

Jens Thomsen: A brief look at developments in the Danish economy

Statement by Mr Jens Thomsen, Governor of the National Bank of Denmark, at the meeting of the Danish Economic Council, Copenhagen, 31 May 2007.

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Since 2004, global growth has been around 5 per cent, and forecasts indicate that it will continue at this level in 2007 and 2008.

In Europe, growth expectations are higher than the Council states, as the European Commission's spring forecast shows. This implies a greater potential for Danish exports.

In other words, demand will still be considerable, notwithstanding the slower growth in private consumption than in 2006.

Whether consumption growth will fall to 1.8 per cent is doubtful in view of the development in incomes and the employment situation.

Thus, the economy is still characterized by a pronounced shortage of labour in many areas.

Developments in 2006 show that in an upswing it is indeed possible to boost employment by reducing unemployment, increasing the participation rate and importing labour from abroad at the same time. This strategy should be maintained.

The Council's forecasts indicate that the capacity pressure will continue, and consequently fiscal policy should not stimulate activity.

In terms of the proposal for an automatic fiscal-policy response to output gaps of a certain size, calculating the output gap constitutes a problem.

Different institutions do not reach the same result, and major revisions take place. (See also: Orphanides, A. and S. van Norden: "The Reliability of inflation Forecasts Based on Output Gap Estimates in Real Time", *Journal of Money, Credit and Banking*, 2005.)

Consequently, a sort of a Taylor rule for fiscal policy is not expedient.

On the other hand, output gap is a relevant – but not the only – indicator when designing fiscal policy since, as the proposal entails, it will be necessary to deviate from a neutral fiscal-policy stance in only a few cases.