Rating Action: **MOODY'S REPORTS: ICELAND'S Aaa RATINGS AND STABLE OUTLOOK BASED ON ECONOMIC RESILIENCY AND SOUND PUBLIC FINANCES**

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New York, June 05, 2003 -- In its new annual report, Moody's Investors Service says Iceland's Aaa ratings and stable outlook are based on a resilient economy with a proven capacity to absorb sizeable economic dislocations. In addition, Iceland boasts healthy government finances, longstanding political stability, and standards of living considerably above the OECD average.

"The ratings are also supported by a structural economic adjustments undertaken during the 1990's, including fisheries management as well as market liberalization, fiscal consolidation, and privatization," say Moody's sovereign analysts Kristin Lindow and Joan Vidra, authors of the report. Moody's also cites increased export diversification, both within the all-important fisheries industry and as a consequence of the development of significant aluminum smelter capacity, and low and declining government direct debt.

The Icelandic economy has reached a relatively benign juncture after a serious bout of overheating in the late1990's that was characterized by huge current account deficits and rapid inflation. Still, the mild recession of 2002 represented a softer landing than Moody's had feared, demonstrating once again the economy's remarkable resilience, with much of the impact being absorbed by the external sector thanks to the relatively flexible labor market, the shift to a floating exchange rate in early 2001, and credible inflation targeting.

Concerns linger about the possible emergence of a new boom-and-bust cycle, given the decision to proceed with a large new aluminum smelter and related power generation facilities, says Moody's. "While controversial because of their negative impact on the government-guaranteed external debt levels, increasing Iceland's vulnerability to external shocks as they expose the small, open economy to wide swings in activity, the new smelter and other industrial expansions are integral to the government's long-term strategy to diversify the economy and its exports," say the analysts. "It is also expected to partly mitigate the population drift toward the southwest of the country."

Spending restraint kept public finances in rough balance last year as the government's budget surplus evaporated along with the buoyancy of tax revenues. If the fiscal authorities fulfill their commitment to maintain better control of spending during the coming high-investment phase, small budget surpluses are likely to re-emerge as early as 2004, says Moody's. Tighter fiscal policy will also be needed to avoid excessive reliance on monetary policy and the recurrence of large external deficits and a wage-price spiral.

The rating agency's report is a yearly update to the markets and is not a formal action to alter the credit rating of the issuer.

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