BANCA D'ITALIA
EUROSISTEMA

Address by Governor

Ordinary General Meeting of Shareholders
Rome, 29 March 2019

125th FINANCIAL YEAR

2018

Financial Year 125th

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Ladies and Gentlemen,

In 2018 the Bank of Italy continued its capital reallocation, a process that began with the reform of the Bank's ownership structure (Law 5/2014). As at 17 February 2019, the last date by which a shareholder could acquire shares with the right to dividends for 2018, 33.3 per cent of the capital had been transferred. Of the Bank's 124 shareholders at the above date, 92 became shareholders after the reform: 6 insurance companies, 7 pension funds, 9 social security institutions, 24 banking foundations and 46 banks. Shareholdings that exceeded the 3 per cent threshold introduced by Law 5/2014 amounted to €2.5 billion, out of a total of €7.5 billion.

Increasing the number of shareholders was one of the goals of the reform. On behalf of the Board of Directors and the Governing Board, I would like to welcome those who are attending their first Shareholders' Meeting. While the reform confirmed that the Bank is a privately-held company, it did not change the nature of the Bank of Italy itself: it remains a public-law institution that performs its functions in the general interest conferred upon it by Italian and European legislation.

The Bank performs its functions autonomously and independently within the guidelines established by the Governing Council of the European Central Bank (ECB), being accountable for its operations in accordance with the principle of transparency. Based on the treaties signed by Italy and by the other member states of the European Union, the members of the Bank's bodies may not seek or take instructions from national or European public entities or from private parties. Law 5/2014 confirms that the Shareholders and the Board of Directors may not intervene in the Bank's institutional functions and limits shareholders' ownership rights to the value of the capital and to the dividends. Shareholders have no claim whatsoever on the Bank's gold and foreign currency reserves, the holding and management of which constitutes one of the fundamental roles assigned to a central bank under the Treaty on the Functioning of the European Union. Irrespective of the specifics of national legislation, the Treaty refers to the task of holding and managing reserves: in our legal system this is implemented through the right of ownership.

The annual accounts presented today for your approval show a net profit of €6.2 billion. This amount is significantly higher than the €3.9 billion reported last year, which was nevertheless the highest level ever recorded by the Bank. The improvement was partly due to the further increase in the amount of securities held for monetary policy purposes and the decline in transfers to financial buffers to offset balance sheet risks.

In December 2018, after four years of uninterrupted growth, the extended asset purchase programme (APP) was terminated. During that four-year period, the balance sheet of the Bank of Italy and that of the Eurosystem both doubled in size. The securities held for monetary policy purposes increased approximately tenfold. Gross profit before taxes and transfers to the provision for general risks increased by about 50 per cent to stand at €8.9 billion.

Looking forward, balance sheet profits will continue to be affected by the general state of the economy, by changes in monetary policy measures and by the riskiness of assets.

The Eurosystem's expansionary monetary policy and the Bank of Italy's annual accounts

In 2018 the Eurosystem's monetary policy stance remained expansionary in order to encourage the gradual convergence of inflation rates to below, but close to, 2 per cent over the medium term.

The ECB Governing Council kept key interest rates unchanged at 0.0 per cent for the main refinancing operations and at -0.40 per cent for the deposit facility. Rates are expected to remain at these levels at least until the end of 2019 and, in any case, for as long as necessary to ensure that inflation moves towards the stated objective.

In the euro area, net purchases of public and private-sector securities were halved, falling to €30 billion per month at the start of 2018; that amount was further reduced to €15 billion from October. As mentioned earlier, these purchases were terminated in December. Central banks are re-investing the principal payments from maturing securities, a measure that is expected to continue for an extended period of time and, in any case, for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation.

The Council also announced that it would assess the possibility of taking further measures to ensure that the banking system had the liquidity necessary for the smooth functioning of the monetary policy transmission mechanism.

Hence, on 7 March 2019 the Governing Council decided to launch a new series of targeted longer-term refinancing operations (TLTRO3), each with a maturity of two years, carried out on a quarterly basis starting in September 2019 and ending in March 2021. Counterparties will be entitled to borrow up to 30 per cent of the stock of eligible loans as at 28 February 2019. The interest rate will be indexed to the interest rate on the main refinancing operations over the life of each operation. Like the outstanding TLTRO operations, the new operations will feature built-in incentives for credit conditions to remain favourable.

The balance sheet

At the end of 2018, the Bank's balance sheet assets amounted to €968 billion, €37 billion more than at the end of 2017. The growth was much smaller than that registered in 2017 and was almost entirely due to securities purchased for monetary policy purposes, which amounted to €393 billion. Most of these securities were Italian government securities, whose value reached €320 billion last year.

Refinancing operations declined by €8 billion, falling to €244 billion, owing to maturing and voluntary repayments of targeted longer-term operations. Overall, assets held for monetary policy purposes represented two thirds of total balance sheet assets.

The value of the gold reserves stood at €88 billion, €3 billion more than in 2017. In line with Eurosystem accounting rules, the unrealised gain was prudently allocated to the revaluation accounts – which record the unrealized gains with respect to the purchase price – in order to offset the negative effects of any future declines in the price of gold.

On the liability side, the Bank of Italy's negative balance in connection with the TARGET2 payment system reached €482 billion at the end of 2018, an increase of €43 billion compared with 2017. The widening of the negative balance occurred mainly in May and June and largely reflected net sales of Italian securities by foreign investors. In the last few months of the year, capital outflows decreased and the Bank's negative TARGET2 balance improved, with inflows peaking in December. In the first few months of

2019, the balance has fluctuated significantly, but has remained on average at the level recorded at year end.

Deposits held by credit institutions with the Bank fell from €143 billion to €89 billion. Banknotes in circulation, disclosed in the balance sheet in proportion to the Bank's share in the ECB's capital, grew by €10 billion to stand at €198 billion. The euro-denominated deposits held by general government increased from €7 billion to €32 billion.

Profitability, risks and organizational measures

As mentioned earlier, gross profit before taxes and transfers to the provision for general risks amounted to €8.9 billion in 2018.

The increase of €0.5 billion over the previous year is mainly due to the growth in net interest income, which benefited from greater interest income on securities purchased for monetary policy purposes and lower interest expense on longer-term refinancing operations. The growth in net interest income was partly offset by the fall in realized gains arising from financial operations and higher write-downs on securities and foreign currency holdings.

In the light of both the expansion of the balance sheet and the Bank's overall risk exposure, assessed under even the most adverse scenarios, the Bank continued to gradually strengthen its financial buffers, increasing the provision for general risks by €1.5 billion (€2.9 billion in 2017). Taxes for the year amounted to €1.2 billion (€1.6 billion in 2017).

Operating expenses fell by 2.5 per cent, mainly owing to the decrease in staff severance payments and the decline in transfers relating to staff severance pay and pensions. As a result, costs for in-service and retired staff fell by €54 million; the remaining costs increased by €4 million overall.

At the end of 2018, the Bank had less than 6,700 employees, 1,000 fewer than in 2008. This decrease reflects the reorganization implemented over the years, largely on account of technological advances, to contain operating costs without compromising the effective performance of institutional functions.

During the year the reorganization of the banknote production function became fully effective. Reflecting the changes underway in Europe, this resulted in a more streamlined organizational structure that makes the Bank's printing works more efficient, productive and competitive within the euro-area public sphere.

The closure of the last ten territorial service units (TSUs), which were set up on a temporary basis in 2015, marked the completion of the plan for the reorganization of the Bank's branch network that was first implemented in 2008. The number of branches declined to 39, 58 branches fewer than in 2008. The current branch network is more agile and efficient in performing the Bank's institutional functions and it plays a larger role in the protection of bank customers, financial education, prudential supervision of non-bank financial intermediaries and communication campaigns.

The reorganization of the Financial Supervision and Regulation function was finalized at the end of 2018. The aim of the reform was to enhance the Bank's participation in the decision-making processes of the Single Supervisory Mechanism, intensifying coordination with other supervisory authorities and strengthening the branches' supervisory activities, taking account of changes to the geographical distribution of financial intermediaries in Italy.

Further information on the activities of the Bank and on the organizational and management measures implemented in 2018 is available in the *Report on Operations and Activities of the Bank of Italy* which will be published on 31 May 2019, on the occasion of the presentation of the *Annual Report*.

Proposal for the allocation of the net profit

Shareholders,

Pursuant to Article 38 of the Statute, acting on a proposal of the Governing Board and after hearing the opinion of the Board of Auditors, I present for your approval the Board of Directors' proposal for the allocation of the net profit. On behalf of the Board of Directors and the Governing Board, I would like to take this opportunity to thank the members of the Board of Auditors, who have reached the end of their term, for their valuable contribution.

As you may recall, under the dividend policy in force, the amount paid to the shareholders is kept within a range of €340 million to €380 million, provided that the net profit is sufficient and without prejudice to the Bank's capital adequacy. The difference between the upper limit of the range and the dividend paid to the shareholders is allocated to the special item for stabilizing dividends, until such item reaches a maximum amount of €450 million.

Accordingly, from the net profit of €6,240 million, we propose allocating €340 million as a dividend to the shareholders, equal to 4.5 per cent of the capital. As a result, €40 million would again be allocated to the special item for stabilizing dividends, which would amount to €120 million.

Pursuant to the Statute, shares exceeding the 3 per cent threshold are not entitled to a dividend. The corresponding dividend, equal to €113 million, is allocated to the ordinary reserve. Therefore, the dividend actually due to the shareholders would amount to €227 million.

We propose transferring €150 million to the ordinary reserve. Taking into account the dividends withheld on shares exceeding the threshold, the total allocation would amount to €263 million.

With the transfer of €1.5 billion to the provision for general risks, together with the share of profits allocated to the ordinary reserve, the total amount allocated to the financial buffers would be €1.8 billion.

As a result, €5,710 million of the Bank's net profit would be allocated to the State, an increase of €2,344 million compared with 2017.

Designed by
the Printing and Publishing Division
of the Bank of Italy