SOVEREIGN AND SUPRANATIONAL

MOODY'S INVESTORS SERVICE

CREDIT OPINION
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Update

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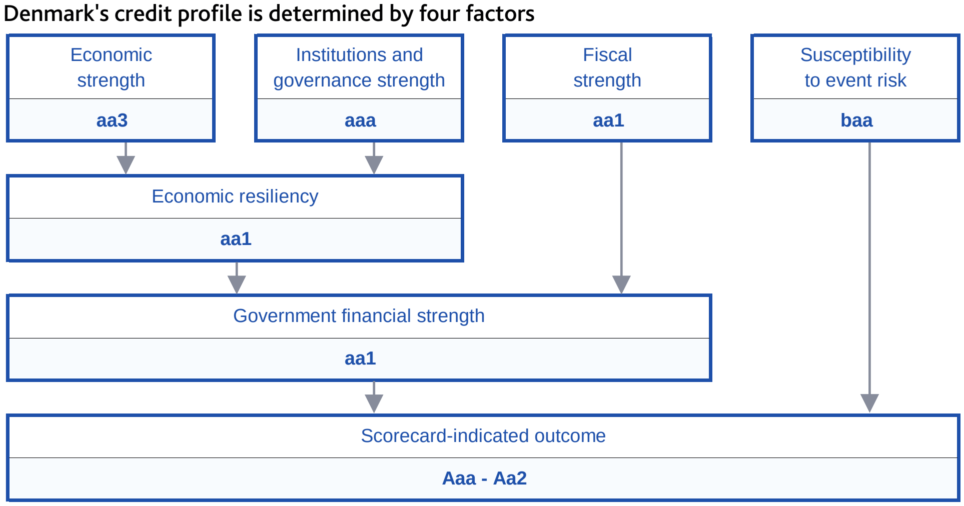
Government of Denmark – Aaa stable

Regular update

Summary

Denmark's credit profile reflects its competitive and diversified economy, high and evenly distributed wealth levels and flexible labour market. The country's strong social safety net drives its very low susceptibility to social risks. Sound institutions and prudent fiscal policy have helped to keep government debt low and affordable. Like other European countries, Denmark faces increased geopolitical risk because of Russia's invasion of Ukraine (Caa3 negative).

Exhibit 1
Denmark's credit profile is determined by four factors



Source: Moody's Investors Service

Credit strengths

» Strong government balance sheet, marked by fiscal prudence and long-term sustainability

» High-quality institutions and forward-looking and credible policy framework

» Very wealthy, flexible and competitive economy with a strong social safety net

Credit challenges

» Maintaining financial stability given large system size and high household debt

» Managing exposure to external shocks, including increasing geopolitical risk

Rating outlook

The stable outlook reflects our view that downside risks to Denmark's very strong credit profile are predominantly external in nature and effectively mitigated by the country's very strong, forward-looking policy effectiveness as well as very high economic and fiscal resilience.

Denmark's proven track record of managing external shocks and proactively addressing long-term challenges, in particular demographic and climate change, underscores its very high resiliency to external shocks. In the recent past, the economic and fiscal resilience as well as very effective policymaking was shown during the pandemic.

Factors that could lead to a downgrade

Denmark's Aaa ratings would come under pressure if its strong fiscal metrics were to record a multiyear and material deterioration with no indication of a reversal. In particular, a significant erosion of Denmark's long-term fiscal sustainability caused by reversing reforms would be credit negative. While we view the rating resilient to an external economic shock, downward pressure would emerge if an external shock would be accompanied by a house price collapse and the materialisation of significant contingent liabilities from the financial sector on the government's balance sheet.

Key indicators

Exhibit 2

Denmark	2017	2018	2019	2020	2021	2022F	2023F	2024F
Real GDP (% change)	2.8	2.0	1.5	-2.0	4.9	3.0	0.5	1.5
Inflation (CPI, % change, Dec/Dec)[1]	0.8	0.7	0.8	0.4	3.4	9.6	3.1	1.9
Gen. gov. financial balance/GDP (%)	1.8	0.8	4.1	0.2	3.6	1.0	0.7	0.2
Gen. gov. primary balance/GDP (%)	2.6	1.6	4.9	0.8	4.2	1.5	1.2	0.8
Gen. gov. debt/GDP (%)	35.9	34.0	33.7	42.2	36.6	32.8	31.9	31.2
Gen. gov. debt/revenues (%)	68.6	66.3	62.6	78.5	67.3	63.3	62.2	62.2
Gen. gov. interest payment/revenues (%)	1.5	1.6	1.4	1.0	1.0	1.0	1.1	1.1
Current Account Balance/GDP (%)	8.0	7.3	8.5	7.9	9.0	13.0	12.4	12.3

[1] Harmonized Index of Consumer Prices (HICP)

Source: Moody's Investors Service

Detailed credit considerations

Denmark's credit profile is determined by its economic strength score of "aa3", score for institutions and governance strength of "aaa", fiscal strength score of "aa1" and score for susceptibility to event risk of "baa".

We assess Denmark's **economic strength** as "aa3", reflecting the country's very high wealth levels and highly diversified economy, very high education levels, well-developed physical and digital infrastructure, high technological advancement and very flexible labour market, which together support the economy's competitiveness. An exceptional social safety net – which includes the provision of basic services, education and health and safety – low income inequality and a high level of social mobility materially reduces Denmark's susceptibility to social risks. As the quantitative scorecard metrics do not fully capture these strengths, we assess Denmark's economic strength two notches above the initial score of "a2".

The assessment also takes into account average real GDP trend growth to be with 1.9% over 2017-26F slightly higher than the median for Aaa rated sovereigns of 1.7%, and the moderate level of growth volatility, which reflects the economy's high degree of openness.

We assess the overall strength of Denmark's **institutions and governance** as “aaa”. In our view, Denmark has one of the strongest institutional setups globally. This is reflected in the high quality of legislative and executive institutions, a strong civil society and high-quality judiciary, as well as strong fiscal and macroeconomic policy effectiveness. Denmark's institutions are highly credible, and policy formulation and implementation are predictable and forward-looking. This is for example reflected in the 10-year policy plans that successive governments have presented over the years, and our assessment also incorporates sustained commitment and broad consensus to preserving strong public finances.

Despite the money-laundering scandal that came to light in 2018 and involved Denmark’s largest bank, the quick political reaction and implementation of measures to strengthen financial supervision supports our assessment.

Monetary policy credibility is underlined by the stable and long-standing exchange rate peg to the euro (and before that to the Deutschmark). This policy has provided a solid anchor for low and stable inflation expectations in Denmark. Denmark’s central bank has an agreement with the European Central Bank (ECB) to keep the krone within a 2.25% band around a rate of DKK7.46 per euro, although in practice it sticks to a much tighter range.

Denmark's **fiscal strength** score is “aa1” which reflects a low debt burden of only 36.6% of GDP in 2021, below the median for Aaa rated sovereigns of 41.7%, and strong debt affordability. We assess Denmark's fiscal strength higher than the initial score of “aa2”, taking into account portion of government debt comprising on-lending to overall financially healthy state-owned enterprises and infrastructure projects; and the long term sustainability of Denmark's government finances because of past pension reforms.

In light of an ageing population, long-term fiscal sustainability is benefiting from the implementation of pension reform that links the retirement age to life expectancy. According to European Commission projections, the total cost of ageing will only slightly increase to 26.9% of GDP in 2070 from 25.4% of GDP in 2019.

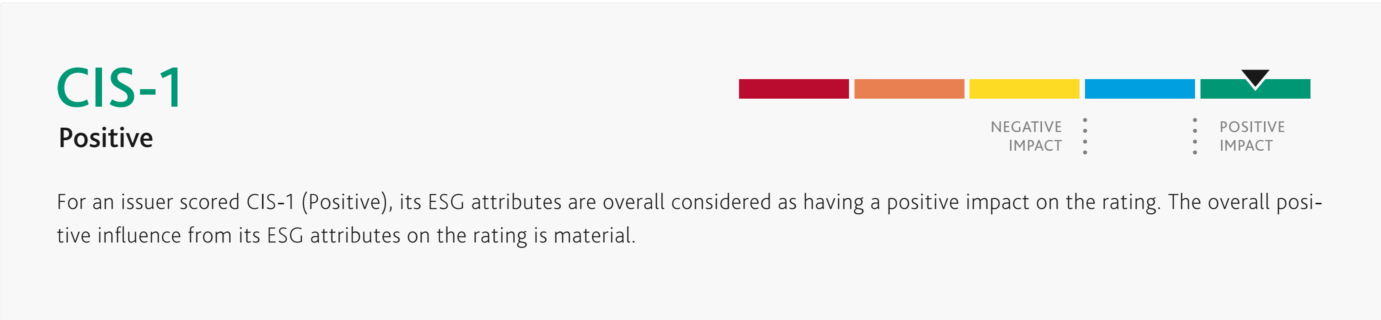
The score for **susceptibility to event risk** is “baa”, driven by political risk. While domestic political risk remains low, Russia’s invasion of Ukraine has raised geopolitical risk which has prompted us to change the political risk score to “baa”. Although Denmark’s NATO membership is ultimately a guarantor of national security, the country also faces contagion risks from the Russia-Ukraine conflict as it is bound by NATO’s Article 5 collective defense clause, which treats an attack on any NATO member as an attack on all treaty signatories. While this is not our base case because of the deterrent effect of this clause, there is a heightened risk that this treaty obligations could ultimately result in Demark needing to use armed force to restore and maintain stability in Europe. The probability of such risks materialising have increased in light of the ongoing military conflict between Russia and Ukraine. Moreover, on 1 July 2022, Denmark joined the Common Security and Defense Policy (CSDP) of the European Union (EU, Aaa stable) which stipulates that the country can participate in the discussion and implementation of decisions and actions that have defense implications.

We assess Denmark's banking sector risk at “a”. This score reflects the intrinsic strength of the Danish banking sector marked by a “baa1” average asset-weighted Baseline Credit Assessment, as well as a total bank assets to GDP ratio of 370.6% as of year-end 2021. We score government liquidity risk and external vulnerability risk both as “aaa”. Relatively small government gross financing needs and strong market access are limiting government liquidity risk, while Denmark’s structural current-account surplus, coupled with a sizeable and growing net asset international investment position shield the country from external liquidity pressures.

ESG considerations

Denmark's ESG Credit Impact Score is Positive CIS-1

Exhibit 3
ESG Credit Impact Score



Source: Moody's Investors Service

Denmark's ESG Credit Impact Score is positive (**CIS-1**), reflecting low exposure to environmental and social risks, and like many other advanced economies, very strong governance and capacity to respond to shocks.

Exhibit 4
ESG Issuer Profile Scores

Source: Moody's Investors Service

Environmental

Specifically, Denmark's exposure to environmental risks is low across all categories. Its overall E issuer profile score is therefore neutral to low (**E-2**).

Social

Similarly, Denmark has very low or low exposure to most sources of social risks, with widely available and accessible high-quality education, housing, healthcare and basic services. Like many advanced economies, Denmark faces demographic change through an ageing population, but we view the long-term economic and fiscal pressures as comparatively limited, given past labour market and pension reforms. Overall, we assess Denmark's S issuer profile score as positive (**S-1**)

Governance

Denmark's very high institutions and governance strength is reflected in a positive G issuer profile score (**G-1**). This is underpinned by the government's high credibility, transparency and consensus on key fiscal policy goals and macroeconomic policies. It also reflects the professional and well-staffed public administration and Denmark's very strong scores in global surveys assessing rule of law, voice and accountability, and the control of corruption. Coupled with comparatively strong government financial strength this supports a very high degree of resilience.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

All of these considerations are further discussed in the "Detailed credit considerations" section above. Our approach to ESG is explained in our report on how the scores depict varied and largely credit-negative impact of ESG factors and our cross-sector methodology General Principles for Assessing Environmental, Social and Governance Risks Methodology.

Recent developments

GDP growth to slow materially in 2023 after strong growth in 2021-22

We forecast the Danish economy to fall into a mild technical recession over the winter half 2022-23 and GDP growth to slow significantly to 0.5% in 2023 from 3.0% in 2022. This is driven by the interplay of the negative impact of elevated inflation, moderate weakening of the situation on the labour market, higher interest rates and falling house prices on domestic demand, weak external demand and heightened uncertainty. For 2024, we expect GDP growth of 1.5%.

Nominal and real house prices peaked in the second quarter of 2022 and the third quarter of 2021, respectively (see Exhibit 6). Since then the correction of the housing market started against the backdrop of the deteriorating economic outlook and steadily rising mortgage rates. Danmarks Nationalbank expects house prices to fall by about 9% in 2023 compared to the peak in the second quarter of 2022.[1] While the housing market correction poses challenges for banks and the sovereign, we view the credit profiles of banks and the sovereign would be resilient to all but the most severe downturns in the housing market.[2]

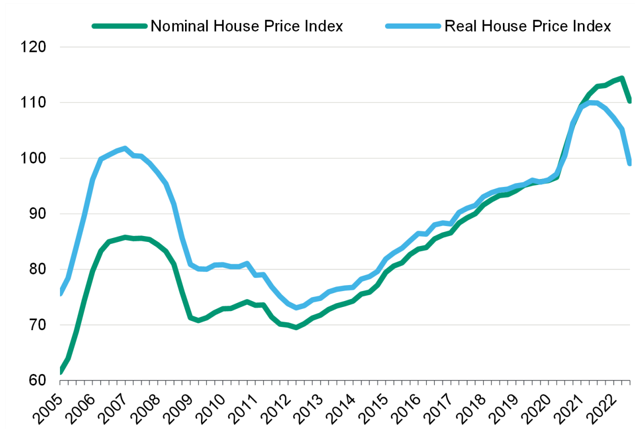
That said, Denmark is relatively sheltered from the gas crisis in Europe because natural gas constitutes only 12% of energy supplies (EU average: 25%) and only 5% of electricity generation in 2021. Denmark is normally self-sufficient in gas but the shutdown because of maintenance of its Tyra II offshore gas facility has made it import dependent until the facility reopens, probably in the 2023-24 winter season. Indigenous gas production to total inland gas consumption was 53% in 2022 which is materially above the EU average of 12%.

The terms of trade (of goods and services) of the Danish economy improved by around 1% year-on-year in 2022 (first to third quarter), which improved the country's income and overall price competitiveness, contrary to the EU-wide weakening of the terms of trade by 4.5%.

High freight rates materially boosted Denmark's export prices and let to a material widening of the freight services surplus which is part of sea transport services. The sea transport services surplus increased to 9% of GDP in the third quarter of 2022 (4-quarter moving average) being 4 percentage points higher year-on-year mainly explaining the widening of the current account surplus to an average 12% of GDP over the past four quarters (see Exhibit 7). For the full year 2022, the current account surplus will likely amount to 13% of GDP. We forecast the current account to remain above 12% of GDP in 2023-24 as a normalisation of freight rates will be balanced by other factors such as the reopening of the Tyra II offshore gas facility.

Exhibit 5

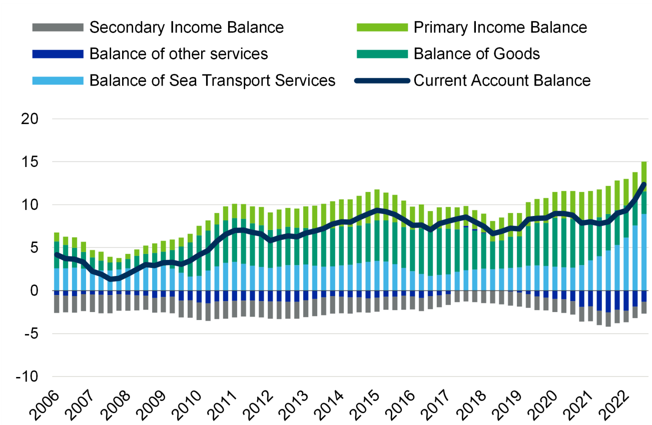
Danish house prices stared to fall
Index, 2020 = 100



Sources: OECD and Moody's Investors Service

Exhibit 6

Widening of sea transport services surplus is key driver of the increased current account surplus in 2022
% of GDP (4-quarter moving average)



Sources: Statistics Denmark and Moody's Investors Service

Danish central bank raises key interest rate following ECB's move but widens spread to ECB's policy rate

On 2 February, the European Central Bank (ECB) decided to raise its key interest rates by 50 basis points to 3.0% amid high consumer price inflation and Danmarks Nationalbank[3] followed suit and raised its key policy rate with effect from 3 February 2023. However, the rate hike of Danmarks Nationalbank was with 35 basis points to 2.1% lower compared to the ECB's rate hike. This widened the gap in the key policy rates and follows interventions of Danmarks Nationalbank to purchase foreign exchange amounting to DKK 13.2 billion in January 2023 and to DKK 22.7 billion since late October 2022 when Danmarks Nationalbank the last time widened the spread in key policy rates to the ECB.

Continued fiscal surpluses and falling debt-to-GDP in 2023-24 but very strong debt affordability metrics will weaken gradually

We expect fiscal surpluses of the general government to be sustained with an average of 0.5% of GDP in 2023-24. Overall support measures to households and companies to offset the impact of higher energy prices are with 2.1% of GDP to date lower compared to the EU-wide average of 3.3% of GDP according to Bruegel (as of 29 November 2022). In addition, Denmark set up a guarantee scheme to provide liquidity support of up to DKK 125 billion (or 4.5% of GDP) which was approved by the European Commission in early November 2022. The scheme will be open to electricity producers and gas shippers and will be managed by Denmark's Export Credit Agency.

Mainly fiscal surpluses and elevated nominal growth will result in a further decrease of debt-to-GDP. Debt-to-GDP already fell to pre-pandemic levels in 2022 and we expect it to further decline to 31% (vs. Aaa-rated median of 37%) in 2024 which is 11 percentage points below the peak level of 42% seen in 2020.

While Denmark's debt affordability metrics are with interest payments-to-revenue of 1.0% (vs. Aaa-rated median of 1.1%) among the strongest globally, we expect the changed interest rate environment to only weaken affordability metrics very gradually because of the favourable debt structure (such as a long average maturity of government debt securities of 9.2 years, very low level of floating-rate debt and a low amount of maturing debt over the coming year[4] amounting to 3.4% of GDP as of December 2022).

Moody's rating methodology and scorecard factors: Denmark — Aaa stable

Factor / Sub-Factor	Metric	Indicator Year	Indicator	Initial Factor Score	Final Factor Score	Weights
Factor 1: Economic strength				a2	aa3	50%
Growth dynamics	Average real GDP growth (%)	2017-2026F	1.9	ba2		25%
	MAD Volatility in Real GDP Growth (%)	2012-2021	0.9	baa2		10%
Scale of the economy	Nominal GDP ($ billion)	2021	398.0	a1		30%
National income	GDP per capita (PPP, Intl$)	2021	64,045.8	aaa		35%
Adjustment to factor 1	*# notches*				2	max ±9
Factor 2: Institutions and governance strength				aaa	aaa	50%
Quality of institutions	Quality of legislative and executive institutions			aaa		20%
	Strength of civil society and the judiciary			aaa		20%
Policy effectiveness	Fiscal policy effectiveness			aaa		30%
	Monetary and macroeconomic policy effectiveness			aaa		30%
Specified adjustment	Government default history and track record of arrears				0	max -3
Other adjustment to factor 2	*# notches*				0	max ±3
F1 x F2: Economic resiliency				aa2	aa1	
Factor 3: Fiscal strength				aa2	aa1	
Debt burden	General government debt/GDP (%)	2021	36.6	a1		25%
	General government debt/revenue (%)	2021	67.3	aa1		25%
Debt affordability	General government interest payments/revenue (%)	2021	1.0	aaa		25%
	General government interest payments/GDP (%)	2021	0.6	aa1		25%
Specified adjustments	*Total of specified adjustment (# notches)*			0	0	max ±6
	Debt Trend - Historical Change in Debt Burden	2013-2021	-7.4	0	0	
	Debt Trend - Expected Change in Debt Burden	2021-2023F	-4.8	0	0	
	General Government Foreign Currency Debt/ GDP	2021	0.9	0	0	
	Other non-financial public sector debt/GDP	2021	18.5	0	0	
	Government Financial Assets including Sovereign Wealth Funds / GDP	2021	6.0	0	0	
Other adjustment to factor 3	*# notches*				1	max ±3
F1 x F2 x F3: Government financial strength				aa2	aa1	
Factor 4: Susceptibility to event risk				baa	baa	Min
Political risk				baa		
	Domestic political risk and geopolitical risk			baa		
Government liquidity risk				aaa	aaa	
	Ease of access to funding			aaa		
Specified adjustment	High refinancing risk				0	max -2
Banking sector risk				a	a	
	Risk of banking sector credit event (BSCE)	Latest available	baa1	baa1		
	Total domestic bank assets/GDP	2021	370.6	230-400		
Adjustment to F4 BSR	*# notches*				0	max ±2
External vulnerability risk				aaa	aaa	
	External vulnerability risk			aaa		
Adjustment to F4 EVR	*# notches*				0	max ±2
Overall adjustment to F4	*# notches*				0	max -2
F1 x F2 x F3 x F4: Scorecard-indicated outcome				**Aa1 - Aa3**	**Aaa - Aa2**	

Note: While information used to determine the grid mapping is mainly historical, our ratings incorporate expectations around future metrics and risk developments that may differ from the ones implied by the scorecard-indicated outcome. Thus, the rating process is deliberative and not mechanical, meaning that it depends on peer comparisons and should leave room for exceptional risk factors to be taken into account that may result in an assigned rating outside the scorecard-indicated outcome. For more information please see our Sovereign Ratings Methodology.

Footnotes: (1) Initial factor score: scorecard indicators combine with the automatic adjustments to produce an initial factor score for every rating factor, as detailed in Moody's Sovereign Ratings Methodology. **(2) Final factor score:** where additional analytical considerations exist, initial factor scores are augmented to produce a final factor score. Guidance on additional factors typically considered can be found in Moody's Sovereign Ratings Methodology; details on country-specific considerations are provided in Moody's research. **(3) Scorecard-indicated outcome:** Factor 1: Economic Strength, and Factor 2: Institutions and Governance Strength, combine with equal weight into a construct we designate as Economic Resiliency (ER). An aggregation function then combines ER and Factor 3: Fiscal Strength, following a non-linear pattern where Fiscal Strength has higher weight for countries with moderate ER and lower weight for countries with high or low ER. As a final step, Factor 4, a country's Susceptibility to Event Risk, is a constraint which can only lower the government financial strength as given by combining the first three factors. **(4) There are 20 ranking categories for quantitative sub-factors:** aaa, aa1, aa2, aa3, a1, a2, a3, baa1, baa2, baa3, ba1, ba2, ba3, b1, b2, b3, caa1, caa2, caa3, ca and 8 ranking categories for qualitative sub-factors: aaa, aa, a, baa, ba, b, caa, ca **(5) Indicator value:** if not explicitly stated otherwise, the indicator value corresponds to the latest data available.

Moody's related publications

» **Outlook:** Sovereigns – Euro area: 2023 outlook is negative driven by the energy crisis and geopolitics, 16 January 2023

» **Outlook:** Sovereigns – Global: 2023 credit outlook is negative as high prices, slow growth intensify social risks, 14 November 2022

» **Outlook:** Global Macro Outlook 2023-24: Global economy faces a reckoning over inflation, geopolitics and policy trade-offs, 10 November 2022

» **Credit Analysis:** Government of Denmark — Aaa stable: Annual credit analysis, 16 November 2022

» **Sector In-Depth:** Macroeconomic stability – Scandinavia: Sovereign and bank credit profiles are resilient to a potential housing market correction, 09 November 2022

» **Sector In-Depth:** Geopolitical risks – Europe: Energy crisis could lead to economic scarring across Europe, 02 November 2022

» **Sector In-Depth:** Sovereigns – Europe: Credit-negative stagflation scenario now more likely in the EU, but country-specific exposures vary, 2 August 2022

» **Rating Methodology**: Rating Methodology: Sovereigns, 22 November 2022

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

Endnotes

1 Danmarks Nationalbank, **Financial Stability – 2nd half 2022**, 1 December 2022

2 See for more details **Macroeconomic stability – Scandinavia: Sovereign and bank credit profiles are resilient to a potential housing market correction**, 9 November 2022.

3 Denmark maintains a fixed-exchange-rate policy vis-à-vis the euro area and participates in the European Exchange Rate Mechanism (ERM 2) at a central rate of DKK7.46 per € with a fluctuation band of +/- 2.25 per cent.

4 Short-term debt and long-term debt with a maturity of less than a year.

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