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Moody's says Icesave amendment supports fiscal sustainability

Amendment to agreement mildly positive for rating, but negative outlook remains

London, <Rating Date Pending> -- Moody's Investors Service expects the planned amendment to Iceland's agreement with the British and Dutch authorities -- over compensation for former Icesave depositors -- to be mildly positive for the government's Baa1 rating, although several outstanding challenges mean the negative outlook prevails.

In June 2009, the Icelandic government came to an agreement with the UK and the Netherlands to cover the re-payment of their residents' deposits in the Icesave division of failed Icelandic bank Landsbanki. The agreement, which meant a significant increase in the country's government debt, was met with popular and political resistance in Iceland.

The Icelandic parliament is now in the final stages of amending the bill for the state guarantee to the agreement. The amendment will place a limit on the government's debt service on an annual basis, as well as providing some insurance if the size of the debt is significantly more than expected. The amendment also formalises a mechanism for renegotiating the agreement if the economic recovery is weaker than forecast.

Moody's considers the amendments to be mildly positive for the government's rating. "By flattening the debt payment profile, the government will gain more time to repair its financial position," says Kenneth Orchard, a Vice President-Senior Analyst in Moody's Sovereign group. "The amendments also reduce the risk of a shock jeopardising the government's creditworthiness in the earlier stages of repayment".

However, while the amendment should support fiscal sustainability, some outstanding challenges mean Moody's does not change its negative outlook on the government's Baa1 rating. In particular, Moody's continues to be concerned about the trajectory of the currency. As private sector debt is relatively high in Iceland, failure to stabilise the currency could severely hinder an economic recovery, if it prevents a reduction in interest rates.

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