

Rating Action: Moody's downgrades issuer rating of Faroe Islands to Aa3; negative outlook

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London, 18 April 2011 -- Moody's Investors Service has today downgraded the long-term issuer rating of the Faroe Islands to Aa3 from Aa2, and has changed the outlook to negative from stable.

RATINGS RATIONALE

"Today's rating action reflects the challenges that the Government of the Faroe Islands is facing in rebalancing its long-term finances in what remains a difficult economy and a challenging global financial environment," says Thomas Amenta, Senior Vice President in Moody's Sub-sovereign Group.

"Historically, the Faroese government has been able to close large deficits and address structural changes in its economy within short timeframes. The current five-year deficit plan lacks definition on the key steps that must be taken, and political consensus has not coalesced around a core set of solutions. This exposes government finances to a longer period of uncertainty and is negative for the credit," adds Mr Amenta.

The deficit reduction plan (approved by the Faroese Parliament) projects deficits till 2015, financed through a moderate increase of the stock of debt. Moody's cautions that even if the government achieves lower deficits than expected, there is no strong political impetus to shorten the budget rebalancing period.

The debt of the Faroe Islands is projected to increase, albeit starting from a moderate level. Moody's notes that while the refinancing risk of outstanding debt appears manageable -- as reserves are sufficient to pay down near-term maturing debt -- and the fundamentals of the economy and government finances easily support interest payments, the Faroe Islands remain exposed to capital market pricing impacts on future debt sales.

Moody's also highlights that the land-based portion of the predominantly fishing-based Faroese economy has been hit by the recent downturn, with one of the two main banks in the Faroe Islands receiving a rescue package from Denmark. Moreover, the islands' largest fish-processing plant was forced to declare bankruptcy in late 2010.

Fleet overcapacity, coupled with resource disputes with neighbouring Norway and the EU over mackerel quotas contributed to increase the pressure on the fishing industry, which is also challenged by increasing oil prices and volatility in fish prices. Moody's notes, however, that these challenges have been mitigated by the sustained value of the total domestic and foreign catch, and may benefit from improved management of Faroese fishing stocks in the longer term.

If Moody's perceives that the Faroe Islands will face difficulties in rebalancing its finances and achieving the Parliament's approved deficit reduction plan, this could result in a downward rating adjustment of one or more notches. Also, a substantial economic downturn, particularly one caused by environmental or structural weakness in the fishing industry, could also exert negative pressure on the rating. Precipitous political actions taken by either the Faroe Islands or the Kingdom of Denmark could have a significant impact on the resources of the Faroese government, although such actions are deemed unlikely.

PRINCIPAL METHODOLOGIES

The principal methodologies used in this rating were "Regional and Local Governments Outside the US -- Updated Rating Methodology", published in May 2008, and "The Application of Joint-Default Analysis to Regional and Local Governments", published in December 2008.

The Faroe Islands is a self-governing country within the Kingdom of Denmark. It is an archipelago of 18 islands located in the North Atlantic, with its closest neighbours being the United Kingdom and Iceland. The standard of living for its population of 48,565 is high, but slightly lower than that of other Nordic countries.

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