

12. October 2021

The Chairmanship's assessment of Denmark's cyclical position and risk outlook is generally in line with that of Danmarks Nationalbank. Activity has recovered quickly, and the economy is expected to enter a boom without overheating in the coming years. Hence, the current extraordinary capacity pressures in the economy are, to some extent, believed to be of a temporary nature.

Danmarks Nationalbank shares the Chairmanship's assessment that it is appropriate to phase out the relief packages. In addition, the Chairmanship recommends that fiscal policy should be tightened more than planned. Danmarks Nationalbank does not see a need to tighten fiscal policy more than planned, as long as prospects are for a moderate boom. But the funds in the Government's so-called war chest should not be used to boost demand after the last measures have been lifted. The Danish economy is fundamentally sound, and competitiveness is solid. Therefore, the economy can cope with a period with higher capacity pressure, even though it will moderately weaken wage competitiveness and reduces the large current account surplus.

However, a high level of uncertainty surrounds the economic outlook, with a risk of a self-reinforcing and unsustainably strong expansion. Consequently, the Government should be prepared to tighten its economic policy more than planned to prevent overheating of the economy, followed by an abrupt economic reversal. Abolishing the Housing Job Scheme (BoligJobordningen) would be an obvious measure in terms of tightening of economic policy, which is also recommended by the Chairmanship.

The Chairmanship assesses that there is no current need to intervene in the housing market, e.g. as a result of the slowdown in both activity and price increases in the housing market. The Chairmanship also assesses that potential house price falls will not be a problem for the macroeconomy or financial stability at present. In contrast, Danmarks Nationalbank believes that this is a good time to improve the structures of the housing market to prevent unsustainable build-up of risks among households and reduce the vulnerability of large fluctuations in the housing market. An amortisation

requirement for highly indebted homeowners will reduce household vulnerability, while a reduction of the tax value of interest deductibility will reduce the incentive to raise debt. Combined with the new, stabilising housing taxation regime, these measures will strengthen the resilience of the Danish economy and financial stability. It is essential to stress that the aim of these measures is not to control price growth in the housing market.

The updated projection of public finances shows that fiscal policy is more than sustainable – although considerably less so than previously assessed by the Chairmanship. The uncertainty surrounding the calculations is considerable, as illustrated by the recent downgrading of fiscal sustainability. Consequently, a more than sustainable fiscal policy should not be seen as an opportunity to ease fiscal policy within a foreseeable timeframe, which would also be inappropriate in the current cyclical situation.

The Chairmanship proposes a relaxation of the Danish Budget Act's (*Budgetloven*) threshold for the structural balance deficit from 0.5 per cent of GDP to 1 per cent of GDP and setting a medium-term balance target of -0.5 per cent of GDP in 2030. The fiscal framework with the Danish Budget Act and medium and long-term projections and targets have successfully supported healthy public finances and provided fiscal credibility. It is essential that this continues to be the case in the future, as this is a condition for an effective fixed exchange rate policy. Lowering the deficit threshold to 1 per cent of GDP – within the limits of the EU Stability and Growth Pact and the Fiscal Compact – would enable appropriate flexibility in the planning of responsible fiscal policy. Danmarks Nationalbank assesses that the Chairmanship's proposal is compatible with healthy and sustainable public finances. Obviously, fiscal policy must continue to take into account the economic situation.

The Chairmanship assesses that a uniform tax on all net carbon emissions is the most cost-effective way to achieve the objectives of the Danish Climate Act (*Klimaloven*). A specific and credible announcement of the future carbon emission tax will increase private investment incentives already when announced. Danmarks Nationalbank shares these assessments. Danmarks Nationalbank also notes that knowledge about future tax levels will support financial stability by helping to clarify the risks of emission-intensive business models. There, individual companies may avoid locking into unprofitable investments. Meanwhile, such knowledge will reduce the uncertainty relating to the transition, thereby supporting the pricing of climate-related risks in financial markets.