

MOODY'S

RATINGS

Announcement of Periodic Review: Moody's announces completion of a periodic review of ratings of Iceland, Government of

22 Mar 2024

London, March 22, 2024 -- Moody's Ratings has completed a periodic review of the ratings of Iceland and other ratings that are associated with this issuer.

The review was conducted through a rating committee held on 14 March 2024 in which Moody's reassessed the appropriateness of the ratings in the context of the relevant principal methodology(ies), and recent developments.

This publication does not announce a credit rating action and is not an indication of whether or not a credit rating action is likely in the near future. Please see the Issuer page on <https://ratings.moodys.com> for the most updated credit rating action information and rating history.

Key Rating considerations and rationale are summarized below.

Iceland's ratings, including its A2 long term issuer rating, are supported by the economy's flexibility, wealth, competitiveness and favorable demographics. The country has built significant fiscal and foreign-exchange buffers, which help mitigate its vulnerability to shocks given its small size and concentration in a limited number of sectors. Public debt is relatively high but the government is pursuing significant fiscal consolidation that has started to bring debt metrics closer to peers.

As expected, real GDP growth slowed over the course of 2023, with growth in the second half of the year markedly more moderate at 1.6% compared to a year earlier than the 6.7% in the first six months of the year. Moody's expects a further slowdown in growth in 2024, as a result of the central bank's decisive monetary tightening and also a somewhat tighter fiscal policy stance than expected earlier. Seismic activity led to the evacuation of the town of Grindavik on the Reykjanes peninsula, with limited impact on the important tourism sector so far, but a resumption of seismic activity could pose downside risks to growth.

The government's fiscal performance has again exceeded budgetary plans with a

central government deficit of only 1.3% of GDP in 2023, against a budgeted deficit of 3%. The 2024 budget includes a further reduction in the central government deficit to 1.1% of GDP. Additional costs for evacuating Grindavik's residents may have a moderately negative impact on public finances. At the same time, the government and the main creditors of the HF Fund (A2 stable) recently agreed to start negotiations over a settlement of the Fund's outstanding bonds. The bonds benefit from a government guarantee and an early resolution could result in a marked drop in government debt as Moody's currently includes the Fund's obligations into its government debt calculations.

Moody's assesses Iceland's economic strength at "baa1" which balances the country's small size and volatile growth performance with very high wealth levels and strong competitiveness. Iceland's institutions and governance strength is assessed as "aa2", reflecting the country's solid track record in restoring economic and financial stability after the banking crisis, with strong banking regulation and supervision and a materially improved fiscal framework. Iceland's fiscal strength is assessed as "a2", reflecting improving fiscal metrics, with a rapidly declining budget deficit and firmly established downward debt trend. The score also reflects Iceland's weaker debt affordability compared to peers due to the large share of inflation-indexed debt as well as higher domestic funding costs. Iceland's susceptibility to event risk is seen as "a", driven by banking system assessment. Other event risks are low, and scored at "aa".

Iceland's rating outlook has been positive since July 2023. The rating could be upgraded if fiscal consolidation continues at the expected pace and the public debt is reduced further in line with expectations. An early consensual resolution to the HF Fund guarantee would accelerate the declining debt trend and would also be positive for the rating. Firmly re-anchoring inflation expectations while ensuring continued robust economic growth would support Moody's assessment of Iceland's strong institutions and would be credit positive. Further evidence that economic diversification efforts are reducing growth volatility would also support a higher rating.

The positive outlook signals that the rating is unlikely to be downgraded in the near term. The outlook would likely be returned to stable if Moody's expectations for the rebuilding of fiscal and economic buffers did not materialize. The rating could face downward pressure if the authorities deviated significantly from their current medium-term fiscal consolidation plans, resulting in a material increase in the public debt ratio.

This document summarizes Moody's view as of the publication date and will not be updated until the next periodic review announcement, which will incorporate material changes in credit circumstances (if any) during the intervening period.

The principal methodology used for this review was Sovereigns published in November 2022. Please see the Rating Methodologies page on <https://ratings.moodys.com> for a copy of this methodology.

This announcement applies only to EU rated, UK rated, EU endorsed and UK

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