REPUBLIC OF ITALY

Rating Analysis - 2/18/16

*EJR Sen Rating(Curr/Prj) CCC+/ N/A
*EJR CP Rating: C
EJR's 3 yr. Default Probability: 14.0%

More troubles - from 2007 to 2014 Italy's debt to GDP rose from 107% to 132% and with an annual deficit (as a percentage of GDP) near 3.5%, we expect debt to GDP to exceed 140% by the end of 2016. From 2011 to 2014, debt rose by 15.4% while during the same period GDP remained more or less level. Italy will probably have to continue providing support to its banks and will see more pressure on its economy. The political situation in Italy has been a bit dicier recently with Renzi's replacing Italy's ambassador in the EU and attacks on EU policy stances. Challenges from the Five Star Movement further complicates matters. The approximately 12% reported unemployment is a major drag on growth.

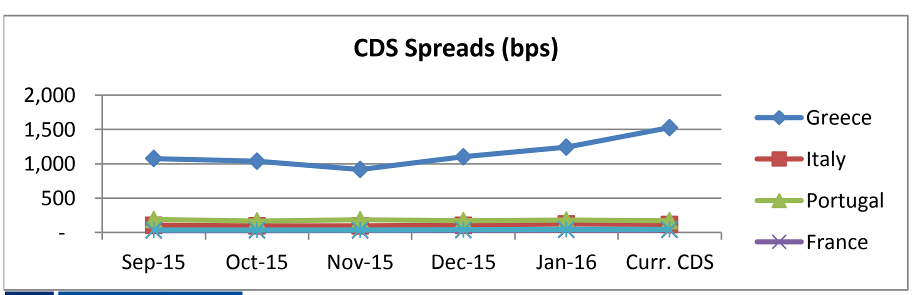
Yields on the 10 year bonds are near 4.8% and are likely to remain high; rates would be greater without ECB support. The ECB and IMF will provide some liquidity help if problems occur in Italy but might subordinate existing creditors. Debt to GDP will continue to rise, albeit more slowly, and the country will remain pressed. We are affirming "CCC+", with a developing watch.

Annual Ratios (source for past results: IMF)

CREDIT POSITION	2012	2013	2014	P2015	P2016	P2017
Debt/ GDP (%)	123.1	128.5	132.1	137.3	142.5	147.3
Govt. Sur/Def to GDP (%)	-3.1	-3.3	-3.5	-3.4	-3.4	-3.4
Adjusted Debt/GDP (%)	123.1	128.5	132.1	137.3	142.5	147.3
Interest Expense/ Taxes (%)	17.3	16.1	15.5	15.8	16.1	16.5
GDP Growth (%)	-1.4	-0.4	0.4	1.3	1.3	1.5
Foreign Reserves/Debt (%)	1.3	1.2	1.3	1.2	1.2	1.1
Implied Sen. Rating	B-	B-	B-	B-	B-	B-

INDICATIVE CREDIT RATIOS	AA	A	BBB	BB	B	CCC
Debt/ GDP (%)	45.0	55.0	75.0	85.0	95.0	145.0
Govt. Sur/Def to GDP (%)	4.0	1.0	-2.0	-5.0	-8.0	-10.0
Adjusted Debt/GDP (%)	40.0	50.0	60.0	80.0	120.0	150.0
Interest Expense/ Taxes (%)	7.0	9.0	12.0	15.0	22.0	26.0
GDP Growth (%)	4.0	3.0	2.0	1.0	-1.0	-5.0
Foreign Reserves/Debt (%)	25.0	20.0	15.0	12.0	9.0	7.0

PEER RATIOS	Other NRSRO Sen.	Debt as a % GDP	Govt. Surp. Def to GDP (%)	Adjusted Debt/ GDP	Interest Expense/ Taxes %	GDP Growth (%)	Ratio-Implied Rating*
Federal Republic Of Germany	AAA	74.9	0.5	74.9	7.7	3.4	BBB-
French Republic	AA	95.5	-3.6	95.5	7.5	0.7	B
Kingdom Of Belgium	AA	106.6	-3.3	106.6	10.0	1.7	BB
Hellenic Republic (Greece)	CCC+	177.1	-3.2	177.1	15.7	-1.8	B
Portugal Republic	BB+	129.9	-5.4	129.9	19.7	1.9	B+



Country (EJR Rtg*)	CDS
Greece (D)	1,528
Italy (CCC+)	114
Portugal (B-)	171
France (BBB)	34
Belgium (BBB)	42

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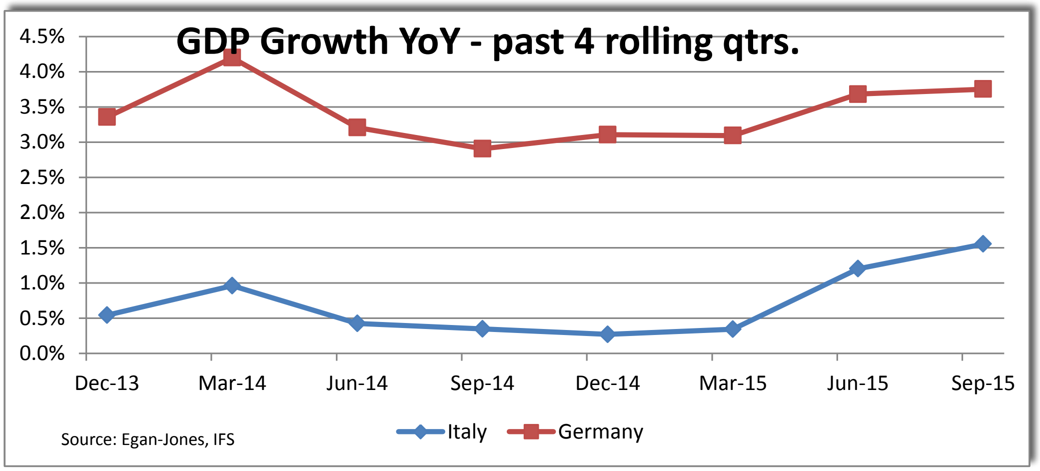
Economic Growth

Low growth - Italy has been experiencing continued slow growth since 2013. The growth rate was less than .5% from June 2014 to March 2015, rising only recently. Italy's GDP rose by 1.5% in the September 2015 quarter according to IMF.

As can be seen from the below chart, although the Italy's GDP has been growing YoY for the last couple of quarters, the rate is much lower than Germany's growth. A large portion of Italy's economy is geared to the tourism and light manufacturing industries. The continued weakness in the EU limits growth in the economy. (Note, the high Debt to GDP further depresses growth.)



Fiscal Policy

Italy's deficit to GDP of 3.48% for 2014 is not comforting, and its projected budget deficit rises from 2.2% for 2015 to 2.6% for 2016. From FYE 2010 through 2014, total sovereign revenues rose by 6.1% while expenses excluding interest rose by 4.2%. The major problem for Italy is its high Debt to GDP and support needed for its banks. As can be seen from the chart to the right, only Greece has a worse Debt to GDP than Italy. Italy's attempts to implement austerity measures and provide real bank relief are likely to fall short. Watch the value of the euro.

	Deficit-to-GDP (%)	Debt-to-GDP (%)	5 Yr. CDS Spreads
Italy	3.48	132.09	113.77
Germany	-0.47	74.93	13.58
France	3.63	95.51	34.26
Belgium	3.33	106.55	42.19
Greece	3.21	177.07	1528.25
Portugal	5.39	129.88	170.93

Sources: Thomson Reuters and IFS

Unemployment

Italy's unemployment rate of 12.65% is higher than Germany's, France's and Belgium's as indicated in the chart at right. The weak level of employment will impede the government's attempts to reduce the budget deficit. We expect unemployment to remain high and to climb over the next year.

Unemployment (%)

	2013	2014
Italy	12.13	12.65
Germany	6.88	6.70
France	9.90	9.90
Belgium	8.40	8.48
Greece	27.38	26.48
Portugal	16.18	13.90

Source: Intl. Finance Statistics

Banking Sector

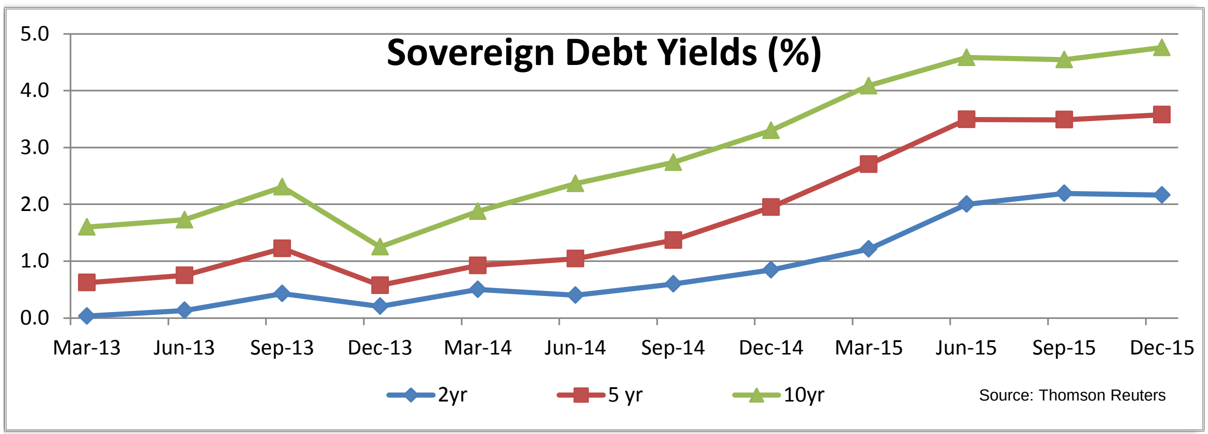
Italy has significant exposure to its banking because the bank's large aggregate size measured in assets. The top five banks have assets equal to 118.8% of GDP versus 80.8% for Germany. Italy will probably be expected to provide financial support to its banks. However, Italy's ability to support its banks is minimal.

Bank Assets (billions of local currency)

	Assets	Cap/ Assets %
UNICREDIT SPA	844.22	6.89
INTESA SANPAOLO	647.34	3.14
BANCA MONTE DEI	183.44	8.56
BANCO POPOLARE S	123.08	6.72
UBI BANCA SCPA	121.79	6.08
Total	1,919.9	
EJR's est. of cap shortfall at 10% of assets less market cap		109.9
Italy's GDP		1,616.3

Funding Costs

Italy has seen a rise in its funding costs over the past 2 years. As can be seen in the below graph, the bond yields declined in the 4th quarter of 2013, but have been rising since then. Other EU governments have requested that the ECB, EFSF, and IMF purchase the government's debt. Watch for ECB actions to suppress Italy's funding costs.



Ease of Doing Business

Major factors for growing the economy are the ease of doing business and the economic freedom; although not the sole factor for determining economic growth, a country which makes it easy for businesses to operate and provides a reasonably free environment to conduct business has a good chance for growth. The chart on the right indicates that with an overall rank of 45 (1 is best, 189 worst) is mediocre.

The World Bank's Doing Business Survey*

	2015 Rank	2014 Rank	Change in Rank
Overall Country Rank:	**45**	**44**	**-1**
Scores:			
Starting a Business	50	48	-2
Construction Permits	86	79	-7
Getting Electricity	59	58	-1
Registering Property	24	22	-2
Getting Credit	97	90	-7
Protecting Investors	36	33	-3
Paying Taxes	137	137	0
Trading Across Border:	1	1	0
Enforcing Contracts	111	124	13
Resolving Insolvency	23	21	-2

* Based on a scale of 1 to 189 with 1 being the highest ranking.

Economic Freedom

As can be seen below, Italy is above average in its overall rank of 61.7 for Economic Freedom with 100 being best.

Heritage Foundation 2015 Index of Economic Freedom
World Rank 61.7*

	2015 Rank**	2014 Rank	Change in Rank	World Avg.
Property Rights	55	50	5	42.2
Freedom from Corruption	43	38.5	4.5	41.9
Fiscal Freedom	54.2	55.5	-1.3	77.4
Government Spending	23.2	25.6	-2.4	61.7
Business Freedom	71.9	75.5	-3.6	64.1
Labor Freedom	55.4	52.5	2.9	61.3
Monetary Freedom	81.2	78.9	2.3	75.0
Trade Freedom	88	87.8	0.2	75.4
Investment Freedom	85	85	0	54.8
Financial Freedom	60	60	0	48.6

*Based on a scale of 1-100 with 100 being the highest ranking.
**The ten economic freedoms are based on a scale of 0 (least free) to 100 (most free).
Source: The Heritage Foundation

Valuation Driver: Taxes Growth:
REPUBLIC OF ITALY has grown its taxes of 0.4% per annum in the last fiscal year which is disappointing. We expect tax revenues will grow approximately 1.4% per annum over the next couple of years and 1.4% per annum for the next couple of years thereafter.

Valuation Driver: Total Revenue Growth:
REPUBLIC OF ITALY's total revenue growth has been less than its peers and we assumed a 1.4% growth in total revenue growth over the next two years.

Income Statement	Peer Median	Co. Avg.	Assumptions Yr 1&2	Yr 3,4,5
Taxes Growth%	1.6	0.4	**1.4**	**1.4**
Social Contributions Growth %	2.3	0.5	**2.0**	**2.0**
Grant Revenue Growth %	0.0	NMF		
Other Revenue Growth %	0.0	2.0		
Other Operating Income Growth%	0.0	0.0		
Total Revenue Growth%	0.9	0.6	**1.4**	**1.3**
Compensation of Employees Growth%	1.9	(0.6)	**(0.6)**	**(0.6)**
Use of Goods & Services Growth%	1.8	0.5	**0.5**	**0.5**
Social Benefits Growth%	2.2	2.4	**2.4**	**2.4**
Subsidies Growth%	6.8	4.4		
Other Expenses Growth%	3.3	3.3		
Interest Expense	0.0	3.5	**3.5**	
Currency and Deposits (asset) Growth%	0.0	0.0		
Securities other than Shares LT (asset) Growth%	0.0	(0.9)	**0.2**	**0.2**
Loans (asset) Growth%	0.1	2.4	**1.6**	**1.6**
Shares and Other Equity (asset) Growth%	3.7	(0.3)	**2.0**	**2.0**
Insurance Technical Reserves (asset) Growth%	0.0	10.6		
Financial Derivatives (asset) Growth%	0.0	0.0		
Other Accounts Receivable LT Growth%	(2.2)	1.5	**1.0**	**1.0**
Monetary Gold and SDR's Growth %	0.0	0.0		
Other Assets Growth%	0.0	0.0		
Other Accounts Payable Growth%	0.0			
Currency & Deposits (liability) Growth%	13.4	6.7	**6.7**	**6.7**
Securities Other than Shares (liability) Growth%	10.2	12.0	**2.8**	**2.8**
Loans (liability) Growth%	3.9	(3.7)	**(1.0)**	**(1.0)**
Insurance Technical Reserves (liability) Growth%	0.0	(912.9)		
Financial Derivatives (liability) Growth%	0.0	41.1	**0.5**	**0.5**
Additional ST debt (1st year)(millions EUR)	0.0	0.0		

ANNUAL INCOME STATEMENTS

Below are REPUBLIC OF ITALY's annual income statements with the projected years based on the assumptions listed on page 3.

ANNUAL REVENUE AND EXPENSE STATEMENT
(MILLIONS EUR)

	2011	2012	2013	2014	P2015	P2016
Taxes	464,907	487,396	483,707	485,837	492,639	499,536
Social Contributions	216,294	215,838	215,288	216,408	220,736	225,151
Grant Revenue						
Other Revenue	66,580	68,499	73,485	74,961	74,961	74,961
Other Operating Income	0	0	0	0		
Total Revenue	747,781	771,733	772,480	777,206	788,336	799,648
Compensation of Employees	169,615	166,130	164,910	163,874	162,845	161,821
Use of Goods & Services	87,166	86,975	89,841	90,325	90,812	91,301
Social Benefits	349,086	354,787	363,147	372,043	381,157	390,494
Subsidies	23,521	25,864	27,425	28,627	28,630	28,633
Other Expenses	57,568	60,657	57,957	59,860	59,860	59,860
Grant Expense						
Depreciation	42,683	43,412	43,943	43,482	43,482	43,482
Total Expenses excluding interest	729,639	737,825	747,223	758,211	766,785	775,591
Operating Surplus/Shortfall	18,142	33,908	25,257	18,995	21,551	24,056
Interest Expense	76,416	84,087	77,942	75,181	77,829	80,569
Net Operating Balance	-58,274	-50,179	-52,685	-56,186	-56,278	-56,513

ANNUAL BALANCE SHEETS

Below are REPUBLIC OF ITALY's balance sheets with the projected years based on the assumptions listed on page 3.

ANNUAL BALANCE SHEETS (MILLIONS EUR)

Base Case

ASSETS	2011	2012	2013	2014	P2015	P2016
Currency and Deposits (asset)	73,446					
Securities other than Shares LT (asset)	23,732	26,328	1,338	1,326	1,329	1,331
Loans (asset)	62,672	87,211	94,680	96,986	98,538	100,114
Shares and Other Equity (asset)	118,828	124,775	120,698	120,383	122,791	125,246
Insurance Technical Reserves (asset)	1,482	77,512	104,028	115,004	115,004	115,004
Financial Derivatives (asset)						
Other Accounts Receivable LT	102,305	105,301	106,884	108,533	109,618	110,715
Monetary Gold and SDR's						
Other Assets						
Additional Assets						
Total Financial Assets	382,465	421,127	427,628	442,232	447,279	452,411
LIABILITIES						
Other Accounts Payable						
Currency & Deposits (liability)	215,647	221,660	219,851	234,549	234,549	234,549
Securities Other than Shares (liability)	1,465,855	1,701,496	1,818,960	2,036,408	2,093,427	2,152,043
Loans (liability)	157,005	184,181	184,328	177,495	233,773	290,285
Insurance Technical Reserves (liability)	-6,164	-1,688	-1,808	14,698	14,698	14,698
Financial Derivatives (liability)	27,528	34,265	28,752	40,575	40,786	40,998
Other Liabilities	97,446	90,070	79,374	58,220	58,220	58,220
Liabilities	1,957,317	2,229,984	2,329,457	2,561,945	2,623,270	2,684,914
Net Financial Worth	-1,574,852	-1,808,857	-1,901,829	-2,119,713	-2,175,991	-2,232,503
Total Liabilities & Equity	382,465	421,127	427,628	442,232	447,279	452,411

Comments on the Difference between the Model and Assigned Rating

In this case, there has been little change in the recent results and therefore we have used our best judgement in making adjustments which are reflected in the results for the projected ratings. We have assigned a rating of "CCC+" whereas the ratio-implied rating for the most recent period is "B-"; the median rating for the peers is significantly higher than the issuer's rating.

Changes in Indicative Ratios

We have not made any adjustment in the indicative ratios at this time.

SEC Rule 17g-7(a) Disclosure

Below are the disclosures as required by Paragraph (a) of Rule 17g-7.

1. The symbol in the rating scale used to denote the credit rating categories and notches within categories and the identity of the obligor, security, or money market instrument as required by Paragraph (a)(1)(ii)(A) of Rule 17g-7:
For the issuer REPUBLIC OF ITALY with the ticker of 2103Z IM we have assigned the senior unsecured rating of CCC+. There are three notches in our rating categories (e.g., A-, A, and A+) other than those deep into speculative grade; for CC, C, and D there are no notches.

2. The version of the procedure or methodology used to determine the credit rating as required by Paragraph (a)(1)(ii)(B) of Rule 17g-7:
We are using the methodology available in our Form NRSRO Exhibit #2 dated May 10, 2015 available via egan-jones.com under the tab at the bottom of the page "Methodologies".

3. The main assumptions and principles used in constructing the procedures and methodologies used to determine the credit rating as required by Paragraph (a)(1)(ii)(C) of Rule 17g-7:
The credit rating assigned reflects our judgement regarding the future credit quality of the issuer. Regarding the specific assumptions used, please refer to page 3 of this Rating Analysis Report.

4. The potential limitations of the credit rating as required by Paragraph (a)(1)(ii)(D) of Rule 17g-7:
Our rating pertains solely to our view of current and prospective credit quality. Our rating does not address pricing, liquidity, or other risks associated with holding investments in the issuer.

5. Information on the uncertainty of the credit rating as required by Paragraph (a)(1)(ii)(E) of Rule 17g-7:
Our rating is dependant on numerous factors including the reliability, accuracy, and quality of the data relied used in determining the credit rating. The data is sourced from publicly-available 10Q and 10K statements, quarterly reports, 8K filings, earnings reports, and other similar sources. In some cases, the information is limited because of issues such as short operating histories, the lack of reported data, a delay in reporting data, restatements, inaccurate accounting, and other issues. Such shortcomings are not always readily apparent. EJR aims to identify such shortcomings and make adjustments using its best judgement.

6. Whether and to what extent third-party due diligence services have been used in taking the rating action as required by Paragraph (a)(1)(ii)(F) of Rule 17g-7:
EJR does not utilize third-party due diligence services.

7. How servicer or remittance reports were used, and with what frequency, to conduct surveillance of the credit rating as required by Paragraph (a)(1)(ii)(G) of Rule 17g-7:
Servicer or remittance reports normally pertain to structured finance issuers; this report does not pertain to a structured finance issuer (EJR is not an NRSRO for structured finance or sovereigns/ municipal issuers). Regarding surveillance, the minimum time period for corporation issuers is normally one year.

8. A description of the data that were relied upon for the purpose of determining the credit rating as required by Paragraph (a)(1)(ii)(H) of Rule 17g-7:
EJR uses 10Q and 10K statements, quarterly reports, 8K filings, earnings reports, and other similar sources for ratings on publicly-traded issuers. In the case of private issuers, EJR relies on information provided mainly by issuers.

9. A statement containing an overall assessment of the quality of information available and considered in the credit rating as required by Paragraph (a)(1)(ii)(I) of Rule 17g-7: The information is generally high quality and readily avail.

10. Information relating to conflicts of interest as required by Paragraph (a)(1)(ii)(J) of Rule 17g-7:
This rating is unsolicited.

11. An explanation or measure of the potential volatility of the credit rating as required by Paragraph (a)(1)(ii)(K) of Rule 17g-7:
Our rating aims to assess the probability of the payment of obligations in full and on-time. Factors which affect such probability, and in turn our rating, include changes in the operating performance of the issuer, changes in capital structure, and merger and acquisition events.

12. Information on the content of the credit rating as required by Paragraph (a)(1)(ii)(L) of Rule 17g-7:
Regarding the historical performance of the credit rating, our rating transition matrix is available in our Form NRSRO, exhibit 1. The expected probability of default and the expected loss in the event of default is listed on the first page of this report.

13. Information on the sensitivity of the credit rating to assumptions as required by Paragraph (a)(1)(ii)(M) of Rule 17g-7:
Below is a summary of the impact of the 5 assumptions which independently would have the greatest impact on our "ratio-implied rating":

	Assumptions			Resulting Ratio-Implied Rating		
	Base	Optimistic	Pessimistic	Base	Optimistic	Pessimistic
Taxes Growth%	1.4	5.4	(2.6)	B-	B-	B-
Social Contributions Growth %	2.0	(1.0)	5.0	B-	B-	B-
Other Revenue Growth %		(3.0)	3.0	B-	B-	B-
Total Revenue Growth%	1.4	0.1	3.4	B-	B-	B-
Monetary Gold and SDR's Growth %	-	(2.0)	2.0	B-	B-	B-

14. If the credit rating is assigned to an asset-backed security, a description of: (i) the representations, warranties, and enforcement mechanisms available to investors; and (ii) how they differ from the representations, warranties, and enforcement mechanisms in issuances of similar securities, as required by Paragraph (a)(1)(ii)(N) of Rule 17g-7:
This credit rating is not assigned to an asset-backed security.

ATTESTATION FORM

In compliance with the US Securities and Exchange Commission (SEC) Rule 17g-7(a), the Egan-Jones analyst who published the report is responsible for the rating action and to the best knowledge of the person:

1) No part of the credit rating was influenced by any other business activities,
2) The credit rating was based solely upon the merits of the obligor, security, or money market instrument being rated, and
3) The credit rating was an independent evaluation of the credit risk of the obligor, security, or money market instrument.

Analyst Signature: **Today's Date**

Mike Huang
………………………………………………………….. February 18, 2016
…………………………………………
Mike Huang
Rating Analyst

Reviewer Signature: **Today's Date**

Caroline Ding
……………………………………………………….. February 18, 2016
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Caroline Ding
Rating Analyst

Sovereign Rating Methodology (Non-NRSRO)

Scope and Limitations: Sovereign Issuer Credit Quality Ratings (CQR) are a forward- looking assessment of a sovereign's capacity and willingness to honor its existing and future obligations in full and on time. Sovereigns are assigned two CQRs: a Local-Currency CQR, which reflects the likelihood of default on debt issued and payable in the currency of the sovereign, and a Foreign-Currency CQR, which is an assessment of the credit risk associated with debt issued and payable in foreign currencies.

Key Rating Drivers: EJR's approach to sovereign risk analysis is a synthesis of quantitative and qualitative judgments. The quantitative factors EJR uses are:

- Debt in relation to GDP.
- Surplus or deficit in relation to GDP.
- Debt plus potential under-funding of major banks in relation to GDP.
- Interest expense in relation to taxes.
- GDP growth.
- Foreign reserves in relation to debt.

Debt levels for many sovereign issuers have increased at an accelerating rate over the past decade, affecting implied ratings. EJR also considers unemployment levels and funding costs. EJR recognizes that no model can fully capture all the relevant influences on sovereign creditworthiness, meaning that the its sovereign ratings can and do differ from those implied by the rating model. Some of the qualitative factors that impact its ultimate assessment of credit quality include the flexibility, stability and overall strength of the economy, efficiency of tax collection, acceptance of contract law, ease of doing business, trade balances, prospects for future growth and health and monetary policy, and economic freedom. These subjective and dynamic qualitative issues are not captured by the model but affect sovereign ratings

For additional information, please see Exhibit 2: Methodologies in EJR's Form NRSRO.