

Rating Action: Moody's upgrades the Government of Faroe Islands' issuer rating with stable outlook

16 Aug 2019

Frankfurt am Main, August 16, 2019 -- Moody's Investors Service ("Moody's") today upgraded to Aa2 from Aa3 the long-term issuer rating of the Government of Faroe Islands. The outlook remains stable.

In Moody's view the Faroe Islands' fundamental credit profile benefits from the reduction of the construction risk associated to a large infrastructure project (i.e. a sub-sea tunnel) which recently reached an important milestone.

In addition, credit fundamentals have continuously materially improved over the last years, as shown by better than expected economic and financial indicators, a trend which should continue going forward.

RATINGS RATIONALE

RATIONALE FOR THE RATING UPGRADE

The rating action reflects Moody's views on the fact that in June 2019, the islands' main infrastructure project (Eysturoy tunnel) has reached an important milestone with the breakthrough of the tunnel construction. The tunnel project company is 100%-owned by the government and we consider it a contingent liability, although with low risk profile. The progress of the construction and milestone reached reduces materially the related construction risk, a credit positive.

In addition, Moody's recognizes the substantially improved financial and economic indicators, which is expected to remain. Financial indicators, including gross operating surpluses of 9% of operating revenues in 2018, expected to reach 10% in 2019. Financial surpluses were reported over the last three years, reaching a level of 2.5% of total revenues in 2018, are expected to further improve in 2019 and 2020. Moody's is confident that similar levels are will be achieved given sound financial planning. Net direct and indirect debt continued its declining trend to 90% of operating revenues in 2018 from 111% in 2015 and is expected to further decrease towards 70% in the next two years. The liquidity profile improved remarkably over time and is extraordinary strong with liquid assets making up around two third of outstanding debt in 2018, a trend which we expect to continue in the near future fueled by planned financial surpluses. Economic indicators' track record also has proved excellent, with local GDP closing the gap in recent years and now at Danish national level, unemployment rate of below 2% in 2018 (it was 8% in 2011) and a steady increase of population over the last couple of years.

Faroe Island's Aa2 rating also takes into account the fiscal autonomy resulting in a high level of revenue and expense flexibility, combined with a track record of prudent budgeting. The stable and historical relationship with the Government of Denmark (Aaa, stable), with joint matters clearly defined under the 1948 Home Rule Act, is also credit positive. While the Faroese economy has a high dependence on the fishing industry, this is somewhat offset by regular fish stock control and a push to diversify the country's trade partners. The rating also takes into account the government's very strong liquidity buffer, which mitigates any refinancing risk.

Moody's changed the assessment of the Faroe Islands' baseline credit assessment (BCA) to a1 from a2.

RATIONALE FOR STABLE OUTLOOK

The stable outlook reflects the sustainable financial performance and expected debt reduction trend, improved macroeconomic metrics and a stable relationship with the Kingdom of Denmark.

WHAT COULD MOVE THE RATING UP/DOWN

An upgrade of the Faroe Islands would require a further significant reduction of debt ratios as well as a more diversified economic structure. A stronger support assumption could also have positive rating implications, although not expected due to the autonomous status.

One or a combination of the following could have negative rating implications: 1) a weakening of the Faroe Islands' relationship with Denmark; 2) a materially increased debt level or financial deficits over several years; 3) an adverse shock impacting the Faroese fishing industry.

The review of material new information, which was received during a recent meeting with the issuer, required the publication of this credit rating action on a date that deviates from the previously scheduled release date in the sovereign release calendar, published on www.moodys.com.

The specific economic indicators, as required by EU regulation, are not available for Government of Faroe Islands. 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\$): 52,121 (2018 Actual) (also known as Per Capita Income)

Real GDP growth (% change): 1.4% (2018 Actual) (also known as GDP Growth)

Inflation Rate (CPI, % change Dec/Dec): 0.7% (2018 Actual)

Gen. Gov. Financial Balance/GDP: 0.5% (2018 Actual) (also known as Fiscal Balance)

Current Account Balance/GDP: 6.1% (2018 Actual) (also known as External Balance)

External debt/GDP: [not available]

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 13 August 2019, a rating committee was called to discuss the rating of 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 2018. Please see the Rating Methodologies 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 credit rating action, if applicable.

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