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Research Update:

Glitnir Bank Downgraded To 'BBB+' On Weak Economy, Reduced Funding And Earnings Prospects

Primary Credit Analyst:

Miguel Pintado, Stockholm (46) 8-440-5904; miguel_pintado@standardandpoors.com

Secondary Credit Analyst:

Louise Lundberg, Stockholm (46) 8-440-5938; louise_lundberg@standardandpoors.com

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Rationale

On April 21, 2008, Standard & Poor's Ratings Services lowered its long-term counterparty credit ratings on Iceland-based Glitnir Bank to 'BBB+' from 'A-'. At the same time the 'A-2' short-term counterparty credit ratings were affirmed. The ratings were removed from CreditWatch, where they were placed with negative implications on March 20, 2008. The outlook is negative.

The downgrade reflects heightened pressure on the Icelandic economy (see "Iceland Sovereign Ratings Lowered On External Funding Risks", published April 17, 2008 on Ratings Direct), which may result in a sharp deterioration of the asset quality of Glitnir's domestic portfolio. It also reflects increased uncertainty about Glitnir's earnings capacity as a result of turbulence in the capital markets and the investment banking sector, and the bank's inability to access international funding. This is putting pressure on Glitnir's liquidity management and impairing its ability to expand its business.

Glitnir's profitability is likely to remain volatile through 2008 and subject to negative conditions in the capital markets and investment banking industry, although the bank's strong retail franchises in Iceland and Norway may partly offset this volatility. Additional pressure on earnings is likely to come from increased funding costs and a probable deterioration of domestic asset quality as imbalances in the Icelandic economy unwind in 2008-2009.

Icelandic banks currently have very limited ability to access the markets, except for some selected private placements. Glitnir has accessed funding from Icelandic institutional investors but domestic investors are unlikely to have the capacity to meet all of the bank's funding requirements in 2008. Glitnir's high reliance on wholesale foreign currency funding makes the availability and cost of its funding extremely sensitive to foreign investor confidence. Such confidence is not only dependent on Glitnir itself but also on the relatively volatile Icelandic economy and news from other Icelandic banks.

Although Glitnir's access to the repo facilities of Iceland's central bank and the liquidity buffers kept by the bank on its balance sheet should be sufficient to meet all maturities falling due in the next nine-12 months, Standard & Poor's is concerned about the impact on Glitnir's reputation and its future ability to raise additional funding should the bank be forced to reduce these liquidity buffers to meet forthcoming maturities.

The negative outlook for the Icelandic economy and the volatility of its currency, which has depreciated by more than 20% since the beginning of 2008, could lead to a deterioration of household and corporate creditworthiness. This applies particularly to those exposed to the mismatch of foreign currency borrowing and income in the rapidly depreciating local currency.

Outlook

The negative outlook reflects the expectation that Glitnir will struggle to maintain comfortable profitability levels as the capital markets continue to deteriorate, the Icelandic economy slows down, and the bank's access to funding remains closed or expensive.

A positive rating action is highly unlikely given the bank's funding structure and current market conditions. The outlook could revert to stable if Glitnir's profitability and asset quality prove resilient to the deterioration of funding conditions and the likely loss of revenue from its investment banking operations.

A negative rating action could follow if earnings capacity and profitability deteriorate significantly as a result of volatile capital market conditions. The rating could also be lowered if Glitnir suffers a significant deterioration in its liquidity position and its asset quality in Iceland. The ratings do not factor in any extraordinary support from the Icelandic authorities, although such support could be forthcoming for the country's banks in certain circumstances.

Ratings List

	To	From
Counterparty credit ratings	BBB+/Negative/A-2	A-/WatchNeg/A-2
Certificates of deposit	BBB+/A-2	A-/WatchNeg/A-2

NB: This list does not include all ratings affected.

Additional Contact:

Financial Institutions Ratings Europe;FIG_Europe@standardandpoors.com

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