

Some Thoughts On Italy's Ratings

By Win Thin

Here are some thoughts regarding the late Friday cut in outlook to negative for Italy's A+ rating by S&P. While we remain negative on the ratings for peripheral euro zone, we don't think a downgrade of Italy by S&P is clearly warranted. Our sovereign ratings model currently has Italy at A+/A1/A+ vs. actual ratings of A+/Aa2/AA-. Moody's is most out of line but S&P appears to be on target and Fitch is off by one notch. If anything, we had expected a move by either Moody's or Fitch, not S&P. With rating agencies still clearly on the warpath, we can't rule out a downgrade here, but the case for a downgrade of Italy just isn't as glaringly obvious as the others in the periphery.

Indeed, Italy's numbers have always been bad, and have in fact stayed remarkably stable during this crisis even as the rest of the periphery blew up. As a point of reference, the implied ratings for Italy, Ireland, Portugal, and Greece all started out at A+/A1/A+ when we began our model in June 2009. But since then, Italy's implied rating has remained at A+/A1/A+ even as those for Portugal, Ireland, and Greece have sunk precipitously to junk levels. Spain's implied ratings started off in June 2009 at AA/Aa2/AA but have since fallen to A/A2/A.

Clearly, the downgrade story will remain in play for the periphery for much of 2011. Other weak euro zone credits to watch out for are Belgium and France, with both facing some mild downgrade pressures. Our model has France as a borderline AA+/Aa1/AA+ credit vs. actual ratings of AAA/Aaa/AAA, and also has Belgium as a AA/Aa2/AA credit vs. actual ratings of AA+/Aa1/AA+. Last week's downgrade of a major French bank due to its exposure to Greece is a warning sign that the sovereign rating itself for France may come under greater vulnerability. With regards to Belgium, we suspect that if there is still no government in Belgium by mid-June, it will likely be downgraded by S&P, which it threatened to do near the start of this year. In other words, it is possible that the next country

that gets their rating cut could very well be a core and not a peripheral country. That would certainly get the market's attention.

DEVELOPED COUNTRY RISK INDEX Q2 11

Country	Current Score	Change vs. Dec	BBB	S&P	Agency Ratings		5-Yr CDS (bp)	5-Yr Spread to US (bp)	
			Implied Rating		Moody's	Fitch		*to Germany	*
Switzerland	11.6	-1.4	AAA	AAA	Aaa	AAA		-120	*
Sweden	13.0	-1.0	AAA	AAA	Aaa	AAA	23	37	*
Luxembourg	13.5	n/a	AAA	AAA	Aaa	AAA			
Australia	15.0	0.6	AAA	AAA	Aaa	AA+	50	335	
Norway	15.8	-0.6	AAA	AAA	Aaa	AAA	16	37	*
New Zealand	16.3	1.5	AAA	AA+	Aaa	AA+	62	227	
Canada	20.8	1.9	AAA	AAA	Aaa	AAA		65	
Netherlands	23.4	0.3	AAA	AAA	Aaa	AAA	29	4	*
Germany	23.5	1.6	AAA	AAA	Aaa	AAA	39	62	
Austria	26.4	1.9	AAA	AAA	Aaa	AAA	63	48	*
US	26.8	1.0	AAA	AAA	Aaa	AAA	50		
France	31.9	1.0	AA+	AAA	Aaa	AAA	73	32	*
Belgium	32.6	0.8	AA	AA+	Aa1	AA+	147	116	*
UK	33.3	-1.4	AA	AAA	Aaa	AAA	59	-38	
Japan	35.5	2.0	AA-	AA-	Aa2	AA	84	-135	
Italy	39.7	0.9	A+	A+	Aa2	AA-	159	156	*
Spain	41.5	1.9	A	AA	Aa2	AA+	260	239	*
Portugal	45.6	1.3	BBB+	BBB-	Baa1	BBB-	639	897	*
Ireland	46.6	-2.0	BBB+	BBB+	Baa3	BBB+	639	920	*
Greece	57.7	1.0	BB-	B	B1	B+	1345	1477	*