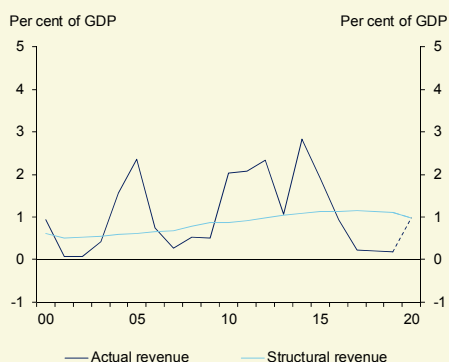
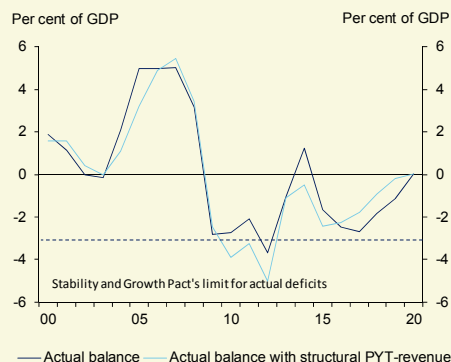
Source: Statistics Denmark and own calculations.

Box 1.2**Revenues from the pension yield tax give significant fluctuations in the actual budget balance**

The actual revenue from the pension yield tax depends, among other things, on the development in share prices and interest rates, which determine bond prices and the yield on interest rate derivatives. As the fluctuations in the financial markets are generally significant – and the total pension assets are very large – the actual revenues from the pension yield tax can fluctuate significantly from year to year. The revenue from the pension yield tax thus contributes to significant fluctuations in the actual budget balance from year to year, with revenue fluctuations of as much as 2 per cent of GDP equivalent to DKK 35–40 bn., *cf. figure a*. Moreover, there is uncertainty associated with the development in the financial markets and, hence, also with the estimated revenues from the pension yield tax. Changes in interest rates and share prices etc. can lead to significant revisions of the estimated budget balance from one economic survey to the next. Fiscal policy is based on the structural balance, which is, among other things, corrected for the considerable fluctuations in the actual revenues from the pension yield tax.

Calculations in *Finansredegørelse 2014 (Danish only)* indicate that the revenues from the pension yield tax have a tendency to be countercyclical. In 2010–15, where the economy has been characterised by a negative output gap, the revenues from the pension yield tax have been considerably above the structural level (except for 2013) due to declining interest rates over the period. The above structural revenues have in isolation ensured a stronger actual budget balance, than if the revenues from the pension yield tax had been equal to the structural level, *cf. figure b*.

After a period with declining interest rates and extraordinarily high actual revenues from the pension yield tax (especially in 2014) the revenue is expected to be below the structural level in 2016 and more so in 2017–19. This partly reflects an expected normalisation of interest rates. In the coming years, the actual revenues from the pension yield tax will thus indicate higher actual deficits than with the structural revenue. This implies that the distance to the EU's 3 per cent of GDP limit for actual deficit will be smaller than the state of the economy otherwise would indicate.

Figure a**Actual and structural revenues from the pension yield tax****Figure b****Impact on actual balance from temporary fluctuations in revenues from the pension yield tax**

Note: The structural revenue from the pension yield tax that enters into the calculation of the structural balance is based on an assumed normal rate of return of 4½ percent on the taxable part of pension assets towards 2019. The projection is structural from 2020 and onwards.

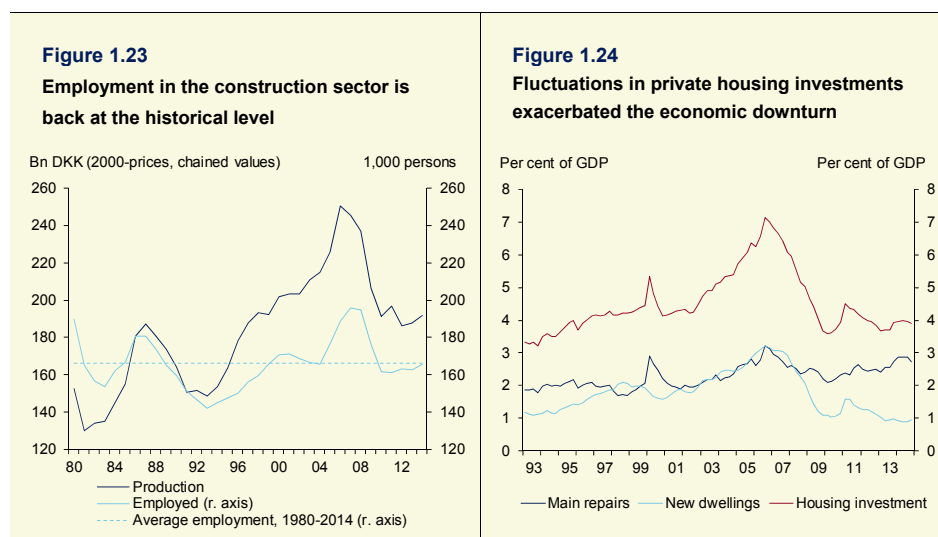
Source: Statistics Denmark, Convergence Programme Denmark 2015 and own calculations.

1.4 The Construction Sector is back in Good State

The construction sector has been through a period of high volatility the past decade. Activity reached an extraordinary and unsustainable high level during the overheating in the mid-2000's. Thus, it was necessary and natural with a subsequent adjustment - even in the absence of the international downturn. The adjustment was amplified by the fact that it coincided with the general downturn in the Danish and the international economy.

Following the economic crisis, fiscal policy has been designed in order to support the economy as much as possible. A high level of public investments along with a series of initiatives has supported the activity in the construction sector. The adjustment now seems close to finished after the meagre years, and the situation in the construction sector is no longer different than the situation in the rest of the business sector. Both production and employment in construction are now increasing. Progress in the housing market along with several major publicly supported fixed asset investments and growth in private business investment support continued progress in the construction sector.

During the overheating of the economy in the 2000's, the activity in the construction sector increased by 25 per cent within a few years and an increasing part of total employment were engaged in the construction sector (defined as the construction of new dwellings and investments in construction both privately and in the public sector), *cf. figure 1.23*. In 2007, employment in construction comprised 7 per cent of total employment which is very high in a historical perspective. The increase in production was particularly driven by progress in the construction of new dwellings, in which production increased by about 45 per cent from 2002 to 2006. The massive increase in activity in the construction sector should be seen in light of the increases in house prices in the same period. They were created by several factors including low real interest rates, a real easing of housing taxes, the propagation of new loan types, and expectations of continued increases in house prices.

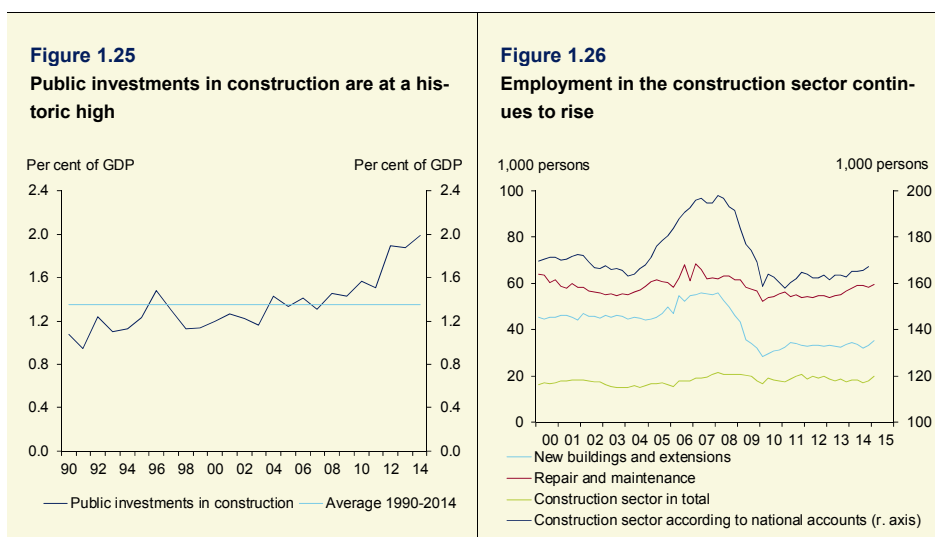


Note: Figure 1.23 shows the development in the construction sector according to the national accounts.
Source: Statistics Denmark.

The imbalances in the construction sector became so extensive during the overheating of the economy that the sector had to go through a major adjustment – even in the absence of the international financial crisis. Activity was already decreasing when the global recession hit Denmark. Production in the construction sector fell by almost 25 per cent from the peak in 2006 to the bottom in 2010, while employment declined by more than 34,000 persons. It was particularly driven by decreasing construction of new dwellings, *cf. figure 1.24*. The construction of new dwellings fell from 3 per cent of GDP in 2006 to 1 per cent of GDP in 2010, which contributed to the fact that Denmark was hit extraordinarily hard during the international economic downturn.

The decline in the construction sector would have been even stronger if economic policy had not supported activity and employment in the sector. The level of public investments in construction has been historically high, *cf. figure 1.25*. At the same time investments in social housing and the Renovation Fund have been moved forward. Along with the Housing Jobs scheme this has contributed to further support activity in the sector. Combined with low interest rates, the many initiatives have contributed to a larger increase in production in the construction sector than the rest of the economy during the last couple of years. Employment in the construction sector has also increased, and it currently constitutes about 165,000 people. Hence, it is now at the historical average from 1980-2014, *cf. figure 1.23*.

The adjustment was particularly severe in the construction of new dwellings, although there were also clear signs of an overheating of repair and maintenance. Following a couple of years with receding employment within repair and maintenance, there is now once again progression. This has happened despite the fact that the Housing Jobs scheme expired on 1 January, 2015, *cf. figure 1.26*.



Note: Figure 1.26 shows the sample based employment projected with the growth according to the sample based construction sector employment together with the total construction sector employment according to the national accounts. Subcomponents in figure 1.26 do not constitute the whole sample and do not total the construction sector employment according to the national accounts.

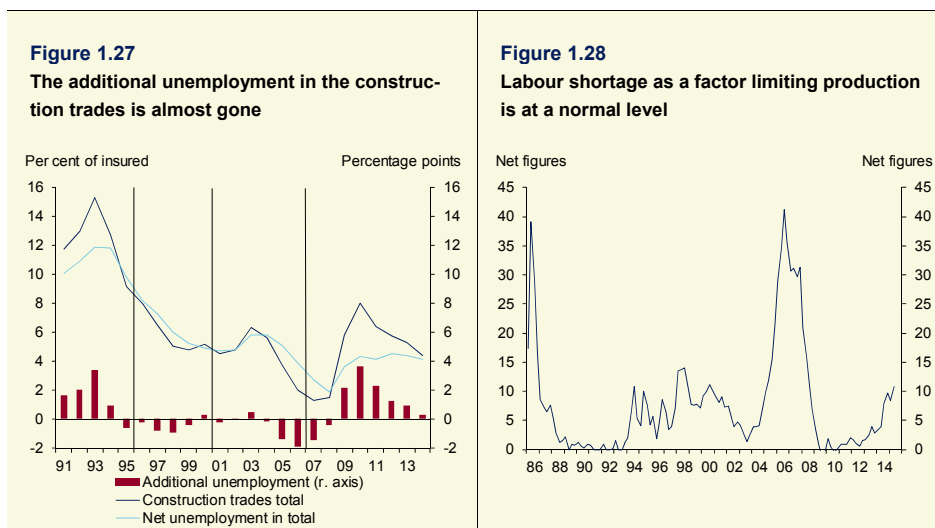
Source: Statistics Denmark and own calculations.

Employment in the construction of new dwellings is expected to increase in the coming years. The high level of activity in construction during the overheating of the economy has reduced the need for new dwellings in recent years, but with the prospects of a continuing rise in house prices, population growth and very favourable financing conditions, construction of new dwellings is expected to increase again. Activity in the private non-residential construction is also expected to rise in line with an expected increase in production.

Growth in the construction sector is also reflected in (net) unemployment² within the construction trades, which have fallen considerably since 2010. Unemployment is at 4.4 per cent which is low in a historical perspective, cf. figure 1.27. The additional unemployment in the construction trades compared to the rest of the labour market during the years following the crisis is just about gone.³

² In the net-unemployment, unemployed in activation (activated unemployed benefit recipients and activated labour market ready cash benefit recipients are not included. They are included in gross unemployment.

³ The additional unemployment measured by the number of gross unemployed was also practically zero in 2014.



Note: The unemployment rate reflects the total net unemployment (recipients of unemployment or cash benefits) in Byggefagernes a-kasse, El-faget, Blik og Rør (- Dec. 2007) and Malerfaget og Maritime (- Dec. 2007) as a fraction of the total number of insured members of the unemployment funds. Unemployed members of 3F's construction trades group are not included. There are no continuous statistics of net unemployment in the construction trades from 1991, and the statistics have been constructed by using four different statistics according. The three vertical lines indicate discontinuities in the statistics.

Source: Statistics Denmark and own calculations.

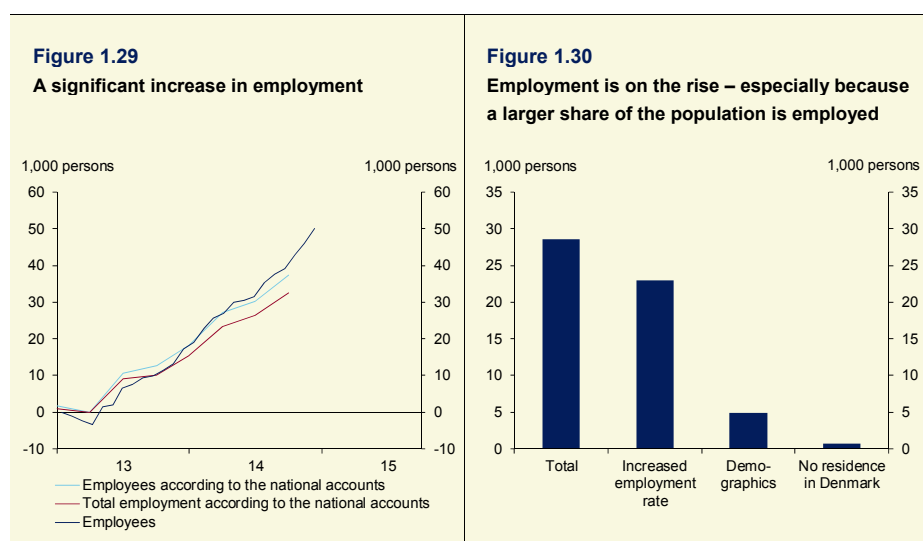
The falling unemployment in the construction trades also reflects that there is less available capacity in the construction sector. The indicator for labour shortage is thus at more or less the same level as observed in the second half of the 1990's, but still far from the situation in the years leading up to the financial crisis, *cf. figure 1.28*.

With the current economic situation and progress in the construction sector in mind, there is no longer the same need to support construction as previously. During the crisis, support was appropriate in order to mitigate the negative consequences of the very large downturn in the construction sector. The sector is further supported by a number of large, planned investments such as the Metro Cityringen, new railways, The Fehmarn Belt connection, super hospitals and social housing. Along with the economic recovery, the activity in the construction sector is thus expected to increase in the coming years even if public support and public investments are gradually rolled back.

1.5 More People in Employment

The increase in employment during the past year has been broadly based across the country, education, age and origin, according to analyses of Statistics Denmark's register of wage earners.

The development on the labour market has been positive during the past couple of years with increasing employment and decreasing unemployment. From 2013Q2 to 2014Q4, private employment has increased by 38,000 persons according to the national accounts, while total employment grew by 32,600 persons. The number of wage earners has continued to rise in the first months of 2015, *cf. figure 1.29*. Meanwhile, employment growth has been accompanied by an almost parallel development in the number of hours worked, suggesting that the average working time has barely changed.



Note: Figure 1.29 shows the change in total employment since the second quarter of 2013. Figure 1.30 shows the increase in employees from the fourth quarter of 2013 until the fourth quarter of 2014. The demographic contribution is computed for constant employment rates based on sex, age (1-year intervals), and heritage (Danish heritage, Western immigrants, non-Western immigrants and descendants).

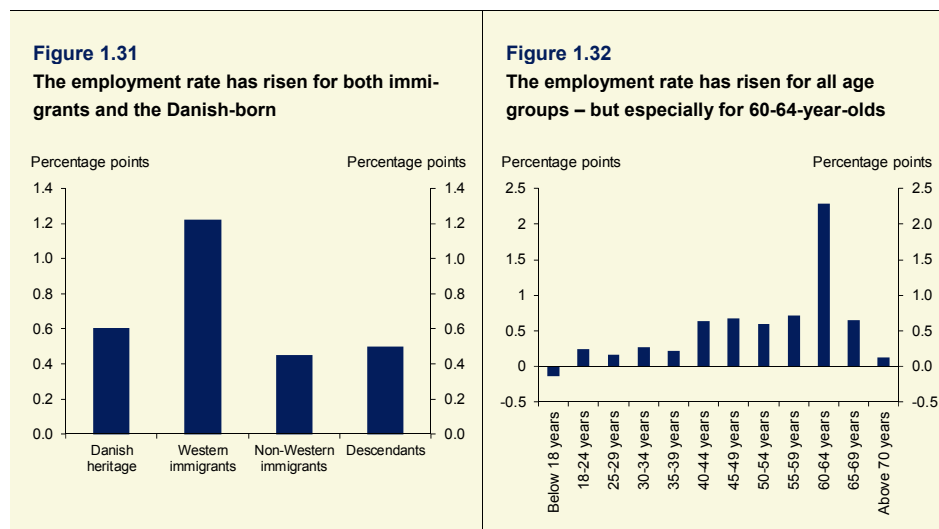
Source: Statistics Denmark and own calculations based on data from the Law Model.

The improvement reflects more employees, while the number of self-employed etc. has fallen slightly. The remaining part of this section highlights the increase in wage earners based on Statistics Denmark's register of wage earners.⁴

The rise in employment is largely due to the fact that a higher proportion of the population has a job. Of the total increase in wage earners of nearly 29,000 persons from 2013Q4 to 2014Q4, the 23,000 persons can be attributed to rising employment rates, *cf. figure 1.30*. The remainder of the increase reflects a contribution from population growth and a modest increase in the number of employees residing abroad. The contribution from demographics covers an increase in the number of immigrants and descendants of immigrants of working age.

⁴ The calculated employment rates thus only concerns wage earners as there is no detailed information on self-employed people after 2013.

The rate of employment has risen for persons of Danish origin, immigrants and descendants of immigrants. The increase has been particularly high among immigrants from Western countries, *cf. figure 1.31*.



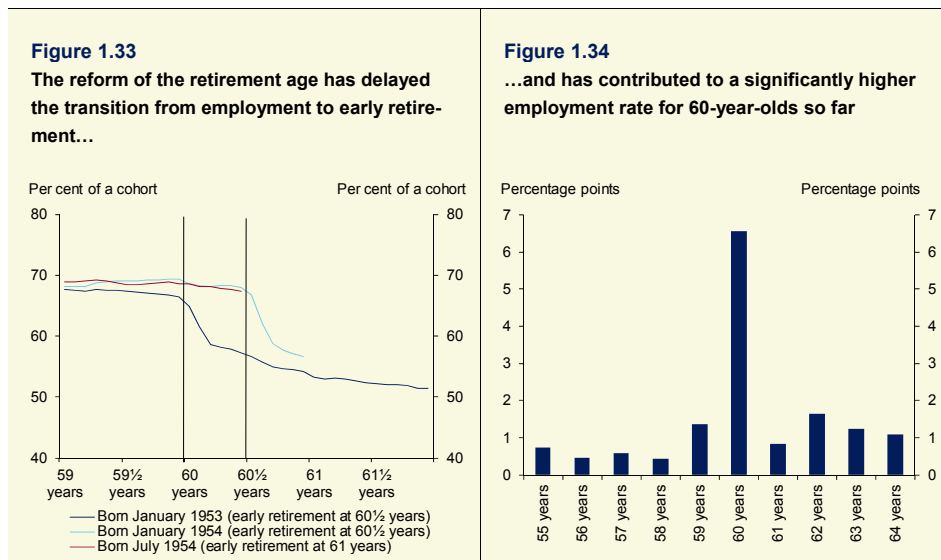
Note: Figure 1.31 includes 18-64-year-olds. Western immigrants include immigrants from the EU, Iceland, Norway, the US, Australia, etc. Both figures show the change from the fourth quarter of 2013 to the fourth quarter 2014. Underlying changes in the composition of sex, age, and heritage have been taken into account. Persons without residence in Denmark have not been included.

Source: Own calculations based on data from the Law Model.

The rise in employment is also widely distributed across age. The employment rate has increased for all groups of age over 18 years, *cf. figure 1.32*. For the very young, the decline in employment reflects an increasing share in education.

The increase in the employment rate has been highest among people over 40, especially people aged 60 to 64. The relatively large increase in the employment rate for 60-64-year-olds reflects that the reform of the retirement age has taken effect in 2014. Those who turned 60 in the first half of 2014 were the first to have their early-retirement age raised (by half a year).

The effect of the reform can be seen clearly. For those generations who have an early-retirement age of 60 years, there is a clear tendency for the employment rate to fall quite a lot in the months immediately after the age of 60. The generations that have an early retirement age of 60½ years (or 61 years) in 2014 continue in employment until the higher early-retirement age is reached, and only after 60½ years of age does the employment rate fall. Hence, experience so far suggests that the majority of people eligible for early-retirement continues in employment until the higher early-retirement age is reached, *cf. figure 1.33*.



Note: Figure 1.34 shows the changes in the employment rate from the fourth quarter of 2013 to the fourth quarter of 2014. Underlying changes in the composition of sex, age, and heritage has been taken into account.

Source: Own calculations based on data from the Law Model.

In 2014 the reform of the retirement age has only affected the 60-year-olds and has contributed to an increase in the employment rate of nearly 7 percentage points for the 60-year-olds, *cf. figure 1.34*. In the coming years, the reform of the retirement age will also contribute to an increase of employment rates for people over 61, along with the incremental increases of the early-retirement age in accordance with the gradual implementation of the reform of the retirement age. In addition to the reform, the general decrease in the amount of people entering early retirement in the previous years has also contributed to an increase in the employment rates for 61 to 64-year-olds during 2014. This reflects the effects of earlier reforms, including the reform of early retirement of 1998 which is working due to more self-financing, and increasing netting out from private pensions saving, among other things.

The rise in employment has also led to an increasing employment rate for all main education groups, *cf. figure 1.35*. It is particularly among skilled workers that the employment rate has risen, which to some extent is a mirror image of the fact that skilled workers saw a relatively larger decrease in the employment rate during the economic crisis compared to people with higher education.

Figure 1.35
The employment rate has risen for educational groups – but mostly for skilled workers, and...

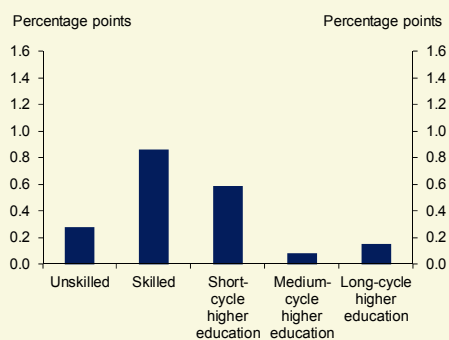
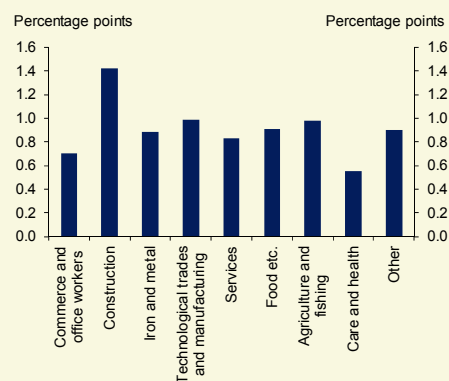


Figure 1.36
... especially among skilled workers with an education in the construction trades

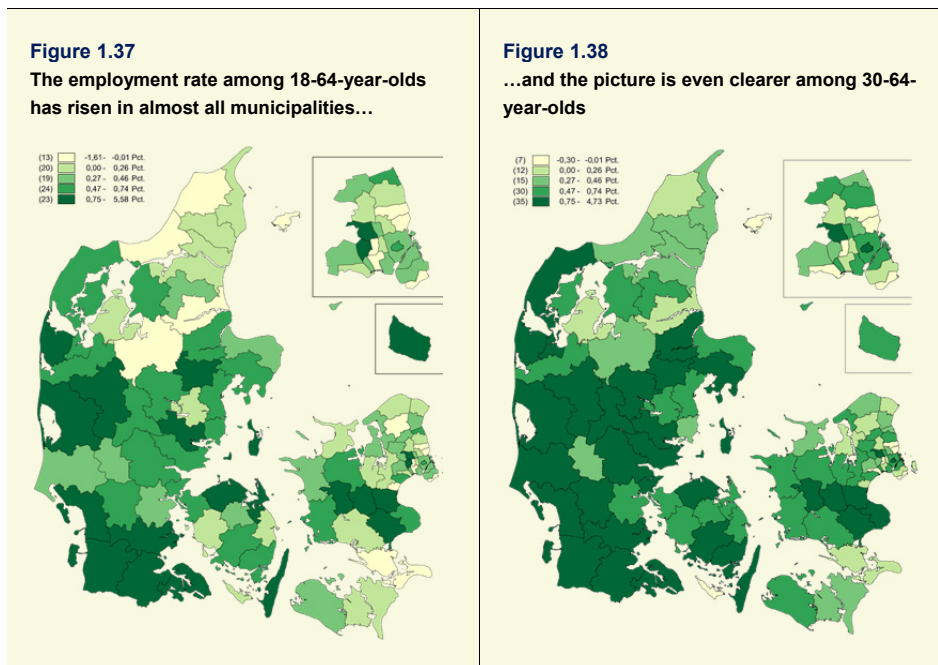


Note: The change in employment rate among 18-64-year-olds from the 2013Q4 to 2014Q4. “Unskilled” includes persons with an unknown education, primary education, or an upper-secondary education as the highest completed educational programme. The statistics are based on the highest completed educational programme as of 1 January of the year. Underlying changes in the composition of age and heritage can affect the results. “Other” in figure 1.36 includes the following trades: pedagogical degrees, graphical trades, transportation trades, and security.

Source: Own calculations based on data from the Law Model.

Among skilled workers the employment rate has increased for individuals with an education within construction, *cf. figure 1.36*. This should be seen in the context of increasing activity in the construction sector – supported by historically low interest rates, rising real estate prices, and a high level of public investments.

The employment rate has increased in all parts of the country during 2014. The municipalities that have experienced the greatest increase in the employment rate for 18-64-year-olds (the dark green municipalities on the map), are scattered across the country, and they are situated in both Southern, Western, and Eastern Jutland, as well as on Funen and Zealand, *cf. figure 1.37*.



Note: The change in the employment rate among 18-64-year-olds from 2013Q4 to 2014Q4. Distributed by residence at the start of the quarter. Underlying changes in the composition of age and heritage can affect the results.

Source: Own calculations based on data from the Law Model.

A small number of municipalities in the northern part of Jutland, in South Zealand, and in Greater Copenhagen have experienced a slight decline in the employment during 2014, and this decline may reflect changes in the composition of the population in the municipalities – for instance, with respect to age and origin, but also with respect to the share of young people in education. Looking solely at the 30-64-year-olds, it is only Læsø, Ærø, and some municipalities in Greater Copenhagen that have experienced a slight decline in the employment rate during 2014, *cf. figure 1.38*.

1.6 Appendix

Table 1.3
Key figures compared to the December Survey

	2014	2015		2016	
		Dec.	May	Dec.	May
Real growth, per cent					
Private consumption	0.5	1.5	1.6	1.6	1.7
Total public demand	2.3	1.4	0.4	-0.2	0.1
- public consumption	1.4	1.5	0.8	0.1	0.4
- public investments	8.6	0.6	-1.9	-2.5	-2.3
Residential investment	6.5	2.5	4.0	5.5	7.0
Fixed business investment	1.2	3.2	3.5	6.8	7.1
Final domestic demand	1.4	1.7	1.5	1.9	2.1
Stock building (per cent of GDP)	0.3	0.0	0.1	0.2	0.2
Total domestic demand	1.7	1.7	1.6	2.1	2.2
Exports of goods and services	2.6	4.0	4.2	4.7	4.9
- of which manufactures	2.3	4.6	4.8	5.3	5.5
Total demand	2.0	2.5	2.5	3.1	3.2
Imports of goods and services	3.8	4.8	4.1	5.3	5.6
- of which goods	2.3	4.1	3.3	4.9	5.4
GDP	1.1	1.4	1.7	2.0	2.0
Gross value added	1.2	1.4	1.8	2.1	2.0
- of which private sector	1.6	1.7	2.6	2.9	2.8
Change in 1,000 persons					
Labour force	4	16	19	17	23
Employment	19	19	23	25	29
- of which private sector	23	15	20	25	28
- of which public sector	-4	4	3	0	1
Gross unemployment	-18	-5	-6	-7	-7
Net unemployment	-11	-3	-6	-8	-8

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

	2014	2015		2016	
		Dec.	May	Dec.	May
Growth, per cent					
Merchandise export prices	-0.2	-0.3	-0.2	1.7	2.2
Merchandise import prices	-0.6	-0.3	-1.3	2.2	2.6
Merchandise terms of trade	0.4	0.0	1.1	-0.5	-0.4
House prices, single-family houses	3.4	3.5	4.5	3.5	4.5
Consumer prices	0.6	0.8	0.8	1.5	1.5
Hourly compensation in the private sector	1.2	1.9	1.9	2.4	2.3
Real disposable income, private sector	-3.4	8.6	7.6	2.9	4.6
Real disposable income of households ¹⁾	2.3	2.4	2.2	1.5	1.5
Productivity in private non-agricultural sector	0.5	0.8	1.2	1.5	1.4
Per cent per year					
Interest rate 1-year adjustable rate loan	0.2	0.2	-0.1	0.3	0.0
10-year government bonds	1.4	1.3	0.5	1.6	0.7
30-year mortgage credit bonds	3.1	3.0	2.2	3.2	2.4
Balances					
Current account (bn. DKK)	118.6	135.3	139.3	135.6	147.7
General government fiscal balance (bn. DKK)	23.9	-49.7	-26.3	-52.7	-50.3
Gross unemployment (thousands)	135	130	128	123	121
Gross unemployment (per cent)	4.8	4.5	4.6	4.2	4.3
Net unemployment (thousands)	107	103	101	96	93
Net unemployment (per cent)	3.8	3.6	3.6	3.3	3.3
External assumptions					
Trade-weighted GDP abroad, per cent	2.0	2.1	2.2	2.4	2.4
Export markets for Danish manufactures, per cent	3.6	5.2	5.4	5.9	5.9
Exchange rate, DKK per \$	5.6	6.0	6.8	6.0	6.9
Oil price, \$ per barrel	99.0	88.0	62.9	97.2	74.1
Oil price, DKK per barrel	556.3	524.4	428.8	579.2	509.1

1) The adjusted income.

Source: Statistics Denmark and own calculations.