22. DENMARK

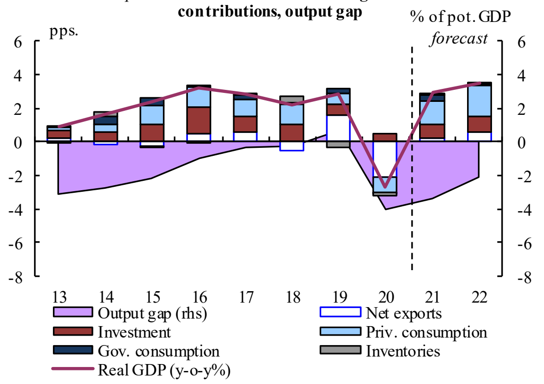
While the second wave of the pandemic in late 2020 and early 2021 deepened and prolonged the COVID-19 crisis in Denmark, the gradual re-opening of the economy should give rise to renewed economic growth in 2021. The general government budget deficit is forecast to widen in 2021 mainly due to one-off expenditures.

Growth returning

Denmark's economy has so far proved to be relatively resilient to the pandemic, with real GDP declining by only 2.7% in 2020, far less than the EU average. While private consumption and exports took a dive in 2020 due to the confinement measures in Denmark and its export markets, investment increased by 2.1%. The construction sector was a major driver, growing by 7.6% in 2020 supported by the public sector and rising house prices.

Widespread lockdown measures were only introduced in December last year, thus growth in 2020-Q4 remained positive, registering 0.7% q-o-q. The impact of restrictions, in place throughout the entire first quarter of this year, are likely to cause a slight decline in GDP for the quarter. A gradual reopening from the second quarter onwards is expected to pave the way for an acceleration of economic activity. Real GDP is forecast to grow by 2.9% this year, gaining momentum through the year and bringing real GDP growth in 2022 to 3.5%.

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



Robust domestic demand

The household saving rate is currently at a record high, as consumers are being prevented from spending on certain items, such as contact-intensive service, and because uncertainty about future employment and income prospects has led households to increase savings. In addition, Danish households received an extraordinary cash transfer from the release of five weeks of frozen holiday savings, equivalent to an additional month's salary (or almost 1.8% of GDP). With the gradual reopening, households are expected to release part of this pent-up demand, driving private consumption growth to 3.1% in 2021 and to 3.9% by 2022.

While construction investment is set to lose some momentum following several years of robust growth, other types of investment are picking up. Following a 7% decline in 2020, machinery and equipment investment is projected to expand at an annual average rate of around 5% over the forecast horizon. Investment supported by the RRF is set to underpin the recovery in the short to medium term while contributing to higher potential growth in the long term. Overall, gross fixed capital formation is forecast to increase by 3.4% in 2021 and 4.2% in 2022.

Return to employment growth

Despite extensive emergency and recovery measures aimed at maintaining employment and keeping businesses afloat, employment declined by 0.7% in 2020 and the unemployment rate increased from 5% in 2019 to 5.8% in 2020. However, of the 70,000 jobs lost in the first half of 2020, more than 50,000 had already been recovered by end of the year, paving the way for a further recovery. The return to economic growth is set to give continued rise to employment over the forecast horizon. Due to the demographically induced rise in the labour force, the unemployment rate is forecast to remain slightly above its 2019 rate and reach 5.1% at the end of 2022.

Better outlook for external trade

Net external trade was a major drag on growth in 2020. While imports fell by 4.8%, exports contracted by 7.7%. Strong external demand, in part triggered by expansionary policies in the US (see Box I.2.1) and strong growth in China, is forecast to provide an impetus to exports over the forecast horizon. While goods exports are set to recover quickly to pre-pandemic levels, the recovery will take longer in the case of service exports, notably in tourism and shipping. The current account surplus dipped in 2020, but still amounted to some 7.8% of GDP. Positive net external trade is set to contribute to an increase in the current account surplus to 8.4% of GDP by 2022.

Inflation returning

Consumer price inflation (HICP) was moderate in 2020 at 0.3% y-o-y on average, mainly due to collapsing oil prices, which was only partly compensated by the impact of tax hikes on tobacco products. Higher oil prices and a recovery in domestic demand are expected to lift HICP inflation to 1.3% in 2021. Inflation in 2022 is forecast to remain around the same level.

Government finances better than feared

At -1.1% of GDP the budget deficit in 2020 turned out smaller than previously expected. Three main reasons help to explain this. On the revenue side, extraordinarily high pension yield tax receipts totalled around 2½% of GDP and the taxation of the first frozen holiday savings pay-out added around 0.8% of GDP. On the expenditure side, the take-up of certain COVID-19-related emergency measures was lower than expected.

In 2021, the deficit is set to widen. Specific COVID-19 business compensation schemes, including payouts linked to mink farmers, are expected to amount to 0.8% of GDP in 2021. However, the taxation of the second payout of frozen holiday savings is set to add around 0.5% of GDP to government revenues. As a result, the general government deficit is expected to rise to 2.1% of GDP in 2021, before declining to 1.4% of GDP in 2022.

The gross government debt-to-GDP ratio rose sharply from 33% in 2019 to 42.2% in 2020, in part triggered by large stock-flow adjustments due to significant tax deferrals from 2020 to 2021. From 2021 onwards, the gross debt ratio is expected to revert to its previous slightly falling trend (albeit at higher levels), declining gradually towards 38.8% of GDP in 2022.

Table II.22.1:

Main features of country forecast - DENMARK

		2019			Annual percentage change					
	bn DKK	Curr. prices	% GDP	01-16	2017	2018	2019	2020	2021	2022
GDP		2335.0	100.0	1.1	2.8	2.2	2.8	**-2.7**	**2.9**	**3.5**
Private Consumption		1076.3	46.1	1.3	2.3	2.7	1.4	**-1.9**	**3.1**	**3.9**
Public Consumption		556.8	23.8	1.4	0.9	0.3	1.2	**-0.1**	**1.6**	**0.4**
Gross fixed capital formation		512.5	22.0	1.4	4.0	4.8	2.8	**2.1**	**3.4**	**4.2**
of which: equipment		142.7	6.1	1.2	10.1	8.6	-5.7	**-7.0**	**4.1**	**6.1**
Exports (goods and services)		1361.8	58.3	3.0	4.8	3.2	5.0	**-7.7**	**5.4**	**6.1**
Imports (goods and services)		1190.2	51.0	3.8	4.2	4.8	2.4	**-4.8**	**5.6**	**5.8**
GNI (GDP deflator)		2404.0	103.0	1.4	2.6	2.8	3.0	**-2.7**	**2.7**	**3.3**
Contribution to GDP growth:	Domestic demand			1.2	2.1	2.4	1.6	**-0.5**	**2.6**	**2.8**
	Inventories			0.0	0.1	0.3	-0.3	**-0.2**	**0.1**	**0.1**
	Net exports			-0.1	0.6	-0.5	1.6	**-2.1**	**0.3**	**0.6**
Employment				0.3	1.5	1.6	1.2	**-0.7**	**0.6**	**0.9**
Unemployment rate (a)				5.8	5.8	5.1	5.0	**5.6**	**5.5**	**5.2**
Compensation of employees / head				2.8	1.7	1.8	1.5	**1.6**	**1.6**	**2.0**
Unit labour costs whole economy				1.9	0.3	1.2	-0.1	**3.7**	**-0.7**	**-0.6**
Real unit labour cost				0.1	-0.8	0.6	-0.8	**1.3**	**-2.1**	**-2.2**
Saving rate of households (b)				7.3	11.8	11.9	9.7	**11.9**	**11.0**	**9.7**
GDP deflator				1.8	1.2	0.6	0.7	**2.3**	**1.4**	**1.6**
Harmonised index of consumer prices				1.6	1.1	0.7	0.7	**0.3**	**1.3**	**1.3**
Terms of trade goods				0.9	-1.5	-2.5	0.0	**1.7**	**0.1**	**0.2**
Trade balance (goods) (c)				4.0	4.5	3.5	5.2	**5.0**	**5.1**	**5.3**
Current-account balance (c)				5.0	8.0	7.0	8.9	**7.8**	**8.0**	**8.4**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				5.0	8.1	7.0	8.9	**7.8**	**8.0**	**8.4**
General government balance (c)				0.5	1.8	0.7	3.8	**-1.1**	**-2.1**	**-1.4**
Cyclically-adjusted budget balance (d)				0.7	2.0	0.8	3.4	**1.2**	**-0.1**	**-0.2**
Structural budget balance (d)				-0.5	2.0	0.8	3.4	**0.5**	**0.1**	**0.4**
General government gross debt (c)				41.0	35.9	34.0	33.3	**42.2**	**40.2**	**38.8**

(a) Eurostat definition. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.