Summary

The Economic Council of the Faroe Islands has revised the growth in GDP for 2022 – 2024 on basis of new data, and Statistics Faroe Islands has published final GDP growth figures in current prices for the years 1998 – 2021. In cooperation with Statistics Faroe Islands, the Economic Council has estimated the growth in GDP to be respectively 8.1% in 2022, 5.9% in 2023 and 1.4% in 2024.

	2020	2021	2022	2023	2024
GDP growth in current prices:	-2.7%	8.0%	8.1%	5.9%	1.4%

Note: 2020 and 2021 are Statistics Faroe Islands' statements. 2022, 2023 and 2024 are estimates made by the Economic Council of the Faroe Islands.
Source: Statistics Faroe Islands and the Economic Council of the Faroe Islands.

The key figures continue to show growth in the Faroese economy. Production (GDP) is expected to grow 5.9% in 2023, unemployment rates are historically low, wage expenditures are growing, employment is record high, and the balance of trade continues to remain in surplus.

Households have experienced high **increases in prices and interest rates** over the past year, but they are slightly more optimistic according to the latest consumer sentiment report from Statistics Faroe Islands. The number of households that find it difficult to make ends meet has not grown between January and June in 2023, and the financial institutions report only a slight increase in households that have asked for deferments so far in 2023 compared to one year ago. **Prices are increasing at a slower pace** now, compared to the past year, but more expensive groceries and interest rates hikes have made the cost of living for households higher; therefore, it is not unlikely that some of those who already were financially stretched will end in a more difficult situation if interest rates continue to rise. It is difficult to cut down on basic goods such as food, fuel and electricity; therefore, Faroese households have chosen to spend less on clothes, shoes and expensive furniture in the first quarter of 2023 compared to the previous year. Car dealerships also report that demand for cars has decreased significantly. On the other hand, the household's consumption abroad in the summer of 2023 has been at the same level as in the previous year. This would suggest that consumer sentiment is relatively high. **The Unemployment rate is historically low** (0.7% in July 2023), which means that most people in the workforce are employed, which in return allows them to maintain a certain level of consumption, even though they get less for their money.

Due to the increase in the cost of living, banks now set more stringent requirements for disposablemonthly amount, which in return limits how high price offers households can submit on houses. Additionally, building materials have become very expensive, making people reluctant to build new houses or buy one that requires major renovations. In and around Tórshavn, fewer houses were sold in the last six months of 2022, however, the number of sales increased again in the first half of 2023. **House prices** in and around Tórshavn are slightly **down** in the first half of 2023 compared to the first six months of 2022. However, if the first half of 2023 is compared to whole year 2022, then house prices in and around Tórshavn are more or less unchanged.

Statistics Faroe Islands' confidence barometer showed that the primary sector is less optimistic in June 2023 compared to January 2023. This is due to decrease in demand, increase in stock and expected price drops compared to 2022. The price of cod is expected to fall in the second half of 2023 and stay steady in 2024. As for salmon, both volume and prices are estimated to remain unchanged in 2023 compared to 2022, while the price is expected to drop slightly in 2024 while the volume produced is expected to increase slightly. However, the export of fishmeal pushes the total export value up in 2023, which is due to a significant increase in the quota for blue whiting in 2023 compared to 2022. The demand for mackerel is low at the moment, and some of the mackerel is landed abroad, to be produced to fishmeal, which decreases the export value of mackerel. However, the volume is expected to be the about the

same in 2023 and 2024 as in 2022. Political statements on changes in fisheries cooperation with Russia and uncertainties regarding export to Russia might have affected the answers given by the primary sector in the June 2023 report. In addition to export of fish, **tourism** is an export industry. So far this year, the activities regarding transportation of travellers, such as flight activity, have been very high, and almost all beds in hotels were occupied in June.

There are several large ongoing government, municipal and private building projects, which means that the major companies in **the construction industry** have ongoing projects for at least the next year and a half. The construction industry reports that lack of labour is the greatest and nearly the sole limitation in the construction industry today.

The Economic Council estimates that **the central government budget** will have a **deficit of DKK 30m in 2023** and a **deficit of DKK 202m in 2024**. The estimate is based on the latest budget proposal for 2023 that showed a surplus of DKK 150m. However, the Economic Council estimates that a further ca. DKK 150m of postponed investments will be used in 2023, and the Ministry of Finance estimates an additional DKK 30m or so in supplementary appropriations to cover various operational costs. For the 2024 central government budget, the Economic Council has projected the Treasury's expenses and income, and the estimated result is a deficit of about DKK 200m in 2024. This corresponds to the appropriation frameworks for 2024, as well as adding DKK 50m in postponed investments. Keeping in mind the growth in the Faroese economy with its record low unemployment rate and a growth in the Treasury's income, it is undoubtedly the case that a deficit in 2023 and 2024 is **poor fiscal management**—also considering both the current economic cycle and the growing challenge relating to fiscal sustainability as the ratio of older people to those in an employable age grows significantly.

Recommendations

The Faroes face a fiscal sustainability challenge. In a few years there will be relatively few taxpayers to support a welfare state like the one we have today. That the number of retired people grows proportionally faster than the employable population will result in public expenses outgrowing income. Therefore, **reforms must be initiated** now that **will improve fiscal sustainability** – the longer we wait, the higher the bill we leave for coming generations. One reform needed to improve sustainability is to **raise the retirement age**, which will have an effect on both the treasury's income and expenses.

Another reform that will lessen public expenses is to **establish a fiscal policy regulation**. Public expenses and investments have been correlating positively with the economic cycles over the last many years. When government revenues have been high, spending has been high and vice versa. This shows that it is difficult for the political system to stand against the pressure and not increase expenses in good times. In this way, economic policies have contributed to heating the economy in good times. Fiscal policy regulations must place a limit on the annual growth in public operating expenses to lessen the pressure on politicians to increase spending and investment, when the economy is doing well.

The political system also ought to make prognoses of government revenuesand expenses, when political initiatives are proposed. E.g., if lower taxes are proposed, the cost should not be calculated only for the fiscal year in which the new tax rates are to be initiated but also what they will cost in the next ten to twenty years. Thus, it becomes transparent what the entire tax relief costs. Such a prognosis would show what is needed in reforms and cuts if the proposal is initiated, and whether the proposal improves or worsens fiscal sustainability. Considering future generations, the political system ought **not** to **pass proposals which will put a pressure on future public expenditures**, such as cancelling set-offs in pension payments.

The great upturn in the Faroese economy is reflected in the low unemployment rate. The Faroes have for an extended period of time had historically low unemployment numbers, and a significant challenge for the economy is **lack of labour**. At the moment the challenge with lack of labour appears in several

places in society, e.g. due to staff shortage, many kindergartens have to close early, and senior homes have to shut down rooms. The political system needs to take this grave situation seriously. **To shorten the workweek reduces the supply of labour**. If the government continues with its plan to shorten the workweek, it will be necessary to increase the available labour market in another way as well as to finance the initiative so that the fiscal sustainability does not worsen. The growing number of older citizens calls for a greater supply of labour in the coming years. The consequence of the lack of labour is that production—and with it, welfare—will be lower than it could be. One consequence may be that the industry will hold back on new investments because they cannot find the employees needed. The political system should therefore **annul special arrangements that reduce labour supply** in the Faroes, such as tax deduction for Faroese who work abroad or state subsidy to fish factories through Fiskavirkisskipanin (a political instrument to subsidise fish factories), which keeps labour in a non-profitable industry. Nor should subsidy be given to fishermen through tax deduction for those working at sea (sjómannafrádráttur) or to the demersal fleet through mackerel quotas. One initiative, on the other hand, that increases labour supply is raising the retirement age.