

DANMARKS NATIONALBANK

25 SEPTEMBER 2017 — No. 17

THE FAROESE ECONOMY

Boom and labour market pressure

- The Faroese economy is booming, driven by high export revenue from farmed salmon, which is currently sold at high prices, and large catch volumes in the fisheries sector. Unemployment is low, and the construction sector, in particular, is reporting labour shortages.
- In earlier boom periods, Faroese fiscal policy has been procyclical, which has not helped to stabilise the economy. This pattern seems to be repeating itself, with a resultant risk that the economy will overheat.
- Consequently, Danmarks Nationalbank assesses that the government surplus should be increased at a faster rate than planned. Central and local governments should consider postponing some of the public investment projects. With the economy in good shape, now is a good time to address the long-term challenges of public finances.

**100 per cent**

increase in the export
prices of Faroese salmon
since the 1st half of 2012

[Read more](#)**20 per cent**

increase in the investment
budgets of Faroese local
governments in 2017

[Read more](#)**5 per cent of GDP**

that is how much govern-
ment finances must be
improved if long-term sus-
tainability is to be achieved

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ECONOMICS AND
MONETARY POLICY

Capacity pressures in the economy

The Faroese economy is booming and production capacity is under pressure. The upswing began in 2013, and in its most recent projection, from September, the Economic Council for the Faroe Islands, ECFI, forecasts continued growth in 2017, cf. ECFI (2017b). Especially exports of fish have boosted growth since 2013. Private consumption has also contributed, but not to the same extent as during the previous boom. Employment has risen at a steady pace, increasing by around 2,300 persons (almost 10 per cent) since the 2nd quarter of 2013. Unemployment is low.

The ECFI estimates that the value of output (nominal gross domestic product, GDP) rose by 6.8 per cent last year, cf. Chart 1, more or less matching the preceding years' high growth rates. In the assessment of the ECFI, GDP will rise by 6.0 and 4.1 per cent in 2017 and 2018, respectively.

The Faroese economy is a small, open economy with a concentrated business structure that is heavily dependent on fisheries and aquaculture. In the fisheries sector, activities are sensitive to e.g. changes in stocks, while aquaculture output is more stable, although there are biological risks. Consequently, the economy fluctuates strongly from time to time. Fisheries and aquaculture account for one sixth of total gross value added in the Faroe Islands and more than 95 per cent of exports of goods, excluding ships and aircraft. This means that the Faroese economy is highly dependent on developments in catch volumes and fish prices. Both fluctuate considerably over time, but not necessarily in the same direction for the various branches of fisheries and species. The fact that earnings have increasingly been diversified across different branches of fisheries to some extent helps to reduce the vulnerability of the economy overall. In addition, growth in aquaculture, where production planning is easier than in the volatile fisheries sector, can help to increase the stability of the Faroese economy.

The Faroese statistical agency, Hagstova Føroya, compiles the national accounts in value terms only (current prices), which complicates an assessment of the Faroese economy. Furthermore, there is a certain lag from the end of a year until national accounts figures are available. Unless otherwise stated, all figures in the analysis are in current prices.

Facts about the Faroe Islands

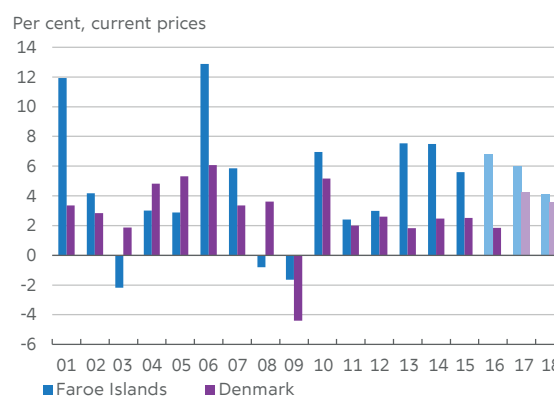
Population (beginning of 2017)	49,864
Gross domestic product, GDP (2015, kr. billion)	16.7
per capita ¹ (kr. '000)	342.7
Gross national income, GNI (2015 ² , kr. billion)	17.1
per capita ³ (kr. '000)	370.1
Currency	Danish kroner

Source: Hagstova Føroya, Statistics Denmark and own calculations.

1. By comparison, GDP per capita in Denmark was kr. 358,000 in 2015.
2. Preliminary data.
3. By comparison, disposable GNI per capita in Denmark was kr. 364,000 in 2015.

High growth in output value since 2013

Chart 1



Note: GDP in current prices. 2016-18 is a projection for the Faroe Islands. 2017-18 is the projection for Denmark.
Source: Hagstova Føroya, ECFI and Danmarks Nationalbank.

According to the Faroese Ministry of Finance, capacity pressures are considerable in the Faroese economy, with estimated output gaps of 4.4 and 5.0 per cent of GDP in 2016 and 2017, respectively.¹ Combined with low unemployment this indicates strong capacity pressures and a considerable risk of overheating.

Higher employment and low unemployment

Since 2013, most of the increase in the number of wage earners has taken place in the private sector, where four in five new jobs have been created. Growth has been driven mainly by construction, aquaculture and trade, etc. In the public sector, local government has made the largest contribution to employment growth, i.e. an increase of 11 per cent since the 2nd quarter of 2013.

Growth has accelerated over the last year. Employment rose by 3.1 per cent in the 2nd quarter of 2017 compared with the corresponding quarter the year before. By comparison, annual growth was 2.2 per cent year-on-year in the 2nd quarter of 2016.

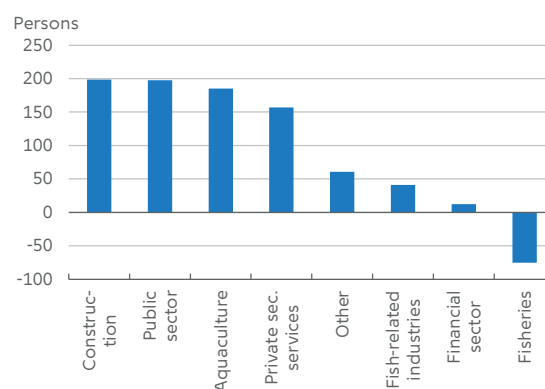
Over the last 12 months, growth in employment has still been strongest in the private sector, notably in aquaculture, where the number of wage earners has increased by 20 per cent year-on-year, cf. Chart 2. Production in this sector requires relatively little labour so productivity per employee is high.²

Employment in construction has risen by 11 per cent over the last year, inter alia due to large public sector projects. By mid-2017, the number of employees in the construction sector had reached the level seen during the construction boom when the economy last peaked, i.e. in the years around 2007. Combined, aquaculture and construction have accounted for every other job created since the 2nd quarter of 2016.

In the public sector, especially the healthcare and social assistance sector has contributed to growth in employment over the last year, with a year-on-year increase of 2.6 per cent in the 2nd quarter of 2017.

Growth in employment is broad-based

Chart 2

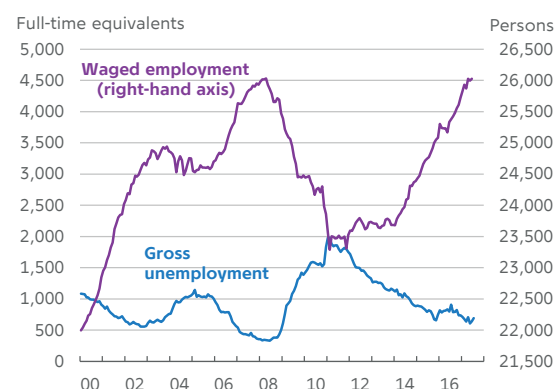


Note: Change in number of persons in each industry in the 2nd quarter of 2017 relative to the corresponding quarter of 2016.

Source: Hagstova Føroya.

Employment has risen more than unemployment has fallen during the upswing

Chart 3



Note: Seasonally adjusted data.

Source: Hagstova Føroya.

¹ The Faroese Ministry of Finance indicates that the estimate is subject to increased uncertainty due to the data basis.

² Aquaculture employed less than 4 per cent of wage earners, but generated more than 6 per cent of gross value added in the Faroe Islands in 2013-15.

This means that just over 10 per cent of new jobs have been within this sector, but – as in previous years – local governments have also taken on more people.

The labour force has expanded during the upswing, so the increase in employment has been greater than the fall in unemployment, cf. Chart 3.

In July 2017, 2.5 per cent of the labour force was unemployed, which is low by historical standards. The low rate of unemployment is a sign of rising capacity pressures. A large share of Faroese firms state that shortage of labour is an impediment to activity, cf. Chart 4.

The level of unemployment is not directly comparable with the level in other economies, as the Faroese population is relatively mobile and responds to high unemployment by emigrating. For example, the labour force shrank during the crisis as a result of net emigration, while the most recent economic recovery has increased the labour force, partly due to net immigration, especially of Faroese people living abroad, cf. Chart 5. In addition, the participation rate is higher.

A large number of Faroese people, especially skilled workers and builders, live in the Faroe Islands but work abroad, attracted by higher wages and tax benefits. The Faroese government may to some extent counter the shortage of labour by reducing the tax benefits. Besides dampening the risk of overheating, this will increase tax revenue.

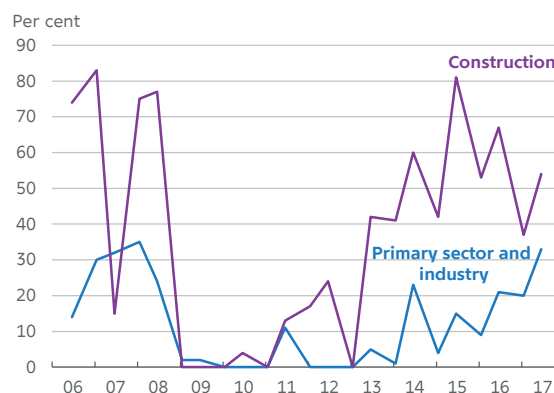
Mackerel and herring generated good earnings for the sixth year in a row

Fisheries improved in 2016, and the value of exports rose by 6.9 per cent, cf. Chart 6. This is attributable to larger catches, while export prices overall had a small downward impact. Pelagic fishing for, inter alia, herring and mackerel is most profitable, while traditional demersal fishing, primarily for cod, saithe and haddock around the Faroe Islands, is still financially squeezed.

Demersal fishing is characterised by local stocks which do not migrate the way pelagic species do. So regulation is a Faroese matter. Stocks of demersal fish, such as cod and haddock, have been historically low, one reason being that catches have exceeded the recommendations of marine biologists in recent decades, cf. the High Commissioner of the Faroe

Labour shortage in the Faroe Islands

Chart 4

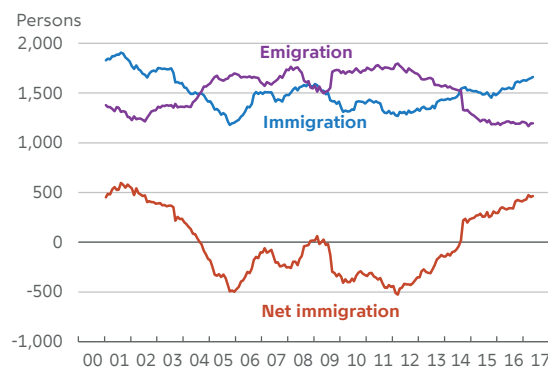


Note: Share of firms stating that shortage of labour is an impediment to production.

Source: Hagstova Føroya.

The economic recovery has led to net immigration to the Faroe Islands

Chart 5

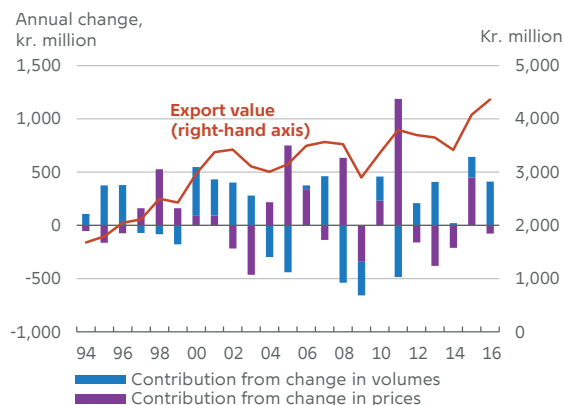


Note: Each observation is the sum for the preceding 12 months.

Source: Hagstova Føroya.

Continued growth in the fisheries sector

Chart 6



Source: Hagstova Føroya and own calculations.

Islands (2016). Despite the low stocks of cod in Faroese waters, cod accounted for 9 per cent of the total value of fish exports in 2016. This is partly attributable to the opportunity to catch cod in, above all, the Russian fishing zone in the Barents Sea. Access to the fishing zones of other countries is regulated in bilateral agreements concluded by the Faroe Islands, cf. Box 2.

Earnings from pelagic fishing have been high since 2010. This is mainly because larger stocks of mackerel in Faroese waters led to average catches in 2011-16 that were more than three times larger than in the preceding six years. At the same time, sales prices were higher, so that the export value was almost five times higher. Although the mackerel quota was around 15 per cent lower in 2016 than in 2015, the value of exports rose by 16.5 per cent due to higher prices and slightly higher export volumes.

After a good year in 2015, herring catches dropped by more than 20 per cent in 2016. This was only partly offset by a slight increase in export prices. Catches of blue whiting rose considerably in 2016 so that the value of exports increased by 9 per cent despite falling prices.

At the recommendation of the International Commission for the Exploration of the Sea, ICES, aggregate North Atlantic quotas for herring, mackerel and blue whiting have been raised in 2017. In order to keep the Faroese share unchanged, the Faroese govern-

Fishing agreements with neighbouring coastal countries

Box 1

Fishing within the Faroese fishing zone is subject to Faroese legislation.¹ The Faroe Marine Research Institute, Havstovan, advises on this fishing.

Fishing in the North Atlantic outside the fishing zones of the coastal countries is regulated by the Northwest Atlantic Fisheries Organization, NAFO and the North-East Atlantic Fisheries Commission, NEAFC. The Kingdom of Denmark is a member of these organisations in respect of the Faroe Islands and Greenland. At the meetings the delegation consists of Faroese and Greenlandic representatives, in order to negotiate and conclude agreements in accordance with the present regulation.

Moreover, the Faroe Islands have concluded a number of bilateral fishing agreements, allowing Faroese vessels to fish in the fishing zones of other countries. These bilateral agreements have been concluded with the EU, Greenland, Iceland, Norway and Russia. For example, it is important for parts of the Faroese long-distance fishing fleet to be able to catch cod and haddock in the Barents Sea. The Faroese Barents Sea quotas are closely linked to Russia's opportunities to catch blue whiting and mackerel in the Faroese fishing zone.

In 2014, the Faroe Islands concluded a 5-year agreement with the EU and Norway on the allocation of mackerel quotas. This agreement was made following disagreement between the coastal countries on the distribution of the mackerel stock in 2010-13.

The coastal countries disagree on the distribution of the herring stock, and, consequently, the Faroe Islands, among others, currently determine their own quotas. The same applies to the blue whiting stock.

1. The fishing zone of a country may extend 200 nautical miles from its shores.

ment has raised the Faroese quotas correspondingly. This will make a positive contribution to the already favourable economy. But in the longer term it is doubtful whether the high growth rates for pelagic fishing can continue.

According to the Faroe Marine Research Institute, the inflow of young demersal fish is increasing, especially for saithe and haddock. Stocks are still low, but due to the inflow of fish they can be expected to rise. This indicates that more fishing along the Faroese coasts could be possible within a few years.

The Faroese government's proposal for a fisheries reform

Box 2

The proposal is based on three main principles:

- Allocation of quotas should be market-based
- Biologically based management of fish stocks
- All fishing rights should be owned by Faroese residents.

In future, the Faroese government would like to sell some of the quotas by auction as short- or long-term fishing licences. A resource tax will be levied on the quotas not sold by auction, corresponding to the price of the quotas. This will give the central government a larger share of the economic rent, which has so far to an excessive degree been capitalised as higher-than-normal profits and wages for a limited group within the Faroese society.

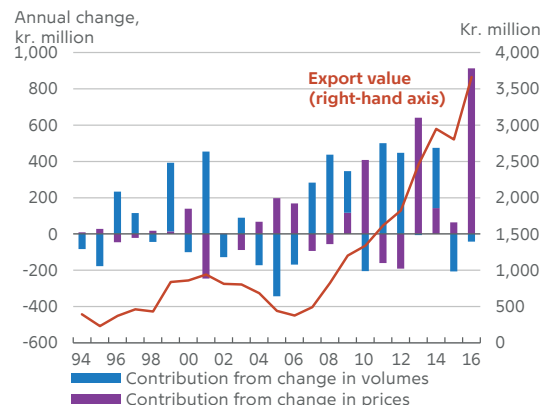
Until now, regulation of e.g. demersal fish has taken place by allocating fishing days, i.e. a number of days during which vessels are free to fish within a certain area. According to the Faroese government, this makes it difficult to manage stocks of demersal fish properly. So it is proposed that the fishing days system be replaced by quotas based on biological advice. This system resembles the method for allocating quotas in the areas where the Faroe Islands are bound by agreements with other countries.

Current fishing legislation permits a foreign ownership share of 67 per cent of equity capital. The Faroese government proposes that in future shipping companies must be 100 per cent under Faroese ownership, i.e. the firm must have been based in the Faroe Islands for at least five years. There will not be any limitations on foreign financing of fishing vessels, etc. There will be a transition period.

On 22 May 2017, the Faroese government presented a bill to reform the regulation of fishing, cf. Box 3. Among other things, it was suggested that fishing rights should be allocated on market-based terms, with partial auctioning of quotas. This could potentially increase the Faroese government's share of the higher-than-normal profits and wages in the fishing sector that stem from free or inexpensive access to the shared fishing resources, i.e. the economic rent. In 2015, the fisheries sector posted substantial higher-than-normal profits of around kr. 1 billion p.a., cf.

Soaring salmon prices in 2016 lead to boom in aquaculture

Chart 7



Note: According to Hagstova Føroya, only farmed salmon is exported. If wild salmon has been caught for exports, volumes are small.

Source: Hagstova Føroya and own calculations.

the High Commissioner of the Faroe Islands (2017). However, the Løgting (parliament) did not reach agreement before the summer break, so the bill was not passed.

The market-based approach outlined in the reform bill, which could potentially increase the government's share of the economic rent, is positive and should make a substantial contribution to long-term fiscal sustainability. It is important that the tender processes are transparent and that the Faroese government ensures multi-year licensing, which will support investment in the fishing industry.

The reform bill was re-tabled on 14 September with some adjustments.

Aquaculture is close to its output limit, but high prices ensured further growth in 2016

Since 2006, salmon farming in the aquaculture sector has increased, and by 2016 the value of salmon exports had multiplied by a factor of almost 10, cf. Chart 7.³

³ Previously, trout has been farmed to some extent. Since 2010, no significant volumes of trout fry have been released and hence no slaughtering of trout is expected in the coming years, cf. the High Commissioner of the Faroe Islands (2016).

Growth continued in 2016, reflecting a strong rise in sales prices. This is attributable to a 7 per cent fall in the global supply of salmon, due to factors such as algal bloom at aquaculture facilities in Chile and biological challenges for the Norwegian aquaculture sector – combined with strong global demand, cf. the United Nations (2017a).

Prices have fallen since the end of 2016. Nevertheless, in June 2017 export prices for salmon remained at the mid-2016 level. Faroese export prices for salmon have risen by approximately 100 per cent since the 1st half of 2012, even if the decline in the 1st half of 2017 is taken into account. The Faroese salmon farming capacity has been fully exploited. The markets expect the high prices to be supported by global demand for salmon and physical and regulatory constraints on global supply growth, cf. the United Nations (2017b). The scope for further growth based on increased production or even higher prices in the next couple of years would seem to be limited.

The largest Faroese firm, Bakkafrost, is planning investments of more than kr. 2 billion in onshore facilities, etc. in 2016-20. According to the company, this will make it possible to increase the onshore time, during which the young fish (smolt) grow before being released into the fjords, so that output capacity will be increased by around 30 per cent over a number of years, starting in 2020. So in the longer term there is a potential for increased salmon production in the Faroe Islands. Besides increasing capacity, longer time in the onshore freshwater facilities means that the fish farmed are less exposed to diseases, and hence the risk of fluctuations in output is reduced, cf. Bakkafrost (2016).

Rising exports of fish have generated large surpluses on the balance of trade in goods

The upswing in the Faroese economy is predominantly attributable to larger exports of fish. Since the 1st half of 2012, exports, excluding ships and aircraft, have risen by around 75 per cent, while imports, excluding ships and aircraft, have risen by only just over 30 per cent. In the 12 months up to June 2017, the surplus on the balance of goods was 7.3 per cent of GDP (kr. 1,370 million).⁴ This sur-

plus reflects higher prices for salmon, among other factors. The trade surplus for goods has stabilised at a high level over the last year as growth in imports has increased. During the previous boom, the Faroe Islands had an equivalently large deficit.

No compilation of the balance of payments is available after 2012, but the surplus can be expected to be considerable. Although the most recent compilation of the balance of services from 2012 showed a large deficit, a number of factors have a strong upward impact. Besides the large surplus on the balance of goods, these include a positive contribution from wage income earned by people living in the Faroe Islands but working abroad (including in Denmark) and the block grant from the Danish government.⁵

Credit growth is limited, but house prices may increase lending in the coming years

Credit growth has been subdued during the upswing, while deposits in banks have risen substantially. Over the last year, total lending by Faroese banks to firms and households has been lower than total deposits. If deposits from and lending to the public sector and non-profit institutions serving households, NPISH, are included, Faroese banks have had customer funding surpluses since 2015.

Lending to firms rose by 6 per cent year-on-year in June 2017, which is a faster rate of increase than in the preceding years. In the same period, firms' bank deposits increased by 11 per cent.

The fisheries sector, which has been the source of sizeable credit losses for banks in previous crisis periods, currently borrows only little from the Faroese banks. Some of the loans for the large-scale private investments in particular are granted by foreign banks. Such investments are mainly made in the aquaculture industry, which is posting large profits these years so that firms can rely on internal funding to some extent.

⁴ Including ships and aircraft.

⁵ The trade deficit for services was approximately kr. 1 billion in 2012. Net income from employment outside the Faroe Islands was calculated at kr. 800 million in 2012. Add to this transfers of approximately kr. 800 million in 2012, mainly comprising the block grant (kr. 642 million in 2017).

Deposits from households increased by 5 per cent year-on-year in June. At the same time, lending by banks to households, mainly for residential purposes, has risen by 5 per cent year-on-year. This is roughly unchanged compared with last year. House prices in Tórshavn rose by 17 per cent in 2016 and this tendency continued in the 1st quarter of 2017, cf. Chart 8. This means that nominal house prices are now higher than during the most recent boom, which peaked in 2007. The higher house prices may result in higher growth in lending to households. House prices are a leading indicator of credit growth in a number of other countries, including in Denmark, cf. Grinderslev et al. (2017). In view of the rise in house prices and the considerable immigration to the Faroe Islands, residential construction is still low.

The Faroese housing market is generally characterised by shorter amortisation periods than in e.g. Denmark. This makes homeowners more resilient to economic shocks and can dampen price developments.

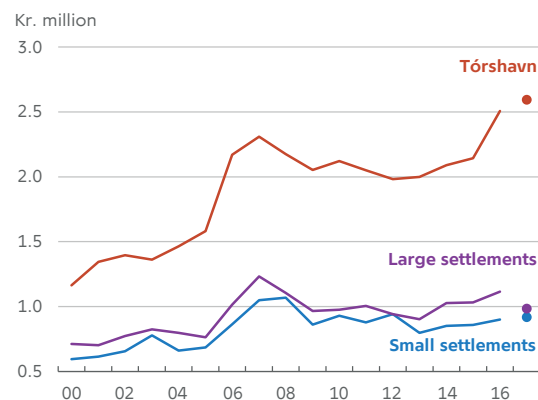
Faroese homeowners do not pay land or property taxes, and, all else equal, this reduces the user cost, thereby buoying up prices. Tax deductibility of interest on housing loans points in the same direction. The ceiling on and percentage rate of support for homeowners' interest costs have both been reduced gradually since 2009 so that in 2016, 35 per cent of interest costs were refunded up to a ceiling of kr. 110,000. The ceiling will be lowered to kr. 100,000 p.a. in 2018.

In March 2017, the Systemic Risk Council recommended that the Minister for Industry, Business and Financial Affairs should activate the systemic buffer for exposures in the Faroe Islands, cf. the Systemic Risk Council (2017). The Faroese economy is small and open with a concentrated business structure. This makes the economy vulnerable to negative economic shocks, which may, directly or indirectly, lead to losses in the banks and amplify fluctuations in the economy. Historically, the Faroese economy has fluctuated strongly, with strong variation in the banks' loan impairment charges. Consequently, the Council found that the financial sector is vulnerable to the structural factors characterising the Faroese economy.

In May 2017, the Minister for Industry, Business and Financial Affairs set the systemic capital buffer for Faroese credit institutions at 1 per cent from 1 January 2018, cf. the Ministry of Industry, Business and Financial Affairs (2017). In the assessment of the

House prices in Tórshavn are out-pacing the rest of the Faroe Islands

Chart 8

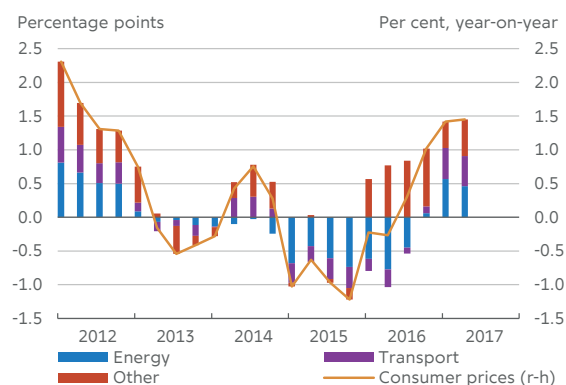


Note: 2017 comprises the 1st quarter only, so the number of transactions is limited.

Source: Hagstova Føroya and Betri.

Consumer prices are rising again after having fallen for a couple of years

Chart 9



Note: Unlike the Danish consumer price index, the Faroese price index includes interest expenses for housing instead of an imputed rental value of an owner-occupied dwelling. In the chart, the growth contribution from interest expenses for housing has been eliminated. "Other" includes rounding.

Source: Hagstova Føroya and own calculations.

Systemic Risk Council, the Faroese banks will be able to meet this requirement with their current level of capitalisation.

The Council found that the buffer rate should be increased in the coming years. The Council will involve the Faroese authorities in the discussion of a suitable buffer rate level and how soon it should be phased in.

Consumer prices have risen

Consumer prices rose by 1.5 per cent year-on-year in the 2nd quarter of 2017, cf. Chart 9. The rise is driven by slightly higher oil prices in the world market since mid-2016, which pushes up energy prices.

Fluctuations in the energy component as a result of changes in oil prices are stronger in the Faroe Islands than in Denmark. This is attributable to differences in indirect taxes, among other factors.⁶

The Faroese government should tighten fiscal policy and ensure long-term sustainability

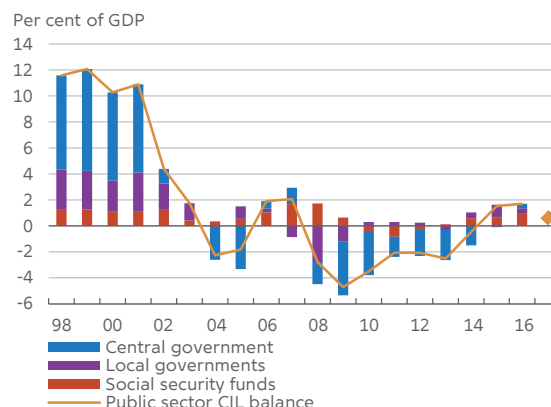
In September 2017, the Economic Council for the Faroe Islands and Hagstova Føroya assessed that public consumption at the national and local government level rose by 9.1 per cent in 2016 and is expected to rise by 2.1 per cent in 2017 and 3.3 per cent in 2018, cf. ECFI (2017b). This is a considerable increase in real public spending, given the low increase in consumer prices. That is not expedient in the current cyclical situation.

In 2015, the government budget balance turned positive for the first time since the financial crisis, reflecting surpluses in local government and social security funds, including the unemployment fund and the public sector pension fund, cf. Chart 10.

The deficits after the crisis related mainly to the central government, which did not achieve a surplus on its current, investment and lending (CIL) balance until 2016. The Finance Act 2017 operates with a central government CIL surplus of 0.8 per cent of GDP (kr. 148 million). The surpluses are mainly attributable to budget effects of the strong cyclical position in the form of increased revenue and lower spending.

The government budget surplus is insufficient in view of the upswing

Chart 10



Note: Particularly the 2017 figures are subject to uncertainty as no clear estimate exists for local government balances. Central and local government revenue may be higher than budgeted for, which will boost balances. The fall in 2002 was mainly attributable to a reduction of the block grant from the Danish government by around one third.

Source: Hagstova Føroya (until and including 2013) and Landsbanki Føroya (2014-17).

Furthermore, the central government's surplus in 2017 is offset by a budgeted local government deficit of 1.2 per cent of GDP (kr. 226 million). According to the Faroese Ministry of Finance, this deficit is, however, subject to a caveat as local government tax revenue, inter alia, is likely to increase by more than the budget shows, given the favourable cyclical position. In the assessment of the Faroese government, the local government sector will post a surplus in 2017.

According to the Faroese Department of Accounting and Financial Administration, Gjaldstovan, local government investment increased by 41 per cent in 2016, and local government budgets operate with a further increase of 20 per cent in 2017. The strong growth in local government investment underscores the need for better coordination of central and local government budgets in order for the Faroese government to ensure coherent management of public finances.

⁶ The weight of components in the consumer price index on which oil and energy prices have a direct impact is more or less the same for Denmark and the Faroe Islands.

The surplus in the social security funds has risen from 0.7 per cent of GDP in 2015 to an expected 1.1 per cent of GDP in 2017.

The government budget surpluses have been limited in the last couple of years, given that the Faroe Islands are experiencing a boom with annual growth rates of 6-8 per cent (in current prices). Combined with soaring house prices, the low rate of unemployment and labour shortages among firms emphasise the need for central and local governments to avoid increasing the level of activity. So far, the central government has not been able to improve public finances sufficiently during the boom. This means that necessary adjustments are being postponed and tightening measures may have to be introduced in a downturn.

Calculations by the ECFI show that public sector consumption and investment have previously risen when government revenue has increased due to an improved cyclical position. So there has been a procyclical effect, both in upswings and downturns, cf. ECFI (2015b). The rise in public sector employment since 2013, when the current upswing began, indicates that this pattern is being repeated, with government spending boosting activity in an already squeezed labour market, cf. Chart 11.

At the same time, central and local government and publicly owned companies are planning a number of large investments. The investment volume was set to rise by 20 per cent from 2014 to 2016, cf. ECFI (2015b). It is expected to rise by a further 34 per cent from 2016 to 2018 (from kr. 1.3 billion to kr. 1.7 billion).

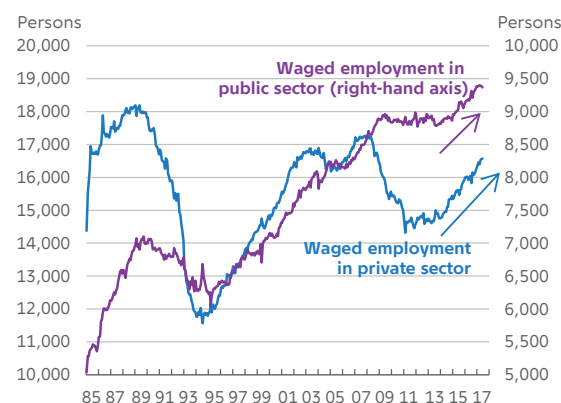
Many of these investments have a large import content, but on account of their total size they will contribute substantially to economic growth and increase the risk of bottlenecks, especially within the construction sector, which is already experiencing large capacity pressures. More than half of all construction firms say that shortage of labour is an impediment to growth.

Hence, there is a risk that the magnitude of the public investments and investments by publicly owned companies and increased public sector spending will further push the economy beyond its capacity limit. This could cause the labour market to overheat.

At the same time, tax revenue has, all else equal,

Following the pattern previously seen government spending seems to be rising in step with the upswing

Chart 11



Source: Hagstova Føroya.

been undermined by tax cuts in 2012 and 2016, and funding via increased revenue from fish resources may fluctuate from year to year, cf. Danmarks Nationalbank (2016).

So to avoid amplifying the upswing, the government budget surplus should be increased faster than planned by the Faroese government. Furthermore, the central and local governments should consider whether some of the large investment projects in the public sector or in publicly owned companies could be postponed.

The booming economy and large profits in the fisheries-related industries also mean that now is a good time to tackle the long-term challenge of fiscal sustainability.

Like many other economies, the Faroese economy is facing large demographic challenges with more old people and fewer people of working age, cf. Danmarks Nationalbank (2016).

In 2015, the ECFI calculated that the government deficit would increase steadily towards 2050. There is a need for permanent fiscal tightening of 5 per cent of GDP in order to stabilise net government debt in the long term, cf. ECFI (2015a). In its report from March 2017, the ECFI assessed that no reforms that will increase revenue or limit expenditure have been introduced since 2015, cf. ECFI (2017a).

However, net immigration since 2015 led the ECFI to recalculate its population projection in the report. As previously mentioned, it is not unusual for net immigration to rise during a boom in the Faroe Islands. Therefore the ECFI concludes that the assumptions are not significantly different from those applying in 2015.

The Faroese government's fisheries reform bill, which could potentially increase revenue from natural resources, would be a step on the way towards long-term sustainable fiscal policy. But other measures are also required. A gradual increase of the retirement age from 67 to 72 years towards 2048 could help to solve part of the challenge, cf. ECFI (2015a). Indexation of the retirement age to life expectancy could future-proof the increase in the retirement age. According to the ECFI, these two measures would be able to solve only two thirds of the sustainability challenge in relation to the public finances.

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ABOUT ANALYSIS



As a consequence of Danmarks Nationalbank's role in society we conduct analyses of economic and financial conditions.

Analyses are published ongoing and assess i.a. the current cyclical position and structural conditions.

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This edition closed for
contributions on 14 september 2017

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MONETARY POLICY



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