4. DENMARK

The moderate recovery continues

The modest recovery of the Danish economy continued in the first half of 2016 and is expected to strengthen over the forecast horizon. The recovery has been driven by domestic demand, underpinned by low interest rates and a buoyant labour market. The general government deficit is expected to remain well below 3% but with strong fluctuations due mostly to the volatility of certain revenue items.

GDP growth has picked up

Following two quarters of negative GDP growth in the second half of last year, GDP picked up in the first half of 2016. On an annual basis, GDP is expected to grow by 1.0% in 2016, mainly driven by domestic demand, in particular by private consumption growth.

Domestic demand remains the main driver

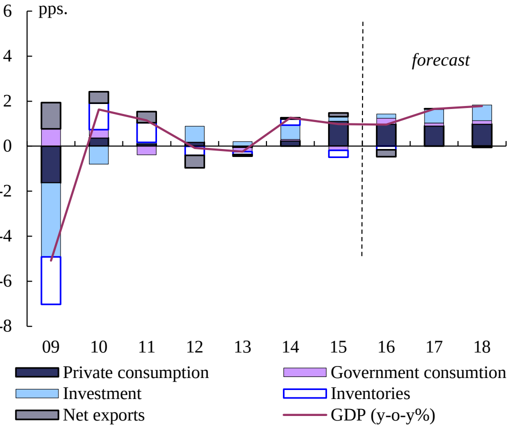
The moderate recovery of the Danish economy is expected to continue in the following two years, with GDP forecast to accelerate to 1.7% in 2017 and to 1.8% in 2018.

Private consumption is projected to remain the main driver of real GDP growth, supported by steadily rising disposable income due to robust employment and wage growth as well as low inflation. The net-asset position of households has also improved, partly due to the increase in house prices since mid-2012. Consumer confidence remains at a level consistent with the continued growth in private consumption, although it has come down from its peak in spring of 2015. Private consumption is expected to grow by around 2% annually between 2016 and 2018.

House prices continued to rise in the first half of the year, but at a somewhat slower pace than in 2015. House prices are supported by low interest rates and growing incomes, while in the large cities – where price growth has been higher than the national average – strong population growth has further increased demand for housing. Residential investments have been to slow to pick up in response to the improvements on the housing market. This is to some extent due to an overhang of housing supply after the crisis, and investments are expected to increase gradually as the recovery entrenches.

Export growth also picked up in the first half of 2016 after a weak performance in 2015. Exports are expected to accelerate in 2017 and 2018, expanding at a rate of 3.0% and 3.5% respectively, supported by higher growth in Denmark's main export markets. With imports forecast to increase in line with final demand, net exports are projected to have a broadly neutral impact on GDP growth in 2017 and 2018.

Graph II.4.1: **Denmark - Real GDP growth and its components**



Strong labour market performance

Employment growth has gathered steam, growing every quarter since the beginning of 2013 and by 1.8% (y-o-y) in the second quarter of 2016. This strong performance, which has in particular been driven by private sector employment, contrasts with the weak recovery of GDP. This should, however, be seen in light of a weak performance of sectors with high capital intensity, such as the oil and gas extraction sector and the shipping industry, whereas more labour intensive sectors have fared better. Unemployment has been on a declining trend since spring 2012 and has flattened out just above 6%, due to a strong increase in the labour force. The strong labour market performance is expected to continue over the coming years with employment forecast to grow by around 1% both in 2017 and 2018.

Inflation remains subdued

Consumer prices (HICP) dropped by 0.3% on an annual basis in September 2016. Inflation has been dragged down by a fall in energy prices and in the price of non-energy industrial goods. Core inflation, which excludes energy and unprocessed foods, stood at 0.0% in September. HICP inflation is expected to be flat in 2016 before rising to 1.2% in 2017 and 1.6% in 2018, with positive contributions from the expected increase in energy prices in 2017 and from services in both 2017 and 2018 partly reflecting a gradual increase in wage growth as labour market conditions tighten.

Risks to the outlook appear broadly balanced

Macroeconomic risks to the forecast appear broadly balanced and are on the one hand related to general uncertainty from the external side, while on the other hand, there is a positive risk related to the possibility of stronger growth in private consumption and investments if households and companies choose to reduce their currently high rates of saving.

Volatility masks an underlying improvement in public finances

The general government balance is expected to improve from a deficit of 1.7% of GDP in 2015 to a deficit of 1.4% of GDP in 2018. The overall improvement is, however, affected by temporary factors, which explain the volatile profile of the headline balance. One important factor is the volatility of revenues from the pension yield tax. The revenues from this tax are expected to increase by around 1 per cent of GDP from 2015 to 2016, before dropping by 1.5 per cent of GDP from 2016 to 2017.

The structural balance is expected to improve from a deficit of 1½% of GDP in 2015 to a surplus of around ½% of GDP in 2016, before returning to negative territory with an expected deficit of around ¾% of GDP in 2017 and around ½% of GDP in 2018. The profile of the structural balance is also affected by the volatility of pension yield tax revenues and of other volatile revenue items such as revenues from North Sea oil and gas extraction.

The general government gross debt level is expected to gradually decrease from 40.4% of GDP in 2015 to 38.2% of GDP in 2018.

Table II.4.1:

Main features of country forecast - DENMARK

	2015			Annual percentage change						
	bn DKK	Curr. prices	% GDP	97-12	2013	2014	2015	2016	2017	2018
GDP		1985.3	100.0	1.3	-0.2	1.3	1.0	**1.0**	**1.7**	**1.8**
Private Consumption		953.5	48.0	1.2	-0.1	0.5	2.3	**2.0**	**1.9**	**2.0**
Public Consumption		518.8	26.1	1.7	-0.7	0.2	-0.7	**1.0**	**0.5**	**0.6**
Gross fixed capital formation		377.9	19.0	1.7	1.1	3.4	1.1	**1.0**	**3.2**	**3.6**
of which: equipment		115.4	5.8	1.9	5.1	5.3	1.1	**0.3**	**4.6**	**3.6**
Exports (goods and services)		1060.5	53.4	4.0	0.9	3.1	0.3	**0.5**	**3.0**	**3.5**
Imports (goods and services)		936.2	47.2	4.8	1.1	3.3	0.0	**1.3**	**3.4**	**4.1**
GNI (GDP deflator)		2036.3	102.6	1.5	0.7	1.5	0.1	**1.3**	**1.7**	**1.8**
Contribution to GDP growth:	Domestic demand			1.4	0.0	0.9	1.1	**1.4**	**1.7**	**1.8**
	Inventories			0.0	-0.1	0.3	-0.3	**-0.2**	**0.0**	**0.0**
	Net exports			-0.1	-0.1	0.1	0.2	**-0.3**	**0.0**	**-0.1**
Employment				0.3	0.1	0.8	1.1	**1.5**	**0.9**	**1.0**
Unemployment rate (a)				5.3	7.0	6.6	6.2	**6.1**	**5.9**	**5.6**
Compensation of employees / head				3.3	1.2	1.8	1.9	**1.9**	**2.3**	**2.7**
Unit labour costs whole economy				2.3	1.5	1.3	2.0	**2.4**	**1.5**	**1.9**
Real unit labour cost				0.1	0.2	0.6	0.8	**1.7**	**-0.2**	**0.0**
Saving rate of households (b)				5.8	7.9	4.4	11.0	**10.7**	**13.8**	**13.9**
GDP deflator				2.2	1.4	0.8	1.2	**0.7**	**1.7**	**1.9**
Harmonised index of consumer prices				2.0	0.5	0.4	0.2	**0.0**	**1.2**	**1.6**
Terms of trade goods				0.7	1.7	0.5	1.7	**0.9**	**0.2**	**0.5**
Trade balance (goods) (c)				2.8	2.7	2.2	2.9	**3.3**	**3.5**	**3.6**
Current-account balance (c)				3.4	7.1	7.7	7.0	**6.5**	**6.4**	**6.3**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				3.4	7.1	7.7	7.0	**6.7**	**6.4**	**6.3**
General government balance (c)				0.7	-1.1	1.5	-1.7	**-0.9**	**-2.0**	**-1.4**
Cyclically-adjusted budget balance (d)				0.3	1.1	3.2	-0.1	**0.7**	**-0.8**	**-0.6**
Structural budget balance (d)				-	-0.4	0.1	-1.5	**0.6**	**-0.8**	**-0.6**
General government gross debt (c)				-	44.7	44.8	40.4	**38.9**	**38.3**	**38.2**

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