

September 29, 2008

Research Update:

Republic of Iceland Cut To FC 'A-/A-2', LC 'A+/A-1' On Support For Glitnir Bank; On Watch Neg

Primary Credit Analyst:

Eileen X Zhang, CFA, London (44) 20-7176-7105; eileen_zhang@standardandpoors.com

Secondary Credit Analysts:

John Chambers, CFA, New York (1) 212-438-7344; john_chambers@standardandpoors.com

Kai Stukenbrock, Frankfurt (49) 69-33-999-247; kai_stukenbrock@standardandpoors.com

Table Of Contents

Rationale

Credit Watch

Ratings List

Research Update:

Republic of Iceland Cut To FC 'A-/A-2', LC 'A+/A-1' On Support For Glitnir Bank; On Watch Neg

Rationale

On Sept. 29, 2008, Standard & Poor's Ratings Services lowered its long- and short-term foreign currency sovereign credit ratings on the Republic of Iceland to 'A-/A-2' from 'A/A-1', and its local currency sovereign credit ratings to 'A+/A-1' from 'AA-/A-1+'. In addition, the long-term ratings were placed on CreditWatch with negative implications. Furthermore, the transfer and convertibility assessment on Iceland was lowered to 'AA-' from 'AA'.

At the same time, Standard & Poor's also lowered its foreign currency ratings on Ibudalanasjodur (Housing Financing Fund), the government-owned enterprise for housing finance, to 'A-/A-2' from 'A/A-1', and its long-term local currency rating to 'A' from 'A+'. The short-term local currency rating of 'A-1' was affirmed. The long-term ratings on Ibudalanasjodur were also placed on CreditWatch with negative implications.

The rating actions follow the Icelandic government's announcement that it has injected €600 million (5.9% of GDP) of equity into Glitnir Bank, one of Iceland's three large commercial banks. The injection was prompted by mounting liquidity difficulties at the bank, and will give the government 75% ownership of the bank. (For details of the rating action concerning Glitnir, see related research update titled "Glitnir Bank Rating Lowered To 'BBB/A-3' From 'BBB+/A-2'; Outlook Remains Negative," published earlier today on RatingsDirect.)

The required capital injection underlines our often-stated concerns about the high external leverage of the Icelandic financial system, and the contingent liabilities this poses to the sovereign. Due in part to banks' financing of their own rapid expansion abroad as well as that of several local entrepreneurs, net external debt of the financial system has risen to 362% of current account receipts (CARs) in 2007, from 161% in 2003. Domestic credit to GDP, meanwhile, has risen to over 384% from 130% in the same period. These are among the highest ratios for rated sovereigns.

The general government's low net debt burden (forecast at 12.5% of GDP in 2008 prior to the equity injection), including sizeable deposits at the central bank (of more than 27% of GDP by end of August) offer the government sufficient resources to provide Glitnir with the announced equity injection. It should also offer a buffer to address the potential need for further short-term liquidity support to the system. Due to its size and structure, the financial sector will continue to pose a large contingent liability to the sovereign, particularly as both the current international financial environment as well as events in Iceland will further complicate the Icelandic banks' efforts to secure external financing.

CreditWatch

The CreditWatch action, which we aim to resolve in the next three months, reflects prevailing downside risks. Should the financial profile of the financial sector (covering external and domestic liquidity, profitability, and asset quality) deteriorate, leading to further government support and further undermining the nation's external profile, the government's ratings could be lowered. The ratings could stabilize at the current level if the Icelandic banking system's risks to the sovereign are attenuated, either through foreign entry to the system or through an improved external funding profile.

Ratings List

Downgraded

	To	From
Iceland (Republic of)		
Sovereign Credit Rating		
Foreign currency long-term	A-/Watch Neg	A/Negative
Foreign currency short-term	A-2	A-1
Local currency long-term	A+/Watch Neg	AA-/Negative
Local currency short-term	A-1	A-1+
Foreign currency senior unsecured	A-/Watch Neg	A
Local currency senior unsecured	A+/Watch Neg	AA-
Commercial paper foreign currency	A-2	A-1
Transfer & Convertibility Assessment	AA-	AA

Ibudalanasjodur (Housing Financing Fund)

Sovereign Credit Rating		
Foreign currency long-term	A-/Watch Neg	A/Negative
Foreign currency short-term	A-2	A-1
Local currency long-term	A/Watch Neg	A+/Negative
Local currency short-term	A-1	A-1
Local currency senior unsecured	A-/Watch Neg	A

Landsbanki Islands

Foreign currency subordinated issue*	A-/Watch Neg	A
--------------------------------------	--------------	---

*Guaranteed by the Republic of Iceland

Additional Contact:

Sovereign Ratings; SovereignLondon@standardandpoors.com

Ratings information is available to subscribers of RatingsDirect, the real-time Web-based source for Standard & Poor's credit ratings, research, and risk analysis, at www.ratingsdirect.com. It can also be found on Standard & Poor's public Web site at www.standardandpoors.com; select your preferred country or region, then Ratings in the left navigation bar, followed by Credit Ratings Search. Alternatively, call one of the following Standard & Poor's numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44)

20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm
(46) 8-440-5914; or Moscow (7) 495-783-4017.

Copyright © 2008 Standard & Poor's, a division of The McGraw-Hill Companies, Inc. (S&P). S&P and/or its third party licensors have exclusive proprietary rights in the data or information provided herein. This data/information may only be used internally for business purposes and shall not be used for any unlawful or unauthorized purposes. Dissemination, distribution or reproduction of this data/information in any form is strictly prohibited except with the prior written permission of S&P. Because of the possibility of human or mechanical error by S&P, its affiliates or its third party licensors, S&P, its affiliates and its third party licensors do not guarantee the accuracy, adequacy, completeness or availability of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. S&P GIVES NO EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE. In no event shall S&P, its affiliates and its third party licensors be liable for any direct, indirect, special or consequential damages in connection with subscriber's or others use of the data/information contained herein. Access to the data or information contained herein is subject to termination in the event any agreement with a third-party of information or software is terminated.

Analytic services provided by Standard & Poor's Ratings Services (Ratings Services) are the result of separate activities designed to preserve the independence and objectivity of ratings opinions. The credit ratings and observations contained herein are solely statements of opinion and not statements of fact or recommendations to purchase, hold, or sell any securities or make any other investment decisions. Accordingly, any user of the information contained herein should not rely on any credit rating or other opinion contained herein in making any investment decision. Ratings are based on information received by Ratings Services. Other divisions of Standard & Poor's may have information that is not available to Ratings Services. Standard & Poor's has established policies and procedures to maintain the confidentiality of non-public information received during the ratings process.

Ratings Services receives compensation for its ratings. Such compensation is normally paid either by the issuers of such securities or third parties participating in marketing the securities. While Standard & Poor's reserves the right to disseminate the rating, it receives no payment for doing so, except for subscriptions to its publications. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

Any Passwords/user IDs issued by S&P to users are single user-dedicated and may ONLY be used by the individual to whom they have been assigned. No sharing of passwords/user IDs and no simultaneous access via the same password/user ID is permitted. To reprint, translate, or use the data or information other than as provided herein, contact Client Services, 55 Water Street, New York, NY 10041; (1)212.438.9823 or by e-mail to: research_request@standardandpoors.com.