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OUTLOOK FOR THE DANISH ECONOMY – MARCH 2017

## Balanced recovery in the Danish economy

- The Danish economy is in a balanced upswing and steadily heading towards a boom. Growth will be lower than previously because structural factors are curbing the growth potential. Fiscal policy should not stimulate demand further.
- The growth scenario assumes that the labour supply will increase as a result of reforms already implemented. Stronger growth in the longer term requires further reforms to increase the labour supply and productivity, but the potential is limited.
- Build-up of strong labour market pressures could lead to higher economic volatility. Economic policies abroad could also impact the growth scenario, including US fiscal policy.

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**1.6 per cent  
per p.a.**

is the expected growth  
in real GDP in the period  
2017-19

[Read more](#)



**About 60,000  
persons**

that is how much em-  
ployment is expected to  
increase by the end of 2019

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**Slightly higher  
wage growth**

is expected in the coming  
years – and the economy  
has scope for such increase

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### CONTACT

**Niels Lynggård Hansen**  
Director and Head of Econo-  
mics and monetary policy

[nlh@nationalbanken.dk](mailto:nlh@nationalbanken.dk)  
+45 3363 6571

ECONOMICS  
AND MONETARY POLICY

## Highlights of the cyclical analysis

- The Danish economy is in a neutral cyclical position and heading towards a boom. There are no major imbalances in the economy to prevent a continued stable recovery.
- The global economic outlook has not changed since the autumn, meaning that the basis for future economic growth in Denmark remains favourable.
- Real GDP is expected to grow by 1.6 per cent per p.a. during the period 2017-19. This is slightly more than the potential growth rate, entailing that capacity pressures will edge up slightly.
- The growth potential is limited, and if the labour force had not increased during the upswing, the growth momentum would already have slowed.
- Fiscal policy should not stimulate demand further. If growth is to be accelerated, new reforms are needed to increase the labour supply and/or productivity, but the potential is limited.
- Based on reforms already implemented, employment growth continues, but at a slower pace. Employment is expected to increase by around 60,000 persons by the end of 2019.
- The indicators show that labour market pressures are increasing, especially in the building and construction sector. In 2018, the discontinuation of tax deductibility of home repairs and improvements will help to ease the pressure on the building and construction sector.
- Wage growth is moderate and expected to increase only modestly. The competitiveness of Danish firms is strong and they are well-positioned to benefit from the expected recovery in export markets, provided qualified labour is available.
- Real wages will continue to rise, but at a slower pace than seen in recent years. Consumer price increases are normalising.
- In the overall Danish housing market, price growth has decreased slightly over the past six months. The situation is different in Copenhagen. Here the rate of price increase is still high, and growth may be driven by self-fulfilling expectations. As new housing is completed, construction activity in the Copenhagen area will eventually dampen price growth.
- The projection involves both upside and downside risks. If US fiscal policy becomes very expansionary, this may strengthen Danish exports to the USA in the short term. On the other hand, if the market response is a sudden increase in long-term interest rates, this may affect exports to other markets as well as domestic demand in Denmark.
- The primary domestic risks hinge on whether it will be possible to attract sufficient labour to meet the growing demand over the coming years.

### Key economic variables

	2016	2017	2018	2019	2016		
					Q2	Q3	Q4
GDP (real), per cent year-on-year	1.1	1.6	1.6	1.6	0.3	0.7	0.2
Employment, 1,000 persons	2,877	2,916	2,936	2,950	2,871	2,882	2,894
Gross unemployment, 1,000 persons	113	115	112	112	112	112	113
Balance of payments, per cent of GDP	8.1	7.5	7.3	7.1	8.5	7.4	9.5
Government balance, per cent of GDP	-1.0	-1.3	-1.0	-1.2	-1.1	-1.8	1.0
House prices <sup>1</sup> , per cent year-on-year	3.8	3.1	2.7	2.4	3.2	4.0	3.4
Consumer prices (HICP), per cent year-on-year	0.0	1.4	1.7	1.7	-0.1	-0.1	0.2
Hourly wages (manufacturing), per cent year-on-year	2.2	2.5	2.7	3.0	2.2	2.1	2.4

<sup>1</sup> Nominal prices of single-family houses.

Source: Statistics Denmark and own calculations.

## The Danish economy

### Prospects of continued balanced growth despite increased capacity pressures

The Danish economy has been in an upswing since late 2012, with steady, balanced growth in the gross domestic product, GDP, and employment. This development is expected to continue. Last year, real GDP grew by 1.1 per cent, or slightly less than in the previous year, primarily due to weaker exports. Employment has increased by 135,000 persons since early 2013, 48,000 of whom entered the labour market last year. There are no major imbalances in the economy, and growth is expected to be close to, but slightly higher than its potential level in the coming years. Real GDP is expected to grow by 1.6 per cent both this year, next year and in 2019.

There are few spare resources in the labour market and the output gap, i.e. the difference between actual and potential output, is closed, cf. Chart 1. Thus, the economy is in a neutral cyclical position and heading towards a boom, with growing pressures on labour resources and other production capacity.

Growing demand for labour is basically expected to be met by increased labour supply, and only a minor acceleration in wages is expected. By the end of the projection period in 2019, GDP is expected to be slightly above its potential level, and all spare resources in the labour market will have been absorbed. Thus, capacity pressures will be moderate.

In view of this scenario, fiscal policy should not stimulate growth further, but rather help to ensure continually balanced growth. Given that the economy is close to a neutral cyclical position, it would be expedient gradually to achieve equilibrium in the structural government balance over the coming years.

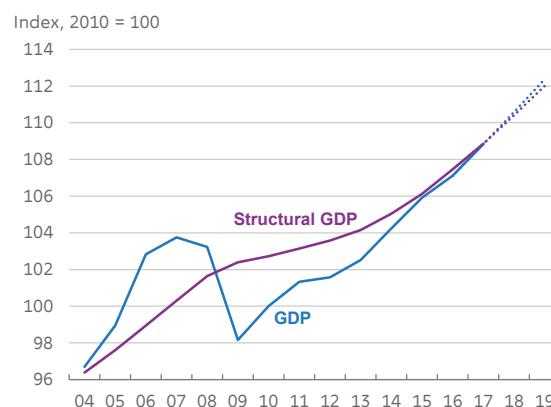
### The economy's potential output growth is limited

Looking ahead, in a balanced growth scenario, real GDP cannot be expected to grow at the high rate previously seen. The reason is that the growth potential depends on the development in structural employment and productivity, which is slower than previously.

The 2006 welfare reform, which indexed the retirement age to life expectancy, and the 2011 retirement

GDP at a cyclically neutral level

Chart 1



Note: Real GDP. The structural GDP level indicates the cyclically neutral level, with no pressure on production capacity.  
Source: Statistics Denmark and Danmarks Nationalbank.

reform among others are estimated to increase the supply of labour by 100,000 persons from 2013 to 2020. This offsets an underlying contraction in the labour force due to the ageing population. As a result of these reforms, older age groups postpone their retirement. The average employment rate in Denmark is high by international standards, but the number of hours worked per employee is below the average for the advanced economies. The general tendency for the employment rate to be high is accompanied by a lower number of hours worked per employee.

Over the coming years, structural employment is expected to contribute 0.2-0.3 percentage point to GDP growth. New reforms are required if the growth contribution is to be increased. Even a small further increase in the retirement age could provide a substantial contribution to the labour force in the future, and thus to growth. This also applies if the immigrant participation rate is increased or more qualified labour is attracted from abroad.

In addition to the expansion of the labour force, the economy's potential output is determined by productivity growth. Productivity growth has been

weak for a number of years in the wake of the 2008 financial crisis. Over the projection period, productivity is expected to grow by up to 1.1 per cent p.a. This is very close to the pre-crisis level, but substantially below the growth rates of previous decades. However, the Danish productivity level is high compared with that of other countries. This makes it difficult to sustain high productivity growth, given the limited potential catch-up effect to the best performing countries. Still, productivity can be improved through reforms, as documented e.g. by the Danish Productivity Commission a few years ago.

### Continued recovery in the labour market, but at a slower pace

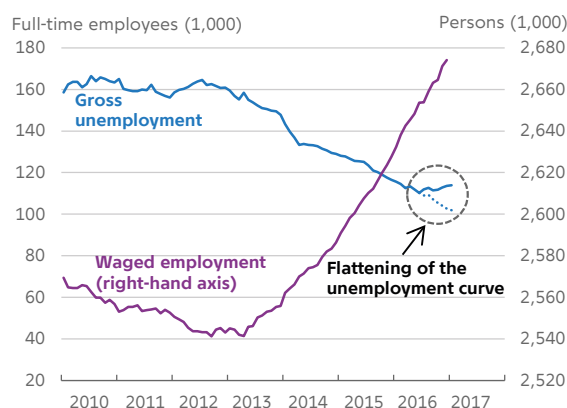
The private sector has been the sole driver of employment growth in Denmark since 2013. The increase has been broad-based across industries, but particularly pronounced within trade and transport, business service and building and construction. The labour force has grown during the upswing, and the increase in employment has been greater than the fall in unemployment, cf. Chart 2. Without an influx of labour to meet the growing demand, the momentum of the economy would already have slowed down.

During the upswing, unemployment has fallen for all groups, including unskilled workers, and across the country. The unemployment rate does not mask any major geographical differences, and contrary to previously, it is now higher in the larger cities than in the country on average. Over the last half year, registered unemployment has flattened close to its cyclically neutral level of around 4 per cent of the labour force, with a small increase in the 4th quarter of 2016. The primary reason is an increase in the number of integration benefit recipients who are ready to enter the labour market. Under the tripartite agreement on labour market integration from March 2016, it was decided, in principle, to treat refugees and family-unified immigrants as ready to enter the labour market. In January, approximately 12,000 recipients of integration benefits were not ready to enter the labour market. As they are increasingly deemed ready to enter the labour market, there will be some – technical – upward pressure on registered unemployment. There are no indications that the labour market recovery is beginning to lose momentum.

There are increasingly clear signs that a shortage of labour is emerging, especially in the cyclically sensitive building and construction sector, cf. Chart 3.

### Employment has risen at a faster rate during the upswing than unemployment has fallen

Chart 2

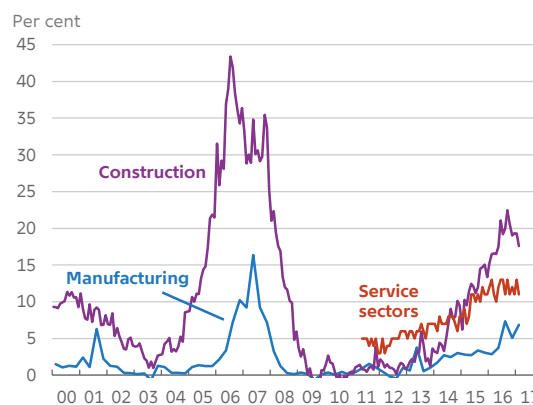


Note: The broken line indicates gross unemployment less the increase since June 2016 in recipients of integration benefits who are ready to enter the labour market.

Source: Statistics Denmark.

### Clearer signs of labour shortages

Chart 3



Note: Share of firms (adjusted for employment), stating that shortage of labour is an impediment to production.

Source: Statistics Denmark.

In this sector, unemployment is already low and a growing number of firms are stating that the shortage of labour is an impediment to production. As planned, the discontinuation of tax deductibility of home repairs and improvements in 2018 will help to ease the pressure on the building and construction sector.

The rise in employment is expected to continue, but at a more subdued pace. Until 2019, employment is expected to grow by a further 60,000 persons as a result of an increase in the supply of labour following reforms already adopted. Currently, there are only few spare resources in the labour market. The labour market gap, indicating how much employment can rise without causing pressures in the economy, is virtually closed. Unemployment, consisting primarily of short-term unemployed workers, is at its cyclically neutral level of around 120,000 persons, and if the expected increase in employment is to be sustainable, more labour must be attracted to the labour force.

### Moderate wage growth and strong Danish competitiveness

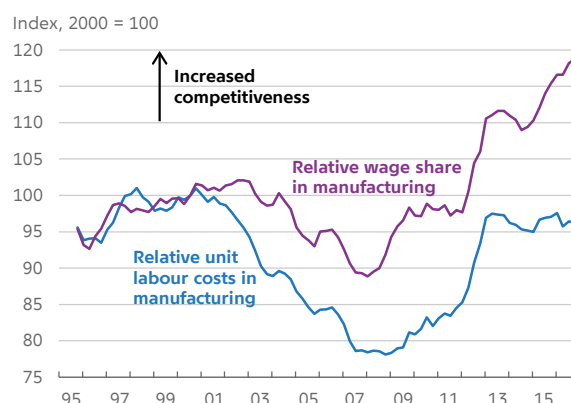
Labour market pressures are not yet reflected in any notable acceleration in wages. The continued economic recovery, with a virtually closed output gap, growing employment and unemployment close to its cyclically neutral level, will put some upward pressure on private sector wage growth over the coming years. However, the collective agreements concluded for the private sector do not indicate any major acceleration in wages. Wage formation is generally sticky, and if wage growth is accelerating, it is difficult to decelerate the rate of growth quickly and smoothly. Therefore, steady wage growth is preferable.

In recent years, private sector wage growth has been moderate, at around 2 per cent p.a. This applies to manufacturing, which has a large share of output for exports. Similar wage growth is seen in the more domestically-oriented construction sector. This sector is highly cyclical in nature, but despite recovery in construction activity and increasingly clear signs of labour shortages, this has only been reflected to a limited extent in wage growth. The reason is a large influx of labour, including foreign labour, during the upswing.

Subdued wage developments have helped Danish industrial firms improve their competitiveness to

### Competitiveness of Danish firms is strong

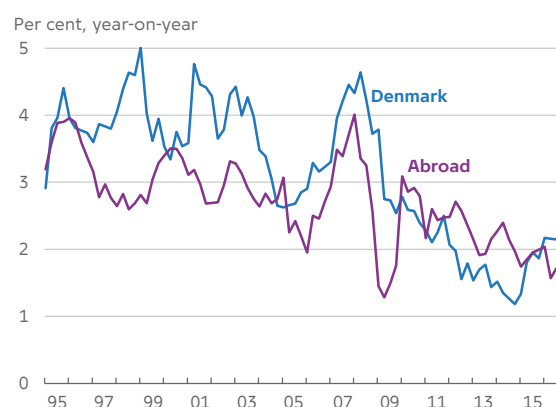
Chart 4



Note: Foreign wages relative to Danish wages.  
Source: Eurostat, OECD, Bureau of Economic Analysis, Bureau of Labor Statistics, Federal Reserve Economic Data and Danmarks Nationalbank.

### Danish wage growth is currently slightly higher than wage growth abroad

Chart 5



Note: Wages abroad are the wage index of manufacturing of 25 countries, weighted using the weights of the real effective krone rate index.  
Source: OECD, Confederation of Danish Employers and Danmarks Nationalbank.

foreign competitors over the past five years, cf. Chart 4. In the past year, Danish wage growth has been higher than abroad, cf. Chart 5. This trend is set to continue in the coming years, and there is room for this in the economy. On the other hand, there has been a small decline in the effective exchange rate of the krone since the autumn, which makes Danish goods less expensive in export markets. Basically, the competitiveness of Danish firms is good – and is expected to remain so. In the slightly longer term, the greatest challenge in this respect is not wage growth, but rather the increasing global tendency for countries to question free trade. The Danish economy is a small open economy and free market access is imperative for Danish firms – and thus Danish prosperity.

Public sector wage growth is also moderate. Viewed over a longer period of time, private and public sector wages grow at the same rate, as public sector wages are regulated relative to those in the private sector. However, in the aftermath of the financial crisis, public sector wage growth exceeded that of the private sector for a couple of years. Consequently, public sector wage growth is set to be moderate in the coming years.

Although wage growth is moderate, even lower consumer price inflation means that most wage earners have benefited from a substantial increase in real wages. This trend will continue this year and the coming years, but with a slightly higher consumer price growth rate, the rate of increase will be slightly slower.

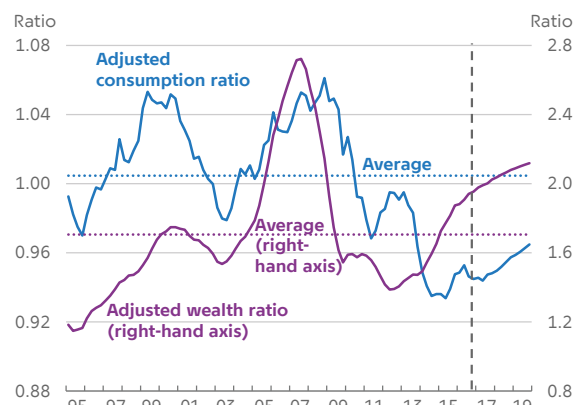
### Strong drivers of domestic demand

Strong drivers continue to support private consumption and investment. Interest rates are low, real disposable incomes are rising steadily, and wealth and home equity are increasing. Looking ahead, real disposable incomes will grow at a slightly slower rate than seen in the past few years as price growth normalises and interest rates move upwards.

The proportion of disposable income spent on consumption (the consumption ratio) is low viewed in a longer perspective, cf. Chart 6. Presumably, this is inter alia because the reduction in household interest payments due to falling interest rates in recent years has yet to be fully translated into increased consumption. Moreover, some consumers may have wanted to bolster themselves against a sudden increase in interest rates or a drop in house prices. This may have curbed consumption for some time.

**Increase in consumption and wealth ratios**

Chart 6



Note: The ratios are averages of the current and three previous quarters. The consumption ratio is consumption relative to disposable income where disposable income has been adjusted for capital pension taxation, etc. The wealth ratio is consumption-determining wealth relative to adjusted disposable income. Average from 1995 until the 3rd quarter of 2016.

Source: Statistics Denmark and Danmarks Nationalbank.

The consumption ratio is expected to edge up slightly over the coming years, driven, inter alia, by a continued increase in wealth. However, the consumption ratio will not reach its historical average.

Interest rates are assumed to rise in the coming years, which will serve to dampen growth in wealth and private consumption. An opposing factor is a one-off repayment of kr. 9 billion of housing taxes in 2019 in connection with the introduction of a new property valuation system. Growth in private consumption is forecast at around 2 per cent p.a. in the projection period, and private consumption and exports thus remain the primary demand drivers, cf. Chart 7.

Residential investment is picking up from a low level in the aftermath of the financial crisis. The greatest recovery is in the Copenhagen area, which has recorded the strongest price increases for houses and owner-occupied flats and where prices per square metre for new construction are assessed to be lower than for existing properties.

In the coming years, the investment ratio for the private non-primary sector will rise to reflect the

growing need for capacity expansion. Business investment in plant and equipment is expected to grow at a slightly faster rate than value added in the private non-primary sector, while building and construction investment will grow only slowly. This reflects the continued availability of quite a large number of vacant premises, which reduces the need for new construction.

### Positive export outlook

Looking ahead, exports will also make a substantial contribution to Danish economic growth after a weak performance for the past two years. The dampening of exports was driven mainly by a decline in exports of sea freight. Due to the size of the Danish merchant fleet, sea freight is an important export component, but on the other hand it has no major bearing on employment. Growth in world trade has been losing momentum for some time. The initial cause is not increased protectionism, but, inter alia, a slowdown in several emerging market economies, including China. A contributory factor is that investment, which has a high import content, is at a low level globally.

Towards the end of 2016, exports of both goods and services picked up, and at the same time world trade gained momentum. This is expected to continue throughout the projection period.

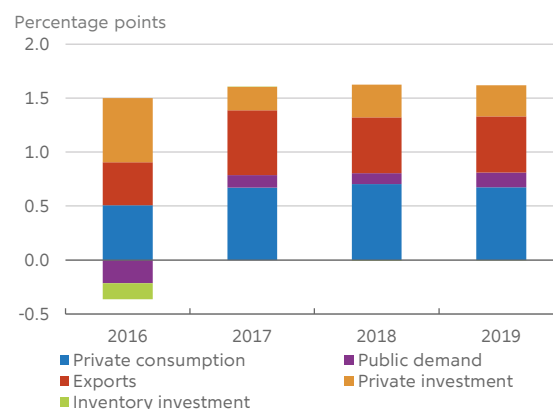
The outlook points to robust export market growth over the coming years, while spare capacity will become scarcer in many of the countries, cf. Chart 8 and the section on the External environment. At the same time, the effective exchange rate of the krone has weakened slightly since the autumn of 2016. After a couple of years of moderate wage increases, Danish firms are well-positioned competitively to benefit from increased foreign demand, provided qualified labour is available.

Last year, the current account showed a surplus of kr. 165 billion, equivalent to 8 per cent of GDP. This represented a small decrease on the previous year, mainly because the surplus on trade in services declined. The net return on foreign assets also showed a fall. On the other hand, the surplus from trade in goods increased.

The large current account surplus is set off by a very large corporate savings surplus, and at the same time the household savings balance has turned positive in recent years, cf. Chart 9. Since the early

**Private consumption and exports are driving growth**

Chart 7



Note: Growth contributions adjusted for imports.  
Source: Statistics Denmark and Danmarks Nationalbank.

**Prospects of export market growth**

Chart 8



Source: OECD and Danmarks Nationalbank.



1990s, large savings surpluses have generally been maintained by the corporate sector, while household surpluses are more unusual. This may reflect that households have changed their behaviour to become more prudent in their consumption decisions. The current account surplus is expected to remain large, but decline slightly over the coming years.

### Prices of owner-occupied housing in the Copenhagen area continue to rise

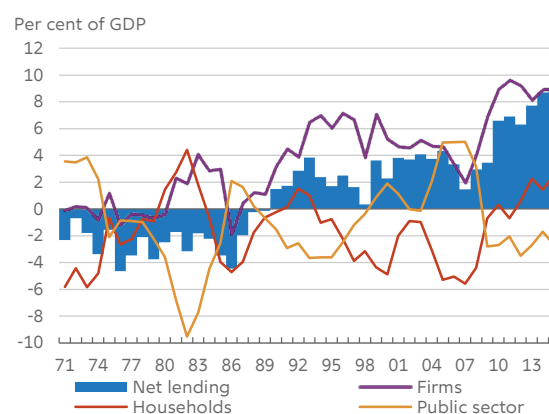
The housing market has been dynamic for some time, but with considerable geographical differences. This development has contributed to supporting demand in the economy and thus the recovery more generally. House price growth has receded a little during the last half year, cf. Chart 10. House prices have risen by just under 4 per cent viewed over the last year.

The Copenhagen area shows a different trend. Price growth has for some time been stronger in the Copenhagen area than in the rest of Denmark, with the risk of being driven by self-fulfilling expectations. For several years, price growth for owner-occupied flats in Copenhagen has been around 10 per cent p.a., but the annual rate of increase was just under 8 per cent in December, according to Statistics Denmark. This is still a high rate of increase. If the real price rises seen in recent years continue, they may be followed by corresponding falls. The slightly slower house price growth in Copenhagen may reflect that prices of owner-occupied flats have risen to a high level relative to the level of income and interest rates. One reason is the growing population in the Copenhagen area. However, there are indications of increasing ripple effects from the housing market in the Copenhagen area to neighbouring regions, which may contribute to alleviating some of the pressure on the market in Copenhagen. In the longer term, construction activity in the Copenhagen area will also dampen price developments in step with the completion of new housing. Last year, the number of completed homes in Copenhagen had returned to the 2007 level, and a number of ongoing large projects will add new homes in the coming years.

In some areas outside the cities, the supply of homes for sale is high relative to turnover, and the time on market is long. Given the declining population in many of these areas, the existing housing stock is large relative to the population. The housing stock is continually decreasing as a result of real write-downs and, to a lesser extent, demolition of empty, aban-

Increased household and corporate savings

Chart 9

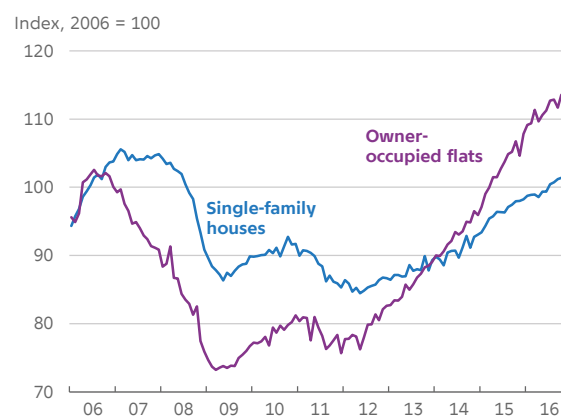


Note: Net lending is the total savings surplus in the economy. Less net capital transfers, net lending is equivalent to the current account surplus. It is adjusted for early taxation of capital pensions in 2013-15.

Source: Statistics Denmark and Danmarks Nationalbank.

Continued growth in house prices

Chart 10



Note: Seasonally adjusted. Around 70 per cent of owner-occupied flats are located in the Copenhagen area.

Source: Statistics Denmark.



done houses, although this adjustment process may take a long time. This represents a structural challenge that cannot be overcome by a booming economy.

For Denmark as a whole, the turnover of houses, measured by the number of trades relative to the housing stock, has risen notably since the autumn, while it has been stable for owner-occupied flats. Turnover of houses is close to its long-term average, while that of owner-occupied flats is relatively high viewed in a longer perspective. Owner-occupied flats are predominantly located in the large towns and cities. The housing supply has been stable in recent years. In general, the time on market has been declining, although mostly in the Copenhagen area where it was down to around 70 days for owner-occupied flats at the end of 2016. This is less than half of the national average for houses.

Recent years' housing market growth should be viewed in the light of developments in interest rates and disposable incomes. Long-term housing interest rates rose a little during the 2nd half of 2016, but at the beginning of this year, it was not much higher than in the first part of 2015, when interest rates fell to a very low level due to capital inflows and an upward pressure on the krone, cf. Chart 11. In addition, the growth in disposable incomes is likely to continue. Against this background, at the national level prices of single-family houses are expected to continue to rise by 3 per cent p.a. on average in the coming years. This is unchanged relative to the previous forecast and only slightly higher than the expected increase in consumer prices.

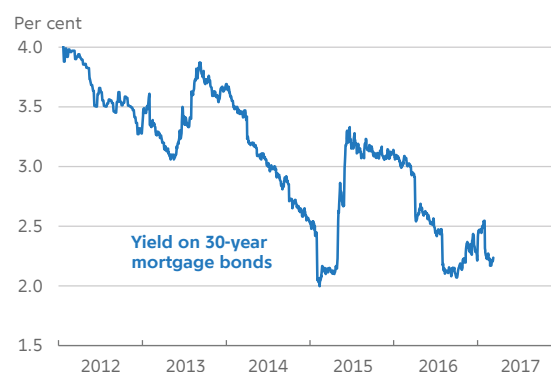
### The rate of price increase is heading towards normalisation

Growth in consumer prices has been very weak in the last few years, cf. Chart 12. In 2016 overall, there was no increase at all. Prices of goods were mainly weighed down by the strong drop in oil prices in the 2nd half of 2015. The low rate of increase in prices of services can mainly be attributed to a notable drop in communication prices, especially mobile services, in the summer of 2016.

From the end of 2016, energy prices again contributed positively to the rate of price increase. Energy prices also impact other products with energy inputs, but oil price developments are passed through with a certain lag. Oil prices rose again in 2016. Together with more pronounced capacity pres-

**Slight increase in long-term interest rate**

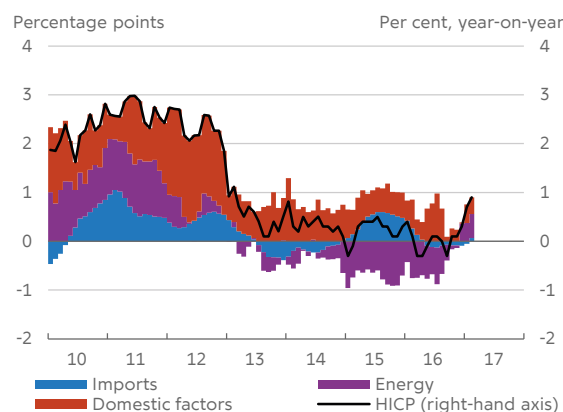
Chart 11



Source: Danmarks Nationalbank.

**Rising trend in inflation**

Chart 12



Note: HICP is the EU Harmonised Index of Consumer Prices.  
Source: Statistics Denmark and Danmarks Nationalbank.

tures in the economy and prospects of some wage acceleration, this means that growth in consumer prices is expected to rise to just under 2 per cent p.a. over the next few years. In 2017, price developments will be dampened by the reduction of some indirect taxes and abolition of the PSO duty.

Underlying price pressures in the economy remain weak. Core inflation, i.e. prices excluding energy and unprocessed food, has been around zero for some time, and the same goes for domestic market-determined inflation, IMI, which is ultimately determined by developments in the level of costs in the economy. Import prices rose towards the end of the year, mainly due to higher commodity prices, but wholesale price pressures remain moderate. Growth in producer prices of Danish goods for the domestic market was also weak.

Over the last half year, the rate of increase in consumer prices has been somewhat lower in Denmark than in the euro area. This applies to core inflation too, although the spread to the euro area is smaller. Part of the explanation is the decline in communication prices due to lower roaming costs. Although this was a consequence of EU legislation, communication prices did not fall correspondingly in the euro area. Growth in prices of clothing was also weaker in Denmark. In the slightly longer term, Danish consumer prices will rise at the same rate as for the currency anchor, i.e. in the euro area. Developments may diverge in the short term, however.

#### **Slow improvement of the general government structural balance**

Moderate growth in public consumption is expected in the coming years, while public investment will slow down a little after a period of high activity. The level of public demand was considerably expanded in order to counter the effects of the financial crisis in 2008.

The government balance improved in 2016, primarily due to higher revenue from pension yield tax. This year, the revenue from pension yield tax is expected to normalise from a high level. The government budget deficit in 2017 is thus forecast at 1.3 per cent of GDP. The government deficit will improve to 1.0 per cent of GDP in 2018, in step with the continuing economic recovery. In 2019, the deficit will rise to 1.2 per cent of GDP. This reflects, inter alia, extraordinary repayment of property taxes in connection with the introduction of a new property valuation system.

According to the government's forecast, the structural deficit is expected to be 0.5 per cent of GDP this year. This is within the framework of the Budget Act, but a smaller deficit would provide more scope for addressing future economic setbacks. According to the government's forecast, the structural deficit is expected to be 0.2 per cent of GDP in 2018.

#### **Where are the projection risks?**

The projection involves both upside and downside risks. The upside risks are mainly domestic, while the downside risks are predominantly external. External risks have become more pronounced over the last half year. One reason is the current substantial uncertainty as to the economic policy stance in a number of major economies, particularly the USA and the UK. Upcoming elections in several large euro area member states this year also generate uncertainty.

The global tendency for countries to question the advantages of free trade may – if it leads to protectionist measures – impede international trade, thereby weakening Danish exports as well as imports. Free access to foreign markets is key to Danish prosperity.

If US fiscal policy becomes very expansionary, it may, on the one hand, strengthen Danish exports to the USA in the short term. On the other hand, the market response may be a sudden increase in long-term interest rates with expected spillovers to Europe, and thus affect other Danish export markets as well as domestic demand in Denmark. A hike in long-term interest rates triggered by a highly expansionary US fiscal policy may potentially lead to an abrupt halt in housing market dynamics in Denmark, resulting in a reversal to declining prices.

The domestic risk factors point to temporarily higher growth than forecast in the projection. It is uncertain whether the labour force can be expanded sufficiently to avoid widespread labour shortages and a consequent acceleration of wage growth. There is economic scope for allowing wage increases in Denmark to be slightly higher than those abroad for a period. Strong wage acceleration and thus a strong decline in competitiveness will, on the other hand, lead to higher economic volatility. In the slightly longer term, labour shortages will lead to lower growth.

A higher-than-expected increase in the currently low consumption ratio may stimulate domestic demand

more than predicted in the projection. In addition, housing market developments, especially in the Copenhagen area, may contribute to excessive growth in demand in the event of substantial ripple effects to large parts of the country. A higher demand growth can partly be covered by increased imports.

## Key economic variables

Table 1

Real growth on preceding period, per cent	2016	2017	2018	2019	2016		
					Q2	Q3	Q4
GDP	1.1	1.6	1.6	1.6	0.3	0.7	0.2
Private consumption <sup>1</sup>	2.1	2.0	2.0	2.0	0.1	-0.1	1.5
Public consumption	-0.2	0.5	0.6	0.8	0.8	-0.7	-1.1
Residential investment	11.1	1.6	3.5	3.0	2.4	-2.7	0.2
Public investment	0.6	-1.5	-0.7	-0.2	-1.4	-2.4	-5.0
Business investment	3.7	3.6	3.6	3.6	0.1	3.9	3.7
Inventory investment, etc. <sup>2</sup>	-0.3	0.0	0.0	0.0	-0.5	1.1	-1.0
Exports	1.4	3.2	2.5	2.5	1.1	0.9	4.1
Industrial exports	3.0	3.7	2.9	2.8	0.5	-0.3	5.7
Imports	2.4	3.5	3.0	3.1	0.3	1.9	3.7
Employment, 1,000 persons	2,877	2,916	2,936	2,950	2,871	2,882	2,894
Gross unemployment, 1,000 persons	113	115	112	112	112	112	113
Balance of payments, per cent of GDP	8.1	7.5	7.3	7.1	8.5	7.4	9.5
Government balance, per cent of GDP	-1.0	-1.3	-1.0	-1.2	-1.1	-1.8	1.0
House prices <sup>3</sup> , per cent year-on-year	3.8	3.1	2.7	2.4	3.2	4.0	3.4
Consumer prices (HICP), per cent year-on-year	0.0	1.4	1.7	1.7	-0.1	-0.1	0.2
Hourly wages (manufacturing), per cent year-on-year	2.2	2.5	2.7	3.0	2.2	2.1	2.4

<sup>1</sup> Includes both households and non-profit institutions serving households, NPISH.

<sup>2</sup> Contribution to GDP growth (this item comprises inventory investment, valuables and statistical discrepancy).

<sup>3</sup> Nominal prices of single-family houses.

## External environment

Overall, the global economic outlook has not changed in recent months, meaning that the basis for economic development in Denmark also remains favourable. The economic recovery has continued in the advanced economies, and spare capacity in the labour markets has been gradually reduced. Among the emerging market economies, growth rates are expected to remain high in China and India, while a slow recovery from recent years' recession is expected in Brazil and Russia. Global GDP growth is expected to rise a little overall in the coming years, but there are considerable risks, including increased protectionism and geopolitical risks.

### Risk of overheating in the US economy

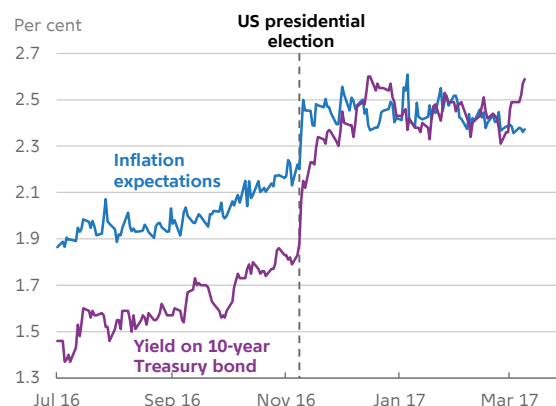
Economic growth continued in the USA. Growth was 1.6 per cent in 2016, but rose in the 2nd half of the year, and the output gap – the difference between actual and potential output – is expected to virtually close this year. In 2016, employment rose by more than 2 million people, corresponding to 1.6 per cent, and the increase has continued into 2017.

In his election campaign, President Trump indicated that he would introduce accommodative fiscal measures, including considerable tax cuts and deregulation. This may have an expansionary effect in the short term via higher consumption and investment. As a result, inflation expectations and yields on US Treasury bonds rose notably after the US presidential election on 8 November 2016, cf. Chart 13.

This also prompted international organisations to adjust US GDP growth upwards, cf. Chart 14.<sup>1</sup> Growth is thus expected to be somewhat higher in the USA than in the euro area, following almost identical growth rates in 2016. However, part of the divergence is attributable to higher growth in the working age population in the USA than in the euro area.

**Higher inflation expectations and interest rates in the USA after the election**

Chart 13

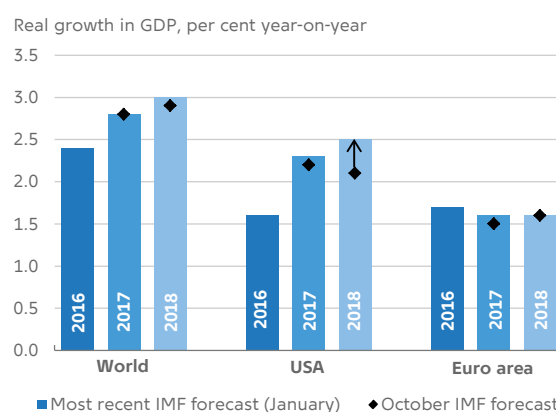


Note: Inflation expectations have been derived via the inflation swap rate and can be interpreted as the expected average inflation rate 5-10 years into the future.

Source: Bloomberg and Macrobond.

**Growth outlook for the USA adjusted upwards**

Chart 14



Source: International Monetary Fund, IMF.

<sup>1</sup> In January 2017, the International Monetary Fund, IMF, factored in a total increase in GDP growth of 0.5 percentage point in 2017-18, while the OECD in November 2016 expected additional growth of 1.3 percentage point in total relative to the baseline scenario without factoring in fiscal stimuli. The substantial differences reflect the uncertainty about US fiscal policy. In March 2017, the OECD slightly revised downwards the additional growth.

Several factors may, however, dampen the US growth outlook. For example, the introduction of protectionist measures, as announced during the election campaign, will lead to lower growth. In addition, the Federal Reserve may have to raise the Fed funds target rate faster than expected if the expansionary fiscal measures result in increasing price pressures. This will put a damper on the propensity to invest and on economic activity.

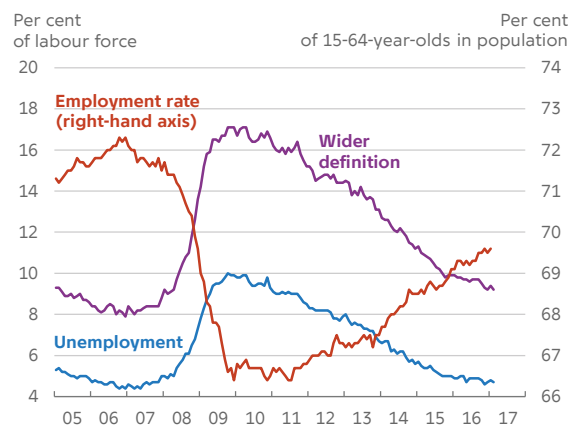
The US labour market situation points to limited spare resources, cf. Chart 15. Unemployment has declined to a level close to the pre-crisis level, bringing it close to the structural level, according to the Federal Reserve and the international organisations. The employment rate remains lower than the pre-crisis level, although the increase in the number of long-term unemployed during the crisis years may have reduced the structural employment rate. The combination of low unemployment and fiscal stimuli may lead to bottlenecks in the labour market. This entails a risk of markedly increasing wage and price pressures and overheating of the US economy.

US debt ceiling is soon to be reactivated  
It is a set task for the new administration to work together with Congress to adopt an increase of the debt ceiling. The debt ceiling has been suspended since November 2015, but will be reactivated on 16 March this year. Congress has the official mandate to set the debt ceiling, which relates to the gross federal debt in nominal terms. It is 106 per cent of GDP, but, according to the Committee for a Responsible Federal Budget, it is expected to rise to 127 per cent of GDP if expansionary fiscal policy measures are implemented, as announced by President Trump during his election campaign, cf. Chart 16. As a result, marked increases of the debt ceiling need to be adopted if the announced economic policy is implemented. Excluding debt to government funds, the US federal debt currently stands at 77 per cent of GDP.

Recent years' tradition has been to wait until the last moment to adopt increases of the debt ceiling. This has generated uncertainty as to whether the government can meet its financial obligations, and in some cases it has resulted in financial market volatility. The reason is that the credit rating agencies may regard retained payments as a credit event which may e.g. trigger payment of credit default swap contracts (CDS contracts). However, the US Treasury may implement temporary liquidity measures, enabling the federal government to at least meet its obliga-

**US unemployment close to the pre-crisis level, but the employment rate is lower**

Chart 15

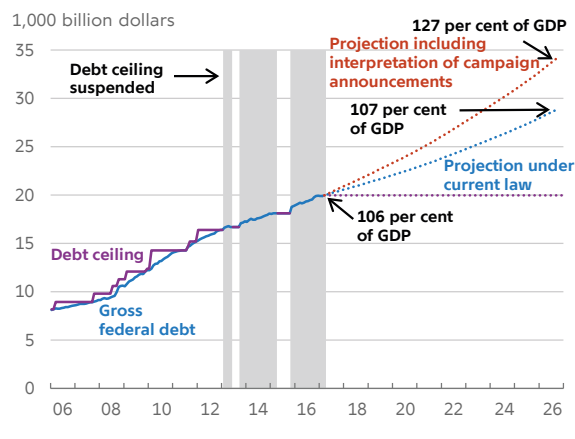


Note: The wider definition of unemployment (U-6) includes not only the unemployed but also those with a marginal affiliation to the labour market and people working part time who would like to work full time.

Source: Macrobond.

**US debt ceiling is soon to be reactivated**

Chart 16



Note: The projection under current law is based on calculations from the Congressional Budget Office, CBO, while the projection including interpretation of announcements during the election campaign is based on calculations from the Committee for a Responsible Federal Budget, CRFB.

Source: CBO, CRFB, Macrobond and own calculations.

tions until the summer, even if the debt ceiling is not raised. Consequently, no notable fluctuations in the pricing of CDS contracts on US Treasury bonds have been observed yet, even though the debt ceiling is soon to be reactivated.

### Continued moderate growth outlook for the euro area

The euro area is in a moderate recovery with GDP growth of 1.7 per cent in 2016. The increase in activity is primarily driven by private consumption, supported by rising real disposable incomes.

Unemployment has continued to fall in most euro area member states and was 9.6 per cent of the labour force in January for the euro area overall. This is the lowest level since May 2009, cf. Chart 17. There are still substantial differences in unemployment across the member states. The employment rate in the euro area has increased for several years and is now approaching the pre-crisis level.

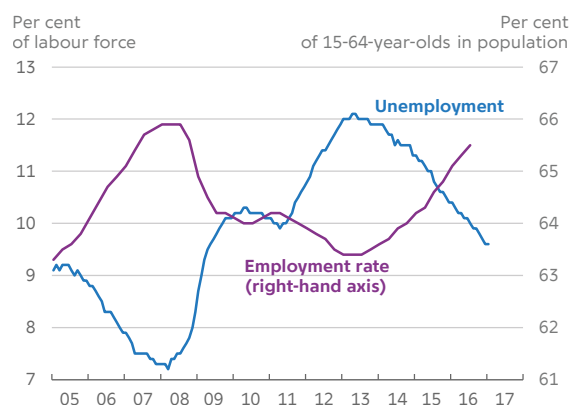
Despite the recovery in the labour market, wage development remains moderate. One reason is the modest price development, which may have affected wage formation.

The moderate growth is expected to continue in the coming years. According to the European Commission, the rise in economic activity will be increasingly driven by exports and less by private consumption. Since actual growth is expected to be slightly higher than potential growth, the output gap will virtually close over the next few years, cf. Chart 18.

However, the growth outlook is associated with a number of – predominantly downside – risks. The political situation in Italy and the outcome of the upcoming presidential election in France generate substantial uncertainty about the economic outlook, including because one of the presidential candidates has questioned France's participation in the euro. This is reflected e.g. in increased interest rate spreads to Germany, cf. Report on Monetary and Financial Trends, March 2017. The Brexit agreement to be negotiated between the EU and the UK may also have an adverse economic impact. As a main rule, structural growth in both the UK and the euro area is expected to be higher, the fewer barriers to trade and labour mobility the agreement contains. On the other hand, the US fiscal expansion may boost growth, due to higher demand for European goods, among other factors. This depends on whether it

### Euro area employment rate is almost at the pre-crisis level, but unemployment is still high

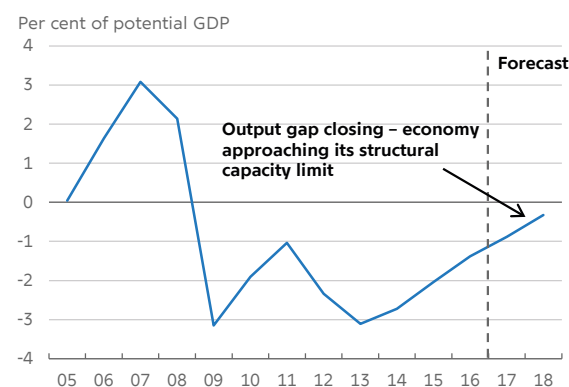
Chart 17



Source: Macrobond.

### The output gap is expected to virtually close during the next few years

Chart 18



Note: The output gap is calculated as the difference between actual and potential output as a percentage of potential output. The chart shows the average of the estimates from the European Commission, the IMF, and the OECD.

Source: Macrobond.

will lead to overheating of the US economy and thus faster interest rate increases.

### Higher oil prices push up inflation

Inflation has risen in the advanced economies over the last year, cf. Chart 19. The rate of price increase in the euro area rose to 2.0 per cent in February 2017, from a level close to zero in most of 2016. In the USA and the UK, inflation was slightly lower in January.

This development reflects in particular the rise in oil prices from around 30 dollars per barrel in January 2016 to around 55 dollars per barrel in early March 2017, due to declining oil production, among other factors. This means that energy prices now contribute positively to the overall price development in the euro area, after a negative contribution in 2014-16, cf. Chart 20.

In the UK, the higher inflation can also be attributed to the marked depreciation of the pound sterling after the Brexit referendum in June 2016. On the other hand, the real economic consequences of the referendum have been limited so far, but the international organisations expect growth to slow down a little in the next few years.

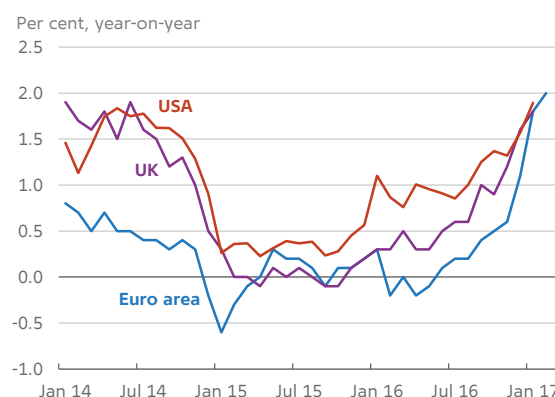
The development in core inflation, i.e. inflation excluding food and energy, continues to be weak, especially in the euro area. The reasons are, inter alia, the subdued wage pressures and the lag in the pass-through of the indirect effects of higher energy prices.

The European Central Bank, ECB, expects inflation to be 1.7 per cent in 2019 and that core inflation will rise to 1.8 per cent, due to both the accommodative monetary policy and the increase in economic activity, cf. Table 2.

The Federal Reserve's estimate of US inflation is slightly higher, because the US economy is closer to its capacity limit. The Federal Reserve's assessment is that the economy will continue to grow at a moderate rate, and the Fed sees no signs of overheating at present. Against this backdrop, the Federal Open Market Committee, FOMC, expects gradual raising of the Fed funds target rate over the next years, cf. Chart 21. Market expectations are slightly lower, but have increased considerably since the presidential election, which has generally led to higher inflation expectations for the USA, cf. above.

**Rising inflation in the advanced economies**

Chart 19

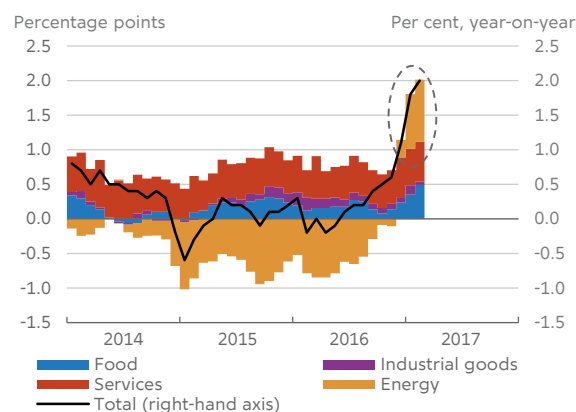


Note: The EU Harmonised Index of Consumer Prices, HICP, is shown for the euro area and the UK and the Personal Consumption Expenditures index, PCE, for the USA.

Source: Macrobond.

**The contribution of energy prices to price developments in the euro area is now positive**

Chart 20



Source: Macrobond and own calculations.



### The ECB and the Federal Reserve expect continued rising inflation over the next few years

Table 2

	2017	2018	2019
Euro area, inflation	1.7	1.6	1.7
Euro area, core inflation	1.1	1.5	1.8
USA, inflation	1.9	2.0	2.0
USA, core inflation	1.8	2.0	2.0

Anm.: The EU Harmonised Index of Consumer Prices, HICP, is shown for the euro area and the Personal Consumption Expenditures index, PCE, for the USA. Forecasts from December 2016 for the USA and March 2017 for the euro area.

Kilde: ECB and Federal Reserve.

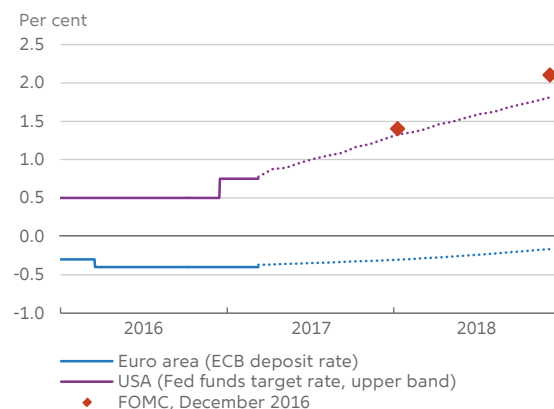
In the euro area, market participants expect the ECB deposit rate to remain almost unchanged over the next few years. This probably reflects the expectation of inflation remaining lower than the ECB's inflation target of below, but close to 2 per cent.

### Euro area fiscal policy is close to neutral

An almost neutral fiscal policy stance is expected for the euro area as a whole in 2017 (measured by changes in the structural balance), cf. Chart 22. Given the cyclical normalisation, fiscal policy thus seems to be aligned with the activity impact. However, a number of euro area member states still have structural budget deficits exceeding the medium-term limit of 0.5 per cent of GDP according to the Fiscal Compact.

### Prospects of rising interest rates in the USA – unchanged level in the euro area

Chart 21

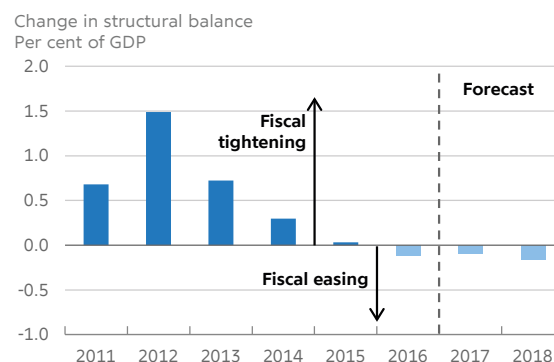


Note: The broken lines indicate the market expectations as at 9 March 2017.

Source: Federal Reserve, Macrobond, Scanrate Rio and own calculations.

### Euro area fiscal policy is almost neutral in 2017

Chart 22



Source: European Commission's Winter Forecast, February 2017.

## Appendix: Assumptions in and revision of the projection for the Danish economy

The projection has been prepared using the macro-economic model MONA and is based on the available economic statistics, including Statistics Denmark's quarterly national accounts for the 4th quarter of 2016. The projection is based on a number of assumptions concerning the international economy, financial conditions and fiscal policy.

### The international economy

The global economic outlook is virtually unchanged relative to the previous projection. In the advanced economies, the labour markets are still improving, while output is rising at a more moderate pace. Growth is being driven by a robust increase in private consumption, supported by higher employment, low oil prices and very low interest rates.

The forecasts of the international organisations are also virtually unchanged, but there are substantial risks. The forecasts of GDP growth in the USA have been adjusted upwards in the light of the announced fiscal easing, the extent of which is uncertain, however. Moreover, there is a risk of protectionist measures, which have not been explicitly taken into account in the projection. Depending on the outcome of the negotiations on trade agreements, there is a risk that Brexit may lead to an actual fall in Danish exports to the UK in 2019, and not only weak growth in that year as assumed in the projection.

Export market growth for 2016 has been adjusted upwards, due to stronger-than-expected growth during the year. Looking forward, growth in the markets for Danish industrial exports is predicted to be 3.2 per cent this year, 3.4 per cent in 2018 and 3.5 per cent in 2019, cf. Table A1.

Foreign wage growth is expected to be moderate as labour markets are still weak – but improving. Moderate foreign price increases are expected this year and the next two years.

### Interest rates, exchange rates and oil prices

Developments in short-term and long-term interest rates in the projection are based on the expectations of future developments that can be derived from

term structures in the financial markets. Throughout the projection period, the 3-month money market interest rate, measured by the CITA swap rate, is expected to be negative.

The average bond yield is an average of the yields to maturity on outstanding government and mortgage bonds. It is expected to rise slightly over the projection period, from just over 0.8 per cent initially to almost 1.6 per cent by the end of 2019.

Since the previous projection, the Swedish krona and the Norwegian krone have strengthened relative to the Danish krone. Especially the higher Swedish krona rate points to a decline in the effective exchange rate of the Danish krone. The dollar's strengthening since November points to higher oil prices measured in kroner, given the almost unchanged oil price in dollars, as well as to a lower effective krone rate. In the projection, the effective krone rate and the dollar rate are assumed to remain constant at the current levels.

At the beginning of March 2017, the price of oil was around 55 dollars per barrel. The oil price is assumed to develop in line with futures prices and be largely flat until the end of 2019. That is more or less unchanged from the most recent projection.

### Fiscal assumptions

The projection is based on preliminary national accounts data on public sector consumption and investment as well as the planned fiscal policy in the Economic Survey from December 2016.

Real public consumption is expected to rise by 0.5 per cent this year, 0.6 per cent in 2018 and 0.8 per cent in 2019, while public investment is expected to fall by 1.5 per cent this year and further by 0.7 per cent in 2018 and 0.2 per cent in 2019, cf. Table A1.

### Revisions in relation to the previous projection

The GDP growth forecast for Denmark is virtually unchanged relative to the previous projection. However, a lower effective krone rate points to larger exports and therefore, among other factors, GDP

growth has been adjusted upwards by 0.2 percentage point for 2017 and 0.1 percentage point for 2018, cf. table A2.

The HICP inflation forecast has been adjusted slightly upwards for 2017, but is otherwise virtually unchanged from the previous projection. The upward adjustment of HICP for 2017 is mainly attributable to a higher-than-expected increase in energy prices since December due, inter alia, to a rising dollar rate.

## Overview of projection assumptions

Table A1

	2016	2017	2018	2019
International economy:				
Export market growth, per cent year-on-year	2.7	3.2	3.4	3.5
Foreign price <sup>1</sup> , per cent year-on-year	-2.6	0.6	1.5	1.5
Foreign hourly wages, per cent year-on-year	1.8	2.1	2.3	2.5
Financial conditions, etc.:				
3-month money market interest rate, per cent p.a.	-0.4	-0.5	-0.4	-0.3
Average bond yield, per cent p.a.	0.8	0.8	1.1	1.4
Effective krone rate, 1980 = 100	100.8	100.3	100.3	100.3
Dollar exchange rate, DKK per USD	6.7	7.0	7.0	7.0
Oil price, Brent, USD per barrel	43.6	56.3	56.4	55.7
Fiscal policy:				
Public consumption, per cent year-on-year	-0.2	0.5	0.6	0.8
Public investment, per cent year-on-year	0.6	-1.5	-0.7	-0.2
Public sector employment, 1,000 persons	818	819	823	826

<sup>1</sup> Weighted import price for all countries to which Denmark exports. The projection assumes that the same growth rates apply to the weighted export prices for all countries from which Denmark imports.

## Revisions in relation to the previous projection

Table A2

Per cent, year-on-year	GDP			Consumer prices, HICP		
	2016	2017	2018	2016	2017	2018
Projection, December 2016	1.0	1.4	1.5	0.0	1.1	1.8
Contribution to revised projection from:						
Export market growth	0.1	0.0	0.0	0.0	0.0	0.0
Interest rates	0.0	0.0	0.1	0.0	0.0	0.0
Exchange rates	0.0	0.2	0.1	0.0	0.1	0.1
Oil prices	0.0	0.0	0.0	0.0	0.0	0.0
Other factors	0.1	0.0	0.0	0.0	0.2	-0.2
This projection	1.1	1.6	1.6	0.0	1.4	1.7

Note: The transition from the previous to this projection may not add up due to rounding. "Other factors" includes data revisions.