

DANMARKS NATIONALBANK

JANUARY 2017 — NO 1

Denmark's fixed exchange rate policy: 30th anniversary of unchanged central rate

The date 12 January 2017 marks the 30th anniversary of the Danish central rate. Looking back, Denmark's fixed exchange rate policy has turned out to be very resilient, even through economic and financial crises along the way.

In brief, the objective of Denmark's monetary policy is to ensure price stability, which the fixed exchange rate policy has helped to deliver. This means that the krone's stable value plays an important role in the financial decisions of Danish households and in firms' planning for the future.

The fixed exchange rate policy is a cornerstone of the Danish economy. The decision to pursue a fixed exchange rate policy was made in the 1980s when the Danish economy was in a crisis. The government and Danmarks Nationalbank found that a new approach was needed after a period of substantial current account deficits and devaluations.

Various governments had devalued the krone throughout the 1960s and 1970s, resulting in lower prices for Danish goods abroad.

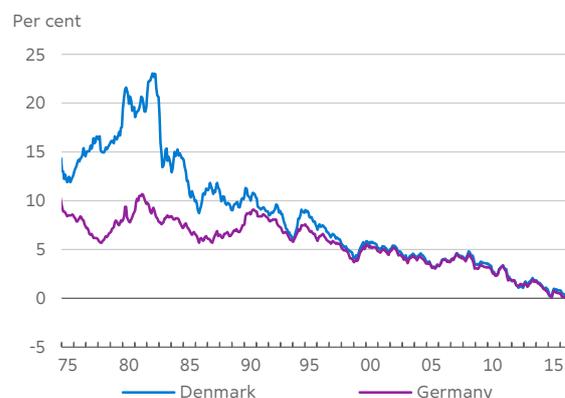
devaluation is on the horizon. The fixed exchange rate policy has a disciplinary effect on the economic policy planning.

Chart 1

Before the introduction of the fixed exchange rate policy, the government bond yield was considerably higher in Denmark than in Germany.

Long-term Danish and German government bond yields

Chart 1



Note: Monthly observations. 10-year benchmark bond yields.
Source: Danmarks Nationalbank, Eurostat and Abildgren (2012).

The decision to pursue a fixed exchange rate policy was made in the early 1980s when the Danish economy was in a crisis. The government and Danmarks Nationalbank found that a new approach was needed. The aim was to create a stable anchor and generate confidence in the Danish economy and monetary policy. Confidence in monetary policy ensures price stability.

The results of insufficient confidence in central banks' ability to maintain low and stable inflation were evidenced in many countries in the 1970s, as wage earners demanded higher wage increases, given the prospects of strong price increases. Denmark's fixed exchange rate policy acts as a simple and clear monetary policy rule.

The will and ability to stand fast

Denmark has shown both the will and the ability to pursue a fixed exchange rate policy. Actually, the fixed exchange rate policy was introduced already in 1982, but the exchange rate of the krone was adjusted twice, in 1986 and in 1987 – but not at

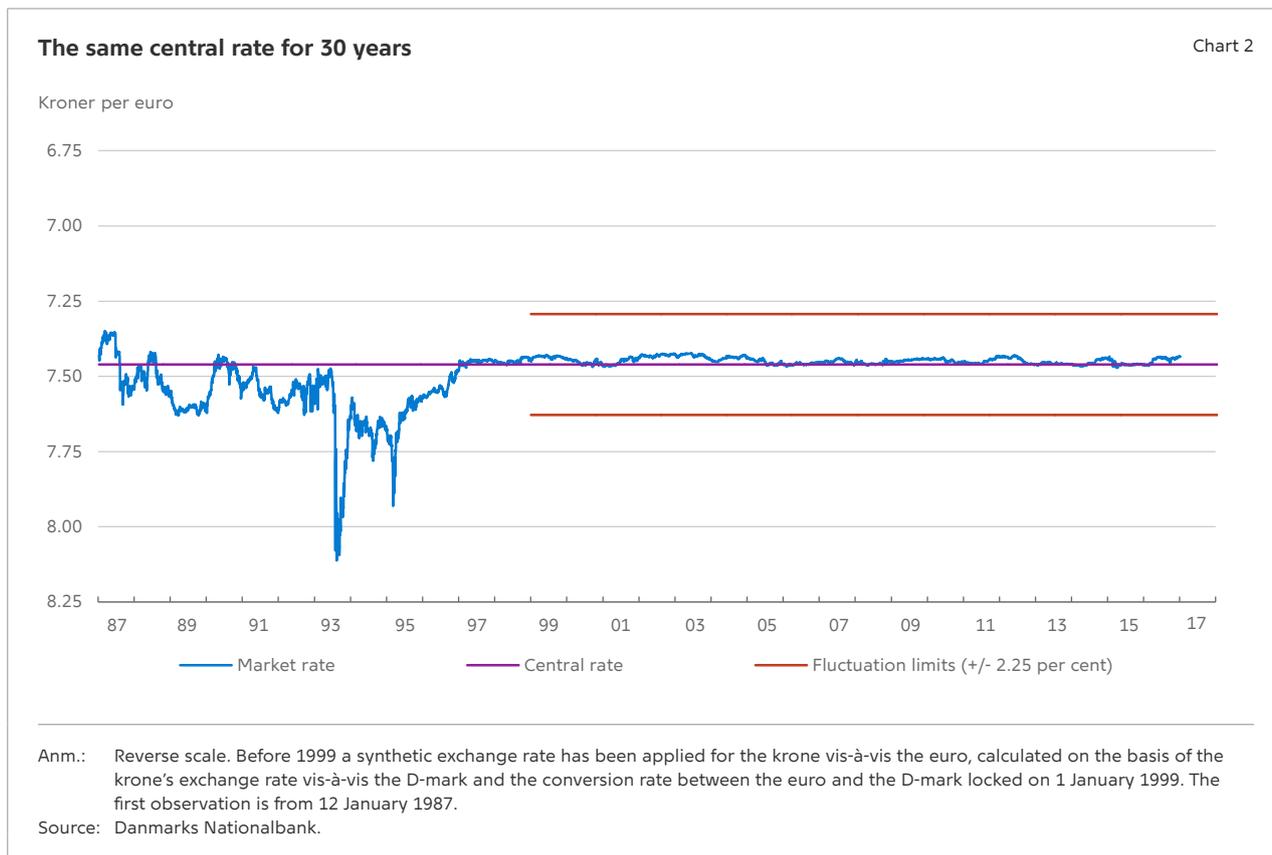
Denmark's initiative. The krone's central rate against the D-mark and from 1999 against the euro has been unchanged since 12 January 1987. The central rate is kr. 7.46038 per euro.

Denmark has a long tradition of using an exchange rate target as the basis for monetary policy. In the 1930s, the krone was pegged to the pound sterling. Later on, Denmark participated in the dollar-based fixed exchange rate system. This system collapsed in the early 1970s. The krone was then pegged to the European currency snake and later to the D-mark and the euro.

The fixed exchange rate policy has weathered several major shocks over the years. The Danish krone came under substantial pressure during the extensive European currency crisis in 1992 and 1993. The speculation created a need for massive intervention

Chart 2

Although the fluctuation band was widened to +/- 15 per cent in 1993 due to speculation against several European currencies, the krone has fluctuated within a narrow band against the euro since 1999.



in support of the krone and led to strong interest rate increases.

While countries like Sweden and Norway had to abandon their fixed exchange rate policies, the Danish government and Danmarks Nationalbank agreed to defend the krone rate, which is key to the economic policy determined by the government and the Folketing (parliament).

The krone has returned to the central rate after each currency crisis, which has strengthened the credibility of Denmark's fixed exchange rate policy. Today, the financial market participants are confident that the exchange rate of the krone will fluctuate in a narrow band around the central rate. The krone may increase or decrease by 2.25 per cent, but the fluctuations have been far smaller for many years.

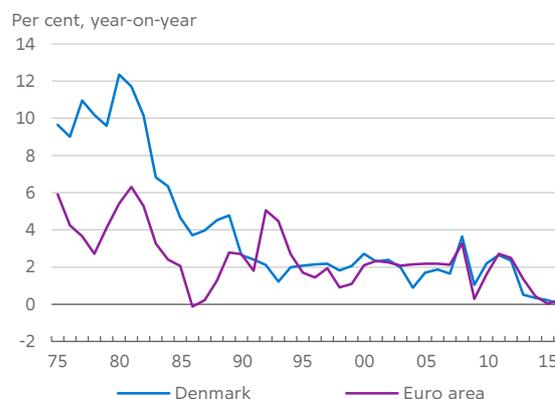
Price stability via the fixed exchange rate policy

Viewed over a number of years, the rate of increase in Danish consumer prices has declined, approaching the level first in Germany, then the euro area. This pattern is mirrored by government bond yields, which were considerably higher in Denmark than in Germany before the introduction of the fixed exchange rate policy, but are now at the same level.

Denmark's fixed exchange rate policy has proven its worth as a framework for stable economic development, and has contributed to ensuring a robust Danish economy. The fixed exchange rate policy entails a clear division of responsibilities in economic policy and supports a flexible, well-functioning labour market.

Annual consumer price inflation

Chart 3



Note: As from 1999, inflation is calculated on the basis of the Harmonised Index of Consumer Prices, HICP, in Denmark and the euro area. Before 1999, inflation is calculated on the basis of the consumer price index in Denmark and Germany/West Germany.

Source: Macrobond.

Chart 3

Consumer price inflation has decreased in Denmark, approaching the development the euro area.

Read more about Denmark's fixed exchange rate policy here www.nationalbanken.dk

DANMARKS NATIONALBANK
HAVNEGADE 5
DK-1093 COPENHAGEN K
WWW.NATIONALBANKEN.DK



CONTACT

Ole Mikkelsen
Communication
and press consultant

omi@nationalbanken.dk
+45 3363 6027

SECRETARIAT
AND COMMUNICATIONS