Creditreform Sovereign Rating

Creditreform Rating

Rating Object	Rating Information	
KINGDOM OF DENMARK	Assigned Ratings/Outlook: **AAA /stable**	Type: Monitoring, Unsolicited
Long-term sovereign rating Foreign currency senior unsecured long-term debt Local currency senior unsecured long-term debt	Initial Rating Publication Date: Rating Renewal: Rating Methodologies:	28-04-2017 27-03-2020 "Sovereign Ratings" "Rating Criteria and Definitions"

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Rating Action

Neuss, 27 March 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 is stable.

Key Rating Drivers

1. Outstandingly strong institutional conditions characterized by very sound and forward-looking policy-making which is based on a high degree of cross-party consensus, as well as strong monetary and fiscal frameworks
2. Very prosperous, highly competitive and diversified economy that features a welcoming and standard-setting business environment, as well as a very flexible labor market which should be supported by migrant inflows and elderly workers; very high household debt coupled with high housing valuations continues to represent the key macro-financial risk
3. We continue to expect solid medium-term real GDP growth, largely driven by private household spending which is likely to benefit from low mortgage rates and real wage growth, backed by low inflation and slower but continued employment growth
4. Near-term outlook seriously dampened by the Covid-19 fallout, with possibly disruptive effects on domestic demand and production; while our baseline scenario assumes a more or less U-shaped pattern of economic development, the forecast is materially clouded by uncertainty and heavily dependent on the success of containing the pandemic
5. Very healthy public finances; while fiscal stance was generally set to become somewhat more neutral in the medium term, the corona crisis will imply costly countermeasures in the short term to limit the damage to the real and financial economy, but large fiscal space and sound debt management should largely mitigate risks to fiscal sustainability

6. Although partly inflated by merchanting and offshore trade related to activities of multinationals, very high current account surplus, buttressing the country's very large and positive NIIP and thus providing for sufficient external buffers

Reasons for the Rating Decision

Creditreform Rating has affirmed the Kingdom of Denmark's AAA ratings, reflecting an extremely low probability that the sovereign will not meet its financial obligations fully and on time; the ratings are buttressed by the sovereign's exceptionally strong macro-institutional fundamentals as well as by very healthy fiscal metrics and solid external finances.

Macroeconomic Performance

Denmark's credit ratings continue to be based on very strong macroeconomic performance which is built around very high per capita incomes, driven by robust and stable growth and a very flexible labor market alongside its highly competitive and diversified economy. The declining but still high household debt and residential property valuations render the Danish economy vulnerable to macro-financial shocks, creating tail risks. Continued economic expansion and further favorable labor market developments are likely to be subject to a Covid-19-related, transitory setback, but should result in ongoing wealth accumulation in the medium term.

Until recently, the Danish economy proved broadly resilient to external influences, namely weak global manufacturing activity and the slowdown of economic growth in its main trading partners. With a real GDP growth of 2.2%, 2019 saw economic expansion almost on par with the previous year's level (2.4%) and the annual average of the preceding five years of economic upswing (2014-2018: 2.3%). What is more, Denmark's economic growth outpaced that of its peers such as Germany (0.6%), and the Netherlands (1.7%), and also lay above the respective EU-28 and EA-19 averages (1.5 and 1.2%). That being said, quarterly growth data already pointed to weakening dynamics, as the year ended on a softer tone in Q4 (1.8%) after real GDP had expanded by at least 2.0% y-o-y in the first three quarters. It should also be mentioned that Danish national accounts data are revised relatively frequently, partly reflecting measurement and forecasting challenges associated with the economic activity of multinational enterprises. Last year, Statistics Denmark undertook some large data revisions, most notably the uplift of the 2016 and 2018 real GDP outcome (2.4 and 1.5 to 3.2 and 2.4% respectively).

Domestic demand continued to be the main pillar of economic growth, but net external trade also made an important contribution to Denmark's economic expansion in 2019 (+1.0 p.p.), after preventing a further expansion of the Danish economy in 2018, subtracting 0.4 p.p. from economic growth. Thanks to pharmaceuticals and the turbine industry, export of goods rose vividly by 6.5%, lifting overall export growth to 1.9% in 2019. By contrast, import growth virtually stagnated (+0.2%), largely driven by base effects related to shipping.

These base effects were also at play with a view to investment activity. Compared to the previous year, growth in gross fixed capital formation almost halved from 5.4% to 2.9% in 2019, largely driven by a sharp decline in investment in machinery and equipment and

weapon systems, as well as in investment in transport equipment, which contracted by 6.0 and 18.1% respectively. On the other hand, investment in intellectual property held up reasonably well, expanding by 3.6% (5.4% of GDP after 5.3% in 2018), whilst gross fixed capital formation in total construction grew by 7.8% in 2019, even faster than in the year before (4.6%). Household spending growth, in turn, came in at a solid 1.9%, contributing a healthy 0.9 p.p. to Denmark's economic growth. Nevertheless, this was somewhat weaker than in the previous year (2.6%), partly mirroring the tendency of Danish households to ramp up precautionary savings and debt repayments. Private consumption benefited mainly from favorable funding cost, as well as continued real wage and employment growth.

The favorable development on the Danish labor market went into its seventh year, although we observed slowing dynamics on the otherwise very well-performing labor market. On the whole, Denmark's sustained economic growth is leading to additional labor demand. The number of employees (national accounts, domestic concept) rose by 1.2% to just under 3.0m in 2019, exceeding the peak recorded in 2008 (2.95m), and increasingly driven by elderly and foreign workers. Employment among the elderly (55-64y) leapt by 5.6% y-o-y in Q3-19, significantly outpacing total employment growth (LFS, trend cycle data); the number of employed elderly workers thus peaked at 526,000 (+12.7% compared to Q3-16). The increase in employment was accompanied by a further decline in unemployment. The unemployment rate fell slightly from 5.1% in 2018 to 5.0% in 2019, its lowest reading since 2008. Furthermore, labor participation increased from 78.3% in Q3-18 to 79.2% in last year's third quarter, corresponding to the third-highest participation rate in the EU-28 (average 74.0%). The outperformance of the Danish labor market is also reflected by the EU Social Scoreboard, according to which Denmark is one of the leading countries.

As regards economic prospects, we expect Danish real GDP growth to decline sharply to 0.4% in 2020, before prospectively rebounding in 2021, mainly reflecting the precarious situation caused by the outbreak of the corona pandemic. While the Covid-19 virus is affecting the Danish economy, and we currently expect the economic impact to be transitory, it is not yet possible to say how deep the impact of the novel corona virus will be from the current perspective. This will depend on the full range of measures eventually taken to combat the virus, and ultimately on the extent and duration of the shock contingent on the development of effective medicines. This being the case, we cannot rule out that economic growth may recede in 2020.

While infected or sick employees will certainly not contribute to an economy's gross value added, the economic impact of public and private containment measures - e.g. closed schools/childcare facilities and factories, travel restrictions, and quarantines - is difficult to gauge.

As of 11 March, the government has shut down large parts of the Danish economy, and since 14 March the border to Denmark has been essentially closed in a bid to contain a further spreading of the virus. While foreigners are no longer allowed to enter the country until 13 April, cargo appears to be exempted. It has been decided that all schools and kindergartens are to be closed, and an aid package has been enacted allowing health authorities to enforce tests and quarantine measures. All libraries and recreational facilities have

also been closed, and all non-essential public service workers have been sent home. A comprehensive package geared towards cushioning the fallout in the private sector has been adopted. As we understand, it will thus be made possible for the state to pay up to 75% of full-time employees' under specific conditions and up to a limit, possibly mitigating widespread lay-offs and saving businesses from closure. Authorities also announced a safety net for businesses and self-employed, compensating for up to 80% of fixed costs of businesses experiencing larger than 40% declines in turnover and up to 75% of revenue losses of self-employed up to a limit. Moreover, the sickness benefit system is to kick in from day one regarding employees infected with Covid-19 or quarantined because of it. Corporate liquidity will be supported by an initiative whereby companies may delay payments of income tax and VAT for a short period.

At present, a sharp decline in the first half of the year now appears almost inevitable. The course of the economy in H2-20 hinges on whether the restrictions continue or are eased or lifted towards the summer. The pandemic is set to curb external demand and final demand for imported goods and services. Production has been hit by direct supply disruptions and subsequent supply chain contagion via Asia and other key industrial economies such as Germany, Italy, and the US. Moreover, domestic demand is set to be curtailed by a fall in aggregate demand as well as by postponed corporate investment decisions and purchase delays by consumers.

Whilst no reliable hard economic data is yet available, our baseline scenario assumes a more or less U-shaped pattern of economic development. Still, the forecast is materially clouded by uncertainty and heavily dependent on the success of containing the pandemic. Due to the highly dynamic unfolding of events, considerable economic effects must be expected.

Against the background of the current macro-financial environment and our baseline assumptions, private consumption should represent the only pillar supporting modest economic expansion in 2020. While we had previously assumed that household spending would increase somewhat more strongly than in 2019, this view has come under scrutiny as the pandemic is set to adversely affect consumption. Although stockpiling efforts in retail stores may somewhat cushion detrimental effects on other parts of the economy, e.g. leisure, accommodation and food service activities, it seems reasonable to assume weaker consumption spending in 2020. Once the corona strains begin to fade, private consumption is likely to kick-start again, benefiting from the structurally strong labor market, modest consumer price inflation, and low financing costs.

Despite the governmental support measures, redundancies are likely to increase somewhat. We expect to see decreasing employment growth in the first half of the year, with the potential to pick up again in H2-20. That said, employment growth had already softened before the outbreak of the corona crisis, with annual growth falling from 1.5% in Q4-18 to 1.0% in the last quarter of 2019. Employment should be bolstered by the rising retirement age going forward, which will gradually increase labor supply in the following years. We also view the government's plans to upskill low-qualified workers, and to facilitate recruitment of foreign workers through less bureaucratic measures, as constructive.

Although labor pressures have leveled off somewhat and the corona fallout should foster this momentum, we assume labor markets will remain rather tight. Up to the fourth quarter of 2019, the number of vacancies remained high, with the vacancy rate standing at 1.9%, which should essentially aid wage growth. Previously, wages had been steadily growing. According to Statistics Denmark data, average earnings have increased by at least 2.0% y-o-y since the beginning of 2018 (Q3-19: 2.1%). At the same time, collective bargaining rounds, which were originally envisaged to take place in 2020, have the potential to accelerate wage growth and stimulate private consumption. Inflation is likely to remain subdued, creating a favorable backdrop for real disposable incomes. It has to be highlighted that one-off measures will presumably provide Danish households with additional purchasing power in 2021 due to the reimbursement of excessively collected property taxes.

Due to the material adverse effects of a combined supply and demand shock to the Danish economy, and despite a possible rebound in the second half of the year, we expect investment activity to support economic growth to an even lesser extent than initially assumed, making a meaningful positive contribution to economic growth very unlikely. Indications that gross fixed capital formation is set to gradually weaken were already visible prior to the crisis. Capacity utilization declined steadily over the course of last year and stood at 80.6% in Q4-19, just below its long-term average since 2000 (80.9%). The slowdown in the dynamics of the housing market in 2019 also suggested softer growth in residential construction. Total construction investment growth, which was the main engine of overall investment growth in 2019, had diminished gradually over the course of the year.

Having said this, corporate funding costs and mortgage interest rates remain low, as Danmarks Nationalbank (DN) maintains its extremely accommodative monetary policy stance. In September 2019, DN lowered the deposit interest rate by 0.1 p.p. to -0.75% on the heels of the ECB's rate cut. Until recently, DN had remained in step with the ECB's monetary policy decisions, targeting the exchange rate peg to the euro, and we saw a heightened probability that DN would implement independent interest rate cuts in 2020, since the ECB left its key interest rates unchanged at its last meeting on 12 March. The kroner still appears to be under pressure, resulting in repeated FX interventions by DN. More recently, the Danish central bank found it necessary to intervene for five consecutive months, having sold a total of DKK 18.7bn since last October with a relatively large intervention this January (DKK 12.1bn). Indeed, DN hiked the CD interest rate by 0.15 p.p. on 19 March, so that the spread towards the ECB's deposit facility declined to 0.1 p.p.

Following supply chain disruptions and even weaker global trade than in 2019, Covid-19 is prospectively creating an even weaker external backdrop for the Danish economy, which leads us to anticipate a decline in external demand. This should have a particularly negative impact on exports of machinery and metal industries, which have accounted for a large part of export growth in recent years. The same does not apply to the equally important pharmaceutical industry, which we view as less cyclical. The drag on export growth may be further accentuated by the lack of intermediate goods imported from countries from Southeast Asia. On top of this, Brexit-related issues may create further headwinds, although we do not expect that the UK will insist on pushing through its negotiation agenda in view of the current extraordinary circumstances. At the same time, we see import growth

also coming under pressure so that the impact on real GDP growth appears limited at the current juncture.

Despite the gloomy outlook, Denmark is likely to remain among the wealthiest and most productive economies in Europe, which we continue to hold as a credit positive. As shown by IMF data, per capita GDP has risen persistently over the last years and amounted to USD 53.882 in 2019 (in PPP terms), broadly in line with its AAA rating peers Germany (USD 53,567) and the Netherlands (USD 58,341), and equaling 121.0% of the weighted EU-28 average. In addition, the high levels of prosperity go hand in hand with comparatively high productivity levels, with labor productivity per hour worked posting 37.7% above the EU-28 total, the third highest reading in the EU-28 in 2018.

What is more, Denmark has sustained its high degree of competitiveness. Denmark's export market share has remained stable in recent years and international institutions have confirmed the high non-cost competitiveness of the Danish economy. According to the Global Competitiveness Report of the World Economic Forum, Denmark maintained its position among the best performers in the world, being ranked 10th out of 141 economies. Moreover, the Danish economy is perceived to feature a welcoming and standard-setting business environment. In the latest Doing Business Report of the World Bank, Denmark occupies an excellent 4th place out of 190 nations, also being the highest ranking country in Europe. In terms of cost competitiveness, pressures appear to have eased more recently. After a relatively strong increase in real unit labor costs in 2018, 2019 only saw a marginal increase of 0.2% (AMECO data).

Tail risks implied by Denmark's very high household debt coupled with high housing valuations remain in place. Denmark still has the highest household debt in the EU-28 (2018: 126.2% of GDP), and also the highest level of debt in relation to households' disposable income, at 239.8% in Q3-19. Risks are somewhat contained by the fact that Danish households concurrently command over an equally large asset position, with net assets equating to 187.5% of GDP (non-consolidated financial sector accounts). However, the usual caveat concerning liquidity applies as assets essentially comprise pension and housing assets. Hence, we have to stay vigilant in this respect.

Institutional Structure

The exceptionally high quality of the sovereign's institutional set-up remains a cornerstone of its creditworthiness. In our view, Denmark features a long-standing track record of very sound and predictable policies which are based on a high degree of cross-party consensus, as well as strong fiscal and monetary frameworks.

Our assessment of Denmark's institutional quality is largely based on the World Bank's Worldwide Governance Indicators (WGIs), in which Denmark constantly achieves outstanding results, not only outperforming the majority of its European peers, but also being a global leader. The latest vintage of WGIs ties into this. With regard to the WGI government effectiveness, Denmark ranks at 7 out of 209 economies, the second highest reading in the EU-28, indicating a very high quality of policy formulation and implementation. Perception

indicators attest Danes to benefit from a very high degree of personal freedoms, i.e. expression, association, and free media, placing the sovereign at rank 5 in the WGI voice and accountability. When it comes to the control of corruption, Denmark has ranked among the top five economies for over 20 years now, coming in at rank 4 in the latest WGI edition. Likewise, the sovereign had achieved at least the sixth rank ever since, before slipping to a still remarkable eighth rank last year.

We continue to view the sovereign's policy-making as very forward-looking and responsive. Since our last review, Denmark has been able to extend the share of the EU Commission's country-specific recommendations on which it recorded at least some progress, lifting this share to 97% (2019: 94%), making the country a European frontrunner.

The outcome of the recent general election is very unlikely to challenge our view in the foreseeable future. In June 2019, parliamentary elections took place in Denmark in which the Social Democrats emerged as the strongest party, with 25.9% or 48 of the 179 seats in the Folketing (2015: 26.3%). The so-called 'red bloc' was able to win many new mandates, and especially the small left-wing parties fared better. Former PM Rasmussen's party reached 23.4%, almost 4 p.p. more than in 2015, but his blue bloc lost overall. The Social Democrats eventually formed a one-party minority government, essentially relying on the support of three left-leaning parties, the Socialist People's Party, the Red-Green Alliance and the Social Liberal Party, a common arrangement in Denmark. While PM Frederiksen envisaged placing a greater focus on social and welfare spending, pursuing ambitious climate policy objectives, and softening some of the tougher measures geared towards immigration, we view policy continuity as given.

Meanwhile, the impact of the Danske Bank money laundering scandal is still being felt, having led to a far-reaching loss of trust in the integrity of Danish financial institutions and the ability of the Danish regulatory and supervisory authorities to combat money laundering. Since then, Denmark has pushed forward with measures targeted towards combating money laundering and the financing of terrorism. In January 2020, the new anti-money laundering (AML) act came into force, which is intended to implement the European statutes of the 4th and 5th AML directives. The budget of Denmark's Financial Intelligence Unit (Money Laundering Secretariat) and the Danish financial supervisory authority have been significantly raised to increase their respective surveillance capacities. Concurrently, the financial supervisory authority established an AML department and almost doubled the number of employees in 2019. The Financial Action Task Force has acknowledged these improvements in the fight against money laundering. However, continued efforts seem necessary, e.g. with a view to the supervision of non-financial institutions and the practical application of newly implemented monitoring manuals and risk analysis tools, which have yet to prove their effectiveness.

We note some delays in tax policy implementation, as the property tax system reform was postponed from 2021 to 2024. More generally, we positively assess that the Danish tax administration is going through a major restructuring, illustrative of the sovereign's stance of constantly and proactively striving to optimize institutional conditions. In 2018, the tax administration was divided into seven agencies, each of them to cover a specific area, with the overarching goal of boosting tax collection efficiency. The new structure is reportedly

showing early signs of success with regard to a dividend tax fraud with fictitious share deals ('cum ex trades') which have led to an estimated monetary damage of approx. DKK 12.7bn or 0.5% of GDP. The Danish tax authority Skattestyrelsen has thus gained access to millions of tax documents that appear to contain information on individuals and companies involved in the dividend scam.

Lastly, we reiterate that we view monetary policy conducted by DN as highly credible and efficient (also see above), resulting in a broadly stable Danish Kroner (DKK) and moderate and stable consumer price inflation, thus rounding off the picture of remarkably high quality institutions in Denmark.

Fiscal Sustainability

Another key pillar to the sovereign's creditworthiness are its very healthy public finances, which should provide for sufficient fiscal leeway with a view to the challenges lying ahead.

The Danish budget recorded a surplus for the fourth consecutive year. After achieving a general government budget surplus of 0.8% of GDP in 2018, the surplus should have increased markedly to 2.5% of GDP last year (Maastricht definition). According to most recent Statistics Denmark data, the stark improvement in general government revenue was largely driven by exceptionally high revenues from the extremely volatile pension yield taxes, which came in at DKK 63.2bn, equivalent to 2.7% of GDP – thus having increased by roughly 360% on the year, after plunging by about 57% a year before. Due to the continuing good performance of the labor market and robust economic growth, the PIT and CIT intake have recorded strong growth of 3.9 and 9.3% respectively (up from 2.2 and -9.3% in 2018). At the same time, current expenditure growth amounted to 1.3%, down from 1.9% in 2018. Whereas growth of social benefits in kind rose from 0.5 to 2.4% in 2018-19, the public wage bill expanded by 2.4%, broadly unchanged from the previous year (2.3%).

Looking into the current year, we expect the general government budget to deteriorate sharply, shifting into deficit. To be sure, we would have expected Denmark's fiscal stance to become somewhat more neutral in the medium term anyway.

In its 2020 budget approved by Parliament in December last year, the newly-elected government placed particular emphasis on the areas of environment, education, healthcare, and the welfare system, which should boost government expenditure. Thus, DKK 600m per year shall be invested in enhancing psychiatric capacities and improving the qualifications of employees from 2020 onwards, and funds for public schools will be gradually raised from DKK 275m to approx. DKK 800m in 2023. The government also envisages a minimum staff-to-children ratio that will be implemented in nurseries and kindergartens stepwise by 2025, for which DKK 600m will be allocated in 2020.

Following the Climate Act, which set the legally binding, though ambitious, target of reducing CO_2 emissions by 70% by 2030, policy-makers tabled initiatives to move ahead with the economy's green transition, including support for the development and dissemination of new technologies, the restructuring of the energy system towards renewable energies, energy storage, energy efficiency and exports of green technologies. In this vein, the so-called 'Denmark's Green Future Foundation' with total funds of DKK 25bn was established.

The budget for 2020 would thus have brought many surplus-decreasing elements underway, notably increasing government expenditure for the current and coming years. These were envisaged to be counter-financed by tax revenues resulting from sustained, though softening economic growth, and tightened green regulations (higher related taxes and excise duties). Apart from that, funds available within fiscal rules shall be exploited, the foreseen reduced inheritance taxation and cuts in taxes on employer-paid IT equipment withdrawn, and additional fiscal leeway created. The repayment of overcharged housing taxes (approx. DKK 18.5bn) should be kept in mind, putting additional strain on the budget, but most probably in 2021.

All that said, the very dynamic spread of Covid-19 and the concurrent costly countermeasures to limit the damage to the real and financial economy will most certainly imply a negative impact on public finances in the short term, turning the authorities' budget plans upside down. The information received so far on measures seized gives a rough indication of where we may be heading (see above), implying additional costs of roughly DKK 40 to 50bn, but it cannot be ruled out that more initiatives may follow. Additionally, it is fair to say that dampened economic growth should curb tax revenues significantly. We therefore pencil in a budget deficit of approx. 2.0% of GDP for the current year, but risks to the estimate are clearly skewed to the downside.

As Denmark has significant fiscal space and very strong debt affordability, we think that risks to fiscal sustainability are largely mitigated. Very sound debt management by the relevant authorities further adds to this.

After general government (EMU) debt had fallen by 1.3 p.p. to 34.2% of GDP in 2018, it should have decreased to 33.5% of GDP last year, making it one of the lowest in Europe. We also note that debt has been steadily declining in nominal terms over recent years. The sovereign thus appears to be in a good position, as authorities have ample room to maneuver in order to shield Danish businesses and households from the worst effects. Still, the corona virus will not leave Denmark's public debt ratio unscathed. With the government bracing for the economic and financial impact of such an unprecedented shock, seized measures will put the brakes on a further debt reduction in the near term, but the public debt ratio should resume a gradual downward path beyond 2020. In view of the implemented emergency measures, the target for government bond issuance in 2020 was increased from DKK 75 to 125bn on 16 March.

Nevertheless, the very high debt affordability will likely be sustained, with the sovereign benefiting from the very low interest-rate environment. The Danish 10y government bond yields remain at historically low levels, posting in negative territory since May 2019. In mid-March (17-03-20), 10y bond yields stood at -0.372%, down from 0.059% a year before, though being subject to very high volatility since the outbreak of Covid-19. Interest payments diminished by 7.7% from DKK 6.1bn in Q3-18 to DKK 5.6bn in Q3-19. As measured by general government revenue, interest outlays stood at a mere 1.9% in the year up to Q3-19 (rolling 4-quarter sum), one of the lowest readings in the EU-28.

At present, the Danish banking sector is in good shape and seems to have sufficient buffers to weather the corona shock, amid further support measures by DN. The non-performing

loans (NPL) ratio decreased further in the year to the third quarter of 2019, dropping from 2.2 to 1.8% (EBA data), among the lowest NPL ratios in Europe (EU-28 average 2.9%). Furthermore, Danish banks exhibited a CET 1 ratio of 17.2% in Q3-19, well above the EU-28 average of 14.6%.

The Danish banking sector, however, remains among the largest in the EU-28, which may pose additional challenges in terms of stabilization in the event of adverse shocks. Measured by total assets, the banking sector grew from 293% of GDP in Q3-18 to 306.9% in the third quarter of 2019. Against this backdrop, we consider it positive that DN launched the extraordinary lending facility on 12 March, which enables banks to take one-week loans against collateral with a current interest rate of -0.35%, as DN increased the CD interest rate (see above), and decided on 19 March to expand the extraordinary lending facility with 3-month variable interest rate loans. These measures should mitigate the worst effects of the coronavirus on the liquidity situation in the Danish banking sector and on secure funding. Also, the Danish government is trying to support bank lending by releasing the countercyclical capital buffer and canceling all planned increases. Nevertheless, we should remain wary, as the results from the most recent stress test conducted by DN suggest that a few banks would fall short of their capital buffer requirements in a severe stress scenario, even after assuming that the CCyB is released.

This is all the more important, as an adverse development in residential real estate - which is currently not our baseline scenario - could have a significant negative impact on fiscal sustainability and on the domestic economy, transmitted mainly through the household sector and the financial system. Valuations still seem high, although we have observed a further slowdown in the Danish housing market since our last review. According to OECD data, annual house price growth flattened significantly from 2.7% in Q3-18 to 0.8% in Q3-19. The 3-year growth rate also declined sharply from 11.7% to 6.7% in Q3-19. Still, house prices are posting 26.4% above their long-term level (1995 to Q3-19), and affordability parameters indicate potential misalignments in the housing market. The price-to-rent and price-to-income ratios stood 17.3 and 13.4% above their long-term average respectively.

We note that growth in mortgage lending is almost entirely driven by fixed-rate loans. According to DN data, the outstanding volume of mortgage loans surpassed the previous year's level by 3.5% in December 2019. While fixed-rate mortgage loans showed a high growth of 11.2%, variable rate loans contracted by 1.6%. Accordingly, the share of fixed interest rate loans increased steadily over the past year, accounting for 44.8% of total loans (all types of properties) at the end of 2019 (Dec-18: 41.1%). Risks also appear somewhat contained by the fact that households are taking advantage of the persistently low interest rates to restructure their debt. Up to the beginning of the year, average mortgage rates had continued to dwindle, having declined to 0.84% in January, after having fallen below the 1%-mark in September 2019 for the first time.

Foreign Exposure

Denmark's external position remains very strong, being supportive to the sovereign's credit assessment. Denmark's current account surplus has been among the highest in the world for years. Last year, its surplus jumped from 7.0% of GDP in 2018 to 8.0% of GDP, broadly

on par with the five-year average of 2014-18 (7.9% of GDP). The improvement came mainly on the back of a significantly stronger goods balance, which went up by 1.8 p.p. to 5.8% of GDP, more than compensating for the decline in the services balance, which halved from 2.0 to 1.0% of GDP. As revealed by Statistics Denmark data, merchanting and goods procured or sold abroad continue to have a decisive impact in this regard. On a net basis, offshore trade posted a surplus of 2.6% of GDP (2018: 2.3% of GDP), whereas goods sold under merchanting accounted for 2.3% of GDP – both variables continuing on their long-term upward trajectory.

The current account balance should ease in 2020, based on the premise that Covid-19 will heavily affect foreign trade, pulling external demand down, while import growth should also come under pressure, somewhat limiting the impact on a net basis. While sustained current account surpluses bode well for Denmark's net international investment position (NIIP), valuation effects, which were an important factor behind the very large NIIP increase over the past decade, may dent the very large and positive NIIP. Having said this, we do not view the situation as alarming against the backdrop of substantial external buffers. According to the latest available data, the Danish NIIP leapt by 16.3 p.p. to 80.2% of GDP in the year up to the third quarter of 2019, the second highest in the EU-28 behind the Netherlands.

Rating Outlook and Sensitivity

Our rating outlook for the Kingdom of Denmark's long-term credit ratings is stable, as we assume that the risk situation underlying the key factors affecting sovereign credit risk – including macroeconomic performance, institutional structure, fiscal sustainability, and foreign exposure – is likely to remain fundamentally unchanged over the next twelve months.

That being said, risks to Denmark's credit ratings are strongly on the downside. Given the current substantial economic and financial market uncertainty and the very dynamic development of Covid-19, the assessment and interpretation of economic developments is materially more difficult than under normal circumstances for the near future, as is the case for other indicators.

We could lower our rating or outlook if the Corona pandemic has a stronger and longer lasting impact on the Danish economy than we expect. Most importantly, its ratings could come under downward pressure if we observe significant adverse effects on Denmark's medium-term potential growth. This could be the case if the consequences of the pandemic and the impact on demand and production are more pronounced than assumed, implying that the disruption of value-chains extends well into the second half of the year and beyond, and if policy-makers fail to minimize the economic fallout.

Moreover, a negative rating action could also be prompted if the public debt ratio, contrary to our belief, follows a sustained upward trend over a prolonged period of time, and/or if house prices fall rapidly, putting macro-financial stability at risk, involving the need to engage in a financial sector bailout.

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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	2.2	0.4
GDP per capita (PPP, USD)	46,347	47,651	48,889	50,570	52,279	53,882	55,675
HICP inflation rate, y-o-y change	0.4	0.2	0.0	1.1	0.7	0.7	0.7
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	0.2	1.7	0.8	2.5 (e)	-2.0
Current account balance/GDP	8.9	8.2	7.8	7.8	7.0	8.0	n.a.
External debt/GDP	166.8	158.9	159.2	155.9	142.3	n.a.	n.a.

Source: International Monetary Fund, Eurostat, Statistics Denmark, own estimates

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

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.

The rating was conducted on the basis of CRAG´s "Sovereign Ratings" methodology in conjunction with its basic document "Rating Criteria and Definitions". 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 the following internet page: www.creditreform-rating.de/en/regulatory-requirements/.

To prepare this credit rating, CRAG has 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, Danmarks Nationalbank, Statistics Denmark, Kingdom of Denmark – Ministry of Economic Affairs and the Interior, Kingdom of Denmark – Ministry of Finance.

A Rating Committee was called consisting of highly qualified analysts of CRAG. The quality and extent of information available on the rated entity were 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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