19 April 2018

Flash Comment Denmark

Cut in electricity taxes could weigh on inflation for years

- **The government is likely to propose a large cut in electricity taxes going into negotiations on a new energy settlement this spring.**
- **The implications could be significant and pull Danish CPI inflation down for years to come.**
- **We stick to our forecast of 0.6 percent this year and 1.3 percent in 2019 for now but risks are skewed to the downside.**

The outlook for a pickup in Danish inflation has deteriorated significantly in recent months as inflation has fallen sharply from 1.6 percent in September to 0.5 percent in March. Now, the probability that inflation will remain below one percent going into next year has increased. The reason is the upcoming energy settlement, which could end up with a large electricity tax cut.

Danish electricity taxes are the highest in Europe, currently making up about 40 percent of the total electricity price, which should be seen in relation to 0-20 percent in other EU countries. In addition, the taxation of electricity is significantly higher than on alternative heat sources such as natural gas and fuel, which makes it less attractive to change an existing oil burner for a more climate friendly heat pump running on electricity. That makes it politically attractive to cut electricity taxes in order to meet future energy political targets.

What is the magnitude of this?

A new analysis from the Ministry of Taxation finds a 40-50 percent self-financing degree of an electricity tax cut, which makes it relatively cheap. The Minister of Taxation has said the government's proposal for an energy settlement will include a significant decrease in the electricity tax. As electricity comprises 2.6 percent of the Danish CPI, such a decrease would likely have a significant impact on inflation. The tax currently amounts to DKK0.914 per kWh and a cut by DKK0.20 would imply a decrease in CPI inflation of about 0.23 percentage points. If the tax is decreased further to 20 percent, more in tune with the rest of Europe, it would imply a decrease in inflation of up to 0.66 percentage points. Most likely, we would see a gradual fading in of the new taxation like the praxis for the phasing out of the Public Service Obligation tax. That would mean we could see a period of five years with electricity prices weighing on inflation, of course the longer period the less each year.

How likely is it?

We know the government is keen to make a big electricity tax cut. Statements from the other parties' energy spokespersons so far indicate a willingness to support this, although several opposition parties are more focused on cutting taxes with a larger impact for CO2 admissions, such as the transportation sector, which would not impact CPI. We know the government prefers a broad-based settlement and this speaks in favour of a tax cut in the DKK0.20 per kWh ballpark.

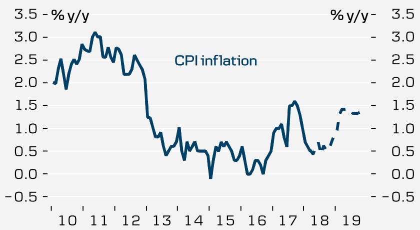
For now, we stick to our forecast of 0.6 percent this year and 1.3 percent in 2019 but risks are skewed to the downside for next year.

Scenarios for cut in electricity taxes

	Current (March)	DKK0.20 cut	20% tax
Tax, DKK/kWh	0.914	0.714	0.337
Tax, %	40.4	34.7	20.0
Total price, DKK/kWh	2.26	2.06	1.68
CPI decrease, %		-8.8	-25.5
CPI impact, %-points		-0.23	-0.66

Source: Statistics Denmark, Danske Bank

We stick to our forecast but risk of more muted inflation outlook has increased



Source: Statistics Denmark, Macrobond Financial, Danske Bank

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This research report has been prepared by Danske Bank A/S ('Danske Bank'). The author of this research report is Bjørn Tangaa Sillemann, Analyst.

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