CURRENT TRENDS IN THE GREENLANDIC ECONOMY

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INTRODUCTION AND SUMMARY

Greenland is faced with considerable economic problems. Activity is falling, and judging by some indicators, rather sharply. In the fisheries sector, which is the predominant export industry, catches of prawns are decreasing, presumably reflecting climatic changes, and catches of other traditional species have not been able to compensate for this. Only few factors within the sector point to growth, but experimental fishing for mackerel may turn out to be of great significance.

The building and construction sector is contracting following some years of high activity, and activities in connection with extraction of and exploration for raw materials have diminished considerably. At present, no mines are in operation.

This development means that unemployment is rising and the population falling as emigration exceeds the excess of births.

Thanks to favourable prices for fish and shellfish, finances are good in large parts of the fisheries sector, which contributed to small government surpluses in 2012 and 2013. Government debt therefore remains modest. Gross debt amounts to approximately 5 per cent of the gross domestic product, GDP. The debts of the companies owned by the Greenlandic government are not included in that figure.

NATIONAL ACCOUNTS AND BALANCE OF TRADE

Economic activity declined in 2012 and 2013 and there are several indications that this has continued into 2014.

The downturn follows a number of years with strong growth, cf. Table 1. From 2003 to 2011, activity rose by an average of just over 3 per cent a year, primarily due to surging investments. But in 2012, the last year for which national accounts data is available, investments plummeted. The fall was particularly strong – exceeding 60 per cent – for investments in mineral and oil exploration, but traditional investments in building and construction also decreased notably. The lower level of investment was, on the whole, matched by lower imports, but has also had a negative impact on activity, not least in the building and construction sector.

It is assessed that the figures for 2013 and 2014 will show a further decline in investments. Exploration activities have been reduced further, cf. the section on raw materials, and building and construction activities are decreasing.

Over the last few years, both public and private consumption has been stagnant and exports have fallen, but prices for exports of fish and shellfish have risen, cf. Chart 1. In value terms, fish and shellfish made up more than 90 per cent of total exports of goods in 2013.

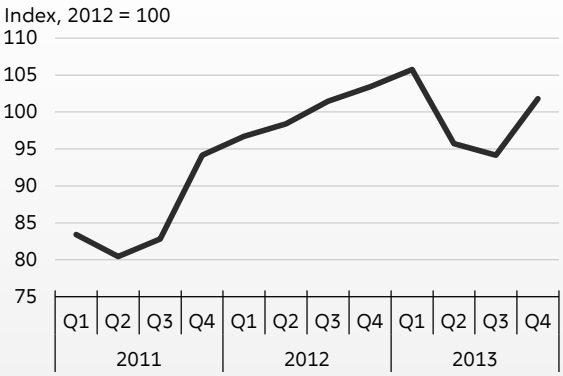
The favourable price trend for fish has led to an improvement of Greenland's balance of

Demand and supply, real growth Table 1

Per cent	Share of GDP in 2012	2006	2007	2008	2009	2010	2011	2012
Private consumption	45.8	0.7	0.8	-0.9	-0.4	1.8	1.5	-0.2
Public consumption	51.5	3.4	8.3	2.2	3.7	-1.4	-1.0	-2.2
Total gross investment	37.6	-0.6	30.8	46.0	-23.7	75.2	31.0	-42.0
Excl. investment in raw materials exploration	23.9	1.6	17.7	37.2	-23.4	4.2	20.2	-13.3
Exports of goods and services	29.7	-0.5	-3.3	8.1	-11.3	12.5	-5.8	-3.7
Final consumption equal to total addition	164.7	1.1	6.5	10.1	-6.7	16.5	7.9	-15.7
Imports of goods and services	64.7	-5.4	11.9	22.7	-14.6	37.6	12.3	-31.1
Gross domestic product	100.0	5.4	3.4	2.1	-0.7	2.5	4.0	-0.9

Source: Statistics Greenland.

Export prices for fish and shellfish Chart 1



Note: Price index for exports of cod, Greenland halibut and prawns weighted by the species' export values in 2012.
Source: Statistics Greenland.

Facts about Greenland

Population (number of people, beginning of 2014)	56,282
Of which in Nuuk (capital)	16,818
Population aged 18-66 years	38,364
Employment[1] (2012)	25,501
Unemployment[2] (2012)	2,655
Gross domestic product (kr. billion, 2012)	13.8
Per capita (kr. 1,000)	243.8
Disposable gross national income (kr. billion, 2012)	17.7
Per capita[3] (kr. 1,000)	313.1

Source: Statistics Greenland and own calculations.
1. Number of people in primary employment, average of monthly data.
2. Approximated ILO definition, average of monthly data.
3. By comparison, disposable GNI per capita in Denmark was approximately kr. 329,500 in 2012. Disposable GNI was approximately 0.9 per cent higher than GDP.

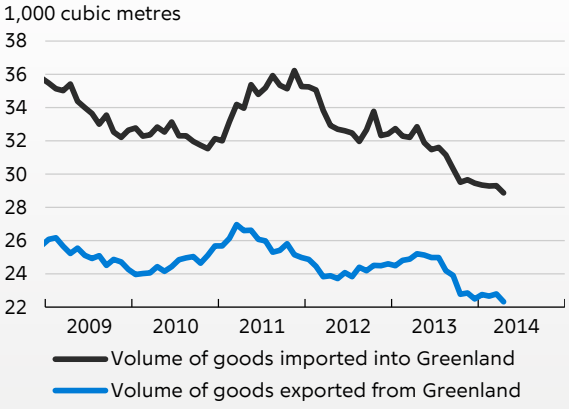
trade, from a deficit of kr. 2.7 billion in 2011 to a deficit of kr. 1.9 billion in 2013, and earnings have been good in large parts of the fisheries sector. This has mitigated the most severe effects of the decrease in volumes on income and taxes.

The latest figures for overall inflation, stated as the annual rate of growth in the consumer price index, are from January 2014, when inflation was 1.3 per cent. This was slightly higher than in Denmark, where it was 1.0 per cent, calculated in the same way.

MOST RECENT CYCLICAL TENDENCIES

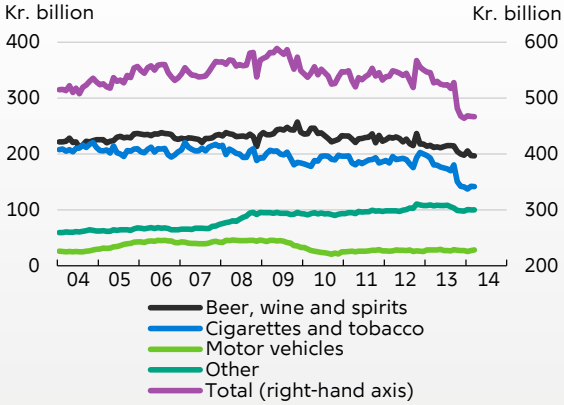
One of the signs of a further decline in activity is that freight volumes both to and from Greenland by Royal Arctic Line, RAL, continue to fall substantially, cf. Chart 2. This indicates that both domestic demand and exports are

Freight to and from Greenland by Royal Arctic Line Chart 2



Note: 12-month averages. The most recent observations are from April 2014.
Source: Royal Arctic Line.

Import duties Chart 3



Note: 12-month sums. The most recent observations are from April 2014.
Source: Greenlandic government.

shrinking. It should be noted that most of the goods for meeting domestic demand, with oil as the main exception, are imported and transported by RAL, which also handles virtually all exports of fish and shellfish. In the most recent 12-month period, both incoming and outgoing freight volumes have been some 10 per cent lower than in the preceding 12-month period.

Revenue from import duties points to stagnant or falling private consumption, cf. Chart 3. Total revenue from such duties has decreased by around 10 per cent over the last year, primarily due to lower revenue from tobacco and alcohol duties, while revenue from other import duties has been relatively flat.

No current statistics of the development in unemployment are available, but monthly compilations are made of the number of people registered as job seekers. This is a count of the people who have contacted the local authorities with unemployment problems at least once within that month. The figures for the first four months of 2014 show that the number of job seekers was considerably higher than in the corresponding months of 2013, which tallies with the picture of a weak economy. However, the figures have proved to be difficult to interpret as they are affected by factors such as local administrative practices.

PUBLIC FINANCES

The main items of the government accounts are shown in Table 2.

Since 2010, the current and investment budget has shown a surplus, which was also the case in 2012 and 2013, despite the weak cyclical position. A key reason for this is that the most important source of income, the block grant from the Danish government, is not affected by the economic development in Greenland, but is adjusted annually over the Danish Finance Act to reflect the increase in the general price and wage index. Income from partnership and fisheries agreements with the EU is not cyclical either.

Capital expenditure fell strongly in 2013, and this more than offset rises in most other expenditure items. When assessing the impact of public finances on activity, it is also necessary to look at the Construction and Renovation Fund. When a capital expenditure is approved, it is charged to the investment budget, and the amount is transferred to the Fund. When the project is actually carried out and paid for, often in subsequent years, it is financed via disbursements from the Fund. In 2013, the Fund's capital decreased by kr. 198 million, which means that activity was almost kr. 200 million higher than the capital expenditure of kr. 597

Main items of the government accounts Table 2

Kr. billion	2007 R[1]	2008 R[1]	2009 R[1]	2010 R[1]	2011 R[1]	2012 R[1]	2013 R[1]	2014 PL[2]
1. Operational expenses	2,604	2,787	2,870	2,984	2,685	2,735	2,720	2,694
2. Statutory expenses	788	837	850	852	870	879	984	1,043
3. Subsidies	1,530	1,592	2,330	1,634	1,897	2,009	2,150	2,242
4. Investment expenses	1,003	930	808	719	1,095	969	597	779
5. Total expenses	5,925	6,144	6,859	6,189	6,547	6,591	6,452	6,757
6. Agreed income[3]	3,555	3,661	3,799	3,828	3,864	3,922	3,976	3,980
7. Direct taxes	850	876	828	1,019	1,135	1,143	1,051	1,035
8. Indirect taxes	740	792	776	772	800	860	824	1,013
9. Other revenue	514	498	509	567	593	601	672	776
10. Total income	5,659	5,827	5,913	6,187	6,392	6,526	6,523	6,803
11. Actual CIL balance: (10)-(5)	-267	-317	-946	-2	-156	-65	71	47
12. CI balance	-28	-93	-511	203	54	150	78	21
13. Increase in unused funds in Construction and Renovation Fund	146	88	87	214	148	-82	-198	-100
14. CIL balance adjusted (11)+(13)	-121	-229	-859	212	-8	-147	-127	-53

Note: In 2011, block grants to local authorities were increased by kr. 302.6 million as care for the disabled was transferred to local authorities. Hence, this amount is transferred from the Greenlandic government's operational expenses to expenses for subsidies.
Source: Government Accounts and Finance Act 2014.
1. Realised data (accounts).
2. Preliminary data (Finance Act 2014).
3. Agreed income mainly comprises the block grant from the Danish government (kr. 3,624 million in 2013), partnership and fisheries agreements with the EU (kr. 226 million in 2013) and sale of fishing rights (kr. 109 million in 2013).

million. All the same, capital expenditure fell substantially from 2012 to 2013.

The Finance Act for 2014 and the budget estimates for the years until 2017 operate with more or less balanced current and investment budgets. A precondition is that overall expenditure remains unchanged in real terms, which will require very firm management. However, the level of government spending in Greenland is so high that this should be possible.

In the slightly longer term, Greenland is faced with a challenge as the baby boomers from the 1960s and 70s approach or reach retirement age. The Economic Council has calculated a fiscal indicator which shows that fiscal tightening by around kr. 1 billion is required if government debt as a ratio of GDP is not to rise up to 2040. That roughly corresponds to the Greenlandic government's revenue from direct taxes. If tightening is to take place on the income side, this will require a broader business sector than at present, e.g. in connection with extraction of raw materials.

Greenland has a favourable point of departure in that its gross general government debt is modest at kr. 600 million or approximately 5 per cent of GDP. However, it should be noted that companies owned by the Greenlandic government have a gross debt of around kr. 3 billion, a figure that is set to rise in the coming years due to projects such as modernisation of the Royal Arctic Line fleet and construction of a new container port in Nuuk.

FISHERIES

The opportunities for sustainably increasing fisheries are limited.

The most important species is prawns. The fisheries sector complies with biological advice and has been certified as sustainable. All the

same, quotas have been falling in recent years. Presumably this is mainly attributable to climate change as prawns are caught in still more northerly waters.

Fishing for Greenland halibut has increased slightly in recent years, primarily reflecting larger catches in sheltered waters in fjords and close to the coast. Biologists are concerned about the sustainability of such fishing.

Cod is becoming more plentiful in the waters off western Greenland, but in order to allow spawning stocks to build up in Greenlandic waters, biologists recommend a cautious approach to direct cod fishing.

Overall, the possibilities of increasing total catches of traditional species must be deemed to be limited, but continuous shifts will be seen between the various species. Although Greenlandic waters are extensive, biologists have a general overview of the fish and shellfish to be found.

However, climate change means that mackerel, and possibly also other schooling fish, can be found in large numbers in Greenlandic waters for part of the summer. In 2013, some 60,000 tonnes of mackerel were caught on an experimental basis, and for 2014 the quota has been increased to 100,000 tonnes. These quotas are determined unilaterally by Greenland with a view to being acknowledged as a coastal state and hence being granted a share of the overall North Atlantic mackerel quota.

From 2014 onwards, this quota will be shared between the EU, Norway and the Faroe Islands. Due to the volume of experimental fishing, the current quota countries have prohibited their vessels from participating in mackerel fishing near Greenland. It is uncertain how this problem will be resolved. There is a risk of overfishing for mackerel as the agreement with the Faroe Islands involved an increase of the quota so that it now exceeds the biological advice, irrespective of the volumes caught in Greenland.

If a solution is found to the mackerel conflict and Greenland is granted a quota share, mackerel may provide a sound growth contribution to the Greenlandic economy. In 2014, a duty has been levied on mackerel fishing, which has been recognised at kr. 95 million in the Finance Act with subsequent amendments. If this revenue target is not met, it will contribute to a government deficit in 2014.

EXTRACTION OF RAW MATERIALS

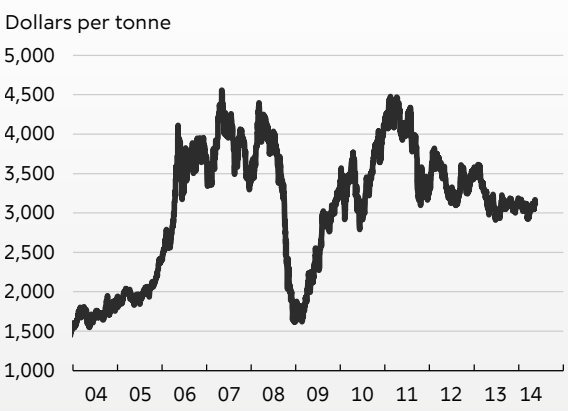
Extraction of raw materials offers the most realistic opportunity to expand the Greenlandic business sector. A number of impediments, including a substantial level of costs that is on the high side of the Danish level, a geographically very scattered population with a resultant lack of economies of scale, high transport costs and, not least, a low level of education, make it difficult to develop internationally competitive traditional industries.

The level of education is low, but rising. In 2012 more than half of the population aged 25-59 had no formal education or training beyond lower secondary school. This is undoubtedly the largest structural problem in Greenland. Opportunities to find employment in the raw materials sector may contribute strongly to raising the level of education.

In 2010 and 2011 there was considerable exploration activity for oil and other types of hydrocarbon in the waters off western Greenland. Exploration costs amounted to approximately kr. 5 billion, which is included as part of the investment in oil and mineral exploration in the national accounts. Traces of hydrocarbon were found, but the amounts were insufficient for commercial exploitation. Since then no exploratory drilling has taken place in Greenlandic waters, but the companies have not surrendered their licenses. Instead, activities have been put on the back burner. Extraction of hydrocarbon from tar sands and from the subsoil via fracking has reduced corporate interest in hydrocarbon from areas where exploration and extraction costs are very high, as would be the case for environmentally responsible extraction in Greenlandic waters.

At present, no mines are in operation in Greenland. The only active mine, a gold mine in southern Greenland with some 80 employees, closed in 2013 after some years of operation. It had been operating at a loss most of the time.

Metal prices at the London Metal Exchange Chart 4



Note: Weighted prices for aluminium, copper, lead, nickel, tin and zinc.
Source: Reuters Datastream.

As regards minerals, there has been considerable exploration activity for some years, and in continuation of these activities Greenland has granted extraction licenses for two projects, a large iron project in the Nuuk Fjord and a smaller ruby project. However, this does not mean that the projects are up and running. The Impact Benefit Agreements, IBA, have yet to be finalised, and furthermore, companies with extraction licenses are looking for investors to finance the projects.

A company has also applied for permission to extract "rare earth elements" in southern Greenland.

In general, exploratory activities have been reduced over the last couple of years. Presumably the main reason is that the prices of many raw materials have fallen from very high levels in 2010-11, cf. Chart 4, and that new mines have opened or are opening elsewhere in the world. Among some observers this has led to concerns about whether the window for establishing new mines is closing for a while.

In this context it is mentioned still more frequently that it may be necessary to reduce investor risk on the projects in question, e.g. via public investments in infrastructure that will be of little value once the mine in question has been depleted. From an investor point of view it would naturally be attractive if the Greenlandic or Danish government would assume some of the risk on the project without receiving more than a marginal share of the expected return.

In February 2014, a committee set up by the University of Copenhagen and the University in Nuuk and chaired by Minik Rosing published a report, To the benefit of Greenland. The report points out that mineral extraction will not in itself be sufficient to ensure Greenland's economic independence of Denmark. The Act on Greenland Self-Government entails that, above a certain threshold, half of Greenland's annual revenue in the form of corporation tax and royalties from extraction of raw materials will be offset against the block grant.

The report has caused quite a stir in Greenland, but its findings can hardly be disputed. The high-profile iron mine planned at the bottom of the Nuuk Fjord was originally estimated by the company in question to yield kr. 28 billion in corporation tax and royalties to the Greenlandic government over a period of 15 years, i.e. some kr. 2 billion a year on average. Hence, this revenue would reduce the block grant by around kr. 1 billion a year. The estimate assumes that there are no unpleasant surprises in connection with the project. So multiple large-scale projects of this nature would be required on a permanent basis before the block grant is reduced to zero. In that context the current low level of exploration activity is a bad omen.

Extraction of minerals would reduce economic dependence on Denmark, but in all likelihood oil and gas extraction is required if such revenue is to fully cancel out the block grant from Denmark.