

FITCH DOWNGRADES ICELAND TO 'BBB-'; REMAINS ON RATING WATCH NEGATIVE

Fitch Ratings-London-08 October 2008: Fitch Ratings has downgraded the Republic of Iceland's long- and short-term Issuer Default ratings (IDRs) as follows:

- Long-term foreign currency IDR to 'BBB-' from 'A-';
- Long-term local currency IDR to 'A-' from 'AA'.
- Short-term IDR to 'F3' from 'F2';
- Country ceiling to 'BBB-' from 'A'.

All of Iceland's sovereign ratings remain on Rating watch Negative.

Maintenance of investment grade status reflects the Icelandic authorities' stated commitment to prioritise sovereign debt service. Fitch has been assured that the Central Bank of Iceland has set aside foreign exchange reserves to fund some US\$600 million of Euro and US dollar denominated commercial paper that matures over the coming months, after which sovereign external debt service is small (just US\$215 million in 2009).

Iceland faces a very severe recession which will result in a further deterioration in banks' domestic assets, while it remains uncertain as to the extent that the sovereign can distance itself from the foreign liabilities of failing Icelandic banks. Consequently, failure to develop a coherent and credible macroeconomic stabilisation programme, with support from the international financial community, notably the IMF, would likely result in further rating downgrades.

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