

RATING ACTION COMMENTARY

Fitch Revises Iceland's Outlook to Positive; Affirms at 'A'

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Fitch Ratings - Frankfurt am Main - 08 Aug 2025: Fitch Ratings has revised the Outlook on Iceland's Long-Term Foreign-Currency (LT FC) Issuer Default Rating (IDR) to Positive from Stable and affirmed the IDR at 'A'.

A full list of rating actions is at the end of this rating action commentary.

KEY RATING DRIVERS

The revision of the Outlook reflects the following key rating drivers and their relative weights:

High:

Sizeable Debt Decline: The Positive Outlook reflects Iceland's strengthened public finances. General government debt is projected to fall significantly in 2025 after the successful settlement of the Housing Financing Fund's (HF Fund) liabilities and the full privatisation of Islandbanki. Fitch forecasts debt to decline to 51.0% of GDP at end-2025, down by 8.4pp from its 2024 level. This marks a significant reduction from 65.7% of GDP in 2019, placing Iceland's debt ratio below the current 'A' category peer median (forecast at 57.3% of GDP at end-2025).

Settlement of HF Fund: The completion of the HF Fund settlement between the government and key investors in June concludes long-standing state plans to wind-down the state-owned housing fund. The fund played a central role in providing affordable housing loans to residents but, after the 2008 financial crisis, faced increasing asset-liability mismatches and growing competition in the mortgage market. The HF Fund settlement and privatisation of Islandbanki (finalised in May) support investor confidence in Iceland's financial sector and institutional framework.

Fiscal Consolidation: Iceland's Medium-Term Fiscal Plan 2026-2030 targets a general government deficit close to balance by 2027. The plan sets out measures over five years, aiming for expenditure consolidation of 1.8% of GDP and new revenue of 1.0% of GDP. Planned actions include merging public institutions, reviewing unemployment benefits, higher taxes on natural resources in tourism and fishing sectors, and tightening tax exemptions. Most measures are under parliamentary review.

Improving Fiscal Metrics: Fitch's baseline is for the fiscal deficit to narrow to 1.1% of GDP by 2027, from 1.5% in 2025. The slower deficit reduction relative to the Medium-Term Fiscal Plan reflects our more conservative view on savings from spending efficiency measures and tax efforts. We expect real underlying expenditure growth will be kept in line with the adopted stability rule, but savings from consolidation of public institutions, concentrated in the latter half of the plan, may not fully meet the government's target. However, for revenues, Fitch recognises potential upside from the kilometre-based road levy on all vehicles and approval of the Fishing Fee Bill on 14 July.

Fitch's fiscal baseline indicates debt-to-GDP ratio will follow a gradual downward trend, reaching 47.6% by 2027.

Medium:

Economic Diversification: Progress continues in diversifying the economy into higher-value-added sectors, such as pharmaceuticals, information and communications technology and biotechnology. Iceland's abundant renewable energy sources and competitive energy prices have attracted investments in energy-intensive data centres. There is also strong potential in aquaculture, where Iceland has a global competitive advantage. At end-2024, high value-added services exports accounted for 21% of total services exports, up from 14% in 2018. According to the IMF, Iceland's medium-term growth potential is around 2.4%, which is above that of most advanced economies.

Iceland's 'A' IDRs also reflect the following key rating drivers:

Global Trade War: Direct trade with the US is limited, accounting for 11.5% of goods exports, although the marine sector is most affected, with the US comprising 10-14% of marine exports. Contagion risks through indirect channels remain significant. The EU is Iceland's largest trading partner, representing 45% of Iceland's total goods imports. Higher imported inflation from a global trade war could pose challenges for fiscal and monetary policy. Our baseline is for Iceland's economy to grow by 1.6% in 2025 and 2.4% in 2026.

Tight Monetary Stance: Amid strong domestic demand pressures, the Central Bank of Iceland faces a challenging task in steering inflation and inflation expectations back to its 2.5%+/-1.5pp target. In July 2025, annual inflation was 4.0%, little changed from 4.6% in January. Fitch forecasts inflation to average 3.9% in 2025 and expects a pause in the monetary easing cycle in 2H25. Since October 2024, the central bank's policy rate has been cut at each consecutive policy meeting, from 9.25% to 7.5%. With a real policy rate of around 4.0%, the monetary stance remains tight.

Sound Banking Sector: Icelandic banks are well capitalised, with strong liquidity buffers well above minimum requirements. Despite high interest rates, non-performing loans are low, at 1.0% for households and 2.6% for corporates. Imbalances in the residential real estate sector persist but are moderating, due to prices cooling and increase in transaction periods. The sector's countercyclical capital buffer remains at 2.5%.

Strong External Buffers: Large net tourism flows and a high goods import dependency can affect exchange rate volatility. Compared with its peer group, Iceland's real effective exchange rate volatility is high (6.9% against a historical median of 4.6% for 'A' rated sovereigns). Large international FX reserves (22% of GDP, May 2025) and close to five months of imports coverage provide headroom against FX volatility risks. Iceland's positive net international investment position (45.8% of GDP, 2024) stands out against the 'A' category peer group (current median negative 9% of GDP), a reflection of its significant private pension fund sector (assets of 170% of GDP).

ESG - Governance: Iceland has an ESG Relevance Score (RS) of '5[+]' for both Political Stability and Rights and for the Rule of Law, Institutional and Regulatory Quality and Control of Corruption. These scores reflect the high weight that the World Bank Governance Indicators (WBGI) have in our proprietary Sovereign Rating Model. Iceland has a high WBGI ranking at the 93.1 percentile, reflecting its long record of stable and peaceful political transitions, well established rights for participation in the political process, strong institutional capacity, effective rule of law and a low level of corruption.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

- **Public Finances:** A marked deterioration in the debt/GDP trajectory, for example, from a sustained period of fiscal loosening.
- **Macro:** A severe economic shock, for example, from a significant slowdown in the global economy.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

- **Public Finances:** Increased confidence in a material and sustained decline in the government debt/GDP ratio.
- **Macro/External:** Continued strong growth and evidence of economic diversification that reduces Iceland's vulnerability to external shocks.

SOVEREIGN RATING MODEL (SRM) AND QUALITATIVE OVERLAY (QO)

Fitch's proprietary SRM assigns Iceland a score equivalent to a rating of 'A' on the LT FC IDR scale.

Fitch's sovereign rating committee did not adjust the output from the SRM to arrive at the final LT FC IDR.

Fitch's SRM is the agency's proprietary multiple regression rating model that employs 18 variables based on three-year centred averages, including one year of forecasts, to produce a score equivalent to a LT FC IDR. Fitch's QO is a forward-looking qualitative framework designed to allow for adjustment to the SRM output to assign the final rating, reflecting factors within our criteria that are not fully quantifiable and not fully reflected in the SRM.

COUNTRY CEILING

The Country Ceiling for Iceland is 'A+', 1 notch above the LT FC IDR. This reflects moderate constraints and incentives, relative to the IDR, against capital or exchange controls being imposed that would prevent or significantly impede the private sector from converting local currency into foreign currency and transferring the proceeds to non-resident creditors to service debt payments.

Fitch's Country Ceiling Model produced a starting point uplift of +2 notches above the IDR. Fitch's rating committee applied an offsetting -1 notch qualitative adjustment to this, under the Balance of Payments Restriction pillar, reflecting Iceland's short record of full liberalisation from capital controls that were in place during 2008-2021.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Iceland has an ESG Relevance Score of '5[+]' for Political Stability and Rights as WBGI have the highest weight in Fitch's SRM and are therefore highly relevant to the rating and a key rating driver with a high weight. As Iceland has a percentile rank above 50 for the respective Governance Indicator, this has a positive impact on the credit profile.

Iceland has an ESG Relevance Score of '5[+]' for Rule of Law, Institutional and Regulatory Quality and Control of Corruption as WBGI have the highest weight in Fitch's SRM and are, therefore, highly relevant to the rating and are a key rating driver with a high weight. As Iceland has a percentile rank above 50 for the respective Governance Indicators, this has a positive impact on the credit profile.

Iceland has an ESG Relevance Score of '4[+]' for Human Rights and Political Freedoms as the Voice and Accountability pillar of the WBGI is relevant to the rating and a rating driver. As Iceland has a percentile rank above 50 for the respective Governance Indicator, this has a positive impact on the credit profile.

Iceland has an ESG Relevance Score of '4[+]' for Creditor Rights as willingness to service and repay debt is relevant to the rating and is a rating driver for Iceland, as for all sovereigns. As Iceland has a record of 20+ years without a restructuring of public debt and captured in our SRM variable, this has a positive impact on the credit profile.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT ⚡	RATING ⚡			PRIOR ⚡
Iceland	LT IDR	A	Affirmed	A
	ST IDR	F1+	Affirmed	F1+

	LC LT IDR	A	Affirmed	A
	LC ST IDR	F1+	Affirmed	F1+
	Country Ceiling	A+	Affirmed	A+
senior unsecured	LT	A	Affirmed	A

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Additional information is available on www.fitchratings.com

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APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Country Ceiling Model, v2.0.3 (1)

Debt Dynamics Model, v1.3.2 (1)

Macro-Prudential Indicator Model, v1.5.0 (1)

Sovereign Rating Model, v3.14.3 (1)

ADDITIONAL DISCLOSURES

- [Dodd-Frank Rating Information Disclosure Form](#)
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Iceland

EU Issued, UK Endorsed

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