Chapter 1
Summary

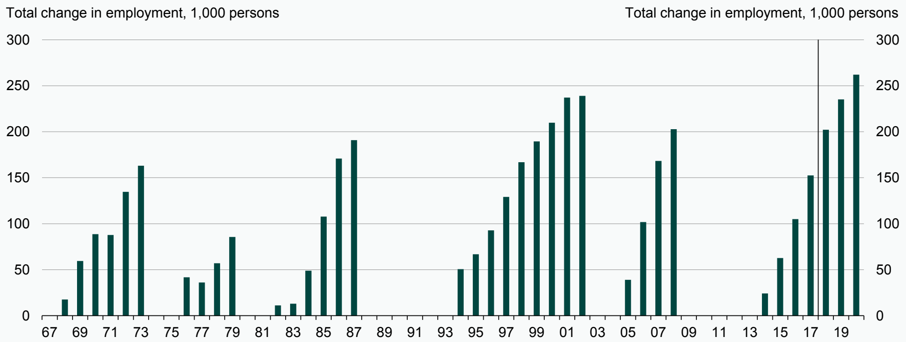
1.1 The current economic outlook

The upturn in the Danish economy continues. Growth has been strong in recent years and GDP has grown by approximately 2¼ per cent per year in 2015-2017. The economic boom is also evident in employment, which has increased continuously since the spring of 2013 and is at its highest level ever. Already, employment growth has matched the entire job creation during the upswing in the 2000s, and job creation in the current recovery is expected to reach a historically high level, *cf. figure 1.1*.

Among other things, a growing labour force supports continued growth. Due to reforms, the retirement age is set to increase further, and it is assumed that the inflow of foreign workers continues. However, capacity constrains are expected to increase, which lowers growth prospects. Fiscal policy restraint is required in order to support sustainable growth. New initiatives that increase labour supply could help extend the economic upturn.

Figure 1.1

Growth in employment is set to reach a record high



Note: The figure illustrates total growth in employment in periods with increasing employment.
Source: Statistics Denmark and own calculations.

Abroad, growth is still solid, but the upswing seems to have lost momentum, including in the euro area. At the same time, protectionist trade measures have already led to some moderation in the global economy and there is a risk of increasing barriers to international trade. Growth in Danish exports is tightly aligned with growth abroad and a more moderate growth in exports is the main reason for the slight slowdown in GDP growth towards 2020. However, growth is set to remain solid throughout the forecast period.

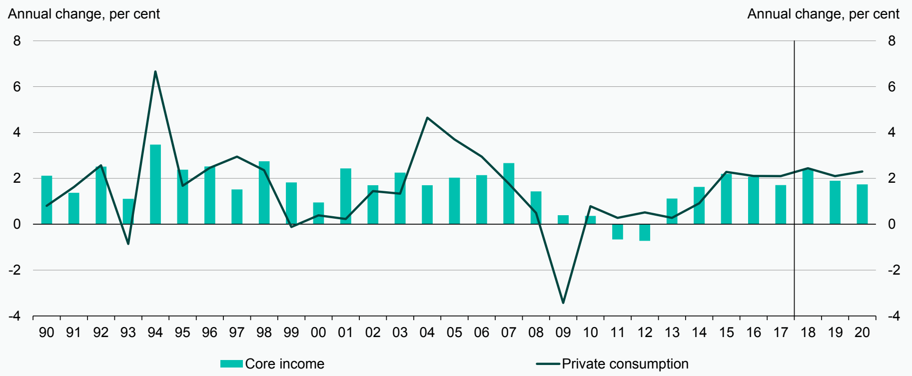
Private-led boom with no signs of a build-up of imbalances

The Danish economy is currently in an economic boom phase after three years with average GDP growth of 2¼ per cent per year. Employment has increased by 128,000 persons in the same period.

The increase in employment has led to a significant increase in incomes, *cf. figure 1.2*. Higher incomes have created the basis for a self-sustaining recovery, where private consumption and rising investment are major drivers of GDP growth.

Figure 1.2

Income growth is the main driver of private consumption



Note: Core income is compensation of employees and social benefits. The figure is adjusted for consumer price inflation.
Source: Statistics Denmark and own calculations.

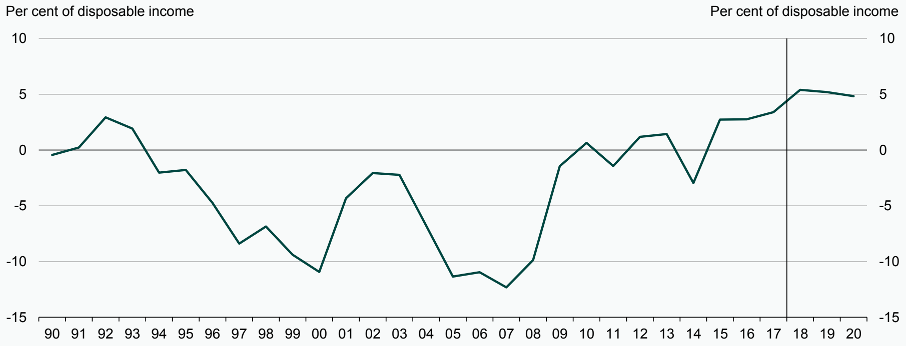
Private consumption per capita reached the highest level ever last year. Towards 2020 consumption is expected to increase further. Nevertheless, households are still cautious in the sense that they are saving to a significant extent. Thus the increase in private consumption in the current recovery is due to increasing incomes and not increased indebtedness.

During the last three years, households have had positive financial savings as opposed to the period 1995-2014, where households in general dis-saved or took out loans, *cf. figure 1.3*. If savings in the form of housing investments is added, savings accounted for 12 per cent of disposable income in 2017.

The high level of savings also allows households to increase consumption relative to income in the coming years without compromising household finances.

Figure 1.3

Households' financial savings are high



Note: Households' financial savings include changes in the stock of securities, pensions, cash and bank deposits (net).
Source: Statistics Denmark and own calculations.

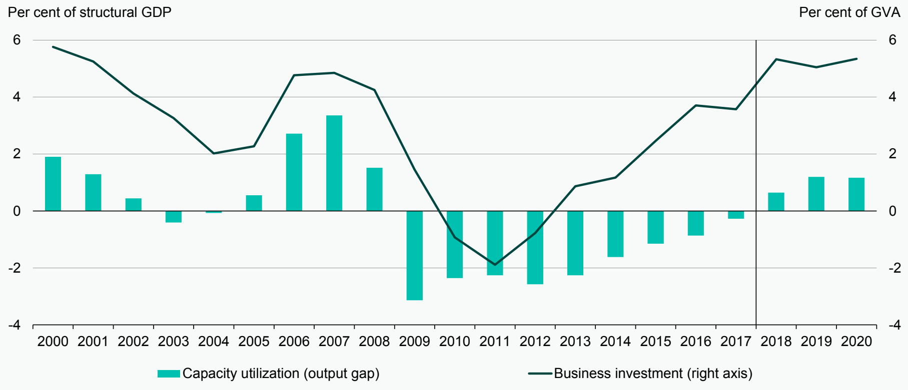
As in previous recoveries, investments have been strong. Over the course of a business cycle, investment typically fluctuates 3-4 times as much as GDP. In line with increasing capacity utilization and more widespread labour shortages, companies' investment needs have increased. Business investments have risen since 2013 after several years of very depressed investments below the level of depreciation of the capital stock, *cf. figure 1.4*.

Investments have now reached a level, where the capital stock is increasing relative to the labour force. The ratio between capital and labour has an impact on productivity, and productivity growth is expected to pick up from the very modest growth rates in recent years along with the rise in capital intensity.

In the housing market there is also significant investment activity. Increasing incomes and continuing low interest rates has led to higher demand for new housing and thereby housing investments. In particular, construction activity has risen considerably in Copenhagen, where prices have increased the most. However, the rest of the country has also seen an upward trend in construction activity.

Figure 1.4

Business investments have increased in line with increasing capacity utilization

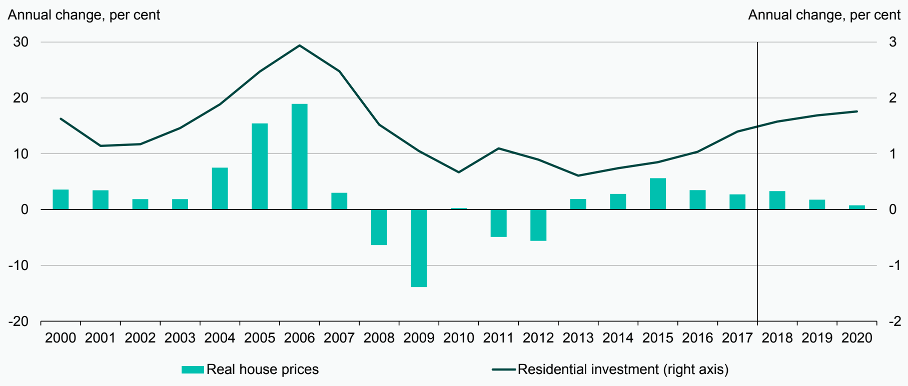


Note: The output gap is the difference between the actual level of GDP and the level which is in line with normal capacity utilization and stable inflation. A narrowing or an expansion of the output gap is equivalent to rising capacity utilization. Business investments are net investments (i.e. less deprecation) and are shown as a share of private sector GVA excl. housing.
Source: Statistics Denmark and own calculations.

New construction is dampening the rise in house prices, and the rate of increase in real house prices has declined in recent years, *cf. figure 1.5*. More moderate growth in house prices reduces the risk of unsustainable developments, where accelerating house prices by themselves could lead to higher loan demand and create a push towards excessive indebtedness.

Figure 1.5

Residential investments reduces the increase in house prices

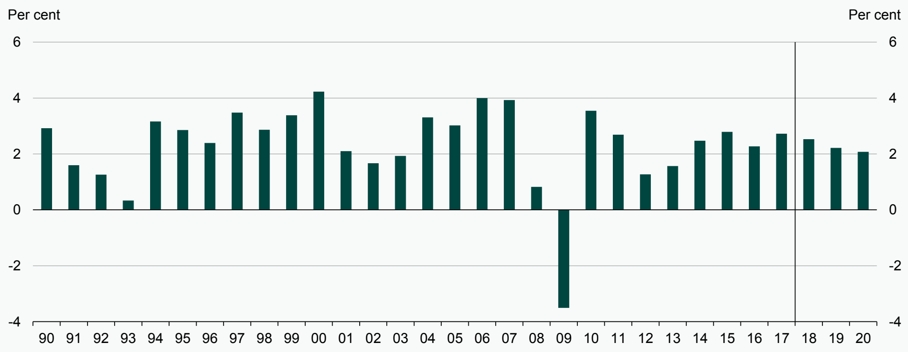


Note: Residential investment is calculated as net investment (residential investment less depreciation).
Source: Statistics Denmark and own calculations.

It is expected that growth in private consumption and investment will continue to be the main driving forces behind the upswing in the coming years, at about the same rate as last year and this year. Exports are also expected to contribute to growth, but to a lesser extent, mainly because the global economy seems to have peaked, *cf. figure 1.6*.

Figure 1.6

Growth in Danish exports markets has peaked



Note: The figure illustrates growth in trade-weighted GDP, which is calculated as the weighted average of the GDP growth in Denmark's 29 most important trade partners.
Source: Statistics Denmark and own calculations.

Many European countries are now faces increasing labour market pressures after five years of constant expansion, and growth is expected gradually to decrease to a rate that is more in line with the underlying potential. In addition, growth in global trade has slowed, partly due to new protectionist measures. The slowdown in the global economy affects the export opportunities of Danish companies', which is the main reason for the expected slight moderation in growth towards 2020.

Reforms support employment growth

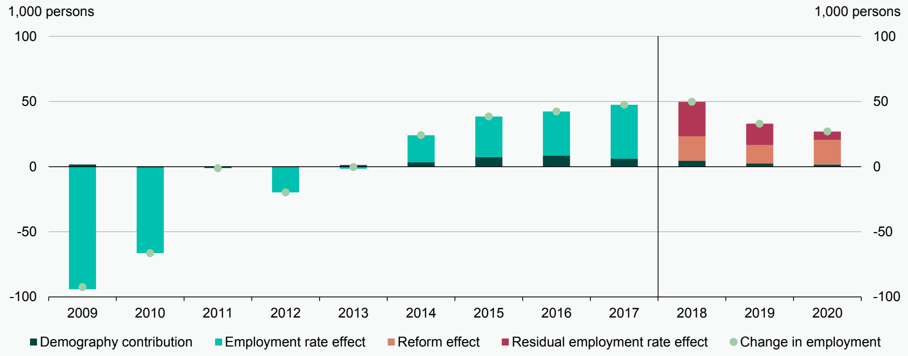
The labour market continues to improve at a strong pace. Employment has grown by more than 10,000 people in every quarter since 2015, and there are no immediate signs of a slowdown. Thus, the increase in employment so far this year has been the strongest since the beginning of the recovery. In the first three quarters of 2018, employment has grown by 39,000 persons, which are 4,000 more than in the same period last year.

Adopted reforms support further employment growth. The retirement age is gradually increased from the current 65 years to 67 years in the period 2019-2022, and the early retirement age has gradually been increased since 2014 and will reach 64 years in 2023. The reform effect of the later retirement age is estimated to almost 13,000 persons a year. In addition, other reforms will contribute to increase the structural employment by around 4,500 persons a year, including the phasing-in of previously agreed tax and transfer measures and the 2018 tax agreement.

Thus, reforms are estimated to increase structural employment by an average of 17,000 persons a year until 2020, *cf. figure 1.7*.

Figure 1.7

Reforms contributes significantly to the increase in employment



Note: The frequency rate illustrates the contribution to the increase in employment due to a higher employment rate (i.e. bigger proportion of the population in employment). In the forecast the effect of higher employment rate is split into a contribution from reforms and a residual contribution, which is not the result of structural reforms but, among other things, contains a cyclical component. The demography contribution is based on Statistic Denmark's population projection.

Source: Ministry of Finance, Statistics Denmark and own calculations.

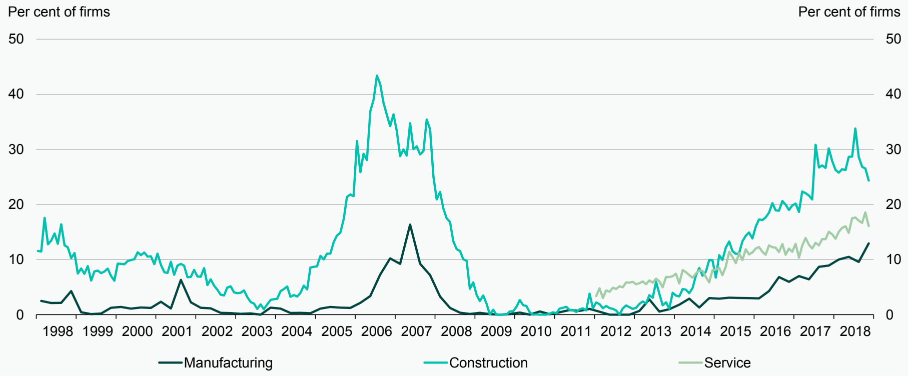
A growing population also contributes to structural employment. The population development implies fewer persons of Danish origin in the working age, but it is offset by an increase in foreign labour. The contribution from demographic changes amounted to 6,000 persons in 2017 and is expected to decline gradually to 2,000 persons by 2020 due to a decrease in the number of persons of Danish origin in the working age and a diminishing contribution from immigration.

In the forecast, employment is expected to increase by a total of 110,000 persons in 2018-2020. The increase in structural employment is estimated at 70,000 persons, and thus labour market pressure will increase slightly. Employment is estimated to be approximately ¾ per cent higher than the calculated structural level this year and is expected to increase further.

The share of firms, which report labour shortages, is already high. The reported labour shortage has been increasing continuously since 2013 and is approaching the level in 2006, where the Danish economy was close to an overheating, *cf. figure 1.8*.

Figure 1.8

The reported labour shortage is high



Note: The figure illustrates the share of firms (weighted by employment) which report shortage of labour as a limit to production.
Source: Statistics Denmark and own calculations.

The increasing pressure on the labour market is less reflected in other indicators. Thus the number of unsuccessful recruitments remains significantly lower than during the boom in the last decade. In addition, wage growth is still relative moderate, although the wage rate has increased since the turn around in the labour market in 2013. However, the excessive wage growth during the economic boom in the last decade emerged late in the recovery, where the labour market was already overheated.

In the forecast it is assumed that growth will gradually slow down, so the economic boom does not end in a hard landing, for example as a result of severe overheating of the labour market.

The expectation of a soft landing should be seen in conjunction with the absence of a significant build-up of imbalances, including unsustainable indebtedness among firms and households, housing prices that are not in line with fundamental economic conditions or poor competitiveness due to significant increases in wage rates.

History has also shown that the possibility of a longer-lasting business cycle upturn and a soft landing is most likely when reforms counteract an increasing capacity pressure and economic policy is aligned with the business cycle, *cf. box 1.1*.

Box 1.1

Reforms support a longer-lasting business cycle upturn

This year the Danish economy has entered into a period of economic boom. This means that the level of production to an increasing extent exceeds the neutral level (i.e. the output gap is positive and increasing).

Economic booms eventually come to an end, but history shows that the pattern of growth and the ensuing downturn can be very different across cycles. The economic booms in the 1980s and the 2000s both ended in an overheated economy and a subsequent protracted slowdown. Overheating occurred both in the housing market, with unsustainable increases in housing prices, and the labour market, where increasing labour shortages lead to excessive wage growth. Overheating occurred quickly resulting in a short-lived economic boom in both instances, *cf. table a*.

In contrast, the economic boom in the 1990s was long lasting and ended with a soft landing, which limited the size of the ensuing economic downturn. Labour market shortages did not build up to the same extent, inter alia due to labour market reforms, which lowered structural unemployment to an extent that roughly corresponded to the increase in employment. Furthermore, fiscal policy contributed to dampen growth, including through increasing the incentive to save through a lowering of the tax value of the deductibility of interest expenditures, which had a dampening effect on consumption and housing price increases.

The current economic boom phase shares several features with the economic boom of the late 1990s. Reforms are leading to a structural increase in the labour force, which, however, do not match the actual employment gains. Furthermore, a number of initiatives have been taken to strengthen financial stability and contribute to a more stable development in the housing market. Currently there a no signs of accelerating wage growth, and moderate wage growth of 2.5 per cent is projected for this year. Similarly, there are no significant imbalances in the housing market, and housing prices are set to increase by 4.2 per cent this year.

Every economic cycle has its particular features, and the present economic boom is, apart from the significant growth contribution from economic reforms, characterized by the fact that households maintain a high savings rate despite the protracted upturn. This is apparent in the consumption ratio, which is below 95 per cent, and has not increased in the same manner as during previous economic boom phases. This also limits the build-up of debt. Therefore, the conditions are in place for the economic boom to last several years and to be followed by a soft landing.

Table a
Economic indicators for previous economic booms

	1985-1986	1995-2000	2005-2007
Duration, years	2	6	3
Duration of ensuing economic downturn, years	7	3	5
Avg. annual difference between actual and potential GDP-growth, per cent.	0.6	0.4	1.2
Output gap (end year), per cent of potential GDP	0.9	1.9	3.4
Consumption ratio(end year), per cent of disposable income	104.5	105.0	105.1
Wage growth rate (end year +1), per cent	10.5	4.2	4.6
House price increases (end year – 1), per cent	17.1	6.9	21.6
Avg. annual difference between the increase in actual and structural level of employment, 1,000 persons	33	14	28
Avg. annual decrease in structural unemployment, 1,000 persons	-4	20	16

Source: Statistics Denmark and own calculations.

Downside risks have begun to materialize

The Danish economy is fundamentally sound and is therefore well-equipped to weather a more negative development relative to what is assumed in the forecast. However, negative shocks – of either domestic or international origin – would lead to a dampening of economic growth.

Downside risks primarily originate from international economic developments, and the somewhat lower international growth prospects have already been incorporated in the forecast. Nevertheless, risks continue to be skewed towards the downside.

The effects of recently introduced protectionist measures have begun to slow world trade growth. Additional measures could potentially lead to a further deceleration. While these measures are not directly targeted at the Danish economy, they could have an impact through their effects on shipping or the participation of Danish companies in global value chains. The main risk related to protectionist measures is not stemming from the short-term effects on economic growth, but the longer-lasting effects stemming from the loss of the gains from international trade, which also has the potential to dampen long-term economic growth. These longer-term effects stem inter alia from a reduced international transfer of technology and know-how thus reducing the pass-through of productivity gains.

The impending exit of the United Kingdom from the EU poses a particular threat to Danish exports. An agreement has been reached between the EU and the United Kingdom, which would keep the United Kingdom within the internal market for a two-year transitional period, but this agreement has not been ratified by the British Parliament. Furthermore, negotiations on the terms of the economic relations between the United Kingdom and the EU after this transitional period are also pending.

In addition, there is also the risk that international economic growth will be lower than previously assumed. In the EU, growth may have peaked last year, which could potentially reflect the fact that capacity utilization has returned to a more normal level following five years of continuous progress. Confidence indicators show a declining trend, and for this forecast it is assumed that growth is slowing over the coming years. In particular, there are risks stemming from developments in Italy. The uncertainty surrounding the fiscal plans has led to financial instability in Italy and declining confidence in Italian banks.

The United States are experiencing a long-lasting economic upswing, and there is potential for the U.S. economy to overheat. If this happens it would lead to lower-than-expected global economic growth. The central bank has already raised interest rates several times, and a faster pace of monetary policy tightening to counteract a potential overheating will also impact financial conditions around the world.

The Danish economy is well placed to cope with a slowing global economy, as domestic demand growth is on a sound footing. However, negative economic sentiment from abroad could impact the Danish economy without any actual deterioration of real economic conditions in Denmark. In the short term, households and businesses may become more reluctant to increase spending on consumption and investments which would lead to slower growth, even though the conditions for continued growth remain in place.

Domestically, there is also a risk that demand could grow too quickly, leading to widespread labour shortages and the economy overheating. For the economy as a whole, the level of capacity utilization is at the moment above the neutral level. Experience from previous economic upturns shows that growing pressures in the labour market can materialize quickly, in the form of increasing wage growth, and that it subsequently takes considerable time to regain the loss of competitiveness and return on new investment, which results from an overheating.

The economic outlook calls for care in designing fiscal policy in order to counteract risks of economic imbalances and overheating. In this respect, it is essential to avoid a situation where fiscal policy unnecessarily adds to demand.

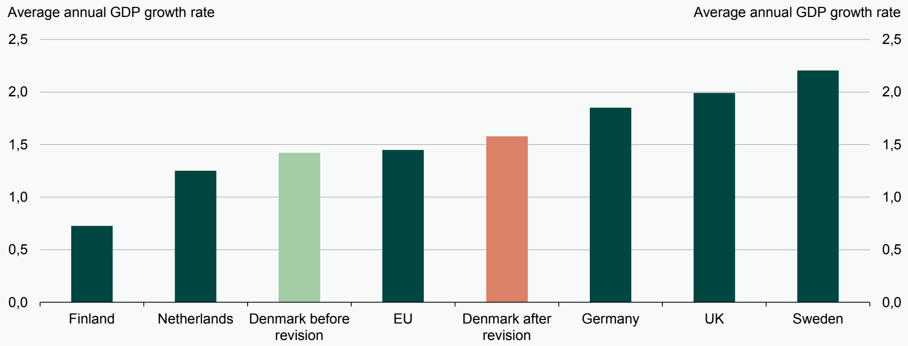
Revisions to national accounts show stronger growth in 2015 and 2016

Statistics Denmark published revised national accounts data for the years 2015-2017 on 7 November 2018. While GDP-growth in 2017 was roughly unchanged, the level of nominal GDP was DKK 28.5 bn. higher than previously estimated. The revisions are part of the regular revision cycle at Statistics Denmark, where new information regarding the latest three years are incorporated into the national accounts, *cf. box 1.2*.

The new information fits better with the picture of solid economic growth in Denmark in recent years, as shown by employment gains. The revision also shows that GDP-growth in Denmark has been slightly above the EU average since 2010, *cf. figure 1.9*.

Figure 1.9

GDP-growth in Denmark has been slightly above the EU average in 2010-2017



Source: Eurostat, Statistics Denmark and own calculations.

Box 1.2

Revisions to GDP-growth

The latest national accounts revisions on 7 November 2018 showed considerably higher economic growth for the years 2015, 2016 and 2017 of respectively 2.3, 2.4 and 2.3 per cent.

Over the long term, there has not been a significant issue with systematic upward revisions to GDP-growth, but Statistics Denmark has found that there has been a positive bias in recent years, *cf. figure a*. Statistics Denmark has therefore decided to look deeper into the reasons for the revision in order to improve the earlier estimates of national accounts.

Together with this work Statistics Denmark is also launching initiatives in two areas, which have led to revisions in recent years, which is the calculation of *gross fixed capital formation* and *imports* and *exports*. A major challenge with the early estimates of *gross fixed capital formation* is that information from corporate accounts can only be incorporated in a summary and provisional form two years after the year in question. Until then, the national accounts are based on fairly limited source material. Two initiatives will attempt to mitigate this:

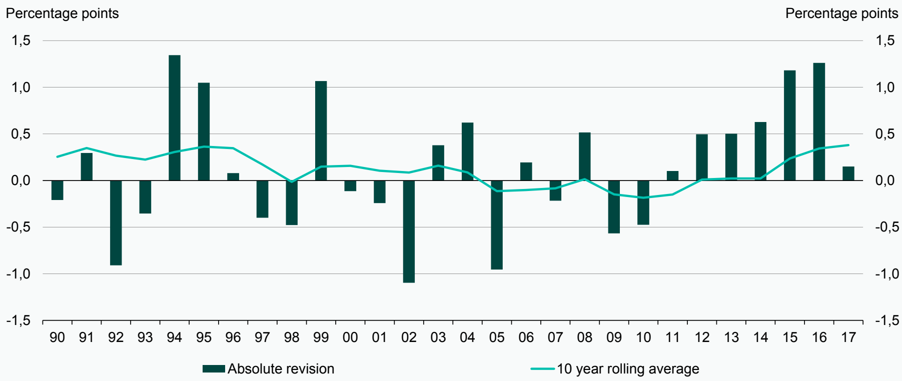
- Using the daily press and the internet to monitor large private sector investment projects in order to include the large investments, which move the numbers, at an earlier stage into the national accounts.
- Creating an indicator for the investments of publicly owned companies for the use in the earlier national accounts estimates.

The challenge to accurately record *imports* and *exports* is a reflection of the complexity of the global economy. Statistics Denmark is working to ensure consistency in the data from the largest and most complex businesses, so that major events, e.g. a restructuring of production, are captured in the numbers at an earlier stage. In addition, Statistics Denmark will analyse the recorded real growth in *imports* and *exports* with a view to improve the data.

In the analysis Statistics Denmark will draw upon international expertise.

Figure a

Revisions of annual GDP growth rates



Note: The figure shows the difference between the final estimate of GDP-growth for a given year with the first estimate of GDP-growth for the same year. For 2016 and 2017 the estimates of GDP-growth are not final yet, and therefore the comparison is with the latest estimate. Upward revisions are shown as positive numbers whereas downward revisions are negative.

Source: Statistics Denmark.

Seen isolation, the revisions to the National Accounts do not materially affect the economic outlook for the coming years, as there are no significant changes to the assessment of capacity pressures or potential growth. This reflects that a number of other indicators, which in practice play a larger role in assessing capacity pressures have not changed in the same way as the GDP numbers – these include in particular employment, unemployment, wage increases and inflation, as well the indicators of capacity utilization and labour shortages as reported in business surveys.

However, the latest revision underlines the uncertainty, which surrounds GDP numbers. In particular, for the most recent quarters and years the estimates are based on limited data and will often be revised significantly in subsequent releases. The forecast for 2018 therefore puts greater weight on labour market developments, in view of the fact that employment growth has continued at an undiminished pace, than the preliminary quarterly national accounts, which are available for this year.

Box 1.3 describes the data underlying the forecast and changes since the August forecast.

Box 1.3

Data underlying the forecast and changes since the August forecast

The forecast is based on national accounts data which are available for the third quarter of 2018 along with a wide range of indicators for economic developments reaching into the fourth quarter.

The forecast for GDP-growth in both 2018 and 2019 has been reduced by 0.1 percentage points to 1.7 per cent. The downward adjustment for 2018 masks a slightly better-than-expected development in domestic demand, while exports have been weaker than expected. The upward revision to private consumption growth in 2018 should also be seen in the light of lower-than-expected inflation. The downward adjustment to projected GDP growth for 2019 reflects lower expected export growth.

The weaker outlook for exports is due to several factors. The international economic has deteriorated and projected export market growth has been revised down by 0.7 percentage points in 2018 and 0.6 percentage points in 2019, primarily due to lower import growth in the major trading partner countries Germany and Sweden.

The warm and dry summer has given rise to expect a larger drop in agricultural production than previously expected. The forecast also incorporates a new forecast for North Sea oil and gas production from the Danish Energy Agency and monthly data for the production of oil and gas up until October 2018. The expectations for North Sea production have been revised down, which is also reflected in lower expected energy exports.

Labour market developments have been somewhat stronger than expected, which has led to an increase in the projected output gap by 0.3 percentage point to 1.2 per cent of potential GDP in 2019.

For 2020, which for the first time has been included as a forecast year, it is assumed that increased capacity pressures will lower growth.

1.2 Fiscal policy and public finances

The prospect of continued growth in demand and employment commends the use of a contractionary fiscal- and structural policy in the years to come in order to counteract the risk of the current economic upswing leading to bottlenecks and increasing pressure on wages and prices.

The output gap is estimated to increase to approx. 1 per cent in 2019 and remain constant at this level in 2020, *cf. table 1.1*. This entails a continuation of the economic upswing, but the capacity pressure and the risk of bottlenecks in the labor market remains moderate. In comparison, the output gap is estimated to have reached 3½ per cent during the overheating of the economy in 2007-2008 and the employment gap peaked in 2008 as it reached approx. 90,000 persons. In contrast to the situation back then, the impact of implemented fiscal and structural policies contributes to dampen capacity pressures in the coming years and allows for further growth in employment. New initiatives increasing labor supply can help further prolong the economic upswing.

Based on the budget bill for 2019, fiscal and structural policy is estimated to dampen the increase in capacity pressure from 2018 to 2019 by approx. 0.2 per cent of GDP measured by the one-year fiscal effect. Based on technical assumptions regarding fiscal policy in 2020, fiscal- and structural policy is estimated to have a dampening effect on capacity pressures corresponding to 0.1 per cent of GDP in 2020. The structural budget balance is estimated to be approx. balanced in 2018 to 2020. In view of this, fiscal- and structural policy is overall assessed to be in line with the prospect of economic growth and to support a balanced economic upswing.

Table 1.1

Main components of the projection relating to fiscal policy

	2018	2019	2020
Structural balance, per cent of structural GDP	0.0	-0.1	-0.1
Actual fiscal balance, per cent of GDP	0.2	-0.1	-0.1
EMU debt, per cent of GDP	33.8	33.4	33.4
Growth in public consumption, per cent [1)]	0.4	0.5	0.4
One-year fiscal effect, per cent of GDP[2)]	0.0	-0.2	-0.1
Output gap, per cent.[3)]	0.6	1.2	1.2
Employment gap, 1,000 persons[3)]	22	32	37

1) The public consumption in table 1.1 is calculated by the input method incl. deductions. The public consumption growth measured by respectively the input method and the output method assumed to be identical in projection years.
2) Calculated measure of how fiscal and structural policy from one year to another affects the capacity pressure. The estimate includes the effects of one-off payments of voluntary early retirement pay in 2018 og property taxes in 2020.
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. The cyclical correction in the calculation of the structural budget balance is based on the output gap excl. oil and gas extraction.

Source: Statistics Denmark and own calculations.

Fiscal policy for 2019 is set by the budget bill and the agreements with municipalities and regions. The structural budget balance is estimated to a deficit of approx. 0.1 pct. of GDP in 2019, which is in accordance with the assessment based on the proposed budget bill for 2019 in august.

The budget bill for 2019 includes, among other things, funds allocated to prioritized welfare areas such as health care, elderly care and children, as well as a package containing reductions in indirect taxes and a strengthening of businesses, which follows up on earlier government initiatives in these areas*, cf. box 1.4*. The initiatives are financed by reserves set aside on the budget proposal.

Box 1.4

Agreement on the public budget bill in 2019

- **An even stronger immigration policy** – A new policy for temporary stay, cap on family reunification, establishing a pre-removal center on the island of Lindholm and significant raise of penalties for criminal deportees and individuals on tolerated stay, who violate The Aliens Act.
- **Better conditions for pensioners** – Pensioners receive a raise in their public pensions and in going forward, pensioners will be fully included in the growth of wealth, as the revalorization of public pension transfer will follow the regular wage trend, *cf. box 1.5*. Simultaneously, there will be a greater incentive for seniors to stay in the labor market by granting a senior premium. Moreover, the deduction for labor market income will be raised along with more lenient rules for off-setting by private pension income.
- **Prioritizing the key welfare services: elderly, health and vulnerable children** – Ensuring better treatment for people with severe hearing impairment, a strengthened effort for lonely elderly and better conditions in daycare centers with vulnerable children.
- **Safety and a sense of security for the citizens** – Prioritizing a larger police force and custom operation against leaving criminals at the Danish borders and in airports. Moreover, enhancing the efforts of the unit of Serious Economic and International Crime in combatting money laundering. Danish Prison and Probations Service's recruiting possibilities will be improved by establishing a new educational institution in western Denmark.
- **Orderly conditions in the labor market** – Ensuring a continued strong effort for orderly conditions and strengthening control on road haulage.
- **Lower taxes linked to production and consumption and better conditions for businesses** – Facilitating business operation in Denmark. This applies in both conditions for smaller businesses, strengthening digitalization and industrial development in a number of important international industries who are exposed to competition. Further, a number of tax and fees reduction are implemented in order to reduce costs for businesses and individuals, including owners of recreational accommodation and individuals residing on islands.
- **Culture for the benefit of all** – A strong prioritization of Danish culture with focus on broad anchoring and communication. Among other things, this includes efforts in relation to our common history and cultural heritage, Danish culture in world class and selected projects, which are important for the Danish people's history.
- **Foresighted infrastructure** – A number of environmental impact assessments, which are to strengthen the basis for decision on future infrastructure projects and a process of discussing investments in infrastructure after 2020 will be initiated.
- **Better climate, cleaner air and more nature** – Implementation of a number of initiatives, which will improve air quality and reduce climate impact, ensure better nature and a cleaner environment. Among other things, it also includes a significant prioritization of coastal protection and an improvement of the air quality by a scrapping scheme for outdated word burning stoves and a higher scrap premium for old diesel vehicles.

In connection with the budget bill, an agreement regarding revalorization of public pensions and implementation of a mandatory retirement savings scheme for beneficiaries has been reached. The agreement includes, among other things, that old age pensions are fully regulated in accordance with the development of regular wages and that supplementary pension savings are gradually build up for those receiving public income transfers, *cf. box 1.5*.

Box 1.5

Agreement on new revalorization of public pension and an implementation of mandatory retirement saving scheme for people receiving public income transfers

- **Better revalorization of public pension** – Old age pension is to be regulated by the regular wage trend without a deduction.
- **Better conditions for retirement for people who receiving public income transfers** – From 2020, the public administration will deposit 0.3 per cent of the relevant public income transfer to a mandatory retirement savings for a number of recipients of public income transfers. Thus the Danish people, who in a period of the lives have been recipients of public income transfers, will receive a higher income as pensioners.
- **The settlement on the rate adjustment pool from 2015 will be discontinued** – The settlement on the rate adjustment pool will be discontinued with effect from the next parliamentary election. A separate reserve will be allocated, which, among other things, will be reserved for measures in social services, health and labor market, especially prioritizing social services.

In the current assessment, which, among other things, is based on the budget agreements with municipalities and regions and the budget bill for 2019, the public consumption is estimated to be reduced by DKK 1¼ bn. in 2019, compared to the estimate of the proposed budget bill from august.

At the same time, the expenditures for public consumption in 2018 is estimated to be lower compared to the assessment at the time of the proposed budget bill, which in isolation leads to a mechanical increase in the real growth rate of public consumption. In total, the adjustments in 2018 and 2019 give rise to increased estimates of the growth in public consumption of 0.1 percentage points in 2019 relative to the estimate in the Economic Survey, August 2018, *cf. box 1.6*.

Box 1.6

Revision of the growth in public consumption in 2019

The projected real growth in public consumption in 2019 has been revised upwards with 0.1 percentage point to 0.5 per cent since the assessment in August.

The increased projected growth in 2019 should be viewed in light of public spending being lower than expected in 2018 – which is due to reduced expected operating expenditures in the governmental institutions. The lower projected expenditures on public consumption in isolation entails a 0.2 percentage point upwards revision of the consumption growth in 2019.

The projection for the public consumption in 2019 is based on the public budgets in 2019, including the budget bill and regional and municipal budgets in 2019. In isolation, the budget bill, etc. entails a 0.1 percentage point reduction in the projected growth in public expenditures in 2019. Primarily, this is caused by a portion of the budgetary reserves – which in the August-assessment were assumed allocated to public consumption – is being assigned to initiatives not included in public consumption.

The projected growth in public consumption in 2019 is subject to on-going reassessment as new information on the expenditure levels in 2018 and 2019 develops.

Source: Statistics Denmark and own calculations.

The fiscal policy for 2020 will be planned in 2019 with the agreement on municipal and regional budgets and the budget bill for 2020. The specific planning of fiscal policy will, among other things, consider the short-term economic projections including the development of the capacity pressure and labor supply.

The projected development in public spending and revenues towards 2020 entails that the expenditure ratio and tax ratio will continue the decreasing tendency of recent years. The tax ratio adjusted for temporary fluctuations (a rough measure of the structural tax ratio) is expected to decrease from 46 per cent of GDP in 2015 to about 44¾ per cent of GDP in 2020, *cf. figure 1.10*.

Correspondingly, the primary public expenditures relative to GDP, adjusted for some temporary conditions, are expected to be reduced from 51 per cent of GDP in 2015 to 48¾ per cent of GDP in 2020, *cf. figure 1.11*.

Figure 1.10

Tax revenue as a ratio of GDP

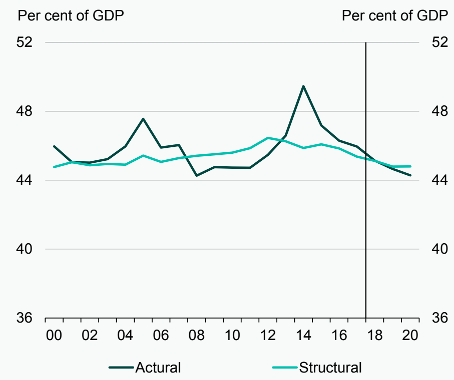
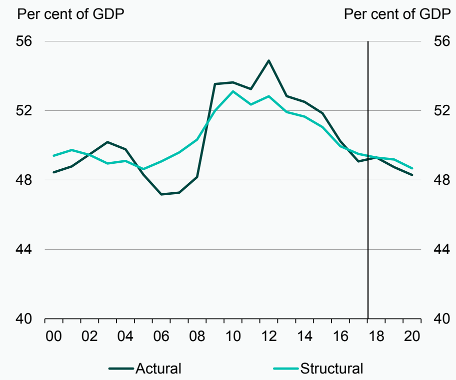


Figure 1.11

Primary public expenditure as a ratio of GDP



Note: The tax ratio is stated excluding revenue from the North Sea. The expenditure ratio is stated excluding interest expenditure. The figures reflect approximated calculations of structural tax- and expenditure ratio by using the same methods that are used when computing the structural budget balance. That is, among other things, controlling for effects stemming from business cycles, one-off payments from conversion of capital pension and reimbursements of early retirement contributions, and moreover, temporary fluctuations in the pension yield taxation revenues and other tax revenues.
Source: Statistics Denmark and own calculations.

The reduction in the structural expenditure ratio is primarily attributable to a moderate growth in public consumption relative to GDP, which entails that public consumption gradually converge towards its level before the financial crisis, *cf. figure 1.12*. Within the framework of a decreasing expenditure ratio, the government has priortised a lift of public investment. Compared to historical levels, public investments have been high in recent years, which is also the case going towards 2020, *cf. figure 1.13*.

Figure 1.12

Public consumption

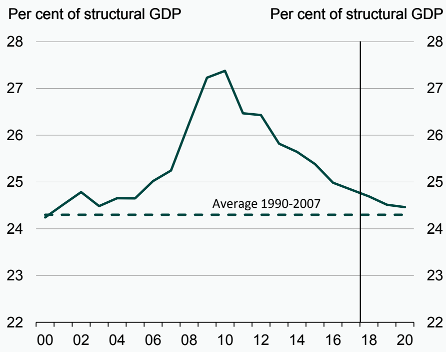
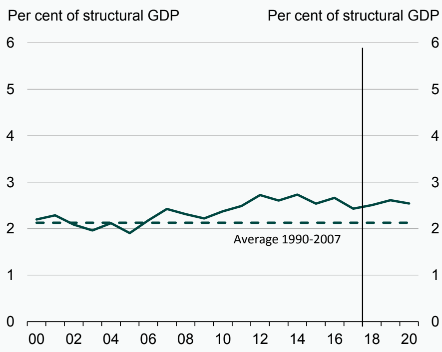


Figure 1.13

Public investments



Note: The public consumption is stated excluding depreciations. Public investments are stated excluding investments in research and development.
Source: Statistics Denmark and own calculations.

Fiscal- and structural policy dampens the capacity pressure

Overall, fiscal policy is planned with a medium term perspective of ensuring structural balance in neutral cyclical conditions. In line with the August-assessment, the structural deficits are estimated to 0.1 per cent of GDP in both 2019 and 2020, *cf. figure 1.8*. In recent years, the structural balance has had increasing distance to the deficit limit in the Danish Budget Law of ½ per cent of GDP.

After the significant relaxation of the fiscal policy following the international financial crisis – from a structural budget surplus on approx. 2 percent of GDP before the crisis to a deficit at more than 1 percent of GDP in 2010 – the deficit was initially reduced to almost ¾ percent of GDP in 2014 and subsequently close to balance in 2015-2018.

There is uncertainty in the calculation of the structural balance. For most of the recent years, the current projections indicate a lower structural deficit than initially expected. This should be seen in the light of expenditures to public consumption being lower than expected, increased structural employment and that revenue from taxation of equity income has been high – including as a result of the partially and temporary suspension of repayment of dividend tax to foreign investors, since the detection of fraud with dividend tax in 2015.

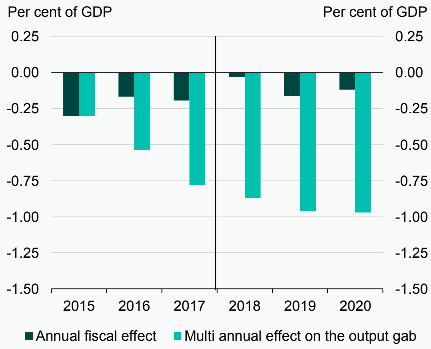
For 2019 and 2020 the public expenditures are presumed to develop in accordance with the current expenditure ceilings. Moreover, the assessment of the structural balance is affected by the decreasing structural public revenue from the oil and gas extraction in the North Sea from 2018 to 2019 and 2020.

Figure 1.14

Development in the structural balance

Figure 1.15

Annual fiscal effect 2015-2020



Note.: Figure 1.15 illustrates the total multi annual fiscal effect on capacity pressure (measured at the output gap) by changes in fiscal- and structural policies compared to 2014

Source: Statistics Denmark and own calculations.

The increasing distance to the deficit limit in the Budget Law is in accordance with the current economic climate. The distance enables maneuverability for fiscal policy in case of future downturns.

Relative to the lenient policy stance of 2014 with a structural deficit of almost ¾ per cent of GDP, the impact of subsequently implemented fiscal and structural policies is estimated to dampen capacity pressures, measured by the output gap, with approx. ¾ per cent of GDP in 2018 and slightly more in 2019 and 2020, *cf. figure 1.15*.

This is primarily due to implementation of reforms that have increased labour supply, including reforms of the retirement age. A number of initiatives in recent years have further contributed to higher labour supply, including the agreement on lower income taxation and a higher deduction for pension contributions (February 2018) and agreements within the public budget bill of 2019. This implies that risks of imbalances and a following overheating would be significantly higher without the pursued fiscal and structural policy.

Actual budget balance and public debt

In isolation, the economic upturn contributes to a bettering of the public finances as employment, taxable income and consumption increase and expenditures for unemployment benefits decline. In spite of these factors, the recorded surplus on the actual budget balance of 1.2 per cent of GDP in 2017 is reduced to approx. balanced budgets in 2018- 2020.

A large part of the worsening of the estimated actual balance is due to temporary conditions such as fluctuations in the pension yield taxation revenues (PAL) and one-off payments such as reimbursements of early retirement contributions in 2018 and real estate taxes in 2020. Without these factors, it is estimated that the budget balance would show surpluses of approx. 1 per cent of GDP in 2017-2020, *cf. figure 1.16*.

In 2018 and 2019 the net public debt is estimated to remain close to 0 (specifically around 1 per cent of GDP), while the EMU-debt is estimated to be below 35 per cent of GDP, *cf. figure 1.17*. The public EMU-debt in Denmark is thus substantially below the debt limit stated in the EU Stability and Growth Pact of 60 per cent of GDP.

Figure 1.16

Actual budget balance

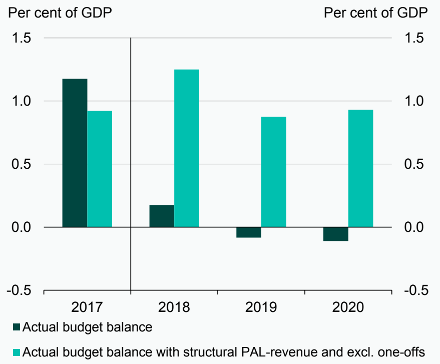
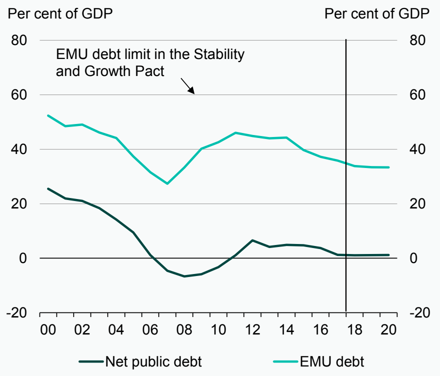


Figure 1.17

Public debt



Note: Figure 1.16 illustrates the actual budget balance corrected for the difference between the estimated and both the actual and structural revenues from pension yield taxation and on-off payments of reimbursements of early retirement contributions in 2018 and accommodation tax in 2020.
Source: Statistics Denmark and own calculations

1.3 Annex table

Table 1.2

Key figures compared to *Economic Survey, December 2018*

	2018		2019		2020
	Aug.	Dec.	Aug.	Dec.	Dec.
Real change, per cent					
Private consumption	2.3	2.4	2.1	2.1	2.3
Total government demand	0.5	0.5	0.6	0.9	0.3
- of which government consumption[1)]	0.4	0.4	0.4	0.5	0.4
- of which government investment	1.2	1.2	2.0	4.1	-0.4
Housing investment	7.0	6.0	5.4	4.5	3.5
Business fixed investment	8.5	7.9	2.2	1.8	4.7
Total final domestic demand	2.8	2.7	1.8	1.8	2.2
Inventory investment (per cent contribution to GDP)	0.0	0.1	0.0	0.0	0.0
Total domestic demand	2.8	2.9	1.8	1.8	2.2
Exports	2.5[2)]	1.7[2)]	2.8	2.6	2.3
- of which manufacturing exports	4.2	4.0	4.0	3.5	3.4
Total demand	2.7[2)]	2.4[2)]	2.2	2.1	2.2
Imports	4.4	3.9	3.0	3.0	3.4
- of which imports of goods	5.2	4.0	2.2	2.2	2.8
GDP	1.8[2)]	1.7[2)]	1.8	1.7	1.6
Gross value added	1.8[2)]	1.5[2)]	1.8	1.6	1.4
- of which private non-farm sector	2.6[2)]	2.6[2)]	2.3	2.1	2.0
Change, 1,000 persons					
Labour force, total	37	41	25	28	24
Employment, total	46	50	30	33	27
- of which private sector	45	45	29	32	27
- of which public sector	1	5	1	1	0
Gross unemployment	-8	-8	-5	-5	-4
Cyclical developments, per cent					
Output gap	0.4	0.6	0.9	1.2	1.2
Employment gap	0.5	0.8	0.7	1.1	1.3
Unemployment gap	-0.1	-0.1	-0.2	-0.3	-0.3

1) Measured by the output method incl. depreciations.
2) Estimates for 2018 are adjusted for a large one-off payment in the 1st quarter of 2017 for use of Danish-owned intellectual property rights, cf. *box 4.1 in Economic Survey, May 2018*.

Table 1.2 (continued)

Key figures compared to *Economic Survey, December 2018*

	2018		2019		2020
	Aug.	Dec.	Aug.	Dec.	Dec.
Change, per cent					
House prices (single family homes)	4.2	4.2	3.3	3.3	2.5
Consumer prices	1.1	0.9	1.6	1.5	1.8
Hourly earnings in the private sector	2.5	2.5	2.8	2.8	3.0
Real disposable income, households	1.6	3.4	1.9	2.2	1.7
Productivity in the private non-farm sector	-0.4	-0.1	0.9	0.6	0.7
Per cent per year					
Interest rate, 1-year rate loan	-0.5	-0.5	-0.2	-0.3	0.3
Interest rate, 10-year government bond	0.5	0.5	1.0	0.6	1.1
Interest rate, 30-year mortgage credit bond	2.2	2.1	2.7	2.3	2.7
Public finances					
Actual public balance (Bn. DKK)	0.0	3.9	-8.2	-1.9	-2.6
Actual public balance (per cent of GDP)	0.0	0.2	-0.4	-0.1	-0.1
Actual public balance (per cent of GDP)	-0.2	0.0	-0.1	-0.1	-0.1
Gross debt (per cent of GDP)	35.1	33.8	34.0	33.4	33.4
Labour market					
Labour force, total	3,068	3,070	3,093	3,097	3,121
Employment, total	2,967	2,969	2,997	3,002	3,028
Gross unemployment (yr. avg., 1,000 persons)	108	108	103	103	99
Gross unemployment (per cent of labour force)	3.5	3.5	3.3	3.3	3.2
External assumptions					
Trade-weighted international GDP-growth	2.7	2.5	2.5	2.2	2.1
Export market growth (manufactured goods)	4.4	3.7	4.4	3.9	3.4
Exchange rate (DKK per USD)	6.3	6.3	6.4	6.6	6.6
Oil price, dollars per barrel	72.3	71.4	74.7	64.6	67.9
Balance of payments					
Current account balance (DKK bn.)	137	129	139	128	122
Current account balance (per cent of GDP)	6.2	5.8	6.1	5.6	5.1