

**Rating Action: Moody's changes outlook on Iceland's ratings back to stable**

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**Global Credit Research - 23 Apr 2010**

London, 23 April 2010 -- Moody's Investors Service has today changed the outlook on the Icelandic government's Baa3 foreign and local currency ratings to stable from negative. The outlooks on the foreign currency bond and deposit ceilings were also changed to stable from negative. The government's short term rating is Prime-3.

The change of outlook was driven by the improvement in Iceland's external liquidity due to the restoration of financing from the IMF and Nordic governments. "The successful passage of the IMF review and re-instatement of the Nordic credit line ensures that Iceland's external liquidity is now secure," says Kenneth Orchard, Vice-President/Senior Credit Officer in Moody's Sovereign Risk Group. "The resumption of official financial inflows into the country should also boost confidence and support the ongoing economic recovery."

Orchard recalled that Moody's changed the outlook on the government's rating to negative several weeks ago due to uncertainty about the country's external liquidity. In particular, Moody's observed that there was some risk that the Icelandic government would be unable to re-finance its maturing eurobonds in late 2011 and early 2012, forcing the central bank to redeem the bonds with its foreign exchange reserves, which would have been sufficient, but there was some uncertainty about the size of the buffer that would remain following the transaction.

However, the recent approval of the second review of Iceland's IMF programme, after a two month delay, and the re-instatement of the multilateral credit line from the Nordic governments, has dramatically improved external liquidity. The two facilities will provide Iceland with approximately €700 million in immediate financing. Iceland should also have access to an additional €1.56 billion from the IMF and Nordic governments over the next sixteen months. The 2011 and 2012 eurobonds have a combined nominal value of €1.25 billion.

"Iceland's ability to re-pay its Eurobonds is now relatively secure," Orchard says. "The renewed liquidity facilities from the IMF and Nordic governments provide a significant backstop if the government is unable to re-finance the bonds in the international capital markets."

Moody's notes that the Icesave dispute with the UK and Netherlands remains unresolved. However, the passage of the IMF review, and re-instatement of the Nordic credit line, suggest that the UK and Netherlands were unable to restrict Iceland's access to financing indefinitely. It also appears likely that a new Icesave deal will be more favourable for Iceland's public finances compared with the previous agreement.

Moody's notes that the economy continues to perform slightly better than expectations, even though the recovery following the 2008 crisis is expected to take several years. New investments in the aluminium and power sectors are forecast to help drive a return to positive GDP growth in 2011. The eruption of the volcano Eyjafjallajökull is not expected to have a material impact on Iceland's economy, as it is in a relatively remote location and air transport was closed for only a few days.

Orchard also mentioned that the government's fiscal consolidation programme remains broadly on-track to eliminate the primary deficit by next year. "Given the government's significant debt burden, continued fiscal consolidation is imperative to reduce the debt ratios to sustainable levels," Orchard emphasised.

The last rating action on Iceland was implemented on 6 April 2010, when Moody's changed the outlook on government's Baa3 local and foreign currency ratings to negative from stable.

The principal methodology used in rating the government of Iceland was Moody's Sovereign Bond methodology, published in September 2008 and available on [www.moody.com](http://www.moody.com) in the Rating Methodologies sub-directory under the Research & Ratings tab. Other methodologies and factors that may have been considered in the process of rating this issuer can also be found in the Rating Methodologies sub-directory on Moody's website.

New York  
Kristin Lindow  
Senior Vice President  
Sovereign Risk Group  
Moody's Investors Service  
JOURNALISTS: 212-553-0376

SUBSCRIBERS: 212-553-1653

London  
Kenneth Orchard  
VP - Senior Credit Officer  
Sovereign Risk Group  
Moody's Investors Service Ltd.  
JOURNALISTS: 44 20 7772 5456  
SUBSCRIBERS: 44 20 7772 5454



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