Chapter 1

Summary

1.1 The current economic outlook

The Danish economy has been experiencing solid growth for several years and has now entered an economic boom phase. The positive development manifests itself in several ways. More than ever before are now in employment, the labour force has reached a record, and wealth has never been higher, *cf. figure 1.1*.

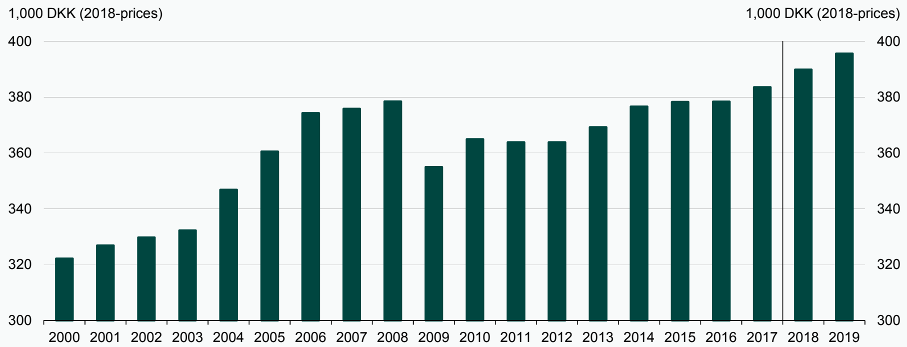
The foundation for a continued upswing is present. Reforms have been implemented in good time, and over the coming years reforms will lift labour supply even further. In addition, measures have been implemented that enhance the robustness of households and contribute to a stable development in the housing market.

Households and firms have consolidated over the past years and are in a good position to increase consumption and investments. That will support a self-sustained upswing in the coming years where the economic policy is planned to dampen capacity pressures in the Danish economy.

The increase in employment will increase pressures in the labour market. As labour shortages gradually emerge, this is expected to put a downward pressure on growth in the Danish economy. New initiatives that increase labour supply and productive capacity in the economy could contribute to reinforcing and prolonging the economic upswing.

Figur 1

Wealth measured as GNI pr. resident is at its highest level ever



Note: Wealth has been converted into 2018-prices using the implicit deflator for private consumption.
Source: Statistics Denmark and own calculations.

Strong Danish economy

GDP growth has gradually increased over the past couple of years to around 2 per cent per annum, which is the highest growth rate for more than a decade. Growth is supported by strong private domestic demand and a solid contribution from exports.

The positive economic development has made its mark in various ways. First and foremost through a significant job creation. Since the beginning of 2013, employment has grown by 180,000 persons, and in March this year the number of wage-earners set yet another record. The pace of the job creation has been especially high since 2015. Since then, employment has grown by more than 40,000 persons each year. The increase has been largest in the region surrounding the capital and Eastern Jutland, but all parts of the country have experienced solid job-growth over the past years, *cf. figure 1.2*.

Figure 1.2

Job-growth in all parts of the country since 2013

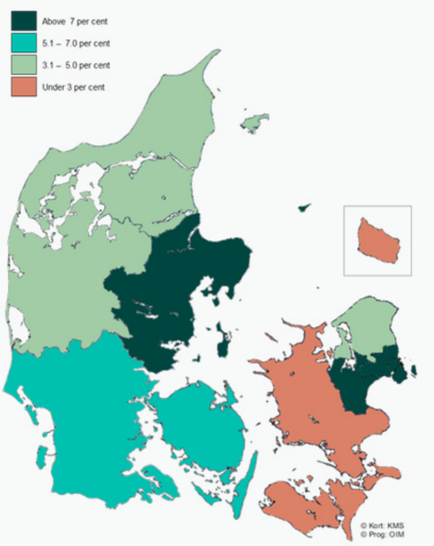
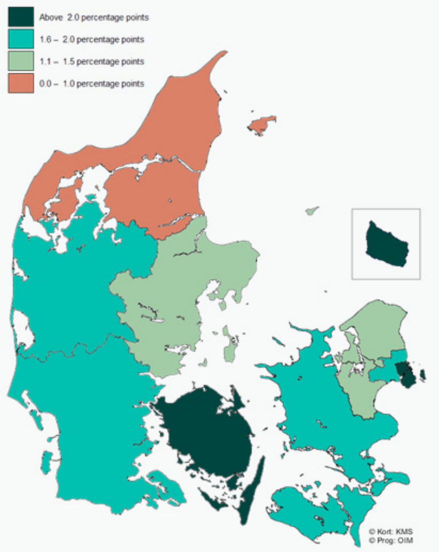


Figure 1.3

Drop in the unemployment rate in all parts of the country since 2013



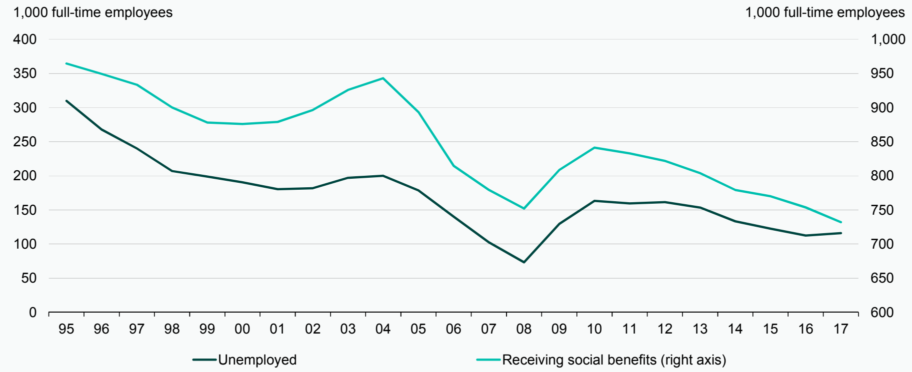
Note: Figure 1.2 shows the increase in wage-earner employment since the 1st quarter of 2013. Figure 1.3 shows the drop in the unemployment rate since the 1st quarter of 2013.
Source: Statistics Denmark and own calculations.

The increase in employment has brought unemployment down to a very low level. The drop in unemployment has taken place across unemployment insurance organisations and across the country, *cf. figure 1.3*. In 2017, unemployment is affected by a change of methodology for recipients of unemployment insurance and the fact that recipients of integration benefits increasingly are classified as labour-market-ready and thereby are included in the gross unemployment statistics. Recent figures, however, show a continued decline in unemployment. Unemployment is currently at its lowest since 2008 where the labour market, unlike today, was severely overheated.

Others have also reaped the benefits of the strong development in the labour market. In 2017, the number of people receiving public benefits was at the lowest level for more than a decade, *cf. figure 1.4*.

Figure 1.4

The positive development has reduced unemployment and the number of people receiving public benefits



Note: The figure excludes old age retirees and students. Based on ADAM's databank, which contains long time series for the number of people receiving income transfers.
Source: Statistics Denmark and own calculations.

When more people have a labour income, and fewer rely on public benefits, the income level goes up. Meanwhile the tax rate has been reduced. Household disposable incomes have increased by 10 per cent in real terms over the past three years. At the same time, falling interest rates have reduced the costs associated with e.g. mortgage debt.

Households have to a large extent spent the increased income on reducing debt levels. The level of mortgage debt today is back at its previous 2005-level, *cf. figure 1.5*.

At the same time, house prices, and hence housing equity levels, have increased such that households are now well-consolidated, *cf. figure 1.6*.

Not only households have benefitted from the upturn of the past years. Firms have re-established their earning power. At the same time, the situation in the world economy is better than it has been for many years with growth rates on par with the pace preceding the financial crisis. Firms have enjoyed the benefits of this, and since 2013 exports have increased by 13 per cent.

Figure 1.5

Households are reducing debt levels

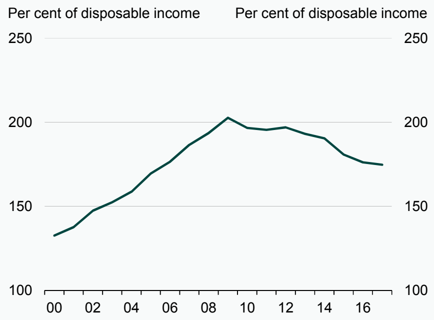
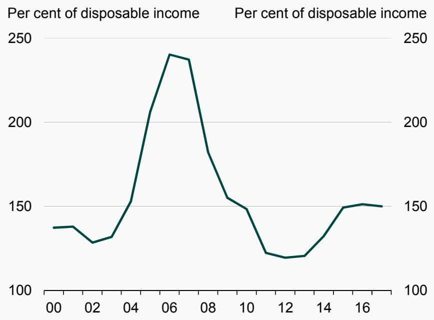


Figure 1.6

Housing equity is on the rise again



Note: The debt in figure 1.5 is total household mortgage debt. The equity in figure 1.6 is the difference between total property value and mortgage debt.
Source: Statistics Denmark and own calculations.

That firms believe in a better development is also expressed by the fact that they are building capital after a few years where the investment level was insufficient to compensate for the yearly depreciation rate, *cf. figure 1.7*.

Figure 1.7

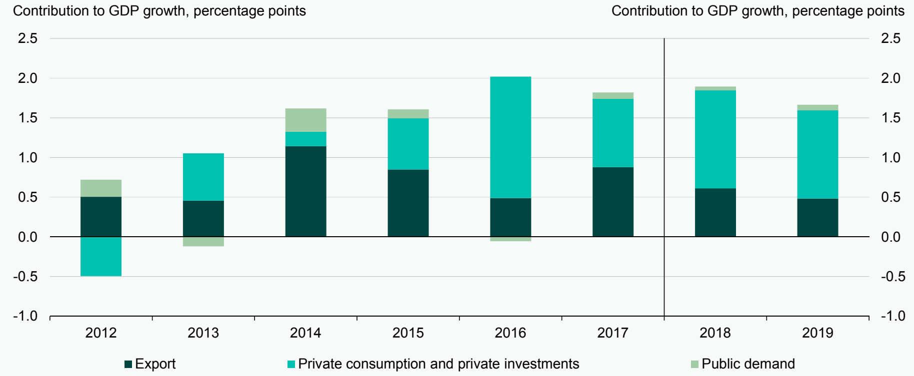
Positive net investments point to more optimistic firms

Note: Private business net investments in machinery, buildings etc. relative to private sector gross value added.
Source: Statistics Denmark and own calculations.

The preconditions are in place for the economic upswing to continue. Households are in a good position to increase consumption and housing investments further, and a strong global economy provides good export conditions. Stronger demand at home and from abroad also increases the need for firms to undertake new investments in order to increase production capacity. Public demand is expected to contribute to dampening the capacity pressure, and increase the possibility for a long-lasting expansion. The improvement in the Danish economy is thus supported by considerable contributions from private consumption, private investments, and exports, *cf. figure 1.8.*

Figure 1.8

The positive development in the Danish economy is supported by contributions from private consumption, private investments, and exports



Note: Growth contributions to GDP are adjusted for the import content in each demand component using the input-output based method. Exports in 2017 have on a discretionary basis been adjusted for a large one-off payment in the 1st quarter of 2017 for use of Danish-owned intellectual property rights.
Source: Statistics Denmark and own calculations.

Increased capacity utilisation and more broad labour shortages are expected to limit the growth potential over the coming years, and hence growth is expected to gradually wane. GDP growth is expected at 1.9 per cent in 2018 and 1.7 per cent in 2019.

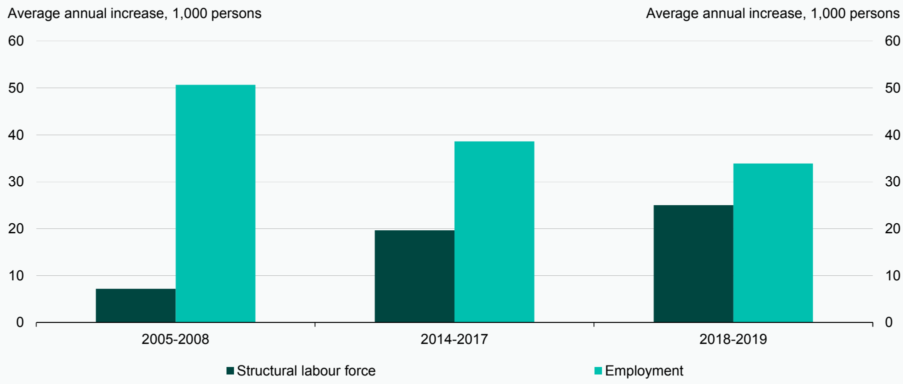
Reforms support a sustainable upswing

The high pace in the job creation means that employment is now slightly above the estimated, structural level. Employment can, however, continue to climb upward, since the structural labour force is also expected to increase in the coming years.

Structural labour supply has increased by around 20,000 persons each year since 2014, amongst other things due to reforms, *cf. figure 1.9.* That pace is expected to continue over the coming years. In 2019, the old age retirement age and early retirement age are increased by six months, which in itself increases the labour supply by almost 8,000 people.

Figure 1.9

Reforms contribute significantly to the future increase in the labour force



Note: Labour force and employment include people on temporary leave from employment. The growth in the structural labour force primarily reflects the effect of reforms, which have been carried out in Denmark after the financial crisis. These include *The Fiscal Consolidation Agreement*, 2010 (*Genopretningsaftalen)* and *The Retirement Reform*, 2011 (*Tilbagetrækningsaftalen)*.
Source: Statistics Denmark and own calculations.

The growth in the labour force also partly reflects an increase in foreign labour. Without this contribution, the current pressure on the Danish labour market would be considerably higher. However, competition for labour is increasing across countries, and it is not given that foreign labour will continue to contribute to the total labour supply to the same extent as has been the case in recent years.

Increasing structural labour supply plays a significant role in the positive development in the Danish economy over the past years, and also the main reason why growth is expected to continue at a sustainable pace. Without reforms, employment would already far surpass potential.

During the economic upswing of the previous decade, the labour force did not increase at nearly the same pace. That led to a very high employment rate and a tight labour market, which ended with a severely overheated labour market.

The projected increase in the employment will gradually increase pressures on the labour market. Already, the industrial, service, and especially construction sector, are reporting of labour shortages as a production constraint. This increases the risks of bottlenecks over the coming years, but the expected increase in employment is assumed to be sustainable.

The possibility for a long-lasting boom should also be seen in light of a number of measures aimed at increasing the robustness of households. Most recently, the government has introduced new guidelines as of January 1st 2018 to limit the use of certain, more risky mortgage loan types. The new guidelines limit the access to risky loan types for households with a debt level surpassing four times the annual gross income and a loan-to-value ratio above 60 per cent for mortgage debt. The new guidelines supplement other initiatives and credit conditions are now more restrictive than during the housing market bubble of the previous decade.

An economic boom phase will at some point come to an end. When that happens, it is important that there has not been a previous build-up of imbalances, which could worsen and prolong the ensuing economic setback. Both the increase in the labour force and measures aimed at the financial stability contribute to prolonging the economic upswing and counteract the risk of significant economic imbalances.

During an economic expansion phase, fiscal policy should contribute to dampening capacity pressure. The government is planning a fiscal and structural policy that supports a sustainable upswing*, cf. part 1.2*.

The uncertainties for the projection are balanced

Risks to the projection appear broadly balanced, and the preconditions for an economic boom lasting several years appear to be in place. However, several scenarios could affect the projected growth path.

Households and firms currently have a large savings surplus and are in a good position to increase consumption and investments further. If the larger demand can be met by increased supply, growth in the coming years may be higher.

However, the development also implies a risk of more widespread labour supply shortages, which could limit the growth potential. If the labour market becomes so tight that it results in accelerating price- and wage pressures, the economic boom could turn into an overheating.

Prospects abroad seem more favourable now than at any previous time during the current upswing. Recently international organisations such as the IMF, OECD, and the European Commission have revised their growth projections upwards.

However, multiple factors of uncertainty regarding the global economy still persist. The customs duty on steel and aluminium introduced by the US is the latest concrete evidence of a more protectionist stance. Increased barriers to trade point to a reduction in world trade, which will also affect the Danish economy.

So far, the full scale and consequences of trade interventions is unclear. An actual trade war could have considerable consequences. IMF has previously projected that a 10 percentage points increase in import-tariffs on goods between all major economies of the world could reduce world trade by 1 per cent and GDP by 0.5 per cent over the course of three years.[1] If this scenario is transferred to Danish conditions, it could reduce export

[1] IMF Working Paper (2017): The Macroeconomic Effects of Trade Tariffs: Revisiting the Lerner Symmetry Result.

market growth by 1 per cent-point and furthermore reduce investment growth by 1 percentage point as a consequence of falling demand and increased uncertainty.

The negative consequences of bigger trade restrictions in this scenario imply that GDP-growth is reduced by 0.2 percentage points in 2018 as well as 2019. The increase in employment is reduced by almost 10,000 persons. If the scenario leads to increased uncertainty and widespread fear of more setbacks, the implications could be larger already in the short term. A more widespread trade war, implying steep increases in trade costs, could hit the Danish economy harder.

Danish economy is in a good position to tackle a less optimistic growth path, and the negative risks mostly point a dampening of the current economic boom rather than bringing it to a halt.

Box 1.1

Data underlying the forecast and changes since the December forecast

The forecast is based on national accounts available for the 4th quarter of 2017 along with a wide range of indicators for the economic development reaching into 2018. Calculations for the forecast were finalised on May 11th 2018. After the cut-off date, Statistics Denmark has published the GDP-indicator for the 1st quarter of 2018. The indicator shows a seasonally adjusted real GDP growth of 0.3 per cent for the 1st quarter of 2018.

Relative to the forecast in *Economic Survey, December 2017,* the assessment of the business cycle is roughly unchanged. The latest indicators for production and demand only give rise to small revisions of the GDP growth forecast and its composition.

Employment has increased slightly faster than previously expected, and a faster pace in the employment increase is now anticipated in 2018-2019. Reversely, with an unchanged GDP growth projection, this implies a slightly weaker development for productivity.

With the publication of the national accounts for the 4th quarter of 2017, Statistics Denmark has included a large one-off payment for use of Danish-owned intellectual property rights. The payment lifts GDP by 0.4 percentage points in 2017 and reduces GDP growth in 2018 accordingly as the one-off contribution to growth falls away.

The payment was not included in the national accounts before the first publication of the national accounts for the 4th quarter of 2017, and hence was not a part of the data underlying the December-projection. The payment in itself does not affect the underlying growth potential in the Danish economy – nor does it influence the overall outlook for the forecast. The periodisation of the payment does have implications for the annual GDP growth, however. Statistics Denmark may revise the current periodisation of the payment in later revisions of the national accounts, which could have implications for the annual growth rate. It is not yet clear if and when that will happen.

Growth projections in this forecast are shown so that they are consistent with the underlying growth potential excluding the negative contribution to growth from the fact that the payment does not support the GDP level in 2018. The GDP level that forms that basis for the annual budget has been corrected to account for this.

1.2 Fiscal policy and public finances

Danish economy has entered an economic boom. Both production and employment are estimated to exceed the structural levels in 2018 and 2019, *cf. table 1.1*. In such a situation it is appropriate that the fiscal and structural policy contribute to dampen capacity pressure in the economy to counteract risks of overheating.

The targets of the fiscal policy for the coming years include a gradual reduction of the current structural deficits. In the coming years, recent years' reforms also contribute by creating room for continued employment growth. In total, fiscal and structural policy is thereby dampening risks of overheating and contributes to maintaining a balanced upswing.

Table 1.1

Main components of the projection relating to fiscal policy

	2017	2018	2019
Structural balance, per cent of structural GDP	-0.1	-0.2	-0.1
Actual fiscal balance, per cent of GDP	1.0	-0.5	-0.5
EMU debt, per cent of GDP	36.4	35.4	34.9
Growth in public consumption, per cent 1)	0.7	0.5	0.3[1]
One-year fiscal effect, per cent of GDP2)	-0.4	-0.2	-0.2
Output gap, per cent.3)	-0.2	0.4	0.9
Employment gap, 1,000 persons3)	0	11	17

1) The Government prioritises an annual basic real growth in public consumption expenditures of 0.3 per cent in the years 2019-2025. Expenditures made possible from reforms and increased investments in the safety of the Danes are additional to this target. The remaining fiscal space in 2019 is technically placed as a reserve for other priorities. The reserve is technically placed as a transfer from the public sector to the households. This implies that the structural budget balance is unaffected by the placement of the reserve. The public consumption in table 1.1 is calculated by the input method incl. deductions. The public consumption growth rate is 1.2 per cent in 2017 calculated by the output method.
2) Calculated measure of how fiscal and structural policy from one year to another affects the capacity pressure.
3) Calculated measure of how far production and employment are from structural levels. When gaps are approx. zero it corresponds to a situation where there are no more available resources in the economy than in a normal situation.
Source: Statistics Denmark and own calculations.

The fiscal policy for 2018 was planned on the basis of a structural deficit of 0.3 per cent of GDP with the approved budget bill and the budget agreements with the municipalities and regions. Since then, new information about, among other things, a slightly higher structural employment and higher revenue from the capital yield taxation, has become available. The structural deficit in 2018 is now estimated to 0.2 per cent, whereas the structural deficit in 2019 is estimated to be reduced to 0.1 per cent of GDP. Estimates of the structural budget balance are subject to uncertainty.

The fiscal policy for 2019 will be determined with the 2019 budget bill and the budget agreements with the municipalities and regions for 2019.

The fiscal policy supports a sustainable upswing

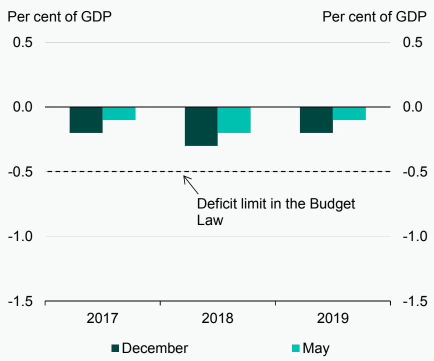
In comparison to the December assessment, the estimated structural deficits in 2017-2019 is adjusted downwards by 0.1 per cent of GDP, primarily due to the above mentioned factors. Thus, the structural deficit in 2017 is now estimated to be 0.1 per cent of GDP compared to 0.2 per cent in the December assessment, *cf. figure 1.11*. In 2018 the structural deficit is estimated to 0.2 per cent of GDP, and the estimated budget balance in 2019 is estimated to -0.1 per cent of GDP.

Figure 1.100

Structural budget balance, 2000-2019

Figure 1.11

Structural budget balance, 2017-2019



Source: Statistics Denmark and own calculations.

The government plans its fiscal policy in line with a target of a structural deficit of 0.1 per cent of GDP in 2020 and a goal of structural balance in 2025, in spite of a decrease in the structural revenues from the oil and gas extractions in the North Sea of approx. ½ per cent of GDP from 2017-2020 and approx. 1/3 per cent of GDP towards 2025. The lines of sights in the fiscal policy thus include a gradual fiscal consolidation that contributes to dampen capacity pressures in the Danish economy.

The economic boom implies, among other things, that more people reach employment, fewer people are receiving public income transfers and the businesses are increasing their production. The actual employment is estimated to exceed the structural level in 2018, in line with the estimate in the December assessment, *cf. figure 1.12*.

It is important that the fiscal and structural policy contributes to dampen capacity pressure in a boom in order to support a sustainable upswing.

Figure 1.12

Employment gap

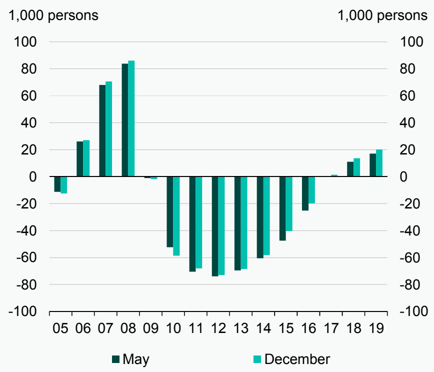
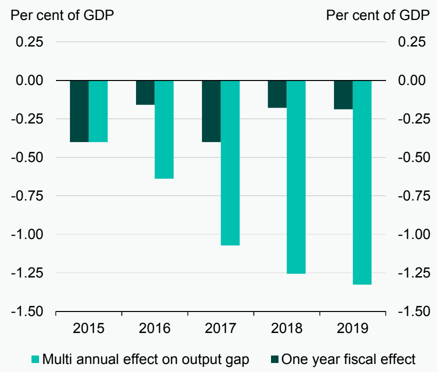


Figure 1.13

Fiscal effect



Notes: Figure 1.13 shows the multi annual fiscal effect on capacity pressure (measured by the output gap) from changes in fiscal policy relative to 2014.
Source: Statistics Denmark and own calculations.

In 2018 and 2019, the fiscal and structural policy is expected to dampen capacity pressure by approx. 0.2 per cent annually measured by the so-called one year fiscal effect. The fiscal effects reflect that later years' structural reforms are expanding labour supply and thereby dampening capacity pressure on the labour market.

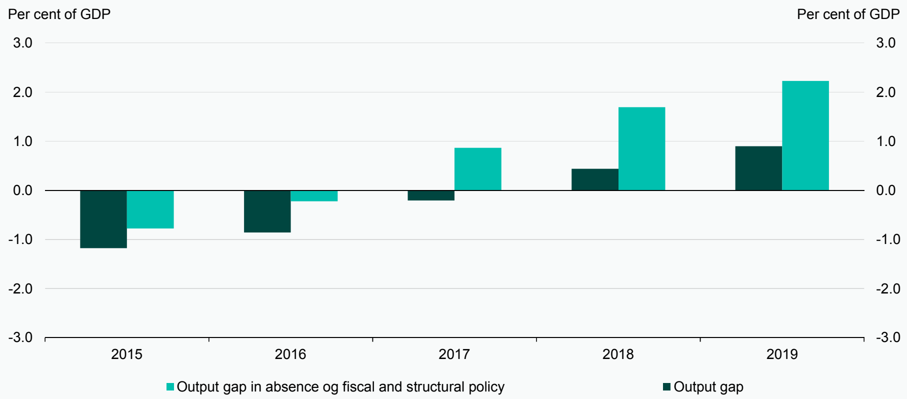
The fiscal and structural policy's effect on capacity pressure can also be measured by the multi annual fiscal effects, which measure the effect on capacity pressure from changes in fiscal and structural policy both in the year concerned and in previous years, currently with 2014 as reference year. The multi annual fiscal effects are calculated in the ADAM-model and the calculated effect is subject to increasing uncertainty, the longer the period concerned.

In total, the tightening of the fiscal and structural policy is estimated to dampen capacity pressure by approx. 1¼ per cent of GDP in 2018 and 2019 relative to the remissive reference point in 2014, *cf. figure 1.13*. The dampening effect can both be attributed to structural reforms and a restrained expenditure policy for among other things public consumption.

The multi annual fiscal effect corresponds to the total level-effect on the output and employment gaps from the fiscal and structural policy. In absence of the fiscal and structural policy's effect on capacity pressures, it is estimated that the output gap would have been positive as soon as in 2017, with prospects of a further expansion of the gap towards 2019, *cf. figure 1.14*.

Figure 1.14

Fiscal and structural policy's effect on the output gap



Source: Statistics Denmark and own calculations.

Actual budget balance and public debt

The initiating boom means, among other things, that the actual budget balance is improved as a consequence of higher revenues from income taxes VAT's etc. as well as lower expenditures to public income transfers. A surplus of approx. 1.0 per cent on the actual budget balance is recorded for 2017 corresponding to more than DKK 20 bn.

In spite of the economic progress, it is estimated that the actual budget balance will show a deficit of 0.5 per cent of GDP in 2018 and 2019. This is, however, highly due to the fact that the actual budget balance is affected by temporary fluctuations in the pension yield taxation revenues. Adjusted for the large variation in the revenue from the pension yield tax it is estimated that the actual budget balance will show surpluses of approx. 0.4 per cent of GDP and 0.5 per cent of GDP in 2018 and 2019, respectively, *cf. figure 1.15*. The surpluses are estimated in spite of one-off payments of early retirement contributions and property taxes due to the *Agreement on more years on the labour market* (June 2018) and the *Agreement on housing taxation* (May 2017).

Figure 1.15

Actual budget balance

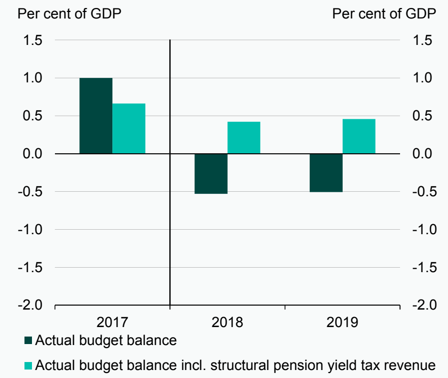
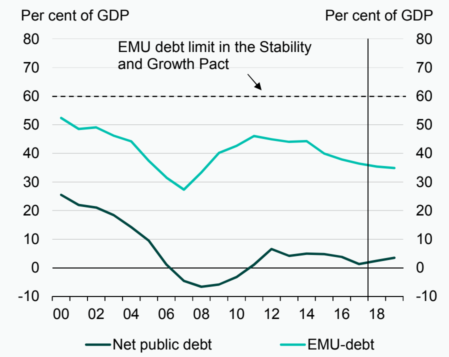


Figure 1.16

Public debt



Source: Statistics Denmark and own calculations.

In 2018 and 2019 the public net debt is estimated to be on a continued low level of approx. 2-3 per cent of GDP, while the EMU-debt is estimated to approx. 35 per cent of GDP, *cf. figure 1.16*. The public debt in Denmark is thus significantly below the debt limit in the EU Stability and Growth pact of 60 per cent of GDP.

1.3 Annex table

Table 1.2

Key figures compared to *Economic Survey, December 2017*

	2017	2018		2019	
		Dec.	May	Dec.	May
Real change, per cent					
Private consumption	1.5	2.3	2.3	2.4	2.2
Total government demand	0.3	0.8	0.5	0.3	0.3
- of which government consumption[1)]	1.2	1.0	0.5	0.3	0.3
- of which government investment	-5.8	-1.1	0.5	-0.1	0.3
Housing investment	6.2	6.0	6.0	5.6	5.4
Business fixed investment	6.6	4.9	4.9	5.5	5.0
Total final domestic demand	1.9	2.4	2.2	2.3	2.2
Inventory investment (per cent contr. to GDP)	0.1	0.0	0.0	0.0	0.0
Total domestic demand	2.0	2.3	2.2	2.4	2.2
Exports	4.4	2.8	3.0[2)]	2.6	2.8
- of which manufacturing exports	5.6	3.6	4.4	3.6	4.1
Total demand	2.8	2.5	2.5[2)]	2.5	2.4
Imports	4.1	3.7	3.8	4.0	4.0
- of which imports of goods	5.3	3.7	3.7	3.8	3.8
GDP	2.2	1.9	1.9[2)]	1.7	1.7
Gross value added	2.3	2.0	2.1[2)]	1.9	1.9
- of which private non-farm sector	3.0	2.6	2.8[2)]	2.6	2.7
Change, 1,000 persons					
Labour force, total	50	29	34	17	23
Employment, total	46	33	41	23	27
- of which private sector	46	31	40	24	28
- of which public sector	0	2	1	-1	-1
Gross unemployment	4	-5	-7	-5	-3
Cyclical developments, per cent					
Output gap	-0.2	0.4	0.4	0.7	0.9
Employment gap	0.0	0.5	0.4	0.7	0.6
Unemployment gap	0.1	-0.2	-0.1	-0.3	-0.2

1) Measured by the output method incl. depreciations.
2) Adjusted on a discretionary basis for a large one-off payment in the 1st quarter of 2017 for use of Danish-owned intellectual property rights. Thereby, growth projections are in line with the underlying growth potential.

Table 1.2 (continued)

Key figures compared to *Economic Survey, December 2017*

	2017	2018		2019	
		Dec.	May	Dec.	May
Change, per cent					
House prices (single family homes)	4.0	3.8	3.7	3.3	3.3
Consumer prices	1.1	1.5	1.0	1.7	1.6
Hourly earnings in the private sector	2.2	2.8	2.8	2.9	2.9
Real disposable income, households	2.1	2.7	3.3	2.2	1.7
Productivity in the private non-farm sector	1.1	1.1	0.8[2)]	1.4	1.3
Per cent per year					
Interest rate, 1-year rate loan	-0.6	-0.5	-0.5	-0.1	-0.2
Interest rate, 10-year government bond	0.5	0.7	0.7	1.1	1.1
Interest rate, 30-year mortgage credit bond	2.3	2.3	2.3	2.7	2.7
Public finances					
Actual public balance (Bn. DKK)	21.5	-17.2	-11.7	-14.8	-11.6
Actual public balance (per cent of GDP)	1.0	-0.8	-0.5	-0.6	-0.5
Actual public balance (per cent of GDP)	-0.1	-0.3	-0.2	-0.2	-0.1
Gross debt (per cent of GDP)	36.4	35.4	35.4	34.6	34.9
Labour market					
Labour force, total	3,031	3,061	3,065	3,079	3,088
Employment, total	2,921	2,955	2,962	2,978	2,989
Gross unemployment (yr. avg., 1,000 persons)	116	112	109	107	106
Gross unemployment (per cent of labour force)	3.8	3.6	3.6	3.5	3.4
External assumptions					
Trade-weighted international GDP-growth	2.5	2.6	2.7	2.3	2.4
Export market growth (manufactured goods)	4.8	4.0	4.9	4.0	4.2
Exchange rate (DKK per USD)	6.6	6.3	6.1	6.3	6.1
Oil price, dollars per barrel	54.3	62.9	71.2	64.3	71.8
Balance of payments					
Current account balance (DKK bn.)	167	170	162	164	160
Current account balance (per cent of GDP)	7.8	7.6	7.3	7.1	7.0