

Iceland

Quantitative Factors (Relative Weights in any New Rating, or change to Existing Rating or Outlook)

24-May-19 **Date of This Review**

07-Dec-18 **Date of Last Review**

Weight	Factor	2016		2017		2018		2019		2020	
		A	A	A	A	E	E	F	F	F	F
Low	GDP per capita (USD, mkt exchange rates)	61,758	61,467	71,723	71,767	77,040	73,949	68,407	70,332	71,811	69,973
Low	Real GDP Growth (%)	7.4	6.6	4.0	4.6	4.5	4.6	3.0	0.0	2.6	2.5
Low	Consumer prices (annual average % change)	0.8	0.8	-1.6	-1.6	0.6	0.7	1.5	1.5	2.0	2.0
Low	General government balance (% of GDP)	12.3	12.4	1.5	0.5	1.2	1.1	1.2	0.6	1.2	0.8
Low	General government debt (% of GDP)	51.7	51.2	41.4	43.1	36.7	37.7	33.2	35.7	29.9	32.7
Low	Current account balance plus net FDI (% of GDP)	11.0	11.0	3.7	4.3	3.8	1.1	3.6	2.9	2.8	2.9
Low	Net external debt (% of GDP)	31.5	31.9	30.8	30.9	22.7	24.4	19.8	19.5	14.0	14.1

Colour key

n/a	IMF Development Classification	DM	Improvement relative to previous review
n/a	CDS Market Implied Rating as at: 08-May-2019	BBB+	Deterioration relative to previous review

Qualitative Factors (Relative Weights in any New Rating, or change to Existing Rating or Outlook)

Weight	Factor	Change since last review
Low	Fiscal Financing Flexibility	Stable
Low	Public Debt Sustainability	Stable
Low	External Vulnerability	Positive
Low	Banking System Strength	Stable
Low	Political Risk/Uncertainty	Stable
Low	Macro-economic Outlook, Policy Coherence and Credibility	Negative
Low	Business Environment and Competitiveness	Stable
High	Other Factors	Positive

Summary: Strength and Weaknesses

Factor	Status	Trend
Macroeconomic	Weakness	Stable
Public Finances	Neutral	Positive
External Finances	Weakness	Stable
Structural Issues	Strength	Stable

Footnotes

- The risks, limitations and uncertainties associated with the ratings are detailed in the Rating Action Commentary.
- Weights - 'High'/'Medium'/'Low' - reflect the relative importance of each Quantitative and Qualitative Factor in the context of a change in the rating or Outlook.
- Weights for Economic Development (IMF Development Classification) and Indicator of Default (CDS Market Implied Rating) will always be n/a because these indicators are not referenced in the Fitch Sovereign Rating Criteria.
- All other relevant rating factors are referenced in the Rating Action Commentary

Discussion Note

Issuer: Iceland

Date of Rating Committee: 22/05/2019

Rating Committee Chair confirms that the Rating Action Report (RAR) is complete and correct, including:

Indicator of default is disclosed, where available (CDS Implied Rating) (Y)

Indicator for economic development is disclosed (EM/DM indicator) (Y)

Weightings of quantitative and qualitative factors are disclosed only for changes in existing ratings or Outlooks and for newly assigned ratings (**for EU Regulated Issuers Only**) (Y)

SRM Output: A+

QO Adjustment: -1 notch (-1 on External Finances)

Final Rating: A

Summary of Discussion

The rating committee discussed the following key issues:

Iceland's medium-term growth potential, impact of shocks from WowAir collapse and pelagic fishing catch, broader pressures in tourism sector, trends in productivity and competitiveness including recent wage agreement, trends in private sector leverage and in real estate sector.

Exchange rate developments and monetary policy; Central Bank of Iceland (CBI) FX interventions and lowering of special reserve requirement; potential impact of Icelandic pension fund portfolio diversification, expectations for interest rates.

Trends in current account, external debt, FX reserve adequacy, risks to capital flows, overall assessment of vulnerability to external shocks.

Impact of the lifting of restrictions on offshore krona assets in March, broader capital control policy, and implications for the Country Ceiling.

Government budget balance and trends, including impact of slowing GDP growth and expected policy response. Debt dynamics projections, fiscal rule and role of sovereign wealth fund.

Banking sector developments including trends in capital adequacy, profitability, credit dynamics, and asset quality including implications of shocks in tourism sector and potential house price correction.

Coalition government dynamics, outlook for economic reform and continuity in macro and fiscal strategy.

Application to Iceland of Fitch's update on 2 May of the Short-Term Ratings Criteria.

Credit strengths and weaknesses, and rating peer comparisons

Potential rating actions, drivers, sensitivities and assumptions

The main opinions and conclusions of the committee are recorded in the RAC.

Definitions

Per capita income: GDP per capita (USD, mkt exchange rates)

Gross domestic product at current market prices in the local currency and converted into US dollars at annual *average* market exchange rates. GDP is the sum of consumption (private and government) *plus* gross fixed capital formation *plus* the change in inventories *plus* exports of goods and services *minus* imports of goods and services. Source: National authorities, international institutions.

GDP growth: Real GDP growth (%)

Annual percentage change (calendar year on calendar year) of a country's GDP in constant prices (ie, volume terms). Source: National authorities, international institutions, Datastream.

Inflation: Consumer prices (annual average % change)

Annual percentage change in the national consumer price index (CPI). Note: these are period averages, *not* year-end to year-end. Source: National authorities, international institutions, mainly IMF IFS.

Fiscal Balance: General government balance (% of GDP)

Consolidated balance of central government, provincial, regional and local governments, social security funds and other extra-budgetary funds; data may be presented on a cash or, more generally and preferably, on an accruals basis. Net lending is treated as an expenditure item and is *included* in the general government balance. Privatisation receipts are treated as a financing item and are *excluded* from the general government balance.

Note: in some countries data are available only for a fiscal year not coinciding with the calendar year. Where this is so, fiscal data are allocated to that calendar year in which the larger part of the fiscal year falls. For fiscal years running July-June, fiscal data are allocated to the year ending 30 June (ie, 1990/91 = 1991). Also note that for euro area countries, the figures may differ from those produced by Eurostat due to Fitch's treatment of UMTS receipts. Source: National authorities, international institutions.

Fiscal Debt: General government debt (% of GDP)

Year-end debt stock of the general government (as defined above); data comprise domestic and externally contracted debt regardless of maturity, and include monetary authorities' debt issued on behalf of the government. Contingent liabilities such as guaranteed debt are excluded, except where these are specified as a line item in the budget. Source: National authorities, international institutions.

External Balance: Current account balance plus net FDI (% of GDP)

Current account balance plus the net annual flow of foreign direct investment (US dollar value of FDI in the economy less resident FDI abroad), expressed as a percentage of GDP. Source: Fitch estimates based on national authorities and IMF.

External Debt: Net external debt (% of GDP)

Calculated by deducting certain classes of gross external assets from a country's gross external debt (GXD). All figures are converted into US dollars at year-end exchange rates and are expressed as a percentage of GDP. A minus sign indicates that the country is a net external creditor (ie, contractual external claims exceed liabilities). For all countries, the definition of gross external assets mirrors the definition of GXD, ie, exclusion of equity FDI and portfolio equity investment.

Fitch has therefore modified the definition of gross external assets for emerging countries, as it previously used "narrow" gross external asset definition, which excluded non-bank private-sector external assets for these countries. Therefore, the claims of the non-bank private sector would be included, on the grounds that these are the product of rational portfolio management and generate an identifiable income stream for the country of origin. Note that for those emerging markets that have entered into Brady debt deals collateralised by US zero-coupon bonds, the US dollar value to date of that collateral is included in official assets. Source: IMF IFS, national authorities, international institutions.

Economic Development: IMF Development Classification

Countries classified as Advanced Economies in the latest IMF World Economic Outlook are reported as Developed Markets (DM). Emerging Market and Developing Economies are reported as Emerging Markets (EM). Source: IMF World Economic Outlook, Fitch classifications for sovereigns not referenced in the IMF World Economic Outlook.

Indicator of Default: CDS Market Implied Rating

Derived from the Fitch CDS Implied Ratings (CDS-IR) model, which processes the collective marketplace view of issuers' credit condition based on its CDS pricing. Source: CDS-IR Fitch Solutions, CDS IHS Markit.



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