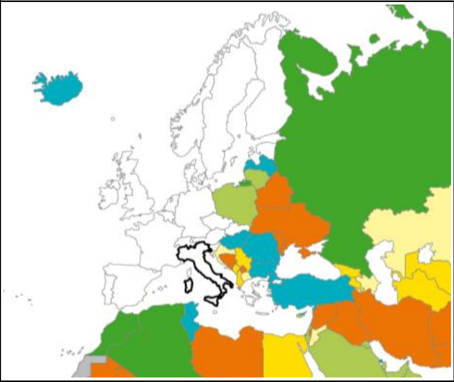
COUNTRY RISK ANALYSIS

Italy

CREATING CONFIDENCE IN YOUR EXPORTS



COUNTRY RISK CATEGORY

0/7

The country risk categories range from 0 to 7. The lower the number the better the credit rating the country has.

0 1 2 3 4 5 6 7

EKN'S OUTSTANDING GUARANTEES ON THE COUNTRY

SHORT-TERM TRANSACTIONS: -

MEDIUM AND LONG-TERM TRANSACTIONS: SEK 6,159 MILLION

DATE

25/09/2014

Political split hampering the economy

A cumbersome political system, a partisan split and unsolved structural problems have led to economic decline. Growth in the Italian economy has been lower than in the rest of the euro area for a long time. The economy is being hampered by weak competition, lack of flexibility in the labour market and low public investment. In addition to a political split, reform efforts are being complicated by public administration that is weak and ineffective from a European perspective. High public debt is making the economy vulnerable, which became clear during the global financial crisis. When the sustainability of the public finances was called into question on the financial markets, the government borrowing costs rose rapidly to unsustainable levels. The worst turbulence in the market did not subside until the European Central Bank (ECB) intervened, buying Italian government securities, major cuts to the national budget and statements that the ECB was prepared to do whatever was necessary to protect the euro. In the recent period, confidence in the country's political ability to solve its sovereign debt problems has increased which has given the government greater room for manoeuvre and created the conditions for long-term reform efforts. In light of the lack of a strong political force that can deal with the underlying structural problems with the support of the electorate, the potential growth of the economy is expected to remain low. Once the crisis awareness subsides, there is a risk that partisan differences of opinion are more likely to once again dominate the political scene rather than long-term reform efforts.

THE COUNTRY'S STRENGTHS AND WEAKNESSES

Strengths

- Large economy with broad industrial base and high GDP per capita.
- Low debt in the private sector and high household wealth.
- Extensive consolidation of the public finances in recent years and initiated reform efforts.

Weaknesses

- Major political split and difficulties coping with widespread corruption and organised crime.
- High public debt and low potential growth, making fiscal consolidation of the public finances harder.
- Major structural problems and weakened competitiveness.

EKN'S POLICY

General risk assessment

Similarly to most euro zone countries and other high-income countries, EKN has placed Italy in country risk category 0. Italy's membership in the euro zone makes the transfer and conversion risk low. There are no other financial and economic circumstances that justify any restrictions on the country policy. Instead, each transaction is assessed on its own merits. In accordance with the EU's competition regulations, EKN and other export credit institutions may not cover any payment risks for transactions where the risk term is less than two years. Euro zone countries and other high-income countries in the OECD are not categorised within the scope of the OECD's country risk categorisation.

WHAT MIGHT CAUSE A CHANGE IN THE COUNTRY POLICY?

The policy may be made more restrictive

- If the on-going strengthening of the public finances and reform efforts stall, Italy runs the risk of once again losing confidence on the financial markets.
- If political tensions increase on the central or regional level as a result of popular protests against continuing cuts to the public sector.
- If the problems in the banking sector return and the banks face refinancing problems.

EKN'S OBLIGATIONS AND EXPERIENCE

Increased exposure during the financial crisis

The inflow of new transactions to Italy increased substantially in conjunction with the financial crisis. As the financial situation in the country has gotten stronger, the provision of both offers and guarantees has fallen in volume. EKN's total exposure to Italy is just over SEK 6.5 billion, with outstanding guarantees accounting for just over SEK 6 billion and outstanding offers accounting for the rest. The decline is mainly in the provision of offers. A certain portion of the guarantees involve operations located in Latin America. EKN has good experience overall in guaranteeing transactions in Italy.

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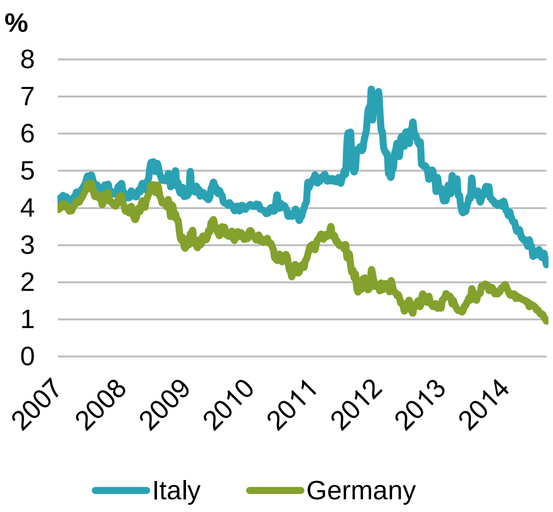
Political and regional split complicating reform efforts

Italy is the EU's third-largest economy. Its industrial base is broad with a position as the world leader in several high-tech industries. However, the Italian economy is also characterised by low growth, high public debt and eroded competitiveness. A prolonged political and regional split is the main obstacles to economic growth. The political climate is characterised by historical and deep ideological differences as well as recurring government reshuffling, minister resignations and corruption scandals. Urgent structural reforms that required broad political support have been postponed or used merely as a tool in partisan battles. A regional division between the relatively prosperous northern parts of the country and the more neglected southern Italy have further fuelled the polarisation among political groupings. The financial and economic crisis that began around 2008 has at least temporarily softened up the deadlocked political situation. When Italy's public finance situation was deemed unsustainable in late 2011, the interest rates of Italian government securities went through the roof and the country's Prime Minister at the time, Silvio Berlusconi, was forced to resign. His successor as Prime Minister, Mario Monti, was assigned to form a caretaker government that implemented an extensive package of measures to consolidate the strained public finances and expedite reform efforts. Monti's government succeeded in boosting the country's confidence on the financial markets, but failed to win the support of the electorate. Discontent with the austerity policy pursued and the perception that economic policies were being control-led from Brussels brought down the government in the election in February 2013. Neither of the two major political blocs got enough votes to form a government, which paved the way for a broad coalition government, which has been led by social democrat Matteo Renzi since the start of 2014.

GOVERNMANT BOND INTEREST RATES

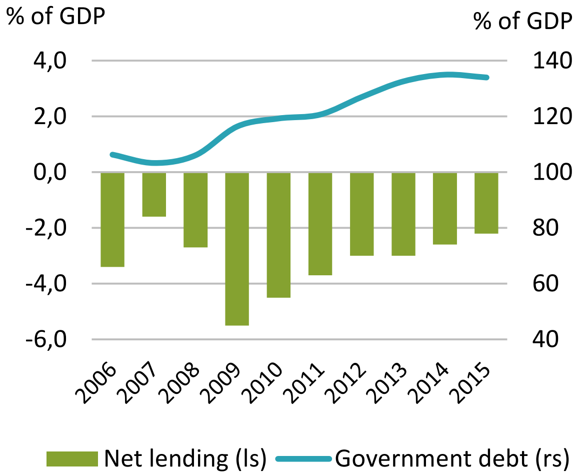


Source: Reuters

Weak public finances created turbulence in the financial markets

In recent years, the government's policies have been geared toward correcting the major imbalances built up in the economy. High public debt, a growing budget deficit and a prolonged period with a current account deficit has made the economy vulnerable to external shocks, which became clear during the financial crisis. The public debt has accumulated gradually over a long period of time, but the debt build-up was stepped up during the beginning of the global economic slowdown. In early 2010, the concern on the financial markets increased with respect to the increasingly strained public finance situation in several euro zone countries, resulting in rising government bond interest rates. Greece was first out of the gates, followed closely by Ireland and Portugal. The fact that the national debt in Italy is largely owned by domestic investors with generally long terms contributed to it taking until late 2011 before the sustainability of the Italian public finances was seriously called into question. The national debt totalled just over EUR 1,900 billion at that time, or just over 120 per cent of GDP. Italy managed to avoid an escalation of the crisis thanks to the government launching an ambitious cost cutting programme with large cuts to the national budget and thanks to the ECB's extensive intervention buying of Italian government securities. The accumulation of public debt has flattened out in recent years and the public finance deficits have been reduced. Market interest rates have fallen gradually since early 2012 as a sign of growing confidence in the country's public finances. The urgent situation with respect to the country's public finance problems is over and the crisis has forced through fiscal measures that are strengthening economic growth in the long term. But very little has been done to fundamentally improve the economy's mode of functioning. Italy is still a divided country, politically and regionally. The national debt is high and the potential for growth is low. Even if the fiscal policy is realigned toward less austerity in the coming years, the country is fiscally crippled for a long time as a result of the high national debt. The scope for extensive public investment or expensive measures that will not generate higher growth until far into the future is very limited. The ECB's quantitative easing is expected to give the economy a much-needed boost, but the recovery is expected to be prolonged and it is highly likely that Italy will continue to grow slower than most other countries in the euro zone.

PUBLIC FINANCES



Source: European Commisson (forecast 2014-2015)

Shaky banking sector

The Italian banking sector consists of a dozen systematically important banks. These banks account for the majority of domestic borrowing and lending. In addition, there are several small banks with regional roots. The deep economic recession has put tremendous pressure on the country's banking sector. The banks' large holdings of Italian government bonds led to rapidly falling asset values during the crisis. The weakened capital adequacy of the banks led to substantial restrictions on lending to households and businesses. The situation in the banking sector has strengthened recently, but profitability remains weak and lending to households and businesses is restrained. This has especially complicated funding for small and medium sized companies. As a result of the weak growth prospects for the real economy, it will take some time before the loan quality and profitability of the banks is strengthened, and increasingly higher provisions will be required for bad loans. Support from the ECB is expected to continue to be extensive, which will ensure normalisation in the banking sector in the long term.

BUSINESS ENVIRONMENT

From a European perspective, Italy has a weak business environment. Widespread corruption and a legal system characterised by lengthy and expensive legal proceedings are the main factors complicating the operating environment. The Monti government tightened anti-corruption laws, but much remains to be done to seriously get the widespread corruption under control and curb organised crime. The government's need to increase tax revenues to reduce the national budget deficits has resulted in higher corporate taxation. In addition, the business environment is weakened by the tight lending terms. It is unlikely that the business environment will undergo sweeping strengthening in the near future, given the scope of the current problems and the public administration deficiencies.