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29 July 2022

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RATINGS

Iceland

	Foreign Currency	Local Currency
Gov. Bond Rating	A2/STA	A2/STA
Country Ceiling	Aa2	Aa1

TABLE OF CONTENTS

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Government of Iceland - A2 Stable

Annual credit analysis

OVERVIEW AND OUTLOOK

Iceland's credit strengths include the economy's flexibility, wealth, competitiveness and favourable demographics, all of which support its long-term growth prospects and help it to absorb shocks. The country's track record of effective macroeconomic management since its crisis in 2008 and carefully managed capital-account liberalisation with minimal disruption demonstrate the strength of its institutions.

The substantial decline in the government's debt burden over the past few years has bolstered our assessment of fiscal strength, notwithstanding the pandemic-induced reversal in 2020. Moreover, a consistent net external creditor position and very large foreign-currency reserves provide a healthy buffer against external shocks.

Iceland's main credit weakness is the economy's small size and concentration in a limited number of sectors, which increases its vulnerability to sector-specific shocks. For example, the coronavirus pandemic weighed heavily on its crucial tourism sector, though it has been recovering strongly since. Other key economic sectors are currently benefiting from the spike in commodity prices that have been amplified by the Russian invasion of Ukraine (Caa3 negative). Over the longer term, further diversification will be key to reduce growth volatility.

The government debt ratio started to decline last year after the increase in 2020 driven by the pandemic and the re-classification of several public companies within the general government accounts. Although debt remains above peers at 75% of GDP, the government's strong fiscal track record over the past few years coupled with robust fiscal institutions and procedures give us confidence that the debt burden will be reduced materially over the coming years. The re-classification exercise in 2020 has also improved fiscal transparency.

Iceland’s rating would be upgraded if the government was able to rebuild its fiscal buffers more rapidly than we expect. A diversification push that leads to a less volatile economic performance would also be positive for the rating.

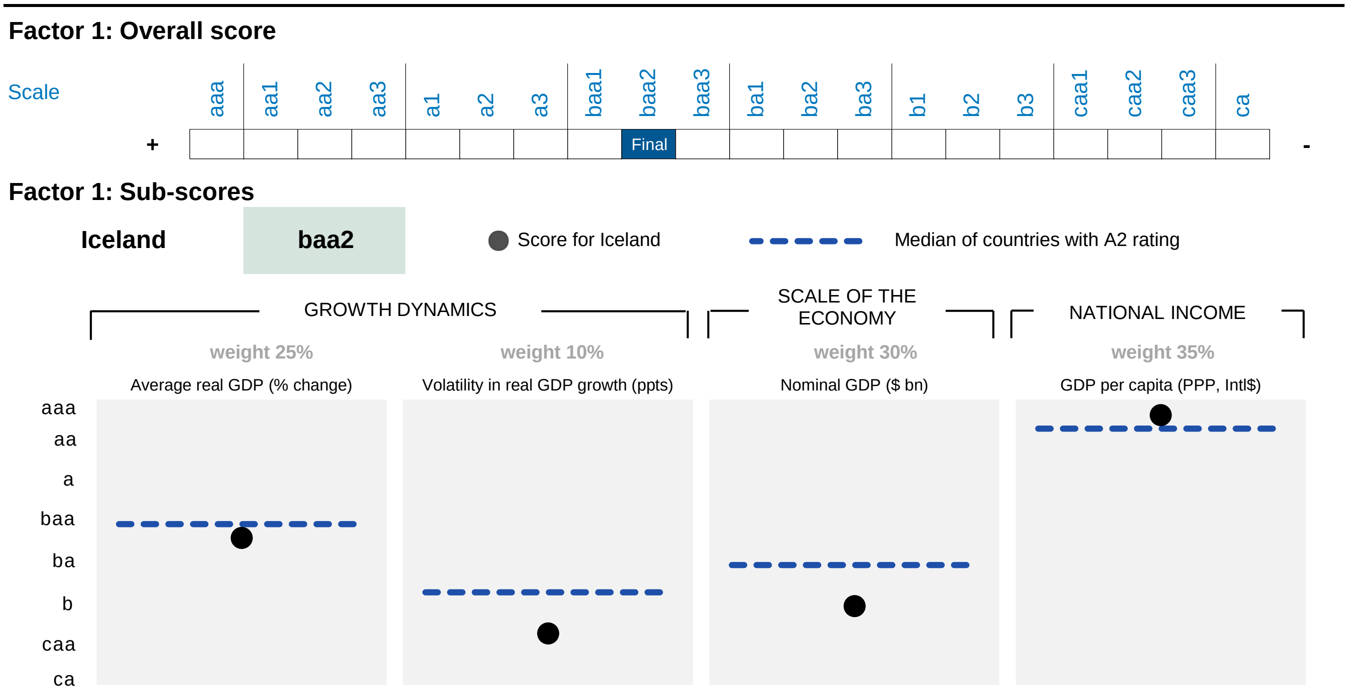
Conversely, the rating would come under downward pressure if the government deviated significantly from its fiscal-consolidation plan that aims to stabilise public debt by the middle of the decade. An economic shock that leads to a large and permanent damage to the tourism industry, or to substantial capital outflows, weakening Iceland’s external position and threatening financial stability, would also be credit negative, although we consider this an unlikely scenario.

This credit analysis elaborates on Iceland’s credit profile in terms of economic strength, institutions and governance strength, fiscal strength and susceptibility to event risk, which are the four main analytic factors in our Sovereign Ratings Methodology.

CREDIT PROFILE

Our determination of a sovereign's government bond rating is based on the consideration of four rating factors: Economic strength, institutions and governance strength, fiscal strength and susceptibility to event risk. When a direct and imminent threat becomes a constraint, that can only lower the scorecard-indicated outcome. For more information please see our Sovereign Ratings Methodology.

Economic strength score: baa2



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. Adjustments to the economic strength factor score most often reflect our judgement regarding the economy's flexibility, diversity, productivity and labour supply challenges.

Note: the initial factor score is shown in light blue in the scale above. In case the initial and final factor scores are the same, only the final score will appear in the table above.

We assess Iceland's economic strength as "baa2", which balances the country's small size and history of boom and bust episodes with its very high wealth levels and strong competitiveness in its core industries. Other sovereigns with the same assessment of economic strength include Latvia (A3 stable) and Peru (Baa1 stable).

Exhibit 1

Peer comparison table factor 1: Economic strength

	Iceland A2/STA	baa2 Median	Brazil Ba2/STA	Latvia A3/STA	Peru Baa1/STA	Pakistan B3/NEG	Chile A1/NEG	Cyprus Ba1/STA
Final score	baa2		baa2	baa2	baa2	baa2	baa1	baa3
Initial score	baa2		baa2	baa2	baa3	baa2	baa1	baa2
Nominal GDP ($ billion)	25.5	78.9	1,609.0	38.9	225.7	348.2	317.1	27.7
GDP per capita (PPP, Intl$)	59,791.5	29,843.2	16,160.7	34,707.3	13,879.0	5,973.1	26,713.3	45,033.6
Average real GDP (% change)	2.4	3.0	1.0	2.4	2.6	4.3	2.2	3.1
Volatility in real GDP growth (ppts)	3.8	3.4	3.1	2.8	6.0	1.9	4.4	5.1

Source: National authorities, IMF, Moody's Investors Service

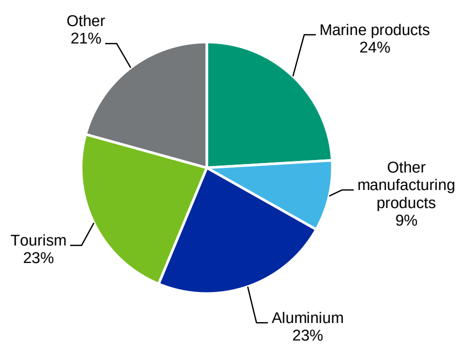
Iceland's wealth and competitiveness mitigate the economy's small size and concentration

With nominal GDP of $25.5 billion in 2021, Iceland's economy is one of the smallest among the sovereigns we rate. Limited diversification and relatively high openness lead to growth volatility, which increases the economy's vulnerability to sector-specific and external shocks. Exports and imports accounted for 38% and 40% of GDP, respectively, in 2021 and over 70% of the country's export revenues come from three sectors: tourism (23% of total export revenues), marine products (24% of total export revenues) and aluminum (23% of total export revenues) (see Exhibit 2).

For example, in 2019, real GDP growth slowed to 2.6% from the average of close to 5% in the previous four years because of a combination of negative events in all three sectors: the collapse of a low-cost airline that affected the tourism industry, production issues at one of the aluminium smelters, and a ban on capelin catch so as to allow for the replenishment of fishing stocks. At the same time, the economy is susceptible to environmental risks, such as the potential for natural disasters to interrupt tourism or for ocean warming to disrupt fishing stocks.

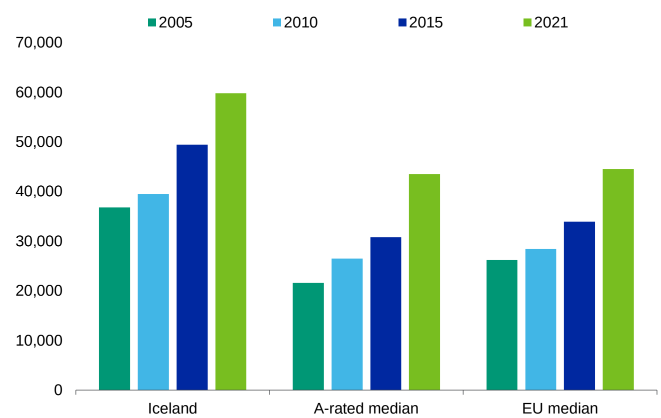
These challenges are mitigated by very high income levels, which are also comparatively evenly distributed.[1] GDP per-capita on a purchasing power parity basis stood at $59,792 in 2021, much higher than the median for A-rated sovereigns of $43,505 and the 15th highest in our rating universe (see Exhibit 3). In addition, household assets in the form of pensions amount to around 200% of GDP, similar to Denmark (Aaa stable) and the Netherlands (Aaa stable) and much higher than most other OECD countries. Together with high income levels, these provide an important shock absorber, as demonstrated during the banking crisis and again during last year's pandemic.

Exhibit 2
Three sectors dominate Iceland's exports
Exports of goods and services by sector (2021)



Sources: Statistics Iceland, Moody's Investors Service

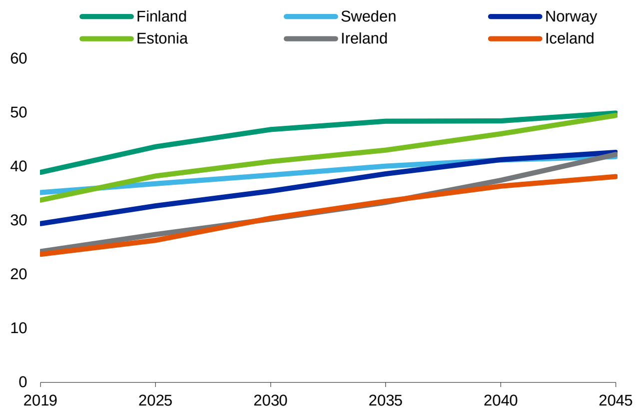
Exhibit 3
Iceland's high income levels act as an important shock absorber
GDP per capita PPP (US$)



Source: IMF and Moody's Investors Service

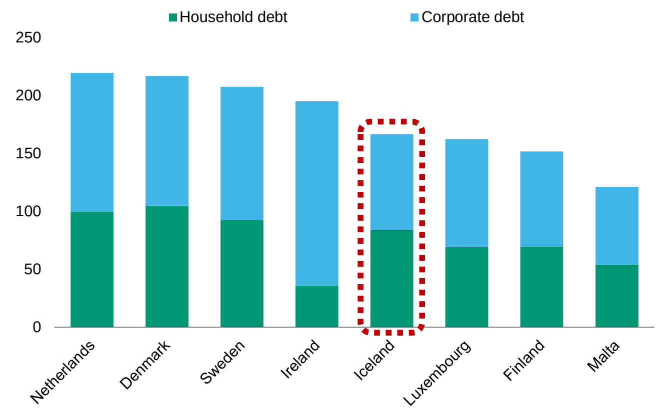
Iceland's economy is highly competitive, as demonstrated by its 16th position in the World Competitiveness Index. The country fares particularly well compared to peers on its institutions, technological readiness, educational environment and labour market efficiency. Iceland's demographic profile is also more favourable than in many other countries — particularly compared to continental Europe — because of exceptionally long working lives, higher fertility rates, a high participation of women to the labour force and the flexibility of the labour market. Iceland's old-age dependency ratio — defined as ratio of population aged 65+ divided by the population aged 20-64 — is projected to remain lower than all EU sovereigns over the next two decades (see Exhibit 4).[2]

Exhibit 4
Iceland is less exposed to population ageing than peers
Old-age dependency ratio (65+ / 20-64)



Source: 2020 Ageing Report, Statistics Iceland and Moody's Investors Service

Exhibit 5
Private sector is less leveraged than peers
Latest (% of GDP)



Source: Eurostat, Statistics Iceland and Moody's Investors Service

Economic recovery is well underway, supported by strong tourism demand

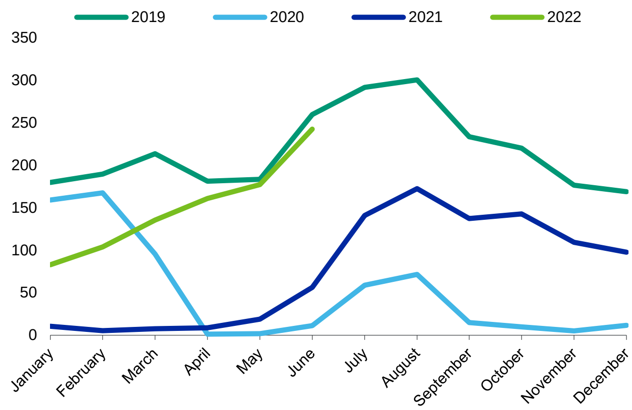
Iceland's economy recovered reasonably strongly last year with real GDP growth of 4.3%, following a deep contraction of over 7% in 2020. The tourism sector recovered in 2021, thanks to good vaccination campaigns in both Iceland and key countries of origin, in particular the United States (US, Aaa stable), the United Kingdom (UK, Aa3 stable) and the European Union (EU, Aaa stable). Tourist arrivals were 49% higher than in 2020 but remained 65% lower than in 2019. The sector directly and indirectly accounted for 22.8% of Iceland's GDP before the pandemic, 20% of employment and 30% of total exports according to the World Travel and Tourism Council (WTTC).[3]

The recovery accelerated further with real GDP growth of 7.3% year-on-year in the first quarter of 2022, helped by domestic demand and strong export growth. We expect the continued recovery in tourism will drive the economy this year and alongside still strong consumption and investment lead to real GDP growth of around 4.5% in 2022. Although the omicron variant dented the recovery at the beginning of the year, tourist arrivals are now close to their 2019 levels and foreign credit card spending in real terms is now higher than before the pandemic. Export growth of marine products and aluminium will also be strong, both supported by strong demand and price dynamics. Higher aluminum and fish prices will more than offset higher input costs, leading to an improvement in Iceland's terms of trade.

The economic recovery as well as the significant support that the government provided to businesses and households during the pandemic has led to a sharp drop in unemployment, which stood at 3.5% in May (seasonally adjusted terms). Labour shortages, particularly in the tourism industry, may somewhat hold back the pace of the recovery but immigration has picked up and is expected to help fill some of the increased demand for labour.

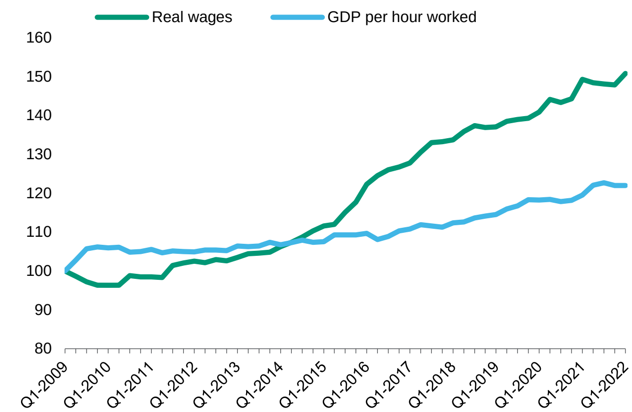
The good employment situation will continue to support domestic demand. Although most of the pandemic-related support will be phased out this year, positive real wage growth of around 1% on average in the first five months of the year will continue to support private consumption. That said, the import content of domestic demand is high in Iceland and imports will also increase materially.

Exhibit 6
Tourism activity is rebounding strongly
Tourist arrivals ('000)



Source: Keflavik Airport and Moody's Investors Service

Exhibit 7
Wages have decoupled from productivity
Q1-2009 = 100



Source: Statistics Iceland and Moody's Investors Service

The invasion of Ukraine has a minimal direct impact on Iceland. Domestic energy prices have not been affected by the spike in commodity prices given that most of Iceland's energy is generated from geothermal and hydropower sources. Iceland also has one of the highest share of electric cars in Europe, reducing the impact of higher fuel costs. In addition, the government has put in place measures in response to higher inflation targeted to poorer households such as bringing forward housing and child benefits as well as pension increases. Overall trade exposure to Russia and Ukraine accounts for 1% of total exports and 0.5% of imports. Iceland will be more affected by the slowdown in growth in its key trading partners, particularly in Europe.

For 2023, we expect slower growth of around 2.8%, mainly due to tighter monetary policy and more moderate economic activity in Iceland's key trading partners, which will be reflected in lower export growth. The Central Bank of Iceland (CBI) has raised its key policy rate by a cumulative 400 basis points since May 2021, reflecting strongly rising inflation. Consumer price inflation reached 8.8% in June, the highest rate since late 2009. Around half of the increase was driven by house prices. Excluding the housing component, inflation stood at 5.2%. Lower interest rates and increased savings during the pandemic have led to a surge in demand for housing while supply is low (see Banking sector risk section for further details).

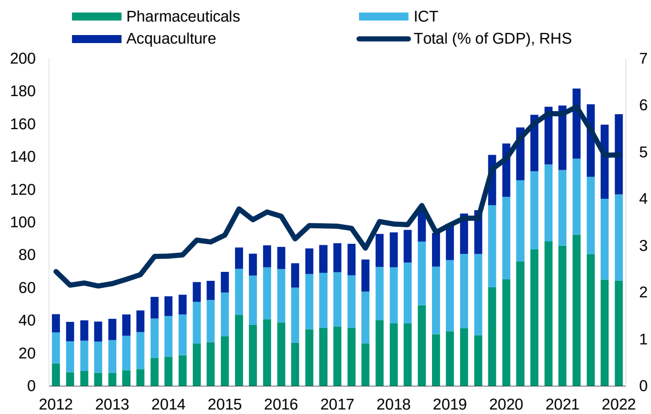
We expect the CBI to raise its key policy rates further in the coming months, which should help to dampen price growth in the quarters ahead (see more detailed discussion in Institutions and Governance section).

Longer-term focus on economic diversification strategy

The pandemic has highlighted the need for further economic diversification to reduce growth volatility. The government estimates growth potential at just below 2.5%, in line with IMF estimates. The government is looking to support a knowledge-based economy, with a view of further raising trend growth by emphasising sectors with good prospects in Iceland such as biotechnology, aquaculture and information technology and communication. Iceland has a tradition in the first two, with exports growing vigorously in both sectors over the past few years (see Exhibit 8). Iceland's aquaculture sector, though still small, has continued to grow despite the pandemic and significant investment is underway to increase the productive capacity. Higher aquaculture exports will help counteract variations in fishing quotas that have impacted GDP growth in recent years and provide significant opportunities for economic diversification.

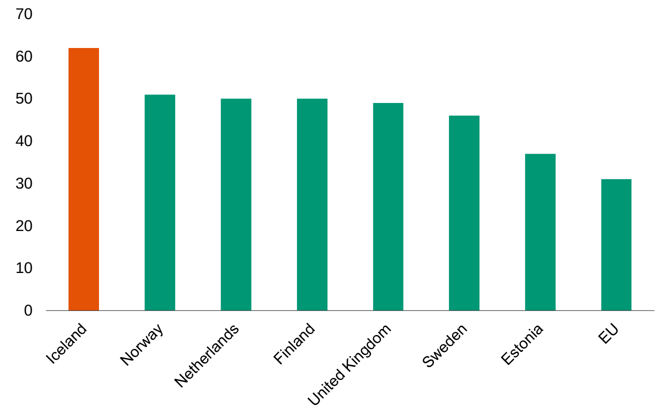
Materially changing the structure of the economy will take time, and the three key sectors – tourism, marine products and aluminum – will likely remain dominant over the medium term. The IMF and the OECD point to other areas that could help Iceland to further raise its growth potential, in particular by improving education outcomes and digitalisation of the economy. The IMF notes that Iceland is well ahead of many other advanced economies in terms of digital skills and infrastructure but high-tech sectors contribute relatively less to growth than in other OECD countries. The government's tax incentives for private-sector R&D investment and public venture capital funds are helping to promote innovation in the economy.

Exhibit 8
Some sectors offer diversification opportunities
4-quarter rolling exports (ISK billion)



Source: Statistics Iceland and Moody's Investors Service

Exhibit 9
Iceland is ahead of peers in terms of ICT adoption
Adults with above basic digital skills (% of total)



Source: Eurostat and Moody's Investors Service

Iceland's spending on education is similar to other countries but educational attainment lags other high-income peers. Education reform is ongoing and the government has recently announced a retraining and upskilling programme for professions in short supply. The government also plans to ease access to work permits for high-skilled workers from outside the European Economic Area, to ease labour shortages.

The OECD and the IMF also point to stringent regulations, in particular in services and startups, that tend to stifle competition. Barriers to entry are high, and administrative burdens and an extensive licensing and permit system protect incumbents and slow new and innovative start-ups. The OECD estimates that reducing administrative burdens would raise per-capita GDP by 1 percentage point over a 10-year period while the IMF estimated that some degree of deregulation could raise GDP by 2.3%.[4].

Institutions and governance strength score: aa2

Institutions and governance 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 is the government's capacity to conduct sound economic policies that foster economic growth and prosperity. Institutions and governance strength is most often adjusted for the track record of default, which can only lower the final score.
Note: the initial factor score is shown in light blue in the scale above. In case the initial and final factor scores are the same, only the final score will appear in the table above.

Our assessment of Iceland's institutions and governance strength as "aa2" is supported by the country's strong scores in the Worldwide Governance Indicators (WGI) and a track record of effective macroeconomic management to restore economic and financial stability after the banking crisis. The latter was demonstrated by the careful liberalisation of the capital account and the increased maturation of financial regulation and supervision in line with global best practices. The reforms introduced following the crisis have also strengthened the macro-policy mix.

Other sovereigns with the same assessment of institutional strength include Austria (Aa1 stable) and Ireland (A1 positive).

Exhibit 10

Peer comparison table factor 2: Institutions and governance strength

	Iceland A2/STA	aa2 Median	Austria Aa1/STA	Ireland A1/POS	France Aa2/STA	Korea Aa2/STA	Australia Aaa/STA	Chile A1/NEG
Final score	aa2		aa2	aa2	aa2	aa1	aa1	aa3
Initial score	aa2		aa2	aa2	aa2	aa1	aa1	aa3
Quality of legislative & executive institutions	aa	aa	aa	aa	aaa	aa	aa	aa
Strength of civil society & judiciary	aaa	aaa	aaa	aa	aaa	aa	aaa	a
Fiscal policy effectiveness	aa	aa	aa	aa	a	aaa	aa	a
Monetary & macro policy effectiveness	a	aa	aa	aa	aa	aa	aaa	aa
Fiscal balance/GDP (3-year average)	-5.7	-4.4	-3.6	-0.6	-5.1	-2.5	-6.4	-4.6
Average inflation (% change)	3.8	2.2	2.4	2.0	2.0	1.9	2.2	3.0
Volatility of inflation (ppts)	1.2	0.9	0.7	0.9	0.8	0.7	0.6	1.1

Source: National authorities, World Bank, Moody's Investors Service

Robust survey scores demonstrate Iceland's strengthened institutions

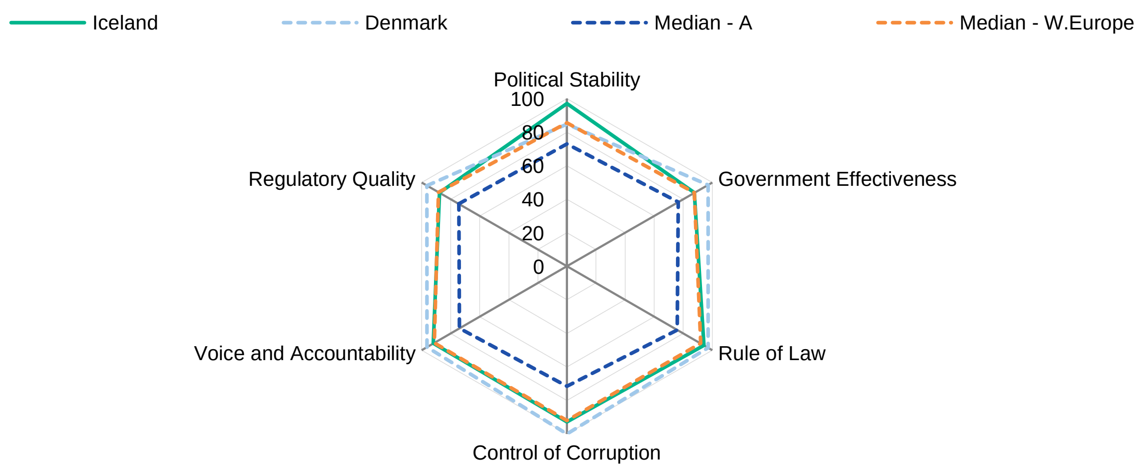
Iceland ranks highly compared to A-rated peers on the Worldwide Governance Indicators (WGI), supporting our strong assessment of the country's institutions. It ranks in the 88th percentile of the WGI's measure of government effectiveness and 89th for regulatory quality, reflecting its highly professional and capable public administration as well as a transparent and predictable legislative framework, underpinning our "aa" assessment for the quality of legislative and executive institutions although key economic data series can be subject to large revisions.

Furthermore, Iceland's rankings in the 93rd percentile for control of corruption and 94th percentile for rule of law reflect limited instances of corruption and that society acts as an effective check on the exercise of government power, supporting our "aaa" assessment for the strength of the civil society and the judiciary. Iceland also scores very strongly on political stability given its long tradition of broad cooperation and consensus on economic matters between the government, employer and employee associations, which contribute positively to policy effectiveness.

Exhibit 11

Iceland's governance indicators rank above A-rated peers

Percentile rank among our rating universe (2020)



Source: Worldwide Governance Indicators and Moody's Investors Service

Following the collapse of the banking system in 2008, the authorities have made significant progress in bringing the economy, the financial system and public finances back onto a sustainable path. In conjunction with a three-year IMF Stand-By Arrangement and post-monitoring programmes, the authorities introduced a number of reforms, such as revised fiscal and monetary policy frameworks, a flexible exchange rate and significant improvements to banking system supervision and regulation to prevent such distortions from happening again. In 2020, the central bank and the Financial Supervisory Authority were merged, with the aim to achieve greater efficiency, operational independence, and powers in financial oversight.

Most capital controls were lifted in March 2019 without material disruption and exchange-rate pressures. The Foreign Exchange Act passed in June 2021 removed the last remaining restrictions on the capital account and paved the way for increased capital movements. The central bank's toolkit has been expanded to limit the risks to financial stability of excessive flows, including transparent and clearly communicated foreign-currency interventions to smooth excessive krona volatility because of the small size of the foreign-currency market. Foreign-currency reserves are very large at around 25% of GDP and significantly higher than the IMF's various reserve adequacy metrics.

A further example of Iceland's strengthened institutions is the swift reaction to the country being placed on the grey list of the Financial Action Task Force (FATF) in October 2019 for gaps in its anti-money laundering framework. In October 2020, Iceland was removed from the grey list, having implemented the FATF's required actions such as ensuring the availability of accurate beneficial ownership information and strengthening the monitoring of financial institutions.

Monetary policy framework has become more credible

The central bank has gained significant credibility following a major revision of the monetary policy framework and its governance and decision-making structure, mostly implemented by 2012. The transparency of monetary policy decisions has been significantly enhanced and is now on par with other advanced economies with an inflation-targeting framework.[5]

Like other economies, inflation has accelerated and has been above the central bank's 2.5% target since May 2020 (see Exhibit 12). The drivers of price growth have shifted from imported inflation during the pandemic, which mostly resulted from the depreciation of the krona, to house prices. In June 2022, consumer price inflation was 8.8%, of which about half was on account of house prices. The CBI started to raise its key policy rate in May 2020, one of the first central banks to do so, and has hiked by a cumulative 400 basis points to 4.75%. We expect further interest rate hikes in the coming months, as near-term inflation expectations have recently risen (see Exhibit 13). Longer-term inflation expectations have risen as well but to a smaller extent, indicating confidence of economic actors that inflation will be brought back to target. Iceland's performance on inflation has materially strengthened compared to the past, when the CBI rarely managed to hit its inflation target.

In addition, the Financial Stability Committee has recently lowered the maximum loan-to-value (LTV) ratio to 80% from 85% and to 85% from 90% for first-time buyers, capped the debt-service to income ratio at 35% and 40% for first-time buyers and restored the countercyclical capital buffer to 2% for banks from September 2022, with the aim of dampening house price inflation. On the other hand, the strengthening of the krona could help moderate inflation in the coming months given the high pass-through from the exchange rate to inflation.[6]

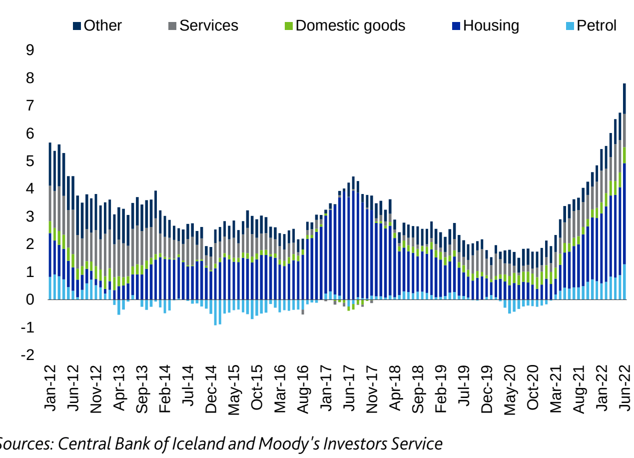
Upcoming wage negotiations scheduled for November 2022 will be a key determinant of the monetary policy outlook. Higher wages will support private consumption in the short term, but could also fuel already elevated inflationary pressures and lead to a tighter monetary policy stance. We expect the agreements will at least compensate for inflation to keep real wage growth positive.

Strong wage increases in the past have raised concerns over declining price competitiveness and an increasing misalignment between wages and productivity growth (see Exhibit 7), but the latest three-year wage agreement from 2019 is generally considered to have helped support private consumption during the pandemic. That said, both the OECD and the IMF advocate linking future wage increases more directly to productivity growth rather than growth in per-capita income as in the 2019 wage agreement.

Exhibit 12

Inflation is mostly driven by rising house prices

%

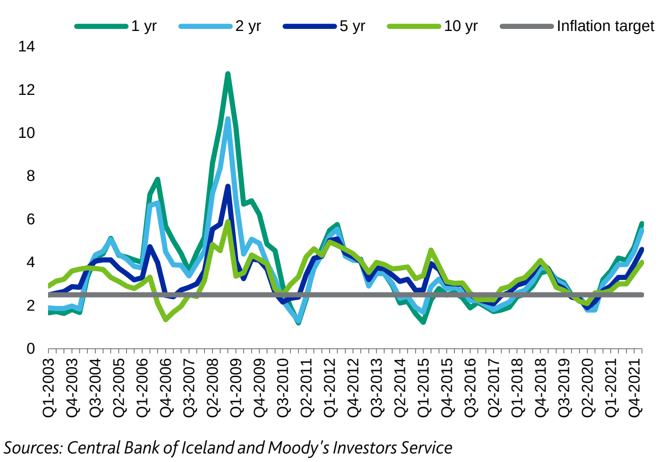


Sources: Central Bank of Iceland and Moody's Investors Service

Exhibit 13

Long-term inflation expectations have risen but are better anchored than in the past

Break-even inflation rate (%)



Sources: Central Bank of Iceland and Moody's Investors Service

Strengthening of the fiscal framework supports policy credibility and effectiveness

Before the banking crisis, weaknesses in the budgetary framework resulted in an often pro-cyclical fiscal stance, weak budget discipline and inadequate surveillance and management of fiscal risks. However, a strong set of fiscal rules has been in place since the Organic

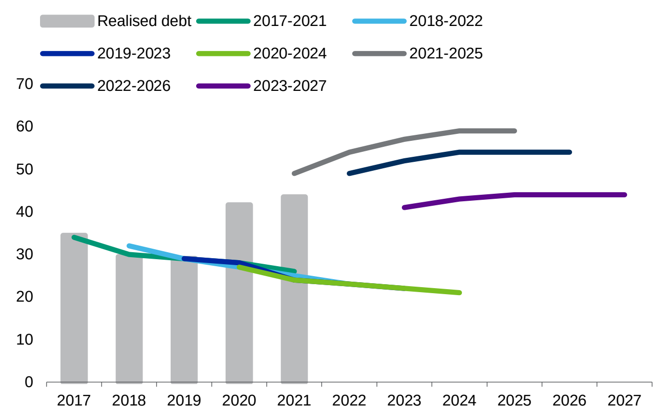
Budget Law was passed in 2015. The rules target a balanced budget over a five-year horizon with a maximum deficit of 2.5% of GDP in any given year and a net debt ceiling of 30% of GDP.[7] The law also requires the government to publish a five-year Fiscal Policy Statement at the beginning of each electoral term, as well as a rolling five-year Fiscal Strategy Plan on an annual basis. The independent fiscal council is tasked with assessing the compliance with the fiscal objectives and whether public finances are on a path where the numerical rules can be reinstated in 2026.

The authorities have demonstrated their adherence to the rules even before the formal entry into force of the law. As a result of solid budgetary outturns and the use of windfall profits for debt reduction, Iceland's public debt declined by more than 50 percentage points of GDP between the peak in 2011 and 2018 (see Exhibit 15). In 2019, the central government's debt ratio stood at 29.1% of GDP, one of the strongest ever episodes of debt reductions globally. Sizeable fiscal buffers provided space for the government's strong fiscal response to the pandemic. The Icelandic Parliament has suspended its fiscal rules until 2025 to support the economy. The government's Fiscal Plan presented in March 2022 aims to return to compliance with the fiscal rules from 2026 onwards and targets a deficit of 1.5% of GDP in 2025. Net debt is expected to reach its peak at 46.5% of GDP in 2025.

Exhibit 14

Iceland has established a track record of adhering to fiscal rules

Central government debt targets and outturn (% of GDP)

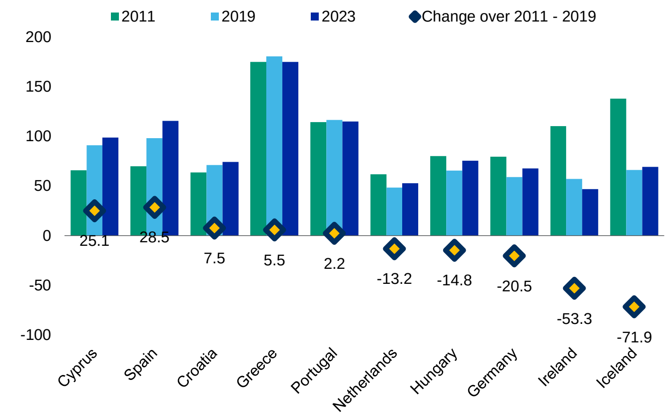


Source: Ministry of Finance and Moody's Investors Service

Exhibit 15

Debt reduction points to strong fiscal policy effectiveness

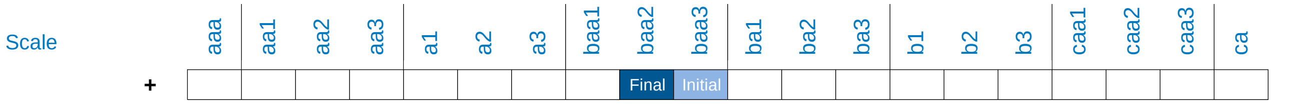
General government debt (% of GDP)



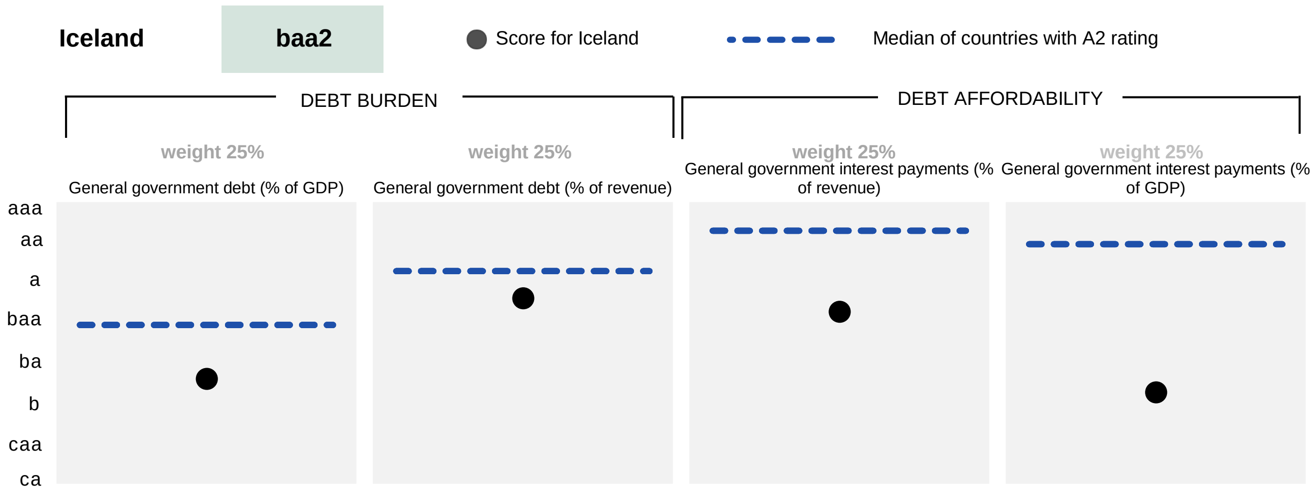
Source: National authorities and Moody's Investors Service

Fiscal strength score: baa2

Factor 3: Overall score



Factor 3: Sub-scores



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: the initial factor score is shown in light blue in the scale above. In case the initial and final factor scores are the same, only the final score will appear in the table above.

We assess Iceland's fiscal strength as "baa2", balancing the government's strong track record in reducing its large budget deficits and very high debt burden after the 2008 crisis against the recent increase in the debt ratio triggered by the pandemic and the re-classification of some public-sector corporations into the general government (+32 pp) in 2020. However, the latter significantly reduces contingent-liability risks and improves of transparency the government's balance sheet, without creating additional fiscal risks. The final score is higher than the initial score of "baa3" because we are confident that debt will again be reduced in the coming years. The re-classification does not fundamentally alter our view of Iceland's fiscal strength; we had previously taken the debt of these companies into account qualitatively, in particular the debt of the HF-Fund (A2 stable), which benefitted from an explicit government guarantee and is in a government-directed winding-down process.

Other sovereigns with a "baa2" assessment of fiscal strength include Cyprus, Ireland and Vietnam (Ba3 positive).

Exhibit 16

Peer comparison table factor 3: Fiscal strength

	Iceland	baa2 Median	Cyprus	Ireland	Vietnam	Japan	Belgium	Spain
	A2/STA		Ba1/STA	A1/POS	Ba3/POS	A1/STA	Aa3/STA	Baa1/STA
Final score	baa2		baa2	baa2	baa2	baa1	baa1	baa3
Initial score	baa3		baa2	a2	baa1	a3	baa1	baa3
Gen. gov. debt (% of GDP)	75.0	47.5	103.6	56.0	39.1	230.8	108.2	118.4
Gen. gov. debt (% of revenue)	185.6	197.5	244.0	243.2	209.5	623.3	219.5	270.8
Gen. gov. interest payments (% of GDP)	4.1	1.0	1.8	0.8	1.3	1.7	1.7	2.2
Gen. gov. int. payments (% of revenue)	10.1	3.9	4.3	3.4	6.8	4.6	3.4	5.0

Source: National authorities, Moody's Investors Service

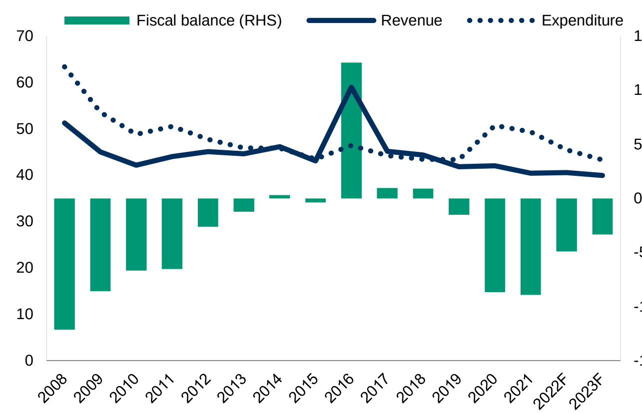
Budget deficit will start to decline in 2022

Last year's budget deficit stood at 8.9% of GDP, slightly higher than in 2020, but still 1.7 percentage points of GDP lower than the government had budgeted because of less uptake of support measures as well as stronger revenue collection. Capital investment was also under-executed due to delays in the implementation of the government's investment plan. Expiring support measures were partly offset by stronger government consumption and wage subsidies.

We expect Iceland's budget deficit to narrow to just below 5% of GDP in 2022 reflecting the expiration of most fiscal support measures during the year as well as strong economic activity. A number of expansionary measures worth 2% of GDP, mostly reflecting the investment plan, will remain in place this year and gradually decline until 2027. The government has also introduced measures to shield poorer households from higher inflation by bringing forward planned increases in social benefits and pensions. Given that the nature of inflationary dynamics mostly stems from house prices, the scale of the support package is much smaller than in other European countries where the spike in inflation has been driven by energy prices.

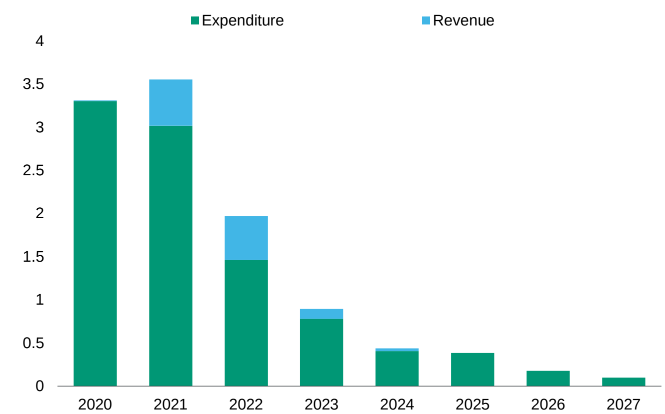
Overall, we expect the budget deficit to narrow faster than the government's expectation of 7.0% in the budget because our GDP growth forecast exceeds budget assumptions. Budget execution for the first quarter of 2021 also points to a stronger performance than assumed in the budget, with the deficit around 67% smaller than in the first quarter of 2021. Revenues were 17.7% higher than a year earlier, while spending growth was contained at 3.7%. The target is composed of a deficit of 6% of GDP at the central government level and a deficit of 1% of GDP at the local government level.

Exhibit 17
The pandemic had a deep impact on fiscal accounts
% of GDP



Source: IMF and Moody's Investors Service

Exhibit 18
Pandemic support will start to wane in 2022
Covid-related fiscal measures (% of GDP)



Source: Ministry of Finance and Moody's Investors Service

Medium-term fiscal strategy aims to gradually rebuild buffers

The government's medium-term fiscal plan for 2023-27 does not include active fiscal-consolidation measures until 2024. According to the Ministry of Finance, the fiscal effort required between 2024 and 2027 to achieve the targets set out in its fiscal plan is manageable at around 0.2% of GDP per year split equally between revenue and expenditures. The fiscal targets are set so as to stabilise the debt ratio and reduce the fiscal deficit to 1% of GDP by the end of 2026. The IMF has outlined the importance of rebuilding fiscal buffers, while the output gap is positive to avoid overheating by saving excess revenue and implementing additional fiscal savings. The government has announced a set of measures to this effect in May 2022 that will reduce the deficit by a further 0.7% of GDP over the medium term, including through the introduction of a road tax, a cap on current expenditure growth (except for health, social and justice spending) and a review of the public investment plan.

Iceland has established a solid fiscal track record over the past decade which gives a high level of confidence that the pandemic-induced fiscal deterioration will be reversed over the coming years. The fiscal rules will be in place again from 2026 onwards, requiring a budgetary surplus on average over a rolling five-year horizon and a 5% annual reduction of the debt in excess of 30% of GDP debt over a three-year period for as long as the public debt ratio is above 30% of GDP. The fiscal rules provide an important medium-term policy anchor and are firmly embedded and accepted across the political spectrum.

Debt will continue to decline, helped by further asset sales

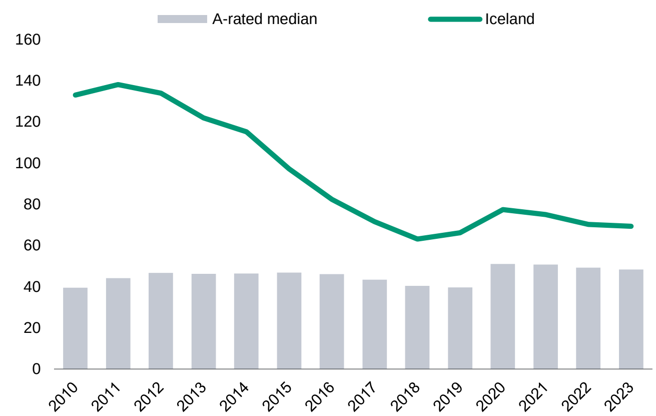
Despite a sizeable fiscal deficit, the public debt ratio declined 2.4 percentage points of GDP in 2021 to 75% of GDP, helped by solid nominal GDP growth and proceeds from the sale of public assets. In June 2021, the government listed 35% of its stake in Islandsbanki, raising ISK55.3 billion (1.7% of GDP) and valuing the company at ISK158 billion. The government's medium-term plan assumes that the debt ratio (as per its definition) will peak at 44% of GDP in 2025. This is significantly lower than the government's expectation from a year earlier, when it forecast that debt would reach 51.5% of GDP in 2026. Based on our definition, we expect the debt ratio to decline to 70% of GDP in 2022, supported by the narrowing in the fiscal deficit as well as strong nominal GDP growth. We also include the listing of a further 22.5% of the government's stake in Islandsbanki in March 2022, which raised ISK53 billion (1.6% of GDP). However, plans to complete the sale of the remaining 42.5% of Islandsbanki by the end of 2023 may face delays due to an ongoing investigation.

Iceland's debt burden will remain above the median for A-rated sovereigns in the foreseeable future (see Exhibit 19). A fiscal shock aside, Iceland's debt trend is relatively resilient to shocks, with debt stabilising below 75% of GDP under most scenarios. The low share of foreign-currency debt reduces risks stemming from exchange-rate movements.

Exhibit 19

Iceland's debt burden has declined rapidly over past years but remains higher than peers

General government debt (% of GDP)

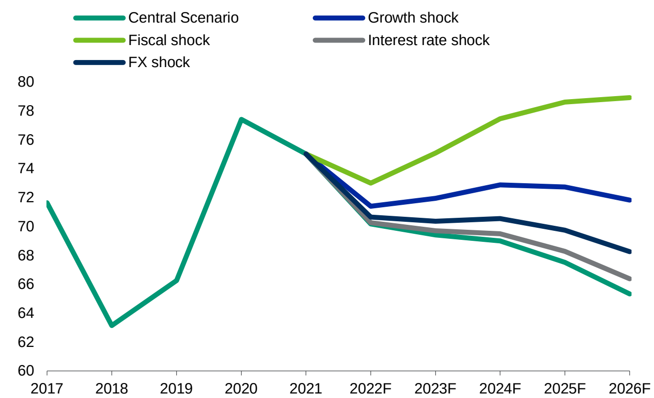


Source: National authorities and Moody's Investors Service

Exhibit 20

Debt trajectory is resilient to most shocks

General government debt (% of GDP)



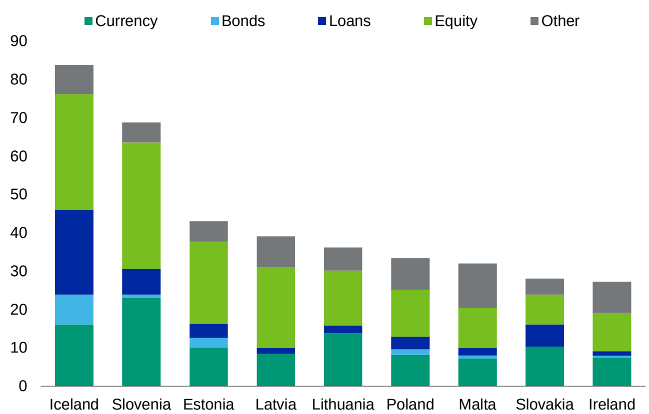
Note: Standardized shocks are based on a 0.5 standard deviation calculated for 10 years over the course of the forecast period.
Sources: Moody's Investors Service

The re-classification of 24 public-sector entities within general government accounts led to a significant deterioration in Iceland's debt ratio and debt-affordability indicators. The debt-to-GDP ratio increased by about 32 percentage points of GDP mainly as a result of the inclusion of the liabilities of the HF-Fund and to a lesser extent the Student Loan Fund. However, its obligations have not materially changed on a net basis because assets have increased by a similar amount. Therefore, the government's balance sheet is stronger than peers when taking assets of 75% of GDP into account (see Exhibit 21). The most important of these are the state's remaining equity stakes in the domestic banks, the HF-Fund's loan book and substantial cash deposits, with the latter amounting to around 15% of GDP. The government has been gradually reducing its shareholding in the financial sector with the sale of Arion Banki in 2018 and the initial public offering of Islandsbanki in 2021 that we expect to be fully privatised in the coming years. The government still owns 98.2% of Landsbankinn, valued at around ISK196 billion (6.6% of GDP), but for which no privatisation plans have been made. The government receives dividends worth around 1% of GDP every year from its equity participations.

Debt affordability remains weaker than with peers but is expected to improve

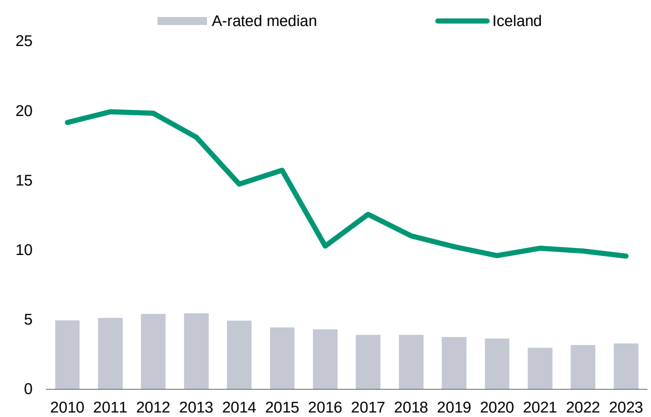
The retirement of higher-cost debt and the rebuilding of the revenue base since the banking crisis have helped to improve the affordability of government debt. After more than doubling to 27% of government revenue in 2009 from 12.7% in 2007, interest payments dropped to 10.1% of revenue in 2021 (see Exhibit 22). However, debt affordability remains weaker than in many similarly rated peers like Poland (A2 stable) and Slovakia (A2 stable). In addition, the revision of the fiscal accounts in 2020 led to a material weakening of debt affordability, mostly as a result of the outstanding HFF bonds which carry high annual interest costs of currently around ISK50 billion (4% of revenue). Iceland's debt-affordability metrics are also weaker than peers, because we do not take into account the sizeable interest receipts that the Icelandic government receives from its large assets. On a net basis, interest payments-to-revenue stand at around 6%, a ratio that is much more comparable to peers.

Exhibit 21
Government assets are much larger than peers
2021 (% of GDP)



Source: Eurostat, Statistics Iceland and Moody's Investors Service

Exhibit 22
Debt affordability has been improving, but remains weak compared to peers
Interest payments (% of revenue)



Source: National authorities, Moody's Investors Service

We expect a tighter monetary policy stance as well as the significant share of inflation-indexed debt will keep interest payments at around 10% of revenue in 2022. At the end of May 2022, 22% of Treasury debt was linked to inflation (see Exhibit 23). That said, we expect debt affordability to remain much more favourable than in the past and for it to continue to improve again over the coming years as inflation recedes and HFF bonds amortise; this will mitigate the impact of higher government debt on our assessment of Iceland's fiscal strength.

Contingent liabilities are low and pose limited risk to the government's balance sheet

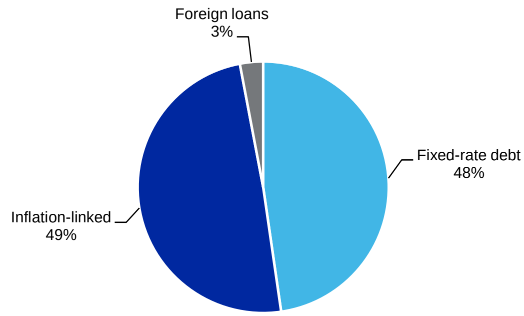
As a result of the reclassification, contingent liabilities are now materially lower at around 1.3% of GDP as of April 2022. HF-Fund is an asset management vehicle in wind-down overseen by the Ministry of Finance and Economic Affairs, responsible for legacy mortgages and the servicing of the remaining outstanding HFF bonds (ISK865 billion or 27% of GDP outstanding at end-2021). HF-Fund faces a significant maturity mismatch between its assets and liabilities, as borrowers are prepaying mortgages, while the Fund cannot accelerate repayment of its bonds, which have long maturities up to 2044. Currently, cash inflows and HF-Fund's cash position are more than sufficient to cover its debt repayments. Although this favourable position will start to reverse in the early 2030s, we expect that the government will have returned its debt burden on a steady downward trajectory by that time, providing ample room to cover annual payments of around 1% of GDP.

The largest guarantees have been extended to the power company Landsvirkjun, which accounts for 49% of total outstanding guarantees. The company has a stable operating performance and has been able to raise debt without government guarantees. It has also markedly improved its equity position and has become a source of revenue for the government in recent years. The company paid ISK6.5 billion (0.2% of GDP) in dividends to the government in 2021.

Exhibit 23

About a fifth of government debt is linked to inflation

Net central government debt (June 2022)

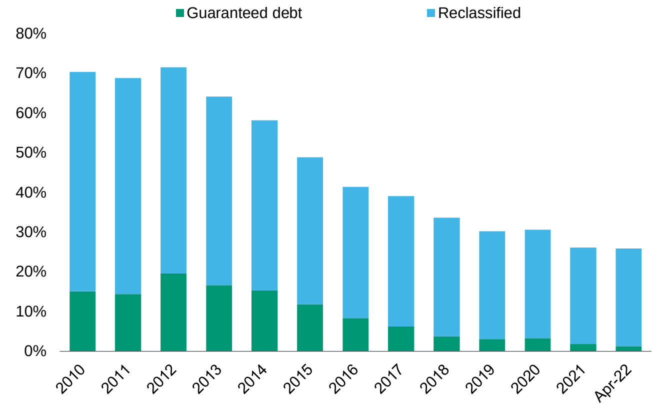


Source: Ministry of Finance and Moody's Investors Service

Exhibit 24

The reclassification exercise in 2020 has reduced the government's contingent liabilities

% of GDP



Source: Ministry of Finance and Moody's Investors Service

Susceptibility to event risk score: a

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 scorecard-indicated outcome.

Note: the initial factor score is shown in light blue in the scale above. In case the initial and final factor scores are the same, only the final score will appear in the table above.

Our assessment of susceptibility to event risk is set at "a", driven by banking system and external vulnerability risk. Icelandic banks have successfully emerged as healthy financial institutions since the economic crisis and with their large capital and liquidity buffers are able to weather shocks. Large foreign-currency reserves and a net creditor position limit external vulnerability risk at "a", while government liquidity and political risks are even lower at "aa".

Frequent elections over the past decade have not impacted policy continuity, geopolitical risks are low

Political event risk, which we assess at "aa", is low in Iceland, which reflects relatively consistent policy in key areas important to safeguarding the credit profile despite several changes in government since 2008. Iceland's geographical location insulates the country from the current geopolitical risks linked to the Russia-Ukraine conflict. Peers sharing this assessment include Australia (Aaa stable) and Canada (Aaa stable).

Exhibit 25

Peer comparison table factor 4a: Political risk

	Iceland A2/STA	aa Median	Australia Aaa/STA	Canada Aaa/STA	Mauritius Baa2/NEG	New Zealand Aaa/STA	Ireland A1/POS	Malta A2/NEG
Final score	aa		aa	aa	aa	aaa	a	a
Voice & accountability, score[1]	1.4	0.9	1.3	1.5	0.7	1.6	1.4	1.1
Political stability, score[1]	1.4	1.0	0.8	1.1	0.9	1.5	1.0	1.0

[1] Composite index with values from about -2.50 to 2.50: higher values correspond to better governance.
Source: Worldwide Governance Indicators, Moody's Investors Service

The coalition government of Left-Green Movement and center/centre-right Progressive and Independence Parties has been confirmed in last September's parliamentary elections, although the relative shares of the parties has shifted somewhat. This was the first time since 2009 that a coalition government has been renewed, with Prime Minister Katrín Jakobsdóttir remaining in her position. The government coalition holds 37 out of 63 seats in the Alþingi, the Icelandic parliament.

In contrast to most other European countries we have not adjusted our score for political risk driven by geopolitical risk for Iceland even though the country is a founding member of NATO, and thus in principle exposed to a potential conflict between NATO and Russia. However, Iceland has no standing army and contributes only on a civilian basis to NATO's operations. Besides Korea (Aa2 stable), Iceland is the only country with a Bilateral Defence Agreement with the US, in force since 1951.

Government liquidity risk is low given strong fiscal credibility, sizeable cash buffer and large domestic investor base

We assess government liquidity risk as "aa". The previous marked reduction in government debt, prudent liquidity management, with significant cash buffers, and a large domestic investor base have mitigated the risks posed by markedly higher borrowing requirements in the context of the pandemic. Other sovereigns sharing a "aa" assessment are Estonia (A1 stable), Saudi Arabia (A1 stable) and Slovakia.

Exhibit 26

Peer comparison table factor 4b: Government liquidity risk

	Iceland A2/STA	aa Median	Estonia A1/STA	Saudi Arabia A1/STA	Slovakia A2/STA	Chile A1/NEG	Ireland A1/POS	Lithuania A2/STA
Final score	aa		aa	aa	aa	aaa	aaa	a
Initial score	aa		aa	aa	aa	aaa	aaa	a
Ease of access to funding	aa	aa	aa	aa	aa	aaa	aaa	a
Gross borrowing requirements (% of GDP)	11.7	8.0	5.3	-3.8	--	3.0	--	6.4

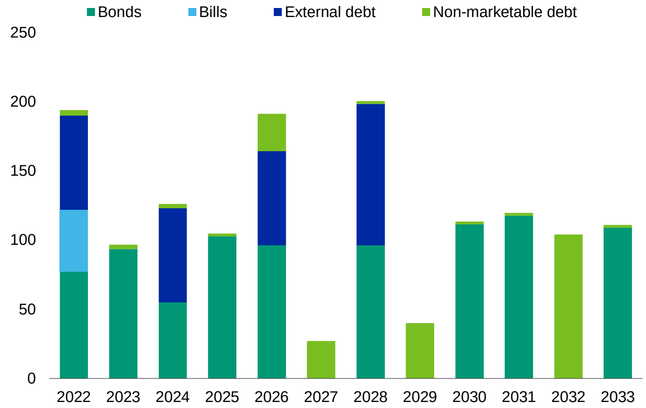
Source: National authorities, IMF, Moody's Investors Service

Iceland's gross borrowing requirements are relatively modest at 11.7% of GDP in 2022, which includes our estimate for the budget deficit and maturing debt. We also assume that the Islandsbanki sale receipts of around 1.6% of GDP will be used for debt-reduction purposes. Refinancing risks are relatively moderate with an average maturity of central government debt of 6 years as of May 2022 (see Exhibit 27).

Iceland has strong market access and a large domestic investor base, in the form of the pension funds which hold around 40% of total Treasury bonds. The Treasury borrows mostly domestically, with around 80% of funding needs planned to be raised domestically in 2022. Foreign investors are much less present than they used to be, holding just 6.7% of Icelandic government bonds in June, compared to 30% at end-2009 (see Exhibit 28). Pension funds are required to invest at least 50% of their assets domestically but a bill currently discussed in Parliament to lower this threshold and allow the large pension fund system to increase their foreign assets could reduce demand for government bonds. The full lifting of capital controls since 2020 could allow inflows of foreign investors to offset the lower participation of pension funds, especially given Iceland's relatively favourable interest rate differential to most advanced economies.

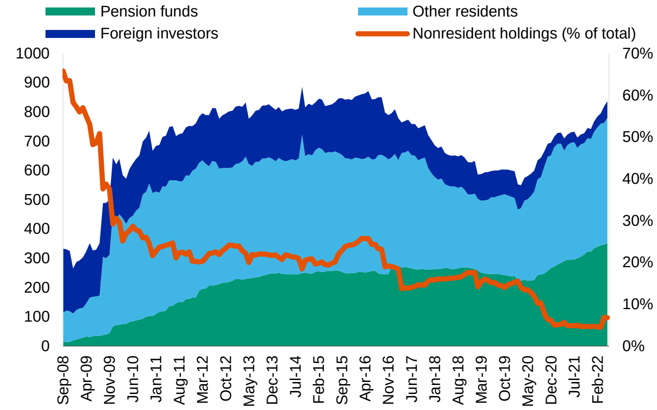
International bonds serve as benchmark issuances for local issuers but are kept in reserve at the central bank, helping to mitigate liquidity risks. In addition, the government set guidance in 2017 to keep at least ISK40 billion in deposits at the central bank. At the end of May 2022, the total balance stood at ISK103 billion (3.2% of GDP) with an additional ISK269 billion held as foreign-exchange deposits.

Exhibit 27
Favourable maturity profile limits refinancing risks
ISK billion



Source: Government Debt Management, Moody's Investors Service

Exhibit 28
The government can rely on a large domestic investor base
Domestic debt by owner (ISK billion)



Sources: Government Debt Management and Moody's Investors Service

Strong capitalisation and liquidity help alleviate concentration risks in the banking system

We assess Iceland's banking sector risk at "a" reflecting the sizeable capital and liquidity buffers of the three large domestic banks. Other peers with a similar assessment of banking sector risk include Bermuda, Estonia, and Ireland.

Exhibit 29

Peer comparison table factor 4c: Banking sector risk

	Iceland A2/STA	a Median	Bermuda A2/STA	Estonia A1/STA	Ireland A1/POS	Cayman Islands Aa3/STA	Malta A2/NEG	Slovenia A3/STA
Final score	a		a	a	a	aa	baa	baa
Initial score	a		baa	a	a	aa	baa	baa
BCA[1]	ba1	baa1	baa2	baa3	baa1	--	--	ba1
BSCE[2]	baa3	baa2	baa2	baa3	baa3	baa2	baa2	ba1-ba2
Total domestic bank assets (% of GDP)	152.2	141.0	368.9	124.6	117.2	43.2	--	95.0

[1] BCA is an average of Baseline Credit Assessments (BCAs) for rated domestic banks, weighted by bank assets.
[2] Where we have no or small rating coverage in a system, we estimate the risk of Banking Sector Credit Event (BSCE) based on available data for aggregate banking system.
Source: National authorities, IMF, Moody's Investors Service

Icelandic banks are now healthy – and much smaller – financial institutions than before the 2008 financial crisis, underpinned by a rapid economic recovery and greater maturity of the regulatory framework under the supervision of the Financial Supervisory Authority and the Central Bank of Iceland (see F2: Institutional Strength for more details). Some of the key measures undertaken under the IMF-supported programme were the introduction of strict limits on banks' scope of activity and high capital requirements including the introduction of a countercyclical capital buffer, which helped increase the resilience of the system.

Banks have very strong capital and liquidity buffers: the average CET1 capital ratio stood at 26.7% at the end of 2021, significantly higher than most rating peers. The pandemic has resulted in limited pressure on banks' asset quality thanks to the significant policy support that was provided to the economy and the rebound in activity. That said, loans in sectors that have been most impacted by the pandemic have become more risky.

The sharp rise in house prices has been accompanied by an increase in household indebtedness, which could pose risks to financial stability. The high share of variable rate loans exposes households to rising interest rates and persistent inflation could impair their ability to repay. That said, the authorities have put in place a number of borrower-based measures to reduce riskier loans and increased the countercyclical capital buffer to 2%.

Iceland benefits from strong external buffers, including a net external creditor position and large foreign-currency reserves

External vulnerability risk is set as “a”, reflecting Iceland's net external creditor position and very large foreign-currency reserves, which help to buffer external shocks. Peers sharing the same risk assessment include Estonia, Poland and Slovakia.

Exhibit 30

Peer comparison table factor 4d: External vulnerability risk

	Iceland A2/STA	a Median	Estonia A1/STA	Poland A2/STA	Slovakia A2/STA	Peru Baa1/STA	Lithuania A2/STA	Chile A1/NEG
Final score	a		a	a	a	aa	aa	baa
Initial score	a		a	a	a	aa	aa	baa
Current account balance (% of GDP)	-2.7	-1.2	-1.1	-0.6	-2.0	-2.3	1.4	-6.4
Net IIP (% of GDP)[1]	38.9	-37.2	-12.2	-37.9	-61.9	-38.6	-7.2	-4.9

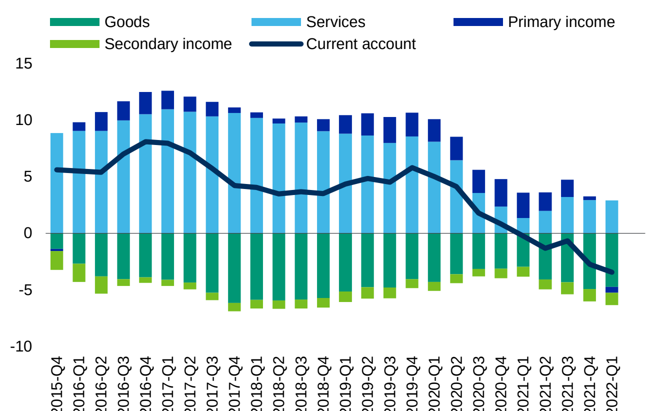
[1] Net international investment position (% of GDP).
Source: National authorities, IMF, Moody's Investors Service

Iceland recorded current-account surpluses between 2012 and 2020, mainly driven by the development of the tourism sector. The bankruptcy of WowAir in 2019 and the pandemic materially reduced the size of the surplus to 0.8% in 2020 from a peak of 8.1% in 2016. The strong rebound in domestic demand in 2021 pushed the current-account into a deficit of 2.7% of GDP while large profits of foreign companies weighed on the primary income balance. We expect the current-account deficit to narrow materially this year, helped by the recovery in tourism and other exports. That said, elevated profits in foreign companies, particularly in the aluminium sector, as well as a rebound in tourism imports from Icelanders travelling abroad will keep the current account in modest deficit of around 0.2% of GDP.

Iceland’s net international investment position (NIIP) has improved significantly since the banking crisis, helping to buffer shocks to its small open economy. The resolution of the failed bank estates in 2015 led to a sharp improvement in Iceland's NIIP, which stood at -5.1% of GDP in 2015 versus -373% a year earlier. The gradual lifting of capital controls has resulted in a further improvement of Iceland's net creditor position reflecting an increase in the pension funds’ foreign investments and substantial returns earned abroad. The NIIP stood at 38.9% of GDP at the end of 2021 (see Exhibit 32).

Exhibit 31

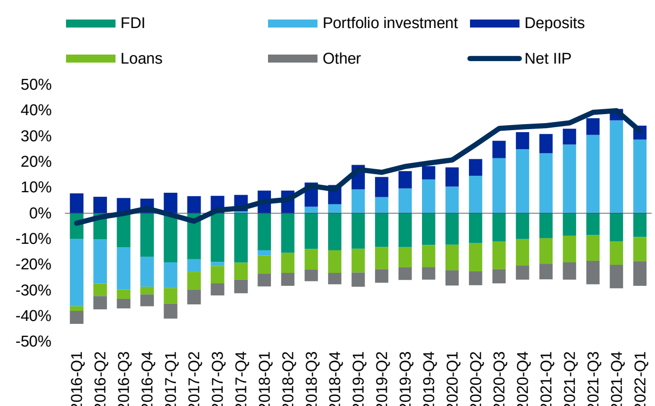
The current account has remained in surplus since 2012
Current account as % of GDP (4-quarter rolling sum)



Note: Excludes banks undergoing winding up. Moody's forecasts
Source: Central Bank of Iceland, Statistics Iceland and Moody's Investors Service

Exhibit 32

Large pension fund holds large assets abroad
% of GDP



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

External surpluses have allowed the central bank to build substantial foreign-currency reserves, which are actively being used to smooth excessive volatility of the exchange rate. Reserves stood at $6 billion at the end of May 2022 up from less than $5 billion in 2015 and equivalent to around 25% of GDP or 29% of the country's total external debt. Using the IMF's reserve-adequacy metrics, the reserves are at ample levels, equivalent to 1.46 times the recommended level at the end of 2021. According to a sensitivity analysis performed by the central bank at the beginning of 2021, they would still remain more than adequate even if reserves were needed to cover outflows of króna assets held by nonresidents which amounted to ISK113 billion (3.5% of GDP) at the end of May 2022.

ESG considerations

Iceland's ESG Credit Impact Score is Neutral-to-Low CIS-2

Exhibit 33
ESG Credit Impact Score

CIS-2
Neutral-to-Low

NEGATIVE IMPACT
POSITIVE IMPACT

For an issuer scored CIS-2 (Neutral-to-Low), its ESG attributes are overall considered as having a neutral-to-low impact on the current rating; i.e., the overall influence of these attributes on the rating is non-material.

Source: Moody's Investors Service

Iceland's ESG Credit Impact Score is neutral to low (**CIS-2**), reflecting neutral to low exposure to environmental and social risks and very strong institutions.

Exhibit 34
ESG Issuer Profile Scores

ENVIRONMENTAL	SOCIAL	GOVERNANCE
E-2	**S-2**	**G-1**
Neutral-to-Low	Neutral-to-Low	Positive

Source: Moody's Investors Service

Environmental
Iceland's exposure to environmental risks is neutral to low **(E-2)** as the country derives nearly all of its energy generation and use from renewable sources, in particular hydroelectric power and geothermal energy. Iceland's unique geological features imply some exposure to physical climate risks but also offer opportunities for the country's key sectors. The impact of warming seas on fish stocks in Icelandic waters is not yet clear; while some varieties may migrate out of Iceland's waters as seen with the decline in capelin fish stocks in 2019, other species have migrated into Icelandic waters. Also, the sector has considerable flexibility to adapt to changing stocks and has proven so many times. Warmer temperatures are favourable for plant productivity and agriculture. Around 11% of Iceland's land mass consists of glaciers; while the melting of glaciers increases the risk of landslides it also increases availability of hydropower, at least for several decades.

Social
We assess its S issuer profile score as neutral to low (**S-2**). Iceland's demographic profile is more favourable than in many other countries because of long working lives, high participation rates of women and the flexibility of the labour force. Iceland also benefits from high-quality education, access to basic services and housing availability. Indicators for access to healthcare are very strong, as seen in the fast response to the coronavirus pandemic. Social risks exert themselves through intensive wage negotiations between employers and trade unions every four years which can impact on Iceland's competitiveness.

Governance
Iceland's very high institutions and governance strength is reflected in a positive G issuer profile score (**G-1**). This is underpinned by its strong scores in most of the Worldwide Governance Indicators, which reflects the high credibility of its institutions and the country's

well-developed macroeconomic policy environment. This contributes to its relatively strong resilience to E and S risks, along with very high wealth levels.

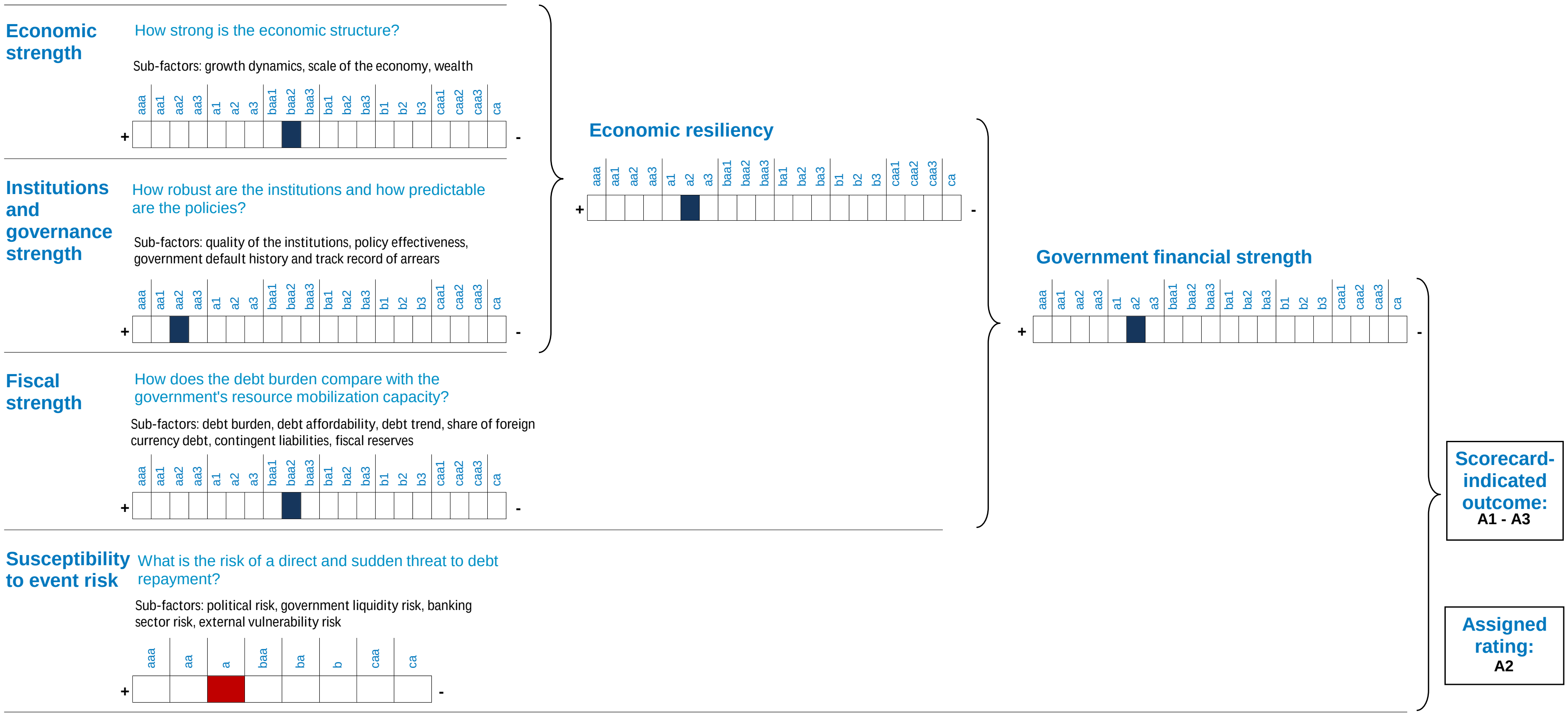
All of these considerations are further discussed in the "Credit profile" section above. Our approach to ESG is explained in our report on how the scores depict varied and largely credit-negative impact of ESG factors and our cross-sector methodology antaGeneral Principles for Assessing Environmental, Social and Governance Risks Methodology.

Scorecard-indicated outcome

Combining the scores for individual factors provides the scorecard-indicated outcome. 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 scorecard-indicated outcome. 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 scorecard-indicated outcome. For more information please see our Sovereign Ratings Methodology.

Exhibit 35

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 scorecard-indicated outcome and shows the relevant credit metrics and factor scores.

Icelands' close peers are similarly small countries, such as Lithuania, Malta and Slovenia, with Iceland's high institutional and governance strength the main differentiating factor. Ireland is a much larger economy but otherwise shares many similarities with Ireland, in particular the strength of its institutions and relatively low susceptibility to event risks. Fiscal strength is also comparable.

Exhibit 36

Iceland's key peers

	Year	Iceland	Slovenia	Malta	Lithuania	Israel	Chile	A2 Median	Western Europe Median
Rating/outlook		A2/STA	A3/STA	A2/NEG	A2/STA	A1/POS	A1/NEG	A2	Aa3
Scorecard-indicated outcome		A1 - A3	A2 - Baa1	A2 - Baa1	Aa3 - A2	Aa2 - A1	A1 - A3	A1 - A3	Aa2 - A1
Factor 1		**baa2**	**baa1**	**baa1**	**baa1**	**aa3**	**baa1**	**baa1**	**a2**
Nominal GDP ($ bn)	2021	25.5	61.5	17.2	65.5	476.2	317.1	45.5	482.4
GDP per capita (PPP, Intl$)	2021	59,792	44,067	49,560	42,944	45,750	26,713	46,252	58,380
Avg. real GDP (% change)	2017 - 2026F	2.4	3.1	4.3	3.1	3.8	2.2	2.8	1.8
Volatility in real GDP growth (ppts)	2012 - 2021	3.8	3.7	5.4	1.5	2.6	4.4	3.0	3.0
Factor 2		**aa2**	**a2**	**a3**	**a1**	**a1**	**aa3**	**a2**	**aa2**
Quality of legislative & executive institutions	Latest available	aa	a	baa	a	aa	aa	a	aa
Strength of civil society & judiciary	Latest available	aaa	a	baa	a	a	a	a	aaa
Fiscal policy effectiveness	Latest available	aa	a	a	aa	baa	a	a	aa
Monetary & macro policy effectiveness	Latest available	a	a	a	a	aa	aa	a	aa
Gen. gov. fiscal balance (% of GDP)	2021 - 2023F	-5.7	-4.0	-6.1	-2.8	-3.6	-4.6	-4.4	-3.4
Average inflation (% change)	2017 - 2026F	3.8	2.2	1.5	4.3	1.5	3.0	3.5	2.0
Volatility of inflation (ppts)	2012 - 2021	1.2	1.1	0.8	1.7	0.9	1.1	1.4	0.9
Factor 3		**baa2**	**a2**	**a2**	**aa2**	**a3**	**a1**	**a2**	**a2**
Gen. gov. debt (% of GDP)	2021	75.0	74.7	57.0	44.3	69.2	36.3	55.4	65.8
Gen. gov. debt (% of revenue)	2021	185.6	170.1	151.9	117.5	186.2	150.8	153.5	151.9
Gen. gov. interest payments (% of revenue)	2021	10.1	2.9	3.1	1.2	5.4	3.6	2.9	2.2
Gen. gov. interest payments (% of GDP)	2021	4.1	1.3	1.2	0.4	2.0	0.9	1.1	0.8
Factor 4		**a**	**baa**	**baa**	**ba**	**baa**	**baa**	**baa**	**baa**
Political risk	Latest available	**aa**	**baa**	**a**	**ba**	**baa**	**a**	**a**	**baa**
Government liquidity risk	Latest available	**aa**	**aa**	**aa**	**a**	**aaa**	**aaa**	**aa**	**aaa**
Gross borrowing requirements (% of GDP)	2022F	11.7	--	--	6.4	10.3	3.0	10.2	12.0
Banking sector risk	Latest available	**a**	**baa**	**baa**	**a**	**a**	**a**	**a**	**a**
BSCE[1]	Latest available	baa3	ba1-ba2	baa2	baa3	baa2	baa2	baa2	baa1
Total domestic bank assets (% of GDP)	2021	152.2	95.0	--	77.3	--	150.2	109.8	248.8
External vulnerability risk	Latest available	**a**	**a**	**aa**	**aa**	**aaa**	**baa**	**aa**	**aa**
Current account balance (% of GDP)	2021	-2.7	3.3	-5.9	1.4	4.7	-6.4	-1.3	1.7
External vulnerability indicator (EVI)	2023F	--	--	--	--	--	142.4	81.6	--
External debt (% of current account receipts)	2021	201.7	104.1	320.6	87.2	--	216.6	201.7	334.6
Net international investment position (% of GDP)	2021	38.9	-7.1	44.4	-7.2	--	-4.9	15.8	17.8

[1] BSCE is our estimate of the risk of a Banking Sector Credit Event (BSCE), which we use for sovereigns where we have no or very limited rating coverage of a system. Otherwise, we use the Baseline Credit Assessment (BCA) for rated domestic banks, weighted by bank assets.

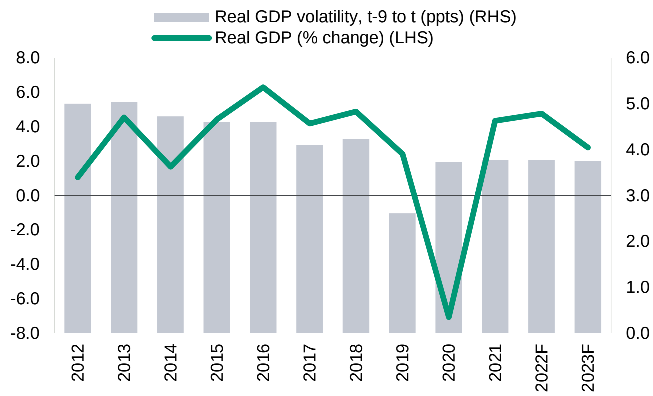
Sources: National authorities, IMF, Moody's Investors Service

DATA, CHARTS AND REFERENCES

Chart pack: Iceland

Exhibit 37

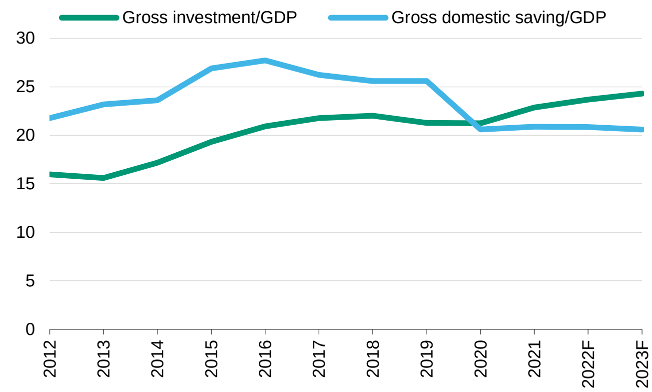
Economic growth



Source: Moody's Investors Service

Exhibit 38

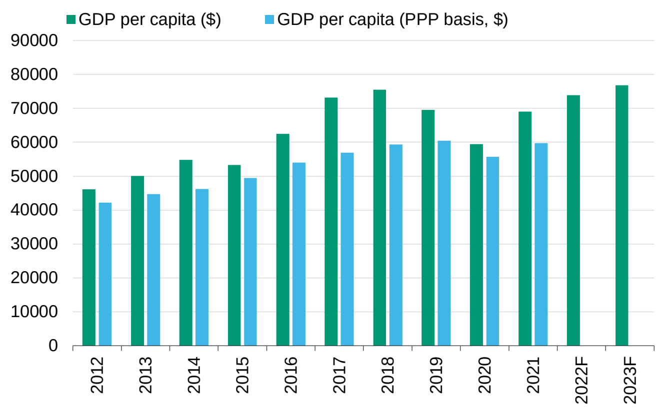
Investment and saving



Source: Moody's Investors Service

Exhibit 39

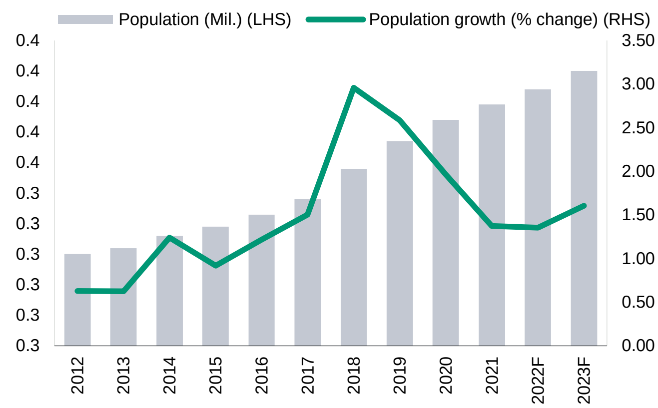
National income



Source: Moody's Investors Service

Exhibit 40

Population

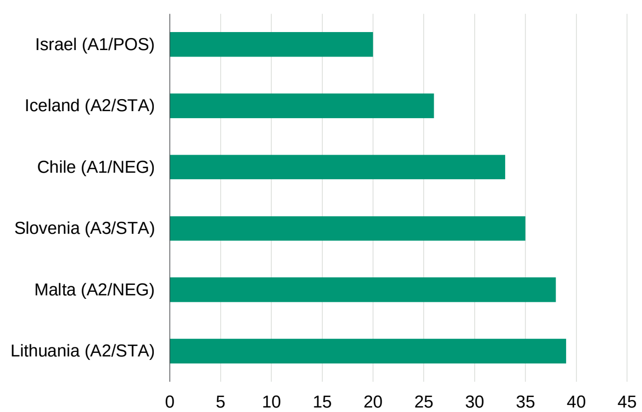


Source: Moody's Investors Service

Exhibit 41

Global Competitiveness Index

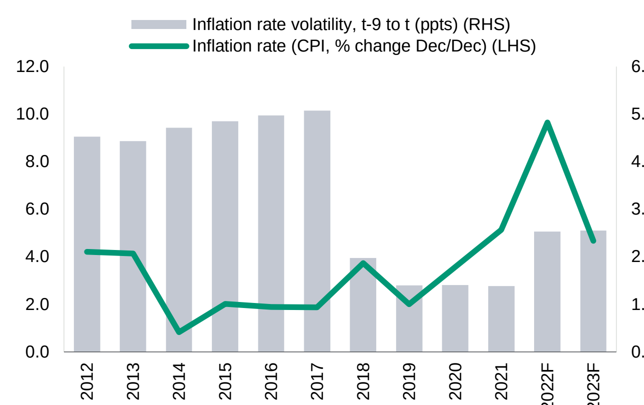
Rank 26 out of 141 countries



Source: World Economic Forum

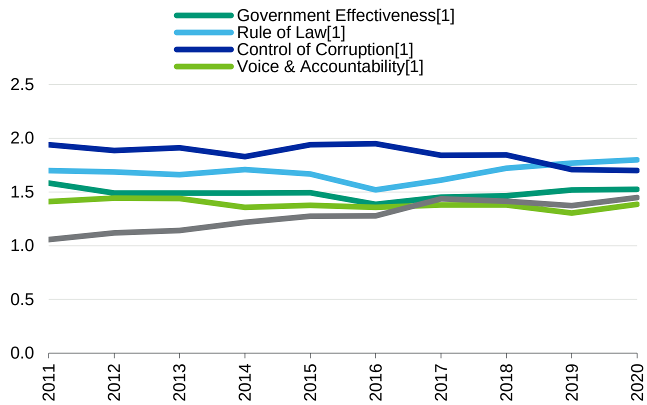
Exhibit 42

Inflation and inflation volatility



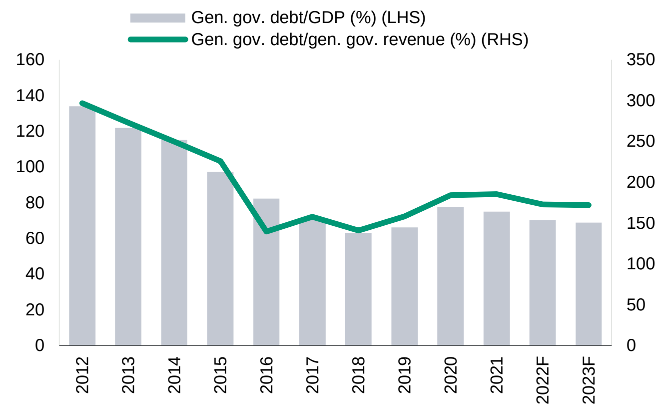
Source: Moody's Investors Service

Exhibit 43
Institutional framework and effectiveness



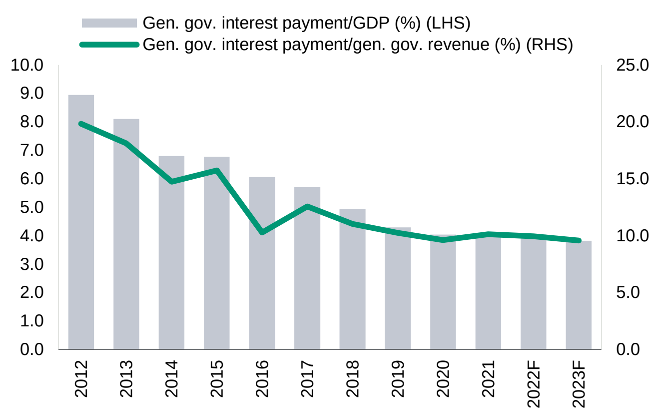
Notes: [1] Composite index with values from about -2.50 to 2.50: higher values suggest greater maturity and responsiveness of government institutions.
Source: Worldwide Governance Indicators

Exhibit 44
Debt burden



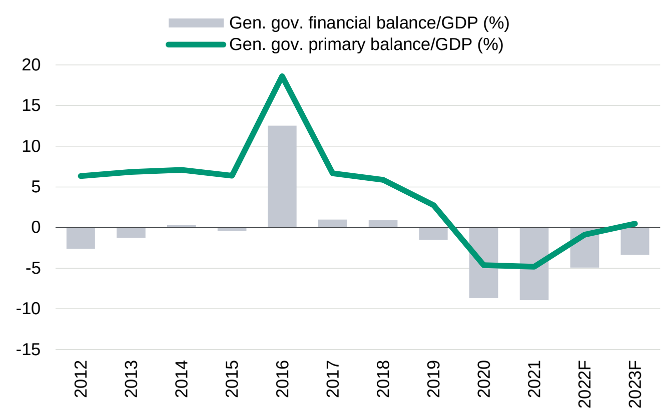
Source: Moody's Investors Service

Exhibit 45
Debt affordability



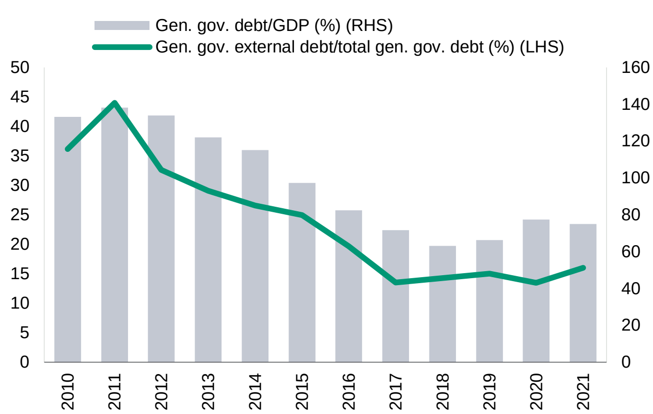
Source: Moody's Investors Service

Exhibit 46
Financial balance



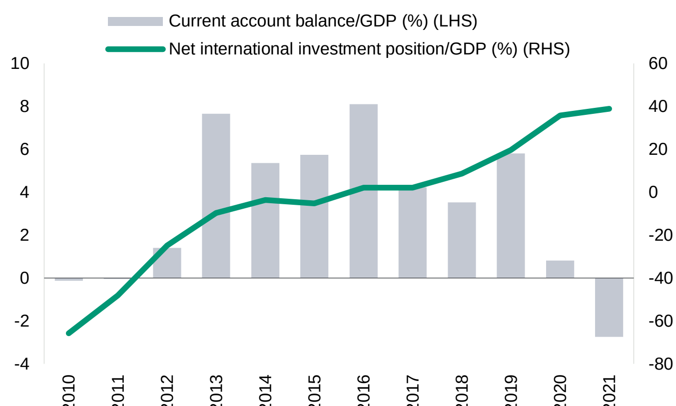
Source: Moody's Investors Service

Exhibit 47
Government liquidity risk



Source: Moody's Investors Service

Exhibit 48
External vulnerability risk



Source: Moody's Investors Service

Rating history

Exhibit 49

Iceland[1]

Long Term Ratings		Outlook	Review Action		Short Term Ratings		Action Date
Foreign Currency	Local Currency		Foreign Currency	Local Currency	Foreign Currency	Local Currency	
A2	A2	STA	-	-	-	-	Nov-19
A3	A3	POS	-	-	-	-	Jul-18
A3	A3	STA	-	-	-	-	Sep-16
Baa2	Baa2	RUR	Possible Upgrade	Possible Upgrade	-	-	Jun-16
Baa2	Baa2	STA	-	-	-	-	Jun-15
Baa3	Baa3	STA	-	-	-	-	Feb-13
Baa3	Baa3	NEG	-	-	-	-	Jul-10
Baa3	Baa3	STA	-	-	-	-	Apr-10
Baa3	Baa3	NEG	-	-	-	-	Apr-10
Baa3	Baa3	STA	-	-	-	-	Nov-09
Baa1	Baa1	NEG	-	-	-	-	Dec-08
A1	A1	RUR	Possible Downgrade	Possible Downgrade	-	-	Oct-08
Aa1	Aa1	RUR	Possible Downgrade	Possible Downgrade	-	-	Sep-08
Aa1	Aa1	STA	-	-	-	-	May-08
Aaa	Aaa	NEG	-	-	-	-	Mar-08
Aaa	Aaa	STA	-	-	-	-	Nov-03
Aaa	Aaa	-	-	-	-	-	Oct-02
Aa3	Aaa	-	-	-	-	-	Jul-97
A1	-	-	Possible Upgrade	-	-	-	Jun-97
A1	-	-	-	-	-	-	Jun-96
A2	-	-	Possible Upgrade	-	-	-	Apr-96
A2	-	-	-	-	-	-	May-89

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

Annual statistics

Exhibit 50
Iceland

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022F	2023F
Economic structure and performance												
Nominal GDP (US$ bil.)	14.8	16.1	17.9	17.5	20.8	24.7	26.3	24.8	21.6	25.5	27.6	29.2
Population (Mil.)	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4
GDP per capita (US$)	46,098	50,078	54,809	53,244	62,442	73,161	75,472	69,523	59,409	68,994	73,896	76,812
GDP per capita (PPP basis, US$)	42,154	44,673	46,239	49,471	53,943	56,945	59,383	60,428	55,717	59,792	--	--
Nominal GDP (% change, local currency)	4.5	6.8	5.9	10.8	8.7	5.2	7.7	7.0	-3.8	10.4	12.6	7.2
Real GDP (% change)	1.1	4.6	1.7	4.4	6.3	4.2	4.9	2.4	-7.1	4.3	4.8	2.8
Inflation (CPI, % change Dec/Dec)	4.2	4.1	0.8	2.0	1.9	1.9	3.7	2.0	3.6	5.1	9.6	4.7
Unemployment rate (%)	6.6	5.8	5.4	4.5	3.3	3.3	3.1	3.9	6.4	6.0	3.8	4.0
Gross investment/GDP	16.0	15.6	17.2	19.3	20.9	21.8	22.0	21.3	21.2	22.9	23.7	24.3
Gross domestic saving/GDP	21.8	23.2	23.6	26.9	27.7	26.2	25.6	25.6	20.6	20.9	20.9	20.6
Nominal exports of G & S (% change, US$ basis)	-2.4	6.0	7.2	-1.7	9.1	14.5	8.3	-10.1	-32.5	30.6	31.6	10.9
Nominal imports of G & S (% change, US$ basis)	1.7	1.3	9.8	-4.1	9.8	20.1	11.6	-13.1	-23.2	35.0	27.5	9.3
Real exports of G & S (% change)	3.6	6.8	3.9	8.9	11.0	5.1	1.7	-4.7	-30.2	12.3	25.8	6.0
Real imports of G & S (% change)	4.6	0.1	10.0	13.5	14.6	11.8	0.9	-8.5	-21.6	20.3	21.9	4.5
Net exports of goods & services/GDP	5.8	7.7	6.4	7.5	6.6	4.5	3.3	4.5	-0.8	-2.1	-1.0	-0.4
Openness of the economy[1]	104.1	98.8	96.7	95.8	88.3	87.0	90.0	84.2	69.5	78.4	93.5	97.5
Government Effectiveness[2]	1.5	1.5	1.5	1.5	1.4	1.5	1.5	1.5	1.5	--	--	--
Government finance												
Gen. gov. revenue/GDP[3]	45.1	44.7	46.1	43.1	59.0	45.4	44.8	41.9	42.1	40.4	40.6	39.9
Gen. gov. expenditures/GDP[3]	47.7	46.0	45.8	43.5	46.4	44.4	43.8	43.4	50.7	49.3	45.5	43.3
Gen. gov. financial balance/GDP[3]	-2.6	-1.2	0.3	-0.4	12.5	1.0	0.9	-1.5	-8.7	-8.9	-4.9	-3.4
Gen. gov. primary balance/GDP[3]	6.3	6.9	7.1	6.4	18.6	6.7	5.8	2.8	-4.6	-4.8	-0.9	0.5
Gen. gov. debt (US$ bil.)[3]	19.2	20.8	18.9	17.3	18.3	18.1	15.4	16.6	17.8	18.6	19.2	20.2
Gen. gov. debt/GDP[3]	133.9	122.0	115.2	97.2	82.4	71.6	63.1	66.2	77.4	75.0	70.2	69.4
Gen. gov. debt/gen. gov. revenue[3]	296.9	272.7	249.8	225.7	139.6	157.9	141.1	158.2	184.1	185.6	173.0	173.8
Gen. gov. interest payments/gen. gov. revenue[3]	19.8	18.1	14.7	15.7	10.3	12.6	11.0	10.2	9.6	10.1	9.9	9.6
External payments and debt												
Nominal exchange rate (local currency per US$, Dec)	129.0	115.6	126.9	129.6	112.8	104.4	116.3	121.1	127.2	130.4	133.0	134.3
Real eff. exchange rate (% change)	-1.1	4.2	6.9	2.6	12.5	12.0	-2.6	-6.7	-7.6	4.2	--	--
Relative unit labor cost	98.4	99.5	100.0	100.0	102.6	106.7	109.2	105.3	107.4	106.6	--	--
Current account balance (US$ bil.)[4]	0.2	1.2	1.0	1.0	1.7	1.0	0.9	1.4	0.2	-0.7	-0.1	0.0
Current account balance/GDP[4]	1.4	7.7	5.4	5.7	8.1	4.2	3.5	5.8	0.8	-2.7	-0.2	0.1
Net foreign direct investment/GDP	28.7	-0.3	4.1	4.0	3.5	0.7	-1.7	-2.8	-2.5	0.0	-2.0	-1.8
Net international investment position/GDP[4]	-24.9	-9.7	-3.7	-5.2	2.0	2.0	8.6	19.7	35.8	38.9	--	--
Official forex reserves (US$ bil.)	4.0	4.1	4.1	4.8	6.9	6.2	6.0	6.4	6.0	6.3	6.3	6.4

[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] Includes public entities previously excluded from the scope of the general government
[4] Excludes DMBs undergoing winding up in 2008-2015

Source: Moody's Investors Service

Moody's related publications

» **Credit Opinion**: Government of Iceland – A2 stable: Regular update, 22 February 2022

» **Rating Methodology**: Sovereign Ratings Methodology, 25 November 2019

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.

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» Sovereign risk group web page

» Sovereign ratings list

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Endnotes

1 Iceland has the lowest Gini coefficent of all OECD countries, implying the most even distribution of wealth among this group of countries.

2 According to forecasts from the **2021 Ageing Report** and Statistics Iceland.

3 Statistics Iceland estimates the contribution to Gross Value Added (at basic prices) to be smaller at 10.3%. Direct employment stood at 13.9% of the total in 2019.

4 See **OECD**, 2020 and **IMF**, 2022

5 For more detail, see **Post-crisis monetary policy reform**, 2018

6 The IMF estimates the exchange rate pass through at 10-30%, implying that a 1% depreciation of the ISK raises inflation by 0.1-0.3ppt.

7 The government defines net general government debt as gross debt excluding pension liabilities, accounts payable and also net of currency and deposits. The definition also excludes the newly reclassified entities, which will however, be included for information purposes in future budgets and financial plans.

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