

Rating Action: Moody's changes outlook on Faroe Islands' Aa3 rating to stable from negative; affirms Aa3 rating

Global Credit Research - 31 Jul 2015

London, 31 July 2015 -- Moody's Public Sector Europe (MPSE) has today changed the outlook to stable from negative on the Aa3 issuer rating of the Government of Faroe Islands and affirmed the rating. Today's rating action reflects the Faroe Islands' steady progress toward budgetary consolidation. The main factors contributing to the stabilization of the outlook are:

- 1) the successful implementation of a long term deficit reduction plan
- 2) debt levels expected to trend downwards from 2016 onwards
- 3) strengthening in wider macroeconomic conditions including real GDP growth and low unemployment levels.

Moody's recognizes a gross operating surplus of DKK91 million reported at year end 2014 as a concrete step toward a positive financing surplus anticipated by 2016 and thereby the start of their debt reversal. The factors supporting positive gross operating balances in 2014 include a 10% increase in tax revenues coupled with a moderate 3.5% increase in operating expenditure.

RATINGS RATIONALE

RATIONALE FOR THE RATING AFFIRMATION

The Faroe Islands' rating affirmation at Aa3 reflects its fiscal autonomy resulting in a high level of revenue and expense flexibility and a track record of prudent budgeting. An additional strength includes the stable and historical relationship with the Kingdom of Denmark (Aaa,Stable), with joint matters clearly defined under the 1948 Home Rule Act. The rating also takes into account the Faroe Islands' dependence on the fishing industry, which represents 20% of GDP. This high dependence is offset by regular fish stock control to restrict the threat of stock depletion and a push to diversify the islands' trade. The Faroe Islands continue to rely on short-term borrowing and are susceptible to funding cost rises. In May 2015, the government's liquidity reserve was recorded at DKK2.2 billion and this represented 15% of GDP, which exceeds the necessary borrowing requirements in any single year and mitigates the refinancing risk associated with the government's reliance on short term borrowing.

WHAT COULD CHANGE THE RATINGS UP

A combination of the following could have positive rating implications: 1) a return to long term structurally balanced budgets; (2) steady debt reduction to pre-recession levels; (3) less reliance on short term borrowing could benefit the rating.

WHAT COULD CHANGE THE RATINGS DOWN

One or a combination of the following could have negative rating implications: 1) failure to implement their deficit reduction as planned; (2) materially increased debt levels above current levels; (3) a weakening of the Faroe Islands' relationship with Denmark; (4) an adverse shock impacting the Faroese fishing sector.

The specific economic indicators, as required by EU regulation, are not available for the Faroe Islands, The government of. The following national economic indicators are relevant to the sovereign rating, which was used as an input to this credit rating action.

Sovereign Issuer: Denmark, Government of

GDP per capita (PPP basis, US\$): 44,343 (2014 Actual) (also known as Per Capita Income)

Real GDP growth (% change): 1.1% (2014 Actual) (also known as GDP Growth)

Inflation Rate (CPI, % change Dec/Dec): 0.1% (2014 Actual)

Gen. Gov. Financial Balance/GDP: 1.2% (2014 Actual) (also known as Fiscal Balance)

Current Account Balance/GDP: 6.3% (2014 Actual) (also known as External Balance)

External debt/GDP: 154.3% (2014 Actual)

Level of economic development: Very High level of economic resilience

Default history: No default events (on bonds or loans) have been recorded since 1983.

SUMMARY OF MINUTES FROM RATING COMMITTEE

On 29 July 2015, a rating committee was called to discuss the rating of the Faroe Islands, Government of. The main points raised during the discussion were: The issuer's economic fundamentals, including its economic strength, have materially increased. The issuer's fiscal or financial strength, including its debt profile, has materially increased.

The principal methodology used in this rating was Regional and Local Governments published in January 2013. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

The weighting of all rating factors is described in the methodology used in this rating action, if applicable.

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