



Executive Board Minutes 22/54-2

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Denmark—2022 Article IV Consultation

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Staff: Segoviano, EUR; Gonzalez, SPR

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CEDA OGADA
Secretary

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¹ Minutes are the official record of a formal Board meeting in which the Board may adopt decisions and reach understandings related to the business of the Fund. Staff background documents issued before the meeting are the principal basis for the meeting. Preliminary “gray” or “buff” statements by Executive Directors and staff’s responses to Directors’ technical questions are circulated prior to the meeting. Adopted decisions and/or summings up—the Chair’s “sense of the meeting” or policy conclusions/recommendations—are issued after the meeting. The minutes include all these elements, as well as the discussion record (a verbatim transcript of the discussion lightly edited for clarity). Minutes are made public consistent with the IMF’s Open Archives Policy.

THE ACTING CHAIR'S SUMMING UP

Executive Directors agreed with the thrust of the staff appraisal. They welcomed the authorities' swift and well-calibrated policy response to the pandemic, which facilitated a strong recovery. At the same time, they noted that uncertainty is high owing to the war in Ukraine and the lingering pandemic, and that the balance of risks is tilted to the downside. Against this background, Directors encouraged the authorities to retain policy flexibility while preserving macro-financial stability and supporting sustainable, inclusive growth.

Given cyclical pressures in the economy, Directors agreed with the planned fiscal tightening in 2022. They underscored, however, the importance of retaining flexibility and recalibrating policies as needed should risks materialize. Directors commended the authorities for their energy compensation scheme, which is small, temporary, and targeted, and agreed that potential additional measures should also be targeted and fiscally neutral.

Directors agreed that the exchange rate peg has served Denmark well, providing a framework for historically low and stable inflation, and that monetary policy should stand ready to maintain it.

Directors commended the resilience of the banking system and recommended implementing additional prudential tools, including revisiting sectoral systemic risk buffers and introducing a fully risk-based prudential framework. They welcomed the authorities' progress in implementing AML/CFT recommendations by adopting a new risk assessment model.

Directors noted the risks stemming from the housing market, with high household leverage and increases in risky mortgages. They saw scope for macroprudential tightening together with structural reforms to increase the supply of affordable housing and strengthen the tax code. Directors agreed that new mortgages extended to highly-leveraged households be subject to minimum down-payment requirements or mandatory amortization until a minimum equity share is reached, as well as reducing mortgage interest deductibility and introducing borrower-based tools, would help address risks.

Directors supported the authorities' labor market reforms that improved employment prospects of the young, the low-skilled, and the foreign-born. To ensure adequate labor supply, they considered that any changes to the indexation of the statutory retirement age to life-expectancy should be consistent with long-term fiscal sustainability, and also recommended reducing labor taxes.

Directors commended Denmark's ambitious green and digital transformation plans. They noted that a prompt decision on carbon pricing would further incentivize the private sector to step up green investment. To further boost productivity growth, Directors recommended enabling high productivity sectors to expand by encouraging broad-based innovation, improving access to equity finance and accelerator capital, while rebalancing taxation.

It is expected that the next Article IV Consultation with Denmark will be held on the standard 12-month cycle.

EXECUTIVE BOARD ATTENDANCE²

B. Li, Acting Chair

Executive Directors**Alternate Executive Directors**

	C. Ekeocha (AE), Temporary
	R. N'Sonde (AF)
	L. Herrera (AG)
	A. Grant (AP)
	F. Fuentes (BR)
Z. Zhang (CC)	
	F. Lopez (CE), Temporary
	F. O'Brolchain (CO)
D. Palotai (EC)	
A. Buisse (FF)	
	H. Koh (GR), Temporary
	R. Goyal (IN), Temporary
	M. Massourakis (IT)
	M. Kashima (JA)
H. Hosseini (MD)	
	F. Al-Kohlany (MI), Temporary
	L. Dresse (NE)
	A. Marcussen (NO)
	S. Potapov (RU)
	M. Alrashed (SA)
R. Lim (ST)	
	B. Piasecki (SZ), Temporary
	D. Ronicle (UK)
	A. Rao (US), Temporary

P. Cirillo, Acting Secretary
 S. Maxwell, Summing Up Officer
 E. Manfred, Board Operations Officer
 L. Nagy-Baker, Verbatim Reporting Officer

Also Present

Communications Department: J. De Haro. European Central Bank: D. Rakitzis, R. Rueffer.
 European Department: J. Bricco, R. Huidrom, H. Jung, M. Segoviano Basurto, R. Srinivas,
 A. Tudyka, S. Yousefi. Legal Department: J. Ams. Strategy, Policy, and Review Department:

² For countries in each constituency, please see the Constituency Codes in the annex.

M. Gonzalez. Executive Director: A. Andrianarivelo (AF), S. Bhalla (IN), A. BinZarah (SA), P. Jennings (CO), I. Mannathoko (AE), M. Mohieldin (MI), P. Moreno (CE), M. Poso (NO). Alternate Executive Director: A. Alhosani (MI), C. Amarasekara (IN), H. Azal (EC), M. El Qorchi (MD), A. Guerra (CE), C. Just (EC), F. Mochtar (ST), C. Roman (FF), J. Romero (CE), F. Sylla (AF). Senior Advisors to Executive Directors: E. Cartagena (CE), M. Choueiri (MI), V. Grossmann-Wirth (FF), P. Harvan (EC), O. Hendrick (AG), R. Mahabir (BR), S. Nghiem (ST), D. Ong (ST), J. Rojas (CE), C. Sassanpour (MD). Advisors to Executive Directors: P. Al-Riffai (MI), D. Andreicut (UK), A. Arevalo Arroyo (CE), R. Bah (AF), S. Belhaj (MD), E. Boukpepsi (AF), I. Bustillo (AG), K. Carvalho da Silveira (AF), L. Cerami (IT), C. Eijking (NE), R. Fayez (MI), D. Hamzah (MI), V. Lankester Campos (CE), M. Merhi (MI), P. Mooney (CO), R. Moral Betere (CE), A. Nainda (AE), I. Ogihara (JA), G. Ogmundsdottir (NO), K. Osei-Yeboah (MD), C. Ramos Capaquira (AG), I. Umrzakov (SZ), I. Valdes Fernandez (NO), J. Yoo (AP), A. Schmelzer (GR).

DISCUSSION RECORD³

The Acting Chair (Mr. Li):

The Denmark authorities' swift and well-calibrated policy response to the pandemic facilitated a strong recovery. This rebound in activity bodes well for the persistence of the recovery, but uncertainty is high because of the war in Ukraine and the pandemic, with the balance of risks tilted to the downside. Although Denmark is well-positioned to weather these headwinds, it is important that macroeconomic policy remains flexible given the uncertain outlook. Policy should also enhance macrofinancial resilience and facilitate the economic transformation while pursuing higher potential growth over the longer-term.

Ms. Marcussen:

I would like to reflect on a few issues that were raised in gray statements.

First, on the outlook and the fiscal policy, the Danish economy remains in a strong position, and the labor market continues to be tight. While Russia's invasion of Ukraine has tipped the balance of risk to the downside, and growth throughout 2022 is expected to slow, the output is still well above potential. In light of the strong cyclical position, the authorities are tightening fiscal policy this year, and measures compensating the most affected households for energy price increases have been limited and temporary. Looking ahead, the government's proposal to lower the structural deficit limit in the budget law was passed by parliament last week, and this will allow us to better deal with demographic pressures.

Second, on the financial sector and risks related to the housing market, we note that many of the statements have raised concerns about high household debt, risky mortgage loans, house price increases—and the high prevalence of interest-only and variable-rate loans do warrant close monitoring. This is on the agenda in Denmark, both among governmental and supervisory institutions, the financial sector, and not least, amongst homeowners.

We note the recommendations from many Directors to deploy further macroprudential policies. As noted in our buff statement, last year's

³ Edited for clarity.

recommendation to the Systemic Risk Council to tighten lending policies was not followed, but the government does agree that risks require vigilant monitoring, and we highly value the input from staff in discussions on the toolkit.

Third, on structural policies, we agree with the statements focusing on the need to increase labor supply, productivity, digitalization, and mitigating climate change, adding to the already wide-ranging reforms in recent years, initiatives have recently been implemented to the labor supply.

Going more into the climate issues, the government has put forth additional proposals to phase out natural gas, boost renewable energy, and implement a CO2 tax reform. On the latter, I would like to reflect on the comments from Ms. Lim, Ms. Grant, and Ms. Kashima on the socioeconomic impact, as well as the comment from Mr. Zhang on leakage. We agree that if large emitters move production outside the country, it will not be good for the Danish economy, and it will not be good for global mitigation. Therefore, the CO2 tax proposal goes hand in hand with support for firms' green transition, investing in education, and reskilling. It is also important to note that the impact on inequality is assessed to be low.

We take positive note of the many references to the need for higher investments. Spurring private investments for the green transition is key, and many of our countries share this goal. There is now a strong business case for companies to invest in renewable energy, and proposals on carbon pricing provide the right incentives to stimulate private investments.

A final note on climate, we appreciate Ms. Medearis's comment on Denmark's role on the Finance Ministers Coalition for Climate Change, where our close cooperation on mainstreaming climate into economic policies and macroeconomic modeling is important.

Fourth, we appreciate the analysis in the Selected Issues Paper of Denmark's high current account surplus, and it has been useful for us to look closely at the drivers of Denmark's surplus from a domestic perspective. The surplus is not a policy objective in itself, and the better we understand the drivers, the better we can address potential policy distortions. We note that the surplus is mainly driven by the corporate sector and does not seem to reflect underlying distortions. We also note staff's finding that increasing investments for structural reasons could reduce the surplus as a byproduct. We look forward to further analysis and collaboration on this topic.

The staff representative from the European Department (Mr. Segoviano):

I thank Directors for their insightful comments and the Danish authorities for the warm welcome, excellent cooperation, and high-quality discussions. We tried to answer all questions received in gray statements. Hence, I will focus my intervention on the staff's views on the near-term outlook and the impact of the work.

Denmark weathered the pandemic well, thanks to previously implemented policies and sound policy response during the pandemic. Consequently, the health and economic impact of the pandemic was among the mildest in Europe, with a swift recovery in 2021, which we foresee to persist. While the war in Ukraine has worsened the global and Danish economic outlook, Denmark is well positioned to withstand the shock. Let me elaborate on Denmark's resilience to these headwinds.

Since the staff report, headline inflation has continued to edge up, reaching a historic high of about 8 percent in May on a year-on-year basis. However, we expect some leveling off in the latter part of this year due to wage effects, as headline inflation had picked up in September 2021. Moreover, the European Central Bank (ECB) has recently started its tightening cycle, which should help keep inflation expectations anchored in the euro area and in Denmark through the peg.

I would like to address a question regarding second-round effects through wages. The inflationary pressures, along with a tight labor market, will entail some increases in nominal wage growth in 2022. But given Denmark's wage bargaining framework, which is characterized by strong coordination among social partners with a focus on competitiveness, we expect nominal wage growth in 2022 to be relatively moderate, falling behind inflation. Beyond this year, we project nominal wage growth to remain broadly aligned with productivity. The ECB has started its tightening cycle, which should help keep inflation expectations anchored in the medium term. In sum, in the baseline, we do not envisage sizeable second-round effects from wages to inflation.

Regarding refugees, as of last week, the authorities have received more than 28,000 applications from Ukrainian refugees under the Special Act, which provides refugees the needed access to the labor market, as well as social and medical assistance. Overall, the authorities are expecting to receive about 50,000 Ukrainian refugees, of which approximately one-fifth of the total are expected to be employed.

Another new development is the recent ban on oil and the gas products from Russia. As we elaborated in our responses to technical questions, Denmark's reliance on oil and gas, including from Russia, is relatively small versus other countries. Natural gas constitutes about 14 percent of Denmark's energy supplies and only 4 percent of its electricity generation. Oil constitutes only about 1 percent of electricity generation, of which imports of oil and petroleum products from Russia are about 15 percent. Oil dependency, defined as net oil imports as a share of gross oil consumption, in Denmark is lower than many European countries, and according to the International Energy Agency, Denmark's emergency oil stocks can last about 473 days of net oil imports.

Regarding natural gas, in the near term for energy security reasons, the authorities are planning to reactivate existing gas fields in the North Sea to temporarily increase gas production and to supply gas to other European states. Given the sanctions' phase-in period, at this point it is hard to precisely pin down the impact on Europe, especially during the interim, as this depends on how Europe hopes to replace Russian oil. We do not see major revisions to inflation and growth projections yet, especially for 2022. However, the revision could be somewhat larger next year, but there is unusually large uncertainty, and we will continue monitoring and will revise our assessment in line with World Economic Outlook assumptions. Overall, the war has actually fast-tracked the phasing out of fossil fuels, as well as expanding renewable energy from wind and solar, as announced in the Denmark Can Do More II.

Denmark's long-term goal to phase out all gas and oil production and energy by 2030 remains, alongside the reactivation of gas fields for near-term energy security. Beyond the conjuncture, a key policy priority is the one related to the green transformation of the economy, and Denmark is a clear leader in this area. Denmark's climate goals are more ambitious than many other European countries, and importantly, to meet these goals, the government has already announced a complete proposal for carbon pricing with provisions to support the green transition for hard-hit industries.

Mr. Buisse:

I issued a gray statement, but I would like to raise a few points for emphasis, in line with Ms. Marcussen's opening remarks.

Denmark weathered the pandemic particularly well with a small contraction, a strong recovery, and no scarring, owing to sound policies. Like

staff, we expect activity to remain high, but with annual growth decelerating toward potential. Although the Russian invasion of Ukraine is expected to have a limited impact on growth, it is a key downside risk to the outlook, mainly through higher inflation and uncertainty. In this context and considering Denmark's projected budget surpluses, low public debt ratio, and ample buffers, we concur with staff that fiscal policy should remain nimble in case the outlook deteriorates. At the same time, the authorities could continue improving the composition of public spending to address long-term priorities related to demographics, public investment, and defense. I note and welcome Ms. Marcussen's comments on the new budget.

The green and digital transitions are a critical part of the response to long-term challenges, and addressing labor and skills shortages and increasing digital and green investment could help to boost potential growth and support Denmark's ambitious climate objectives. We recognize the progress made and welcome recent plans, including the expansion of carbon taxation aimed at achieving the 2030 emission reduction targets. Strengthening the circular economy, including waste management, and accelerating the deployment of energies could also contribute to this aim.

Finally, we share staff's assessment that while systemic risk is low, financial sector vulnerabilities linked to the real market remain and require close monitoring.

Mr. Hosseini:

Let me begin by congratulating the Danish authorities for their strong and proactive policies that have enabled them to weather the pandemic successfully. The sound fundamentals and policy flexibility will again prove essential for Denmark to withstand the fallout from the war in Ukraine. I would like to briefly touch on a few points.

First, on climate. Like most Directors, we welcome the authorities' strong commitment to climate issues and applaud their ambition to become one of the most climate-friendly countries in the world. We believe that the ample fiscal buffer could be used to promote public green investment and accelerate the process of greening the economy. That said, we remain strong advocates of a multilateral and multidimensional approach to addressing climate issues and stress the need for further analysis by staff to assess all aspects of carbon taxation on different economic sectors and to explore socially optimal alternatives.

Second, on the labor market, there are visible signs of tightness that call for action to address skills shortages and mismatches. We welcome the authorities' effort to improve employment and labor market participation and particularly given the long-term demographic challenge, we emphasize the potential for greater integration of immigrants and refugees into the labor force to enhance their contribution to the country's growth and prosperity.

Finally, like many other Directors, we stress the need to closely monitor the risks arising from high household indebtedness. A holistic approach to housing market pressures is needed, including measures to improve the supply of affordable housing for first-time buyers and vulnerable groups.

Mr. O'Brolchain:

First, like Mr. Stephan, we encourage the authorities to preserve the krone as pegged while standing ready to react to possible monetary policy changes in the eurozone, particularly given the price shocks stemming from Russia's invasion of Ukraine.

Second, we welcome measures that grant Ukrainian refugees rapid access to the labor market, thereby addressing both labor supply shortages and supporting displaced people from the war in Ukraine.

Finally, we welcome the authorities' focus on the green transition, and we echo Mr. Buisse's remarks pertaining to the upgrading of the energy networks and improving energy efficiency.

Mr. Massourakis:

We share staff's appraisal, and we welcome that the authorities' agenda is broadly aligned with staff's policy recommendations. Today I want to focus on the climate agenda, which is already quite advanced and headed in the right direction. We commend the authorities for the progress achieved so far, as demonstrated by the sizeable contribution of renewable resources in their energy mix, and we support their agenda to advance the green transformation. We concur with staff that private investment can play an important role, and additional measures, including taxation, may be further explored to support and incentivize entrepreneurship, innovation, equity, finance, and the capital markets. Furthermore, we support staff's recommendation to enhance the institutional framework on competition.

I also thank staff for their insightful analysis of the drivers behind the large surpluses of the Danish current account. We welcome the finding that these surpluses may not reflect policy objectives but rather the behavior of corporates. However, we note that the extent to which a few large nonfinancial multinationals drive the large and persistent savings investment gaps remains an open question. We encourage further work based on more granular data to better understand the measurement bias related to retained earnings.

Mr. Fuentes:

We commend the Danish authorities for the timely and well-coordinated policy response during the pandemic, including a very high level of vaccination, which contributed to minimal scarring and a quick rebound of the economy. On the back of a long tradition of sound policies and strong institutions, the economy is well positioned to withstand the increasing uncertainty emanating from the war in Ukraine. That said, risks to the economic outlook remain high with risks tilted to the downside in the near term. We issued a comprehensive gray statement addressing the main themes presented in the staff report, but I want to underscore the following two points.

First, as the economy continues to navigate this highly uncertain environment, we urge the authorities to address the potential stress in the housing market. With house prices rising faster than incomes during the pandemic and the large and growing proportion of variable rate mortgages in an environment of tightening financial conditions, macrofinancial vulnerabilities remain high. Under these circumstances, a sharp revaluation could harm highly leveraged households—particularly those who purchased in overvalued urban areas—and low-income households. Therefore, we encourage the authorities to continue to monitor the housing market and to implement any necessary macroprudential measures to mitigate the possible vulnerabilities.

Finally, the country's long-established flexicurity model and supporting compensatory measures provided support for the labor market during the pandemic. We take positive note of the increasing labor force participation and the sustained downward trend experienced by the unemployment rate. We also applaud the authorities' successful initiatives to incentivize the participation of senior citizens and foreign workers. We commend the authorities for opening the doors to thousands of Ukrainian refugees and enacting new legislation to grant them quicker access to the labor

market. The basic integration education program expanded by the government in 2020 could also be an effective policy tool to support the integration process.

Mr. Dresse:

We issued an extensive gray statement in which we associated ourselves with the gray statement of Mr. Buisse. I would like to make a few points for emphasis today.

First, on the housing market, many policymakers are behind the curve when it comes to imposing policies in countries like Denmark. Fueling demand with relatively easy lending terms and tax incentives is especially unnecessary in times of low interest rates. Like most Directors, we support staff's recommendation to tighten macroprudential policies, including limiting the access to interest-only mortgages. Given the political complexity of this, there may be reasons to place a mandate to decide on these policies outside the scope of the government's remit in the interest of macroeconomic and financial stability. Staff's comments are welcome.

Second, on the external sector, it is important to get a better understanding of the current account surplus to design specific policies that address underlying distortions if needed. Statistical issues could for a large part explain the savings surplus of multinational firms having no real macroeconomic impact. We note that parts of the gap of the External Sector Assessment is explained by the country's fiscal stance, which was not as expansionary as in the rest of the world. In the current juncture of high debt levels and high deficit, we would caution against advising countries to spend more just because other countries do. In line with the comments made by Ms. Marcussen and Mr. Stephan, we underline the importance of sound fiscal policymaking and do not see the current account as a fiscal policy objective per se.

Finally, we support Mr. Stephan, Mr. Jennings, and Mr. Herrera and Mr. Ronicle in welcoming the substantial progress made in improving the Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) framework and welcome the authorities' continued attention to financial integrity risks.

Mr. Zhang:

First, we take positive note that increased investment to fully support activity, as well as adequate labor supply, could raise potential growth by 1.8 percent in the medium term. We commend the Danish public investment framework for its high multiplier and effectiveness in attracting private investment. We welcome the planned increase in public investment.

Second, while the Danish financial sector remains resilient, the emerging signals of vulnerabilities in household indebtedness and real estate market warrant close monitoring. We support staff recommendations to tighten macroprudential tools and agree that borrower-based tools should be included in the policy toolkit. Meanwhile, measures should be taken to address housing supply constraints, and the tax code should be adjusted to cool down the market.

Mr. Lopez:

We associate ourselves with Mr. Buisse's statement and would like to offer a few remarks in addition to our comprehensive gray statement.

First, on fiscal policy, given the ample buffers, the main feature of fiscal policy should be flexibility to accommodate current and also potential short-term spending needs and to face long-term challenges. In this respect, we have commended the authorities for the new budget law that could address these challenges with the proposed increase in the structural deficit limit. We also welcome the country's long commitment to climate change mitigation and adaptation and the authorities' strategy on climate change, including the announced green tax reform. Combining taxation and carbon price measures with other incentives to promote the use of green technology and also protect the vulnerable is the right way to go.

On the labor market and pensions, we support further measures to limit early retirement and incentivize longer professional careers. We commend the authorities for their efforts on the inclusion of migrant refugees. This is an increasingly relevant and challenging topic for many other member countries with broad implications on the labor market, pension system, and the social system more generally. We invite the staff to continue working on this issue to provide tailored policy advice.

Finally, on the financial system, we see that vulnerabilities related to the housing market are long-lasting. It is true that the financial system is in

good health with no materialization of risks so far, but we also observe higher and riskier leverage of households and higher housing valuations. Regarding the factors driving the increase in riskier mortgages, and despite the staff's written responses to technical questions, we are still a bit puzzled by the behavior that we observed in Denmark in the context of increasing interest rates. We believe the direction of variable and fixed-rate mortgages in new lending flows may be a bit different in other countries, and we would like to know how extensive this practice is in other countries.

Finally, we share other Directors' views on additional macroprudential measures and strengthening the institutional macroprudential framework in line with international best practice.

Ms. Koh:

We issued a gray statement where we associated ourselves with Mr. Buisse's written statement. We thank staff for the comprehensive report and Ms. Marcussen for her update this afternoon. We feel reassured by Ms. Marcussen's remarks on how to mitigate risks stemming from the housing market. Like other Directors, such as Mr. Fuentes, Mr. Zhang, and Mr. Lopez, we are particularly concerned about households shifting toward variable rate mortgages. We welcome staff's recommendation to introduce additional supervisory measures, such as minimum down payment requirements for mandatory amortization to achieve minimum equity shares.

Mr. Ekeocha:

We agree that the fiscal policy is appropriate. We also agree that the exchange rate peg has served Denmark well, helping to improve trade, reduce risks, and stabilize prices and the economy. The Danish banking system remains capitalized, liquid, and profitable. However, vigilance is warranted as are measures to further enhance the resilience of the financial system.

The staff representative from the European Department (Mr. Segoviano):

I would like to get started with the comments regarding the framework for macroprudential policy setting. Since 2019, we had observed what we would consider some inaction bias. This was related to an increase in the countercyclical capital buffer. We had pointed out that best practice focused on giving independent authorities an adequate legal mandate to act and then keeping the corporate governance by explaining why they acted, whereas in Denmark the Systemic Risk Council does not have the mandate, and the

government needs to comply or explain. This is a point that we discussed at length with the authorities. It was then taken by the Financial Sector Assessment Program (FSAP). The FSAP in 2020 made the point, and this is a point that we continue to discuss. We believe that the framework should be aligned with best practices, and we note that in other countries there have been reforms that point in this direction.

In summary, we believe that the best practice should be to give independent authority an adequate legal mandate to act.

Regarding the increase in risky loans, what we observe is that the yield curve cuts deepened, and as a result, the short-term interests are currently much shorter than long term, so this has provided an incentive for certain new mortgage debtors to get borrowers to go for short-term variable rates. At the same time, the proportion of deferred amortization loans has increased. By 2021, that increase had gone from 44 percent in 2020 to around 48 or 49 percent at the end of 2021. We also know that almost 50 percent of deferred amortization loans given in 2021 were granted to high-leveraged individuals. The latest numbers are that about 20 percent of deferred amortization loans are now being granted in 2022 with fixed rates and approximately 27 percent with variable rates.

Ms. Marcussen:

I do not have further comments other than to thank chairs for the comments today in addition to the ones we received in statements.

The Acting Chair (Mr. Li):

This is an interesting discussion on macroprudential policy and the housing market. I also want to echo what Mr. Segoviano said about the best practice and institutional arrangement for macroprudential policy. In fact, our staff have been writing a number of FSAP reports on this issue, and we will continue to help countries to inform their institutional setup for macroprudential policy.

Denmark is an Article VIII member, and no decision is proposed. The 2022 Article IV Consultation with Denmark is hereby concluded.

The Acting Chair (Ms. Li) adjourned the discussion.

ANNEX

- Gray Statements
- European Central Bank Statement
- Staff's Responses to Executive Directors' Technical Questions
- Constituency Codes

Statement by Ms. Marcussen and Ms. Ogmundsdottir on Denmark
Executive Board Meeting 22/54
June 13, 2022

On behalf of the Danish authorities, we would like to thank staff for the candid and constructive policy discussions during the Article IV mission held in April and May. The authorities appreciate staff's high-quality report and analytical work on relevant issues.

Outlook and risks

The Danish economy is in a strong position despite increasing headwinds. Russia's invasion of Ukraine has created new turmoil in the global economy with increasing commodity prices and higher uncertainty. The Danish economy will also be affected and while GDP is projected to grow by 3½ percent in 2022, activity is expected to stagnate or even fall in parts of 2022 as high inflation and increased uncertainty leads to lower demand.

Nevertheless, the basis for continued growth remains present. Employment and output continue to exceed their structural levels. High savings and record employment levels buoy household demand. Danish businesses have seen strong growth in exports and are in a sound financial position.

Risks to the outlook are mainly to the downside, in view of the consequences of the war in Ukraine. In particular, a stop to the supply of natural gas from Russia to Europe could lead to lower growth. Furthermore, should high inflation levels prove more persistent, this could lead to further substantial increases in interest rates and financial market turbulence which could dampen the outlook for the global and Danish economy.

Fiscal Policy

For more than two decades, Danish fiscal policy has been conducted within a forward-looking medium-term fiscal framework. The framework entails operational targets for the medium-term structural budget balance and plays an important role in ensuring long-term fiscal sustainability. The most recent update of the 2025-plan aims at structural budget balance in 2025.

Despite the expenses related to the Russian invasion of Ukraine, the structural budget balance is close to being balanced in 2022 and thus keeps a safe distance to the current deficit limit of 0.5 percent in the Budget Law. New targeted and temporary support measures to households in view of the increase in energy prices have been limited to 0.1 percent of GDP and no energy taxes have been reduced. Given the strong cyclical position of the Danish economy, fiscal policy is planned to be tightened substantially in 2022 and 2023, measured by the one-year fiscal effect.

In March 2022, the Danish government and a majority of parliament agreed to revise the structural deficit limit in the Budget Law from 0.5 percent of GDP to 1.0 percent of GDP in compliance with the EU fiscal framework and continued long-term fiscal sustainability. The revision of the Budget Law provides better conditions for dealing with forthcoming

demographic pressures on public finances while maintaining room for fiscal maneuver in case of an economic downturn.

Financial sector and real estate markets

Overall, the authorities consider the Danish financial sector to be resilient. The increase in impairments during the pandemic was a result of management buffers due to expectations that the economy would deteriorate. In general, these buffers have not been used. Government support packages, such as deferred VAT payments and wage compensation to businesses, helped mitigate the impact of the pandemic. Additionally, the government released the Countercyclical Capital Buffer (CCyB) in March 2020 to support banks' lending capacity during the pandemic. Following the recommendations by the Systemic Risk Council in June 2021, December 2022, and March 2022 the government has gradually rebuilt the CCyB to 2.5 percent (effective from 31 March 2023).

The authorities continuously monitor developments in the housing market. During the Covid19 pandemic, housing prices increased rapidly, but since summer 2021, the increase has been lower. In June 2021, the Systemic Risk Council recommended tightening lending policies in the housing market, specifically to restrict access to interest-only loans for borrowers with an LTV above 60. The primary purpose of reducing access to interest-only loans is to increase the resilience of homeowners – and the Danish economy – to falling house prices, increasing interest rates, and other negative economic shocks that may impact the individual homeowner or the Danish economy. The government chose not to follow the recommendation based on its assessment that financial stability and household robustness against shocks were not currently threatened, referring to the pandemic-related and temporary nature of the extraordinary activity in the housing market, as well as the moderate credit growth compared to the years leading up to the financial crisis in 2008. However, the government recognizes the need for vigilantly monitoring the risks stemming from the housing market.

The recent increase in inflation and higher nominal interest rates have diverse effects on the financial sector. A higher interest rate level will loosen the squeeze on banks' interest rate margins and strengthen profitability in the banking sector. On the other hand, investors face significant losses on financial assets and uncertainty is high. A downturn in the property market may significantly affect the business cycle and impose losses in the financial sector. However, Danish credit institutions are much better capitalized today than before the financial crisis.

Preventing the use of the financial system for money laundering and terrorist financing is of great importance for the government. Strengthening AML/CFT frameworks is highly prioritized, as evident in the progress in the implementation of the FATF recommendations. The Danish government is working internationally to strengthen cross-border cooperation between authorities in the fight against money laundering and terror financing, including through the joint Nordic-Baltic engagement with the IMF. Furthermore, the government has actively supported the European Commission's proposals for an Anti-Money Laundering Authority.

Productivity and structural policies

Wide-ranging reforms – of retirement and early retirement rules, the labor market, and taxes – have contributed significantly to increase the labor supply over the last decades. This includes the recent reform agreement “Denmark Can Do More I”, which is estimated to increase potential GDP by around 0.7 percent in 2030 through increased labor supply and productivity gains.

With the government’s policy proposal “Denmark Can Do More II”, the focus is on reducing Danish dependence on Russian gas and accelerating the green transition. This includes through phasing out natural gas for heating, expanding renewable energy from wind and solar, and a green tax reform with higher and more uniform taxation of CO₂. Furthermore, the government has an ambition to entirely phase out the use of natural gas by 2030, such that Danish gas usage will be fully covered by biogas and other renewable energy gases in 2030. The green tax reform implies a tax on carbon at 100 euro/tCO₂ for sectors not covered by the EU Emissions Trading Scheme (ETS), 150 euro/tCO₂ in total (incl. ETS price) for sectors covered and 113 euro/tCO₂ for mineralogical processes where risks of leakage are higher. The tax will be phased in gradually from 2025-30 and will be combined with targeted support for the green transition of firms.

The authorities agree with staff that there is a need to step up investments, especially in the green transition, which in Denmark is mainly a question of private sector investments.

In 2020, the Danish climate law was passed with the core aim of reducing emissions in Denmark by 70 percent relative to 1990 levels. Since the current government entered office in 2019, the emission reduction shortfall has been halved. Further, with the government’s carbon tax proposal and policies in the “Denmark Can Do More II” proposal, plans for more than two thirds of the shortfall have been put forth.

External Sector Assessment and current account analysis

The Danish authorities welcome staff’s work on understanding the Danish current account surplus, which has been substantial for a number of years. A current account surplus is not a policy objective per se, but rather the result of individual decisions by households and firms. While the surplus partially reflects savings associated with the build-up of labor market pensions, the authorities take note of the finding that firms, and a small group of multinationals in particular, play a key role in driving the surplus. To some extent, the surplus may also reflect deleveraging among households with high levels of debt and a continued focus on the long-run sustainability of public finances. Importantly, while policies aimed at boosting investment could reduce the current account surplus, the surplus does not appear to reflect underlying distortions to the economy. In any case, potential policies would need to take as given the central parity of the krone vis-à-vis the euro, which is an integral part of the framework for economic policy in a Danish context.

**Statement by Mr. Ronicle and Ms. Andreicut on Denmark
Executive Board Meeting 22/54
June 13, 2022**

We thank staff for the helpful set of papers and Ms. Marcussen and Mrs. Ogmundsdottir for their informative buff statement.

Denmark recorded a strong rebound from the pandemic, making good use of strong policy buffers built up prior to the COVID-19 crisis. We commend the authorities for their handling of the pandemic, which led to Denmark experiencing one of the mildest health and economic crises in Europe. While the war in Ukraine and its spillovers are creating uncertainty also for Denmark, we agree with staff that the rebound in activity will likely continue. Nonetheless, we share staff's policy advice on retaining policy flexibility amidst the current uncertain global environment, while enhancing macro-financial resilience and supporting a sustainable and inclusive growth path.

The authorities' fiscal response provided a key boost to the economy as COVID hit and facilitated the ongoing economic transformation. We particularly welcome the Green Tax Reform which will give a further boost to Denmark's sustained climate efforts – delivered against the challenging backdrop of rising energy prices. We also welcome the authorities' ambition to become one of the most climate-friendly countries in the world and staff's advice for further policies that would bring Denmark closer to its target. We agree with staff that the ongoing fiscal tightening, in the context of a strong rebound, positive output gap and inflationary pressures, is appropriate. Support for households in the face of rising energy prices should continue to be anchored in Denmark's successful medium-term fiscal framework.

We welcome the Danish central bank's successful management of the peg against the background of appreciation pressures in 2021. As noted by staff, the peg has proved successful in maintaining a low and stable inflation rate. Policy will need to remain nimble in the presence of policy tightening in the Euro Area and potentially diverging price pressures.

Denmark's financial sector weathered the pandemic well, but some vulnerabilities exist. Banks remained robust, with high levels of capital and liquidity, and their resilience was echoed by recent stress tests. We also welcome good progress made on improving the AML / CFT framework. We are reassured at the authorities' ongoing vigilance against emerging vulnerabilities and welcome the increase in the counter-cyclical capital buffer, which will strengthen general resilience further. Nonetheless, like staff we think sector-specific actions appear warranted to deal with specific emerging vulnerabilities, especially high household

leverage and rising house prices. Fortunately for the authorities, this is an area where a rich array of successful macroprudential tools is available, and we welcome the detailed staff discussion. We hope this enriches the domestic debate and can help spur further action in this area.

Statement by Mr. Buissé on Denmark
Executive Board Meeting 22/54
June 13, 2022

We thank Staff for their clear and insightful Report and Selected Issues paper in the context of Denmark's Article IV consultation. We also thank Ms. Marcussen and Mrs. Ogmundsdottir for their informative Buff statement. We commend the national and EU authorities' resolve to fight the economic, social, and health consequences of the pandemic.

Underpinned by sound macroeconomic policies, Denmark has weathered the COVID-19 shock particularly well. The strong rebound in 2021 is expected to carry over into this year, before levelling off in 2023. While the Russian invasion of Ukraine is expected to have a limited impact on growth, it constitutes a key downside macroeconomic risk, especially via higher inflation and uncertainty. In this context, and given the country's low debt and ample buffers, fiscal policy should remain nimble in case the outlook deteriorates. The Danish labor market is functioning well, but it is also getting tight, and therefore addressing skill shortages should be an integral part of Denmark's green and digital transition, also to support Denmark's very ambitious climate goals. Finally, high household indebtedness and rising real estate prices constitute a vulnerability and call for close monitoring of the housing market.

Macroeconomic Developments

We broadly share Staff's positive macroeconomic outlook, and also agree that downside risks to growth and upside risks to inflation prevail. Denmark experienced one of the smallest contractions in Europe during the COVID-19 shock and growth rebounded strongly on the back of robust domestic demand. Activity was also supported by a buoyant labor market, which is leading to growing labor shortages, and could result in a faster reduction of the unemployment rate than projected by Staff. We expect the strong rebound of 2021 to carry over into this year, with annual growth slowing down but remaining robust in 2022 and 2023. However, amid a high level of uncertainty, the balance of risks to growth is tilted to the downside. The Russian invasion of Ukraine is expected to have a negative but limited impact on growth and add to inflationary pressures. Overall, risks to the inflation outlook are tilted to the upside as higher energy, commodity prices, and supply side bottlenecks could last longer than previously expected, and trigger an upward shift in wage growth and inflation expectations, also on account of the tight labor market.

Fiscal policies

Considering Denmark's low public debt level and sound public finances, fiscal policy should remain nimble in case the outlook deteriorates. The general government balance is expected to remain in surplus in 2022 and 2023, leading to additional declines in the debt ratio, one of the lowest in the EU. For 2022, the fiscal stance, based on expenditure growth including the Recovery and Resilience Facility and other EU Funds and net of temporary emergency measures, is expected to be appropriately supportive, whereas for 2023, it is expected to be neutral. Given the country's ample buffers, fiscal policies should and can remain flexible to respond to potential downside risks. At the same time, it remains important to continue improving the composition of spending to address long-term priorities related to demographic headwinds, public investment and defense. These could be addressed by shifts in the budget without increasing the expenditure ratio, which is already one of the highest in the EU.

Structural policies

Denmark enjoys a favorable economic environment, but addressing labor and skills shortages and increasing green and digital investment could boost potential growth and support the country's ambitious climate objectives. The Danish labor market has performed well, although signs of tightness have appeared, underlining the need to address skills shortages. In this respect, policies should aim primarily at the upskilling of young, low-skilled and foreign-born workers, especially in green and digital skills. There is also a need to increase both public and private investment targeting the green and digital transitions, support broad-based innovation, enhance the institutional framework for competition, and improve the capital market, including through tax reforms. These actions could help to boost productivity and potential growth, and in the short run, may also help to reduce the current account surplus. On the green transition, we recognize progress made towards achieving the 70 percent reduction target embedded in Denmark's climate law, and recently announced plans to further expand renewable energy, implement a green tax reform with higher and more uniform CO₂ taxation and phase out natural gas for heating. The latter will also contribute to the strengthening of the circular economy and waste management policies, including through a shift to greener sources of heat generation. Linked to this, Denmark could also accelerate the deployment of renewables, including by simplifying and expediting administrative procedures, upgrading energy networks, increasing interconnections with neighboring countries, and improving energy efficiency. As regards housing, the new property tax system could ensure fairer taxation and stimulate investment of affordable housing, which would also strengthen the financial resilience of highly indebted borrowers.

Financial sector policies

We share Staff's assessment that while systemic risk is low, financial sector vulnerabilities linked to the real estate market remain despite policy action, requiring close monitoring. The banking sector weathered the pandemic well, and remains profitable, liquid, and well capitalized. Stress tests show that banks can withstand losses in a severe recession scenario without breaching their combined buffer requirements. However, macro-financial vulnerabilities persist due to high household indebtedness and an increasing share of risky mortgages amid high house valuations and strong price growth. This remains a source of concern despite the authorities' actions to tackle the build-up of risks, following the recommendations made in the 2019 Art IV Report and those by the Systemic Risk Board to raise the Counter Cyclical Capital Buffer. While we share Staff's view that these developments warrant close monitoring, we also consider the potential risks to financial stability in the case of a major house price correction to be somewhat more muted than presented in the report. Finally, we welcome the Danish authorities continued effort to strengthen the Anti Money Laundering framework.

Statement by Mr. Herrera and Ms. Bustillo on Denmark
Executive Board Meeting 22/54
June 13, 2022

We thank staff for the informative report and Selected Issues paper and Ms. Marcussen and Mrs. Ogmundsdottir for their informative Buff statement. Denmark was able to successfully weather the pandemic and lay the ground for a strong recovery due to substantial buffers, strong institutions, high levels of social cohesion, and well calibrated policies. While the economy is resilient, the outlook is uncertain due to the war in Ukraine, which could weigh on economic activity and accelerate inflation.

We concur that the planned fiscal tightening is appropriate but, given the uncertain outlook, fiscal policy should remain flexible. While fiscal policy is tightening as exceptional COVID-19 support measures are being withdrawn, fiscal space should be used if the geopolitical and economic situation worsens. In this context, the relaxation of the structural deficit limit in the Budget Law from 0.5 percent of GDP to 1.0 percent of GDP provides more flexibility and allows to address long-term structural priorities, including demographic pressures, defense spending, and an increase in public investment. Return to the medium-term objective of neutral stance remains appropriate. We also note that Denmark is expected to receive by 2026 about half percent of GDP in EU Recovery and Resilience Facility grants, which will facilitate the fiscal effort towards the green and digital transition and boost potential growth.

On foreign exchange policy, the exchange rate peg has continued to serve Denmark well. In the specific conditions of the Danish economy and its close trade and financial links with the Euro zone economies, this policy has provided a framework for low and stable inflation.

The banking system is sound. The staff report shows that banks remain profitable, capitalized, and liquid. At the same time, systemic risk is low and stress tests indicate that banks are resilient, but the high concentration of real estate exposures should continue to be closely monitored as macrofinancial vulnerabilities mainly stem from high household leverage and an increasing share of risky mortgages. Macroprudential tools have been actively used to bolster the robustness of the financial system, most notably the countercyclical-capital-buffer; further strengthening of buffers against adverse real estate shocks might be warranted.

We take positive note of the continued commitment to ensure financial integrity. The prevention of the use of the financial system for money laundering and terrorist financing remains a priority with progress in strengthening AML/CFT frameworks, in the implementation of the FATC recommendations, and in working towards strengthening cross-border cooperation.

On the property market, increasing household leverage amid potentially rapid increases in interest rates is a source of concern. We see merit in tighter income-based measures to better address high leverage and encourage mandatory amortization requirements. Moreover, further efforts to expand the supply of housing, address rent controls, and enhance rental market flexibility would help contain property prices.

We welcome the 2021 launch of Denmark Can Do More, which focuses on strengthening the Danish economy and society through reforms, innovation, education, job creation, and growth. Flexicurity and the authorities' efforts to improve employment and the labor force participation rate, including opportunities for the young, low-skilled, and foreign born are commendable and, like staff, we believe that efforts to support labor supply in the longer term should continue. Moreover, we welcome the authorities' efforts to reduce emissions, including the carbon tax proposal and policies in the Denmark Can Do More II.

With these comments, we wish the people and authorities of Denmark every success in their future endeavors.

Statement by Mr. Massourakis and Ms. Cerami on Denmark
Executive Board Meeting 22/54
June 13, 2022

We thank staff for their insightful report and Selected Issues paper and Ms. Marcussen and Mrs. Ogmundsdottir for their informative Buff statement. We broadly agree with the staff's assessment and associate ourselves with Mr. Buisse's statement. We offer a few additional remarks.

- **The Danish economic outlook remains favorable despite the high uncertainty over the negative spillovers from the lingering pandemic and the conflict in Ukraine.** Denmark has overall weathered the economic impact of the pandemic well, delivering a strong rebound in economic activity. The recovery is projected to continue strengthening in the next couple of years, supported by strong fundamentals and limited exposure to Russia. Nonetheless, given the high uncertainty over the indirect impact of the war through subdued growth in trading partners, higher inflation, and tighter financial conditions, we agree with staff that a flexible fiscal stance is appropriate.
- **Monetary policy should continue to safeguard the peg with the euro.** The peg has served the economy well, delivering low and stable inflation over time. However, more recently, the increase in global energy prices has added further domestic inflationary pressures stemming from an increasingly tighter labor market. These developments require close monitoring also from a financial stability perspective, as lower disposable incomes and higher interest rates can be a significant source of risk in a context of elevated household indebtedness.
- **Elevated valuations in the housing market are a cause for concern.** Rising property prices and the increasing share of risky mortgages remain a macro-financial vulnerability, despite the recent tightening of macroprudential measures. Like staff, we see scope for further tightening, including via limiting access to interest-only mortgages, as also recommended by the Systemic Risk Council. Moreover, we welcome the new property tax system, which is expected to improve affordability, and support further measures to ease housing supply constraints.
- **We support the authorities' agenda to promote the green and digital transformation of the economy, on the back of a well-functioning labor market and ongoing initiatives to increase the labor supply.** In this context, the planned shift of public spending towards investment can reinforce tax reforms to support the green economy, as well further measures to support innovation and equity finance, as recommended by staff. These catalysts are expected to boost private investment and productivity, accelerate the transition, and help narrow the saving-investment gap.

Statement by Mr. Hosseini and Mr. Belhaj on Denmark
Executive Board Meeting 22/54
June 13, 2022

We thank staff for the comprehensive reports and Ms. Marcussen and Mrs. Ogmundsdottir for their helpful Buff Statement.

Denmark's strong track record of sound economic policies underpins a solid post-pandemic economic recovery. We welcome the overall favorable outlook and note with satisfaction that the pandemic is not likely to have material permanent scarring. We also note that risks to the outlook are tilted to the downside, mainly due to uncertainties related to the war in Ukraine. However, Denmark is well positioned to withstand shocks, given its strong buffers. We appreciate that the authorities are successfully addressing structural challenges to unlock potential output growth and support their transformational efforts, including in the climate and digital transition. **We broadly agree with staff's assessment and would like to make the following comments.**

Fiscal Policy

We agree that the unwinding of the pandemic-related measures in 2022 is appropriate and welcome the new targeted and temporary support to vulnerable households to cope with higher energy prices. We note that the fiscal policy is planned to be tightened in 2022 and agree with staff that the authorities need to remain flexible given the global uncertainties, before returning to a neutral fiscal stance over the medium term. We welcome the planned relaxation of the annual structural deficit limit, which will allow flexibility and provide room to respond to spending priorities, including pensions and age-related spending, as well as necessary public investment, especially in green and digital areas. We note positively that this relaxation would not put long-term fiscal sustainability at risk, given Denmark's large fiscal space.

Financial Sector

We are pleased to note that the banking system remains highly capitalized, liquid, and profitable, and that stress tests show high resilience of systemic and non-systemic banks to severe recession scenarios. Pockets of vulnerability, particularly those related to the housing market, warrant close monitoring, and in this connection, we welcome the authorities' response to the build-up of risks and encourage the strengthening of buffers against real estate shocks.

Housing Market

Denmark's household debt-to-income ratios are among the highest in the OECD. Increasing share of risky mortgages leave households vulnerable to price and interest rate shocks. We encourage the authorities to strengthen macroprudential tools, in line with staff's recommendations. We also encourage the authorities to seek to improve housing supply, eliminate distortive tax incentives to debt-financed home ownership and enhance the flexibility of the rental market. *Can staff elaborate further on non-distortive measures to deal with affordability issues for first-time homebuyers? are there any recent signs of cooling down of the housing markets?*

Structural Reforms

We commend the authorities for their sound labor policies. Employment flexibility and a strong safety net has proven effective in protecting jobs during the pandemic and facilitating a quick recovery when conditions permitted. We welcome the initiatives to promote labor market participation of refugees, the youth and the low-skilled and encourage continued reforms to improve labor supply, including upskilling workers, and strengthening the integration of emigrants into the workforce, and the society more broadly.

Denmark is reaping the benefits of its bold and early commitment to economic transformation, making it a leader in the green and digital economy, where reforms in these areas have added to pre-pandemic initiatives targeting key areas, including skilled labor and competitiveness. Denmark's commitment to green transformation offers an opportunity to further stimulate public and private investment. We see room for increased public green investment given the ample fiscal space available.

We are pleased to note the authorities' commitment to expanding highly productive sectors, encouraging innovation, and strengthening the institutional framework for competition, which bodes well for increasing the country's potential output. Denmark's strong commitment to ambitious carbon neutrality goals is exemplary.

We wish the Danish authorities and people success in their ambitious reforms.

Joint Statement by Ms. Lim, Ms. Grant, Ms. Kashima, Mr. Nghiem, Mr. Yoo, and Ms. Ogihara on Denmark
Executive Board Meeting 22/54
June 13, 2022

We thank staff for the comprehensive report, and Ms. Marcussen and Mrs. Ogmundsdottir for their informative Buff statement. Denmark experienced a strong, inclusive, and broad-based recovery, thanks to the authorities' sound policy responses, strong institutions, and substantial buffers. The economy has shown strong resilience during the pandemic and amid initial spillovers from the war in Ukraine. However, the economic environment is highly uncertain, and labor shortages could pose risks to the recovery. We broadly share staff's assessment and policy advice, and would like to provide the following comments for emphasis.

Fiscal policy should be sufficiently flexible in the near term, while facilitating reallocation and a green and digital transition. We welcome Denmark's sound fiscal position, and agree with staff that the planned relaxation of the structural deficit limit in the Budget Law would allow for medium-term spending priorities, while providing flexibility to react to economic fluctuations. Government support for a greener society is critical, and Denmark's ambitious emissions targets call for a comprehensive strategy, including tax reform and appropriate incentives for private sector investment. *In this regard, does the war in Ukraine bring near-term challenges to Denmark's climate policies?* As for the green tax reform, we encourage staff to carefully follow the discussions taking into account its socio-economic impact and leakages.

The Danish banking system remains resilient and systemic risk is low, but the authorities should be vigilant to the build-up of risks surrounding household debt and real estate. We positively note that private sector balance sheets remained sound during the pandemic. However, high household indebtedness amid elevated house valuations is a key source of concern. We welcome the authorities' decision to raise the Countercyclical-capital-buffer to 2.5 percent. We encourage the authorities to further strengthen macroprudential toolkits, including tighter borrower-based measures and mandatory amortization requirements, and to address generous tax incentives provided to mortgages. We also encourage the authorities to stay vigilant to the impact of global tightening and persistent inflationary pressures on the housing sector, and housing supply constraints. On AML/CFT, we welcome the authorities' substantial progress in implementing FATF recommendations, and encourage the authorities to continue to enhance their AML/CFT framework, including on virtual asset providers.

Various initiatives to increase investment and labor supply will further support robust growth. Denmark's *flexicurity* model, together with supportive labor market measures during the pandemic, proved to be effective in safeguarding labor market outcomes and sustaining a strong recovery. As staff highlighted, further enhancement of the ALMP and *flexicurity* would help facilitate labor market reallocation, which is critical for a smooth transition to a greener and digitalized economy. Furthermore, we agree with staff and the authorities that an

adequate indexation of the SRA to life-expectancy for the pension system is key to maintain labor supply and ensure fiscal sustainability. Additional measures to eliminate labor distortions, such as those among elderly and foreign workers, would also help strengthen labor supply. To further boost potential growth, we echo staff's call to bolster the expansion of highly productive sectors, foster broad-based innovation, and improve access equity finance.

The authorities' comprehensive business-oriented policy strategy to transform the economy is commendable. We are encouraged by the authorities' digital and green initiatives to keep Denmark ranked top in the region for digitalization and economic greening. We share staff's view that support policies are warranted to attract private investment for green and inclusive growth, including incentives for high-tech start-ups to nurture the high-skilled labor force for the long term digitalization strategy.

Statement by Mr. Stephan, Ms. Koh, and Mr. Schmelzer on Denmark
Executive Board Meeting 22/54
June 13, 2022

We thank staff for the informative set of reports and Ms. Marcussen and Ms. Ogmundsdottir for their very helpful Buff statement. **We broadly concur with the staff report's appraisal and associate ourselves with the Gray by Mr. Buissé.** In addition, we would like to emphasize the following aspects:

We take positive note that the fiscal position remains solid despite high outlays during the pandemic and welcome further consolidation in light of the strong recovery. Nevertheless, the authorities are encouraged to retain adequate buffers and make provisions to meet future fiscal burdens, such as rising health and pension costs for a steadily ageing population. As rightly noted by staff, adjusting the retirement age to match life expectancy as well as fostering additional labor market participation of senior citizens will also be important elements in preserving long-term fiscal sustainability. At the same time, substantial public and private investment will be needed to achieve the green and digital transformation of the economy.

On monetary policy, we encourage Denmark's central bank to stand ready to react to possible monetary policy changes in the Eurozone as needed while preserving the krona's peg. This seems important as additional price shocks from the war in Ukraine as well as lasting supply chain disruptions could further drive up inflation and this could turn out to be even more persistent. We also note in this regard that despite the recent uptick in inflation in Denmark, medium-term inflation expectations remain well-anchored and broadly similar to those in the Eurozone. Danish domestic inflationary pressures are expected to ease as the fiscal stance returns to a more neutral position and the positive output gap closes.

We note that the Danish financial system has been broadly stable throughout the pandemic and has performed robustly in recent stress tests. Nevertheless, we see merit in additional macroprudential measures in light of highly leveraged households and signs of a potential decoupling of housing prices from incomes. In addition, financial stability risks from regional interlinkages of Danish financial institutions should be monitored closely, including possible AML/CFT risks. We note that staff finds substantial progress in implementing FATF recommendations since the body's 2021 report and we encourage the authorities to continue strengthening their supervisory frameworks and practices in this area.

Furthermore, we would support staff's call for strengthening the institutional arrangements of macroprudential policy making. Designing an institutional setup that ensures decisions can be taken swiftly while minimizing the influence of potentially competing political goals is important to ensure robust macroprudential supervision.

While we agree that higher investment in the green and digital transition could also contribute to reducing the current account surplus, which is assessed by staff as "moderately stronger than the level consistent with medium-term fundamentals", we would like to point out that the External Balance

Assessment “estimates remain subject to uncertainties” and that staff does not identify policies to explain the bulk of the estimated current account gap (cf. Annex III.). Given such uncertainties in the model, policy choices for additional investment would seem to be better driven by their potential for enhancing productivity and/or achieving climate goals than by aiming at a narrower CA gap. We note in this regard that the authorities are also pointing to structural features of the economy not adequately captured by the EBA-model.

Statement by Mr. Potapov on Denmark
Executive Board Meeting 22/54
June 13, 2022

1. **We thank staff for the comprehensive reports and Ms. Marcussen and Mrs. Ogmundsdottir for their informative Buff statement.** Denmark's economy was one of the most resilient in the EU throughout the Covid-19 pandemic. The size of the economy surpassed the pre-pandemic levels as early as in the second quarter of last year. At the same time, with the economy operating above potential, inflationary pressures are gradually building up and the labor market continues to tighten. Elevated household debt together with the risk of an overheated housing market pose a threat to macro-financial stability. We encourage the authorities to build on their strong track record of sound policies and reforms to further enhance macro-financial resilience and boost potential growth.
2. **While the recovery remains strong, the risks to the outlook are tilted to the downside.** The geopolitical developments and heightened uncertainty can negatively impact the Danish economy. Weaker demand from the key trading partners will weigh on exports and growth, with higher inflation eroding purchasing power and hampering private consumption. The unwinding of the Covid-19-related measures is expected to lead to a decline in public consumption. At the same time, given sound macroeconomic management and robust buffers, staff argue that Denmark is well positioned to face these challenges.
3. **Fiscal policy should remain prudent to help withstand shocks and address long-term challenges.** Given the strong cyclical position and rising inflation, we agree that the tightening of the fiscal stance is appropriate in the short term to dampen aggregate demand. At the same time, as staff's analysis shows, Denmark has substantial fiscal space over the long term to address the macro-critical issues of population aging, digital transformation, and climate resilience. We note that the relaxation of the structural deficit rule in the Budget Law is expected to provide additional funding to deal with rising demographic pressures.
4. **According to staff, the exchange rate peg has served Denmark well, providing a framework for low and stable inflation in the country.** *At the same time, with rising inflationary pressures and the risk of de-anchoring inflation expectations in the euro area, could staff elaborate on an appropriate policy mix to contain a potentially protracted inflation in Denmark?*
5. **While the financial sector is healthy, we share the concerns about the risks stemming from the housing market and high household leverage.** We note a sizable share of risky mortgages, while the interest-rate sensitivity of homeowners can be high. The

tightening of global financial conditions can trigger a sharp reassessment of fundamentals and house price corrections, with adverse implications for investment and financial stability. In this context, we encourage the authorities to closely monitor these risks. The tightening of macroprudential measures may be needed. We also welcome the authorities' efforts to further strengthen the AML/CFT framework.

Statement by Mr. Fuentes and Ms. Mahabir on Denmark
Executive Board Meeting 22/54
June 13, 2022

We thank staff for the report and Ms. Marcussen and Mrs. Ogmundsdottir for their helpful buff statement. Denmark was minimally affected by the pandemic, both in terms of economic activity and infections, on the back of timely containment and mitigation measures and a high rate of vaccination. While the direct impact of the war in Ukraine is expected to be limited, the country is experiencing high levels of inflation due to the spike in electricity and heating prices. This is occurring even though the country's dependence on foreign energy is lower than its peers. Risks to the outlook will remain tilted to the downside, particularly, regarding the supply of natural gas from Russia to Europe, that could lead to lower overall growth in the region.

The rebound in the economy has been accompanied by a falling unemployment rate, which was already below its pre-crisis level in July 2021 and continued to decline in 2022. The pressures in the labor market have been partially eased by increased participation, particularly by older and foreign workers. We take note that the inflow of refugees from Ukraine can aid to release some of the tightness in the labor market. *Could staff provide an update on the number of refugees and identify any potential stress points associated with this inflow?* We also take positive note of the various schemes enacted to increase participation into the workforce.

Fiscal policy continues to be guided by a strong medium-term fiscal framework. The authorities expect to remain somewhere close to a balanced structural budget in 2022 despite the expenses related to mitigating the impacts of the war. In addition, the authorities aim to withdraw some support from the economy considering the strength of the recovery. That said, amendments to the Budget Law are being considered, in particular, a relaxation of the annual structural deficit limit from $\frac{1}{2}$ percent of potential GDP to 1 percent. Such a move will provide more fiscal space for the authorities to respond to ongoing economic needs. We take note of staff's assessment that this adjustment is not expected to significantly impact on the country's long-term fiscal sustainability.

The financial sector remains sound but pressures from the housing market continue to be of concern. Banks are reported to have remained highly capitalized, liquid, and profitable, with returns on assets and equity increasing in 2021. Importantly, stress tests indicate that the banks can withstand the unwinding of government support. Nonetheless, housing prices rose faster than incomes during the pandemic, and the use of variable-rate mortgage loans has increased. These factors increase the vulnerability of homeowners to changes in interest rates. We concur with staff on the need to adjust existing macroprudential tools and

implement reforms to reduce mortgage interest deductibility and include borrower-based tools in the policy toolkit.

We welcome the progress in structural reforms to boost potential growth and increase productivity. The recent “Denmark Can Do More I” is estimated to increase potential GDP by around 0.7 percent in 2030 through increased labor supply and productivity gains, and the proposed “Denmark Can Do More II” is expected to accelerate the green transition through phasing out natural gas for heating and expanding renewable energy from wind and solar. In addition, there is scope to increase support for entrepreneurship by rebalancing taxation for start-ups and the share of employment in knowledge-intensive services (KIS) and boost ICT investment.

With these remarks we wish the authorities the best in their future endeavors.

Statement by Mr. Moreno and Mr. Lopez on Denmark
Executive Board Meeting 22/54
June 13, 2022

We thank staff for their reports and Ms. Marcussen and Mrs. Ogmundsdottir for their informative Buff statement. We broadly share staff's appraisal and associate ourselves with Mr. Buisse's statement. We would like to offer the following comments for emphasis.

We support staff's view on outlook and risks. The economic recovery is well entrenched, helped by the authorities' well-managed measures to support activity and mitigate the impact of the pandemic. The war in Ukraine is having an indirect and manageable effect on the economy so far, facilitated by ample policy buffers. Strong institutions and sound economic policies are supporting a solid economic performance, driven by domestic demand and a tightening labor market. However, the balance of risks is tilted to the downside and macrofinancial vulnerabilities related with the housing market are growing. In line with staff's assessment on the external sector, structural policies promoting investment would help reduce the large current account surplus, while reinforcing the authorities' efforts on climate change mitigation and digitalization. *We would have appreciated a more detailed analysis in the SIP on the main drivers—including tax incentives—of the large share of merchanting activities. Staff's comments are welcome.*

Given the ample buffers, fiscal policy should remain flexible to accommodate short-term needs and face long-term challenges. The authorities should continue responding to the current crisis with targeted, non-distortionary and well-focused measures, protecting the most vulnerable groups and accommodating new spending needs in defense and integration of refugees. Flexibility should be maintained to respond to potential adverse shocks in the current uncertain outlook. From a medium-term perspective, the low levels of public debt would allow the authorities to face structural challenges and spending priorities, supporting investment and innovation, helping the green and digital transformations, and fostering labor force participation. In this respect, we welcome the new Budget Law that would increase the limit on the structural deficit. Additionally, these actions would help ease inflationary pressures, reduce labor supply constraints and adjust the sizeable external surplus.

We commend the authorities for the ambitious green agenda. The country is long committed to climate change mitigation. The intermediate goals to reduce net emissions by 70 percent, below 1990 levels, by 2030 are commendable. The authorities should develop a comprehensive agenda, combining taxation and carbon price measures with other incentives to promote the use of green technology. The recently announced Green Tax Reform, along

with other initiatives to expand the use of renewable energies, is a welcome step that should be complemented with other measures targeted to critic sectors such as agriculture and transportation.

The well-functioning labor market should retain its main mechanisms, while making further improvements to increase labor force participation. We concur with staff that a full-fledged flexicurity, including extensive ALMP measures and a flexible wage bargaining framework, are facilitating the good performance of the labor market and improving the employability of the young, low-skilled and foreign workers. Like staff, we also support further measures to limit early retirement and incentive seniors to work.

On the financial sector, high household leverage amid elevated housing valuations continues to be the main source of concern. High capitalization, liquidity and profitability ratios underpin the resilience of the banking system and support the increase in credit. Nevertheless, long existing vulnerabilities in the housing market continue to pose risks to financial stability. We welcome the authorities' response to contain those risks, although, like staff, we believe more should be done to strengthen the macroprudential toolkit and deploy new and existing instruments —such as sectoral-based and borrower-based buffers— to prevent excessive leverage and enhance the resilience of households and banks. *Despite the measures implemented in past years to limit interest-only and floating-rate mortgages to highly indebted households, staff's report shows a higher preference for riskier mortgage products more recently. Could staff comment on the potential reasons for this behavior and the type of households affected?* To further mitigate risks, measures to facilitate housing supply, eliminate distortive tax incentives to debt-financed home ownership, and enhance rental market flexibility would be advisable.

Finally, we welcome the authorities' measures to improve the AML/CFT framework. The implementation of several initiatives has been instrumental to reduce risks associated with these illicit activities. We encourage the authorities to build on these efforts and take additional steps to enhance AML/CFT supervision, along the lines recommended by staff.

**Statement by Ms. Medearis and Ms. Rao on Denmark
Executive Board Meeting 22/54
June 13, 2022**

We thank staff for their comprehensive reports and Ms. Marcussen and Mrs. Ogmundsdottir for their helpful Buff statement. We commend the authorities for their effective policy response to the pandemic, made possible by a legacy of robust institutions and policies that had delivered strong economic performance and substantial buffers. This enabled Denmark to weather the pandemic with one of the mildest economic contractions in Europe and set the stage for a sound recovery. The authorities continue to demonstrate deft crisis management, including in the temporary, targeted support to shield vulnerable households from higher energy prices resulting from Russia's war against Ukraine. Spillovers from the war could further fuel inflation and introduce uncertainty into the outlook, thus warranting close monitoring. **We broadly agree with the staff appraisal and offer the following comments for emphasis.**

We concur with staff that fiscal tightening is appropriate given strong aggregate demand, but we urge the authorities not to hesitate to deploy the country's substantial fiscal space if downside risks materialize and the recovery falters. In this context, we note that the adverse scenario laid out in Annex VII envisions Russian oil and gas export volumes decreasing by an additional 10 percent in 2022 and 20 percent in 2023 relative to the baseline projections in the April 2022 WEO. *Given EU conversations around an import and insurance ban on seaborne Russian oil and Gazprom cutoffs of natural gas to European customers including Denmark's Ørsted, does staff believe the baseline and/or adverse forecasts should be downgraded further?* We welcome the Danish Parliament's discussion around relaxing the annual structural deficit limit from 0.5 percent of potential GDP to 1 percent, which would provide additional fiscal flexibility as needed in the medium term without compromising debt sustainability.

We applaud the authorities' ambition to become one of the most climate-friendly countries in the world, and we laud the authorities for their pioneering leadership, as part of the Coalition of Finance Ministers for Climate Action, to integrate climate into macroeconomic modeling. We echo staff on the need for a comprehensive strategy to achieve Denmark's climate vision, building on this work. We encourage staff and the authorities to undertake further analysis on options to recycle carbon revenues to address leakages, reduce labor taxes, and secure a just transition, thereby helping to enhance public acceptability of climate proposals.

We urge the authorities to remain vigilant about elevated macrofinancial vulnerabilities. We welcome the authorities' recent increase of the countercyclical capital buffer in response to a recommendation from the Systemic Risk Council. We appreciate the authorities' recognition of the need to monitor risks stemming from the housing market, as

reflected in the Buff statement, and encourage the authorities to closely heed staff's macroprudential policy recommendations related to the Danish housing market. This is particularly important given the outsized importance of housing within the Danish financial sector, high household leverage, and an increasing share of risky mortgages. Given this context, staff rightly note that a reassessment of fundamentals or tightening of global financial conditions could trigger a house price correction with potentially wide-reaching consequences for the Danish economy. We welcome staff analysis in the useful selected issues paper on Denmark's large and persistent current account surplus and its drivers. We agree with staff that structural policies aimed at raising investment, including green and digital investment, would be desirable both inherently and in terms of reducing the current account surplus.

We commend the authorities on Denmark's exceptionally strong labor market and on their ongoing efforts to expand the labor supply, including through integration of migrants and refugees into the labor force. We welcome the Special Act that grants Ukrainian refugees quicker access to the labor market.

**Statement by Mr. Jennings, Mr. O'Brolchain, and Mr. Mooney on Denmark
Executive Board Meeting 22/54
June 13, 2022**

We thank staff for the well-written report and Ms. Marcussen and Mrs. Ogmundsdottir for the comprehensive Buff statement. The Danish economy has emerged strongly from the pandemic, as sound pre-pandemic policies provided substantial buffers which were swiftly utilized when the crisis hit. These buffers leave Denmark well positioned to contain the spillover effects from Russia's invasion of Ukraine. Headline inflation has increased in 2022, but remains lower than many regional peers due to a lower contribution from energy prices. **We agree with the thrust of the report and offer the following points for emphasis.**

Fiscal policies should remain flexible to respond to potential downside risks, in light of Denmark's ample buffers. We welcome the authorities' policy of ensuring that compensation for higher energy prices is only temporary and targeted to lower-income households. We encourage the authorities to continue improving the composition of spending to address long-term priorities related to demographic headwinds and public investment. We welcome the proposed strengthening of the carbon pricing regime, as outlined on page 15 of the report, and agree with staff that complementary fiscal incentives at the sectoral level are also needed.

We positively note that the Danish banking system remains highly capitalized, liquid, and profitable, while stress tests indicate that banks are resilient and can withstand the unwinding of government support. The authorities should remain vigilant in monitoring the risks stemming from the housing market, utilizing the macroprudential toolkit where appropriate. We welcome the ongoing efforts to strengthen the AML/CFT framework, and the development of a new supervisory strategy by the DFSA will be helpful in this regard.

We welcome the authorities' focus on the green transition, particularly plans to expand the renewable energy sector. In order to further accelerate the deployment of renewable energy, the authorities should examine the potential of increasing interconnectivity with neighboring states. In terms of the labor market, the authorities should focus on upskilling the youth and unemployed in green and digital skills. We positively note that Denmark has one of the smallest gender gaps in the EU, and we encourage the authorities to take measures to further enhance the parental leave framework.

Statement by Mr. Palotai, Mr. Just, and Mr. Harvan on Denmark
Executive Board Meeting 22/54
June 13, 2022

We thank staff for their informative reports, and Ms. Marcussen and Mrs. Ogmundsdottir for the helpful Buff statement. Underpinned by sound macroeconomic policies and an effective response, the Danish economy weathered the COVID-19 crisis very well, already surpassing pre-pandemic GDP and employment levels. The outlook is clouded by inflation pressures, a pandemic resurgence, and potential spillovers from the Russian invasion of Ukraine. We broadly concur with staff's assessment of the key challenges and policy recommendations. We associate ourselves with the statement by Mr. Buissé and would like to provide the following comments for emphasis.

The planned **fiscal** tightening in 2022 will further reduce public debt in the context of ample fiscal buffers and the fiscal policy should remain flexible in 2023. We welcome that since the inception of energy crisis, the government has used this space for temporary and well-targeted social measures, and not for permanent and nationwide expenditures. *We note the review of the Budget Law which could lead to relaxing the medium-term objective, as allowed by the Fiscal Compact, and would welcome additional details on whether the pace of convergence to the target would also be less stringent.* We broadly concur with staff on the scope to provide further support for the digital and green transition in order to ensure achievement of the national and EU targets, but addressing long-term structural priorities might be better served by redirecting public expenditure, given their very high levels.

We underscore **financial sector** concerns related to high household indebtedness amid elevated house valuations and concur on the need for close monitoring of the housing market and the potential need for further policy actions. We welcome the macroprudential tightening, new property tax system, and the sound assessment of the banking sector capital adequacy under different stress scenarios. *We see a case for proactively addressing the vulnerabilities related to the increasing share of risky variable-rate mortgages, as financing conditions have already started to tighten alongside monetary policy, and would welcome staff's views on gaps in borrower-based measures, including in access to mortgages for highly leveraged borrowers.* Current guidelines for stricter lending standards should apply not only in densely populated agglomerations such as Copenhagen and Aarhus, but also across Denmark. Moreover, mortgage interest deductibility should be reduced. We welcome the substantial progress in reducing **AML/CFT** risks. Supervisory and regulatory authorities should make use of their powers, keep more on-site controls, and consider a more targeted regulation of virtual assets providers.

We concur with staff on the priorities for **structural policies**, including fostering labor supply, as well as supporting the green and digital transition. We welcome the structural reforms aimed at increasing labor market participation among vulnerable groups. We underscore the importance of ensuring that the pension system continues to adapt to changes in life expectancy. *We positively note that Denmark is performing well in the EU's digital and climate change objectives, and would welcome staff's assessment on the Rescue and*

Resilience Plan, with regards to meeting national climate change and energy policy objectives. We note the significance of structural factors in driving the current account surplus and the uncertainties of the assessment, as highlighted by staff.

Statement by Mr. Dresse and Ms. Eijking on Denmark
Executive Board Meeting 22/54
June 13, 2022

We thank staff for a comprehensive set of insightful reports and Ms. Marcussen and Mrs. Ogmundsdottir for their helpful Buff statement. We agree with the thrust of the staff appraisal, picturing a resilient economy with buffers in all sectors. However, high household leverage weighs on financial and macroeconomic stability and the tight labor market may add to inflationary pressures. We associate ourselves with the Gray of Mr. Buissé and would like to offer additional comments in the areas of (i) financial vulnerabilities related to household debt, (ii) climate change mitigation policies (iii) labor market developments, and (iv) the external sector.

We commend the authorities on effectively managing the Covid-19 pandemic as well as the current headwinds stemming from the war in Ukraine. Denmark was the first EU country able to lift all pandemic-related restrictions, allowing a return to flexicurity to facilitate an effective reallocation of labor resources towards (new) expanding sectors. We note with interest that Denmark succeeded in introducing targeted measures to compensate lower-income households for higher energy prices. We welcome measures that grant Ukrainian refugees quicker access to the labor market, addressing both labor supply shortages and supporting displaced people from the war in Ukraine.

We support staff's recommendations to tighten macroprudential policies related to household borrowing and support a review of the efficacy of institutional arrangement in this area. Also in other countries, like the Netherlands, the share of households opting for interest-only mortgages is rising, probably because of households trying to save on their monthly payments, even if this excludes those homebuyers from interest deductibility. This points to increasing affordability issues and increased financial stability concerns. *Could staff further elaborate on the pros and cons of an independent macroprudential authority vs. decision-making power lying fully with the government?*

We welcome staff's views on possible second-round effects given the tight labor market. We understand that the Danish wage bargaining framework allows for wage flexibility over and above the collectively negotiated wages. *Given the tight labor market and 'inflation surging to a historic high', what does this imply for nominal wage growth over the period to come?* We feel that this element is missing in the report.

We welcome the Selected Issues Paper on the CA surplus and encourage staff to further increase their understanding of the persistent CA surplus, stemming largely from corporate savings. We note that the corporate sector has been contributing to almost half of the saving surplus over the past years, largely concentrated among a few multinational corporations. It would be interesting to better understand the link with the wage bargaining framework which allows export industries to restrain wage growth and thereby save. *Given that there might also be statistical explanations, did staff apply the RE bias tool that was approved by the Board in March to determine the share of domestic corporate savings (or undistributed profit) attributed to foreign portfolio investors?*

We welcome staff's focus on climate policies but would have appreciated better targeted and more in-depth policy advice. First, the reference to the 'Climate Change Performance Index' seems misleading given that the Fund's policy advice is about the policies to reach the climate objectives and not about the ambitiousness of the objectives themselves. Still, we praise Denmark for its leading position in terms of climate policies and would welcome the introduction of carbon taxation proposals and welcome the policies set in place to further close the emission reduction shortfall, as outlined in the Buff statement. Second, with a large coastal line and multiple islands, adaptation policies are important but there's no coverage of an adaptation policy in the report. Third, we note that many countries are given similar advice in terms of introducing a system of feebates. Though this might be valuable policy advice we hope that the increased staff resources will allow for more granular policy advice in the area of climate mitigation.

Statement by Mr. Mohieldin and Ms. Choueiri on Denmark
Executive Board Meeting 22/54
June 13, 2022

1. We thank staff for the well-written reports and Ms. Marcussen and Mrs. Ogmundsdottir for their helpful Buff statement. The Danish economy entered the pandemic in a strong position, which, together with an adequate and timely response to the crisis, allowed Denmark to experience one of the smallest contractions in Europe in 2020. Although uncertainty remains high due to the war in Ukraine and the pandemic, we share the authorities' view, as conveyed in the Buff, that the basis for continued growth remains present. We concur with staff that policy should remain flexible in the near term while preserving macro-financial stability and supporting a sustainable and inclusive growth path.

2. **Fiscal policy should remain flexible given the uncertain outlook and available fiscal space.** To mitigate the impact of rising energy prices, support measures were provided to households. We positively note that they were targeted, temporary, and limited and were also less distortionary compared with measures in other countries, as noted by staff. The Green Tax Reform, implemented despite the increase in global energy prices, will further support Denmark's ambition to become one of the most climate-friendly countries in the world. We welcome the planned relaxation of the structural deficit limit from 0.5 percent of GDP to 1.0 percent of GDP as it will allow policy to respond to demographic pressures, while also providing the flexibility to deal with cyclical challenges.

3. **The exchange rate peg has continued to serve Denmark well** by providing an anchor for low and stable inflation. The authorities are to be commended for managing the peg skillfully amidst appreciation pressures in 2021.

4. **Denmark's banking system is sound and resilient to stress, although rising risks in the real estate market warrant monitoring and possible macroprudential measures.** The banking system is well-capitalized, liquid, and profitable. Nonetheless, given high household indebtedness and the growing share of risky mortgages, the authorities rightly recognize that risks stemming from the housing market need vigilant monitoring. *We would appreciate staff's views on the reasons why risky mortgages grew in past years despite measures aimed at limiting lending to highly indebted households.* We support the staff's recommendations to consider macroprudential tools, including minimum down-payment requirements or mandatory amortization until a minimum equity share is reached, as well as debt-service-to-income caps.

Statement by Mr. Zhang and Ms. Yang on Denmark
Executive Board Meeting 22/54
June 13, 2022

We thank staff for the well-written reports and Ms. Marcussen and Mrs. Ogmundsdottir for the helpful Buff statement. Supported by strong institutions and sound policies, the Danish economy has seen a solid rebound with employment and output continuing to exceed their structural levels. Going forward, structural reforms should be advanced to facilitate a green and digital transition. We broadly agree with staff's appraisal and would like to focus our comments on the following points.

Near-term fiscal stance should remain flexible as the outlook is highly uncertain. The planned fiscal tightening is appropriate given the strong cyclical position of the Danish economy. In view of higher energy prices, the targeted and temporary support measures to benefit lower-income households have limited distortionary effects. We agree with staff that fiscal policy should remain flexible and be recalibrated as needed if either downside or upside risks materialize. The revision of the Budget Law is welcome, as it provides better conditions for dealing with adverse demographics while maintaining room for fiscal maneuver should it be needed. *We see merits in the planned increase in public investment to reduce the S-I gap, and staff comments on the institutional designs and effectiveness of public investment, as well as the relative contributions of public and private investment to growth, would be appreciated.*

While the Danish financial sector remains resilient, the emerging signals of vulnerabilities in household indebtedness and real estate market warrants close monitoring. We take positive note that Danish banks remain highly capitalized, liquid and profitable, and stress tests indicate that banks can withstand the unwinding of government support. However, risks stemming from property market are alarming, as implied by rising property prices and household leveraging. Highly leveraged households are exposed to price and interest rate shocks, and vulnerabilities are compounded by the large and growing proportion of variable-rate mortgages. We support staff recommendations to tighten macro-prudential tools and agree that borrower-based tools (limits on LTVs, DTIs, and DSTIs) should be included in the policy toolkit. Meanwhile, measures should be taken to address housing supply constraints, and the tax code should be adjusted to cool down the market booming.

Structural reforms should be advanced to raise productivity and facilitate a green transition. We take positive note that the enhancements to *flexicurity* have well supported the labor market in the pandemic and facilitated the reallocation of labor to expanding sectors. Initiatives to improve employment prospects for the young, low-skilled, and refugees are bearing fruits, and the basic integration education program will be expanded to further

promote labor market participation of refugees. *In this context, we welcome staff comments on how the program has improved the employment prospects of refugees who have enrolled in it, such as the percentage of participants who have received a job offer after the program.* We welcome Denmark's green transformation commitment and the launch of the Green Tax Reform, which set carbon tax targets for different sectors. *We would like to know if those carbon price targets are consistent across the EU, and if price differences exist, would there be a carbon border adjustment mechanism between EU countries?* In addition to higher carbon price, the use of feebates could help meet the emission commitment. We note that the authorities plan to phase out natural gas for heating and expand renewable energy from wind and solar. *Given the fluctuations in the supply of wind and solar may cause instability in the grids, could staff comment on the optimal share of wind and solar in energy resources?*

With these remarks, we wish the authorities every success in their policy endeavors.

**Statement by Mr. Trabinski and Mr. Piasecki on Denmark
Executive Board Meeting 22/54
June 13, 2022**

We agree with the staff that Denmark’s fiscal policy should continue to be flexible amidst heightened global uncertainty. Given ample fiscal buffers and low public debt, Denmark has favorable conditions to adapt its fiscal policy to new priorities. The COVID-19 pandemic had a mild effect on Denmark’s economy mostly due to the appropriate policy mix deployed to mitigate the negative consequences of the lockdowns as well as a very successful vaccination campaign. Moreover, Denmark is not strongly exposed to the immediate risks coming from the Russian war in Ukraine and its potential escalation. We commend the authorities for their commitment to fiscal neutrality, with the debt-to-GDP ratio set to drop to 32 percent over the medium term. At the same time, we take note of the need to adapt fiscal policy to new priorities such as military spending, energy transition, and targeted compensation for higher energy prices. *Could staff elaborate on whether the downward trend in public debt could be sustained given increased military and energy transition expenditures.* In addition, we welcome plans to strengthen and unify carbon pricing under the Green Tax Reform (GRT). We note the tradeoff between potential leakage and population tolerance. *Could staff elaborate on the social impact of carbon pricing reforms, and how the authorities intend to communicate the trade-offs to society with a view to secure acceptance?*

We welcome the resilience of the banking sector to recent stress, but structural issues remain and should be addressed with a comprehensive strategy. The risks have grown given the increasing share of risky mortgages, continued strong housing price growth, as well as further growth of the already large financial system, which is highly interconnected through real estate exposures. Moreover, part of household savings is invested in covered bonds, thus exposing them to housing market shocks. We advocate close scrutiny towards the group of highly indebted households. Despite the authorities’ general outlook that households have sufficient buffers to withstand shocks, households with high savings might not be the ones indebted the highest. We concur with staff’s call on tightening borrower-based prudential tools. We also encourage the authorities to follow the staff’s advice to reassess the effectiveness of the macroprudential policy toolbox. Having said that and bearing in mind the vulnerabilities in the Danish financial sector, we encourage the authorities to implement or complete implementation of the FSAP recommendations. A comprehensive review of macroprudential tools seems to be warranted. We encourage the authorities to follow the staff’s advice to reassess the effectiveness of the Dutch macroprudential policy toolbox against international best practices. Having said that and bearing in mind the high vulnerabilities in the Danish financial sector, we encourage the authorities to implement or finish implementing the FSAP recommendations.

**Statement by Mr. Andrianarivelo, Mr. N'Sonde, and Mrs. BoukpeSSI on Denmark
Executive Board Meeting 22/54
June 13, 2022**

We thank staff for the well-written reports and Ms. Marcussen and Mrs. Ogmundsdottir for their informative Buff statement.

The Danish economy has weathered the Covid-19 crisis well, on the account of sound institutional and macroeconomic frameworks, a comprehensive and timely policy response package as well as an effective vaccination campaign. The ongoing recovery is set to continue growing on the back of strong private consumption and investment. Nevertheless, the near-term outlook is uncertain and remains susceptible to spillovers from the war in Ukraine on activity and inflation; increasing commodity prices; protracted pandemic, and underlying vulnerabilities notably in the financial sector and labor market. Against this backdrop, we agree that nimble policies are warranted, and we encourage continuing efforts to further safeguard macro-financial stability, strengthen the labor market and boost productivity to sustain long-term growth.

We broadly concur with staff's policy recommendations and would like to provide the following comments.

The fiscal stance in 2022 and the return to the medium-term objective of zero budget balance by 2025, seem appropriate, although flexibility is necessary given the high level of uncertainty surrounding the outlook. We note the withdrawal of Covid-related measures and the recent energy measures introduced to support vulnerable households. We agree that going forward any supplementary support would need to be well targeted and fiscally neutral. In addition, we concur that automatic stabilizers should operate fully to accommodate shocks when downside risks materialize, and that the fiscal policy should be recalibrated if upside risks occur. We welcome the planned relaxation of the structural deficit limit from ½ percent of potential GDP to 1 percent under the new Budget Law, in compliance with the EU fiscal framework while preserving the overarching objective of budget balance. We note Denmark's ambition to become one of the most climate-friendly countries in the world and welcome the initiatives set up by the authorities, including the Model 2 of the Green Tax Reform (GTR) to meet the country's emissions reduction targets. We agree with staff that a swift decision on carbon pricing is warranted as it would positively impact and foster green investment from the private sector. Incentives financed by the EU RRF grants; the Digitalization Fund; and green bonds; to accelerate green and digital transitions will boost potential growth by increasing productivity and competitiveness.

The Danish banking system is overall sound and resilient, but vulnerabilities in the sector--stemming notably from banks' high interconnectedness, large real estate exposures and possible regional spillovers--remain and need to be closely monitored and addressed. We welcome the indication that the exchange rate peg continues to serve the economy well and note that the authorities remain committed to maintain it despite rising inflationary pressures. We also welcome the tightening of the Countercyclical-Capital Buffer

(CCyB), consistent with the recommendations by the Systemic Risk Council to further strengthen capital buffers. *We note that the authorities see the risks stemming from regional spillovers and the potential fallout from the war in Ukraine as limited and would appreciate staff's further elaboration on this matter.* The newly established Danish Financial Supervisory Authority, as part of the authorities' efforts to strengthen anti-money laundering supervision and enforcement is commendable. We encourage further steps in the implementation of the FATF recommendations.

We strongly encourage the authorities to address macro financial vulnerabilities related to housing market, high household leverage and increased risky mortgages is warranted. In that regard, we share staff's call for enhancing the macroprudential toolkit in line with international best practices, along with advancing measures aimed at improving housing supply, reducing rent controls, and strengthening the tax code.

Tailored structural policies to further boost labor supply, increase productivity and augment investment are key to lift potential growth while ensuring long term macroeconomic sustainability. We commend the authorities for the effective measures under the *flexicurity model*, that have positively supported the labor market and contributed to the ongoing strong recovery. We concur with staff and the authorities that the flexicurity model along with the wage-bargaining framework and further active labor market policies will help mitigate pressures and increase labor supply, especially for the youth, reduce further the gender gap and better integrate migrants into the labor market. Finally, improving access to equity finance for new small, or cutting-edge technology firms, increasing spending in R&D and enhancing institutional framework for competition would improve productivity and promote investment.

With these remarks, we wish the Danish authorities every success in their endeavors.

Statement by Mr. Bhalla and Mr. Goyal on Denmark
Executive Board Meeting 22/54
June 13, 2022

1. We thank Staff for a comprehensive and analytically rich report and Ms. Marcussen and Mrs. Ogmundsdottir for a helpful Buff statement on Denmark.
2. Denmark is one of those countries with the least pandemic incidence, and the economy recovered much faster than its peers. The load of COVID cases was relatively low even before the availability of the vaccines. As the Oxford Stringency Index reveals, Denmark successfully contained the pandemic without resorting to tough restrictions on economic activity. Strong policy support also contributed to faster economic recovery.
3. While the strong policy support has led to a fast economic recovery, a continued accommodating policy stance seems to be causing some concerns about economic stability — sharp movement in real estate prices and rising indebtedness of households adding vulnerability to the financial sector. Similarly, inflation has risen to a record high level.
4. Though inflation has risen sharply due to high energy prices, core inflation has also moved up. The latter appears to be an outcome of excess demand as growth exceeded the pre-pandemic level, and the output gap turned positive in 2021. Even though Denmark enjoys ample fiscal space with a debt ratio of about half the euro benchmark, we welcome authorities' intentions to gear up for fiscal tightening to reduce excess demand and contain inflationary pressures.
5. Accommodating monetary stance, abundant liquidity and low-interest rates have led to a sharp rise in household leverage. Further, the shift to variable interest loans has also added to vulnerabilities. We support Staff suggestion that appropriate macro-prudential norms should be deployed to guard against vulnerabilities and risks associated with real estate price movement. Similarly, the provision of mortgage interest deductibility may need to be lowered.
6. The Staff has assessed a significant downside risk to growth in Denmark due to geopolitical developments in Ukraine. We observe that Denmark's direct exposure to Russia or Ukraine is very limited. While indirect impact can arise due to external euro area demand, in the recent economic rebound, the net contribution of the external sector has been very limited. Further, a large inflow of refugees is expected

from Ukraine. Given that Denmark is battling a labour shortage with employment rising above the pre-pandemic level and soaring wages, how will the inflow of refugees impact Denmark's economy? We welcome Staff comments.

We wish authorities all the success in their future endeavours.

Statement by Ms. Mannathoko and Mr. Ekeocha on Denmark
Executive Board Meeting 22/54
June 13, 2022

We thank staff for the comprehensive set of reports and Ms. Marcussen and Mrs. Ogmundsdottir for their helpful Buff statement. We broadly agree with the staff appraisal and provide the following comments.

After a solid rebound in 2021, growth has slowed due to the Russia-Ukraine war. However it would seem the impact is moderated by Denmark's low reliance on fossil fuel imports and its robust household, corporate and government balance sheets. The economy has remained resilient in the wake of the war. That said, downside risks persist with heightened uncertainty over developments in Europe. Future policies should remain adaptive with a focus on strengthening macro-financial resilience, supporting economic transformation, and boosting higher long-term potential growth.

Fiscal Policy: The fiscal policy stance is appropriate. We support the ongoing withdrawal of exceptional COVID-related measures in 2022, to allow space for war-related spending and to support fiscal sustainability, while allowing some flexibility in the fiscal rule over the next couple of years given the elevated uncertainty and risks. Near-term fiscal consolidation will help ensure low public debt and sustainable public finances. Targeted social support for lower-income households, including immigrants, should help to compensate for rising energy prices and should be carefully tailored to be less distortive, timely, and more efficient. While we commend the authorities on Denmark having one of the lowest debt ratios in the region, looking ahead, we agree that a forward-looking medium-term fiscal framework is necessary in the face of uncertainties, to maintain long-term fiscal sustainability. We agree that social assistance should be fiscally neutral or based on conditional cash transfers. We appreciate staff's SIP Annex 1 elaborating on concerns around current pension reforms, indexation and long-term fiscal sustainability and encourage the authorities to take these into account.

Monetary and Exchange Rate Policies: We agree that the exchange rate peg has served Denmark well, helping to improve trade, reducing risks, and stabilizing prices and the economy. We note that inflation and interest rates remain within narrow spreads relative to the euro zone, and that medium-term euro area inflation expectations are well anchored. Nevertheless, the tight labor market could trigger more sustained inflation if it leads to rapid wage growth. As the Danish central bank rightly regards the exclusive objective of monetary policy as being to maintain the peg, we note it will have to rely on interventions for short-term FX fluctuations and on interest rate adjustments for more persistent external price developments. *The staff report proposes this response should protracted inflation in the euro area potentially trigger ECB policy tightening. Could staff also elaborate on their expectations in the case of domestic inflationary pressures from rapid wage growth?*

Financial Sector Policy: The Danish banking system remains capitalized, liquid, and profitable; however, vigilance is warranted as are measures to further enhance the resilience of the financial system. The acceleration in house and equity prices amid high household debt is a concern necessitating close monitoring and timely measures to reduce macroeconomic and financial stability risks going forward. With the real possibility of a

tightening of global financial conditions, if this triggers a house price correction, we agree with staff that the adverse impacts could be significant, extending beyond the banking sector to the non-bank financial sector as well. This in turn would stifle the strong demand supporting the recovery. We encourage a coordinated policy response to strengthen financial resilience while closely monitoring macro-financial vulnerabilities in the housing market and other sectors. We welcome the authorities' decision to increase the countercyclical buffer to 2.5 percent, and like staff we urge the authorities to consider the use of a sectoral systemic-risk-buffer, with additional capital charges for specific risks such as mortgage loans with debt-to-income limits above a specified threshold. This would help to strengthen buffers against adverse real estate shocks.

We commend the authorities' broad implementation of staffs' 2019 AML/CFT recommendations and like staff, encourage developing a risk-based prudential framework using the credit registry, and expanding AML/CFT measures in accordance with FATF 2021, including strengthening the AML/CFT regulatory framework for virtual asset providers. We welcome the Danish Financial Supervisory Authority's new institutional risk assessment model and supervisory strategy.

Structural Reforms: In the labor market, we encourage targeting young, low-skilled, and foreign-born workers to improve labor supply and reduce upward pressure on wages and prices. In view of weak recruiting data, integrating Ukrainian and other migrants, and providing resources to improve their skills, could help address skilled labor demand. Labor market flexibility and reskilling policies should also aim to boost private investment. Strategies should seek to optimize benefits from digital transformation, with broadened access to technologies and lower barriers to digital trade, alongside access to finance, being used to support the growth of new firms.

We applaud Denmark's successful transition out of fossil fuels with an energy sector that is now dominated by renewables. We encourage the Danish authorities to build on this by continuing to reduce greenhouse gas emissions in industry and sustaining efforts to meet their goal of entirely phasing out the use of natural gas by 2030. Medium-term public investment should seek to enhance productivity and facilitate a shift in output toward higher-value-added industries. The emergence of higher real wage paying firms will increase the average real wage, and help to reduce the savings-investment gap while enhancing long-term growth.

**Statement by Rasmus Rueffer (ECB Representative) and Dimitrios Rakitzis (Advisor) on
Denmark – 2022 Article IV Consultation**

IMF Executive Board Meeting

13 June 2022

We would like to thank Mrs. Marcussen and Mrs. Ogmundsdottir for the informative Buff statement, and Staff for their balanced Report. We broadly agree with Staff and share many of the main findings, in particular those related to the challenges facing the Danish economy and priorities ahead. We associate ourselves with the statement of Mr. Buissé and would also like to highlight the following items for emphasis.

We broadly share Staff's assessment of the macroeconomic outlook in Denmark. Underpinned by sound macroeconomic policies and a favourable business climate, the Danish economy weathered the COVID-19 crisis particularly well and the economy grew by 4.7% in 2021 driven by a strong rebound in domestic demand and exports. Economic activity has been also supported by a strong performance of the labour market. The rapid recovery after the crisis was accompanied by a sharp increase in employment over a short period, thus resulting in growing labour shortages. Uncertainty remains high due to the war in Ukraine, with risks tilted to the downside.

We concur with Staff that the risks to the inflation outlook are tilted to the upside, clouding the economic prospects. The war in Ukraine generated additional inflationary pressures through higher energy and commodity prices. Recent developments have confirmed a further rise in inflation in Denmark and broadening inflationary pressures. Inflation could further increase in the coming months, driven mainly by higher commodity prices, broadening price pressures and a further aggravation of supply bottlenecks resulting from the war. Overall, risks to the inflation outlook are tilted to the upside as inflationary pressures stemming from the war could last longer than previously expected and trigger an upward shift in wage growth and inflation expectations.

We broadly share Staff's assessment regarding the planned fiscal policy stance, which should maintain scope for flexibility given the uncertain outlook. The planned fiscal stance in 2022 is expected to appropriately dampen aggregate demand, while the broadly neutral stance in the medium term would help protect buffers. Fiscal policy should remain nimble until the recovery is well established, amid the still high level of uncertainty (related to the pandemic and the war in Ukraine). Regarding the review of the Budget Law, we note the intended relaxation of the annual structural deficit limit from ½% of potential GDP to 1%, which the Danish Parliament is discussing and Staff welcomes. With this reform, Danish public finances would remain overall sound while the new deficit limit would be overall in line with the Fiscal Compact. Still, it remains desirable that fiscal policies maintain efforts to improve the composition of spending to respond to the long-term priorities related to demographic headwinds, public investment and defence.

We welcome the selected issues paper on the Danish current account and broadly support the structural policy recommendations put forward by Staff. We concur in particular with Staff's view on

the need to raise investment, including climate and digital-related, by supporting broad-based innovation, enhancing the institutional framework for competition and improving the capital market, including trough tax reforms. As mentioned in the Staff report, this would help to boost productivity and enhance potential output as well as to reduce the large current account surplus in Denmark.

We share Staff's assessment that the banking system weathered the pandemic well and remains profitable, liquid, and well capitalized, and note that while systemic risk is low, financial sector vulnerabilities remain. Stress tests undertaken by the Danish authorities as well as EU-wide exercises show that both systemic and non-systemic banks can withstand losses in a severe recession scenario without breaching their combined buffer requirements. Yet, as mentioned in the Staff Report, macro-financial vulnerabilities persist due to high leverage and an increasing share of risky mortgages. In the same vein, in its last Financial Stability report (second half 2021), Danmarks Nationalbank stressed that credit institutions have granted more housing loans to highly indebted homeowners in 2021 and high loan-to-value ratios may cause vulnerabilities in the financial sector to a subsequent fall in house prices.

Against this background, and despite the authorities' actions to tackle the build-up of risks in the housing market, high household indebtedness amid elevated house valuations remains a macro-financial vulnerability and a key source of concern. The recommendations made in the 2019 Article IV Staff Report have been largely addressed and the government followed the recommendation by the Systemic Risk Council (SRC) to raise the Countercyclical Capital Buffer (CCyB) to 2.5%. Yet, macro-financial vulnerabilities persist. Residential property prices surged in the second half of 2021, reaching double digit growth, and continued to increase strongly through the beginning of 2022. As Staff note, these developments warrant close monitoring of the housing market and alertness with a view towards potential further policy actions.

Denmark - 2022 Article IV Consultation

Responses to Technical Questions Posed by Executive Directors in Advance of
EBM/22/54—June 13, 2022

Staff's responses to technical and factual questions are below. Broader policy questions on the near-term outlook will be addressed in staff's intervention at the Board meeting.

Outlook and Risks

1. Given EU conversations around an import and insurance ban on seaborne Russian oil and Gazprom cutoffs of natural gas to European customers including Denmark's Ørsted, does staff believe the baseline and/or adverse forecasts should be downgraded further?

There is no gas pipeline directly from Russia to Denmark; Denmark gets most of the gas via Germany. According to the Danish Energy Agency, Danish buyers have the option of buying from sources other than Gazprom. Ørsted expects this to be possible. Natural gas constitutes only about 14 percent of Denmark's energy supplies and only 4 percent of its electricity generation. For near-term energy security, the authorities are planning to reactivate existing gas fields in the North Sea to temporarily increase gas production.

Denmark imports about 15 percent of its oil and petroleum products from Russia (smaller share than many countries in Europe). Oil dependency (net oil imports as share of gross oil consumption) in Denmark is lower than many European countries; oil constitutes only about 1 percent of electricity generation. According to the [IEA](#), Denmark's emergency oil stocks can last 473 days of net oil imports which is well above the minimum of 90 days obligated by the Agreement on International Energy Programme. The sanctions on seaborne Russian oil have a phase-in period—the sanctions will ban seaborne imports of Russian crude oil as of December and ban petroleum product imports as of February next year. At this point, it is hard to precisely pin down the impact on Europe—especially during the interim—as this depends on where Europe goes to replace Russian oil (United States, West Africa, Middle East are possible alternatives).

Taken together, at this point, staff do not see a material impact on the baseline and the adverse scenario, especially for 2022. But the situation remains very fluid. Staff will continue to monitor and adjust the projections accordingly.

2. Given the tight labor market and 'inflation surging to a historic high', what does this imply for nominal wage growth over the period to come?

The tight labor market along with high inflation in the conjuncture will entail some increase in nominal wage growth in 2022 (relative to 2021). But still, staff project nominal

wage growth (close to 4 percent) to fall behind inflation in 2022 (close to 5 percent). Over the medium term, staff project nominal wage growth to be in line with productivity.

Housing Market

- 3. Can staff elaborate further on non-distortive measures to deal with affordability issues for first-time homebuyers? Are there any recent signs of cooling down of the housing markets?**

The proposed risk-based prudential framework should facilitate calibration of buyer-based measures to account for risk differentiation across groups. As first-time home buyers tend to exhibit lower risk, buyer-based measures could be consistently relaxed for this group and improve affordability. Policy measures aimed at improving supply would further improve affordability. While still elevated, average house price growth in the whole country as well as in Copenhagen seems to be receding from its peak in 2021 in the recent months.

- 4. Despite the measures implemented in past years to limit interest-only and floating-rate mortgages to highly indebted households, staff's report shows a higher preference for riskier mortgage products more recently. Could staff comment on the potential reasons for this behavior and the type of households affected?**
- 5. We would appreciate staff's views on the reasons why risky mortgages grew in past years despite measures aimed at limiting lending to highly indebted households.**

The shift towards variable mortgages can to an extent be explained by the steepening of the yield curve (increasing the spread between long and short-term mortgage rates). This prompted more borrowers to choose cheaper short-term, variable-rate loans. Half of new loans by MCIs to highly indebted homeowners were with deferred amortization in 2021:Q3. The increase in these loans is particularly widespread among homeowners who refinance or modify their loans.

Fiscal Policy

- 6. We note the review of the Budget Law which could lead to relaxing the medium-term objective, as allowed by the Fiscal Compact, and would welcome additional details on whether the pace of convergence to the target would also be less stringent.**

So far, staff have not received any information whether the review of the Budget Law would lead to a relaxation of the medium-term objective. The current medium-term objective is a zero structural balance in 2025. The authorities have not yet announced the medium-term objective for 2030.

- 7. Could staff elaborate on whether the downward trend in public debt could be sustained given increased military and energy transition expenditures?**

Denmark plans to increase defense spending to 2 percent by 2033. Based on the Ministry of Defense, defense spending in 2022 is estimated around 1 percent (and around 1 percent during 2023-25). The details (timeline, composition) of higher defense spending plans are not yet available. For now, staff assume defense spending would increase gradually over 2022-2033 reaching the 2 percent target by 2033. During the projection horizon (2022-2027), this entails a small incremental increase to defense spending (as share of GDP). This is consistent with a flat debt-GDP ratio around the end of the projection horizon, little above 30 percent of GDP (much lower than the EU threshold of 60 percent).

Regarding energy transition, the key policy is the Green Tax Reform which will be phased in after 2025. There is a role for spending—related to subsidies and green investment. But the centerpiece of this reform is a higher and more uniform carbon pricing, the tax revenues from which will contribute towards funding the spending. While final details are not yet available (the reform is still being negotiated), the fact that it will be phased in after 2025 and that carbon pricing is the centerpiece (rather than spending) should entail no large impact on debt-GDP ratio during the projection horizon.

Climate Policies

8. In this regard, does the war in Ukraine bring near-term challenges to Denmark's climate policies?

The war has fast tracked the phasing out of natural gas to be independent from Russian imports as well as expanding renewable energy from wind and solar as announced under *Denmark Can Do More II*. Denmark is also moving ahead with planned increase in energy excises during 2023-25 (*Phase 1 of Green Tax Reform*). For the next phase of the Green Tax Reform (after 2025), the government has put in a concrete proposal for higher and more uniform carbon prices.

For near-term, however, to ensure energy security, the authorities are planning to reactivate existing gas fields in the North Sea to temporarily increase gas production to also supply gas to European states. However, their long-term goal to phase out all gas and oil production in the North Sea by 2050 remains.

9. Could staff elaborate on the social impact of carbon pricing reforms, and how the authorities intend to communicate the trade-offs to society with a view to secure acceptance?

The government has put forward a concrete proposal for the Green Tax Reform to be phased in after 2025. Carbon pricing—higher and more uniform carbon prices—remains the centerpiece which, staff highlight, is the most efficient mechanism to reduce emissions from an economic standpoint. That said, the proposal includes additional support of DKK 7 billion (4 billion for adjustment support including reserve for hard-hit companies to address carbon leakages and 3 billion for carbon capture and storage (CCS). The authorities have also indicated a just transition that address vulnerable groups would be part of the package (the Green Tax Reform is still being negotiated). All

in all, with these measures, the authorities seek to make the proposed reform more acceptable to the society.

10. We would like to know if those carbon price targets are consistent across the EU, and if price differences exist, would there be a carbon border adjustment mechanism between EU countries?

The proposed green tax reform implies a carbon tax at 100 euro per ton of CO₂ for sectors not covered by the EU Emissions Trading Scheme (ETS), 150 euro in total (including ETS price) for sectors covered and 113 euro for mineralogical processes where risks of leakage are higher. This would put carbon prices in Denmark above *current* carbon prices in many peer European countries.¹ The proposed carbon price in Denmark would be in the range of carbon price *targets* in select European countries for which such information is available. For instance, France, Germany, and Italy target USD 140 (EUR 133 at today's exchange rate) for the power and industry by 2030.²

The proposed EU Border Carbon Adjustment (BCA) is the relevant mechanism for Denmark (and other EU countries). It is designed to complement the EU ETS by placing a carbon price on certain imports into the EU from non-EU countries that do not tax carbon at an EU-approved level. So this would reduce emissions outside the EU. The proposed EU BCA is expected to come into effect in 2026. For details, see [European Commission \(2021\)](#).

11. Given the fluctuations in the supply of wind and solar may cause instability in the grids, could staff comment on the optimal share of wind and solar in energy resources?

A sizable portion (about 50 percent in 2020) of electricity consumed by the Danish power sector comes from variable renewable energy (VRE) sources. At the same time, Denmark maintains a world-class security of supply—the 10-year average of security for power availability is close to 100 percent ([Danish Energy Agency](#)). A key driver for flexibility is the electricity market. The market design—such as an intra-day market and hourly electricity price—plays a key role in cost-effectively unlocking flexibility. Furthermore, Denmark's participation in the Nordic power exchange Nord Pool facilitates cross-border trading with neighboring countries providing an important source of flexibility. Going forward, the focus is generally shifting towards increased sector coupling and demand-side flexibility through new technologies, innovative use of existing technologies, digitalization and data-driven business models. This should support Denmark's goal of 100 percent renewable power system by 2030.

¹ Black, Simon, Ian Parry, and Karlygash Zhunussova "Carbon Taxes or Emissions Trading Systems? Instrument Choice and Design" Staff Climate Note, forthcoming.

² Black, Simon, Danielle Minnett, Ian Parry, James Roaf, and Karlygash Zhunussova. "The Carbon Price Equivalence of Climate Mitigation Policies." Working paper, International Monetary Fund, Washington, DC, forthcoming.

- 12. We welcome staff’s focus on climate policies but would have appreciated better targeted and more in-depth policy advice. First, the reference to the ‘Climate Change Performance Index’ seems misleading given that the Fund’s policy advice is about the policies to reach the climate objectives and not about the ambitiousness of the objectives themselves. Still, we praise Denmark for its leading position in terms of climate policies and would welcome the introduction of carbon taxation proposals and welcome the policies set in place to further close the emission reduction shortfall, as outlined in the Buff statement. Second, with a large coastal line and multiple islands, adaptation policies are important but there’s no coverage of an adaptation policy in the report. Third, we note that many countries are given similar advice in terms of introducing a system of feebates. Though this might be valuable policy advice we hope that the increased staff resources will allow for more granular policy advice in the area of climate mitigation.**

Climate Change Performance Index measures both policy objectives and actual emissions. Policy objectives account for 20% of the ranking while 80% of the ranking is driven by actual data on GHG emissions (40%), renewable energy (20%) and energy use (20%). Hence the index does indicate not only the ambitiousness of the target but the actual actions that impact the environment. While Denmark is leading the CCP Index, staff encourages policies to continue the green transformation. Therefore, staff highlights that “investment needs for climate mitigation **and adaptation** are significant” and that public and foremost private investments must shift to meet these needs.

Given that Denmark is one of the few countries that is moving ahead with explicit policies to address mitigation our analysis has mainly focused on this aspect. Please also see last year’s [staff report](#) and IMF working paper “Climate Mitigation Policy in Denmark: A Prototype for Other Countries” [here](#). However, adaptation is a topic to be covered in future consultations.

While adaptation has not be yet a focal point of our analysis, we already looked at some aspects of it. For instance, we mention investments needs for adaptation in the staff report.

- 13. We positively note that Denmark is performing well in the EU’s digital and climate change objectives, and would welcome staff’s assessment on the Rescue and Resilience Plan, with regards to meeting national climate change and energy policy objectives.**

Denmark is expected to receive about 1½ billion euros (½ percent of 2021 GDP) in EU RRF grants by 2026 (European Commission 2021). Around 59 and 25 percent of these funds are planned for the green and digital transitions respectively. The EC’s assessment of Denmark’s RRF plan is that the measures would accelerate green and digital transitions and also boost potential growth by increasing productivity and competitiveness (European Commission 2021).

Additionally, green bonds worth 5 billion DKK were issued by the DN in January 2022, and a total of 15 billion DKK is planned for this year. From Digitalization Fund, 125 million DKK is reserved per year.

Policy Mix

- 14. According to staff, the exchange rate peg has served Denmark well, providing a framework for low and stable inflation in the country.** At the same time, with rising inflationary pressures and the risk of de-anchoring inflation expectations in the euro area, could staff elaborate on an appropriate policy mix to contain a potentially protracted inflation in Denmark?

The exchange rate peg has historically served Denmark well. Hence staff underscores the need to keep the exchange rate policy nimble to policy tightening in the Euro Area and potentially diverging price pressures.

Therefore, the DN should continue to use interventions for short-term FX fluctuations and interest rate adjustments for more persistent movements, such as protracted inflation in the euro area. Moreover, the ECB recently started its tightening cycle, which will help to keep inflation expectations anchored in the euro area. In sum, staff therefore believes that the exchange rate peg continues to provide an adequate framework.

Given the baseline cyclical position—positive output gap, labor shortages, and inflationary pressures—the planned fiscal tightening—by unwinding pandemic-related measures—is appropriate. However, if the recovery wavers, fiscal space should be deployed as needed. If upside risks materialize, the authorities should stand ready to tighten further.

Financial Stability and Macroprudential Policies

- 15. We see a case for proactively addressing the vulnerabilities related to the increasing share of risky variable-rate mortgages, as financing conditions have already started to tighten alongside monetary policy, and would welcome staff's views on gaps in borrower-based measures, including in access to mortgages for highly leveraged borrowers.**

As valuation-based measures can be less binding when housing prices appreciate rapidly, the limits applying to "highly-leveraged" borrowers should become binding if either DTI or loan-to-value (LTV) limit is breached, instead of the current joint requirement. Based on borrowers' riskiness, differentiated limits on income-based measures and LTVs for interest-only and floating-rate mortgages should also be considered. Debt-service-to-income (DSTI) caps should be considered to protect against liquidity shocks. The proposed risk-based prudential framework should facilitate calibration of these measures, to account for risk differentiation across groups, e.g., first-time home buyers to improve affordability. National legislation should include borrower-based tools (limits on LTVs, DTIs, and DSTIs) in the policy toolkit

16. Could staff further elaborate on the pros and cons of an independent macroprudential authority vs. decision-making power lying fully with the government?

It is international best practice to provide independent authorities with a legal mandate to implement macroprudential policy to limit risks of inaction bias and/or political considerations (not related to financial stability) influencing macroprudential policy decisions.

According to the [Staff Guidance Note on Macroprudential Policy](#) (paragraphs 79, 80 and 82) “dominant role of the MoF risks delaying macroprudential action and can compromise the independence of participating agencies, including the central bank and separate supervisory agencies. Some of these risks can be countered by assigning the central bank the chairmanship on a macroprudential committee, a strong voice or a veto over policy decisions.

To strengthen ‘willingness to act,’ it is important that the macroprudential mandate is assigned to a body or a committee. Collective action problems can lead to underinvestment in systemic risk identification and mitigation across agencies and reduce accountability. It is desirable for the central bank to play an important role in macroprudential policy. This can harness the expertise of the central bank in systemic risk identification, its incentives to ensure macroprudential policy is pursued effectively, and foster policy coordination between macroprudential and monetary policy while preserving the independent pursuit of the latter. It can finally help shield macroprudential policymaking from political interference that can slow the deployment of tools or bias their use toward other objectives.”

17. We note that the authorities see the risks stemming from regional spillovers and the potential fallout from the war in Ukraine as limited and would appreciate staff’s further elaboration on this matter.

The authorities pointed to the limited direct regional balance sheet exposures (as well as limited trade and commodity markets) in particular to Russia and Ukraine, and to the strong balance sheets of local banks in general. However, staff is of the view that risks could still stem from shocks transmitted through other channels than direct balance sheet interlinkages, such as broad shifts in sentiment or asset prices.

Labor Market

18. Could staff provide an update on the number of refugees and identify any potential stress points associated with this inflow?

19. Given that Denmark is battling a labor shortage with employment rising above the pre-pandemic level and soaring wages, how will the inflow of refugees impact Denmark's economy? We welcome Staff comments.

As of June 8, 2022, the authorities received 28,243 applications from Ukraine refugees under the Special Act. Overall, the authorities are expecting to receive about 50,000 Ukrainian refugees. They are still in the process of being incorporated into the labor force ;

some one-fifth of the total refugees arrived are expected to be employed. This inflow into the labor market should help ease labor market pressures. Fiscal measures to support this inflow are estimated less than 0.1 percent of GDP in 2022 (this amount is expected to decline over the medium term).

No stress points were discussed with the authorities as the number of refugees is relatively low compared to other countries and given ample fiscal space to accommodate these refugees. However, potential areas that could prove difficult to provide over the short term due to supply constraints—as in other countries—could be the supply of social housing and day care support for children.

20. In this context, we welcome staff comments on how the program has improved the employment prospects of refugees who have enrolled in it, such as the percentage of participants who have received a job offer after the program.

The government, the labor unions and the employer association deem the program successful in integrating refugees into the Danish labor market and have therefore extended it several times. Since the programs inauguration in 2016 more than 2800 refugees have participated in the program. As of April 2022, more than 4,300 18-64-year-old refugees and family reunified refugees are included in the gross target group for program under the Integration Act according to the Danish Ministry of Integration. As of the 1st quarter in 2022, 42 percent of the 21-64-year-old refugees and family reunified refugees with 3 years' residence in Denmark are registered in paid employment.

External Sector

21. We would have appreciated a more detailed analysis in the SIP on the main drivers—including tax incentives— of the large share of merchanting activities. Staff's comments are welcome.

Data limitations and lack of disclosures complicate the estimation of the effect of merchanting on the current account. However, merchanting activities are indeed an important part of Denmark's large current account surplus. Merchanting activities seem related to the top Danish multinational companies which the SIP highlights as a possible driver of Denmark's large current account surplus. The underlying mechanisms, however, remain unclear without detailed data. On one hand, this could be related to actual optimization strategies that impact these companies' saving and investment patterns (possibly reflected in large merchanting and processing). However, more data on the ownership structure and savings behavior of these entities are necessary for a fuller investigation. Analyses in this round of the AIV consultation were constrained by data availability issues and staff highlight this as an important avenue for future work.

22. Given that there might also be statistical explanations, did staff apply the RE bias tool that was approved by the Board in March to determine the share of domestic corporate savings (or undistributed profit) attributed to foreign portfolio investors?

Yes, in collaboration with RES, staff estimated in the SIP the portfolio equity retained earning bias (RE). However, the results for the RE bias are quantitatively smaller than the inflation bias and don't show a clear trend. On one hand, the stock approach generally points to CA balance understatement, consistent with Denmark's position as a net creditor on portfolio equity (implying more missing income credits than debits). On the other hand, the corporate saving approach points to CA balance overstatement over the past decade, given high corporate saving in Denmark. This is related to the issue of obtaining more data on corporate sector ownership and saving (as mentioned above in response to the question on merchanting) as this would help address this discrepancy.

23. We see merits in the planned increase in public investment to reduce the S-I gap, and staff comments on the institutional designs and effectiveness of public investment, as well as the relative contributions of public and private investment to growth, would be appreciated.

The public investment framework seems to be effective as public investment tends to have a large multiplier (above one) and is expected to crowd-in private investment. Furthermore, the multiplier from public investment tends to be larger when the infrastructure quality is better which is true in the case of Denmark (relative to other countries).

In 2021, gross domestic investment constituted 23.3 percent of GDP and public investment constituted about 3.3 percent of GDP. Both total investment and public investment is projected to increase to 24.7 and 3.6 percent respectively by 2027. Potential growth analysis from last year's staff report suggests that increased investment to boost productivity as well as adequate labor supply could raise potential growth by 1.8 percent in the medium term.

CONSTITUENCY CODES

OEDAE

Angola, Botswana, Burundi, Eritrea, Eswatini, Ethiopia, The Gambia, Kenya, Lesotho, Liberia, Malawi, Mozambique, Namibia, Nigeria, Sierra Leone, Somalia, South Africa, South Sudan, Sudan, Tanzania, Uganda, Zambia, and Zimbabwe

OEDAF

Benin, Burkina Faso, Cameroon, Central African Republic, Chad, Comoros, Democratic Republic of Congo, Republic of Congo, Côte d'Ivoire, Djibouti, Equatorial Guinea, Gabon, Guinea, Guinea Bissau, Madagascar, Mali, Mauritania, Mauritius, Niger, Rwanda, São Tomé & Príncipe, Senegal, Togo

OEDAG

Argentina, Bolivia, Chile, Paraguay, Peru, and Uruguay

OEDAP

Australia, Kiribati, Korea, Marshall Islands, Federated States of Micronesia, Mongolia, Nauru, New Zealand, Palau, Papua New Guinea, Samoa, Seychelles, Solomon Islands, Tuvalu, and Vanuatu

OEDBR

Brazil, Cabo Verde, Dominican Republic, Ecuador, Guyana, Haiti, Nicaragua, Panama, Suriname, Timor-Leste, and Trinidad and Tobago

OEDCC

China

OEDCE

Colombia, Costa Rica, El Salvador, Guatemala, Honduras, Mexico, and Spain

OEDCO

Antigua and Barbuda, The Bahamas, Barbados, Belize, Canada, Dominica, Grenada, Ireland, Jamaica, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines

OEDEC

Austria, Belarus, Czech Republic, Hungary, Kosovo, Slovak Republic, Slovenia, and Turkey

OEDFF

France

OEDGR

Germany

OEDIN

Bangladesh, Bhutan, India, and Sri Lanka

OEDIT

Albania, Greece, Italy, Malta, Portugal, and San Marino

OEDJA

Japan

OEDMD

Afghanistan, Algeria, Ghana, Islamic Republic of Iran, Libya, Morocco, Pakistan, and Tunisia

OEDMI

Bahrain, Egypt, Iraq, Jordan, Kuwait, Lebanon, Maldives, Oman, Qatar, United Arab Emirates, and Yemen

OEDNE

Andorra, Armenia, Belgium, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, Georgia, Israel, Luxembourg, Moldova, Montenegro, Netherlands, Republic of North Macedonia, Romania, and Ukraine

OEDNO

Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway, and Sweden

OEDRU

Russian Federation and Syrian Arab Republic

OEDSA

Saudi Arabia

OEDST

Brunei Darussalam, Cambodia, Fiji, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Nepal, Philippines, Singapore, Thailand, Tonga, and Vietnam

OEDSZ

Azerbaijan, Kazakhstan, Kyrgyz Republic, Poland, Serbia, Switzerland, Tajikistan, Turkmenistan, and Uzbekistan

OEDUK

United Kingdom

OEDUS

United States