Republic of Iceland 'AA-/A-1+' FC Ratings Affirmed On Healthy Public Finances; Outlook Stable

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LONDON (Standard & Poor's) Oct. 31, 2005--Standard & Poor's Ratings Services said today it affirmed its 'AA-' long-term foreign currency and 'AA+' long-term local currency sovereign credit ratings on the Republic of Iceland. At the same time, the 'A-1+' short-term foreign and local currency ratings on Iceland were affirmed. The outlook is stable.

The full analysis on Iceland is available to subscribers of RatingsDirect, Standard & Poor's Web-based credit analysis system, published earlier today.

"The ratings on Iceland are supported by its stable political institutions, a very wealthy and flexible economy, and healthy public finances," said Standard & Poor's credit analyst Kai Stukenbrock. "The ratings remain constrained by very high levels both of external financing needs and of external debt throughout the economy."

The financial sector in Iceland has recovered from the imbalances created by the pre-2001 lending boom. Improved regulation and supervision, as well as the expansion of operations within the Scandinavian region and beyond, and the recent entry of commercial banks into the mortgage market, leave the sector much more resilient and less sensitive to developments in the Icelandic economy, as well as providing easier access to funds. Nevertheless, rapidly increasing levels of already very high external leverage are a source of concern.

Public finances remain healthy. Thanks to strong economic growth, privatization proceeds, and budget surpluses up to and including 2006, gross general government debt will continue to decline rapidly, to less than 22% of GDP by 2008, from 50% in 2001.

Growth is forecast to average 3.9% between 2005 and 2008. The boom in domestic demand and credit growth that is driving economic expansion is also fueling macroeconomic imbalances, however, creating the risk of a disorderly unwinding once the demand boom ends.

External financing needs are among the highest of any rated sovereign, driven by very high levels of external debt throughout the economy, and large current account deficits. Levels of net external debt continue to rise rapidly, despite a steep decline in central government debt.

In addressing the expansionary pressures, monetary policy is already carrying the majority of the burden, increasing the risk of unbalanced economic adjustment once demand growth comes to an end.

"Consequently, adhering to, or better still exceeding the government's medium-term fiscal framework is central to maintaining the sovereign ratings," said Mr. Stukenbrock. "Any further significant increase in net external leverage, or an aggravation of macroeconomic imbalances on the back of the large investment projects could weaken Iceland's creditworthiness."