

Rating Action: Moody's: Iceland's ratings outlook changed to negative from stable

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London, 06 April 2010 -- Moody's Investors Service has today changed the outlook on the Icelandic government's Baa3 ratings to negative from stable, prompted by ongoing uncertainty related to the country's external liquidity. The outlooks on the Baa2 foreign currency bond ceiling and Baa3 foreign currency deposit ceiling were also changed to negative from stable.

"The recovery of the Icelandic economy is threatened by the delays in the resolution of the Icesave dispute, which constitutes an obstacle in the resumption of official and private financial flows into the country," says Kenneth Orchard, Vice-President/Senior Credit Officer in Moody's Sovereign Risk Group.

The negotiations with the UK and Netherlands over Iceland's reimbursement of Icesave depositors may yet yield a more favourable outcome for Iceland's public finances compared with the previous agreement, according to the analyst. Still, the level of uncertainty generated by such protracted discussions is harmful to short-term economic and financial prospects.

In this context, while there are no immediate payment concerns, Moody's notes that the stalled negotiations have created some risk that the government may not be able to re-finance its December 2011 and May 2012 eurobonds in the international capital markets.

"The central bank is projected to have sufficient resources to repay the issues when they mature and, in fact, the central bank has been actively buying the issues in the secondary market," Orchard remarks. "However, there is some doubt whether the size of the buffer that would exist following repayments would be consistent with an investment grade sovereign rating."

Moody's notes that the economy performed much better than expected in 2009. However, the economy is likely to underperform forecasts in 2010, perhaps contracting by 5% or more. "The ongoing uncertainty and lack of foreign financing means that planned investment projects in the aluminium and power sectors will probably be delayed," Orchard says. "These projects were anticipated to offset a considerable decline in other investment."

The Icelandic government recently announced that it is seeking to resume its programme with the IMF and its associated financing from other Nordic countries. The second review of the IMF programme has been blocked by the British and Dutch governments ever since the Icelandic president declined to sign the Icesave bill in January. In Moody's opinion, a resumption of the programme would be a positive development, but may not be sufficient on its own to maintain Iceland's external liquidity at an investment grade level, especially without the full re-instatement of the liquidity facility from the Nordic countries.

Moody's will continue to monitor Iceland's liquidity and market access situation on an ongoing basis. In what we consider to be the most likely case, the conclusion of an agreement settling the Icesave dispute, allowing the resumption of the Nordic loan programme, would cause the outlook to be changed back to stable. Alternatively, in the less likely -- but significantly more problematic -- case that Iceland is unable to normalise international financial flows, the rating would likely be placed on review for possible downgrade.

The last rating action on Iceland was implemented on 11 November 2009, when Moody's downgraded the government's local and foreign currency ratings to Baa3 with a stable outlook from Baa1 with a negative outlook.

The principal methodology used in rating the government of Iceland was Moody's Sovereign Bond methodology, published in September 2008 and available on www.moody.com in the Rating Methodologies sub-directory under the Research & Ratings tab. Other methodologies and factors that may have been considered in the process of rating this issuer can also be found in the Rating Methodologies sub-directory on Moody's website.

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