

DENMARK

After years of strong expansion, the construction boom is now over and falling house prices have put an end to debt-financed consumption growth. As the impact of global financial turmoil materialises, exports are likely to remain weak during 2009, leading businesses to cut back investment.

Denmark enters the slowdown with severe capacity pressures and wages rising much faster than warranted by productivity growth. There is thus little need presently for fiscal demand stimulus, especially since monetary conditions are set to ease along with those of the euro area.

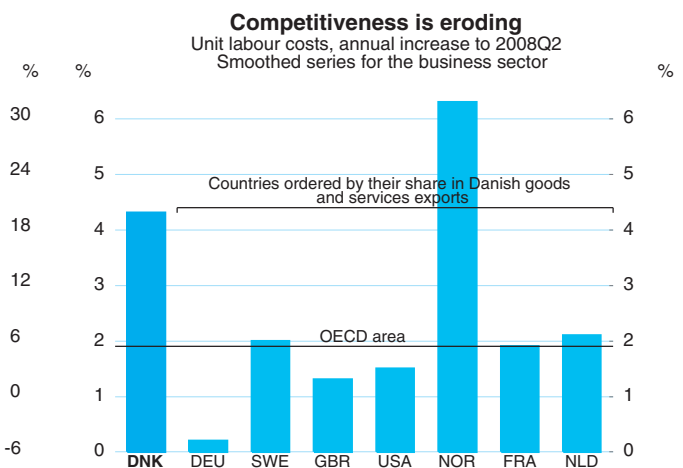
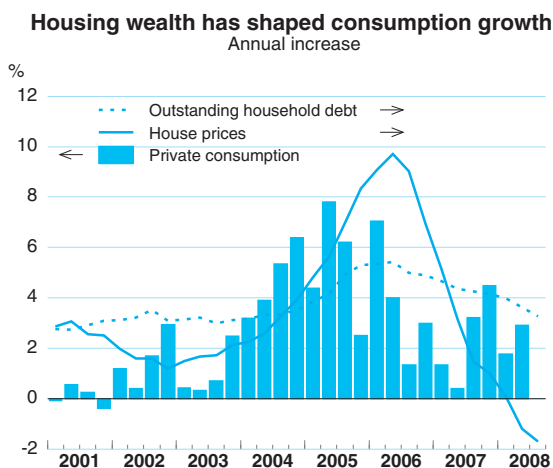
Growth has stalled but wage pressures have intensified

GDP has been essentially flat since the second half of 2007 and, more recently, all major components of demand have weakened. Strong food and energy price inflation cut retail sales, and car sales also weakened. Export orders have declined sharply, and firms indicate that they are trimming investment plans. Nevertheless, employment and hours worked continued to rise in early 2008 and registered unemployment reached a new record low in September. For the private sector as a whole, hourly wage growth rose to nearly 5% in the second quarter of 2008. With productivity growth averaging 1% over the past ten years, this implies overheating and eroding competitiveness. Core inflation, which has gathered momentum, points in the same direction.

Financial turmoil will have a material impact

Credit has expanded strongly in recent years, but with rising defaults, notably by property developers, a couple of small banks have recently been taken over by competitors and a medium-sized bank was taken over and closed down by the central bank in the early autumn. The spread between secured and unsecured interbank interest rates has widened. Tighter credit conditions are likely to weigh on activity well into 2009, notwithstanding the unlimited Government-backed guarantee issued in

Denmark



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Denmark: Demand, output and prices

	2005	2006	2007	2008	2009	2010
	Current prices DKK billion	Percentage changes, volume (2000 prices)				
Private consumption	759.8	3.8	2.3	1.5	0.3	0.8
Government consumption	401.3	2.0	1.6	0.9	1.5	1.0
Gross fixed capital formation	304.8	14.0	5.9	0.6	-4.3	-2.1
Final domestic demand	1 465.8	5.4	2.9	1.1	-0.5	0.2
Stockbuilding ¹	5.9	0.6	-0.3	-0.3	-0.2	0.0
Total domestic demand	1 471.8	6.0	2.6	0.8	-0.5	0.2
Exports of goods and services	761.6	9.0	1.9	2.6	0.5	3.4
Imports of goods and services	685.2	14.1	3.8	4.0	0.4	2.2
Net exports ¹	76.4	-1.8	-0.9	-0.7	0.1	0.7
GDP at market prices	1 548.2	3.9	1.7	0.2	-0.5	0.9
GDP deflator	—	2.0	1.7	3.4	2.3	2.2
<i>Memorandum items</i>						
Consumer price index	—	1.9	1.7	3.5	1.6	1.6
Private consumption deflator	—	2.1	1.9	2.5	1.5	1.6
Unemployment rate ²	—	3.9	3.7	3.1	4.0	4.5
Household saving ratio ³	—	-3.1	-2.8	-1.9	-0.7	1.7
General government financial balance ⁴	—	5.0	4.4	2.4	0.1	-0.6
Current account balance ⁴	—	2.7	1.1	0.8	0.9	2.0

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. Based on the Labour Force Survey, being ½-1 percentage point above the registered unemployment rate.

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

4. As a percentage of GDP.

Source: OECD Economic Outlook 84 database.

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October, covering all deposits and other bank liabilities except subordinated loan capital.

Housing wealth losses will depress consumption and construction will contract

House prices are now declining and the rate of forced sales has risen over the past year, albeit from a low level. Even only a partial reversal of the spectacular house price gains seen in recent years will entail strong negative wealth effects which will weigh heavily on private consumption. Household borrowing has already slowed as interest rates have increased. With the saving ratio negative over the past four years, the reduction in debt-financed consumption should be expected to continue throughout 2009-10. The acceleration in both private and public sector pay, coupled with tax cuts worth 0.2% of GDP in 2009, will underpin disposable income growth. But the effects on consumption will be moderated by falling employment and general uncertainty. At the same time, housing construction is set to contract sharply. Construction permit issuance has plunged, and with a shrinking backlog of sites under construction, the fall in private residential investment that started in the first half of 2008 is bound to become more pronounced.

**The fixed exchange rate
requires policy discipline**

In late October 2008, capital outflows forced the central bank to hike its interest rate to keep the exchange rate at its central parity. Consequently, the short-term interest rate differential vis-à-vis the euro area widened to about 1 percentage point. The tensions are likely to be eased by a large-scale euro lending facility put in place since then. Fiscal policy must also be cautious, however. Aggressive fiscal stimulus to keep unemployment at recent record-low levels would magnify the loss of competitiveness and, ultimately, challenge the stability of the fixed exchange rate regime. This would make it difficult to lower interest rates in line with cuts in the euro area.

**With weak growth,
capacity pressures will ease**

With all major demand components weakening, GDP is projected to contract mildly in 2009. Headline inflation will fall along with global commodity prices. Starting from a situation of acute labour shortages, however, underlying inflation pressures will ease only gradually; the unemployment rate will not exceed its estimated structural level before 2010. The accumulated loss of competitiveness means that recoveries abroad will not feed through fully to Danish export demand. Against this backdrop, business investment is set to decline. Weak activity, low asset prices and falling revenues from North Sea oil production will lead to a fiscal deficit in 2010.

**Financial turmoil is the
overriding risk**

Recent events illustrate the unpredictable nature of financial turmoil. A more dramatic fallout than seen so far, combined with the accumulated loss of competitiveness and imbalances that have built up in the housing market, could prolong the downturn.

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This book has...



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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

	2008	2009	2010	2008	2009				2010				Q4 / Q4			
				Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2008	2009	2010
Per cent																
Real GDP growth																
United States	1.4	-0.9	1.6	-0.3	-2.8	-2.0	-0.8	0.6	1.2	1.7	2.1	2.7	2.9	0.1	-0.3	2.3
Japan	0.5	-0.1	0.6	-0.4	-1.0	0.8	0.6	-0.3	0.2	0.7	0.9	1.0	1.0	-0.4	0.3	0.9
Euro area	1.0	-0.6	1.2	-0.9	-1.0	-0.8	-0.4	0.1	0.7	1.3	1.7	2.2	2.5	0.0	-0.1	1.9
Total OECD	1.4	-0.4	1.5	-0.2	-1.4	-0.8	-0.2	0.5	1.1	1.7	2.0	2.5	2.7	0.2	0.2	2.2
Inflation ¹																
	year-on-year															
United States	3.6	1.2	1.3	4.4	2.8	2.1	1.3	0.3	1.1	1.3	1.3	1.2	1.2			
Japan	1.4	0.3	-0.1	2.0	1.4	1.1	0.5	-0.3	-0.2	-0.1	-0.1	-0.1	-0.1			
Euro area	3.4	1.4	1.3	3.9	2.7	1.9	1.4	1.0	1.3	1.3	1.3	1.3	1.3			
Total OECD	3.3	1.7	1.5	3.8	2.9	2.3	1.7	1.1	1.5	1.5	1.5	1.4	1.4			
Unemployment rate ²																
United States	5.7	7.3	7.5	6.0	6.5	6.9	7.2	7.4	7.5	7.6	7.6	7.5	7.4			
Japan	4.1	4.4	4.4	4.1	4.3	4.4	4.4	4.4	4.4	4.4	4.4	4.4	4.4			
Euro area	7.4	8.6	9.0	7.5	7.8	8.2	8.5	8.8	9.0	9.1	9.1	9.0	9.0			
Total OECD	5.9	6.9	7.2	6.0	6.3	6.6	6.9	7.1	7.2	7.3	7.3	7.2	7.2			
World trade growth																
	4.8	1.9	5.0	3.4	1.0	1.3	1.9	2.5	3.8	5.3	6.2	6.9	7.3	2.9	2.4	6.4
Current account balance ³																
United States	-4.9	-3.9	-3.6													
Japan	3.8	4.3	3.9													
Euro area	-0.4	-0.1	0.0													
Total OECD	-1.5	-1.1	-1.1													
Fiscal balance ³																
United States	-5.3	-6.7	-6.8													
Japan	-1.4	-3.3	-3.8													
Euro area	-1.4	-2.2	-2.5													
Total OECD	-2.5	-3.8	-4.1													
Short-term interest rate																
United States	3.3	1.7	2.0	3.2	3.6	1.8	1.4	1.7	2.0	1.8	1.8	2.0	2.5			
Japan	0.8	0.7	0.4	0.8	0.9	0.7	0.7	0.7	0.6	0.6	0.5	0.4	0.4			
Euro area	4.7	2.7	2.6	5.0	4.6	2.9	2.7	2.7	2.6	2.5	2.5	2.6	2.8			

Note: Real GDP growth, inflation (measured by the increase in the consumer price index or private consumption deflator for total OECD) and world trade growth (the arithmetic average of world merchandise import and export volumes) are seasonally and working-day (except inflation) adjusted annual rates. The "fourth quarter" columns are expressed in year-on-year growth rates where appropriate and in levels otherwise. 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 28 October 2008; in particular 1\$ = 95.69 yen and 0.80 €;
- price of oil for a barrel of Brent crude is fixed at 60\$;
- in the United States, the target federal funds rate is assumed to be eased to ½ percent early in 2009 and then, as the economic environment begins to improve, interest rates are raised towards the end of 2009 and in 2010 reaching 2½ per cent by December 2010;
- in the euro area, policy rates are assumed to be eased by 125 basis points by early 2009. They will then remain at 2% until mid-2010 before being gradually raised to around 2½ per cent by the end of 2010;
- in Japan, the policy interest rate is assumed to remain at 30 basis points in 2009 and 2010.


The cut-off date for other information used in the compilation of the projections is 14 November 2008.

1. USA; price index for personal consumption expenditure, Japan; consumer price index and the euro area; harmonised index of consumer prices.

2. Per cent of the labour force.

3. Per cent of GDP.

Source: OECD Economic Outlook 84 database.

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