



Rating Action: **Moody's affirms Faroe Islands' Aa2 rating with stable outlook**

11 Aug 2023

Frankfurt am Main, August 11, 2023 – Moody's Investors Service (Moody's) has affirmed the a1 Baseline Credit Assessment (BCA) and Aa2 long-term issuer rating of the Government of the Faroe Islands and maintained the stable outlook.

RATINGS RATIONALE

RATIONALE FOR THE AFFIRMATION

The affirmation of the a1 BCA and Aa2 issuer rating reflects the Faroe Islands' record of continued positive operating balances, consistently strong financial performance as well as prudent and sophisticated financial management. The rating also takes into account Faroe Islands' narrow and less diversified economic base relying on the fishing industry but partially offset by high wealth levels, providing greater shock-absorption capacity.

The Government of the Faroe Islands has recorded positive gross operating balances (GOB) during the past decade and its financial results are consistently close to budgeted numbers. Moody's projects that the Faroe Islands will be able to maintain strong financial outcomes in 2023-2024 in line with historical trends. Gross operating balances averaged 8.1% of revenue between 2018 and 2022.

Faroe Islands' credit profile is supported by strong governance and forward-looking management practices reflected in a consistent performance against fiscal targets. Faroe Islands is able to reduce or adjust operating revenues and spending and modify capital plans as necessary to meet long-term fiscal plans.

The Faroe Islands' liquidity profile continues to provide a significant buffer against unexpected fiscal pressures. Liquidity includes rising levels of cash and investments, which stood at DKK3.874 billion at year-end 2022 and covered 0.76x net direct debt and 0.46x operating expenditures. These liquidity levels represent 17% of GDP, which is above the internally set threshold (15% of GDP).

The Government of the Faroe Islands benefits from strong debt affordability and manageable levels of debt. The debt maturity profile is well distributed, with predictable and manageable debt maturities. Moody's expects the Faroe Islands' net direct and indirect debt (NDID) to measure 62.3% of forecasted operating revenue in 2023, a consistent decline since 2020 when NDID was 97.7% of operating revenue.

The rating also reflects Faroe Islands' narrow economic base and heavy reliance on the fishing industry. More than 90% of total export value of goods and around 20% of Gross Domestic Product is directly linked to this industry, which is highly exposed to external factors such as the variability in fish prices, oil prices and fish stock depletion.

The Aa2 rating incorporates a Baseline Credit Assessment (BCA) of a1 and a strong extraordinary support assumption from the Government of Denmark (Aaa stable).

RATIONALE FOR THE STABLE OUTLOOK

The stable outlook reflects Moody's expectation that the Faroe Islands' sound financial performance and ability to contain debt levels, good macroeconomic metrics and the stable relationship with the Government of Denmark will

continue.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE CONSIDERATIONS

Faroe Islands' ESG Credit Impact Score is neutral-to-low (CIS-2). Exposure to environmental risks is mitigated by strong governance and capacity to respond to shocks.

Faroe Islands' exposure to environmental risks (E-3) stems from physical climate risks, including rising sea levels because of rising temperatures, which would affect its important fishing industry. Sharing responsibilities with the Government of Denmark, which would provide support to the Government of the Faroe Islands in the event of natural disasters, helps to mitigate the potential financial impact of these risks for the Faroe Islands. With 18 islands, the Faroe Islands are also exposed to moderate water management risks.

The Faroe Islands' exposure to social risks is neutral-to-low (S-2). The population of the Faroe Islands is ageing, resulting in declining labour supply and higher pension and social costs. Furthermore, the Faroe Islands are benefiting from immigration at substantial growth rates, reflecting the attraction to live and work on the islands.

Governance is appropriate (G-2). This is underpinned by the government's high credibility, transparency and consensus on key economic policy goals. Coupled with exceptionally high wealth levels and financial strength, these support a high degree of resilience. However, its small size and interest rate volatility combined with relatively short average debt maturity resulting in high annual refinancing needs represent constraints.

The specific economic indicators, as required by EU regulation, are not available for 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\$): 70,924 (2022) (also known as Per Capita Income)

Real GDP growth (% change): 3.8% (2022) (also known as GDP Growth)

Inflation Rate (CPI, % change Dec/Dec): 9.6% (2022)

Gen. Gov. Financial Balance/GDP: 3.4% (2022) (also known as Fiscal Balance)

Current Account Balance/GDP: 13.5% (2022) (also known as External Balance)

External debt/GDP: 133.6% (2022)

Economic resiliency: aa1

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

On 08 August 2023, 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 not materially changed. The issuer's institutions and governance strength, have not materially changed. The issuer's fiscal or financial strength, including its debt profile, has not materially changed.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

An upgrade of the Faroe Islands' rating would require a significant reduction in debt ratios as well as a more diversified economic structure. A stronger support assumption could also have positive rating implications, but this is not expected because of its autonomous status.

One or a combination of the following could have negative rating implications: (1) a weakening in the Faroe Islands' relationship with Denmark; (2) significantly higher debt than the current levels or structural financial deficits over several years; and (3) any unexpected adverse shock affecting the Faroe Islands fishing industry.

The principal methodology used in these ratings was Regional and Local Governments published in January 2018 and available at <https://ratings.moodys.com/rmc-documents/66129>. Alternatively, please see the Rating Methodologies page on <https://ratings.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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For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on <https://ratings.moodys.com/rating-definitions>.

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Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://ratings.moodys.com/documents/PBC_1288235.

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