

Economic Survey, May 2011 – The Forecast

The Danish economy is currently in a moderate recovery, supported by high growth in key export markets, low interest rates and growth in real disposable incomes. **GDP** expanded by 2.1 per cent in real terms in 2010, driven particularly by exports and private consumption. Following a slowdown in late 2010, growth appears to have continued at the same pace this year, and in 2011 GDP is expected to grow by 1.9 per cent, while growth in 2012 is expected at 1.7 per cent.

In 2010, GDP growth was 0.1 percentage point higher than estimated in the *Economic Survey*, December 2010, and the estimates for both 2011 and 2012 have been adjusted upwards by 0.2 percentage points. The revisions are mainly due to higher exports in 2011, while private consumption has been adjusted upwards in 2012. Growth in residential investments and in business investments have been revised up slightly in both years.

Despite the rise in inflation, **households' real disposable incomes** are expected to increase by 2 per cent, partly due to low interest rates, following a rise in incomes in 2010 of 4½ per cent (excluding reimbursements from the Special Pension scheme, SP) as a result of tax cuts. Incomes are expected to expand further by 3¼ per cent in 2012, due to the reimbursement and fewer payments of Voluntary Early Retirement Pension (VERP) contributions following the pension reform, increasing real wages and a high annual adjustment of public transfer rates. In both 2011 and 2012 the tax initiatives in the Fiscal Consolidation Agreement and the financing of the tax reform in Spring Package 2.0 pulls in the opposite direction.

Private consumption is projected to grow by 1¾ per cent in 2011 and by 2¼ per cent in 2012 following a growth rate of 2¼ per cent in 2010. The profile reflects the increases in income. The savings rate is expected to stop rising. Households' assets have increased robustly in the course of 2010 due to a rise in stock prices. In 2011 and 2012 assets are expected to be broadly stable in real terms.

The price of **single-family houses** is expected to be broadly stable in 2011-12 after rising by 2½ per cent in 2010.

Residential investments are projected to grow by 2-3 per cent in both 2011 and 2012, partly due to an increase in subsidised housing. The residential investments reached a historical high level of just over 6½ per cent of GDP in 2006. The current level of residential investments corresponds to the level in the mid-1990s. This reflects a high level of repairs and improvement of houses, while the level of new constructions is low.

Fixed business investments are projected to grow by around 6 per cent in both 2011 and 2012, due to the rise in production in the private business sector, low interest rates and a historical low investment ratio in 2010.

The large adjustments in **inventories** after the financial crisis are now expected to have come to an end, and inventories are projected to grow weakly by 0.1 per cent of GDP in 2011, and then to remain stable in 2012.

Based on the budgets for regions and municipalities as well as the Budget Bill, real growth in **public consumption** in 2011 is expected at -0.3 per cent. In 2012, public consumption is expected to grow by 0.5 per cent on the back of the Fiscal Consolidation Agreement. According to the preliminary national accounts, public consumption grew by 1.0 per cent in 2010, in line with the December estimate.

After a significant growth of 12 per cent in 2009-10 as part of the growth supporting measures, **public investments** are expected to grow by 7 per cent in 2011. In 2012, public investments have technically been set to fall by 7 per cent as a part of the normalisation of the investment level towards 2013.

Market growth for Danish manufactures is expected at 7 per cent in 2011 and 6¼ per cent in 2012. The relatively high growth, especially in 2011, reflects mainly high growth in Germany and Sweden, as well as continued high growth in East Asia, and implies a significant potential for growth in Danish exports.

Wage growth in Denmark (adjusted for exchange rate fluctuations) is expected to be in line with the wage growth abroad in 2011 and to be slightly higher in 2012. This will contribute to a slight deterioration of Danish **competitiveness**. In 2010, Danish wage growth was significantly lower than abroad (measured in the same currency) due to the lower effective exchange rate of the krone. In almost the entire period from 2001 to 2009, Danish wage growth has been markedly higher than abroad. Danish productivity growth has at the same time been weaker than abroad for most of the years. This has put Danish competitiveness under pressure. In 2008-10, the gap in productivity in Danish manufacturing companies compared to abroad has been closed, but it requires a longer period with lower wage growth in Denmark than abroad and/or higher productivity growth in order to catch up in terms of competitiveness.

On this background, **manufacturing exports** are expected to rise by 5½ per cent in 2011 and by 4½ per cent in 2012. The estimates imply a continued, moderate loss of market shares following a significant loss in 2009. **Total exports** of goods and services are expected to grow in real terms by 4½ per cent in 2011 and 3¾ per cent in 2012.

The growth in demand is expected to lead to a rise in **imports** of goods and services by 4½-4¾ per cent in both 2011 and 2012.

The **current account** surplus is expected to be DKK 81 bn or around 4½ per cent of GDP in both 2011 and 2012. The estimates have been revised upwards by

around DKK 10 bn in both years compared to the December Survey. The surplus in 2010 was, according to available data, DKK 16½ bn higher than estimated in December, primarily due to improved balance of services.

Due to the continued, high current account surpluses, **net foreign assets** are expected to rise to DKK 330 bn or close to 18 per cent of GDP by the end of 2012, compared to DKK 168 bn ultimo 2010.

Private business sector **productivity** rose by just over 6 per cent in 2010 following the weak development in productivity over the previous years, including a fall of just over 4 per cent in 2007-09. Even after the cyclical recovery of productivity, productivity growth has been remarkably low seen over the whole period 2007 to 2010. A quite large, but declining, productivity growth is expected in 2011 and 2012 of almost 3 and 2½ per cent respectively.

Employment was stabilised in 2010 and the labour force survey for the 1st quarter showed broadly unchanged employment compared to the 4th quarter of 2010. Growth in private business sector production and a more moderate growth in productivity are expected to imply a rise in private employment by 3,000 persons in 2011 and 7,000 persons 2012. Public employment is expected to be unchanged in 2011-12 due to broadly constant public consumption, following a rise in public employment by 10,000 persons in 2010.

The **labour force** is estimated to decline slightly by 4,000 persons in 2011 following a drop of close to 45,000 persons in 2010. In 2012 the growth in the labour force is expected to correspond to the decline this year.

Unemployment has developed more favourably than expected. With improved employment developments, **gross unemployment** (including people in activation measures) is expected to fall to 160,000 persons in 2011 and 152,000 in 2012 (5½ and 5¼ per cent of the labour force respectively) compared to 164.000 persons in 2010.

Registered unemployment is expected to fall from 114,000 persons in 2010 to 107,000 in 2011. Compared to the December Survey, the estimated registered unemployment has been revised down by 14,000 persons in 2011. In 2012 registered unemployment is expected to fall slightly to 104,000 persons or 3½ per cent of the labour force. This is broadly in line with the estimated structural unemployment rate.

In 2011, private sector **wage growth** is expected at 2.5 per cent, and in 2012 wage growth is expected to increase to 2.9 per cent partly due to the lower unemployment.

The **consumer price inflation** has increased over the last 6 months, primarily due to rising prices on oil and food. For the year 2011, consumer price inflation is

expected at 2.5 per cent, or 0.8 percentage points higher than in the December Survey. In 2012 consumer price inflation is expected to fall to 1.5 per cent, partly due to lower contributions from energy, food and indirect taxes.

According to preliminary estimates, the **public finance** deficit was 2.9 per cent of GDP in 2010. Given the planned economic policy and the assessment of the Danish economy, the deficit is estimated to 4.1 per cent of GDP in 2011 and 4.3 per cent of GDP in 2012. The initiatives in the Fiscal Consolidation Agreement strengthens public finances in 2011 and 2012, but the effect is partly offset by low revenues from pension yield taxation following the historically high revenues in 2010, and realised losses concerning the Credit Package and individual state guarantees in primarily Amagerbanken for DKK 7¼ bn. Moreover, in 2012 the VERP-contributions are reimbursed (one-off) in line with the pension reform, a reform that strengthens public finances significantly in the longer term. Excluding the reimbursement, the public deficit is adjusted downwards in all three years compared to the December Survey.

The **structural balance** (cyclically adjusted and adjusted for temporary fluctuations in for example pension yield taxes and oil revenues) is estimated to strengthen from a deficit of 1.6 per cent of GDP in 2010 to a deficit of 1.0 per cent in 2012.

Public gross debt (EMU definition) stood at 43½ per cent of GDP by the end of 2010 and is expected to increase slightly to 45½ per cent of GDP by the end of 2012. By the end of 2010, the **public net asset** (including both assets and liabilities) stood at just over 1 per cent of GDP. Due to the public finance deficits, the net asset is expected to turn into **public net debt** of just over 7 per cent of GDP ultimo 2012.

The **fiscal policy** in 2009-2011 is generally estimated to be approximately neutral for demand growth in 2011, even if the planned fiscal policy for 2011 alone has an estimated effect on activity of -0.4 per cent of GDP (and -0.3 per cent of GDP when consumption expenditures are assumed to precisely match the agreed level). This reflects lagged positive effects on demand in 2011 from the expansionary fiscal measures in 2009 and especially in 2010. The fiscal policy in 2011 should also be seen in connection with low interest rates in Denmark. In 2012 the one-year fiscal effect is estimated at -0.3 per cent of GDP, while the rise in output from the reimbursement of VERP-contributions is estimated at ¼ per cent of GDP. The total effect on activity is therefore estimated to be close to neutral.

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For further information on developments in public finances, please see the Budget Outlook.

Annex:

Table 1: Key figures for the Danish economy

Table 2: Key figures compared to the December Survey.

	2007	2008	2009	2010	2011	2012
Percentage change from previous year						
Real GDP	1.6	-1.1	-5.2	2.1	1.9	1.7
Trade-weighted GDP abroad	3.1	-0.5	-4.1	2.9	2.6	2.3
Markets for Danish manufactures	8.3	1.2	-10.6	7.3	7.0	6.2
International competitiveness	-2.8	-3.6	-3.3	3.6	-0.5	-0.7
Export of manufactures, volume	2.2	1.3	-13.1	6.2	5.5	4.6
Hourly wages	4.1	4.6	3.0	2.7	2.5	2.9
Consumer price index	1.7	3.4	1.3	2.3	2.5	1.5
Price index for single-family houses	4.9	-3.7	-12.8	2.6	0.5	0.0
Merchandise export prices	2.2	7.1	-6.1	4.6	3.0	1.4
Merchandise import prices	1.8	6.6	-9.0	4.5	4.2	1.2
Merchandise terms of trade	0.5	0.4	3.2	0.1	-1.1	0.2
Productivity in private non-agricultural sector	-0.1	-1.9	-2.4	6.3	2.9	2.5
Real disposable income of households ¹⁾	-0.8	0.5	0.7 ²⁾	4.6	2.0	3.3
Labour market						
Labour force (thousands)	2,939	2,960	2,922	2,878	2,874	2,879
Employment (thousands)	2,861	2,909	2,824	2,764	2,767	2,775
Of which in private sector	2,038	2,097	1,994	1,924	1,928	1,935
in public sector	823	812	830	840	840	840
Percentage change in total employment	2.8	1.7	-2.9	-2.1	0.1	0.3
Gross unemployment (thousands)	103	74	129	164	160	152
Gross unemployment (per cent)	3.5	2.5	4.4	5.7	5.6	5.3
Unemployment (thousands)	78	52	98	114	107	104
Unemployment rate (per cent)	2.7	1.7	3.4	4.0	3.7	3.6
Unemployment rate, EU-def. (per cent)	3.8	3.3	6.0	7.4	7.2	6.8
Long term bond yields, exchange rate						
10-year government bonds	4.3	4.3	3.6	2.9	3.6	4.0
30-year mortgage credit bond	5.4	6.1	5.5	4.7	5.2	5.6
The effective krone rate (1980=100)	103.2	105.8	107.8	104.0	104.5	105.0
Balance of payments						
Goods and services (bn DKK)	38.7	55.2	63.2	97.5	96.8	98.0
Current account (bn DKK)	23.0	46.2	59.0	95.6	81.1	81.2
Current account (per cent of GDP)	1.4	2.7	3.6	5.5	4.5	4.3
Net foreign assets, ultimo (bn DKK)	-96.0	-98.7	75.6	167.5	249.3	331.3
Net foreign assets (per cent of GDP)	-5.7	-5.7	4.6	9.6	13.8	17.7
Public finances						
Government net lending (bn DKK)	81.4	56.9	-46.5	-50.8	-74.3	-80.0
Government net lending (per cent of GDP)	4.8	3.3	-2.8	-2.9	-4.1	-4.3
General government gross debt,	466.9	600.1	691.9	760.7	767.5	852.5
General government gross debt,	27.5	34.5	41.8	43.6	42.5	45.5
Tax burden (per cent of GDP)	49.1	48.2	48.2	48.2	46.5	46.5
Expenditures (per cent of GDP)	50.0	51.0	57.2	57.0	56.5	56.2

1) Adjusted.

2) Including the disbursement of SP-savings, real disposable income grew by 4.5 per cent in 2009.

Table 2
Key figures compared to the December Survey

	2011		2012	
	Dec.	May	Dec.	May
Percentage change from previous year				
Private consumption	2.2	1.8	1.8	2.3
Total public demand	0.5	0.3	-0.4	-0.1
- public consumption	-0.3	-0.3	0.3	0.5
- public investment	9.4	7.0	-8.1	-7.0
Residential construction	1.5	2.6	3.0	3.3
Fixed business investments	5.0	6.1	4.1	5.9
Final domestic demand	1.9	1.8	1.4	2.0
Stock building (cont. to GDP growth)	0.1	0.1	0.1	0.0
Total domestic demand	1.9	1.9	1.5	2.0
Exports of goods and services	3.8	4.6	3.9	3.7
- of which manufactures	4.5	5.5	4.7	4.6
Total demand	2.6	2.8	2.3	2.6
Imports of goods and services	4.4	4.8	4.2	4.5
- of which goods	4.1	4.7	3.7	4.2
GDP	1.7	1.9	1.5	1.7
Gross value added	2.0	1.9	1.6	1.8
- of which private sector	3.4	3.2	2.6	2.9
Change in 1,000 persons				
Labour force	6	-4	-1	4
Employment	0	3	4	7
Of which in private sector	3	3	4	7
in public sector	-3	0	0	0
Gross unemployment	7	-4	-9	-8
Net unemployment	6	-7	-6	-3

Table 2 (continued)
Key figures compared to the December Survey

	2011		2012	
	Dec.	May	Dec.	May
Percentage change from previous year				
Merchandise export prices	2.2	3.0	1.6	1.4
Merchandise import prices	2.9	4.2	1.7	1.2
Merchandise terms of trade	-0.7	-1.1	-0.1	0.2
House prices, single-family house	2.0	0.5	0.0	0.0
Consumer prices	1.7	2.5	1.7	1.5
Hourly compensation, private sector	2.4	2.5	2.7	2.9
Real disposable income, private sector	3.2	2.2	0.4	2.3
Real disposable income of households ¹⁾	1.6	2.0	0.5	3.3
Productivity in private non-agricultural sector	3.5	2.9	2.8	2.5
Per cent per year				
Interest rate 1-year adjustable rate loan	1.7	1.8	2.3	2.7
10-year government bonds	3.4	3.6	4.0	4.0
30-year mortgage credit bond	4.9	5.2	5.5	5.6
Balances				
Current account (bn DKK)	69.0	81.1	71.1	81.2
Government net lending (bn DKK)	-83.9	-74.3	-62.5	-80.0
Gross unemployment (thousands)	172	160	164	152
Net unemployment (thousands)	121	107	116	104
External assumptions				
Trade-weighted GDP abroad, per cent	2.1	2.6	2.2	2.3
Markets for Danish manufactures, per cent ²⁾	6.3	7.0	6.7	6.2
Exchange rate, DKK per \$	5.4	5.2	5.4	5.1
Oil price, \$ per barrel	89.2	110.3	93.1	109.1
Oil price, DKK per barrel	479.7	569.9	500.7	552.5

1) In 2012, the reimbursement of VERP-pension is included.

2) China has now been included in the export market growth calculations. The number for December has been adjusted correspondingly.