

Box 4 Credit ratings

International agencies assign credit ratings to the Republic of Iceland, Landsvirkjun (the National Power Company) and the three major commercial banks, Búnaðarbanki Íslands hf., Íslandsbanki hf. and Landsbanki Íslands hf. Credit ratings become increasingly crucial, the more that banks fund their operations in the markets rather than with deposits. The following is a summary of the most recent changes; the ratings of the Republic and the banks were upgraded at the end of 2002 and early in 2003.¹

The short-term ratings of Landsbanki Íslands and Búnaðarbanki Íslands were also upgraded from P-2 to P-1 in April. Moody's upgraded the short-term ratings of several commercial banks after a study which showed that it is natural for the short-term rating P-1 and long-term rating A3 to be in tandem under certain conditions. Fitch also assesses Íslandsbanki and Landsbanki and its ratings for them were unchanged in 2002 and the first part of this year.

Credit ratings for Íslandsbanki, Landsbanki Íslands and Búnaðarbanki Íslands

| | Moody's | | | Fitch | | |
|--------------------------|------------------|------------|--------------------|------------------|------------|--------------------|
| | Foreign currency | | | Foreign currency | | |
| | Long-term | Short-term | Financial strength | Long-term | Short-term | Financial strength |
| Íslandsbanki hf. | A1 | P-1 | B- | A | F1 | C |
| Landsbanki Íslands hf. | A3 | P-1 | C | A | F1 | C |
| Búnaðarbanki Íslands hf. | A3 | P-1 | C | | | |

The Republic of Iceland is assessed by three agencies: Moody's, Standard & Poor's and Fitch. In October last year Moody's was the first to upgrade the Republic's rating for long-term foreign obligations from Aa3 to Aaa.² This upgrade followed a review of Moody's assessment methodologies. In November Standard & Poor's upgraded its outlook for the Republic from negative to stable, and affirmed its other ratings. At the end of March 2003 Fitch also upgraded the Republic's outlook from negative to stable.

Moody's also assesses the three commercial banks and upgraded the ratings of them all in April this year. Íslandsbanki's long-term deposit and debt rating was upgraded from A2 to A1 and its financial strength from C+ to B-. Its short-term rating of P-1 was affirmed.

Credit ratings for the Republic of Iceland

| | Foreign currency | | Domestic currency | | Outlook |
|-------------------|------------------|------------|-------------------|------------|---------|
| | Long-term | Short-term | Long-term | Short-term | |
| Moody's | Aaa | P-1 | Aaa | P-1 | Stable |
| Standard & Poor's | A+ | A-1+ | AA+ | A-1+ | Stable |
| Fitch | AA- | F1+ | AAA | - | Stable |

The recent upgrading of ratings for the Republic and commercial banks is the result of both revised methodologies and an improvement in the economic situation and outlook in Iceland. Furthermore, the new bank formed by the pending merger between Búnaðarbanki Íslands and Kaupping will require a rating, which is expected to be made as soon as it begins operation. Moody's has already issued a statement that the planned merger will not have any effect on Búnaðarbanki's current rating.

1. For a discussion of the methodologies of credit rating agencies, see Ólafur Ísleifsson: "Iceland's international credit ratings", *Monetary Bulletin* 2001/3.

2. The credit ratings of Australia and New Zealand were raised from Aa2 to Aaa at the same time.