4. DENMARK

Strong increase in unemployment from record lows

Recession already took hold in early 2008

The Danish economy is in the midst of a recession, which had already started in the beginning of 2008, well ahead of the time when the global crisis became visible. The 1.1% contraction in GDP in 2008 was initially triggered by domestic factors as a result of an economic overheating, marked by strong house price increases and labour shortages.

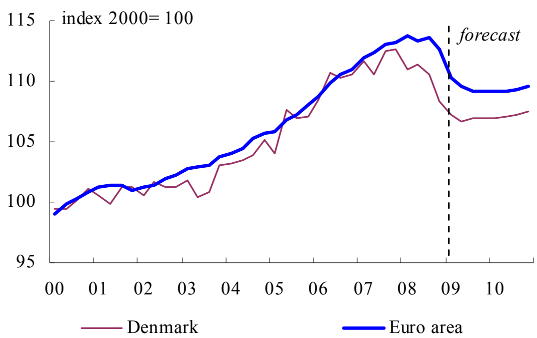
Domestic demand began to decline right from the start of the year, amidst a cooling housing market, mounting inflation and waning confidence. Growth in general government consumption had also been weak. Triggered by a fall in profits that had already begun in 2007, investment showed a strong negative trend, most notably in construction. Net exports acted as a drag on activity due to strong growth in imports. Although starting to diminish, employment remained at a very high level. Productivity therefore weakened significantly and unit labour costs increased markedly.

The rapidly deteriorating global external environment accelerated the ongoing contraction and GDP fell at a quarterly rate of 1.8% in the last quarter of 2008, amidst sharply falling investment and private consumption, and massive destocking.

Recession to deepen in 2009

The outlook over the forecast period is one of a deepening recession that goes well beyond a mere correction of the previous overheating. The most significant economic drag stems from dismal export prospects, with order volumes falling at an extremely rapid rate. Exports, which in 2008 remained relatively stable despite a loss in competitiveness, are expected to fall by more than 10% in 2009. With imports falling at a relatively lower pace, net exports should reduce GDP growth by about one percentage point, leading a small current account surplus to disappear.

Graph 2.4.1: **Denmark - GDP development compared with euro area**



The accompanying reduction in activity, combined with a tightening of credit conditions, will magnify the ongoing retrenchment in investment. Equipment should be hit the worst. Private construction is also set to decline sharply, but government incentive schemes and public investments should help to stabilise the sector somewhat.

The fall in output levels will lead to a significant reduction in employment. Unemployment is expected to double from its record low of 3.3% of the labour force in 2008 to over 6% in 2010. While there are signs of significant labour hoarding at the end of 2008, it is unlikely that companies will be able to continue to do so as the crisis deepens and the need emerges to reduce wage costs in view of agreed wage increases of over 3% in 2009.

Rising unemployment should result in a negative wage drift in 2009 and lead to more modest agreements for 2010. Lower wage pressures are contributing to the ongoing rapid decline in inflation that resulted from lower commodity and housing prices. Following an inflation rate of 3.6% in 2008, price increases are expected to fall below 1% in 2009 and remain below 1½% in 2010.

Stimulus packages gradually yield results

The government already passed sizeable expansionary measures in its 2009 budget bill. Much of this stimulus started to have an impact in the first half of this year. These measures entail a significant increase in real disposable income in spite of a stagnating aggregate gross wage bill. Rapidly falling inflation levels play their part in supporting household incomes. This should stabilise private consumption, but it is not expected to push its annual growth rate into positive territory in 2009. A crucial factor is uncertainty, as evidenced by low consumer confidence, and the still necessary consolidation of household balance sheets in view of high private debt levels. It is therefore expected that the Danish savings rate will make a sizeable jump in 2009 and remain at high levels in the following year as well.

To the extent that the tax reductions and the ability to tap into the private pension funds of the special pensions scheme at beneficial rates will indeed lead to an increase in domestic demand, it is difficult to assess ex ante how much of this impulse will remain in Denmark. On the one hand, there are strong incentives to spend money on housing, which would be largely domestically contained. On the other hand, the openness of the economy suggests that a sizable part will leak out of the economy as imports, notably tourism.

Overall, the size and the timing of the fiscal expansion should lead to a more moderate contraction in 2009 than in the rest of Europe. In combination with the expected turnaround of the global economy it is expected that growth rates will turn mildly positive in 2010.

High budget surpluses become deficits

The massive budget surpluses that Denmark built up in the past are set to disappear rapidly. Following a surplus of 3.6% of GDP in 2008, Denmark is likely to register a deficit of 1½% in 2009, which might rise to 4% in 2010. Close to half of this increase is due to the downturn, activating the very strong automatic stabilisers. This is amplified by the diminishing revenue from volatile sources, such as the fall in oil and gas revenues and falling tax receipts on financial assets.

In addition, the government has passed fiscal packages with a sizeable expansionary impact. As of 2009, the tax reform, which was already decided in August 2007, will reduce revenues by some 0.5% of GDP. Also, agreements on green transport and municipal investment will add some 0.4% of GDP to expenditures. For 2010, the most important fiscal development is the so-called spring package, which will reduce taxes by a further 0.6% of GDP and raise investment by 0.2%. The deficit figure for 2010 is topped off by a sizeable one-off for the pension yield compensation amounting to about ¾% of GDP.

Rising deficits combined with stability measures for the domestic financial banks and vulnerable partner countries (Iceland, Latvia) are leading to a rapid increase in gross debt levels from 27% of GDP in 2007 to 34% in 2010.

Table 2.4.1:

Main features of country forecast - DENMARK

	2007		Annual percentage change						
bn DKK	Curr. prices	% GDP	92-04	2005	2006	2007	2008	2009	2010
GDP at previous year prices	1687.9	100.0	2.2	2.4	3.3	1.6	-1.1	-3.3	0.3
Private consumption	826.7	49.0	1.9	3.8	4.4	2.4	-0.1	-1.6	1.1
Public consumption	438.8	26.0	2.2	1.3	2.1	1.3	1.1	2.1	1.1
Gross fixed capital formation	374.3	22.2	3.8	4.7	13.5	3.1	-3.6	-9.1	-0.7
of which : equipment	137.4	8.1	3.6	1.6	13.2	5.4	-3.7	-13.0	0.2
Exports (goods and services)	882.8	52.3	4.5	8.0	9.1	2.2	2.2	-10.7	-0.1
Imports (goods and services)	846.6	50.2	5.5	11.1	13.9	2.8	3.7	-9.3	0.8
GNI at previous year prices (GDP deflator)	1696.2	100.5	2.4	3.4	3.8	0.3	0.2	-3.9	0.1
Contribution to GDP growth : Domestic demand			2.2	3.1	5.3	2.2	-0.6	-2.2	0.7
Stockbuilding			0.1	0.2	-0.3	-0.3	0.1	-0.1	0.0
Foreign balance			-0.1	-0.8	-1.7	-0.2	-0.7	-1.0	-0.5
Employment			0.3	1.0	2.0	2.7	1.0	-2.2	-2.0
Unemployment rate (a)			6.0	4.8	3.9	3.8	3.3	5.2	6.6
Compensation of employees/head			3.5	3.6	3.6	3.1	4.7	3.1	2.5
Unit labour costs whole economy			1.6	2.2	2.2	4.2	7.0	4.1	0.2
Real unit labour costs			-0.2	-0.7	0.3	2.2	2.6	2.6	-1.2
Savings rate of households (b)			-	-	6.4	5.1	5.6	7.8	7.7
GDP deflator			1.8	2.9	2.0	2.0	4.3	1.5	1.4
Harmonised index of consumer prices			1.9	1.7	1.9	1.7	3.6	0.9	1.4
Terms of trade of goods			0.9	1.3	0.6	-1.1	0.6	0.7	0.0
Trade balance (c)			3.3	2.3	0.4	-0.8	-1.1	-1.0	-1.3
Current account balance (c)			1.9	4.3	2.9	0.7	2.0	0.4	-0.6
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			1.9	4.5	2.9	0.7	2.1	0.4	-0.6
General government balance (c)			-0.4	5.2	5.2	4.5	3.6	-1.5	-3.9
Cyclically-adjusted budget balance (c)			-0.3	4.7	3.6	3.0	3.7	1.1	-1.0
Structural budget balance (c)			-	4.7	3.6	3.0	4.2	1.2	-0.4
General government gross debt (c)			60.4	37.1	31.3	26.8	33.3	32.5	33.7

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.