

STATEMENT

DANMARKS NATIONALBANK'S COMMENTS ON THE DANISH ECONOMIC COUNCIL'S DISCUSSION PAPER, SPRING 2017

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In general, Danmarks Nationalbank agrees with the Chairmanship's assessment of the cyclical position and the fiscal policy requirements. The Danish economy is in a more or less balanced cyclical position and growth is set to continue. The assessment of how strong the expected growth can be is a little higher than in Danmarks Nationalbank's projection. This reflects a more optimistic view of structural productivity growth and of the potential of the reforms already implemented to increase the supply of labour.

Capacity is assumed to be almost fully exploited from now and until 2025. Over a period of that length, there is bound to be one or more cyclical downturns. What matters when the economy reverses is that the preceding boom has been handled in such a way that major imbalances are avoided – in the labour market, in the housing market and in the financial sector. In three of the last four upswings – there is typically one strong upswing in each decade – that was not the case and the subsequent downturns were long and deep.

The current account shows large surpluses and wage growth remains moderate. This means that part of the adjustment can come from imports and moderately higher wage increases if the economy is under pressure. However, the speed should not be too high. Another current risk factor is the housing market, where prices in some regions have reached a higher level than warranted by developments in disposable incomes and interest rates. And there are indications that price rises are spreading in earnest, also to areas outside the cities. Credit growth remains weak, but generally tends to come late in an upswing.

Once fully implemented in 2021, the recently agreed future housing tax regime will have a more stabilising effect than the system which has been in place since 2001. Before then, a certain dampening effect may also be

seen on price pressures on owner-occupied flats, which have been driven not only by the procyclical tax freeze but also by the special underestimation of land values in this sector. In the longer term, there is reason to note the passage in the agreement which says that higher-than-expected revenue will be used to reduce housing taxes. Such a decision would counter and possibly eliminate the stabilising effect of the link between taxation and house prices. Presumably, the new system with discounts and freezing of taxes will be a challenge mainly in terms of complexity and tax collection. But attention should also be focused on lock-in effects in the longer term and on trading patterns around the turn of the year 2020/21.

Inclusion of "dynamic" effects of fiscal policy decisions is a question of methodology. This requires a lot in terms of estimating the size and time horizon of derived effects. The Chairmanship is right when it says that it also requires consistent application to all elements of fiscal policy. It is reassuring that the fiscal policy management tools include a number of different indicators, one reason being that the use of "dynamic" effects could give fiscal policy an expansionary tendency. If "dynamic" effects are included, this should preferably be done to a modest extent based on a prudential approach. If the structural balance subsequently shows a better-than-required trend, it will be possible to implement a general policy easing at that time.

Foreign labour has proved to be an important factor in relation to tackling capacity pressures and may have contributed to reducing structural unemployment in Denmark to a historically low level.