

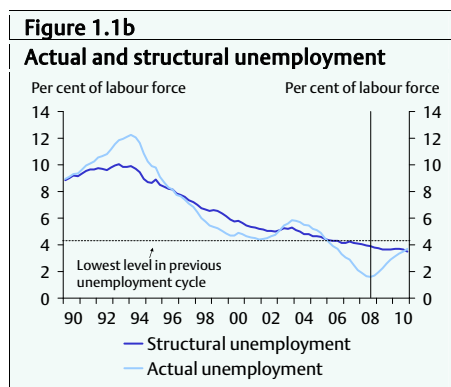
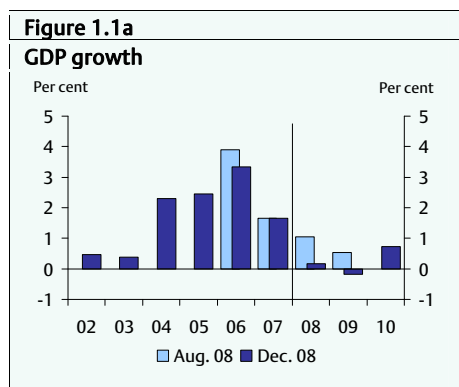
Economic Survey December 2008 – English Summary

Short term outlook

The outlook for Danish economy is marked by the financial turmoil and bleak prospects for the global economy. The exchange rate and the interest rate spread vis-à-vis the euro area have been under pressure, confidence indicators have fallen further and public finances are expected to deteriorate amid falling stock and oil prices. In 2010 the fiscal balance is expected to turn clearly negative for the first time since the mid-1990's.

The recent escalation in the financial turmoil, combined with the gloomy prospects for the international economy, has led to a downward revision of an already weak outlook. GDP is now projected to contract marginally in 2009, and grow moderately in 2010, *cf. figure 1.1a*.

The slowdown in Danish economy started already in the end of 2006, and according to present available information, GDP growth has been close to zero in 2008. The total period of weak growth is thus expected to last for 3-4 years. Weak GDP growth has been accompanied by sturdy growth in domestic demand up until the turn of the year, and employment has risen to a very high level. This development has been reflected in high import growth, a significant fall in productivity and rising unit labour costs, indicating substantial pressures on production capacity. Total demand is now weakening due to the financial turmoil, the slowdown in external demand, and the falling house prices. Labour market pressures are therefore expected to ease.

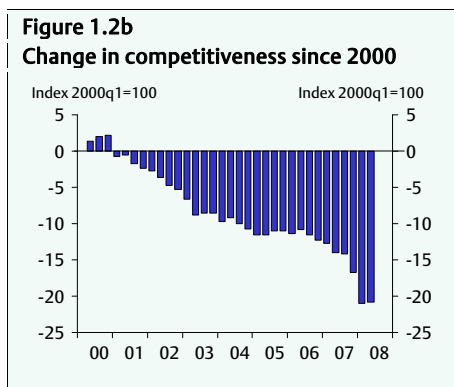
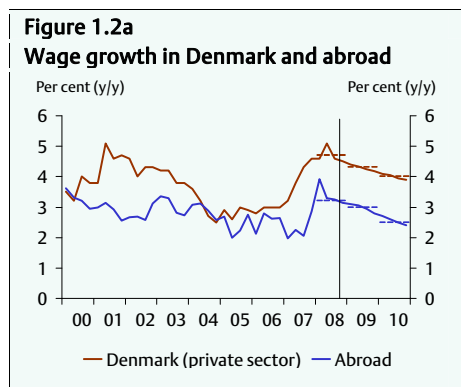


Source: Statistics Denmark and own calculations.

Labour market pressures continue, however, to be an issue also in the period ahead, due to Denmark's cyclical starting point. Unemployment rose a little in October, as expected, but from a very low level, significantly below the estimated structural level of unemployment, *cf. figure 1.1b*. In some sectors there still is a reported lack of la-

bour. Cost competitiveness for Danish producers is still deteriorating and inflation is higher than in the euro area, in part due to the labour market pressures.

Ensuring moderate wage developments is therefore still a priority in Denmark. Despite the weakening outlook, and easing wage pressures, the cost competitiveness among Danish producers will still be deteriorating. This reflects the parallel cyclical slowing among Danish trading partners, of which most had substantially lower capacity utilisation even before the recent weakening of growth prospects. The dampening effects on wages may therefore be less pronounced in Denmark than abroad, cf. figure 1.2a. The accumulated loss in competitiveness over the last few years may prolong the downturn in Danish economy, cf. figure 1.2b.



Note: Horizontal dotted lines in figure 1.2a are estimated annual wage growth in Denmark and abroad in 2008-10. Figure 1.2b shows relative unit labour costs in Denmark and its most important trading partners based on OECD data.

Source: OECD, Statistics Denmark, DA and own calculations.

The forecast is subject to an exceptional degree of uncertainty, reflecting the risks of a prolonged financial turmoil and tightening credit conditions stemming from deleveraging in the banking sector, which could reduce the stimulating effects on demand from the accommodative monetary policy. Thus, the main risk is the emergence of a substantial credit crunch, where well-functioning, creditworthy households and companies would have trouble getting finance for their activities, which might amplify the adjustment in the housing market.

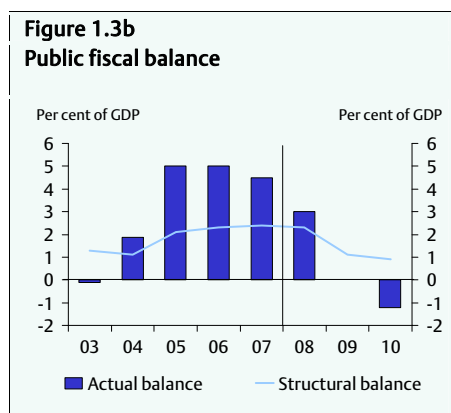
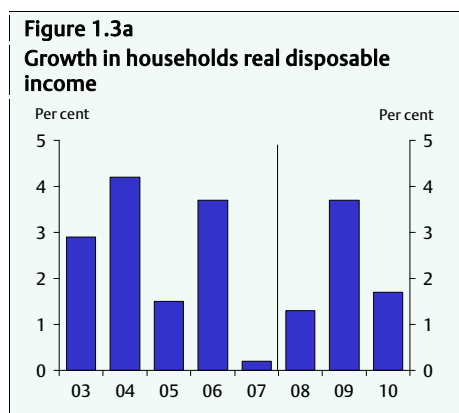
On the other hand, domestic demand will be supported by economic policy measures. Monetary policy rates are expected to fall to a very low level, which may support the housing market and the financial stability, especially if the financial turmoil is contained. At the same time, fiscal policy is eased due to high growth in public consumption and cuts in personal income taxes. In addition, automatic stabilisers are quite powerful in Denmark.

	2008		2009		2010
	Aug.	Dec.	Aug.	Dec.	Dec.
Real growth¹⁾, per cent					
Gross domestic product	1.1	0.2	0.5	-0.2	0.7
Private consumption ²⁾	1.6	0.9	1.1	0.7	1.1
Public consumption ²⁾	1.6	1.6	1.1	1.2	1.0
Export markets, manufacturing	5.0	3.7	4.0	-0.3	3.1
Per cent of GDP					
Public budget balance	3.6	3.0	3.0	0.0	-1.2
Current external account	1.3	1.7	2.0	1.8	2.3
1,000 persons					
Increase in overall employment	25	10	-21	-37	-49
Unemployment	49	50	64	79	99
Per cent increase					
House prices, single-family house	-4.0	-4.0	-2.0	-4.5	0.0
Consumer prices	3.5	3.3	2.7	1.6	2.2
Hourly compensation, private sector	4.7	4.7	4.6	4.3	4.0
Yield on 10-year government bonds	4.5	4.4	4.6	4.2	4.4
Oil price, \$ per barrel	117.3	98.2	123.1	55.0	55.0
Exchange rate, DKK per \$	4.8	5.1	4.7	5.8	5.8
Oil price, DKK per barrel	561.9	502.2	579.2	319.3	319.3
1) The real growth rates of the macro variables are calculated using chain indices.					
2) Real growth of public consumption reflects growth in inputs, not improvements of output and is therefore not readily comparable to private consumption growth.					

Household's real disposable income is expected to rise by 3¾ per cent next year, despite the fall in employment. This is almost in line with the rise in 2004, when the so-called Spring Package was implemented (fiscal stimulus package containing income tax reductions and other initiatives), *cf. figure 1.3a*. The expected rise in real disposable income is mainly due to tax cuts, relatively high wage growth, and falling oil and other commodity prices. Real disposable income is also underpinned by the continued suspension in 2009 of contributions to the Special Pension scheme (SP).

Strong income growth, lower interest rate and falling house prices may induce a significant fall in the housing burden (share of real disposable income spent on housing) especially among first-time buyers and a gradual improvement in consumer confidence, provided that the financial turmoil is contained. A lower housing burden will support both private consumption and the housing market.

Denmark’s starting point with substantial pressures on the labour market and with the exchange rate under pressure means that the challenges in Denmark have a different character than in countries entering 2009 with a relatively low level of capacity utilisation. The main challenges in Denmark is securing financial stability, reducing the interest rate spread, and dampening labour cost growth.



Source: Statistics Denmark and own calculations.

Fiscal policy and public finances

Fiscal policy is relatively expansionary in Denmark, and in total fiscal policy is estimated to add a fiscal impulse of 0.2 per cent of GDP in 2008 and 0.4 per cent of GDP in 2009. The direct budgetary impact from active fiscal policy, a basis for calculating the fiscal impulse, is estimated to almost 1 per cent of GDP in 2009.

Due to active fiscal policy decisions, the estimated structural surplus is reduced from around 2 per cent of GDP in 2008 to around 1 per cent in 2009, *cf. figure 1.3b*. The structural balance is a measure of the underlying development in public finances, taking cyclical and other temporary effects into account.

With Denmark’s starting point and the already planned fiscal easing, the expected rise in unemployment should not lead to further fiscal policy easing. Attempts to keep unemployment at its current extraordinary low level will lead to increased imports, a further deterioration of competitiveness, weakening public finances and increased pressure on the interest rate, and may lead to an even higher increase in unemployment than currently projected.

Periods of financial distress raises the requirement for economic policy discipline in small economies, like Denmark, with a fixed exchange rate regime outside the euro area. Fiscal policy should support the credibility surrounding the fixed exchange rate regime by ensuring sustainable public finances, and will in this manner contribute to an inflation level in line with the euro area and a lowering of the interest rate spread vis-à-vis the euro area. Lower interest rates will support the housing market and the

financial system at the same time as capacity utilisation normalizes and wage pressures dampen.

Also monetary policy conditions are conducive to growth. The European Central Bank (ECB) has already eased the monetary policy rates considerably, and is expected to ease further towards mid-2009. The expected fall in interest rates from 2008 onwards will support demand and is estimated to stimulate the activity by 0.4 percentage points in 2009 and 0.9 percentage points in 2010. The effect depends on a containment of the financial turmoil, so that money market rates and banks lending rates follow the easing in monetary policy rate, and that tightened credit standards and balance sheet adjustments do not inflict a major slowdown in activity.

The automatic stabilisers, including automatic changes in tax payments and transfer payments, will dampen the downturn. The dampening effects from automatic stabilisers are more powerful in Denmark than in most other countries. Compared to discretionary fiscal stimulus, automatic stabilisers have the advantage of being well timed, and do not affect the sustainability of public finances.

The financial turmoil and weaker external demand – especially as reflected in the large drop in energy prices and equity prices – along with fiscal policies are expected to lead to a significant weakening of the public finances in the coming years. The surplus is expected to fall from 4½ to 5 per cent of GDP 2-3 years ago, to 3 per cent of GDP this year and around balance next year. In 2010 a deficit of 1.2 per cent of GDP is expected. The striking shift also reflects that the high surpluses the last few years have been affected by temporary conditions. In 2010 public finances will be negatively affected by a one-off cost to the pension sector of DKK 15 billion (around € 2 billion).

In Denmark, where the starting point is significantly better than many other countries and there still is some room for manoeuvre as opposed to countries that have not been saving in “good times”, it is important that this room is used wisely. Further easing now will reduce, or remove, the fiscal policy options further ahead, when a real need for discretionary fiscal policies might arise.

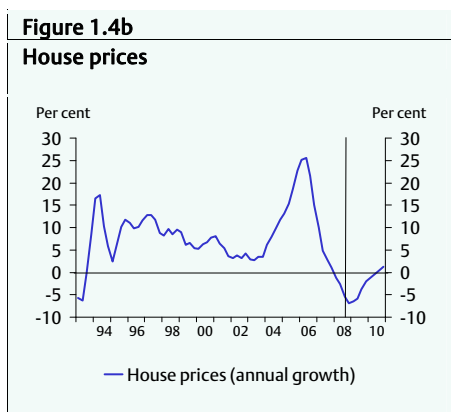
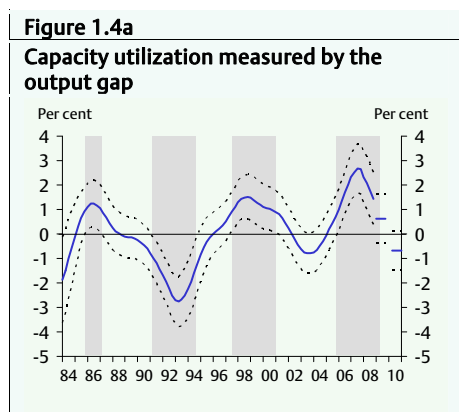
The weakening of public finances means that further fiscal easing and new initiatives will increase a quite large expected deficit. At the same time, further easing can bring the structural surplus under its medium term target of (at least) balance in 2015, and thereby increasing the requirements to future economic policy setting. This is to be seen in light of the uncertainty surrounding estimates of the structural surplus, especially in periods of big changes in the economic conditions. Historical evidence shows that there is a tendency of underestimating the deterioration of public finances in downturns.

The central targets in the 2015-plan, presented by the government in 2007, are sustainable fiscal policies and surplus on the structural balance all the way towards 2015.

The updated 2015-plan in Denmark’s *Convergence Program 2008*, indicates that these targets are fulfilled, given the same structural policy requirements as in 2007, even though public finances are under increasing pressure.

Capacity utilisation and wage developments

On the back of the slowdown in activity this year, where GDP-growth is expected to be around 0.2 per cent, GDP-growth is expected to turn slightly negative next year, before growing moderately again in 2010. GDP-growth is estimated at -0.2 per cent in 2009 and ¾ per cent in 2010. This is a continued slowdown from growth rates of 3.3 per cent in 2006, and 1.7 per cent in 2007. The output gap is expected to be close to neutral in 2010, and the movement towards a more neutral cyclical stance takes place faster than previously expected, cf. figure 1.4a.



Note: Dotted lines in figure 1.4a indicate the uncertainty surrounding the output gap estimates. Shaded areas mark upturns and downturns defined by output gap significantly different from zero. Horizontal lines in 2009-10 are estimated annual levels. House prices in figure 1.4b are prices for single family dwellings, national average.

Source: Statistics Denmark and own calculations.

Employment has increased by 185,000 persons (almost 7 per cent) from the end of 2004 to the beginning of 2008. According to preliminary national accounts data, employment growth has been slowing in 2008, and a further slowdown is expected in 2009-10, in line with low growth in activity.

Unemployment is expected to rise from 1.7 per cent of the labour force in October 2008 to around 3½ per cent in 2010. The estimate is subject to considerable uncertainty. It can not be ruled out that Danish employers will reduce the number of employees more than expected, due to the weak development in productivity, worsened credit conditions, and the reduced export opportunities, stemming both from the financial turmoil and weak growth prospects abroad.

On the other hand, the rise in unemployment, especially in 2010, may be reduced by a significant growth in household’s real disposable income and falling interest rates,

by a reduction in the labour force due to demographic factors, and by reduced working hours and fewer cross-border commuters due to the cyclical downturn. The unemployment rate is expected to reach its structural level in 2010, and the rise will gradually reduce the labour market pressures. The unemployment level will, however, still be lower than the lowest level in the previous unemployment cycle, reached in 2001. Also, in a historical perspective employment will stay at a relatively high level, and unemployment at a correspondingly low level. Due to the parallel slowdown in other countries, Danish wages are expected to rise more than abroad, contributing to weak export performance.

Table 1.2
Employment, labour force, and unemployment

	2006- level	Avg. 1990- 2007	2007	2008		2009		2010
				Aug.	Dec.	Aug.	Dec.	Dec.
	1,000 persons			Change, 1,000 persons				
Private sector	1,956	11	79	24	14	-22	-44	-50
Public sector	826	3	-3	1	-5	1	7	1
Total employment	2,781	15	76	25	10	-21	-37	-49
Labour force	2,891	4	44	-4	-18	-6	-17	-21
Unemployment	109	-11	-32	-28	-28	15	20	28

Source: ADAM and own calculations.

Domestic demand

Overall, domestic demand growth is projected to weaken to 0.9 and -0.2 per cent in 2008 and 2009. In 2010 domestic demand is expected to turn positive again, by 0.3 per cent. This is a significant slowdown compared to 2005-06 when domestic demand grew by 3.4 and 5.3 per cent respectively.

Growth in private consumption has been adjusted downwards compared to the August Survey and is now estimated at 0.9 per cent in 2008. In terms of annual averages, the slowing is expected to continue in 2009 with 0.7 per cent growth. In 2010 growth in private consumption is expected to rise to 1.1 per cent. Private consumption will be supported by relatively high growth in real disposable income in 2009-10 and falling interest rates.

Fixed business investments are expected to fall moderately from a very high level in 2009-10, due to more neutral capacity utilisation and the closing of the output gap, but underpinned by falling interest rates. Fixed business investments are expected to fall by 0.1 per cent in 2008, 4.2 per cent in 2009, and 2.1 per cent in 2010.

Residential investments are expected to fall by 5-6 per cent each year in 2008-10, mainly due to the developments in the housing market and the high construction

costs. The level of investments will still be high in a historical perspective. In 2007 residential investments reached a historical high and accounted for 7 per cent of GDP. House prices (national average for single family dwellings) are expected to fall by 4 per cent in 2008 and 4½ per cent in 2009. House prices are expected to stabilize in 2010, due to low interest rates, relatively high real income growth and lower housing burden, *cf. figure 1.4b*.

Public consumption is estimated to grow by 1.6 per cent in real terms in 2008 and 1.2 per cent in 2009. The estimate for 2008 is in line with the August Survey, while the estimate for 2009 is adjusted upwards by 0.1 percentage point, due to the budget agreement for 2009. In 2010 real growth in public consumption is estimated to 1.0 per cent – in line with the 2015-plan. In 2009-10 public consumption is expected to account for around 27 per cent of cyclically adjusted GDP. This is the highest share since 1983, and slightly higher than the 26½ per cent benchmark in the 2015-plan.

Public investment growth in 2008 has been adjusted upwards since the August Survey, and is now expected at 6.4 per cent in 2008 and 1.2 per cent in 2009. The adjustment is to be seen in light of an expected rise in local public investments due to exemptions granted this year and preliminary budget planning for 2009. In 2010 public investment growth is estimated to 3.8 per cent, in line with the 2015-plan.

International trade and the external current account

Real growth in manufacturing exports is expected to turn negative next year, falling from 1.9 per cent growth in 2008 to -1.2 per cent in 2009. In 2010 growth is expected to turn positive again, by 2.3 per cent. Growth in manufacturing exports has been adjusted downwards by 4 percentage points in 2009 since the August Survey, due to effects stemming from the financial turmoil. The slowdown is also due to deteriorating competitiveness and loss of market shares.

Exports of goods and services are expected to stagnate next year, following 3.3 per cent growth in 2008. Growth is dragged down in 2008-09 by lower energy exports due to declining production of oil and gas in the North Sea, while production is expected to increase in 2010. Exports are expected to grow by 2.0 per cent in 2010.

Slower expansion in total demand will lead to slower growth in imports, which is estimated at -0.1 per cent in 2009 and 1½ per cent in 2010. In 2008 imports are expected to grow by 4.8 per cent.

After a significant deterioration of the current account from a surplus of 4.3 per cent of GDP in 2005 to 0.7 per cent of GDP in 2007, an improvement is expected to 1.7 per cent in 2008 and 2.3 per cent of GDP in 2010, mainly due to higher export growth.

	2007	2005	2006	2007	2008	2009	2010
	Bill. DKK	Real growth, per cent					
Private consumption	826.7	3.8	4.4	2.4	0.9	0.7	1.1
Public consumption ²⁾	438.8	1.3	2.1	1.3	1.6	1.2	1.0
Public investment	29.3	0.8	16.4	-10.0	6.4	1.2	3.8
Residential construction	117.2	17.3	11.2	4.8	-4.4	-6.0	-5.0
Fixed business investment	230.2	-0.1	14.0	4.3	-0.1	-4.2	-2.1
Stock building ³⁾	9.5	0.2	-0.3	-0.3	0.2	0.0	0.0
Total domestic demand	1,651.7	3.4	5.3	1.9	0.9	-0.2	0.3
Exports of goods and services	882.8	8.0	9.1	2.2	3.3	-0.1	2.3
of which manufactures ⁴⁾	361.1	7.9	6.3	2.2	1.9	-1.2	2.0
Total demand	2,534.5	5.0	6.6	2.0	1.7	-0.2	1.0
Imports of goods and services	846.6	11.1	13.9	2.8	4.8	-0.1	1.5
of which goods	558.3	9.3	11.9	2.2	2.8	-0.5	1.2
Gross domestic product	1,687.9	2.4	3.3	1.6	0.2	-0.2	0.7
Gross value added	1,427.1	1.5	3.0	1.7	0.4	-0.2	0.8
of which in private non-agricultural sector	931.2	2.5	4.7	2.5	0.6	-0.6	0.7
GDP per capita (1,000 DKK)	309.4	2.2	3.0	1.2	-0.2	-0.4	0.5

1) The real growth rates of the macro variables are calculated using chain indices.
2) Real growth of public consumption reflects growth in inputs, not improvements of output and is therefore not readily comparable to private consumption growth.
3) Contributions to GDP growth.
4) Excluding ships and planes.

Source: Statistics Denmark and own calculations.

Financial market conditions

The main effects of the financial turmoil came to Denmark when Lehman Brothers fell in mid-September. Interbank markets froze and risk premiums in the Danish interbank market rose significantly. The rise in risk premiums were not as strong as in the euro area and the US, which may indicate that confidence in the Danish banking sector has not weakened more than in other countries.

A number of initiatives have been launched in order to support financial stability. In order to unfreeze the interbank market, the National Bank has launched initiatives easing the access to liquidity for the banking sector. The Danish parliament, Folketinget, passed an “act on financial stability” in the beginning of October, aiming to support the banks financing and creating confidence in the sector. The law issued a guarantee covering all deposits and other bank liabilities except subordinated loan capital for banks participating in the arrangement. The banks pay for the Govern-

ment-backed guarantee, covering losses exceeding 35 billion kroner (around € 4.7 billion, and close to 2 per cent of GDP).

The initiatives have, together with similar initiatives abroad, reduced the risk premiums in the interbank market. Compared to the monetary policy rates the money market rates fell quite significantly in Denmark, and to begin with they fell more than in the euro area. Due to capital outflows, the central bank increased its interest rate in October to keep the exchange rate at its central parity vis-à-vis the euro, thus increasing the spread between monetary policy rates in Denmark and the euro area from 0.25 per cent in the beginning of September to 1.75 per cent. Money market interest rates are therefore higher in Denmark than in the euro area, but risk premium, illustrated by the spread between unsecured and secured money market interest rate, is at the same level in Denmark as in the euro area.

Table 1.4						
Key figures for the Danish economy						
	2005	2006	2007	2008	2009	2010
Percentage change from previous year						
Real GDP	2.4	3.3	1.6	0.2	-0.2	0.7
Trade-weighted GDP abroad	2.0	3.2	2.9	1.3	0.0	1.2
Markets for Danish manufactures	5.9	8.8	7.7	3.7	-0.3	3.1
International competitiveness	-1.1	-1.0	-2.8	-3.3	0.2	-0.8
Export of manufactures, volume ¹⁾	7.9	6.3	2.2	1.9	-1.2	2.0
Hourly wages	3.6	3.6	4.1	4.7	4.3	4.0
Consumer price index	1.8	1.9	1.7	3.3	1.6	2.2
Price index for single-family houses	17.4	21.6	5.2	-4.0	-4.5	0.0
Merchandise export prices	5.0	3.7	1.8	4.4	-1.1	0.7
Merchandise import prices	3.6	3.1	2.9	3.3	-1.4	0.6
Merchandise terms of trade	1.4	0.6	-1.1	1.1	0.4	0.0
Productivity in private non-agricultural sector	1.3	1.9	-2.3	0.6	2.0	3.5
Real disposable income of households	1.5	3.7	0.2	1.3	3.7	1.7
Labour market						
Labour force (thousands)	2,868	2,891	2,934	2,917	2,899	2,879
Employment (thousands)	2,727	2,781	2,857	2,867	2,829	2,780
Of which in private sector	1,902	1,956	2,035	2,049	2,005	1,955
in public sector	825	826	822	818	824	825
Percentage change in total employment	1.1	2.0	2.7	0.3	-1.3	-1.7
Unemployment (thousands)	141	109	78	50	70	99
Early retirements 60-64 year (thous.)	125	126	127	128	129	130
Unemployment rate (per cent)	4.9	3.8	2.6	1.7	2.4	3.4
Unemployment rate. EU-def. (per cent)	4.8	3.9	3.7	2.4	3.4	4.8
Long term bond yields. exchange rate						
10-year government bonds	3.4	3.8	4.3	4.4	4.2	4.4
30-year mortgage credit bond	4.4	5.1	5.4	6.4	6.0	5.9
The effective krone rate (1980=100)	102.3	102.0	103.2	105.5	104.1	104.1
Balance of payments						
Goods and services (bill. DKK)	75.8	49.5	36.2	37.3	39.1	48.3
Current account (bill. DKK)	67.1	47.0	12.0	30.3	32.0	43.0
Current account (per cent of GDP)	4.3	2.9	0.7	1.7	1.8	2.3
Net foreign assets. ultimo (bill. DKK)	51.2	-26.9	-111.6	-177.7	-145.4	-102.2
Net foreign assets (per cent of GDP)	3.3	-1.7	-6.6	-10.1	-8.1	-5.5
Public finances						
Government net lending (bill. DKK)	77.1	81.5	75.1	52.2	-0.3	-22.9
Government net lending (per cent of GDP)	5.0	5.0	4.5	3.0	0.0	-1.2
General government gross debt, year-end, (bill. DKK)	563.1	500.1	443.9	531.8	503.1	487.7
General government gross debt, year-end, (per cent of GDP)	36.4	30.7	26.3	30.3	27.9	26.3
Tax burden (per cent of GDP)	51.0	49.8	48.8	47.6	45.7	46.1
Expenditures (per cent of GDP)	51.9	50.7	50.0	50.2	51.2	52.8

1) Excluding ships and planes.