Macro Research

Denmark

Recession is now a clear and present danger

It now appears inevitable that the COVID-19 outbreak will have a significant negative impact on global and Danish GDP growth. The draconian measures taken by governments in their attempt to cushion the severity of the virus' spread, the meltdown of financial markets, the escalation in the oil price war, and the very likely hit to discretionary spending and investments all indicate that recession is now a major and real threat. Of course, the spread and duration of the virus, as well as the policy response, will determine the girth of the decline, but a likely scenario is that Denmark will have close to zero growth this year and gross unemployment will rise up towards 5 percent by the end of the year.

Benign scenario seems like wishful thinking

The speed of the spread of COVID-19 outside China and the measures being taken by authorities to cushion the severity of the outbreak have made the negative economic impact ever more obvious. We have so far operated with two scenarios regarding the impact of the virus and with the help of Oxford Economics' global model have looked at possible outcomes for the Danish and global economies.

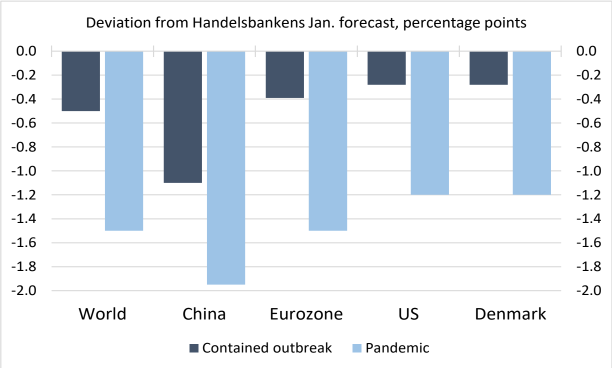
- ***Scenario 1: Contained outbreak.*** The spread of COVID-19 tails off quickly and economic activity in China, South Korea and Italy starts to normalise during the second quarter. In this benign scenario, global growth would be 0.5 p.p. lower in 2020 and growth in Denmark would be around 0.3 p.p. lower compared to our forecast in January.

- ***Scenario 2: Pandemic*.** The virus continues to spread rapidly in many countries in the first half of the year. Quarantines, travel bans and increasing uncertainty hit production, investment and consumption hard, and leads to a negative demand shock on top of the initial supply shock. Those developments lead to a global recession and a 1.3 p.p. reduction in Danish GDP growth this year. Given that we already expected the Danish economy to slow this year, even before the virus outbreak (1.2 percent in our January forecast), it leaves GDP growth at close to 0% or below. The unemployment rate would increase dramatically.

As things are changing rapidly on a daily basis, it is clear that the uncertainty regarding the economic consequences of the virus is enormous. However, given the recent extremely negative trends in financial markets and the WHO now declaring the outbreak a pandemic, the first, more benign, scenario is looking less and less likely. Currently, we assess that we probably are somewhere in between the two scenarios, but also that the recession threat in scenario 2 is approaching at an eerie speed. Wherever we end up will of course depend on the continued spread and duration of the virus, as well as the responses by policy makers. On a positive note, it appears that China's draconian containment measures have got the outbreak under control. However, the response from the US authorities seems so far to be inadequately behind the curve. Also, the complete lockdown of the Italian economy will have negative repercussions for the rest of Europe; the risk is that other countries will have to implement the same sort of measures at some point.

In addition, the recent collapse in oil prices poses an added threat to the global economy, in our view. In 'normal' times, a sharp drop in oil prices is seen as a boon for oil-importing countries, leading to higher consumption growth, for example. In combination with the virus outbreak, it is very uncertain if lower fuel prices will lead to higher consumption, as uncertainty keeps households' propensity to consume at bay. Furthermore, lower oil prices – if sustained – will most likely also have a negative impact on the US economy, which today is a net oil exporter, and hurt the already somewhat distressed shale-oil industry.

COVID-19 scenarios, effects on 2020 GDP



Source: Oxford Economics global model and Handelsbanken

Handelsbanken Capital Markets

Anti-virus measures speeding up in Denmark

The Danish economy is expected to be hit by the virus outbreak on several fronts. There will be a direct effect on exports as global demand dampens and supply disruptions will most likely also hit production. Sentiment will take a hit as households and businesses experience increased uncertainty, curtailing discretionary spending and investment. The recent measures implemented by the Danish government will also take their toll on economic activity, as it constitutes a major supply shock to the economy, with a likely ensuing significant demand shock.

The latest relatively draconian measures taken by the Danish government should be seen in light of the rapid spread of COVID-19 in Denmark. There are now 785 confirmed cases (as of March 13), a very clear acceleration from only 10 cases 8 days ago. The newest measures to dampen the spread of the virus, which are initially in place for two weeks, but may be extended, include:

- All public employees who are not viewed as critically essential are sent home (with pay)
- Private companies are asked to follow the example and keep employees at home if possible
- All educational and day-care facilities (including schools), as well as public places such as libraries and museums, are closed
- The government is expected to shortly have legislation in place that effectively bans gatherings or meetings with more than 100 participants
- The government asks that nightclubs, bars, cafés etc. close down

The negative economic impact from such measures is likely to be significant in the short run. As things stand right now, they will most likely be extended beyond the current 14-day period. So far, the hard economic data from Denmark only covers the period prior to the virus outbreak, so we have no real evidence of how hard the economy is hit yet.

We see an increasing risk that GDP growth in Q1 will be severely hampered, although an apparent unfortunate hoarding of food and medical/household supplies could mask some of the negative impact. Currently, we are not optimistic that GDP growth will improve markedly in Q2 and thus the risk of a so-called technical recession is high, in our view. Dependent on how the virus develops, we could see some stabilisation in the second half of the year, but we do not expect any significant catch-up effects in consumption and unemployment is expected to be permanently higher by the end of the year.

In order to mitigate some of the negative impact from COVID-19 on the economy, the government has already taken some initial steps. VAT payments and corporate taxes can be postponed, which to some extent will reduce the risk of a liquidity squeeze and probably help some of the most affected companies to stay afloat. Also, the government has promised reimbursement to companies that are exposed to its recent restrictions. Further initiatives were recently added to the list. The countercyclical capital requirement for banks has been released, while new guarantee arrangements have been introduced that ease access and make it possible to grant credit to individual companies. Furthermore, companies can now more easily reduce the working hours of its employees by making access to supplementary social benefits easier. Also, companies' payments for the first part of an employee's sickness period, if caused by COVID-19, are suspended.

The initiatives so far by the Danish government appear timely and appropriate. They will probably help cushion the blow to the economy, but will not prevent a sharp economic downturn, in our view. In that sense, it is positive that the government has announced that 'all the money needed' will be used to get through the crisis; we believe that a larger fiscal package will be appropriate at some point. However, it probably make sense to wait until the virus' effect on demand is better known.

The upshot is that we believe the Danish government is acting in a timely and appropriate manner, but as the virus spreads around the world, it will be extremely difficult to avoid a significant hit to the Danish economy. We believe the risk of recession is very real and that further fiscal policy measures will be needed at a later point to shore up the economy. For now, we think GDP growth in Denmark is at risk of falling to 0% or below this year and that gross unemployment will rise towards 5% by the end of the year.

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