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Assessment of the 2018 Convergence Programme for

Denmark

(Note prepared by DG ECFIN staff)

CONTENTS

1. INTRODUCTION

On 24 April 2018, Denmark submitted its 2018 convergence programme (hereafter called convergence programme), covering the period 2018-2025.

Denmark is currently subject to the preventive arm of the Stability and Growth Pact (SGP) and should preserve a sound fiscal position which ensures compliance with the medium-term budgetary objective (MTO).

This document complements the Country Report published on 7 March 2018 and updates it with the information included in the convergence programme.

Section 2 presents the macroeconomic outlook underlying the convergence programme and provides an assessment based on the Commission 2018 spring forecast. The following section presents the recent and planned budgetary developments, according to the convergence programme. In particular, it includes an overview on the medium term budgetary plans, an assessment of the measures underpinning the convergence programme and a risk analysis of the budgetary plans based on Commission forecast. Section 4 assesses compliance with the rules of the SGP, including on the basis of the Commission forecast. Section 5 provides an overview on long term sustainability risks and Section 6 on recent developments and plans regarding the fiscal framework. Section 7 provides a summary.

2. MACROECONOMIC DEVELOPMENTS

According to the convergence programme, the Danish economy will show a solid expansion in the coming years. Having expanded by 2.2% in 2017, real GDP is forecast to grow by 1.9% in 2018 and 1.7% in 2019. Economic growth is set to be driven by domestic demand, while net trade's contribution is projected to be negative. Private consumption growth is expected to pick up from 1.5% in 2017 to rates slightly above 2% in 2018 and 2019 on the back of rising employment and real wage increase. With companies under pressure to expand their production capacities, investment is set to expand by 3.7% in 2017, 4.2% in 2018 and 4.7% in 2019.

Comparing the projections in the convergence programme with last year's projections in the convergence programme, GDP growth has been adjusted upwards in 2018, unchanged in 2019 and revised down in 2020. While private consumption and investment growth has been revised upwards both for 2018 and 2019, the more negative contribution from net trade in 2019 is expected to leave the real GDP growth projection unchanged that year. Regarding 2020, this year's convergence programme is more pessimistic on investment and exports developments resulting in lower economic growth compared to last year's projections in the convergence programme.

The programme's macroeconomic assumptions are in general plausible and broadly in line with the Commission 2018 spring forecast. Both projections expect real GDP growth of slightly less than 2% in 2018 and 2019, driven by domestic demand. The programme forecasts slightly higher private consumption growth for both 2018 and 2019, while the expected increase in compensation of employees is broadly in line with the Commission 2018 spring forecast. The programme expects somewhat stronger investment, but lower exports growth than the Commission 2018 spring forecast in both 2018 and 2019. The programme projects HICP inflation rates of 1.4% and 1.7% in 2018 and 2019, respectively. In contrast, the Commission 2018 spring forecast predicts somewhat lower inflation rates of 0.8% in 2018 and 1.4% in 2019. The discrepancies relate to the different appreciations of the pass-through of the lowering of various indirect taxes and the cut-off dates for the projections. The macroeconomic projections underpinning the programme is a technical update of the projection presented in December 2017. On the other hand, the Commission forecast dates from spring 2018 and hence incorporates data released between December 2017 and April 2018, notably the low inflation observed in the first quarter of 2018 while the programme does not.

The negative output gap, as recalculated by Commission based on the information in the programme following the commonly agreed methodology, is gradually closing in the programme period. It is estimated at -0.4% of GDP in 2018 and expected to narrow to -0.1% in 2021.

Overall the macroeconomic scenario underpinning the budgetary projections of the programme is plausible in 2018-2019.

Table 1: Comparison of macroeconomic developments and forecasts

	2017		2018		2019		2020	2021
	COM	CP	COM	CP	COM	CP	CP	CP
Real GDP (% change)	2.2	2.2	1.8	1.9	1.9	1.7	1.6	1.6
Private consumption (% change)	1.5	1.5	2.0	2.3	2.2	2.4	2.2	2.3
Gross fixed capital formation (% change)	3.7	3.7	3.8	4.1	4.1	4.8	3.7	4.1
Exports of goods and services (% change)	4.4	4.4	3.3	2.8	3.0	2.6	3.2	3.2
Imports of goods and services (% change)	4.1	4.1	3.9	3.7	3.7	4.0	4.0	4.3
Contributions to real GDP growth:								
- Final domestic demand	1.8	1.8	1.9	2.1	2.1	2.2	2.0	2.1
- Change in inventories	0.1	0.1	0.0	0.0	0.0	0.0	-0.1	-0.1
- Net exports	0.4	0.4	-0.1	-0.2	-0.1	-0.5	-0.2	-0.4
Output gap[1]	-0.7	-0.7	-0.7	-0.4	-0.6	-0.3	-0.2	-0.1
Employment (% change)	1.6	1.6	1.2	1.1	0.9	0.8	0.7	0.5
Unemployment rate (%)	5.7	5.9	5.5	5.6	5.2	5.4	5.4	5.4
Labour productivity (% change)	0.6	0.6	0.6	0.7	1.0	0.9	1.0	1.1
HICP inflation (%)	1.1	1.0	0.8	1.4	1.4	1.6	1.2	1.6
GDP deflator (% change)	1.6	1.6	1.3	1.8	1.9	1.8	1.6	1.8
Comp. of employees (per head, % change)	1.3	1.3	2.2	2.7	2.8	2.7		
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	7.8	7.8	7.6	7.9	7.6	7.4	5.1	5.1

Note:

[1]In % of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source :

Commission 2018 spring forecast (COM); Convergence Programme (CP).

3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS

3.1. DEFICIT DEVELOPMENTS IN 2017 AND 2018

The general government headline balance improved to 1.0% of GDP in 2017, up from -0.4% in 2016. This compares to deficits of 1.9% and 0.0% envisaged in last year's programme and the Ministry of Finance's Economic Survey from December 2017, respectively. The improvement was mainly due to higher pension yield tax and corporate tax revenues.

The convergence programme forecasts a deterioration of the budget balance to -0.7% of GDP in 2018, compared to -0.9% forecast in last year's programme. The difference reflects a downward revision of public expenditure of 0.3% of GDP, which is partially offset by a decrease of 0.1% of GDP in revenue. The downward revision in expenditure reflects lower spending on compensation of employees and social transfers.

The deterioration of the headline balance from 2017 to 2018 is primarily the result of a projected decrease in revenue from the pension yield tax and to a lesser extent from a decrease in revenue from corporate taxes.

3.2. MEDIUM-TERM STRATEGY AND TARGETS

Denmark's MTO is set at -0.5% of GDP, in line with SGP requirements. Fiscal policy is planned within the framework of the Budget Law, the SGP and current medium-term plan. The latter currently covers the years until 2025. While the MTO remains unchanged at -0.5% of GDP, the government targets a balanced structural budget is now set for 2025. This is at a later point in time compared to last year's convergence programme where the government targeted a balanced structural budget in 2020.

The structural balance as recalculated by the Commission on the basis of the information in the programme according to the commonly agreed methodology (henceforth "recalculated structural balance") stands at 0.4% in 2018. It is expected to improve to 0.6% of GDP in 2019 before stabilising at 0.3% of GDP in 2020 and 2021. As a result, Denmark plans structural balances higher than the MTO over the programme period.

The headline balance is expected to deteriorate to -0.7% of GDP in 2018 and to remain around this level until 2021, before achieving a balanced position in 2025. The shift to a deficit in 2018 is primarily the result of a projected decrease in revenue from the volatile pension yield tax, a transfer to households of an estimated 0.2% of GDP due to a reform of the voluntary early retirement scheme and to a smaller extent of lower revenue from corporate taxes. The headline deficit forecasts of the 2018 programme differ from those of the 2017 programme, as the former estimates smaller deficits for 2018 and 2019, but larger ones for 2020 and 2021. In general, the projected headline balance mainly reflects developments at state level, as the fiscal policy framework aims at ensuring balanced budgets in the regions and municipalities.

Public expenditure is planned to fall from around 50.6% of GDP in 2018 to around 49.2% of GDP in 2021. According to the convergence programme, this development reflects the effects of previously introduced reforms which support GDP growth and lower social payments. It also results from the plan to maintain a subdued growth in public consumption, although this is partially offset by the simultaneous increase in the funds reserved for the pursuit of government priorities.

General government revenue is projected to fall from 49.8% of GDP in 2018 to around 48.6% of GDP in 2021. Around half of this fall can be attributed to lower current taxes on income and wealth which are estimated to fall due to previously introduced tax reforms. The revenue from indirect taxes is also set to decline as a proportion of GDP between 2018 and 2021, particularly due to the phasing out of the Public Service Obligation (PSO) tax and the reform of car registration tax. Revenue from the pension yield tax is projected to be low in the next few years due to the expected normalisation of interest rate levels.

Similarly to Commission forecasts, the programme projections are based on no policy-change assumptions. Specifically, the projections in the convergence programme only consider reforms and agreements where a majority in parliament has been found.

Table 2: Composition of the budgetary adjustment

(% of GDP)	2017	2018		2019		2020	2021	Change: 2017-2021
	COM	COM	CP	COM	CP	CP	CP	CP
Revenue	**52.9**	**51.8**	**49.8**	**51.6**	**49.3**	**48.8**	**48.6**	**-4.3**
of which:								
- Taxes on production and imports	16.1	16.0	16.1	16.0	16.0	15.9	15.7	-0.4
- Current taxes on income, wealth, etc.	30.1	29.0	28.4	29.0	28.0	27.7	27.6	-2.5
- Social contributions	0.9	0.9	0.1	0.9	0.0	0.0	0.0	-0.9
- Other (residual)	5.9	5.8	5.3	5.8	5.2	5.2	5.3	-0.6
Expenditure	**51.9**	**51.9**	**50.6**	**51.6**	**50.0**	**49.5**	**49.2**	**-2.7**
of which:								
- Primary expenditure	50.8	50.8	49.6	50.6	49.1	48.6	48.2	-2.6
of which:								
Compensation of employees	15.5	15.3	15.3	15.1	15.1	15.0	14.9	-0.6
Intermediate consumption	8.9	8.9	9.0	9.0	8.9	8.8	8.8	-0.1
Social payments	17.9	17.8	17.6	17.4	17.3	17.2	17.0	-0.9
Subsidies	1.8	1.8	1.7	1.8	1.7	1.6	1.5	-0.3
Gross fixed capital formation	3.4	3.5	3.2	3.4	3.2	3.2	3.3	-0.1
Other (residual)	3.3	3.5	3.6	3.8	3.8	3.7	3.3	0.1
- Interest expenditure	1.1	1.1	1.0	1.0	0.9	0.9	1.0	-0.1
General government balance (GGB)	**1.0**	**-0.1**	**-0.7**	**0.0**	**-0.7**	**-0.7**	**-0.6**	**-1.6**
Primary balance	**2.1**	**1.0**	**0.3**	**1.0**	**0.2**	**0.3**	**0.4**	**-1.7**
One-off and other temporary	0.0	0.0	-0.9	-0.6	-1.1	-0.9	-0.9	-0.9
GGB excl. one-offs	**1.0**	**-0.1**	**0.2**	**0.6**	**0.4**	**0.2**	**0.3**	**-0.7**
Output gap[1]	-0.7	-0.7	-0.4	-0.6	-0.3	-0.2	-0.1	0.7
Cyclically-adjusted balance[1]	1.4	0.3	-0.5	0.3	-0.5	-0.6	-0.6	-2.0
Structural balance[2]	**1.4**	**0.3**	**0.4**	**0.9**	**0.6**	**0.3**	**0.3**	**-1.1**
Structural primary balance[2]	2.5	1.4	1.4	1.9	1.5	1.3	1.3	-1.2

Notes:

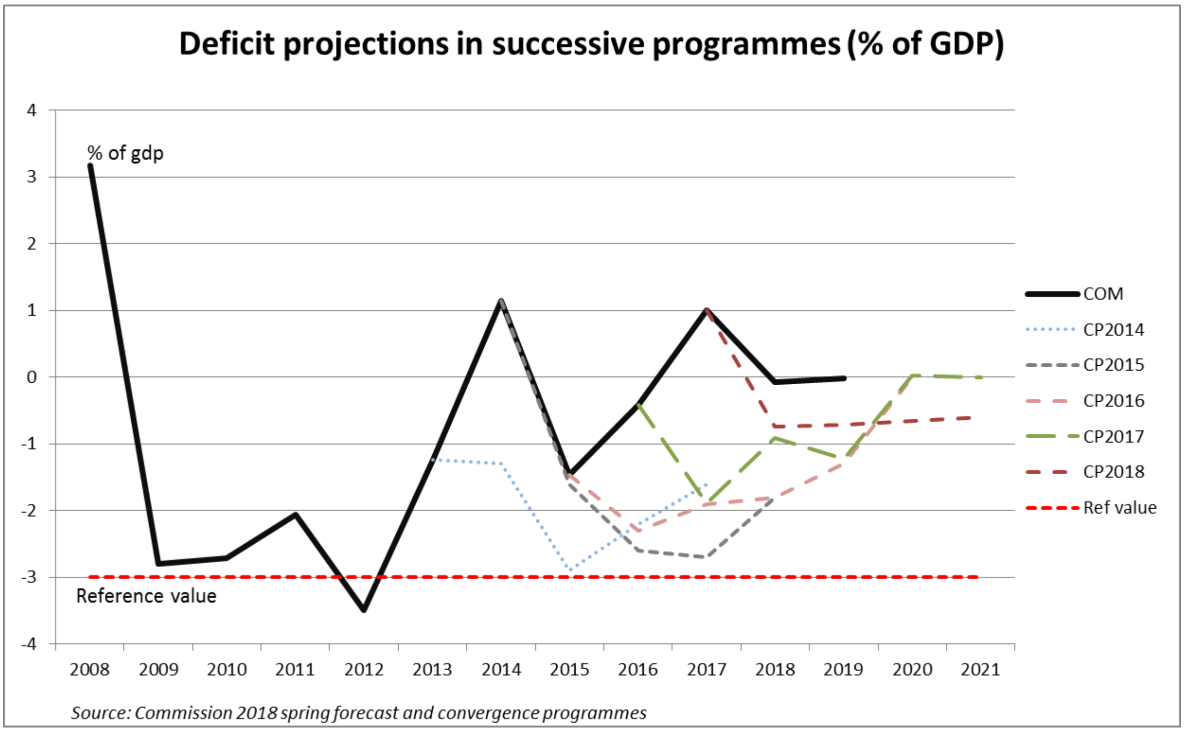
[1]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission on the basis of the programme scenario using the commonly agreed methodology.

[2]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source :

Convergence Programme (CP); Commission 2018 spring forecasts (COM); Commission calculations.

Figure 1: Government balance projections in successive programmes (% of GDP)



3.3. MEASURES UNDERPINNING THE PROGRAMME

Denmark has undertaken a number of reforms in recent years which are expected to have a positive impact on labour supply, employment, growth and public finances in 2018 and beyond. These include the 2011 pension reform, the 2012 reform of disability pension, flex jobs, student grants and social transfers, as well as the 2009 spring package. According to the convergence programme, increases in early and statutory retirement ages have contributed to an average annual increase in the structural labour force by 0.6% between 2014 and 2017. This trend is forecast to continue from 2018 to 2022. The estimated increase in the structural labour force is in turn expected to contribute to a rise in employment of 135.000 between 2017 and 2025. Similarly, previously implemented reforms are set to result in a fall of around 0.75% of GDP in social transfers from 2017 to 2025. While public investment is projected to decrease slightly as a percentage of GDP in the next few years, recent initiatives such as highway construction on Vestfyn and a new defence agreement will support public investment, which could eventually stabilise around 3.5% of GDP in 2021.

The convergence programme lists the discretionary measures underpinning the projections. Their quantitative impact, however, is only fully specified in a few cases, which is inconsistent with the guidelines laid down in the Code of Conduct.[1]

[1] "Specifications on the implementation of the Stability and Growth Pact and Guidelines on the format and content of Stability and Convergence Programmes", 3 September 2012: http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/coc/code_of_conduct_en.pdf.

3.4. DEBT DEVELOPMENTS

The convergence programme projects public debt to GDP to fall in 2018 to 35.6% and to decline slightly further in 2019 and 2020. The Commission projects a somewhat larger decline, mainly as a result a large negative stock-flow adjustment related to the reduction of the cash buffer. According to the convergence programme, public debt is set to rise to 36.2% in 2021, and is planned to reach around 40% of GDP by 2025. The increase in public debt after 2020 is primarily the result of the 2016 agreement on property tax and the 2017 agreement on a new financing model for social housing. Both reforms entail a build-up in public assets as well as liabilities, the latter of which are recorded as gross debt.

Table 3: Debt developments

(% of GDP)	Average 2012-2016	2017	2018		2019		2020	2021
			COM	CP	COM	CP	CP	CP
Gross debt ratio[1]	**42.2**	**36.4**	**33.6**	**35.6**	**32.3**	**34.8**	**34.2**	**36.2**
Change in the ratio	-1.6	-1.5	-2.9	-0.8	-1.2	-0.8	-0.6	2.0
Contributions[2] :								
1. Primary balance	**-0.5**	**-2.1**	**-1.0**	**-0.3**	**-1.0**	**-0.2**	**-0.3**	**-0.4**
2. "Snow-ball" effect	**0.6**	**-0.3**	**0.0**	**-0.3**	**-0.2**	**-0.3**	**-0.1**	**-0.1**
Of which:								
Interest expenditure	1.6	1.1	1.1	1.0	1.0	0.9	1.0	1.0
Growth effect	-0.5	-0.8	-0.6	-0.7	-0.6	-0.6	-0.6	-0.5
Inflation effect	-0.4	-0.6	-0.5	-0.6	-0.6	-0.6	-0.5	-0.6
3. Stock-flow adjustment	**-1.8**	**0.9**	**-1.8**	**-0.2**	**0.0**	**-0.2**	**-0.3**	**2.5**

Notes:

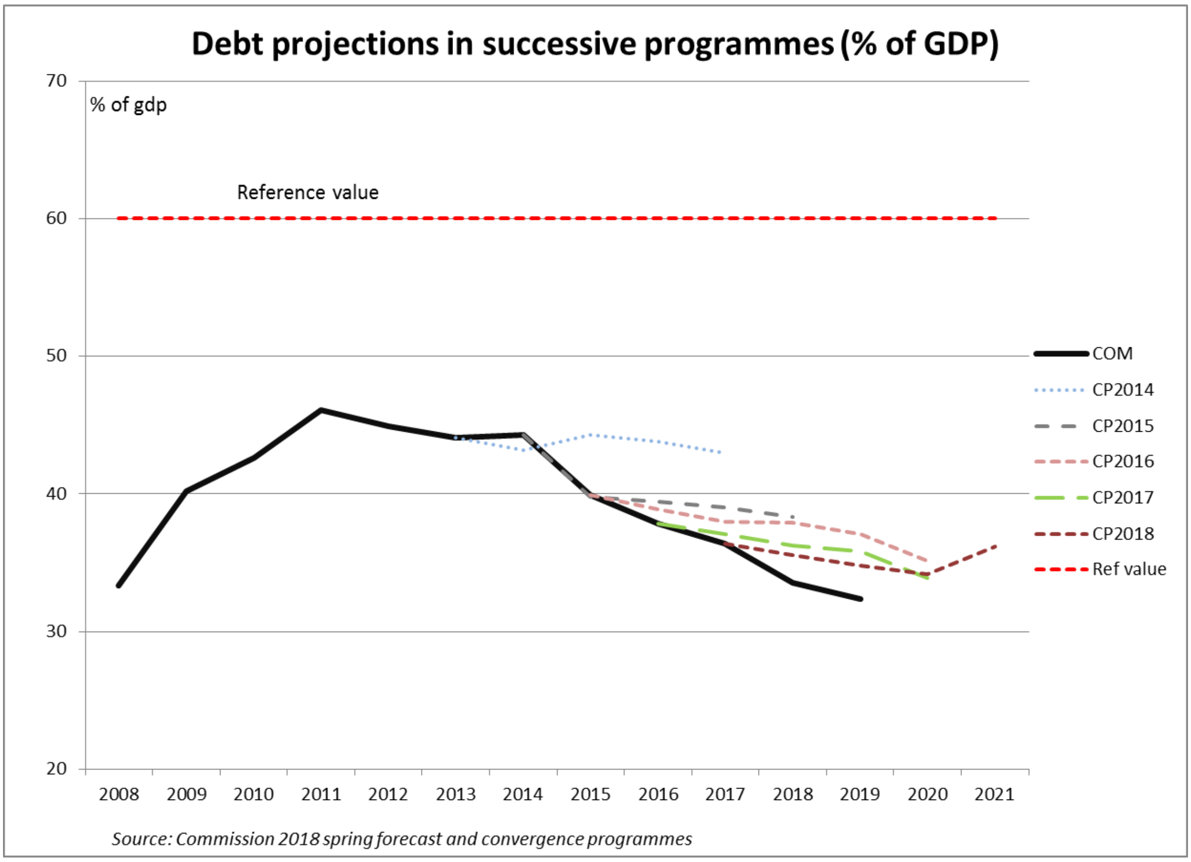
[1] End of period.

[2] The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

Source :

Commission 2018 spring forecast (COM); Convergence Programme (CP), Comission calculations.

Figure 2: Government debt projections in successive programmes (% of GDP)



3.5. RISK ASSESSMENT

Risks to the projection in the convergence programme are assessed to be broadly balanced.

In general, the Danish public finances rely on large and volatiles revenue items. These include the revenues from the pension yield tax as well as those from oil and gas drilling in the North Sea. While programme projections of these revenue items generally are prudent, their inherent volatility has previously led to both positive and negative surprises for the headline budget balance in a single year.

The introduction in 2014 of multiannual expenditure ceilings for all three levels of general government (state, regions and municipalities) appears to have had contributed to budget discipline. The framework, which is buttressed by economic sanctions in case of non-compliance, has put an end to overspending by municipalities, which was the main driver behind higher-than-planned public consumption in the 1990s and 2000s.

There are some upside risks to the headline balance projections, which are primarily linked to the revenue from the pension yield tax. The programme's assumption of around ¼% of GDP average annual revenue from the pension yield tax between 2018 and 2021 could turn out as pessimistic given the authorities' previous estimates of 1.1% of GDP from this item in normal times.

Risks to public debt developments are assessed to be broadly balanced, as Denmark has a stable fiscal outlook and a favourable initial position with a relatively low gross debt level, even with the planned increase to around 40% of GDP in 2025.

4. Compliance with the provisions of the Stability and Growth Pact

Since 2014, Denmark has been subject to the preventive arm of the Stability and Growth Pact. On 11 July 2017, the Council did not address a recommendation to Denmark in the context of fiscal compliance under the European Semester since the Council was of the opinion that Denmark complies with the Stability and Growth Pact. The general government budget was in surplus in 2017 and is planned to show deficits of around ½% of GDP over the programme horizon.

Based on outturn data, the structural balance is estimated to have improved from a surplus of 0.3% in 2016 to 1.4% in 2017, well above the medium-term objective and confirming compliance with the SGP.

For 2018, the recalculated structural balance based on the convergence programme is estimated to fall to 0.4% of GDP, reflecting that some volatile revenue components, particularly the pension yield tax revenue are forecast to decline significantly (according to the programme by 1.4 percentage points of GDP).

In 2019, the recalculated structural balance is planned to improve to 0.6% in 2019.

The Commission 2018 spring forecast envisages a slightly lower structural balance in 2018 compared to the recalculated structural balance of the convergence programme. This difference mainly relates to difference in the nominal headline balance and to the accounting of volatile revenue components, such as pension yield tax revenue, as one off and other temporary items.

Table 4: Compliance with the requirements under the preventive arm

(% of GDP)	2017	2018		2019	
Initial position[1]					
Medium-term objective (MTO)	-0.5	-0.5		-0.5	
Structural balance[2] (COM)	1.4	0.3		0.9	
Structural balance based on freezing (COM)	-0.4	0.3		-	
Position vis-a -vis the MTO[3]	At or above the MTO	At or above the MTO		At or above the MTO	
(% of GDP)	**2017**	**2018**		**2019**	
	COM	**CP**	**COM**	**CP**	**COM**
Structural balance pillar					
Required adjustment[4]	Compliance				
Required adjustment corrected[5]					
Change in structural balance[6]					
One-year deviation from the required adjustment [7]					
Two-year average deviation from the required adjustment [7]					
Expenditure benchmark pillar					
Applicable reference rate[8]					
One-year deviation adjusted for one-offs[9]					
Two-year deviation adjusted for one-offs[9]					
PER MEMORIAM: One-year deviation [10]					
PER MEMORIAM: Two-year average deviation [10]					

Notes

[1] The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points (p.p.) is allowed in order to be evaluated as having reached the MTO.

[2] Structural balance = cyclically-adjusted government balance excluding one-off measures.

[3] Based on the relevant structural balance at year t-1.

[4] Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 38.).

[5] Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

[6] Change in the structural balance compared to year t-1. Ex post assessment (for 2014) is carried out on the basis of Commission 2015 spring forecast.

[7] The difference of the change in the structural balance and the corrected required adjustment.

[8] Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is adjusting towards its MTO, including in year t.

[9] Deviation of the growth rate of public expenditure net of discretionary revenue measures, revenue increases mandated by law and one-offs from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

[10] Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

<u>*Source*</u> *:*

Convergence Programme (CP); Commission 2018 spring forecast (COM); Commission calculations.

5. FISCAL SUSTAINABILITY

Denmark does not appear to face fiscal sustainability risks in the short run.[2]

Based on the Commission 2018 spring forecast and a "no fiscal policy change"-scenario beyond the forecast horizon, government debt, at 36.4% of GDP in 2017, is expected to decrease (to 9.0% in 2028), thus remaining well below the 60% of GDP Treaty threshold. Over this horizon, government debt peaks in 2017. A sensitivity analysis shows similarly low risks.[3] Overall, this highlights low risks for the country from debt sustainability analysis in the medium term. The full implementation of the convergence programme would put debt on a higher and more slowly decreasing path by 2028 reaching 25% of GDP in 2028, with debt remaining well below the 60% of GDP reference value.

The medium-term fiscal sustainability risk indicator S1[4] is at -5.5 percentage points of GDP, primarily thanks to the favourable initial budgetary position and the low level of government debt which contribute together with -5.4 percentage points of GDP. This result indicates low risks in the medium term. The full implementation of the convergence programme would put the sustainability risk indicator S1 at -4.6 percentage points of GDP, leading to a fairly similar medium-term risk. Overall, risks to fiscal sustainability over the medium-term are therefore low. Fully implementing the fiscal plans in the convergence programme would marginally increase those risks, but the medium-term risk category would remain low.

The long-term fiscal sustainability risk indicator S2 is at -0.9% of GDP. In the long-term, Denmark therefore appears to face low fiscal sustainability risks thanks to the favourable initial budgetary position contributing with -1.4 percentage points of GDP. Full implementation of the programme would put the S2 indicator at 0.1 percentage points of GDP, leading to a higher long-term risk, while the long-term risk category would remain low.[5]

[2] This conclusion is based on the short-term fiscal sustainability risk indicator S0. See the note to Table 5 for a definition of the indicator.

[3] Sensitivity analysis includes several deterministic debt projections, as well as stochastic projections (see Debt Sustainability Monitor 2017 for more details).

[4] See the note to Table 5 for a definition of the indicator.

[5] The projected costs of ageing used to compute the debt projections and the fiscal sustainability indicators S1 and S2 are based on the updated projections, endorsed by the EPC on 30 January 2018, and to be published in the forthcoming Ageing Report 2018.

Table 5: Sustainability indicators

Table 5 . Fiscal Sustainability Assessment
Denmark

Time horizon				Commission Scenario		Stability / Convergence Programme Scenario	
Short Term				**LOW risk**			
	S0 indicator [1]			0.2			
		Fiscal subindex		0.0	LOW risk		
		Financial & competitiveness subindex		0.3	LOW risk		
Medium Term				**LOW risk**			
	DSA [2]			LOW risk			
	S1 indicator [3]			-5.5	LOW risk	-4.6	LOW risk
	of which						
		Initial Budgetary Position		-3.3		-2.5	
		Debt Requirement		-2.1		-2.1	
		Cost of Ageing		-0.1		0.0	
		of which					
			Pensions	-0.3		-0.2	
			Health-care	0.2		0.2	
			Long-term care	0.4		0.3	
			Other	-0.4		-0.3	
Long Term				**LOW risk**		**LOW risk**	
	S2 indicator [4]			-0.9		0.1	
	of which						
		Initial Budgetary Position		-1.4		-0.5	
		Cost of Ageing		0.5		0.6	
		of which					
			Pensions	-1.3		-1.2	
			Health-care	0.7		0.6	
			Long-term care	1.6		1.5	
			Other	-0.5		-0.4	

Source: Commission services; 2018 stability/convergence programme.

Note: the 'Commission' scenario depicts the sustainability gap under the assumption that the structural primary balance position evolves according to the Commissions' spring 2018 forecast covering until 2019 included. The 'stability/convergence programme' scenario depicts the sustainability gap under the assumption that the budgetary plans in the programme are fully implemented over the period covered by the programme. Age-related expenditure as given in the 2018 Ageing Report.

[1] The S0 indicator of short term fiscal challenges informs the early detection of fiscal stress associated to fiscal risks within a one-year horizon. To estimate these risks S0 uses a set of fiscal, financial and competitiveness indicators selected and weighted according to their signalling power. S0 is therefore a composite indicator whose methodology is fundamentally different from the S1 and S2 indicators, which quantify fiscal adjustment efforts. The critical threshold for the overall S0 indicator is 0.46. For the fiscal and the financial-competitiveness sub-indexes, thresholds are respectively at 0.36 and 0.49*.

[2] Debt Sustainability Analysis (DSA) is performed around the no fiscal policy change scenario in a manner that tests the response of this scenario to different shocks presented as sensitivity tests and stochastic projections*.

[3] The S1 indicator is a medium-term sustainability gap; it measures the upfront fiscal adjustment effort required to bring the debt-to-GDP ratio to 60 % by 2032. This adjustment effort corresponds to a cumulated improvement in the structural primary balance over the 5 years following the forecast horizon (i.e. from 2020 for Commission scenario and from last available year for the SCP scenario); it must be then sustained, including financing for any additional expenditure until the target date, arising from an ageing population. The critical thresholds for S1 are 0 and 2.5, between which S1 indicates medium risk. If S1 is below 0 or above 2.5, it indicates low or high risk, respectively*.

[4] The S2 indicator is a long-term sustainability gap; it shows the upfront and permanent fiscal adjustment required to stabilise the debt-to-GDP ratio over the infinite horizon, including the costs of ageing. The critical thresholds for S2 are 2 and 6, between which S2 indicates medium risk. If S2 is below 2 or above 6, it indicates low or high risk, respectively*.

* For more information see Fiscal Sustainability Report 2015 and Debt Sustainability Monitor 2017.

6. FISCAL FRAMEWORK

The 2012 Budget Law and the amendments introduced in December 2016 transpose the provisions of the TSCG. The fiscal framework includes a structurally balanced budget rule with a correction mechanism, and an independent monitoring assigned to the Danish Economic Council (DØRS). According to the Budget Law, at the time the draft budget is presented in August every year, the projected structural deficit in the following year may not surpass the MTO of -0.5% of GDP. In the period after the presentation of the draft budget, political decisions may not be made that lead to a breach of the MTO. If the Fiscal Council finds that the draft budget points to a significant deviation from the MTO, i.e. a structural deficit of 1.0% of GDP or higher – a correction mechanism will be triggered and the Finance Minister is required to correct the deviation.

The structural balance projections in the programme suggest adherence to the requirement of the Budget Law up to 2025.

The fiscal objectives are supported by multiannual expenditure ceilings, which apply for all three levels of general government and cover around three quarters of all public expenditure. Current expenditure ceilings are fixed by law for the years until 2021. The expenditure ceilings are buttressed by sanctions mechanisms, which take effect if the ceilings are not adhered to. The expenditure ceilings came into effect in 2014 and have arguably been successful in improving budgetary discipline.

In its report from October 2017, DØRS applying the Budget Law's methodology, estimates an increase in the structural balance from -0.6% of GDP in 2018 to -0.1% of GDP in 2020. DØRS estimates imply some temporary deviation from the MTO in 2018, reflecting differences particularly in the accounting of revenue from the pension yield tax on the nominal headline balance as well as the different output gap estimates.

Based on the information provided in the convergence programme, the past, planned and forecast fiscal performance in Denmark appears, as confirmed by the Fiscal Council (DØRS), to comply with the requirements of the applicable national numerical fiscal rules.

7. SUMMARY

The assessment of the convergence programme shows that Denmark complied with the provisions of the Stability and Growth Pact in 2017 and is also expected to be compliant in 2018 and 2019 based on both the convergence programme and the Commission 2018 spring forecast.

In 2017, Denmark achieved the MTO. According to the convergence program, the structural fiscal position is estimated to remain positive and therefore above its medium-term objective in 2018 and 2019. This is in line with the Commission 2018 spring forecast.

8. ANNEX

Table I. Macroeconomic indicators

	2000-2004	2005-2009	2010-2014	2015	2016	2017	2018	2019
Core indicators								
GDP growth rate	1.6	0.3	1.2	1.6	2.0	2.2	1.8	1.9
Output gap [1]	0.9	1.3	-2.6	-1.7	-1.3	-0.7	-0.7	-0.6
HICP (annual % change)	2.1	2.0	1.6	0.2	0.0	1.1	0.8	1.4
Domestic demand (annual % change) [2]	1.9	0.8	1.1	1.3	2.4	2.0	2.0	2.2
Unemployment rate (% of labour force) [3]	4.9	4.4	7.2	6.2	6.2	5.7	5.5	5.2
Gross fixed capital formation (% of GDP)	21.0	22.2	18.7	19.5	20.4	20.4	20.7	21.1
Gross national saving (% of GDP)	24.5	26.0	26.5	28.8	28.3	28.8	29.0	29.1
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	**1.0**	**3.1**	**-1.7**	**-1.5**	**-0.4**	**1.0**	**-0.1**	**0.0**
Gross debt	**48.0**	**34.0**	**44.4**	**39.9**	**37.9**	**36.4**	**33.6**	**32.3**
Net financial assets	**-20.2**	**1.3**	**-2.7**	**-4.8**	**-3.8**	**n.a**	**n.a**	**n.a**
Total revenue	54.1	54.6	54.7	53.3	53.2	52.9	51.8	51.6
Total expenditure	53.1	51.5	56.4	54.8	53.6	51.9	51.9	51.6
of which: Interest	3.1	1.8	1.8	1.6	1.4	1.1	1.1	1.0
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	**4.4**	**4.2**	**9.0**	**8.3**	**6.4**	**5.5**	**6.0**	**5.7**
Net financial assets; non-financial corporations	**-61.7**	**-76.0**	**-79.1**	**-111.2**	**-97.1**	**n.a**	**n.a**	**n.a**
Net financial assets; financial corporations	**-13.3**	**-32.0**	**-16.4**	**-13.9**	**-9.7**	**n.a**	**n.a**	**n.a**
Gross capital formation	12.9	13.0	11.3	12.0	12.6	12.9	13.2	13.6
Gross operating surplus	22.6	22.2	23.3	23.9	22.9	23.4	23.5	23.4
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	**-2.4**	**-4.2**	**-0.1**	**1.6**	**1.4**	**1.4**	**1.8**	**1.9**
Net financial assets	**82.1**	**105.6**	**128.8**	**163.5**	**164.7**	**n.a**	**n.a**	**n.a**
Gross wages and salaries	47.0	47.2	47.2	47.4	47.7	47.4	47.6	47.5
Net property income	1.4	1.7	2.2	4.1	3.5	3.5	3.6	3.6
Current transfers received	22.9	22.7	24.5	24.6	24.0	23.5	23.1	22.4
Gross saving	3.5	2.7	3.7	5.6	5.8	5.9	6.2	6.1
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	**2.9**	**3.1**	**7.2**	**8.5**	**7.3**	**7.8**	**7.6**	**7.6**
Net financial assets	**13.5**	**1.6**	**-29.7**	**-32.8**	**-53.3**	**n.a**	**n.a**	**n.a**
Net exports of goods and services	6.6	4.1	6.6	7.3	6.2	7.1	6.8	6.6
Net primary income from the rest of the world	-1.2	0.9	2.6	3.1	2.5	2.0	2.0	2.0
Net capital transactions	0.0	0.0	0.0	-0.4	0.0	0.0	0.0	0.1
Tradable sector	41.0	38.9	38.6	38.6	38.1	38.3	n.a	n.a
Non tradable sector	45.0	46.4	47.9	48.2	48.5	48.5	n.a	n.a
of which: Building and construction sector	4.6	4.8	3.9	4.0	4.2	4.2	n.a	n.a
Real effective exchange rate (index, 2010=100)	88.2	98.5	97.2	95.2	96.1	97.1	99.4	99.5
Terms of trade goods and services (index, 2010=100)	93.6	96.7	99.5	101.1	100.3	101.4	101.7	101.8
Market performance of exports (index, 2010=100)	107.8	104.5	101.4	98.1	97.2	97.0	95.4	94.4

Notes:

[1] The output gap constitutes the gap between the actual and potential gross domestic product at 2005 market prices.

[2] The indicator on domestic demand includes stocks.

[3] Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed. The unemployment rate covers the age group 15-74.

Source :
AMECO data, Commission 2018 spring forecast