DENMARK

UNDER PRESSURE

With relatively few Covid-19-related deaths, and after what proved to be a mild recession in 2020, Denmark is one of the countries that has pulled through the pandemic the best. Economic activity has already returned to pre-crisis levels, the cyclical environment was still going strong over the summer months, and the spread of the Delta variant did not pose much of a threat to a largely vaccinated population. The rapid economic recovery is already revealing a few tensions in terms of production capacity and employment. The central bank is not very alarmed and is expected to maintain the status quo, with negative money market rates. The government has begun to better target its subsidies.

With a total of 2,650 deaths reported so far (455 deaths per million inhabitants), Denmark is one of the countries with the lowest number of Covid-19-related deaths (Sweden, for example, reported three times more victims as a share of its population). Thanks to a largely vaccinated population (76%, vs a European Union average of 66%), Denmark was one of the very first countries to lift all health restrictions (end of mask requirements and "vaccine passports"). As a result, after limiting its losses in 2020, the economy is recovering rapidly.

FIRST IN CLASS

GDP had already returned to pre-pandemic levels in Q2 2021, and full-year growth is expected to near 3% or more. As in many countries, the rebound was fuelled by the catching-up of private consumption, and in counterpart, the unblocking of forced savings built up in 2020. As fall approaches, this growth engine does not seem to have fully run its course yet, and the household confidence index is still holding at a high level.

Investment prospects are also positive, as illustrated by surveys of business leaders, which were still upbeat through August. Exports are driving production and equipment purchases, and export growth is easily expected to surpass 5% in 2021.

The rapid economic recovery has been accompanied by hiring troubles, as illustrated by the rebound in job vacancies over the past year. For Denmark's central bank, these pressures are only temporary because they are limited to competition between companies to find skilled employees as the health crisis comes to an end. They are unlikely to accelerate significantly to all employees[1].

Inflation rose to 1.8% year-on-year in August. This increase is largely due to energy prices, which accounted for 8% of the price index but 50% of the increase. Core inflation (excluding energy and food prices) is still very low at 0.7%. The Danish central bank hardly needs to change its policy after adjusting the key rate corridor last spring in response to upward pressures on the krone (DKK)[2]. It will maintain its key deposit rate unchanged at -0.6%.

Although the Danish government did not abandon the principle of "whatever the cost" during the crisis, the pre-existence of powerful social shock absorbers reduced the need for fiscal transfers. According to IMF estimates, since the beginning of the pandemic fiscal transfers have amounted to a total of DKK 79.5 bn, or 3.4% of 2020 GDP. Although this is high, it is nowhere near the amounts engaged by the so-called "liberal" economies, such as the United States and the UK. Government efforts went hand in hand with those of companies and employees, which helped limit the rise in unemployment. At 3.2% of the active population in July, the unemployment rate has returned to low levels.

GROWTH AND INFLATION (%)

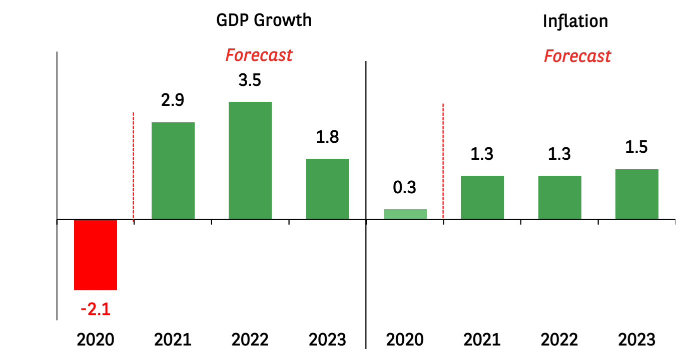

CHART 1 SOURCE: EUROPEAN COMMISSION, BNP PARIBAS

As economic activity returns to normal, the government has begun to better target its subsidies, reserving them for the most vulnerable sectors and companies. Its priorities are now shifting towards "green" investments. Denmark's fiscal policy is unfolding in a rather unrestrictive environment. It still has low deficits despite the pandemic (2.1% of GDP in 2021, according to the European Commission), and its public debt is contained at 40% of GDP.

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1 Denmarks Nationalbank, *Outlook for the Danish Economy*, September 2021.
2 BNP Paribas, *EcoPerspectives*, 2nd quarter 2021