Rating Update:

Creditreform Rating affirms Denmark’s credit ratings at “AAA”, outlook “stable”

Rating action

Neuss, 25 September 2020

Creditreform Rating has affirmed the unsolicited long-term sovereign rating of “AAA” for the Kingdom of Denmark. Creditreform Rating has also affirmed Denmark’s unsolicited ratings for foreign and local currency senior unsecured long-term debt of “AAA”. The outlook remains stable.

Reasons for the rating decision and latest developments

The Kingdom of Denmark’s credit ratings continue to reflect very sound economic fundamentals based on a confluence of factors, namely very high per capita incomes, a highly competitive and well-diversified economy alongside a very flexible labor market, as well as an investment- and innovation-friendly business environment.

Economic conditions have changed for the worse since our last review, as the Danish economy will experience a significant, though temporary, decline in total output this year. However, we believe that sound macroeconomic policies, a flexible labor market, and the past years of strong and stable growth will support its recovery in 2021. Denmark thus entered the year on a strong footing, having grown at an annual average of 2.4% in 2015-19, with last year’s real GDP growth revised upwards to 2.3%, still considerably faster than that of the euro area at 2.0%.

Six months into the corona crisis, the Danish economy turned out to be more robust than that of most other European countries. After a comparatively mild slump in the first quarter, when real GDP contracted by 2.0% q-o-q (euro area: -3.7%), real economic growth presumably reached its trough in Q2, having fallen by 6.9% according to Statistics Denmark data. Although suffering a historic fall, Denmark’s plunge may be considered as relatively moderate by European standards, as overall economic activity in the euro area plummeted by 11.8%, and peers such as Germany and Sweden showed declines of 9.7% and 8.3%. We note that Denmark generally displays robust results on our Pandemic Vulnerability Index (rank 3 out of 28 European economies), i.e. is structurally less vulnerable to pandemics and better prepared to cope with adverse effects.

Judging by higher frequency data and unconventional leading indicators, the recovery is well underway and we now expect that real GDP will shrink by 4.6% in 2020 before recovering by 4.0% next year. Moreover, illustrating the high flexibility of the Danish labor market, some improvement is already visible in latest data, with gross unemployment fell to 5.2% of the total labor force in July after jumping from 3.7% to 5.6% between February and May 2020 (Statistics Denmark). We anticipate that rising infection numbers will be countered by targeted and regionally limited measures, and that the economy will continue to recover gradually going forward. Still, these estimates are subject to extreme uncertainty, as an effective and tested vaccine is not yet available and the path to recovery is highly dependent on the development of Covid-19.

Household spending has been hit hard in the lockdown months and will be dampened by lower employment and wage growth. While future spending patterns are subject to elevated uncertainty, we expect private consumption to lead the recovery, as it has begun to normalize in tandem with the economy's gradual reopening, buttressed by strong automatic stabilizers and aid measures.

Although we remain somewhat concerned about prospects for global trade, exports should be supported by their composition, resuming growth in key trading partners, and by government measures. Due to their favorable composition, exports have not been disrupted as severely as in other parts of Europe. Roughly 41.5% of total goods exports are made up of chemicals and related products and agricultural products (2019 data). Exports in these goods categories even rose - by 17.4% and 2.3% y-o-y respectively - in the first half of 2020. Additionally, Denmark's main trading partners such as Germany, Sweden, and the Netherlands seem to be weathering the crisis somewhat better than other peers, having posted only single-digit growth declines in the second quarter.

Business investment activity should take longer to recover to pre-crisis levels, as uncertainty related to demand and profits will linger for some time. As opposed to the global financial crisis, the more balanced composition of gross fixed capital formation should somewhat limit this year's still steep decline and help restore its growth momentum in the medium term. We see an increased share of intellectual property products in investment (2003-07 avg. 17.3% vs. 25.0% in 2015-19). In particular, we view relatively high levels of intellectual property investment - at 5.5% of GDP among the highest in EU27 - as conducive to the economy's underlying growth potential. In any case, significantly ramped up public investment should somewhat cushion the decline in overall investment.

We remain vigilant of substantial household debt, which remains a key vulnerability, in tandem with stretched house-price valuations. We are aware that vulnerabilities have not deepened, as household debt further followed its firm downward trajectory, as it dwindled to 226.7% of disposable income in this year's first quarter (Q1-19: 233.5%), which nevertheless corresponds to the highest reading in Europe. Furthermore, overall house price growth has steadied over the last few years, in particular prices for owner-occupied flats have diminished significantly nationwide; nevertheless, risks in metropolitan areas remain. The housing market was adversely affected by Covid-19, with prices for one-family houses and owner-occupied flats taking a severe though transitory blow in March. However, prices have been recovering since then.

The outstandingly high institutional quality remains a hallmark of the Danish sovereign, possibly best reflected by the World Bank's Worldwide Governance Indicators. Denmark exhibits a long-standing track record of very sound and predictable policies which are based on a high degree of cross-party consensus. We also view the sovereign's policy-making as very forward-looking and responsive.

In this vein, we think that strict confinement measures coupled with rapid and substantial support measures were key to limiting the economic fallout and containing the spread of Covid-19. In fact, lockdown measures were taken well ahead of many European peers. By the same token, containment measures were gradually eased early on, with the staged re-opening starting already in mid-April, accompanied by a reasonable testing and detection strategy. More recently, the 14-day cumulative number of COVID-19 cases (per 100k) has begun to rise rapidly again, climbing from 18.7 on 31 August to a new peak at 74.1 on 20 September. Accordingly, the gov-

ernment seized targeted and timely measures applying until 4 October, geared towards vulnerable groups (elderly, etc.), gatherings, restaurants, retail, social activities, as well as workplaces and public transport.

The authorities' forward-looking approach is further evidenced by the recently-tabled DK2025 strategy, sketching the priorities and goals for economic and fiscal policy for the coming years. While the framework has to be fleshed out in more detail going forward, DK2025 envisages the overarching principle of aiding economic recovery, while ensuring equitable growth and greening the economy. Earlier this year, the government had already endorsed the green housing agreement, foreseeing green renovations in the social housing sector, and a climate agreement for energy and industry geared towards developing, expanding, and integrating green technologies in the energy and industrial sector.

The very high quality of Denmark's institutional framework is further buttressed by highly credible and efficient monetary policy-making by Danmarks Nationalbank (DN). While monetary policy remains essentially determined by the ECB's monetary policy, DN has been successful in keeping the krone close to its euro peg. After the interest hike by 0.15 p.p. in March, the CD interest rate remained unchanged, and with it the spread towards the ECB's deposit facility (0.1 p.p.). DN also flanked the government's Covid-19 measures, as it had implemented an extraordinary lending facility in March and established swap agreements with the ECB and the Fed.

The economic shock entailed by the corona crisis and the costly Covid-19 support package to soften the impact on the labor market and business economy will see the budget balance swing to a large deficit, and result in a reversed public debt trajectory. However, the sovereign entered the crisis with very healthy public finances, implying ample fiscal space to address the challenges at hand. In addition, a track record of prudent debt management and very affordable debt further attenuate concerns about fiscal sustainability.

Denmark's headline surplus had widened substantially from 0.5% to 3.7% of GDP in 2018-19, mainly due to vivid tax revenues which came on the back of an 360% y-o-y increase in pension yield taxes. For 2020, we expect a headline deficit of approx. 4.5% of GDP, which will likely narrow in the following year as the support measures gradually subside and economic activity gains traction. Automatic stabilizers should weigh on public finances, as will the government's aid measures and the reimbursement of excessively collected property taxes.

We gather that the various initiatives of the strong fiscal response to Covid-19 have added up to roughly DKK 131bn (approx. 5.9% of GDP) as of 27 August. The biggest items among the initially implemented support package are the wage compensation scheme (DKK 10.2bn), the compensation for self-employed (DKK 14.3bn), and the compensation scheme for companies' fixed expenses (DKK 65.3bn). Following that, policy-makers adopted several initiatives which entail additional outlays with a view to 2020 and 2021, summing up to roughly DKK 76bn, and more recently measures highlighted in the draft budget 2021.

Labor market support measures are featured prominently, inter alia, through the new tripartite agreement on a new structure which is to replace the wage compensation scheme, and through the agreement on strengthened retraining and extraordinary support for the unemployed. Public investment will be significantly increased via the climate proposal for energy, industry, and waste. To lend further support to a continued recovery of its economy, DKK 12bn and 6.4bn are allocated to 2020 and 2021 respectively under the green housing agreement. At the same time,

the authorities' estimate for the compensation for fixed costs was significantly revised downwards (to DKK 13bn) due to underutilization of the scheme. Moreover, in view of normalizing economic activity and the release of the frozen holiday pay, the tax intake may develop more favorably than initially expected.

General government (EMU) debt is set to rise substantially due to the large deficit and additional costs related to social housing investment (approx. DKK 28.8bn), prospectively leaping to just short of 45% of GDP in 2020 before stabilizing on that level in 2021. We think that Denmark's public debt ratio will remain at a level of around 45% of GDP over the medium term, as the recently published DK2025 strategy foresees exploiting the fiscal space to support medium-term growth and employment, and making room for scaled-up public investment to achieve the economic policy goals such as financing the green transition.

We nevertheless believe that fiscal risks are limited due to the sovereign's credible, sound, and transparent debt management. Prior to the outbreak of the novel coronavirus, EMU debt had persistently fallen from a temporary peak of 44.3% of GDP in 2014 to 33.2% of GDP in 2019, making it one of the lowest levels in Europe. Concurrently, debt will remain highly affordable in the short to medium term. Interest expenses account for a mere 1.3% of general government revenue, having decreased from 1.1% to 0.7% of GDP in 2018-19, and we expect interest payments to stay on that level in the near term. Danish 10y government bond yields remain at historically low levels, posting in negative territory since May 2019.

Despite the large size of the banking sector (Q1-20: 305% of GDP), related fiscal risks seem contained at this stage, as soundness indicators up to Q1 paint a favorable picture of Danish credit institutions. Recent Covid stress tests, conducted by DN as well as by the IMF, point to limited financial stability risks for now. According to DN, lending to corporates that have been severely hit by Covid-19 makes up for 6% of total NFC lending, with medium-sized banks carrying a larger share of vulnerable corporates on their books than SIFIs. In case of a severe liquidity shock, SIFIs should be able to cover their liquidity needs for up to five months. Nevertheless, the development of the number of insolvencies should be monitored, as more widespread insolvencies may have negative ramifications for banks' asset quality. We closely monitor progress in terms of money laundering issues and the financing of terrorism. Against this backdrop, we took note of the FSA's recently launched investigation on Danske Bank's excessive collection of debt.

We perceive external vulnerabilities as very low, as the sovereign can draw on extensive external buffers, further backing Denmark's credit assessment.

Denmark's vulnerability to external influences continues to be limited. Although we expect the current account surplus, which came in at a high 7.8% of GDP in 2019 (10y-avg.: 7.5%), to narrow markedly, largely driven by declining trade and primary income balances, we nevertheless view a prospective decline to just under 6% of GDP as transitory. Its net international investment position, standing at 66.4% of GDP at the end of Q1-20 (Q1-19: 68.0%), remains one of the highest in Europe, providing for substantial external buffers. Even the narrower definition, which excludes non-defaultable instruments, posted at a comparatively high 26.2% of GDP in this year's first quarter.

Rating Outlook and Sensitivity

Our rating outlook on the Kingdom of Denmark's long-term sovereign ratings is stable, as we see risks related to the significantly deteriorating economic and fiscal performance entailed by

the corona crisis as broadly offset by the economy's sound economic fundamentals and by the above-mentioned factors mitigating fiscal risks. We emphasize that the evolution of the Covid-19 pandemic is extremely uncertain. As a corollary, any assessment of the further economic development is extraordinarily uncertain and significantly more difficult than usual, as is the case for other metrics, e.g. from the fiscal realm.

A negative rating action could be triggered if we observe significant adverse effects on Denmark's medium-term potential growth. This could be the case if there is another round of far-reaching containment measures to protect health and life as seen in March and April. In addition, failed EU-UK trade negotiations or more permanently disrupted global value-chains would be detrimental, as Denmark's economy is highly dependent on external trade, and the external environment will be crucial for the pace of its recovery. Downward pressure could also result from a persistent and prolonged rise in the sovereign's public debt ratio coupled with deteriorating debt affordability, and/or if house prices fall rapidly, putting macro-financial stability at risk, entailing financial sector bailouts.

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Ratings*

Long-term sovereign rating	AAA /stable
Foreign currency senior unsecured long-term debt	AAA /stable
Local currency senior unsecured long-term debt	AAA /stable

*) Unsolicited

Economic Data

[in %, otherwise noted]	2014	2015	2016	2017	2018	2019	2020e
Real GDP growth	1.6	2.3	3.2	2.0	2.4	2.3	-4.6
GDP per capita (PPP, USD)	46,347	47,651	48,889	50,570	52,279	53,882	n.a.
HICP inflation rate, y-o-y change	0.4	0.2	0.0	1.1	0.7	0.7	0.3
Default history (years since default)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Life expectancy at birth (years)	80.7	80.8	80.9	81.1	81.0	n.a.	n.a.
Fiscal balance/GDP	1.1	-1.2	0.1	1.8	0.7	3.7	-4.5
Current account balance/GDP	8.9	8.2	7.8	7.8	7.0	7.8	n.a.
External debt/GDP	166.8	158.9	159.2	155.9	142.3	142.7	n.a.

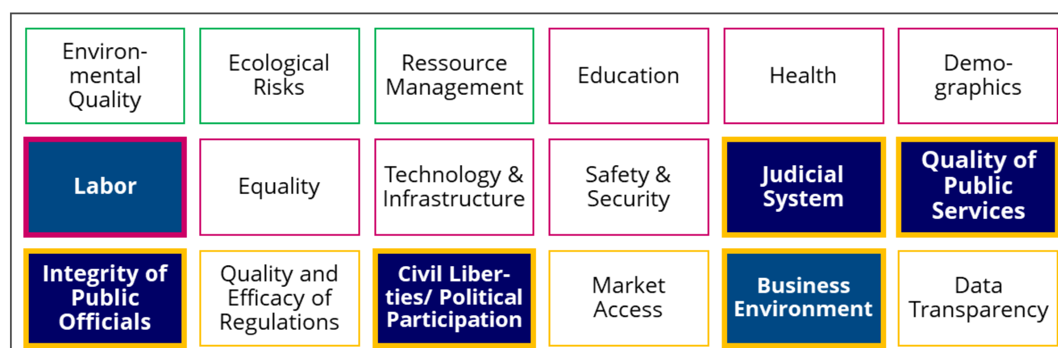
Source: International Monetary Fund, Eurostat, own estimates

ESG Factors

While there is no universal and commonly agreed typology or definition of environment, social, and governance (ESG) criteria, Creditreform Rating views ESG factors as an essential yardstick for assessing the sustainability of a state. Creditreform Rating thus takes account of ESG factors in its decision-making process before arriving at a sovereign credit rating. In what follows, we explain how and to which degree any of the key drivers behind the credit rating or the related outlook is associated with what we understand to be an ESG factor and outline why these ESG factors were material to the credit rating or rating outlook.

For further information on the conceptual approach pertaining to ESG factors in public finance and the relevance of ESG factors to sovereign credit ratings and to Creditreform Rating credit ratings more generally, we refer to the basic documentation, which lays down key principles of the impact of ESG factors on credit ratings.

ESG Factor Box



The governance dimension plays a pivotal role in forming our opinion on the creditworthiness of the sovereign. As the World Bank's Worldwide Governance Indicators Rule of Law, Government Effectiveness, Voice and Accountability, and Control of corruption have a material impact on Creditreform Rating's assessment of the sovereign's institutional set-up, which we regard as

a key rating driver, we consider the ESG factors 'Judicial System and Property Rights', 'Quality of Public Services and Policies', 'Civil Liberties and Political Participation', and 'Integrity of Public Officials' as highly significant to the credit rating.

Since indicators relating to the competitive stance of the sovereign such as the World Bank's Ease of Doing Business index and the World Economic Forum's Global Competitiveness Indicator add further input to our rating or adjustments thereof, we judge the ESG factor 'Business Environment' as significant.

The social dimension plays an important role in forming our opinion on the creditworthiness of the sovereign. Labor market metrics constitute crucial goalposts in Creditreform Rating's considerations on macroeconomic performance of the sovereign, and we regard the ESG factor 'Labor' as significant to the credit rating or adjustments thereof.

While Covid-19 may have significant adverse effects on several components in our ESG factor framework in the medium to long term, it has not been visible in the relevant metrics we consider in the context of ESG factors – though it has a significant bearing concerning economic prospects and public finances. To be sure, we will follow ESG dynamics closely in this regard.

Appendix

Rating History

Event	Publication Date	Rating /Outlook
Initial Rating	28.04.2017	AAA /stable
Monitoring	30.03.2018	AAA /stable
Monitoring	29.03.2019	AAA /stable
Monitoring	27.03.2020	AAA /stable
Monitoring	25.09.2020	AAA /stable

Regulatory Requirements

In 2011 Creditreform Rating AG (CRAG) was registered within the European Union according to EU Regulation 1060/2009 (CRA-Regulation). Based on the registration Creditreform Rating AG is allowed to issue credit ratings within the EU and is bound to comply with the provisions of the CRA-Regulation.

This sovereign rating is an unsolicited credit rating. Neither the rated sovereign nor a related third party participated in the credit rating process. Creditreform Rating AG had no access to the accounts, representatives or other relevant internal documents for the rated entity or a related third party. Between the disclosure of the credit rating to the rated entity and the public disclosure no amendments were made to the credit rating.

Unsolicited Credit Rating	
With Rated Entity or Related Third Party Participation	NO
With Access to Internal Documents	NO
With Access to Management	NO

The rating was conducted on the basis of CRAG's "Sovereign Ratings" methodology (v1.2, July 2016) in conjunction with its basic document "Rating Criteria and Definitions" (v1.3, January 2018). CRAG ensures that methodologies, models and key rating assumptions for determining sovereign credit ratings are properly maintained, up-to-date, and subject to a comprehensive review on a periodic basis. A complete description of CRAG´s rating methodologies and basic document "Rating Criteria and Definitions" is published on our website.

To prepare this credit rating, CRAG used the following substantially material sources: International Monetary Fund, World Bank, Organization for Economic Co-operation and Development, Eurostat, European Commission, European Banking Authority, European Central Bank, World Economic Forum, European Centre for Disease Prevention and Control, Danmarks Nationalbank, Statistics Denmark, Kingdom of Denmark (Ministry of Economic Affairs and the Interior, Ministry of Finance, Ministry of Health).

A Rating Committee was called consisting of highly qualified analysts of CRAG. The quality and extent of information available on the rated entity was considered satisfactory. The analysts and committee members declared that the rules of the Code of Conduct were complied with. No conflicts of interest were identified during the rating process that might influence the analyses and judgements of the rating analysts involved or any other natural person whose services are placed at the disposal or under the control of Creditreform Rating AG and who are directly involved in credit rating activities or approving credit ratings and rating outlooks. The analysts presented the results of the quantitative and qualitative analyses and provided the Committee with a recommendation for the rating decision. After the discussion of the relevant quantitative and qualitative risk factors, the Rating Committee arrived at a unanimous rating decision. The weighting of all risk factors is described in CRAG´s "Sovereign Ratings" methodology. The main arguments that were raised in the discussion are summarized in the "Reasons for the Rating Decision".

As regards the rating outlook, the time horizon is provided during which a change in the credit rating is expected. This information is available within the credit rating report. There are no other attributes and limitations of the credit rating or rating outlook other than displayed on the CRAG website. In case of providing ancillary services to the rated entity, CRAG will disclose all ancillary services in the credit rating report.

The date at which the credit rating was released for distribution for the first time and when it was last updated including any rating outlooks is indicated clearly and prominently in the rating report; the first release is indicated as "initial rating"; other updates are indicated as an "update", "upgrade or downgrade", "not rated", "affirmed", "selective default" or "default".

In accordance with Article 11 (2) EU-Regulation (EC) No 1060/2009 registered or certified credit rating agency shall make available in a central repository established by ESMA information on

its historical performance data, including the ratings transition frequency, and information about credit ratings issued in the past and on their changes. Requested data are available on the ESMA website: https://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml.

An explanatory statement of the meaning of each rating category and the definition of default are available in the credit rating methodologies disclosed on the website.

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