

## **Jens Thomsen: Brief overview of the Danish economy**

Statement by Mr Jens Thomsen, Member of the Board of Governors of the National Bank of Denmark, at the meeting of the Danish Economic Council, Copenhagen, 27 May 2004.

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It now seems probable that the Danish economy reached a trough in the autumn of 2003 and that an upswing has set in; an upswing which has not been acknowledged until now, near the middle of 2004.

The upswing has primarily been reflected in private consumption, but in addition unemployment has been falling slightly since the turn of the year. Naturally, the final impact on unemployment is difficult to predict since unemployment typically reacts with a considerable and varying lag.

Unlike most other Western European countries, Denmark has a relatively low unemployment rate, and a strong upswing could lead to overheating. The greatest risk would be if a substantial economic upswing materialised in our neighbouring countries, but there are no indications of this. Germany, in particular, is having difficulties boosting its economy. A positive aspect is that growth in the 10 new EU member states is above four per cent, although they account for only four per cent of Denmark's exports.

In the short term it would seem that only a domestically driven consumption boom with a substantial increase in the consumption ratio could lead to overheating. The consumption ratio is currently low, and the wealth ratio is high. Consequently, a marked consumption effect cannot be ruled out.

The reversal of the Danish economy emphasises how difficult it is to finetune the economy by means of fiscal policy. Our knowledge is incomplete. It takes time to prepare fiscal-policy measures, and it takes time before they have an impact on unemployment. Such measures can easily have a disruptive effect on the economy when the underlying cyclical factors are uncertain and changing. "In practice there is a genuine risk that attempts to conduct active stabilisation policy will in themselves lead to cyclical fluctuations", cf. the former economic advisor Torben Andersen in *Udviklingslinier i økonomisk teori - Trends in economic theory* - (2000, ed. Chr. Hjorth-Andersen).

If fiscal policy is eased, it must also be tightened at a later stage; otherwise it will not be possible to maintain the long-term targets for the development in public finances.

The reflections on the sustainability of public finances in the consultation paper emphasise this need for subsequent fiscal-policy adjustment. In order to be sustainable, public finances must comply with a budgetary restriction to the effect that future government revenue must match the current government debt and future government expenditure. Such a restriction means that any budgetary relaxation must subsequently be counterbalanced by a tightening.