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October 4, 2011

Research Update:

Ratings On Kingdom of Denmark Affirmed At 'AAA/A-1+'; Outlook Stable

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Table Of Contents

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Overview

- The Danish economy is wealthy and diversified, with GDP per capita expected to exceed $59,000 in 2011.
- The Danish government has a track record of running substantial budgetary surpluses during periods of economic expansion.
- We expect the newly elected government will bring the primary fiscal deficit back to balance by 2014.
- We are therefore affirming our 'AAA/A-1+' foreign- and local-currency ratings on Denmark.
- The stable outlook reflects our view of the low likelihood of significant and sustained fiscal slippages, and of the government's commitment to pursuing policies that will promote sustainable growth.

Rating Action

On Oct. 4, 2011, Standard & Poor's Ratings Services affirmed its 'AAA/A-1+' long- and short-term foreign- and local-currency sovereign credit ratings on the Kingdom of Denmark. The outlook is stable.

Rationale

The sovereign ratings on Denmark are supported by our view of the government's longstanding commitment to fiscal discipline and growth-oriented macroeconomic policies. This commitment is reflected in the country's prosperous and diversified economy. We see Denmark's large external borrowing needs, relatively high stock of banking sector external debt, and aging population, as the main risks for the ratings.

Danish governments have a strong track record of prudent macroeconomic and fiscal policies. Between 2004 and 2008, Denmark operated significant budget surpluses of 4% of GDP on average. These accumulated past savings provided the authorities with the necessary buffer to finance fiscal stimulus during 2009-2011, when the budget shifted into a deficit of more than 3% of GDP.

As the economy recovers, we expect the government's budgetary position to tighten gradually. In May 2010, the outgoing center-right government signed the Fiscal Consolidation Agreement, aiming to improve the underlying budgetary position by 1.5% of GDP in 2011-2013, in cumulative terms, as a first step toward balancing the budget by 2020. Some but not all of the measures contemplated in the Agreement have been accepted by the newly elected center-left government. Previous expenditure targets have, however, been increased; as a consequence we anticipate that total savings from the

Agreement are likely to be lower than the target. The outgoing coalition's plans to reform the retirement system are also being supported by one of the larger opposition groups, the Social Liberal Party. This makes it likely that retirement reform will be implemented despite the change in the government.

In our opinion, the newly elected center-left government, led by the Social Democrats, will pursue sufficient budgetary policies to stabilize net general government debt levels below 40% of GDP over the medium term, albeit with an increased emphasis on revenue-side measures. We also expect the new government will focus more on promoting economic growth, in particular via increased public investment projects. During 2012, we anticipate the budget deficit will widen to 4.8% of GDP, affected by the one-off negative effect of the retirement reform (estimated at 1.6% of GDP) and then will decline to 3.0% of GDP in 2013. Our forecast includes our expectation that the pension yield tax will produce negligible revenues for the government. In the event that the stock market performs well, however, it would, contrary to our projections, contribute positively to budgetary performance.

Denmark benefits from a wealthy, diversified, and flexible economy. We expect GDP per capita to exceed $59,000 in 2011. Denmark's high wealth reflects the dominance of high-value-added sectors in the economy, the skilled workforce, and relatively high participation rate. The performance of the Danish economy is closely linked to developments in its main trading partners, Germany and Sweden, which account for about one-third of Danish exports. We believe that the weakening global economic environment will lead to a slowdown in Denmark's economic recovery to 1.1% in 2012 from 1.5% in 2011.

In our opinion, Denmark's aging population will put pressure on public finances and economic growth in the medium term (see "Global Aging 2010: Denmark," published on May 20, 2011). Although Denmark benefits from past reforms of the pension and tax systems, we believe further measures are necessary. In our opinion, the implementation of the proposed retirement reform plan, which envisages an increase in the early retirement age, is an important step to increase labor supply and decrease government pension expenditure.

We consider Denmark's high external liquidity needs as one of the key weaknesses for the rating. We forecast average gross external financing needs (current account payments plus short-term external debt at the end of the prior year, non-resident deposits at the end of the prior year, and long-term external debt maturing within the year) at 184% of current account receipts plus usable reserves for 2011-2014, primarily reflecting the large refinancing needs of the banking sector. The figure, however, is inclusive of Danske bank operations in Sweden, Norway, and Denmark, which are refinanced as if they are in Denmark, and account for a large share of Denmark's external balance sheet. We estimate Danish narrow net external debt (stock of foreign- and local-currency public- and private-sector borrowings from nonresidents less liquid external assets) at 98% of current account receipts in 2011. That said, Standard & Poor's projects that Denmark will run current account surpluses of an average 5% of GDP between 2011-2014, which should improve the country's external position in the medium term.

Outlook

The stable outlook reflects our expectation that the wealthy and diversified Danish economy will remain resilient in the face of most potential economic shocks. Any sustained and significant slippages in the government's efforts to return the primary budgetary position back toward balance over the medium term could put downward pressure on the ratings, as would a sudden deterioration of the Danish financial system's access to international markets. However, under most likely scenarios, we see Denmark's credit metrics remaining consistent with a 'AAA' rating under our criteria.

Related Criteria And Research

- Sovereign Government Rating Methodology And Assumptions, June 30, 2011
- Criteria For Determining Transfer And Convertibility Assessments, May 19, 2009
- Global Aging 2010: Denmark, May 20, 2011
- Further Bank Failures Likely In Denmark, July 28, 2011

Ratings List

Ratings Affirmed

Kingdom of Denmark	
Sovereign Credit Rating	AAA/Stable/A-1+
Transfer & Convertibility Assessment	AAA
Senior Unsecured	AAA
Short-Term Debt	A-1+
Commercial Paper	A-1+
Danish State Railways	
Senior Unsecured*	AAA
Oresundsbro Konsortiet	
Senior Unsecured**	AAA

*Guaranteed by Kingdom of Denmark. **Guaranteed by Kingdoms of Denmark and Sweden.

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