

**Rating Action: Moody's confirms the Faroe Islands' Aa3 rating and assigns negative outlook**

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Global Credit Research - 10 Sep 2013

London, 10 September 2013 -- Moody's Investors Service has today confirmed the Aa3 issuer rating assigned to the Faroe Islands reflecting Moody's view that the domestic economy is resilient enough to withstand EU sanctions on Faroese herring and mackerel exports. This concludes the review for downgrade assigned to the rating on 13 August 2013.

At the same time, Moody's has assigned a negative outlook to the rating to reflect the continued uncertainty around the Faroese economy.

**RATINGS RATIONALE**

**RATIONALE FOR CONFIRMATION**

Moody's placed the Faroe Islands' Aa3 rating on review for downgrade on 13 August 2013 following a vote on 31 July by the EU member states in favour of applying trade sanctions against the Faroe Islands. The sanctions, which were applied the next week, prohibited Faroese exports of herring and mackerel to and via EU countries, which together accounted for approximately 12% (or DKK 640 million) of Faroese exports of goods in 2012.

However, Moody's notes that the Faroese economy is sufficiently resilient to withstand the imposed trade sanctions due to the following: (1) Faroese fish companies are already diverting affected exports to non-EU countries; (2) downward pricing pressure on Faroese herring and mackerel sold to non-EU countries is likely to be limited; and (3) herring and mackerel catches are now no longer constrained by the EU quota framework.

**RATIONALE FOR NEGATIVE OUTLOOK**

Moody's has assigned a negative outlook to the rating to reflect the continued uncertainty around the Faroese economy, namely (1) in a worst-case scenario, sanctions could be extended to other fish stocks such as salmon, which accounts for approximately one third of all Faroese goods exports and which would have severe consequences for the economy; and (2) the Faroe Islands has limited capacity to assume more debt in response to lower tax revenues from its fishing sector given that its public finances have been in deficit since 2008 and are likely to remain so until 2015 (according to Faroese forecasts, which do not factor in sanctions).

**WHAT COULD MOVE THE RATING UP/DOWN**

The rating would come under pressure if EU sanctions are extended, for example to salmon exports. The rating could also come under pressure if the Faroe Islands fails to cut its deficit as planned and/or is forced to materially increase the level of borrowing above current levels. A weakening of its relationship with Denmark could also put the rating under pressure.

An upgrade is currently unlikely given the uncertainty associated with trade sanctions. However, structurally balanced budgets combined with steady debt reduction could stabilise the outlook on the rating.

Specific economic indicators as required by EU regulation are not applicable for this entity.

On 09 September 2013, 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 institutional strength/ framework, have not materially changed. The issuer has become increasingly susceptible to event risks.

The principal methodology used in this rating was Regional and Local Governments published in January 2013. Please see the Credit Policy page on [www.moody's.com](http://www.moody's.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.

The Faroe Islands is a self-governing autonomy 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 thousands is high, but slightly lower than that of other Nordic countries.

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