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Assessment of the 2019 Convergence Programme for

Denmark

(Note prepared by DG ECFIN staff)

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EXECUTIVE SUMMARY

Denmark is subject to the preventive arm of the SGP.

The Danish economy is growing at a stable pace. The Commission 2019 spring forecast expects real GDP growth of 1.7% in 2019 and 1.6% in 2020, driven by private consumption and investment, in line with the Convergence Programme forecast. The macroeconomic scenario underpinning the budgetary projections of the Programme in 2019-2020 is plausible compared to the Commission 2019 spring forecast.

The general government balance turned out at a surplus of 0.5% of GDP in 2018, which the Convergence Programme expects to turn to a slight deficit of 0.1% of GDP in 2019 and 2020. The Programme estimates the structural balance to be -0.1% of GDP in 2019 and 0.0% of GDP in 2020 (0.9% of GDP in 2019 and 1.1% of GDP in 2020 as recalculated by the Commission according to the commonly agreed methodology). The fiscal stance is expected to be slightly contractionary over the Convergence Programme's forecast horizon. Risks to Danish public finances primarily relate to the reliance on some large and volatile revenue components, which historically have led to large fluctuations in the headline balance.

Denmark met its medium-term budgetary objective (MTO) in 2018 and is according to the Commission 2019 spring forecast expected to meet it in 2019 and 2020 as well.

1. INTRODUCTION

On 10 April 2019, Denmark submitted its 2019 Convergence Programme[1] (hereafter called Convergence Programme), covering the period 2019-2025.

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 27 February 2019 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 2019 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 the 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.

[1] The English version of Denmark's 2019 Convergence Programme was received on 2 May 2019

2. MACROECONOMIC DEVELOPMENTS

According to the Convergence Programme, the Danish economy will keep growing at a stable pace in the coming years. The underlying macroeconomic projections of the Programme are a technical update of the December 2018 Economic Survey and project real GDP growth at 1.7%, 1.7% and 1.6% in 2018, 2019 and 2020, respectively. Economic growth is set to be driven by domestic demand, while net export's contribution is projected to be zero in 2019 and negative in the years afterwards. Private consumption is forecast to be the main driver of economic growth expanding by 2.1% in 2019 and 2.3% in 2020 on the back of robust labour market developments and steadily increasing disposable incomes. After expanding at an average pace of around 5.7% between 2015 and 2018, investment is projected to grow at a more moderate rate of 2.8% in 2019, but to accelerate again to 3.8% in 2020 driven by an increasingly positive output gap.

Headline GDP growth projections have remained unchanged for both 2019 and 2020 when compared to the Convergence Programme from last year. Investment and imports growth in 2018 have been higher than foreseen in last year's Programme because of a large acquisition in the shipping sector, which lifted equipment investment as well as goods imports last year. Due to this temporary base effect, both investment and imports have been revised down in 2019. Export as well as import growth have been revised downwards for 2020, but the net export contribution to growth is expected to remain unchanged. After a stronger-than-expected labour market performance in 2018, both labour force and employment growth has been revised upwards, while the unemployment rate has been revised downwards for both 2019 and 2020.

The Programme's macroeconomic assumptions are in general plausible and broadly in line with the Commission 2019 spring forecast. Discrepancies between the Programme and the Commission 2019 spring forecast regarding the 2018 figures stem from the cut-off dates for the projections. The macroeconomic projection underpinning the Programme is a technical update of the projection presented in December 2018, while the Commission forecast dates from May 2019 and hence incorporates data released between December 2018 and April 2019. According to Statistics Denmark, real GDP expanded by 1.4% in 2018, but the Convergence Programme shows 1.7% of GDP growth for the same period, as the data for the full year of 2018 was not yet available and it excludes the negative base effect of a large one-off related to the export of service in 2017. Both the Commission 2019 spring forecast and the Convergence Programme expect real GDP growth of 1.7% in 2019 and 1.6% in 2020. However, the Programme forecasts stronger domestic demand growth, while the Commission 2019 spring forecast is more optimistic on net exports. The Programme forecasts slightly higher private consumption growth in 2020, due to the more dynamic rise of compensation per employees than projected in the Commission 2019 spring forecast. The Programme projects higher unemployment than the Commission 2019 spring forecast. This is due to the Programme being based on an estimate for 2018, while the Commission uses the outturn, the latter of which turned out to be lower. This explains the higher projections for unemployment in 2019 and 2020 in the Programme. The programme forecasts stronger investment and import growth for both 2019 and 2020 mainly due to a more positive assessment of the output gap. The Programme projects HICP inflation rates of 1.4% and 1.8% in 2019 and 2020, respectively, while the Commission 2019 spring forecast predicts somewhat lower inflation of 1.3% and 1.5% for the same period. The difference in 2020 stems from higher wage increase foreseen in the Convergence Programme, which is expected to trigger higher domestic price pressures.

The negative output gap, as recalculated by the Commission based on the information in the programme following the commonly agreed methodology, is slightly decreasing from -0.5% in 2018 to -0.3% of GDP in 2022. This differs from the Convergence Programme, which

estimates that the output gap turned positive in 2018, and expects it to remain positive until 2022.

Overall the macroeconomic scenario underpinning the budgetary projections of the Programme is plausible in 2019-2020.

Table 1: Comparison of macroeconomic developments and forecasts

	2018		2019		2020		2021	2022
	COM	CP	COM	CP	COM	CP	CP	CP
Real GDP (% change)	1.4	1.7	1.7	1.7	1.6	1.6	1.5	1.1
Private consumption (% change)	2.3	2.4	2.0	2.1	2.1	2.3	1.8	1.9
Gross fixed capital formation (% change)	5.1	6.1	1.7	2.8	2.3	3.8	2.8	2.1
Exports of goods and services (% change)	0.6	1.7	2.5	2.6	2.3	2.3	1.9	1.4
Imports of goods and services (% change)	2.7	3.9	2.2	3.0	2.5	3.4	2.3	2.3
Contributions to real GDP growth:								
- Final domestic demand	2.3	2.5	1.4	1.7	1.6	2.0	1.7	1.5
- Change in inventories	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
- Net exports	-1.0	-0.8	0.3	0.0	0.0	-0.5	-0.1	-0.4
Output gap[1]	-0.5	-0.5	-0.5	-0.4	-0.7	-0.3	-0.1	-0.3
Employment (% change)	1.8	1.7	1.1	1.1	0.9	0.9	0.3	0.1
Unemployment rate (%)	5.0	5.9	4.8	5.1	4.7	5.4	5.2	5.2
Labour productivity (% change)	-0.4	0.1	0.6	0.6	0.7	0.7	1.2	1.0
HICP inflation (%)	0.7	0.8	1.3	1.4	1.5	1.8	1.8	1.5
GDP deflator (% change)	0.4	0.8	1.6	1.6	1.8	2.0	1.7	1.7
Comp. of employees (per head, % change)	2.0	2.0	2.6	2.5	2.6	2.9	3.1	3.0
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	6.2	5.8	6.3	5.6	6.5	5.1	4.1	5.3

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 2019 spring forecast (COM); Convergence Programme (CP).

3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS

3.1. DEFICIT DEVELOPMENTS IN 2018 AND 2019

The general government balance turned out at a surplus of 0.5% of GDP in 2018, down from 1.4% of GDP in 2017. This fall can largely be attributed to the volatile pension yield and corporate income taxes, which declined from high levels, dragging down total revenue. Taxes on production were supported by VAT receipts, driven by strong private consumption growth. Expenditure remained broadly stable in 2018, supported by the multiannual spending ceilings. Despite around 1% public employment growth, the public sector wage bill remained stable as a share of GDP. The decline in interest expenditure came to a halt in 2018 and amounted to 1.1% of GDP. Public investment amounted to 3.4% of GDP in 2018, which is well above

historical levels. Moreover, the reform of the voluntary early retirement scheme led to the reimbursement of DKK 4 billion (0.2% of GDP) to households in 2018.

The outturn for the 2018 general government balance compares to a projection of -0.7% of GDP in last year's Convergence Programme. The difference of 1.2% of GDP between the outturn and last year's Programme projections is primarily due to the pension yield and corporate income taxes,[2] which despite their relatively low outturn were higher than expected.

This year's Convergence Programme projects a balance of -0.1% of GDP in 2019, compared to -0.7% of GDP in last year's Programme. The difference is the result of a downward revision in public expenditure of 0.3% of GDP, as well as an increase of 0.3% of GDP in total revenue, stemming primarily from higher taxes on production and on income and wealth. According to the Programme, the fiscal stance is expected to have a slightly contractionary impact on activity.

This year's Convergence Programme is based on the Ministry of Finance Economic Survey from December 2018 which has only been mechanically updated. The headline balance for 2018 is thus still assumed at 0.2% of GDP. It is forecast to deteriorate to -0.1% of GDP in 2019 due to a proportionally larger fall in revenue than in expenditure, partially explained by an expected decline in corporate tax revenue and to a lesser extent pension yield revenue. The Programme's lower projected revenue from these items also largely explains the discrepancy between the Commission and Programme estimations for the general government position in 2019.

3.2. MEDIUM-TERM STRATEGY AND TARGETS

Denmark's medium-term budgetary objective (MTO) is set at -0.5% of GDP. This is consistent with the updated minimum MTO for 2020-2022, which for Denmark is -1% of GDP. The MTO therefore reflects the objectives of the Pact. The MTO is also enshrined within the framework of the Budget Law, which limits the allowed structural budget deficit to 0.5% of GDP under normal economic conditions. The medium-term strategy presented in the Convergence Programme rests on reaching a balanced structural position in 2025 and is therefore more stringent than required by the MTO.

The structural balance as recalculated by the Commission on the basis of the information included in the Programme according to the commonly agreed methodology (henceforth 'recalculated structural balance') is estimated at 0.9% of GDP in 2019. It is set to increase to 1.1% of GDP in 2020 and fall slightly to 0.8% of GDP in 2022. The recalculated structural balance differs from the authorities' own estimates of a small deficit gradually giving way to small surpluses before reaching a balanced position in 2025. This relates to a different estimation of the output gap and to the way Denmark treats some volatile revenue items. Denmark therefore plans structural balances that are higher than the MTO over the forecast horizon.

The headline position is projected to reach a balanced position in 2022 and maintain it towards the end of the forecast horizon in 2025. This year's forecast of the headline deficit

[2] The data provided in the Convergence Programme's table 2a is not reported in EDP form. See the annex for further details.

developments differs from last year's Programme as the latter projected slightly larger deficits, although with the same goal of a balanced position in 2025.

Forecasts of the headline position in Denmark do, as a rule, reflect the balance at the central government level, as fiscal rules require local governments (regions and municipalities) to be in balance.

General government expenditure is projected to fall from 49.7% of GDP in 2019 to 49.2% of GDP in 2022. According to the Programme, this decline is supported by subdued growth in public consumption, although this is partially counteracted by a growing pool reserved for government priorities, included in the Table 2 under 'Other (residual)'. Social payments are set to decline due to previously implemented reforms, while public investment is projected to remain stable as a percentage of GDP.

General government revenue is estimated to decrease from 49.6% of GDP in 2019 to 49.2% of GDP in 2022. A large proportion of this fall can be attributed to an expected reduction in revenue from personal income tax, due particularly to a projected rise in interest rates which is associated with higher tax credits for higher interest expenditure and capital losses. The rise in interest rates is also expected to keep pension yield tax revenue low in the next few years. Indirect taxes are projected to decline, most notably due to the lower energy tariffs and the phasing out of the Public Service Obligation (PSO) tax.

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)	2018	2019		2020		2021	2022	Change: 2018-2022
	COM	COM	CP	COM	CP	CP	CP	CP
Revenue	**51.9**	**51.7**	**49.6**	**51.4**	**49.1**	**49.1**	**49.2**	**-2.7**
of which:								
- Taxes on production and imports	16.2	16.0	16.2	15.8	16.1	15.9	15.8	-0.3
- Current taxes on income, wealth, etc.	29.0	29.1	28.2	29.2	27.9	27.9	28.1	-0.9
- Social contributions	0.9	0.9	0.0	0.9	0.0	0.0	0.0	-0.8
- Other (residual)	5.9	5.7	5.1	5.6	5.0	5.2	5.2	-0.6
Expenditure	**51.4**	**51.1**	**49.7**	**51.5**	**49.2**	**49.3**	**49.2**	**-2.2**
of which:								
- Primary expenditure	50.3	50.0	48.7	50.4	48.3	48.4	48.3	-2.0
of which:								
Compensation of employees+Intermediate	24.1	23.9	23.8	23.7	23.7	23.6	23.6	-0.4
Compensation of employees	15.3	15.2	15.1	15.0	15.0	14.9	15.0	-0.3
Intermediate consumption	8.8	8.7	8.7	8.6	8.7	8.7	8.7	-0.1
Social payments	17.5	17.5	17.6	17.6	17.3	17.2	17.2	-0.3
Subsidies	1.7	1.7	1.7	1.6	1.6	1.6	1.6	-0.1
Gross fixed capital formation	3.4	3.5	3.3	3.4	3.3	3.4	3.4	-0.1
Other (residual)	3.6	3.4	2.4	4.1	2.4	2.6	2.5	-1.1
- Interest expenditure	1.1	1.1	0.9	1.1	0.9	0.9	0.9	-0.2
General government balance (GGB)	**0.5**	**0.6**	**-0.1**	**-0.1**	**-0.1**	**-0.2**	**0.0**	**-0.5**
Primary balance	**1.6**	**1.6**	**0.8**	**1.0**	**0.8**	**0.7**	**0.9**	**-0.7**
One-off and other temporary	0.0	0.0	-0.8	-0.7	-1.0	-1.1	-0.6	-0.6
GGB excl. one-offs	**0.5**	**0.6**	**0.7**	**0.6**	**0.9**	**0.9**	**0.6**	**0.1**
Output gap[1]	-0.5	-0.5	-0.4	-0.7	-0.3	-0.1	-0.3	0.1
Cyclically-adjusted balance[1]	0.8	0.9	0.1	0.3	0.1	-0.1	0.2	-0.5
Structural balance[2]	**0.8**	**0.9**	**0.9**	**1.0**	**1.1**	**1.0**	**0.8**	**0.1**
Structural primary balance[2]	1.9	2.0	1.9	2.1	0.9	1.8	1.7	**-0.2**

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 2019 spring forecasts (COM); Commission calculations.

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

Source: Commission 2019 Spring Forecast. Convergence programmes

3.3. MEASURES UNDERPINNING THE PROGRAMME

Reforms implemented in recent years have, according to the Programme, contributed to increase labour supply, support growth, lift public investment and reduce expenditure. The 2006 welfare and 2011 pension reforms are estimated to lift structural employment by 18000 people on average in the coming years until 2022, and additionally by around 9000 annually between 2023 and 2025. Public investment is projected to increase slightly towards 2025, supported by recent political agreements. These include an agreed infrastructure investment plan, which prioritises DKK 4.5 billion (0.2% of GDP) to lift public investment between 2021 and 2025. A political agreement on health reform commits an additional DKK 300 million to public investment in the medium term. Previous reforms are also expected to ensure subdued growth in expenditure on social transfers towards 2025, despite an increase in public pensions in the 2019 budget.

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.[3]

3.4. DEBT DEVELOPMENTS

The Convergence Programme forecasts gross public debt to decrease to 33.4% of GDP in 2019 driven by a draw-down in cash buffers. This is a slightly smaller drop in debt than projected by the Commission, which expects a larger contribution from the primary balance

[3] "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

that is only partially compensated by larger interest expenditure. The Programme expects the public debt ratio to remain stable in 2020, before picking up in 2021 and increasing to 35.5% of GDP by 2022. This increase is primarily the result of the property tax reform in 2016 and a new financing model for public housing implemented in 2017. The latter reform, in particular, entails a simultaneous build-up in state assets and liabilities, of which only the latter is recorded in public gross debt figures. The Commission 2019 spring forecast expects debt to decrease slightly faster in 2020 than the Programme, driven by a more moderate development in stock-flow adjustments.

Table 3: Debt developments

(% of GDP)	Average 2013-2017	2018	2019		2020		2021	2022
			COM	CP	COM	CP	CP	CP
Gross debt ratio[1]	**40.2**	**34.1**	**33.0**	**33.4**	**32.5**	**33.4**	**34.0**	**35.5**
Change in the ratio	-1.9	-1.3	-1.1	-0.7	-0.5	-0.1	0.6	1.5
Contributions[2] :								
1. Primary balance	**-1.4**	**-1.6**	**-1.6**	**-0.8**	**-1.0**	**-0.8**	**-0.7**	**-0.9**
2. "Snow-ball" effect	**0.3**	**0.4**	**0.0**	**-0.2**	**0.0**	**-0.3**	**-0.2**	**0.0**
Of which:								
Interest expenditure	1.4	1.1	1.1	0.9	1.1	0.9	0.9	0.9
Growth effect	-0.8	-0.5	-0.6	-0.6	-0.5	-0.5	-0.5	-0.4
Inflation effect	-0.4	-0.1	-0.5	-0.5	-0.6	-0.6	-0.6	-0.6
3. Stock-flow adjustment	**-0.8**	**-0.2**	**0.6**	**0.3**	**0.5**	**1.0**	**1.5**	**2.5**

Notes:

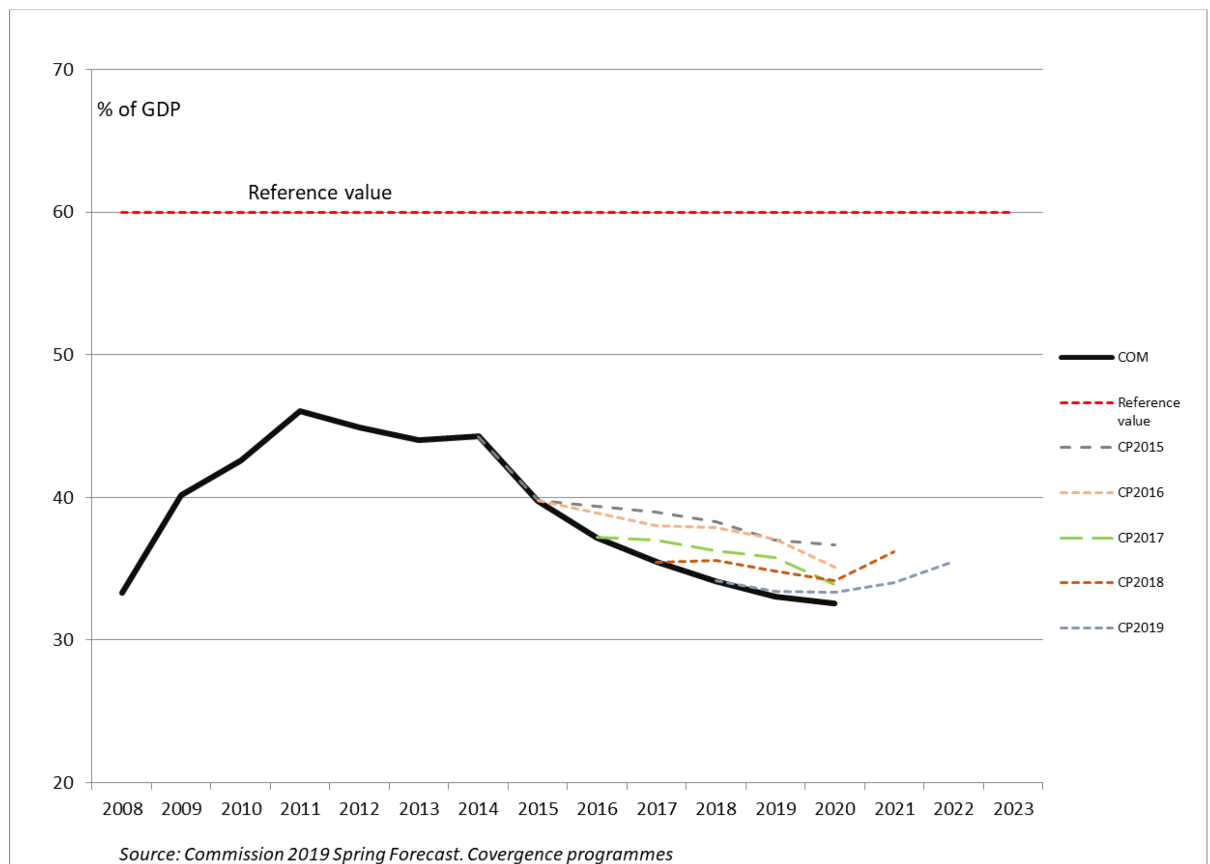
[1] End of period.

[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 2019 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.

The 2012 budget law introduced expenditure ceilings for all levels of government (state, communes and regions) from 2014 onwards. These binding ceilings cover a 4-year period and are supported by the possibility of economic sanctions. The introduction of the budget law ended excessive spending by municipalities, which had been the main reason behind larger-than-expected public consumption in the 1990s and 2000s. According to the Convergence Programme, preliminary data for 2018 shows that the expenditure ceiling was respected for the central government. Based on outturn data from 2014 to 2017 expenditure ceilings were respected for all levels of government.

Risks to Danish public finances primarily relate to the reliance on some large and volatile revenue components. These include the pension yield and corporate income taxes whereas the importance of revenue tied to oil and gas drilling in the North Sea has declined in recent years. Danish authorities' projections of these revenue items are generally quite conservative, but the revenue outturn has nevertheless historically led to large fluctuations in the headline balance. While a prudent approach to these revenue items appears appropriate, the current estimates do seem very low. Annual projections of revenue from the pension yield tax range between 0.2% and 0.5% of GDP over the next few years to 2022, despite the Danish authorities' own estimated structural level of around 1.2% of GDP from this revenue component. Further risks to the public finances relate to the upcoming general election in the

summer of 2019, where the pension reform and the agreed indexation of the statutory retirement age could come under political scrutiny.

Risks to the public debt developments appear 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 37.8% of GDP in 2025.

4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT

Denmark is subject to the preventive arm of the Stability and Growth Pact and should ensure compliance with its MTO. Under the European Semester in July 2018 the Council considered that Denmark complied with the Stability and Growth Pact. The headline balance showed a surplus of 0.5% of GDP in 2018, and is forecast by the Programme to remain close to balance throughout the forecast horizon.

The structural balance is estimated to have fallen from around 1.5% of GDP in 2017 to around 0.8% of GDP in 2018. This is well above the medium-term budgetary objective (MTO) of a structural deficit of 0.5% of GDP, in compliance with the Stability and Growth Pact.

The recalculated structural balance based on the Convergence Programme for 2019 is expected to be around 0.9% of GDP, and to increase further to 1.1% of GDP in 2020. Thus, based on the Convergence Programme, Denmark is expected to be above its MTO in 2019 and 2020. The Commission 2019 spring forecast confirms this assessment.

There are some differences between the Commission's and the Danish authorities' estimates of the structural balance. This is primarily the result of different definitions and ways of filtering out volatile revenue components. The Danish authorities use estimated 'structural levels' of certain volatile revenue components for their projections to filter out some of the volatility of, for instance, the pension yield tax and income from North Sea drilling.

Table 4: Compliance with the requirements under the preventive arm

(% of GDP)	2018	2019		2020	
Background budgetary indicators[1]					
Medium-term objective (MTO)	-0.5	-0.5		-0.5	
Structural balance[2] (COM)	0.8	0.9		1.0	
Setting the required adjustment to the MTO					
Structural balance based on freezing (COM)	0.5	0.9		-	
Position vis-a -vis the MTO[3]	At or above the MTO	At or above the MTO		At or above the MTO	
Required adjustment[4]	0.0	0.0		0.0	
Required adjustment corrected[5]	-2.0	-1.0		-1.4	
Corresponding expenditure benchmark[6]	6.9	5.5		6.2	
Compliance with the required adjustment to the MTO					
	COM	**CP**	**COM**	**CP**	**COM**
Structural balance pillar					
Change in structural balance[7]	Compliance				
One-year deviation from the required adjustment[8]					
Two-year average deviation from the required adjustment[8]					
Expenditure benchmark pillar					
Net public expenditure annual growth corrected for one-offs[9]					
One-year deviation adjusted for one-offs[10]					
Two-year deviation adjusted for one-offs[10]					
Finding of the overall assessment					

Legend

'Compliance' - the recommended structural adjustment or a higher adjustment is being observed.

'Some deviation' - a deviation from the recommended structural adjustment is being observed, but it is below the threshold for a significant deviation.

'Significant deviation' - a deviation which has reached or breached the threshold for a significant deviation (i.e. 0.5% of GDP over one year, 0.25% of GDP over two years on average).

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] 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.

[7] Change in the structural balance compared to year t-1. Ex post assessment (for 20XX-1) is carried out on the basis of Commission 20XX spring forecast.

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

[9] Net public expenditure annual growth (in %) corrected for discretionary revenue measures, revenue measures mandated by law and one-offs (nominal)

[10] 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.

Source:

Convergence Programme (CP); Commission 2019 spring forecast (COM); Commission calculations.

5. DEBT SUSTAINABILITY ANALYSIS AND FISCAL RISKS

Denmark does not appear to face fiscal sustainability risks in the short run.[4]

Based on Commission 2019 spring forecasts and a no-fiscal policy change scenario beyond the forecast horizon, government debt, projected at 33.0% of GDP in 2019, is expected to decrease to 9.2% of GDP in 2029, thus remaining below the 60% of GDP Treaty threshold. Over this horizon, government debt is projected to peak in 2019. Sensitivity analysis shows similar low risks.[5] 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 2029, although remaining below the 60% of GDP reference value in 2029.

The medium-term fiscal sustainability risk indicator S1[6] is at -5.5 percentage points of GDP, primarily related to the favourable initial budgetary position and the low level of government debt, which contribute together with -5.6 percentage points of GDP. This indicator thus signals low risks in the medium term. The full implementation of the Convergence Programme would put the sustainability risk indicator S1 at -5.4 percentage points of GDP. Based on the debt sustainability analysis and the S1 indicator, overall medium-term fiscal sustainability risks are, therefore, low. While fully implementing the fiscal plans in the Convergence Programme would slightly increase those risks, they would nonetheless remain low.

The long-term fiscal sustainability risk indicator S2 is at -0.9 percentage points of GDP. In the long term, Denmark therefore appears to face low fiscal sustainability risks, primarily related to the favourable initial budgetary position contributing -1.5 percentage points of GDP. Full implementation of the programme would put the S2 indicator at -0.3 percentage points of GDP, leading to a slightly higher long-term risk, while the S2 risk category would remain low.[7] The debt sustainability analysis discussed above points to low risks so that, overall, long-term fiscal sustainability risks are assessed as low for Denmark.

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[4] 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.

[5] Sensitivity analysis includes several deterministic debt projections, as well as stochastic projections (see Fiscal Sustainability Report 2018 for more details).

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

[7] The projected costs of ageing that are used to compute the debt projections and the fiscal sustainability indicators S1 and S2 are based on the projections of the 2018 Ageing Report.

Table 5: Debt sustainability analysis and sustainability indicators

Time horizon			Commission Scenario		Stability / Convergence Programme Scenario	
Short-term			**LOW risk**			
S0 indicator [1]			0.1			
Fiscal subindex			0.0	LOW risk		
Financial & competitiveness subindex			0.2	LOW risk		
Medium-term			**LOW risk**			
DSA [2]			LOW risk			
S1 indicator [3]			-5.5	LOW risk	-5.4	LOW risk
of which	Initial Budgetary Position		-3.6		-3.3	
	Debt Requirement		-2.0		-2.2	
	Cost of Ageing		0.1		0.1	
	of which	Pensions	-0.2		-0.1	
		Health care	0.2		0.1	
		Long-term care	0.5		0.3	
		Other	-0.3		-0.2	
Long-term			**LOW risk**			
DSA [2]			LOW risk			
S2 indicator [4]			-0.9	LOW risk	-0.3	LOW risk
of which	Initial Budgetary Position		-1.5		-0.9	
	Cost of Ageing		0.7		0.7	
	of which	Pensions	-1.2		-1.1	
		Health care	0.7		0.6	
		Long-term care	1.6		1.5	
		Other	-0.4		-0.3	

Source: Commission services; 2019 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 2019 forecast until 2020. 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 2033. This adjustment effort corresponds to a cumulated improvement in the structural primary balance over the 5 years following the forecast horizon (i.e. from 2021 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 2018.

6. Fiscal framework

Denmark's fiscal framework largely derives from the 2012 Budget Law and the amendments introduced to it in December 2016. The law limits the structural deficit allowed in a draft budget proposal to 0.5% of GDP in the following year, which is in line with the MTO. Political decisions may not be made during the year that could result in the violation of this limit. The Danish Economic Council (DØRS) acts as fiscal watch dog and monitors adherence to the fiscal rules. If it finds that there is a risk of significant deviation from the legal limit, i.e. a structural deficit of 1.0% of GDP or higher, a corrective mechanism will be triggered, requiring the Finance Minister to resolve the breach of the deficit ceiling.

The structural balance projections contained in the Programme suggest that the requirements of the Budget Law will be observed up to 2025.

The structural deficit cap is supported by multiannual expenditure ceilings for all levels of government that cover the majority of public expenditure. These ceilings are enforced by sanctioning mechanisms that are activated in cases of non-compliance. Since their entry into force in 2014 and until 2017, all ceilings appear to have been adhered to. The review of the Budget Law has been postponed and is now expected for the parliamentary year of 2019-2020.

DØRS estimates the structural balance at -0.2% of GDP in 2019 and to improve slightly in the years to 2025. Their projections were made using the Budget Law's methodology, and were published in the fiscal watchdog's report from autumn 2018. DØRS thus expects the national fiscal rules to be observed over the forecast horizon.

Based on the information provided in the Convergence Programme, the past, planned and forecast fiscal performance in Denmark therefore appears to comply with the requirements of the applicable national numerical fiscal rules.

7. Summary

The information provided in the Convergence Programme demonstrates that Denmark complied with the provisions of the Stability and Growth Pact in 2018. Based on both the Convergence Programme and the Commission 2019 spring forecast, Denmark is projected to remain in accordance with the Pact in 2019 and 2020.

Denmark achieved the MTO in 2018. According to the Programme as well as the Commission 2019 spring forecast, the structural fiscal position is projected to remain positive and thus above its medium-term budgetary objective in 2019 and 2020.

8. ANNEXES

Table I. Macroeconomic indicators

	2001-2005	2006-2010	2011-2015	2016	2017	2018	2019	2020
Core indicators								
GDP growth rate	1.3	0.3	1.3	2.4	2.3	1.4	1.7	1.6
Output gap [1]	0.7	0.3	-2.5	-0.7	-0.1	-0.5	-0.5	-0.7
HICP (annual % change)	1.9	2.1	1.2	0.0	1.1	0.7	1.3	1.5
Domestic demand (annual % change) [2]	1.9	0.3	1.5	2.5	2.2	2.6	1.5	1.7
Unemployment rate (% of labour force) [3]	5.0	4.9	7.0	6.2	5.7	5.0	4.8	4.7
Gross fixed capital formation (% of GDP)	20.9	21.6	19.0	20.9	21.2	22.2	22.1	22.1
Gross national saving (% of GDP)	25.0	25.7	27.4	29.4	29.6	28.8	28.9	28.9
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	**1.6**	**1.5**	**-1.4**	**-0.1**	**1.4**	**0.5**	**0.6**	**-0.1**
Gross debt	**45.1**	**35.0**	**43.8**	**37.2**	**35.5**	**34.1**	**33.0**	**32.5**
Net financial assets	**-17.0**	**3.9**	**-4.3**	**-3.4**	**-0.5**	**n.a**	**n.a**	**n.a**
Total revenue	54.4	54.1	54.6	52.6	52.6	51.9	51.7	51.4
Total expenditure	52.8	52.6	56.0	52.7	51.2	51.4	51.1	51.5
of which: Interest	2.8	1.7	1.7	1.3	1.1	1.1	1.1	1.1
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	**4.4**	**5.1**	**8.8**	**6.6**	**4.9**	**3.3**	**3.6**	**4.1**
Net financial assets; non-financial corporations	**-63.3**	**-76.8**	**-87.5**	**-99.1**	**-106.4**	**n.a**	**n.a**	**n.a**
Net financial assets; financial corporations	**-15.6**	**-30.7**	**-12.1**	**-10.0**	**-14.5**	**n.a**	**n.a**	**n.a**
Gross capital formation	12.7	12.6	11.8	13.4	13.5	14.5	14.3	14.4
Gross operating surplus	22.4	22.2	23.6	24.1	24.1	23.1	23.1	23.2
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	**-2.5**	**-3.1**	**0.1**	**1.4**	**1.7**	**2.4**	**2.2**	**2.5**
Net financial assets	**86.8**	**104.3**	**138.9**	**166.7**	**175.0**	**n.a**	**n.a**	**n.a**
Gross wages and salaries	46.9	47.6	47.1	47.0	46.9	47.9	48.0	48.0
Net property income	1.6	1.6	2.7	3.4	4.0	4.0	3.9	3.9
Current transfers received	23.1	22.9	24.5	23.7	23.1	23.1	22.9	22.6
Gross saving	3.6	3.2	3.9	5.5	6.3	6.8	6.9	6.8
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	**3.5**	**3.6**	**7.5**	**7.9**	**8.0**	**6.2**	**6.3**	**6.5**
Net financial assets	**9.5**	**0.0**	**-34.2**	**-53.3**	**-52.7**	**n.a**	**n.a**	**n.a**
Net exports of goods and services	6.4	4.4	6.6	6.7	7.1	5.3	5.6	5.6
Net primary income from the rest of the world	-0.5	1.1	2.8	2.6	2.2	2.4	2.3	2.2
Net capital transactions	0.1	0.0	-0.1	0.0	0.0	0.0	0.0	0.3
Tradable sector	40.5	38.6	38.7	38.3	38.5	37.8	n.a	n.a
Non tradable sector	45.2	47.0	47.9	48.4	48.4	48.9	n.a	n.a
of which: Building and construction sector	4.5	4.6	4.0	4.5	4.6	5.0	n.a	n.a
Real effective exchange rate (index, 2000=100)	90.3	99.7	96.1	94.9	96.1	98.2	97.0	96.7
Terms of trade goods and services (index, 2000=100)	94.4	97.4	99.8	102.3	102.8	101.2	101.3	101.5
Market performance of exports (index, 2000=100)	107.1	103.8	101.1	99.1	98.2	95.9	95.7	94.9

Notes:

[1] The output gap constitutes the gap between the actual and potential gross domestic product at 2010 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 2019 spring forecast

Mandatory variables not included in the Convergence Programme

The data provided in the Convergence Programme's table 2a is not reported in EDP form. E.g. DK treats sales and consumption of fixed capital differently than required in EDP form. Not included mandatory variables do not impede the Commission's ability to assess the Convergence Programme on the basis of the Programme's assumptions.