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BOXES

The Appendix is available only online at: www.bancaditalia.it

SYMBOLS AND CONVENTIONS

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.

OVERVIEW

The world economy grew at a modest pace in 2024, with forecasts for 2025 pointing to continued sluggish activity, albeit with different trends across geographical areas. The wars in Ukraine and the Middle East and heightened geopolitical tensions still pose a risk to global economic and financial stability.

International financial markets benefited from increasingly less restrictive monetary policies, but they remain exposed to significant uncertainty, amid high levels of public debt in a number of countries and low risk premiums on some financial assets. In the United States, the presidential election results led to a rebalancing in investors' portfolios from government securities to equities.

In Italy, although the macrofinancial environment has been stable overall since the spring, there are still risks arising from severe international geopolitical tensions and fragile macroeconomic conditions. Looking ahead, lower interest rates could boost the economy.

Domestic financial market conditions remain favourable overall. The spread between ten-year Italian and German government bond yields narrowed further and market liquidity conditions remain relaxed. Volatility is still low, although it temporarily increased over the summer months amid global market turbulence.

House prices continued to rise in real terms, though they remained below pre-pandemic levels; by contrast, commercial property prices stabilized. Overall, the risk to financial stability in Italy posed by real estate market developments is still small.

The risks to the household sector remain limited, as a result of improved income and higher financial wealth. The reallocation of savings towards government bonds progressed further and investment in asset management products and shares resumed.

After a long period of growth, which had only paused during the pandemic, firms' profitability showed signs of deterioration. Macroeconomic weakness and high financing costs could weigh on the profits of highly leveraged firms. However, firms' ability to repay their debts remains good overall and the default rate on bank loans is still low.

The Italian banking system remains on a good footing. Profitability improved further in the first half of the year and is expected to remain high for the whole of 2024. The Eurosystem's unwinding of ample excess liquidity is proceeding smoothly. Looking ahead, a reduction in net interest income and higher loan loss provisions could have a negative impact on banks' profitability. Their capitalization rose, and for significant institutions it is higher than the average for their counterparts in the countries participating in the Single Supervisory Mechanism (SSM). Exposure to operational and cyber risks requires keeping close watch.

Insurers' capitalization fell slightly in the first half of the year, although it continues to be high. Profitability improved overall, but is still negative in the life business as a result of unrealized capital losses on the investment portfolio. The liquidity position remained sound, partly due to a recovery in premium income in the life business.

Net subscriptions to Italian investment funds turned positive, as inflows into bond funds more than offset outflows elsewhere. Risks remain low overall.

This year saw a further significant increase in placements of certificates, mainly purchased by households. These instruments, whose value is not easy to assess, may expose holders to large losses in adverse scenarios. The Bank of Italy has been warning of this for some time and continues to monitor any developments.

Three special-focus boxes are included in this Report. The first one describes the latest supervisory *assessments of less significant banks, which show no material changes in their overall riskiness. The second one reports on the findings of an analysis of the relation between customers' propensity to use digital channels to transfer deposit funds and the stability of bank funding. According to these findings, during the interest rate hike cycle, there were no significant differences in sight deposit trends between banks with more digital-oriented customers and other banks; on the other hand, the former saw stronger growth in term deposits. The third box provides an overview of supervisory analyses of the stress tests carried out by the managers of potentially vulnerable open-end investment funds. These analyses point to areas for improvement, though fund managers' practices are essentially compliant with the regulations in force.*

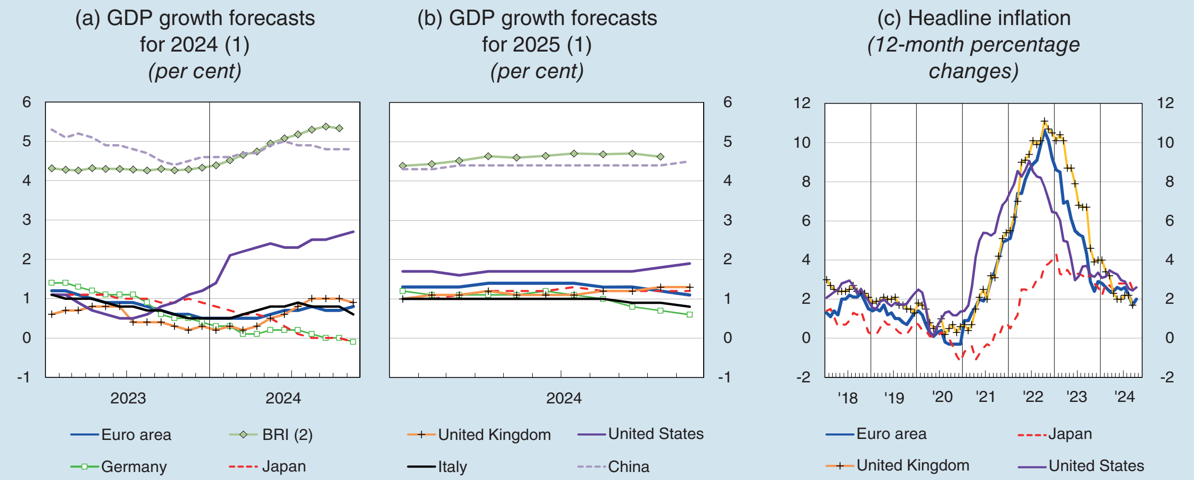
1 MACROECONOMIC, FINANCIAL AND SECTORAL RISKS

1.1 GLOBAL RISKS AND EURO-AREA RISKS

The global economy continued to grow at a relatively slow pace over the past months. Signs of weakness mostly came from the euro area, although there was a mild improvement in the third quarter, and from China, whereas growth in the United States has proven to be stronger than expected (Figure 1.1.a). Expectations for 2025 continue to indicate that economic activity will stay generally weak, with downside risks linked to the continuation of the conflicts in Ukraine and the Middle East and from international trade tensions (Figure 1.1.b). Inflation in the advanced economies returned to being close to the target levels set by central banks (Figure 1.1.c), which have started a normalization of monetary policy.

Figure 1.1

Growth expectations and headline inflation
(monthly data)



Sources: Consensus Economics for GDP growth forecasts, and national statistics for inflation.
(1) The x-axis shows the month of publication of the forecast. – (2) Average of the forecasts for Brazil, Russia and India (BRI), weighted on the basis of each country's GDP (IMF, World Economic Outlook Database, October 2024).

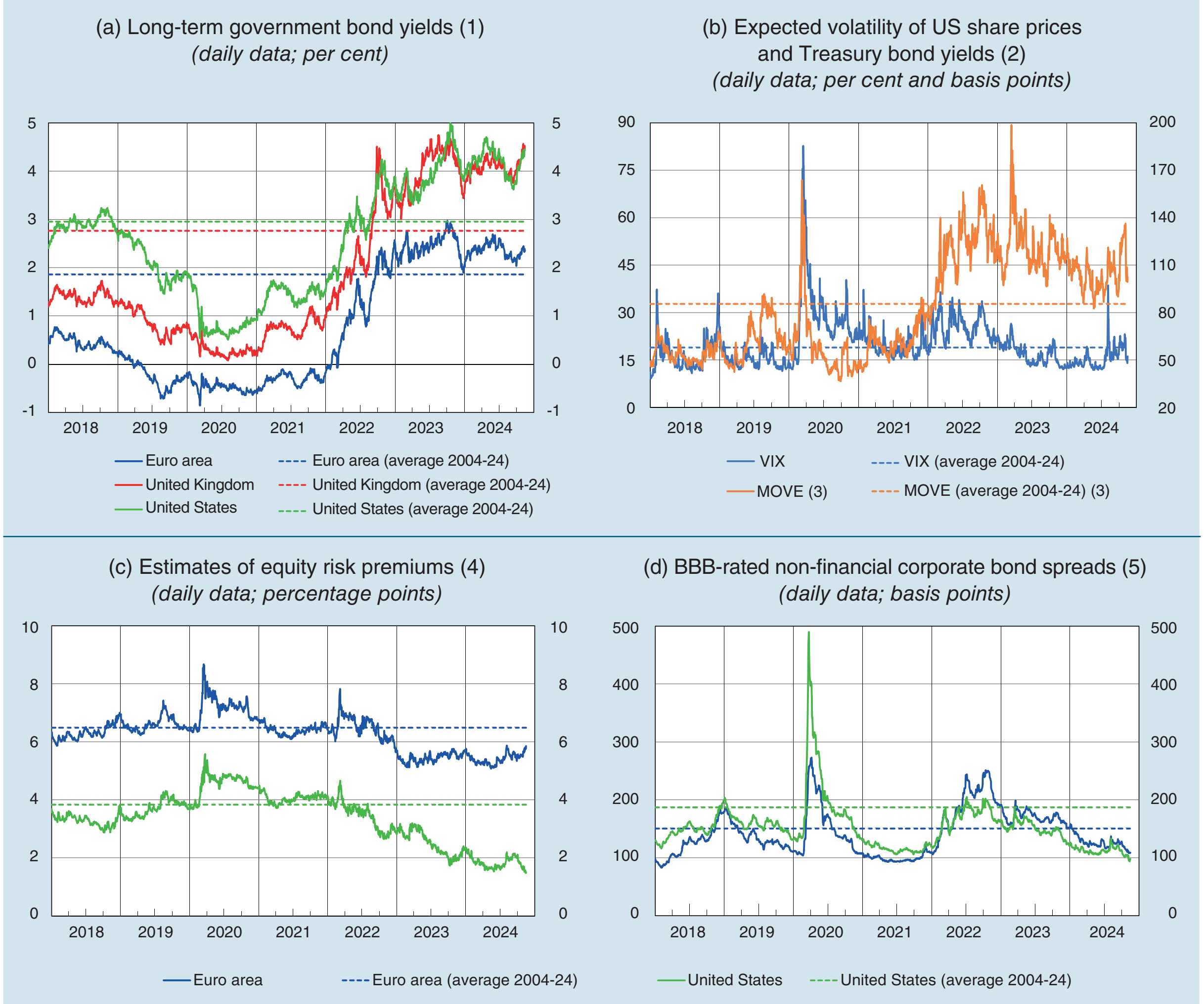
In a context of considerable macrofinancial uncertainty, global financial market conditions benefited from the launch of monetary easing policies. Starting last spring, investors gradually shifted their attention to the risks stemming from a slowdown in economic growth, while concerns over inflation trends diminished.

The yields on long-term government bonds issued by the main advanced countries displayed high instability (Figure 1.2.a). Yields were falling up to the beginning of the autumn, in connection with expectations of a further decline in inflation and in monetary policy rates. In October, however, better-than-expected macroeconomic data releases in the United States drove yields up again. The implied volatility of US treasury securities decreased after the presidential election (Figure 1.2.b). In the euro area, there was a widening of spreads against German government bonds following the European elections and the unexpected early parliamentary elections in France, which was quickly reabsorbed in all countries except France.

Share prices rose significantly in the United States, whereas they fell in the euro area. Stock prices benefited from expectations of faster monetary easing, but in the euro area they were also affected by concerns about global growth. The August tensions led to a sharp drop in prices, which was later fully recouped, and a substantial increase in volatility (Figure 1.2.b).[1] In the United States, the presidential election results led to a marked rebalancing in investors' portfolios from government securities to equities, and especially towards the sectors most exposed to the business cycle. Equity risk premiums continue to be well below their long-term averages, especially in the United States (Figure 1.2.c).

Figure 1.2

Government bond yields, volatility and risk premiums



Sources: Bloomberg, ICE Bank of America Merrill Lynch (BofAML) and LSEG.
(1) Yields on the German 10-year Bund for the euro area; yields on the US 10-year Treasury for the United States and yields on the UK 10-year Gilt for the United Kingdom. – (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 Treasury bonds with various maturities. – (3) Right-hand scale. – (4) For the S&P 500 (United States) and Datastream EMU Total Market (euro area) indices, the ratio of the 10-year moving average of earnings to the value of the stock index (both at constant prices) is calculated. From the resulting ratio, which is an estimate of the expected real return on the shares, we deduct the real rate obtained by subtracting the inflation swap rate from the 10-year overnight indexed swap (OIS) rate. The resulting figure is 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 Treasury bonds for securities in dollars), option-adjusted and weighted by market capitalization of the companies' individual bonds.

[1] For further details, see K. Todorov and G. Vilkov, 'Anatomy of the VIX spike in August 2024', BIS Bullettin, 95, 2024.

Thanks to strong demand, non-financial corporate bond spreads remained at very low levels (Figure 1.2.d). The gradual reduction in interest rates is expected to help bring down funding costs for firms and default rates.

Overall, the international financial markets remain exposed to high macrofinancial uncertainty amid considerable geopolitical tensions (which have also been reflected in a sharp rise in the price of gold), high levels of government debt in a number of countries, and extremely low risk premiums on some financial assets.

1.2 MACROFINANCIAL CONDITIONS IN ITALY

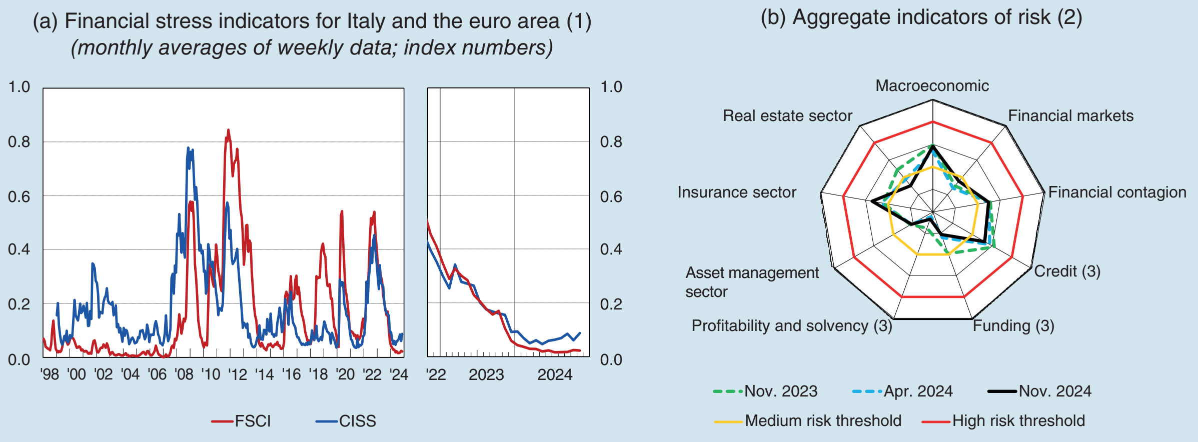
The Italian macrofinancial environment has been stable since last April. However, there continue to be distinct downward risks referable to the heightened geopolitical tensions, to the significant uncertainty in some advanced economies, and to the possibility of stronger-than-expected effects of restrictive monetary policies. The exposure to these risks, mainly of an exogenous nature, is amplified by Italy's high level of public debt and low economic growth.

The financial stress conditions index for Italy has remained at low levels (Figure 1.3.a). On the Italian financial markets, conditions have improved slightly in the segments of government securities and bank shares and bonds (see Section 1.3), whereas they have worsened for non-financial corporation shares.

The macroeconomic situation is still rather fragile (Figure 1.3.b). According to Istat's preliminary estimates, output growth, which was modest in the first half of the year, came to a halt in the third quarter. Looking ahead, the reduction in interest rates and the recovery in household purchasing power, fostered by moderate inflation, could act as a boost to the economy.

Figure 1.3

Synthetic indicators of risks for financial stability



Sources: Based on Bank of Italy, ECB and LSEG data.
(1) The index ranges from 0 (minimum risk) to 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 the 2019 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.

Our latest projections, which have remained broadly unchanged since April, indicate that GDP will grow by 0.6 per cent in 2024, by 1.0 per cent in 2025, and by 1.2 per cent in 2026.[2] Growth projections are subject to mainly downside risks, which already partly materialized in the third quarter.[3] Inflation rate forecasts have lowered further, to 1.1 per cent in 2024 and to 1.6 per cent for the subsequent two years (see *Economic Bulletin*, 4, 2024).

Under the policy framework laid out in the medium-term fiscal-structural plan for the years 2025-29 (MTP 2025-29),[4] net borrowing is projected to fall significantly this year (to 3.8 per cent of GDP) and to continue to decline gradually over the subsequent five years, falling below the 3 per cent threshold as of 2026. In the current year and over the next two years, the debt-to-GDP ratio is expected to rise, to up to 137.8 per cent of GDP, owing in part to the cash impact of the sizeable building renovation incentives granted in recent years. It is then expected to start decreasing from 2027 onwards.

The MTP budget provisions appear broadly consistent with the new EU governance framework requirements. However, in a context of rising uncertainty over the growth outlook, even greater prudence in managing the public finances will be needed. The high level of public debt, particularly, still constitutes a significant weakness of the Italian economy, and it remains a priority to ensure that its ratio to GDP be set on a course of stable reduction in the medium term.

1.3 THE FINANCIAL MARKETS

Conditions on the Italian financial markets have remained relaxed overall, benefiting from the prospect of monetary policy easing.

The spread between Italian and German government bond yields has narrowed since last April, returning to the values observed at the end of 2021 (Figure 1.4.a); the credit default swap (CDS) spread and the ISDA basis in the CDS market have decreased as well (Figure 1.4.b).

The liquidity of the secondary market for government bonds is still abundant, in the context of substantial supply in the primary market and the gradual reduction of reinvestment in securities by the Eurosystem (Figure 1.5.a).

Volatility has continued to be subdued (Figure 1.5.b), despite the temporary increases recorded in connection with the political instability in France following the European elections in June and the stock market turbulence in August. The market's ability to absorb large orders with no significant price impact has remained significant.

In the first half of 2024, the share of government securities held by Italian households neared 13 per cent, partly thanks to the issuance of securities targeted at retail investors (Figure 1.6). The share

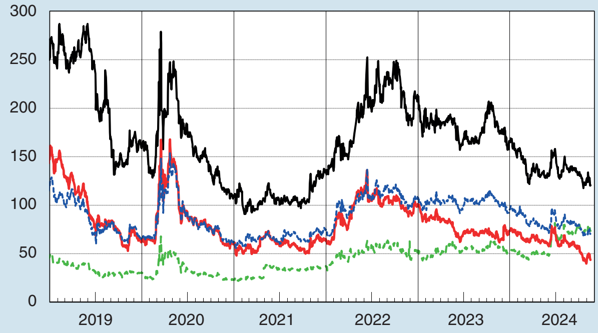
[2] The growth rates are adjusted for calendar effects. Without this adjustment, GDP growth would be 0.8 per cent in 2024, 0.9 per cent in 2025 and 1.3 per cent in 2026. The Government's policy scenario, laid out in the medium-term fiscal-structural plan for the years 2025-29, gives slightly higher growth rate expectations in cumulative terms over the three years, at 1.0 per cent, 1.2 per cent and 1.1 per cent respectively.

[3] The projections are based on the information available at 4 October, and do not therefore take into account the estimate for GDP growth in the third quarter of 2024, which was lower than expected.

[4] For more details, see 'Preliminary hearing on the medium-term fiscal-structural plan for 2025-29', testimony by S. Nicoletti Altimari, Director General for Economics, Statistics and Research at the Bank of Italy, before the 5th Committee of the Chamber of Deputies (Budget, Treasury and Planning) and 5th Committee of the Senate of the Republic (Economic Planning and Budget), sitting jointly, Chamber of Deputies, Rome, 7 October 2024 (only in Italian).

Figure 1.4

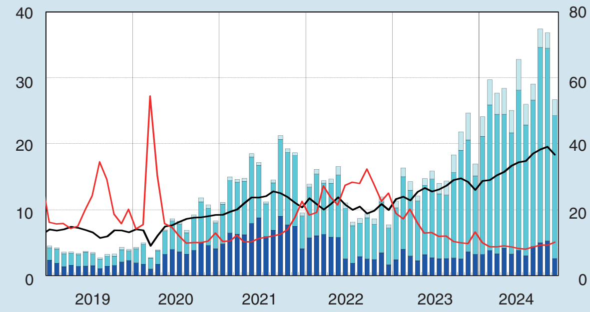
Risk premiums on government securities
(daily data; basis points)

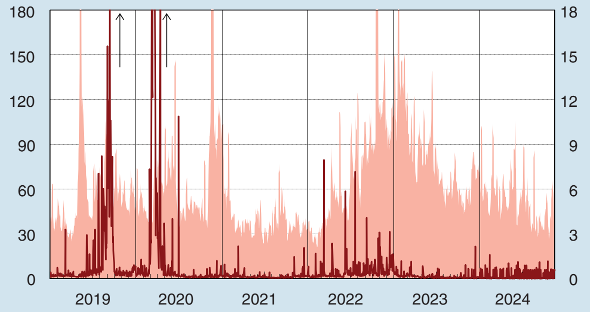


Sources: Based on data from ICE Data Derivatives UK Limited and LSEG.
(1) Differences between the yields on the benchmark 10-year government bonds of the countries in the key and the yield on the corresponding German Bund. – (2) The International Swaps and Derivatives Association (ISDA) is an organization 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, which provide protection in the event of redenomination, and the CDS spread on the same contracts under the 2003 ISDA Definitions.

Figure 1.5

Liquidity indicators for Italian government securities



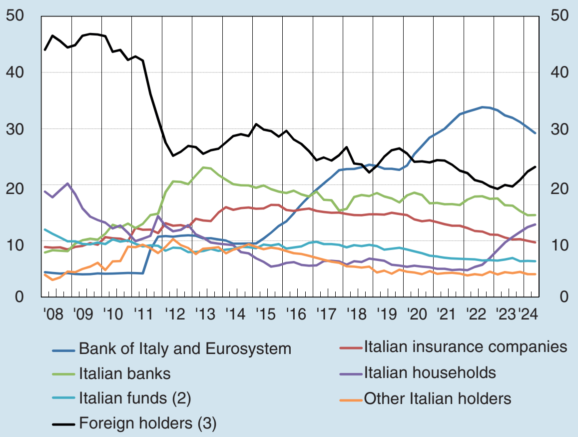


Source: Based on MTS data.
(1) Since October 2022, the series has only included data on BOTs because the stocks of CTZs were reduced to zero following the suspension of the placement of this kind of bond and the redemption of the last CTZs to mature. – (2) Average of the bid and ask quantities recorded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

held by foreign investors rose to over 23 per cent following a significant increase in purchases (see *Economic Bulletin*, 4, 2024). The shares of government securities held by the Bank of Italy and the Eurosystem declined further, as did those held by resident banks and insurance companies. Recent analyses conducted jointly by economists from the Bank of Italy and the Deutsche Bundesbank show

Figure 1.6

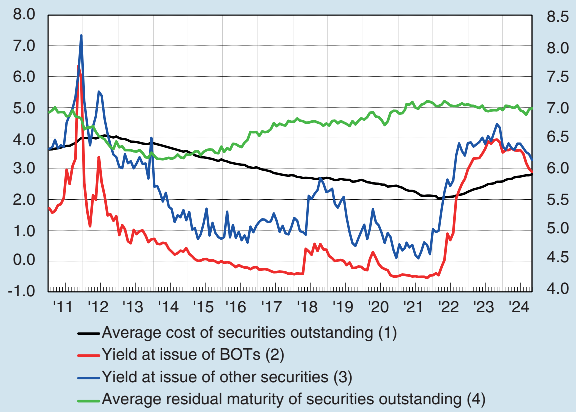
Italian government securities by holder category (1)
(quarterly data; per cent)



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 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.

Figure 1.7

Average cost, yield at issue and average residual maturity of government securities
(monthly data; per cent and years)



Sources: Based on Bank of Italy and Ministry of Economy and Finance (MEF) data, updated as at 31 October 2024.
(1) Weighted average of the yields at issue of government securities outstanding at the end of the 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 weighted by the outstanding amounts. The figure does not include loans from the European Commission. Right-hand scale.

that the significance and characteristics of the different categories of investors can affect the liquidity conditions, and therefore the soundness, of government bond markets.[5] In Italy, the relatively high share of domestic investors – which mainly use long-term investment strategies (buy and hold) – tends to promote stability, mitigating the possible impact of changes in the way foreign institutional investors manage their portfolios.[6] On the other hand, a particularly large presence of domestic holders leads to a greater degree of interconnectedness within an economy.

The placement of government securities continued smoothly, with quantities on the increase for medium- and long-term securities, and average yields at issue down from the peak recorded last May (Figure 1.7).

The average cost of the stock of government securities outstanding reached 2.8 per cent, up by 80 basis points from the lowest value observed in March 2022. The growth trend slowed as a result of the lower cost of new issues. Residual maturity is just under 7 years.

[5] In particular, the analyses conducted show that the different types of participants, their investment strategies and the microstructure of the markets are among the factors that may affect liquidity conditions in government bond markets. For further details on the analyses conducted on the Italian and German government bond markets, see Deutsche Bundesbank, *Financial Stability Review 2024,* November 2024; and P. Abbassi, M.L. Bianchi, D. Della Gatta, R. Gallo, H. Gohlke, D. Krause, A. Miglietta, L. Moller, J. Orben, O. Panzarino, D. Ruzzi, W. Scherrieble and M. Schmidt, 'The German and the Italian government bond markets: the role of banks vs. non-banks', Banca d'Italia, Mercati, infrastrutture, sistemi di pagamento (Markets, Infrastructures, Payment systems), forthcoming.

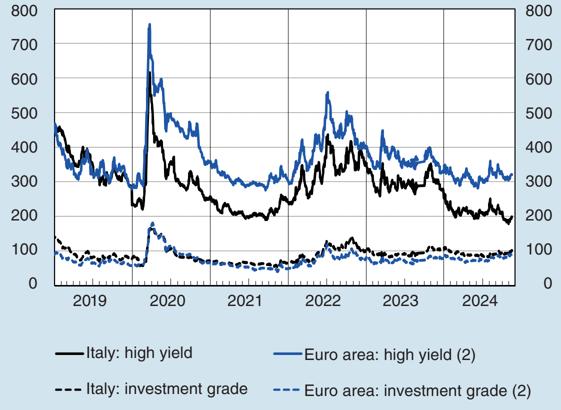
[6] These are mainly investment funds, which in some cases behave procyclically (see O. Panzarino, 'Investor behavior under market stress: evidence from the Italian sovereign bond market', Banca d'Italia, Mercati, infrastrutture, sistemi di pagamento (Markets, Infrastructures, Payment systems), 33, 2023).

The yield spread between bonds issued by Italian firms and the risk-free rates (asset swap spread) widened for investment grade securities but narrowed for those with a low credit rating (Figure 1.8), especially for securities in the telecommunications sector. The asset swap spread of euro-area firms showed a similar trend. At the same time, the face value of outstanding bonds of highly-rated firms fell, while that of low-rated ones increased.

Figure 1.8

Asset swap spreads (1)

(daily data; basis points)



Source: Based on ICE BofAML data.
(1) Asset swap spreads weighted by the market capitalization of individual securities issued by non-financial corporations. – (2) The BofAML indices for the euro area have been recalculated to exclude Italy.

The issuance of corporate bonds earmarked to fund projects with a positive environmental impact (green bonds) continued: the volumes outstanding as a share of GDP grew, although they are still lower than in the other main European countries (2.4 per cent against 5.2 per cent).

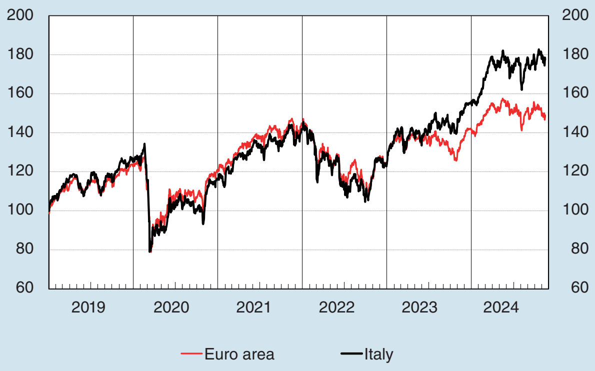
Since last spring, Italian share prices have continued to outperform the average for the rest of the euro area (Figure 1.9.a), benefiting from the contribution of the financial sector. Implied volatility ticked up, as it did in the euro area, reflecting greater uncertainty about the economic cycle and the geopolitical landscape (Figure 1.9.b).

Figure 1.9

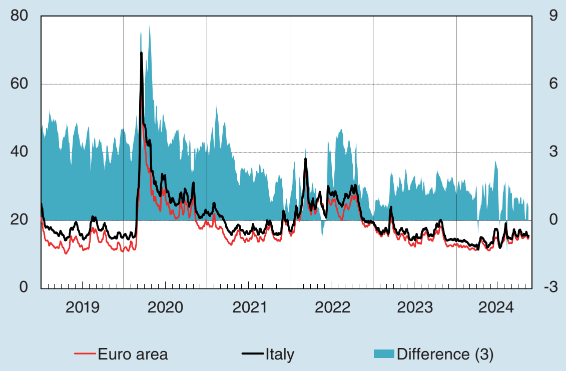
Equity market indicators

(daily data; indices, per cent and percentage points)

(a) Equity prices (1)



(b) Implied volatility (2)



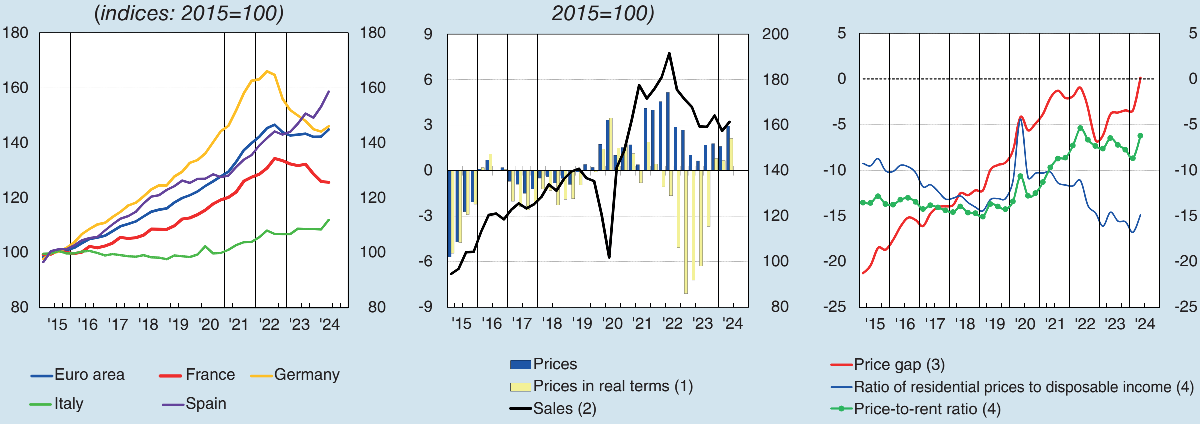
Source: Based on Bloomberg data.
(1) Indices: 1 January 2019=100. For Italy, MSCI Italy IMI; for the euro area, MSCI EMU IMI (see the disclaimer under 'Symbols and Conventions'). – (2) Implied volatility in the prices of 2-month options on the FTSE MIB index for Italy and on the Euro STOXX 50 index for the euro area. 5-day moving average. – (3) Difference between implied volatility in Italy and in the euro area. Right-hand scale.

1.4 REAL ESTATE MARKETS

The risks to financial stability connected with developments in the real estate markets continue to be low overall.

Figure 1.10

Residential property market in the euro area and in Italy
(quarterly data)



Sources: Based on data from the Bank of Italy, Eurostat, Istat and the Italian Revenue Agency's Osservatorio del Mercato Immobiliare (OMI).
(1) Data deflated using the change in consumer prices. – (2) Adjusted for seasonal and calendar effects. Right-hand scale. – (3) The price gap is defined as the percentage deviation of the house price index in real terms from its long-term trend. – (4) The data are expressed as a percentage deviation compared with the long-term average.

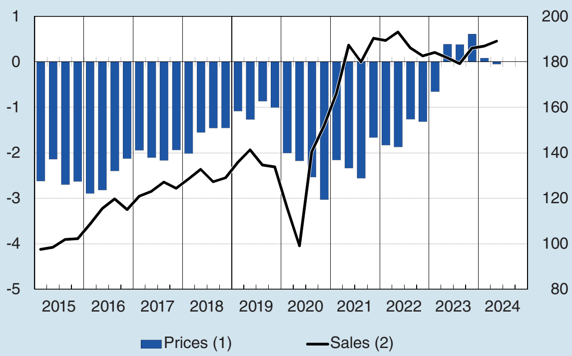
In the first half of 2024, house prices in the euro area recorded their first year-on-year increase since the end of 2022 (Figure 1.10.a). By contrast, commercial property prices kept declining, albeit at a slower pace than in the second half of 2023, both in the euro area as a whole and in its major countries.

Residential property prices in Italy continued to grow, strengthening in the second quarter of this year; house prices have been rising in real terms since the end of 2023 (Figure 1.10.b), although they remain well below their 2019 levels. In the first half of 2024, sales stagnated at the levels recorded over the previous six months. In the autumn, according to the latest data compiled on the basis of the listings published on the Immobiliare.it online platform and of the opinions of the real estate agents interviewed between September and October as part of our surveys, demand for housing remained weak but showed signs of picking up. Our forecasts suggest that the growth in house prices will remain moderate over the course of 2024 and 2025, to then slow in 2026, reflecting the dampening of the recovery in disposable income following the inflationary shock.[7] Looking at long-term trends, the indicators continue to show no risks of overvaluation (Figure 1.10.c).

Sales continued to rise in the non-residential sector in the first half of 2024, while prices remained stable (Figure 1.11).

Figure 1.11

Non-residential property market in Italy
(quarterly data)



Sources: Based on data from Osservatorio del Mercato Immobiliare (OMI) and Scenari Immobiliari.
(1) Percentage changes on year-earlier period; 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.

[7] 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 low, although the fragility of the macroeconomic framework (see Section 1.2) could influence future developments.

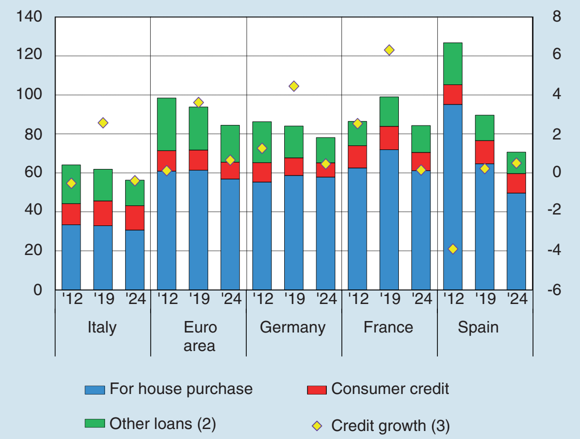
Household income improved in the first half of 2024, as purchasing power rose owing to the collective bargaining agreement renewals and the fall in inflation (see *Economic Bulletin*, 4, 2024). The Bank of Italy's Survey of Italian Households (Short-term Outlook), carried out at the end of the third quarter of 2023 and of 2024, reported an increase in the share of households that expected to accumulate savings by the end of the corresponding year.

Financial wealth also increased; deposits continued their downward trend and investment in government bonds its upward trend. Purchases of asset management products increased (see Section 2.3), and so did purchases of shares and participating interests. Debt securities issued by banks were stable over the period considered. Among them, certificates played a key role. The share of these complex and relatively risky instruments in households' portfolios has grown significantly since 2022, reaching almost 12 per cent of debt securities holdings in June 2024. Based on the Survey, around 10 per cent of households, mostly enjoying favourable income and financial conditions, invest in certificates (see Chapter 3).

The ratio of financial debt to disposable income recorded last June remains very low compared with the euro-area average (Figure 1.12). In the twelve months ending in September, the growth in loans to households by banks and financial corporations turned upwards (1.0 per cent), though at a slower pace than income. Based on the responses of the Italian banks interviewed for the euro-area bank lending survey (BLS), demand for loans to households for house purchase rose in the third quarter; credit access conditions became less stringent.

Figure 1.12

Financial debt and growth in bank loans (1)
(as a percentage of disposable income; 12-month percentage changes)



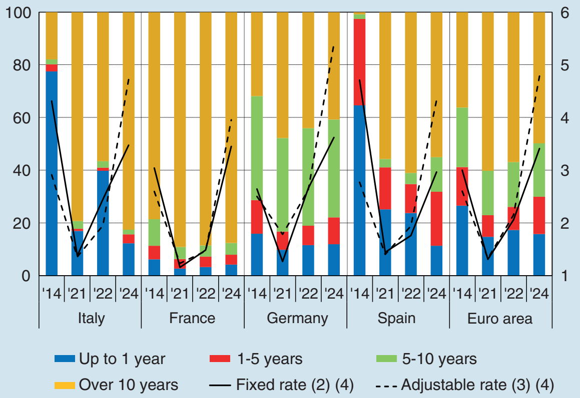
Sources: For Italy, Bank of Italy and Istat; for euro-area countries, ECB.
(1) End-of-period data referring to consumer and producer households and non-profit institutions serving households. For 2024, the latest available data for the ratio of financial debt to disposable income and for the growth rate of bank loans refer to Q2 and Q3, respectively. – (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. – (3) The data refer exclusively to loans granted by banks, adjusted for loan securitizations and sales. Right-hand scale.

In the first nine months of the year, interest rates on new fixed-rate and adjustable-rate mortgages fell by about 80 basis points (to 3.2 per cent) and by almost 50 basis points (to 4.5 per cent), respectively. Over that period, more than 80 per cent of new mortgages and over 70 per cent of total outstanding mortgages for house purchase were fixed-rate (Figure 1.13).

The fall in the key interest rates was not yet reflected in the total cost of new consumer loans, which was broadly unchanged at 10.5 per cent in September, remaining almost 200 basis points higher than in the euro area. The fact that the cost of consumer credit did not decrease was not an impediment to its robust growth (by 5.5 per cent). As a share of disposable income, consumer credit remained virtually unchanged at 12.5 per cent in June, about 1 percentage point higher than the average for the last 15 years and almost 4 percentage points higher than the euro-area average.

Figure 1.13

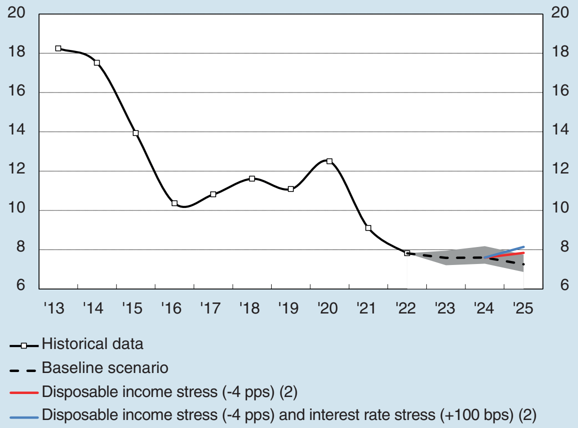
Composition of new loans by rate term and developments in fixed and adjustable rate loans (1)
(percentage shares and points)



Source: ECB.
(1) The data refer to consumer and producer households and non-profit institutions serving households. Reference period averages. For 2024, the latest available figure refers to September. – (2) The fixed rate is that applied to mortgage loans for which the interest rate is set for a period of more than 10 years. – (3) The adjustable rate is that applied to mortgage loans for which the interest rate is set for a period of less than 1 year. – (4) Right-hand scale.

Figure 1.14

Share of debt held by vulnerable households (1)
(yearly data: per cent)



Source: Based on the Survey on Household Income and Wealth (SHIW).
(1) Households are considered vulnerable when their debt-service to income ratio is above 30 per cent and their equivalized disposable income is below the median. The latest available SHIW data refer to 2022. In this edition of the survey, the data extracted from the previous edition were updated to take account of changes in the sample design. The shaded area represents the interval between the 10th and the 90th percentiles of the probability distribution in the simulations. – (2) Compared with the baseline scenario, the assumptions for 2025 are that: (a) the growth rate of nominal income is 4 percentage points lower; (b) the growth rate of nominal income is 4 percentage points lower and the 3-month Euribor, the 10-year interest rate swap (IRS) and the interest rate on consumer credit are 100 basis points higher.

In the third quarter of the year, the default rate for loans to households remained stable at 0.8 per cent, a low level by historical standards and a reflection of the good quality of loans for house purchase. The default rate for consumer credit came to 2.4 per cent, remaining above that for personal loans (see Section 2.1).

The projections of the Bank of Italy's microsimulation model[8] suggest that the financial fragility of households will decrease in 2025. The expected favourable trend in disposable income and the fall in interest rates will help to keep the share of financially vulnerable households stable at 1.5 per cent (about one third of which are households that also took out consumer loans). The share of debt held by these financially vulnerable households is projected to decline slightly (Figure 1.14). In an adverse scenario marked by especially unfavourable income and interest rate conditions, the share of debt held by vulnerable households would increase moderately.

Firms

Firms' ability to repay their debts remains good thanks to the still sound financial and economic conditions, despite a slight decline in profits. Risks connected to weak economic growth and high financing costs are still a factor and, going forward, this could affect the profitability of the most indebted firms.

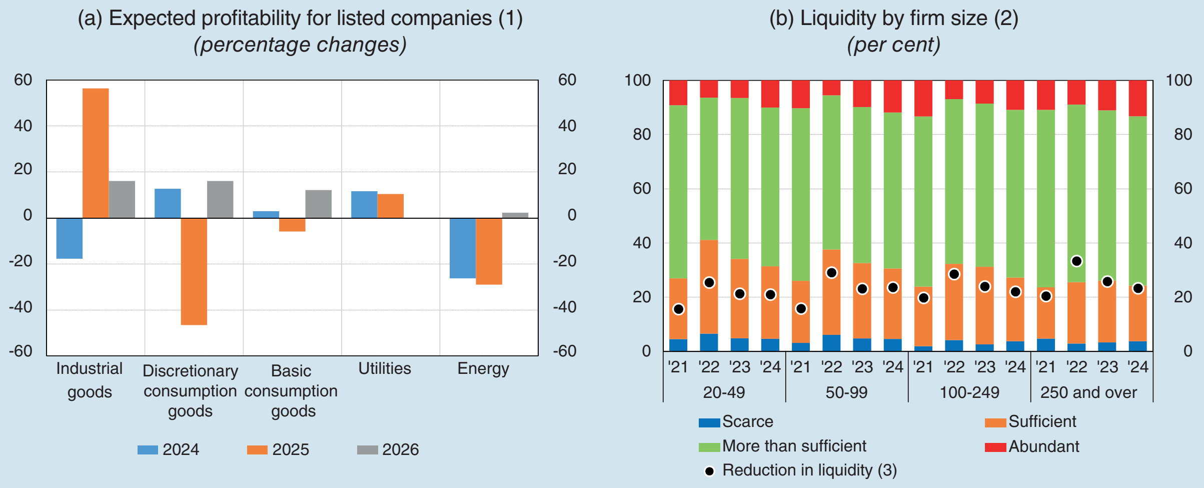
[8] For details on the microsimulation model, see C.A. Attinà, F. Franceschi and V. Michelangeli, 'Modelling households' financial vulnerability with consumer credit and mortgage renegotiations', *International Journal of Microsimulation*, 13, 2020, pp. 67-91, also published in Banca d'Italia, Questioni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

After a long period of expansion that began in 2014 and was interrupted only in 2020 by the pandemic crisis, gross operating income fell by 2.6 per cent in the twelve months ending in June. The decline was more pronounced in the manufacturing sector – also owing to the negative contribution of net exports – and in the construction sector, which was affected by the reduction in residential building incentives (see *Economic Bulletin*, 4, 2024).

The Business Outlook Survey of Industrial and Service Firms conducted in September by the Bank of Italy points to a decrease in the share of industrial firms planning to close the business year with a profit, especially among those that registered a higher share of exports in relation to turnover in the previous year. Analysts' expectations for 2025 indicate that listed companies' profits will fall compared with those expected for the end of 2024, especially in the sectors most sensitive to the economic cycle (discretionary consumption goods and energy; Figure 1.15.a).

Figure 1.15

Corporate profitability and liquidity



Sources: Based on data from I/B/E/S Estimates and from the Bank of Italy's Business Outlook Survey of Industrial and Service Firms (see the disclaimer under 'Symbols and Conventions').
(1) Growth rate of earnings expected by analysts for 2024-26 referring to listed companies included in the MSCI Italy sectoral indices. – (2) Share of firms interviewed in September assessing their level of cash holdings in relation to their operational needs until the end of the year. The intervals on the x-axis refer to the number of employees of the companies. – (3) Share of companies reporting that they had reduced their cash holdings in the first nine months of the year.

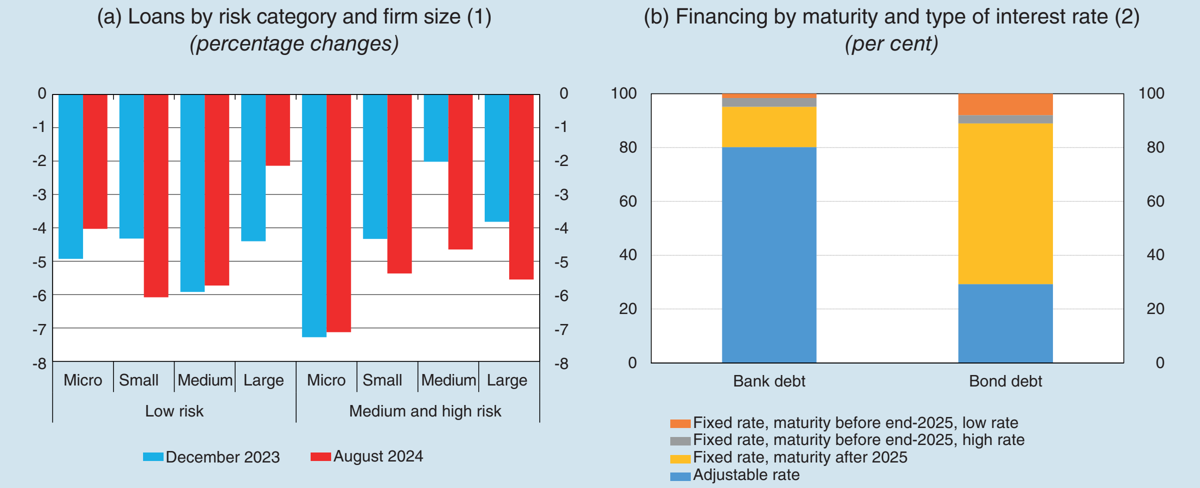
The smaller contraction in internal financing compared with investment was reflected in an increase in liquidity in the second quarter, to 25.2 per cent of GDP, about 1 percentage point higher than at the end of 2023 and almost 4 percentage points higher than in 2019. According to the Survey, the share of firms that considered their holdings to be scarce when looking at their operational needs up to the end of the year was practically unchanged at a low level, including for small firms (Figure 1.15.b).

Financial debt as a percentage of GDP continued to decrease, to 59.7 per cent in the second quarter, a very low figure compared with the euro-area average. Leverage remained broadly stable at 32.9 per cent, in line with the European average.

The contraction in bank lending became less pronounced (-2.8 per cent in the twelve months ending in September), still reflecting the sizeable repayments of outstanding loans. The decline was widespread across all classes of riskiness of firms (Figure 1.16.a) and across sectors. According to the Italian banks interviewed for the BLS, credit demand continued to weaken over the course of the year, while credit standards eased slightly. This trend is confirmed by business surveys. Istat's survey of manufacturing

Figure 1.16

Financing: trend and composition



Sources: For panel (a), Central Credit Register and Cerved. For panel (b), based on data from AnaCredit, the securities registry database, and Dealogic.
(1) The data refer to the annual change in financing for a sample of about 500,000 limited companies. Loans include those granted by financial corporations, take account of securitizations, and also include bad loans. Allocation into the risk groups is based on Cerved's CeBi-Score4 indicator. Low- (medium- and high-) risk firms have a score ranging from 1 to 4 (5 to 10). The breakdown by firm size is based on Commission Recommendation 2003/361/EC, which defines micro firms as those employing fewer than 10 workers and whose turnover or total assets do not exceed €2 million; small firms as those employing fewer than 50 workers and whose turnover or total assets do not exceed €10 million, not including micro firms; medium-sized firms as those employing fewer than 250 workers and whose turnover or total assets do not exceed €50 million and €43 million respectively, not including micro and small firms; and large firms as all the remaining ones. – (2) Composition of outstanding loans at the end of June and of September 2024, for bank debt and bond debt respectively. Bank debt only considers performing loans. Bond debt considers securities issued by Italian non-financial corporations and groups.

firms points to an easing in credit access conditions across all size classes since the start of the year, although smaller firms continue to find it more difficult to obtain new loans.

The cost of bank borrowing decreased slightly as a result of the gradual decline in the key interest rates. In the coming months, it will continue to fall for most firms, which mainly have adjustable-rate exposures. However, the costs could increase for those firms that had borrowed at a fixed rate before the monetary tightening and which will soon have to roll over their maturing debt at higher rates. Yet, our analyses suggest that only 2 per cent of lending is attributable to firms with a fixed-rate loan taken out at an interest rate below that expected for 2025 and maturing by the end of next year (Figure 1.16.b).

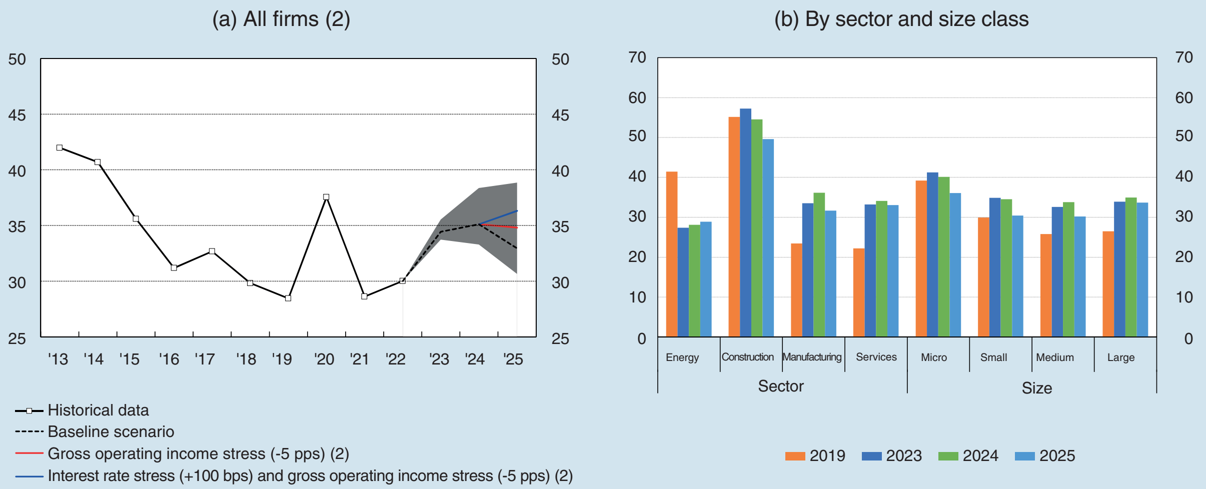
The loan default rate of bank loans was largely stable at 2.2 per cent in the third quarter, similar to the figure for the first quarter; it was down in manufacturing, up in construction and unchanged in services (see Section 2.1).

Recourse to the bond market increased: in the first nine months of the year, gross placements rose by 28 per cent compared with the year-earlier period, more so for the financially soundest firms. The number of issuers also rose, but only among large firms. Although the cost of issuing debt has been declining, around 8 per cent of the funding will mature by the end of 2025 at a low fixed rate, and might therefore be rolled over at a higher cost. The share of outstanding bonds in the BBB category – those most exposed to the risk of a downgrading to high yield – stood at 84 per cent of total investment grade issues in Italy at the beginning of November, against a lower euro-area average of 60 per cent. This difference primarily reflects the lower creditworthiness of the Italian sovereign issuer.

The latest macroeconomic projections suggest that the share of total debt ascribable to vulnerable firms will decrease to around 33 per cent in 2025, following the increases recorded in recent years (Figure 1.17).[9] The decline is expected across almost all sectors and firm size classes and is likely to be attributable to a greater reduction in interest expense than in operating income. However, in an adverse scenario characterized by a more pronounced reduction in profitability and an unchanged cost of financing, the share of debt at risk would increase to a limited extent.

Figure 1.17

Debt held by vulnerable firms: share of total financing (1)
(annual data; per cent)



Source: Based on Cerved data.
(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 2022. – (2) Compared with the baseline scenario, the assumptions for 2025 are that: (a) the growth rate of nominal gross operating income is 5 percentage points lower, (b) the nominal interest rate is 100 basis points higher and the growth rate of nominal gross operating income is 5 percentage points lower.

[9] The indicator leads the loan default rate by about twelve months; the increase in the share of debt at risk estimated for 2024 is therefore consistent with the projected figure for the loan default rate in 2025, which is gradually increasing. 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 in Banca d'Italia, Questioni di Economia e Finanza (Occasional Papers), 293, 2015.

2 RISKS TO FINANCIAL INTERMEDIARIES

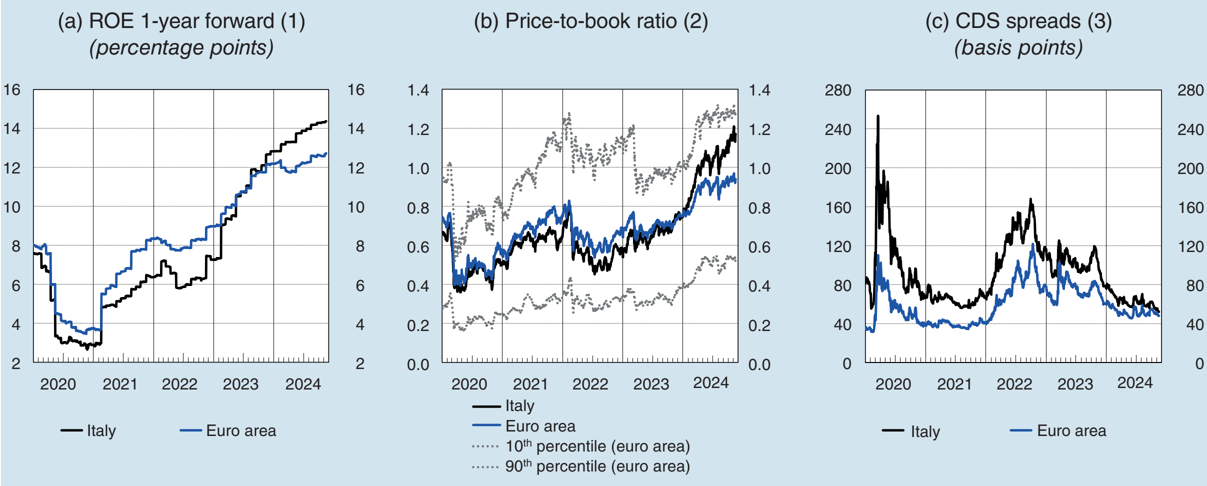
2.1 BANKS

The financial situation of the Italian banking system remains sound, despite some signs of worsening in credit quality. The main risk in the medium term is linked to the uncertain outlook for domestic and international economic growth (see Sections 1.1 and 1.2). Moreover, the gradual reduction in net interest income, in connection with the easing of monetary policy and the need to roll over liabilities issued in times of very low interest rates, as well as the greater loan loss provisions expected over the next two years, could have a negative impact on banks' profitability, currently at its highest level since 2008. Liquidity risks remain low.

Market indicators continue to show a positive trend: the average price-to-book ratio for the largest Italian listed banks has increased further, to above one, resulting in a wider spread vis-à-vis the major listed banks in the euro area (Figure 2.1). This development is mainly driven by analysts' profitability expectations. The leading Italian banking groups saw their credit default swap (CDS) spreads – a measure of default risk – fall from the first quarter, close to European levels.

Figure 2.1

Italian listed banks: an international comparison
(daily data)



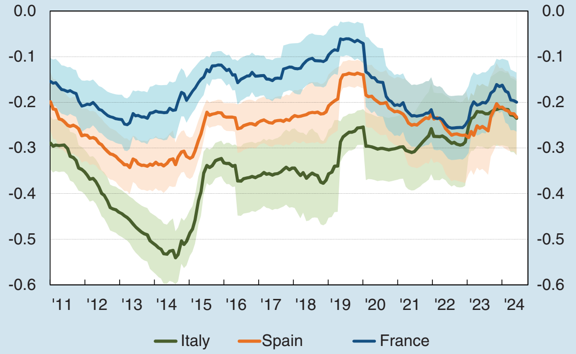
Source: Based on LSEG data.
(1) Return on equity (ROE) is estimated by market operators. Average weighted according to market value. The data refer to the banks included in the Euro STOXX Banks index: for Italy, UniCredit, Intesa Sanpaolo, Banco BPM, Banca Monte dei Paschi di Siena, Banca Popolare di Sondrio, and BPER Banca. – (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.

In the past, Italian bank shares have depreciated at times when the yield spread between Italian and German government bonds widened; these declines were generally more pronounced than the corresponding falls in Spanish and French banks' share prices. In recent years, Italian banks' share valuations have become less sensitive to spread widening, in line with their counterparts in other major countries (Figure 2.2), reflecting improved capital and liquidity positions.

The Bank of Italy's annual assessment of less significant Italian banks shows no notable changes in their overall riskiness (see the box 'Supervisory assessments of less significant banks').

Figure 2.2

Bank shares' sensitivity to daily spread movements (1)



Sources: FTSE Russell, Bloomberg.
(1) The lines show the strength of the relation between the daily return of the banking sector and the daily percentage change in the government bond spread; the bands represent the 95 per cent confidence interval. The strength was estimated at each date considering the previous three years.

SUPERVISORY ASSESSMENTS OF LESS SIGNIFICANT BANKS[1]

The Bank of Italy performs an annual Supervisory Review and Evaluation Process (SREP) for Italian less significant institutions (LSIs), which in 2024 reflected the highly uncertain macroeconomic scenario and the gradual alignment of the Bank's assessment methodologies with those of the ECB. The evaluation focused especially on the potential deterioration in credit quality, operating cost trends (including inflation dynamics), interest rate risk in the banking book and, not least, IT and cyber risks.

Excluding those subject to ongoing inspections or involved in extraordinary financial transactions, 106 banks out of 119 received a SREP assessment (83 banks with a traditional business model and 23 specialized banks).[2] There were no significant changes – on an aggregate level – in the overall riskiness of banks compared with the 2023 assessment.

On the one hand, the measures taken in recent years – also promoted by the Bank of Italy – have strengthened banks' capital position and liquidity planning. On the other hand, continued uncertainty in the macroeconomic scenario suggests that the assessment of exposure to credit risks should remain prudent, as the ratio of NPLs to total loans and the associated coverage levels are not always satisfactory. The current scenario also warranted particular caution in the assessment of interest rate risk in terms of its impact on both net interest income and economic value, taking into account a wide range of scenarios for future interest rate developments. Banks were encouraged to protect themselves from operational risks by strengthening their management of IT and cyber risks, including when outsourcing information systems,[3] as these risks are increasing as a result of technological innovation in the financial sector. Finally, in terms of corporate governance and internal control framework, areas for improvement were

[1] By Michele Petronzi and Stefania Vanacore.

[2] Specialized banks include banks with business models geared towards specific forms of lending (salary- and pension-backed loans, leasing, factoring), asset management, and the purchase and management of non-performing loans.

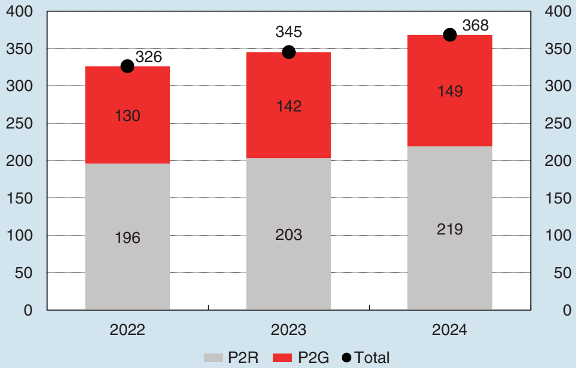
[3] In this context, the ability to ensure adequate governance and control safeguards for outsourced activities was assessed.

identified both in the composition of banks' governing bodies, despite the steps already taken to ensure gender balance, and in the qualitative and quantitative adequacy of control systems.

These assessments resulted in a capital add-on – defined as the sum of Pillar 2 requirement (P2R) and Pillar 2 guidance (P2G) – of 368 basis points on average (of which 219 P2R points), 23 basis points higher than last year (see the figure). Approximately two-thirds of this add-on is assigned to the P2R, mainly reflecting conservative assessments of credit risk – including the risk of ineffective public and private guarantees – and interest rate risk. Overall, capital requirements are in line with those of Italian significant banks; as at June 2024, no bank was failing to meet the requirements.

Figure

P2R and P2G for less significant banks: 2022-24 SREP cycles (1)
(basis points)



Source: Bank of Italy (annual bank assessment database).
(1) Data for 2024 are provisional.

However, some banks have shown vulnerabilities, which the Bank of Italy was already monitoring, often due to shortcomings in their corporate governance and internal control framework. Specific corrective actions were taken for these intermediaries, some of which are still under way. The Bank of Italy closely monitors the technical situation of supervised entities to prevent new potentially critical issues, including through horizontal analyses and early warning tools.

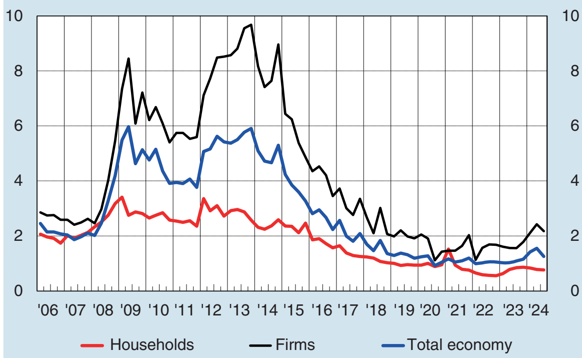
Asset risks

The quality of bank assets worsened slightly, albeit remaining high in a historical perspective. In the third quarter, the ratio of new non-performing loans (NPLs) to performing loans (loan default rate) was essentially unchanged from March, at 1.3 per cent (Figure 2.3). However, the loan default rate rose on average over the first three quarters, compared with the corresponding period of 2023; the increase is attributable to loans to firms.

The ratio of non-performing loans to total loans (NPL ratio), net of loan loss provisions, was 1.5 per cent in June (Figure 2.4.a; see Table A2 in the Appendix). The ratio for Italian significant banking groups is in line with the average ratio of all the intermediaries directly supervised by the European Central Bank (Figure 2.4.b).

Figure 2.3

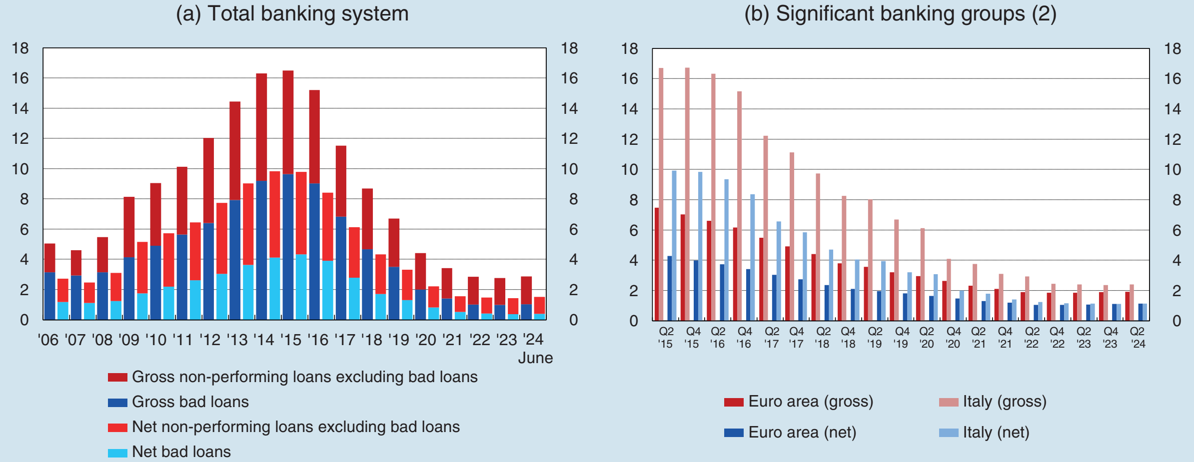
Loan default rates (1)
(quarterly data; per cent)



Source: Central Credit Register.
(1) The loan default rate is calculated as the annualized quarterly flow of adjusted NPLs on the stock of performing loans at the end of the previous quarter. Data seasonally adjusted where necessary.

Figure 2.4

Non-performing loans: share of total loans (1)
(per cent)



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; includes banks specializing in NPL management, whose share of the banking system as a whole in terms of NPLs is around 5 per cent. Amounts are calculated net and gross of loan loss provisions. The data for June 2024 are provisional. – (2) The perimeter of significant banks and less significant banks differs between the dates shown in the figure: in June 2019, with the reform of the cooperative banking sector, Cassa Centrale Banca became a banking group classified as significant for supervisory purposes; 143 cooperative credit banks (BCCs) joined the ICCREA group, which was already classified as significant before the reform. Mediolanum and FinecoBank have been included among the significant banks since June 2022.

The arrears rate measures the payment arrears of performing borrowers[1] and tends to be an early warning of credit deterioration. The arrears rate for non-financial corporations as a whole stood at 1.2 per cent in June; it increased moderately for construction firms, while it fell for real estate service providers. It did not rise on home mortgage loans to households. By contrast, the share of consumer loans in arrears[2] inched up to 2.1 per cent, from 1.9 per cent in December, mainly due to the personal loan component.

The amount of Stage 2 loans under the IFRS 9 accounting standard declined from last December; as a share of total performing loans, it fell by about 1.4 percentage points, to 8.4 per cent, below the pre-pandemic level (9.0 per cent in December 2019). The share of Stage 2 loans is higher for less significant banks than for significant banks.

The vulnerability of Italian banks stemming from commercial real estate (CRE) loans remains limited (Figure 2.5).

Between December 2021 and June 2024, the Italian banking system's exposure to Russia fell from 2.0 to 1.0 per cent of total foreign lending; off-balance-sheet exposures dropped from 2.1 to 0.3 per cent.

[1] Arrears are exposures past due for at least 30 days but not yet non-performing. The arrears rate is the annualized ratio of the quarterly flow of new arrears to performing loans (that are not in arrears) at the end of the previous quarter.

[2] This indicator identifies arrears on one or two loan instalments based on data from the credit protection association (*Consorzio di tutela del credito*), which include quarterly information on a representative sample of consumer loans granted by both banks and financial corporations.

The majority of balance-sheet exposures to Russia are attributable to Italian subsidiaries with local operations.[3]

According to our projections, which are in line with the macroeconomic scenario published by the Bank of Italy in October,[4] the loan default rate for firms will edge up to 2.8 per cent in 2025, driven by high funding costs and lower profitability. The rate for households is set to remain stable at 1 per cent.

Market risk and interest rate risk

The value at risk (VaR) for the entire securities portfolio (banking and trading books) remained unchanged from April 2024 (Figure 2.6), as a slight increase in risky assets was offset by lower risk factor volatility.[5]

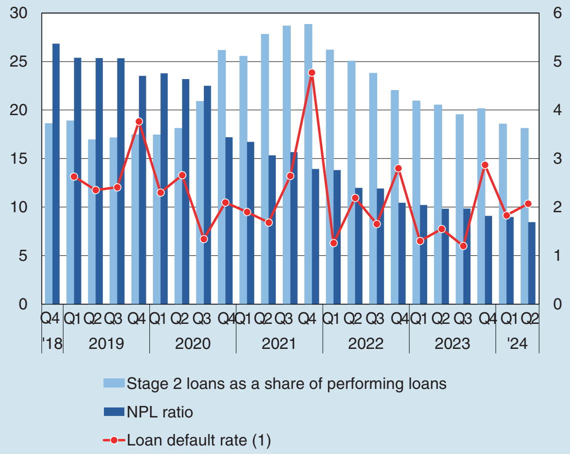
Public sector securities as a share of resident banks' total assets held broadly stable at 8.5 per cent in September 2024 (Figure 2.7.a). Average duration rose to 4.4 years (Figure 2.7.b). The share of public sector securities valued at amortized cost fell slightly, to 74.7 per cent, reflecting the change recorded for significant banking groups.

The improvement in the market value of Italian public sector securities contributed to the reduction in unrealized losses in the portfolio valued at amortized cost. The impact of these losses for the entire banking system, as estimated with reference to the portfolio outstanding at the end of June and taking into account the benefits from hedging derivatives, averaged 42 basis points of CET1 ratio in September, about half the figure in March.

In a scenario in line with the expectations implied by market interest rate curves, with both short- and

Figure 2.5

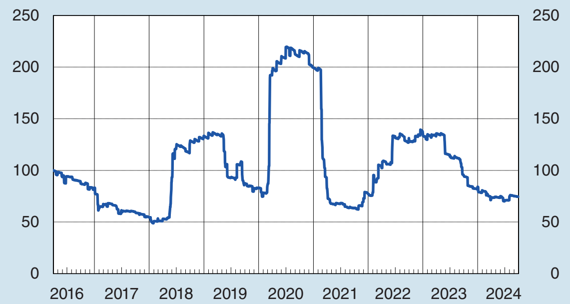
CRE loan deterioration
(per cent)



Source: AnaCredit.
(1) Calculated as the annualized quarterly flow of non-performing loans on the stock of performing loans at the end of the previous quarter. Right-hand scale.

Figure 2.6

The VaR trend of Italian banks (1)
(daily data; index: March 2016=100)

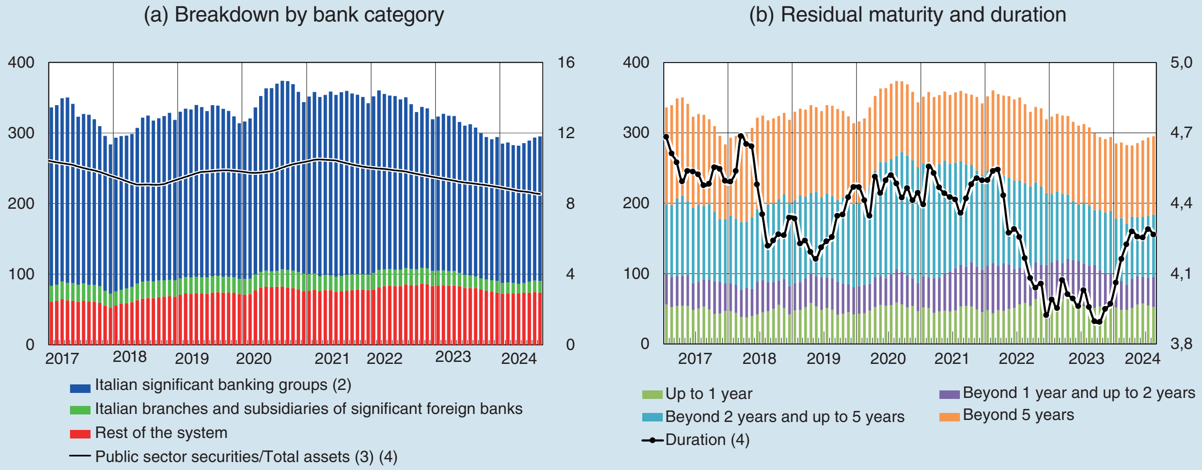


Sources: Based on data from the securities registry database, LSEG, and supervisory reports.
(1) Averages, weighted according to the size of each bank's portfolio. VaR is the loss on a portfolio that within one day will not exceed a given tail level (99 per cent). The indicator for the banking system as a whole is calculated, for each trading day, 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 business days.

[3] For an analysis of banks' exposures to Russia, Belarus and Ukraine in 2021, see the box 'Risks to banks' assets deriving from the war in Ukraine', *Financial Stability Report*, 1, 2022.
[4] 'Macroeconomic projections for the Italian economy', Banca d'Italia, 11 October 2024.
[5] VaR performance is mainly driven by changes in interest rates and, to a lesser extent, by changes in credit spreads. The contribution of equity risk and exchange rate risk remains limited.

Figure 2.7

Banks' investment in Italian public sector securities (1)
(monthly data; billions of euros; per cent and years)



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.

medium-to-long-term rates falling,[6] the economic value of the assets and liabilities included in the banking book at the end of last June[7] would remain broadly stable for the Italian banking system.

Refinancing risk and liquidity risk

Bank funding continued to decrease in September, recording a 3.5 per cent contraction year on year. The key factor behind this was once again the reduction in liabilities to the Eurosystem (Table 2.1). The decline in households' deposits eased, while deposits from firms began to fall again. Placements of debt securities, especially certificates, continued to grow, with a particularly sharp increase in holdings by households (see Section 1.5 and Chapter 3).

[6] This scenario assumes that, starting in June 2024, interest rates fall by as much as 160 basis points for maturities up to one year, with smaller declines for subsequent maturities and broadly stable rates for maturities beyond 7 years.

[7] The estimates are based on the simplified methodology for determining exposure to interest rate risk as defined by Bank of Italy Circular 285/2013 containing supervisory provisions for banks.

Table 2.1

Italian banks' funding (1)
(billions of euros and percentage changes)

	Stocks (share of the total)	12-month percentage changes (2)	
	September 2024	March 2024	September 2024
Deposits of Italian residents (3)	1,529 (68.0)	0.1	0.7
of which: households	877 (39.0)	-3.7	-0.8
firms	498 (22.1)	5.0	-0.2
Deposits of non-residents	393 (17.5)	23.9	5.5
Debt securities	248 (11.0)	20.0	10.9
of which: held by households	69 (3.1)	36.6	16.4
Net liabilities vis-à-vis central counterparties (4)	49 (2.2)	-15.1	-11.4
Liabilities vis-à-vis the Eurosystem (5)	31 (1.4)	-79.4	-80.7
Total funding	2,250 (100.0)	-5.9	-3.5

Source: Individual supervisory reports. Excludes Cassa Depositi e Prestiti SpA.
(1) Excludes liabilities to other banks resident in Italy. – (2) Adjusted for reclassifications, value adjustments and exchange rate movements. – (3) Excludes transactions with central counterparties. – (4) Includes repurchase agreements only; represents foreign funding via central counterparties. – (5) The aggregate includes the accounts with the Eurosystem for monetary policy operations.

The rise in interest rates during the recent period of monetary tightening does not appear to have led to greater instability in bank funding for institutions with a tech-savvier customer base (see the box 'Online deposit transfers and bank funding stability').

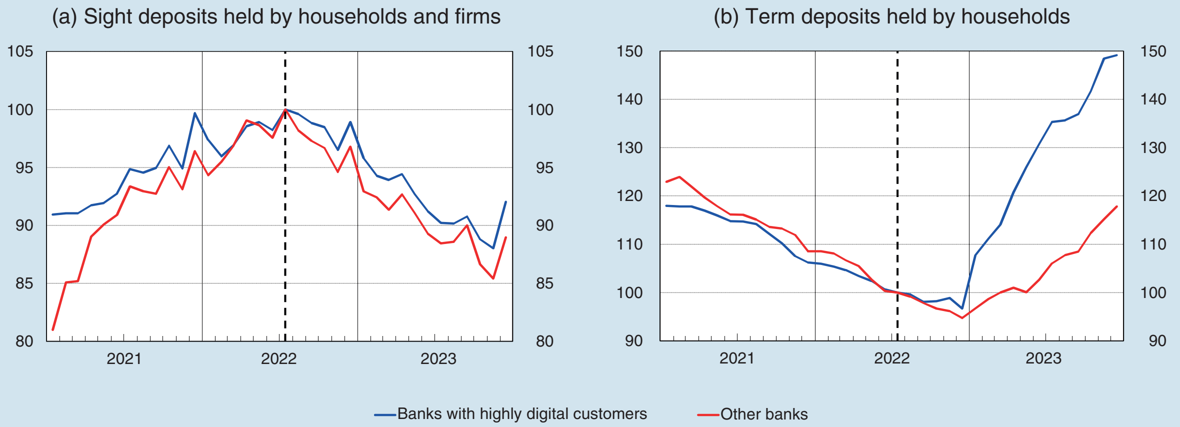
ONLINE DEPOSIT TRANSFERS AND BANK FUNDING STABILITY[1]

Partly on account of the banking crises which occurred outside Italy in the spring of 2023,[2] a debate was recently sparked regarding the relationship between the stability of bank funding and the propensity of customers to use digital channels. Thanks to remote banking services (via PC or smartphone), customers are now able to transfer their deposits more readily than in the past. At times of stress or in the event of a shock, this could lead to faster deposit outflows. There is scant empirical evidence on this issue, with only some research coming from the United States, the results of which are not consistent.[3]

To investigate the entity of this phenomenon, we analysed the effects of the increase in interest rates referable to the monetary tightening phase that began in July 2022 on the amount of deposits held with Italian banks (sight and term deposits, held by both households and firms) and on the related interest rates between January 2021 and December 2023. Italian intermediaries were differentiated by means of an indicator that approximates the propensity of customers to transfer money via online channels. More

Figure

Deposits held at banks with highly digital customers compared with other banks (1)
(index numbers: July 2022=100)



Source: Supervisory reports.
(1) The dashed vertical line indicates the start of monetary tightening in July 2022.

[1] By Federica Ciocchetta and Silvia Magri. This box is based on the discussion in F. Ciocchetta, R. Gallo, S. Magri and M. Molinari, 'Friends or foes? Banks and digital deposits in a monetary tightening', mimeo, 2024.

[2] For further details, see Basel Committee on Banking Supervision, 'Report on the 2023 banking turmoil', BIS, October 2023; also Basel Committee on Banking Supervision, 'The 2023 banking turmoil and liquidity risk – A report to G20 Finance Ministers and Central Bank Governors', BIS, October 2024; Financial Stability Board, 'Depositor behaviour and interest rate and liquidity risks in the financial system – Lessons from the March 2023 banking turmoil', FSB, October 2024.

[3] In one study from 2023, online banks (with few branches) raised interest rates further than other banks in response to monetary tightening in 2022 and, unlike the other banks, attracted deposit inflows (I. Erel, J. Liebersohn, C. Yannelis and S. Earnest, 'Monetary policy transmission through online banks', NBER Working Papers Series, 31380, 2023); in a different study, online banks (whose platforms receive numerous reviews) were instead subject to a stronger outflow of deposits than other banks, despite the more substantial increase in interest rates (N. Koont, T. Santos and L. Zingales, 'Destabilizing digital "bank walks"', NBER Working Papers Series, 32601, 2024).

in detail, we defined as 'banks with highly digital customers' the ones that in the four quarters prior to the launch of monetary tightening displayed a substantial share of money transfers ordered online by their customers (above 89 per cent of the total, thus within the top quintile of the distribution).[4]

The analysis shows that, other conditions being equal, the increase in official interest rates was on average accompanied by a reduction in the sight deposits held by households and firms at banks with highly digital customers on a similar scale as that observed for the other banks (see panel (a) of the figure); there were no significant differences with the interest rates on these deposits, either. Conversely, households' term deposits grew for all banks, but the increase was more significant, on average, for deposits held at banks with highly digital customers (see panel (b) of the figure), which also increased their rates more significantly on new deposits of this type.[5]

One possible interpretation of these results is that, on average, banks with highly digital customers used the phase of higher official rates to rebalance their funding towards a more stable form (household term deposits). At the same time, being aware of their customers' sensitivity to the conditions applied, these banks may also have decided to adjust the interest rates paid on term deposits more quickly in order to mitigate potential outflows and to attract new customers.

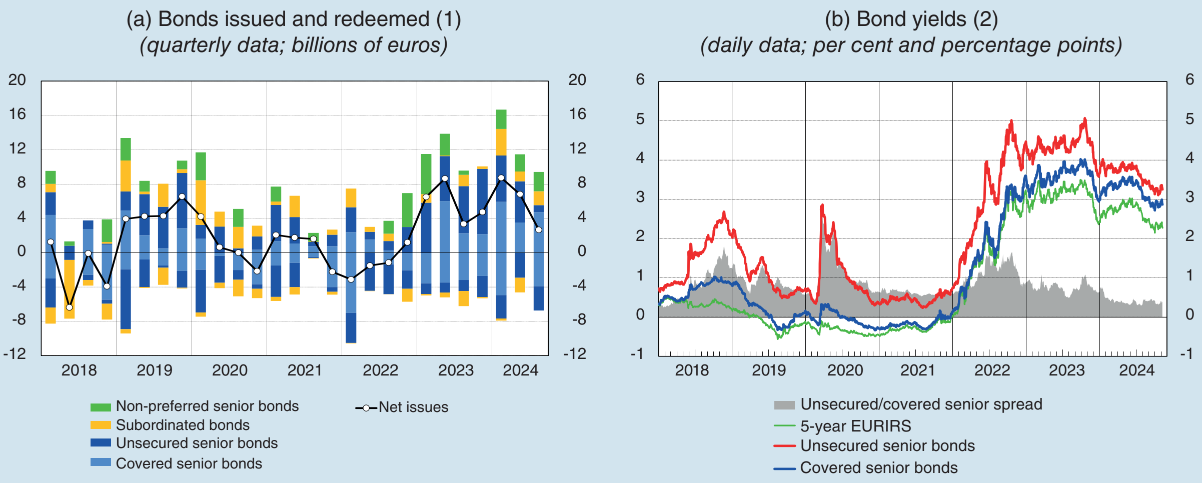
4 The analysis was carried out at the level of stand-alone banks and excluding foreign bank branches and subsidiaries. The final sample of banks with highly digital customers is made up of 60 intermediaries, which, prior to the monetary tightening, accounted for 28 per cent of the deposits examined.

5 As for the term deposits held by firms, which bear very little weight on the sample, no significant differences were found between the two types of bank in terms of growth or remuneration.

In the third quarter of this year, Italian banks' net bond issues on international wholesale markets plummeted to €2.7 billion, a sharp drop compared with first-half levels, largely reflecting a reduction in placements of unsecured senior bonds (Figure 2.8.a). Yields fell more strongly on unsecured bonds

Figure 2.8

Bank bonds placed on international markets



Sources: Bloomberg and Dealogic.
(1) Italian banks' issues on international markets. Does not include issues retained on issuers' balance sheets and those earmarked for the retail market. Includes securitized bonds. Positive values show bond issues, negative values show bond redemptions. – (2) Yields to maturity of Italian bank bonds with residual maturity of 5 years.

than on covered bonds, bringing the spread between the two to very low levels; this trend reflects the lower riskiness of banks as perceived by investors (Figure 2.8.b).

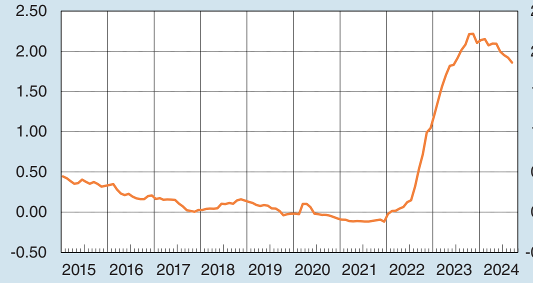
The marginal cost of bank funding went down to 1.9 per cent in September, around 20 basis points less than in March. The decline was broad-based across the main sources of funding, with the exception of sight deposits, whose yield had remained close to zero even during the monetary tightening phase. However, the marginal cost of funding for Italian banks remains high by historical standards (Figure 2.9).

Effective on 18 September 2024, following the ECB Governing Council's operational framework review, the spread between the interest rate on main refinancing operations (MRO) and the deposit facility rate narrowed from 50 to 15 basis points, reducing the cost of funding through MRO and three-month longer-term refinancing operations (LTRO). Italian banks' daily outstanding amounts for these operations averaged €14.8 billion at the end of October after the ECB's decision came into effect, up from €8.8 billion earlier in the year.

Italian banks have continued gradually unwinding third-series targeted longer-term refinancing operations (TLTRO III) in an orderly manner. Since April, banks have repaid a total of €42.2 billion worth of outstanding TLTRO III, mainly using their excess liquidity deposits with the Bank of Italy, which stood at €99 billion in the maintenance period to October 2024 (Figure 2.10), €67 billion less than in April. The outstanding TLTRO III funds, amounting to €12.4 billion, will be fully repaid at the final maturity date in December.

Figure 2.9

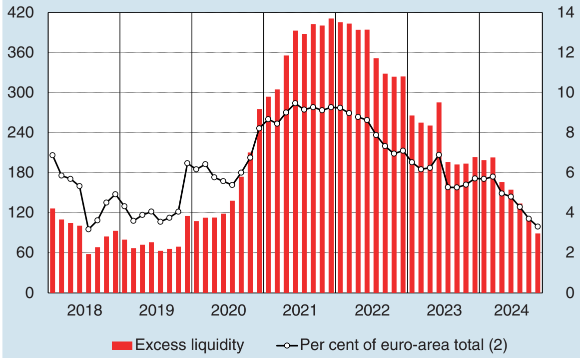
Marginal cost of bank funding (1)
(monthly data; percentage points)



Source: Based on supervisory reports.
(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 2.10

Excess liquidity of counterparties operating in Italy (1)
(billions of euros and per cent)

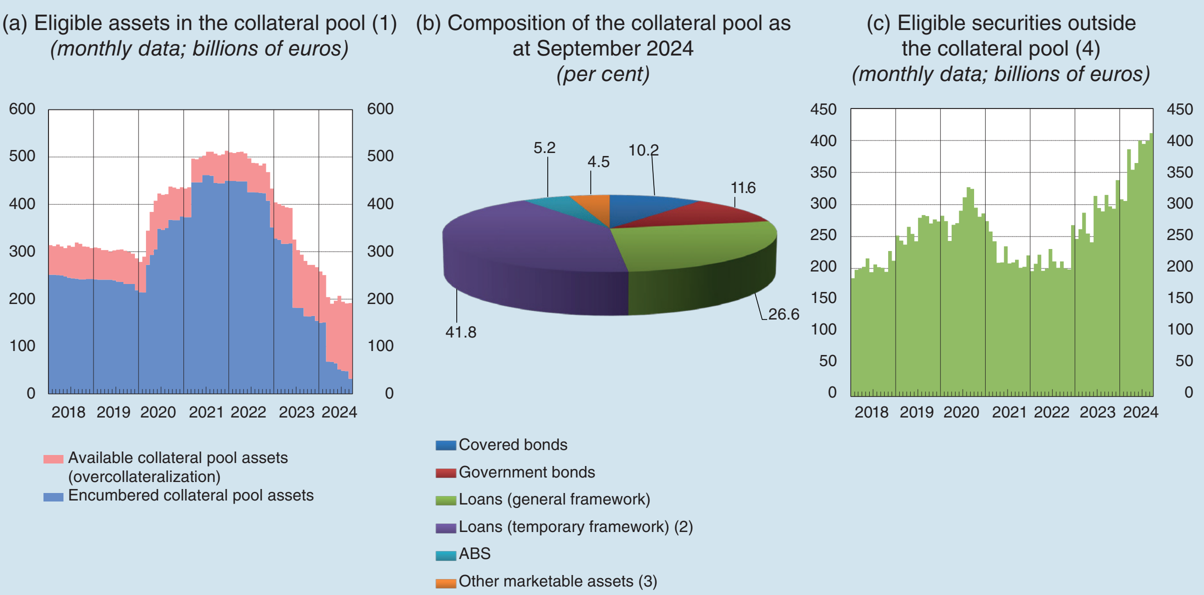


Sources: Based on Bank of Italy and ECB data.
(1) Each bar shows average excess liquidity for each maintenance period, calculated as the sum of banks' average reserve balances, net of the reserve requirement, plus the average recourse to the deposit facility. The last datum refers to the 6th maintenance period of 2024, which ended on 22 October. – (2) Right-hand scale.

The value of (available and encumbered) assets pledged as collateral in Eurosystem operations (collateral pool) fell by €12 billion between March and September, to €192 billion (Figure 2.11.a), in line with the downward trend that has been underway for some time. The decline was broad-based across almost all eligible asset classes and was especially pronounced for government bonds and for loans; the latter are still the largest asset class in the collateral pool (68 per cent of the total; Figure 2.11.b). Despite the reduction in collateral assets, overcollateralization remains substantial (€160 billion, or 83 per cent of the pool). In addition, Italian banks have €411 billion in eligible securities available outside the collateral pool, of which 63 per cent are government bonds (Figure 2.11.c).

Figure 2.11

Eligible assets of the Italian banking system

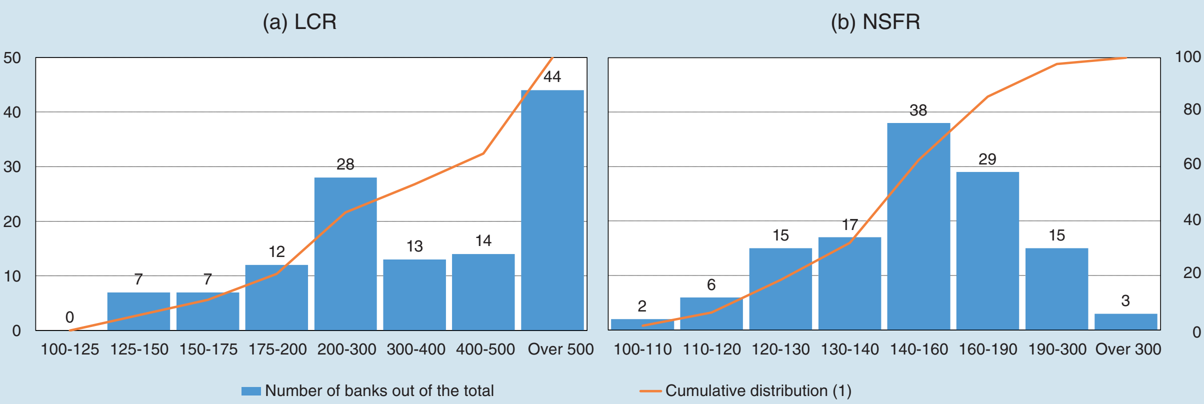


Sources: Based on Eurosystem data and supervisory reports.
(1) End-of-period data for the monetary policy counterparties of the Bank of Italy. The volume of encumbered Eurosystem collateral pool assets includes the part covering accrued interest and refinancing in dollars. The collateral pool is valued 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.

Bank's liquidity profile remains balanced for both short- and medium-term maturities: in June, the one-month liquidity coverage ratio (LCR) averaged 177 per cent and the net stable funding ratio (NSFR) stood at 134 per cent (versus 189 and 133 per cent respectively in December 2023). Both indicators were above the 100 per cent regulatory minimum for all banks, and well above it for over 90 per cent of banks (Figure 2.12).

Figure 2.12

Distribution of Italian banks by LCR and NSFR as at June 2024
(per cent)



Source: Based on supervisory reports.
(1) Right-hand scale.

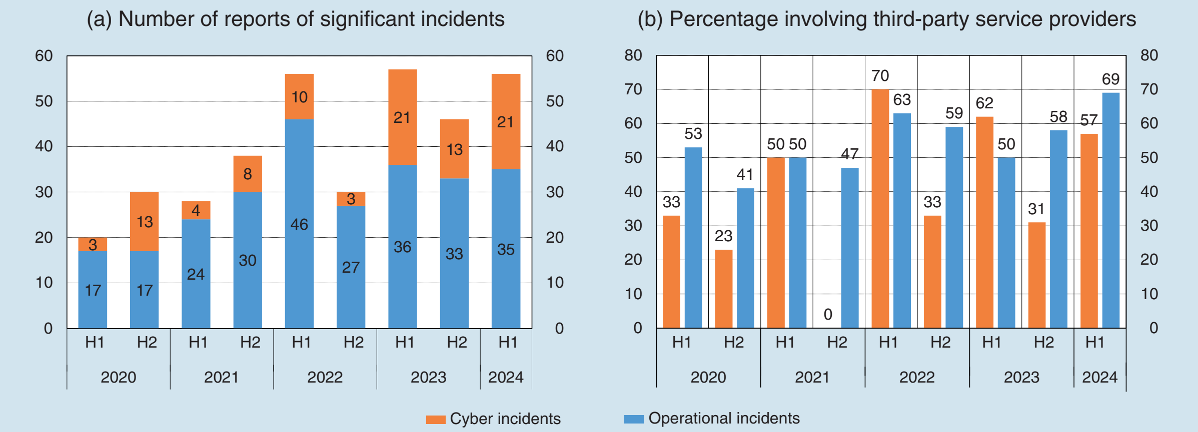
In line with Italian banks' funding plans, 2024 saw a reduction in central bank funding; a further contraction is expected in 2025 as there will be no rollover of short-term funding operations used by some banks in partial substitution for TLTRO funding. There are, however, important differences in the funding forecasts of significant and less significant banks for 2025. The former assume a slight increase in liabilities, mainly driven by wholesale bond issuance and, to a lesser extent, by customer deposits. By contrast, the latter estimate a stronger expansion in liabilities, through greater recourse to both customer and market funding. This trend should be more pronounced for banks with specialist business models, e.g. in factoring and NPL management, which forecast strong growth in deposits, including through online platforms.

Operational and cyber risks

Based on the Bank of Italy's monitoring of operational and cyber risks,[8] Italian financial intermediaries[9] reported 56 significant incidents in the first half of the year, 21 of which were cyber incidents (they were 57 and 21 respectively in the first half of 2023; Figure 2.13). The events reported include attacks on service providers, affecting various financial entities, albeit with limited consequences.

Figure 2.13

Operational and cyber incidents (1)
(units and per cent)



Source: Based on supervisory reports.
(1) Cyber incidents include cyber attacks and incidents that have the effect, even unintended, of sharing and/or altering the confidential data of the bank and/or its clients. Operational incidents arise due to inadequate or malfunctioning processes, human or system error, or due to force majeure. The latter also includes natural events, software and hardware errors, accidents, process malfunctions, and sabotage (physical attacks).

In mid-July, a major, non-malicious cyber incident hit the US technology company CrowdStrike.[10] A flawed security update caused an estimated 8.5 million devices running Microsoft Windows operating systems to crash. The event, which had a serious impact on the energy, financial and transport sectors, drew attention to the importance of risk profiles, including systemic risks, posed by obtaining IT

[8] 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'.

[9] Banking groups, stand-alone banks, payment institutions and e-money institutions are subject to reporting.

[10] It is one of the world's largest providers of IT security software services and cyber threat analysis and cyber incident management services.

services from companies operating on a global scale.[11] In Italy, bank branch operations, ATMs and some internal processes were affected. In a few cases there were slight delays in the processing of payments and temporary disruptions on digital platforms. Most operators were able to restore critical services to users during the same day as the incident.

The Digital Operational Resilience Act (DORA),[12] which will enter into force on 17 January 2025, will intensify the financial system's focus on operational or security incidents by introducing a new reporting scheme to harmonize taxonomies, templates and procedures. As for the management of third-party risk, DORA extends a number of regulatory requirements, already in place only for outsourcing arrangements, to contractual ones with third-party service providers. In this regard, DORA emphasizes the need for financial entities to develop strategies to address IT risks stemming from third-party service providers and to maintain control over operational risks, information security and business continuity in their contractual arrangements. In addition to the requirements for financial entities subject to DORA, the regulation introduces a European oversight framework for service providers deemed critical to the system, under which the European supervisory authorities (EBA, ESMA and EIOPA),[13] with input from the national authorities, will carry out off-site reviews and inspections.

In July, the ECB concluded its first cyber resilience stress test for the banks under its direct supervision. The exercise assessed banks' capacity to react in the event of a successful cyber attack.[14] The results showed that most banks have 'response and recovery' frameworks in place, although some areas show room for improvement. These include: (a) the adequacy of the business continuity, communication and recovery plans, which should encompass a sufficiently wide range of cyber risk scenarios; (b) the ability to achieve the recovery objectives; (c) the proper assessment of reliance on third-party suppliers; and (d) a suitable estimate of the direct and indirect losses arising from a cyber attack. The outcome contributed qualitatively to the 2024 Supervisory Review and Evaluation Process, including the cyber risk governance and management profiles.

Capital and profitability

The capital position of Italian banks improved in the first half of the year. The CET1 ratio for the entire banking system – i.e. the ratio of CET1 to risk-weighted assets (RWAs) – was 15.9 per cent, 30 basis points higher than at the end of 2023. The increase was seen for both significant and less significant banks, due primarily to the positive contribution from profitability for the period. In June, the average level of capitalization of Italian significant banks was about 40 basis points higher than that of all the significant banks in the countries participating in the Single Supervisory Mechanism (SSM).

The leverage ratio, which measures capital adequacy relative to non-risk-weighted assets, was 15 basis points higher for the entire banking system, reaching 6.3 per cent. The leverage ratio of Italian significant banks stood at 6.1 per cent, above the European average by 40 basis points, while for

11 The risk profiles include: (a) the interdependence between systemically important events and business continuity for digital services and infrastructure; (b) supply chain management, including security audits and product quality and IT services checks; and (c) technological diversification profiles.

12 Regulation (EU) 2022/2554 of the European Parliament and of the Council.

13 The European Banking Authority (EBA), the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA).

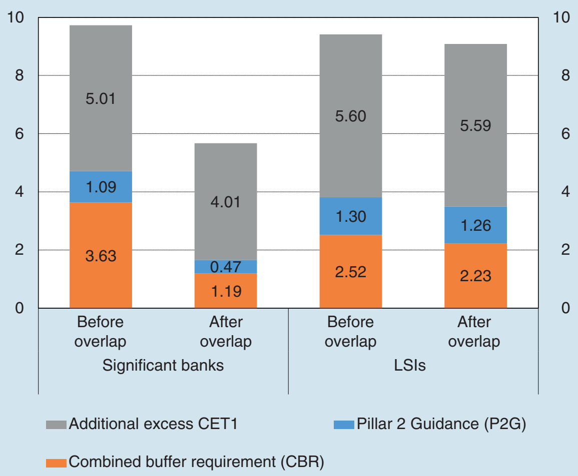
14 For further information, see the Bank of Italy's website: 'The ECB concluded its cyber resilience stress test on 109 banks', press release, 26 July 2024.

less significant institutions (LSIs) it was 7.3 per cent.

Issuance of eligible liabilities to meet the minimum requirement for own funds and eligible liabilities (MREL), mostly by significant banks, was substantial in the first half of the year. The ratio of MREL liabilities to RWAs for banks subject to resolution rose to 35.1 per cent, well above the average values for the regulatory requirements. As at 30 June 2024, all banks complied with the MREL requirements in force.

Figure 2.14

Loss-absorption capacity by category of bank (1)
(percentage of RWAs)



Sources: Consolidated supervisory reports for banking groups and individual supervisory reports for stand-alone banks.
(1) The regulation allows for the simultaneous use of CET1 for the different applicable requirements, such as risk-weighted requirements, the leverage ratio and the MREL. Overlaps reduce the availability of buffers to absorb losses, when the same unit of capital is also used to satisfy a minimum requirement. In such situations, recourse to those buffers would result in a breach of the minimum requirement, which could also lead to resolution or winding-up proceedings.

Capital overlaps[15] resulting from the simultaneous use of CET1 for weighted leverage and MREL requirements can have significant effects on banks' loss-absorbing capacity, as they reduce the amount of capital buffers usable[16] without breaching a minimum requirement.[17] These effects are considerable, especially for significant banks,[18] whose overall loss-absorption capacity – in relation to risk-weighted assets – is 4 percentage points lower if overlaps are taken into account (from 9.7 to 5.7 per cent; Figure 2.14). By contrast, for less significant banks, overlaps are negligible (reducing the loss-absorption capacity from 9.4 to 9.1 per cent). Despite overlaps, Italian banks' capital levels provide ample loss-absorption capacity overall, also in comparison with other European banks.

The profitability of Italian banks improved further in the first half of the year. The return on equity (ROE), net of non-recurring items, rose from 13.2 to 14.3 per cent (Figure 2.15), and stood at 15.4 per cent for significant banks and at 11.4 per cent for less significant banks. The increase in profitability mainly reflects the growth in net interest income (9.1 per cent), owing to the increase in interest income on loans, whose average return was higher than in the first six months of 2023. Higher net interest income, and to a lesser extent fee income (8.0 per cent), drove the increase in gross income (8.2 per cent). Operating costs rose slightly (3.3 per cent), mainly as a result of the higher staff expenses associated with the renewal of the national collective bargaining agreement for the banking sector at the end of 2023. Net loan loss provisions fell slightly (-2.8 per cent), chiefly reflecting reversals of impairment on Stage 1 exposures that more

[15] See the note to Figure 2.14 for more details; for an explanation of overlaps and the methodology used by the Bank of Italy to measure them, see the box 'The actual usability of the combined buffer requirement for Italian banks: a comprehensive approach', in *Financial Stability Report,* 1, 2022. See also W. Cornacchia and G. Guerra, 'Overlaps between minimum requirements and capital buffers: the case of Italian banks', Banca d'Italia, Notes on Financial Stability and Supervision, 30, 2022.

[16] This is the combined buffer requirement (CBR), the Pillar 2 Guidance (P2G) and any excess capital available.

[17] Breaching a minimum requirement may have far more severe consequences than the use of other capital buffers (excess capital, P2G or CBR; see Footnote 16), including, in the most extreme cases, the resolution or winding-up of the bank.

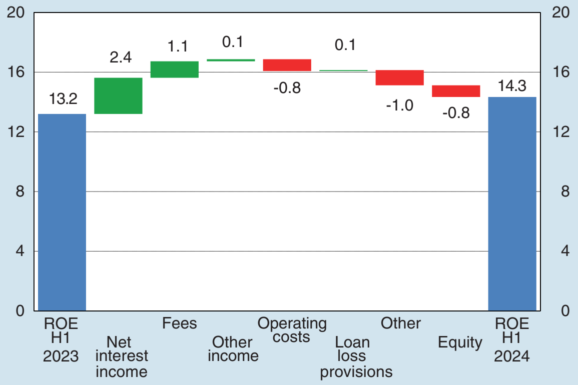
[18] Specifically, overlaps are material especially for top tier banks subject to MREL minimum subordination requirements.

than offset the write-downs on Stage 2 and Stage 3 positions.

Based on estimates consistent with the macroeconomic scenario published by the Bank of Italy in its October *Economic Bulletin*,[19] banks' overall profitability is set to remain close to 2023 levels, and to decline in the next two years, albeit remaining largely positive and above the average for the last five years. Net interest income is expected to further increase this year, slowing down only in 2025-26. Loan loss provisions are estimated to rise over the next two years, owing to the expected increase in the loan default rate, while remaining below pre-pandemic levels.

Figure 2.15

Breakdown of changes in ROE from H1 2023 to H1 2024 (1)
(percentage points)



Sources: Consolidated supervisory reports for banking groups and individual supervisory reports for stand-alone banks.
(1) Changes are expressed as a ratio to equity. A green/red bar indicates a positive/negative contribution to ROE in the first six months of 2023, giving the final ROE value for the first half of 2024.

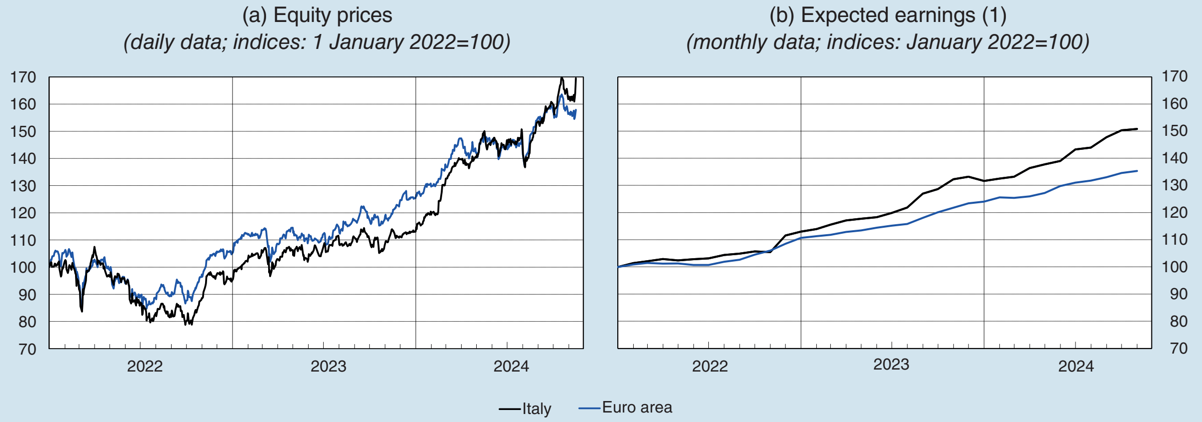
2.2 INSURANCE COMPANIES

Financial stability risks in the Italian insurance sector are virtually unchanged at medium levels (Figure 1.3). The recovery in premium income has led to improved profitability and lower liquidity risks, which nevertheless continue to be significant due to still high surrenders.

Expectations of an increase in the earnings of the leading Italian insurance companies, which exceeded the expectations for euro-area insurers as a whole, pushed equity prices further up (Figure 2.16).

Figure 2.16

Italian and euro-area insurance companies



Source: Based on LSEG data.
(1) Average of expected earnings per share in the 12 months following the reference date for a sample of 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 Unipol. For the euro area, the data refer to the leading companies included in the Datastream euro-area insurance sector index.

[19] 'Macroeconomic projections for the Italian economy', Banca d'Italia, 11 October 2024.

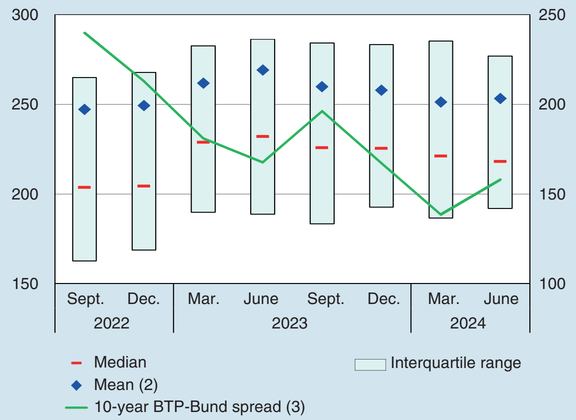
Insurers' capitalization fell slightly in the first six months of 2024, but it remained high: the average solvency ratio in June was 253 per cent (from 258 per cent in December 2023; Figure 2.17). Investment risks are still greater than those directly associated with insurance activity (see Figure A7 in the Appendix).

In June, investments by Italian insurance companies amounted to €997 billion, or 12 per cent of total investment in the sector at European level. Looking at the composition of the investments for which insurers bear the risk (€727 billion), public sector securities still made up the bulk of it and their share, while gradually shrinking, far exceeded the European average (24 per cent; Figure 2.18.a); more than two thirds of these investments were in Italian government securities. Corporate bonds, which accounted for 21 per cent of the insurance companies' portfolios, consisted above all of securities issued by foreign non-financial corporations (Figure 2.18.c), mostly with a BBB and A rating (49 per cent and 31 per cent of corporate bonds respectively; Figure 2.18.b). Equity and investment funds were stable at 14 and 15 per cent respectively.

Figure 2.17

Solvency ratio and BTP-Bund spread (1)

(per cent and basis points)



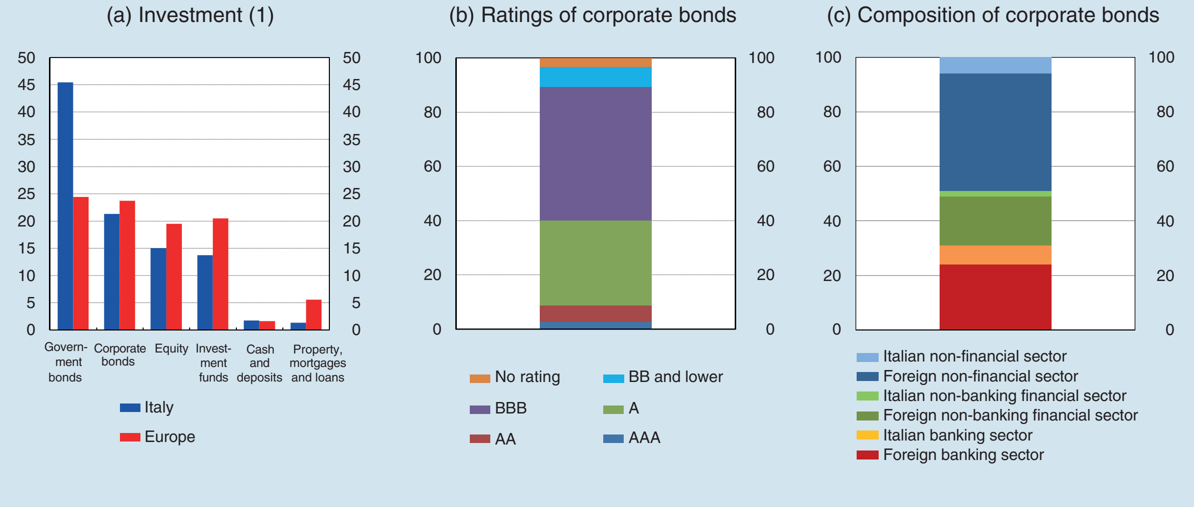
Sources: IVASS and calculations based on LSEG data.
(1) The solvency ratio is calculated as the ratio of eligible own funds held for coverage to the solvency capital requirement established under Solvency II. The data are taken from the quarterly Solvency II supervisory reports based on the quantitative 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.

Some 9 per cent of the corporate bonds in the investment portfolios of Italian insurance companies were green bonds, slightly up from June 2023 (8 per cent) and above the European average.

Figure 2.18

Insurance company investments

(data as at 30 June 2024; per cent)



Sources: IVASS and EIOPA.
(1) The data for Europe, as at 31 March 2024, refer to the European Economic Area.

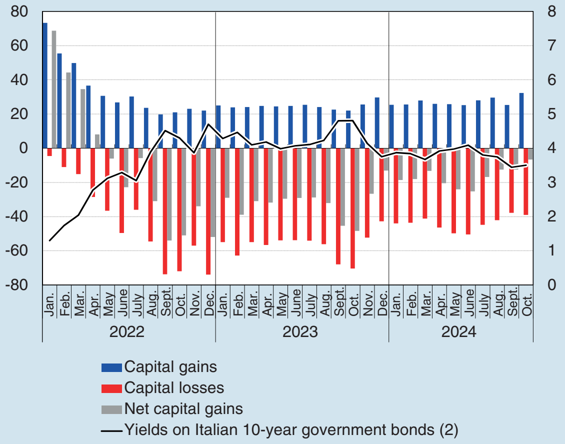
In October, net unrealized losses on investments amounted to €7 billion, an improvement from December of last year (€13 billion; Figure 2.19). About 70 per cent of the unrealized losses were related to government bonds.

A limited number of Italian insurers, which account for around 5 per cent of the sector's assets, decided to temporarily suspend the effects of unrealized investment losses on the profitability for the first half of 2024, as permitted by law in turbulent market situations.[20]

The ROE for the life sector was negative in the first six months of 2024 (-9 per cent) due to capital losses (Figure 2.20.a), despite performing better year on year. The improvement was partly driven by the recovery in premium income from traditional and unit-linked insurance products, after the decline recorded in recent years (Figure 2.20.c).

Figure 2.19

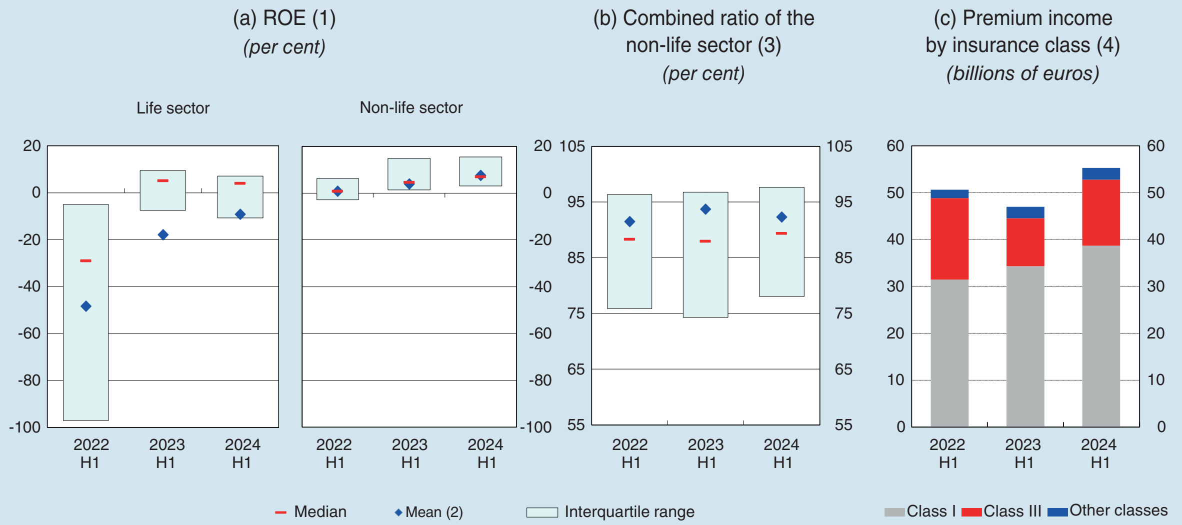
Unrealized capital gains and losses (1)
(billions of euros and per cent)



Sources: IVASS and calculations based on LSEG data.
(1) Unrealized capital 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.

Figure 2.20

Main balance sheet indicators for Italian insurance companies and life premium income



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.

[20] The Decree of the Ministry of Economy and Finance of 27 September 2024 extended to the year 2024 the exception that 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, using the unrecognized amount to build up a 'non-distributable reserve'.

The non-life ROE rose to 8 per cent; this confirmed the upward trend in this sector, with a 7 per cent increase in premium income from June 2023. The combined ratio edged down to 92 per cent (Figure 2.20.b).

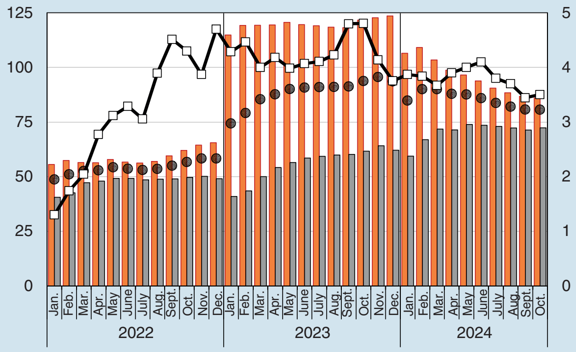
In recent months, the recovery in life premium income has progressively lowered the ratio of surrenders to premium income, from 94 per cent in October 2023 to 81 per cent at the end of October of this year (Figure 2.21). Growth in premium income has been driven by companies distributing products through banks or financial advisors; while the ratio for these companies has remained slightly higher (86 per cent), the gap with other insurers has narrowed considerably. For unit linked policies, however, surrenders continue to be high and on the rise.

The liquid asset ratio[21] of Italian insurers was stable at a median value of 62 per cent in June 2024 compared with end-2023, higher than the European median (45 per cent in March 2024).

Figure 2.21

Surrenders to premium income ratio by distribution channel (1)

(per cent)



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

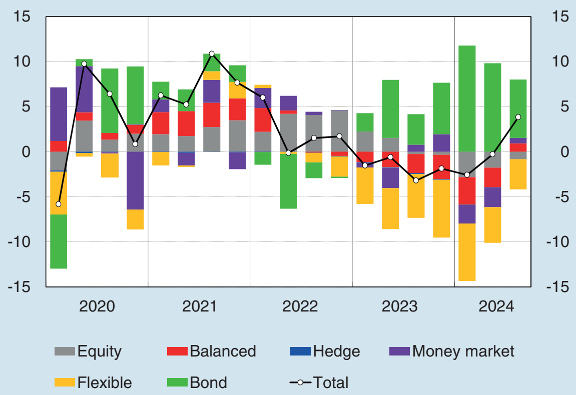
2.3 THE ASSET MANAGEMENT INDUSTRY

The risks to financial stability stemming from the activity of Italian investment funds remain limited overall. In the second and third quarters of 2024, the total assets of open-end investment funds managed by Italian companies and groups reached €629 billion,[22] partly thanks to positive net subscriptions (about €3.5 billion; Figure 2.22). Net subscriptions to bond funds, which began as market yields rose, more than offset net outflows in the other segments. Net subscriptions to funds that comply with environmental, social and governance (ESG) criteria continued to be negative.

Figure 2.22

Italian open-end investment funds: net subscriptions (1)

(quarterly data; billions of euros)



Source: Assogestioni.
(1) The data refer to Italian and foreign funds run by asset management companies that are Italian or belong to Italian groups. Provisional data for Q3 2024.

In the first half of the year, the overall exposure of Italian and euro-area funds to the Italian bond markets increased. Investment by these funds plays an important role, especially for

[21] The indicator is calculated as the ratio of liquid assets to total assets. Liquid assets are calculated by applying haircuts to the different asset categories using EIOPA's liquidity risk monitoring methodology (for more details, see the box 'Launch of liquidity risk monitoring in the insurance sector', *Financial Stability Report*, 2, 2020).

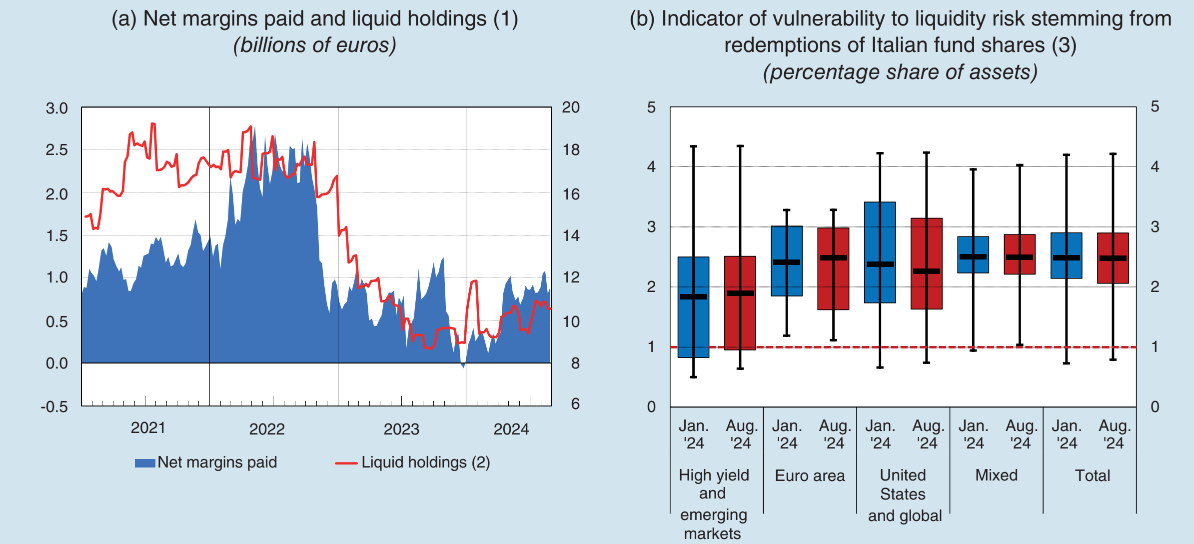
[22] This sector accounts for around 50 per cent of the total assets of funds distributed in Italy, which also include funds managed by foreign groups.

non-financial corporations; they hold about one third of outstanding bonds in this segment, while their share in the market for government securities is around one tenth.

Borrowing from banks and other financial intermediaries by Italian open-end investment funds[23] is still moderate[24] and available credit lines have remained stable. In August, synthetic leverage, calculated as the ratio of gross notional exposure in derivatives to net assets, was less than 1. The margins paid for the use of derivatives are also low overall compared with the available liquidity (Figure 2.23.a).

Figure 2.23

Liquidity risk indicators for Italian open-end investment funds



Sources: Based on Regulation (EU) No 648/2012 (European Market Infrastructure Regulation, EMIR), supervisory reports and ECB data (Centralised Securities Database).
(1) Aggregate value of margins paid net of those received for exposures in derivatives and aggregate liquid holdings from January 2021 to August 2024. Weekly data. – (2) Right-hand scale. – (3) Includes open-end investment funds in the mixed and bond segments. The liquidity risk indicator is equal to the ratio of a 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 segments 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). The coloured areas represent the interquartile difference; the lower and upper dashes of the vertical lines indicate the 1st and 99th percentiles of the distribution, respectively. Funds below the dashed red line are considered vulnerable.

The liquidity risk stemming from particularly high redemption requests was stable between January and August for non-equity segments (Figure 2.23.b).[25] Within these, vulnerable fund assets remained at low levels (1.9 per cent of the total).[26] An analysis of the liquidity stress tests conducted by the managers of a sample of vulnerable funds revealed areas for improvement in the models and scenarios used (see the box 'Analysing the liquidity stress tests carried out by the managers of vulnerable open-end funds').

[23] The total assets of Italian investment funds supervised by the Bank of Italy are around 40 per cent of those held by asset management companies belonging to Italian groups. The remainder is attributable to foreign investment funds.

[24] Italian law provides that 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.

[25] The liquidity indicator is equal to the ratio of the fund's assets weighted by the degree of liquidity of its components to net redemptions under a stress scenario (see note (3) to Figure 2.23).

[26] Vulnerable funds are those for which the liquidity indicator is less than 1.

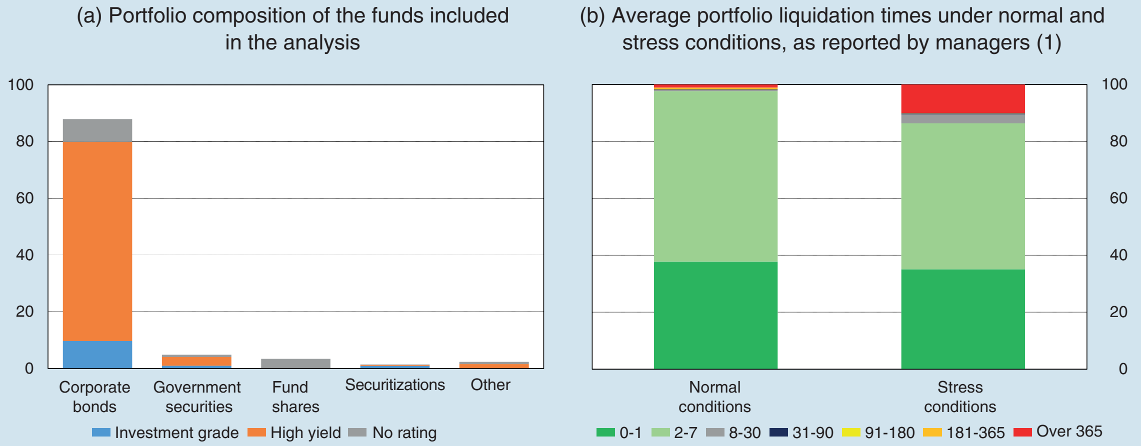
ANALYSING THE LIQUIDITY STRESS TESTS CARRIED OUT BY THE MANAGERS OF VULNERABLE OPEN-END FUNDS[1]

The activity of open-end investment funds is exposed to risks associated with the mismatch between the liquidity of assets and that of liabilities. One of the safeguards against these risks is the regulatory requirement for managers to conduct periodic stress tests.[2] To assess the characteristics and adequacy of these tests, an in-depth analysis was conducted on a sample of Italian open-end funds that are particularly exposed to liquidity risk, which account for just under 1 per cent of the domestic sector's total assets. These financial intermediaries have an indicator of vulnerability to liquidity risk stemming from redemptions below 1[3] and, in line with their investment policies, are more exposed to bonds with a rating below investment grade (see panel (a) of the figure).

Although the findings of this analysis show that the practices adopted by fund managers broadly comply with the current regulations, some areas for improvement were identified. Specifically, some managers decided to conduct stress tests less frequently than the characteristics of their funds would require; others do not use adequate thresholds to activate contingency measures or do not identify scenarios that could lead to significant liquidity risk for riskier funds. Furthermore, as some managers did not assume particularly severe scenarios, the estimates of average portfolio liquidation times were insensitive to a deterioration in market conditions during periods of stress (see panel (b) of the figure).

Figure

Securities portfolios of the investment funds analysed
(per cent)



Source: Based on fund manager reports.
(1) Average share of portfolio securities that the funds can liquidate within the specified number of days.

The analysis also shows areas for improvement that are partly connected to the fact that the current European regulatory framework for open-end non-money market funds only sets out general principles for conducting stress tests and provides individual managers with ample

[1] By Dario Portioli and Paolo Cantatore.
[2] ESMA, 'Guidelines on liquidity stress testing in UCITS and AIFs', 2020.
[3] See Figure 2.23, Footnote 3.

autonomy to measure liquidity risk and define stress scenarios. Furthermore, fund managers are not required to report the results of their tests to the competent authorities on a regular basis, except in the case of significant risks. The analysis shows that this highly discretionary approach may, in some circumstances, lead managers to adopt insufficiently prudent practices.

The rules on liquidity risk management are among those subject to the European Commission's consultation on macroprudential policies for non-bank financial intermediation.[4] This consultation is part of the international efforts to increase the soundness of the global non-bank financial sector.[5] In this context, the definition of regulatory liquidity metrics for open-end non-money market funds, the introduction of harmonized reporting on stress tests, and the expansion of the intervention powers of the competent authorities would help to better assess the sector's liquidity risks.

4 For further information, see the European Commission's website, 'Targeted consultation assessing the adequacy of macroprudential policies for non-bank financial intermediation (NBFI)', May 2024.

5 FSB, *Enhancing the resilience of non-bank financial intermediation: progress report,* July 2024.

In June 2024, the assets managed by non-real estate alternative investment funds (AIFs) exceeded €50 billion (about 12 per cent of Italian funds' assets), mostly thanks to growth in private equity funds, which account for almost half of the assets. Investors in the new AIFs set up in the first half of the year are almost only Italian, mainly insurance companies and pension funds. About a quarter of Italian AIFs (around 6 per cent of total assets) are attributable to sub-threshold managers, which are subject to a simplified regulatory regime;[27] almost all of these operate in the private equity sector, mainly in venture capital.

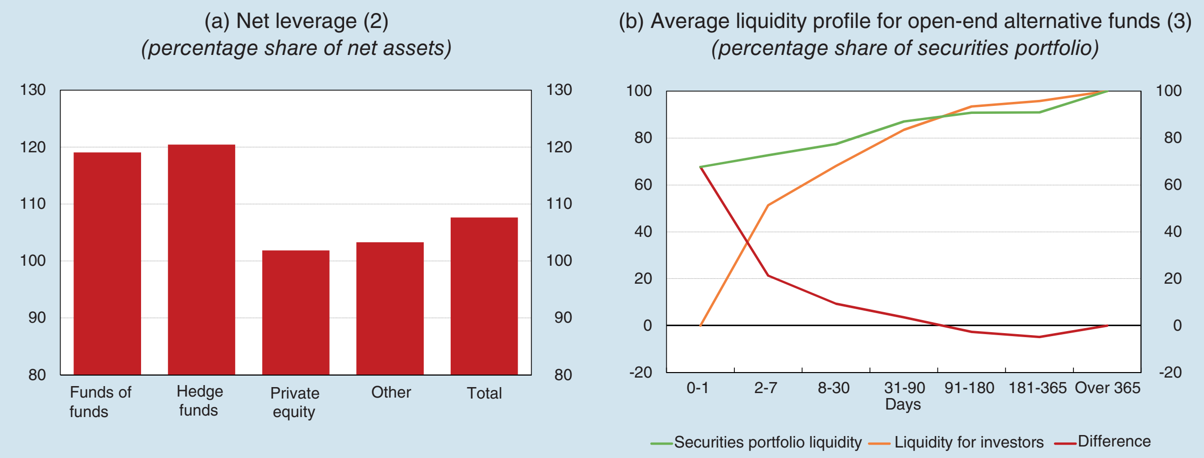
The risks stemming from the use of leverage by Italian AIFs remain limited: leverage is still low (108 per cent; Figure 2.24.a) and below the euro-area average (122 per cent). Indirect leverage of private equity funds, attributable to borrowing by subsidiaries, edged down to 53 per cent of the sector's net assets. Liquidity risks continue to be limited as well, since national legislation provides that AIFs investing more than 20 per cent of their portfolio in illiquid assets be set up as closed-end funds; asset liquidity and the redemption profile of short-term liabilities for open-end AIFs, which account for just over 10 per cent of the sector's assets, are virtually aligned (Figure 2.24.b).

In the first six months of 2024, the assets managed by the Italian real estate fund sector remained stable (Figure 2.25.a). Investors in newly established funds are mainly non-financial corporations and other euro-area funds (Figure 2.25.b). Almost two thirds of the new investments in the sector continue to be concentrated in the province of Milan and more than 80 per cent in commercial real estate (CRE). In the first half of the year, real estate funds made net write-downs equal to about 0.4 per cent of their portfolio (Figure 2.26.a).

27 This category includes fund managers with assets of less than €100 million or up to €500 million, provided that the funds do not use leverage and that the rights of participants to redeem units or shares are not exercisable for a period of at least five years from the date of initial investment. For sub-threshold managers, the initial minimum share capital is set at €50,000 instead of €1 million (€500,000 for managers of reserved AIFs); furthermore, they are not subject to bans on investment, prudential rules on risk containment and fragmentation, and other administrative and information requirements.

Figure 2.24

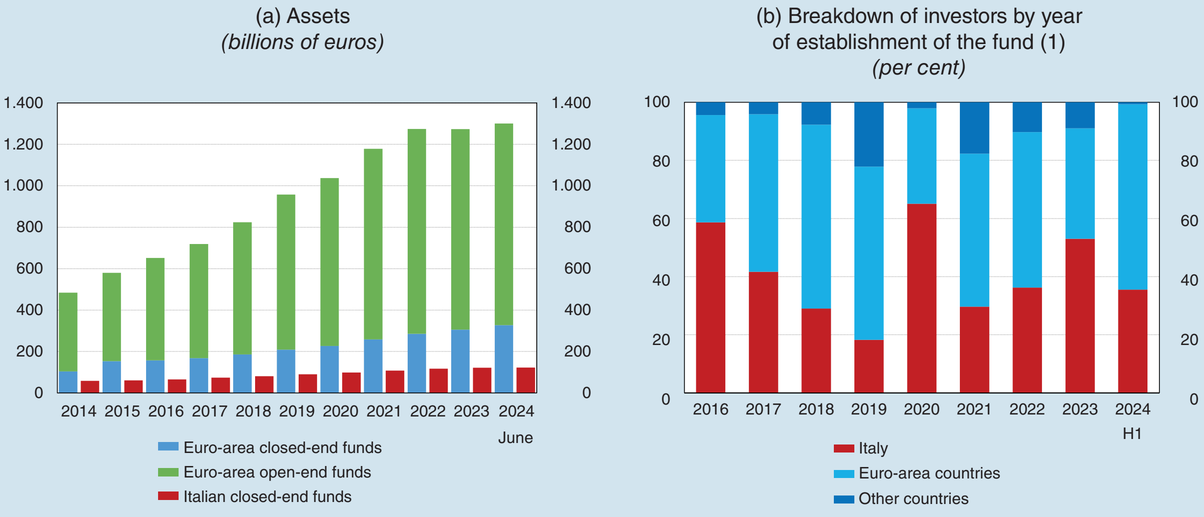
Indicators for Italian non-real estate AIFs as at June 2024 (1)



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 AIF managers 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 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.

Figure 2.25

Real estate funds

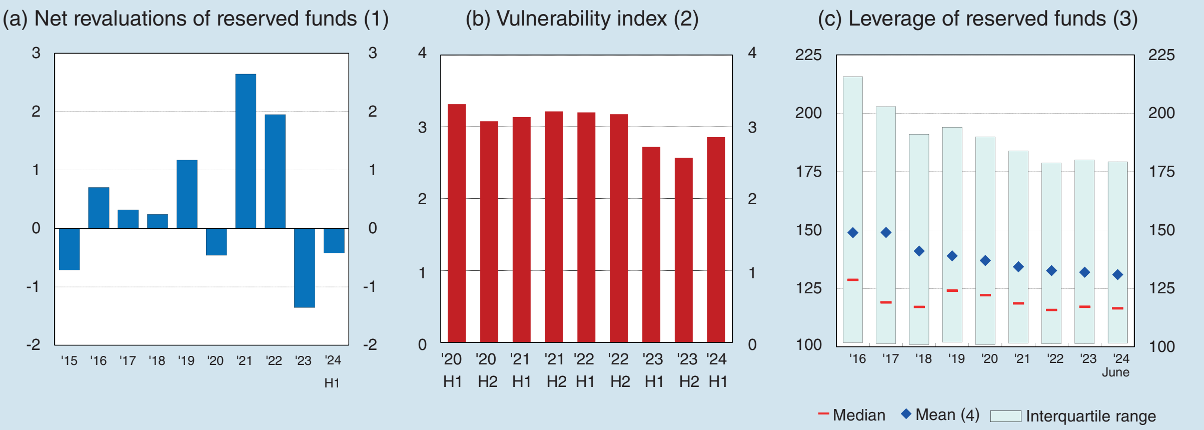


Source: Supervisory reports.
(1) Share of net assets subscribed by the different categories of investors.

The risks to financial stability stemming from the activity of real estate funds remain limited overall. Unlike most European funds, Italian funds are closed-end under current legislation and are therefore not subject to the liquidity risk arising from high redemption requests. The risk that, at maturity, the valuation of the funds' real estate portfolio could diverge significantly from market values also continues to be low (Figure 2.26.b).

Figure 2.26

Main indicators for real estate funds
(per cent)



Sources: Supervisory reports and calculations based on data from Istat and OMI.
(1) Ratio of reserved fund balance sheet revaluations net of write-downs 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.

Leverage remains at low levels (131 per cent in June 2024; Figure 2.26.c), in line with the European average. Highly leveraged funds (i.e. with a leverage ratio above 300 per cent) hold less than 3 per cent of the sector's total assets. The funds with negative net assets, a condition that indicates particular financial stress, continue to account for around 1 per cent of assets.

Direct exposures of Italian banks and other financial intermediaries to the sector remain modest: in June, the loans granted to Italian real estate funds were about 1 per cent of total lending. Almost all the loans granted were term loans, in line with the medium to long-term horizon of the funds. The ratio of NPLs to total outstanding loans to the sector, gross of loan loss provisions, was stable at around 13 per cent.[28]

[28] The ratio of NPLs to bank loans alone, gross of loan loss provisions, instead fell to around 5 per cent.

3 FINANCIAL STABILITY POLICIES

To strengthen the banking system's resilience against unexpected events, including those that are independent of the economic and financial cycle, the Bank of Italy has recently activated a 1 per cent systemic risk buffer (SyRB). The first half of the reserve is to be built by the end of 2024 and the remaining 0.5 per cent by 30 June 2025. The level of system capitalization is more than sufficient to meet the new requirement and the announcement of the measure did not affect the share prices of listed banks.[1]

In the absence of any risks to financial stability deriving from credit growth, the Bank of Italy has maintained the countercyclical capital buffer (CCyB) rate at zero per cent for the last two quarters of 2024 (see Table A11 in the Appendix).[2]

The Bank of Italy has identified Russia, Switzerland, Türkiye, the United Kingdom and the United States[3] as material third countries for the Italian banking system for the purposes of the application of the CCyB.[4] The direct monitoring of the risks of these five countries is carried out by the European Systemic Risk Board (ESRB), which has included them among the material countries for the entire European Economic Area.

In July and November the Bank of Italy assessed requests to reciprocate a Portuguese[5] and a Danish[6] macroprudential measure and decided not to apply them domestically, since the exposures of Italian banks to the risks addressed by these measures are negligible.

The Bank of Italy confirmed the UniCredit, Intesa Sanpaolo, Banco BPM, BPER Banca, Banca Nazionale del Lavoro, Mediobanca and ICCREA banking groups as other systemically important institutions (O-SIIs), without changing the capital buffers for 2025.[7]

[1] M. Molinari and L. Moller, 'Analysis of the impact of the SyRB activation on Italian banks' share prices', Banca d'Italia, Notes on Financial Stability and Supervision, 41, 2024.

[2] Bank of Italy, 'The Countercyclical Capital Buffer (CCyB) rate for the fourth quarter of 2024 remains unchanged at zero per cent', press release, 27 September 2024.

[3] Bank of Italy, 'Identification by Italy of material third countries pursuant to Recommendation ESRB/2015/1 of the European Systemic Risk Board', press release, 30 June 2024.

[4] 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.

[5] Bank of Italy, 'Decision not to reciprocate a Portuguese macroprudential measure pursuant to Recommendation ESRB/2023/13 of the European Systemic Risk Board (ESRB)', press release, 26 July 2024.

[6] Bank of Italy, 'Decision not to reciprocate a macroprudential measure adopted by Denmark pursuant to Recommendation ESRB/2024/3 of the European Systemic Risk Board (ESRB)', press release, 8 November 2024.

[7] Bank of Italy, 'Identification for 2025 of other systemically important institutions authorized to operate in Italy', press release, 22 November 2024.

The tools available to the Bank of Italy for preserving the stability of the national financial system include the product intervention power under Regulation (EU) 600/2014.[8] To this end, the Bank regularly conducts analyses of the risks that may stem from financial instruments traded, distributed or sold in Italy or from Italy.[9] According to the most recent analyses of debt securities and derivatives, the amount of certificates held by Italian households grew further (see Section 1.5), totalling €56 billion last June (from €44 billion in mid-2023); at an aggregate level, this category of debt securities now accounts for the largest share in households' portfolios after national government bonds. These instruments are complex and may in some cases be subject to wide price fluctuations, thereby exposing holders to large losses if adverse scenarios occur.

In July, the Committee for Macroprudential Policies held its first meeting, chaired by the Governor of the Bank of Italy;[10] the meeting was attended by the presidents of the Italian Companies and Stock Exchange Commission (CONSOB), the Institute for the Supervision of Insurance (IVASS) and the Italian Pension Fund Supervisory Authority (Covip), and by the Director General of the Treasury. The Committee analysed the risks to the Italian financial system and assessed the macroprudential policies adopted by the participating authorities.[11] The next meeting is scheduled for 13 December 2024.

8 The same power is also granted to the Italian Companies and Stock Exchange Commission (CONSOB), with the aim of safeguarding investors and 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'.

9 For further information on the criteria used by the Bank of Italy to exercise its product intervention power, see its website, 'The Bank of Italy's "intervention power" concerning financial instruments, structured deposits and related financial activities/practices: legal, analytical and methodological framework', April 2024. 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'.

10 Committee for Macroprudential Policies, 'First meeting of the Committee for Macroprudential Policies', press release, 5 July 2024.

11 Committee for Macroprudential Policies, 'Minutes of the meeting of 5th July 2024', 2 August 2024.