DENMARK

Economic growth is projected to strengthen in 2017 and 2018, on the back of stronger private consumption, stronger foreign demand and a very accommodative monetary policy stance. With labour markets tightening, inflationary pressures will surface. Public investment is set to ease. The current account surplus will remain sizeable, driven by an improving trade balance and strong income from large net foreign asset holdings.

The fiscal stance remains broadly neutral, and fiscal initiatives should focus on investment and bringing more people to the labour market to ease supply constraints. Sustained very low interest rates risk fuelling a housing bubble; prices have been rising already in Copenhagen. With monetary policy governed by the currency peg, tighter macro-prudential restrictions would be prudent.

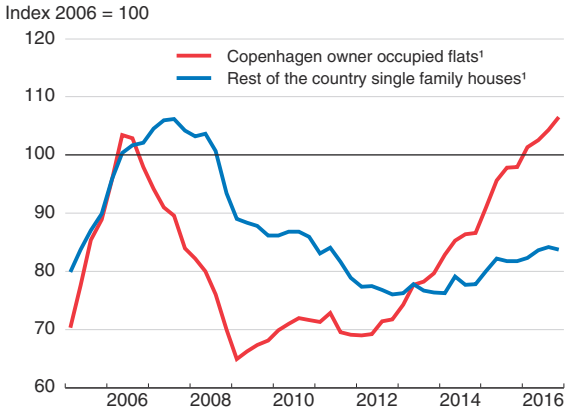
Denmark is well integrated in the global trade system. A strong social safety net and sizeable active labour market programmes are in place to ensure fairly smooth adjustment to changing labour market needs. Recent policy initiatives to improve labour market integration of migrants and to extend working lives are bearing fruit. To maintain a competitive position, wage growth needs to follow productivity improvements.

Economic fundamentals have strengthened

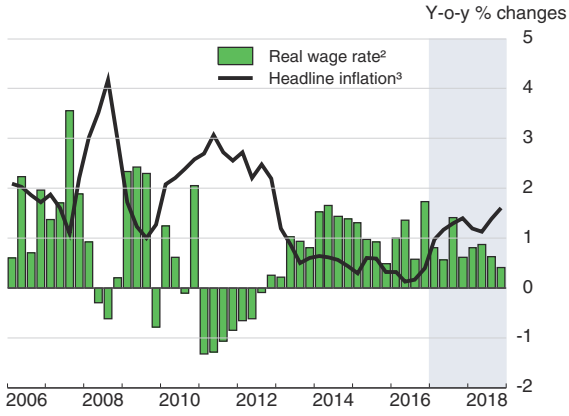
Solid private consumption has been driven by broad-based employment growth in the private sector, low inflation and firming up of the housing market across the country. Residential investment has rebounded, while business investment has started to recover. Easy financial conditions have fed rising house prices, especially in Copenhagen. Despite recent reforms to bring more people to work, some sectors have started to face labour shortages. Exports, though overall weak, surprised on the upside at the end of 2016.

Denmark

House prices are rising



Inflation is projected to rise



1. Deflated by the private consumption deflator.
2. Deflated by the consumer price index.
3. Consumer price index.

Source: OECD Economic Outlook 101 database; and Statistics Denmark.

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Denmark: **Demand, output and prices**

	2013	2014	2015	2016	2017	2018
	Current prices DKK billion	Percentage changes, volume (2010 prices)				
GDP at market prices	1 929.7	1.7	1.6	1.3	1.6	2.1
Private consumption	920.3	0.5	1.9	1.9	1.9	2.1
Government consumption	501.9	1.2	0.6	-0.1	0.0	0.9
Gross fixed capital formation	367.7	3.5	2.5	5.2	2.5	3.1
Final domestic demand	1 789.9	1.3	1.6	2.0	1.5	2.0
Stockbuilding[1]	12.3	0.1	-0.3	-0.4	-0.3	0.0
Total domestic demand	1 802.2	1.5	1.3	1.6	1.2	2.0
Exports of goods and services	1 058.0	3.6	1.8	1.7	4.5	3.0
Imports of goods and services	930.5	3.6	1.3	2.4	4.1	3.0
Net exports[1]	127.5	0.3	0.4	-0.2	0.5	0.2
Memorandum items						
GDP deflator	_	0.8	0.9	0.4	1.3	1.7
Consumer price index	_	0.6	0.5	0.2	1.2	1.3
Private consumption deflator	_	0.8	0.6	0.5	1.1	1.5
Unemployment rate[2]	_	6.5	6.2	6.2	6.5	6.5
Household saving ratio, net[3]	_	-1.8	4.4	5.1	5.1	5.0
General government financial balance[4]	_	1.4	-1.3	-0.9	-0.8	-0.4
General government gross debt[4]	_	59.0	53.1	52.2	52.9	53.1
General government debt, Maastricht definition[4]	_	44.0	39.6	37.8	38.5	38.7
Current account balance[4]	_	8.9	9.2	8.1	8.5	8.7

1. Contributions to changes in real GDP, actual amount in the first column.
2. The unemployment rate is based on the Labour Force Survey and differs from 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 101 database.

StatLink http://dx.doi.org/10.1787/888933505790

The accommodative monetary stance requires stronger macro-prudential measures

The krone-euro peg has forced a highly expansionary monetary stance. This is adding to property price increases in high demand areas (Copenhagen and Aarhus), with a risk that self-fulfilling expectations will become disconnected from fundamentals. Stronger macro-prudential measures to tighten credit growth, in particular for those with high debt-to-income ratios and who have variable interest rate mortgages, would be appropriate, as suggested recently by the Systemic Risk Council. Fiscal policy can also play a stronger role. An agreement on the property tax reform is welcome as it includes regular valuation upgrades and an abolition of the existing tax freeze. However, it will be implemented fully only in 2021 and contains a potentially pro-cyclical option of tax cuts in the event of sustained revenue growth. Measures to develop the rental market, such as easing rent regulation while striking a balance between landlord and tenant protection, would also ease the current home ownership bias.

The labour market continues to perform well. Strong employment growth in the private sector has been supported by recent structural reforms, which reduced disincentives to work for the elderly and the unemployed. Labour force participation has been edging up and the unemployment rate is down close to its structural level. Last year's

tripartite agreement on faster labour market integration of asylum seekers has started to bear fruit. Nevertheless, more needs to be done to ensure that labour shortages and strengthening wage pressures do not undermine future growth and competitiveness. The employability of marginalised groups, such as second-generation immigrants and the disabled, needs to be improved to raise their living standards as well as their social integration.

The upswing will continue

Economic activity is projected to gradually strengthen, underpinned by solid private consumption, recovering trade and stronger business investment. Price and wage inflation is projected to pick up as excess capacity narrows. The current account surplus will remain considerable, reflecting a strong trade balance, partly due to significant private sector saving, and positive returns on net foreign assets. The public finances will remain in moderate deficit despite a gradual easing of past strong public investment.

The evolution of the Danish economy depends on growth outcomes in Europe. Due to trade links with the United Kingdom and the safe-haven status of the *krone*, the economy is exposed to Brexit risks. Domestic risks include higher unit labour costs that would undermine export growth, while rising imbalances in the housing market could contribute to overheating in the short term and a risk of a crash later on. On the positive side, continuing strong labour force growth would hold wage pressures down, while adding needed resources to the economy.