

**Rating Action: Moody's places Faroe Islands' Aa3 rating on review for downgrade**

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Global Credit Research - 13 Aug 2013

London, 13 August 2013 -- Moody's Investors Service today placed the Faroe Islands' Aa3 issuer rating on review for downgrade following a vote by the European Union member states in favor of trade sanctions against Faroe Islands.

**RATINGS RATIONALE**

**RATIONALE FOR THE REVIEW FOR DOWNGRADE**

The decision to place Faroe Islands' issuer rating on review for downgrade follows a vote on 31 July 2013 by EU member states to favor implementation of sanctions against Faroe Islands' fishing exports. This action follows ongoing disputes between the EU and the Faroe Islands over fishing quotas, which escalated in March 2013, when the Faroe Islands unilaterally set its own 2013 quota for herring and mackerel.

The EU has stated that a final decision on the proposed sanctions will be taken during August 2013, by the European Commission. At present, the extent of the potential sanctions is unknown. However, if implemented, sanctions could include restrictions on Faroese herring and mackerel exports to the EU.

The Faroese economy would be impacted, if extensive sanctions are implemented. A substantial part of the country's economic output is directly related to the fishing industry. Moreover, fish products account for 91% of total Faroese exports and 67% of Faroese exports are to EU countries (as of 2012). Herring and mackerel exports to the EU, which could be impacted by sanctions, account for approximately 10% of total exports from Faroe Islands (as of 2012). The Faroese public finances have been in deficit every year since 2008, when its export-oriented economy was hit by the global economic downturn. The Faroe Islands have made progress on a plan to completely cut the deficit by 2016. However, Moody's believes the deficit-reduction plan would be derailed if the EU imposes extensive sanctions. A higher deficit would likely pressure the islands to take on greater debt, which in turn would put downward pressure on its Aa3 rating. A higher level of debt would present Faroe Islands with refinancing risk because the investor base for Faroese debt has traditionally been small and concentrated to small and mid-sized Danish financial institutions.

**FACTORS TO BE CONSIDERED IN THE REVIEW**

The review of Faroe Islands' rating will focus on two issues.

- (1) The decision by the EU Commission to impose or not to impose sanctions on Faroe Islands;
- (2) The extent of the sanctions, if they are imposed, and their impact on the Faroese economy.

We expect to conclude the review a) once it becomes clear if sanctions will be imposed and b) once we know the extent of the sanctions.

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

The Faroe Islands' rating could be downgraded if the EU imposes extensive trade sanctions against the Faroe Islands. The rating could also come under pressure if the Faroe Islands fail to cut its deficit as planned and is forced to materially increase the level of borrowing above current levels. An upgrade is currently unlikely given the threat of EU trade sanctions. However, structurally balanced budgets combined with steady debt reduction could put upward pressure on the rating.

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

On 09 August 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 has become increasingly susceptible to event risks. Other views raised included: The issuer's institutional strength/ framework, have not materially changed.

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](http://www.moodys.com) for a copy of this methodology.

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.

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

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