Republic of Iceland 'AA-/A-1+' FC Ratings Affirmed On Healthy Public Finances; Outlook Stable

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FRANKFURT (Standard & Poor's) March 16, 2006--Standard & Poor's Ratings Services said today it affirmed its 'AA-' long-term foreign currency and 'AA+' long-term local currency sovereign credit ratings on the Republic of Iceland. At the same time, the 'A-1+' short-term foreign and local currency ratings on Iceland were affirmed. The outlook is stable.

"The ratings on Iceland are supported by its stable political institutions, a very wealthy and flexible economy, and healthy public finances," said Standard & Poor's credit analyst Kai Stukenbrock. "The ratings remain constrained by very high levels both of external financing needs and of external debt throughout the economy."

Public finances remain healthy. Thanks to strong economic growth, privatization proceeds, and budget surpluses up to and including 2006, gross general government debt will continue to decline rapidly, to about 21% of GDP by 2009, from 50% in 2001.

External financing needs are among the highest of any rated sovereign, driven by very high levels of external debt throughout the economy, and large current account deficits. Levels of net external debt continue to rise rapidly, despite a steep decline in central government debt. Nevertheless, completion of the investment projects, a cooling in domestic demand, and rising exports should help to push the current account deficit (projected at 13% of GDP in 2006) down significantly from 2007 onward. The recent weakening of the exchange rate is still well within the limits expected by Standard & Poor's.

The rapid growth in domestic demand, driven by consumer and business confidence, large-scale investment projects in energy-intensive industries, and a credit boom, has created mounting macroeconomic imbalances. Despite higher-than-expected general government surpluses in 2005-2006, monetary policy is carrying the majority of the burden of addressing the expansionary pressures. This increases the risk of unbalanced economic adjustment once demand growth comes to an end.

"To maintain the sovereign ratings, it will be essential for the government to continue adhering to, or better still, to further exceed its medium-term fiscal framework," said Mr. Stukenbrock. "Fiscal policy, rather than monetary policy, would have to shoulder the burden of further unforeseen adjustment needs."

"Any further significant increase in net external leverage, or an aggravation of macroeconomic imbalances on the back of the large investment projects, could weaken Iceland's creditworthiness," added Mr. Stukenbrock.

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