

Demographic headwinds increase the need for fiscal adjustment in the Faroe Islands

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The Faroese economy is booming, with high employment and widespread pressure on production capacity in large parts of the economy. Despite several good years, there have been no significant surpluses in public finances. The Faroese economy is also facing demographic changes that put pressure on long-term fiscal sustainability. The Faroese economy is relatively monolithic, which increases the need to use the upturns to increase resilience and prepare for the future. In the financial sector, banks are now better equipped than before to withstand a potential crisis.



Booming economy with widespread labour shortage

The Faroe Islands are in an economic boom with historically low unemployment and effectively full employment. However, wage growth remains moderate. Inflation has fallen again and underlying price pressures have also eased considerably. In recent years, the fishing industry has benefited from high demand and high global fish prices.



More capital and increased earnings strengthen banks

Banks have built up capital over a number of years and the gap to risk-based capital requirements is somewhat higher than before. Combined with increased earnings in 2023, that will strengthen the resilience of banks if the upturn in the economy changes.



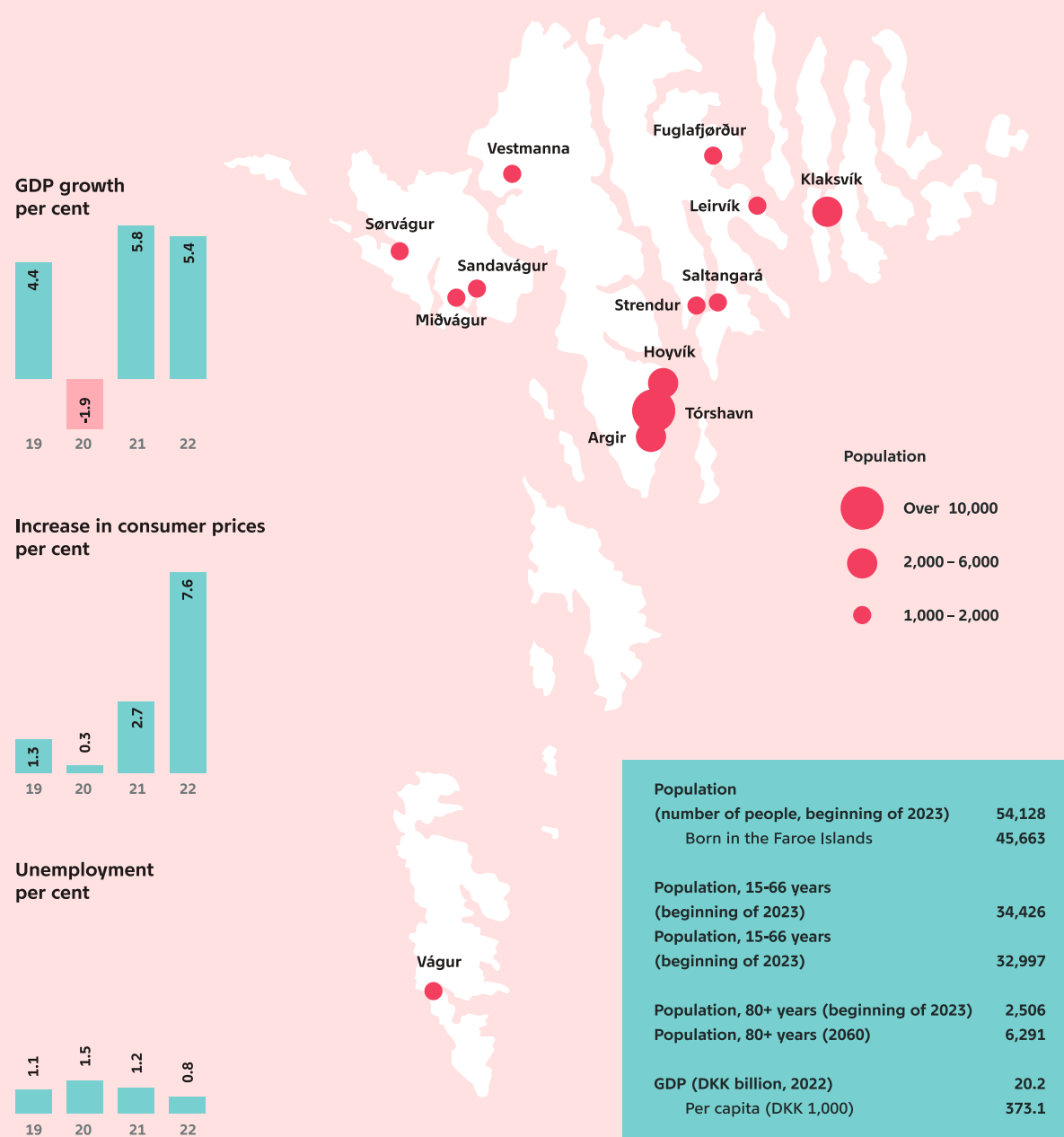
Need to address future challenges

The management of public finances has not ensured an appropriate tightening of public finances during the boom. Neither have the Faroe Islands seriously addressed future demographic challenges for public finances.

Why is it important?

Danmarks Nationalbank is the central bank for the entire Danish Realm. We therefore continuously analyse the development in the Greenlandic and Faroese economies to live up to our purpose of ensuring stable prices and ensuring the best basis for assessing the possible emergence of socio-economic imbalances.

Main chart: Facts about the Faroe Islands



Source: Hagstova Føroya and own calculations.



Tórshavn, Faroe Islands

Topics

The Faroese Economy

01

Booming economy in the Faroe Islands

The Faroese economy is booming, with pressure on production capacity in large parts of the economy. Expansion has been going on for well over a decade, only temporarily halted by the coronavirus pandemic in 2020. The economy is generally healthy, helped by the strong economic recovery of recent years. The Faroese economy is currently characterised by high employment and low unemployment, a balance of payments surplus and positive foreign assets, low public debt and well-consolidated households.

For the first time this year, the Faroese statistics office (Hagstova Føroya) has published the gross domestic product, GDP, in real terms, which makes it easier to compare the economic development of the Faroe Islands with other countries. Real GDP grew by 5.4 per cent in 2022, and the increase in activity is driven mainly by the service and primary sectors, each of which contributed about half of the total growth.¹ Over the past ten years, growth in the Faroe Islands has been among the highest in Europe.²

Continued growth in Faroese exports

The Faroe Islands has a small, open economy that relies heavily on trade with the outside world. Exports are concentrated around fisheries and aquaculture, which account for more than 90 per cent of total goods exports. Faroese goods exports (measured in value) saw solid growth of just over 20 per cent in both 2021 and 2022, see chart 1. This is especially true in light of high growth in the Faroese export markets and historically high global prices for salmon, herring and mackerel.

The very favourable conditions for the Faroese export sector have ebbed slightly over the past year. Fish prices have started to fall again, while growth in the Faroese export markets has slowed, partly due to a tighter monetary policy. Growth in the Faroese export markets is also expected to be moderate in the coming years.

Faroese export companies so far appear to be only slightly affected by the global growth slowdown, and goods exports have continued to increase during 2023, albeit at a slower pace than before. Fish exports are generally less sensitive to global economic fluctuations, and the Faroese export sector can therefore be expected to have a certain degree of resilience to cyclical changes.³

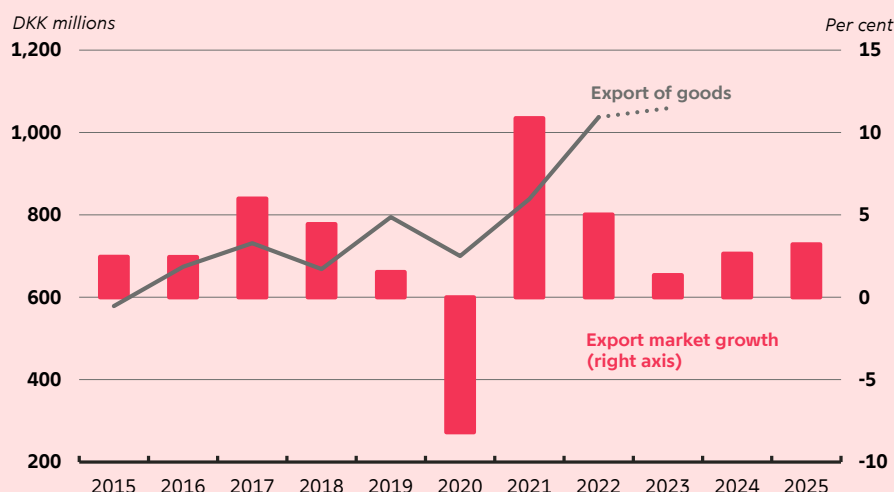
¹ Measured by growth contribution to gross value added (GVA), in real terms.

² Over the past ten years, the average annual GDP growth rate in Denmark and the EU20 has been 2.1 per cent and 1.4 per cent respectively. In the Faroe Islands, the GDP has grown by an average of 3.4 per cent per year over the past ten years.

³ For cyclical sensitivities of food products in Denmark, see Adrian Michael Bay Schmith and Helle Eis Christensen, *Stort fald i dansk eksport, men sammensætningen kan være en stødpude* ('Big fall in Danish exports, but its composition may provide a buffer'), *Danmarks Nationalbank Economic Memo*, no. 8, June 2020 ([link](#)).

CHART 1

Exports continue to grow despite global growth slowdown



Note: Export market growth is based on the OECD *Economic Outlook* from November 2023. Export market growth is calculated based on trade-weighted imports of goods and services from the Faroe Islands' 12 largest trading partners. 2023 goods exports are the average value for the period January to September.

Source: Hagstova Føroya, OECD and own calculations.

Faroese fisheries benefit greatly from being able to fish in different waters. A number of international agreements have ensured that the Faroe Islands and neighbouring countries have been able to fish in each other's waters, which has acted as a risk diversification. For decades, the Faroese fisheries agreement with Russia and other countries has allowed the Faroese to fish primarily for cod in the Barents Sea, while Russian ships have fished primarily for blue whiting in Faroese waters.

Russia is one of the Faroe Islands' largest export markets and currently accounts for around 10 per cent of total Faroese exports. After a big drop in exports to Russia in the wake of the invasion of Ukraine, fish exports have rebounded. Excluding salmon exports, which have been suspended since the invasion, fish exports to Russia are roughly the same as before the war. While most fish species are sold in many countries, Russia is the main buyer of Faroese herring and mackerel, which are harder to sell on other markets.

The labour market is still very tight

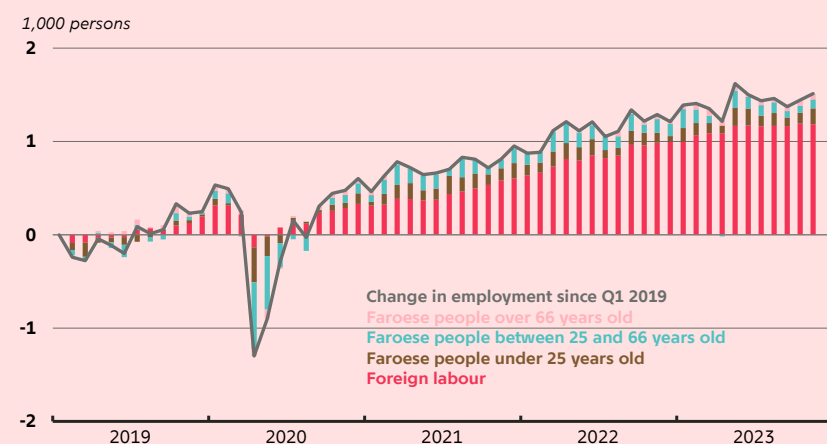
The improvement in the Faroese economy is also reflected in the labour market, where employment has increased in recent years. In November 2023, employment was over 28,000, corresponding to more than 80 per cent of the population between the ages of 15 and 66. This is among the highest employment rates in Europe. The unemployment rate has been 0.7 per cent since spring and has been below 1 per cent since the beginning of 2022. This means that more or less everyone available for the labour market is employed. The labour market growth of recent years is the result of a large influx of foreign labour instead. Employment has increased by 1,500 people since 2019, with almost 1,200 of those coming from abroad, see chart 2.

Despite the large influx of foreign labour, the labour market is under pressure and many companies believe that labour shortages are limiting production. This

is especially true in the construction industry, where companies in the second half of 2023 reported labour shortages at a historically high rate. The situation is less serious in manufacturing, where the labour shortage indicator has fallen slightly over the past year and is currently on a par with the mid-2010s.

CHART 2

Foreign labour has boosted employment



Note: Foreign labour is defined as persons in employment not born in the Faroe Islands. Own seasonal adjustment.

Source: Hagstova Føroya and own calculations.

Labour shortages may also become a challenge for the public sector in the future. As the Faroese population lives longer and the number of children and elderly people in relation to the number of people of working age increases, the need for labour in the welfare sector is expected to rise. The Economic Council of the Faroe Islands estimates that the public sector will be short of 1,500 employees in 2030.⁴

The Faroese labour market is generally characterised by a high degree of flexibility.⁵ A large amount of foreign labour has entered the labour market during the current economic boom, whereas times of economic downturn have historically resulted in the opposite trend, with the share of foreign labour decreasing. Foreign labour has thus supported the flexibility of the Faroese labour market. It is important that the structures of the labour market continue to promote flexibility, so that labour can come in when it is needed and leave when it is not.

Also, Faroese working abroad should have the incentive to return to the Faroe Islands when the labour market is under pressure. The current tax deductions for Faroese working abroad make it less attractive to take a job in the Faroe Islands. Such schemes may seem inappropriate in periods like the current one with widespread labour shortages in the economy, and in light of the expected future need for more employees in the public sector, among others.

⁴ See the report *Í góðum hondum*, spring 2022 ([link](#)). In Faroese only.

⁵ See Adrian Michael Bay Schmith and Flora Nagy, 'The Faroese economic boom is losing momentum', *Danmarks Nationalbank Analysis*, no. 29, 16 December 2020 ([link](#)).

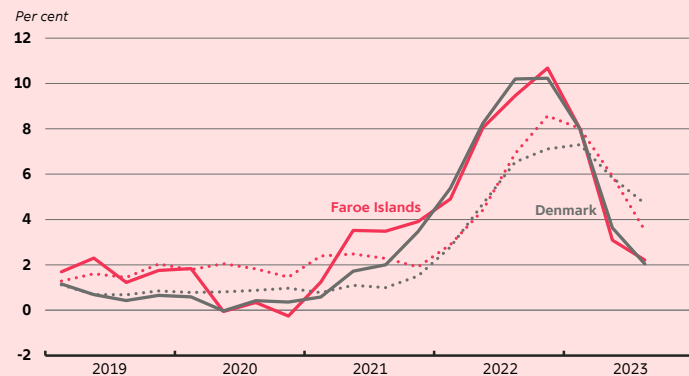
Inflation has fallen significantly

Consumer price growth in the Faroe Islands, like the rest of Europe, has slowed over the past year. Inflation has fallen from around 10 per cent in Q2 2022 to 2.2 per cent in Q3 2023, with the overall trend closely following that in Denmark, see chart 3.⁶ Unlike in Denmark, it is mainly increases in consumer food prices that continue to keep inflation high in the Faroe Islands. Food prices increased by 8 per cent in Q3.

CHART 3

Although it has fallen significantly, inflation excluding energy is still high...

Year-on-year changes in total consumer prices (solid lines) and consumer prices excluding energy (dotted lines)

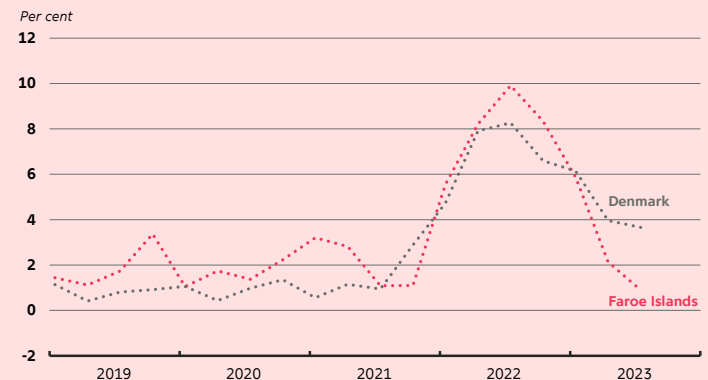


Note: The consumer price index excludes the rental value of homes and interest payments on mortgage loans. This makes Danish and Faroese consumer prices more comparable. Solid lines indicate inflation; dotted lines indicate inflation excluding energy. Danish inflation is calculated using the EU Harmonised Index of Consumer Prices (HICP).

Source: Hagstova Føroya, Statistics Denmark and own calculations.

CHART 4

... but the *instantaneous inflation rate excluding energy* has decreased



Note: Instantaneous inflation tries to minimise distortion from random fluctuations. Instantaneous inflation is calculated as a weighted sum of last year's seasonally adjusted price changes, where weighting for the quarters is determined to get the most accurate information from quarterly changes while minimising distortion from random fluctuations.

Source: Hagstova Føroya, Statistics Denmark and own calculations.

The large fluctuations in inflation in most of the world are a result of the unusually large fluctuations in the prices of electricity and gas in particular. Unlike the case in Europe, the Faroe Islands' energy supply is not based on natural gas from Russia, but on oil. Oil prices have generally been less volatile than natural gas prices, and therefore the direct effect of energy price increases has been smaller in the Faroe Islands compared to other European countries.

However, oil prices have also dropped significantly and consumer energy prices are now contributing negatively to inflation. In Q3, consumer energy prices pulled overall inflation down by 0.3 percentage points. In comparison, the fall in consumer energy prices pulled Danish inflation down by over 2 percentage points in the same period.⁷ Although consumer energy prices have fallen, they are still around 30 per cent higher than in the first half of 2021, before energy price increases took off.

Inflation excluding energy has also fallen, but is still higher than before price increases took off in early 2021. A large proportion of the goods consumed by

⁶ A comparison of price trends in the Faroe Islands with other countries is complicated by the fact that the weighting in the consumption curve has not been updated since 2009. Since people typically shift consumption towards cheaper goods, inflation is likely to be overestimated.

⁷ Measured by the EU Harmonised Index of Consumer Prices, HICP.

Faroese households are imported. This means that although the Faroe Islands have been less directly affected by higher energy prices than most other European countries, some of the energy price increases abroad are still passed on to the Faroese economy through higher prices on imported goods. This is partly due to a delayed effect from higher energy prices in the production of other goods and services, so-called 'indirect effects'.

To assess current inflationary pressures, it is necessary to look at the momentum of consumer price changes rather than at the annual rate of increase. The momentum can be illustrated by *instantaneous inflation*, which places greater emphasis on developments in recent months.⁸ Using this yardstick, the momentum in inflation excluding energy in the Faroe Islands has fallen from around 10 per cent in mid-2022 to around 1 per cent in Q3 2023, see chart 4. The momentum has fallen slightly less in Denmark. The decline in momentum in inflation excluding energy indicates that underlying inflationary pressures in the Faroe Islands have eased significantly.

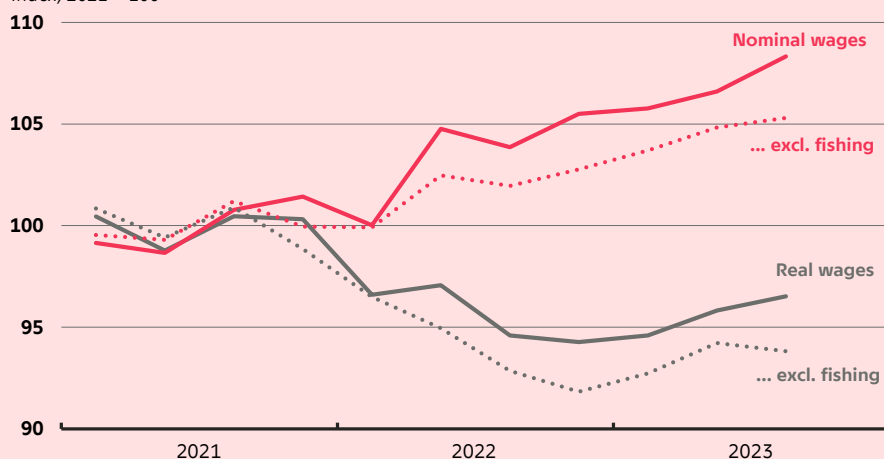
Continued moderate wage increases

The tight labour market and high inflation have not yet caused wages in the Faroe Islands to rise significantly. The annual wage growth (measured as wages per employee) in Q3 2023 was 4.3 per cent and should be seen in light of a 9 per cent growth in wages in the fishing industry in the same period, see chart 5. Wage growth in the rest of the economy was lower, at 3.3 per cent in Q3. The current level of annual wage growth is roughly on par with the years before the corona pandemic.

CHART 5

Real wages have started to rise again

Index, 2021 = 100



Note: Calculated as the actual wage per employee. Real wages are deflated with the consumer price index.

Source: Hagstova Føroya and own calculations.

⁸ See Box 1 in Danmarks Nationalbank, 'Persistently high inflationary pressures call for tight economic policy', *Danmarks Nationalbank Analysis (Outlook for the Danish economy)*, no. 13, September 2023 ([link](#)).

However, the high inflation of recent years has reduced the purchasing power of households, as measured by real wages. As inflation has come down, real wages have started to rise again during 2023, but in Q3 2023 they were still around 3.5 per cent lower than in 2021 before inflation began to rise.

02

Increased earnings and more capital prepare banks better for hard times

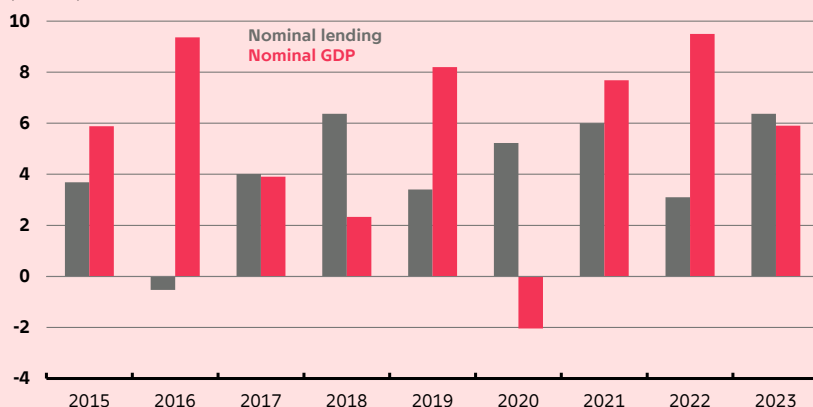
The financial sector in the Faroe Islands has performed well in recent years with the pandemic, war in Ukraine and general price and interest rate increases. During 2023, credit growth accelerated and now exceeds the general growth of the Faroese economy, see chart 6.

Faroese banks continue to fund their lending activities with deposits from customers, but the deposit surplus has fallen since 2020. At the end of the first half of 2023, loans and other receivables accounted for around 90 per cent of deposits, but this conceals a certain amount of variation across banks. Vulnerability may increase if deposit deficits begin to build up in parts of the financial sector, as financing lending via the financial markets will typically be more sensitive to changes in market conditions and assessment of the individual bank's financial situation.

CHART 6

Credit growth now exceeds growth in the Faroese economy

Per cent,
year-on-year



Note: Nominal lending by banks and mortgage credit institutions to Faroese counterparts excluding monetary financial institutions. Lending growth is based on nominal lending at year-end with the exception of 2023, where lending growth is calculated based on the latest observation for nominal lending from October 2023. Nominal GDP in 2023 is based on the Faroese Economic Council's estimate of growth of the Faroese GDP at current prices.

Source: Danmarks Nationalbank, Hagstova Føroya and the Faroese Economic Council.

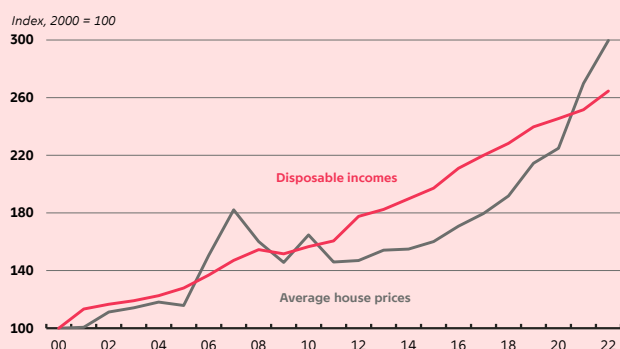
Signs of a slowdown in house prices

After several years of stronger growth in house prices than in disposable income, 2023 showed signs of a slowdown in house prices in the Faroe Islands, see charts 7 and 8. The slowdown in house prices follows a period where households' real wages have been eroded and interest rates have risen. Both factors contribute to dampening housing demand. Conversely, the supply of housing in the Faroe Islands has struggled to keep up with population growth for a number of years, which has helped to keep house prices buoyant.⁹

There is no tax on property in the Faroe Islands, and homeowners can receive subsidies for interest expenses on housing loans, which currently amount to up to DKK 35,000 per year.¹⁰ Both factors contribute to lowering the user cost of housing and increasing the volatility of house prices. The introduction of housing taxation in the Faroe Islands linked to prices in the housing market could thus dampen price fluctuations and the cyclicity of the economy in general.¹¹

CHART 7

Several years of strong growth in house prices in the Faroe Islands

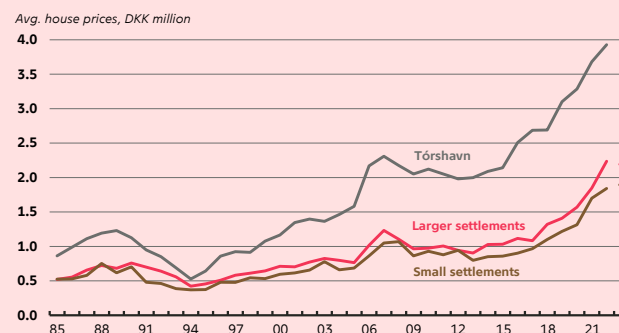


Note: Income includes income, profits from a privately-owned business (including self-employment), payments from the public sector (e.g. pension, unemployment benefits, interest deductions and student grants) and capital income less tax (and other statutory taxes). Disposable incomes for 2022 are estimated.

Source: Hagstova Føroya, Landsbanki Føroya and own calculations.

CHART 8

Slowdown in house prices in parts of the Faroese housing market



Note: Figures for 2023 are house prices for 2022 projected with the growth in house prices in 2023 calculated by BankNordik.

Source: Hagstova Føroya, BankNordik and own calculations.

Financing home purchases via bank loans is still the most common method, and the composition of home lending means that interest rate changes are quickly passed on to Faroese homeowners. This is because the majority of housing loans to households are floating-rate loans with the option to adjust the interest rate within one month. In addition to the interest rate sensitivity of homeowners, the Faroese housing market is also characterised by the fact that housing debt is

⁹ In the period 2015-2022, the number of newly built homes in the Faroe Islands increased by approx. 1,520, while the population grew by approx. 5,500 people from January 2015 to December 2022. With an average number of people per household of around 2.9, this equates to an estimated need for around 1,900 new homes.

¹⁰ Cf. the High Commissioner of the Faroe Islands, *Report 2022* ([link](#)), the High Commissioner of the Faroe Islands, December 2022, and the tax authority TAKS ([link](#)).

¹¹ For a more detailed explanation of how housing taxes stabilise house prices and the benefits of this, see Asbjørn Klein, Simon Juul Hviid, Tina Saaby Hvolbøl, Paul Lassenius Kramp and Erik Haller Pedersen, 'House price bubbles and the advantages of stabilising housing taxation', *Danmarks Nationalbank Monetary Review*, 3rd Quarter 2016 ([link](#)).

typically amortised. This helps to increase homeowners' resilience in the event of a shock to the economy.

The implementation of regulations in the Faroe Islands was proposed in 2023 to limit access to risky loan types for households with high debt-to-income ratios and loan-to-value ratios.¹² A revised executive order on best practice for financial companies in the Faroe Islands came into force on 1 January 2024.¹³ The revised executive order includes a number of new rules, including rules on credit rating, down payment and debt-to-income ratio corresponding to the Danish executive order on best practice for housing credit. The new rules will support the maintenance of sound credit standards in banks.

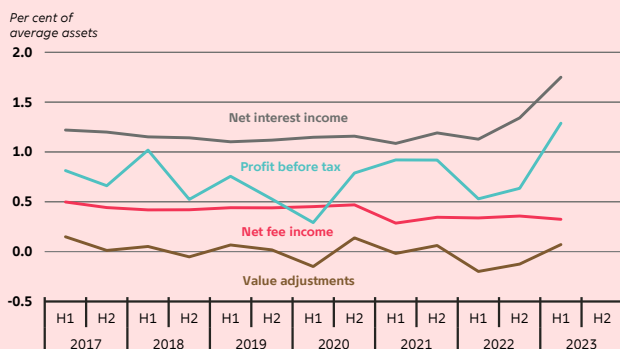
Higher interest rates and increased bank earnings

2023 has so far been a good year for Faroese banks with significantly higher earnings than in 2022, see chart 9. The increase in bank earnings is particularly supported by higher net interest income. The higher net interest income should be seen in the context of banks increasing lending rates more than deposit rates since 2022, causing the interest margin to widen, see chart 10. Higher current earnings improve the Faroese banks' first line of defence against losses should the good times in the economy turn.

Despite rising interest rates and prices, there are no signs so far that bank customers are having trouble meeting their debt obligations. This is reflected in the fact that Faroese banks reversed impairment charges in the first half of 2023. The reversals have come at a time when the economy is in a boom period with continued growth in exports and a very tight labour market, see also chapter 1. On the other hand, management estimates to impairment charges due to macroeconomic uncertainty have been maintained.

CHART 9

Higher net interest income has boosted the profits of Faroese banks

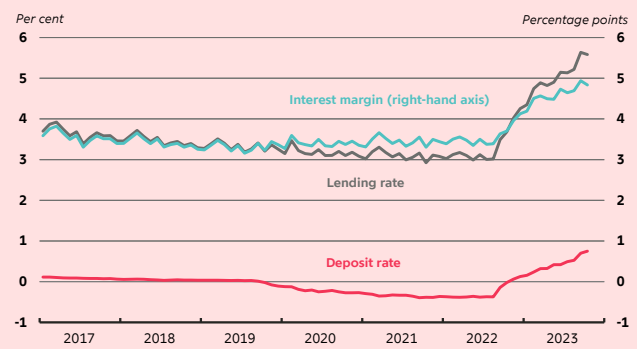


Note: Half-year data for Faroese banks. Average assets are calculated as the average of total assets at the beginning and end of the period.

Source: The Danish Financial Supervisory Authority and own calculations.

CHART 10

Faroese banks have widened their interest margin



Note: The average weighted interest rate of Faroese banks on deposits from Faroese households and non-financial corporations and the Faroese banks' average weighted interest rate on loans to Faroese households and non-financial corporations. The interest margin is calculated as the difference between the two interest rates. The most recent observations are from October 2023.

Source: Danmarks Nationalbank.

¹² See the Danish Financial Supervisory Authority's accompanying letter on consultation on the Executive Order for the Faroe Islands on best practice for financial companies, 1 May 2023 ([link](#)).

¹³ See Executive Order for the Faroe Islands on best practice for financial companies, 6 December 2023 ([link](#)).

Faroese banks have built up capital

Faroese banks have generally built up capital since 2017, see chart 11. In recent years, however, total capitalisation has remained largely unchanged, but this conceals variation across banks.

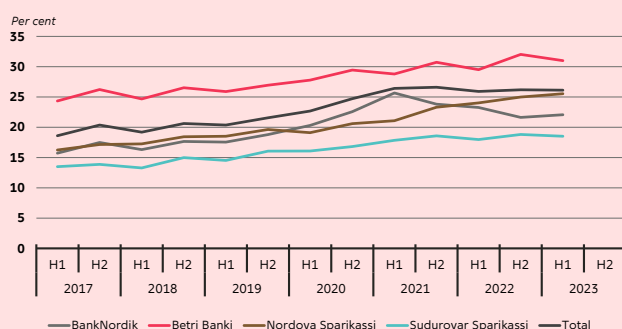
Capital build-up has contributed to increasing the gap between actual capital and the risk-based capital requirements, also known as excess capital adequacy, see chart 12. However, after a period of gradual increase in excess capital adequacy, it has decreased in recent years. Despite the decrease, excess capital adequacy is still higher than previously observed. Higher excess capital adequacy reduces the risk of banks not being able to fulfil capital requirements if the economy is hit by a crisis.

The increased capital should be seen in the context of the phasing-in of the requirement for the Faroese banks' eligible liabilities, also known as the MREL requirement. To fulfil the requirement, Faroese banks predominantly use Common Equity Tier 1 capital. The MREL requirement was applied to some Faroese banks in 2019 and will be phased-in over the coming years.¹⁴ The MREL requirement is designed to ensure that each bank has sufficient capital and eligible liability instruments to absorb losses and recapitalise the bank if its problems become so severe that it fails. It is important that banks ensure adequate excess MREL-eligible liabilities relative to the MREL requirement as it is gradually phased-in.

The capital requirements of Faroese banks are different from those of Danish banks. This is because a general systemic capital buffer of 2 per cent has been introduced in the Faroe Islands. The aim is to make banks more resilient to structural vulnerabilities in the Faroese economy, which is relatively monolithic with a high dependence on fishing and aquaculture. In addition, a countercyclical capital buffer of 1 per cent has been introduced to ensure that banks have sufficient leeway to bear losses and continue to provide credit to households and businesses in a crisis.

CHART 11

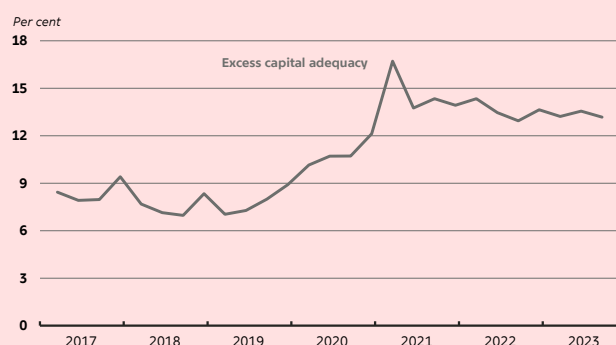
Faroese banks have increased capitalisation over a number of years



Note: Half-year data for Faroese banks. Common Equity Tier 1 capital (CET1) as a percentage of risk-weighted exposures.
Source: Banks' financial statements and own calculations.

CHART 12

Capital build-up has contributed to increased excess capital adequacy over a number of years



Note: Quarterly data for the Faroese banks. Excess capital adequacy is calculated as Common Equity Tier 1 capital less the total Common Equity Tier 1 capital requirement (including capital buffers).
Source: The Danish Financial Supervisory Authority.

¹⁴ See e.g. the Danish Systemic Risk Council's analysis, *Requirements for the Faroese Banks*, 4 March 2020 ([link](#)).

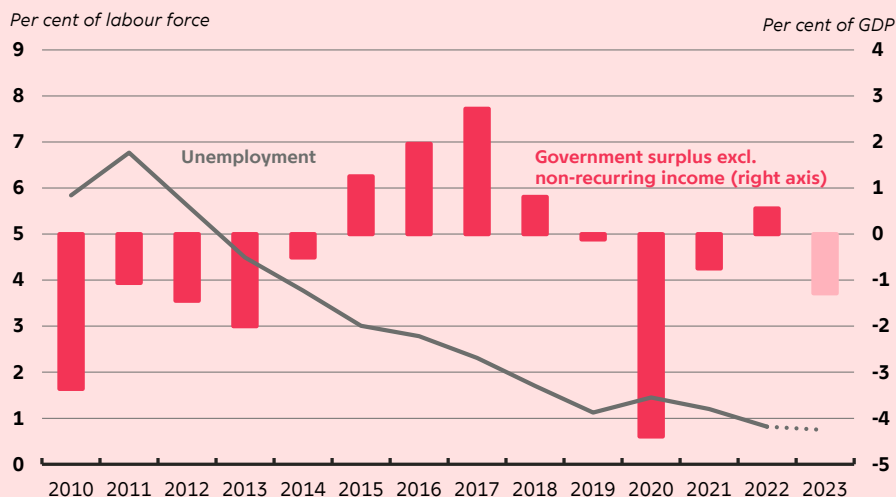
03 Need for fiscal planning

Despite several good years in the Faroese economy, there has not been a significant surplus on the public balance sheet, see chart 13. Neither are significant surpluses in public finances expected in the coming years.¹⁵ The public sector thereby contributes to amplifying the boom in a period when private demand is high, rather than contributing to a more stable economic cycle.

The fact that public finances have not improved sufficiently during the boom means that the public sector in the Faroe Islands is postponing necessary adjustments and risks having to implement austerity measures during a recession.

CHART 13

**Massive improvement in the Faroese economy
has not resulted in a surplus in public finances**



Note: The chart shows the sum of state and municipal current surpluses and social funds. 2023 is a forecast from the Faroese Economic Council. Non-recurring income of DKK 212, 134 and 95 million has been deducted in 2021, 2022 and 2023, respectively. In 2021, the income is due to the closure of the Financing Fund of 1992; in 2022, extraordinary dividends from the sale of BankNordik's Danish branch; and in 2023, divestment of the Home Government of the Faroe Islands' ownership interests in P/F Tjaldur and P/F Smyril. The unemployment rate in 2023 is based on the average value in the period January to October.

Source: Hagstova Forøya, Faroese Economic Council and own calculations.

In addition to fiscal policy helping to amplify economic booms, a number of schemes also help to amplify cyclical fluctuations. These include, for example, tax deductions for Faroese working abroad and the 35 per cent subsidy from the Governmental Bank on household interest payments on home loans.

¹⁵ The Finance Act for 2024 predicts a surplus in the Governmental Bank of DKK 4 million ([link](#)).

There is also no taxation of property in the Faroe Islands.¹⁶ The implementation of a property tax based on house price trends will act as an automatic stabiliser for both the real economy and the financial sector by helping to reduce house price fluctuations. Property taxes based on price trends are also generally less distortionary than many other taxes.

A significant part of Faroe Island income is generated by companies utilising the Faroese marine and fisheries resources. A monolithic economy like the Faroese is relatively vulnerable to external factors, and it is therefore important to focus on pursuing a stability-orientated fiscal policy that puts money aside in times of prosperity. This can help mitigate the consequences of, for example, changing external conditions that affect parts of the Faroe Islands' primary source of income.

It is only natural that some of the profits from the common Faroese natural resources are redistributed and accrue to the general population through taxation of abnormally high profits, known as the economic rent.¹⁷ Taxes on fish catches and aquaculture contribute to this redistribution. It is important that such taxes are designed appropriately so that they do not distort incentives. The tax system should thus not affect the decisions of Faroese companies on such matters as the onward processing of fish.

The organisation of catch and aquaculture taxes should be evaluated on an ongoing basis to ensure that trends in current tax revenues reflect those in the economic rent. In May, the Faroese parliament decided to revise such taxes, which, according to the Ministry of Finance and the Ministry of Foreign Affairs, Industry and Trade, is estimated to increase revenues for the Faroe Islands Governmental Bank by a total of 1.1 per cent of GDP.¹⁸ The changes mean that taxes increase faster when sales prices rise and decrease faster when prices fall. The new tax on aquaculture products is based on the profit from the fish after production costs.

Demographic headwinds put pressure on long-term sustainability

In the coming years, the Faroe Islands will face a shift in demographic composition that will put pressure on the long-term sustainability of public finances. In 2015, the Economic Council of the Faroe Islands estimated that it would require a permanent fiscal tightening of 5 per cent of the GDP to balance public finances in the long term.¹⁹

The ratio of people of working age²⁰ to people over state pension age has steadily decreased in recent years and is expected to continue to decrease in the future. While there are currently approximately four people of working age for every person over retirement age, this will be halved to just over two people by 2060, see chart 14. This is the result of people living longer and thus spending a smaller proportion of their lives on the labour market, and because increasingly large numbers of the older generations will be leaving the workforce in the coming years.²¹

¹⁶ See the High Commissioner's report 2022, p. 51 ([link](#)).

¹⁷ See e.g. Jens Warming, *Om grundrente af fiskegrunde* ('On economic rent on fishing grounds'), *Nationaløkonomisk Tidsskrift*, no. 49, pages 499-505, 1911 and Jens Warming, *Aalegaardsretten*, *Nationaløkonomisk Tidsskrift*, no. 69, pages 151-162, 1931.

¹⁸ DKK 75 million in additional revenue from higher catch taxes in 2023 and DKK 200 million in additional revenue from increased aquaculture taxes. See e.g. the High Commissioner of the Faroe Islands, *Orientering* (Briefing), no. 9, 2023 ([link](#)).

¹⁹ See Report F15, The Economic Council of the Faroe Islands, 2015 ([link](#)).

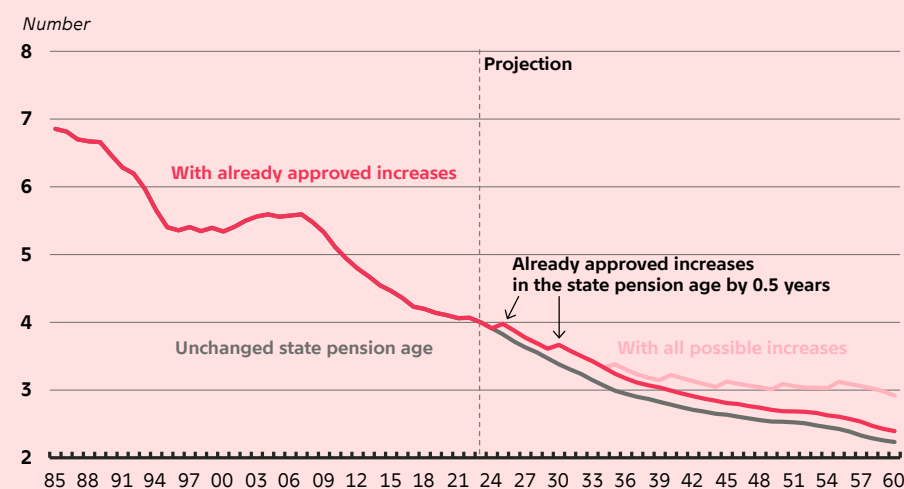
²⁰ People of working age are defined here as between the age of 15 and the state pension age at any given time.

²¹ Demographic forecasts for most countries are usually relatively accurate in the short and medium term. The reason is that most of the population growth is based on the number of births less deaths, which can be predicted with reasonable precision. The situation is different in the Faroe Islands, where a relatively high proportion of population growth is due to immigration. Firstly, it is difficult to predict the number of immigrants and emigrants in the coming years. Secondly, it is difficult to predict their age and gender.

CHART 14

The proportion of people below state pension age will drop significantly in the coming years

The chart shows the number of people of working age, defined as people between the age of 15 and the state pension age at any given time, compared to the number of people above state pension age.



Note: The light red graph shows the ratio of people of working age to people above retirement age, assuming all increases in the state pension age are realised within the current system. This is equivalent to raising the state pension age by 0.5 years every five years.

Source: Hagstova Forøya and own calculations.

The Faroese parliament has already decided to raise the retirement age in 2025 and 2030 by six months at a time, which will increase the number of people below retirement age by around 300 with each increase.²² However, increases in the state pension age will only counteract the increased proportion of older people in the population and increased longevity to a limited extent. Further increases in the state pension age can help to ensure a more even development in the relationship between working years and longevity across generations and thus contribute to improving long-term fiscal sustainability.

The demographic challenges of the coming years, combined with the fact that the Faroe Islands, as a small and relatively monolithic economy, is vulnerable to external factors, emphasises the need to address known challenges promptly whilst saving up in good times to ensure financial room for manoeuvre to support the economy during downturns.

²² For people born before 1 July 1957, the state pension age is 67 years. For people born between 1 July 1957 and 31 December 1962, the state pension age is 67.5 years. For people born after 31 December 1962, the state pension age is 68 years. For people born after this date, a calculation is made every five years to determine whether the retirement age should be raised. The retirement age can be increased by a maximum of 0.5 years each time. See e.g. the Report of the High Commissioner, 2022 ([link](#)).

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The analysis is available in a Danish, Faroese and English version. In case of doubt as to the correctness of the translation, the Danish version will prevail.

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