

Announcement: Iceland

Moody's issues annual report on Iceland

New York, April 08, 2008 -- In its annual report on Iceland, Moody's Investors Service says the government compares very favorably against its Aaa- and Aa-rated peers on many important credit rating metrics, both quantitative and qualitative.

"Iceland looks better on many measures including low government debt, high per capita income, economic flexibility, a relatively young demographic profile, and its pension system dynamics," said Moody's Analyst Joan Feldbaum-Vidra, author of the report, which describes the difficult macroeconomic and financial conditions the country is currently facing after years of overheating. "The economy is heading for a difficult landing that could lead to negative GDP growth for a few quarters," she said.

These and other concerns have led to unprecedented risk premia on Icelandic debt. "Because conditions have objectively worsened and risk has heightened, the authorities in Iceland may have to find ways, like in other countries, to support the financial system," notes Feldbaum-Vidra. "It is our view that current spreads exaggerate credit risk by a large measure."

Noting that the economy has been extremely flexible in response to shocks, she said Moody's does not see a crisis that would disrupt the payments ability of the government.

The report references the large buildup in external debt by the banks over this recent period of overheating. "Most of this has financed investments abroad or Icelandic corporates with natural hedges in foreign currency," said Feldbaum-Vidra. "Our concern is that these foreign currency contingent liabilities are stretching the sovereign authorities' lender of last resort capacity in a way that is not compatible with a Aaa standing."

This concern prompted the change in outlook on Iceland's Aaa government ratings to negative from stable in March. Feldbaum-Vidra authored a special comment entitled "Iceland's Aaa Rating at a Crossroads" in January 2008, describing Moody's views on Iceland's ratings dynamics.

She said the "Crossroads" report, and a subsequent special comment on bank bail-outs by Aaa-rated countries entitled "Anchors in the Storm," outline Moody's Sovereign Risk Unit's current examination of the stringent requirements to maintain a Aaa sovereign rating. She said that a series of analytical papers on this and related rating topics will be published in coming months.

Referring to the rapid buildup in external debt and strong credit growth, the analyst said, "Perhaps it reflects the banks' overly optimistic profitability forecasts and of course it exposes the country to greater financial volatility. As an advanced economy and a member of the Nordic community, the sovereign is well-equipped to handle problems that could crystallize from this or any other sector in the economy."

She said that recent Central Bank of Iceland measures are helping ease the difficult funding conditions currently prevailing for the banks. Also, a more relaxed fiscal policy will soften the blow of the economy's hard landing. Feldbaum-Vidra pointed out that public investment projects previously delayed because of the overheating conditions in the economy are now getting underway.

Moody's report, "Iceland: 2008 Credit Analysis" is a yearly update to the markets and is not a rating action.

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