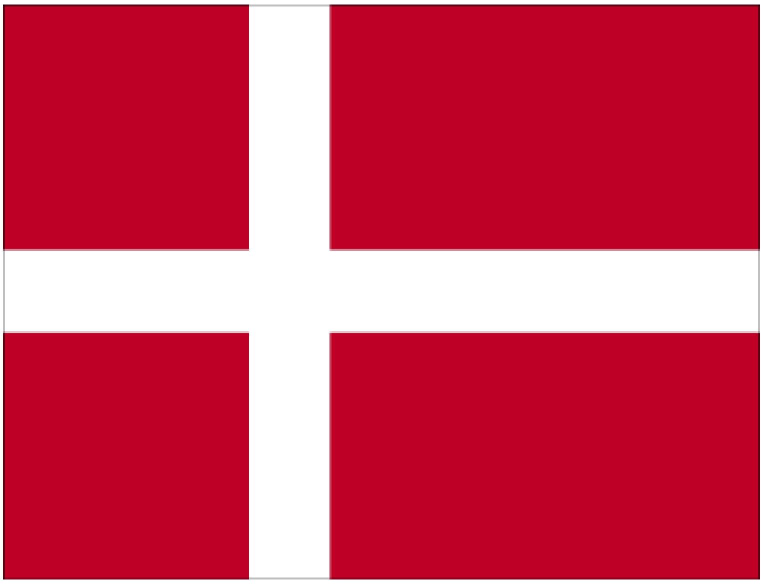
Rabobank

Country report **DENMARK**



Summary

Barely recovered from the house price correction and the deep 2009 recession, the Danish economy is now hampered by eurozone headwinds. Despite the monetary and fiscal stimulus we expect only meager growth going forward. Although the banking sector remains a weak spot, we note that the Danish economy is based on very healthy public finances and a competitive business sector.

Things to watch:

- Difficulties for banking sector to attract sufficient funding.
- Need to reduce the high level of public expenditures.
- High dependency on European debt crisis for economic recovery.

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Denmark

National facts	
Type of government	Constitutional monarchy
Capital	Copenhagen
Surface area (thousand sq km)	43
Population (millions)	5.6
Main languages	Danish
Main religions	Lutheran (95%) Other Christian (3%) Muslim (2%)
Head of State (president)	Queen Margrethe II
Head of Government (prime-minister)	Helle Thorning-Schmidt
Monetary unit	DKK

Economy		2011
Economic size	*bn USD*	*% world total*
Nominal GDP	333	0.48
Nominal GDP at PPP	226	0.29
Export value of goods and services	182	0.83
IMF quotum (in mln SDR)	1891	0.87
Economic structure	*2011*	*5-year av.*
Real GDP growth	1.1	-0.1
Agriculture (% of GDP)	1	1
Industry (% of GDP)	22	24
Services (% of GDP)	77	74
Standards of living	*USD*	*% world av.*
Nominal GDP per head	59678	553
Nominal GDP per head at PPP	40505	328
Real GDP per head	46347	570

Social and governance indicators	rank / total
Human Development Index (rank)	16 / 187
Ease of Doing Business Index (rank)	5 / 183
Index of Economic Freedom (rank)	11 / 179
Corruption Perceptions Index (rank)	2 / 183
Press Freedom Index (rank)	10 / 178
Gini index (income distribution)	24.7
Population below $1.25 per day (PPP)	n.a.

Foreign trade			2010
Main export partners (%)		*Main import partners (%)*	
Germany	17	Germany	21
Sweden	14	Sweden	13
UK	8	Norway	7
US	6	Netherlands	7
Main export products (%)			
Machinery and transport equipment			25
Food, drinks and tobacco			18
Chemicals and related products, n.e.s.			16
Mineral fuels, lubricants, and related materials			9
Main import products (%)			
Machinery and transport equipment			31
Food, drinks and tobacco			13
Chemicals and related products, n.e.s.			12
Mineral fuels, lubricants, and related materials			7
Openness of the economy			
Export value of G&S (% of GDP)			55
Import value of G&S (% of GDP)			49
Inward FDI (% of GDP)			3.5

Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

Full report:

The Danish economy experienced a very slow recovery after the deep 2008-2009 recession. At the end of 2011, GDP was still more than 5% below its pre-crisis level (08Q2). The economy was not only hit by the global recession due to the financial crisis, but also by a severe drop in house prices during 2008 (-20% in nominal terms). The deflation of the house price bubble caused a steep fall in both business investments (currently still 21% below its pre-crisis level) and private consumption, as households started to repair their balance sheets. Exports did contribute to growth, but slowed considerably during 2011 mainly due to the intensification of the European debt crisis. Reflecting the flexible character of the labor market, unemployment rose quickly from 3.2% in 2008 to currently 7.9%.

For 2012 we expect only meager growth, mainly as export growth will remain subdued amid weak demand from the eurozone. However, domestic demand should be able to contribute gradually to growth in the coming years. A precondition is that the recent rise of consumer and producer confidence continues, as the debt crisis pushed their levels clearly below their long term average in the autumn of 2011. This and next year the government will use its fiscal space to cushion the effects of the economic slowdown by a fiscal stimulus package amounting to 1%-GDP. Although dependent on the evolution of the debt crisis, we believe also export growth might function as a growth driver again from next year onwards. Due to the peg of the krone and the euro, the Danish central bank was tempted to follow the ECB's policy rate movements. However, in December the central bank cut its policy rate to 0.70%, below the ECB's rate of 1.00%. Although the interest rate differential was created to reduce the upward pressure on the krone as a result of safe haven flows, it might also support domestic demand going forward.

As a consequence of the severe recession and the relatively large impact of automatic stabilizers in Denmark (partly due to the flexible labor market), public finances deteriorated significantly in recent years. Gross public debt rose from 28%-GDP in 2008 to 46%-GDP in 2011 and will rise further as the budget deficit is expected to increase to more than 5%-GDP this year. It should be noted that public financial assets are almost equal to gross public debt. As the current debt position suggests fiscal space and financial markets seem to have high confidence in Danish debt sustainability, indicated by bond yields comparable to Germany, we believe the current fiscal stimulus package is sensible. This conviction is also based on the steps taken by the current government to improve Denmark's long term public finances. The minority coalition of three center-left parties – elections were held in September 2011 – pushed a pension reform through parliament in December 2011. In the next two decades, the retirement age will be increased gradually from 65 to 69 years, while the minimum retirement age will be increased from 60 to 66 years. The current effective retirement age (64.4 years for men and 61.9 for women) is average compared to other OECD countries, while also future population aging is average from an OECD perspective. Further, the current government proposed a tax reform which entails that only those holding jobs will receive tax cuts. This reform is part of a number of policy actions aimed to bring down the unemployment rate, which rises steeply during downturns as a consequence of loose firing regulation in the Danish flexicurity model. Given the high unemployment rate, the acceptance of labor unions to let nominal wages rise only modestly until March 2014, in combination with extra funding for education and retraining schemes, is encouraging. That said, there remain challenges for the government. The very high level of public expenditures (58%-GDP in 2010, highest among OECD-countries) should be lowered as the resulting large tax burden on the private sector might act as a drag on growth. However, it is questionable whether the current government is able to push forward harsh expenditure cuts when momentum improves.

The financial position of the Danish private sector is average from a European perspective. Households have a sizeable gross debt position (151%-GDP, of which 101%-GDP are mortgages) which makes them vulnerable to large movements of housing prices and interest rates, especially as 65% of the outstanding mortgage debt has adjustable or floating interest rates. However, it should be noted that households have even larger financial assets (including pension savings), as a result of which their net financial assets are positive (102%-GDP in 2010). Danish firms are competitive, which is also shown by the 8th ranking (out of 142) in the Global Competitiveness Index 2011-2012. However, during the last decennium firms have experienced a relatively large rise of unit labor costs, which has deteriorated their price competitiveness. In this light, the recent agreement on wage moderation should help to underpin the position of Danish firms. Overall, the history of steady current account surpluses has resulted in only a slightly positive net investment position. The banking sector remains a weak spot in Denmark. Although the banking sector regained profitability and increased its solvency after the real estate correction, banks remain vulnerable especially due to the large dependency on wholesale funding. Besides that, the future of the large covered-bond market is uncertain as it is yet unsure whether covered bonds will be fully eligible under the Basel 3 liquidity regulation. Therefore the attraction of sufficient funding might become more problematic for Danish banks, especially given the tight (and therefore expensive) Danish saving market. The banking sector is not only a threat to public finances, but might also hamper economic growth if banks end up reducing their balance sheets.

Denmark

Selection of economic indicators	2007	2008	2009	2010	2011	2012e	2013f
Key country risk indicators							
GDP (% real change pa)	1.6	-0.8	-5.8	1.3	1.1	0.5	1.1
Consumer prices (average % change pa)	1.7	3.4	1.3	2.3	2.8	2.4	2.1
Current account balance (% of GDP)	1.5	2.9	3.3	5.5	6.7	4.1	3.4
Economic growth							
GDP (% real change pa)	1.6	-0.8	-5.8	1.3	1.1	0.5	1.1
Gross fixed investment (% real change pa)	0.4	-4.1	-13.4	-3.7	0.3	1.0	2.8
Private consumption (real % change pa)	3.0	-0.3	-4.2	1.9	-0.2	1.1	1.5
Government consumption (% real change pa)	1.3	1.9	2.5	0.3	-0.7	1.1	0.7
Exports of G&S (% real change pa)	2.8	3.3	-9.8	3.2	7.0	1.5	2.8
Imports of G&S (% real change pa)	4.3	3.3	-11.6	3.5	5.3	2.5	3.8
Economic policy							
Budget balance (% of GDP)	4.8	3.2	-2.8	-2.8	-2.5	-5.0	-3.3
Public debt (% of GDP)	28	34	41	43	46	49	50
Money market interest rate (%)	4.3	4.9	1.8	0.7	1.1	1.0	1.0
M2 growth (% change pa)	13	9	-3	-4	-9	3	2
Consumer prices (average % change pa)	1.7	3.4	1.3	2.3	2.8	2.4	2.1
Exchange rate LCU to USD (average)	3.7	3.7	3.7	3.7	3.7	n.a.	n.a.
Recorded unemployment (%)	3.6	2.6	4.7	6.0	6.0	6.5	6.3
Balance of payments (mln USD)							
Current account balance	4769	10000	10402	17133	22300	12700	10700
Trade balance	392	911	7945	8643	10000	6900	3800
Export value of goods	100720	115137	92176	95771	112700	109100	110800
Import value of goods	100330	114230	84230	87127	102800	102300	107000
Services balance	7970	10197	4490	8509	9100	7200	8000
Income balance	1739	4566	3312	5772	9400	4200	4600
Transfer balance	-5329	-5670	-5344	-5793	-6200	-5600	-5800
Net direct investment flows	-8186	-12134	-1942	-11007	-12500	-6730	-7210
External position (mln USD)							
International investment position	-19254	-16890	11672	30400	n.a.	n.a.	n.a.
Total assets	713467	680013	747666	776158	n.a.	n.a.	n.a.
Total liabilities	732721	696903	735994	745758	n.a.	n.a.	n.a.
Key ratios for balance of payments, external solvency and external liquidity							
Trade balance (% of GDP)	0.1	0.3	2.6	2.8	3.0	2.2	1.2
Current account balance (% of GDP)	1.5	2.9	3.3	5.5	6.7	4.1	3.4
Inward FDI (% of GDP)	3.8	0.6	1.3	-2.5	3.5	0.0	0.4
International investment position (% of GDP)	-6.2	-4.9	3.8	9.7	n.a.	n.a.	n.a.

Source: EIU