

Rating Action: Moody's Places Iceland's Ratings on Review for Downgrade

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London, 30 September 2008 -- Moody's Investors Service has placed Iceland's Aa1 government bond ratings and its Aa1 country ceiling for foreign currency bank deposits on review for possible downgrade.

Moody's review of Iceland's credit ratings has been prompted by the exceptional conditions in the international credit markets that helped precipitate the Icelandic government's EUR 600 million capital injection in one of the country's three largest banks, Glitnir, on Monday.

Moody's downgraded today Glitnir, and placed Landsbanki and Kaupthing under review for downgrade, in light of a very challenging international environment and the Icelandic banking system's weakened financial fundamentals.

"While this emergency capital infusion does not mean that the government will have to assume all the bank's foreign currency liabilities, it does indicate that government finances will come under pressure if the probable restructuring of the banking system leaves it involved," according to Moody's analyst for the sovereign rating of Iceland, Joan Feldbaum-Vidra.

Iceland's Aaa credit rating was downgraded to Aa1 in May 2008 specifically because of the foreign currency liquidity constraints emanating from its large internationalized banking sector. In Moody's opinion, the scale of these contingent liabilities relative to the size of the government's balance sheet encumber the authorities' lender of last resort capabilities to an extent not apparent in any other Aaa-rated sovereign.

"Still, Iceland's ratings were stable at Aa1 because of the low likelihood of a systemic crystallisation of contingent liabilities, the government's fiscal room of maneuver in local currency, and the proven financial access of the sovereign," said Feldbaum-Vidra. The Icelandic central bank also negotiated a backup EUR 1.5 billion liquidity line with other Nordic central banks several months ago.

"However, with the recent unprecedented global credit tightening and the crisis management response put in place all over the world, the risk that some of Iceland's banking system liabilities would migrate onto the balance sheet of the government materialized with the government's capital infusion into Glitnir," said Feldbaum-Vidra.

In its review, Moody's will examine the government's various options for managing the banks' liquidity problems and its probable course of action. In particular, Moody's will focus on how the government intends to maintain financial stability and extend some support to banks, including in foreign currency, while not endangering its own credit standing.

Feldbaum-Vidra also noted that Iceland's advanced economic characteristics, high affordability of direct government debt, favorable labor force demographics and flexible economy help support its ratings at a high level in spite of the large scale of banking system's foreign currency contingent liabilities.

The Aaa country ceiling for foreign currency bonds and notes, which measures the risk of a moratorium in the hypothetical case that the government would default in foreign currency, remains intact and carries a stable outlook.

Any rating actions affecting other entities in Iceland will be announced in separate press releases.

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