BNL Economic Research

focus

ECONOMIA E BANCHE

NUMERO 21

30 October 2023

Overview of the Italian Banking Market

BNL BNP PARIBAS

La banca per un mondo che cambia

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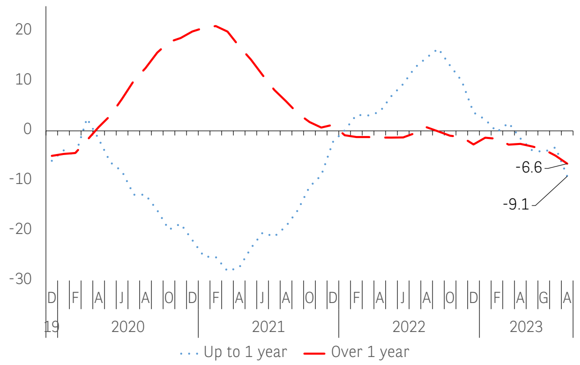
SUMMARY

After declining in the second quarter, economic activity in Italy has continued to remain weak both in manufacturing and services. Italian households benefited from the further improvement of labour market conditions, while suffering from both higher consumer prices and increasing interest rates. The uncertainty about the economic outlook has dampened business and consumer confidence, contributing to a fall in credit demand. In the third quarter 2023, the decrease of bank loans to firms and households became more pronounced. The decline reflected the weakness in credit demand, due to the rise in the cost of loans, and the feeble demand from firms for investment and from households for house purchase.

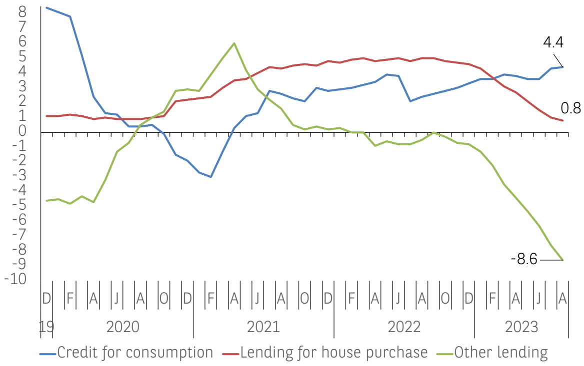
Italy: loans to Non-financial corporations

(y/y % non adjusted changes)



Italy: loans to Households

(y/y % non adjusted changes)



In the first eight months of 2023 bank lending to the private non-financial sector declined (-0.4% y/y after adjusting for notional cash pooling and securitization). The growth of loans to non-financial corporations declined on average -2.1% recording a significant deceleration with respect to 2022 (when the average rate of growth was 2.7%). In the first eight months of 2023 outstanding loans to households increased by 1.2% y/y (calculated using adjusted data), significantly less than the 2022 average (3.9% y/y). Consumer credit increased by 3.9% y/y (on average +3.0% in 2022) and loans for house purchase rose by 2.4% (4.9% on average in 2022).

The stock of non-performing loans continued to fall: in Q2 2023, NPLs outstanding was €56bn (-17% y/y), €12 billion less than in the corresponding period of the previous year, a result achieved thanks to the sale of non-performing loans and to securitisation transactions.

Overview of the Italian Banking Market

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Italy: economic outlook

The recovery of the Italian economy stuttered in Q2 2023. After a 0.6% increase in Q1, real GDP fell by 0.4%, with the annual growth rate declining from 2.1% to 0.3% and the carry over for 2023 from 0.9% to 0.7%. Despite the Q2 contraction, Italian GDP is more than 3% higher than in Q4 2019.

In Q2, domestic demand excluding stocks subtracted 0.4% from the overall growth, driven by falling investment, which declined by almost 2%, with a 0.4% negative contribution to the GDP. Spending in construction decreased by more than 3%, mainly due to the phasing out of the extraordinary incentives for building improvement. Investment in machinery and ICT equipment fell by 0.7%, reflecting the worsening of economic and financial conditions of firms, which are still coping with producer prices 20% higher than at the beginning of 2021. Private consumption moderately recovered in real terms, going slightly above pre-crisis level, while the value of expenditure is almost 15% higher. Italian households benefited from the further improvement of labour market conditions, while suffering from both higher consumer prices and increasing interest rates. In Q2, net exports contribution was negative (-0.2%), as exports declined while imports remained unchanged. According to trade balance data, the value of exports fell in the last period, after having strongly increased in 2021 and 2022.

In Q2, the contraction of activity resulted widespread by sector. Manufacturing recorded the fifth decline in the last six quarters, with value added slightly above pre-crisis level. Industrial activity suffered in sector with higher production costs, such as chemical, wood, paper, rubber and plastic. Services value added unexpectedly declined, also reflecting the slower recovery of tourism. In H1 2023, expenditure of foreign travellers was higher than in the same period of 2019, while the number of travellers was lower by about 4.5 million.

Bank loans

In the first eight months of 2023 bank lending to the private non-financial sector declined (-0.4% y/y after adjusting for notional cash pooling and securitization). After the modest rate of growth registered in the period January-April (1% y/y), the trend became progressively more negative and in August the declined reached -3.3%. The uncertainty about the economic outlook has dampened business and consumer confidence, contributing to a fall in credit demand. In the third quarter 2023, the fall in bank loans to firms and households became more pronounced. The decline reflected the weakness in credit demand, due to the rise in the cost of loans, and the feeble demand from firms for investment and from households for house purchase. The lending to non-financial corporations is conditioned by the abundant liquidity that firms accumulated in the last three years, by the rise of interest rates and by uncertainties about the evolution of the economic scenario.

The increase in the ECB's key interest rates continues to be transmitted to the cost of credit: since the beginning of the monetary policy normalization process, the rate on new loans has risen by 3.8 percentage points for firms and by 2.9 percentage points for mortgage loans.

* Views and opinions expressed are those of the authors and do not necessarily reflect the view of the bank.

In the first eight months of the year, outstanding loans to public sector decreased by -4.8% on a y/y basis (-0.3% in the whole 2022) and in August the decline was equal to -6.4%.

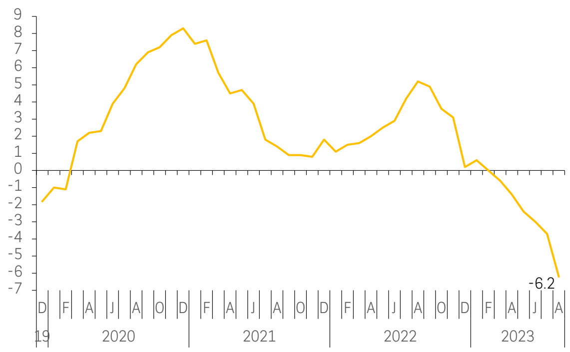
Loans to Non-financial firms

In August 2023, total adjusted outstanding loans to non-financial firms declined (-6.2% y/y) for the sixth month in a row. In the first eight months of 2023 loans declined on average -2.1% recording a significant deceleration with respect to 2022 (when the average rate of growth was 2.7%).

According to a survey conducted by the Bank of Italy, firms are still pessimistic about investment conditions across all sectors. They also anticipate a slowdown in nominal investment expenditure for the current year as a whole due in part to some difficulties in accessing credit. According to the Bank of Italy, in the construction sector the benefits connected with the 'Superbonus' are going to gradually fade out, partly offset by the sustain of the incentives in the public works segment.

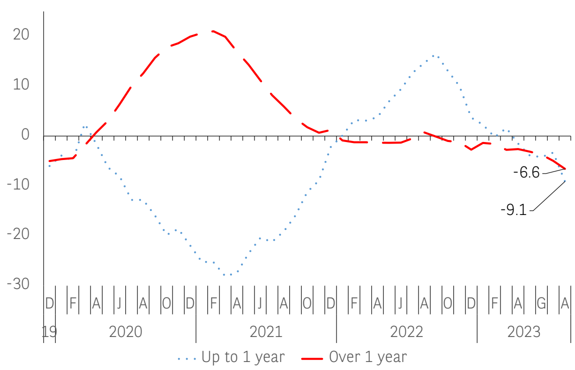
The decrease of loans to non-financial corporations affected both the segment of loans with maturities up to one year (-9.1% y/y in August; -2.3% on average, since January) and the segment with maturities beyond this term (-6.6% y/y in August; -3.3% on average, since January). The contraction in loans to firms continued to be stronger for firms with less than 20 employees.

Italy: loans to Non-financial corporations
(y/y % adjusted changes)



Source: BNL Economic Research calculations on ECB data

Italy: loans to Non-financial corporations
(y/y % non adjusted changes)



Source: BNL Economic Research calculations on ECB data

The liquidity held by firms on deposits and current accounts remains high, although declining. The slowdown in gross fixed investment led to lower recourse to sources of internal financing by firms. Thus, internal financing sources expanded slightly, with sight deposits standing out at historically high levels. According to some estimates carried out by the Bank of Italy, part of the loans to non-financial firms remained in the current accounts as liquidity buffer. At the end of August 2023 firms' deposits amounted to €402 billion (-€37 billion from the peak recorded in July 2022).

The increase in ECB policy rates determined an increase in the borrowing cost for both firms and households. In August, interest rates on new lending to non-financial corporations arrived to 5% (against 1.4 recorded in August 2022); those on new loans up to €1 million were 5.6% (from a low of 2.2 in August 2022), while the rates on new loans above that amount were 4.5%

(from 1.1% 12 months earlier). In Q2, the debt of Italian non-financial corporations to GDP ratio was almost stable at 66% well below the euro-area average (99%).

Loans to Households

Since November 2022 lending to households gradually attenuated. In the first eight months of 2023 outstanding loans to households (calculated using adjusted data) increased by 1.2% y/y, significantly less than the 2022 average (3.9% y/y).

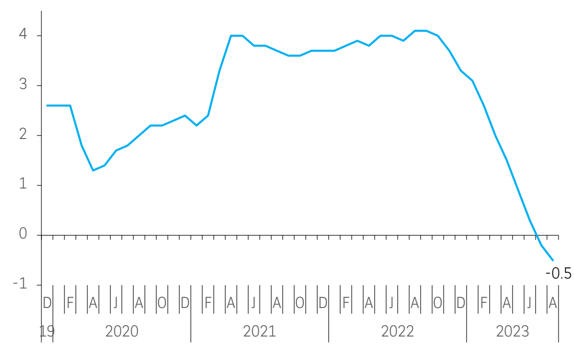
In the first eight months of the year consumer credit increased by 3.9% y/y (on average +3.0% in 2022) and loans for house purchase rose by 2.4% (4.9% on average in 2022). On the contrary, the outstanding amount of the so-called "other loans" further decelerated: on average, the monthly rate of growth in the first eight months has been -4.9% (-0.4% in 2022). Loans to sole proprietor firms, which account for about 40% of "other loans", decreased by 8%, with respect to the -3.7% y/y of 2022.

Households' demand for loans for house purchase has declined since the start of the ECB's monetary policy normalization, reflecting the general increase in interest rates and decreasing consumer confidence. In the second quarter of 2023, the share of house purchases financed with a mortgage loan remained stable at 64.1%. The ratio between the size of the loan and the value of the property was also substantially unchanged at 76.7% (76.6% in the previous quarter).

In August 2023, the average interest rate on new loans to households for house purchase markedly increased to 4.3% (from a value equal to 2.1% in August 2022).

Italy: loans to Households

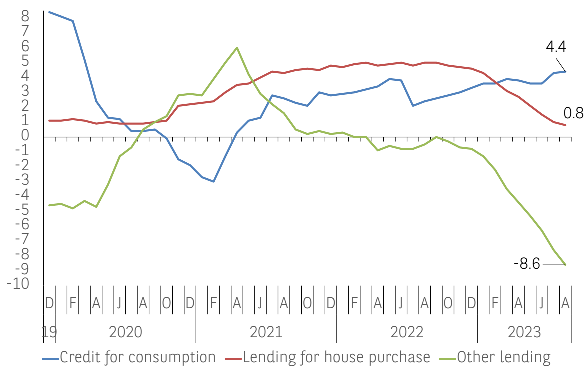
(y/y % adjusted changes)



Source: BNL Economic Research calculations on ECB data

Italy: loans to Households

(y/y % non adjusted changes)



Source: BNL Economic Research calculations on ECB data

In Q2 2023, household debt as a percentage of disposable income decreased to 60%, (it was 60.8% in Q1), well below the euro-area average (90.6%), mainly as a result of the growth in disposable income. As a share of GDP, households' debt declined slightly, from 40.8% to 39.6% (55% in the euro area).

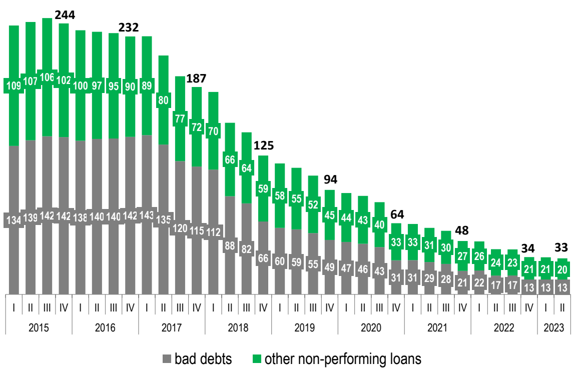
Asset quality

The stock of non-performing loans continues to fall: in Q2 2023, NPLs outstanding was €56bn (-17% y/y), €12 billion less than in the corresponding period of the previous year, a result achieved thanks to the sale of non-performing loans and to securitisation transactions. The amount of non-performing loans sold on the secondary market in the whole 2022 is estimated to be around €20 billion, in line with that observed in 2021. More developed markets, together with a reduced flow of new NPLs, have both contributed to the fall in the stock of this type of asset. In the second quarter of the year, the ratio of new non-performing loans to total loans was 1%, a level similar to that recorded in the first three months of 2023.

In Q2 bad loans decreased at a faster rate (-23%, to 21 billion) than UTPs (-16% to 31 billion); while, the decline in the past due loans came to an end. In Q2 the growth of past due recorded a positive value for the fifth quarter in a row (+11% y/y, to €4.4 billion). In Q2, NPLs ratio (gross value) decreased to 2.4%; narrowing to 0.6 pp the gap with the European banks.

Italy: NFCs' non-performing loans

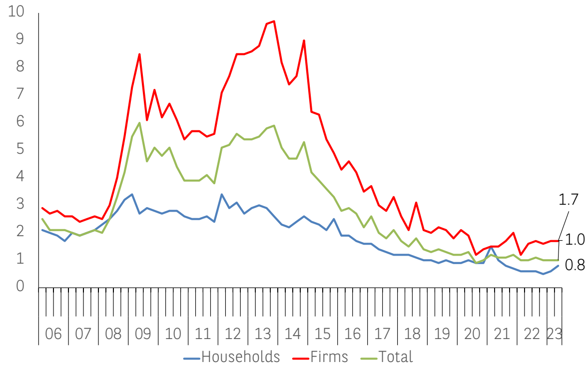
(billion of euros)



Source: BNL Economic Research calculations on Bank of Italy data

Italy: loan default rate

(new non-performing loans to performing loans)



Source: BNL Economic Research calculations on Bank of Italy data

The ratio of Stage 2 loans to total performing loans has declined to 11.2% (for the significant institutions), a level slighty higher than that recorded prior to the pandemic (8.8% in December 2019).

In Q2 2023, non-performing loans of firms amounted to about 33 billion (13 bn bad loans, 19 bn UTP, 1 bn past due loans), 8 billion less than a year earlier.

In Q2 2023 new NPLs of non-financial firms remained stable at historically low levels (1.7%). Compared to Q2 2022, riskiness remained almost stable for most sectors. A severe deterioration is recorded only for the "Manufacture of computer, electronic and optical products" sector (peaked to 6.7% from 0.9% in June 2022), "Manufacture of fabricated metal products" sector (peaked to 1.7% from 1% in June 2022) and "Water supply, sewerage, waste management and remediation activities" (peaked to 1.7% from 0.5% in June 2022). The new NPLs rate of the construction sector remained stable (over 3%) on a level almost double compared to the average level of non-financial firms.

In Q2 2023, households' non-performing loans amounted to €14 billion (5.5 bn bad loans, 6.8 bn UTP, 2.2 bn past due loans), €2 billion less than a year earlier. The decrease was common to all categories of non-performing loans. The new non-performing loans rate increased at 0.8%, 20 b.p. higher than the previous quarter.

The current situation shows the improvements achieved thanks to the efforts jointly with public authorities and the market. However, uncertainty about the economic pespectives requires prudence; the cyclical slowdown and the more restrictive financing conditions might lead to a worsening of the credit quality.

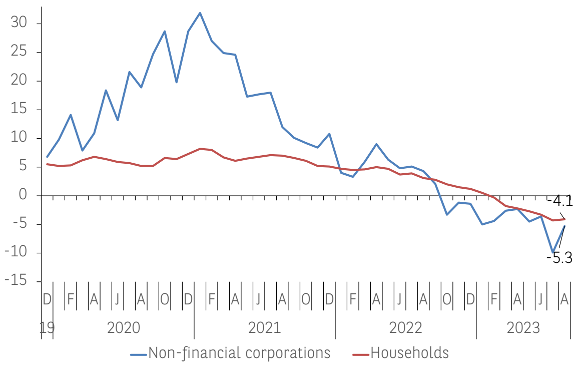
Borrowing from customers

Since the beginning of the new interest rates cycle, due to the ECB's monetary policy normalization process, growth in residents' deposits has gradually weakened, reflecting developments in current account deposits. The rate of growth of sight deposits, which was 9.8% at the end of 2021, slowed gradually and turned negative as of October 2022. In 2023 the contraction continued at a faster pace and was only partially offset by stronger growth in other deposit such as fixed-term deposits. This development is due to the slower adjustment of the interest rates on current account deposits to changes in the key interest rates compared with fixed-term deposits. This also appears to have supported an increase in households' demand for government bonds.

In August, bank funding contracted by 7.9% on an annual basis, as repayments of the TLTRO III operation resulted in a further decrease in liabilities to the Eurosystem. Bank funding was also affected by a decline in Italian residents' deposits, as households and firms shifted part of their funds from current accounts to higher-yielding financial assets. The cost of funding increased further, mostly as a result of the rise in money market interest rates.

In August 2023, funding from private sector decreased by 1.9% y/y, the eleventh negative change in a row. In the first eight months of the year, funding from domestic cutomers declined on average by 2% y/y. In the same period current accounts, which represent 59% of total funding, declined on average -7.6% y/y (vs +6% in the same period of 2022).

Italy: bank deposits by sector
(y/y % changes)



Source: BNL Economic Research calculations on ECB data

The reduction of purchasing power for households, the increasing cost of loans and tighter credit standards also for the non-financial corporations are weighing on the evolution of deposits. In the first eight months of the year, households deposits declined by 2.3% (on average) recording in August the seventh negative growth in a row (-4.1% y/y) since January 2012.

In the first eight months of 2023 deposits of non financial companies declined by 4.7% y/y on average, showing in August the eleventh monthly decline in a row. In the second quarter, net issuance of bank bonds intensified significantly (€6.8 billion, after 0.1 bn in Q1), whereas in the third quarter, based on preliminary data from Bloomberg, redemptions exceeded gross issuance, with net redemptions in the banking sector more than offsetting the large number of new issues in the previous quarter. Starting from July, bank bond yields rose by 20 basis points (9 basis points in the euro area), with their levels remaining higher than before the US regional bank collapses and the Credit Suisse crisis in March.

Italy: 2019-2023 banking trends

1 Loans: adjusted changes (*)

annual averages	2019	2020					2021					2022					2023		
and y/y %	**a.a.**	**I**	**II**	**III**	**IV**	**a.a.**	**I**	**II**	**III**	**IV**	**a.a.**	**I**	**II**	**III**	**IV**	**a.a.**	**I**	**II**	**July-Aug**
Total	**0.8**	1.0	2.2	4.1	5.3	**3.2**	4.9	4.2	2.5	2.3	**3.5**	2.6	3.2	4.4	3.0	**3.3**	1.3	-0.7	-2.6
Loans to non financial corporations	**-0.8**	-0.1	2.8	6.0	7.8	**4.1**	6.9	4.4	1.4	1.2	**3.5**	1.4	2.5	4.8	2.3	**2.7**	0.0	-2.3	-5.0
Loans to households	**2.6**	2.3	1.5	2.0	2.3	**2.0**	2.6	3.9	3.7	3.7	**3.5**	3.8	3.9	4.0	3.7	**3.9**	2.6	0.9	-0.4

(*) changes adjusted for reclassifications, value adjustments, exchange rate movements and securitizations

1.1 Loans: not adjusted changes

annual averages	2019	2020					2021					2022					2023		
and y/y %	**a.a.**	**I**	**II**	**III**	**IV**	**a.a.**	**I**	**II**	**III**	**IV**	**a.a.**	**I**	**II**	**III**	**IV**	**a.a.**	**I**	**II**	**July-Aug**
Total	**-3.0**	-1.2	0.4	2.6	4.1	**1.5**	3.7	2.7	1.2	1.1	**2.2**	1.5	1.9	3.2	1.9	**2.1**	0.6	-1.2	-3.8
Loans to non financial corporations	**-6.3**	-3.2	0.7	4.4	6.6	**2.1**	5.3	2.1	-1.1	-1.1	**1.3**	-0.5	0.4	3.1	0.6	**0.9**	-1.2	-3.2	-5.9
of which: - up to 1 year	**-9.1**	-2.1	-5.3	-13.8	-20.1	**-10.3**	-26.2	-23.8	-18.7	-7.4	**-19.0**	2.1	6.7	14.6	8.9	**8.1**	1.2	-3.2	-6.2
- more than 1 year	**-4.9**	-3.6	3.4	12.8	18.8	**7.8**	20.5	14.1	5.9	1.2	**10.4**	-1.1	-1.3	0.1	-1.6	**-1.0**	-1.9	-3.1	-5.8
Loans to households	**0.6**	0.8	0.1	0.7	1.4	**0.8**	2.0	3.4	3.4	3.3	**3.0**	3.5	3.5	3.3	3.3	**3.4**	2.4	0.8	-0.4
of which: - consumer credit	**8.6**	7.0	1.6	0.4	-1.2	**2.0**	-2.3	0.9	2.6	2.6	**0.9**	3.0	3.7	2.4	3.0	**3.0**	3.7	3.7	4.4
- loans for house purchase	**1.6**	1.1	0.9	0.9	1.8	**1.2**	2.6	3.7	4.4	4.6	**3.8**	4.9	4.9	4.9	4.7	**4.9**	3.7	2.1	0.9
- other	**-7.1**	-4.5	-3.1	0.3	2.4	**-1.2**	3.9	4.4	1.4	0.3	**2.5**	0.1	-0.8	-0.4	-0.6	**-0.4**	-2.3	-5.3	-8.1

Sources: ECB, BNL Economic Research - BNP Paribas

2. Deposits & Securities

annual averages	2019	2020					2021					2022					2023		
and y/y %	**a.a.**	**I**	**II**	**III**	**IV**	**a.a.**	**I**	**II**	**III**	**IV**	**a.a.**	**I**	**II**	**III**	**IV**	**a.a.**	**I**	**II**	**July-Aug**
Total	**2.7**	4.1	5.0	5.7	5.2	**5.0**	6.6	5.0	4.7	4.5	**5.2**	3.3	3.6	1.8	-0.6	**2.0**	-1.1	-1.7	-2.5
Bank deposits	**3.7**	5.0	6.3	7.0	6.7	**6.3**	8.4	6.4	6.0	5.5	**6.6**	4.3	4.6	2.8	-0.3	**2.9**	-1.5	-3.2	-4.8
of which: - current accounts	**5.9**	7.4	8.3	9.4	12.5	**9.4**	14.5	12.8	11.6	9.5	**12.1**	6.8	6.3	4.0	-1.0	**4.0**	-4.7	-8.0	-11.2
- redeemable at notice	**1.5**	1.9	2.9	2.6	3.0	**2.6**	2.7	1.7	1.1	0.6	**1.5**	0.1	0.0	0.9	0.6	**0.4**	0.5	-0.5	-1.6
Bank securities	**-3.3**	-1.5	-3.4	-3.7	-6.1	**-3.7**	-6.3	-5.6	-5.2	-3.6	**-5.2**	-4.5	-5.6	-6.4	-2.9	**-4.8**	2.6	9.4	13.8

Sources: ECB, BNL Economic Research - BNP Paribas