REPUBLIC OF ITALY

Rating Analysis - 8/27/13
Debt: EUR1,988.7B

*EJR Sen Rating(Curr/Prj) CCC+/ C
*EJR CP Rating: C
EJR's 5 yr. Default Probability: 35.0%

More troubles - from 2007 to 2011 Italy's debt to GDP rose from 107% to 126% and with an annual deficit (as a percentage of GDP) near 3.0%, we expect debt to GDP to exceed 132% by the end of 2013. From 2007 to 2011, debt rose 12.4% while during the same period GDP rose only .3%. Italy will probably have to provide additional support to its banks and will see more pressure on its economy. The 11.9% reported unemployment is a major drag on growth. Italy's independent ability to support its banks is questionable given the country's and banks' weak condition; the travails of Monti dei Paschi and Unicredit exacerbates credit pressures on Italy. With turmoil in the federal government, uncertainty has increased.

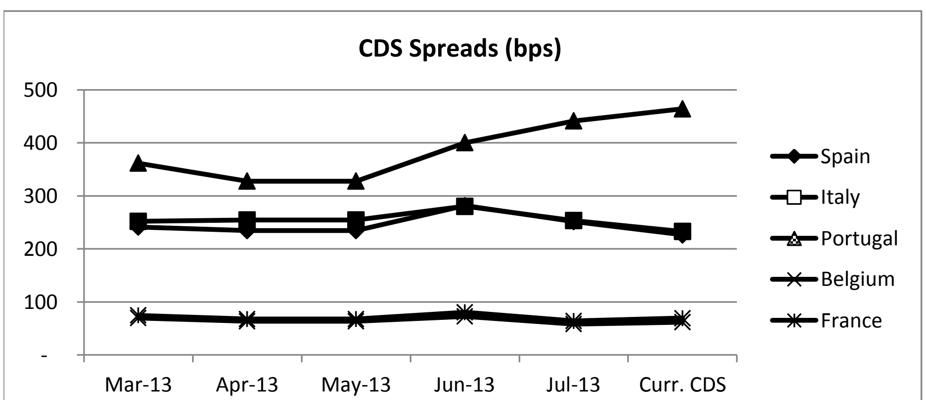
The Republic of Italy needs to rollover approximately EUR135B in 2013 and EUR266B next year and is likely to experience increasing yields and restricted access without external intervention. Yields on the 10 year bonds are near 4.5%; rates would be greater without ECB support. Future intervention by the ECB and IMF will provide some liquidity but might subordinate existing creditors. Italy cannot support all of its debt if the EU economy falters. Debt/GDP will continue to rise and the country will remain pressed. The real test will probably come after the German elections. We are affirming at "CCC+", with a neg. watch.

Annual Ratios (source for past results: IMF)

CREDIT POSITION	2009	2010	2011	P2012	P2013	P2014
Debt/ GDP (%)	121.9	123.0	125.9	130.1	134.7	139.6
Govt. Sur/Def to GDP (%)	-4.5	-3.8	-3.0	-4.9	-5.2	-5.6
Adjusted Debt/GDP (%)	121.9	134.0	136.7	141.2	146.0	151.1
Interest Expense/ Taxes (%)	15.8	15.5	16.8	19.5	19.5	20.3
GDP Growth (%)	2.0	-0.5	-2.8	-2.0	-2.0	-1.8
Foreign Reserves/Debt (%)	1.3	1.4	1.3	1.3	1.3	1.3
Implied Sen. Rating	B-	B-	B-	CCC+	CCC+	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	S&P 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	83.7	0.2	93.3	11.1	0.3	BB+
French Republic	AA+	91.9	-4.8	115.2	9.7	-0.3	B
Kingdom Of Belgium	AA	105.9	-3.9	105.9	11.9	-0.5	BB
Kingdom Of Spain	BBB-	82.3	-10.6	95.0	12.3	-1.9	BB
Portugal Republic	BB	118.5	-6.4	127.3	13.0	-3.8	B+



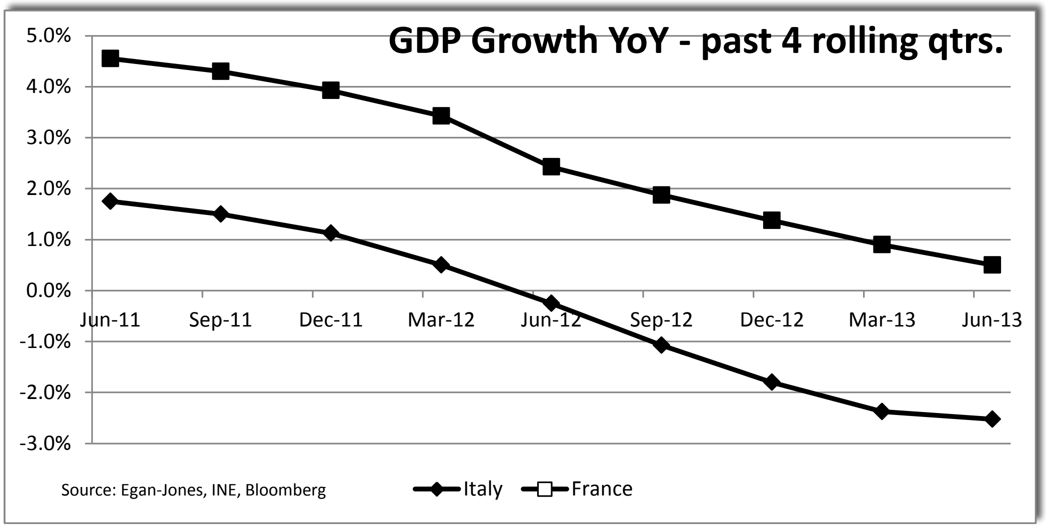
Country (EJR Rtg*)	Current CDS	Targeted CDS
Spain (C)	227	5,000
Italy (C)	233	5,000
Portugal (CCC+)	464	1,500
Belgium (BBB-)	62	400
France (BBB)	69	300

* Projected Rating
* EJR's targeted CDS based on rating

Economic Growth

No growth - Italy was hobbled by the global financial crisis of 2007 and did not show signs of a recovery until Sept. of 2010. The country is currently in a recession with economic contraction over the last couple of quarters. For the March 2013 quarter, Italy's GDP declined .8% according to ISTAT.

As can be seen from the below chart, the Italy's rolling four quarter GDP growth has been negative; Italy is currently shrinking while Germany has recorded growth near 1%. A large portion of Italy's economy is geared to the tourism and light manufacturing industries. The continued weakness in the EU limit's growth in the economy. (Note, the high debt to GDP further depresses growth.)



Fiscal Policy

Italy's deficit to GDP of 3.0% is not comforting and is likely to grow over the next couple of years. From FYE 2008 through 2011, total sovereign revenues rose .7% while expenses excluding interest rose 5.2% 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, none of the listed countries have a worse Debt to GDP than the Italy. Italy's attempts to implement austerity measures and provide real bank relief are likely to fall short and will increase debt.

	Deficit-to-GDP (%)	Debt-to-GDP (%)	5 Yr. CDS Spreads
Italy	3.0	125.9	254
Germany	(0.2)	83.7	27
France	4.8	91.9	64
Belgium	3.9	105.9	58
Spain	10.6	82.3	252
Portugal	6.4	118.5	441

Sources: Bloomberg and IFS

Unemployment

The Italy's unemployment rate of 11.4% is higher than Germany's and Belgium's as indicated in the chart at right. Furthermore, as of the March 2013 quarter, the rate rose to 11.92%. 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 (%)	2011	2012
Italy	9.3	11.4
Germany	6.8	6.9
France	9.8	10.5
Belgium	7.1	8.1
Spain	22.9	26.0
Portugal	14.0	16.9

Source: Intl. Finance Statistics

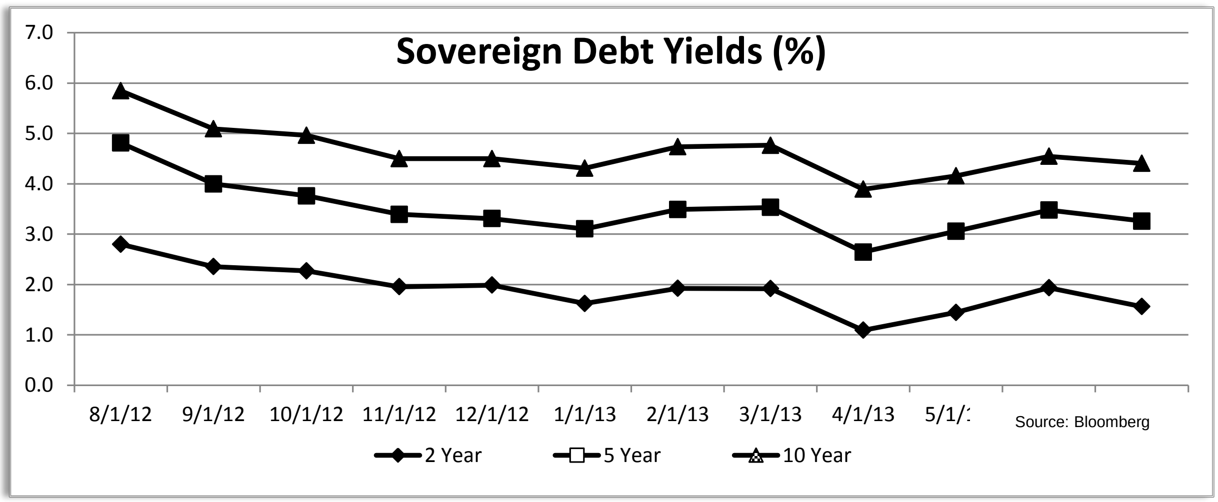
Banking Sector

Italy has significantly exposure to its banking because the bank's large aggregate size measured in assets The top five banks have assets equal to 132% of GDP versus 125% for Germany. Italy will probably be expected to provide financial support to its banks over the next couple of quarters to ameliorate asset quality problems; banks appear to be undercapitalized and equity is severely diluted by reserve shortfalls. However, Italy's ability to support its banks is minimal.

Bank Assets (billions of local currency)	Assets	Cap/ Assets %
UNICREDIT SPA	927	7.2
INTESA SANPAOLO	673	7.5
BANCA MONTE DEI	219	2.9
BANCO POPOLARE S	132	6.8
UBI BANCA SCPA	132	8.0
Total	2,084	
EJR's est. of cap shortfall at 10% of assets less market cap		171
Italy's GDP		1,579

Funding Costs

As a result of concerns about a reduction in the level of central bank easing and a weakening of Italy's credit metrics, Italy has seen a slight rise in its funding costs over the past couple of months. As can be seen in the below graph, the bond yields have declined since Aug. 2012, but have risen recently. Other EU governments have requested that the ECB, EFSF, and IMF purchase the government's debt. Watch 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 65.8 (1 is best, 183 worst) is strong.

The World Bank's Doing Business Survey*	2012 Rank	2011 Rank	Change in Rank
Overall Country Rank:	**65.8**	**65**	**-0.8**
Scores:			
Starting a Business	84	76	-8
Construction Permits	103	100	-3
Getting Electricity	107	109	2
Registering Property	39	47	8
Getting Credit	104	97	-7
Protecting Investors	49	46	-3
Paying Taxes	131	133	2
Trading Across Borders	55	59	4
Enforcing Contracts	160	160	0
Resolving Insolvency	31	32	1

* Based on a scale of 1 to 183 with 1 being the highest ranking.

Economic Freedom

As can be seen below, Italy is above average in its overall rank of 58.8 for Economic Freedom with 100 being best.

Heritage Foundation 2012 Index of Economic Freedom
World Rank 59*

	Rank**	2011 Rank	Change in Rank	World Avg.
Business Freedom	**77.4**	77.3	0.1	64.3
Trade Freedom	**87.1**	87.6	-0.5	74.8
Fiscal Freedom	**55.0**	55.4	-0.4	76.3
Government Spending	**19.4**	28.6	-9.2	63.9
Monetary Freedom	**82.0**	82.1	-0.1	73.4
Investment Freedom	**75.0**	75.0	0.0	50.2
Financial Freedom	**60.0**	60.0	0.0	48.5
Property Rights	**50.0**	50.0	0.0	43.5
Freedom from Corruption	**39.0**	43.0	-4.0	40.5
Labor Freedom	**43.0**	44.4	-1.4	61.5

*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 & Wall Street Journal

Assumptions for Projections

Income Statement	Peer Median	Issuer Average	Base Case Yr 1&2	Base Case Yr 3,4,5
Taxes Growth%	6.9	1.7	**1.0**	**1.0**
Social Contributions Growth %	2.4	1.7	**1.0**	**1.0**
Grant Revenue Growth %	0.0	NMF		
Other Revenue Growth %	9.9	5.7	**1.0**	**1.0**
Other Operating Income Growth%	0.0	0.0		
Total Revenue Growth%	5.9	2.0	**1.0**	**0.9**
Compensation of Employees Growth%	0.0	(1.6)	**1.0**	**1.0**
Use of Goods & Services Growth%	1.8	1.2	**1.2**	**1.2**
Social Benefits Growth%	2.4	1.4	**1.4**	**1.4**
Subsidies Growth%	(6.1)	(5.5)		
Other Expenses Growth%	1.0	1.0	**1.0**	**1.0**
Interest Expense	0.0	3.8	**4.5**	
GDP Growth%			**(2.0)**	**(1.8)**
Currency and Deposits (asset) Growth%	12.5	0.0		
Securities other than Shares LT (asset) Growth%	(2.2)	13.0	**1.2**	**1.2**
Loans (asset) Growth%	30.1	9.1	**1.0**	**1.0**
Shares and Other Equity (asset) Growth%	(0.8)	(3.4)	**2.0**	**2.0**
Insurance Technical Reserves (asset) Growth%	2.8	2.2	**2.2**	**2.2**
Financial Derivatives (asset) Growth%	0.0	0.0		
Other Accounts Receivable LT Growth%	7.3	1.5	**1.0**	**1.0**
Monetary Gold and SDR's Growth %	0.0	0.0	**5.0**	**5.0**
Other Assets Growth%	0.0	0.0		
Other Accounts Payable Growth%	0.0			
Currency & Deposits (liability) Growth%	6.0	(2.8)	**0.5**	**0.5**
Securities Other than Shares (liability) Growth%	8.5	(5.0)	**(3.5)**	**(3.5)**
Loans (liability) Growth%	5.7	3.9	**3.9**	**3.9**
Insurance Technical Reserves (liability) Growth%	0.0	0.0		
Financial Derivatives (liability) Growth%	0.0	16.5	**1.3**	**1.3**
Addl debt. (1st Year) million EUR	0.0	0.0		

Base Case

ANNUAL REVENUE AND EXPENSE STATEMENT (MILLIONS EUR)

	Dec-09	Dec-10	Dec-11	PDec-12	PDec-13	PDec-14
Taxes	440,654	447,456	454,987	459,537	464,132	468,773
Social Contributions	212,555	213,401	216,963	219,133	221,324	223,537
Grant Revenue	0	0	0	0	0	0
Other Revenue	52,715	53,839	56,886	57,455	58,029	58,610
Other Operating Income	0	0	0	0	0	0
Total Revenue	705,924	714,696	728,836	736,124	743,486	750,920
Compensation of Employees	171,050	172,002	169,209	170,901	172,610	174,336
Use of Goods & Services	89,676	90,177	91,222	92,279	93,348	94,430
Social Benefits	336,211	343,967	348,919	353,942	359,038	364,207
Subsidies	16,743	17,412	16,461	16,463	16,464	16,466
Other Expenses	66,488	56,733	57,297	57,867	58,442	59,023
Grant Expense	0	0	0	0	0	0
Depreciation	30,118	31,346	31,234	31,234	31,234	31,234
Total Expenses excluding interest	710,286	711,637	714,342	722,686	731,137	739,696
Operating Surplus/Shortfall	-4,362	3,059	14,494	13,439	12,349	11,224
Interest Expense	69,697	69,206	76,493	89,490	90,623	95,154
Net Operating Balance	-74,059	-66,147	-61,999	-76,051	-78,274	-83,930

Sources: Historical - IMF, Projections - EJR

Base Case

ANNUAL BALANCE SHEETS (MILLIONS EUR)

ASSETS	Dec-09	Dec-10	Dec-11	PDec-12	PDec-13	PDec-14
Currency and Deposits (asset)						
Securities other than Shares LT (asset)	18,298	21,027	23,753	24,038	24,326	24,618
Loans (asset)	54,932	58,346	63,683	64,320	64,963	65,613
Shares and Other Equity (asset)	130,593	123,479	119,284	121,670	124,103	126,585
Insurance Technical Reserves (asset)	1,513	1,450	1,482	1,515	1,548	1,582
Other Accounts Receivable LT	98,998	98,496	100,001	101,001	102,011	103,031
Monetary Gold and SDR's						
Additional Assets	81,049	92,377	73,446			
Total Financial Assets	385,383	395,175	381,649	385,989	390,398	394,876
LIABILITIES						
Other Accounts Payable						
Currency & Deposits (liability)	220,741	221,804	215,635	215,635	215,635	215,635
Securities Other than Shares (liability)	1,526,586	1,542,983	1,466,528	1,415,661	1,366,559	1,319,160
Loans (liability)	148,335	151,327	157,212	233,263	311,537	395,467
Insurance Technical Reserves (liability)						
Financial Derivatives (liability)	2,291	3,342	3,892	3,943	3,994	4,046
Other Liabilities	79,383	80,189	83,488	138,644	138,644	138,644
Liabilities	1,977,336	1,999,645	1,926,755	2,007,146	2,089,829	2,178,237
Net Financial Worth	(1,591,953)	(1,604,470)	(1,545,106)	(1,621,157)	(1,699,431)	(1,783,361)
Total Liabilities & Equity	385,383	395,175	381,649	385,989	390,398	394,876

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.