



BANCA D'ITALIA  
EUROSISTEMA

# Financial Stability Report

November 2023

2 | 2023





**BANCA D'ITALIA**  
EUROSISTEMA

# **Financial Stability Report**

**Number 2 / 2023**  
**November**

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## SYMBOLS AND CONVENTIONS

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Unless otherwise specified, Bank of Italy calculations; for Bank of Italy data, the source is omitted.

In the tables:

- the phenomenon does not exist;
- .... the phenomenon exists but its value is not known;
- .. the value is nil or less than half of the final digit shown;
- :: not statistically significant;
- () provisional.

In the figures with different right- and left-hand scales, the right-hand scale is identified in the notes.

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## OVERVIEW

*The global economy is slowing down and the strong geopolitical tensions and the deceleration in economic activity in China are weighing on the growth outlook. Inflation is declining in the advanced economies, but it remains above the targets of monetary policy, which continues to be tight.*

*Concerns about a longer than expected period of monetary tightening have led to a worsening of global financial market conditions since last summer, although they have largely improved in recent weeks. Interest rates have risen sharply and volatility remains high in long-term government bond markets, especially in the United States.*

*In Italy, the risks to financial stability are benefiting from the improvement in the conditions of the banking system and from the low level of private debt, but the overall macroeconomic picture remains uncertain. In addition to the weakness in the global economy, there is considerable public debt – which the Government's recently published Update to the 2023 Economic and Financial Document envisages will fall only marginally over the next three years – and fears of returning to structurally low growth.*

*Liquidity and the functioning of the secondary market for government securities have not been impacted by the reduction of government bonds on the Eurosystem balance sheet, which has been more than offset by the increase in purchases by households. Although favourable, liquidity conditions are extremely sensitive to global economic news, to fiscal policy and to monetary policy decisions.*

*House prices have continued to grow, albeit at a much slower pace than in 2022 and well below inflation. The slowdown is expected to continue in 2024. Sales are still decreasing, also owing to the tightening in financing conditions.*

*The risks stemming from the financial situation of households remain limited. Household financial wealth increased in the first half of the year; against*

*a backdrop of low interest rates on sight deposits, households have reduced their holdings in these accounts and have shifted towards financial assets. The ratio of financial debt to disposable income, already low by international standards, fell. However, the loan default rate rose, especially for adjustable-rate mortgages.*

*The economic slowdown and the high financing costs are having an impact on the financial situation of firms, whose riskiness is in any case still limited overall. Lending contracted significantly owing to higher costs, lower financing needs for investment and the increase in repayments of the public-guaranteed loans obtained during the pandemic. The debt-to-GDP ratio continued to decline, remaining well-below the euro-area average; debt servicing capacity remains good. The increase in financing costs could, however, cause the loan default rate to rise in 2024.*

*The main risks to the banking system continue to stem from the weak growth outlook. Although banks' asset quality has only shown slight signs of deterioration up until now, the deceleration in economic activity and the higher interest rates could hamper borrowers' ability to service their debt. Profitability rose sharply, helped along by the positive trend in net interest income, but it is projected to be affected by higher funding costs and a higher loan default rate over the next two years. The liquidity profile remains balanced; the repayment, in June, of a sizeable amount of the third series of targeted longer-term refinancing operations (TLTRO III) did not have a significant impact. The capital ratios have improved. The recent stress test on the banks directly supervised by the Bank of Italy shows that overall they would be able to weather the impact of adverse macroeconomic events, in line with what was already found for significant groups in the EU-wide stress testing carried out in recent months.*

*In the first nine months of this year, the capitalization of the insurance sector rose, reflecting the growth in*

*the value of investments. Profitability improved in the first half of the year, although it continued to be affected by the unrealized losses on the insurers' securities portfolios. The liquidity position has remained solid overall, although in the life sector premium income has continued to fall and contract surrenders have persisted.*

*In the second and third quarters of 2023, net subscriptions of Italian open-end investment funds were negative, reflecting the uncertainty connected with the macroeconomic outlook and the increase in interest rates. The outflows were mainly attributable*

*to retail investors. Investment funds increased their holdings in government securities and investment grade bonds, reducing their cash holdings. The risks in this sector remain low.*

*The Bank of Italy has recently reviewed the methodology for identifying systemically important institutions at national level (O-SIIs) and calibrating their capital buffers, identifying seven O-SIIs for 2024. With the introduction of the new buffers, the macroprudential requirements imposed on Italian O-SIIs are close, on average, to those applied to other European O-SIIs with similar risk profiles.*

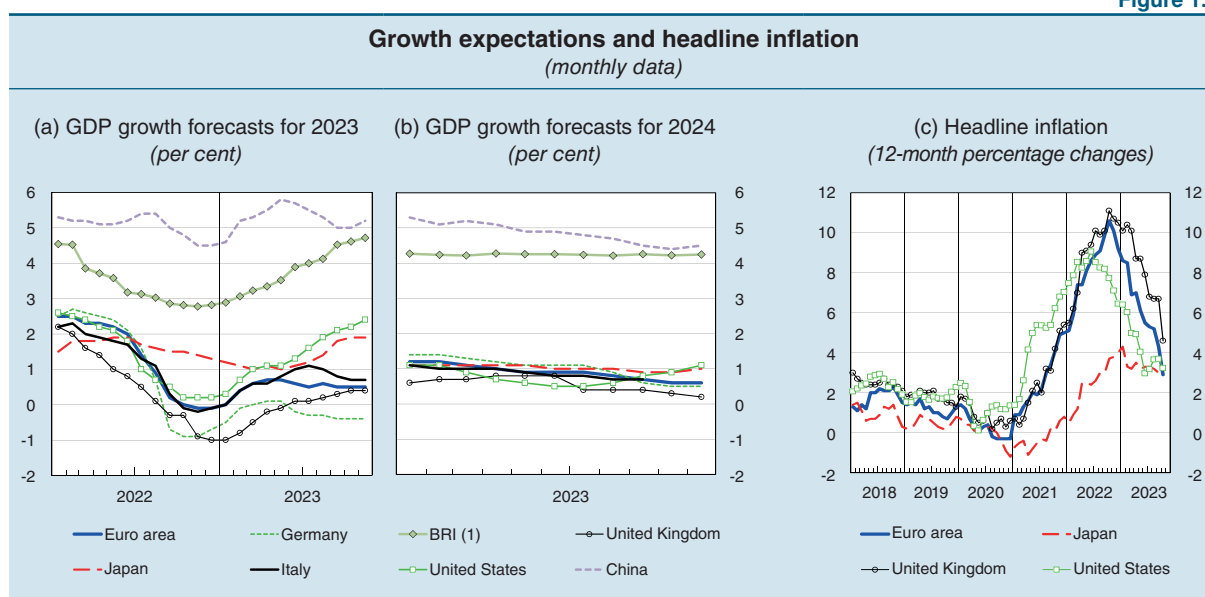


# 1 MACROECONOMIC, FINANCIAL AND SECTORAL RISKS

## 1.1 GLOBAL RISKS AND EURO-AREA RISKS

The global economy has been slowing down since the second quarter of 2023. High interest rates, the deceleration in economic activity in China and the geopolitical tensions stemming from the continuing war in Ukraine and further aggravated by the recent conflict in the Middle East are weighing on the growth prospects for 2024 (Figures 1.1.a and 1.1.b). The reduction in energy prices came to a halt in August, partly as a result of oil production cuts by OPEC countries. Although inflation is declining in advanced economies, it remains above monetary policy objectives (Figure 1.1.c). At their most recent respective meetings, the main central banks kept policy rates unchanged, while indicating that their monetary policy stance could remain tight for a prolonged period, should inflationary pressures continue to be strong.

Figure 1.1



Sources: Based on Consensus Economics for GDP, and on national statistics for inflation.

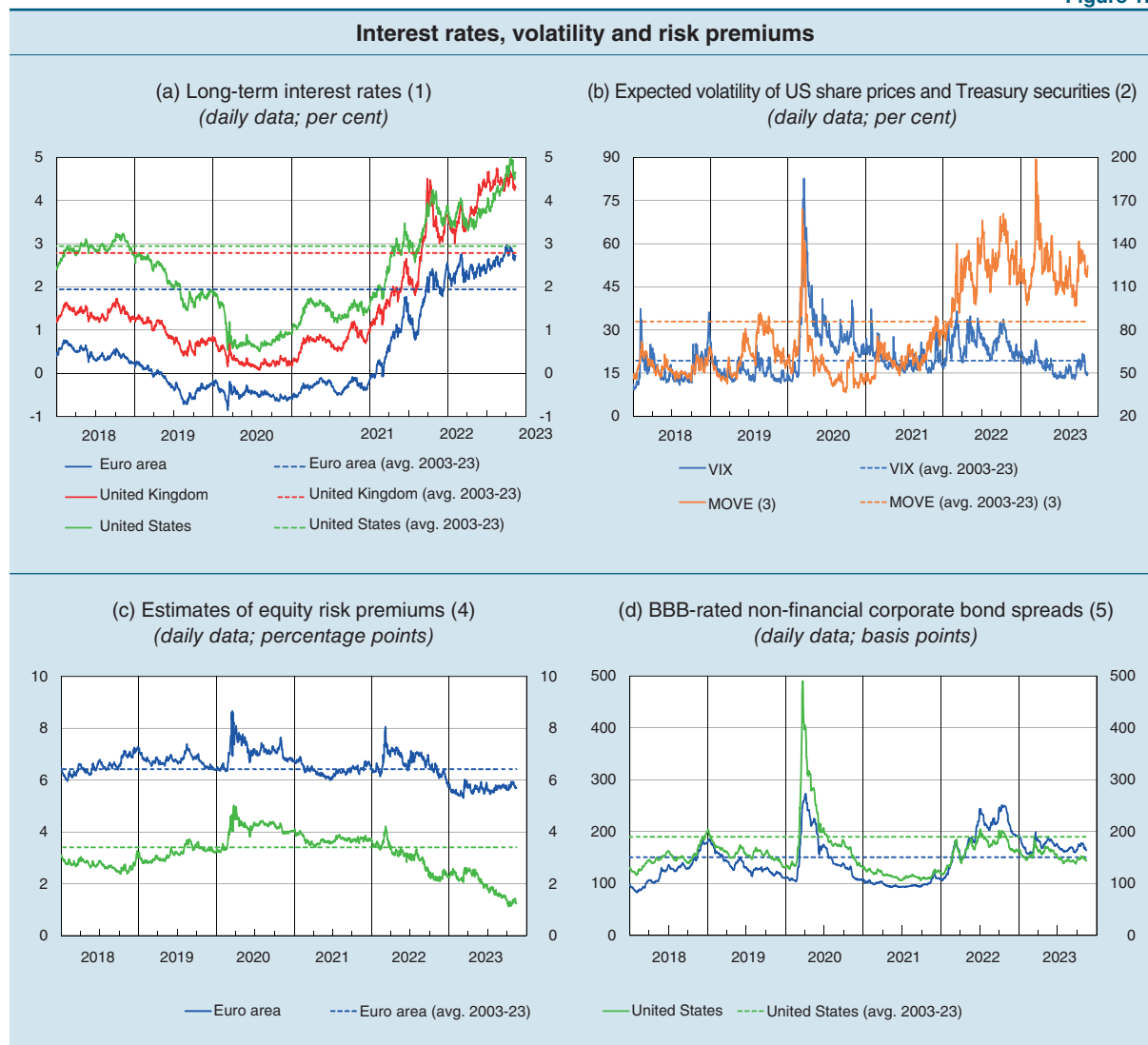
(1) Average of the forecasts for Brazil, Russia and India (BR1), weighted on the basis of each country's GDP (IMF, World Economic Outlook Database, October 2023).

Global financial market conditions began worsening again in August, reflecting investors' concerns about the effects on growth and on financial asset prices of a longer period of monetary tightening in the major advanced economies than was previously anticipated. Since the end of October, the prices of financial assets have been rising.

Starting last spring, long-term government bond yields rose in the leading countries (Figure 1.2.a). This was especially marked in the United States, due to the strength of the economy, high macro-financial uncertainty and the considerable supply of securities by the Treasury, in a context of gradual reduction in the Federal Reserve's securities holdings. The rise in US yields was partly transmitted to

the yields of other major advanced economies. Volatility in the United States continued to remain well above its long-term average (Figure 1.2.b), exposing the market to episodes of malfunctioning.<sup>1</sup>

Figure 1.2



Sources: ICE Bank of America Merrill Lynch, Bloomberg and Refinitiv.

(1) Yields on the German 10-year Bund for the euro area; yields on the US 10-year Treasury and yields on the UK 10-year Gilt. – (2) VIX: implied volatility in the prices of 1-month options on the S&P 500 index. MOVE: implied volatility in 1-month options on futures on US government securities of various maturities. – (3) Right-hand scale. – (4) For S&P 500 (United States) and Datastream EMU Total Market (euro area), the ratio of the 10-year moving average of average earnings per share to the value of the stock index (both at constant prices) is calculated. We deduct from the resulting ratio, which is an estimate of the expected real return on the shares, the real return on inflation-indexed 10-year government bonds to obtain an estimate of the equity risk premium. – (5) Yield spreads between corporate bonds issued by non-financial corporations and the corresponding risk-free bonds (obtained from the yield curve of German government bonds for euro-denominated securities and the yield curve of US government bonds for securities in dollars), option-adjusted and weighted by market capitalization of the companies' individual stocks.

<sup>1</sup> Episodes of malfunctioning in the US Treasury market could result from the reduced capacity of primary dealers to absorb investors' sales orders when volatility is particularly high (see, for instance, D. Duffie, 'Resilience redux in the US Treasury market', Stanford University Graduate School of Business Research Paper, 4552735, 2023), as well as from considerable numbers of highly leveraged short positions on US Treasury futures (see D. Barth, R.J. Kahn and R. Mann, 'Recent developments in hedge funds' Treasury futures and repo positions: is the basis trade "back"?', FEDS Notes, August 2023, and F. Avalos and V. Sushko, 'Margin leverage and vulnerabilities in US Treasury futures', *BIS Quarterly Review*, September 2023, pp. 4-5).

Developments in share prices differed across sectors and geographical areas, as they responded differently to macro-financial risks. Volatility in the main stock market indices is relatively low and risk premiums remain below their long-term averages, particularly in the United States (Figure 1.2.c). This exposes prices to marked downward corrections, especially in sectors that are more responsive to a slowdown in the cycle.

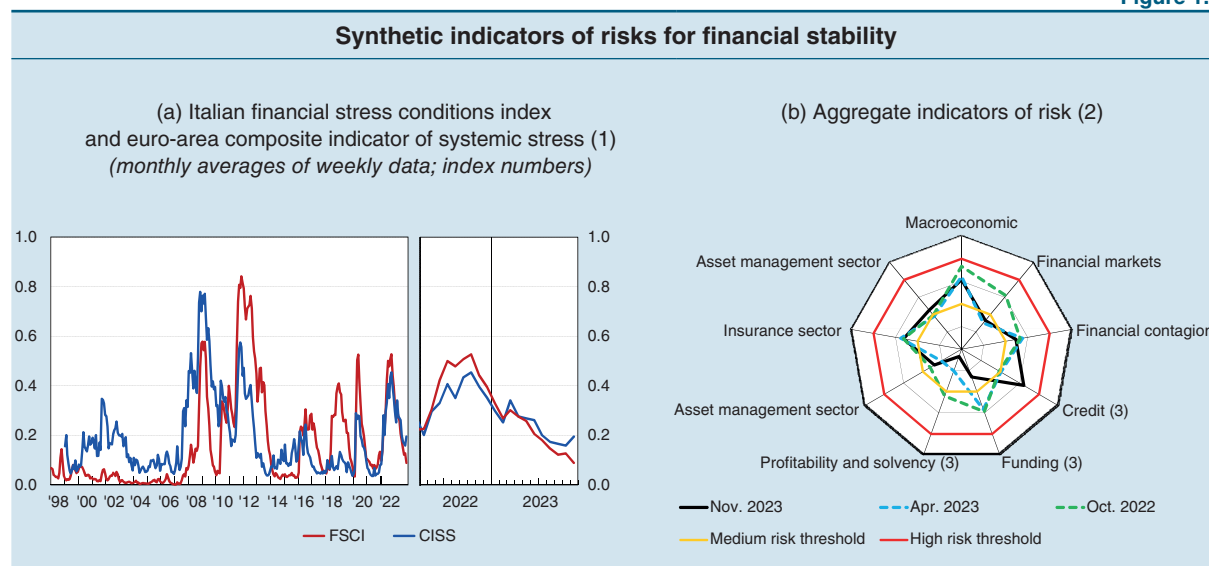
The spreads on the bonds of non-financial corporations have risen temporarily since mid-September as expectations of high interest rates over a prolonged period strengthened (Figure 1.2.d). Coupled with an economic downturn, high bond yields determine a significant increase in credit risk and potential debt refinancing difficulties, especially for riskier firms. According to some rating agencies, the default rate in the global high yield sector is expected to remain broadly stable in the coming months, but could come close to the levels observed during the 2008-09 global financial crisis, should some of the downside risks to growth materialize.

## 1.2 MACROFINANCIAL CONDITIONS IN ITALY

The risks to financial stability in Italy are benefiting from the improvement in the conditions of the banking system (see Section 2.1), though they remain significant. They are being affected by high interest rates and by the uncertainty over growth prospects owing to the slowdown in economic activity and to the renewed geopolitical tensions at global level (see Section 1.1).

The Italian financial stress conditions index has decreased since the start of the year (Figure 1.3.a). Despite improving slightly (Figure 1.3.b), there are problems looking ahead in the overall macroeconomic picture, mainly linked to the considerable public debt and to the risk of returning to structurally low

Figure 1.3



Sources: ECB, and based on Refinitiv and Bank of Italy data.

(1) The index ranges from 0 (minimum risk) and 1 (maximum risk). The two indicators are comparable as they are based on the same estimation methodology. For further details on the Italian financial stress conditions index (FSCI), see A. Miglietta and F. Venditti, 'An indicator of macro-financial stress for Italy', Banca d'Italia, Questioni di Economia e Finanza (Occasional Papers), 497, 2019. Compared with the version used in this paper, the indicator used in this chart also includes the corporate bond, repo and short-term government bond market segments, which were not previously considered. For further details on the euro-area composite indicator of systemic stress (CISS), see D. Holló, M. Kremer and M. Lo Duca, 'CISS – A composite indicator of systemic stress in the financial system', European Central Bank, Working Paper Series, 1426, 2012. – (2) The aggregate indicators are based on the analytical framework for assessing risks described in F. Venditti, F. Columba and A.M. Sorrentino, 'A risk dashboard for the Italian economy', Banca d'Italia, Questioni di Economia e Finanza (Occasional Papers), 425, 2018. – (3) Risk indicators referring to the banking sector.

growth. Our projections indicate that GDP will increase by 0.7 per cent in 2023 and by 0.8 per cent in 2024, a decline compared with previous forecasts.<sup>2</sup>

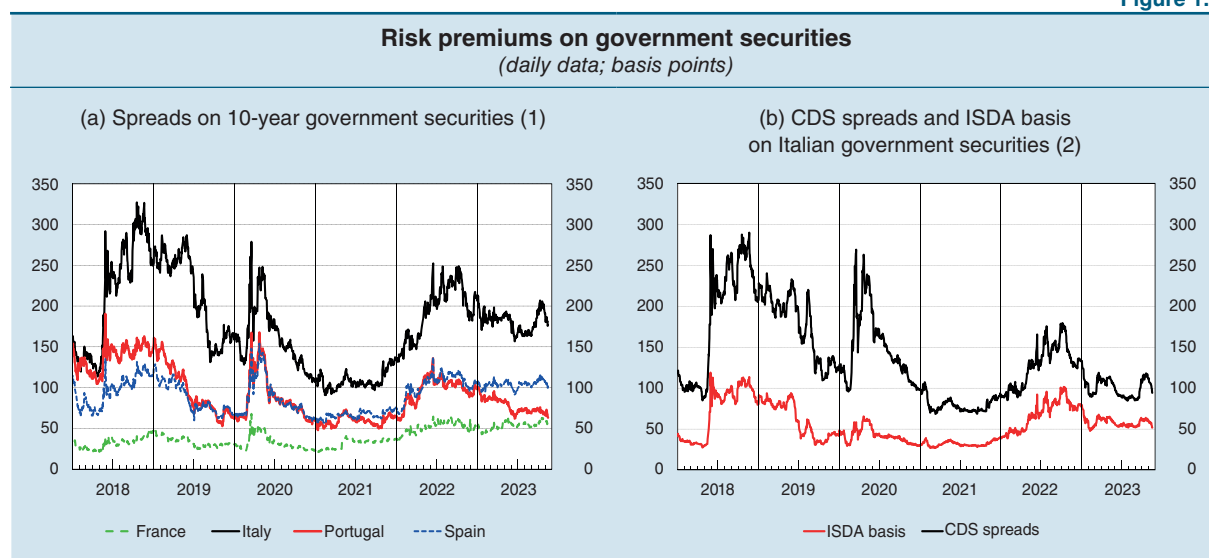
According to official estimates, both government net borrowing and debt will decrease to 5.3 and 140.2 per cent of GDP respectively this year. For 2024, in line with what is planned in the Update to the 2023 Economic and Financial Document (NADEF 2023), the budgetary package presented by the government in October envisages an increase in the deficit compared with the current legislation scenario of 0.7 percentage points, to 4.3 per cent, and a reduction in the debt-to-GDP ratio of 0.1 percentage points. In the following two years, while net borrowing is expected to fall gradually to 2.9 per cent of GDP, the debt-to-GDP ratio will fall marginally, to 139.6 per cent in the policy scenario. The uncertainties over the dynamics of the debt-to-GDP ratio are still non-negligible, both in the short and in the medium to long term, in part owing to the upward revision of the estimates for construction incentives. In order to counteract these uncertainties, prudent fiscal policy-making will need to be accompanied by reforms that can boost the economy's potential growth.<sup>3</sup>

### 1.3 THE FINANCIAL MARKETS

#### *The government bond market*

Since last April, the yield spread between Italian and German government securities has remained broadly stable (Figure 1.4.a), as have the ISDA basis and the credit default swap (CDS) premium (Figure 1.4.b).

**Figure 1.4**



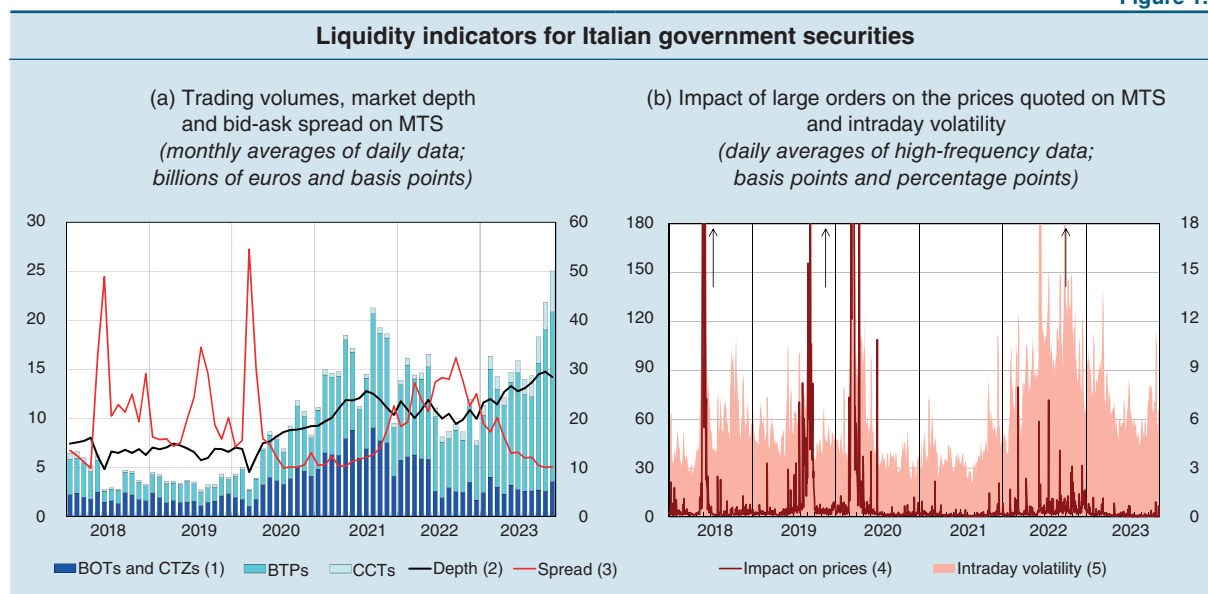
Sources: Based on Reuters and ICE Data Derivatives UK Limited data.

(1) Differences between the yields on the benchmark 10-year government bonds of the countries in the key and the yield on the corresponding German Bund. – (2) The International Swaps and Derivatives Association (ISDA) is an organization for participants in the OTC derivatives market. The ISDA basis measures the difference between CDS spreads on 5-year US dollar contracts under the 2014 ISDA Definitions and the 2003 ISDA Definitions.

<sup>2</sup> These estimates are broadly in line with those of the other leading forecasters (see *Economic Bulletin*, 4, 2023).

<sup>3</sup> *Preliminary hearing on the budgetary provisions for the three years 2024-2026*, testimony by A. Brandolini, Deputy Director General for Economics, Statistics and Research at the Bank of Italy, before the 5th Committee of the Senate of the Republic (Economic Planning and Budget) and the 5th Committee of the Chamber of Deputies (Budget, Treasury and Planning), sitting jointly, Rome, 13 November 2023.

Figure 1.5



Source: Based on MTS data.

(1) Since October 2022, the series has only included data on BOTs because the stocks of CTZs were reduced to zero following the suspension of the placement of this kind of bond and the redemption of the last CTZs to mature. – (2) The average of the bid and ask quantities recorded during the entire trading day for the BTPs quoted on MTS. – (3) The simple average of the bid-ask spreads recorded during the entire trading day for the BTPs quoted on MTS. Right-hand scale. – (4) Average daily impact on bid-ask prices quoted on MTS of a sale or purchase order of €50 million. The indicator refers to the 10-year BTP benchmark and is based on data recorded at 5-minute intervals. – (5) A measure of volatility (realized volatility) based on the 10-year BTP benchmark intraday returns calculated at 5-minute intervals; 5-day moving average of annualized values. Right-hand scale.

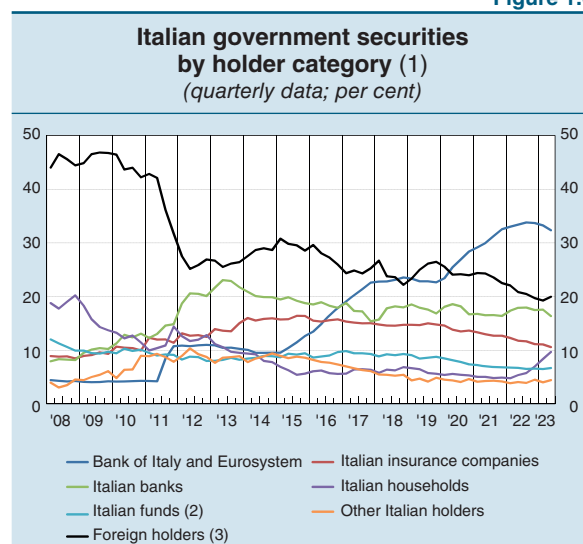
The liquidity conditions in the secondary market have remained relaxed overall over the last few months (Figure 1.5). The reduction of government bonds on the Eurosystem balance sheet has had no significant impact on the liquidity and functioning of the secondary market.

Nevertheless, the market liquidity situation and the spread continue to be extremely sensitive to macroeconomic news, both local and international, to fiscal policy and to monetary policy decisions. At times of extreme uncertainty, the liquidity of government securities can decline very quickly, with negative consequences for the efficient functioning of the secondary market.

The share of government securities held by Italian households continued to increase in the first half of this year, while that held by banks and insurance companies declined further (Figure 1.6).

Sovereign auctions continued at a steady pace, though with average yields at issue that are increasing significantly (Figure 1.7). Activity in the primary market has also benefited from a sizeable increase in direct placements with retail investors (with a new issue of BTP Italia and two issues of BTP Valore).

Figure 1.6



Sources: Bank of Italy, Financial Accounts, and estimates based on Assogestioni and ECB data.

(1) Shares calculated on data at market prices and net of securities held by Italian general government. The data refer to a subset of holders. – (2) Includes foreign individually managed portfolios and investment funds attributable to Italian investors (round trip). – (3) Securities held by foreign investors net of those held by the Eurosystem and by round-trip managed portfolios and investment funds.

The average cost of government securities outstanding reached 2.6 per cent and their residual maturity is just under seven years.

### *The equity and corporate bond markets*

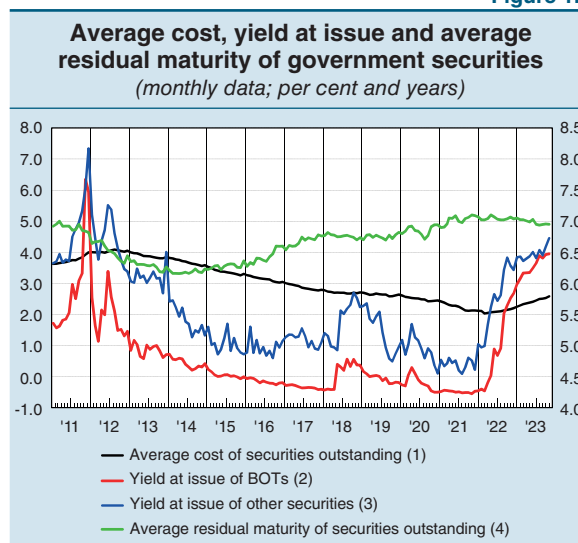
The average yield to maturity on bonds issued by Italian investment grade firms in 2023 increased to 4.6 per cent, while for high-yield firms it rose to 8.0 per cent (from 2.1 per cent and 4.7 per cent for those issued in 2022). Following the increase in costs, riskier companies are reducing their issuances.

Assuming that financing needs are unchanged, in 2024 and 2025, Italian firms will need to renew around 2 and 16 per cent of the nominal value of bonds issued before interest rates began to rise. The expected increase in the cost of refinancing for outstanding securities is 213 and 205 basis points for investment grade and high-yield firms respectively (Figure 1.8).<sup>4</sup>

The issuance of green bonds continues; the volumes outstanding as a share of GDP are growing, but they are still lower than in the other main European countries (2.1 per cent against 4.6 per cent of GDP). On the secondary market, the yield on green bonds is lower on average by about 4 basis points than that of traditional securities with similar maturities and the same credit risk (this yield spread is referred to as the ‘greenium’).

At a time of generally low volatility (Figure 1.9.b; see Section 1.1), Italian share prices have recorded higher returns than European ones since last April (Figure 1.9.a). The difference was mainly attributable to the banking and automotive sectors. The cost of hedging against marked declines in equity prices (risk reversal) has fallen and the term structure of implied volatility points to a decline in the risks expected in the short term.

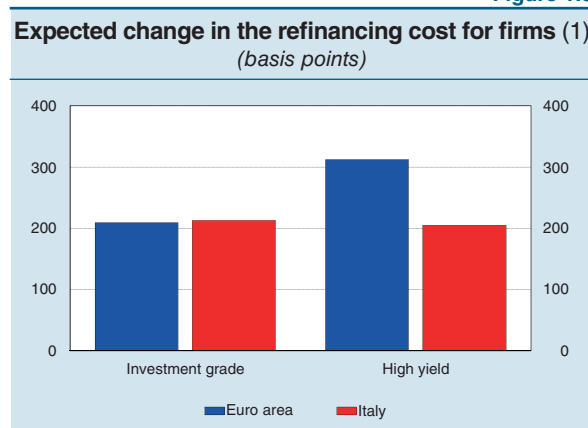
**Figure 1.7**



Sources: Based on Bank of Italy and Ministry of Economy and Finance (MEF) data, updated to 31 October 2023.

(1) Weighted average of the yields at issue of government securities outstanding at end of month. – (2) Weighted average of the yields at issue of all the BOTs placed during the month, by settlement date. – (3) Weighted average of the yields at issue of securities other than BOTs and indexed BTPs placed during the month, by settlement date. – (4) End-of-period values, expressed in years, weighted by the outstanding amounts. Right-hand scale.

**Figure 1.8**

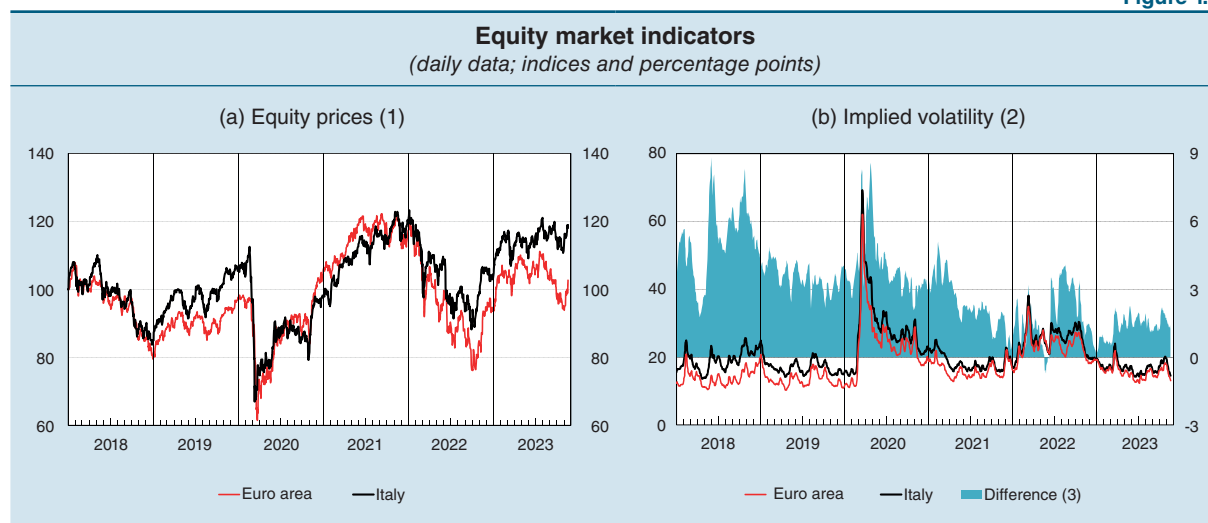


Based on ICE Bank of America Merrill Lynch (BofAML) and Bloomberg data. (1) The analysis only includes euro-denominated bonds of non-financial corporations resident in euro-area countries with a maturity of up to 10 years. The BofAML indices for the euro area have been recalculated to exclude Italy. For each bond, the expected change in the refinancing cost at maturity is equal to the difference between: (a) the sum of the forward rate for an investment in Bunds – starting on the bond's maturity date and having a maturity equal to the original maturity of the bond itself – and the spread between the yields to maturity of the bond and the Bund with the same residual maturity; and (b) the annual coupon rate paid by the bond. The values obtained are weighted by market capitalization and aggregated by distinguishing between bonds issued by Italian and euro-area companies, and investment-grade and high-yield companies.

<sup>4</sup> The difference between the expected increase in the cost of financing for Italian and European high-yield firms is explained by the worse average rating for European firms and by the different sectoral composition of the basket (it is more concentrated in the automotive and public utilities sectors in the euro area).



Figure 1.9



Sources: Based on Refinitiv and Bloomberg data.

(1) Indices: 1 January 2018=100. Datastream general equity indices for Italy and for the euro area. – (2) Implied volatility in the prices of 2-month options on the FTSE MIB index for Italy and on the Euro STOXX 50 index for the euro area. 5-day moving average. – (3) Difference between implied volatility in Italy and in the euro area. Right-hand scale.

### The money market

The increase in the monetary policy reference rates continued to be transmitted to money market rates, with no significant frictions, in both the unsecured deposits (€STR) and the repo segments. The continuing repayment of targeted longer-term refinancing operations (TLTRO III) and the reduction of government securities on the balance sheet of central banks have helped to increase the availability of assets that can be used as collateral, thereby favouring, together with the Eurosystem's securities lending and the repo activity of some sovereign issuers,<sup>5</sup> a compression in the premiums connected to the lack of securities. Repo market trading remains close to historical highs and liquidity conditions are gradually easing, following the modest deterioration observed over the course of 2022.

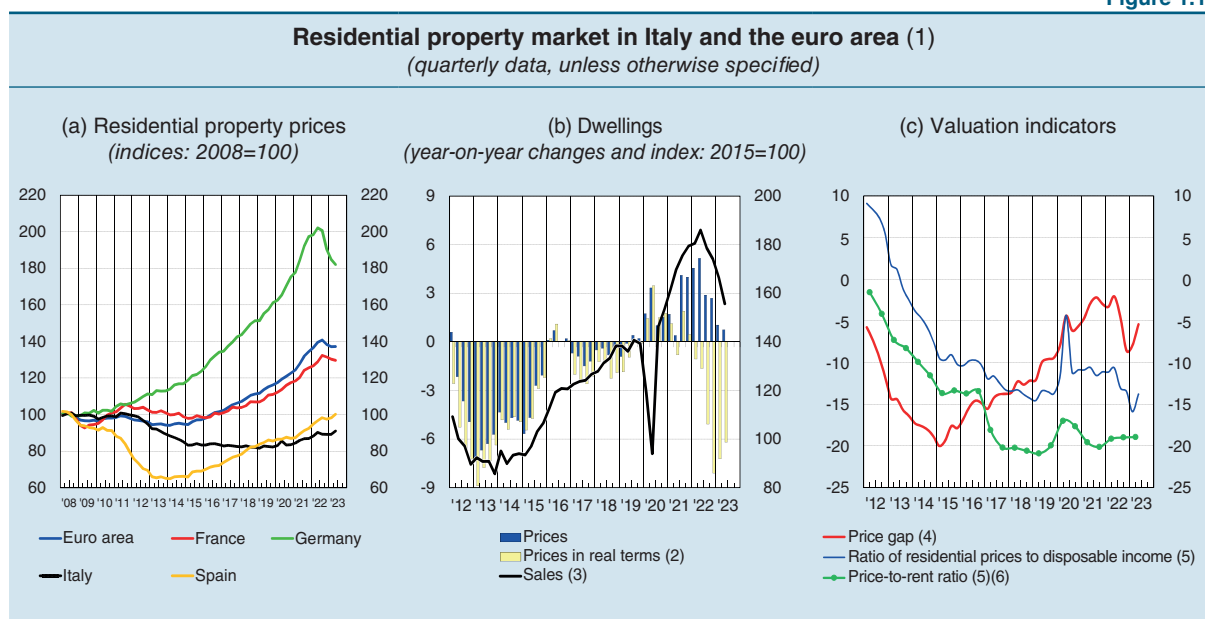
## 1.4 REAL ESTATE MARKETS

In the first half of this year, house prices in the euro area fell by 0.6 per cent compared with the same period in 2022. The decline – the first since the end of 2013 – reflected the marked fall in prices in Germany and the slowdown in the other major countries (Figure 1.10.a). Prices in the commercial sector fell further.

Over the same period, house prices in Italy continued to grow in year-on-year terms, albeit at a much slower pace than in 2022 and well below inflation (Figure 1.10.b); sales decreased further, also owing to the tightening in financing conditions (see Section 1.5). According to the real estate agents interviewed last October for the [Italian Housing Market Survey](#), the situation in the market

<sup>5</sup> The Ministry of Economy and Finance (MEF) updated the securities portfolio to be used exclusively for repos in October; as a result of these changes, the total amount of the portfolio went up from €45 billion to €50 billion, increasing the availability of securities borrowed on the market; see MEF, press release, 10 October 2023.

Figure 1.10

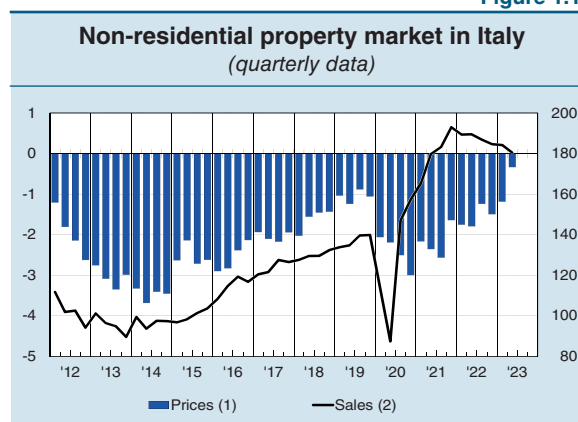


Sources: Based on data from the Bank of Italy, Eurostat, Istat, Nomisma, Osservatorio del mercato immobiliare (OMI) and Scenari Immobiliari. (1) Panels (b) and (c) refer to Italy. – (2) Data deflated using the change in consumer prices. – (3) Data adjusted for seasonal and calendar effects. Right-hand scale. – (4) The price gap is defined as the percentage deviation of the house prices index in real terms from its long-term trend. – (5) The data are expressed as a percentage deviation compared with the long-term average. – (6) Half-yearly data.

has weakened compared with the spring. Our calculations, based on the listings published on the digital platform Immobiliare.it, suggest that the demand for housing has remained resilient overall, despite the contraction in contacts between potential buyers and sellers.<sup>6</sup> Our estimates suggest that the growth in house prices will likely slow over 2023 and 2024, and will come to a halt in 2025.<sup>7</sup> Considering the long-term trends, the indicators that make it possible to assess the dynamics of the residential market continue to show no risks of overvaluation (Figure 1.10.c).

Sales remained stable in the non-residential segment, while the drop in prices moderated (Figure 1.11). The potential vulnerabilities stemming from this segment remain limited (see Section 1.5 and the box ‘An analysis of commercial real estate loans in comparison with the main euro-area countries’).

Figure 1.11



Sources: Based on data from the Bank of Italy, Istat, Nomisma, Osservatorio del Mercato Immobiliare (OMI) and Scenari Immobiliari. (1) Year-on-year percentage changes. The indicator, which is still being tested, uses data drawn from transactions actually concluded on the market. – (2) Index: 2015=100; data adjusted for seasonal and calendar effects. Right-hand scale.

<sup>6</sup> The time series of Immobiliare.it data is available since the beginning of 2016. As regards their predictive capacity, see M. Loberto, A. Luciani and M. Pangallo, ‘The potential of big housing data: an application to the Italian real-estate market’, Banca d’Italia, Temi di Discussione (Working Papers), 1171, 2018.

<sup>7</sup> The estimates are based on the models described in S. Emiliozzi, E. Guglielminetti and M. Loberto, ‘Forecasting house prices in Italy’, Banca d’Italia, Questioni di Economia e Finanza (Occasional Papers), 463, 2018.

## 1.5 HOUSEHOLDS AND FIRMS

### Households

The risks stemming from the financial situation of households remain limited overall. Purchasing power contracted slightly in the second quarter of 2023, as did disposable income. The propensity to save has returned to levels below those recorded prior to the pandemic period, even though, according to the latest issues of the ECB's Consumer Expectations Survey (CES), the share of households that plan to save over the next twelve months remains high. The share of firms that anticipate a worsening of their own operating conditions has held stable.

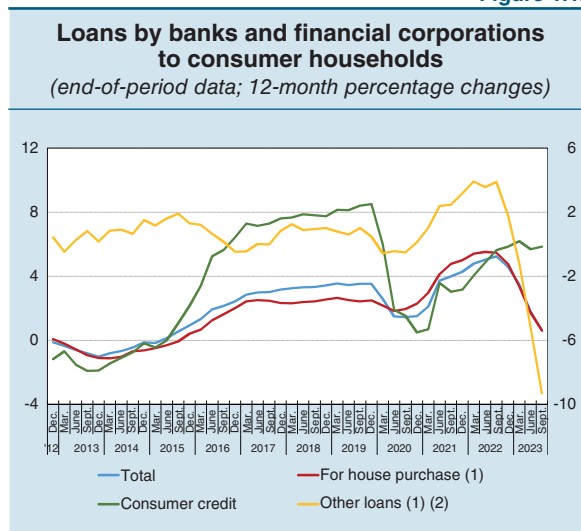
Financial wealth increased in the first half of the year due to positive market developments (see Section 1.3). New investments shifted towards financial assets that present limited risks and offer higher returns than sight deposits, which contracted: equity, investment fund shares and life policies declined (see Section 2.2); by contrast, term deposits and bonds, especially government bonds, increased.

At the end of June 2023, the ratio of financial liabilities to disposable income fell to 60.0 per cent (90.5 per cent in the euro area). Since the end of 2022, the expansion of credit to households has slowed (Figure 1.12), owing both to the slowdown in lending for house purchase and the decline in other loans. According to the Italian banks that took part in the euro-area bank lending survey (BLS), the weakening of credit in the third quarter is attributable above all to the lower demand connected with the rising interest rates and the reduction in consumer confidence. Credit supply conditions have tightened slightly.

The average rate for new fixed-rate and adjustable-rate mortgages increased to 4.0 and 4.9 per cent respectively in September (from 3.6 and 2.8 per cent in December 2022). Some 18.3 per cent of adjustable-rate contracts concluded in the first nine months of the year have a cap on debt servicing costs. The further increase in the share of fixed-rate loans for house purchase (65.5 per cent of total outstanding amounts in September 2023) helped to keep the overall average rate on loans at a moderate 3.1 per cent (compared with 2.3 per cent at the end of 2022). Based on our pilot survey conducted between August and September,<sup>8</sup> households reacted to the increase in the instalments of variable-rate loans mainly by reducing consumption.

Over the course of the year, consumer credit has continued to grow at a robust pace (5.8 per cent in September 2023) and the total cost of new loans has increased by 130 basis points, to 10.5 per cent. The share of those taken out by households belonging to the worst quartile of the distribution in terms of creditworthiness has not increased.

Figure 1.12



Source: Supervisory reports.

(1) The figure refers to bank loans only. – (2) Other loans: the most significant are current account overdrafts and mortgage loans other than those for the purchase, construction and renovation of properties for residential purposes. Right-hand scale.

<sup>8</sup> The survey was conducted on a sample of approximately 1,900 households.

Overall, the quality of credit to households remains good. The loan default rate rose, reaching 0.9 per cent in the third quarter, from 0.5 per cent at the end of 2022 (see Section 2.1), mainly reflecting the moderate deterioration in adjustable-rate mortgages owing to the increase in debt service charges. The loan default rate for consumer credit rose slightly (to 2.4 per cent, from 2.1 per cent).<sup>9</sup>

The projections of the Bank of Italy's microsimulation model<sup>10</sup> (Figure 1.13) point to an overall decrease in the share of financially fragile households (with a small increase among those that took out adjustable-rate mortgages); the debt held by these households, after increasing in 2023, is projected to decline on account of the contraction in credit. This would help to limit the share of debt held by vulnerable households, even in a particularly adverse scenario.

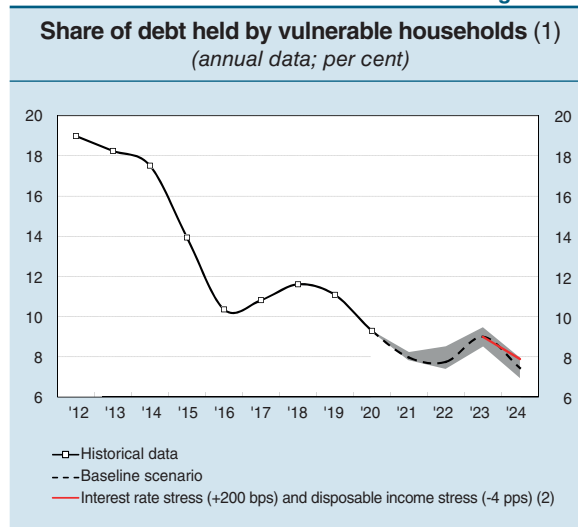
## Firms

The economic slowdown and the high financing costs are having an impact on the financial situation of firms. The vulnerability of the sector is limited overall, reflecting a more robust financial structure than in the past, high profitability and ample cash holdings.

Gross operating income has slowed since last spring, in line with weakening aggregate demand and economic activity. The cost of commodities and intermediate products has continued to decline, benefiting profitability. Firms with at least 20 employees interviewed in September in the Bank of Italy's [Business Outlook Survey of Industrial and Service Firms](#) expect an improvement in their balance sheet results across all economic sectors for this year. Analysts' operating profit forecasts for listed companies in 2024 have been revised downwards during the year, but remain slightly higher than those for 2023 (Figure 1.14). However, in the coming months – against a backdrop of high macroeconomic and geopolitical uncertainty – overall profitability might be affected by developments in production costs that could turn out to be less favourable than previously expected and by the continued weakness in domestic and global demand.

In the first half of the year, cash holdings fell by 5.8 per cent, though they are still above pre-pandemic levels (25.1 per cent of GDP, from 21.6 per cent at the end of 2019). According to the survey, the reduction in cash holdings affected about one fifth of firms (a lower share than last year; Figure 1.15.a); the share of firms that considered their holdings to be scarce when looking at their operational needs up to the end of the year remained limited, including for small firms and for those that stated that they had used such holdings to repay their debts.

Figure 1.13



Source: Based on the Survey on Household Income and Wealth (SHIW).  
(1) Households are considered vulnerable when their debt-service ratio is above 30 per cent and their equivalized disposable income is below the median. The latest available SHIW data refer to 2020. The shaded area represents the interval between the 10<sup>th</sup> and the 90<sup>th</sup> percentiles of the probability distribution in the simulations. – (2) Compared with the baseline scenario, the assumptions for 2024 are that the 3-month Euribor, the 10-year interest rate swap (IRS) and the interest rate on consumer credit are 200 basis points higher and the growth rate of nominal income is 4 percentage points lower.

<sup>9</sup> The rate is calculated on the basis of data provided by Consorzio per la Tutela del Credito, a credit information company, which includes quarterly data on the characteristics of individual contracts and borrowers for a representative sample of consumer loans.

<sup>10</sup> For further details on the microsimulation model, see C.A. Attinà, F. Franceschi and V. Michelangeli, 'Modelling households' financial vulnerability with consumer credit and mortgage renegotiations', *International Journal of Microsimulation*, 13, 2020, pp. 67-91, also published as 'Modeling households' financial vulnerability with consumer credit and mortgage refinancing', *Banca d'Italia, Questioni di Economia e Finanza (Occasional Papers)*, 531, 2019.

The debt-to-GDP ratio continued to decline, falling to 65.7 per cent in June, remaining well below the euro-area average (97.5 per cent). Leverage, calculated as the ratio of financial debt to the sum of financial debt and net equity valued at market prices, decreased by 1 percentage point (to 35.5 per cent, a slightly higher value than in the euro area) owing to the increase in the value of shares.

Total lending contracted significantly (-6.2 per cent in the twelve months ending in September, from -0.1 per cent in December 2022). The reduction was widespread for firms across all size classes and risk categories (Figure 1.15.b), also as a result of the reduced attractiveness for many firms of renewing their maturing debt and the increase in repayments of public-guaranteed loans obtained during the pandemic (see the box 'Loans to firms backed by COVID-19 guarantees: repayment and risk trends' in Chapter 2).

According to the Italian banks interviewed for the BLS, firms' demand for loans declined again in the third quarter, owing to high financing costs, lower financing needs for investment and greater use of own funds; credit supply conditions have tightened further. The firms interviewed for the Business Outlook Survey expect a further moderate worsening in the second half of the year.

Figure 1.14

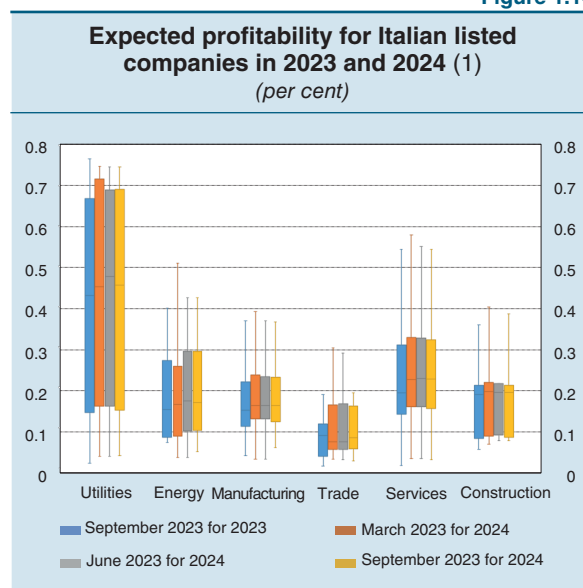
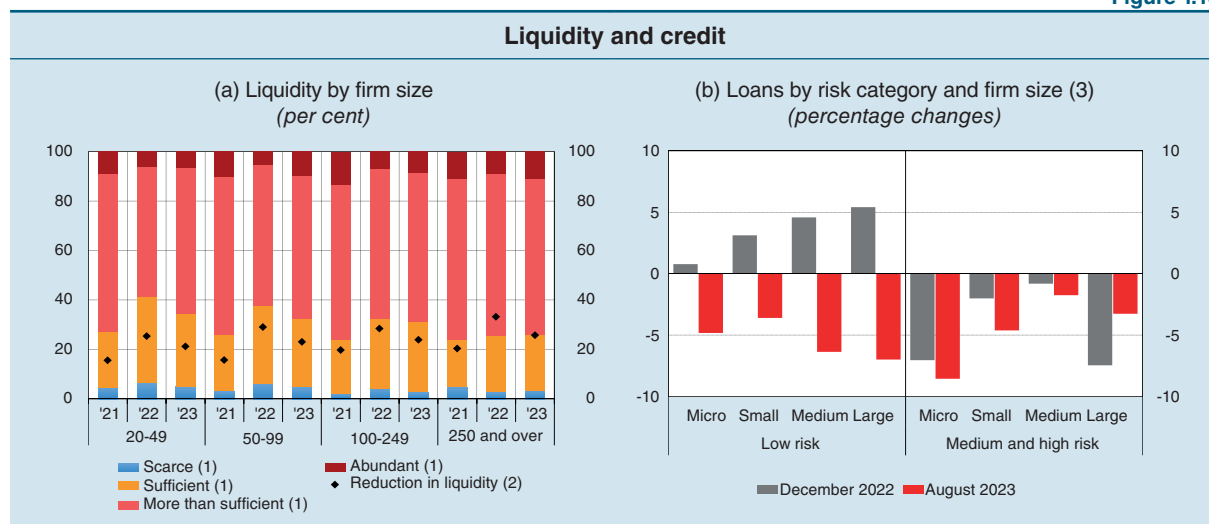


Figure 1.15



The average rate on outstanding bank loans reached 5.1 per cent in September, up by 2 percentage points since the end of last year. The effects of the increased debt burden on firms' ability to repay it are mitigated by the increased prevalence of variable-rate financing for large firms and among financially sound businesses. Large companies have also made greater use of hedging schemes or debt write-offs to counteract the rise in interest rates compared with the rest of firms.

Gross bond issuances rose in the first nine months of the year; their average value also increased, reflecting the lower issuance by small firms, against the backdrop of high yields at issue. In early November, the share of bonds in the BBB category – those most exposed to the risk of a downgrading to speculative grade – fell to 84.3 per cent of total investment grade issues in Italy (compared with 87.2 per cent in April), against a euro-area average of 59.6 per cent (down from 61.0 per cent in April).

In the twelve months ending in June, the ratio of net financial charges to gross operating income reached 7.9 per cent, 2 percentage points higher than at the end of 2022; however, it remains much lower than in the run-up to the financial crises of 2008-09 and 2011-12. In the third quarter, the loan default rate remained stable at low levels (1.5 per cent; see Section 2.1). Leading indicators of financial stress, such as payment delays, have not increased. Moreover, there are no significant differences in default rates between variable and fixed rate loans. The riskiness of loans in the real estate sector also remained at low levels (see the box 'An analysis of commercial real estate loans in comparison with the main euro-area countries').

#### AN ANALYSIS OF COMMERCIAL REAL ESTATE LOANS IN COMPARISON WITH THE MAIN EURO-AREA COUNTRIES<sup>1</sup>

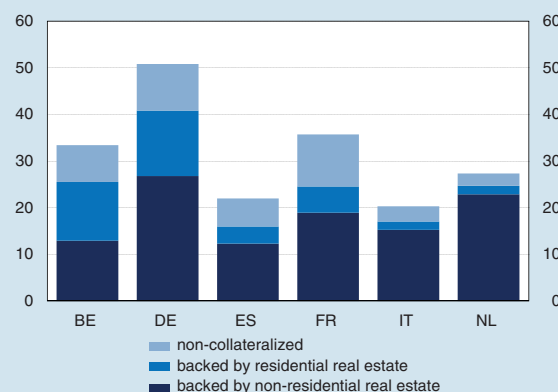
In Italy, bank loans to non-financial corporations 'backed by' or 'for the purchase of' residential and commercial real estate (CRE loans) account for about 20 per cent of total loans to non-financial corporations, which is on a level with Spain, but a lower share than in the other main euro-area countries (Figure A). The larger part of these loans (around 85 per cent) is backed by real estate, most of which is non-residential and thus typically riskier than housing.

Several factors may contribute to the riskiness of these loans. Last June, 80 per cent of them were variable-rate, both in Italy and in Spain. Compared with Germany and France, where the share of variable-rate loans was lower (at 26 and 17 per cent respectively), additional protections are in place in Italy (financial, personal, and state guarantees, including state guarantees made available during the pandemic) in addition to real estate.

In Italy, neither the residential nor the commercial property markets are showing any signs of overvaluation. Loans with a

Figure A

CRE loans by type of collateral (1)  
(per cent; June 2023)



Source: AnaCredit.

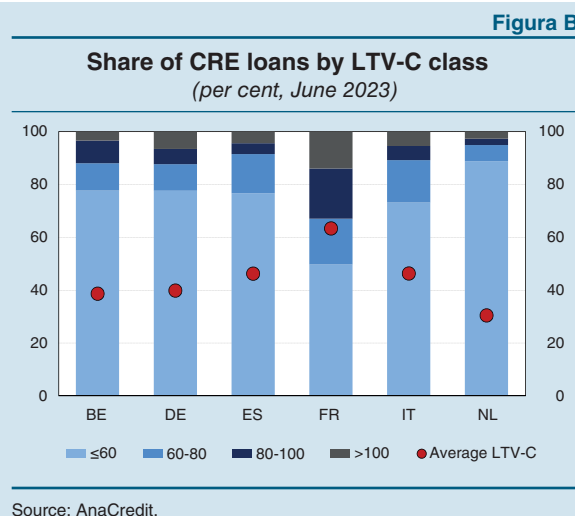
(1) Share of CRE loans out of total loans to non-financial corporations. Recommendation ESRB/2019/03 defines CRE loans as including loans to firms backed by real estate as well as loans for the purchase of real estate or for investment in construction (including loans not collateralized by real estate). More in detail, a distinction is made between loans backed by residential real estate, those backed by non-residential real estate and non-collateralized loans. With residential real estate, what distinguishes CRE loans from residential real estate loans is the fact that the loans are granted to a business (legal entity) and the property is assumed to generate income (as in the instance of apartments managed by real estate rental firms or building construction for sale purposes).

<sup>1</sup> By Federica Ciocchetta and Ivan Quaglia.

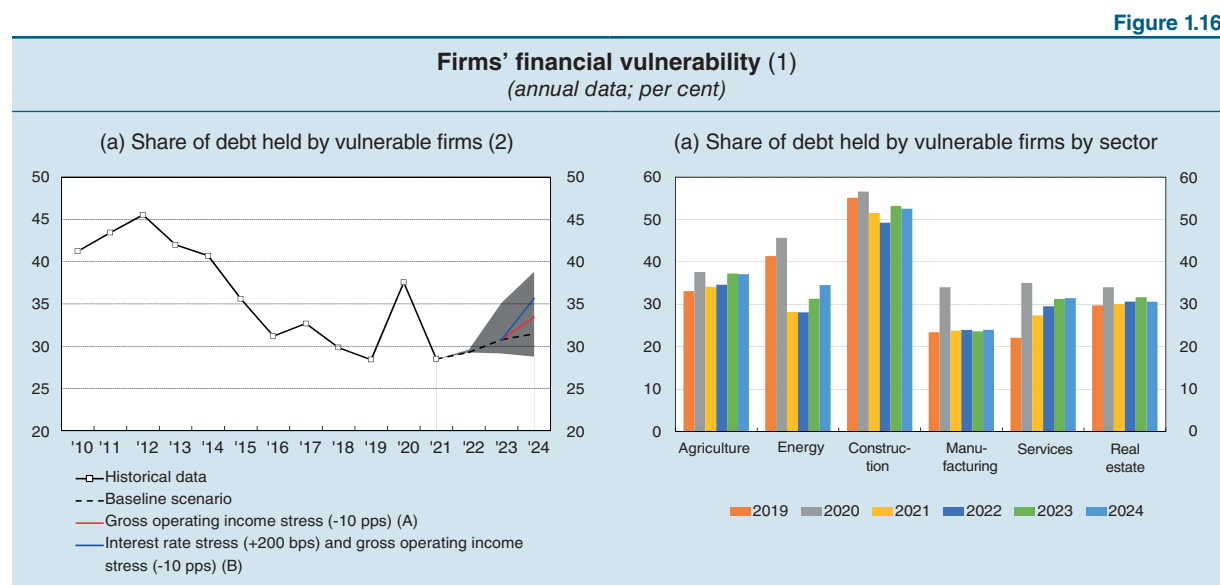


high ratio (above 80 per cent) of the current loan principal to the current value of the property pledged as collateral (current loan-to-value ratio, LTV-C), which are typically associated with a higher risk of loss given default, represent a limited share of total CRE exposures, as is the case in most euro-area countries except France (Figure B).

In all countries, the share of non-performing loans is larger for CRE loans than for loans to other sectors. However, the loan default rate for CRE loans is on a level with that of the total of non-financial corporations and does not point to heightened vulnerability in the specific sector.



In a baseline scenario consistent with the latest macroeconomic forecasts, the share of debt held by vulnerable firms would rise modestly at the end of 2024 (Figure 1.16).<sup>11</sup> In a particularly adverse scenario, characterized by very negative changes in profitability and in the cost of debt, the share would rise more markedly, nevertheless reaching a level far below that recorded during the previous crises of 2008-09 and 2011-12.



(1) Vulnerable firms are those whose gross operating income is negative or whose ratio of net interest expense to gross operating income exceeds 50 per cent. The definition excludes firms with bad loans. The latest available annual financial statements for the whole sample of firms refer to 2021. – (2) The shaded area indicates a confidence interval of 95 per cent around the baseline scenario. Compared with the baseline scenario, the assumptions for 2024 are that: (A) the growth rate of nominal gross operating income is 10 percentage points lower; (B) the interest rate is 200 basis points higher and the growth rate of nominal gross operating income is 10 percentage points lower.

<sup>11</sup> For details on the microsimulation model, see A. De Socio and V. Michelangeli, 'A model to assess the financial vulnerability of Italian firms', *Journal of Policy Modeling*, 39, 2017, 147-168, also published as 'Modelling Italian firms' financial vulnerability', *Banca d'Italia, Questioni di Economia e Finanza (Occasional Papers)*, 293, 2015.

# 2 RISKS TO FINANCIAL INTERMEDIARIES

## 2.1 BANKS

The main risks to the banking system continue to stem from the weak growth outlook and from global geopolitical developments (see Section 1.1).

Market valuations, as implied by key indicators, do not currently show any particular signs of stress in the sector. In the first half of the year, the average price-to-book (PTB) ratio for Italian banks rose, partly as a result of improved profitability. It still remains below one, in line with PTB ratios for euro-area banks (Figure 2.1).

Figure 2.1



Source: Based on Refinitiv data.

(1) Return on equity (ROE) is estimated by market operators. Average weighted according to market value. The data refer to the banks included in the FTSE Italy Banks and the Euro STOXX Banks indices. – (2) Average weighted according to market value. For the banks included in the sample, see note 1. – (3) The data refer to the following sample of banks: for Italy, UniCredit and Intesa Sanpaolo; for the euro area, BNP Paribas, Société Générale, Crédit Agricole, Deutsche Bank, Commerzbank, Banco Santander, Banco Bilbao Vizcaya Argentaria. Simple average of 5-year CDS spreads.

### Asset risks

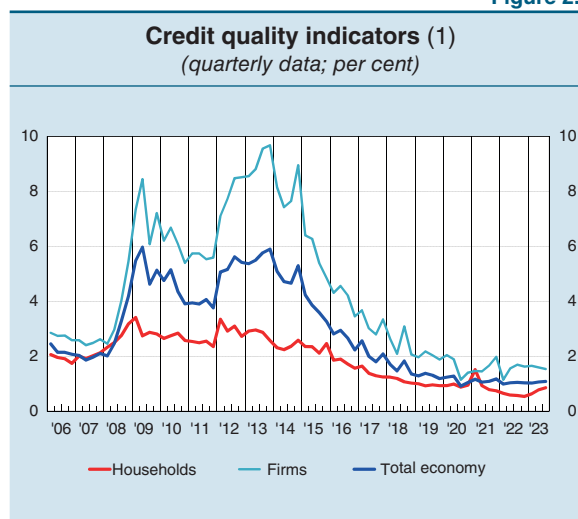
Banks' asset quality remained satisfactory in the first nine months of the year. The loan default rate inched up marginally, to 1.1 per cent (Figure 2.2), mainly due to the household component (0.9 per cent, from 0.5 per cent in December 2022), while the figure for firms was virtually unchanged at 1.5 per cent. The riskiness of loans backed by pandemic-related government guarantees has increased somewhat, but remains moderate (see the box 'Loans to firms backed by COVID-19 guarantees: repayment and risk trends').

Some €3 billion in non-performing loans were sold in the first six months of 2023. The ratio of non-performing loans to total loans (NPL ratio), net of loan loss provisions, held stable at 1.4 per cent (Figure 2.3.a), reflecting the concomitant reduction in outstanding loans (see Table A2 in the Appendix). The gap between Italian significant banking groups and the intermediaries directly supervised by the ECB as a whole essentially closed (Figure 2.3.b).

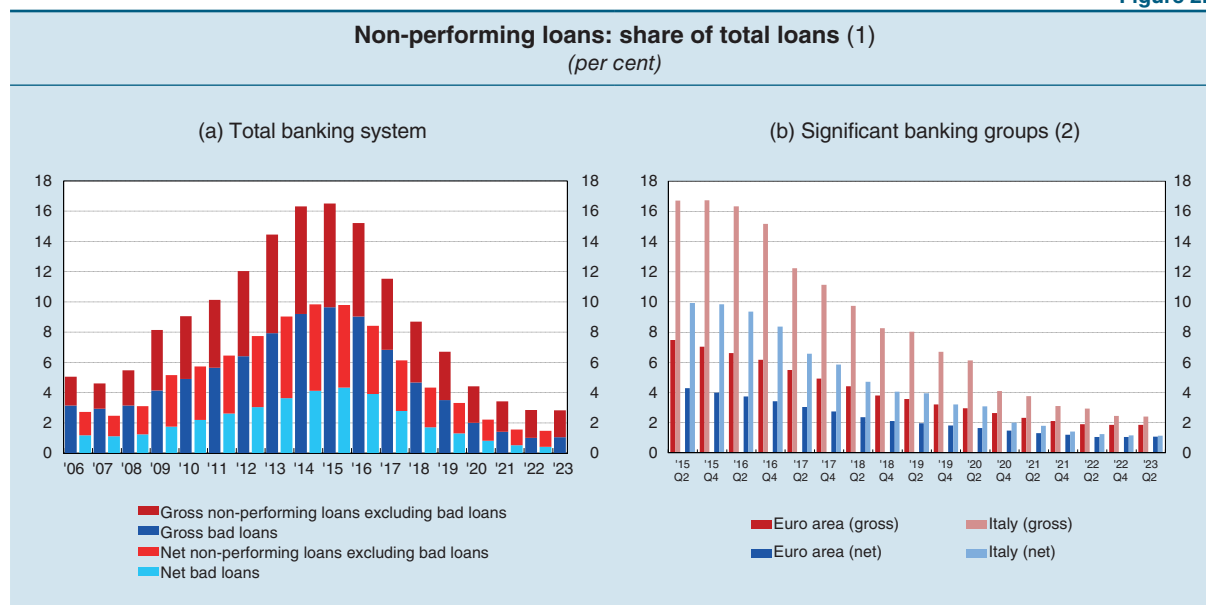
The ratio of Stage 2 loans under IFRS 9 to total performing loans, gross of loan loss provisions, declined further (by 30 basis points, to 9.7 per cent). The gap between significant and less significant banks is almost nil.

The trends of early warning indicators of deterioration in creditworthiness (e.g. payments in arrears on the part of performing borrowers) do not show any particular signs of worsening credit quality. However, the impact of higher interest rates and of the less favourable macroeconomic environment, which has not yet fully materialized, could affect the future repayment ability of borrowers with a large share of floating-rate loans. In its supervisory activity, the Bank of Italy continues to monitor closely the adequacy of banks' loan loss provisions.

**Figure 2.2**



**Figure 2.3**



Sources: Consolidated supervisory reports for Italian banking groups and individual supervisory reports for the rest of the system; ECB, 'Supervisory Banking Statistics' for the euro area.

(1) Includes loans to customers, credit intermediaries and central banks. Includes banking groups and subsidiaries of foreign banks; excludes branches of foreign banks. Amounts are calculated net and gross of loan loss provisions. The data for June 2023 are provisional. – (2) The perimeter of significant banks and less significant banks differs between the dates shown in the figure: since June 2019, when the reform of the cooperative banking sector was completed, Cassa Centrale Banca has become a significant banking group for supervisory purposes and 143 cooperative credit banks (BCCs) have joined the ICCREA group, which was already classified as significant before the reform. Mediolanum and FincoBank have been included among the significant banks since June 2022.

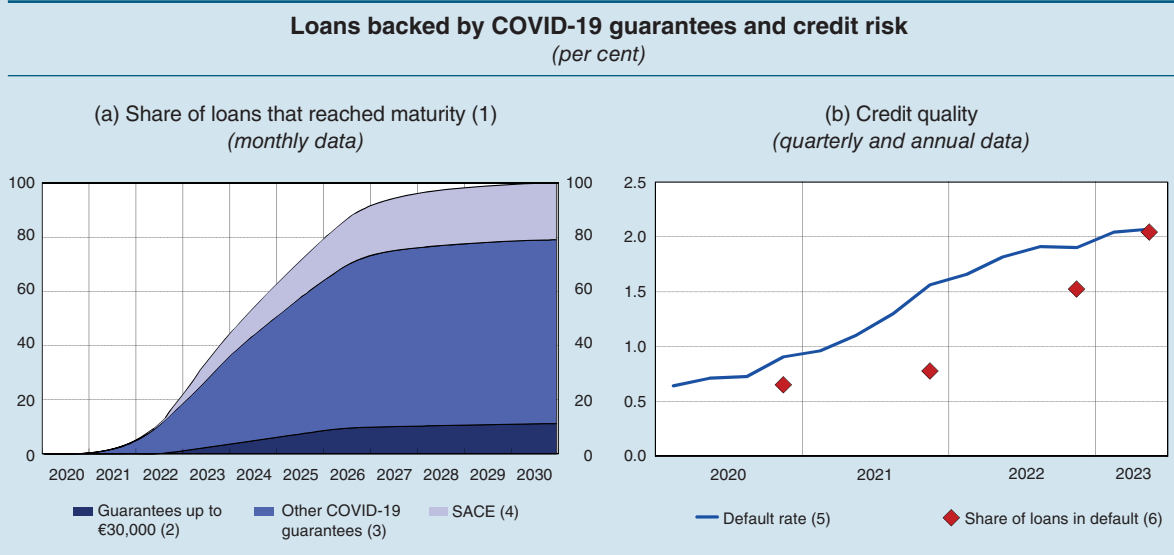
According to our projections,<sup>1</sup> which are in line with the macroeconomic scenario outlined in the Bank of Italy's October *Economic Bulletin*, the overall loan default rate for households and firms is set to edge up over the next two years, to 3.2 per cent in 2025, driven by the higher cost of debt. However, the loan default rate is projected to remain well below the level seen in previous times of crisis for both households and firms.

## LOANS TO FIRMS BACKED BY COVID-19 GUARANTEES: REPAYMENT AND RISK TRENDS<sup>1</sup>

The EU's Temporary Framework for State aid measures to ensure access to credit during the pandemic (COVID-19 guarantees) through the granting of public guarantees expired on 30 June 2022.<sup>2</sup>

The ending of the interest-only period (which lasted about 17 months on average) led to a sharp increase in the percentage of loans on which borrowers began to make principal, in addition to interest, payments. Some 50 per cent of the loans were in the amortization phase in mid-2022, a number expected to reach 93 per cent by the end of this year. The share of the principal to be repaid by the end of 2023 is expected to reach just under 45 per cent of the total, and to then rise to 62 per cent at end-2024 and 80 per cent at the end of 2025 (see panel (a) of the figure).<sup>3</sup>

Figure



Sources: Based on data from the Central Credit Register (CR), Mediocredito Centrale and SACE.

(1) Share estimated based on the amortization schedules reconstructed using contractual information contained in the microdata obtained from Mediocredito Centrale and SACE. Loans covered by subsidiary state-backed guarantee under Article 56 of Decree Law 18/2020 ('Cure Italy' decree) are excluded. – (2) Guarantees provided for by Article 13(m) of Decree Law 23/2020 ('Liquidity Decree'). – (3) Includes the guarantees issued by the Guarantee Fund for SMEs in accordance with State aid rules – provided for by the European Commission in paragraph 3.2 of the Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak (C(2020) 1863 final of 19 March 2020) – other than the guarantees provided under Article 56 of the 'Cure Italy' decree. – (4) Includes only guarantees given under the 'Guarantee Italy' programme. – (5) Annualized quarterly flows of adjusted NPLs in relation to the stock of loans, net of NPLs adjusted at the end of the previous quarter (4-quarter moving average). The indicator is calculated based on a closed sample of firms listed in the CR that benefited from at least one COVID-19 guarantee, other than those under Article 56 of the 'Cure Italy' decree. – (6) Share of loans backed by COVID-19 guarantees granted to firms classified as in default, calculated based on the initial amount of loans given to firms listed in the CR at the end of the period. Right-hand scale.

<sup>1</sup> By Iconio Garri.

<sup>2</sup> In June 2023, COVID-19 guaranteed loans made up about one fifth of outstanding bank loans to firms.

<sup>3</sup> These estimates may differ from the actual figure as a result of, for example, corporate insolvencies or large amounts of early repayments.

<sup>1</sup> For further details on the methodology, see E. Bonaccorsi Di Patti and G. Cascarino, 'Modelling the dynamics of non-performing loans in Italy', Banca d'Italia, Notes on Financial Stability and Supervision, 19, 2020.

In addition to the increase in loans on which repayment of the principal portion has begun, there has been a slight rise in the corresponding loan default rate; this has remained higher than the default rate for firms that did not take advantage of government-guaranteed loans (2.1 and 1.1 per cent, respectively, in June). At the end of June, around 4 per cent<sup>4</sup> of total guaranteed loans pertained to firms in adjusted default status (panel (b) of the figure).

Firms' capacity to repay guaranteed loans is supported by their instalment payments being on average a small percentage of their turnover – around 5 per cent on an annual basis – and by the relatively limited impact of recent interest rate hikes on floating-rate loans, which account for more than 60 per cent of the total amount lent. It is estimated that the higher interest rates caused instalments to rise an average of 7.5 per cent compared with March 2022 on loans that had not yet been repaid at the end of June 2023. The limited impact was helped by the fact that the guaranteed loans have a low residual maturity, 3.5 years on average.<sup>5</sup>

<sup>4</sup> This is an overestimation of the NPL ratio for two reasons: (a) the adjusted default status, which is defined at system level and is the basis for the calculation of the loan default rate, does not require that all the firm's loans be in default but just a significant portion of them (for more information, see the methodological notes to 'Banks and Financial Institutions: Credit Conditions and Risk by Sector and Geographical Area', Banca d'Italia, Statistics Series, 31 December 2020); (b) some firms may have repaid (even partially) the guaranteed loan before defaulting.

<sup>5</sup> The increase was about double for loans with a residual maturity of more than six years, which amounted to less than 10 per cent of the total in June 2023.

### Market risk and interest rate risk

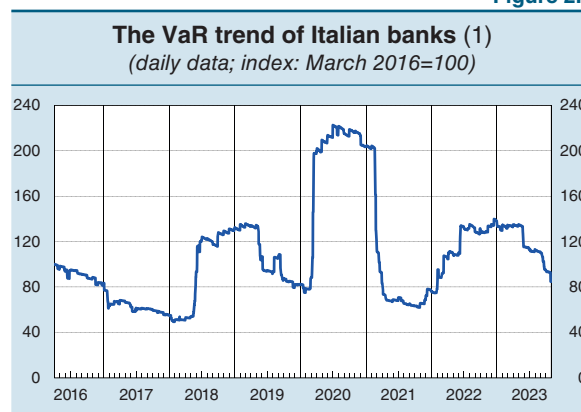
The value at risk (VaR) for the entire securities portfolio (banking and trading books) continued to decline, returning to the levels seen prior to the outbreak of the conflict in Ukraine (Figure 2.4).

Between March and September, the share of public sector securities in banks' total assets and their duration remained virtually stable, at 9.1 per cent and 4 years (Figure 2.5). The share of securities valued at amortized cost declined slightly for both significant and less significant banks, to 70.6 and 73.3 per cent respectively.

Changes in the value of the debt securities portfolio valued at amortized cost do not have a direct impact on banks' profitability or capital. Any unrealized losses materialize only if the intermediary has to sell those securities before maturity, e.g. in order to meet urgent liquidity needs. Based on the securities' market value at the end of September, the estimated impact of unrealized losses was on average around 2 per cent of the system's risk-weighted assets (RWAs), taking into account the benefits arising from the use of hedging derivatives. These losses were held by banks with an average liquidity coverage ratio (LCR) well above minimum requirements, thus reducing significantly the likelihood of their materializing.

Rates on deposits from households and firms have so far adjusted to key interest rate hikes to a limited extent; they are expected to continue to rise in the coming months. If the pass-through on deposits were

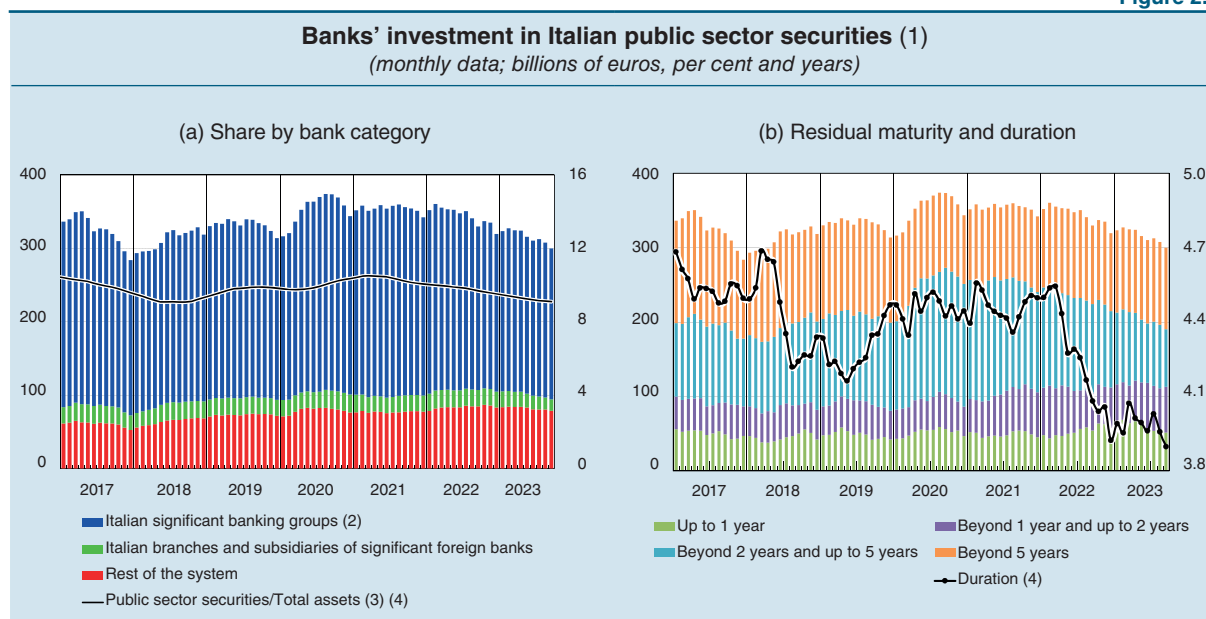
Figure 2.4



Sources: Based on data from the securities registry database, supervisory reports and Refinitiv.

(1) Averages, weighted according to the size of each bank's portfolio. VaR is the loss on a portfolio that within 1 day will not exceed a given tail level (99 per cent). The indicator for the banking system as a whole is calculated at the end of each month, using granular data on the stocks and the characteristics of the assets in the portfolio of each Italian bank, taking account of the changes in risk factors over the last 250 working days.

Figure 2.5



Source: Supervisory reports.

(1) Comprises all public sector securities, including those issued by local authorities. Excludes Cassa Depositi e Prestiti SpA. – (2) Includes the cooperative credit banks merged into cooperative credit banking groups. – (3) Twelve-month moving average ending in the month indicated. The series 'total assets' does not include bond buybacks. – (4) Right-hand scale.

to increase from 10 per cent over the period June 2022-June 2023 to 40 per cent,<sup>2</sup> annual net interest income would fall by around 2 percentage points of RWAs.

Taking into account total assets and liabilities in the banking book at end-June 2023, in a hypothetical scenario of a 200-basis point parallel shift up in the entire yield curve, as envisaged by the European Banking Authority (EBA) guidelines,<sup>3</sup> the weighted average change in the portfolio's economic value would be negative for both significant and less significant banks (-3.4 and -1.9 percentage points of RWAs respectively).

### Refinancing risk and liquidity risk

In September, bank funding was down by 7.0 per cent year-on-year, reflecting the decline in resident deposits and in liabilities vis-à-vis the Eurosystem.

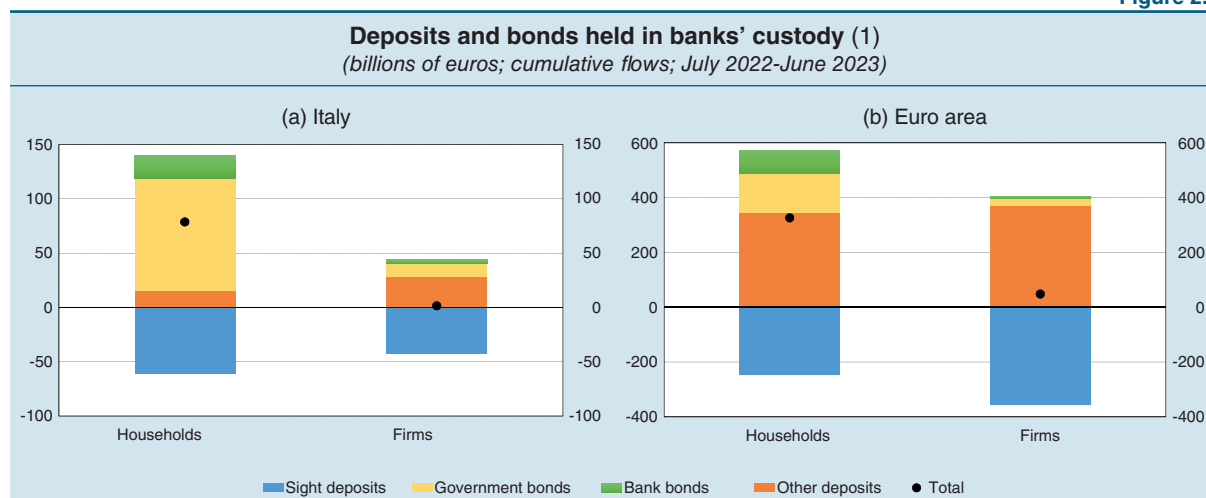
Between July 2022 and June 2023, households and firms reallocated part of their liquidity towards higher-yielding assets. The drop in sight deposits went in parallel, especially for households, with higher inflows into government bonds and, to a lesser extent, into bank bonds and other types of deposits (Figure 2.6.a). In the euro area as a whole, this reallocation was mainly geared towards higher-yielding types of deposit (Figure 2.6.b).

<sup>2</sup> The pass-through is the ratio of the change in the average rate on customer deposits to the change in key interest rates.

<sup>3</sup> This is one of the six scenarios outlined by the EBA Guidelines 2018/02 and referred to in Article 98 of Directive (EU) 2019/878 (Capital Requirements Directive, CRD5).



Figure 2.6

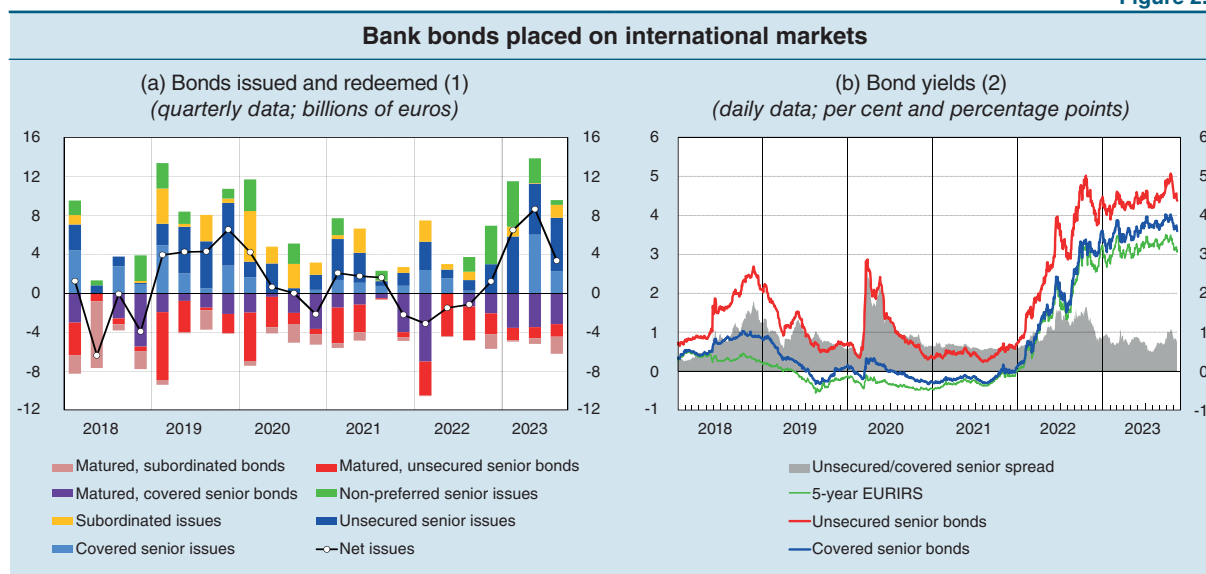


Sources: Based on Bank of Italy and ECB data.

(1) Bank and government bonds are considered alternative forms of investment for customers, in addition to deposits.

In the third quarter, net bond issuance was €3.3 billion, i.e. €5.3 billion lower than in the previous quarter, but well above the average for the three-year period 2020-22 (Figure 2.7.a). Yields held relatively stable, though at quite high levels by historical standards (Figure 2.7.b).

Figure 2.7



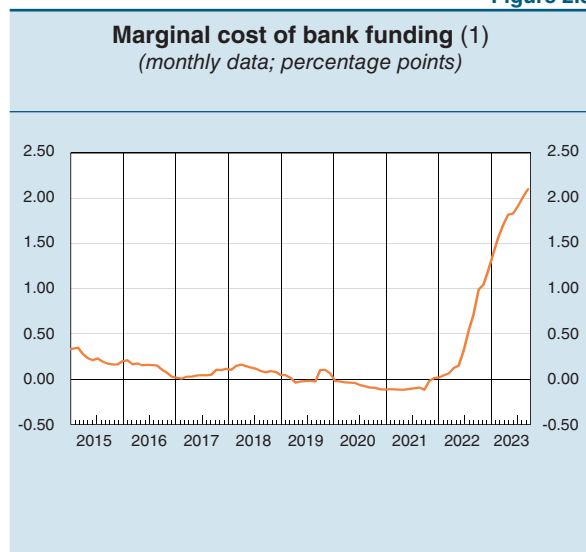
Sources: Bloomberg and Dealogic.

(1) Italian banks' issues on international markets. Does not include issues retained on issuers' balance sheets or those earmarked for the retail market. Includes securitized bonds. – (2) Yields to maturity of Italian bank bonds with residual maturity of 5 years.

Retail bank funding in excess of outstanding loans increased further, with the funding gap going from -11.2 to -14.4 per cent between February and September.<sup>4</sup> At the end of the third quarter, the marginal cost of funding was 2.1 per cent, approximately twice as high as at the end of last year (Figure 2.8).

<sup>4</sup> The funding gap is the difference between the value of loans and retail funding, expressed as a percentage of loans.

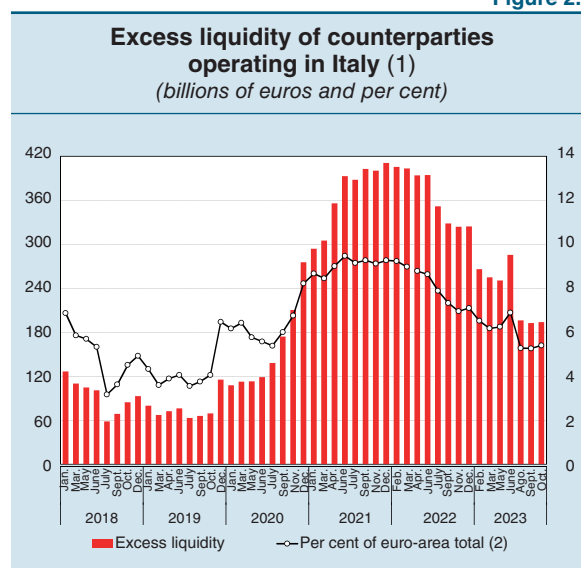
Figure 2.8



Source: Based on Bank of Italy data.

(1) The marginal cost of funding is calculated as a weighted average of the costs of banks' various funding sources, using their respective outstanding amounts as weights. This is the cost that a given bank would incur to increase its balance sheet by one unit, drawing on funding sources in proportion to the composition of its liabilities at that time.

Figure 2.9



Sources: Based on Bank of Italy and ECB data.

(1) The months indicated on the x-axis are those ending each maintenance period. Excess liquidity is calculated as the sum of banks' average reserve balances, net of the reserve requirement, plus the average recourse to the deposit facility. – (2) Right-hand scale.

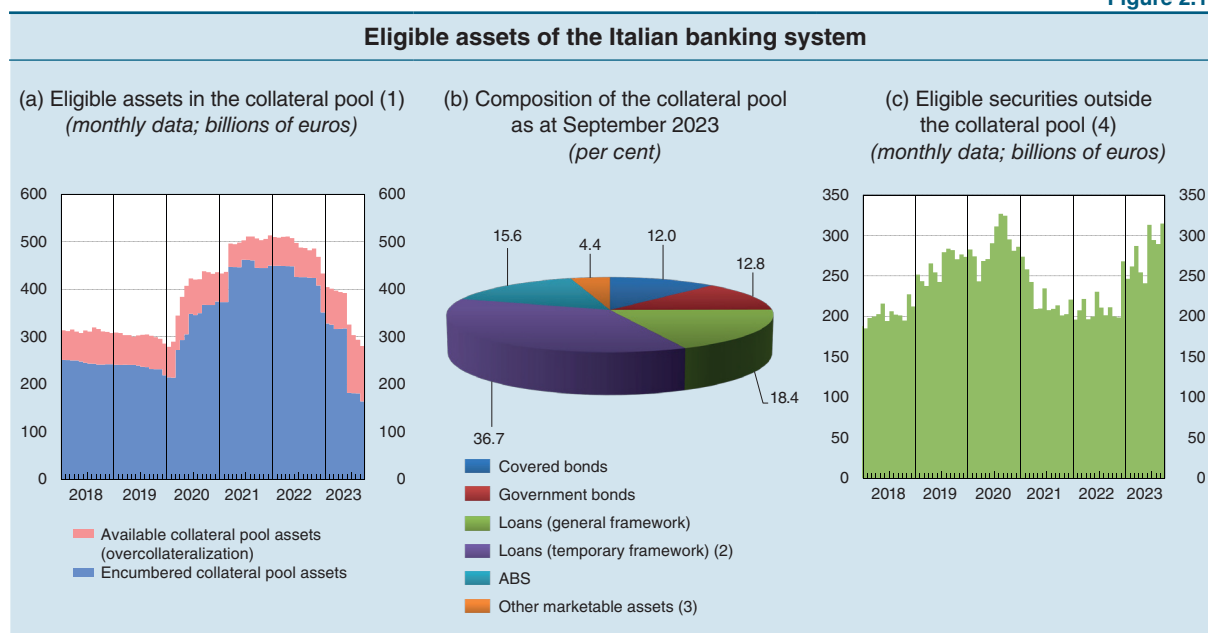
At the end of September, outstanding TLTRO III refinancing amounted to €152 billion, of which around 51 per cent due by March 2024. Since last March, TLTRO III repayments have totalled €176 billion, of which €146 billion in June. The latter were largely covered by excess liquidity (over minimum reserve requirements) held with the Bank of Italy, which had been increased in the first half of the year by a sizeable net issuance of bonds, especially on the part of significant banks, as well as by tapping the repo market. Banks' ability to raise new funding on the markets reduced the need for recourse to the ECB's standard refinancing operations.

In the maintenance period that ended in September, excess liquidity was €192 billion (Figure 2.9). For leading Italian banks, it was much higher than the outstanding TLTRO III amounts. Several banks, mostly small ones, will instead need to raise funds on the market to repay their maturing operations, either by securing new central bank funding or by cutting part of their assets.

Between March and September, following TLTRO III repayments, the value of the assets pledged as collateral in Eurosystem operations (collateral pool) fell by €119 billion, to €278 billion (Figure 2.10.a). Covered bank bonds and government bonds were mostly released from the pool. Loans are the largest asset class in the pool (55 per cent of the total; Figure 2.10.b). The measures taken in response to the pandemic emergency, which eased the eligibility criteria for assets posted as collateral, have continued to increase the availability of collateral by €37 billion. These measures will be reviewed in 2024. In addition, Italian banks have €315 billion in unencumbered eligible securities available outside the collateral pool, of which 70 per cent are government bonds (Figure 2.10.c).

The repayments of TLTRO III loans maturing in the coming months are unlikely to have a significant impact on Italian banks' liquidity profile, which remains balanced on both short- and medium-term horizons. At the end of June, the liquidity coverage ratio (LCR) averaged 175 per cent (190 per cent at the end of 2022) and the net stable funding ratio (NSFR) stood at 134 per cent. Both indicators were above the regulatory minimum (100 per cent) for all banks, and well above it for over 90 per cent of banks (Figure 2.11).

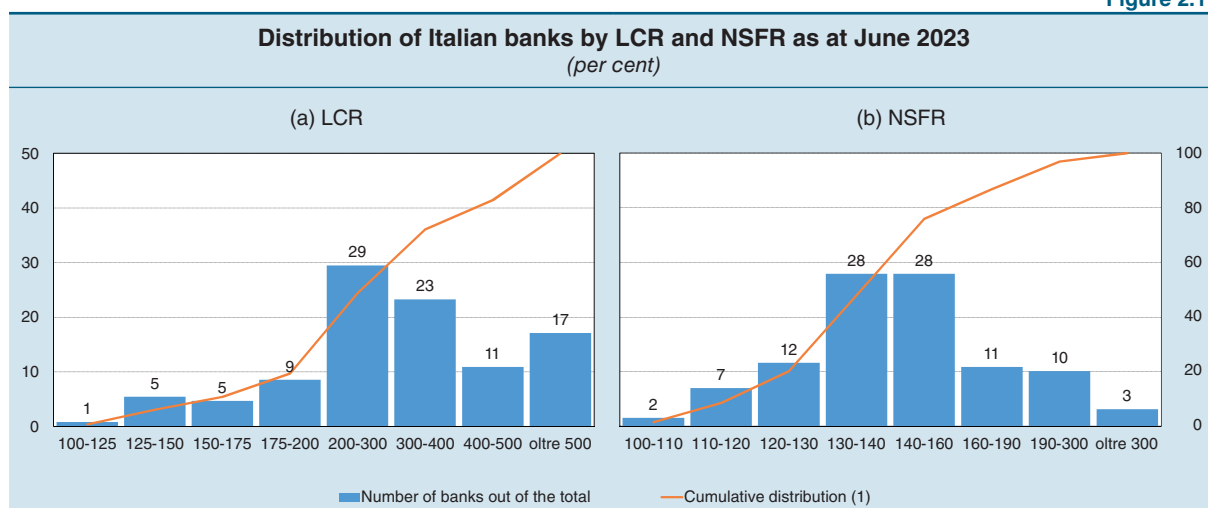
Figure 2.10



Sources: Based on Eurosystem data and supervisory reports.

(1) End-of-period data for the monetary policy counterparties of the Bank of Italy. The volume of encumbered Eurosystem collateral pool assets includes the part covering accrued interest and refinancing in dollars. The collateral pool is valued at the prices taken from the Common Eurosystem Pricing Hub, net of haircuts. – (2) Under the temporary framework, the eligibility criteria for assets that can be used as collateral are set by the individual national central banks pursuant to the rules provided by the ECB Governing Council (under the general framework, the criteria are set according to common rules that are applicable to the entire Eurosystem). – (3) Includes bank bonds, including those backed by the state guarantee scheme, and securities issued by non-financial corporations and supranational organizations. – (4) End-of-period data for the entire banking system, not including Cassa Depositi e Prestiti SpA and Poste Italiane SpA. Amounts at market values as reported by banks, net of the haircuts applied by the Eurosystem.

Figure 2.11



Source: Based on supervisory reports.

(1) Right-hand scale.

## Capital and profitability

The capital adequacy of Italian banks improved in the first half of 2023. The CET1 ratio (i.e. the ratio of common equity tier 1 to RWAs) for the entire banking system averaged 15.6 per cent in

June, following similar increases for significant and less significant banks, to 15.9 and 16.8 per cent respectively.<sup>5</sup> For the former, the CET1 ratio in June was about 20 basis points higher than the average CET1 ratio for banks in the Single Supervisory Mechanism (SSM).

Significant banks benefited from the substantial contribution of self-financing and, to a lesser extent, from the improvement in the capital reserve related to accumulated other comprehensive income.<sup>6</sup> These items more than offset the residual effects of the IFRS 9 phase-in regime<sup>7</sup> and of a new share buyback by a leading financial intermediary.

The reduction in RWAs also continued, in line with a trend that has been in place for some time: over the three-year period 2020-22, the sizeable increase in CET1 ratios for Italian significant banks was due only to the decline in RWAs, against a negative capital contribution, while the opposite was seen for SSM banks as a whole, whose level of capitalization improved to a lesser extent.<sup>8</sup>

For less significant banks, the contribution of profitability more than offset the IFRS 9 phase-in effect. Recent stress tests show the sector is resilient overall and would be able to weather the impact of adverse macroeconomic events (see the box ‘Stress tests on Italian less significant banks’).

#### STRESS TESTS ON ITALIAN LESS SIGNIFICANT BANKS<sup>1</sup>

The Bank of Italy recently carried out a stress test exercise on Italian less significant banks (Less Significant Institutions, LSIs); the sample included 112 banks, representing both traditional and specialized business models, accounting for about 10 per cent of the total assets of the entire banking system.<sup>2</sup>

This exercise, which the Bank carries out as part of its ordinary supervisory activities, assessed banks’ capacity to withstand adverse macroeconomic events and, similarly to the EU-wide stress test on the significant banks coordinated by the EBA and the ECB,<sup>3</sup> did not automatically lead to the adoption of supervisory measures. The results are used as part of the Supervisory Review and Evaluation Process (SREP) for a variety of purposes, including: (a) verifying capital adequacy; and (b) quantifying the non-binding capital requirements (Pillar 2 Guidance, P2G).

The banks were not directly involved in the analysis (top-down approach), which referred to the same baseline and adverse macroeconomic scenarios adopted in the EU-wide stress test. The starting data for the simulations

<sup>1</sup> By Alessandro Croce and Mauro Ronca.

<sup>2</sup> Specifically, 84 of them follow a traditional business model (39 of which are members of the Raiffeisenkassen cooperative banking group), 14 are asset managers, 6 are specialized lenders and 8 are classified as ‘other’. The exercise excluded firms undergoing a significant revision of their business model, in the process of changing their corporate structure, or under special administration.

<sup>3</sup> For more information, see the EBA website: [EU-wide stress testing](#) and, specifically, the [methodological notes](#) on the most recent exercise and the [document](#) that sets out the macro-financial scenarios to be used.

<sup>5</sup> The total banking system also includes Italian subsidiaries of foreign banks, which are classified as neither significant nor less significant, and whose average CET1 ratio was 12.3 per cent in June.

<sup>6</sup> The reserve related to accumulated other comprehensive income is affected by changes in the value of assets and liabilities that are not reflected in the profit or loss for the year, but feed into a specific item of equity, and thereby into regulatory capital. In the first half of the year, the increase in the value of government bonds held by banks also played a part.

<sup>7</sup> Under the phase-in regime governed by Article 473-bis of Regulation (EU) 575/2013 (Capital Requirements Regulation, CRR), banks can include in CET1 a portion, decreasing over time, of the higher loan loss provisions recognized in the result for the financial year following the first-time application of IFRS 9.

<sup>8</sup> M.A. Aiello, C. Ciancaglioni and G. Manzelli, ‘Risk-weighted assets dynamics for Italian and SSM banks over the last three years’, Banca d’Italia, Notes on Financial Stability and Supervision, forthcoming.

are as at the end of 2022 and the estimations of the impact refer to the three-year period 2023-25.

Over the time horizon considered, the Italian LSIs as a whole demonstrate an adequate capacity for resilience in the adverse scenario, with an average fully loaded CET1 ratio of 11.1 per cent (see the figure). The expected 4.9 percentage point reduction would be due mainly to the increase in operating expenses caused by rising inflation (which would have an impact of 15.5 percentage points),<sup>4</sup> to the increase in credit risk (with an expected impact of 5.7 percentage points) and to the change in market risk, reflecting the depreciation in the bonds held in the portfolio at fair value (which would have an impact of 1.8 percentage points). These impacts are partially offset by the contribution of net interest income (positive by 12.3 points despite the expected increase in the cost of funding) and of fee and commission income (7.1 points).

The fully loaded leverage ratio average is set to fall by 1.8 percentage points (from 6.4 to 4.6 per cent, which is nonetheless higher than the minimum requirement of 3.0 per cent).

Compared with the EU-wide stress test, the capital reduction for the LSIs with traditional operations was 1.5 percentage points more than that observed for Italian significant banks. The impact was more pronounced for credit risk and operating expenses. By contrast, the LSIs benefit more from the increase in net interest income.

The results of the stress test are one of the supervisory tools used to assess the overall risk profiles of banks. The Bank of Italy has been monitoring the banks that would be unable to meet at least one of the prudential requirements in the adverse scenario, also requiring them to take corrective measures.

<sup>4</sup> It is expected that at the end of the three-year period, the annual value of personnel and other administrative expenses will rise by 13.2 and 22.3 per cent respectively, compared with the starting value.

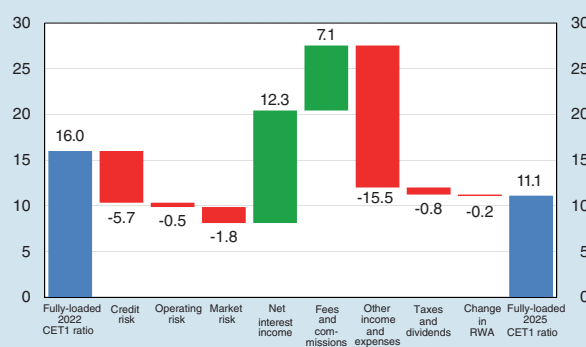
In the first half of 2023, the leverage ratio, which measures capital adequacy relative to non-risk-weighted assets, rose by 10 basis points, to 6.1 per cent (versus a 3.0 per cent regulatory requirement), mainly as a result of a lower overall exposure (the denominator). The leverage ratio for Italian significant banking groups stood at 5.9 per cent, 20 basis points above the SSM average; for less significant banks, it was 6.9 per cent.

Over the same period, there was sizeable issuance of eligible liabilities to meet the minimum requirement for own funds and eligible liabilities (MREL), mostly by significant banks.<sup>9</sup> The ratio of MREL liabilities to RWAs for significant and less significant banks subject to resolution rose to 32.8 per cent, well above the average values for the intermediate and final regulatory requirements. Some institutions are still not in line with the final requirements to be met by 1 January 2024 (or any extended deadline, as determined by the resolution authority), but are gradually reducing the shortfall of eligible liabilities.

<sup>9</sup> Issues were concentrated in senior and senior non-preferred securities.

**Figure**

**Change in the fully loaded CET1 ratio in 2023-25 for Italian LSIs under the adverse scenario (1)**  
(per cent and percentage points)



Source: Supervisory reports.  
(1) Aggregate results of the 2023 stress testing of LSIs under the adverse scenario. Any mismatches are due to rounding.

The profitability of Italian banks improved in the first half of the year. Net of non-recurring items, ROE rose from 9.0 to 13.2 per cent (Figure 2.12).

The largest contribution to higher profitability came from the strong growth in net interest income (up by 44.5 per cent year-on-year). This, in turn, was mainly due to higher interest income on loans to households and firms. Interest on debt securities also made a contribution, albeit to a lesser extent.

Higher net interest income boosted gross income (up by 19.1 per cent), despite slightly lower fees and trading revenues. The decrease in loan loss provisions (-35.2 per cent) too contributed to the improvement in profitability; operating costs rose just barely (by 3.5 per cent).

Based on estimates consistent with the macroeconomic scenario published by the Bank of Italy in its October *Economic Bulletin*, the overall profitability of Italian banks is set to remain high in the current year, above 2022 levels, and to decline in the following two years, albeit remaining strongly positive. Net interest income is projected to increase by more than one third in 2023, before slowing markedly in the following two years, partly reflecting the gradual adjustment of interest on deposits. In line with the expected rise in the loan default rate, loan loss provisions are poised to grow modestly in 2023 and more strongly in 2024, before stabilizing in 2025. However, their value is forecast to remain very low, even by historical standards.

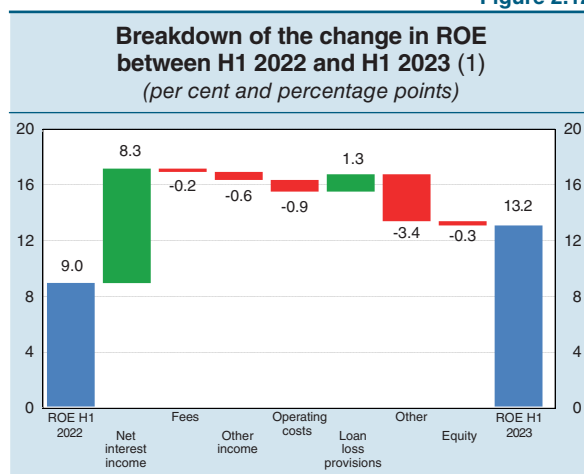
Law 136/2023 introduced an extraordinary tax on banks' net interest income. Its amount will be determined by applying a 40 per cent rate to the portion of net interest income for 2023 that exceeds 110 per cent of net interest income for 2021. However, the levy cannot exceed 0.26 per cent of RWAs. As an alternative to paying the tax, banks can set up a non-distributable capital reserve worth no less than 2.5 times the tax amount, when approving the 2023 financial statements. Most institutions seem inclined to choose this option.

Based on the findings of the Bank of Italy's monitoring activities,<sup>10</sup> Italian financial intermediaries had 20 significant cyber incidents in the first half of the year, compared with 13 in 2022 as a whole. Most reports relate to attacks to service providers, in some cases in connection with the conflict in Ukraine.

## 2.2 INSURANCE COMPANIES

The equity prices and expected earnings of Italian insurance companies have increased from last April, in line with the euro-area markets (Figure 2.13).

Figure 2.12



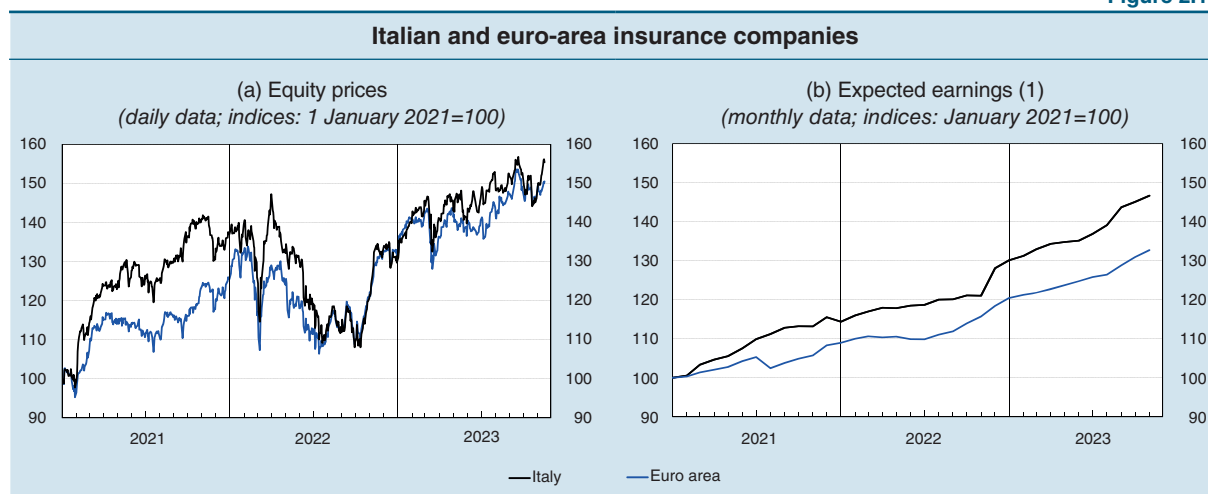
Sources: Consolidated supervisory reports for banking groups and individual supervisory reports for stand-alone banks.

(1) Changes are expressed as a ratio to own funds and reserves. A green/red bar indicates a positive/negative contribution to ROE in the first half of 2022, giving the final ROE value for the first half of 2023.

<sup>10</sup> Monitoring activities are based on the reporting of significant operational or security incidents as required by the Bank of Italy. For more information, see the Bank of Italy's website: [‘Reporting significant operational or security incidents’](#).



Figure 2.13



Source: Calculations based on Refinitiv data.

(1) Average of expected earnings per share in the 12 months following the reference date for a sample of the leading Italian and euro-area insurance companies, weighted by the number of outstanding shares. For Italy, the data refer to Assicurazioni Generali, Mediolanum Assicurazioni, Poste Italiane and UnipolSai. For the euro area, the data refer to the leading companies included in the Datastream euro-area insurance sector index.

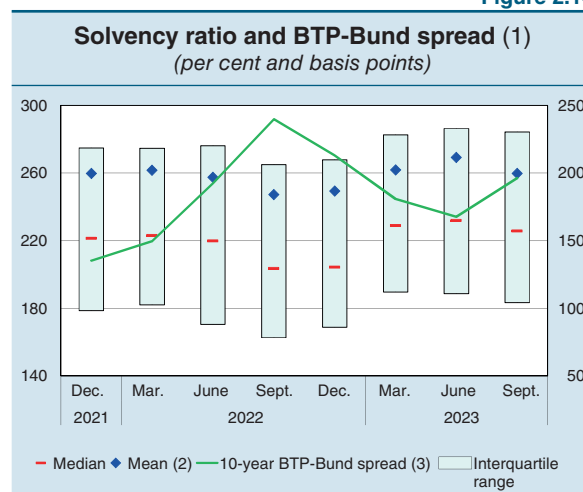
The crisis of the Eurovita insurance company (see *Financial Stability Report*, 1, 2023) was finally resolved in October, with the sale of the company's assets and a return to normal business practices, while safeguarding policyholders' rights.<sup>11</sup>

The average solvency ratio of Italian insurers came to 260 per cent in September, from 249 per cent in December 2022 (Figure 2.14). The increase reflected the growth in the value of investments.

Public and private bonds (accounting respectively for 45 and 21 per cent of investments for which insurance companies bear the risk; Figure 2.15.a) have continued to generate net unrealized losses (see *Financial Stability Report*, 1, 2023). At the end of October, the net negative balance between unrealized gains and losses stood at €48 billion, wider than in June (Figure 2.16).

Private bonds held in insurance companies' portfolios consisted mainly of securities issued by foreign companies and non-financial corporations (Figure 2.15.c), with a prevalence of BBB and A-rated instruments (50 per cent and 32 per cent respectively; Figure 2.15.b).

Figure 2.14

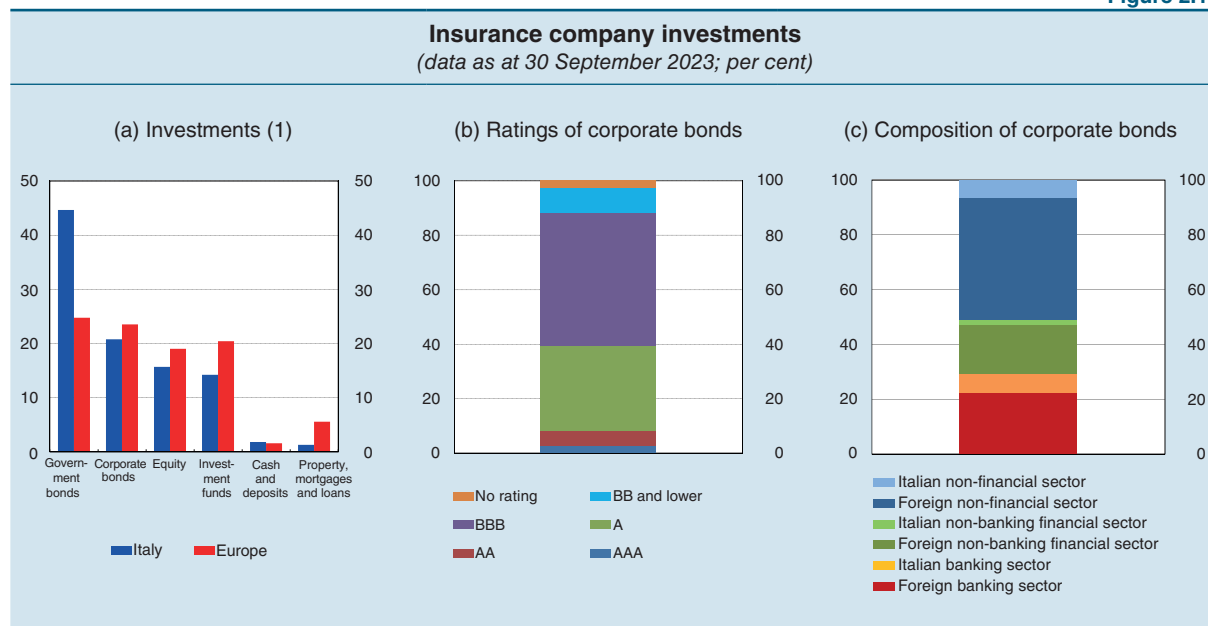


Sources: IVASS and calculations based on Refinitiv data.

(1) The solvency ratio is calculated as the ratio of eligible own funds held for coverage to the solvency capital requirement established under Solvency II. The data are taken from the quarterly Solvency II supervisory reports based on the quantitative reporting templates. – (2) Weighted average with weights equal to the solvency capital requirement. – (3) The BTP-Bund spread refers to the end of each period. Right-hand scale.

<sup>11</sup> IVASS, 'Eurovita spa and Eurovita Holding spa in compulsory winding up - transfer of corporate business' (only in Italian), notice, 30 October 2023.

Figure 2.15



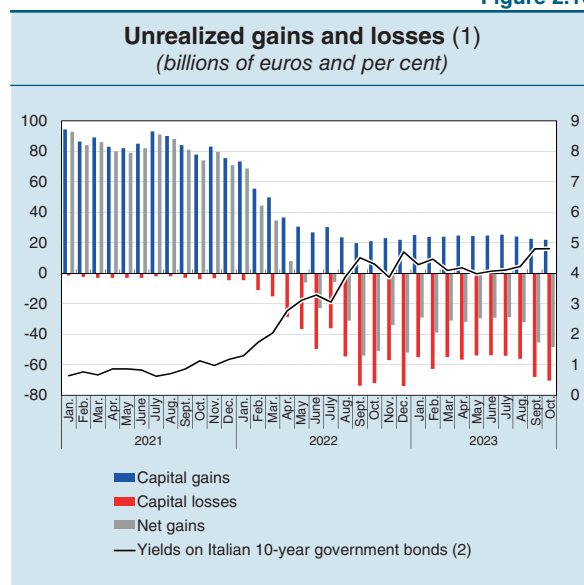
Sources: IVASS and EIOPA.

(1) The data for Europe, as at 30 June 2023, refer to the European Economic Area.

Given the persistent volatility of security prices, the legislation that makes it possible to temporarily suspend the effects of unrealized investment losses on the profitability for the financial year was extended to 2023.<sup>12</sup>

In the first six months of the year, this option was used by a limited number of companies which, in terms of assets, account for 16 per cent of the market. Unrealized losses therefore negatively affected profitability, especially in the life sector, where ROE remained negative, though to a lesser extent than in the same period of 2022 (Figure 2.17.a). This is also attributable to the sharp fall in the premiums of unit-linked policies (-33 per cent), which was only partly offset by the recovery in premium income from traditional life insurance products (up by 10 per cent; Figure 2.17.c). The non-life ROE for the first half of 2023 turned upwards year-on-year as a result of an increase in premium income (8 per cent), partly owing to inflation

Figure 2.16

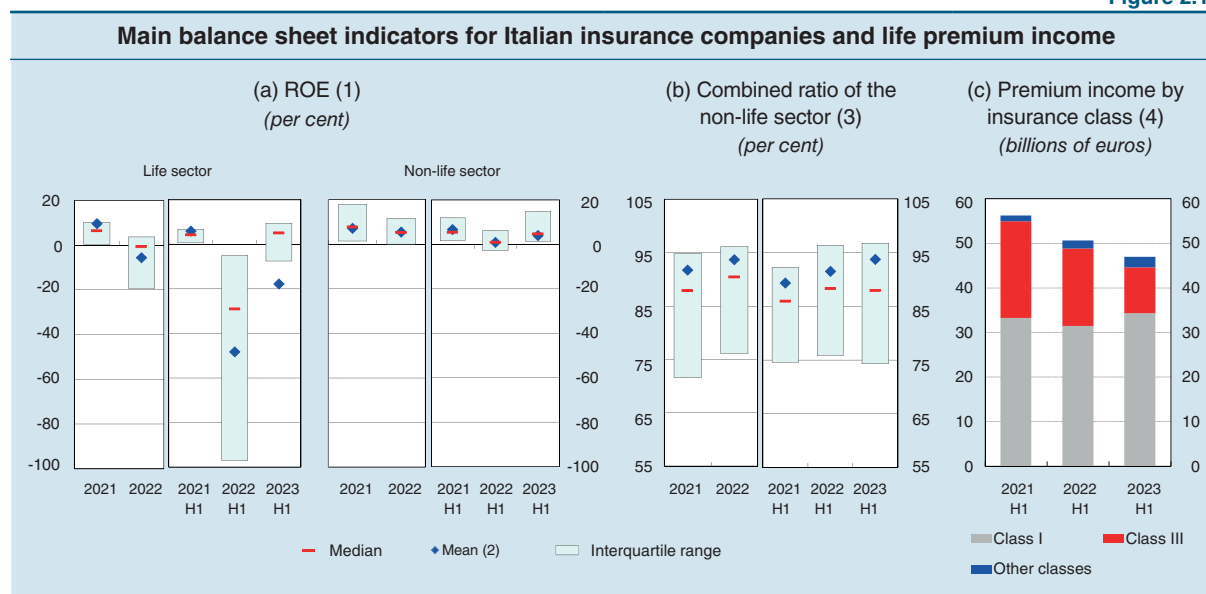


Sources: IVASS and calculations based on Refinitiv data.

(1) Unrealized gains and losses are the difference between the market value and the book value of portfolio securities. – (2) Right-hand scale. End-of-period data.

<sup>12</sup> The exception allows insurance companies that do not adopt the international accounting standards to recognize available-for-sale securities based on the book value as reported in their most recent annual financial statements, except in the case of impairment losses. Companies that exercise this option shall use the unrecognized amount to build up a 'non-distributable reserve'.

Figure 2.17



Source: IVASS.

(1) Ratio of earnings to shareholders' equity. The half-yearly ROE data are not annualized and are based on a representative sample of the leading Italian insurance companies. – (2) Weighted average with weights equal to the denominator of each ratio. – (3) Ratio of claims plus operating expenses to premium income. – (4) 'Class I' mainly includes with-profit policies (traditional life insurance policies with guaranteed returns); 'Class III' is mainly composed of unit- and index-linked policies (life insurance policies where policyholders bear the risk); 'Other classes' includes all the other kinds of life insurance policies.

dynamics.<sup>13</sup> However, the combined ratio worsened (coming to 94 per cent, from 92 per cent in June 2022; Figure 2.17.b) because of the higher costs incurred by insurers; the growth is likely to continue in the current half-year period as a result of higher claim costs,<sup>14</sup> only partially mitigated by the increase in the price of insurance coverage, which is usually gradual. As a result of the performance of both sectors, the overall profitability of the insurance industry stood at around 2 per cent at the end of the first half of 2023.

Last June, the median value of the liquid asset ratio<sup>15</sup> turned slightly downwards compared with December 2022 (from 65 to 60 per cent) but was still well above EU levels.

At the end of October, the ratio of surrenders to premium income in the life sector was still high (94 per cent against 57 per cent year-on-year), especially among companies that distribute products through banks and financial advisors (122 per cent, up from 61 per cent in October 2022; Figure 2.18).

In the first half of 2023, nearly one third of the payments for surrenders of with-profit life insurance policies was in respect of contracts with technical provisions in excess of €500,000;

<sup>13</sup> The annual percentage change in motor liability premiums was 5.9 per cent, against a 6.4 per cent increase in the overall consumer price index (see IVASS, 'IPER: Trend in actual prices for motor liability insurance in the second quarter 2023', [only in Italian](#)), Statistical communication Year II, 6, September 2023). In June, this insurance class accounted for 31 per cent of total non-life premium income.

<sup>14</sup> A recent analysis by EIOPA examined the possible impact of inflation dynamics and high interest rates on the future profitability of European insurance companies; for further details, see EIOPA, 'Impact of inflation on the insurance sector', 5 October 2023.

<sup>15</sup> The indicator is calculated as the ratio of liquid assets to total assets. Liquid assets are calculated for the different asset categories by applying haircuts consistent with the banking sector rules set by Commission Delegated Regulation EU/2016/322.

for these policies, the lapse ratio<sup>16</sup> was double the market average observed in the same period (10 and 5 per cent respectively). In June 2023, these contracts accounted for 14 per cent of the technical provisions of all with-profit life policies.

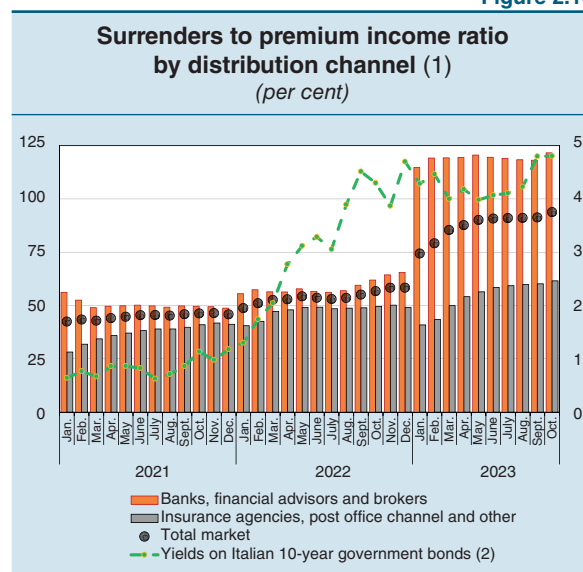
The results of analyses carried out at national and EU level show that Italian insurance companies will likely require more time than EU insurers for the returns on their insurance-based investment products to converge towards market yields because of the longer average maturity of their bond portfolios.<sup>17</sup>

## 2.3 THE ASSET MANAGEMENT INDUSTRY

In the second and third quarters of 2023, net subscriptions to Italian open-end investment funds were negative (by about €4 billion; Figure 2.19), reflecting the uncertainty connected with the macroeconomic scenario and the increase in yields that encourages reallocation towards investment in debt securities (see Section 1.5). The outflows were mainly attributable to retail investors. In line with the trend that started with the increase in interest rates, net flows were negative for balanced, flexible and money market funds; inflows to equity funds instead continued. There were net subscriptions in the bond sector as well, especially for European government bond funds. Investors continued to prefer funds that invest in accordance with environmental, social and governance (ESG) criteria.

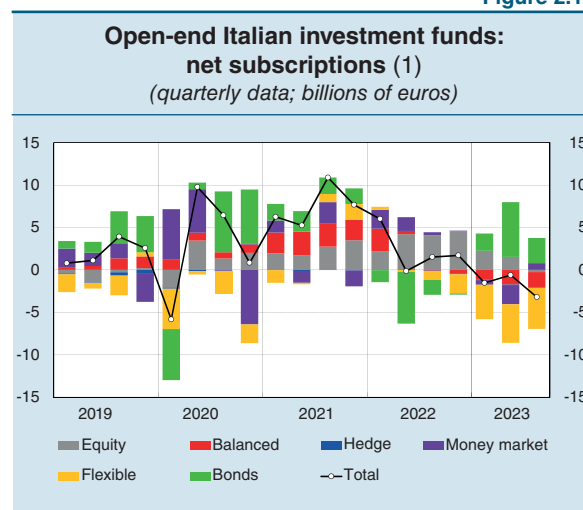
In the first half of the year, the exposure of non-equity funds to interest rate risk increased slightly; the average duration of the bond portfolio (around five years) remained lower than the euro-area average (6.4 years). These funds also reduced their share of cash holdings<sup>18</sup> (from 13 to 11 per cent of their assets), similarly to what was observed in the euro area. At the same time, the share of

Figure 2.18



Sources: IVASS and calculations based on Refinitiv data.  
(1) This indicator is calculated by dividing surrenders by premium income. –  
(2) Right-hand scale. End-of-period data.

Figure 2.19



Source: Assogestioni.  
(1) The data refer to Italian and foreign funds run by asset management companies belonging to Italian groups. Provisional data for Q3 2023.

<sup>16</sup> The lapse ratio is obtained by dividing the total amount of surrenders occurred during a certain period by the technical provisions set aside at the beginning of that same period.

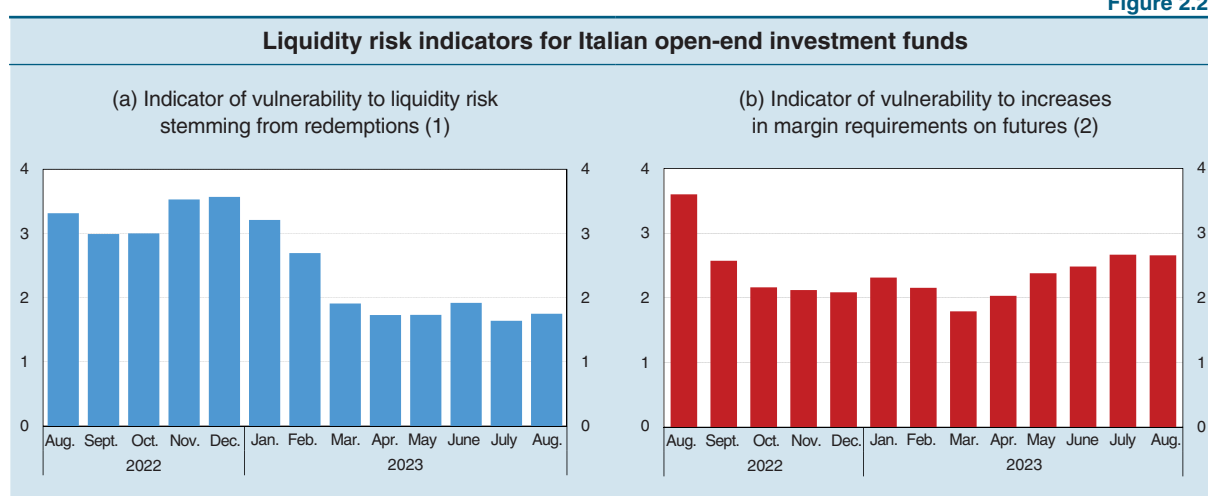
<sup>17</sup> In ten years' time, 64 per cent of the bonds held by Italian insurers, and 70 per cent of those held by EU insurers (see EIOPA, 2023, op. cit.), will have reached maturity.

<sup>18</sup> Cash holdings include current account holdings – net of purchases, sales and subscriptions to be settled – and cash equivalent assets, such as bonds with a maturity of less than one year.

government securities and investment-grade bonds increased. The reallocation of portfolios at euro-area level has helped to broaden the importance of the funds' investments in Italian bond markets. In June, euro-area funds as a whole held around one tenth of Italian government securities and one third of the bonds issued by Italian non-financial corporations.

Among Italian investment funds,<sup>19</sup> the share of non-equity funds vulnerable to particularly high redemption requests<sup>20</sup> decreased in the first eight months of the year, to 1.7 per cent (Figure 2.20.a). In contrast, the share of funds vulnerable to liquidity risk stemming from changes in margin requirements rose slightly, from 2.3 to 2.7 per cent (Figure 2.20.b); this trend reflects the increase in synthetic leverage, measured as the exposure in derivatives in relation to net assets. Borrowing from banks and other intermediaries remains modest.<sup>21</sup>

Figure 2.20



Sources: Supervisory reports and ECB (Centralised Securities Database).

(1) Ratio of the assets of funds with a liquidity risk indicator of less than 1 to the assets of all funds in the market segment. Open-end investment funds in the flexible and mixed bond segments are included. The liquidity risk indicator is equal to the ratio of the fund's assets weighted by the degree of liquidity of each exposure to net redemptions under a stress scenario. The stress scenarios are equal to the average of the values above the 99th percentile of the distribution of net monthly redemptions in relation to total assets for each of the sectors analysed between January 2008 and November 2020 (high yield and emerging market funds: 14 per cent; euro area: 30 per cent; United States and global: 24 per cent; mixed funds: 24 per cent). – (2) Ratio of vulnerable funds' assets to total sub-sector assets. Vulnerable funds are those whose ratio of liquid assets to margin requirements, determined under the stress scenario and applied to futures positions is less than 1. The stress scenario is equal to the 1st percentile in the distribution of variation margins in the period from January 2008 to November 2020. Liquid assets include bank current accounts, government securities of euro-area countries and government securities of other countries with ratings equal to or higher than AA.

In June, the total assets of alternative investment funds (AIFs) were at the same levels as at the end of 2022, and they continued to account for 12 per cent of overall assets of Italian funds. The risks to financial stability stemming from activity in this sector remain low. Leverage has increased slightly, from 102 to 104 per cent of net assets on average (Figure 2.21.a), but is still lower than the euro-area average (139 per cent). Indirect leverage of private equity funds, attributable to the borrowing of subsidiaries, stood at 60 per cent of the sector's net assets. Short-term liquidity risks are also mitigated by Italian legislation, which provides that funds investing more than 20 per cent of their portfolio in illiquid assets be set up as closed-end funds. Liquidity risks also remain limited for

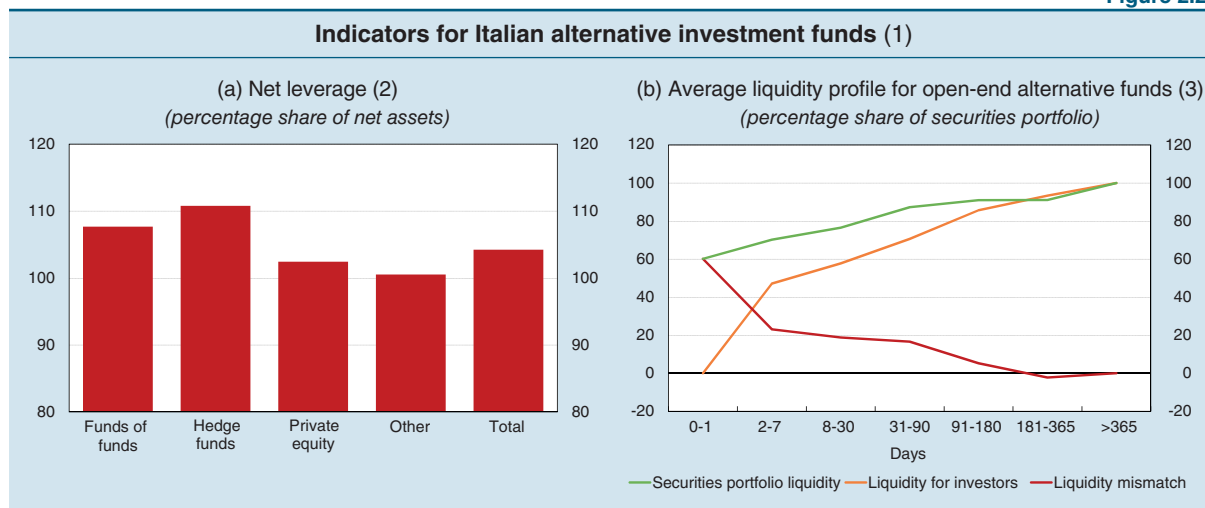
<sup>19</sup> The total assets of Italian investment funds, supervised by the Bank of Italy, account for around 40 per cent of those of asset management companies, based both in Italy and abroad and belonging to Italian groups.

<sup>20</sup> Funds for which the liquidity indicator, which is equal to the ratio of the fund's assets weighted by the degree of liquidity of its components to net redemptions under the stress scenario, is less than 1 are defined as vulnerable (see note (1) to Figure 2.20).

<sup>21</sup> Italian law provides that Italian open-end investment funds can only take out loans on a temporary basis, according to the need to invest in or disinvest from fund assets, and within the maximum limit of 10 per cent of the overall net value of the fund.

open-ended alternative funds (Figure 2.21.b),<sup>22</sup> which account for around one sixth of the assets of AIFs.

Figure 2.21



Sources: Supervisory reports and data submitted pursuant to the Alternative Investment Fund Managers Directive (AIFMD).

(1) The figure is based on supervisory reports and data submitted pursuant to Directive 2011/61/EU (AIFMD); this requires the managers of such funds to regularly provide the competent authorities with information on their main assets and exposures. – (2) Overall exposure calculated using the method based on the ratio of commitments to net assets of alternative funds managed by Italian asset management companies. ‘Other’ includes funds that provide direct financing or buy credit from other financial intermediaries and those not included in the other categories, according to the criteria adopted by the European Securities and Markets Authority (ESMA). – (3) For each period, the liquidity mismatch is the difference between the liquidity of the securities portfolio, equal to the average share of the securities portfolio that the open-end alternative funds can liquidate by that date, and the liquidity profile for investors, equal to the average share of assets that investors in these funds can redeem in the same period. The estimate does not take account of cash holdings.

Growth in the assets of Italian real estate funds came to a halt in the first half of the year (Figure 2.22.a), in line with the slowdown in the Italian and European commercial real estate markets (see Section 1.4). The investors in the funds set up in the first half of the year are mainly Italian operators (Figure 2.22.b), while foreign investments have declined. The new investments in the sector continue to be concentrated in the province of Milan. Overall, real estate funds made a net write-down of just under 1 per cent of their portfolio (Figure 2.23.a).

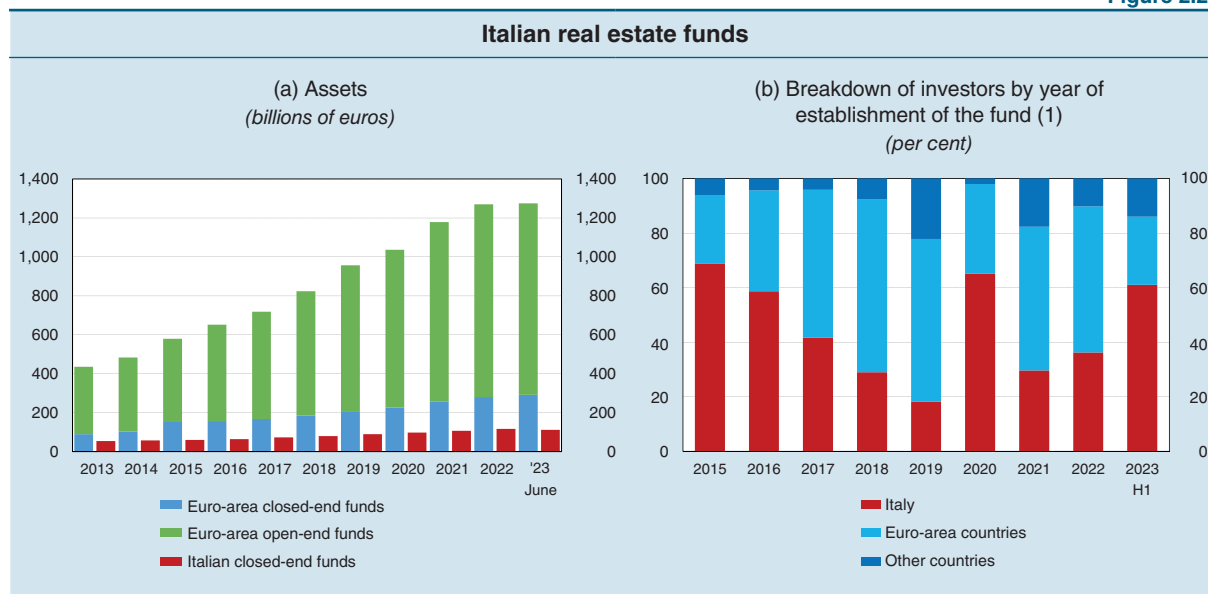
The risks to financial stability stemming from the activity of real estate funds remain limited overall. The funds are not actually subject to the liquidity risk deriving from high demand for redemptions, as they are closed-end, in line with Italian legislation. The risk that, at maturity, the valuation of the real estate portfolio entered on the funds’ books could diverge significantly from market values also remains low (Figure 2.23.b).

Leverage of real estate funds is at historically low levels (132 per cent; Figure 2.23.c), in line with the euro-area average. In June 2023, around 4 per cent of the sector’s total assets were held by highly leveraged funds, i.e. above 300 per cent. The share of funds with negative net assets, a condition that indicates particular financial stress, continues to be essentially stable, at 1.1 per cent. Direct exposures of banks and other intermediaries operating in Italy to the sector remain modest: in June, the loans granted to Italian real estate funds accounted for less than 1 per cent of total lending. The ratio of NPLs to total outstanding loans to the sector, gross of loan loss provisions, stayed at 14 per cent.

<sup>22</sup> In the event of persistent outflows over a time horizon of between six months and one year, there might be a mismatch between asset liquidity and redemptions for investors, equal to about 2.2 per cent of the securities portfolio, less than the figure for December 2022 (6.4 per cent).



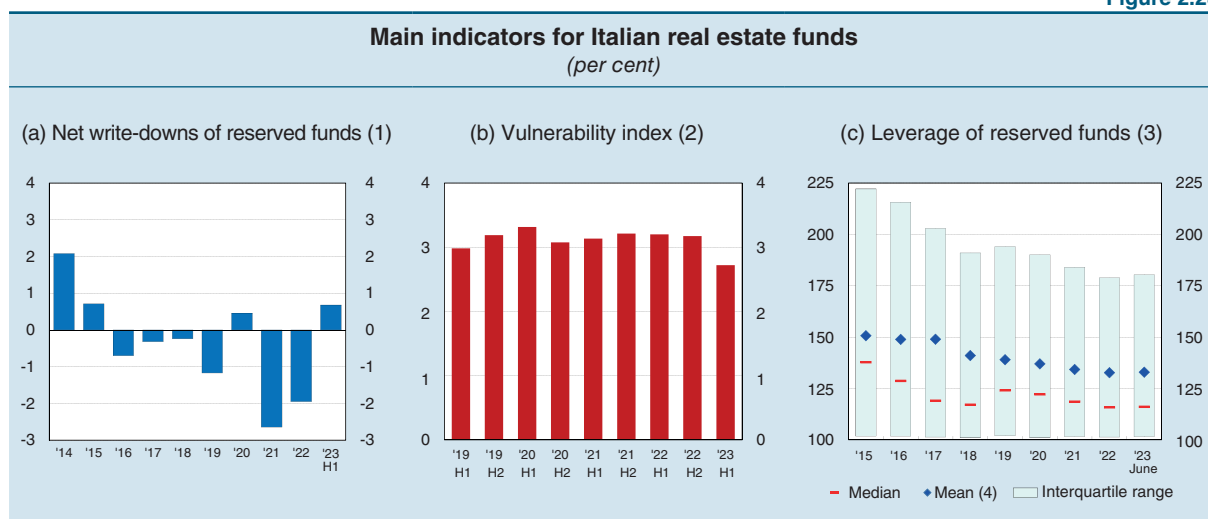
Figure 2.22



Source: Supervisory reports.

(1) Share of net assets subscribed by the different categories of investor.

Figure 2.23



Sources: Supervisory reports and calculations based on data from Istat and the Osservatorio del Mercato Immobiliare (OMI).

(1) Ratio of reserved fund balance sheet write-downs net of revaluations to the average of total assets at the end of the reference year and at the end of the previous year. – (2) Share of the sector's total assets held by real estate funds for which the estimated difference between the book value and the market value of properties is greater than net assets. For each fund, the difference is calculated between the fund's cumulative net write-downs as a ratio to its assets and the cumulative variations of a theoretical price index for the properties in the portfolio. The index is calculated as the weighted average of the price indices for properties (divided into residential and commercial) for each Italian region. The weights are equal to the shares of the assets of each fund that are invested in the markets included in the price indices under consideration. Write-downs and variations in the indices are calculated from the year that each fund was established or from 2009 (the year in which data became available) if the fund was set up prior to that date. Excludes funds in liquidation and those set up in the half year prior to the reference period. – (3) Ratio of total assets to net assets. – (4) Weighted average with weights equal to the denominator of each ratio.

# 3 FINANCIAL STABILITY POLICIES

In the absence of any risks to financial stability deriving from excessive credit growth, the Bank of Italy has maintained the countercyclical capital buffer (CCyB) rate at zero per cent (see Table A9 in the Appendix).<sup>1</sup> In Europe, the number of countries with a positive CCyB is growing, in many cases even under normal conditions, i.e. when cyclical risks are balanced ('positive cycle-neutral CCyB'; see the box 'The use of the CCyB in European Economic Area countries').

The analytical framework for CCyB decisions is reviewed on a regular basis, in line with the requirements set in the European Union by the European Systemic Risk Board (ESRB).<sup>2</sup> The Bank of Italy has recently started a comprehensive review of the national methodological framework, in order to verify its adequacy for the purposes of the buffer. The review will also take account of the Basel Committee's acknowledgement of the possibility of introducing a positive cycle-neutral CCyB.

The Bank of Italy has identified Russia, Switzerland, the United Kingdom and the United States as material third countries<sup>3</sup> for the Italian banking system for the purposes of the application of the CCyB.<sup>4</sup> Direct supervision of the risks of these four countries is carried out by the ESRB, which has included them among those of systemic importance for the entire European Economic Area.

Between June and September, the Bank of Italy assessed the request to reciprocate three macroprudential measures adopted by Norway<sup>5</sup> and one by Sweden,<sup>6</sup> and decided not to apply them domestically due to the non-material exposures of Italian banks.

## THE USE OF THE CCYB IN EUROPEAN ECONOMIC AREA COUNTRIES<sup>1</sup>

In the CCyB calculation methodology proposed by the Basel Committee and transposed into European legislation, the buffer is activated when the credit-to-GDP gap is positive. However, the decision is not automatic, but follows the principle of guided discretion whereby, when deciding on the introduction and level of the buffer, the competent authorities combine a rules-based approach with the exercise of their discretionary powers.

<sup>1</sup> By Luca Bonato and Massimo Molinari.

<sup>1</sup> Bank of Italy, 'The Countercyclical Capital Buffer (CCyB) rate for the fourth quarter of 2023 remains unchanged at zero per cent', press release, 22 September 2023.

<sup>2</sup> ESRB, 'Recommendation of the European Systemic Risk Board of 18 June 2014 on guidance for setting countercyclical buffer rates (ESRB/2014/1)', 18 June 2014.

<sup>3</sup> Banca d'Italia, 'Identification by Italy of material third countries pursuant to Recommendation ESRB/2015/1 of the European Systemic Risk Board (ESRB)', 30 June 2023.

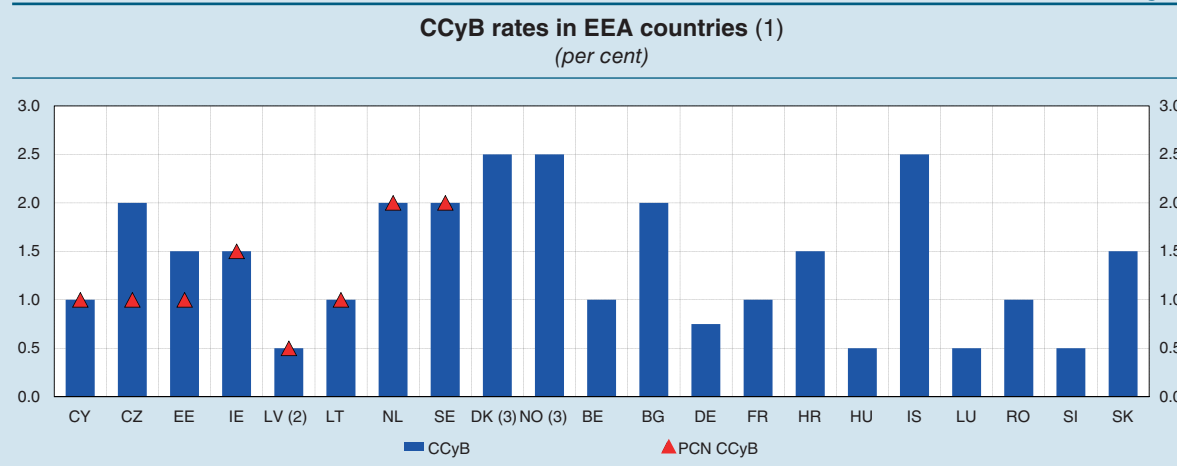
<sup>4</sup> ESRB, 'Recommendation of the European Systemic Risk Board of 11 December 2015 on recognising and setting countercyclical buffer rates for exposures to third countries (ESRB/2015/1)', 11 December 2015.

<sup>5</sup> Banca d'Italia, 'Decision not to reciprocate three macroprudential measures adopted by Norway pursuant to recommendation ESRB/2023/1', 9 June 2023.

<sup>6</sup> Banca d'Italia, 'Decision not to reciprocate a macroprudential measure adopted by Sweden pursuant to Recommendation ESRB/2023/4 of the European Systemic Risk Board (ESRB)', 29 September 2023.

According to the latest available data, 21 out of the 30 European Economic Area countries will have a positive CCyB by the end of 2024, with rates ranging between 0.5 and 2.5 per cent (see the figure). With the exception of France and Germany, the buffer requirement was activated when the credit-to-GDP gap was negative.

Figure



Sources: Basel Committee and individual national authorities.

(1) Data updated to the latest available decisions; also includes the rates announced but not yet in force. The figure shows that, in the countries that have introduced it, the PCN CCyB fully determines the overall CCyB (i.e. their levels coincide), with the exception of the Czech Republic and Estonia, where the overall CCyB also reflects a standard component linked to higher cyclical risks. – (2) Latvia signalled its intention to introduce, via a decision next December, a PCN CCyB of 0.5 per cent from December 2024 and of 1.0 per cent from December 2025. – (3) Denmark and Norway follow an early build-up approach.

Of the 19 countries with a negative credit-to-GDP gap, 9 used alternative metrics to that proposed by the Basel Committee (including synthetic risk indicators or national variants of the credit-to-GDP gap calculation mechanism);<sup>2</sup> the remaining 10 decided to activate a capital buffer under normal conditions, i.e. when the cyclical risks are neither high nor low (positive cycle-neutral CCyB, or PCN CCyB), a possibility recently acknowledged by the Basel Committee.<sup>3</sup> The reasons for introducing a PCN CCyB are similar across countries: (a) to increase the availability of capital that can be released for unforeseen events that are not necessarily linked to the domestic financial cycle; (b) to manage uncertainty in the assessment of cyclical risks; (c) to take account of both the inevitable delays in the availability of the data used for decisions and the time needed to implement measures; and (d) to allow this instrument to be used more flexibly and proactively.

The PCN CCyB target rates range from 1.0 to 2.5 per cent. The differences in calibration observed are the result of different approaches, which include assessments of historical losses, stress tests, cost-benefit analyses of additional capital and a discretionary component; the latter also takes account of the soundness of the banking system and of the interplay with other macroprudential tools. Differences also remain in other respects, such as the frequency of updates, the conditions for the release of the buffer and the interaction between the PCN CCyB component and the cyclical CCyB.<sup>4</sup>

<sup>2</sup> The 9 countries are: Belgium, Bulgaria, Croatia, Hungary, Iceland, Luxembourg, Romania, Slovakia and Slovenia.

<sup>3</sup> Basel Committee, 'Newsletter on positive cycle-neutral countercyclical capital buffer rates', October 2022. The 10 countries are: Cyprus, the Czech Republic, Denmark, Estonia, Ireland, Latvia, Lithuania, the Netherlands, Norway and Sweden. Denmark and Norway have an 'early build-up' policy, which means that their buffer, although not explicitly referred to as a PCN CCyB, is already equal or close to 2.5 per cent under normal conditions.

<sup>4</sup> In some jurisdictions, the two components are additive, and therefore an increase in the PCN CCyB component leads to an equal increase in the overall requirement; in others, an increase in one component results in a (at least partial) reduction in the other component. Most supervisory authorities consider the CCyB ceiling to be 2.5 per cent, including when a PCN CCyB is active.

Of the 9 countries,<sup>5</sup> including Italy, with a CCyB of zero per cent, only 3 (Italy, Greece, Spain) have not even activated systemic risk buffers (SyRBs).

<sup>5</sup> Austria, Finland, Greece, Italy, Liechtenstein, Malta, Poland, Portugal and Spain.

The Bank of Italy confirmed the UniCredit, Intesa Sanpaolo and Banco BPM banking groups as other systemically important institutions (O-SIIs) for 2024 and included the BPER Banca, Mediobanca, Banca Nazionale del Lavoro groups and the ICCREA cooperative credit banking group in this category for the first time.<sup>7</sup> As of 2024, the three O-SIIs already identified last year must maintain a capital buffer equal to 1.50, 1.25 and 0.50 per cent respectively of their total risk-weighted exposures; the credit institutions identified for the first time will be required to maintain a capital buffer of 0.25 per cent, to be achieved within two years (Table 3.1). The buffer requirements were identified and assigned using the new methodology developed by the Bank of Italy (see the box ‘The new classification of other systemically important institutions’).

**Table 3.1**

Banking group	O-SII buffers (per cent)	
	From 1 Jan. 2024	From 1 Jan. 2025
UniCredit	1.50	1.50
Intesa Sanpaolo	1.25	1.25
Banco BPM	0.50	0.50
BPER Banca	0.125	0.25
Mediobanca	0.125	0.25
ICCREA	0.125	0.25
Banca Nazionale del Lavoro	0.125	0.25

## THE NEW CLASSIFICATION OF OTHER SYSTEMICALLY IMPORTANT INSTITUTIONS<sup>1</sup>

The Bank of Italy has reviewed the methodology for the identification and calibration of the buffers for other systemically important banks, following the ECB’s update of its floor methodology for assessing the adequacy of the capital buffer rates proposed by national authorities for O-SIIs.<sup>2</sup>

For the purposes of the update, the structure of the Italian banking system was assessed through a cluster analysis<sup>3</sup> applied to the systemic importance scores calculated for each Italian bank or banking group.<sup>4</sup> The results of the analysis conducted on end-2022 data show that the Italian

<sup>1</sup> By Francesca Francetti.

<sup>2</sup> The ECB floor methodology is a tiered structure that assigns minimum capital buffer levels based on O-SII identification scores. It was introduced by the ECB in 2017 for the possible exercise of its power – assigned under Regulation (EU) 1024/2013 establishing the SSM – to apply higher capital buffer requirements if national authorities define O-SII buffers that are deemed too low in relation to the systemic importance of banks. For the latest update, see ECB, ‘[Governing Council statement on macroprudential policies](#)’, December 2022.

<sup>3</sup> For the cluster analysis, see F. Francetti and M. Galardo, ‘Other systemically important institutions: cluster analyses for Italy’ (only in Italian), Banca d’Italia, Notes on Financial Stability and Supervision, 33, 2023.

<sup>4</sup> The scores are calculated by following the EBA’s ‘[Guidelines on the criteria to determine the conditions of application of Article 131\(3\) of Directive 2013/36/EU \(CRD\) in relation to the assessment of other systemically important institutions \(O-SIIs\)](#)’, December 2014; the four criteria for the scoring of systemic importance (size, importance for the domestic economy, complexity and interconnectedness with the financial system) are weighted on the basis of ten indicators. The scoring process takes place at the highest consolidation level.

<sup>7</sup> Banca d’Italia, ‘[Identification for 2024 of other systemically important institutions authorized to operate in Italy](#)’, 24 November 2023.

banking system can be divided into five groups of banks with similar characteristics. The analysis also suggests that the lowest category of systemic importance scores around 310 basis points on average. Therefore, in order to better match the systemic risk characteristics of Italian banks, the identification threshold was set at 300 points, in line with the EBA guidelines, which allow the basic identification threshold of 350 basis points to be reduced to 275 basis points.<sup>5</sup>

The buffers (see the table) have thus been grouped into the following categories: (a) for financial intermediaries with a score of between 300 and 399 basis points, one category corresponding to a buffer of 0.25 per cent; (b) for intermediaries with a score of between 400 and 3,999 basis points, five additional categories with buffers from 0.50 to 1.50 per cent, each increasing by 0.25 percentage points; (c) two additional categories (currently empty) for banks with scores of 4,000 basis points or higher, to discourage larger banks from increasing their systemic importance.

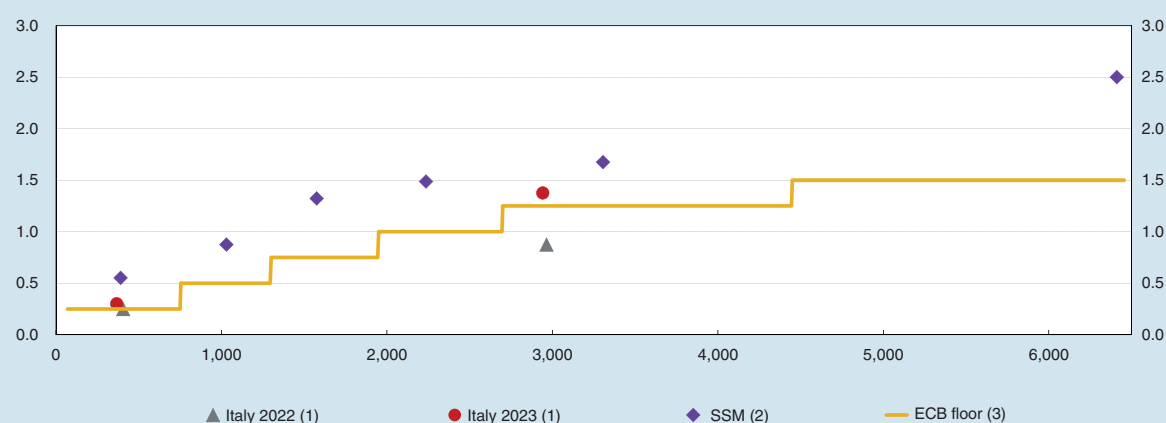
With the introduction of the new buffers, the requirement imposed on Italian O-SIIs is close – on average and within the same score bucket – to that for the O-SIIs identified in other SSM countries (see the figure).

**Table**

<b>Categories of systemic importance</b> (basis points and per cent)		
Bucket	Score interval	Buffer
8	5,000 and above	3.00
7	4,000-4,999	2.00
6	3,000-3,999	1.50
5	2,000-2,999	1.25
4	1,200-1,999	1.00
3	800-1,199	0.75
2	400-799	0.50
1	300-399	0.25

**Figure**

**O-SII scores and corresponding buffers in SSM member countries**  
(per cent and basis points)



Source: EBA, 'List of O-SIIs notified to the EBA by year', 2022.

(1) Simple average of the scores and buffers assigned to Italian O-SIIs in 2022 and 2023; the average is calculated for each bucket defined by the ECB floor methodology. – (2) Simple average of the scores and buffers assigned to O-SIIs identified in SSM member countries other than Italy; the average is calculated for each bucket defined by the ECB floor methodology. – (3) O-SII score intervals and corresponding buffers according to the ECB floor methodology.

<sup>5</sup> The Guidelines provide that the threshold of 350 basis points may be reduced or increased by 75 basis points.

The tools available to the Bank of Italy for preserving the stability of the national financial system include the product intervention power, envisaged under Regulation (EU) 600/2014.<sup>8</sup> To this end, the Bank of Italy regularly conducts analyses of the risks to the stability of Italy's financial system that may stem from financial instruments traded, distributed or sold in Italy or from Italy.<sup>9</sup> Based on the latest analyses of securities and derivatives, in June 2023, the instruments potentially posing a risk to financial stability were securitizations, additional tier 1 subordinated bonds (AT1 bonds, also known as contingent convertibles), and certificates. Our in-depth analysis of the instruments listed above suggests that the risks to financial stability are currently limited; however, we continue to monitor certificates closely. The latter, which have been growing strongly in 2023, are held mostly by households but account for a very small share of their financial wealth on average (around 1 per cent). Although these instruments are particularly complex to assess, households invest predominantly in certificates with risk profiles comparable to those of equities and bonds.

<sup>8</sup> The same power is also granted to the Italian Companies and Stock Exchange Commission (Consob) with the aim of safeguarding investors and promoting the orderly functioning and integrity of the financial and goods markets. For more information on the product intervention power, see the Bank of Italy's website: [‘The Bank of Italy's ‘intervention power’ concerning financial instruments, structured deposits and related financial activities/practices’](#).

<sup>9</sup> For further information on the criteria used by the Bank of Italy to exercise its product intervention power, see Banca d'Italia, [‘The Bank of Italy's ‘intervention power’ concerning financial instruments, structured deposits and related financial activities/practices: legal, analytical and methodological framework’](#), April 2023. For the list and definitions of all the financial instruments analysed within the scope of its product intervention power, see the Bank of Italy's website: [‘Glossary of the types of financial instruments analysed by the Bank of Italy within the scope of its intervention power’](#).