MOODY'S RATINGS

ISSUER COMMENT
14 March 2025

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Government of Iceland

Early resolution of HF Fund will help reduce government debt further

On 10 March, Iceland's (A1 stable) Ministry of Finance and Economic Affairs and pension funds agreed a proposal to resolve the HF Fund (A1) after more than a year of negotiations. The agreement paves the way for the consensual settlement of the fund's liabilities, resulting in a potentially substantial one-off reduction in the government debt ratio.

We upgraded Iceland's rating to A1 in September 2024 to reflect our view that the government's fiscal metrics would continue to improve. The expected reduction in the debt ratio comes on top of the clearly established downward trajectory in the government debt burden since 2020. We could upgrade the rating further if the government debt ratio continues to decline much faster than under our baseline assumptions and debt affordability metrics aligned with those of higher-rated peers.

The proposal was agreed with 18 pension funds which are the main holders of the remaining HF-Fund bonds. Under the proposed terms, the Icelandic government will issue ISK540 billion, or 11.8% of 2024 GDP, in new Treasury bonds to refinance its debt to the HF Fund and settle its obligations, as well as providing other securities including cash in domestic and foreign currency. This proposal will be presented at a creditors' meeting on 10 April. The proposal requires approval from creditors representing 75% of the total claims before it can proceed to parliamentary approval.

The agreement would allow the government to wind down the fund and exit its guarantee of collection on the bonds. This will result in a potentially substantial one-off reduction in the government debt ratio. The government estimates that the settlement, if approved, will reduce the treasury's debt by at least 5% of GDP and cut state-guaranteed debt by 88%. The book value of the guarantee for the HF Fund, amounting to 14.3% of GDP, is fully incorporated into our definition of government debt.

The government is also preparing to sell its remaining stake —about 42.5% of the bank's shares — in Islandsbanki (A2/A3 stable, baa2[1]) this year, with the proceeds likely to also be used to reduce debt beyond what we currently include in our forecasts. We expect the broad political consensus in favour of prudent public financial management will continue under the new government, which took office in December 2024. The new administration plans to replace the current balanced budget rule with an expenditure rule, which we consider to be credit positive because it would further strengthen the framework by contributing more to macroeconomic stability.

Endnotes

1 Deposit and senior unsecured debt ratings and corresponding outlook, as well as Baseline Credit Assessment

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

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