



Republic of Italy L-T Rating Cut To 'A+' From 'AA-' On Poor Fiscal Prospects; Outlook Stable

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LONDON (Standard & Poor's) Oct. 19, 2006--Standard & Poor's Ratings Services said today it lowered its long-term sovereign credit rating on the Republic of Italy to 'A+' from 'AA-', on poor prospects for a sustained fiscal consolidation program. At the same time, the 'A-1+' short-term sovereign credit rating on Italy was affirmed. The outlook is stable.

A commentary titled "Italy's 2007 Budget: The Door Closes On Another Consolidation Opportunity," will be published later today on RatingsDirect, the real-time Web-based source for Standard & Poor's credit ratings, research, and risk analysis. An updated full analysis report on the Republic of Italy, including an up-to-date forecast of fiscal and economic data through 2010, will also be published later today on RatingsDirect.

Standard & Poor's will hold a teleconference on Thursday, Oct. 19, 2006, to discuss the rating action. The call will begin at:

--2:00p.m. British Summer Time;
--3:00p.m. Central European Summer Time; and
--9:00a.m. Eastern U.S. Time.

See section "Teleconference Information" toward the end of the text for access details.

"The downgrade reflects the new government's inadequate response to Italy's structural economic and fiscal challenges," said Standard & Poor's credit analyst Moritz Kraemer. "The budget bill does little to drive forward on meaningful supply-side reforms, and will actually lead to net increases in spending as a share of GDP, instead of curtailing high current expenditure, which is the root cause of Italy's fiscal imbalance."

The targeted reduction of the deficit to 2.8% of GDP in 2007 (from 3.6% in 2006, net of one-off items) is to be achieved through tax increases. In practice, the budget outturn in 2007 is unlikely to come in below 3% of GDP, as certain of the proposed measures may be optimistic, namely the assumed success in rolling back tax evasion and the savings that can be generated by making the civil service more efficient.

More important than the expected mild slippage on fiscal targets in 2007 is the fact that the budget may have undermined the prospects for meaningful reform aimed at curtailing current expenditure in the areas of pensions, health care, public administration, and fiscal federalism. The upfront tax-and-spend concessions to the reform-skeptical members of the center-left coalition have effectively reduced the bargaining power of the modernizers in the cabinet.

In this context, the prospects for structural measures needed to ensure the resumption of a clear, significant, and sustainable downward trend of the government debt-to-GDP ratio, which Standard & Poor's had repeatedly indicated would be essential to avoid a lowering of the rating, have receded. As a consequence, Standard & Poor's assumes that the primary balance will recover from the current low level (less than 1% of GDP in 2005 and 2006), but is unlikely to significantly surpass 2% during the rest of the current decade.

Consequently, the debt ratio will hardly decline at all, to reach 105.7% of GDP by 2010 (compared with the government's 100.7% target), from 107.6% in

2006. In the light of Italy's low potential GDP growth rate (1.3% per year) and the onset of spending pressures in the next decade associated with a rapidly aging society, the implied slight improvement in the debt ratio is insufficient to sustain Italy in the 'AA' rating category.

"If the debt ratio were to rise significantly from current levels, the long- and short-term ratings would come under renewed downward pressure," said Mr. Kraemer. "Conversely, the rating could be raised if structural measures were implemented that would ensure the resumption of an unambiguous, significant, and sustainable downward trend of the government debt ratio."

TELECONFERENCE INFORMATION

Standard & Poor's will hold a teleconference on Thursday, Oct. 19, 2006, to discuss the above rating action. The call will begin at:

- 2.00p.m. British Summer Time;
- 3.00p.m. Central European Time; and
- 9.00a.m. Eastern Time.

The call will feature a presentation by Standard & Poor's sovereign credit analyst Moritz Kraemer. International public finance credit analyst Myriam Fernandez de Heredia will also be in attendance. Participants will have the opportunity to put questions to any member of the panel following the presentation.

To participate in the call, please dial:

- Europe dial-in number: (44) 20-7019-0812, conference passcode: STANDARD; leader ID: Alice Downer
- Italy dial-in number: (39) 02-3600-0326, conference passcode: STANDARD; leader ID: Alice Downer
- U.S. dial-in number: (1) 210-795-0472, conference passcode: STANDARD; leader ID: Alice Downer

The title of the teleconference is "Standard & Poor's teleconference on the downgrade of Italy." The teleconference will begin promptly at the time indicated. Please dial in at least 15 minutes before the scheduled start to complete the pre-call registration process. If the number you dial is busy, please call one of the other numbers. There is no charge to participate other than long-distance telephone charges, if applicable. Participants will be asked to provide their name, company affiliation, and fax number or e-mail address. The entire call will last approximately 120 minutes.

Recorded replays of the call will also be made available about one hour after the call concludes, until Nov. 9, 2006. To listen to a replay of the call, please dial:

- International replay: (44) 20-7970-8420, access code: 101906

If you have any questions about the teleconference, please contact Client Support Europe at (44) 20-7176-7176 or via e-mail: ClientSupportEurope@standardandpoors.com

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