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Research Update:

Republic of Iceland Ratings Lowered And Removed From CreditWatch Negative

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Rationale

On Oct. 6, 2008, Standard & Poor's Ratings Services lowered its foreign currency sovereign credit rating on the Republic of Iceland to 'BBB/A-3' from 'A-/A-2' and its local currency sovereign credit rating to 'BBB+/A-2' from 'A+/A-1'. At the same time, Standard & Poor's removed the long-term ratings from CreditWatch, where they were placed on Sept. 29, 2008, with negative implications. In addition, Standard & Poor's lowered its transfer and convertibility assessment on Iceland to 'A-' from 'AA-'.

In conjunction with these rating actions, Standard & Poor's also lowered its foreign currency ratings on Ibudalanasjodur (Housing Financing Fund; HFF), the government-owned enterprise for housing finance, to 'BBB/A-3' from 'A-/A-2' and its local currency rating to 'BBB/A-3' from 'A+/A-1'. In addition, Standard & Poor's removed the long-term ratings on HFF from CreditWatch, where they were placed Sept. 29, 2008, with negative implications.

The outlook on both the Icelandic government and HFF is negative, which indicates that the balance of risks is on the downside.

These rating actions follow the Icelandic government's announcement that it will guarantee deposits of the domestic banking system and its submission to parliament today of legislation to grant the Financial System Supervisor greater power to intervene in Icelandic banks. In a speech to the Icelandic public today, Prime Minister Geir Haarde implied that depositors and creditors of overseas subsidiaries of Icelandic banks must rely on the financial resources of the overseas subsidiaries themselves and even warned that the Icelandic banks may "become to some extent non operational." Standard & Poor's believes that these measures will help to limit the contingent fiscal risks to the government and thus help preserve the investment-grade rating, but they will also limit the Icelandic banking system's access to international markets, which in turn will engender a contraction of real GDP that is much sharper than we had foreseen. This economic contraction, combined with the depreciation of the krona, will hurt the asset quality of the banks, depress the fiscal revenues of the state, and markedly alter what had been low government debt levels.

Outlook

The removal of the ratings from CreditWatch indicates our view that the acute pressures on the nation's external position will be staunchly resisted by these government efforts to preserve the domestic banking system at the expense of its foreign subsidiaries and perhaps its external creditors and by efforts we expect shortly to augment international reserves. The negative outlook speaks to more medium-term issues regarding the ability of policymakers to adjust the

Icelandic model to lower and less volatile growth, with a much smaller contribution from its financial sector.

Ratings List

Downgraded

	To	From
Iceland (Republic of)		
Sovereign Credit Rating		
Foreign Currency	BBB/Negative/A-3	A-/Watch Neg/A-2
Local Currency	BBB+/Negative/A-2	A+/Watch Neg/A-1
Senior Unsecured (5 issues)		
Foreign currency	BBB	A-/Watch Neg
Senior Unsecured (7 issues)		
Local currency	BBB+	A+/Watch Neg
Commercial Paper		
Foreign Currency	A-3	A-2
Transfer & Convertibility Assessment		
Local Currency	A-	AA-
Iceland (Republic of)		
Short-Term Debt (1 issue)	A-2	A-1
Commercial Paper (2 issues)	A-3	A-2
Landsbanki Islands		
Subordinated (1 issue)	BBB/Watch Neg	A-/Watch Neg
Ibudalanasjodur (Housing Financing Fund)		
Sovereign Credit Rating		
Foreign Currency	BBB/Negative/A-3	A-/Watch Neg/A-2
Local Currency	BBB/Negative/A-3	A/Watch Neg/A-1
Ibudalanasjodur (Housing Financing Fund)		
Senior Unsecured (4 issues)	BBB	A-/Watch Neg

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