Rating Object	Rating Information	
ITALIAN REPUBLIC	Assigned Ratings/Outlook: **BBB- /positive**	Type: Monitoring, Unsolicited with participation
Long-term sovereign rating Foreign currency senior unsecured long-term debt Local currency senior unsecured long-term debt	Initial Rating Publication Date: Rating Renewal: Rating Methodologies:	28-10-2016 19-01-2024 "Sovereign Ratings" "Rating Criteria and Definitions"

Contents

Rating Action

Neuss, 19 January 2024

Creditreform Rating has revised its outlook on the Italian Republic to positive from stable and affirmed the unsolicited long-term sovereign rating of "BBB-" for the Italian Republic. Creditreform Rating has also affirmed Italy's unsolicited ratings for foreign and local currency senior unsecured long-term debt of "BBB-".

The outlook revision on the Italian Republic reflects

(i) our firming expectation of strengthening resilience against economic shocks and a more constructive medium-term growth outlook on the back of the recent acceleration in RRP disbursements after some delays and significant progress in terms of diversification of energy import sources;

(ii) our perception of a relatively stable political constellation at present, including the parliamentary majority of the government, which we assume to be conducive to fiscal planning and further reform implementation; and

(iii) based on the above and amid increasing resilience of the banking sector strengthening confidence regarding a more benign debt trend beyond the short term, notwithstanding the current dilution stemming from accounting changes and despite weakening debt affordability

Key Rating Drivers

1. Large, wealthy and diversified economy; following a likely significant slowdown of GDP growth in 2023, headwinds posed by the monetary policy cycle and high inflation should ease in 2024, also reducing downside risks from a weak international environment to some extent, while tourism should remain a supportive pillar; the economic growth rate should increase more notably in 2025
2. The medium-term growth outlook remains largely constructive; progressing implementation of the Recovery and Resilience Plan (RRP) should be conducive to improving long-standing challenges over the medium term, in particular low productivity, some structural challenges on the labor market and a partly complex business environment; sub-national level execution of the RRP measures may have to be monitored
3. Generally strong institutional framework, notwithstanding room for improvement as suggested by the latest set of the World Bank's Worldwide Governance Indicators and a track

record of political volatility with frequent changes of government, partly weighing on effective policymaking; broad-based judicial reform is ongoing, and progress is being made in terms of improving procurement procedures

4. Fiscal risks remain the main credit-negative factor in our rating assessment; following marked declines since its pandemic peak in 2020, we expect an only gradual moderation of the debt-to-GDP ratio on a high level by 2025; the headline deficit which, also due to changes in accounting, was revised upward, should - in the short term - decrease more slowly than previously expected; over the medium-to-longer term, the annual spending reviews may benefit a higher degree of fiscal discipline in the absence of economic or geopolitical shocks, while steps to improve tax collection seem to be paying off, prospectively strengthening the revenue base
5. While we continue to view risks associated with the relatively robust banking sector as contained, contingent liability risks linked to public guarantees remain elevated; with a view to unfavorable demographic developments, age-related costs continue to pose fiscal challenges; sound debt management remains a risk-mitigating factor
6. We deem external risks to be manageable; amid retreating energy prices, the current account balance has likely turned slightly positive again in 2023, having temporarily fallen into deficit; a moderate expected surplus this year and next would also support Italy's net international investment position, which has turned into a moderate net creditor position over the last few years

Reasons for the Rating Decision and Latest Developments[1]

Macroeconomic Performance

Italy's macroeconomic profile is buttressed by the large size of its economy, high level of wealth and a healthy degree of diversification. Comparatively moderate levels of private indebtedness, and a high net wealth of private households, provide for some shock-absorbing capacities. Given a track record of low productivity and structural challenges on the labor market, as well as a partly complex business environment, the significance of effective and timely execution of the RRP-related measures on all government levels is underscored. The medium-term growth outlook is supported by constructive prospects for potential growth amid full implementation of the RRP reforms, with the absorption rate of the RRF funds remaining to be monitored.

Following the recovery from the pandemic, the Italian economy has weathered the adverse consequences of the war in Ukraine relatively well, bolstered partly by recovering tourism. Real GDP increased by 3.7% in 2022 (euro area: 3.4%), having exhibited an upward revised growth rate of 8.3% in 2021. Nevertheless, over the five-year period 2018-2022, the annual average expansion of Italy's real economic output could not match that of the euro area, posting at 0.9% compared to an average expansion of 1.3% in the euro area (EA) as a whole. We note that, as a result of a recent revision to the National Accounts (Sep-23), the level of Italy's nominal GDP was lifted by 1.9% for 2021 and by 2.0% for 2022.

---

[1] This rating update takes into account information available until 12 January 2024.

Italy's economy is the third-largest in the euro area and the tenth-largest globally (2022, IMF data), with a GDP per capita estimated to be at approx. USD 51,827 in 2022 (IMF data, PPP terms, current prices), which corresponds to an increase of 11.4% from the preceding year. With that, Italy's GDP per capita stood at 95% of the EU level in 2022, halting a widening gap observed over prior years.

Real GDP growth in 2022 was driven by domestic demand, in particular private consumption and investment, whereas net exports posed a drag on total output as the weaker international economic environment and higher energy prices took their toll. While the results for the final quarter 2023 are pending, annual GDP growth in 2023 was likely significantly slower than in 2022, hampered by high inflation rates and tighter financing conditions amid the aggressive monetary policy tightening cycle.

Over the quarters of 2023, Italy's economic output showed a marked degree of volatility. In Q3-23, GDP grew by only 0.1% q-o-q, following a decline by 0.4% in the second quarter and an increase by 0.6% q-o-q in Q1-23. An exceptional building renovation bonus introduced in 2020 ('superbonus') was scrapped in Q2-23, contributing to the dent in construction investment. Moreover, machinery and equipment saw a second consecutive decline in Q3-23. Sentiment indicators, as well as the Bank of Italy's Ita-coin indicator, indeed point to a weak Q4-23, with the service sector likely to have held up better than the manufacturing sector.

For the current year, we expect domestic demand to remain the main growth pillar. Private household expenditure should remain supported by the relatively resilient labor market and some fiscal support. That said, measures to alleviate the effect of higher energy prices on households are to be wound down in the course of the year. However, a cut in social security contributions is to bring some relief, alongside welfare measures for large families. Over the medium term, the envisaged reduction of the labor tax wedge may offer some relief as well. First steps towards this reform have been undertaken, and we will continue to monitor respective progress.

Retreating energy prices offer support to private consumption as well. While on average, Italy's HICP inflation rate came to 5.9% in 2023, in December 2023, the rate had fallen to 0.5% according to preliminary data (EA Nov-23: 2.4%), with the core rate (excluding energy, food, alcohol and tobacco) decreasing to 3.0% at the end of last year. The road ahead may turn out to be rocky in view of fading base effects and in the face of the geopolitical tensions, which pose risks of renewed energy price increases, but the average headline inflation should be significantly lower this year.

As regards Italy's labor market, the monthly unemployment rate has hovered around 7.6% lately (Nov-23: 7.5%, s.a.), having trended down over recent years, while remaining above the euro area level (EA Nov-23: 6.4%). Comparing employment growth over the four-year period to Q3-23 (vs. Q3-19), Italy's economy underperformed the euro area, and q-o-q increases in employment have slowed lately. Relatively weak performance regarding the European Commission's (EC) social scoreboard adds somewhat to remaining structural challenges on the labor market, although we note that improvement is underway. Similarly, Italy's labor participation remains one of the lowest in the EU. In this context, it seems worth recalling initiatives such as the national program for the guaranteed employability of workers (GOL), which aim to address remaining challenges.

Bearing in mind higher loan costs and banks' tightening credit standards, gross fixed capital formation looks set to remain hampered this year, in particular private investment. Expired construction incentives related to the scrapping of the superbonus will likely add to this. However, investment linked to the RRP should continue to provide impetus via public investment, following some implementation delays and modifications in the course of 2023, chiefly due to higher prices for energy and infrastructure, and partly compounded by a higher-than-expected take-up of the superbonus.

In December 2023, Italy's amended RRP, including a REPowerEU chapter, was greenlighted by the EC and the Council of the EU. The plan is now worth a total of EUR 194.4bn, with EUR 122.6bn via loans and EUR 71.8bn via grants to foster the green and digital transformation and pursue social inclusion in various forms. In Dec-23, the EC disbursed a fourth RRF payment (EUR 16.5bn) linked to 28 milestones and targets, among others covering public procurement and follow-up measures to the adopted justice and public employment reforms. In total, roughly EUR 101.9bn in grants and loans including pre-financing has now been paid out. Also, in Dec-23, Italy submitted a payment request for a fifth disbursement (EUR 10.6bn).

Likely fading headwinds to foreign demand from monetary policy amid moderating inflation rates should benefit exports in the course of the current year, while elevated geopolitical uncertainty and the associated economic reverberations pose some downside risks. Ultimately, we anticipate an only moderately positive growth contribution from net exports in 2024.

Overall, we expect GDP growth to have decreased to 0.7% in 2023 and to display an annual rate of 0.8% in 2024, on the back of a weak start into the year and some acceleration over the later course, which could lift GDP to roughly 1.2% in 2025 amid advancing implementation of the RRP. We are aware that the Parliamentary Budgetary Office (PBO), in a recent assessment (Dec-23), flagged some implementation challenges, pointing to a high number of small projects and some capacity constraints, partly alluding to regional disparities. Evidently, effective RRP implementation also hinges on effective implementation of secondary legislation and/or regulation, i.e. acts that define in more detail the methods of application of laws and respective execution, also on sub-national levels. Steps to improve administrative capacities in this respect are underway.

We continue to regard the medium-term growth outlook as backed by anticipated progress in terms of RRP execution, which should be conducive to raising low productivity growth, and ultimately potential growth, hence long-standing challenges weighing on Italy's economic performance. In terms of Italy's energy security, significant progress was made in terms of lowering the dependency on gas imports from the Russian Federation. From 40% in the period Jan-Oct-21, the respective import share was reduced to 5% in the period Jan-Oct-23, according to the Ministry of Finance (MoF, referring to Snam and MIMIT), with Algeria and Azerbaijan gaining in importance as gas suppliers.

According to estimates by the EC, Italy's potential growth could reach 0.8% and 0.9% this year and next, which would be well above the 10-year average of 0.1% in the period 2013-2022 (AMECO data). We would also expect some improvement to Italy's somewhat complex business environment, which entails some challenges for SMEs in particular. In the most recent IMD global competitiveness ranking, Italy retained its 41st rank out of 64 countries included, hinting at scope for improvement. A stronger impression of Italy's innovative capacities is underscored by its rank of 26 regarding the UN's Global Innovation Index (2023), which takes into account 132 countries.

Some room to catch up also remains with regard to basic digital skills, as suggested by the recent Digital Decade 2023 assessment (EC), which also points to below-EU-average performance in terms of provision of digital public services for citizens and businesses, whereas the assessments attests to a good performance in terms of digital infrastructure.

Looking at recent developments concerning its real unit labor costs, Italy's competitive stance deteriorated slightly against some of its main European trading partners, while a longer-term comparison remains by and large favorable. Overall, its global export market share, one of the highest among the EU countries, decreased to 2.41% in 2022 (Eurostat data), dragged down by a decreasing share in global goods exports (2022: 2.58%), partially compounded by challenges around supply chain disruptions and soaring energy costs. By contrast, the share in global service exports has increased further, but still remained below its pre-pandemic level (2022: 1.84%).

Institutional Structure

Italy features a generally strong institutional framework, including the benefits linked to EU/EMU membership, among them access to the single market and extensive EU-funding. The country's track record of frequent changes in government, and the associated political volatility, balance this to some extent. That said, the resulting center-right government following the September 2022 election commands a parliamentary majority in both chambers, potentially benefiting coherent policymaking and planning stability. The latest issue of the Worldwide Governance Indicators (WGIs) exhibited a slightly mixed performance on the part of Italy, overall continuing to hint at room to improve with regard to government effectiveness and the judicial system in the European context. While challenges remain, a broad-based judiciary reform is ongoing, and there has been tangible progress towards digitization, simplification and greater efficiency of public procurement procedures.

The four pillars which we consider key among the World Bank's WGIs showed slightly mixed developments in the latest annual set of indicators released in Sep-23 (reference year 2022), and continue to display room to improve when compared to the euro area median. Partly reflecting the abovementioned political volatility, 'government effectiveness' has tended to weaken since the middle of last decade, but improved by five places to rank 71 out of 213 countries in the most recent vintage (EA median: 43). Similarly, 'rule of law' has shown a weakening trend over recent years, but retained a stable rank 89 in the latest data set (EA median: 36). At the same time, we assess as positive continued improvements when it comes to 'control of corruption' (rank 67, EA median: 49). In terms of 'voice and accountability', hence the freedom of expression, of association, and a free media; Italy remains roughly in line with the euro area median (IT: rank 37, EA median 33).

While the justice system still displays some deficiencies by European comparison, these are being addressed by a broad-based reform approach aiming to reduce comparatively long procedural times and the backlog of cases, foster the digitalization of the system, and digitize and enhance enforcement processes concerning insolvency procedures. To reduce the abovementioned bottlenecks over the period 2024-2026, the government aims to finalize recruitment of temporary staff in 2024. Apart from these measures, the full effect of the reform of the High Council for the judiciary is currently being evaluated by the EC, which in its latest Rule of Law report (Jul-23) mentioned some remaining concerns as regards the potential impact on the independence of judges.

In a bid to further strengthen the institutional framework, a new public procurement code aimed at simplification and efficiency of procedures is being applied from Jul-23. Moreover, a new law on whistleblower protection entered into force from July 2023. Significant progress was also made in terms of digitization and enhancing the interconnection of registries, likely benefiting the work of police and prosecution services. Possibly somewhat more ambivalent, a framework law to implement differentiated levels of autonomy for regions, adopted by the government in Feb-23, could potentially increase regional disparities. Further to the political sphere, we will monitor developments around a recent proposal towards a constitutional reform and potential implications on the political system, including elections.

Turning to efforts regarding the green transformation, Italy's ecological innovation performance is considered to be above the EU level, measured by its eighth position among the 27 EU members in the EC's Eco-innovation index (base year 2022). In the same year, Italy's overall share of energy from renewable sources remained slightly below the EU average (19.0% vs. EU 23.0%, Eurostat data). Given the increasing frequency of hazardous weather events, new legislation will make insurance to cover damage caused by natural disasters mandatory for companies operating in Italy by the end of the year. According to data provided by the European Environment Agency, Italy ranks among the EU countries with the highest climate-related economic losses (euro per inhabitant), as measured by the thirty-year average.

Fiscal Sustainability

Risks to fiscal sustainability represent the key weakness of the sovereign's creditworthiness in our assessment, underpinned by the very high general government debt-to-GDP ratio and repeated fiscal slippages, partly compounded by recurrent phases of political volatility. The impression of a relatively stable political constellation currently, and the recent progress made on RRP implementation, generally inspire a higher degree of confidence in a downward trajectory of the public debt ratio beyond 2024. While uncertainty around the pace and extent of the anticipated decrease in debt-to-GDP remains high in light of currently envisaged spending measures, effects of the tax reform and weakening debt affordability, we assess significant progress made concerning tax compliance as positive. Sound debt management remains a risk-mitigating factor, and financial soundness metrics point towards increasing banking sector stability, with strengthening asset quality, capitalization, and profitability. We continue to pay close attention to the development of currently elevated public guarantees. Age-related costs remain set to add to fiscal pressures in the medium- to long-term.

Italy's headline deficit decreased from 8.8% of GDP in 2021 to 8.0% of GDP in 2022, still comparing unfavorably on a European scale (EA-20: -3.6% of GDP) and turning out much higher than we had estimated in our last review (-5.6%, Jan-23). However, these outturns have been affected by data revisions as set out by the Italian Statistical Office (Istat). More specifically, the general government accounts for 2019-2021 have been subject to adjustments following a change in the accounting treatment of tax credits.

Boosted by higher subsidies related to energy support measures, and by higher interest rate expenditure, total government expenditure ultimately increased by 6.4% in 2022, whereas general government revenue rose more sharply (8.0%) on the back of rising tax receipts and net social contributions. Focusing on 2023, notwithstanding a slower economic pace, cumulative monthly tax revenue grew by 4.4% y-o-y from Jan-Oct-23 to EUR 434.7bn (cash basis), with personal income tax revenues rising by a strong 8.2%, also reflecting broadly benign labor market developments.

The outcome for the headline balance in 2023 and 2024 will still be affected by energy support measures, partly covering extensions of existing measures and newly introduced measures such as a heating bonus benefitting all households, which applied from October to December 2023. Overall, the energy support package is estimated to come to 1.3% of GDP in 2023 (MoF), which would be less than half compared to what was registered in 2022 (2.8% of GDP). At the same time, a windfall tax on the profits of energy producers and suppliers should have brought some relief to last year's fiscal balance. The social bonuses aimed at vulnerable households, as well as other - minor - measures, have been extended until the first quarter of 2024, with the government aiming to phase out the cost-of-living measures completely by the end of this year.

Deficit-increasing tax measures coming with the 2024 budget law also include the suspension of the Plastic Tax and Sugar Tax until 30 June 2024, in a bid to support firms. Moreover, wages of public employees are to be raised further, with special attention given to health care workers. Net effects of the intended larger overhaul of the tax system with the aim of simplification and increasing its efficiency remain to be monitored. The tax reform is scheduled to be implemented within two years (2024-2026). The first two draft legislative decrees were approved by the cabinet in October 2023, covering reforms in personal income tax and international taxation. Key contents of the decrees include the adjustment of tax brackets for low- and middle-income individuals, a new definition regarding the tax residence of natural persons, as well as amendments to the regime for 'Impatriate' workers and the implementation of a global minimum tax.

While we expect Italy's headline deficit in 2023 to come in higher than previously envisaged, partly in light of revised estimates of tax credits for building renovations (superbonus), the take-up of which was higher than the government had expected, it should still continue to decrease y-o-y, to 5.5% of GDP in 2023. The decline should be supported by lower spending on energy measures and a lower outturn of interest expenditure compared to the preceding year, given lower payments related to inflation-linked bonds. Over Q1-23 to Q3-23, interest payments declined by 0.5% y-o-y (Istat data).

With the winding down of energy support measures, and aided by the expected pick-up of GDP growth later in the year, we believe that the headline deficit will narrow further to -4.4% in 2024 and -3.8% in 2025. To be sure, uncertainty around these estimates remains high, not least due to the challenging geopolitical environment and limited visibility regarding the effects of the envisaged tax reform. We also note that the government currently only targets a deficit reduction to below 3% of GDP from 2026, and a primary surplus from 2025, constituting some push-back compared with the Apr-23 Stability Program, partly on account of the abovementioned accounting changes and take-up of the tax credits.

That said, we assess measures established to further enhance tax compliance, including compulsory electronic invoicing and incentives to rely on electronic payments, as positive. According to the EU VAT gap report 2023, Italy's VAT gap as a percentage of the VTTL decreased sharply to 10.8% in 2021, but remained well above the EU reading of 5.3%. Expectations for the continuous shrinking of the VAT gap in 2022 and 2023 are generally positive, in light of additional measures implemented as part of the RRP. Moreover, the recent introduction of spending reviews could contribute to enhancing fiscal discipline going forward.

Following the pandemic-induced upward shift in its already high debt level, Italy's general government debt-to-GDP ratio declined from 147.1% of GDP in 2021 to 141.7% of GDP in 2022. Previously released debt ratio figures for 2021 and 2022 were revised downward as a consequence of the abovementioned revisions to the GDP. We estimate that the public debt ratio will have decreased to 139.9% of GDP in 2023 overall, thanks to still strong nominal GDP growth and the narrowing headline deficit. Assuming higher debt-servicing costs and fading inflationary effects, as well as some more pronounced stock-flow adjustments owing to the abovementioned changes in accounting, we expect the public debt ratio to be roughly stable over this year and next, at this stage penciling in a debt-to-GDP ratio of 140.0% of GDP for 2024 and 139.8% of GDP for 2025.

Contingent liability risks remain elevated, as underscored by an estimated take-up of public guarantees of 14.9% of GDP as of Jun-23 (MoF). Accounting for 7.2% of GDP, the largest part consists of the SMEs' Central Guarantee Fund, followed by the Guarantee for non-market risks in favor of SACE. The share of domestic general government debt securities held by Italian banks in terms of banks' total assets counts among the more pronounced ones among the EA members (9.3% in Nov-23, EA: 2.7%, ECB data), serving as a reminder of some risk related to a potentially negative bank-sovereign feedback loop in times of economic or financial stress.

Having significantly increased in the run-up to and the early phase of the ECB's aggressive tightening cycle, the yield on 10-year Italian government bonds moved within a relatively narrow range over much of 2023. With market speculation over prospective interest rate cuts becoming more prominent, the yield has started to trend down lately, standing at 3.73% as of 12-Jan-24 (weekly data). Similarly, the Bund spread has come down from a peak at 251bp in Oct-22 to 155bp as of 12-Jan-24.

Following the phase of sharp interest rate hikes, the ECB has kept its key policy rates unchanged starting from its Oct-23 monetary policy meeting, with generally downward trending inflation rates firming the impression that policy rates have reached their high and will be lowered in the course of the current year. We think that a first rate cut in the second half of 2024 remains a more likely scenario, not least given some expected inflation volatility over the next few months, although this shapes up to be a close call. At its meeting in Dec-23, the Governing Council expressed the intention to discontinue reinvestments under the PEPP at the end of 2024. Meanwhile, the decline of the APP portfolio, for which reinvestments were stopped from Jul-23, is proceeding according to plan. As of Oct-23, the share of Italian government bonds held by the central bank had edged down to 29.0% (Banca d'Italia, BdI data). We recall that in case of any perceived unwarranted market disturbances, the ECB's Transmission Protection Instrument (TPI) remains available, subject to conditions.

We continue to deem fiscal risks as partially mitigated by sound debt management and the relatively favorable debt profile. As of 31-Dec-23, government debt displayed an average maturity of 6.97 years, having been increased compared to the phase of the euro area debt crisis. That said, against the backdrop of rising debt issuance costs, debt affordability is set to weaken going forward.

Meanwhile, the profitability of banks has increased in the higher interest-rate environment, reinforcing the impression of a more solid Italian banking sector. Capitalization as measured by the CET1 ratio has been strengthened and is now slightly above the capital position of the EU overall, having climbed from 14.7% in Sep-22 to 16.2% in Sep-23 (EU Sep-23: 15.9%, EBA data). Given the amendments to an initial proposal of a windfall tax on banks' profits last year, banks have the option to create non-distributable reserves (at least 2.5 times the payable tax amount) instead of paying the extraordinary tax, which will likely strengthen the capital base further to some extent. In terms of asset quality, Italy's NPL ratio remains above the EU level (Sep-23: 2.4%

vs. EU 1.8%), but continued to improve y-o-y, thus narrowing the gap further. Return on assets rose to 1.1% in Sep-23 from 0.6% one year before.

Potential vulnerabilities of the Italian banking sector as regards exposure to Russia are closely monitored by the BdI and appear manageable at this stage. Banks' exposure to Russian counterparties amounted to EUR 11.6bn as of Jun-23, corresponding to about 0.3% of total assets in the banking sector (Jun-23) or roughly 0.6% of GDP, having declined by 13.2% compared to Dec-22 (BdI). With a view to macroprudential levers, the Bank of Italy decided to keep the countercyclical capital buffer (CCyB) unchanged at 0% in the first quarter of 2024. Any risks related to the housing market and associated price developments seem limited.

By contrast, unfavorable demographic changes and the anticipated increase in age-related costs are likely to weigh on the sustainability of public finances in the medium to long term. In the current year, pension costs are set to rise markedly due to indexation to the relatively high 2023 inflation rate. While awaiting the updated estimates of age-related costs amid the EU Ageing Report due this spring, we would highlight recent projections presented by Istat, according to which the ratio of working-age to non-working age individuals could reach about one to one in 2050, compared to three to two in 2022.

Foreign Exposure

External risks continue to appear manageable. Following the deterioration in the current account balance led by high energy prices in 2022, more recent developments point towards an improving trend as energy prices have decreased and tourism continues to recover. Diversification of energy imports away from the Russian Federation has progressed significantly, somewhat reducing vulnerabilities to possible renewed commodity price shocks, although energy import dependency remains pronounced. Italy has become a moderate net external creditor over recent years, which should be partly supported by moderate current account surpluses in the medium term.

Having exhibited an annual average surplus of 2.9% of GDP over 2016-2021, Italy's current account balance turned sharply into a deficit in 2022 (-1.5% of GDP) as soaring energy prices drove up the import bill, dragging the goods trade balance into deficit (-1.8 p.p. to -0.9% of GDP).

More recently, drawing on the four-quarter average, the current account deficit narrowed to -0.1% of GDP Q3-23 (preliminary BdI data), on account of receding energy prices, with the goods balance having returned to positive territory. We expect the overall current account balance to have just reached surplus territory for 2023 as a whole and to remain moderately positive in the medium term, with the surplus likely on somewhat lower levels than prior to the corona pandemic, as energy prices seem set to settle at higher levels, and due to higher import demand as the RRP is further implemented.

Meanwhile, the NIIP decreased somewhat from 7.3% of GDP in 2021 to 4.7% of GDP in 2022, mainly reflecting a deterioration in the 'other investment' component. The sovereign remained a net external creditor in the first half of 2023, with positive valuation effects contributing to an increase to 5.3% of GDP as of Q2-23. In a similar vein, Italy's NIIP excluding non-defaultable instruments remained in positive territory, improving to 3.0% of GDP.

Rating Outlook and Sensitivity

Our rating outlook on the Italian Republic is positive, as we expect macroeconomic and fiscal risks to moderate over the next 12-24 months.

We could contemplate lifting Italy's credit rating if we gain confidence in a firm downward trajectory of its public debt ratio. This could be buttressed by tangible further progress in executing the RRP measures, possibly aided by a persistently stable political environment, and strengthening expectations for - or resulting in signs of - a boost to productivity and ultimately a higher path for potential growth.

Conversely, we could contemplate a negative rating action if the public debt ratio fails to move onto a persistent downward path, or if there are major setbacks regarding the execution of the RRP. Significant delays to further RRP implementation would likely bear down on medium-to-longer-term growth prospects and the fiscal outlook. Materializing contingent liability risks, possibly exacerbated by stronger-than-anticipated increases in debt servicing costs and/or significantly deteriorating prospects for age-related costs, could also have us consider a downward revision of the outlook or the rating.

Analysts

Primary Analyst
Fabienne Riefer
Head of Public Finance
F.Riefer@creditreform-rating.de
+49 2131 109 1462

Analyst
Dominic Prott
Analyst Public Finance
D.Prott@creditreform-rating.de
+49 2131 109 3810

Person Approving Credit Ratings
Philipp J. Beckmann
p.beckmann@creditreform-rating.de

Ratings*

Long-term sovereign rating	BBB- /positive
Foreign currency senior unsecured long-term debt	BBB- /positive
Local currency senior unsecured long-term debt	BBB- /positive

*) Unsolicited

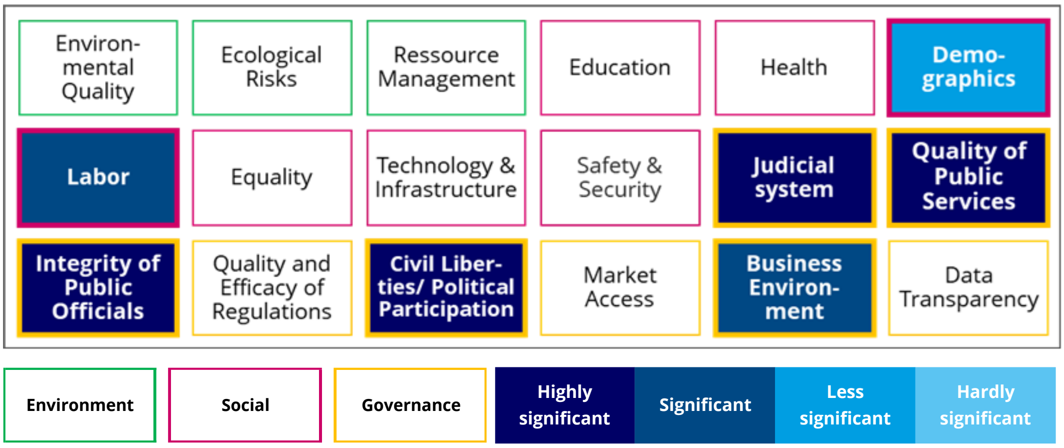
ESG Factors

Creditreform Rating has signed the ESG in credit risk and ratings statement formulated within the framework of the UN Principles for Responsible Investment (UN PRI). The rating agency is thus committed to taking environmental and social factors as well as aspects of corporate governance into account in a targeted manner when assessing creditworthiness.

While there is no universal and commonly agreed typology or definition of environment, social, and governance (ESG) criteria, Creditreform Rating views ESG factors as an essential yardstick for assessing the sustainability of a state. Creditreform Rating thus takes account of ESG factors in its decision-making process before arriving at a sovereign credit rating. In the following, we explain how and to what degree any of the key drivers behind the credit rating or the related outlook is associated with what we understand to be an ESG factor, and outline why these ESG factors were material to the credit rating or rating outlook.

For further information on the conceptual approach pertaining to ESG factors in public finance and the relevance of ESG factors to sovereign credit ratings and to Creditreform Rating credit ratings more generally, we refer to the basic documentation, which lays down key principles of the impact of ESG factors on credit ratings.

ESG Factor Box



The governance dimension plays a pivotal role in forming our opinion on the creditworthiness of the sovereign. As the World Bank's Worldwide Governance Indicators Rule of Law, Government Effectiveness, Voice and Accountability, and Control of corruption have a material impact on Creditreform Rating's assessment of the sovereign's institutional set-up, which we regard as a key rating driver, we consider the ESG factors 'Judicial System and Property Rights', 'Quality of Public Services and Policies', 'Civil Liberties and Political Participation', and 'Integrity of Public Officials' as highly significant to the credit rating.

Since indicators relating to the assessment of an economy's competitive stance by e.g. the World Bank, the World Economic Forum, the European Commission, and IMD Business School and the World Intellectual Property Organization (UN) add further input to our rating or adjustments thereof, we judge the ESG factor 'Business Environment' as significant.

The social dimension plays an important role in forming our opinion on the creditworthiness of the sovereign. Labor market metrics constitute crucial goalposts in Creditreform Rating's considerations on macroeconomic performance of the sovereign, and we regard the ESG factor 'Labor' as significant to the credit rating or adjustments thereof. Indicators or projections providing insight into likely demographic developments and related cost represent a social component affecting our rating or adjustments thereof. Hence, we regard the ESG factor 'Demographics' as less significant in our ESG framework.

While Covid-19 may exert adverse effects on several components in our ESG factor framework in the medium to long term, it has not been visible in the relevant metrics we consider in the context of ESG factors – though it has a significant bearing on public finances. To be sure, we will follow ESG dynamics closely in this regard.

Economic Data

[in %, otherwise noted]	2017	2018	2019	2020	2021	2022	2023e	2024e
Macroeconomic Performance								
Real GDP growth	1.7	0.9	0.5	-9.0	8.3	3.7	0.7	0.8
GDP per capita (PPP, USD)	42,112	43,617	44,704	41,342	46,534	51,827	54,259	56,016
Credit to the private sector/GDP	98.1	93.6	91.8	99.8	90.8	85.4	n/a	n/a
Unemployment rate	11.3	10.6	9.9	9.3	9.5	8.1	n/a	n/a
Real unit labor costs (index 2015=100)	98.5	99.4	99.7	101.2	99.0	98.7	98.1	99.0
World Competitiveness Ranking (rank)	44	42	44	44	41	41	41	n/a
Life expectancy at birth (years)	83.1	83.4	83.6	82.3	82.7	83.0	n/a	n/a
Institutional Structure								
WGI Rule of Law (score)	0.3	0.2	0.3	0.2	0.2	0.2	n/a	n/a
WGI Control of Corruption (score)	0.2	0.2	0.2	0.5	0.5	0.5	n/a	n/a
WGI Voice and Accountability (score)	1.0	1.0	0.9	1.1	1.1	1.1	n/a	n/a
WGI Government Effectiveness (score)	0.5	0.4	0.5	0.4	0.3	0.4	n/a	n/a
HICP inflation rate, y-o-y change	1.3	1.2	0.6	-0.1	1.9	8.7	5.9	2.0
GHG emissions (tons of CO2 equivalent p.c.)	7.4	7.4	7.3	6.5	7.1	n/a	n/a	n/a
Default history (years since default)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Fiscal Sustainability								
Fiscal balance/GDP	-2.4	-2.2	-1.5	-9.6	-8.8	-8.0	-5.5	-4.4
General government gross debt/GDP	134.2	134.5	134.2	154.9	147.1	141.7	139.9	140.0
Interest/revenue	8.1	7.9	7.2	7.3	7.4	8.9	n/a	n/a
Debt/revenue	289.5	290.8	285.6	326.9	309.4	294.9	n/a	n/a
Total residual maturity of debt securities (years)	6.9	6.9	6.9	7.0	7.1	7.0	n/a	n/a
Foreign exposure								
Current account balance/GDP	2.7	2.6	3.3	3.9	2.4	-1.5	n/a	n/a
International reserves/imports	33.4	30.3	36.9	49.4	40.1	32.7	n/a	n/a
NIIP/GDP	-7.5	-5.2	-2.0	0.9	7.5	4.7	n/a	n/a
External debt/GDP	122.1	120.5	124.7	140.1	135.4	128.0	n/a	n/a

Sources: IMF, World Bank, Eurostat, AMECO, ECB, Istat, own estimates

Appendix

Rating History

Event	Publication Date	Rating /Outlook
Initial Rating	28.10.2016	BBB- /stable
Monitoring	29.09.2017	BBB- /stable
Monitoring	31.08.2018	BBB- /stable
Monitoring	30.08.2019	BBB- /stable
Monitoring	21.08.2020	BBB- /negative
Monitoring	05.03.2021	BBB- /negative
Monitoring	11.02.2022	BBB- /stable
Monitoring	20.01.2023	BBB- /stable
Monitoring	19.01.2024	BBB- /positive

Regulatory Requirements

In 2011 Creditreform Rating AG (CRAG) was registered within the European Union according to EU Regulation 1060/2009 (CRA-Regulation). Based on the registration Creditreform Rating AG is allowed to issue credit ratings within the EU and is bound to comply with the provisions of the CRA-Regulation. The rating was not endorsed by Creditreform Rating AG from a third country as defined in Article 4 (3) of the CRA-Regulation.

This sovereign rating is an unsolicited credit rating. The Ministero dell'Economia e delle Finanze (MEF) participated in the credit rating process as it provided additional information and commented on a draft version of the report. Thus, this report represents an updated version, which was augmented in response to the factual remarks of MEF during their review. However, the rating outcome as well as the related outlook remained unchanged.

Unsolicited Credit Rating	
With Rated Entity or Related Third Party Participation	YES
With Access to Internal Documents	NO
With Access to Management	NO

The rating was conducted on the basis of CRAG's "Sovereign Ratings" methodology (v1.2, July 2016) in conjunction with its basic document "Rating Criteria and Definitions" (v1.3, January 2018). CRAG ensures that methodologies, models, and key rating assumptions for determining sovereign credit ratings are properly maintained, up-to-date, and subject to a comprehensive review on a periodic basis. A complete description of CRAG´s rating methodologies and basic document "Rating Criteria and Definitions" is published on our website.

To prepare this credit rating, CRAG has used the following substantially material sources: International Monetary Fund, World Bank, Organization for Economic Co-operation and Development, Eurostat, European Commission, European Banking Authority, European Central Bank, World Economic Forum, World Intellectual Property Organization (WIPO), IMD Business School, Dipartimento del Tesoro/ Ministero dell'Economia e delle Finanze, Banca d'Italia, Istituto Nazionale di Statistica, Ufficio Parliamentare di Bilancio (PBO).

A Rating Committee was called consisting of highly qualified analysts of CRAG. The quality and extent of information available on the rated entity was considered satisfactory. The analysts and committee members declared that the rules of the Code of Conduct were complied with. No conflicts of interest were identified during the rating process that might influence the analyses and judgements of the rating analysts involved or any other natural person whose services are placed at the disposal or under the control of Creditreform Rating AG and who are directly involved in credit rating activities or approving credit ratings and rating outlooks. The analysts presented the results of the quantitative and qualitative analyses and provided the Committee with a recommendation for the rating decision. After the discussion of the relevant quantitative and qualitative risk factors, the Rating Committee arrived at a unanimous rating decision. The weighting of all risk factors is described in CRAG´s "Sovereign Ratings" methodology. The main arguments that were raised in the discussion are summarized in the "Reasons for the Rating Decision."

As regards the rating outlook, the time horizon is provided during which a change in the credit rating is expected. This information is available within the credit rating report. There are no other attributes and limitations of the credit rating or rating outlook other than displayed on the CRAG website.

No ancillary services in the regulatory sense were carried out for this rating object. Creditreform Rating AG ensures that the provision of ancillary services does not present conflicts of interest with its credit rating activities and discloses ancillary services provided for the rated entity or any related third party, if any, in its rating reports. For the complete list of provided rating and credit service ancillaries please refer to https://www.creditreform-rating.de/en/about-us/regulatory-requirements.html#non-core-busi-ness-activities.

The date at which the credit rating was released for distribution for the first time and when it was last updated including any rating outlooks is indicated clearly and prominently in the rating report; the first release is indicated as "initial rating"; other updates are indicated as an "update", "upgrade or downgrade", "not rated", "affirmed", "selective default" or "default".

In accordance with Article 11 (2) EU-Regulation (EC) No 1060/2009 registered or certified credit rating agency shall make available in a central repository established by ESMA information on its historical performance data, including the ratings transition frequency, and information about credit ratings issued in the past and on their changes. Requested data are available on the ESMA website: https://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml.

An explanatory statement of the meaning of each rating category and the definition of default are available in the credit rating methodologies disclosed on the website.

Disclaimer

Any rating issued by Creditreform Rating AG is subject to the Creditreform Rating AG Code of Conduct which has been published on the web pages of Creditreform Rating AG. In this Code of Conduct, Creditreform Rating AG commits itself – systematically and with due diligence – to establish its independent and objective opinion as to the sustainability, risks and opportunities concerning the entity or the issue under review.

When assessing the creditworthiness of sovereign issuers, Creditreform Rating AG relies on publicly available data and information from international data sources, governments, and national statistics. Creditreform Rating AG assumes no responsibility for the true and fair representation of the original information.

Future events are uncertain, and forecasts are necessarily based on assessments and assumptions. Hence, this rating is no statement of fact, but an opinion. Nor should these ratings be construed as recommendations for investors, buyers or sellers. They should only be used by market participants (entrepreneurs, bankers, investors etc.) as one factor among others when arriving at investment decisions. Ratings are not meant to be used as substitutes for one's own research, inquiries and assessments. Thus, no express or implied warranty as to the accuracy, timeliness or completeness for any purpose of any such rating, opinion or information is given by Creditreform Rating AG in any form or manner whatsoever. Furthermore, Creditreform Rating AG cannot be held liable for the consequences of decisions made on the basis of any of their ratings.

Creditreform Rating AG

Creditreform Rating AG
Europadamm 2-6
D - 41460 Neuss

Phone +49 (0) 2131 / 109-626
Fax +49 (0) 2131 / 109-627
E-Mail info@creditreform-rating.de
Internet www.creditreform-rating.de

CEO: Dr. Michael Munsch
Chairman of the Board: Michael Bruns
HRB 10522, Amtsgericht Neuss