

Denmark

GDP is projected to grow almost 3% a year before abating somewhat in 2007. Recent house price increases are likely to sustain consumption growth into 2006. Starting with a slight negative output gap, economy-wide wage and price inflation is expected to gather pace towards 2007, with the construction sector already now beginning to show signs of overheating.

Monetary conditions, reinforced by new loan types on the mortgage market, are providing stimulus for the economy and this is likely to continue with shortterm interest rates remaining stable in line with those of the European Central Bank. In this context, the sizeable extra revenues from North Sea oil exploration must be used to reduce public debt, with fiscal policy helping to contain aggregate demand. Measures to raise labour supply should also be considered.

After some years of slow growth, the economy is now back on track with GDP expanding by over 2% year-on-year since second quarter 2004. Unemployment is steadily declining. Most of the expansion comes from private consumption, partly driven by income tax cuts introduced in mid 2004. Simultaneously, constantly falling interest rates and increased use of new mortgage loans with variable interest rates and without repayment of principal have pushed house price inflation to a peak of 18%. The fall in interest rate has been particularly strong recently as the differential vis-à-vis Germany started to decline in late 2004 and even turned negative from May for comparable ten-year bonds, having previously been stable at 0.2-0.3 percentage point for a number of years. Wealth effects from rising house prices have, therefore, added to the robustness of private consumption with the savings ratio falling and consumer confidence even rising in the autumn. Following a 10% loss of market share during 2003 and 2004, export performance improved considerably in the first half of 2005. But because of the high import content of private consumption growth, net exports are not contributing much to GDP growth. So far, wage growth has been modest and CPI inflation, while it has increased from its 2004 trough, remains around 2%.

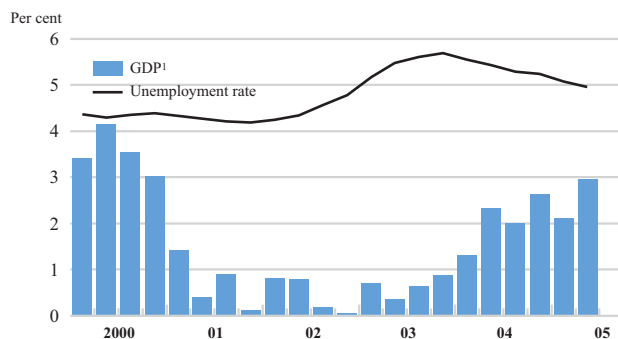
Consumption drives growth as house prices increase rapidly

Surveys indicate that manufacturing capacity utilisation is now somewhat above its historical average. At 12¾ per cent of GDP in 2004, business investment is in the low part of the 12-15% band within which it has moved during the last two decades, and therefore seems set to grow. Following housing investment growth of about 10% in both 2003 and 2004, however, capacity constraints are starting to show in the construction sector. Consequently there is an upper limit to how much total investments

Business investment is set to grow

Denmark

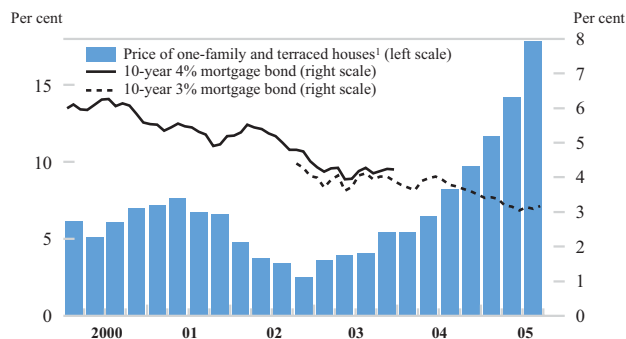
Unemployment is coming down again



1. Year-on-year percentage change.

Source: Statistics Denmark and the Association of Danish Mortgage Banks.

House prices soar as interest rates fall



Denmark: Demand, output and prices

| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 |
|---|-------------------------------|------|----------------------------|------|------|------|
| | Current prices DKK billion | | Percentage changes, volume | | | |
| Private consumption | 651.4 | 1.4 | 3.8 | 4.4 | 3.0 | 2.1 |
| Government consumption | 359.1 | 0.4 | 2.0 | 1.2 | 0.8 | 0.6 |
| Gross fixed capital formation | 268.5 | 1.6 | 3.3 | 3.5 | 6.1 | 4.3 |
| Final domestic demand | 1 279.1 | 1.1 | 3.2 | 3.3 | 3.0 | 2.2 |
| Stockbuilding ¹ | 3.3 | -0.1 | 0.2 | -0.2 | -0.1 | 0.0 |
| Total domestic demand | 1 282.4 | 1.0 | 3.4 | 3.1 | 2.9 | 2.2 |
| Exports of goods and services | 648.0 | -1.1 | 3.2 | 9.3 | 5.7 | 5.7 |
| Imports of goods and services | 567.8 | -0.6 | 6.5 | 10.2 | 6.4 | 5.7 |
| Net exports ¹ | 80.1 | -0.3 | -1.1 | 0.1 | -0.1 | 0.3 |
| GDP at market prices | 1 362.5 | 0.6 | 2.1 | 3.0 | 2.7 | 2.4 |
| GDP deflator | — | 2.2 | 2.1 | 1.7 | 2.0 | 2.8 |
| <i>Memorandum items</i> | | | | | | |
| Consumer price index | — | 2.1 | 1.2 | 1.8 | 1.7 | 2.4 |
| Private consumption deflator | — | 2.0 | 1.6 | 1.5 | 1.4 | 2.4 |
| Unemployment rate | — | 5.5 | 5.4 | 4.9 | 4.6 | 4.4 |
| Household saving ratio ² | — | 3.6 | 2.9 | 0.8 | 0.5 | 0.4 |
| General government financial balance ³ | — | 0.0 | 1.7 | 2.8 | 2.4 | 1.9 |
| Current account balance ³ | — | 3.3 | 2.5 | 3.0 | 2.2 | 2.7 |

Note: National accounts are based on official chain-linked data. This introduces a discrepancy in the identity between real demand components and GDP. For further details see OECD Economic Outlook Sources and Methods, (<http://www.oecd.org/eco/sources-and-methods>).

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 78 database.

Statlink: <http://dx.doi.org/10.1787/125256086218>

can grow, and the housing boom may to some extent damp construction activities associated with business investments.

Higher oil prices boost the fiscal balance

Higher oil prices are affecting the economy in an atypical way. Tax revenues from North Sea oil exploration are 1% of GDP higher in 2005-07 than in 2003, and this will boost the fiscal balance. While the direct effect of higher oil costs will to some extent damp domestic activity, the windmill industry, accounting for 5% of manufacturing employment, could see export orders soar as markets now consider the oil price increase as more durable or indeed permanent.

Growth should continue at a solid pace

GDP is projected to grow by almost 3% this year and next before abating somewhat in 2007. The combination of oil-related consumer-price increases and capacity constraints starting in the construction sector is expected to push up wage growth and spill over into core inflation. But beginning with a slight negative output gap, economy-wide wage and price inflation is expected to gather pace only towards 2007. On the back of wealth effects from recent house price increases, private consumption is projected to continue expanding faster than GDP well into 2006. With fixed investments accelerating, strong domestic demand will push up imports, and net exports are not expected to contribute to GDP growth despite export being projected to advance by over 5% a year. The fiscal balance rises to about 3% of GDP from 2005 as a result of oil revenue and the pension yield tax. A bursting bubble on the housing market is not a likely risk scenario, as most of the historic house price increase can be explained by fundamentals, in particular the low interest rate. However, the housing market is vulnerable to interest rate increases as mortgage loans with variable interest rates have become more common than some years ago.

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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 |
| mb/d | 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 | | |

Summary of projections

| | 2005 | 2006 | 2007 | 2005 | 2006 | | | | 2007 | | | Fourth quarter | | |
|---|----------|------|------|------|------|-----|-----|-----|------|-----|--|----------------|------|------|
| | | | | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | | 2005 | 2006 | 2007 |
| | Per cent | | | | | | | | | | | | | |
| Real GDP growth | | | | | | | | | | | | | | |
| United States | 3.6 | 3.5 | 3.3 | 3.7 | 3.3 | 3.5 | 3.5 | 3.3 | 3.2 | 3.2 | | 3.7 | 3.4 | 3.1 |
| Japan | 2.4 | 2.0 | 2.0 | 1.7 | 1.9 | 2.1 | 1.9 | 2.0 | 2.0 | 2.1 | | 3.2 | 2.0 | 2.1 |
| Euro area | 1.4 | 2.1 | 2.2 | 2.2 | 1.9 | 2.0 | 2.2 | 2.1 | 2.2 | 2.2 | | 1.8 | 2.1 | 2.2 |
| Total OECD | 2.7 | 2.9 | 2.9 | 3.1 | 3.0 | 2.8 | 2.6 | 2.9 | 3.2 | 2.9 | | 3.0 | 2.8 | 2.9 |
| Inflation | | | | | | | | | | | | | | |
| United States | 2.7 | 2.5 | 2.3 | 2.9 | 2.2 | 2.3 | 2.3 | 2.3 | 2.6 | 2.2 | | 2.9 | 2.3 | 2.2 |
| Japan | -1.1 | -0.1 | 0.6 | -0.2 | 0.0 | 0.1 | 0.3 | 0.5 | 0.6 | 0.7 | | -1.3 | 0.2 | 0.8 |
| Euro area | 1.8 | 1.7 | 1.9 | 1.9 | 1.5 | 1.5 | 1.5 | 1.8 | 2.0 | 2.1 | | 1.9 | 1.6 | 2.0 |
| Total OECD | 2.1 | 1.9 | 1.9 | 1.5 | 1.4 | 2.1 | 2.4 | 2.0 | 1.7 | 1.8 | | 1.9 | 2.0 | 1.9 |
| Unemployment rate | | | | | | | | | | | | | | |
| United States | 5.1 | 4.8 | 4.7 | 5.0 | 4.9 | 4.9 | 4.8 | 4.8 | 4.7 | 4.7 | | 5.0 | 4.8 | 4.7 |
| Japan | 4.4 | 3.9 | 3.5 | 4.3 | 4.1 | 4.0 | 3.9 | 3.8 | 3.7 | 3.5 | | 4.3 | 3.8 | 3.3 |
| Euro area | 8.7 | 8.4 | 8.1 | 8.6 | 8.5 | 8.5 | 8.4 | 8.4 | 8.3 | 8.2 | | 8.6 | 8.4 | 8.0 |
| Total OECD | 6.5 | 6.3 | 6.0 | 6.4 | 6.3 | 6.3 | 6.2 | 6.2 | 6.1 | 6.1 | | 6.4 | 6.2 | 5.9 |
| World trade growth | 7.3 | 9.1 | 9.2 | 9.3 | 8.8 | 8.8 | 8.9 | 9.1 | 9.3 | 9.4 | | 8.1 | 8.9 | 9.3 |
| Current account balance | | | | | | | | | | | | | | |
| United States | -6.5 | -6.7 | -7.0 | | | | | | | | | | | |
| Japan | 3.4 | 3.9 | 4.7 | | | | | | | | | | | |
| Euro area | -0.2 | -0.2 | -0.1 | | | | | | | | | | | |
| Total OECD | -1.8 | -2.0 | -2.0 | | | | | | | | | | | |
| Cyclically-adjusted fiscal balance | | | | | | | | | | | | | | |
| United States | -3.6 | -4.2 | -3.9 | | | | | | | | | | | |
| Japan | -6.3 | -6.1 | -6.4 | | | | | | | | | | | |
| Euro area | -2.2 | -2.1 | -2.0 | | | | | | | | | | | |
| Total OECD | -3.1 | -3.3 | -3.2 | | | | | | | | | | | |
| Short-term interest rate | | | | | | | | | | | | | | |
| United States | 3.5 | 4.8 | 4.9 | 4.2 | 4.6 | 4.9 | 4.9 | 4.9 | 4.9 | 4.9 | | 4.2 | 4.9 | 4.9 |
| Japan | 0.0 | 0.0 | 0.7 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.3 | 0.6 | | 0.0 | 0.0 | 1.0 |
| Euro area | 2.2 | 2.2 | 2.9 | 2.2 | 2.2 | 2.2 | 2.2 | 2.3 | 2.6 | 2.8 | | 2.2 | 2.3 | 3.3 |

Note: Real GDP growth, inflation (measured by the increase in the GDP deflator) and world trade growth (the arithmetic average of world merchandise import and export volumes) are seasonally and working-day-adjusted annual rates. The "fourth quarter" columns are expressed in year-on-year growth rates where appropriate and in levels otherwise. The unemployment rate is in per cent of the labour force while the current account balance is in per cent of GDP. The cyclically-adjusted fiscal balance is in per cent of potential GDP. Interest rates are for the United States: 3-month eurodollar deposit; Japan: 3-month certificate of deposits; euro area: 3-month interbank rate.

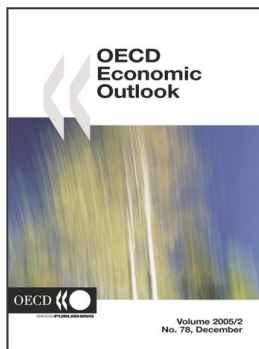
Assumptions underlying the projections include:

- no change in actual and announced fiscal policies;

- unchanged exchange rates as from 11 November 2005; in particular 1\$ = 118.00 yen and 0.85 euros;

The cut-off date for other information used in the compilation of the projections is 22 November 2005.

Source: OECD Economic Outlook 78 database.



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