MOODY'S
INVESTORS SERVICE

ISSUER IN-DEPTH
3 August 2018

Rate this Research

Government of Iceland – A3 positive

Annual credit analysis

RATINGS

Iceland

	Foreign Currency	Local Currency
Gov. Bond Rating	A3/POS	A3/POS
Country Ceiling	A3	A1
Bank Deposit Ceiling	A3	A1

TABLE OF CONTENTS

Contacts

Kristin Lindow +1.212.553.3896
Senior Vice President
kristin.lindow@moodys.com

Michael S. Higgins +1.212.553.1619
Associate Analyst
michael.higgins@moodys.com

Evan Wohlmann +44.20.7772.5567
VP-Senior Analyst
evan.wohlmann@moodys.com

Dietmar Hornung +49.69.70730.790
Associate Managing Director
dietmar.hornung@moodys.com

Yves Lemay +44.20.7772.5512
MD-Sovereign Risk
yves.lemay@moodys.com

OVERVIEW AND OUTLOOK

The credit profile of Iceland (A3 positive) is supported by the country's economic flexibility and wealth, which helps it absorb economic shocks, an efficient and educated work force and abundant natural resources that provide it with robust potential for economic growth.

Growth is now more sustainable than before the economic crisis, given the rebalancing of the economy and large external surpluses, which are reducing the country's once sizeable public and external debt. Strong institutions focus on avoiding the vulnerabilities that led to the 2008 banking sector collapse. Iceland has a long tradition of broad cooperation and consensus on economic matters between the government, employers and employee associations. A well-funded pension system, long working lives and favourable demographics also support the country's long-term fiscal sustainability.

The main credit challenges include the economy's small size, relatively limited diversification, openness and small currency area, which increase its vulnerability to shocks and cause volatility in annual growth rates. The country's substantial, although reduced, exposure to external risks requires careful management to protect economic and financial stability. In addition, large contingent liabilities derived from state-owned companies would pose risks to public finances if they were to crystallize on the government's balance sheet.

We would consider upgrading the country's ratings if the government achieved further improvements in its debt metrics and successfully managed a soft landing of the economy amid slowing growth in the tourism sector and expected wage increases without a material weakening of its external position. A downgrade of the rating, or removal of the positive outlook, would be considered in the event of a disruptive slowdown or contraction in tourism revenue. A downgrade would also be considered if other economic shocks were to weaken the sustainability of public or external debt or threaten Iceland's financial stability, particularly if it had to resort to broad capital controls again.

This credit analysis elaborates on Iceland's credit profile in terms of economic strength, institutional strength, fiscal strength and susceptibility to event risk, which are the four main analytic factors in Moody's Sovereign Bond Rating Methodology.

CREDIT PROFILE

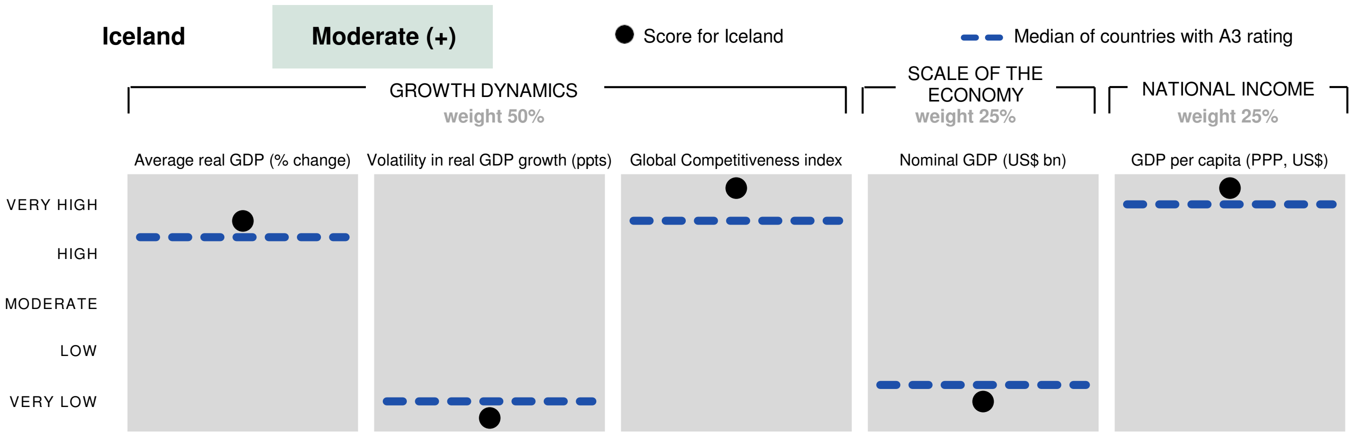
Our determination of a sovereign's government bond rating is based on the consideration of four rating factors: Economic strength, institutional strength, fiscal strength and susceptibility to event risk. When a direct and imminent threat becomes a constraint, that can only lower the preliminary rating range. For more information please see our Sovereign Bond Rating methodology.

Economic strength: Moderate (+)

Factor 1: Overall score

Scale	VH+	VH	VH-	H+	H	H-	M+	M	M-	L+	L	L-	VL+	VL	VL-	
+						Indicative	Final									-

Factor 1: Sub-scores



Economic strength evaluates the economic structure, primarily reflected in economic growth, the scale of the economy and wealth, as well as in structural factors that point to a country's long-term economic robustness and shock-absorption capacity. Economic strength is adjusted in case excessive credit growth is present and the risks of a boom-bust cycle are building. This 'credit boom' adjustment factor can only lower the overall score of economic strength.

Note: In case the Indicative and Final scores are the same, only the Final score will appear in the table above.

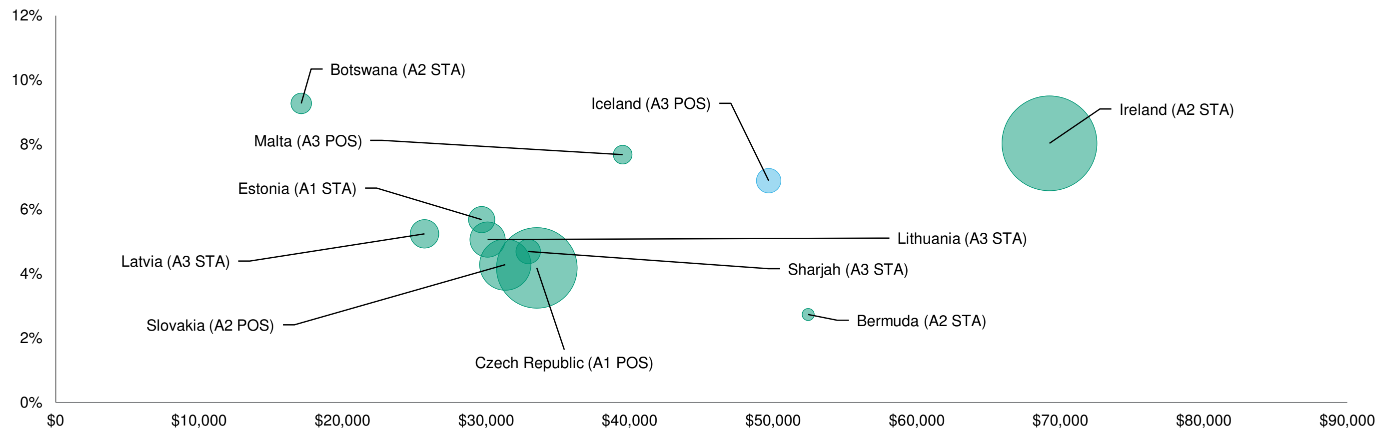
We assess Iceland's economic strength as "Moderate (+)", below the indicative score of "High (-)" because of the country's small size and associated history of economic boom and bust episodes. Other sovereigns with the same assessment of economic strength include Latvia (A3 stable), Lithuania (A3 stable) and Slovakia (A2 positive).

Peer comparison table factor 1: Economic strength

	Iceland A3/POS	M+ Median	Latvia A3/STA	Lithuania A3/STA	Slovakia A2/POS	Slovenia Baa1/STA	Romania Baa3/STA	Oman Baa3/NEG
Final score	M+		M+	M+	M+	M+	M+	M+
Indicative score	H-		M	M+	H-	M+	H-	H-
Nominal GDP (US$ bn)	23.9	91.6	30.3	47.2	95.8	48.8	211.9	73.1
GDP per capita (PPP, US$)	51,841.5	26,076.3	27,644.1	32,298.9	33,025.2	34,407.1	24,508.4	45,156.9
Average real GDP (% change)	3.6	3.2	2.9	2.9	3.4	2.9	4.2	2.8
Volatility in real GDP growth (ppts)	4.0	2.9	6.1	5.9	3.1	3.7	4.3	3.3
Global Competitiveness Index	5.0	4.3	4.4	4.6	4.3	4.5	4.3	4.3

Iceland's gross domestic product (GDP) per capita, on a purchasing power parity basis, was $51,842 in 2017. This is higher than more than 89% of sovereigns rated by Moody's and has overcome the significant loss after the 2008 banking and currency crisis. Iceland's nominal GDP ($23.9 billion as of 2017) is the second smallest in the A-rating range, ahead of only Malta (A3 positive, $17.8 billion). Compared to other A-rated sovereigns, Iceland's robust growth performance, aided both by its flexible currency and labour markets and its very high per capita income, stand out favourably (see Exhibit 1).

Exhibit 1
Robust growth and high per capita income are Iceland's strengths relative to A-rated peers
(Avg. Real GDP Growth 2012-2021F — y-axis; GDP per Capita US$ PPP — x-axis)



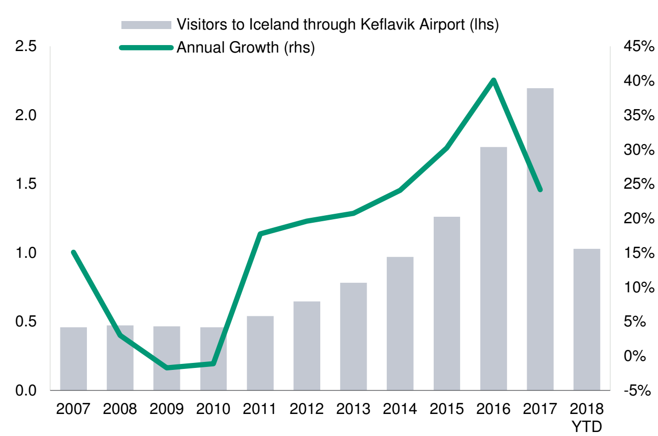
Note: Size of bubble is determined by 2017 GDP in nominal US$ billion
Source: Moody's Investors Service

The high incomes of Icelandic households allowed them to absorb the significant shock of the banking crisis. Their financial situation was buffered by substantial pension assets and savings, despite declines in wealth levels after house prices collapsed. Moreover, special legislation approved in 2015 allowed households to draw upon their supplementary pension savings for debt repayment and consumption purposes, an allowance that was extended and is currently in effect through 2019.

Growth rebalancing suggests a soft landing for the economy

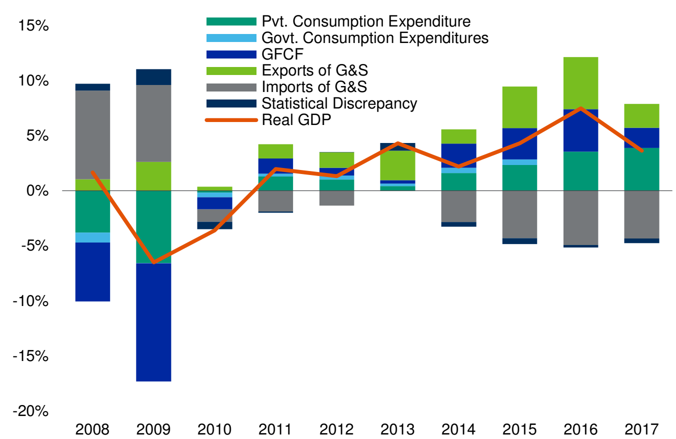
Real GDP growth picked up to 6.7% year-over-year (yoy) in Q1-2018, led by domestic demand when tourism growth slowed further after halving (to a still substantial 24%) in 2017 (see Exhibit 2). The base effect for exports from the first quarter of 2017 – when there was a strike in the fishing sector – was also an important factor. Growth had decelerated faster than expected in 2017, to 3.6% from 7.5% in 2016, as a result of the ongoing rebalancing with a larger contribution from domestic demand and a drag on growth from net exports (see Exhibit 3).

Exhibit 2
The growth in foreign tourist arrivals slowed in 2017...
(Millions of persons — lhs; percent — rhs)



Source: Icelandic Tourist Board/Isavia, Moody's Investors Service

Exhibit 3
....leading exports of goods and services to make a smaller contribution to real GDP growth.
(Percentage point contribution to real GDP growth)



Source: Statistics Iceland, Moody's Investors Service

Tourist arrivals rose to roughly 2.2 million people in 2017, when the tourism sector was estimated to have accounted for 8.6% of GDP, up from 8.1% in 2016. The tourism industry has served as a positive external shock to both the economy and the country's balance of payments in recent years, becoming the single most important source of export revenue. The industry accounted for more than 40% of all exports of goods and services in 2017, surpassing marine products (16% in 2017, albeit depressed due to the first quarter strike), which had previously been the leading export sector.

Indeed, exports of travel-related services increased by 146.6% between 2013 and 2017 to ISK323 billion ($3.2 billion). Growth of tourist arrivals is forecast to be below 10% in 2018, with both the data from the first half of the year and anecdotal evidence from industry experts suggesting that the 'boom' is levelling off to more sustainable levels.

Domestic demand-led growth signals a broad-based expansion

Domestic demand, both public and private, played a larger role in the expansion of the economy in 2016 and 2017. In the future, economic growth will likely become more broad-based and built upon a more solid foundation of both domestic and externally driven factors.

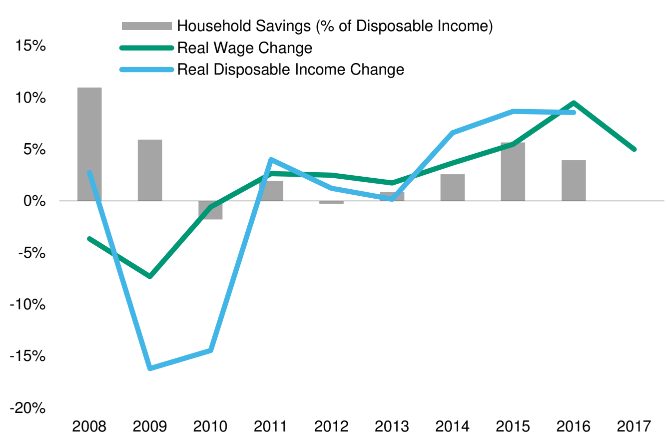
On the domestic side, household consumption will be boosted by lower debt burdens, rising real disposable incomes and a tight labour market. Households' savings rates have remained positive (see Exhibit 4) and their financial positions have strengthened despite the growth in spending. By 2016, the household saving rate rose to about 6% and households' net financial position climbed to more than 150% of GDP. Households have undergone significant deleveraging in recent years, with household debt falling from a peak of more than 113% of GDP in 2009 to approximately 77% of GDP in 2017.

Supply shortages, increased household purchasing power, solid population growth and low interest rates led to high house price inflation in 2013-16. House price increases started to slow last year as the rate of house-building gained pace and prices will now likely increase at rates more in line with fundamentals, including slower construction of hotels and tourist-focused apartments.

Compositionally, fixed investment has also shown solid momentum over the last few years, after collapsing immediately following the crisis. As a share of GDP, government, residential and private businesses' investment have all regained momentum from their recent troughs in 2009-11 (see Exhibit 5). Public investment spending is expected to remain strong over the next two to three years at least: the government fiscal strategy calls for increasing transport-related construction, in part to accommodate tourism requirements such as the airport and the roads network, and for building a new hospital and nursing homes that will be needed for the ageing population. On the external side, we expect tourism to continue supplementing exports from the traditional fishing and aluminium sectors, but the sector is likely to register slower growth than before as it matures.

Exhibit 4

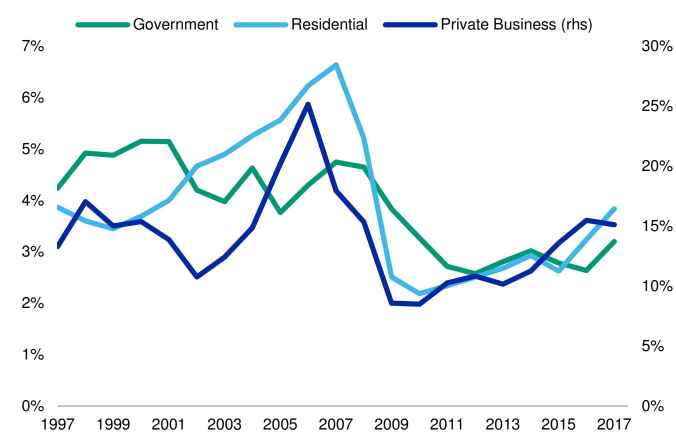
Households are in a much stronger position now...
(Percent)



Source: Statistics Iceland, Moody's Investors Service

Exhibit 5

....while investment spending across the economy has turned around.
(Percent of GDP)



Source: Statistics Iceland, Moody's Investors Service

Competitiveness aided by high quality of infrastructure, social services and labour market dynamics

An additional strength of the Icelandic economy is its high degree of competitiveness, as demonstrated by its 28th position in the World Economic Forum's Global Competitiveness Rankings. Among the aspects where Iceland stands out relative to its peers are its institutions, technological readiness, educational environment and labour market efficiency (see Exhibit 6). The latter has been a key contributor to strong labour productivity growth over the last few years (see Exhibit 7).

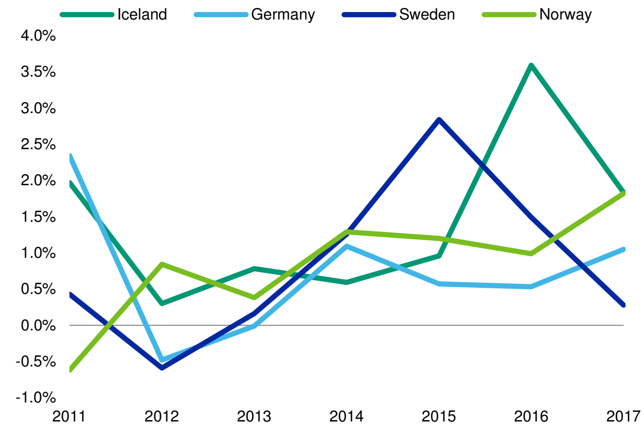
Exhibit 6

Iceland stands out among its peers in a number of areas of competitiveness...
(Higher value = more competitive)

Source: World Economic Forum

Exhibit 7

...which have led to continued productivity gains in line with other advanced economies.
(Annual percent change in output per worker)



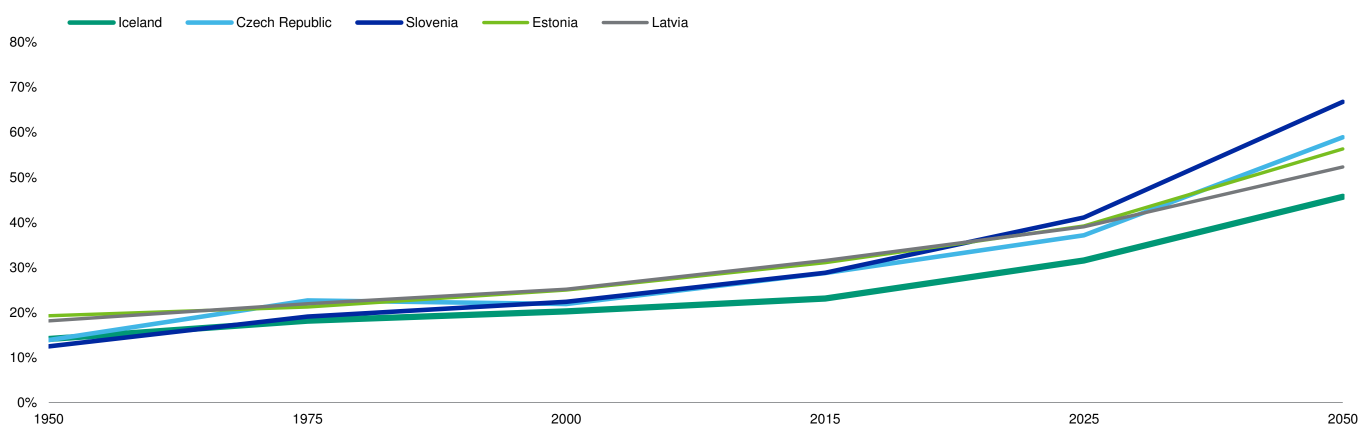
Source: OECD, Moody's Investors Service

Favourable demographics outlook supports long-term economic growth prospects

Iceland's demographic profile is more positive than in many other advanced or developing nations — particularly in continental Europe — because of exceptionally long working lives, higher fertility rates, the share of women who work and the flexibility of the labour force. Iceland's age-old dependency ratio — defined as ratio of population aged 65+ divided by the population aged 15-64 — is projected to remain below that of peers over the coming decades, according to forecasts made by the OECD in 2017.

Exhibit 8

Iceland's demographics are comparably younger than those of peers
(Old-age dependency ratio)



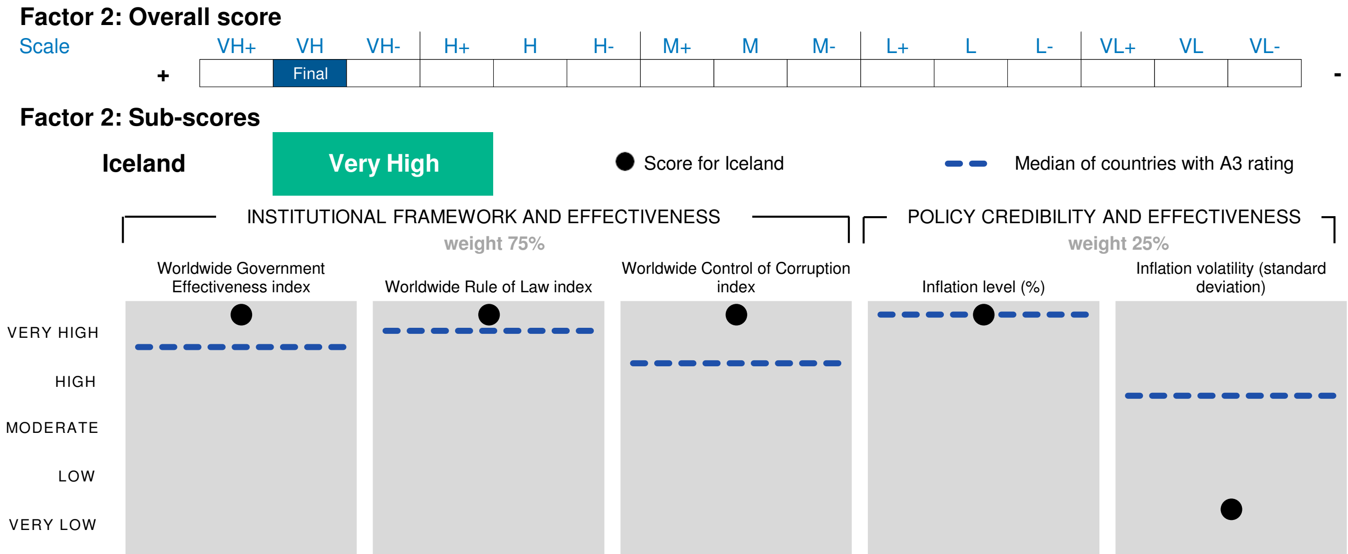
Source: OECD, Moody's Investors Service

Moreover, the average life expectancy for an Icelander is 82.5 years, above the European average of 77.5 years, while Iceland's fertility rate at 1.8 births per woman as of 2016 was above the rates of Slovenia (Baa1 stable, 1.6), Czech Republic (A1 positive, 1.6), Norway (Aaa stable, 1.7) and the Netherlands (Aaa stable, 1.7).

The flexibility of Iceland's work force is one reason why high wage awards given in 2015 did not lead to higher inflation, since at times of strong labour demand and full employment, Icelandic companies hire workers from other countries, mainly other Nordic and East European countries, who then return home when those jobs are finished. During 2017, the strong appreciation of the króna combined with higher nominal wage increases balanced out the inflation picture.

We expect the upcoming round of wage negotiations to lead to large real increases across sectors. With the currency no longer appreciating and oil prices rising, inflation risks over the next two years are therefore higher. Accordingly, we expect both the monetary and the fiscal policy stance to remain quite tight to keep inflation close to the 2½% target.

Institutional strength: Very High



Institutional strength evaluates whether the country's institutional features are conducive to supporting a country's ability and willingness to repay its debt. A related aspect of institutional strength is the capacity of the government to conduct sound economic policies that foster economic growth and prosperity. Institutional strength is adjusted for the track record of default. This adjustment can only lower the overall score of institutional strength.
Note: In case the Indicative and Final scores are the same, only the Final score will appear in the table above.

We assess Iceland's institutional strength as "Very High," consistent with the country's strong scores in the Worldwide Governance Indicators (WGI). Iceland ranks in the 86th percentile of the WGI's measure of government effectiveness, the 87th percentile for the rule of law and the 94th for the control of corruption.

Iceland's scores for government effectiveness and rule of law are on par with the VH median, while its score for control of corruption is well above that of the VH median. When compared to the A3 median, Iceland outperforms in all three governance indicators. Other sovereigns with the same assessment of economic strength include Austria (Aa1 stable), Belgium (Aa3 stable), and Israel (A1 positive).

Peer comparison table factor 2: Institutional strength

	Iceland A3/POS	VH Median	Austria Aa1/STA	Belgium Aa3/STA	Estonia A1/STA	Ireland A2/STA	Israel A1/POS	Czech Republic A1/POS
Final score	VH		VH	VH	VH	VH	VH	VH
Indicative score	VH		VH+	VH+	VH	VH+	VH+	VH
Gov. Effectiveness, percentile [1]	86.4	85.3	88.7	81.9	77.4	83.4	84.2	74.4
Rule of Law, percentile [1]	87.2	86.1	93.2	85.7	84.2	87.9	77.4	80.4
Control of Corruption, percentile [1]	93.9	86.1	87.2	88.7	81.2	89.4	78.9	66.1
Average inflation (%)	2.4	1.7	1.8	1.5	1.8	0.9	0.9	1.5
Volatility in inflation (ppts)	4.1	1.4	0.9	1.5	3.3	2.3	1.8	1.8

[1] Moody's calculations. Percentiles based on our rated universe.

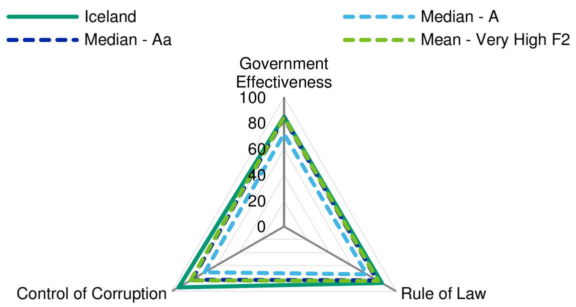
Iceland benefits from clear competitive strengths in areas such as its high-quality education system, an innovative and high tech-oriented business sector, an efficient labour market and well-developed infrastructure.

International surveys convey similarly strong assessments of institutional strength

Iceland's WGI quantitative indicators declined marginally in 2016 from previous years, but the rankings remain well above the A and even Aa rating category medians (see Exhibit 9) and have notably improved with regards to regulatory quality (see Exhibit 10).

Exhibit 9

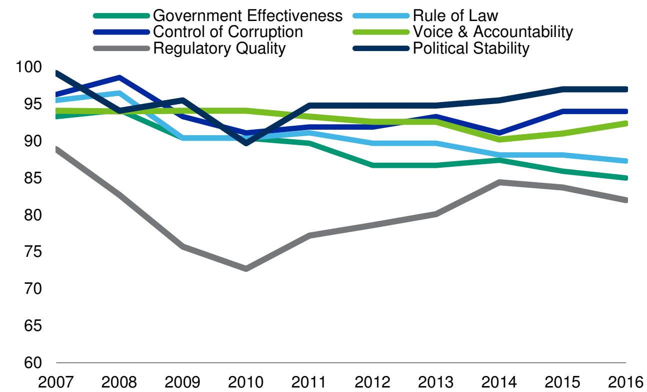
Perceptions of Iceland's institutions rank above peer groups...
(Percentile rank*)



*Note: Percentile rank based on Moody's rated sovereigns
Source: WGI, Moody's Investors Service

Exhibit 10

....and there has been a significant improvement in regulatory quality.
(Percentile rank*)



*Note: Percentile rank based on Moody's rated sovereigns
Source: WGI, Moody's Investors Service

Recovery of institutional strength is cemented with emerging track record of macro policy coherence

Iceland's government has made significant progress in bringing the economy, the financial system and the public finances back onto a sustainable path after the collapse of the country's banking system in 2008. In conjunction with a three-year IMF Stand-By Arrangement and post-monitoring program in place at the time, the authorities introduced a number of reforms, such as tighter fiscal and monetary policy, a flexible exchange range and significant banking system supervision, to prevent such distortions from recurring.

Arguably some of the most important measures undertaken since the crisis were the introduction of more stringent supervision and regulation of the banking sector, including tougher reporting requirements, greater transparency and strict limitations on the new banks' scope of activity.

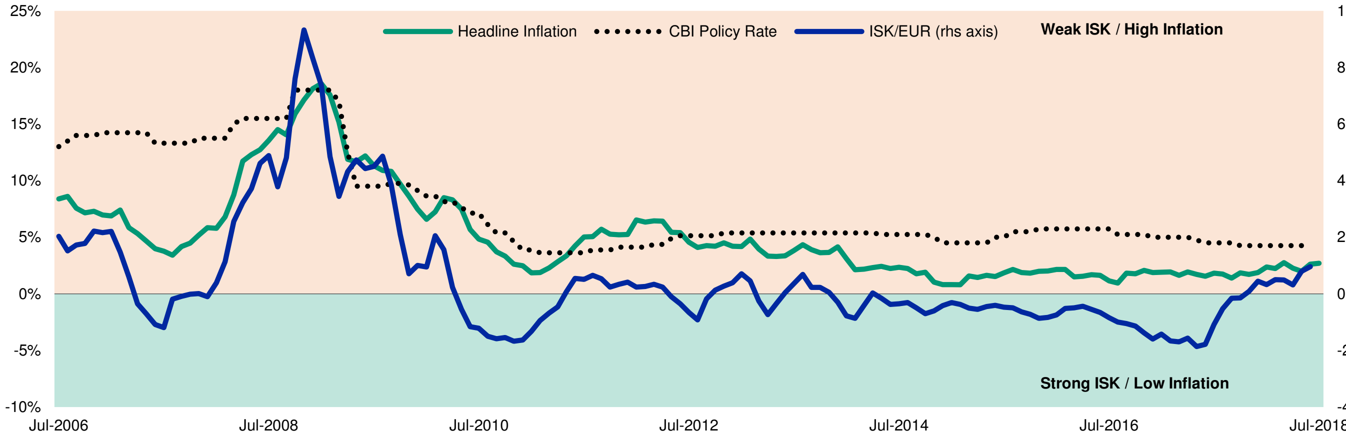
There is also greater collaboration between the central bank and the banking regulator, the Financial Supervisory Authority (FME), in addition to the introduction of a Financial Stability Council to oversee the monitoring of systemic risks. These rules are meant to assure that the new banking system is well capitalized, liquid and funded primarily by long-term deposits or wholesale funding. Asset quality at the three big banks has also improved significantly, in part as a result of widespread loan restructuring.

Monetary policy framework has helped gain policy credibility and improve effectiveness

In 2001, Iceland adopted an inflation-targeting framework, in line with developments internationally. With a numerical target of 2½ % annual rate in headline consumer price inflation, the chief priority of the Central Bank of Iceland (CBI) has been price stability. Following the crisis and comprehensive rule changes in 2009, the framework became much more transparent.

The 'Inflation targeting-plus' monetary policy regime now in place includes improvements to the inflation target and macro-prudential tools, including the capital flow mechanism (CFM). The framework has gradually gained market credibility. Monetary policy is also better aligned with the fiscal policy stance now than before the crisis, which has led to positive but not excessively positive real interest rates over the last few years. After rising into double digits after the 2008-09 depreciation, inflation has been below target (approximately 2.0% from 2015 through 2017), driven by the fall in oil import prices initially and then a further steep appreciation of the króna (see Exhibit 11).

Exhibit 11
Inflation has remained moderate because of low oil prices and a steep appreciation of the króna
(Percent)



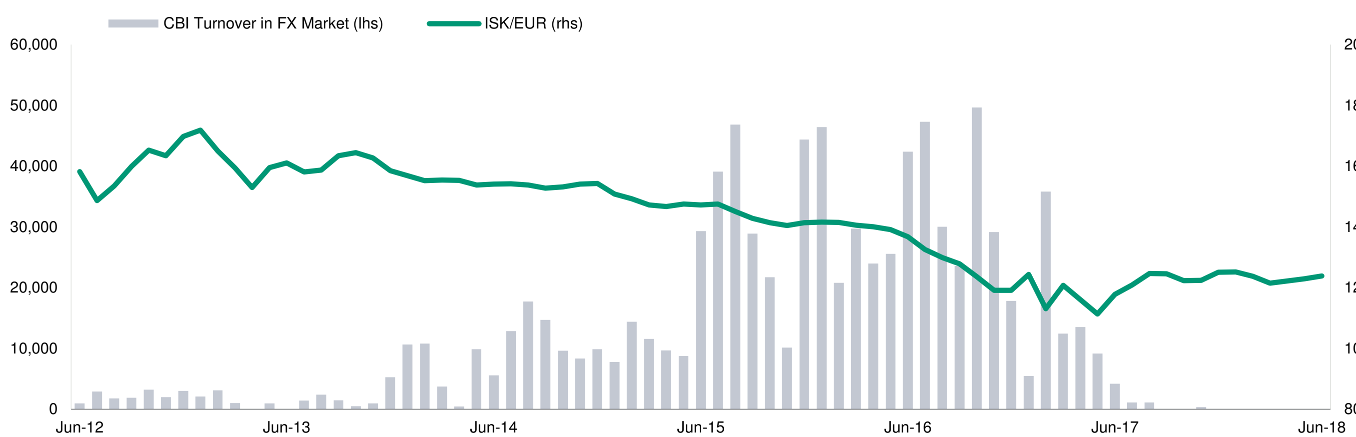
Source: Statistics Iceland, Central Bank of Iceland, Moody's Investors Service

As of July 2018, headline inflation increased to 2.7% year-over-year, slightly above the central bank target. Excluding housing costs, however, inflation has been structurally lower, at 1.4% as of July 2018. As house price inflation has eased over the past year together with slower pressure from the tourism sector, we anticipate that headline inflation will remain at about these levels through the end of 2018. Inflation is likely to pick up slightly next year, however, driven by front-loaded wage increases in the next wage round.

Careful capital account liberalization provides exchange rate stability, further evidence of improved institutional strength

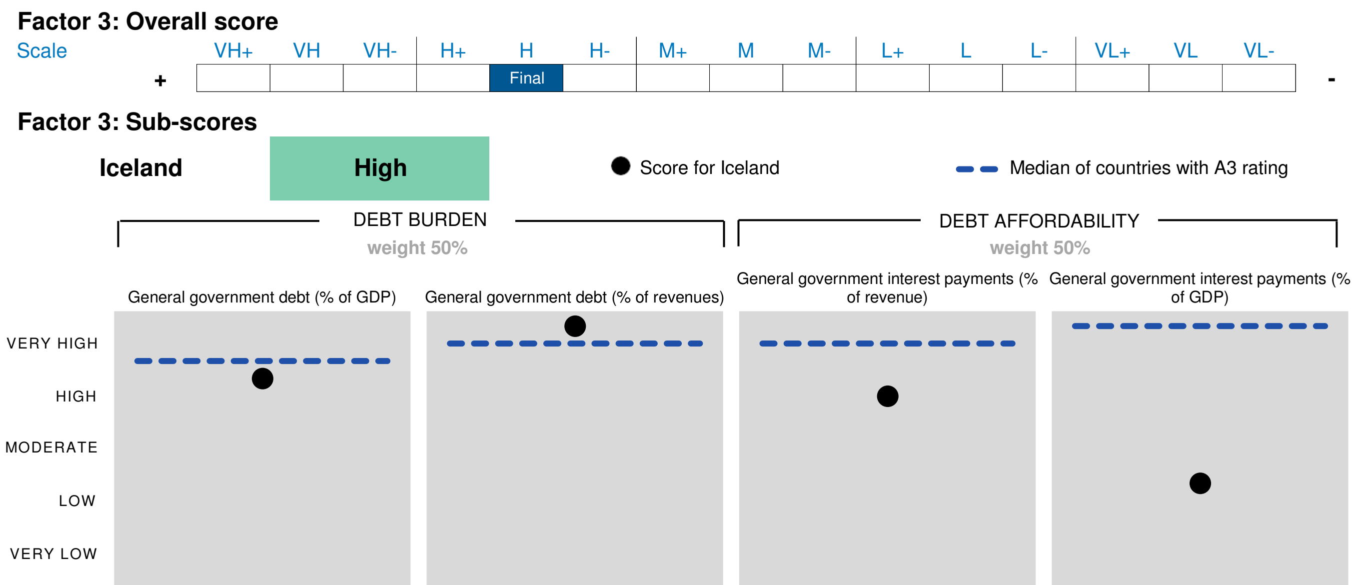
On 14 March 2017, Iceland removed almost all remaining capital controls, signaling the country's return to economic normalcy more than eight years after the start of the banking crisis. During the final four years of the controls, the central bank heavily intervened in the domestic foreign exchange market to buy up excess foreign exchange to bolster its reserves and combat excessive exchange-rate volatility. After the removal of the capital controls and with the slowing of tourism income growth, those interventions have essentially ceased (see Exhibit 12).

Exhibit 12
Foreign exchange intervention slowed following the removal of most capital controls in March 2017
(Mil. ISK — lhs; ISK/EUR — rhs)



Source: Central Bank of Iceland, Moody's Investors Service

Fiscal strength: High



Fiscal strength captures the overall health of government finances, incorporating the assessment of relative debt burdens and debt affordability as well as the structure of government debt. Some governments have a greater ability to carry a higher debt burden at affordable rates than others. Fiscal strength is adjusted for the debt trend, the share of foreign currency debt in government debt, other public sector debt and for cases in which public sector financial assets or sovereign wealth funds are present. Depending on the adjustment factor the overall score of fiscal strength can be lowered or increased.

Note: In case the Indicative and Final scores are the same, only the Final score will appear in the table above.

We assess Iceland's fiscal strength as "High." Other sovereigns with a "High" assessment of fiscal strength include Azerbaijan (Ba2 stable), Israel and Poland (A2 stable).

Peer comparison table factor 3: Fiscal strength

	Iceland A3/POS	H Median	Azerbaijan Ba2/STA	Bolivia Ba3/STA	Bulgaria Baa2/STA	Israel A1/POS	Poland A2/STA	St. Maarten Baa2/NEG
Final score	H		H	H	H	H	H	H
Indicative score	H		M	M	H-	H+	H	VH+
Gen. gov. debt/GDP	43.3	46.9	53.3	42.4	25.4	60.9	50.6	31.5
Gen. gov. debt/revenue	99.6	156.5	156.0	133.3	70.3	156.9	127.9	122.0
Gen. gov. interest payments/GDP	4.0	1.8	0.6	0.7	0.8	2.3	1.6	0.7
Gen. gov. int. payments/revenue	9.2	5.0	1.8	2.3	2.2	6.0	4.0	2.8

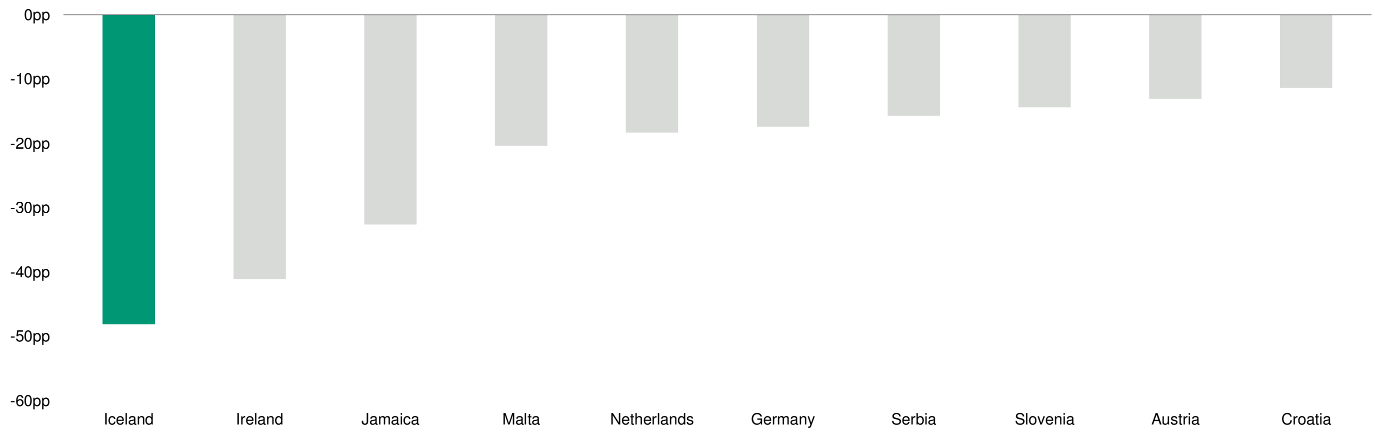
Fiscal metrics have continued to outperform expectations

After peaking at 114.7% of GDP in 2011, Iceland's gross government debt burden has continued to decline at a markedly fast pace. Since 2010, this debt reduction has been achieved through the combination of (1) significant fiscal consolidation, (2) the restored health of the Icelandic economy and substantial accumulation of foreign exchange reserves, which among other assets has helped pay down debt ahead of schedule and (3) the stability contributions from the estates' of the failed Icelandic banks.

Compared with other sovereigns rated by Moody's, the restoration of Iceland's fiscal health following the global financial crisis has been unparalleled – even exceeding that of Ireland (A2 stable), which has experienced more rapid nominal GDP growth. Additionally, Iceland is the only rated sovereign that has an outstanding debt burden as of the end of 2017 that is smaller than the debt reduction achieved over the 2014-2019 period, in percentage points of GDP (see Exhibit 13).

Exhibit 13

Iceland's scorecard-captured debt trend is the largest across all Moody's rated sovereigns
(Percentage point change in Debt/GDP Ratio 2014 — 2019F)



Note: Iceland's debt burden peaked in 2011 (not 2014), resulting in the actual reduction being even larger (72 percentage points) than what is shown in the above exhibit
Source: Moody's Investors Service

Consolidation through prudent fiscal rules, revenue enhancements and expenditure restraint

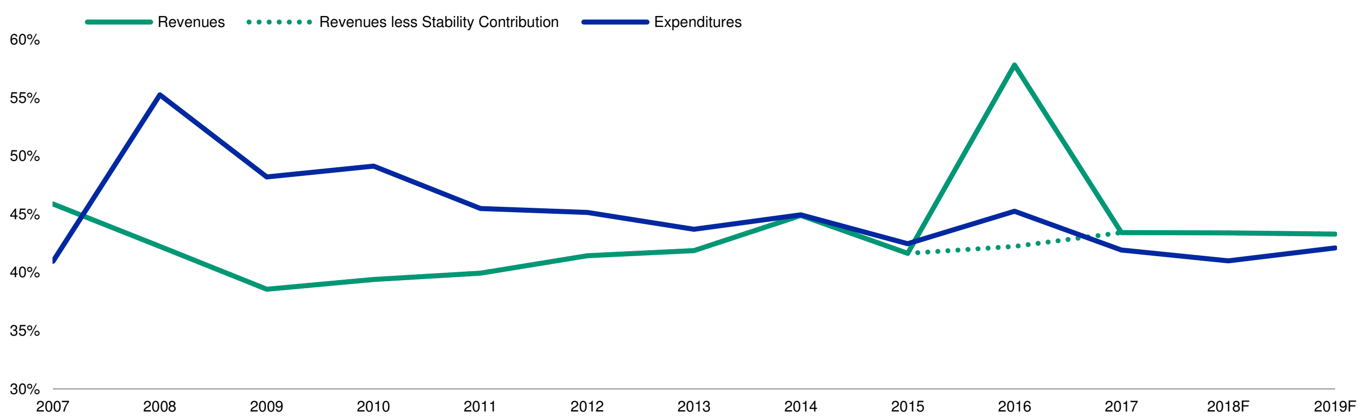
Since the passing of the Organic Budget Law (OBL) at the end of 2015, successive governments have approved fiscal policy statements and strategies that adhere to the prudent framework. There are two overarching fiscal rules: (1) no deficit can exceed 2.5% of GDP in any one year, and (2) over a five-year period, net lending must be positive. The government's latest five-year fiscal policy framework envisages the net lending balance to gradually decline from 1.0% of GDP in 2019 to 0.9% in 2023.

Beyond the OBL, there have been a number of refinements to the fiscal strategy that have improved fiscal outcomes. On the revenue side, the value added tax was reformed in 2015 and the taxable base was broadened to capture more of the gains from the tourism industry. These changes increased the VAT take from 8.2% of GDP in 2015 to 8.8% of GDP in 2017.

On the expenditure side, the government significantly cut investment spending and curtailed the growth of current expenditure, including compensation of employees and purchases of goods and services. Overall, expenditure declined from 48.2% of GDP in 2009 to 41.9% in 2017 (see Exhibit 14).

Exhibit 14

Expenditure control and buoyant tax receipts have bolstered fiscal outturns
(% of GDP)



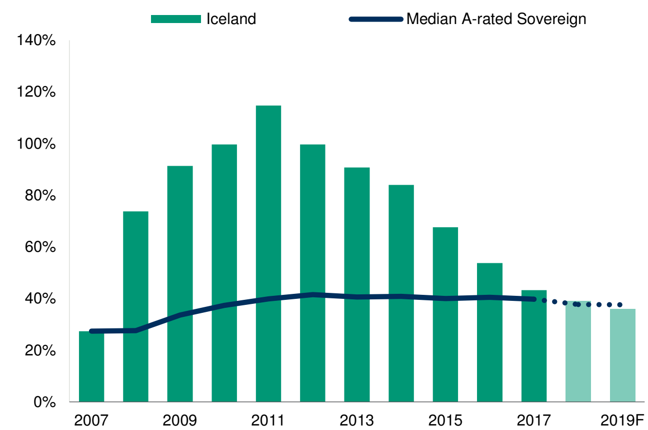
Source: Statistics Iceland, Moody's Investors Service

Healthier economy and accumulation of FX assets allowed for fast pace of debt reduction

During 2017, the government reduced outstanding treasury debt by approximately ISK200 billion and up to June 2018, another ISK53 billion was retired. The government plans negative net issuance of ISK30-40 billion annually between 2018-23, after accounting for debt buybacks. The slower pace of debt reduction reflects both the lower level of marketable debt available to prepay and the increased pace of spending on infrastructure and social services.

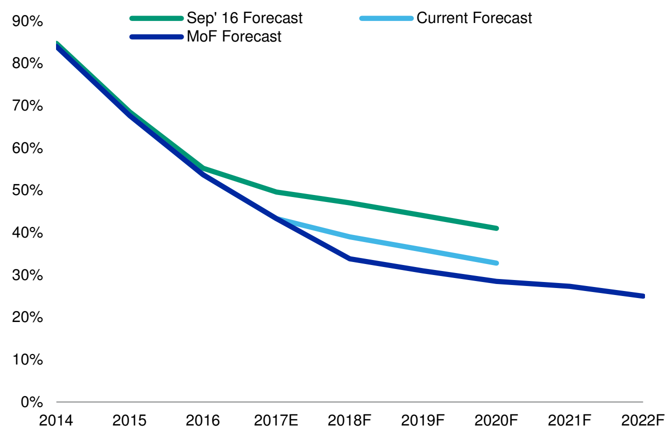
At the end of 2018, Iceland's debt burden will be equivalent to the median for A-rated sovereigns (see Exhibit 15) and, in the absence of unexpected shocks, it will continue to fall at a pace faster than our previous forecasts projected (see Exhibit 16). The improvements are driven by both stronger than anticipated nominal GDP growth and larger debt reductions than previously envisaged. The latest Medium Term Debt Strategy targets a general government net debt to GDP ratio of 23% by 2022.

Exhibit 15
Iceland's debt burden is aligned with the median A-rated sovereign...
(Gen. Govt. Debt as a % of GDP)



Source: Moody's Investors Service

Exhibit 16
...and has declined faster than our previous expectations
(Gen. Govt. Debt as a % of GDP)



Source: Ministry of Finance & Economic Affairs, Moody's Investors Service

Stability contributions will be used to reduce Treasury debt, but at a slightly slower pace

At the central government level, surpluses have also been driven by the receipt of the failed banks' stability contributions. During 2016, government revenue was boosted by an accrual of ISK384.2 billion (15.7% of GDP or 27.1% of 2016 General Government revenue) from the stability contributions. Of this, the government expects to receive ISK63 billion in cash during 2018. Total dividends from the banks are estimated at ISK158 billion over the period 2018-23 according to a scenario provided by the government.

In a report published a week after confirmation of the February 2018 sale of the Treasury's 14% stake in Arion Bank, the government estimated that the state's average annual nominal return on the capital contribution to Arion Bank since 2008 was about 10.8%, with the state's estimated total gain on financial interest in Arion and transactions with the Kaupthing estate at just over ISK150 billion. The government is considering selling part or all of its stake in Islandsbanki (valued at ISK185 billion) to further pay down debt or reduce pension liabilities. The government also owns a 98.2% share of Landsbankinn, valued at around ISK200 billion. The Ministry of Finance & Economic Affairs has outlined two scenarios for the eventual sales of these holdings (see Exhibit 17).

Although the most likely or even preferred scenario has not yet been determined by the government, debt will fall further as a consequence of the sales, but not by as much as occurred in recent years.

Exhibit 17

The Treasury has outlined two potential scenarios for the proceeds of the remaining government stakes in two Icelandic commercial banks

Scenario 1:

In addition to the base case, Islandsbanki will be fully sold between 2021-2023.

→ ISK 35 billion would be allocated to debt reduction
→ ISK 95 billion would be allocated to reduction of unfunded pension liabilities

Scenario 2:

In addition to to the measures in Scenario 1, the Treasury assumes the sale of the 30% share in landsbanki in 2023.

→ ISK 50 billion would be allocated to debt reduction
→ ISK 100 billion would allocated to reduction of unfunded pension liabilities
→ ISK 50 billion would be allocated to establish a stability fund (e.g. Sovereign Wealth Fund)

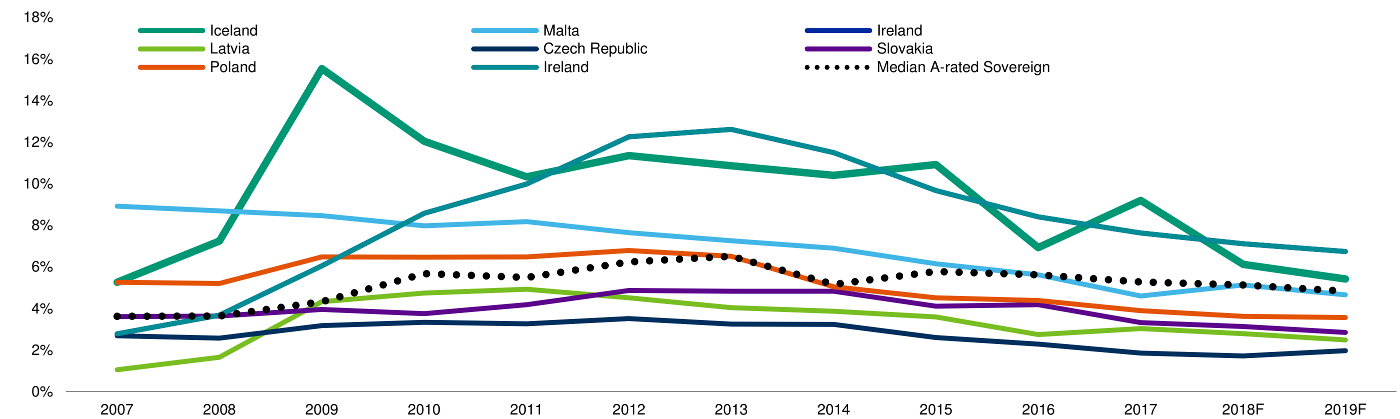
Source: Ministry of Finance and Economic Affairs

Debt affordability improves significantly, reducing exchange rate and interest rate risk

Following the crisis, the government's revenue base took an immediate hit — declining to 38.6% of GDP in 2009 from 42.2% of GDP in 2008. Borrowing costs also spiked, with interest payments as a share of revenue more than doubling to 15.5% in 2009 from 7.2% in 2008. However, over the course of the last nine years, there has been a marked improvement in the government's debt affordability because of the retirement of higher-cost debt and the rebuilding of the government's revenue base. Iceland's debt affordability is now in line with the median for A-rated sovereigns (see Exhibit 18).

Exhibit 18

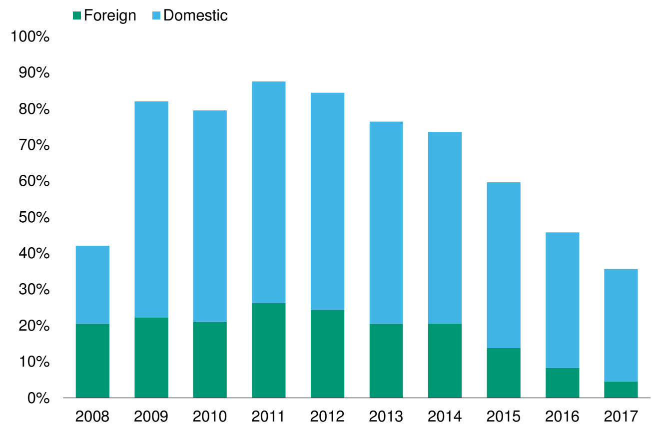
Iceland's debt affordability is now in line with that of many single-A rated European peers
(Gen. Govt. Interest Payments % of Gen. Govt. Revenue)



Source: Moody's Investors Service

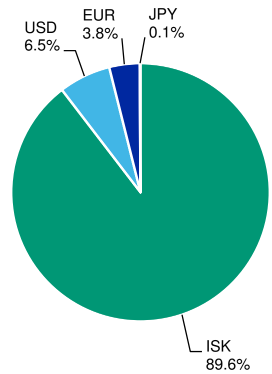
With regards to reducing other risks to debt affordability, the amount of foreign currency debt outstanding has continued to decline (see Exhibit 19). Some 87% of all outstanding treasury debt was denominated in krónur as of June 2018 (see Exhibit 20).

Exhibit 19
The foreign currency share of outstanding debt has declined...
(Percent of outstanding Gross Treasury Debt)



Source: Central Bank of Iceland, Statistics Iceland, Moody's Investors Service

Exhibit 20
...with almost 90% of outstanding debt now in Icelandic krónur
(Percent of outstanding Gross Treasury Debt, as of June 2018)



Source: Government Debt Management Office, Moody's Investors Service

Latest fiscal framework prioritises maintaining and building on gains already achieved

With its lighter debt load, the current government's fiscal strategy for 2019-2023 uses some of its extra fiscal space to catch up on infrastructure expansion, mainly in the health sector and also transport and other public services, although the debt metrics will continue to improve. According to preliminary figures published by Statistics Iceland, the general government surplus in 2017 was 1.5% of GDP, yet when excluding one-offs from dividend receipts that were higher than budgetary estimates, it was a more narrow 0.5% of GDP. The exhibit below presents some of the key factors and targets behind the latest fiscal 2019-2023 strategy:

Exhibit 21
Overview of the Fiscal Framework for 2019-2023

Area	Targets
Total Balance	Surplus should not be under 1% of GDP in 2019, 0.8% - 0.9% of GDP in 2020 - 2023
Revenue	Nominal growth of primary revenues of 3.5% - 4.5% in the period which is below GDP growth due to tax reform
	The tax burden decreases gradually during the period
	The impact of estimated increased dividend payments from the financial institutions are included in the plan
Expenditure	The growth of primary expenses will be similar to the growth of GDP during the period, but somewhat higher in 2019-2021
	This is due to the temporary increase in state investment level (mainly investment in transport infrastructure)
Debt	Total debt of the Treasury will be below the 25% of GDP goal by the end of 2019 and will not exceed 20% of GDP by the end of 2023
	Estimated irregular cash flow of ISK120 billion during 2018-2021 will be used to reduce debt
Investment	Treasury investment as a % of GDP will increase in 2019-2021 and will be around 2.5% of GDP
	Expected that irreguar cash flow through excess payments from financial institutions (ISK22 billion) will be used for public infrastructure

Source: Ministry of Finance and Economic Affairs, Moody's Investors Service

On the revenue side of the budget, the fiscal policy framework of the current government acknowledges that a more simple and efficient tax system would better suit an economy posting slower economic growth. That said, the government's plan prioritises stability in the labour market, safeguarding jobs, the purchasing power of businesses and households and firms' competitiveness.

Overall the government foresees only a modest reduction in the tax burden (0.5 percentage points of GDP to 27.2% by 2023), in light of planned reductions in the payroll tax, the bank levy rate and a few other less significant tax measures. As regards to taxation of tourism, the government is currently in an exploratory phase with the industry and interested parties to assess in how a particular tourism tax could be levied. An increase in revenue from such a tax is not assumed in the baseline projections for 2018-19; however, an increase in revenue from tourism taxation is presumed beginning in 2020. With the exploratory phase for the possible tax extending through 2019, the government should have ample time to observe the current tourism slowdown and be able to make a determination on that basis.

Large, yet declining, government contingent liabilities

The government's contingent liabilities are very large, although they have been roughly halved in both nominal and relative terms since the peak of the crisis. They mainly derive from guarantees for the Housing Financing Fund (HFF, Baa1 positive) and Landsvirkjun (LV, Baa2 stable).

As of June 2017, outstanding guarantees to HFF and LV were ISK809 billion (31% of GDP) and ISK160 billion (6% of GDP), respectively, constituting 97.6% of all state guarantees. Both HFF and LV have experienced stronger operating results over the last few years. HFF's equity ratio stood at 7.3% at the end of 2017, the highest ratio in the fund's history, while default ratios are down and improved economic conditions within Iceland have reduced the overall risk of the mortgage loan portfolio. Significantly, no new debt has been issued since 2012 and the Ministry of Finance and Economic Affairs expects no further capital injections to be needed. LV's equity ratio stood at 45.4% — also an all-time high — and recent funding has been raised without government guarantees.

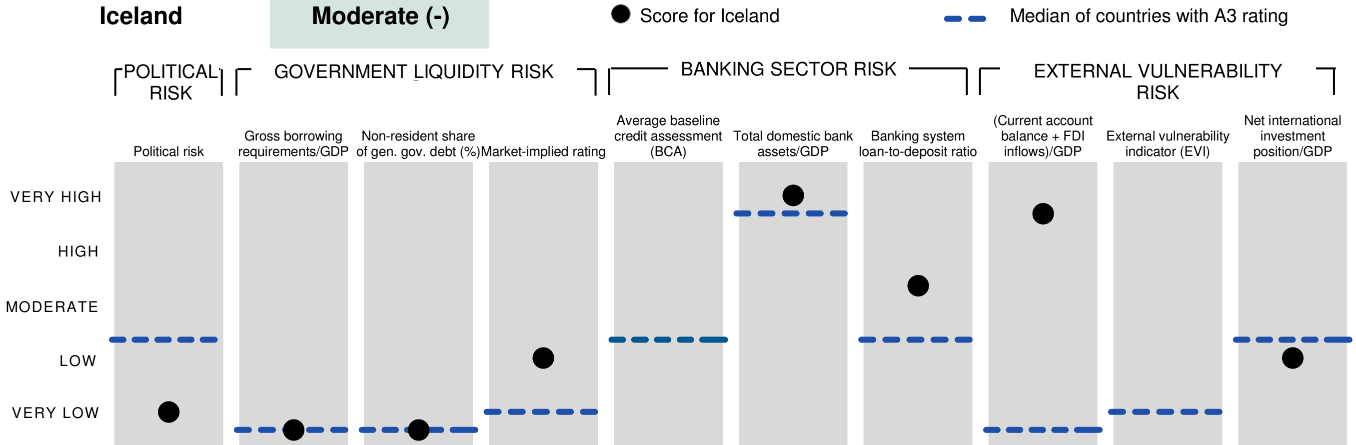
Susceptibility to event risk: Moderate (-)

Factor 4: Overall score

Scale	VL-	VL	VL+	L-	L	L+	M-	M	M+	H-	H	H+	VH-	VH	VH+	
+							Final		Indicative							-

Factor 4: Sub-scores

Iceland **Moderate (-)**



Susceptibility to event risk evaluates a country's vulnerability to the risk that sudden events may severely strain public finances, thus increasing the country's probability of default. Such risks include political, government liquidity, banking sector and external vulnerability risks. Susceptibility of event risk is a constraint which can only lower the preliminary rating range as given by combining the first three factors.

Note: In case the Indicative and Final scores are the same, only the Final score will appear in the table above.

Our assessment for susceptibility to event risk is "Moderate (-)". Political risk and government liquidity risk are assessed as "Very Low," while external vulnerability risk is assessed at "Low."

Frequent elections have had limited effect on policy continuity

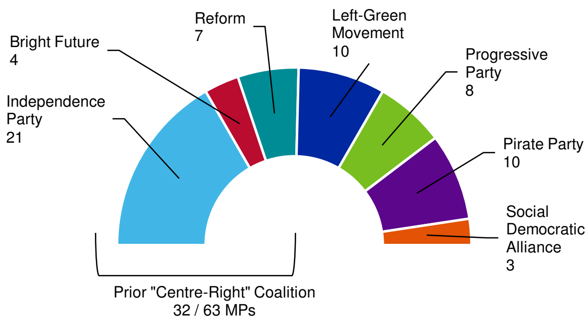
Peer comparison table factor 4a: Political risk

	Iceland A3/POS		Bahamas Baa3/NEG	Barbados Caa3/STA	Denmark Aaa/STA	Ireland A2/STA	Malta A3/POS	Norway Aaa/STA
Final score	VL		VL	VL	VL	VL	VL	VL
Geopolitical risk	VL	--	VL	VL	VL	VL	VL	VL
Domestic political risk	VL	--	VL	VL	VL	VL	VL	VL

Political risk is "Very Low" for both domestic and geopolitical risk, because there has been relatively consistent policy in key areas important to safeguarding the government's credit profile despite several changes in government since 2008. Peers sharing this assessment include Malta, Ireland, Germany (Aaa stable), France (Aa2 positive), Finland (Aa1 stable) and Chile (A1 stable).

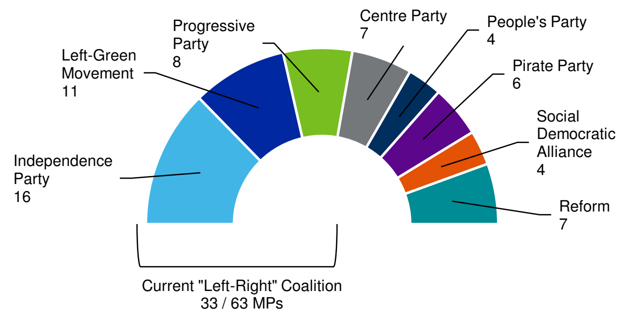
Of the four Icelandic governing coalitions since 2007, only one has served the full four-year term, that being the centre-left coalition that lasted from 2009-13 immediately after the crisis erupted. Although the current government has just a narrow majority (see Exhibits 22 and 23), it represents a broader coalition from left-to-right as compared to the outgoing centre-right government. Prime Minister Katrin Jakobsdottir has said that the current government will seek to rebuild Icelandic citizens' trust in government and restore stability to the political environment.

Exhibit 22
The outgoing centre-right coalition had a narrow majority…
(Outgoing government as of Sept. 2017)



Source: Alpinigi, Moody's Investors Service

Exhibit 23
…which continues, but with more breadth across the political spectrum.
(Current government as of October 2017)



Source: Alpinigi, Moody's Investors Service

Banking sector risk: Moderate (-)

Peer comparison table factor 4c: Banking sector risk

	Iceland A3/POS	M- Median	Armenia B1/POS	Belarus B3/STA	Ireland A2/STA	Slovenia Baa1/STA	Panama Baa2/POS	Hungary Baa3/STA
Final score	M-		M-	M-	M-	M-	M-	M-
Indicative score	M+		M-	L+	M-	M	L+	M-
Baseline credit assessment	--	b1	b2	b3	ba1	b1	baa3	ba2
Total dom. bank assets/GDP	188.4	79.4	78.2	63.4	112.4	93.5	193.6	85.7
Loan-to-deposit ratio	143.4	90.9	102.3	149.7	94.0	90.9	--	84.1

We assess Iceland's banking sector risk as "Moderate (-)", better than the indicative score of "Moderate (+)". Because Moody's does not rate any of the Icelandic banks, the indicative banking sector risk score is incomplete. That said, we incorporate our aggregate analysis of the Icelandic banking system derived from publicly available information into the final score, which leads to the two notch uplift from the indicative score.

The banking system appears to be coping well with the relaxation of capital controls, as the central bank and the banking regulator require the banks to maintain very high levels of liquidity and capital and their lending activities are restricted to the domestic economy.

That said, wholesale funding remains very high with a loan-to-deposit ratio of 136% and the banking system is very concentrated. Also, according to the IMF, non-insignificant risks are still present as more work needs to be done on strengthening the power of the supervisors and regulators and reducing the gaps in financial safety nets and the deposit insurance and bank resolution frameworks.

Financial profile supported by favourable economic conditions…

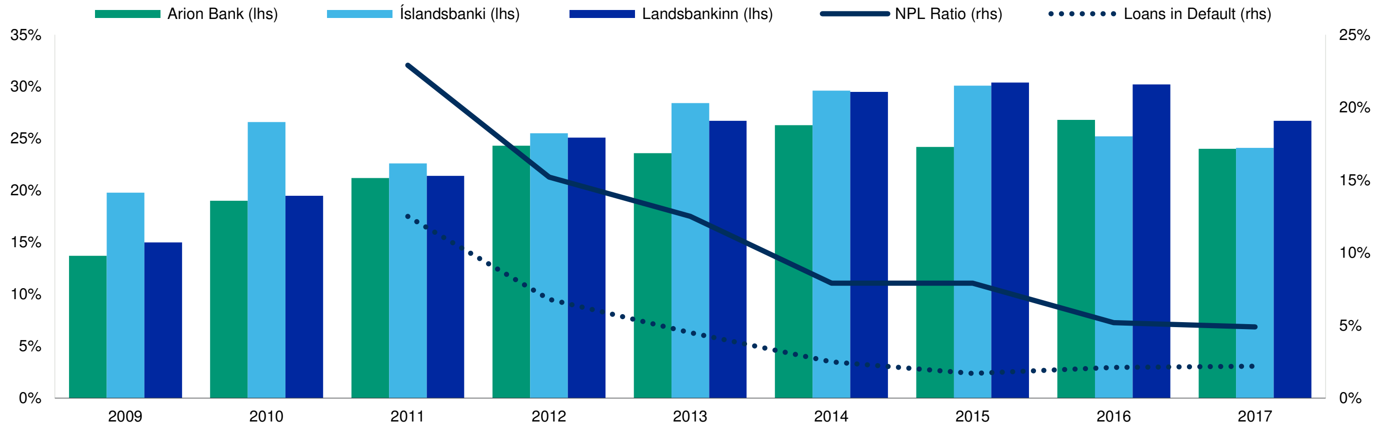
The Icelandic banks have successfully emerged as healthy financial institutions since the economic crisis, underpinned by the rapid economic recovery in recent years and under the regulatory supervision of the FME and the CBI. The structure of the financial system has also changed in recent years. The pension funds have increased their share of assets, the share of deposit institutions has shrunk and the shadow banking system has grown.

The three domestic systemically important banks (D-SIB) account for about 98% of deposit institutions' assets. However, the system now has significantly improved solvency indicators: very high capital ratios (22%-28%) and low single digit non-performing loan (NPL) ratios because of extensive restructuring of loan portfolios (see Exhibit 24).

Exhibit 24

D-SIBs' capital adequacy and loan quality are far improved

(Capital base % of risk-weighted assets — lhs; percent of total loans (all D-SIBs) — rhs)



Source: Central Bank of Iceland, Moody's Investors Service

…but tail risks remain, particularly within the area of the real estate market and tourism

However, given the small scale of the economy and population size we see a substantial level of interconnectedness within the country and contagion risk among the three main economic sectors. This makes banks highly susceptible to boom-bust cycles, creating significant tail risk since banks cannot diversify in such a system.

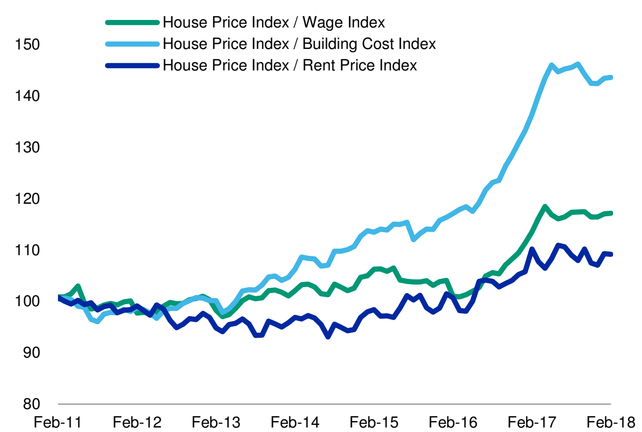
Credit provided both directly and indirectly to the tourism sector (for example, construction, services and households) suggests that asset quality could suffer as the tourism industry matures, in the event that overconfidence in past rapid growth led to credit-financed overinvestment in the sector.

With regards to the real estate market, while house prices have increased sharply, various measures of house prices compared to key determinants (see Exhibit 25) and systemwide household debt metrics compared to household wealth (see Exhibit 26) suggest that the risks are manageable.

Exhibit 25

House prices have risen beyond fundamentals…

(Index, January 2011 = 100)

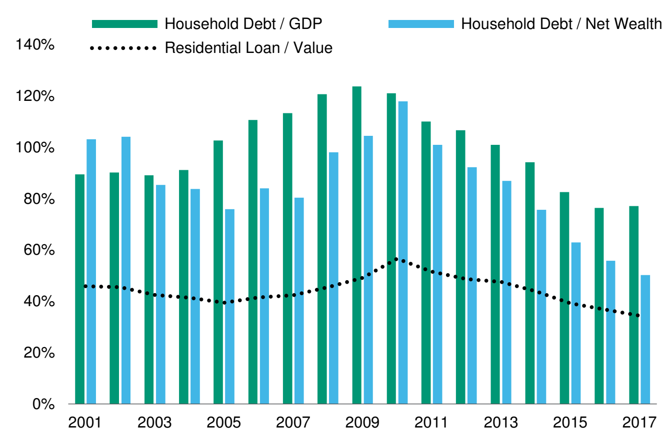


Source: Central Bank of Iceland, Moody's Investors Service

Exhibit 26

….yet metrics systemwide have indeed improved

(Percentage)



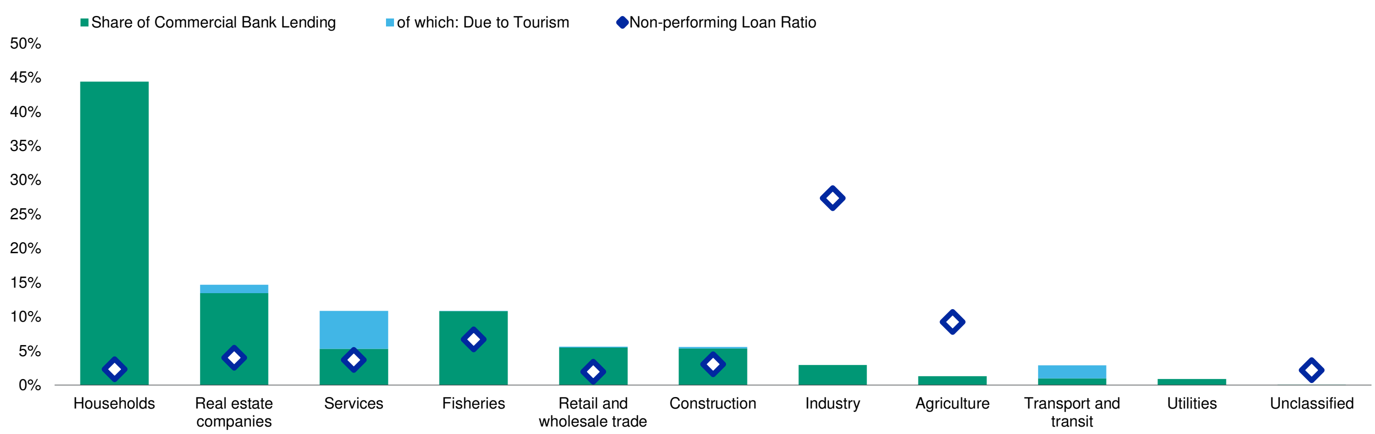
Source: Central Bank of Iceland, Moody's Investors Service

At the industry level, the D-SIBs' loan portfolio is mostly directed towards holding companies, industry and agriculture. Lending directly to the tourism sector accounts for only about 9% of the D-SIBs' loans to customers, up from approximately 7% since the first half of 2015.

Most of the services industry is concentrated around tourism activity, and as a percentage of D-SIBs' lending, services accounted for only 12.2% as of February 2018. Moreover, most of these loans are over collateralized — with 32% of the loans backed by commercial real estate, which limits the downside risks to financial stability in the event that slower tourism activity leads to increased risk for banks' loans.

Households have is the largest share of bank loans, followed by real estate companies and services. Non-performing loan ratios in all of these sectors are relatively low (see Exhibit 27). The share of nonperforming loans among corporates is low but increasing, with the trend that corporate arrears are attributable to a few companies with larger facilities.

Exhibit 27
Icelandic banks have a relatively high concentration among a few key sectors
(Percent)



Note: non-performing loan ratios not available for Transport and transit and Utilities
Source: Central Bank of Iceland, Moody's Investors Service

Government liquidity risk: Very Low

Peer comparison table factor 4b: Government liquidity risk

	Iceland A3/POS	VL Median	Bermuda A2/STA	Botswana A2/STA	Panama Baa2/POS	Romania Baa3/STA	Saudi Arabia A1/STA	Sharjah A3/STA
Final score	VL		VL	VL	VL	VL	VL	VL
Indicative score	VL		VL	VL	VL+	VL+	VL+	VL
Gross borrowing req./GDP	1.7	5.2	0.9	6.1	5.2	7.3	6.7	3.6
Gen. gov. ext. debt/gen. gov. debt	22.2	45.6	96.7	70.8	77.9	45.6	41.5	30.0
Market funding stress indicator	Baa2	Baa1	Baa2	--	A3	A3	Baa1	Baa1

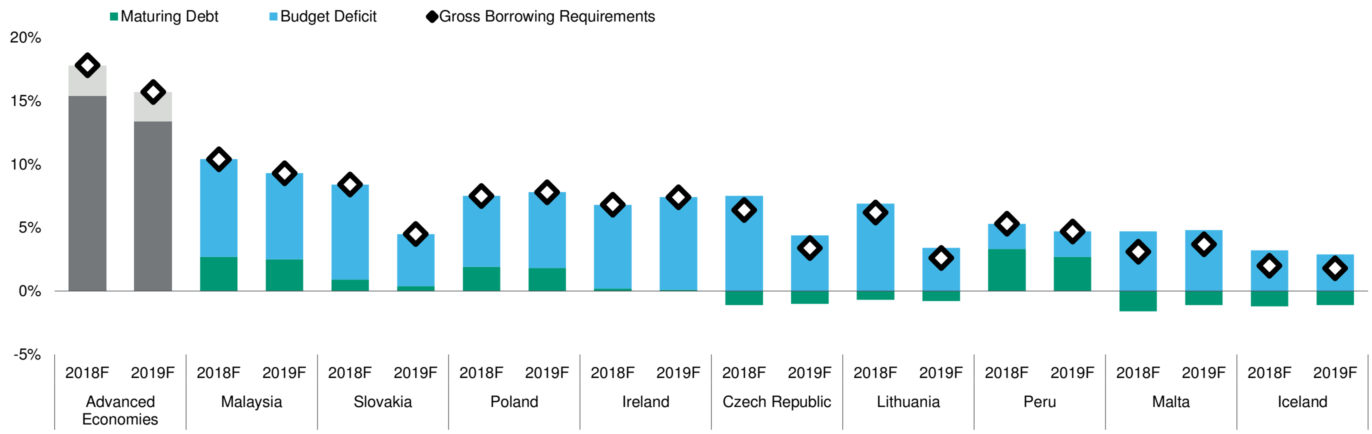
We assess government liquidity risk as “Very Low.” The government's funding situation remains very comfortable with low borrowing requirements because of fiscal surpluses and declining debt.

The government has recorded financial surpluses over the last two years — 12.6% of GDP in 2016 and 0.5% of GDP in 2017. The former was inflated by a one-off ISK384.2 billion (about 1.5% of 2017 GDP) stability contribution from the estates of the fallen banks that was ultimately used to pay down outstanding debt.

The trend of not refinancing maturing debt and now general government financial surpluses has led to a marked decline in Iceland’s gross borrowing requirements. The Debt Management Office projects negative net financing needs of between ISK23,600 million (0.9% of 2017 GDP) and ISK38,700 (1.5% of 2017 GDP) over the 2018—2022 period.

According to estimates from the IMF Fiscal Monitor, gross borrowing requirements are 1.9% of GDP in 2018 and 1.4% of GDP in 2019, a significant reduction from 18.8% of GDP in 2011. When compared to similarly rated peers, Iceland has the lowest gross borrowing requirements both this year and next (see Exhibit 28).

Exhibit 28
Iceland benefits from the lowest gross borrowing requirements among peers with similar ratings
(% of GDP)



Source: IMF Fiscal Monitor, Moody's Investors Service

Moreover, the government's relatively long average maturity of debt, at approximately 6.5 years for all outstanding debt, limits refinancing needs. Roughly one third (35.5%) of the total debt will mature within 36 months.

Additionally, owners of marketable Treasury bonds are relatively diverse and primarily consist of pension funds, which have maintained a stable holding of government debt over the last few years. General government external debt as a share of general government debt was 22.2% as of 2017, less than half of the "Very Low" median for rated sovereigns.

External vulnerability risk is Low, with current account surpluses contributing to net external creditor position

Peer comparison table factor 4d: External vulnerability risk	Iceland A3/POS	L Median	Lithuania A3/STA	Ireland A2/STA	Poland A2/STA	Costa Rica Ba2/NEG	Bahamas Baa3/NEG	Albania B1/STA
Final score	L		L	L	L	L	L	L
Indicative score	M+		VL+	L	L	L+	VL+	L
(Curr. acc. bal. + FDI inflows)/GDP	-25.7	0.8	3.1	21.2	1.5	2.0	-15.0	0.7
Net international inv. position/GDP	7.2	-41.7	-35.4	-155.8	-65.9	-32.8	--	-48.1

External vulnerability risk is set at "Low", which is below the indicative score of "Moderate (+)". Given that our scorecard focuses on gross FDI outflows, the accounting treatment of ownership changes in a large pharmaceuticals firm and the winding-up of special purpose entities established before the financial crisis, gives a false signal regarding Iceland's external vulnerability, especially because those outflows are fully netted out elsewhere in the capital account. Peers sharing the "Low" assessment of external vulnerability risk include Ireland, Lithuania and Poland.

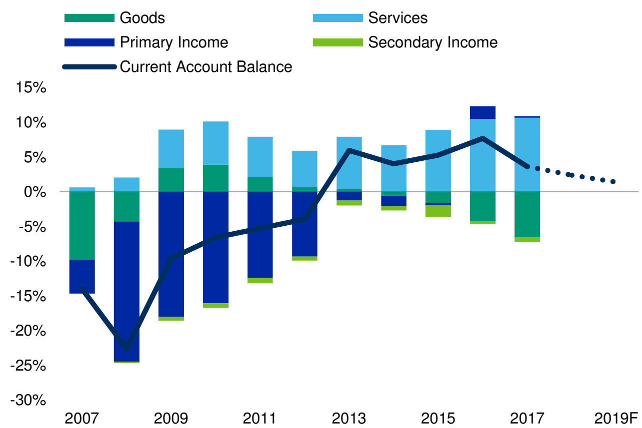
Iceland's return to economic normalcy over the past few years has been bolstered by a turnaround in its external position, even after the economy returned to strong growth and capital controls were eased. That said, the current account surplus narrowed somewhat to ISK93 billion (3.7% of GDP) in 2017 (see Exhibit 31).

We expect the current account surplus to continue to narrow in the coming years as aggregate demand strengthens, pulling in imports, the króna depreciates and as the benefits of lower oil prices tail off. Positive balance of payments dynamics allowed the CBI to purchase substantial foreign exchange in the foreign exchange market, bolstering its free foreign exchange reserves to US$6.1 billion (roughly 25% of GDP) as of May 2018.

Additionally, Iceland's net international investment position (net IIP) has improved significantly in the years since the crisis because current account surpluses facilitated the paying down of external debt, while rising prices increased the value of Iceland's foreign assets and the owners of the failed banks wrote down their external debt in the context of winding-up proceedings. After the resolution of the failed bank estates in 2016, Iceland's net IIP improved sharply, moving into a positive territory of 2.6% of GDP at the end of 2016 from -4.8% of GDP at the end of 2015 (see Exhibit 32). As of the end of the first quarter of 2018, Iceland's net IIP stood at 9.2% of 2017 GDP.

Exhibit 29

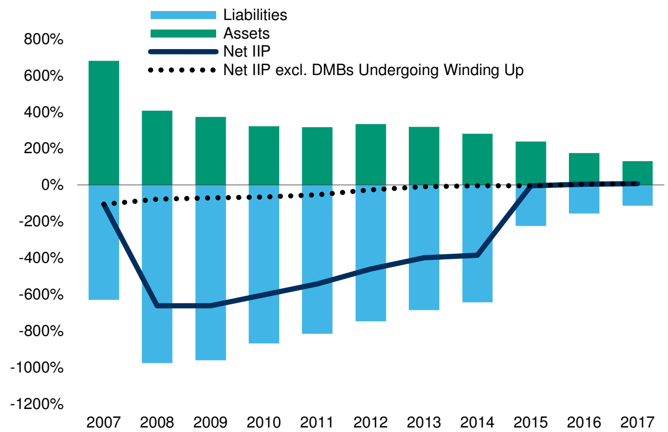
Current account has moved to sizable surpluses from large deficits…
(% of GDP)



Source: Central Bank of Iceland, Statistics Iceland, Moody's Investors Service

Exhibit 30

…which along with resolution of the bank estates has helped turn the net IIP positive.
(% of GDP)



Source: Statistics Iceland, Central Bank of Iceland, Moody's Investors Service

Deteriorating competitiveness represents the most significant threat to the sustainability of Iceland's external position, which would be endangered if wage increases granted in the next couple of years are outsized relative to inflation and productivity.

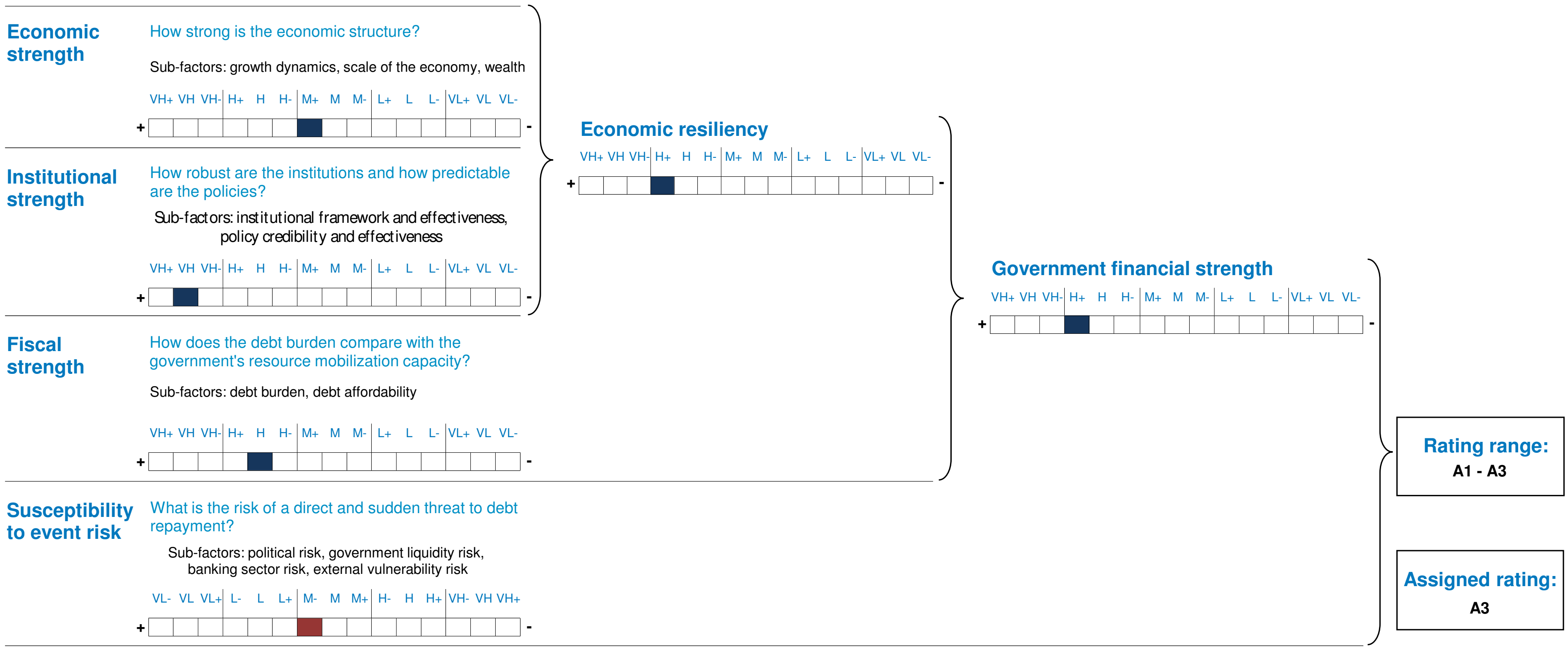
The authorities' "capital flow mechanism" is meant to protect economic and financial stability by deterring speculative capital inflows. Introduced in June 2016, the mechanism has been highly successful in helping to maintain macro and financial stability. Iceland has a very small economy with its own currency and a monetary policy that is tighter than in the rest of the advanced world.

Rating range

Combining the scores for individual factors provides an indicative rating range. While the information used to determine the grid mapping is mainly historical, our ratings incorporate expectations around future metrics and risk developments that may differ from the ones implied by the rating range. Thus, the rating process is deliberative and not mechanical, meaning that it depends on peer comparisons and should leave room for exceptional risk factors to be taken into account that may result in an assigned rating outside the indicative rating range. For more information please see our Sovereign Bond Rating methodology.

Exhibit 31

Sovereign rating metrics: Iceland



Source: Moody's Investors Service

Comparatives

This section compares credit relevant information regarding Iceland with other sovereigns that we rate. It focuses on a comparison with sovereigns within the same rating range and shows the relevant credit metrics and factor scores.

Iceland compares well against near-peers on the rating scale with its dynamic growth, very high wealth, strong institutions, fast falling debt and declining susceptibility to event risk as the banking system continues to mature. By comparison, Slovakia and Ireland have significantly higher debt although their membership of the single currency area reduces their cost of funding. All of the A3 and some of the A2 peers have weaker institutional strength by 2-3 notches.

Exhibit 32
Iceland's key peers

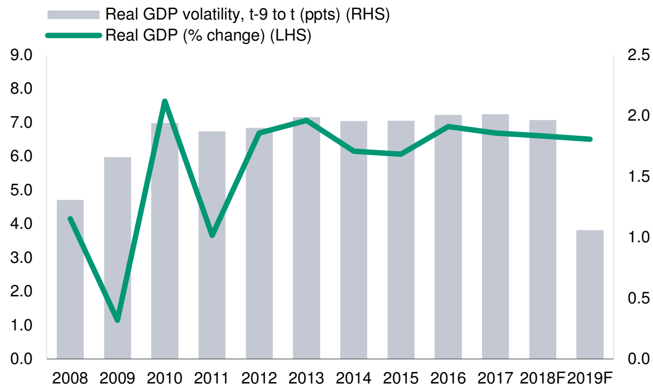
	Year	Iceland	Slovenia	Slovakia	Latvia	Malta	Botswana	A3 Median	Western Europe Median
Rating/Outlook		A3/POS	Baa1/STA	A2/POS	A3/STA	A3/POS	A2/STA	A3	Aa2
Rating Range		A1 - A3	A2 - Baa1	Aa3 - A2	A1 - A3	A1 - A3	Aa3 - A2	A1 - A3	Aa2 - A1
Factor 1		**M+**	**M+**	**M+**	**M+**	**H-**	**M-**	**M+**	**H+**
Nominal GDP (US$ bn)	2017	23.9	48.8	95.8	30.3	12.5	17.6	38.7	406.6
GDP per capita (PPP, US$)	2017	51841.5	34407.1	33025.2	27644.1	41944.8	17835.9	30625.0	49868.7
Avg. real GDP (% change)	2013-2022	3.6	2.9	3.4	2.9	5.6	4.5	3.2	1.8
Volatility in real GDP growth (ppts)	2008-2017	4.0	3.7	3.1	6.1	3.5	5.3	3.8	2.3
Global Competitiveness index	2017	5.0	4.5	4.3	4.4	4.7	4.3	4.6	5.2
Factor 2		**VH**	**H+**	**H+**	**H+**	**H**	**H**	**H+**	**VH**
Government Effectiveness, percentile [1]	2016	86.4	78.9	69.9	72.9	70.6	63.9	70.6	88.7
Rule of Law, percentile [1]	2016	87.2	79.6	69.1	75.9	78.9	66.1	75.9	88.7
Control of Corruption, percentile [1]	2016	93.9	73.6	60.9	65.4	72.1	77.4	65.4	90.9
Average inflation (% change)	2013-2022	2.4	1.2	1.1	1.6	1.5	3.9	2.4	1.4
Volatility in inflation (ppts)	2008-2017	4.1	1.7	1.8	4.8	1.1	3.1	2.3	1.3
Factor 3		**H**	**H-**	**VH**	**VH-**	**H+**	**VH+**	**H+**	**H+**
Gen. gov. debt/GDP	2017	43.3	73.6	50.9	40.1	50.8	15.5	39.9	62.8
Gen. gov. debt/revenue	2017	99.6	170.8	129.2	106.9	125.5	48.2	130.7	136.0
Gen. gov. interest payments/revenue	2017	9.2	5.8	3.5	2.5	4.6	1.6	6.1	3.5
Gen. gov. interest payments/GDP	2017	4.0	2.5	1.4	0.9	1.9	0.5	1.5	1.8
Gen. gov. financial balance/GDP	2017	1.5	0.0	-1.0	-0.5	3.9	-1.3	-0.6	0.5
Factor 4		**M-**	**M-**	**L+**	**M-**	**L+**	**L**	**M-**	**L+**
Current account balance/GDP	2017	3.4	6.4	-2.1	-0.8	12.6	7.9	0.9	3.2
Gen. gov. external debt/gen. gov. debt	2017	22.2	68.4	52.8	74.8	11.3	70.8	29.6	46.1
Net international investment position/GDP	2017	7.2	-31.2	-63.7	-56.3	62.8	34.1	-1.4	7.2

[1] Moody's calculations. Percentiles based on our rated universe.
Source: Moody's Investors Service

DATA, CHARTS AND REFERENCES

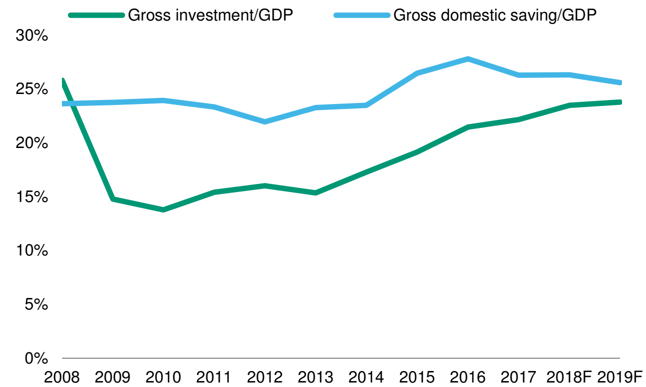
Chart pack: Iceland

Exhibit 33
Economic growth



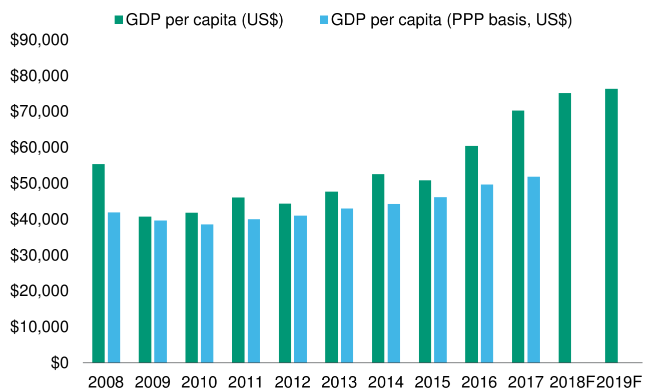
Source: Moody's Investors Service

Exhibit 34
Investment and saving



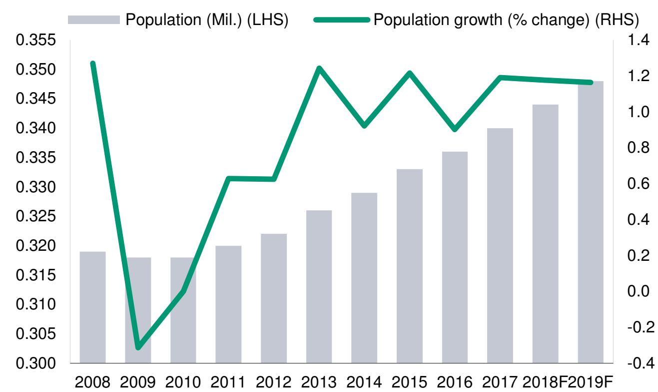
Source: Moody's Investors Service

Exhibit 35
National income



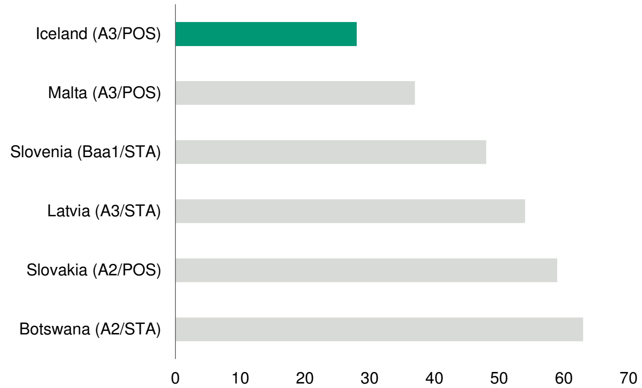
Source: Moody's Investors Service

Exhibit 36
Population



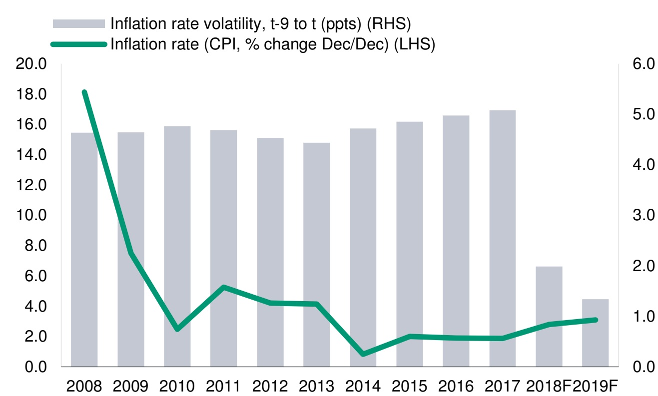
Source: Moody's Investors Service

Exhibit 37
Global Competitiveness Index
Rank 28th out of 137 countries



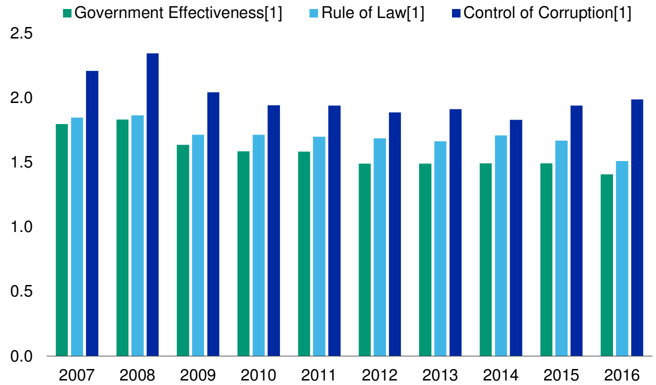
Source: World Economic Forum

Exhibit 38
Inflation and inflation volatility



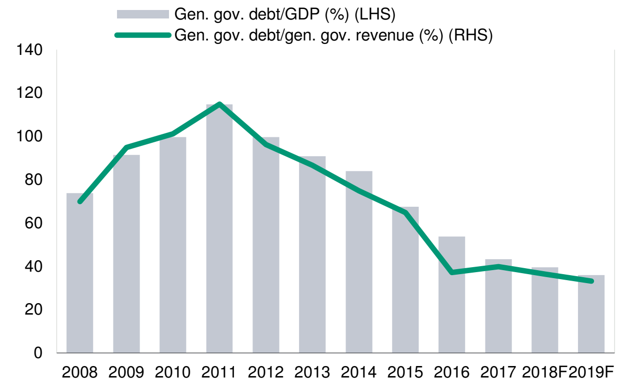
Source: Moody's Investors Service

Exhibit 39
Institutional framework and effectiveness



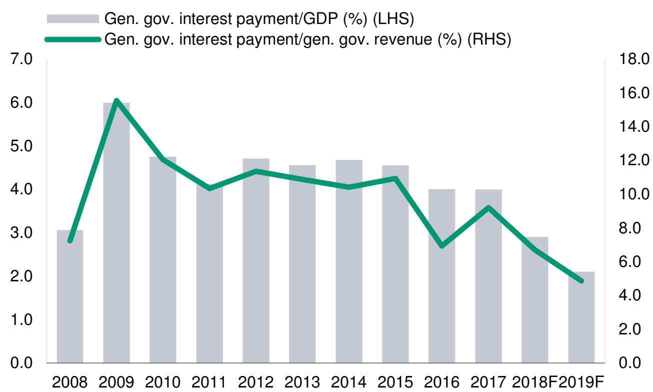
Note: [1] Composite index with values from about -2.50 to 2.50: higher values suggest greater maturity and responsiveness of government institutions.
Source: Worldwide Governance Indicators

Exhibit 40
Debt burden



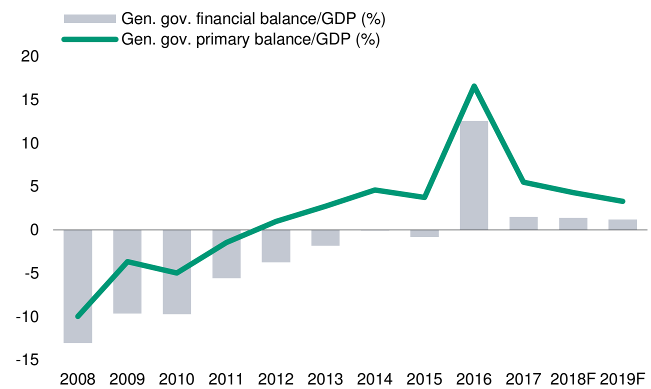
Source: Moody's Investors Service

Exhibit 41
Debt affordability



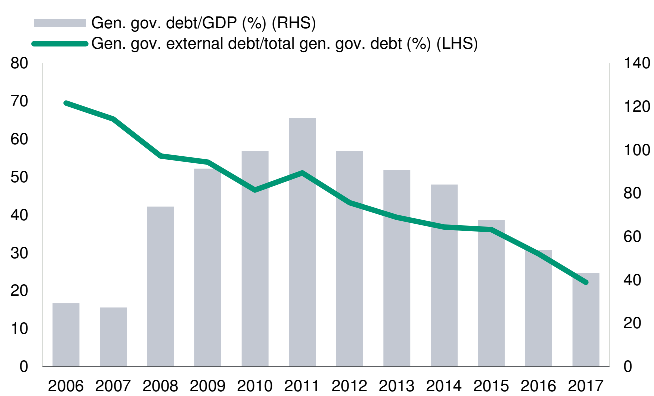
Source: Moody's Investors Service

Exhibit 42
Financial balance



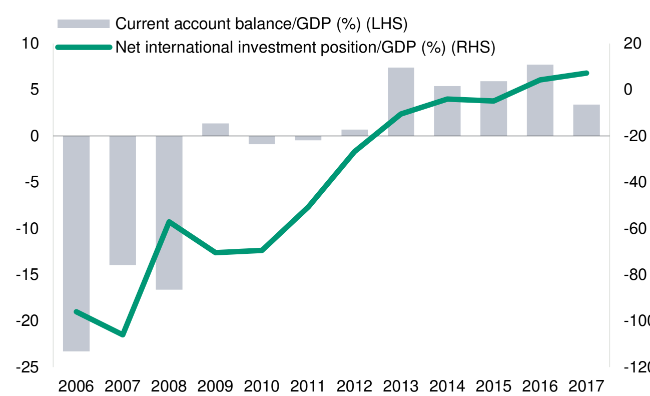
Source: Moody's Investors Service

Exhibit 43
Government liquidity risk



Source: Moody's Investors Service

Exhibit 44
External vulnerability risk



Source: Moody's Investors Service

Rating history

Exhibit 45

Iceland[1]

	Government Bonds			Foreign Currency Ceilings				
				Bonds & Notes		Bank Deposit		
	Foreign Currency	Local Currency	Outlook	Long-term	Short-term	Long-term	Short-term	Date
Outlook Changed	--	--	Positive	--	--	--	--	Jul-18
Rating Raised	A3	A3	Stable	A3	--	A3	--	Sep-16
Outlook Changed	Baa2	Baa2	RUR-	Baa2	P-2	Baa2	P-2	Jun-16
Rating Raised	Baa2	Baa2	--	Baa2	--	Baa2	--	Jun-15
Outlook Changed	--	--	Stable	--	--	--	--	Feb-13
Rating Lowered	--	--	--	Baa3	--	--	--	Nov-12
Outlook Changed	--	--	Negative	--	--	--	--	Jul-10
Outlook Changed	--	--	Stable	--	--	--	--	Apr-10
Outlook Changed	--	--	Negative	--	--	--	--	Apr-10
Outlook Changed	--	--	Stable	--	--	--	--	Nov-09
Rating Lowered	Baa3	Baa3	--	Baa2	P-3	Baa3	P-3	Nov-09
Rating Lowered	Baa1	Baa1	Negative	A2	P-2	Baa1	P-2	Dec-08
Rating Lowered & Review for Downgrade	A1	A1	RUR-	Aa1	--	A1	--	Oct-08
Review for Downgrade	Aa1	Aa1	RUR-	--	--	--	--	Sep-08
Rating Lowered	Aa1	Aa1	Stable	--	--	Aa1	--	May-08
Outlook Changed	--	--	Negative	--	--	--	--	Mar-08
Rating Raised	Aaa	--	Stable	Aaa	--	Aaa	--	Oct-02
Rating Assigned	--	Aaa	--	--	--	--	--	Jul-97
Rating Raised	Aa3	--	Stable	Aa3	--	Aa3	--	Jul-97
Review for Upgrade	A1	--	RUR+	--	--	--	--	Jun-97
Outlook Assigned	--	--	Positive	--	--	--	--	Mar-97
Rating Raised	A1	--	--	A1	--	A1	--	Jun-96
Review for Upgrade	A2	--	RUR+	--	--	--	--	Apr-96
Rating Assigned	--	--	--	--	--	A2	P-1	Oct-95
Rating Assigned	--	--	--	--	P-1	--	--	Oct-90
Rating Assigned	A2	--	--	A2	--	--	--	May-89

Notes: [1] Table excludes rating affirmations. Please visit the issuer page for Iceland for the full rating history.
Source: Moody's Investors Service

Annual statistics

Exhibit 46
Iceland

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018F	2019F
Economic structure and performance												
Nominal GDP (US$ bil.)	17.7	12.9	13.3	14.7	14.3	15.5	17.3	16.9	20.3	23.9	26.2	28.3
Population (Mil.)	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
GDP per capita (US$)	55,356	40,705	41,857	46,040	44,385	47,694	52,596	50,878	60,429	70,324	76,254	81,363
GDP per capita (PPP basis, US$)	41,867	39,657	38,594	40,023	41,005	42,953	44,221	46,147	49,683	51,842	--	--
Nominal GDP (% change, local currency)	13.7	3.1	1.7	5.0	4.6	6.3	6.4	10.6	9.8	4.1	6.0	6.2
Real GDP (% change)	1.7	-6.5	-3.6	2.0	1.3	4.3	2.2	4.3	7.5	3.6	3.2	2.8
Inflation (CPI, % change Dec/Dec)	18.1	7.5	2.5	5.3	4.2	4.1	0.8	2.0	1.9	1.9	2.8	3.1
Unemployment rate (%)	3.0	7.2	7.6	7.1	6.0	5.4	5.0	4.0	3.0	2.8	2.4	2.6
Gross investment/GDP	25.8	14.8	13.8	15.4	16.0	15.4	17.3	19.1	21.5	22.2	23.5	23.8
Gross domestic saving/GDP	23.6	23.8	23.9	23.3	22.0	23.3	23.5	26.5	27.8	26.3	26.3	25.6
Nominal exports of G & S (% change, US$ basis)	2.4	-12.0	11.1	16.7	-2.4	5.9	6.7	-1.5	9.0	14.3	10.9	9.1
Nominal imports of G & S (% change, US$ basis)	-15.4	-31.6	9.9	23.8	1.7	1.3	9.9	-3.8	9.9	20.0	14.3	11.7
Real exports of G & S (% change)	3.3	8.3	1.0	3.4	3.6	6.7	3.2	9.2	10.9	4.8	4.3	3.9
Real imports of G & S (% change)	-20.3	-22.4	4.4	6.8	4.6	0.1	9.8	13.8	14.5	11.9	7.5	6.3
Net exports of goods & services/GDP	-2.2	9.0	10.2	7.9	5.9	7.9	6.2	7.3	6.3	4.1	2.8	1.8
Openness of the economy[1]	84.6	90.0	96.7	104.8	107.4	102.4	99.5	99.0	90.4	89.8	92.1	94.2
Government Effectiveness[2]	1.8	1.6	1.6	1.6	1.5	1.5	1.5	1.5	1.4	--	--	--
Government finance												
Gen. gov. revenue/GDP	42.2	38.6	39.4	39.9	41.4	41.9	44.9	41.7	57.8	43.4	43.4	43.3
Gen. gov. expenditures/GDP	55.3	48.2	49.1	45.5	45.2	43.7	45.0	42.5	45.2	41.9	42.0	42.1
Gen. gov. financial balance/GDP	-13.0	-9.6	-9.7	-5.6	-3.7	-1.8	-0.1	-0.8	12.6	1.5	1.4	1.2
Gen. gov. primary balance/GDP	-10.0	-3.6	-5.0	-1.4	1.0	2.7	4.6	3.7	16.6	5.5	4.6	4.1
Gen. gov. debt (US$ bil.)	9.5	11.7	14.1	16.0	13.8	14.9	13.4	11.7	11.7	10.6	10.5	10.2
Gen. gov. debt/GDP	73.8	91.4	99.7	114.7	99.7	90.8	84.0	67.6	53.7	43.3	39.5	35.9
Gen. gov. debt/gen. gov. revenue	174.8	237.0	252.9	287.1	240.5	216.8	187.1	162.2	92.9	99.6	91.0	82.9
Gen. gov. interest payments/gen. gov. revenue	7.2	15.5	12.0	10.3	11.3	10.9	10.4	10.9	6.9	9.2	7.3	6.7
External payments and debt												
Nominal exchange rate (local currency per US$, Dec)	120.6	124.9	115.1	122.7	129.0	115.6	126.9	129.6	112.8	104.4	102.0	101.0
Real eff. exchange rate (% change)	-21.4	-19.4	5.2	1.5	-0.3	4.6	6.7	2.3	11.8	12.1	--	--
Relative unit labor cost	130.7	90.0	100.0	105.2	105.7	109.9	120.1	131.9	151.0	174.7	--	--
Current account balance (US$ bil.)[3]	-2.9	0.2	-0.1	-0.1	0.1	1.1	0.9	1.0	1.6	0.8	0.6	0.4
Current account balance/GDP[3]	-16.6	1.3	-0.9	-0.5	0.7	7.4	5.4	5.9	7.7	3.4	2.4	1.4
Net foreign direct investment/GDP	29.0	-17.0	19.6	7.4	29.6	-0.3	4.2	4.1	3.5	0.4	0.7	1.3
Net international investment position/GDP[3]	-57.1	-70.5	-69.5	-50.8	-26.8	-10.5	-4.0	-4.8	4.3	7.2	--	--
Official forex reserves (US$ bil.)	3.5	3.6	5.6	7.7	4.0	4.1	4.1	4.8	6.9	6.2	7.1	7.4

[1] Sum of Exports and Imports of Goods and Services/GDP
[2] Composite index with values from about -2.50 to 2.50: higher values suggest greater maturity and responsiveness of government institutions
[3] Excludes DMBs undergoing winding up in 2008-2015
Source: Moody's Investors Service

Moody's related publications

» **Rating Action**: Moody's changes Iceland's outlook to positive from stable and affirms A3 ratings, 20 July 2018

» **Credit Opinion**: Government of Iceland - A3 positive: Update following outlook change to positive, 20 July 2018

» **Issuer Comment**: Government of Iceland: Iceland's Keflavik Airport investment will expand economic benefits of tourism, 22 January 2018

» **Country Statistics**: Iceland, Government of, 30 May 2018

» **Outlook**: Sovereigns - Global: 2018 outlook stable as healthy growth tempers high debt, geopolitical tensions, 8 November 2017

» **Rating Methodology**: Sovereign Bond Ratings, 22 December 2016

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

Related websites and information sources

» Sovereign Risk Group Web Page

» Sovereign Ratings List

» Statistics Island

» Central Bank of Iceland

Authors
Kristin Lindow
Senior Vice President

Michael Higgins
Associate Analyst

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.

REPORT NUMBER 1135627

MOODY'S
INVESTORS SERVICE