London
Kenneth Orchard
Vice President - Senior Analyst
Sovereign Risk Group
Moody's Investors Service Ltd. - England
JOURNALISTS: 44 20 7772 5456
SUBSCRIBERS: 44 20 7772 5454

New York
Kristin Lindow
Senior Vice President
Sovereign Risk Group
Moody's Investors Service - New York NY
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653

Moody's issues annual sovereign credit report on Iceland

London, 23 January 2009 -- In its annual sovereign credit report on Iceland, Moody's Investors Service says that it still considers Iceland to be an investment grade country, despite the country's current financial and economic crisis and the future challenges it faces. However, Moody's is maintaining its negative outlook on the Baa1 rating because the economic outlook for the country remains uncertain and could change quickly.

Moody's has evaluated Iceland to have a medium level of economic strength, a very high level of institutional strength, low government financial strength and a moderate susceptibility of event risk.

“Moody’s recognises that Iceland’s current financial and economic crisis is unprecedented in scope for any advanced industrial country relative to the size of the economy,” says Kenneth Orchard, a Vice President-Senior Analyst in Moody’s Sovereign Risk Group. Indeed, the events of the past few months – the collapse of the banking system and currency – nearly caused the ruin of an economy that was once one of the richest in the world. As a result of these events, Moody’s has downgraded the Icelandic government’s ratings twice during the crisis period – to A1 from Aa1 in October 2008, and subsequently to Baa1 in December 2008. At Baa1, Iceland remains an investment grade-rated government.

“Moody’s considers Iceland’s economic strength to be damaged, but not beyond repair,” explains Mr. Orchard. Moody’s has appraised Iceland’s economic strength at medium, primarily due to the scale and concentration of its economy. Although Moody’s believes that Iceland’s wealth, a key measure of the government’s ability to raise revenue to service its debt, will likely diminish over the next few years, it should gradually increase over the long term and remain relatively high by international standards.

Moody’s acknowledges that, while it considers Iceland’s institutional strength to be very high, the country’s quality institutions have struggled in the current environment. However, Iceland’s high degree of social consensus, flexible labour market and well educated population should help it to adapt and facilitate the economic adjustment.

Moody's also recognises that Iceland's financial strength has been severely weakened by the banking and currency crisis. In an effort to improve matters, Iceland has adopted an IMF stand-by arrangement to stabilise its currency, rebuild a sound banking sector and restore medium-term fiscal sustainability. However, Moody's notes that the economic outlook for 2009 and beyond is subject to a high degree of uncertainty and will be largely dependent on the global economic environment. As such, Iceland's large amount of debt (gross government debt/GDP is forecast to peak at 146% in 2010) could remain much higher for longer than presently anticipated.

Moody's notes that Iceland's currency has stabilised with the aid of high interest rates, strict capital controls and some support from the country's central bank. Moody's expects that the continuation of these policies should ensure that the currency remains stable in the short term. Although there are some limits to the effectiveness of these measures over the medium term, Moody's expects that improving economic conditions and confidence should eventually allow the strict policies to be relaxed.

London

Pierre Cailleteau

Managing Director

Sovereign Risk Group

Moody's Investors Service Ltd. - England

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