REPUBLIC OF ITALY

Rating Analysis - 6/19/17

*EJR Sen Rating(Curr/Prj) CCC+/ NR
*EJR CP Rating: C

Fragile recovery - Italy has improved its nominal GDP growth rate from -1.48% in 2012 to 1.64% in 2016. However, its debt-to-GDP ratio rose from 136.2% to 156.4%, as a result of continued deficits and tepid GDP growth. The deficit-to-GDP ratio remained high at 2.94%.

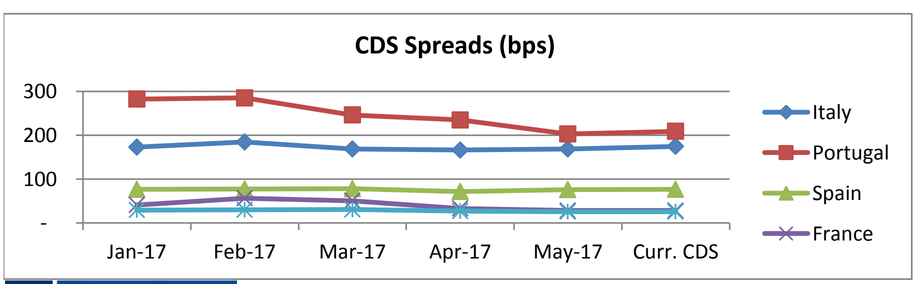
Italy's economy relies heavily on tourism and trading within the EU zone, and therefore it is likely to be hurt by the EU's slow recovery. In 2016, the prime minister Matteo Renzi was replaced by Paolo Gentiloni; the new government was formed but remains vulnerable. After France's election, Italy has become the greatest source of uncertainty in the EU. This together with Italy's reliance on the European market makes Italy's economy fragile. Another major concern is Italy's weak bank industry. The average non-performing loan ratio of Italian banks remained high at 18% in 2015 and did not improve much during 2016. More banks are likely to seek support after the bailout of Banca Monte dei Paschi. The unhealthy banking sector will restrain Italy's economy recovery. We are affirming the rating of "CCC+".

Annual Ratios (source for past results: IMF)

CREDIT POSITION	2014	2015	2016	P2017	P2018	P2019
Debt/ GDP (%)	156.0	157.5	156.4	156.9	157.6	158.1
Govt. Sur/Def to GDP (%)	-3.5	-3.1	-2.9	-3.1	-3.4	-3.4
Adjusted Debt/GDP (%)	156.0	157.5	156.4	156.9	157.6	158.1
Interest Expense/ Taxes (%)	15.2	13.8	13.4	13.6	13.8	14.0
GDP Growth (%)	1.1	1.5	1.6	2.3	2.3	2.5
Foreign Reserves/Debt (%)	1.1	1.2	1.2	1.2	1.1	1.1
Implied Sen. Rating	B	B	B	B	B	B

INDICATIVE CREDIT RATIOS	AA	A	BBB	BB	B	CCC
Debt/ GDP (%)	100.0	115.0	130.0	145.0	170.0	200.0
Govt. Sur/Def to GDP (%)	2.5	0.5	-2.0	-5.0	-8.0	-10.0
Adjusted Debt/GDP (%)	95.0	110.0	125.0	140.0	160.0	190.0
Interest Expense/ Taxes (%)	9.0	12.0	15.0	22.0	26.0	35.0
GDP Growth (%)	3.5	3.0	2.0	1.0	-1.0	-5.0
Foreign Reserves/Debt (%)	3.0	2.5	2.0	1.5	1.0	0.5

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	76.5	0.6	76.5	5.9	3.3	AA-
French Republic	AA	123.5	-3.2	123.5	6.5	1.9	BBB-
United Kingdom	AA	123.2	-2.1	123.2	9.0	4.1	A
Portugal Republic	BB+	146.5	-3.3	146.5	16.9	3.0	BBB
Kingdom Of Spain	BBB	117.2	-5.0	117.2	12.7	3.6	A+

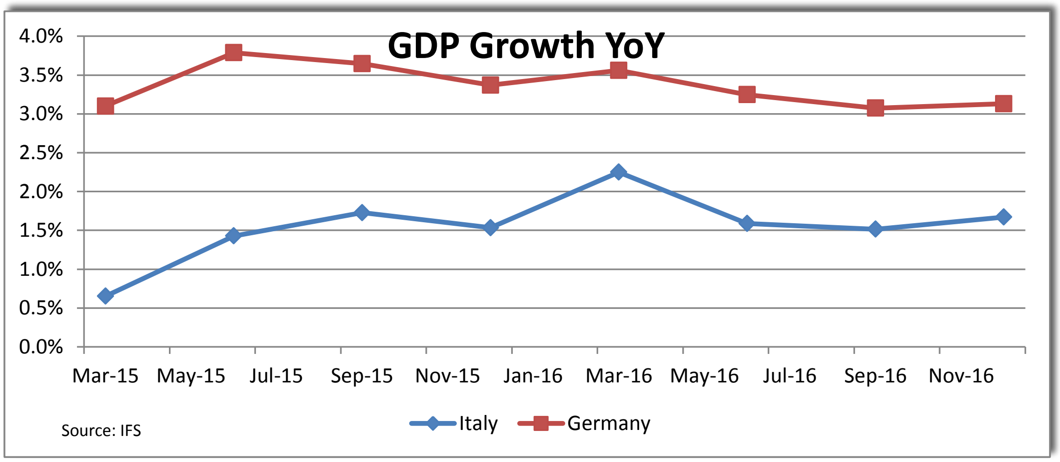


Country	CDS
Italy	175
Portugal	209
Spain	77
France	28
UK	26

Economic Growth

Italy has been experiencing continued slow growth since 2013. The growth rate was around 1.5% over the last 2 years according to IMF, which was much lower than Germany's growth of approximately 3.0%.

A large portion of Italy's economy is geared to tourism and light manufacturing industries, and more than 63.8% of its import and export trading is within Europe, making the economy vulnerable from its possible exit from EU. Also, Italy's GDP growth is likely to be depressed by its high debt-to-GDP ratio, fiscal deficits and the support of its banks. Watch for Italy's uncertain political environment and future bank bailout.



Fiscal Policy

From FYE 2010 through 2016, Italy's total sovereign revenues rose by 7.7%, while expenses including interest increased by 5.2%. The deficit to GDP of 2.94% for 2016 is not comforting, especially with a debt-to-GDP ratio of 156.4% (using the market value of debt), which is at the highest level compared to its peer countries. Another major concern is the need of support for Italian banks. Italy's attempts to implement austerity measures and provide real bank relief are likely to fall short. Watch the value of the euro.

	Surplus-to-GDP (%)	Debt-to-GDP (%)	5 Yr. CDS Spreads
Italy	-2.94	156.39	174.72
Germany	0.65	76.47	16.07
France	-3.25	123.55	28.46
UK	-2.06	123.25	25.54
Portugal	-3.33	146.46	209.26
Spain	-4.99	117.22	76.84

Sources: Thomson Reuters and IFS

Unemployment

Italy's unemployment rate of 11.68% is higher than most of its peer countries in Europe. The weak level of employment will impede Italy's attempts to reduce the budget deficit. More importantly, high unemployment rates might strengthen the voice of leaving EU, and make the fragile political system more vulnerable. We expect Italy's unemployment to remain high over the next year.

Unemployment (%)

	2015	2016
Italy	11.89	11.68
Germany	4.60	4.10
France	10.40	10.06
UK	5.37	4.90
Portugal	12.43	11.05
Spain	22.10	19.60

Source: Intl. Finance Statistics

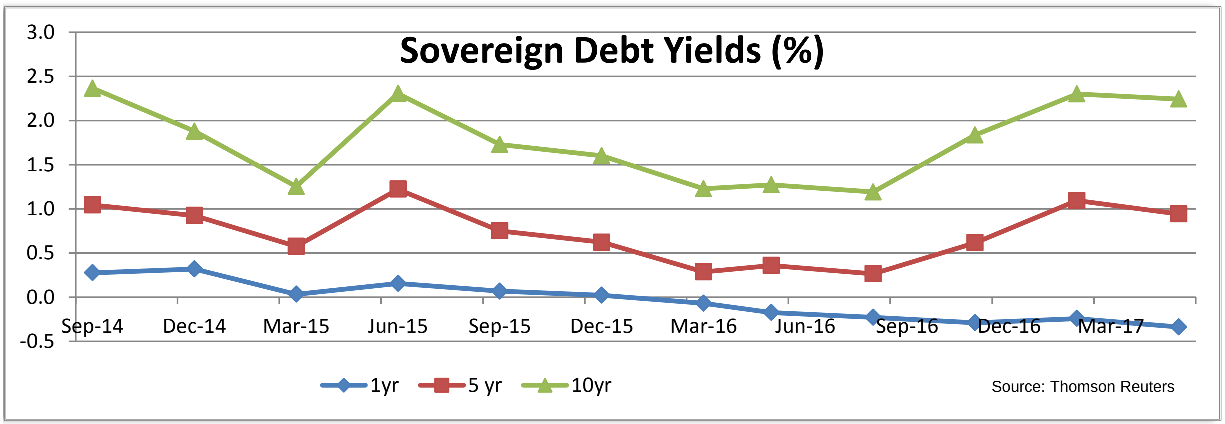
Banking Sector

Italy has significant exposure to its banking sector because of the large aggregate size and high non-performing loans. The top five banks have assets equal to 117.6% of GDP versus 80.8% for Germany. Banks in Italy don't have enough capital to absorb losses on bad loans. There will probably be more banks which need bailouts after Monte dei Paschi. Italy's ability to support its banks is limited.

Bank Assets (billions of local currency)	Assets	Mkt Cap/ Assets %
UniCredit SpA	859.53	3.98
Intesa Sanpaolo SpA	725.10	5.59
Banco Bpm SpA	117.41	3.54
Banca Monte dei Paschi	153.18	0.29
UBI Banca	112.38	2.90
Total	1,967.6	
EJR's est. of cap shortfall at 10% of assets less market cap		114.2
Italy's GDP		1,672.4

Funding Costs

Italy has seen a rise in its long-term funding costs over last year, while the short-term yield declined. The increased long-term yields can be explained by the increased inflation since the 4th quarter of 2016. Short-term yields have been suppressed by the ECB's support; the question is how long the support will last in the case of weak Italian banking system. Watch for future ECB actions and potential acquisition of Italian banks.



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 50 (1 is best, 189 worst) is above average.

The World Bank's Doing Business Survey*	2017 Rank	2016 Rank	Change in Rank
Overall Country Rank:	**50**	**45**	**-5**
Scores:			
Starting a Business	63	50	-13
Construction Permits	86	86	0
Getting Electricity	51	59	8
Registering Property	24	24	0
Getting Credit	101	97	-4
Protecting Investors	42	36	-6
Paying Taxes	126	137	11
Trading Across Borders	1	1	0
Enforcing Contracts	108	111	3
Resolving Insolvency	25	23	-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 62.5 for Economic Freedom with 100 being best.

Heritage Foundation 2017 Index of Economic Freedom
World Rank 62.5*

	2017 Rank**	2016 Rank	Change in Rank	World Avg.
Property Rights	74.6	50.0	24.6	52.2
Government Integrity	44.7	43.0	1.7	42.4
Judical Effectiveness	55.4	N/A	N/A	44.4
Tax Burden	54.9	55.8	-0.9	77.3
Gov't Spending	22.3	22.1	0.2	63.0
Fiscal Health	66.9	N/A	N/A	66.3
Business Freedom	69.8	70.3	-0.5	64.8
Labor Freedom	52.9	53.0	-0.1	59.4
Monetary Freedom	86.9	84.5	2.4	76.3
Trade Freedom	87.0	88.0	-1.0	75.9

*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

Credit Quality 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 0.8% per annum over the next couple of years and 1.0% per annum for the next couple of years thereafter.

Credit Quality Driver: Total Revenue Growth:
REPUBLIC OF ITALY's total revenue growth has been less than its peers and we assumed a 0.8% growth in total revenue over the next two years.

Income Statement	Peer Median	Issuer Avg.	Assumptions Yr 1&2	Assumptions Yr 3,4,5
Taxes Growth%	1.7	0.4	**0.8**	**1.0**
Social Contributions Growth %	3.9	1.1	**1.2**	**1.1**
Grant Revenue Growth %	0.0	NMF		
Other Revenue Growth %	0.0	NMF		
Other Operating Income Growth%	0.0	(2.2)		
Total Revenue Growth%	1.5	0.3	**0.8**	**0.3**
Compensation of Employees Growth%	2.7	1.3	**1.0**	**1.3**
Use of Goods & Services Growth%	1.4	1.1	**1.1**	**1.1**
Social Benefits Growth%	1.8	1.5	**1.5**	**1.5**
Subsidies Growth%	0.2	7.5	**2.0**	
Other Expenses Growth%	0.0			
Interest Expense	2.0	2.5	**2.5**	
Currency and Deposits (asset) Growth%	0.0	0.0		
Securities other than Shares LT (asset) Growth%	0.0	0.0		
Loans (asset) Growth%	0.5	(0.3)		**(0.3)**
Shares and Other Equity (asset) Growth%	2.2	6.3	**6.0**	**6.3**
Insurance Technical Reserves (asset) Growth%	(1.3)	3.1	**3.0**	**3.1**
Financial Derivatives (asset) Growth%	0.0	0.0		
Other Accounts Receivable LT Growth%	(1.7)	(2.3)	**(2.0)**	**(2.3)**
Monetary Gold and SDR's Growth %	0.0	0.0	**2.0**	**3.0**
Other Assets Growth%	0.0	0.0		
Other Accounts Payable Growth%	0.0			
Currency & Deposits (liability) Growth%	10.8	(2.0)	**0.5**	**0.5**
Securities Other than Shares (liability) Growth%	4.8	1.0	**0.7**	**0.7**
Loans (liability) Growth%	(1.7)	0.5	**0.5**	**0.5**
Insurance Technical Reserves (liability) Growth%	0.0	0.0		
Financial Derivatives (liability) Growth%	0.0	(5.6)	**(3.0)**	**(5.6)**
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 5.

ANNUAL REVENUE AND EXPENSE STATEMENT
(MILLIONS EUR)

	2013	2014	2015	2016	P2017	P2018
Taxes	484,887	488,245	494,056	495,848	499,815	503,813
Social Contributions	215,290	214,347	219,061	221,441	224,098	226,787
Grant Revenue						
Other Revenue						
Other Operating Income	71,913	73,887	72,822	71,213	71,213	71,213
Total Revenue	772,090	776,479	785,939	788,502	795,126	801,814
Compensation of Employees	164,784	163,468	161,997	164,084	165,725	167,382
Use of Goods & Services	89,580	88,890	90,092	91,066	92,022	92,988
Social Benefits	363,241	371,072	376,562	382,025	387,567	393,190
Subsidies	27,547	30,413	28,481	30,604	31,219	31,847
Other Expenses				59,536	59,536	59,536
Grant Expense						
Depreciation	44,428	44,457	44,345	44,108	44,990	45,890
Total Expenses excluding interest	746,776	758,119	769,034	771,423	781,060	790,833
Operating Surplus/Shortfall	25,314	18,360	16,905	17,079	14,066	10,981
Interest Expense	77,606	74,377	68,066	66,272	67,951	69,673
Net Operating Balance	-52,294	-56,016	-51,161	-49,193	-53,885	-58,692

ANNUAL BALANCE SHEETS

Below are REPUBLIC OF ITALY's balance sheets with the projected years based on the assumptions listed on page 5.

ANNUAL BALANCE SHEETS
(MILLIONS EUR)

Base Case

ASSETS	2013	2014	2015	2016	P2017	P2018
Currency and Deposits (asset)				86,433	86,433	86,433
Securities other than Shares LT (asset)						
Loans (asset)	94,680	96,440	94,284	93,996	93,996	93,996
Shares and Other Equity (asset)	124,986	125,242	130,082	138,252	146,547	155,340
Insurance Technical Reserves (asset)	1,323	1,308	1,278	1,318	1,358	1,398
Financial Derivatives (asset)						
Other Accounts Receivable LT	111,628	116,722	115,005	112,370	110,123	107,920
Monetary Gold and SDR's						
Other Assets					28,699	28,699
Additional Assets	103,151	113,501	104,075	28,699		
Total Financial Assets	435,768	453,213	444,724	461,068	467,155	473,786

LIABILITIES	2013	2014	2015	2016	P2017	P2018
Other Accounts Payable						
Currency & Deposits (liability)	219,932	234,667	239,722	234,828	234,828	234,828
Securities Other than Shares (liability)	1,819,914	2,037,504	2,097,250	2,118,730	2,133,920	2,149,219
Loans (liability)	184,026	177,239	177,240	178,065	231,950	290,642
Insurance Technical Reserves (liability)						
Financial Derivatives (liability)	28,752	40,522	31,899	30,110	29,207	28,330
Other Liabilities	81,683	79,992	78,048	83,909	83,909	83,909
Liabilities	2,334,307	2,569,924	2,624,159	2,645,642	2,705,614	2,770,937
Net Financial Worth	-1,898,539	-2,116,711	-2,179,435	-2,184,574	-2,238,459	-2,297,151
Total Liabilities & Equity	435,768	453,213	444,724	461,068	467,155	473,786

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

The industry has recovered over the past couple of years and we have adjusted the ratios to reflect the improvement. Nonetheless, we prefer to smooth the results so if the business conditions deteriorate, the industry ratios can be adjusted at a more measured pace.

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%	0.8	4.8	(3.2)	B	B	B
Social Contributions Growth %	1.2	4.2	(1.8)	B	B	B
Other Revenue Growth %		3.0	(3.0)	B	B	B
Total Revenue Growth%	0.8	2.8	(1.2)	B	B	B
Monetary Gold and SDR's Growth %	2.0	4.0	-	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:

Mike Huang

…………………………………………………………..
Mike Huang
Rating Analyst

Today's Date

June 19, 2017
………………………………………….

Reviewer Signature:

Caroline Ding

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Caroline Ding
Rating Analyst

Today's Date

June 19, 2017
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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.