

Bank of America Merrill Lynch  
Italy Day Conference

**Italian Banks: where they stand  
and the challenges ahead**

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London, 19 February 2018

## 1. The macroeconomic picture

In 2017 Italian economic growth strengthened considerably more than had been expected at the beginning of the year, while economic expansion became more balanced across demand components and economic sectors.

GDP has been supported by domestic demand. Households' consumption has benefited from steadily improving labour market conditions and rising confidence. Investment expenditure has grown at a robust pace, supported by positive demand developments and favourable economic policies, as well as by reduced uncertainty and growing confidence. Investment in productive capital has regained much of the decline recorded between 2008 and 2013; it is expected to attain pre-crisis levels next year. The recovery in the construction sector, while far from complete, has been continuing for some time.

Exports, which have been expanding at or above potential foreign demand since 2010, have continued to perform well, in spite of the appreciation of the euro since last summer. The current account surplus has been positive since 2013 and has exceeded 2.5 per cent of GDP in the last two years. This is the main driver of the significant improvement in Italy's negative net international investment position, from 27 per cent of GDP in 2014 to below 7.5 per cent at the end of 2017. Looking ahead, if the current account evolves in line with our projections, which are close to those of the IMF, Italy's net international investment position will turn positive in three years from now.

After increasing by more than 30 percentage points since the beginning of the crisis, in the last three years the debt-to-GDP ratio has remained broadly stable thanks to the pick-up in GDP growth and to persistent primary surpluses. In particular, according to preliminary estimates, in 2017 the debt-to-GDP ratio declined by about half of a percentage point of GDP.<sup>1</sup> Yet, public debt in Italy remains at a high level. The opportunity offered by the ongoing recovery must be seized to reduce the debt-to-GDP ratio with increasing determination. Progress on this front and on structural reforms will help reduce the persistent growth gap with respect to the EU average.

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<sup>1</sup> On February 15 the Bank of Italy released a first estimate of the general Government debt for 2017; the final figure will be released in April, with the Notification of the data on public finances to Eurostat. The National Statistical Office will release the 2017 figure for nominal GDP at the beginning of March.

## 2. Banks: the recent past and the current situation

The Italian banking industry is emerging from a prolonged period of distress. The ongoing economic recovery and the resolution of important critical cases<sup>2</sup> have drastically reduced tail risk and are helping to improve confidence.

During the financial crisis, Italy's banking system proved much more resilient than expected by many observers. The recession suffered by the Italian economy was significantly deeper than for other European countries, yet the costs for the taxpayer – in the form of public support to ailing banks – have been much lower than elsewhere. The costs of the crises have been largely shouldered by bank shareholders and by the banking sector itself.<sup>3</sup>

The banking system is now on a recovery path. Improvement is becoming visible in several areas. Lending to the private sector has been growing again since the end of 2016 (Fig. 1); various indicators suggest that the continued slow expansion is being largely driven by low demand for lending by firms, rather than by restrictions on supply by banks.<sup>4</sup>

Credit risk is improving. The flow of new non-performing loans (NPLs) has been decreasing since 2014. It is now about 2 per cent of total loans, below the pre-crisis average (Fig. 2).<sup>5</sup> Banks are also selling very large amounts of NPLs on the market: €30 billion in 2017 alone, while more than €25 billion are expected to be sold in the first half of 2018. This represents a sharp increase from annual sales recorded in the previous five years (about €5 billion on average).

As a result of these trends, the NPL stock is diminishing at a remarkable pace (Fig. 3). Including the sales that will be completed in the next few months, by mid-2018 the volume of NPLs net of provisions will amount to less than €140 billion, almost one third below the peak of 2015. The net NPL ratio will stand at 7.8 per cent, against 10.8 per cent in 2015. Considering only

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<sup>2</sup> In 2017 the Italian State intervened to recapitalize Banca Monte Paschi di Siena and to liquidate Banca Popolare di Vicenza and Veneto Banca. Moreover, the four banks put into resolution in November 2015 were eventually sold.

<sup>3</sup> At the end of 2017 Italian GDP was still almost 6 percentage points below its pre-crisis level, whereas for the euro area it was 5.6 points above. At the end of 2016 the impact of State aid on public debt amounted to 22 per cent of GDP in Ireland, 9.5 per cent in Austria, 7.2 per cent in Germany, 4.6 per cent in Spain, and 3.2 per cent in the Netherlands. The average for the euro area was 4.5 per cent. In Italy it is currently estimated at 0.8 per cent of GDP (this figure includes the public interventions listed in Footnote 2).

<sup>4</sup> Survey data collected from both banks and firms highlights that in recent years banks' credit supply policies have been very expansionary. Moreover, firms' liquidity buffers are at historically high levels.

<sup>5</sup> In the next few months the volume of new NPLs and provisions might be affected by one-off effects related to new accounting and prudential rules (IFRS9 and calendar provisioning; see below).

bad loans, the ratio amounts to 3.5 per cent. The coverage ratio has been increasing in recent years and, as I will remark later on, it is now in line with recovery rates.

Exposure to the domestic sovereign is decreasing. The fall since the peak of 2015 amounts to €120 billion, almost one third of the initial stock.

Gradual improvement is also observable on the liabilities side. In 2017 net bond issues in the wholesale market turned positive for the first time since 2015, driven by the unsecured component (Fig. 4). Funding costs are declining, as are credit spreads over other leading banks (Fig. 5). The cost of equity has declined by three percentage points in 2017.

In the first nine months of 2017 the annualized ROE of Italian Significant Institutions – the banking groups under the direct supervision of the Single Supervisory Mechanism (SSM) – net of one-off revenues, was 4.4 per cent against 1.4 per cent in the same period of 2016. Capital adequacy has increased: at end-September the common equity tier 1 of Italy's banking system represented 13.6 per cent of risk-weighted assets, up from 12.6 per cent twelve months earlier.

The Italian banking sector is making significant changes to its industrial organization. Following a reform of the mutual banking sector, more than 300 small cooperative banks (the so-called *banche di credito cooperativo*) will soon form three large banking groups. The largest cooperative banks (*banche popolari*) were transformed into joint stock companies, as required by a law approved in 2015. Two of them subsequently merged, forming Italy's third largest banking group.

### **3. The outlook for banks: key challenges and factors of change**

Against this overall improvement, there are still vulnerabilities to be addressed and challenges to be met. I will focus on three key issues for banks and the Italian financial system as a whole: de-risking, profitability, and firms' access to non-bank sources of finance.

#### ***3.1 Bank de-risking***

De-risking is a key factor in banks' efforts to contain the cost of funding and to attract fresh capital. The sources of risk differ across jurisdictions and business models. For traditional lenders, especially in economies severely hit by the crisis, the main source of risk is the NPL legacy. Italian banks are among them.

Reducing NPLs is an uncontroversial policy objective, and I fully support efforts by banks, supervisors, and national and European authorities to address the problem. Last March the SSM published its NPL Guidance, calling on Significant Institutions with high NPL levels to actively tackle the problem and produce NPL reduction plans. The Bank of Italy actively contributed to this task and was the first national competent authority to issue a similar Guidance for the banks under its own responsibility (the so-called Less Significant Institutions).<sup>6</sup>

The issue is not *whether* to address the high NPL ratio, but *how* to do it. Some commentators have been advocating the imposition of a swift and generalized disposal of NPLs. This policy is designed to rapidly reduce the perception of riskiness of the banking system. However, it would come at a potentially high cost, because of the gap between book values and market prices of NPLs.

This gap does not imply that NPLs are under-provisioned in banks' balance sheets. First, it is primarily attributable to the very high returns required by the buyers and to accounting rules.<sup>7</sup> Second, in recent years for Italian banks recovery rates on bad loans have been around 35 per cent of the original loan value in net present value terms, broadly in line with the net book value of bad loans observed on average in banks' balance sheets.<sup>8</sup>

A generalized sale of NPLs on the market would imply a large transfer of resources from banks to buyers. While the secondary market for NPLs is showing signs of rapid growth, it is still opaque and relatively oligopolistic. Simultaneous, blanket sales would further depress market prices, magnifying the gap between the book and market values of NPLs. The result for banks would be significant losses and reduced capital. This could have unintended effects on individual banks as well as macroeconomic consequences through a contraction in credit supply in countries where high NPL stocks are a concern for several banks.

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<sup>6</sup> The Guidance for Italian LSIs is available at: [http://www.bancaditalia.it/compiti/vigilanza/normativa/orientamenti-vigilanza/Guidance-NPL-LSI.pdf?language\\_id=1](http://www.bancaditalia.it/compiti/vigilanza/normativa/orientamenti-vigilanza/Guidance-NPL-LSI.pdf?language_id=1).

<sup>7</sup> Ciavoliello, L.G., F. Ciocchetta, F. M. Conti, I. Guida, A. Rendina, G. Santini (2016) 'What's the Value of NPLs?', Notes on Financial Stability and Supervision, 3 (<https://www.bancaditalia.it/pubblicazioni/note-stabilita/2016-0003/>).

<sup>8</sup> Conti, F.M., I. Guida, A. Rendina and G. Santini (2017) 'Bad loan recovery rates in 2016', Notes on Financial Stability and Supervision, 11 (<https://www.bancaditalia.it/pubblicazioni/note-stabilita/2017-0011/index.html>).

These considerations suggest that there is a speed limit when dealing with NPL reduction. Banks and supervisors should aim for the maximum speed, but heed the limit. This concept should come as no surprise, and is not new.<sup>9</sup>

In countries where the high NPL phenomenon is widespread, such as Italy, exceeding the limit might entail tensions on several banks at once. Such a problem could only be addressed by mobilizing public resources, a choice made by many countries<sup>10</sup> during the financial crisis but one that is no longer contemplated under the current European legislative framework.

The Action Plan presented by the European Council last summer goes in the right direction, proposing measures to help banks improve their NPL internal management, to boost the efficiency of secondary markets for distressed assets, and to reduce the duration of judicial proceedings for the credit recovery process.<sup>11</sup> Following the Plan, the European Commission issued for consultation an important proposal that envisages a gradual increase of provisioning, to a coverage ratio of up to 100 per cent in the steady state. The proposal would take the form of a regulation and would be a Pillar 1 measure. The measure would be applied to NPLs stemming from new loans, to allow banks to adjust their lending policies to the new rule and to grant them an adequate transition period. The SSM is working on a non-binding Guidance to address the same issue under a Pillar 2 framework. The two proposals, which will be finalized in March, should be adequately coordinated to achieve optimal results and to avoid generating confusion among banks and investors.

The European Council also stressed the importance of public Asset Management Companies (AMCs) and encouraged the European Commission to develop a blueprint for setting them up. Making banks' participation voluntary is necessary to avoid possible instability due to a generalized surge in credit losses. The transfer price, while allowing the AMCs to be profitable, should not be far from the real economic value of the assets. In order to reduce uncertainty, ex-ante guidelines should be provided on how to estimate market prices and real

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<sup>9</sup> More than 125 years ago the famous Austrian economist Carl Menger wrote: *'Consider ... the owner of a stock ... who is obliged through sudden distress, or through pressure from creditors, to convert it into money. The prices which it will fetch will be highly accidental ... And this holds good of all kinds of conversions which in respect of time are compulsory sales'*. In a footnote he continues: *'Herein lies the explanation of the circumstance why compulsory sales, and cases of distraint in particular, involve as a rule the economic ruin of the person upon whose estate they are carried out, and that in a greater degree the less the goods in question are saleable. Correct discernment of the uneconomic character of these processes will necessarily lead to a reform in the available legal mechanism.'* Carl Menger, 1892, 'On the Origin of Money', *Economic Journal*, pp. 239-255.

<sup>10</sup> See Footnote 3.

<sup>11</sup> See <http://www.consilium.europa.eu/en/press/press-releases/2017/07/11/conclusions-non-performing-loans/pdf>.

economic values, on the building blocks of the restructuring plans, and on the governance and funding of the AMCs. The blueprint should clarify to what extent the BRRD and State aid rules could be interpreted in a way that facilitates NPL disposals. Given the importance of this initiative, it is key to avoid the risk that overly tight criteria could end up preventing the creation of an AMC.

But on the NPL front more can and must be done by banks themselves. In many cases action has been slow. NPLs have been left to the back office. This attitude is now changing due to the application of the SSM Guidance addressed to Significant Institutions that I mentioned earlier, which requires banks to define precise NPL strategies and operational plans. Particular emphasis is placed on governance issues. As I have mentioned, the results of these efforts are already visible in the reduction of the stock of NPLs, but a lot remains to be done to optimize the management of these assets and speed up the solution to the NPL problem.

A first crucial issue is information quality. Banks need high-quality, detailed information to maximize value extraction from NPLs and to develop consistent reduction strategies. NPL buyers also need it, to perform the necessary due diligence rapidly and at a low cost so as to reduce the bid-ask spreads currently prevailing on the NPL secondary market. For this reason, in 2016 the Bank of Italy introduced a new system for reporting bad loans, asking for detailed data on the status of recovery procedures and the nature of the collateral. The quality of NPL databases is already better, but there is ample scope for further improvement. We will continue our action on this front.

A second issue is the duration of judicial proceedings. It is well known that in Italy the credit recovery process is long (Fig. 6) and that this contributes to driving up the stock of NPLs. The legislative reforms introduced in 2015 and in 2016<sup>12</sup> are helping to shorten the recovery process, but further progress is necessary to converge to the EU average. The wide heterogeneity in the duration of proceedings across different Italian courts<sup>13</sup> suggests that progress is possible also without the intervention of the legislator, via efficiency-enhancing organizational changes at the individual court level. The benefits of these changes would extend well beyond the issue of NPLs; they would improve credit allocation, reduce the cost of credit for borrowers, and improve the perception of the ease of doing business in Italy, with important benefits for economic growth.

In countries such as Italy the introduction of mechanisms requiring a 100 per cent coverage of NPLs calls for an aggressive approach by the Government to reduce the length of credit

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<sup>12</sup> For an analysis of the main measures taken in the past ten years, see: Giacomelli, S., S. Mocetti, G. Palumbo and G. Roma (2018), 'Civil justice in Italy: recent trends', Bank of Italy Occasional Papers, 401, <http://www.bancaditalia.it/pubblicazioni/qef/2017-0401/index.html>.

<sup>13</sup> The duration of insolvency procedures ranges from 4.8 years in the most virtuous districts to 10 years in the less efficient ones. The duration of real-estate foreclosures ranges from 2 to 8 years.

recovery procedures. Until then, the implementation of these mechanisms will need close monitoring.

I argued above that de-risking is a key factor for banks to contain the cost of funding and to attract fresh capital. Some commentators link de-risking to the creation of a European Deposit Insurance Scheme (EDIS), the missing pillar of the Banking Union, arguing that regulators should tighten prudential rules on sovereign exposures to break the link between banks and the sovereign.<sup>14</sup> This proposal does not fully consider the fact that the microeconomic and macroeconomic costs of such a prudential reform could be sizeable, while the benefits are uncertain. The bank-sovereign nexus, in fact, goes well beyond simple direct credit exposures, and depends above all on the impact that both banks and sovereigns have on the real economy. Furthermore, in some circumstances increasing banks' sovereign exposures may actually play a stabilizing role.<sup>15</sup> These considerations, shared by most global supervisors, recently led the Basel Committee to leave unchanged the prudential treatment of sovereign assets. The problem of high public debt should be addressed by Governments directly, with determination. It should not be improperly tackled with prudential regulation.

More generally, while it may make sense to start from a clean slate before going forward with EDIS, blind spots should be avoided. While NPLs or sovereign bonds may represent a source of risk for some banks, for others – such as large intermediaries engaged in investment banking – risks take the form of a high incidence of complex financial instruments, those classified for accounting purposes as Level 2 and Level 3. These are, to a large extent, assets and liabilities not directly traded in active markets or marked to model, whose value is difficult to assess. At the end of 2016 there were about €3.6 trillion of these instruments on the assets side and €3.2 trillion on the liabilities side of the balance sheets of euro-area Significant Institutions. The total is €6.8 trillion, about 12 times that of net NPLs of all euro-area banks.<sup>16</sup>

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<sup>14</sup> See for example Wolff (2016), 'European Parliament testimony on EDIS' (<http://bruegel.org/wp-content/uploads/2016/05/EDIS-EP-statement.pdf>).

<sup>15</sup> See Lanotte, M., G. Manzelli, A.M. Rinaldi, M. Taboga and P. Tommasino (2016), 'Easier said than done? Reforming the prudential treatment of banks' sovereign exposures', Bank of Italy Occasional Paper, 326, [https://www.bancaditalia.it/pubblicazioni/qef/2016-0326/QEF\\_326\\_16.pdf](https://www.bancaditalia.it/pubblicazioni/qef/2016-0326/QEF_326_16.pdf). On the same subject, see also: <https://voxeu.org/article/recent-developments-regulatory-treatment-sovereign-exposures>.

<sup>16</sup> The reason for considering this total rather than the net value is that the available data do not tell us if and to what extent the risk embedded in assets is effectively hedged by liabilities. See Roca, R. and F. Potente (2017), 'Risks and challenges of complex financial instruments: an analysis of SSM banks', Bank of Italy Occasional Paper, 417 <https://www.bancaditalia.it/pubblicazioni/qef/2017-0417/index.html?com.dotmarketing.htmlpage.language=1>.



Level 2 and Level 3 instruments play an important role in the functioning of the financial system. However, the available information is limited, in spite of their huge volumes. Their complexity and opacity create substantial room for discretionary accounting and prudential choices by banks, which have incentives to use this discretion to their advantage. As a result, valuation risks are unknown, but probably non-negligible. Overall, a serious debate on de-risking cannot ignore the risk posed by Level 2 and Level 3 instruments.

One area where in my view the new European regulatory framework needs further work is crisis management. The number of authorities involved at European level has grown strongly; their responsibilities are not clearly attributed and the objectives assigned to them are not always aligned. We have also seen in practice how – in the absence of a reserve of liabilities able to absorb losses in the event of a crisis (MREL) – this arrangement may lead to risks to financial stability, especially in view of the fact that the rules, their interpretation, the procedures themselves have become more complex. For banks subjected to TLAC and MREL requirements, this state of affairs will come to an end when the new equilibrium is achieved (requirements are fully phased in and respected by these banks). For the other, smaller banks, liquidation remains the only tool to address a crisis. I believe that this is unsatisfactory.

### ***3.2 Bank profitability***

Low profitability is a second challenge – in my view the key one – that Italian banks must face. It is not just an Italian issue: most European banks are still unable to create enough value to meet investors' expectations. However, the gap between the cost of capital and profitability is larger on average for Italian banks, in spite of the recent improvements.

The problem is partly cyclical. Provisions originating from the recession have been the main driver of ROE (Fig. 7). As the recovery strengthens and new NPLs ebb, provisions are diminishing and profitability is re-emerging. However, in the first nine months of 2017 provisions still absorbed almost two thirds of the operating profits of Italian Significant Institutions.<sup>17</sup>

A second cyclical determinant of weak profits is the low net interest margin, which in turn is driven by a combination of low interest rates, a flat yield curve and anemic credit growth. Again, the economic recovery is reducing the impact of these factors. We expect net interest income to grow in the next two years, driven by credit growth and a steepening of the yield curve.

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<sup>17</sup> Over the last three years banks needed to increase the coverage ratios to sell impaired assets on the market.

This, together with a steady increase in non-interest income (50 per cent since 2008, mainly through fees and commissions; Fig. 8), will improve the outlook for profits.

According to the plans of the Italian Significant Institutions, average ROE is expected to increase to 9 per cent by 2019, substantially closing the gap with the cost of capital. However, risks to this scenario are mostly on the downside. Various factors contribute to this assessment.

The digital revolution is reshaping financial markets, creating opportunities but also risks for banks that fail to adjust rapidly. New players are entering the financial services market, offering traditional banking products at a lower cost. Banks' payment services, brokerage and asset management fees and even interest income are being tested by FinTech companies.

Regulatory changes are a second structural shift to which banks need to adjust. Recent reforms have increased capital and liquidity buffers; the new resolution and liquidation regime requires a large volume of liabilities with high loss absorption capacity. Furthermore, banks must also comply with additional requirements, such as those on anti-money laundering and consumer protection. The new Markets in Financial Instrument Directive (MiFID2) will enhance consumer protection, but at the same time it will increase the burden of compliance.

The benefits of these regulatory changes are clear: banks are safer than in the past. At the same time, achieving pre-crisis profitability levels has become extremely challenging. Indeed, an industry with much lower risk levels should entail lower returns and cost of equity.

To face these challenges banks need to take firm action to reduce costs and achieve efficiency gains.<sup>18</sup> Massive investments in information technologies and in human capital are necessary. Progress is ongoing on this front.<sup>19</sup>

Against this background, a key avenue to improve efficiency and profitability is bank consolidation. Indeed, some of the factors of change are having an impact on scale economies and the optimal bank size. Setting up the technological infrastructure needed to do banking business today requires conspicuous investment; in the face of negligible marginal costs, this is a factor increasing scale economies. Fixed compliance costs have also risen considerably in recent years, due to stricter and more pervasive regulation.

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<sup>18</sup> In countries where a widespread adoption of new technologies has been coupled with large IT investments by banks, intermediaries tend to exhibit a higher ROE than elsewhere, sustained by a low cost-income ratio.

<sup>19</sup> Italian banks are reducing their branch network and are increasingly relying on digital resources. The number of branches at the end of 2017 was 20 per cent lower than in 2008. Ambitious programs of staff reduction and internal restructuring have been announced (and in many cases are being implemented) by all the largest banking groups.

Past experience suggests that mergers and acquisitions, if properly designed and based on sound industrial projects, can yield material efficiency gains.<sup>20</sup> Many Italian banks can obtain remarkable benefits from consolidation. They must explore this possibility in order to obtain the efficiency gains, the technological skills, the product and geographical diversification that are necessary to compete successfully in the domestic and international market and to finance the real economy.

### ***3.3 Firms' financial structure***

The last issue I wish to address is firms' financial structure. The regulatory changes introduced in the aftermath of the global financial crisis are inducing banks in many countries to deleverage and to reduce their appetite for risk. In economies like the Italian one, where firms – by international comparison – are relatively small and heavily reliant on bank credit, the consequences of such reforms for the financing of the real economy must be analyzed carefully.

In order to mitigate possible unintended consequences, the development of a more diversified financial system is a priority for the Italian economy. In recent years the Italian authorities have introduced tax incentives and administrative simplifications to reduce the overall cost of IPOs, to incentivize bond issues and to stimulate investment in innovative startups. The legislation on ACE (allowance for corporate equity) is helping to improve firms' capitalization levels. The adoption of consolidated international contractual practice has prompted the entry of foreign specialized operators in the private debt placement market. Cooperation between the public and private sectors has stimulated the creation of venture capital funds.<sup>21</sup> To encourage the demand for financial instruments issued by Italian companies, the 2017 budget law has introduced tax exemptions for long-term individual savings plans (*Piani Individuali di Risparmio*, PIR).

These measures have produced encouraging results. Since 2011 the share of bonds among firms' total financial liabilities has almost doubled, to 12.6 per cent last September (from €90

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<sup>20</sup> In Italy, between mid-1995 and the mid-2000s, mergers and acquisitions triggered a restructuring process that allowed the banking industry to absorb excess capacity. In connection with the far-reaching consolidation that took place, between 1995 and 2004 large productivity gains were achieved: total assets and value added per employee grew respectively by 4.6 and 2.4 per cent per year at constant prices See Focarelli, Panetta and Salleo (2002) "Why Do Banks Merge?" *Journal of Money, Credit, and Banking*, v. 34, and Focarelli and Panetta (2003) "Are Mergers Beneficial to Consumers? Evidence from the Market for Bank Deposits" *American Economic Review*, v. 93, 4.

<sup>21</sup> Thanks to a public-private partnership, the *Fondo Italiano di Investimento* between 2012 and 2016 created two venture capital funds of funds that invested €100 million in venture capital private funds; the size of the Italian funds involved in these transactions is equal to €400 million.

billion to more than €150 billion in absolute terms). The number of firms issuing bonds is increasing; moreover, while in the past only large industrial groups were active in the market, now recourse to bonds is spreading to smaller firms. Also the number of IPOs has been relatively high in recent years. We need to consolidate and accelerate these trends, to stimulate the growth of capital markets and improve the financial soundness of Italian firms.

Significant progress on the capital market union, one of the objectives pursued at European level, would be an important move in this direction. Building a genuine capital market union does require far-reaching legal changes, such as EU-wide company and bankruptcy legislation.

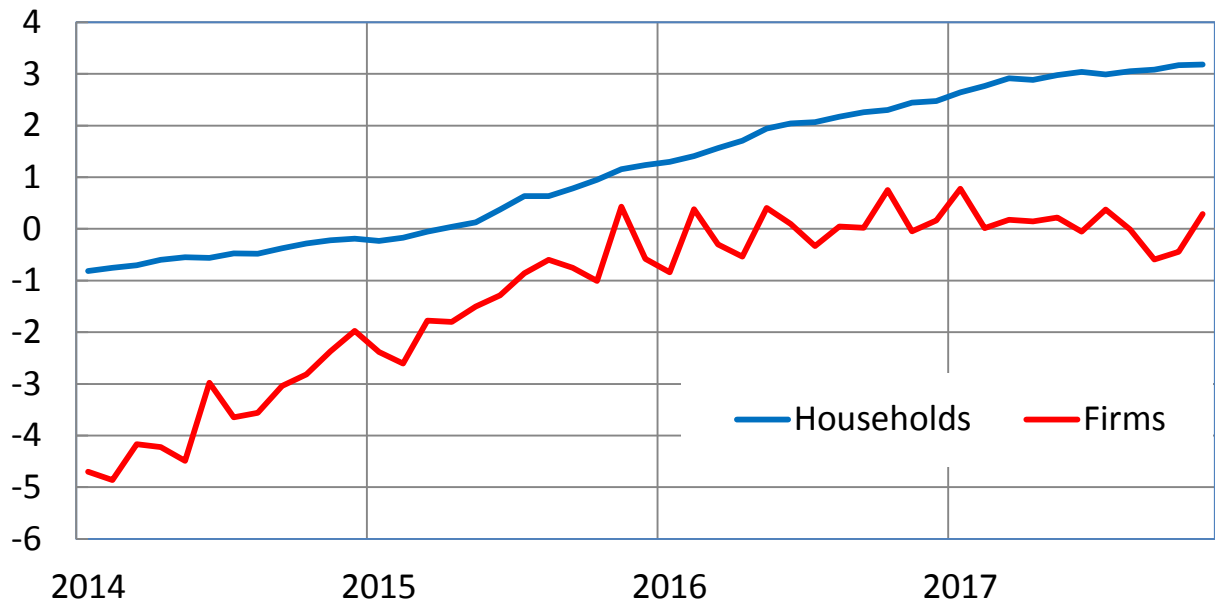
Banks can play an important role in helping firms access alternative sources of external finance and can benefit from this process. The shift towards a less bank-dependent financial structure of corporates can provide banks with a valuable opportunity to broaden their revenues, by focusing on the provision of related and complementary services in the area of corporate finance and asset management. This will require intermediaries to acquire adequate human resources and technological capacity in order to exploit the large pool of information on firms, to interact with investors and markets, and to avoid conflicts of interest.

## **Conclusions**

To conclude, now that the economic recovery is gaining momentum, banks can make further progress in strengthening their balance sheets. De-risking, via a rapid reduction of NPLs, is under way. Profitability, though still low and affected by the structural shifts imposed by the digital revolution and by the recent wave of regulatory reforms, can benefit from bank consolidation. The conditions are there for Italian banks to face the challenges posed by the new regulatory and market environment. The improvements obtained in the recent past will allow them to support economic growth and more solid, financially diversified, enterprises. It will also let them face the challenges of the next decade: cross-border integration, digitalization and competition by FinTech companies.

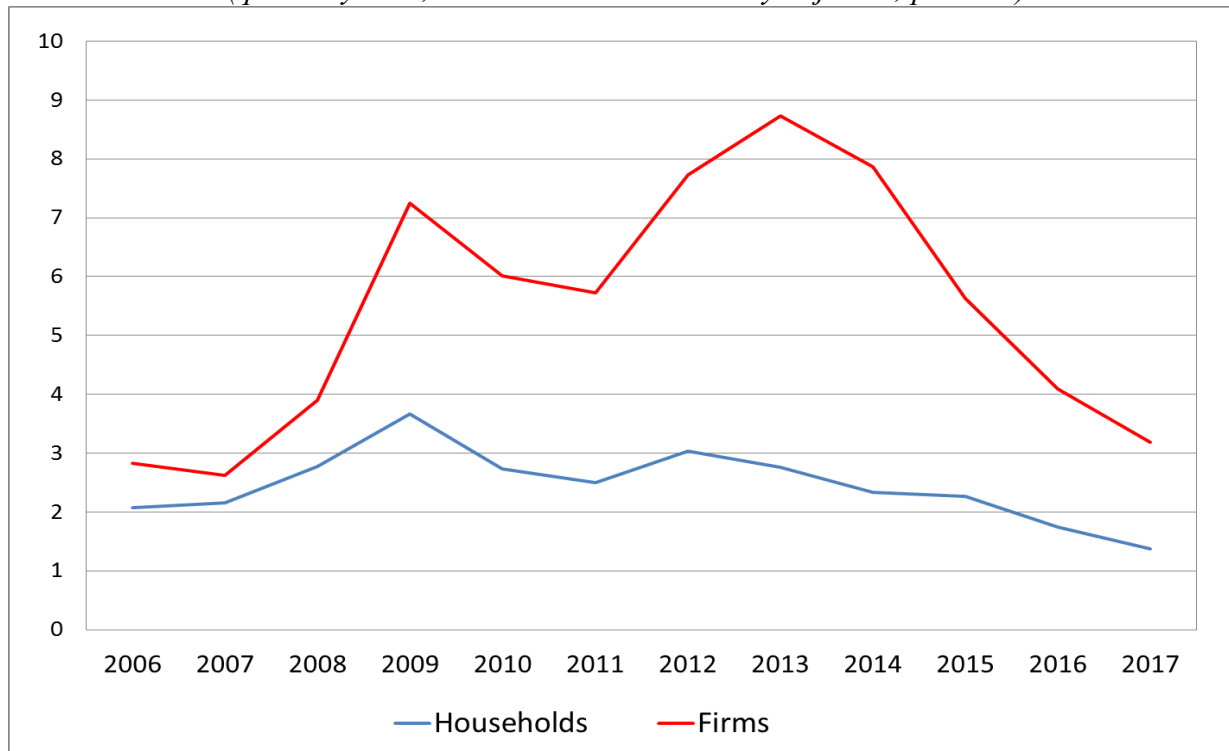
Thank you for your attention.

**Figure 1. Bank loans to firms and households**  
(yearly rate of change; per cent)



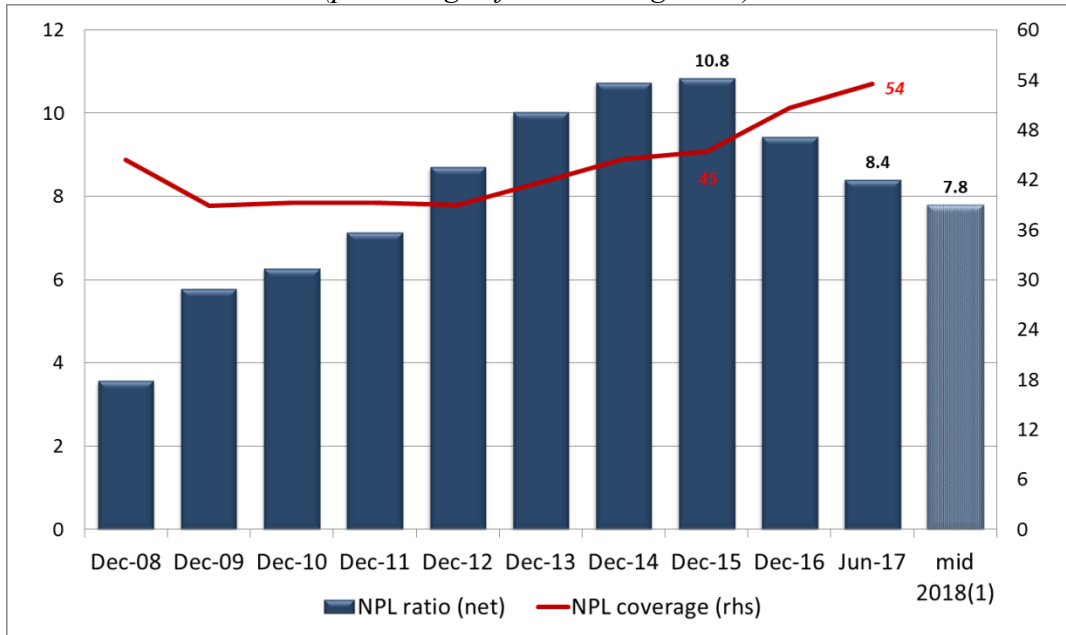
Source: Bank of Italy.

**Figure 2. New non-performing loans to performing loans**  
(quarterly data, annualized and seasonally adjusted; per cent)



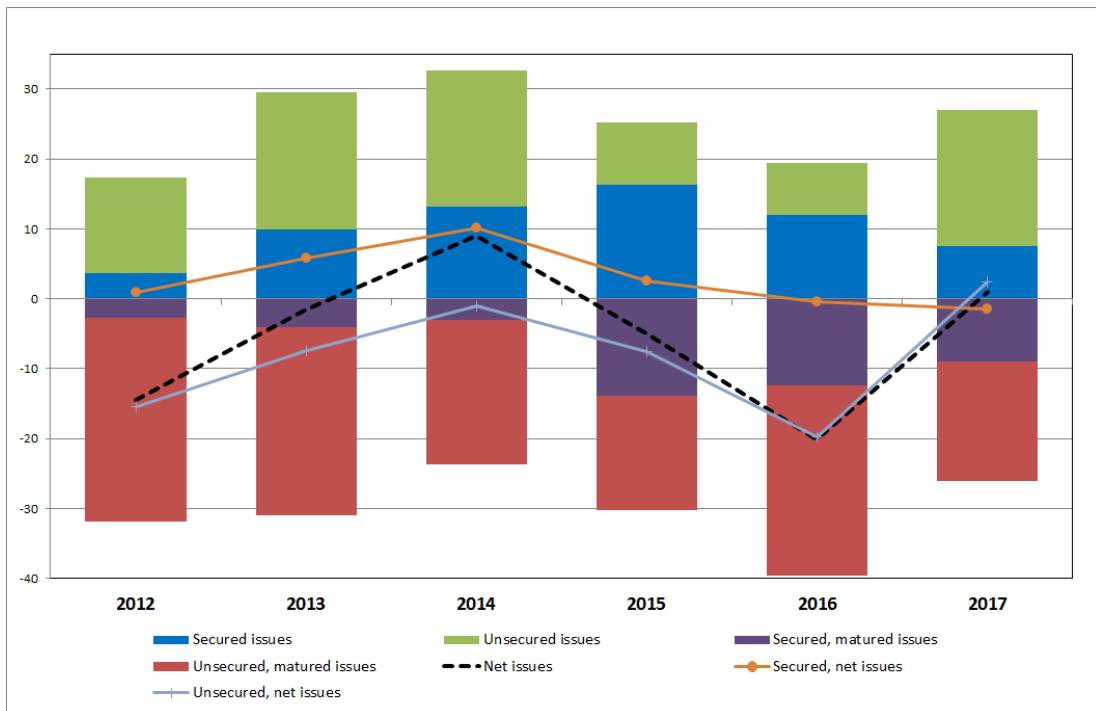
Source: Bank of Italy, Central credit register.

**Figure 3. Net non-performing loan ratio and coverage ratio**  
(percentage of outstanding loans)



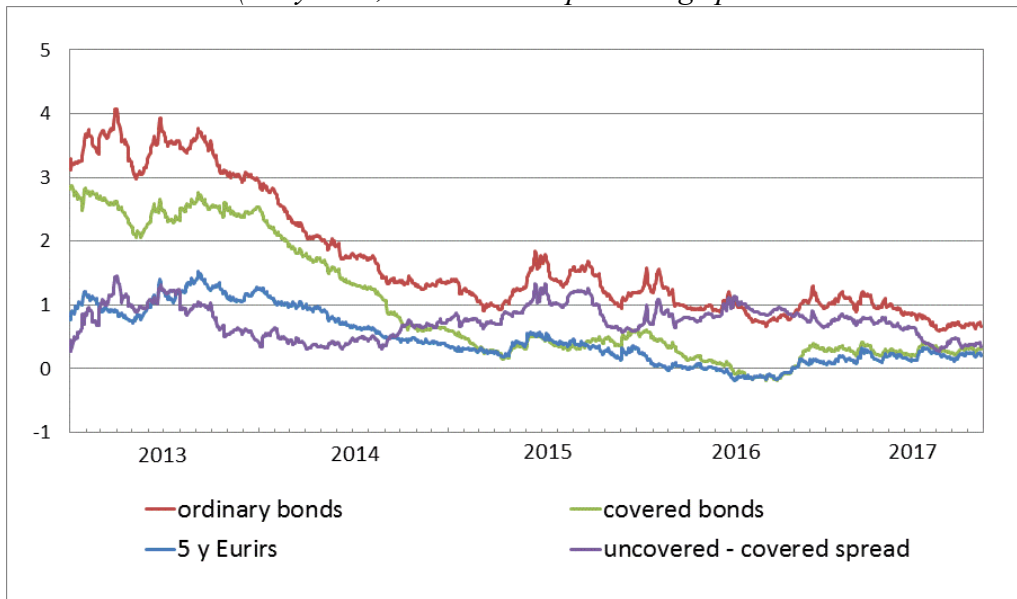
(1) Expected mid-2018 data are calculated considering September 2017 data for banking groups and June 2017 for stand-alone banks. NPL disposal by MPS (expected by mid-2018) is also taken into account.

**Figure 4. Bonds issued and matured**  
(yearly data; billions of euros)



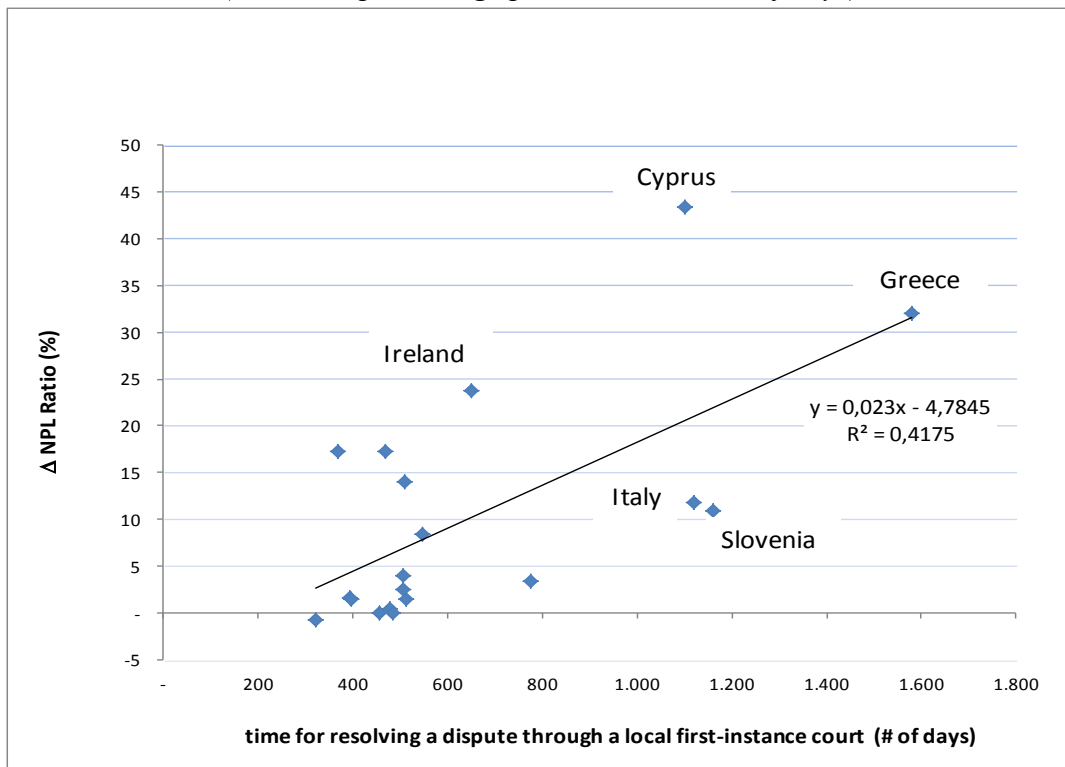
Source: Based on Dealogic.

**Figure 5. Bond yields**  
*(daily data; amounts and percentage points)*



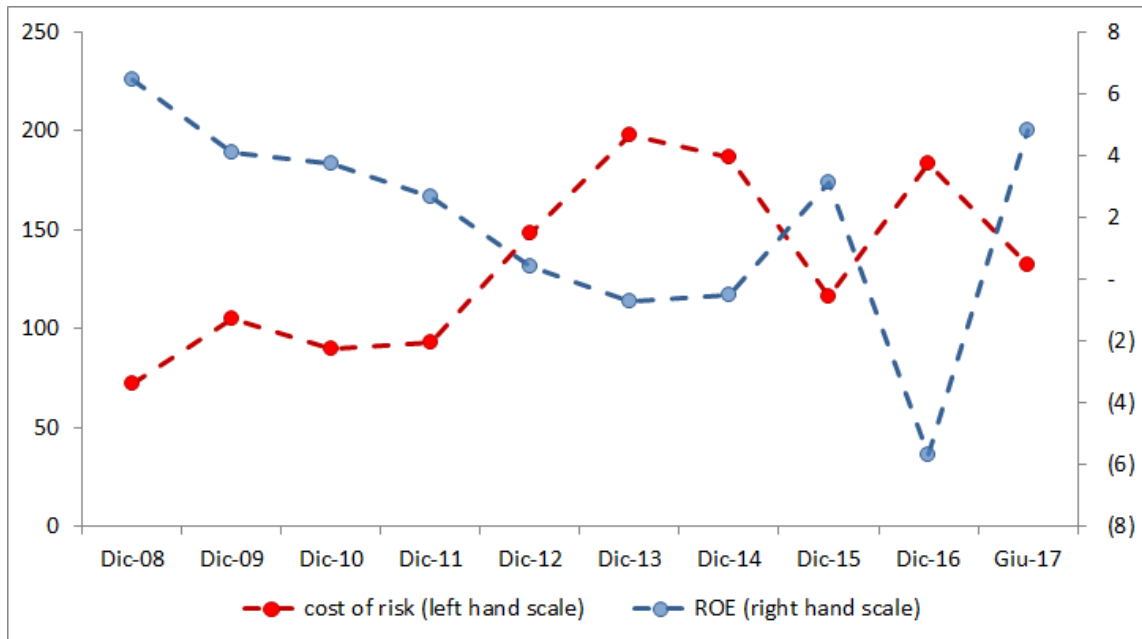
Source: Based on Bloomberg.

**Figure 6. Relationship between the NPL ratio and time for enforcing contacts**  
*(EU area; percentage points and number of days)*



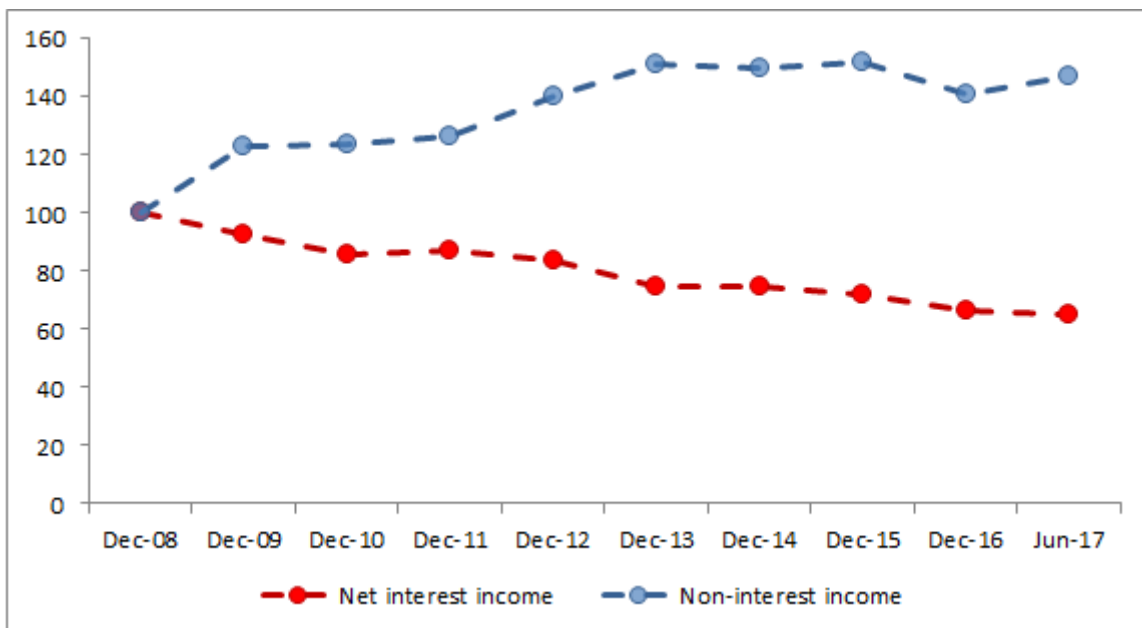
Source: ECB Consolidated Banking Data and World Bank Doing Business Database.

**Figure 7. Cost of risk and ROE**  
*(annualized data; basis points and percentage points)*



Source: Bank of Italy.

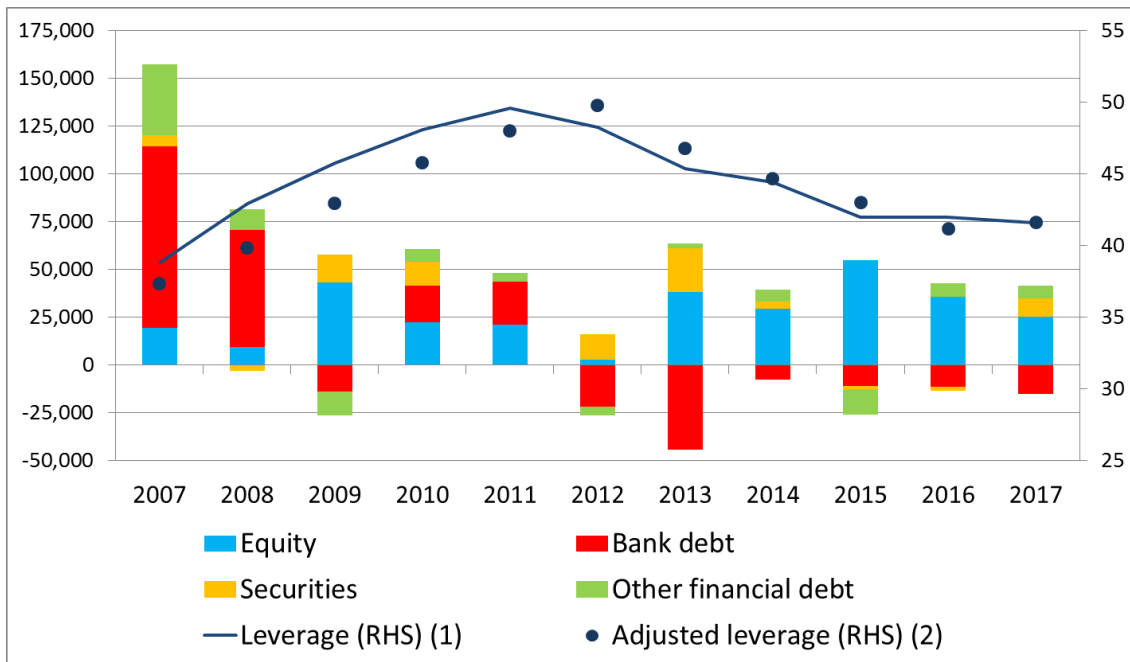
**Figure 8. Gross income: dynamic of interest and non-interest income**  
*(annualized data; indices, 100= December 2008)*



Source: Bank of Italy.



**Figure 9. Sources of funding and leverage of Italian firms**  
*(annual flows in billions of euro and per cent)*



Source: Bank of Italy and Cerved.

(1) Leverage is calculated as the ratio of financial debt to the sum of financial debt and net equity at market prices. (2) Adjusted leverage is calculated by removing the effects of changes in the market value of net equity. A value above (below) the solid line indicates, for a given year, a decrease (increase) in the market value of equity.

