DANMARKS
NATIONALBANK

9 DECEMBER 2020 — NO. 26

OUTLOOK FOR THE DANISH ECONOMY — DECEMBER 2020

Spread of coronavirus delays recovery

Two-speed Danish economy
Increased infection rates and new restrictions in Denmark and abroad are again slowing down parts of the economy, delaying recovery. At the same time, activity is high in substantial parts of the economy, leading to a two-speed economy.

Growth picking up in 2021
Economic growth is expected to be weak over the winter, picking up in 2021 as the population is vaccinated and restrictions are likely to be eased. Aggregate activity is expected to have largely recovered by 2022.

No current need for further fiscal stimulus
To ensure a smooth business cycle in industries that are not affected by restrictions, and in which activity is already high, fiscal policy should not be eased further currently. Industries affected by restrictions may still need access to temporary relief measures.

Outlook and economic policy

Resurgence of coronavirus delays Denmark's economic recovery

The coronavirus pandemic has been resurging in Denmark and Europe since September, leading to the imposition of a series of restrictions that will hamper economic activity over the winter. On the other hand, the roll-out of an effective vaccine has moved closer, and with it also the time when many restrictions are likely to be eased again.

In the 3rd quarter, large parts of the Danish economy had reopened after the spring lockdown, and gross domestic product, GDP, grew by 4.9 per cent, driven by exports and private consumption. Consumption especially increased in the parts worst affected by the spring lockdown such as clothing stores and restaurants. However, when the pandemic resurged, GDP was still 4.1 per cent lower than at the end of 2019.

So far, the current restrictions in Denmark and most other countries are not as severe as those seen in the spring and, therefore, the economic consequences of the rise in infection rates are generally smaller. Restrictions reduce the consumption of some services such as travel and, most recently, restaurants and culture activities and shift consumption towards industries that are not affected by restrictions such as the retail trade. Several of these industries are recording substantially higher revenue than before the coronavirus outbreak. Overall, the Danish economy is still growing, albeit with considerable differences across industries. In September, close to 60 per cent of the economy recorded higher than pre-pandemic revenue, while revenue in the rest of the economy was lower. Thus, the Danish economy is currently a two-speed economy.

Spread of coronavirus weakens European recovery

New measures to contain the spread of coronavirus have paused the European economic recovery in the 4th quarter after strong growth over the summer. During the autumn, several business confidence indicators deteriorated and are now pointing towards declining economic activity, although the deterioration is considerably weaker than in the spring. The US growth slowdown is less pronounced than in Europe, but the recent strong resurgence of the coronavirus in the USA increases the risk that growth will slow here as well. In China, which has seen a strong recovery, GDP is higher than before the pandemic struck.

The pandemic affects different parts of the economy differently. In the euro area, restrictions and behavioural changes are hampering the service sector, in particular, and restrictions have caused a notable shift of consumption from certain services towards goods. This supports industrial production and growth in global trade in goods, which is almost back at pre-pandemic levels. Conversely, trade in services, including travel, remains weak.

Services exports severely affected by restrictions

Export market developments are reflected in Danish exports, which are considerably lower than before the coronavirus outbreak, although they have recovered slightly since the start of the summer. Services exports have been hit the hardest, down 20 per cent in the 3rd quarter relative to the 4th quarter of 2019, in real terms. The sharp drop is mainly attributable to tourism and aviation, which have periodically been shut down completely due to restrictions. Until the pandemic is over, activity in these industries is expected to remain very low.

Danish exports of goods are affected less severely than exports of services, down 3 per cent in the 3rd quarter relative to end-2019. Exports of goods are comprised largely of agricultural products, pharmaceutical products and wind turbines. Demand for these products is less reliant on activity abroad, and the composition of exports of goods has been a buffer against the economic downturn abroad.[1] Agri-

1 See Adrian Michael Bay Schmith and Helle Eis Christensen, Large drop in Danish exports, but the composition might ease the fall, *Danmarks Nationalbank Economic Memo,* No. 8, June 2020 (memo available in Danish only).

cultural exports will be impacted by lower exports of fur skins after the culling of all Danish mink. However, due to the relatively small size of Danish fur exports, the overall economic consequences will be limited, although appreciable for some local communities.

Consumption is less hampered by restrictions than in the spring

Consumptions quickly picked up, as many restrictions were eased over the summer, and was boosted further by the disbursement of holiday allowance in October, see Chart 1.

Card turnover is currently close to its 2019 level, despite increased infection rates this autumn and the introduction of more restrictions, most recently the lockdown of restaurants and cultural activities in parts of Denmark. However, restrictions are imposed on fewer industries and are mostly less restrictive than seen in the spring. Thus, up until December, card turnover in restaurants and bars was considerably higher than in the spring; however, restrictions contribute to shifting consumption towards industries that are not affected by restrictions.

Although household consumption quickly recovered after the lockdown, it is still lower relative to household income than before the pandemic struck, and savings are high. However, households are widely expected to revert to pre-pandemic consumption and savings patterns. This is due to several reasons.

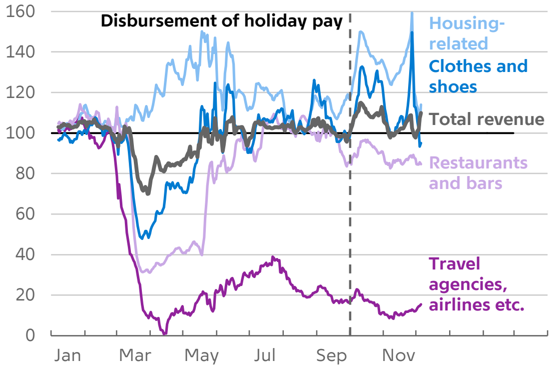
Firstly, the increase in savings is assessed to be driven largely by restrictions, rendering it partly involuntary, while precautionary savings has only played a minor role.[2]

Secondly, households have been consolidating since the financial crisis and already had high savings before the outbreak of the pandemic, see Chart 2, indicating that household savings ratios may return to pre-pandemic levels relatively quickly.

Thirdly, there are no clear signs that the pandemic will lead to permanent changes in the composition of household consumption. When restrictions were eased in the spring, consumption by older age

Consumption was boosted by October's disbursement of holiday allowance

Chart 1

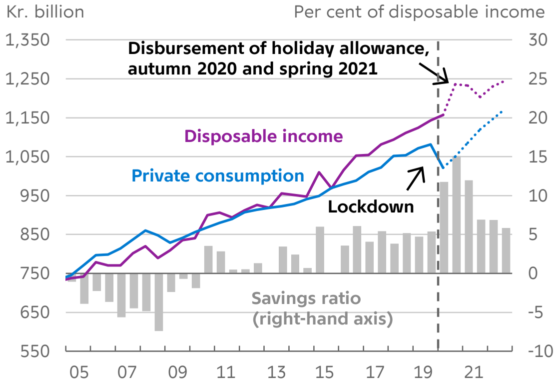


Note: Card turnover covers Danish cards processed by Nets. The turnover is a seven-day moving average up to and including 5 December 2020. From 6 April 2020, a comparison has been made with 15 April 2019 to ensure a correct comparison of the Easter weeks. From 10 October 2020, a comparison has been made with 12 October 2019 to ensure a correct comparison of the autumn half-term break. From 23 November 2020, a comparison has been made with 25 November 2019 to ensure a correct comparison of the Black Friday period. The categories are broadly defined and comprise related goods as well as services.

Source: Nets Denmark A/S and own calculations.

Savings were already high before the pandemic

Chart 2



Note: The chart shows semi-annual observations. The vertical line marks the transition from data to projection. Disposable income is adjusted for estimated disbursement of frozen holiday allowance, restructuring of capital pensions and savings under LD Pensions in 2013 and 2015.

Source: Statistics Denmark and own calculations.

2 Precautionary savings are estimated to account for about 5 per cent of the rise in the savings ratio from the 4th quarter of 2019 to the 2nd quarter of 2020, while 85 per cent of the increase was driven by factors such as restrictions. Estimates are based on the approach used in Maarten Dossche and Stylianos Zlatanos, Covid-19 and the increase in household savings: precautionary or forced?, *ECB Economic Bulletin*, No. 6, 2020.

groups rapidly increased – even in parts of the economy requiring high levels of social interaction.[3]

Consumption boosted by the disbursement of holiday allowance

The disbursement of three weeks of frozen holiday allowance boosted consumption by at least kr. 3 billion in October alone, see Box 1. The holiday allowance has to a minor extent only benefited industries affected by restrictions. Instead, the disbursement has been spent in parts of the economy in which activity was already high, for instance DIY and clothing stores.

The holiday allowance is likely to support activity for some time to come, as larger consumption decisions such as car purchases or home improvements may be made with some delay. Moreover, in December, an agreement was adopted to allow employees to cash in the final two weeks of frozen holiday allowance as well. Overall, the disbursements of holiday allowance are expected to boost private consumption by kr. 23 billion from the 2nd half of 2020 until early 2022.

High turnover and surging prices in the housing market

Trading activity in the housing market is high, and the number of homes on the market has declined. While prices fell during the March lockdown, they have since been surging, and in the 3rd quarter they were 4.3 per cent and 6.6 per cent higher than last year for single-family houses and owner-occupied flats, respectively.

These price increases are largely explained by income and interest rate developments. Household incomes have been supported by compensation schemes, while mortgage rates have been trending slightly downward since 2019. Household confidence about their own financial situation has remained relatively high despite the pandemic, which also helps

Holiday allowance will boost consumption by kr. 23 billion Box 1

On two occasions, the Folketing (Parliament) has decided to allow Danish employees to cash in the holiday allowance frozen when the Danish holiday act was amended. In August, employees were given the opportunity to cash in three out of five weeks of frozen holiday allowance in October, at which time kr. 52 billion of a maximum of kr. 60 billion was cashed in. In December, it was decided to give Danes the opportunity to cash in the final two weeks of frozen holiday allowance.

A total of kr. 100 billion may be cashed in, which is expected to boost consumption by an estimated close to kr. 23 billion from the 3rd quarter of 2020 up until and including the 1st quarter of 2022. It is assumed that 86 per cent of the holiday allowance will be cashed in, same as for the disbursement of the first three weeks of frozen holiday allowance; that the effective tax rate on the funds will be 35 per cent; and that the marginal propensity to consume will be 43 per cent.[1]

Disbursements boosted consumption by kr. 3 billion in October

Disbursements of the first three weeks of frozen holiday allowance is estimated to have boosted consumption by at least kr. 3 billion in October relative to September, in terms of card turnover. This estimate is subject to considerable uncertainty. Consumption especially benefited DIY stores, home furnishing stores and clothing stores, whose revenue increased by about kr. 2 billion, while the disbursement did not significantly increase consumption on hotels and restaurants. Estimates include the disbursement of the tax-free one-off subsidy to recipients of transfer incomes totalling kr. 2 billion.

The effect on consumption is estimated using detailed card turnover data. Several factors may cause these estimates to be downward biased: The expected disbursement may have boosted consumption before the disbursement of holiday allowance; some consumption groups are settled by invoice rather than payment card; revenue of supermarkets used as control group may presumably have been supported by the disbursements to some extent.

Restrictions reduce the impact on employment

Using input-output calculations, the employment impact of increased consumption is estimated at 2,000 persons for October. With restrictions reducing consumption opportunities for a number of services, the impact on employment is reduced, as services tend to have lower import content and be more labour-intensive than goods. The impact on employment is estimated to have been 2,600 persons if increased consumption had also benefited restaurants and hotels.

1. See Henrik Yde Andersen, Spending when illiquid savings become liquid: evidence from Danish wage earners, *Danmarks Nationalbank Working Paper*, No. 161, September 2020.

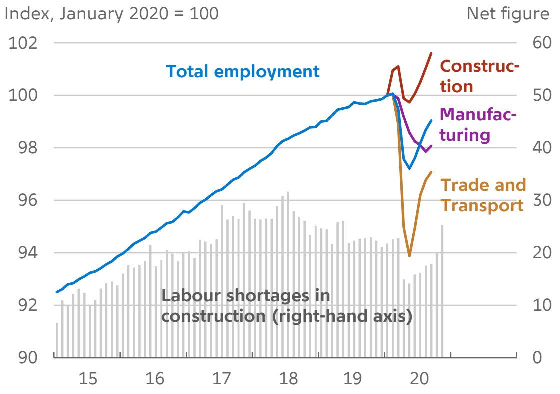
3 Source: Danske Bank's card turnover data.

to underpin prices. Moreover, the typical home buyer has not been as severely affected by the economic consequences of the pandemic as the households in general.[4] Behavioural changes may also have boosted housing demand, increasing the pressure on the housing market during the pandemic. However, as housing demand is satisfied or if behaviour normalises, this pressure may abate.

Developments in the housing market are expected to be more subdued going forward, with prices largely reflecting income growth. However, very low costs of financing, combined with higher disposable incomes and temporarily high demand for housing, could lead to self-reinforcing increases in house prices and increased accumulation of debt, which may subsequently result in an abrupt slowdown. The market for owner-occupied flats is especially vulnerable because prices were already high before the pandemic struck.

Employment is affected very differently across sectors

Chart 3



Note: Labour shortages are own season adjustment.
Source: Statistics Denmark and own calculations.

Lower investment reduces corporate borrowing needs

Business investment rose in the 3rd quarter as demand recovered. However, following the substantial drop in the spring, investment is still lower than at the end of 2019, mainly because corporations expected a sharp slowdown in growth prospects for Denmark and the rest of the world. The pandemic has also increased uncertainty, also causing business investment to decline.[5]

Fewer investments reduce corporate borrowing needs. At the same time, Danish corporations have increased their resilience by increasing savings for a number of years before the coronavirus outbreak, and public relief packages have also helped to meet the increased liquidity needs of corporations suffering drops in revenue.[6] This means that corporate borrowing has risen only slightly during 2020 – also in several of the industries affected by restrictions.

Some corporations will need increased access to credit when having to pay deferred VAT and tax bills in 2021, which could lead to an increase in the number of defaults. Corporate credit standards remained largely unchanged in the 3rd quarter, and there are no indications that access to credit will hamper investment when the current relief packages expire.

Low employment in parts of the economy

Employment increased sharply over the summer and has now recovered almost two thirds of its fall in the spring. However, real-time indicators suggest that the labour market recovery has lost momentum over recent months.

There are considerable differences in the development of employment across industries. Despite significant recovery over the summer, employment is still very low in transport, hotels, restaurants and culture, see Chart 3. The manufacturing industry

4 See Svend Greniman Andersen, Simon Juul Hviid and Agnete Gad, Moderate setback on the housing market, *Danmarks Nationalbank Economic Memo*, No. 5, June 2020 (memo available in Danish only).

5 See Mikkel Bess, Erik Grenestam, Alessandro Tang-Andersen Martinello and Jesper Pedersen, Uncertainty and the real economy: Evidence from Denmark, *Danmark Nationalbank Working Paper*, No. 165, 2020.

6 See Alexander Meldgaard Otte, Carina Moselund Jensen, Nastasija Lonchar and Rasmus Mose Jensen, Lower borrowing needs in Danish corporations compared to European during COVID-19, *Danmarks Nationalbank Analysis*, No. 20, October 2020.

has recorded a gradual fall in employment since the spring, possibly reflecting that activity in the export-reliant manufacturing industry has been affected with some lag. On the other hand, employment in construction is higher than before the pandemic.

The labour market downturn has dampened private-sector wage growth across all industries. The strongest wage growth is still seen in construction, with a large proportion of corporations once again reporting labour shortages.

Outlook of several years of low activity abroad

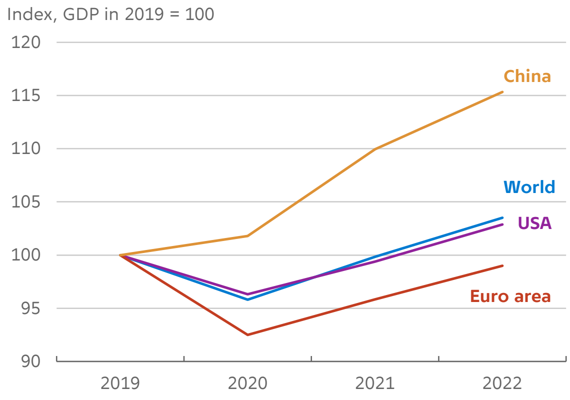
The further recovery of the Danish economy over the next couple of years especially depends on the deployment of vaccines and the speed of recovery of export markets.

International organisations expect a gradual recovery of the global economy in the coming years. The OECD's December Economic Outlook forecasts global GDP growth of 4.2 per cent in 2021 and 3.7 per cent in 2022 following a historic contraction of 4.2 per cent in 2020. The UK and the EU are assumed to enter into a trade agreement, preventing a sudden and sharp deterioration of their terms of trade.

However, the euro area GDP will still be lower at the end of 2022 than in 2019, see Chart 4. The weak level of activity is explained, among other things, by the OECD's expectation that household consumption and savings patterns will normalise only gradually and that savings will remain high until 2022.

The global economic recovery is underpinned by accommodative financial conditions, especially in the form of low interest rates. Central bank asset purchase programmes and liquidity support measures have helped to contain fluctuations in financial markets, thereby more broadly supporting lending and activity.

Euro area will not recover from decline in activity until 2022 Chart 4



Source: OECD.

Recovery will gain momentum with the deployment of vaccines

Danish growth is estimated to have slowed down significantly in recent months, and the trend is expected to continue over the winter. Based on a number of real-time indicators and the extent of restrictions, GDP is expected to grow by between 0.5 and 1 per cent in the 4th quarter. In the projection, the recovery will regain momentum with the deployment of one or more vaccines during spring 2021, and most restrictions are assumed to have been lifted come summer 2021.[7]

Consumption has already recovered substantially, and the remainder is expected to recover rapidly with the expected easing of restrictions in spring and summer 2021. Recovery will be more gradual in Denmark's export markets, affecting exports and, thereby, the need for investment. Because the Danish economy is less affected than other economies, imports will grow more than exports until 2022. This will weigh on the current account, which will, however, continue to show a considerable surplus.

7 The projection is based on statistics published up until and including 2 December. This means that the projection does not factor in the impact of recently announced political initiatives, including the latest Finance Act agreement and the introduction of new restrictions on restaurants and cultural activities in parts of Denmark. The initiatives announced have limited effect on activity, and overall they are not believed to have a significant impact on the projection.

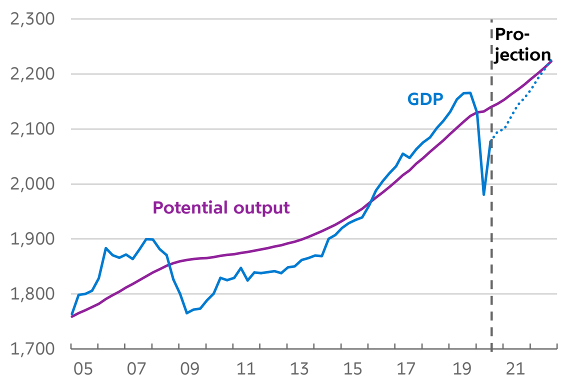
Overall, GDP is expected to contract by 3.9 per cent in 2020 and then grow by 2.9 per cent and 3.3 per cent, respectively in 2021 and 2022, see Table 1.

Activity will be restored to pre-pandemic levels by the end of 2021, but there will still be a backlog compared to neutral capacity utilisation until the 2nd half of 2022, see Chart 5. The Danish economy is expected to move from a mild recession to a more neutral cyclical position over the projection period.

Employment is expected to rise by 45,000 persons from the 3rd quarter of 2020 until the end of 2022 as activity gradually recovers, while unemployment will decline by 20,000. The increase in employment is supported by labour force growth due to reforms already adopted, including indexation of the statutory retirement age.

Inflation is expected to rise gradually over the coming years, but remain subdued throughout the projection horizon as a result of low import price inflation and modest wage growth.

Output will be slow to recover Chart 5



Note: Potential output is the long-term level of sustainable real output in the economy without creating inflationary pressures.
Source: Statistics Denmark and own calculations.

Risk outlook is dominated by the pandemic
The evolution of the pandemic dominates the risk outlook, and the uncertainty surrounding growth prospects is high. Risks are predominantly negative over the coming months as rising infection rates may trigger further restrictions and an economic slowdown.

However, if one or more of the vaccines developed are quickly given final approval and can be mass produced and distributed widely, economic activity may recover more quickly and emerge stronger than assumed. Should the vaccines not be approved, the pace of recovery will be considerably slower than expected.

Also, the recovery in other countries may be accelerated if consumption and savings patterns normalise faster than expected by international organisations, which would strengthen export opportunities of Danish corporations.

Massive relief packages have been implemented to keep corporations afloat during the pandemic, for instance by supporting corporate liquidity needs by way of compensation schemes and deferral of payment deadlines. So far, the level of defaults in Denmark has been low, but it could rise with the expiry of relief packages.

Relief packages have resulted in higher government deficits and debt across countries. This could pose risks to the long-term sustainability of public finances in countries with high government debt, leading to the inexpedient tightening of fiscal policy and financial conditions.

The future of the UK's relationship with the EU remains unclear, and a hard Brexit would reduce growth in the UK and in several other Danish export markets. The uncertainty surrounding international trade conditions post-Brexit is also linked to a trend towards increased protectionism and global tensions. In the longer term, weaker trade relations could lead to poorer utilisation of comparative advantages between countries and, therefore, weaker productivity.

No current need for further fiscal stimulus
Activity is low in the parts of the economy affected by restrictions or lower foreign demand. But other parts of the economy – such as construction – are recording high activity and employment.

To ensure a smooth business cycle across industries, fiscal policy should not stimulate demand further at this point; fiscal easing only to a small extent benefits industries affected by restrictions, and instead supports industries in which activity is already high. In other words, fiscal easing increases the pressure in industries that are not affected by restrictions. In that context, the temporary extension of the 'Housing-Job Scheme' in 2021 is inexpedient.

Experience from the spring shows that activity may quickly return when restrictions are eased. Consequently, the disbursement of holiday allowance may prove to be unnecessary, or even inexpedient, in terms of ensuring a smooth business cycle, and fiscal policy should not be eased further.

Providing relief measures to industries in which activity is currently low comes at a cost to society – but not doing so also comes at a cost. The costs of relief packages should be weighed against the costs of viable corporations defaulting, resulting in losses for employees, owners and society.

Experience from the easing of the lockdown in the spring indicates that households will quickly return to pre-pandemic demand patterns when there are no restrictions or widespread infection. This would indicate that activity will largely return in industries currently suffering from low earnings due to restrictions.

The possibility of a rapid roll-out of an effective vaccine also reduces the risk that long-term relief packages will be needed. Both an expected normalisation of the composition of consumption and an early roll-out of vaccines would indicate that industries affected by restrictions should be offered relief, for instance through short-time work schemes. Denmark can afford to do so because government debt is low. But it is important that all temporary relief measures to individual corporations are removed as soon as restrictions are lifted.

Economic policy

To ensure a smooth business cycle in industries that are not affected by restrictions, and in which activity is already high, fiscal policy should not be eased further at this point. Access to temporary relief measures may be necessary for some industries.

Economic uncertainty is high, and economic growth could be significantly stronger or weaker than expected. Therefore, it is important to be ready to tighten or ease the planned fiscal policy.

The extension of the 'Housing-Job scheme' is inexpedient because it supports activity in industries in which activity is high, including construction.

Key economic variables

Table 1

Real growth relative to the previous period, per cent	2019	2020	2021	2022	2020 Q1	2020 Q2	2020 Q3
GDP	2.8	-3.9	2.9	3.3	-1.6	-7.0	4.9
Private consumption[1]	1.4	-4.1	5.9	4.2	-3.0	-6.3	4.2
Government consumption expenditure	1.2	-0.5	1.8	0.8	-1.8	-1.7	1.0
Residential investment	6.2	4.8	3.7	1.8	6.1	-0.1	-0.3
Government investment	0.3	7.9	3.4	2.6	13.3	-3.0	3.4
Business investment	2.3	-2.8	2.4	4.9	1.0	-9.5	4.8
Inventory investment, etc.[2]	-0.3	-0.3	0.0	0.0	-0.1	-1.7	1.7
Exports	5.0	-9.4	4.0	6.5	-3.1	-11.6	5.3
Industrial exports	10.1	-2.0	2.1	5.1	1.9	-8.0	3.3
Imports	2.4	-7.4	6.4	6.6	-2.4	-11.9	5.4
Employment, 1,000 persons	3,003	2,980	3,004	3,020	3,012	2,933	2,982
Gross unemployment, 1,000 persons	104	133	126	121	108	154	140
Current account, per cent of GDP	8.9	7.4	6.3	6.6	8.1	8.0	7.0
Government balance, per cent of GDP	3.8	-3.4	-2.0	-1.9	-0.2	-4.4	-1.5
House prices[3], per cent year-on-year	3.0	3.1	3.0	2.7	2.4	1.9	4.3
Consumer prices (HICP), per cent year-on-year	0.7	0.3	1.1	1.4	0.6	0.0	0.4
Hourly wages[4] (manufacturing), per cent year-on-year	2.5	2.1	2.1	2.4	2.8	2.1	1.9

Source: Statistics Denmark and own calculations.
1. Includes both households and non-profit institutions serving households (NPISH).
2. Contribution to GDP growth (this item comprises inventory investment, valuables and statistical discrepancy).
3. Nominal prices of single-family houses.
4. Statistics Denmark's implicit wage index.

PUBLICATIONS

NEWS

News offers a quick and accessible insight into an Analysis, an Economic Memo, a Working Paper or a Report from Danmarks Nationalbank. News is published continuously.

ANALYSIS

Analysis from Danmarks Nationalbank focuses on economic and financial matter. Some of the analyses are published with a regular frequency e.g. *Outlook for the Danish economy and Financial stability*. Other analyses are published continuously.

REPORT

Report comprises recurring reports and reviews of the functioning of Danmarks Nationalbank. For instance Report includes the *Annual report* and the annual publication *Danish government borrowing and debt.*

ECONOMIC MEMO

Economic Memo is a cross between Analysis and Working Paper and it often shows the ongoing study of the authors. The publication series is primarily targeted at professionals. Economic Memo is published continuously.

WORKING PAPER

Working Paper presents research projects by economists in Danmarks Nationalbank and their associates. The series is primarily targeted at professionals and people with an interest for academia. Working Paper is published continuously.

The analysis consists of a Danish and an English version. In case of doubt regarding the correctness of the translation the Danish version is considered to be binding.

DANMARKS NATIONALBANK
LANGELINIE ALLÉ 47
DK-2100 COPENHAGEN Ø
WWW.NATIONALBANKEN.DK

This edition closed for contributions on 8 December 2020

DANMARKS NATIONALBANK

CONTACT

Ole Mikkelsen
Communications and Press Officer

omi@nationalbanken.dk
+45 3363 6027

SECRETARIAT AND COMMUNICATIONS