

March 21, 2001

Outlook on Iceland's FC Issuer Rating Revised To Stable From Pos; 'A+' FC Rating Affirmed

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LONDON (Standard & Poor's CreditWire) March 21, 2001--Standard & Poor's today affirmed its ratings on the Republic of Iceland, including its single-'A'-plus long-term foreign currency ratings, and revised the outlook on the long-term foreign currency issuer rating to stable from positive. (See list below.)

The outlook revision reflects growing external imbalances, which have led to a rapid increase in the level of external indebtedness to 265% of exports in 2000. The current account deficit reached 10% of GDP last year and this has been compounded by net foreign direct investment (FDI) outflows of 2% of GDP and negative portfolio flows caused by international diversification of Icelandic private pension funds. Standard & Poor's expects the economy's growth rate to slow to 1.7%, which is likely to reduce the current account deficit to a still-high 7.4% of GDP. External borrowing has been channelled principally through the domestic financial sector, which is characterized by a 40% market share by state-owned banks. As a result, the net external debtor position of the banking sector as a share of exports is expected to have almost doubled to 135% in 2001 from 1999. The banking system has become more vulnerable to adverse shocks as capital adequacy ratios and provision levels have weakened.

The applied policy mix has not been sufficiently restrictive to counter the declining domestic savings rate and to assure a gradual softening of the economy to more sustainable levels. Important recent

progress has been made in consolidating public finances. The general government surplus amounted to 2.9% of GDP last year and is estimated at a similar level in 2001. Tighter fiscal policy would have contributed to counter persistent overheating pressures. With the currency locked into an exchange rate band and the absence of capital controls, the more restrictive stance of monetary policy has been ineffective in reigning in unsustainable domestic credit expansion.

OUTLOOK: STABLE

The rating would be strengthened if domestic lending growth and external imbalances are reduced, while structural fiscal surpluses are maintained. Similarly, privatization of the state-owned banks would also bolster the ratings. Privatization could be used to attract FDI, which in turn would reduce balance of payments pressures and strengthen the financial resilience of the domestic banking sector. A reconciliation of conflicts between monetary and exchange rate policy would also be considered positive. A hard economic landing leading to difficulties in the financial sector and/or fiscal slippage could exert downward pressure on the ratings.

Standard & Poor's will host a conference call to discuss the credit outlook for Iceland at 3 p.m. GMT, 10 a.m. ET, tomorrow--Thursday 22, March 2001. Details will follow later today. -- CreditWire

RATINGS AFFIRMED, OUTLOOK REVISED TO STABLE FROM POSITIVE

Iceland (Republic of)

Long-term issuer credit rating (FC) A+

OUTSTANDING RATINGS AFFIRMED

Iceland (Republic of)

LC issuer credit ratings AA+/Stable/A-1+

FC short-term issuer credit rating A-1+

Senior unsecured debt (LC) AA+

Senior unsecured debt (FC) A+

Commercial paper A-1+

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