Just under three weeks ago, we published a forecast for the Danish economy headed ‘Fragile recovery’. However, much has happened since then in both the Danish and the global economies, so naturally we wish to take a fresh look at the state of play. Starting with Denmark, we have received the new National Accounts figures that include the ESA 2010 comprehensive revision. This constituted a slight positive surprise, as the figures showed the Danish economy has grown for four quarters in a row for the first time since the financial crisis. Growth has not been particularly high, but at least it has been better than the previous numbers had indicated. Nevertheless, we have decided to revise down our growth forecast for the coming months and next year, as Danish economic data, which now stretches into Q3 14, has been generally disappointing. Moreover, increasing global economic uncertainty is undermining the outlook for exports: Germany has downgraded its growth outlook for 2015 from 2.0% to 1.3%, while the IMF has revised down its expectations for both global and European growth and we have recently downgraded our 2015 eurozone growth forecast from 1.9% to 1.5%.

In our September forecast we expected growth of 0.8% this year, rising to 1.8% next year. Given the latest economic data from Denmark and abroad, we now see growth of 0.7% this year and 1.3% next year as more likely. However, although we are lowering our growth forecast, we still expect the Danish economy to improve – we just expect the pick-up will be weaker than previously estimated. Furthermore, while growth will not impress, we still expect a slight pick-up in employment in the coming years. We estimate that around 10,000 new jobs will be created between Q2 this year and the end of next year, which is rather modest, given that employment has increased by 30,000 over the past one and a half years – i.e. during a period of lower growth than today.

Private consumption will probably be the main driving force behind this modest pace of growth, as we expect disposable income to increase slightly on the back of rising real wages, while the uncertain global economic situation has pushed interest rates down to all-time lows – to the benefit of the housing market. Thus while the Danish economy looks set to develop less favourably than one might have wished, we still expect to see rising house prices, which traditionally have been very important for consumption growth. Significantly lower oil prices in recent months should also help spur consumption via lower inflation and hence greater purchasing power. Pulling in the opposite direction are equity prices, which have fallen in recent weeks. However, as Danish equity investments are done mainly via pension savings, falling equity prices generally do not have a major impact on consumption growth.
While consumption growth still looks set to be reasonable, we have to acknowledge that the export outlook is not encouraging. The German economy in particular looks more fragile than it has for a long time, and that will inevitably have repercussions for Denmark. We therefore expect only very modest export growth in the coming years, so net exports are likely to be a slight drag on economic activity.

Government finances have been a hot topic in Denmark, though an outsider would probably say they were one of the smaller problems facing the Danish economy. The government’s draft budget pushed public finances to the limit, so the concern was that Denmark might overstep the EU’s 3% deficit limit in 2015. As a result of these concerns, the government has made an agreement with the left-wing Unity List party that should reduce the risk of an overrun. The agreement focuses once again on bringing forward tax revenues (from capital pension (lump sum) conversions and so-called LD pension savings). If the politicians, as promised, refrain from using the additional revenue to increase spending, the pension intervention should improve government finances by around DKK15bn in 2015. However, as the lower growth outlook points to a higher deficit and falling oil prices have reduced government balances by DKK3-5bn, we still cannot fully rule out a breach of the 3% limit. In our view, however, Denmark’s public finances should not be a major cause for concern. If the deficit were to cross the famous 3% line due to lower economic activity and oil prices, the breach would be temporary and not undermine the essential sustainability of Denmark’s fiscal policy – nor would we expect it to change investors’ view on the Danish economy. We are not saying this gives the politicians carte blanche with respect to further fiscal easing, but given the planned fiscal policy, which in fact encompasses modest tightening, we do not believe the politicians have gone too far.
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