

# KINGDOM OF DENMARK

Rating Analysis - 2/2/11

Debt: DKK689.2B, Cash: DKK219.4B

EJR Sen Rating(Curr/Prj) BBB-/ N/A

EJR CP Rating: A2

EJR's 1 yr. Default Probability: 2.3%

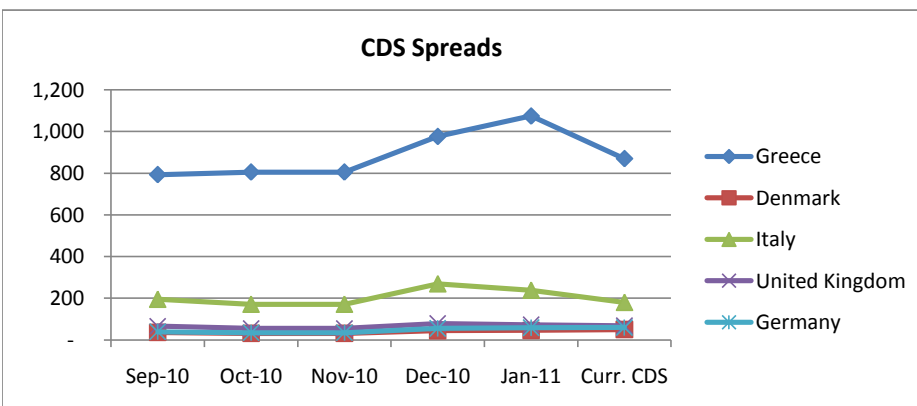
Denmark's economy expanded 1.0% QoQ (3.3% YoY) in Q3 2010, following a 1.7% rise in Q2 2010. Private consumption was up 0.3% during the quarter while government consumption was down 0.3%. Overall growth surpassed economists expectations. The Danish Central Bank forecasts the economy to grow 2.0% this year and 1.7% in 2011 before slowing to 1.5% growth in 2012. Unemployment remained unchanged in November from the month prior at 4.2%. Gross unemployment increased by 1,200 persons during the month. Denmark's CPI was up 2.6% YoY in November, a 0.1% gain over the month prior. Inflation in Denmark averaged 2.22% in the first 11 months of 2010. Denmark's benchmark lending rate remains at a record-low 1.05%, unchanged since January 2010. The country's public sector budget deficit is forecast to reach 4.7% of GDP in 2011, revised upward from a previously estimated 4.4%. Danish housing prices were up 3.3% in the third quarter.

Denmark's CDS spreads have increased in recent months and are currently trading at 47.40 bps. Like its Nordic peers, the country's spreads remain significantly lower than those of other EU countries. Denmark's benchmark lending rate has been at a record low 1.05% since January 15, 2010. The ECB's benchmark rate is currently 1%.

INDICATIVE CREDIT RATIOS	Annual Ratios					
	Dec-08	Dec-09	Dec-10	Dec-11	Dec-12	Dec-13
Debt/ GDP (%)	32.3	41.2	44.8	48.7	53.1	58.0
Govt. Sur/Def to GDP (%)	3.4	-2.7	0.7	1.0	1.1	1.1
Adjusted Debt/GDP (%)	40.3	50.1	53.6	57.4	61.7	66.5
Interest Expense/ Taxes %	3.0	4.6	4.3	4.6	5.0	5.5
GDP Growth (%)	-3.3	3.3	1.0	1.0	1.0	1.0
Foreign Reserves/Debt (%)	4.4	6.3	5.8	5.4	4.9	4.5
Implied Sen. Rating	BBB+	BBB-	BBB	BBB	BBB	BBB-

INDICATIVE CREDIT RATIOS	AA	A	BBB	BB	B	CCC
Debt/ GDP (%)	40.0	50.0	60.0	80.0	120.0	150.0
Govt. Sur/Def to GDP (%)	5.0	3.0	0.5	-2.0	-5.0	-9.0
Adjusted Debt/GDP (%)	45.0	55.0	65.0	85.0	125.0	155.0
Interest Expense/ Taxes %	7.0	9.0	12.0	15.0	22.0	26.0
GDP Growth (%)	5.0	4.0	2.0	1.0	-1.0	-5.0
Foreign Reserves/Debt (%)	25.0	20.0	15.0	12.0	9.0	7.0

PEER RATIOS	S&P Sen.	Debt	Govt. Surp.	Adjusted	Interest	GDP	Ratio-
		as a % GDP	Def to GDP (%)	Debt/ GDP	Expense/ Taxes %	Growth (%)	Implied Rating*
United Kingdom	AAA	79.6	-11.4	99.0	7.0	1.7	BB
Federal Republic Of Germany	AAA	73.0	-3.0	79.7	10.7	3.9	BB+
Kingdom Of Spain	AA	53.0	-11.1	56.3	9.6	0.2	BBB-
Italian Republic	A+	115.2	-5.3	120.6	15.9	1.1	B+
Hellenic Republic (Greece)	BB+	124.7	-15.4	127.9	25.8	-4.6	B-



Country (EJR Rtg*)	Current CDS	Targeted CDS
Greece(B+)	869	600
Denmark(BB)	50	400
Italy(BBB+)	180	158
United Kingdom(AA)	68	30
Germany(AA)	59	30

\* Projected Rating

**Economic Recovery**

In the years leading up to the financial crisis, Denmark's economy had benefited from a strong consumption-driven upswing. By 2007, the economy began to slow with the end of the housing boom. In the following year, the global financial crisis only added to the economic slowdown. Danish GDP contracted by 0.9% in 2008 and by 4.7% in 2009.

By the first quarter of 2010 the economy had expanded 0.5%. In the second quarter, GDP continued to grow by an even greater 1.7%. Growth slowed slightly in the third quarter to a rate of 1.0%. Denmark's Central Bank expects the economy to grow 2.0% this year and 1.7% in 2011 before slowing to a rate of 1.5% in 2012.

<b>Heritage Foundation 2010 Index of Economic Freedom - Denmark*</b>				
World Rank: 8 of 183; Regional Rank: 3 of 43**				
	<b>2011 Rank</b>	<b>2010 Rank</b>	<b>Change in Rank</b>	<b>World Average</b>
<b>Business Freedom</b>	<b>99.7</b>	97.9	+1.8	64.3
<b>Trade Freedom</b>	<b>87.6</b>	87.5	+0.1	74.8
<b>Fiscal Freedom</b>	<b>43.2</b>	35.9	+7.3	76.3
<b>Government Spending</b>	<b>19.5</b>	22.0	-2.5	63.9
<b>Monetary Freedom</b>	<b>81.4</b>	79.3	+2.1	73.4
<b>Investment Freedom</b>	<b>90.0</b>	90.0	No Change	50.2
<b>Financial Freedom</b>	<b>90.0</b>	90.0	No Change	48.5
<b>Property Rights</b>	<b>90.0</b>	90.0	No Change	43.6
<b>Freedom from Corruption</b>	<b>93.0</b>	93.0	No Change	40.5
<b>Labor Freedom</b>	<b>92.1</b>	93.7	-1.6	61.5

\*The ten economic freedoms are based on a scale of 0 (least free) to 100 (most free).  
 \*\*World: Based on a scale of 1-183 with 1 being the highest ranking; Regional: Europe region includes 43 countries total.  
 Source: The Heritage Foundation & Wall Street Journal

Denmark rose from ninth to eighth place in the Heritage Foundation/Wall Street Journal's 2011 Index of Economic Freedom. The country's overall freedom score, up 0.7 points from the year prior, is well above the regional average.

**Strong Fiscal Policy**

Denmark's fiscal position is among the strongest in the EU. The country has met the criteria to join the EMU as specified under the Maastricht Treaty but has opted to remain independent of the currency bloc to date. Denmark's budget deficit, like those of most Nordic countries, is among the most contained of the advanced economies at 2.7% of GDP (year-end 2009). In the third quarter of 2010, the government budget deficit increased 5 billion kroner YoY to a total 18 billion kroner as a result of increased expenditures.

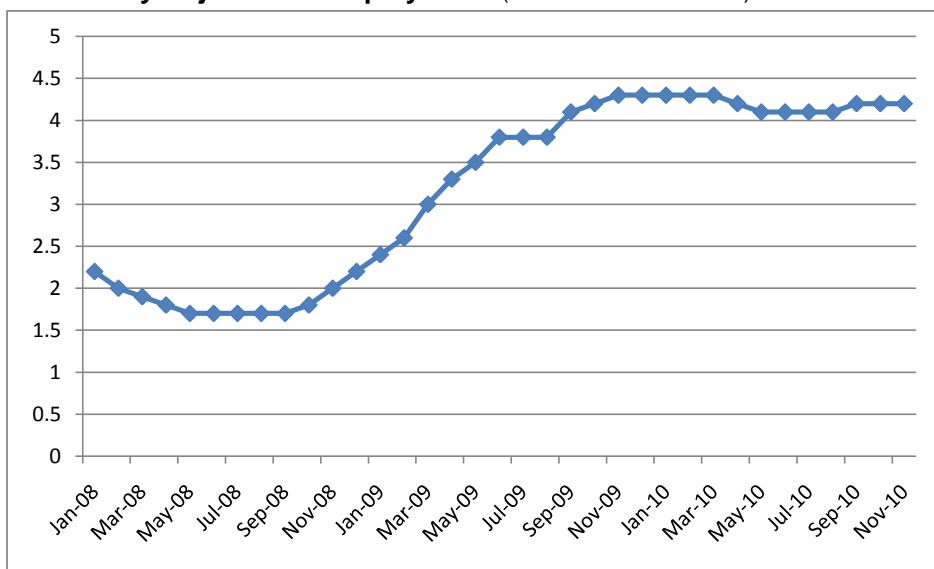
The country has a very high income tax rate and a moderate corporate tax rate. In January 2010, Denmark lowered its top income tax rate from 59% to 51.5%. The top corporate tax rate is 25%. Taxes worth nearly 50% of GDP in 2009 accounted for 85% of the country's revenues during the year. In the third quarter of 2010, revenue from taxes and charges fell by 8 billion kroner, a 3.9% drop from the prior quarter.

**Maintaining Monetary Stability**

Inflation in Denmark is relatively low, having averaged 2.3% since the onset of the global financial crisis. In December 2010, both the CPI and HICP measured 2.8% YoY, up 0.1% from the month prior. Meanwhile, the Producer Price Index (PPI) was up 3.48% YoY in December, a 0.34% increase over the month prior.

**Unemployment Relatively Stable**

Denmark has historically recorded low levels of unemployment. Though levels rose sharply during the global financial crisis, unemployment has remained below 5%, about half the level of overall EU unemployment. In November 2010, 4.2% of Denmark's labor force was unemployed. Meanwhile, unemployment in the OECD area remained unchanged at 8.6%. Denmark's slight recovery in employment is likely due to increased government spending.

**Seasonally Adjusted Unemployment** (% of Total Labor Force)

Source: Statistics Denmark

**Trade Surplus Remains Stable**

Denmark's economy depends heavily on foreign trade and as such the country has strongly opposed trade barriers as a member of the EU. Regardless, the common EU weighted average tariff rate of 1.2% (2009) applies to all products entering from non-EU countries. Denmark's export controls comply with EU regulations.

In November 2010, exports increased 1.5% to a level of 45 billion kroner while imports remained almost unchanged at 39 billion kroner. Exports of fuel and agricultural products recorded the most significant rate of increase. Germany, Sweden and Norway are among the nation's main trade partners. The U.S., which falls slightly behind in trade volume with the country, is Denmark's largest trade partner outside of the EU.

**Mortgage Bond Market**

Denmark's mortgage-bond market is the third largest in the world after only the U.S. and Germany. At \$490 billion, it is roughly 1.5 times the size of the country's own GDP and more than seven times the size of the government bond market. The market saw record foreign demand in late 2010, sending yields to all-time lows as investors sought safety from European government debt in the wake of the global financial crisis. According to the Danske Bank Mortgage Bond-Market Index, prices rose 6.6% in 2008, 7.1% in 2009 and 4.6% in 2010.

The latest mortgage-bond market auction took place over the three weeks from November 25 through December 13, 2010. Yields on 1-year notes fell to 1.51% from last year's 1.78%. Meanwhile, three-year yields fell to 2.17% from 2.81% last year and five-year yields fell to 2.80% from last year's 3.34%. In recent months, the Danish government has expressed concern that the new Basel III rules set by the Basel Committee on Banking Supervision could potentially hamper demand for the country's top-rated mortgage debt as lenders may sell the debt in order to meet new requirements on holdings.

**Assumptions for Projections**

	Peer	Issuer	Base Case	
	Median	Average	Yr 1&2	Yr 3,4,5
<b>Income Statement</b>				
Taxes Growth%	(4.8)	(4.4)	<b>1.0</b>	<b>1.0</b>
Social Contributions Growth %	(1.8)	1.2	<b>1.2</b>	<b>1.2</b>
Grant Revenue Growth %	0.0	0.0		
Other Revenue Growth %	0.1	1.8	<b>2.0</b>	<b>2.0</b>
Other Operating Income Growth%	0.0	0.0		
Total Revenue Growth%	(6.4)	(3.5)	<b>1</b>	<b>1.0</b>
Compensation of Employees Growth%	5.4	7.5	<b>1.3</b>	<b>1.3</b>
Use of Goods & Services Growth%	5.4	7.0	<b>3.0</b>	<b>3.0</b>
Social Benefits Growth%	8.7	7.3	<b>2.0</b>	<b>2.0</b>
Subsidies Growth%	2.3	18.1		
Other Expenses Growth%	0.1	0.1	<b>0.1</b>	<b>0.1</b>
Special Items (millions DKK)	0.0	0.0		
<b>Balance Sheet</b>				
Currency and Deposits Growth%	0.4	(24.9)	<b>1.0</b>	<b>1.0</b>
Securities other than Shares LT Growth%	7.8	393.6	<b>2.0</b>	<b>2.0</b>
Loans Growth%	2.4	25.1	<b>4.0</b>	<b>4.0</b>
Shares and Other Equity Growth%	14.8	(0.2)	<b>2.0</b>	<b>2.0</b>
Insurance Technical Reserves Growth%	2.7	3.2	<b>3.2</b>	<b>3.2</b>
Financial Derivatives Growth%	0.0	(581.9)	<b>2.0</b>	<b>2.0</b>
Other Accounts Receivable LT Growth%	8.0	29.0	<b>2.0</b>	<b>2.0</b>
Monetary Gold and SDR's Growth %	0.0	0.0	<b>5.0</b>	<b>5.0</b>
Other Accounts Payable Growth%	9.2	NMF		
Currency & Deposits Growth%	4.5	2.7	<b>2.7</b>	<b>2.7</b>
Securities Other than Shares Growth%	16.3	16.7	<b>11.7</b>	<b>11.7</b>
Growth%	0.0	0.0		
Loans Growth%	0.8	7.0	<b>2.0</b>	<b>2.0</b>
Insurance Technical Reserves Growth%	0.0	0.0		
Financial Derivatives Growth%	0.0	0.0		
Addl debt. (1st Year) million DKK	0.0	0.0		

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**Base Case****ANNUAL REVENUE AND EXPENSE STATEMENT (MILLIONS DKK)**

	<u>Dec-07</u>	<u>Dec-08</u>	<u>Dec-09</u>	<u>PDec-10</u>	<u>PDec-11</u>	<u>PDec-12</u>
Taxes	810,309	818,736	782,376	790,200	798,102	806,083
Social Contributions	31,491	31,670	32,047	32,428	32,815	33,205
Grant Revenue	0	0	0	0	0	0
Other Revenue	100,144	109,875	111,900	114,138	116,421	118,749
Other Operating Income	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total Revenue	941,945	960,281	926,323	936,766	947,337	958,037
Compensation of Employees	284,237	299,196	321,675	325,857	330,093	334,384
Use of Goods & Services	150,367	159,613	170,740	175,862	181,138	186,572
Social Benefits	277,418	284,234	304,860	310,957	317,176	323,520
Subsidies	37,234	37,101	43,825	43,829	43,834	43,838
Other Expenses	53,192	62,275	62,347	62,347	62,419	62,419
Grant Expense	0	0	0	0	0	0
Depreciation	<u>30,713</u>	<u>32,082</u>	<u>33,190</u>	<u>33,190</u>	<u>33,190</u>	<u>33,190</u>
Total Expenses	833,161	874,501	936,637	952,043	967,850	983,923
Operating Surplus/Shortfall	108,784	85,780	-10,314	-15,276	-20,513	-25,886
Interest Expense	<u>26,817</u>	<u>24,710</u>	<u>35,734</u>	<u>33,666</u>	<u>36,943</u>	<u>40,604</u>
Net Operating Balance	81,967	61,070	-46,048	-48,943	-57,456	-66,490

**ANNUAL BALANCE SHEETS (MILLIONS DKK)****ASSETS**

	<u>Dec-07</u>	<u>Dec-08</u>	<u>Dec-09</u>	<u>PDec-10</u>	<u>PDec-11</u>	<u>PDec-12</u>
Currency and Deposits	147,536	292,186	219,353	255,749	258,306	260,889
Securities other than Shares LT	17,172	19,548	96,484	98,414	100,382	102,390
Loans	102,631	132,567	165,846	172,480	179,379	186,554
Shares and Other Equity	253,891	251,600	251,153	256,176	261,300	266,526
Insurance Technical Reserves	625	600	619	639	659	680
Financial Derivatives	489	(662)	3,190	3,254	3,319	3,385
Other Accounts Receivable LT	118,707	154,338	199,134	203,117	207,179	211,323
Monetary Gold and SDR's						
Additional Assets	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total Financial Assets	<u>641,051</u>	<u>850,177</u>	<u>935,779</u>	<u>989,828</u>	<u>1,010,524</u>	<u>1,031,746</u>

**LIABILITIES**

Other Accounts Payable	109,545	107,329	143,236	143,236	143,236	143,236
Currency & Deposits	13,297	14,182	14,562	14,562	14,562	14,562
Securities Other than Shares	345,986	490,572	572,668	639,752	714,695	798,417
Loans	108,645	122,197	130,751	130,751	133,961	137,953
Insurance Technical Reserves						
Financial Derivatives						
Other Liabilities				<u>35,907</u>	<u>35,907</u>	<u>35,907</u>
Liabilities	<u>577,473</u>	<u>734,280</u>	<u>861,217</u>	<u>964,208</u>	<u>1,042,361</u>	<u>1,130,074</u>
Net Financial Worth	<u>63,578</u>	<u>115,897</u>	<u>74,562</u>	<u>25,619</u>	<u>(31,837)</u>	<u>(98,328)</u>
Total Liabilities & Equity	<u>641,051</u>	<u>850,177</u>	<u>935,779</u>	<u>989,828</u>	<u>1,010,524</u>	<u>1,031,746</u>

## **Sovereign Rating Methodology**

Egan-Jones takes the perspective of the investor as its primary point of view when developing the ratings it issues for sovereigns. Therefore, in the case of sovereign ratings, we attempt to take a more holistic view of credit quality to include not only analytic comparisons of various sovereign issuers but also the impact on our quantitative and qualitative analyses by current global, sovereign, governmental and market events, including the effects of government investments in speculative, volatile or other high risk investment products. For example, many sovereign issuers have taken on significant exposures of major financial institutions over the past several years. Hence, we calculate the under-funding of financial institutions and include this amount in the total indebtedness of sovereigns. (We use a base assumption that no country can afford to allow its major banks to fail and therefore we believe that there will almost always be an intervention by either a host or allied nation should financial institutions or markets require support at some measurable level.)

Generally we devise modeling calculators and do an analysis that examines the debt load of a country with respect to its GDP and other economic indicators. The analysis is then adjusted to reflect the outlook on a myriad of factors that reflect the firm's overall view of the sovereign debt and the quality of the country's ability to meet and thrive under such load. Some of the qualitative factors that impact our ultimate assessment of credit quality such as the flexibility, stability and overall strength of the economy, ease of tax collection, acceptance of contract law, ease of doing business, and prospects for future growth and health. The non quant issues are generally subjective and a moving target, so each rating of a sovereign may differ because of the non-quantitative nuances being addressed.

## **Nota Bene**

History has proven that defaults on domestic public debt do occur. In fact, seventy out of three hundred twenty defaults since 1800 have been on domestic public debt (1). Egan-Jones does not view a country's ability to print its own currency as a guarantee against default. Additionally, Egan-Jones generally views cases of excessive currency devaluation as a de facto default.

1. "This Time Is Different: Eight Centuries of Financial Folly", Reinhart & Rogoff, p.111, 126