

Denmark

Growth picked up again in 2004, as households raised their spending and strong external demand pulled up exports. The expansion should continue, with accelerating exports gradually taking over as the main driver of growth. Inflationary pressures are likely to be modest as the output gap is projected to stay just below zero, but they may be less benign if households spend even more out of their income and wealth gains.

Tax cuts in 2004 and other measures to strengthen households' disposable incomes continue to boost prospects for this year, while the planned resumption of Special Pension contributions will take back some of the stimulus next year. Monetary policy settings may provide further underpinning of growth in the near term, while a gradual tightening is projected in 2006, as Danish interest rates follow those of the European Central Bank. With growth likely to be above potential, the government should now return its focus to its medium-term targets for the fiscal balance and employment.

Private consumption accelerated markedly towards the end of 2004 as households responded to tax cuts and rising house prices. A strong pick-up in business investment added to the expansion of domestic demand. But net exports subtracted substantially from real GDP in the second half of the year, as export market share was lost and import penetration rose. Some weakening of retail sales suggests a more moderate expansion of household spending early this year, but car sales point to renewed growth from the second quarter. Business indicators are mixed, as manufacturing is on a downbeat note, while the construction and service sectors remain buoyant. A significant improvement in the labour market has still to materialise, although the unemployment rate has edged down over the past year. Part of the explanation is that much of the extra household spending has been on foreign-produced goods and services, generating little extra labour demand domestically. Wage gains have remained somewhat subdued as a consequence.

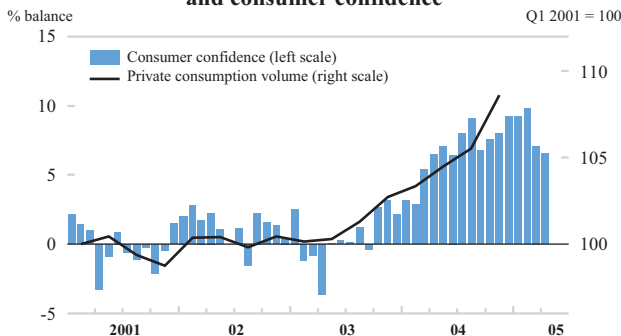
Domestic demand has rebounded strongly

The fiscal stimulus from the past year's tax cuts and other measures to boost households' disposable incomes continues to be the main driver of growth this year. In addition, lower interest rates, a moderate rise in house prices and a gradual improvement in employment prospects are likely to spur households to reduce their savings ratio. In this growth-supportive climate, the recovery should continue, with household spending driving up domestic demand and firms' expansion of capacity providing further underpinning of activity.

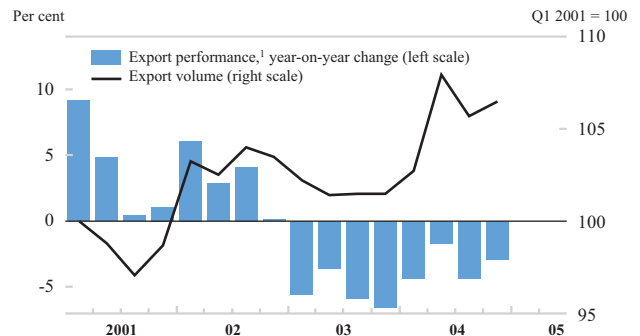
Activity should remain sturdy this year

Denmark

Tax cuts have sparked private consumption and consumer confidence



Export performance is still weak



1. Ratio between export volumes and export markets for total goods and services.
Source: Statistics Denmark; OECD.

Denmark: Demand, output and prices

	2001	2002	2003	2004	2005	2006
	Current prices billion DKK	Percentage changes, volume (1995 prices)				
Private consumption	624.5	0.6	0.9	4.3	3.8	2.1
Government consumption	343.3	2.1	1.0	0.7	0.7	0.8
Gross fixed capital formation	268.4	2.3	1.5	4.7	5.7	5.3
Final domestic demand	1 236.2	1.4	1.1	3.5	3.5	2.6
Stockbuilding ¹	3.8	0.0	-0.2	0.4	0.0	0.1
Total domestic demand	1 240.0	1.4	0.9	3.9	3.5	2.7
Exports of goods and services	590.9	4.7	-1.6	4.0	3.3	6.3
Imports of goods and services	505.4	7.3	-1.4	7.4	5.6	7.0
Net exports ¹	85.5	-0.8	-0.1	-1.4	-1.0	-0.3
GDP at market prices	1 325.5	0.5	0.7	2.4	2.4	2.4
GDP deflator	—	1.4	2.2	1.6	1.6	1.8
<i>Memorandum items</i>						
Harmonised index of consumer prices	—	2.4	2.1	1.2	1.6	1.9
Private consumption deflator	—	2.1	1.8	1.1	1.6	1.9
Unemployment rate	—	4.6	5.6	5.7	5.4	5.0
Household saving ratio ²	—	0.1	0.3	-1.1	-3.1	-2.6
General government financial balance ³	—	1.6	1.0	2.3	1.8	1.5
Current account balance ³	—	2.2	3.3	2.5	1.6	1.6

1. Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.

2. As a percentage of disposable income, net of household consumption of fixed capital.

3. As a percentage of GDP.

Source: OECD Economic Outlook 77 database.

The policy stance will become less supportive of growth next year

In 2006, the temporary suspension of compulsory Special Pension contributions is supposed to end, thus clawing back some of the earlier stimulus. Monetary conditions may not begin to tighten until next year, as domestic interest rates follow those in the euro area, and such tightening will be welcome when it comes. Private consumption growth could then begin to moderate as a consequence, while a projected re-acceleration in external demand would help keep the economy growing at a rate above potential. The labour market should improve further as firms increase hiring, but inflationary pressures may remain contained as output is expected to stay below its potential level until the end of 2006.

The fiscal balance is weakening in spite of strong activity

Despite substantial fiscal easing, the general government surplus rose above 2¼ per cent of GDP last year on the back of surprisingly high property income and revenue from, *inter alia*, the pension yield tax. Some of this is likely to be of a temporary nature, and the surplus is projected to drop back by around ¾ of a percentage point of GDP over this year and next. The resumption of tax-exempt Special Pension contributions in 2006 adds to the decline of the surplus that year. After adjusting for these one-off factors, the structural surplus is likely to be close to the lower bound of the government's target of 1½ to 2½ per cent of GDP. However, substantial adjustment costs in the run-up to the restructuring of local governments from 2007 risk pushing the structural surplus below the target next year.

The momentum of the expansion depends on household behaviour

Household consumption behaviour is the main source of uncertainty in the outlook. If households decide to spend even more of their extra income from the earlier policy stimulus, in particular on domestically produced goods and services, inflationary pressures may emerge. Also, floating-rate loans have become much more common among homeowners, making them more sensitive to the assumed near-term easing of the European Central Bank's monetary policy stance.

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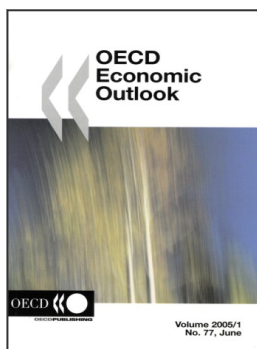
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Conventional signs

\$	US dollar	.	Decimal point
¥	Japanese yen	I, II	Calendar half-years
£	Pound sterling	Q1, Q4	Calendar quarters
€	Euro	Billion	Thousand million
mbd	Million barrels per day	Trillion	Thousand billion
..	Data not available	s.a.a.r.	Seasonally adjusted at annual rates
0	Nil or negligible	n.s.a.	Not seasonally adjusted
–	Irrelevant		



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