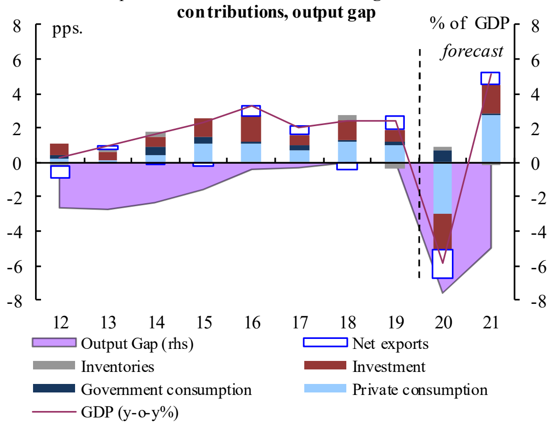
22. DENMARK

Denmark's economy is forecast to contract sharply this year as the COVID-19 pandemic is taking a significant economic toll despite the decisive policy response of Danish authorities to mitigate its impact. The general government budget deficit is projected to rise above 7% of GDP and government debt to increase by over 10 pps., albeit from a comparatively low level.

Abrupt downturn

Denmark entered the COVID-19 crisis with strong economic fundamentals and without any major macroeconomic imbalances. Real GDP expanded by 2.4% in 2019, above its potential growth rate, with positive contributions from all demand components. The general government budget recorded a surplus of 3.7% of GDP last year. These favourable trends continued into 2020 before coming to an abrupt halt in early March. Economic activity took a sharp downturn following the introduction of restrictions to prevent the spread of the pandemic. Denmark's GDP is estimated to have contracted significantly in the first quarter of 2020, but an even steeper decline is expected in the second quarter. The gradual reopening of the economy from 15 April could help reignite economic growth from the third quarter of 2020 onwards, provided the containment of the COVID-19 virus remains effective.

Graph II.22.1: **Denmark - Real GDP growth and contributions, output gap**



Strong policy measures put swiftly in place by the government, including direct support to partly cover businesses' fixed costs and wage expenditures, tax payment deferrals and liquidity provisions for banks and firms are expected to significantly mitigate the negative economic impact of the crisis. Still, real GDP is forecast to contract by almost 6% in 2020, followed by a rebound in 2021, with GDP growth expected to exceed 5%.

Domestic demand takes a big hit

Consumer spending fell sharply, when measures to contain the pandemic, such as the shutdown of shops and restaurants or the cancellation of events and suspension of other economic activities, were taken. Uncertainty about the future employment and income situation is expected to lead households to increase precautionary savings. On the other hand, strong automatic stabilisers should cushion negative labour market developments. Nevertheless, private consumption is forecast to fall by more than 6% in 2020.

In the current economic turmoil, many companies are postponing or cancelling investment decisions. As a result, investment is set to fall by around 10% in 2020. In particular equipment investment, which is highly dependent on external demand, is expected to contract sharply. Public investment and the global economic recovery are forecast to drive an investment rebound in 2021.

Labour market downturn

Denmark entered the present crisis with close to full employment and a low unemployment rate. However, the restrictions on economic activity have led to a rapid and sizeable rise in unemployment. This rise was highly uneven across sectors with tourism, hospitality, food services, transport and retail hit particularly hard. The emergency packages adopted by the government appear to have been successful so far in keeping many workers in employment and limiting a sharp increase in unemployment. Overall, by the end of 2020, the total number of people in employment is forecast to fall by more than 40,000. Despite the rising pension age, the labour force is projected to stagnate this year as many foreign workers have returned to their home countries. As a result, the unemployment rate is forecast to moderately increase from 5% in 2019 to around 6½% in 2020 before decreasing again to below 6% in 2021.

Sharp contraction in external trade

The global downturn and the disruption of cross-border value chains and trading patterns imply a sharp contraction of foreign trade in 2020. Services exports, in particular shipping, are set to see a sharp fall. However, the composition of Danish goods exports (high share of pharmaceutical and food products) is less sensitive to business cycles, potentially preventing a sharper downturn. Still, exports of goods and services are projected to contract by around 10% in 2020. Despite some import compression, net external trade is forecast to detract from real GDP growth in 2020.

Moderately increasing inflation

Consumer price inflation remained moderate at 0.7% in 2019, due to low energy prices and decreasing domestic price pressures. Collapsing oil prices and sharp contraction of consumption are forecast to further ease inflationary pressures in 2020. On the other hand, the announced increase of tobacco taxes in 2020 and 2021 and expected increases in food prices are set to push inflation upwards. As a result, headline inflation is projected to moderate to 0.3% in 2020 before increasing again to 1.3% in 2021.

Strong initial public finances help to mitigate the shock

The 2020 recession and the emergency measures adopted in response to the COVID-19 outbreak are projected to have a substantial impact on government finances. On the expenditure side, automatic stabilisers and emergency packages equivalent to over 4% of GDP should result in the largest deficit in years. The repayment of excessively collected property taxes is estimated to add a further ¾% of GDP to the deficit. On the revenue side, the deferral of significant tax revenues until 2021 should have a temporary deficit-increasing effect in 2020 that should be reversed in 2021. In addition, marked shortfalls in tax revenue are projected as a result of the slump in economic activity in 2020. The deficit is forecast to exceed 7% of GDP in 2020, before the expected recovery and reversal of tax payment deferrals reduces the deficit to around 2¼% of GDP in 2021, based on an assumption that the measures adopted to fight the pandemic only have a temporary effect in 2020. The gross debt ratio should rise sharply from 33.2% of GDP in 2019 to around 45% of GDP at the end of 2020.

Table II.22.1:

Main features of country forecast - DENMARK

	2018		Annual percentage change						
bn DKK	Curr. prices	% GDP	00-15	2016	2017	2018	2019	2020	2021
GDP	2246.0	100.0	1.1	3.2	2.0	2.4	**2.4**	**-5.9**	**5.1**
Private Consumption	1047.7	46.7	1.1	2.4	1.6	2.6	**2.2**	**-6.4**	**5.9**
Public Consumption	546.8	24.3	1.6	0.2	1.0	0.4	**0.5**	**3.1**	**0.5**
Gross fixed capital formation	494.7	22.0	1.4	7.9	3.0	5.4	**3.4**	**-9.5**	**7.9**
of which: equipment	143.4	6.4	1.3	7.2	3.3	7.4	**-5.6**	**-17.1**	**15.8**
Exports (goods and services)	1249.7	55.6	3.5	4.1	4.6	2.4	**1.6**	**-10.7**	**8.7**
Imports (goods and services)	1113.9	49.6	4.4	3.7	4.3	3.6	**0.1**	**-8.8**	**8.1**
GNI (GDP deflator)	2304.3	102.6	1.4	2.6	1.7	2.9	**2.4**	**-6.0**	**5.1**
Contribution to GDP growth:	Domestic demand		1.2	2.7	1.6	2.5	**1.9**	**-4.3**	**4.5**
	Inventories		0.0	0.0	-0.1	0.3	**-0.4**	**0.2**	**-0.2**
	Net exports		-0.1	0.5	0.5	-0.4	**0.8**	**-1.7**	**0.8**
Employment			0.2	1.7	1.6	1.4	**1.2**	**-1.6**	**1.4**
Unemployment rate (a)			5.7	6.0	5.8	5.1	**5.0**	**6.4**	**5.7**
Compensation of employees / head			2.9	1.3	1.6	1.7	**1.5**	**1.0**	**1.7**
Unit labour costs whole economy			2.0	-0.2	1.1	0.7	**0.3**	**5.6**	**-1.9**
Real unit labour cost			0.0	-0.5	0.0	-0.1	**-0.7**	**5.0**	**-3.7**
Saving rate of households (b)			6.7	11.5	12.3	12.3	**12.3**	**19.9**	**17.2**
GDP deflator			2.0	0.3	1.1	0.8	**1.0**	**0.5**	**1.8**
Harmonised index of consumer prices			1.8	0.0	1.1	0.7	**0.7**	**0.3**	**1.3**
Terms of trade goods			0.9	1.4	-1.4	-2.4	**0.0**	**0.2**	**0.2**
Trade balance (goods) (c)			4.0	5.4	4.9	4.0	**5.7**	**4.8**	**5.3**
Current-account balance (c)			4.6	7.8	7.8	7.0	**7.9**	**6.2**	**6.7**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			4.6	7.8	7.8	7.0	**7.9**	**6.3**	**6.9**
General government balance (c)			0.7	0.1	1.8	0.7	**3.7**	**-7.2**	**-2.3**
Cyclically-adjusted budget balance (d)			0.4	0.4	2.0	0.8	**3.6**	**-2.7**	**0.6**
Structural budget balance (d)			-	0.3	2.0	0.8	**3.6**	**-1.9**	**0.6**
General government gross debt (c)			42.0	37.2	35.8	33.9	**33.2**	**44.7**	**44.6**

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.