Summary

The Economic Council of the Faroe Islands has revised the growth in GDP in the years 2021 - 2023. In cooperation with Statistics Faroe Islands, the Faroese Economic Council estimates the GDP growth figures in current prices to be 7.3% in 2021, 11.2% in 2022 and 2.6% in 2023. Statistics Faroe Islands has also issued definitive GDP growth figures in current prices for the years 1998 to 2020.

	2019	2020	2021	2022	2023
Est. GDP-growth in current prices	8,6%	-2,8%	7,3%	11,2%	2,6%

Note: 2019 - 2020 are calculated by Statistics Faroe Islands. 2021 - 2023 are estimated by the Economic Council.
Source: Statistics Faroe Islands and the Economic Council.

The Faroese economy is still growing. The high activity is reflected in the low unemployment rate and urgent demand for labour in both the private and public sector. Wage expenditures are high, the number of employees so far in 2022 has hit a record, and there is still a surplus on the trade balance of goods. 2022 GDP growth is, however, marked by the high inflation reflected in both the global and domestic market. In 2021 the Faroe Islands experienced a high growth in GDP in current prices, which to a large extent stemmed from increased export volumes, conversely, the **high GDP growth in 2022** is largely **due to higher prices**. The GDP growth in 2022 does therefore not reflect a significant growth in economic activity as compared to 2021, but rather that the goods and services exported and imported have become more expensive.

If **GDP** were calculated **in constant prices**, then GDP growth in 2022 **would be lower** than the calculated GDP growth in current prices. In order to calculate GDP in constant prices a GDP deflator would be required, which is currently unavailable for the Faroese economy. If the consumer price index is used as an approximate alternative, the real GDP growth would be 3.9% in 2022, when the annual consumer price index growth in the 2nd quarter of 2022 of 7.3% is deducted from GDP growth in 2022 in current prices. In spring 2022 the Faroese Economic Council estimated that GDP growth in current prices in 2022 would reach 3.3%. GDP calculations in current prices hence pose challenges when comparing across years, particularly now when inflation is at its highest level in several years.

The Faroese Economic Council has revised the 2021 GDP growth using updated figures, while higher prices in particular have led to a revision of the preconditions underpinning GDP forecasts for the years 2022 and 2023. **Inflation** first hit during Covid-19 while countries were in lockdown, which caused i.a. supply shortages and transport delays. At the same time several countries implemented expansionary fiscal and monetary policies, which stimulated demand. The cost of energy and materials was already rising during Covid-19 and afterwards the war in Ukraine led to further increases in energy prices, as well as in commodity and food prices, which subsequently has spread to most of the goods and services we buy. Both oil and food prices have since fallen again.

The steep rise in the consumer price index in the 2nd quarter of 2022 is as high as it has ever been in the Faroe Islands in the past 14 years. While some goods are not purchased very often, other goods are necessity products that make up the bulk of ordinary **household** budgets. Increasing oil prices have had a significant impact on the disposable income of the households, as oil is used both to heat homes and fuel cars. Moreover, price increments for food in general have, amongst other reasons, been because of increased costs of transport and energy, which play a major role in the production of certain food products.

In order to restrain rising price levels central banks around the world have **increased the interest rates**. Though the Faroese households are aware that prices and interest rates are on the rise, there does not appear to be any major change in private consumption. Most households are in sound financial condition, as financial institutions have not reported any increases in requests for delayed instalments and arrears are not more frequent than usual amongst commercial banking customers.

The impact of inflation on **industry** differs between sectors but overall depends on the proportion of price increases that can be passed on to the customers. The **retail sector** reports a drop in demand for home

furnishings and luxury goods, which may be due to price hikes affecting household consumption patterns. On the other hand, it could also be explained by the relatively high domestic household spending in 2020 and 2021, particularly on goods such as home furnishings, home repairs and improvements, which has shifted since the households were allowed to resume international travel.

In the **construction industry** rising materials prices have been a factor for a while now. The activity in the construction industry has also led to wage pressures as the construction industry still reports a high demand for labour. The **tourism industry**, on the other hand, is characterised by great optimism; demand is high and 2022 is expected to become a record year. The new Fast Track scheme, which enables import of labour from third world countries, has eased labour shortages significantly, particularly in the tourism industry. It remains uncertain whether 2023 will prove as good a year for tourism as 2022, given that price hikes in transport as well as goods and service may cause travellers, who otherwise would like to visit the Faroe Islands, to alter their plans. In addition, Covid-19 still remains a cause for caution among travellers globally.

The export companies are subject to both positive and negative influence from inflation. In the first half of 2022 the price on both demersal fish and salmon increased significant. However, the production- and transport costs rose as well. Oil, which ships consume in large volumes, rose steeply in the first half of 2022. Another example is the flour used by salmon breeders to produce feed, which too has become significantly more expensive during this period. Hence, the increase in fish prices has not entirely been translated into increased profits for Faroese exporters. In August 2022 oil prices descended to levels before the Russian invasion of Ukraine, and the prices of e.g. wheat and salmon likewise have fallen again.

In spring several Faroese export companies took measures to halt exports to Russia in response to the Russian invasion, this is expected to cause a drop in prices, while trade with alternative markets is being developed. Fish farming exporters do not appear to have any difficulties finding new markets, and the demand for salmon is still higher than supply to a degree that the significant price increasements of salmon in the first half of 2022 have not led to any noticeable change in demand. To date, mackerel fisheries has generated relatively good prices, but an overall dip in mackerel prices is expected in 2022. The sale of herring for fish meal production has also yielded good prices. Cod prices are much higher in 2022 than the foregoing year, and also the price for haddock have seen a substantial increase. The increased export values derived from price rises in various fish species is, however, countered by increased import values. The inflation hitting import goods is contributing to push GDP growth in current prices down in 2022.

The **treasury deficit** is forecasted to reach DKK 216 million for 2022 (RLÚ 1), due to changes in both expenditure and revenue compared to the Budget Act of 2022. The original budget foresaw a DKK 38 million surplus in 2022. However, increased revenues from national government taxes amounting to DKK 50 million, and DKK 100 million in increased revenues from catch and license fees, in addition to DKK 75 million in extra dividend payment from BankNordik, yields a surplus of DKK +263 million in 2022. Subsequently, additional expenditure of DKK 200 million in supplementary allocations grants, DKK 150 million in additional investments, lower revenues from registration fees of DKK 50 million, as well as the likely postponement beyond 2022 of the sale of shares in Smyril Line worth DKK 79 million must be subtracted (DKK -479 million in total). When combined, this yields a deficit for 2022 of DKK 216 million. Both revenues and expenditures will be carried over from the 2022 estimate to 2023 at +3%, and revenues from the sale of Smyril Line amounting to DKK 79 million will be added. This means that the budget for 2023 is projected to a total deficit of DKK 225 million. It should, however, be noted that 2023 is an election year.

Fiscal policies must be sustainable – at present and in the long term

In spite of the heated economy, both the treasury and collective municipal budgets show deficits. With an unemployment rate close to nil and high revenue growth the public budgets should be yielding a surplus. Running budget deficits in 2022 and 2023 is in no way sustainable when the economy is booming, particularly knowing the upcoming challenges with rising expenditure associated with the aging population, i.e. increased costs to public pensions, care of the elderly, health care and other headings.

If supplementary appropriations are approved, they should be fully funded. If it proves necessary to allocate more funding to one area, then politicians should find the money to fund the additional requirement by either raising income or by reducing expenditure in other areas.

The municipalities too are running up a combined deficit in their annual budgets in the middle of an economic upswing, which, as with the central government, puts additional pressure on the economy, which is already under significant pressure from high economical activity in the private sector. This is precisely the time when the public sector ought to decrease spending and ensure public budget surpluses.

Experience shows that it is difficult for the political system to hold back and not increase spending during upturns. As the Faroese Economic Council has pointed out, it would be sensible if the political system were to enact fiscal policy regulations designed to safeguard the sustainability of any fiscal policies implemented by restricting expenditure growth to 2 – 3% per annum, while keeping investment levels constant.

Moreover, there is a need for tangible plans to ensure fiscal policies that are sustainable in the long-term. An aging population is a challenge for the fiscal sustainability of the Faroese economy, and it is critical that investments in care for the elderly and safeguarding the social care system are a current priority, i.e. by launching construction of housing units designed to enable more efficient management of the elderly care sector. One consequence of the current fiscal policy could become that this generation ties down future generations with debt owing to unsustainable fiscal policies.

Schemes should not encourage people to leave the Faroese labour market

Labour shortages remain a challenge for the Faroese society both as concerns the private and public sector. It appears that the new Fast Track scheme has improved the situation, in particular for the tourist industry; however, the construction industry still faces challenges recruiting. One obvious measure available to the government to remedy the situation would be to eliminate the tax rebate granted to Faroese people domiciled in the Faroe Islands, but working abroad. This would encourage residents to return to the Faroe Islands to work where they are needed.

Similarly, it is at present difficult to find qualified labour for the public sector; e.g. in childcare, social care and health care. In this context it would not be sensible to enact a law, which would allow public funding allocated to childcare to 'follow the child' in any setting. The proposed bill may encourage people to stay at home to look after their children instead of participating in the labour market, and this cannot be deemed sustainable given the current labour shortages, and even less so in the future when the need for labour, with growing numbers of older people in proportion to people in the working age, will become even greater.