4. DENMARK

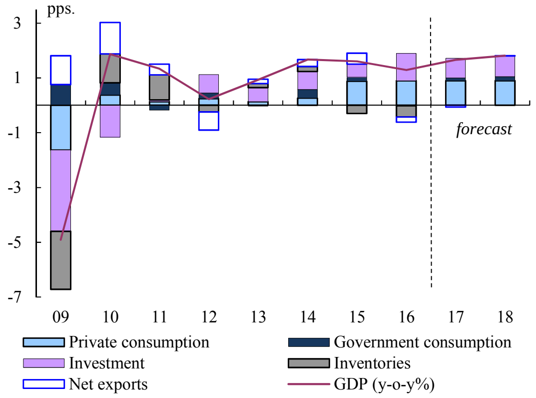
Domestic demand set to drive economic growth

Economic growth is forecast to strengthen this year and next, supported by robust private consumption and dynamic investment. Employment growth is expected to remain strong and unemployment to fall further despite a growing labour force. Inflation is set to pick up as energy and service prices rise. The general government deficit is projected to remain moderate.

Gradual strengthening of GDP ahead

Economic growth in Denmark is gaining pace. Real GDP expanded by 1.3% in 2016 and is expected to accelerate to 1.7% in 2017 and 1.8% in 2018. Domestic demand is forecast to remain the driver of economic growth, underpinned by robust private consumption and business investment. The contribution of net trade to GDP growth is projected to be marginally negative.

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



Private consumption remains the main driver

Private consumption expanded at a rate of 1.9% in 2016 and is projected to grow at a similar pace over the forecast horizon, supported by strong employment growth, steadily rising disposable income and low interest rates. In addition, the financial wealth and home equity of households has been increasing, supporting consumer confidence. The household saving rate is expected to decrease slightly from high levels despite growing pension savings. Government consumption is projected to expand at a modest pace of 0.4% in 2017 and 0.6% in 2018.

Business investment is boosting economic growth

Residential investment rebounded in 2016, expanding by 11% on the back of dynamically rising housing prices, particularly in the main urban areas. With housing price increases expected to moderate in the coming years, housing investment is also set to grow more moderately by around 6% in 2017 and 2018. Machinery and equipment investment is expected to expand by about 4% per annum over the forecast horizon as the overall recovery consolidates and a growing need for capacity expansion emerges.

Foreign trade rebounds

Trade performance was sluggish in the first half of 2016, partly due to the weakness of sea freight. Nevertheless, both exports and imports picked up in the second half of 2016 as world trade gained momentum. The outlook points to robust trade performance over the forecast horizon. The current account surplus declined in 2016 to 8.1% of GDP (-1.1 pps. from 2015), due to reductions in the primary income balance and the external balance of goods and services. The current account balance is expected to fall gradually as business investment increases and the economic recovery strengthens.

Labour market remains robust

Employment growth was strong in 2016, expanding at a rate of 1.7%. However, the unemployment rate remained stable at 6.2% due to the growing labour force. The private sector, particularly the services and construction sectors, has been the main driver of employment growth since 2013. By contrast, employment in the public sector has been declining gradually. Over the forecast horizon, employment growth is expected to outpace the expansion of the labour force resulting in a gradual decline of the unemployment rate to 5.8% in 2017 and 5.7% in 2018. Despite indications of growing labour shortages in several sectors, wages are expected to accelerate only in line with projected productivity developments.

Inflation picks up

Growth in consumer prices has been very weak in recent years due to the steep fall in oil prices. Consumer prices (HICP) were flat in 2016 but they are expected rise to 1.4% in 2017 and 1.7% in

2018. This pick-up is supported by both the increase in prices of energy prices and wage growth.

Risks to the outlook are broadly balanced

Upside risks are primarily related to domestic factors. Private consumption could turn out higher if economic uncertainties wane and households scale back saving. Business investment has been subdued for an extended period and the savings surplus in the corporate sector remains high, which could provide support for stronger business investment. Negative risks to the forecast are primarily related to external factors, particularly the economic policies of some major economies.

Stable public finances

The general government deficit reached 0.9% of GDP in 2016, slightly better than previously expected due to higher revenues from the pension yield tax. Public consumption is expected to grow moderately, while public investment is projected to slightly decrease in 2018. The general government deficit is projected to rise slightly to 1.3% of GDP in 2017 before falling to 0.9% of GDP in 2018.

Favourable nominal GDP growth developments, low interest rates and the modest general government deficit pave the way for a further reduction in the general government debt-to-GDP ratio, which is expected to decrease from 37.8% in 2016 to 36.0% 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		2027.2	100.0	1.3	0.9	1.7	1.6	**1.3**	**1.7**	**1.8**
Private Consumption		955.9	47.2	1.3	0.3	0.5	1.9	**1.9**	**1.9**	**1.9**
Public Consumption		520.8	25.7	1.8	-0.1	1.2	0.6	**-0.1**	**0.4**	**0.6**
Gross fixed capital formation		389.9	19.2	1.7	2.7	3.5	2.5	**5.2**	**3.6**	**3.7**
of which: equipment		118.3	5.8	1.8	10.6	2.7	-0.5	**4.6**	**3.9**	**3.8**
Exports (goods and services)		1119.5	55.2	4.2	1.6	3.6	1.8	**1.7**	**3.3**	**3.9**
Imports (goods and services)		969.5	47.8	5.0	1.5	3.6	1.3	**2.4**	**4.0**	**4.4**
GNI (GDP deflator)		2095.1	103.4	1.6	1.8	2.1	1.3	**0.6**	**1.7**	**1.8**
Contribution to GDP growth:	Domestic demand			1.4	0.7	1.1	1.4	**1.9**	**1.7**	**1.8**
	Inventories			0.0	0.1	0.3	-0.2	**-0.4**	**0.0**	**0.0**
	Net exports			-0.1	0.2	0.3	0.4	**-0.2**	**-0.1**	**0.0**
Employment				0.3	0.0	1.0	1.3	**1.7**	**1.1**	**0.9**
Unemployment rate (a)				5.3	7.0	6.6	6.2	**6.2**	**5.8**	**5.7**
Compensation of employees / head				3.3	1.6	1.5	1.5	**1.6**	**2.3**	**2.7**
Unit labour costs whole economy				2.2	0.6	0.8	1.1	**2.0**	**1.7**	**1.8**
Real unit labour cost				0.0	-0.3	0.1	0.2	**1.6**	**0.1**	**0.1**
Saving rate of households (b)				5.9	8.8	5.2	10.5	**11.7**	**11.5**	**11.3**
GDP deflator				2.2	0.9	0.8	0.9	**0.4**	**1.6**	**1.7**
Harmonised index of consumer prices				2.0	0.5	0.4	0.2	**0.0**	**1.4**	**1.7**
Terms of trade goods				0.6	1.4	1.0	1.7	**3.2**	**0.1**	**0.0**
Trade balance (goods) (c)				3.0	3.7	3.5	4.2	**5.0**	**5.2**	**5.2**
Current-account balance (c)				3.6	7.8	8.9	9.2	**8.1**	**7.8**	**7.7**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				3.7	7.7	8.7	8.8	**8.1**	**7.4**	**7.4**
General government balance (c)				0.7	-1.0	1.4	-1.3	**-0.9**	**-1.3**	**-0.9**
Cyclically-adjusted budget balance (d)				0.2	0.6	2.6	-0.4	**0.0**	**-0.4**	**-0.1**
Structural budget balance (d)				-	-0.9	-0.5	-1.8	**0.0**	**-0.4**	**-0.1**
General government gross debt (c)				-	44.0	44.0	39.6	**37.8**	**36.7**	**36.0**

(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.