Credit Opinion: Iceland

Iceland

Ratings

Category	Moody's Rating
Outlook	Stable
Country Ceiling: Fgn Currency Debt	Aaa/P-1
Country Ceiling: Fgn Currency Bank Deposits	Aa1/P-1
Iceland, Government of	
Outlook	Stable
Senior Unsecured MTN	Aa1
Commercial Paper	P-1
Other Short Term	P-1

Contacts

Analyst	Phone
Joan Feldbaum-Vidra/New York	1.212.553.1653
Kristin Lindow/New York	
Pierre Cailleteau/London	44.20.7772.5454

Key Indicators

Iceland

	2002	2003	2004	2005	2006	2007E	2008F
Real GDP (% change)	0.1	2.4	7.7	7.1	4.2	0.9	0.4
Inflation (CPI, % change Dec/Dec)	4.8	2.1	3.2	4.0	6.8	4.9	4.1
Gen. Gov. Financial Balance/GDP (%)	-2.5	-2.8	0.2	5.3	7.0	3.9	0.7
Gen. Gov. Primary Balance/GDP (%)	0.4	-0.1	2.6	7.4	9.1	6.6	3.2
Gross Gen. Gov. Debt/GDP (%)	43.3	40.6	35.4	25.5	28.9	29.4	27.3
Gross Gen. Gov. Debt/ Gen. Gov. Revenue (%)	104.0	95.0	80.1	53.7	59.3	60.4	57.9

Opinion

Credit Strengths

The credit strengths of Iceland include:

- Advanced level of economic and political development

with a GDP per capita among the highest in the world

and evenly distributed standard of living

- Healthy government finances, low public direct debt

- Longstanding political stability and consensus-based

society

- Increasingly diversified economic base

Credit Challenges

The credit challenges facing Iceland include:

- Heavy contingent liabilities for the government

deriving from a large, internationalized banking sector

- Small, open economy susceptible to an unusual degree

of macroeconomic volatility for a highly developed country

- Limited capacity of monetary policy to control macro

imbalances, given the openness of the financial market

Rating Rationale

The government of Iceland's foreign- and domestic-currency debt was downgraded to Aa1 on May 20, 2008 because the government's very large foreign-currency contingent liabilities raise uncertainties whether it has "unquestioned access to finance" -- which is a key characteristic of a triple-A sovereign according to a just-released comprehensive study by Moody's. These potential liabilities stem mostly from its large, internationalized banks whose financial strength ratings were recently downgraded to C-, lower than any other Aaa-rated country. Moody's believes that the government could handle a crisis in any sector, including the outsized banking sector and that the risk of disruptive systemic stress is low.

Iceland has many credit features that compare positively with other Aa rated countries. Among these are the country's advanced economic structure, low government debt, high per capita incomes, and nearly fully-funded pension system. Furthermore, its economy has proven itself to be unusually flexible and highly capable of withstanding shocks.

Strong private sector and commercial bank expansion in foreign markets and large foreign investment projects continue to help diversify the economy away from fishing, even as they introduce exaggerated but temporary macroeconomic imbalances. Government debt is low, equivalent to only about 30% of GDP, less than half the weighted average of Eurozone member countries. Government finances will continue to benefit in coming decades from favorable labor force demographics, with a young population, low unemployment, long working lives, and very healthy pension funding.

Rating Outlook

Moody's assigns a stable outlook on all of Iceland's ratings: Aa1 for government bonds and foreign-currency ceiling for bank deposits, and Aaa/P-1 for all other ratings.

What Could Change the Rating - Up

The ratings could revert to Aaa if the risk of a call on the government to take on enormous foreign currency exposure to support its banks would diminish significantly. It could also move up if uncertainties surrounding Iceland's unquestioned access to finance were fully to disappear.

What Could Change the Rating - Down

Iceland's Aa1 ratings incorporate a low-probability/high-severity banking crisis. Downward pressure would emerge only if Iceland displayed an inability to manage such a crisis, whether because of lack of sufficient access to financing or poor policy decisions.

Recent Results and Developments

The newly announced EUR 1.5 billion liquidity facility with Nordic central banks is a clear indication of the authorities' access to finance. This proactive arrangement of financing in advance of a low probability event of a banking system crisis is the mark of a high quality rating and a testimony to the government's ability to withstand shocks.

Difficult liquidity conditions for the banks are adding to domestic factors that are already slowing economic growth. The fiscal accounts are budgeted to remain in surplus for the year, but the slowdown in tax receipts due to weaker growth and tax cuts could lead to a smaller fiscal surplus than planned.

© Copyright 2008, Moody's Investors Service, Inc. and/or its licensors including Moody's Assurance Company, Inc. (together, "MOODY'S"). All rights reserved.

ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY COPYRIGHT LAW AND NONE OF SUCH INFORMATION MAY BE

COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT. All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, such information is provided "as is" without warranty of any kind and MOODY'S, in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness, completeness, merchantability or fitness for any particular purpose of any such information. Under no circumstances shall MOODY'S have any liability to any person or entity for (a) any loss or damage in whole or in part caused by, resulting from, or relating to, any error (negligent or otherwise) or other circumstance or contingency within or outside the control of MOODY'S or any of its directors, officers, employees or agents in connection with the procurement, collection, compilation, analysis, interpretation, communication, publication or delivery of any such information, or (b) any direct, indirect, special, consequential, compensatory or incidental damages whatsoever (including without limitation, lost profits), even if MOODY'S is advised in advance of the possibility of such damages, resulting from the use of or inability to use, any such information. The credit ratings and financial reporting analysis observations, if any, constituting part of the information contained herein are, and must be construed solely as, statements of opinion and not statements of fact or recommendations to purchase, sell or hold any securities. NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER. Each rating or other opinion must be weighed solely as one factor in any investment decision made by or on behalf of any user of the information contained herein, and each such user must accordingly make its own study and evaluation of each security and of each issuer and guarantor of, and each provider of credit support for, each security that it may consider purchasing, holding or selling.

MOODY'S hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MOODY'S have, prior to assignment of any rating, agreed to pay to MOODY'S for appraisal and rating services rendered by it fees ranging from $1,500 to approximately $2,400,000. Moody's Corporation (MCO) and its wholly-owned credit rating agency subsidiary, Moody's Investors Service (MIS), also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually on Moody's website at www.moodys.com under the heading "Shareholder Relations - Corporate Governance - Director and Shareholder Affiliation Policy."