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Assessment of the 2017 convergence programme for

Denmark

(Note prepared by DG ECFIN staff)

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1. INTRODUCTION

On 28 April 2017, Denmark submitted its 2017 convergence programme (hereafter called convergence programme), covering the period 2017-2020.

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

This document complements the Country Report published on 22 February 2017 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 2017 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.

2. MACROECONOMIC DEVELOPMENTS

According to the convergence programme, Denmark's economic growth is expected to gradually strenghten in the coming years. Real GDP growth was 1.3% in 2016 and it is projected to increase from 1.5% in 2017 to 2.0% in 2020. Economic growth is forecast to be driven by domestic demand, while net exports are expected to weigh on GDP developments. Private consumption is projected to remain a stable growth engine, with growth hovering around 2%. Investment growth is expected to rise from 2.7% in 2017 to 5% in 2020 boosting real GDP growth until 2020.

Comparing the projections in the convergence programme with last year's projections in the convergence programme, GDP growth has been adjusted downwards in 2017-2019. Particularly this year's convergence programme is more pessimistic on gross fixed capital formation between 2017 and 2020.

The programme's macroeconomic assumptions are in general plausible and broadly in line with the Commission 2017 spring forecast. Both projections forecast a gradual strengthening of the economic recovery over the coming years driven by domestic demand. While the programme projects GDP growth of 1.5% in 2017 and 1.7% in 2018, the Commission forecasts slightly stronger growth of 1.7% and 1.8%, respectively. The main difference concerns the development of gross fixed capital formation, where the Commission 2017 spring forecast projects higher growth rates. Following a surge of 11% in 2016, the Commission 2017 spring forecast expects housing investment to remain robust, while equipment investment is forecast to expand firmly as world trade strenghtens and the overall recovery becomes more firmly established. The convergence programme's projections for private consumption growth (the tax base for indirect taxes) and the increase in wages and

salaries (the tax base for personal income tax and social contributions) are broadly in line with the Commission 2017 spring forecast.

The output gaps as recalculated by Commission based on the information in the programme, following the commonly agreed methodology, are gradually closing up to 2020. The (recalculated) output gap is estimated at -1.3% of GDP in 2017 and is expected to narrow to -0.4% in 2020.

Overall the macroeconomic scenario underpinning the budgetary projections of the convergence programme is plausible in 2017-2018.

Table 1: Comparison of macroeconomic developments and forecasts

	2016		2017		2018		2019	2020
	COM	CP	COM	CP	COM	CP	CP	CP
Real GDP (% change)	1.3	1.3	1.7	1.5	1.8	1.7	1.7	2.0
Private consumption (% change)	1.9	1.9	1.9	1.8	1.9	2.0	2.0	2.1
Gross fixed capital formation (% change)	5.2	5.2	3.6	2.7	3.7	3.8	4.3	5.0
Exports of goods and services (% change)	1.7	1.7	3.3	2.4	3.9	2.7	3.6	3.8
Imports of goods and services (% change)	2.4	2.4	4.0	2.9	4.4	3.4	4.6	4.4
Contributions to real GDP growth:								
- Final domestic demand	1.9	1.9	1.7	1.6	1.8	2.0	2.1	2.1
- Change in inventories	-0.4	-0.4	0.0	0.0	0.0	0.0	-0.2	0.0
- Net exports	-0.2	-0.2	-0.1	-0.1	0.0	-0.2	-0.2	-0.1
Output gap[1]	-1.4	-1.3	-1.4	-1.3	-1.3	-1.0	-0.8	-0.4
Employment (% change)	1.7	1.7	1.1	1.0	0.9	0.9	0.7	0.8
Unemployment rate (%)	6.2	6.2	5.8	5.9	5.7	5.7	5.7	5.7
Labour productivity (% change)	-0.4	-0.4	0.6	0.5	0.9	0.9	1.0	1.2
HICP inflation (%)	0.0	0.0	1.4	1.0	1.7	1.4	1.1	1.5
GDP deflator (% change)	0.4	0.4	1.6	1.6	1.7	1.9	1.2	1.6
Comp. of employees (per head, % change)	1.6	1.7	2.3	2.3	2.7	2.6	2.8	3.1
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	8.1	8.1	7.4	7.9	7.4	7.9	6.7	7.5

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 2017 spring forecast (COM); Convergence Programme (CP).

3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS

3.1. DEFICIT DEVELOPMENTS IN 2016 AND 2017

The headline balance for the general government was -0.9% of GDP in 2016. This compares to deficits of 2.3% and 1.3% envisaged in last year's programme and the Economic Survey

from December 2016, respectively. The better than expected outcome was mainly attributed to higher revenue from the pension yield tax.

The convergence programme forecasts a deterioration of the budget balance to -1.9% of GDP in 2017, similar to the headline balance in last year's programme. The unchanged headline balance for 2017 reflects a downward revision of public revenue by 0.7% of GDP, fully offsetting an expected similar-sized decline in public expenditure. The downward revision to revenue reflects weaker revenue from pension yield tax and other indirect tax. On the expenditure side, the downward revision reflects lower public consumption and lower social transfers, the latter reflecting lower inflow of refugees. The deterioration in the headline balance from 2016 to 2017, mainly reflects a marked decline in pension yield tax revenue(1.4 pps of GDP).

3.2. MEDIUM-TERM STRATEGY AND TARGETS

The convergence programme targets a balanced budget in structural terms in 2020. Denmark's MTO is set at -0.5% of GDP. This is in line with what the Pact requires. 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 2020. The MTO and the target of a balanced structural budget remain the same as in last year's programme.

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 0.0% in 2017. It is expected to improve gradually to 0.5% of GDP in 2018 and 2019 before declining to 0.3% of GDP in 2020. As a result, Denmark plans structural balances higher than the MTO over the programme period.

The headline deficit is expected to increase to 1.9% of GDP in 2017 followed by targets of around 1% in 2018 and 2019, respectively, and a balanced fiscal position in 2020. The deterioration in 2017 primarily reflects an expected shortfall in revenue stemming from the volatile revenue from pension yield taxes. The targets envisaged in the 2017 convergence programme are broadly in line with last year's programme, except for 2018 where the target was revised up from -1.9% of GDP to -0.9%. The projected headline balance mainly reflects developments in the state, as the fiscal policy framework aims at ensuring balanced budgets in the regions and municipalities.

Public expenditure’s share in GDP is planned to be reduced from 53.6% of GDP in 2016 to 50.0% in 2020, according to the convergence programme. This marked decline reflects improving economic conditions and lower social transfers over the programme horizon. It also reflects a normalisation of the current high public investment levels and the effects of previously agreed reforms, particularly the 2006 welfare and the 2011 pension reforms.

The convergence programme projects declining general government revenue from 52.7% of GDP in 2016 to 50.0% in 2020. Pension yield taxes explain the bulk of the reduction, notwithstanding the projected increase of pension yield tax revenue by 0.9pps of GDP in 2020. Taxes on income and wealth explain most of the remaining decline in general government revenue.

The projections rely on principles similar to the non-policy change assumptions, applied by the Commission. Specifically, the projections in the convergence programme only considers reforms and agreements where a majority in parliament has been estasblished.

Table 2: Composition of the budgetary adjustment

(% of GDP)	2016	2017		2018		2019	2020	Change: 2016-2020
	COM	COM	CP	COM	CP	CP	CP	CP
Revenue	**52.7**	**52.0**	**49.8**	**51.4**	**49.9**	**49.4**	**50.0**	**-2.7**
of which:								
- Taxes on production and imports	16.3	16.3	16.2	16.3	16.3	16.2	16.1	-0.2
- Current taxes on income, wealth, etc.	29.6	28.8	28.0	28.2	28.1	27.6	28.4	-1.2
- Social contributions	1.0	0.9	0.1	0.9	0.1	0.1	0.1	-0.9
- Other (residual)	5.9	5.9	5.5	5.8	5.5	5.5	5.4	-0.4
Expenditure	**53.6**	**53.3**	**51.7**	**52.3**	**50.9**	**50.6**	**50.0**	**-3.7**
of which:								
- Primary expenditure	52.3	52.2	50.6	51.4	49.9	49.6	49.0	-3.3
of which:								
Compensation of employees	15.9	15.7	15.7	15.5	15.6	15.6	15.4	-0.5
Intermediate consumption	9.0	9.2	9.0	9.2	9.0	9.0	8.9	-0.2
Social payments	18.4	18.2	18.5	17.8	18.2	18.0	17.8	-0.6
Subsidies	1.9	1.9	1.9	1.8	1.8	1.7	1.6	-0.2
Gross fixed capital formation	3.7	3.6	3.4	3.6	3.2	3.2	3.2	-0.5
Other (residual)	3.3	3.7	2.9	3.5	3.0	2.9	2.8	-0.5
- Interest expenditure	1.3	1.0	1.1	0.9	0.9	1.1	1.0	-0.3
General government balance (GGB)	**-0.9**	**-1.3**	**-1.9**	**-0.9**	**-0.9**	**-1.2**	**0.0**	**0.9**
Primary balance	**0.4**	**-0.3**	**-0.8**	**0.0**	**0.0**	**-0.2**	**1.0**	**0.6**
One-off and other temporary	0.0	0.0	-1.1	0.0	-0.6	-1.2	0.0	0.0
GGB excl. one-offs	**-0.9**	**-1.3**	**-0.8**	**-0.9**	**-0.3**	**0.0**	**0.0**	**0.9**
Output gap[1]	-1.4	-1.4	-1.3	-1.3	-1.0	-0.8	-0.4	1.0
Cyclically-adjusted balance[1]	0.0	-0.4	-1.1	-0.1	-0.3	-0.7	0.3	0.3
Structural balance[2]	**0.0**	**-0.4**	**0.0**	**-0.1**	**0.3**	**0.5**	**0.3**	**0.3**
Structural primary balance[2]	1.3	0.6	1.1	0.8	1.3	1.6	1.3	0.0

Notes:

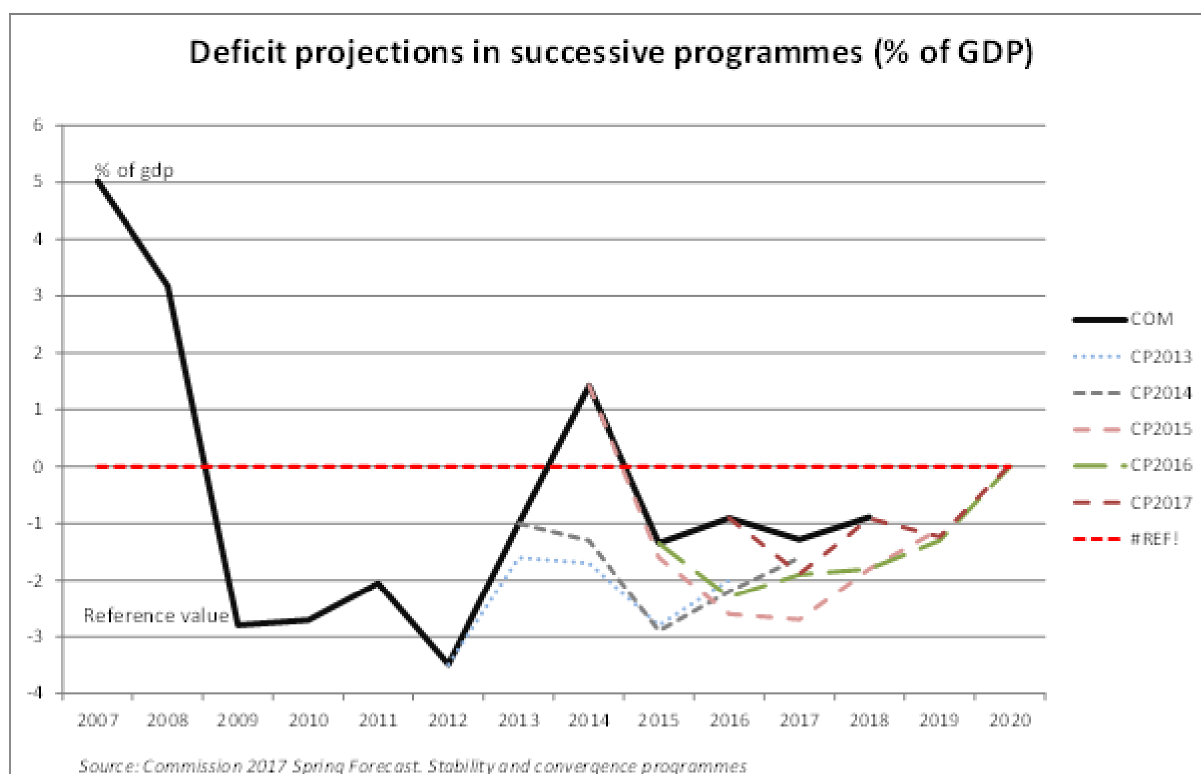
[1]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission on the basis of the programme scenario using the commonly agreed methodology.

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

Source :

Convergence Programme (CP); Commission 2017 spring forecasts (COM); Commission calculations.

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



3.3. MEASURES UNDERPINNING THE PROGRAMME

Over the last eight years, Denmark has undertaken a number of reforms that are expected to have a positive effect on labour supply, employment and public finances in the coming years[1]. Among these are the 2011 pension reform, the 2012 reform of disability pension, flex jobs, student grants and social transfers, as well as the 2009 spring package. This year's National Reform Programme estimates that these reforms will increase employment by close to 80 000 by 2020, corresponding to an increase in employment of approximately 3% by 2020 (compared to a scenario without these reforms). In addition, a central assumption behind the projection up to 2020 is a gradual reduction of public investments from the currently high level to a level in 2020 that is closer to, but still higher, than the historical average.

The convergence programme does not quantify the discretionary measures underpinning the projections, which is inconsistent with the guidelines laid down in the Code of Conduct.[2]

[1] The property tax reform was agreed on 2 May 2017, after the cut-off date of the convergence programme, hence not considered.

[2] "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 ratio to gradually decline from 37.0% in 2017 to 33.9% in 2020, largely due to favourable snow-ball and stock-flow effects. The primary balance, on the other hand, is expected to remain broadly stable and contribute less to the declining public debt. These projections are broadly in line with those of the Commission 2017 spring forecast, although small differences persist due to different assumptions for the cash buffer of the state, as reflected in different stock-flow adjustments.

Table 3: Debt developments

(% of GDP)	Average 2011-2015	2016	2017		2018		2019	2020
			COM	CP	COM	CP	CP	CP
Gross debt ratio[1]	**43.7**	**37.8**	**36.7**	**37.0**	**36.0**	**36.3**	**35.8**	**33.9**
Change in the ratio	-0.6	-1.8	-1.0	-0.7	-0.7	-0.8	-0.5	-1.9
Contributions[2] *:*								
1. Primary balance	**-0.4**	**-0.4**	**0.3**	**0.8**	**0.0**	**0.0**	**0.2**	**-1.0**
2. "Snow-ball" effect	**0.7**	**0.7**	**-0.2**	**-0.1**	**-0.4**	**-0.4**	**0.0**	**-0.3**
Of which:								
Interest expenditure	1.7	1.3	1.0	1.1	0.9	0.9	1.1	1.0
Growth effect	-0.5	-0.5	-0.6	-0.5	-0.6	-0.6	-0.6	-0.7
Inflation effect	-0.5	-0.1	-0.6	-0.6	-0.6	-0.7	-0.4	-0.6
3. Stock-flow adjustment	**-0.9**	**-2.1**	**-1.1**	**-1.5**	**-0.4**	**-0.4**	**-0.7**	**-0.6**

Notes:

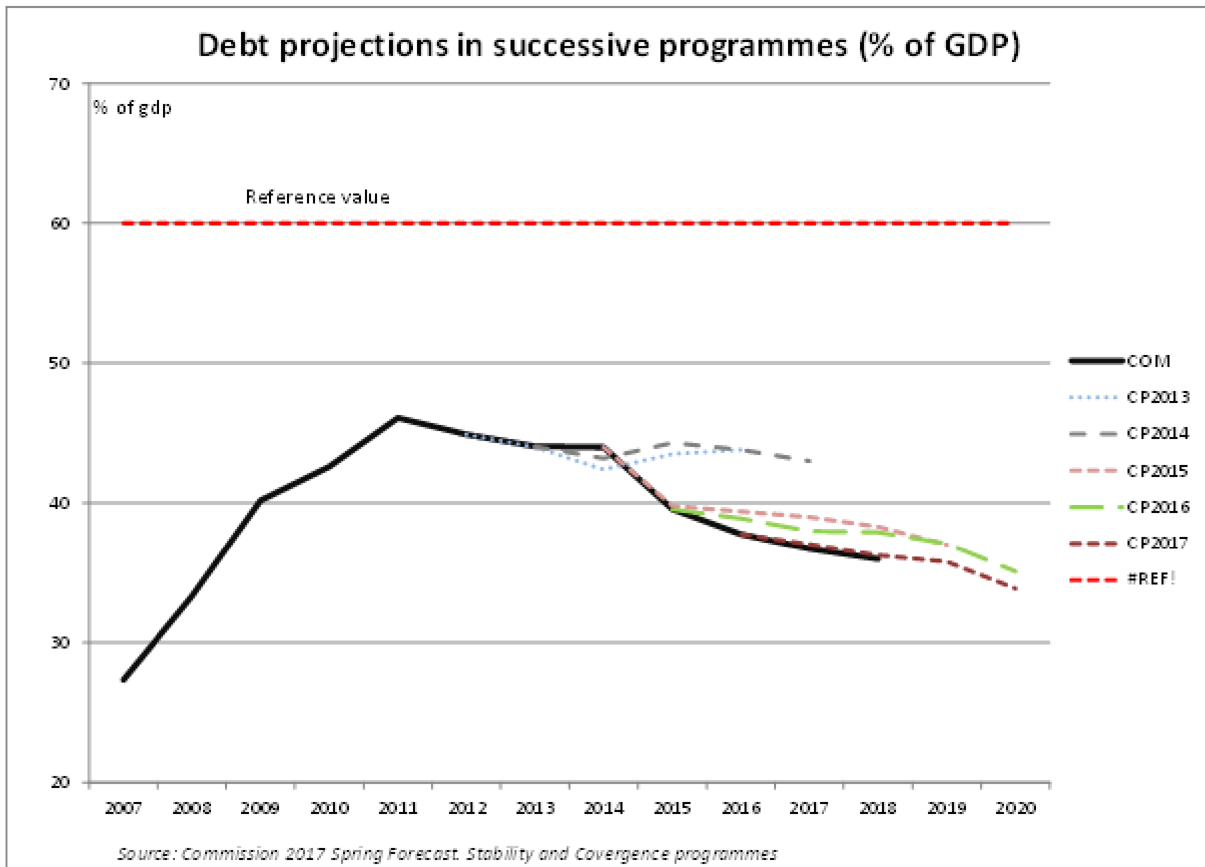
[1] End of period.

[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 2017 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 volatile revenue items. Examples of these are revenues from the pension yield tax and from oil and gas drilling in the North Sea. The programme projections of developments in these items are prudent, but due to their inherent volatility surprises – either positive or negative – can have a significant impact on 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-adherence, has put an end to overspending by municipalities, which was the main driver behind higher-than-planned public consumption in the 1990s and 2000s. Public spending, particularly in 2019, is subject to upside risks, mainly stemming from the November 2016 agreement to reimburse excessively collected property taxes.

Risks concerning debt developments are assessed to be broadly balanced, as Denmark has a favourable initial position, with a relatively low gross debt level, and a stable fiscal outlook.

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

Since 2014, Denmark has been subject to the preventive arm of the SGP. The 3% of GDP general government deficit reference value in the Treaty has been respected, and the general government deficit is expected to remain below that threshold over the programme period. With general government gross debt level at 37.8% of GDP at the end of 2016, Denmark is not subject to any requirements concerning debt reduction.

Based on outturn data, the structural balance is estimated to have improved from -1.8% in 2015 to a balanced position in 2016, pointing to compliance with the SGP. At the same time, the growth of government expenditure, net of discretionary revenue measures and one-offs, in 2016 did not exceed the applicable expenditure benchmark.

For 2017, the recalculated structural balance based on the convergence programme is estimated to remain stable, at around 0.0% of GDP, reflecting that some volatile revenue components, particularly the pension yield tax, are treated as one-offs and temporary factors. According to the convergence programme, pension yield tax revenue is forecast to decline by 1.4pps of GDP, explaining the decline in the cyclical adjusted balance. Since Denmark excludes the developments in pension yield taxes from the estimation of the structural balance, the recalculated structural balance does not deteriorate to the same extent as the nominal headline balance (from -0.9% of GDP in 2016 to -1.9% of GDP in 2017). With respect to the expenditure benchmark pillar, according to the information provided in the convergence programme, the growth of government expenditure, net of discretionary revenue measures and one-offs, in 2017 is not expected to exceed the applicable expenditure benchmark.

In 2018, the convergence programme continues pointing towards compliance with the SGP. The recalculated structural balance is planned to improve from a balanced position in 2017 to 0.3% of GDP in 2018. With respect to the expenditure benchmark pillar, according to the information provided in the convergence programme, the growth of government expenditure, net of discretionary revenue measures and one-offs, in 2018 is not expected to exceed the applicable expenditure benchmark.

The Commission 2017 spring forecast also confirms compliance with both the structural balance and the expenditure benchmark pillars in 2016, as well as over the forecast horizon. The Commission 2017 spring forecast envisages a slightly more negative structural balance in 2017 compared to the recalculated structural balance of the convergence programme, despite forecasting a more benign headline balance. This difference mainly relates to the accounting of revenue from pension yield taxes, which the convergence programme excludes when estimating the structural balance.

Box 1. Council recommendations addressed to Denmark

On 12 June 2016, the Council addressed recommendations to Denmark in the context of the European Semester. In particular, in the area of public finances the Council recommended torespect the medium-term budgetary objective in 2016 and achieve an annual fiscal adjustment of 0.25% of GDP towards the medium-term budgetary objective in 2017.

Table 4: Compliance with the requirements under the preventive arm

(% of GDP)	2016	2017		2018	
Initial position[1]					
Medium-term objective (MTO)	-0.5	-0.5		-0.5	
Structural balance[2] (COM)	0.0	-0.4		-0.1	
Structural balance based on freezing (COM)	0.6	-0.4		-	
Position vis-a -vis the MTO[3]	At or above the MTO	At or above the MTO		At or above the MTO	
(% of GDP)	**2016**	**2017**		**2018**	
	COM	**CP**	**COM**	**CP**	**COM**
Structural balance pillar					
Required adjustment[4]	0.0	0.0		0.0	
Required adjustment corrected[5]	0.0	-1.1		-0.1	
Change in structural balance[6]	1.8	0.1	-0.4	0.3	0.3
One-year deviation from the required adjustment [7]	1.8	1.2	0.8	0.4	0.4
Two-year average deviation from the required adjustment [7]	0.8	1.5	1.3	0.8	0.6
Expenditure benchmark pillar					
Applicable reference rate[8]	1.1	2.9		3.2	
One-year deviation adjusted for one-offs[9]	1.3	1.9	0.5	0.1	0.8
Two-year deviation adjusted for one-offs[9]	1.6	1.6	0.9	1.0	0.6
PER MEMORIAM: One-year deviation [10]	0.0	1.0	0.5	0.5	0.8
PER MEMORIAM: Two-year average deviation [10]	0.1	2.0	0.2	0.8	0.6
Conclusion					
Conclusion over one year	Compliance	Compliance	Compliance	Compliance	Compliance
Conclusion over two years	Compliance	Compliance	Compliance	Compliance	Compliance

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.

Source :

Convergence Programme (CP); Commission 2017 spring forecast (COM); Commission calculations.

5. LONG-TERM SUSTAINABILITY

Denmark does not appear to face fiscal sustainability risks in the short run, according to the S0 indicator, which captures short-term risks of fiscal stress stemming from the fiscal, as well as the macro-financial and competitiveness sides of the economy.

Based on Commission forecasts and a no-fiscal policy change scenario beyond forecasts, government gross debt, at 37.8% of GDP in 2016, is expected to decrease (to 18.6% in 2027), thus remaining well below the 60% of GDP Treaty threshold. Over this horizon, government debt is projected to have peaked in 2016. 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 similarly decreasing path by 2027, with debt remaining below the 60% of GDP reference value in 2027.

The medium-term fiscal sustainability risk indicator S1 is at -4.2 pps. of GDP, primarily thanks to the initial budgetary position and the low level of government debt, thus indicating low risks in the medium term. The full implementation of the convergence programme would put the sustainability risk indicator S1 at -5.0 pps. of GDP, leading to even lower 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 further decrease those risks.

The long-term fiscal sustainability risk indicator S2 (which shows the adjustment effort needed to ensure that the debt-to-GDP ratio is not on an ever-increasing path) is at 0.0 pps of GDP. In the long-term, Denmark therefore appears to face low fiscal sustainability risks, primarily thanks to the favourable initial budgetary position (contributing with -0.3 pps of GDP) which offsets the negative impact from projected ageing (contributing with 0.3 pps of GDP). Full implementation of the programme would put the S2 indicator at 0.1 pps. of GDP, leading to a fairly similar long-term risk.

Table 5: Sustainability indicators

Time horizon				No-policy Change Scenario		Stability / Convergence Programme Scenario	
Short Term				**LOW risk**			
S0 indicator [1]				0.3			
	Fiscal subindex			0.0	LOW risk		
	Financial & competitiveness subindex			0.4	LOW risk		
Medium Term				**LOW risk**			
DSA [2]				LOW risk			
S1 indicator [3]				-4.2	LOW risk	-5.0	LOW risk
of which							
	Initial Budgetary Position			-2.0		-2.6	
	Debt Requirement			-1.8		-2.3	
	Cost of Ageing			-0.4		-0.1	
		of which					
			Pensions	-0.5		-0.3	
			Health-care	0.3		0.2	
			Long-term care	0.3		0.3	
			Other	-0.5		-0.3	
Long Term				**LOW risk**		**LOW risk**	
S2 indicator [4]				0.0		0.1	
of which							
	Initial Budgetary Position			-0.3		-0.6	
	Cost of Ageing			0.3		0.7	
		of which					
			Pensions	-1.3		-1.0	
			Health-care	0.5		0.5	
			Long-term care	1.6		1.5	
			Other	-0.6		-0.4	

Source: Commission services; 2017 stability/convergence programme.

Note: the 'no-policy-change' scenario depicts the sustainability gap under the assumption that the structural primary balance position evolves according to the Commissions' spring 2017 forecast covering until 2018 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 2015 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 2031. This adjustment effort corresponds to a cumulated improvement in the structural primary balance over the 5 years following the forecast horizon (i.e. from 2019 for No-policy Change 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 2016.

6. FISCAL FRAMEWORK

As Denmark has ratified the Treaty on Stability, Cooperation and Governance (TSCG) and opted to apply Article 14.5 of the TSCG, it is bound by the substance of the TSCG, including its Fiscal Compact. The national fiscal framework of Denmark essentially consists of the Budget Law and a medium-term budgetary strategy (currently up to 2020). The basic budgetary principle of the framework targets fiscal sustainability and achieving a structural general government balance in 2020.

The 2012 Budget Law transposed the provisions of the TSCG, including the introduction of a structurally balanced budget rule with a correction mechanism, and independent monitoring assigned to the Danish Economic Council (DØRS). Thus, at the time the budget bill proposal is presented in August every year, the structural deficit in the following year may not surpass the MTO of -0.5% of GDP. In the period after the presentation of the budget bill proposal, political decisions may not be made that lead to a breach of the MTO. If the projections point 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.

The structural balance projections in the programme suggest adherence to the requirement of the Budget Law up to 2020.

The fiscal objectives are supported by multiannual expenditure ceilings, which apply for all three levels of general goverment and cover around three quarters of all public expenditure. Current expenditure ceilings are fixed by law for the years until 2020. 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 interim report from February 2017, DØRS, applying the Budget Law's methodology, estimates an increase in the structural balance from -0.6% of GDP in 2016 to 0.2% of GDP in 2020. DØRS estimates imply some temporary deviation from the MTO in 2016, reflecting differences particularly in the accounting of revenue from the pension yield tax as well as the level of structural employment and thus the level of potential GDP.

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

7. SUMMARY

The assessment of the convergence programme for Denmark shows that Denmark complied with the provisions of the Stability and Growth Pact in 2016 and is also expected to be compliant over the programme period, i.e. from 2017 to 2020.

The structural fiscal position is estimated to remain balanced or positive between 2016 and 2020. Although these estimates benefit from excluding the volatile pension yield taxes from the recalculated structural balance, the growth of government expenditure, net of discretionary revenue measures and one-offs, indicates overachievement of the applicable expenditure benchmark rate in 2016, as well as over the programme period.

8. ANNEX

Table I. Macroeconomic indicators

	1999-2003	2004-2008	2009-2013	2014	2015	2016	2017	2018
Core indicators								
GDP growth rate	1.7	1.9	-0.1	1.7	1.6	1.3	1.7	1.8
Output gap [1]	1.6	3.3	-2.7	-1.9	-1.5	-1.4	-1.4	-1.3
HICP (annual % change)	2.3	2.0	1.8	0.4	0.2	0.0	1.4	1.7
Domestic demand (annual % change) [2]	1.0	2.9	-0.5	1.5	1.3	1.6	1.9	2.0
Unemployment rate (% of labour force) [3]	4.8	4.3	7.1	6.6	6.2	6.2	5.8	5.7
Gross fixed capital formation (% of GDP)	21.0	22.3	18.9	19.2	19.2	20.0	20.4	20.7
Gross national saving (% of GDP)	24.8	26.6	25.2	28.9	28.9	28.2	28.3	28.6
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	**0.7**	**4.0**	**-2.4**	**1.4**	**-1.3**	**-0.9**	**-1.3**	**-0.9**
Gross debt	**49.0**	**34.8**	**43.6**	**44.0**	**39.6**	**37.8**	**36.7**	**36.0**
Net financial assets	**-23.5**	**-2.7**	**-0.5**	**-4.5**	**-4.4**	**n.a**	**n.a**	**n.a**
Total revenue	54.1	54.9	54.3	56.7	53.5	52.7	52.0	51.4
Total expenditure	53.4	50.8	56.7	55.3	54.8	53.6	53.3	52.3
of which: Interest	3.4	1.9	1.9	1.5	1.6	1.3	1.0	0.9
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	**5.4**	**3.8**	**8.6**	**9.0**	**9.0**	**7.2**	**7.0**	**6.8**
Net financial assets; non-financial corporations	**-53.5**	**-76.7**	**-74.9**	**-96.3**	**-115.1**	**n.a**	**n.a**	**n.a**
Net financial assets; financial corporations	**-22.2**	**-26.6**	**-19.5**	**-9.4**	**-14.5**	**n.a**	**n.a**	**n.a**
Gross capital formation	12.9	13.4	11.0	11.8	11.8	11.9	12.2	12.6
Gross operating surplus	22.3	22.7	22.5	23.3	23.8	22.1	22.0	22.0
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	**-2.6**	**-4.7**	**0.0**	**-1.7**	**1.2**	**1.9**	**1.7**	**1.5**
Net financial assets	**84.6**	**103.5**	**117.6**	**155.8**	**171.6**	**n.a**	**n.a**	**n.a**
Gross wages and salaries	47.3	46.6	47.7	47.2	47.3	48.1	48.2	48.3
Net property income	1.1	2.0	1.7	3.0	4.0	2.9	2.6	2.6
Current transfers received	22.7	22.6	24.3	25.1	24.4	23.6	22.7	22.0
Gross saving	3.1	2.5	4.1	2.6	5.5	6.3	6.2	6.0
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	**3.5**	**3.2**	**6.2**	**8.7**	**8.8**	**8.1**	**7.4**	**7.4**
Net financial assets	**15.0**	**3.0**	**-21.8**	**-44.8**	**-36.8**	**n.a**	**n.a**	**n.a**
Net exports of goods and services	6.7	4.3	6.1	7.0	7.4	6.9	6.9	6.7
Net primary income from the rest of the world	-1.2	0.8	2.0	3.6	3.4	2.7	2.8	2.8
Net capital transactions	0.2	0.0	0.1	-0.2	-0.4	0.0	-0.4	-0.3
Tradable sector	41.2	39.7	38.1	38.7	38.4	38.3	n.a	n.a
Non tradable sector	44.7	45.6	48.2	48.0	48.4	48.5	n.a	n.a
of which: Building and construction sector	4.6	4.8	4.0	4.0	4.1	4.2	n.a	n.a
Real effective exchange rate (index, 2000=100)	87.2	96.1	98.7	97.0	94.6	96.5	96.7	96.7
Terms of trade goods and services (index, 2000=100)	93.0	96.2	98.8	100.4	100.6	100.7	100.8	100.9
Market performance of exports (index, 2000=100)	108.4	103.5	102.7	101.2	98.1	96.7	96.4	96.3

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 2017 spring forecast