6 May 2022 Sovereign and Public Sector

Kingdom of Denmark
Rating Report

STABLE OUTLOOK
AAA

Credit strengths

- Wealthy and competitive economy
- Sound public finances and low public debt
- Solid external position
- Strong institutional framework and stable governance

Credit challenges

- High levels of household debt
- Vulnerabilities related to high and rising property prices

Rating rationale

Wealthy and competitive economy: Denmark has one of the highest GDP-per-capita ratios in Europe and ranks third in the 2021 IMD World Competitiveness Ranking. Economic output proved resilient during the Covid-19 pandemic, and the economy is in a strong position to withstand pressures from the fallout of the Russia-Ukraine war.

Public finances: Denmark benefits from sound public finances characterised by broadly balanced budgets and primary surpluses over the medium-term, and a moderate debt burden. Challenges of an ageing population and investment needs to support its competitiveness are being addressed.

Strong external position: Denmark has generated a current account surplus every year since 1998, and the IMF expects continued surpluses above 6% for the next five years. A credible commitment to maintaining its fixed exchange rate is backed by large official reserves.

Strong institutional framework: Denmark ranks among the top countries globally in terms of governance indicators. It has a strong record of implementing structural reforms, maintaining fiscal discipline and conducting appropriate monetary policy, with gradual tightening expected in H2 2022.

Rating challenges include: i) vulnerabilities in the Danish financial system, including from high household debt; and ii) banking sector vulnerabilities related to high and rising property prices.

Denmark's sovereign rating drivers

Risk pillars		Quantitative scorecard: Weight	Quantitative scorecard: Indicative rating	Reserve currency adjustment (notches)	Qualitative scorecard: Notches	Final rating
Domestic Economic Risk		35%	aaa		+1/3	AAA
Public Finance Risk		25%	aaa		+1/3	
External Economic Risk		10%	aaa		+1/3	
Financial Stability Risk		10%	aaa		-1/3	
ESG Risk	Environmental Risk	5%	aaa		+1/3	
	Social Risk	5%	a-		0	
	Governance Risk	10%	aaa		+1/3	
Overall outcome		**aaa**		**0**	**+1**	

Note: The sum of the qualitative adjustments, capped at one notch per rating pillar, is weighted equally and rounded to the nearest integer. The reserve currency adjustment applies to currencies in the IMF's SDR basket. For details, please see Scope's Sovereign Rating Methodology. Source: Scope Ratings GmbH

Outlook and rating triggers

The Stable Outlook reflects Scope's view that risks to the ratings are balanced over the next 12 to 18 months.

Positive rating-change drivers

- Not applicable

Negative rating-change drivers

- A severe economic shock, resulting in weaker medium-term growth prospects
- A deteriorating fiscal outlook, resulting in an upward trend in government debt ratios
- Increasing banking system risks, resulting in broader systemic risk

Ratings and Outlook

Foreign and local currency

Long-term issuer rating	AAA/Stable
Senior unsecured debt	AAA/Stable
Short-term issuer rating	S-1+/Stable

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Bloomberg: RESP SCOP

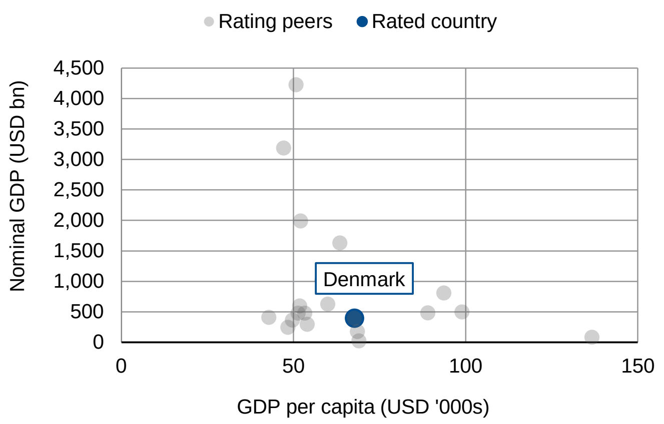
Domestic Economic Risks

- **Growth outlook:** Economic output proved resilient during the Covid-19 pandemic, falling by only 2.1% in 2020 compared with a peer group average decline of 3.5%. Output increased by 4.1% in 2021, reaching its pre-pandemic level by mid-2021 and its pre-pandemic trend by the end of the year. An effective vaccination campaign and an early reopening of the economy supported domestic consumption, while Denmark's high-value-added economy benefited from strong growth in key export markets. We expect the Danish economy to expand by 2.9% in 2022, supported by private sector savings but hampered by rising inflationary pressures due to the Russia-Ukraine war. Continued growth of 2.1% is expected for 2023 before it moderates towards its medium-term potential of around 1.5% per year.
- **Inflation and monetary policy:** Inflation (HICP) reached 6% in March 2022 compared with the same month in 2021, the highest level on record since 1996. Strong demand for exports and high domestic wage growth are likely to keep inflation elevated, averaging around 5%-6% this year. Denmark's central bank pegs the exchange rate to the euro. As euro area monetary policy targets an inflation rate of 2% over the medium term, the fixed-exchange-rate policy provides a framework for low and stable inflation. However, limited monetary policy and exchange rate flexibility restricts the central bank's ability to address financial imbalances, control money supply and take unconventional measures such as quantitative easing. The ECB's monetary policy stance remains highly accommodative with the deposit rate unchanged at negative 0.5%. We expect gradual monetary tightening over the coming months.
- **Labour markets:** Denmark has a highly competitive and flexible labour market. The unemployment rate fell to 5.4% in 2021, slightly down from 5.6% in 2020. We expect a gradual decrease in the unemployment rate to below pre-pandemic levels, reaching 4.9% in 2022 as labour shortages ease across the manufacturing, construction and private services sectors. In the near term, rapidly rising inflationary pressures are likely to fuel wage growth. Over the next decade, the government aims to alleviate pressures in the labour market by better integrating foreigners into the workforce and increasing structural employment.

Overview of Scope's qualitative assessments for Denmark's *Domestic Economic Risks*

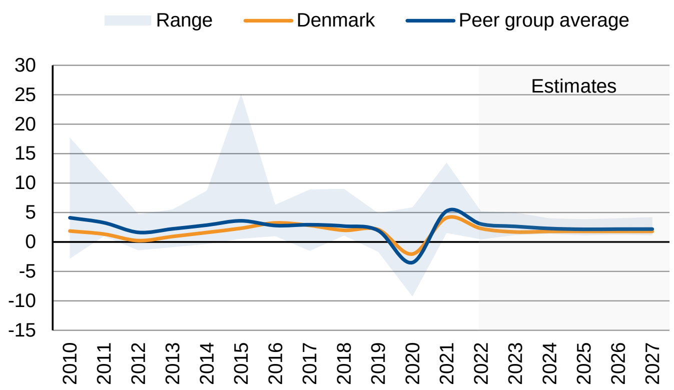
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Growth potential of the economy	Neutral	0	Robust growth potential and pre-crisis track record of sustained growth
	Monetary policy framework	Neutral	0	The fixed-exchange-rate policy ensures low inflation and has supported external competitiveness, but it restricts the central bank's ability to control money supply.
	Macroeconomic stability and sustainability	Strong	+1/3	Competitive economy, favourable business environment and highly skilled labour force support productivity growth; highly flexible labour market

Nominal GDP and GDP per capita, USD '000s



Source: IMF WEO, Scope Ratings GmbH

Real GDP growth, %



Source: IMF WEO, Scope Ratings GmbH

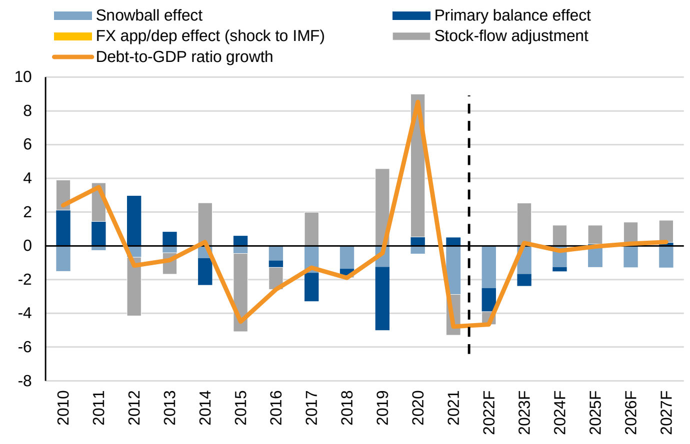
Public Finance Risks

- **Fiscal outlook:** Given the strong economic recovery, many pandemic-related support measures such as the wage compensation scheme have already been withdrawn. In response to the fallout from the Russia-Ukraine war, the Danish government plans to gradually raise defence spending from 1.4% of GDP in 2020 to 2% of GDP by 2033. The government has also agreed to increase the limit on the structural deficit from 0.5% of GDP to 1% of GDP and to target a government deficit of 0.5% of GDP in the medium-term planning for its 2030 fiscal policy plan. This will provide budget flexibility to accommodate increased military spending and fund investments to support the green transition. We expect a fiscal surplus of around 1.6% this year to gradually decline and turn into a small fiscal deficit in the coming years. Denmark's fiscal outlook is supported by its forward-looking pension policies given an ageing population. The retirement age increases to 67 this year and is expected to rise to 68 by 2030, after which it will be linked to future increases in life expectancy.
- **Debt trajectory:** Denmark's general government debt ratio declined in the years before the pandemic, falling from 46.1 % in 2011 to 33.6% in 2019. Fiscal support measures caused the ratio to increase to 42.1% in 2020, which compares favourably to an average of around 45% in peer countries with AAA ratings. We expect the lower-than-expected fiscal deficit and faster economic recovery to push the debt ratio to 32.7% this year, slightly below pre-pandemic levels. Spending pressures due to an ageing population and continued investment needs are expected to result in public debt levels remaining broadly stable over the next few years.
- **Debt profile and market access:** Denmark benefits from a stable debt structure and excellent market access. Although market conditions remain favourable, financing costs have increased. The country's 10-year yield has risen in line with other highly rated economies, from 0.1% at the beginning of the year to 1.3% at the time of writing. The average maturity of government debt stood at 8.8 years as of February 2022, longer than that of most governments in Denmark's sovereign peer group.

Overview of Scope's qualitative assessments for Denmark's *Public Finance Risks*

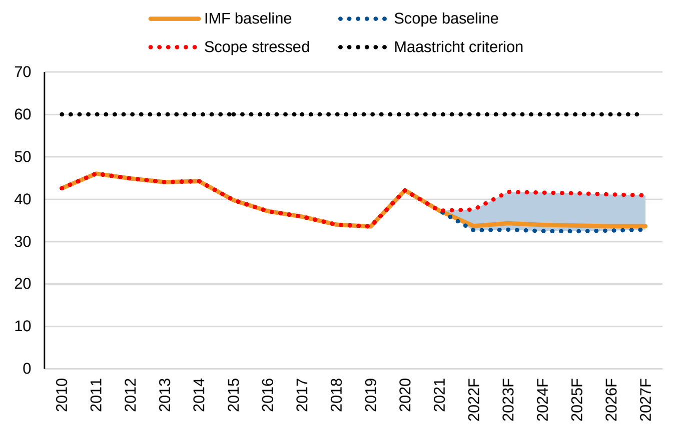
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Fiscal policy framework	Strong	+1/3	Appropriate response to Covid-19 shock with sizeable countercyclical stimulus; pre-crisis track record of balanced budgets; progressive pension reform to adapt retirement age
	Debt sustainability	Neutral	0	Stable debt trajectory
	Debt profile and market access	Neutral	0	Excellent market access; low government financing costs in line with those of peers

Contributions to changes in debt levels, pp of GDP



Source: Scope Ratings GmbH

Debt-to-GDP forecasts, % of GDP



Source: IMF WEO, Scope Ratings GmbH

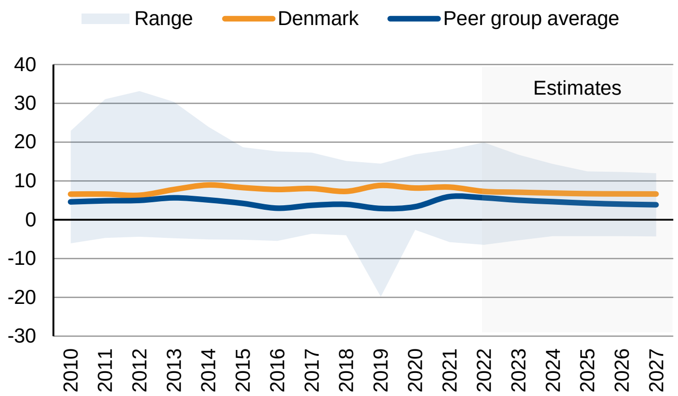
External Economic Risks

- **Current account:** Denmark has consistently run current account surpluses above the peer group average. The IMF forecasts Denmark's current account surplus will decrease slightly from 8.4% in 2021 to 7.3% in 2022 and remain above 6% over the subsequent five years. This follows more than two decades of persistent current account surpluses, reflecting Denmark's large financial sector, exceptionally high domestic savings and strong exports of high-value goods and services. Danish exports recovered quickly and grew by 8% following the pandemic shock, which led to a decline in services activities, particularly in the transport, construction and IT sectors. We expect continued growth in exports, despite the attack on Ukraine, thanks to Denmark's highly competitive and less cyclically sensitive export sector.
- **External position:** Danish external debt declined from above 180% of GDP in 2010 to around 145% in 2019 before increasing again at the onset of the pandemic. It stood at 150% in 2021 and relates mainly to debt in the financial institutions sector (94% of GDP). Short-term debt relative to total gross external debt has also declined, from 52% in 2010 to 43% in 2021. Denmark's external position remains sound with a net international asset position of 72.7% of GDP as of 2021, up from negative 5% in 2008. This is in line with the peer group average.
- **Resilience to shocks:** Denmark's central bank has intervened repeatedly in foreign-exchange markets since October 2019 to support the krone's peg to the euro. It has succeeded in maintaining the peg in line with its primary mandate. Denmark's credible commitment to maintaining its fixed exchange rate is backed by its large official reserves totaling DKK 538.5bn (22.7% of 2021 GDP) as of March 2022.

Overview of Scope's qualitative assessments for Denmark's *External Economic Risks*

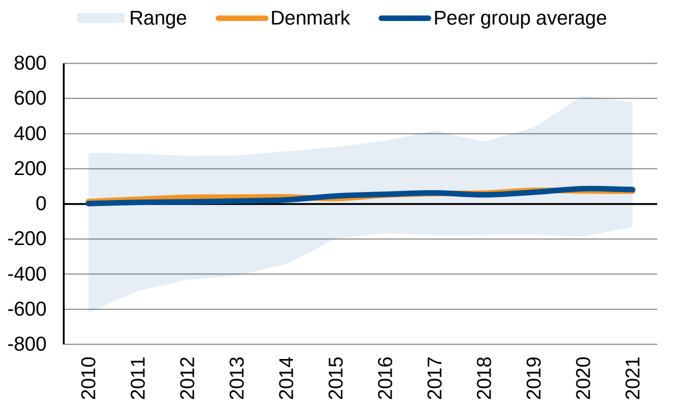
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Current account resilience	Neutral	0	Low cyclicality of export composition and external sector competitiveness support current account resilience.
	External debt structure	Neutral	0	Relatively high external debt, especially in the financial institutions sector
	Resilience to short-term shocks	Strong	+1/3	Very large net external creditor position, regional safe-haven currency

Current account balance, % of GDP



Source: IMF WEO, Scope Ratings GmbH

NIIP, % of GDP



Source: IMF WEO, Scope Ratings GmbH

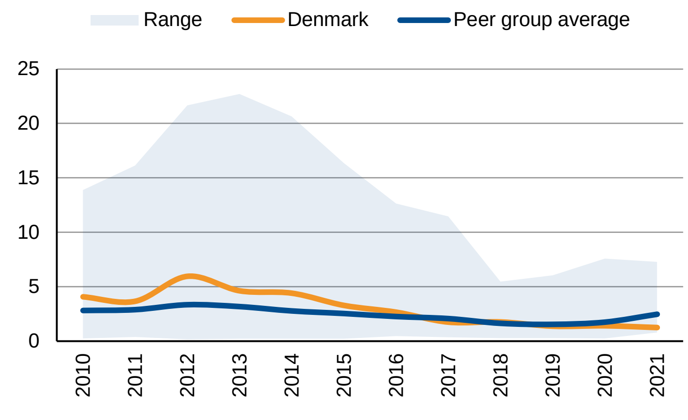
Financial Stability Risks

- **Banking sector:** The banking sector was stable throughout the pandemic as capital buffers and liquidity coverage ratios remained high, while non-performing loans fell from 1.4% before the pandemic to 1.2% in December 2021. Lower-than-expected losses during the pandemic improved profitability, which remains subdued due to a rising cost base. Stress testing by the central bank indicated that the banking sector is sufficiently capitalised to withstand a severe shock, although some banks would breach their minimum buffer requirements.
- **Private debt:** Household debt amounted to 259% of net disposable income in 2020, the highest among OECD countries. High levels of mortgage debt have increased vulnerability to rising interest rates, higher unemployment and sharp declines in house prices. However, these risks must be viewed in the context of very high levels of household assets, with Danish households' net worth at 807% of their net disposable income in 2020, the highest level in the OECD. This provides a strong safety net against short-term income shocks, and the credit risk of Danish residential mortgages remains manageable on aggregate.
- **Financial imbalances:** House prices increased by around 16% in the period between the onset of the pandemic and Q4 2021, although they started to moderate during the last quarter. The financial system is exposed to the domestic housing sector, with mortgage banks' real estate lending comprising around 47% of total Danish financial sector assets. High amounts of household savings and assets held in the pension system facilitated the development of the world's largest mortgage covered bond market. A sharp correction in the housing market could weigh on consumption and result in spill-over effects in Denmark's highly interconnected financial system of mortgage credit institutions, pension funds and insurance companies. Rising interest rates are likely to dampen house price growth. In 2021, credit institutions increasingly granted mortgages with deferred amortisation, even to homeowners with high loan-to-value ratios. This increases vulnerabilities to a downturn in the housing market, although households' sensitivity to higher interest rates at an aggregate level has fallen in recent years due to a shift towards fixed-rate mortgages. The Systemic Risk Council recommended that the countercyclical capital buffer be increased to 2.5% from March 2023.

Overview of Scope's qualitative assessments for Denmark's *Financial Stability Risks*

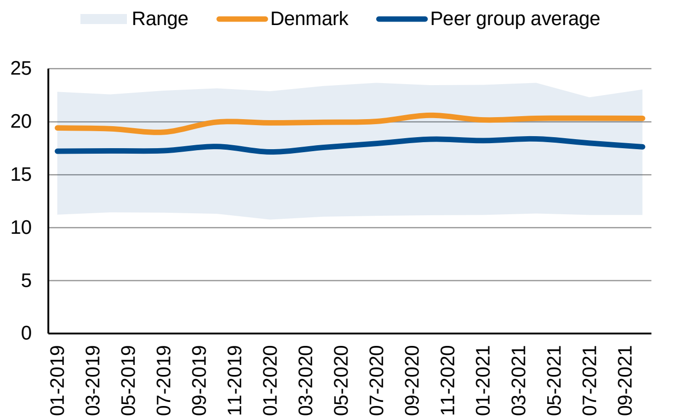
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Banking sector performance	Neutral	0	High capitalisation levels, stable levels of non-performing loans
	Banking sector oversight	Neutral	0	Prudent oversight under Denmark's central bank and financial supervisory authority; improvements in anti-money laundering/ combating the financing of terrorism framework
	Financial imbalances	Weak	-1/3	High private-sector debt, large size of banking sector vis-à-vis the real economy, and high interconnectedness in the Danish financial system

NPLs, % of total loans



Source: IMF WEO, Scope Ratings GmbH

Tier 1 ratio, % of risk-weighted assets



Source: IMF WEO, Scope Ratings GmbH

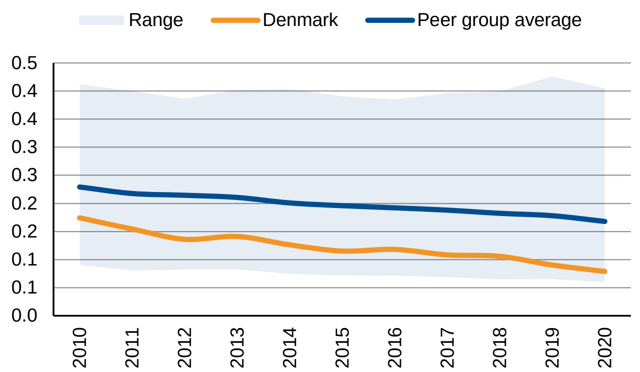
ESG Risks

- **Environment:** Denmark aims to reduce greenhouse gas emissions by 70% by 2030 (relative to 1990 levels) and reach carbon neutrality by 2050, and it has recently set a goal of achieving 100% green gas in heating by 2030 in order to reduce its dependence on Russian gas. The country has earmarked 60% of its share of the EU's Recovery and Resilience Facility for green initiatives, well above the EU's 37% target. In addition, it issued its first green bond in January with a value of DKK 5bn. Around 43% of energy consumption came from renewable sources in 2021, and coal consumption has declined rapidly in recent years, from 19% in 2010 to just 7% in 2021. The Danish Council on Climate Change noted in February 2022 that while the Danish government has adopted significant mitigation measures and climate initiatives, there is still a reduction gap of 10m tonnes of CO_2 to reach the 70% emission reduction target by 2030, and further policy initiatives will be required to fill this gap. The council suggested introducing a general tax on GHG emissions as the basis of climate policy action in the run-up to 2030.
- **Social:** Denmark benefits from high GDP per capita and an advanced social safety net, which contributes to low income inequality. However, the country faces an elevated old-age dependency ratio, which places greater demands on welfare services, particularly healthcare. Non-EU migrants experience a high jobless rate with persistent employment gaps relative to Danes due to insufficient job qualifications. The 'Denmark can do more' reform plan and greater investment in education and digitalisation should help increase labour market participation in future.
- **Governance:** Since gaining representation in parliament requires only 2% of the vote, many political parties are represented (currently more than 10), and minority governments are common, requiring broad coalition-building to pass specific pieces of legislation. A long history of consensus-building therefore supports longer-term policy continuity. Following Russia's invasion of Ukraine, the Danish government announced it would hold a referendum on June 1 on whether to join the common EU defence policy. Denmark is already a NATO member.

Overview of Scope's qualitative assessments for Denmark's *ESG Risks*

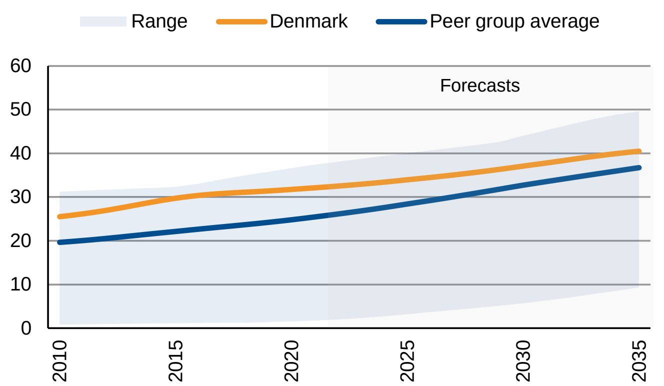
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Environmental risks	Strong	+1/3	Strong environmental standards, ongoing allocation of resources to achieve ambitious long-term targets for carbon neutrality and emissions reduction
	Social risks	Neutral	0	Relatively favourable demographics, well-established social safety nets, inclusive labour market
	Institutional and political risks	Strong	+1/3	High quality institutions, stable political environment

CO_2 emissions per GDP, mtCO2e



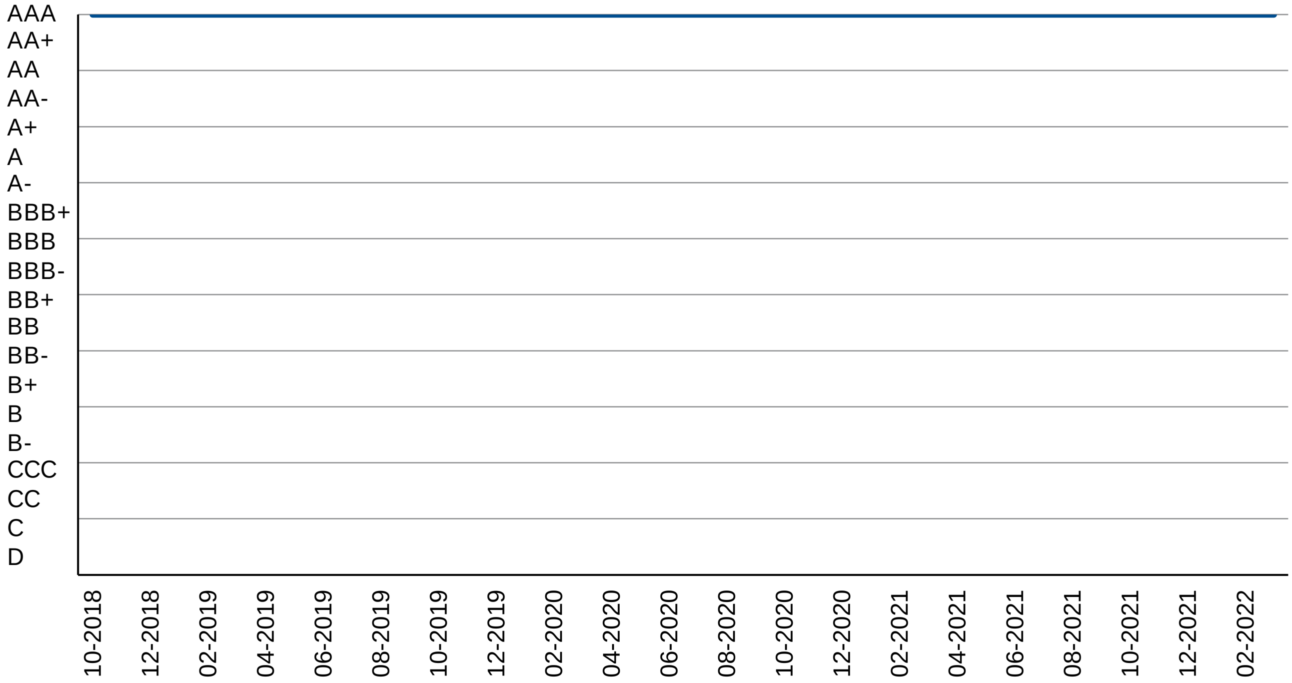
Source: European Commission, Scope Ratings GmbH

Old-age dependency ratio, %



Source: United Nations, Scope Ratings GmbH

Appendix I. Rating history



Appendix II. Rating peers

Rating peers are related to sovereigns with an indicative rating in the same rating category or in adjacent categories per Scope's Core Variable Scorecard.

Peer group*
Austria
Belgium
Denmark
Finland
Germany
Ireland
Luxembourg
Netherlands
Norway
Sweden
Switzerland
United Kingdom

Publicly rated sovereigns only; the full sample may be larger.

Appendix III. Statistical table for selected CVS indicators

This table presents a selection of the indicators (24 out of 29) used in Scope's quantitative model, the Core Variable Scorecard.

	2016	2017	2018	2019	2020	2021	2022F	2023F
Domestic Economic Risk								
GDP per capita, USD '000s	54.9	57.8	61.7	59.9	61.2	67.8	68.1	71.3
Nominal GDP, USD bn	313.1	332.1	356.8	347.6	356.1	395.7	399.1	419.3
Real growth, %[1]	3.2	2.8	2.0	2.1	-2.1	4.1	2.9	2.1
CPI inflation, %	0.0	1.1	0.7	0.7	0.3	1.9	3.8	2.1
Unemployment rate, %[1]	6.0	5.8	5.1	5.0	5.7	5.1	4.9	4.7
Public Finance Risk								
Public debt, % of GDP[1]	37.2	35.9	34.0	33.6	42.1	37.3	32.7	32.8
Interest payment, % of government revenue	1.0	-0.2	-0.7	-0.6	-0.6	-0.4	-0.4	-0.6
Primary balance, % of GDP[1]	0.4	1.7	0.4	3.8	-0.5	-0.5	1.4	0.7
External Economic Risk								
Current account balance, % of GDP	7.8	8.0	7.3	8.8	8.1	8.4	7.3	7.1
Total reserves, months of imports	4.7	5.0	4.2	4.0	4.6	-	-	-
NIIP, % of GDP	50.2	59.0	62.0	77.4	74.3	72.7	-	-
Financial Stability Risk								
NPL ratio, % of total loans	3.2	2.3	1.7	1.7	1.8	-	-	-
Tier 1 ratio, % of risk-weighted assets	18.4	19.7	19.8	20.0	20.6	20.3	-	-
Credit to private sector, % of GDP	166.6	161.8	161.3	160.9	163.3	-	-	-
ESG Risk								
CO_2 per EUR 1,000 of GDP, mtCO2e	118.1	108.3	105.7	90.3	78.8	-	-	-
Income quintile share ratio (S80/S20), x	4.1	4.2	4.1	3.9	-	-	-	-
Labour force participation rate, %	77.4	77.9	78.2	79.0	-	-	-	-
Old-age dependency ratio, %	30.4	30.8	31.1	31.4	31.7	32.1	32.5	32.9
Composite governance indicator[2]	1.7	1.7	1.7	1.7	1.7	-	-	-

[1] Forecasted values are produced by Scope and may differ from those presented in the charts of the previous sections.
[2] Average of the six World Bank Governance Indicators
Source: European Commission, IMF WEO, World Bank, Scope Ratings GmbH

Appendix IV. Economic development and default indicators

IMF Development Classification	Advanced economy
5y USD CDS spread (bps) as of 6 May 2022	12.2

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