

Something Rotten In Denmark

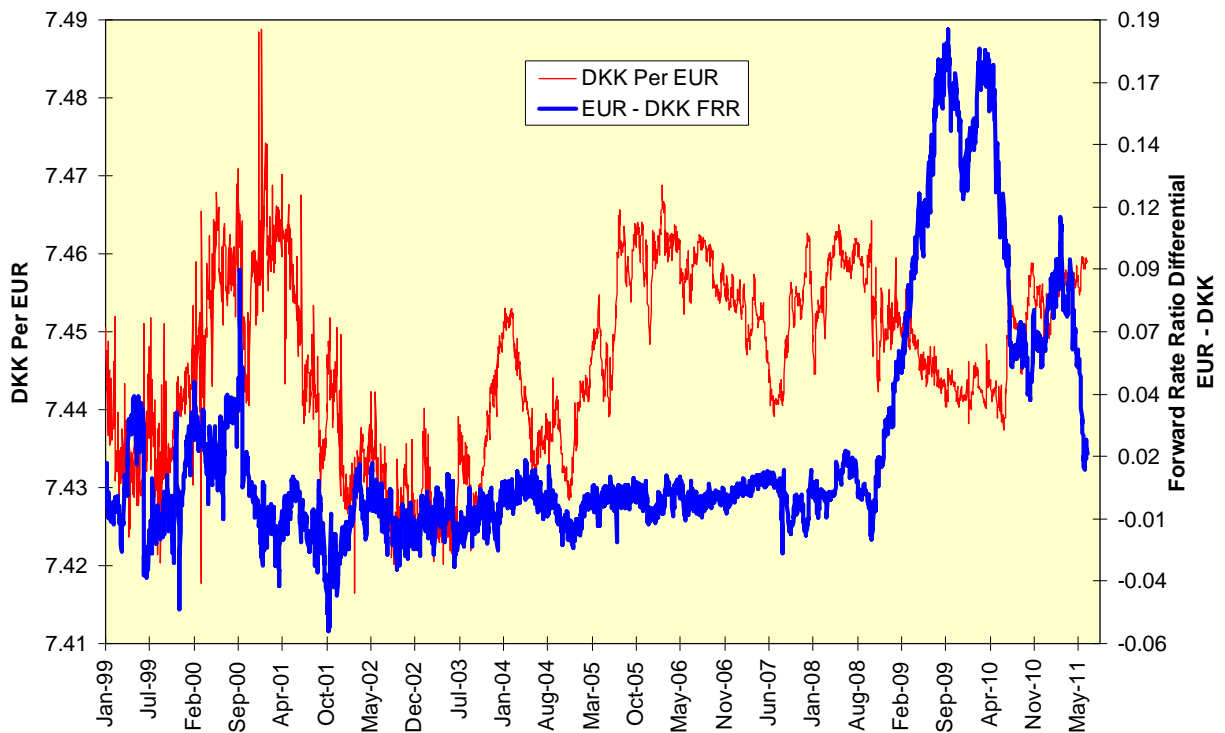
The story goes the Häagen-Dazs was a trade name created in 1961 simply to look like a Danish word; the idea was nobody held the Danes in low regard. Little did the founders know that by 2006 the Danish flag would be burned in various Islamic communities in protest of cartoons depicting Mohamed unfavorably. I do remember wondering at the time from whence all those Danish flags came; I would not be able to produce one myself in short order.

The Danish citizenry, much to the chagrin of the Danish elites, did not vote in favor of the Maastricht Treaty and therefore continue to use the Danish krone (DKK) and not the euro. Democracy can be a messy thing when you are trying to run an enlightened society, so the Danish government and central bank did the next best thing and pegged the DKK to the euro. Neither the Norwegians nor the Swedes gave up their currencies, either, but neither country pegged their krone or krona, respectively, to the euro.

Board Games

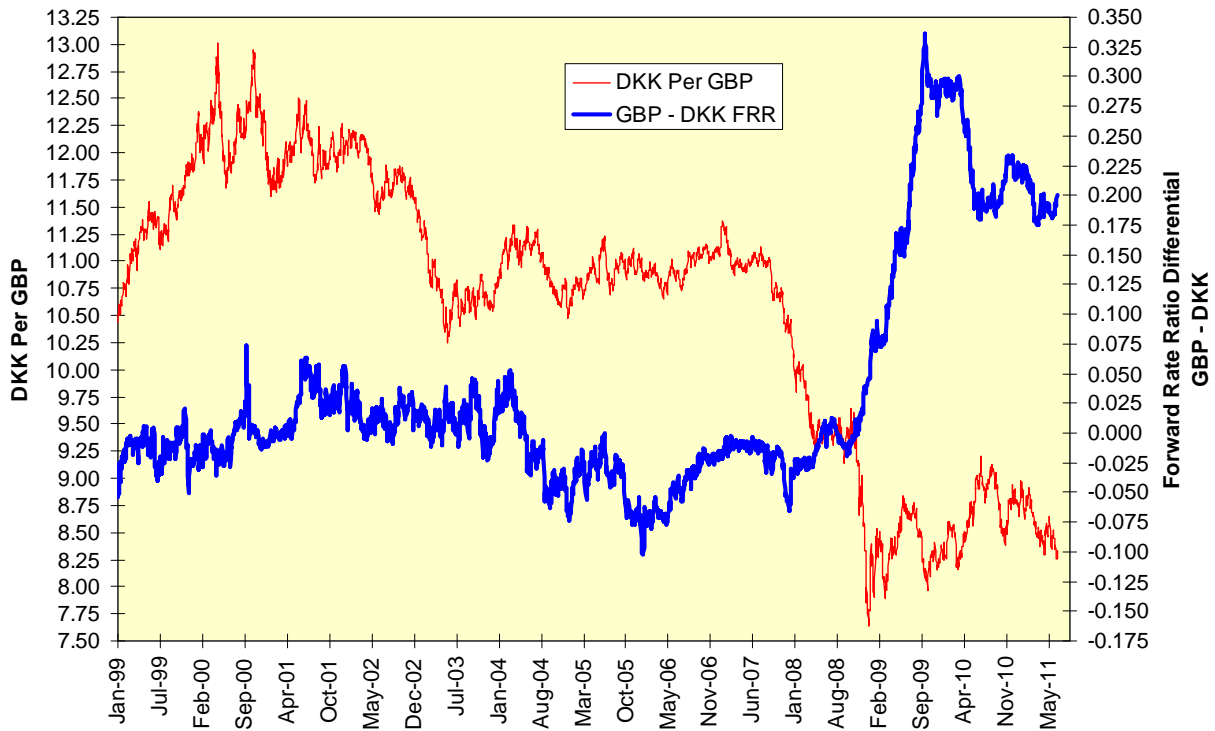
When you peg a currency, you as the peggee have to import the monetary policy of the peggor, if I may create two neologisms in one sentence. This can spell disaster as countries such as Argentina and Bulgaria have discovered. The Danes have done a good job of maintaining their peg to the EUR, but as the European Central Bank raises its interest rates to fight inflation (and, I might add, squish the Eurozone's periphery to benefit its core) Denmark has to follow suit. We can see how the expected interest rate differential between the Eurozone and Denmark as measured by the forward rate ratios from six to nine months ($FRR_{6,9}$) has pancaked lower in recent months. The $FRR_{6,9}$ is the rate at which we can lock in borrowing for three months starting six months from now, divided by the nine-month rate itself.

Differential Interest Rate Expectations Between EUR And DKK



A different situation exists in comparing Denmark to the U.K. Here the British are acting like Americans and Japanese in trying to solve everything by loading money into a helicopter and dropping it hither and yon just to see what happens. As a result, the DKK is strengthening against the GBP.

Differential Interest Rate Expectations Between GBP And DKK



Denmark's economy is struggling; real GDP declined 0.1% in the first quarter from the fourth quarter, and their housing situation, while not as bad as Nevada's, is pretty bad. Will Denmark keep following the Eurozone in raising rates or will it decide an interest rate penalty to preserve a completely arbitrary currency exchange rate makes no sense?

I will go with the latter; a similar bet in 1992 allowed George Soros to break the Bank of England. What do we learn from history? That people do not learn from history, that is what.