

The Italian Banking System

Nicola Bilotta*

Abstract: Italy's economy is in deep trouble. Since the economic crisis hit the country, the government has been struggling to re-launch the economy. Among member countries, Italy's banking system is one of the biggest challenges facing the EU. This paper presents a framework of the Italian banking system with details of its main characteristics and describes the critical problems that require fixing.

The Italian banking system was not deeply affected by the 2007-2008 financial crisis. Its traditional structure based on deposits and loans limited its exposure to a crisis grounded in short-term leverage. However, Italian banks were intensely damaged by the economic recessions and the national debt crisis. According to the minutes of its meeting, in July 2017, for the first time in its history, the US Federal Reserve formally discussed the Italian banking system. Federal Reserve Board members noticed European banks, specifically Italian banks, were facing financial instability due to the economic crisis, low profits and high exposure to credits risks.¹ Indeed, the Italian banking system is experiencing severe stress. According to the IMF's estimations, in 2015 the NPLs of Italian banks represented 18% of total loans, for a value of more than 360 billion euro.² The massive amount of NPLs and the consequent need for enormous loan provisions are affecting banks' earnings and liquidity.

* Nicola Bilotta is a research analyst at The Banker Research Team, Financial Times and Institute Fellow at Seven Pillar Institute for Finance & Ethics. He holds a BA in History and a MA in Historical Science from the University of Milan, and a MSC in Economic History from the London School of Economics and Political Science. He collaborates with ISAG (Istituto di Alti Studi di Geopolitica e Scienze Ausiliare) and with GRI (Global Risk Insights).

¹ M. Udland, Here's everything the FED is worried about right now, 17/007/2016, <http://uk.businessinsider.com/fed-minutes-concerns-2016-8?r=US&IR=T>

² IMF, Italy Country Report July 2016, p. 3-5
<https://www.imf.org/external/pubs/ft/scr/2016/cr16223.pdf>

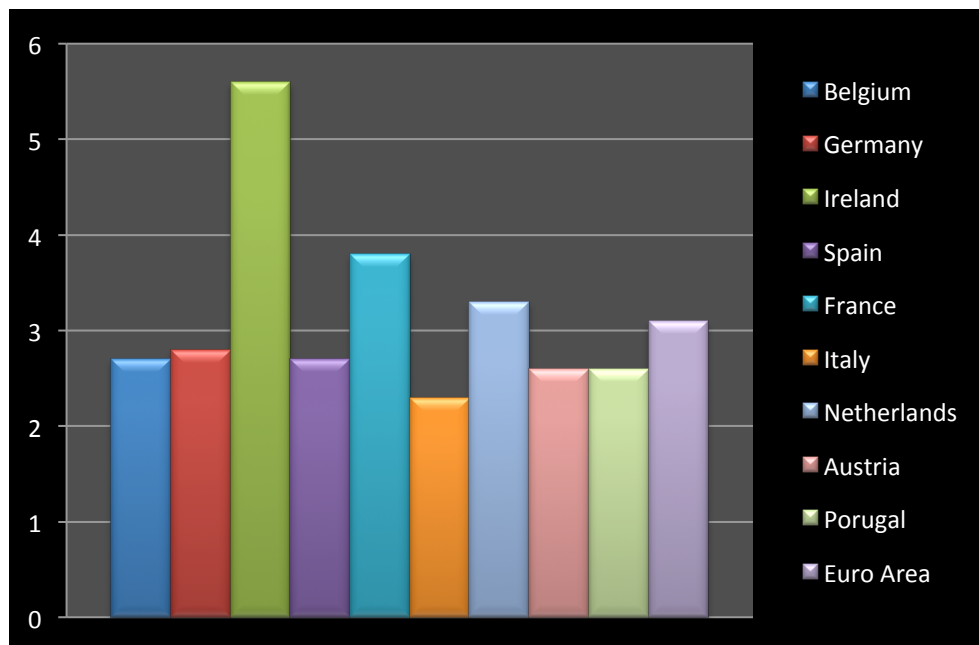
The Italian banking system has three main characteristics driving the evolution of the sector: (i) Italy has many local small and middle-sized banks; (ii) Italy has one of the highest rates of private savings in the world. Families tend to not invest but to deposit their capital in banks; (iii) Italian banks have developed a close relationship with Italian enterprises. As Italy does not have an advanced stock market, companies rely on loans to establish and grow their businesses.

This paper provides a theoretical framework to contextualize the subsequent papers included in this issue of *Moral Cents*. It presents the main characteristics and the crucial challenges currently facing the Italian banking system.

1: The Italian Banking system

The Italian banking system is smaller than those of other European countries. According to the Central European Bank, in 2014 the Italian figure of MFIs' (Monetary Financial Institutions) assets as a percentage of national GDP was 2.3 compared to 3.1, the average of European Union countries. The Italian financial sector also appears smaller compared to the biggest European economies: France recorded a figure of 3.8, Germany 2.8 and the Netherlands 3.3.³

Figure 1: EU MFI's assets as a percentage of national GDP



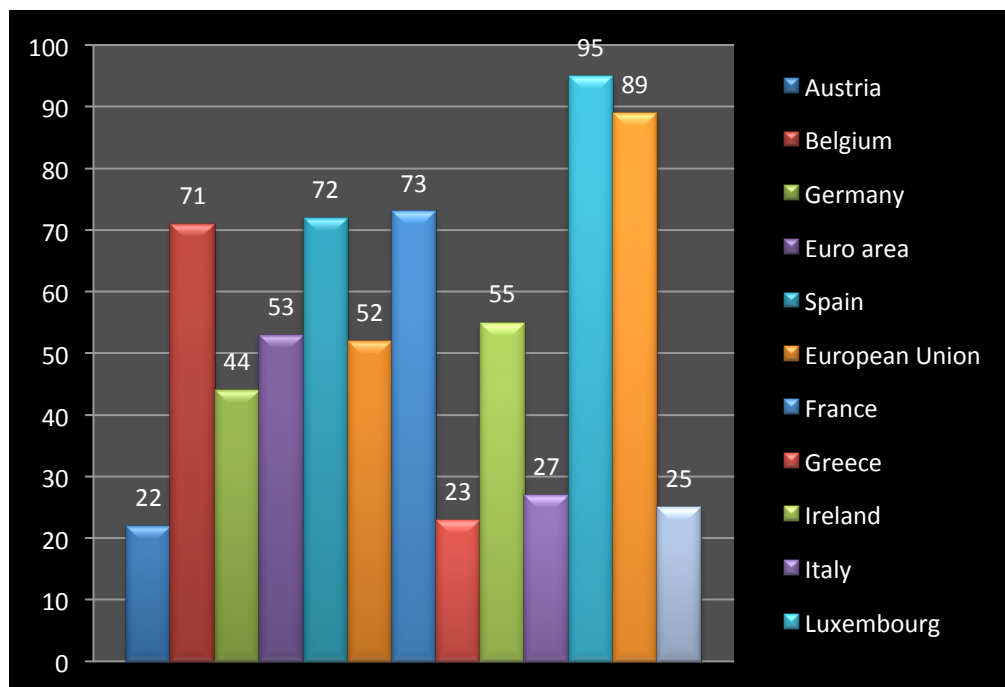
Source: European Central Bank, Report on Financial Structures, October 2015, p. 55

³ European Central Bank, Report on Financial Structures, October 2015, p. 55
<https://www.ecb.europa.eu/pub/pdf/other/reportonfinancialstructures201510.en.pdf>

Stock market capitalization is one of the most commonly used indicators of financial market development. The total value of a country's stock market capitalization represents the aggregate share price times the number of shares outstanding for listed domestic companies. Among the biggest economies in Europe, Italy recorded the lowest stock market capitalization over GDP.

In Italy, the financial bond between banks and enterprises is stronger than in other countries. In the pre-crisis period, around 20% of Italian banks' assets comprised of loans to commercial clients, while the average figure in Europe was 13%. In addition, 70% (against the average of 50% in Europe) of companies' debts were to banks.⁴

Figure 2: Stock Market capitalization as a percentage of GDP in 2014



Source: World Bank Dataset, Stock Market capitalization as a percentage of GDP

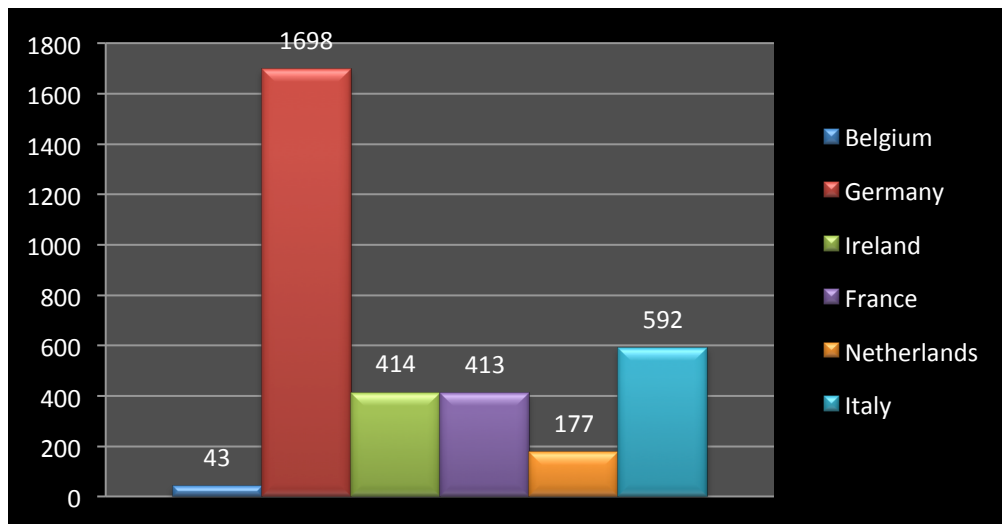
In addition to a low rate of stock market capitalization, Italy records high levels of private wealth and private savings. In 2014 the financial private wealth (bank accounts, bonds, shares, insurances and financial investments) of Italian families reached 3.858 billion euro. Such a figure is not only bigger by 400 billion euro from the figure registered in 2011 but it is also bigger than the

⁴ L. Signorini, *Banche e Imprese nella Crisi*, Banca d'Italia 2012, p.1-3
<https://www.bancaditalia.it/pubblicazioni/interventi-vari/int-var-2012/signorini-031012.pdf>

data recorded in 2006.⁵ However, as argued by several analysts, Italian families tend to invest their capital in long-term and not productive products like state's bonds. According to the Global Wealth Report published by Credit Suisse, in 2014 Italy ranked third in the top average wealth per adult rank. Behind Australia and Belgium, Italy recorded a figure of 142.000 euro per adult.⁶

Even though Italy has a high number of bank holding companies, it has an undercapitalized market. Compared to all other European countries, as seen in Fig. 3, Italy has many small and middle-sized banks that operate locally. Italy and Germany have similar banking structures. In 2014 the former had 592 bank holding companies while the latter had 1,698. In Germany, there are several small local savings banks (called *sparkasse*), domestically owned subsidiaries of German *landesbanks*. This means the number of German bank holding companies is actually smaller than the number of bank holding companies in Germany. Looking at the share of total assets owned by the Top 5 bank holding companies by country, Germany and Italy recorded the lowest percentage figures, 30.6% and 41% respectively (Fig. 4). These figures reflect the low level of concentration in the German and the Italian banking market. In 2014, according to Banca d'Italia, 70% of Italian banks were classified as local banks.⁷

Figure 3: Number of banks by nation in 2014



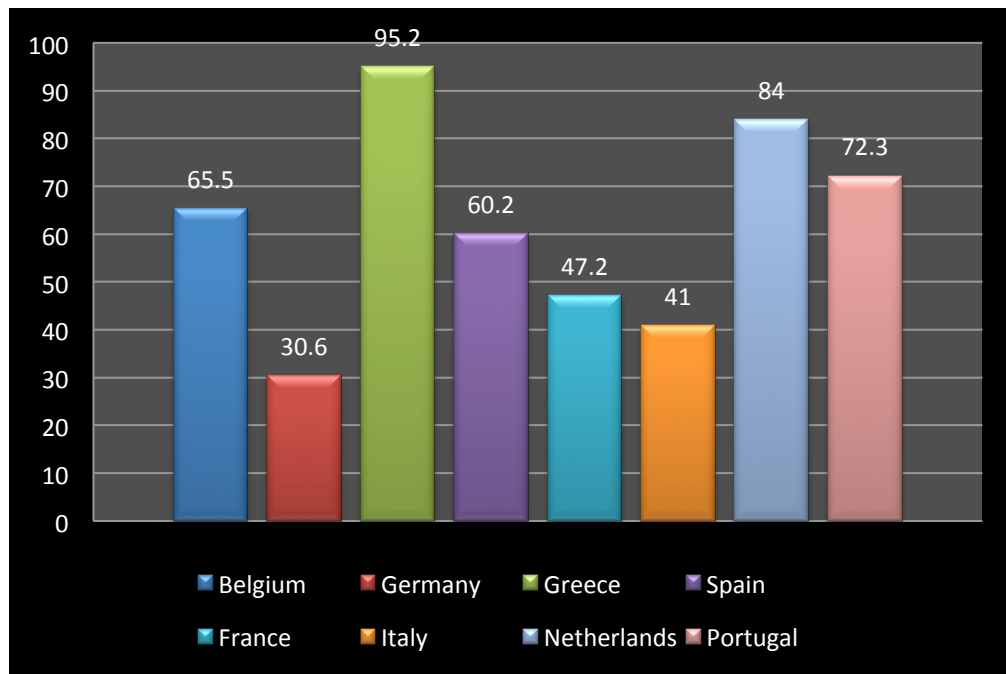
Source: European Central Bank, Report on Financial Structures, October 2015, p. 58

⁵ F. Pavesi, Il paradosso delle due Italie: ricchezza private record e debito pubblico ai massimi, Il Sole 24 Ore 30/10/2014

⁶ Global Wealth Report 2015, Credit Suisse, p. 33

⁷ Banca d'Italia, Questioni di Economia e Finanza, Le Banche locali e il finanziamento dei territori (2007-2014), March 2016, https://www.bancaditalia.it/pubblicazioni/qef/2016-0324/QEF_324_16.pdf

Figure 5: Percentage of assets owned by the TOP 5 bank holding companies in some European countries in 2014



Source: European Central Bank, Report on Financial Structures, October 2015, p. 59

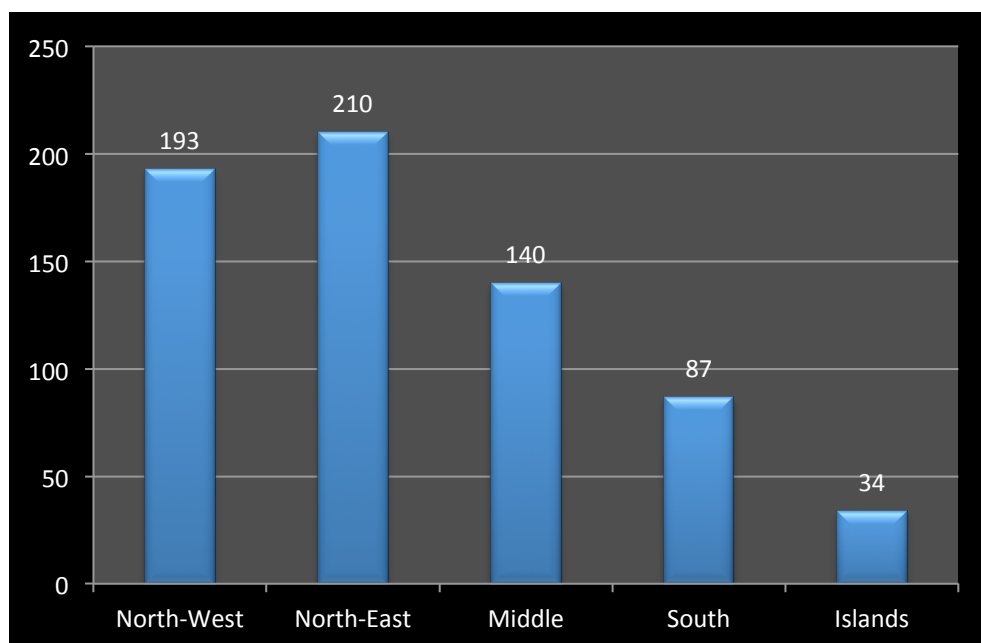
Until the 1990s, 75% of Italian banks were in public hands. The Amato Law in 1990 transformed the Italian banking system forcing “*publicly-owned banks to become joint stock companies and the formally private foundations that owned them.*”⁸ In 1998, the Ciampi Law made banks reduce the shareholdings of foundations to less than 50% to decrease the leverage of foundations and their connections with local political institutions. Since the 1990’s the Italian authorities have encouraged consolidation among banks. The aim was to reduce the number of small entities and to create a few big banks able to compete internationally. Between 1995 and 2007, there were 347 mergers and 395 purchases in the Italian banking system. During this period, three banks emerged as the leaders of the Italian market: Unicredit, IntesaSan Paolo and Monte dei Paschi di Siena.

Another crucial feature of Italy is the economic gap between the industrialized North and the South of the country. A serious economic inequality exists among Italian regions. In 2014 the average per-capita GDP in the North-East region was 30.497 euro per year, in the North-West 30.148 euro per year, in

⁸ M. Hallerberg and C. Gandrud, How not to create zombie banks: lessons for Italy from Japan, Policy Contribution Issue n.6 2017, Brugué, p.5

the Central regions, 26.156 euro, in the South 17.913 euro per year and in the Islands 17.632 euro. The per-capita GDP of Lombardia (located in the North-East of the country) was more than the double of the figure in Calabria (region in the South of Italy). This economic disparity is also reflected in the banking system. In the top 35 Italian bank holding companies by total assets, only two are in the South of Italy. Among the Top 10 bank holding companies, six are in the North-West region, one in the North-East region and three in the Central region. Milan, the financial centre of the country, hosts three of the Top 10 Italian banks. Bank holdings and foreign owned subsidiaries are concentrated in the productive regions of Italy.⁹

Figure 6: Number of banks by region in 2014

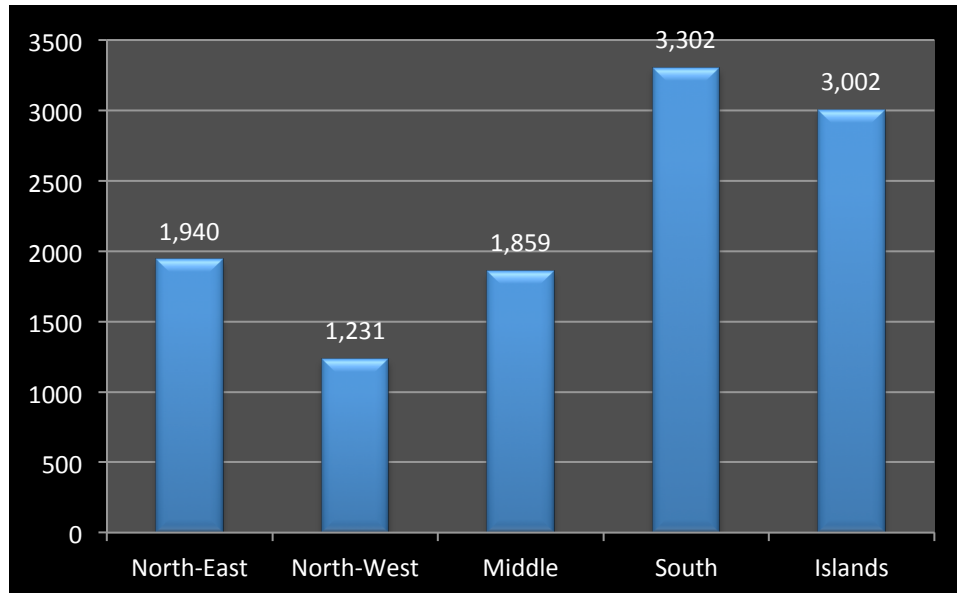


Source: Data elaborated by the author from different sources

The ratio of bank branches per region's population shows the lag in the Southern regions of the country. While the Southern regions and the islands had one branch for every 3,152 inhabitants, the rest of the country recorded a branch for every 1,676 inhabitants. The economic underdevelopment of the South of Italy is reflected in the lack of growth of the banking system.

⁹ Data elaborated by the author derived from different sources

Figure 7: Branches of banks per population by region in 2014



Source: Data elaborated by the author from different sources

2: Economic crisis and Italian banks

The structure of the Italian economy shows why the Italian stock market is undercapitalized. Because the country has many small and middle-sized companies that are unable to access capital in any stock exchange, banks need to allocate loans and capital to enterprises. Between 2000 and 2007 Italian companies increased their leverage (the relationship between financial debt and the sum of financial debt plus the equity of a company). Italian companies were enjoying a situation of easy access to credit whereby banks allocated funds to companies with high debt. Italy is the only big country in Europe in which banks allocate more credit to the corporate sector rather than the retail sector. In the EU, the average figure of companies' debts to banks is 68%. In France and Germany the average is 57% while in Italy it is 73%.¹⁰

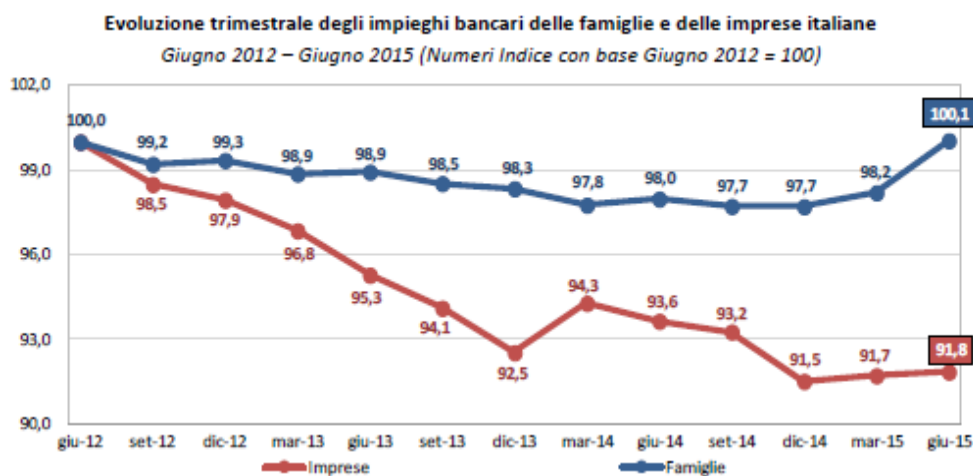
If enterprises rely on the banking sector to raise capital, the real economy and the financial market are co-dependent forces. When the financial crisis hit Italy, Italian banks started to decrease the access to credit to retail and corporate customers. According to Confcommercio, between 2011 and 2016 Italian banks reduced credit to the corporate sector by 117.8 billion euro. In

¹⁰ Focus, Settimanale del Servizio Studi BNL, n.8 March 2017, BNL
<http://www.bnpparibas.it/it/2017/03/07/bnl-focus-la-relazione-tra-banca-e-impresa-in-italia/>

particular, in 2014 small enterprises (with less than 500,000 euro of revenues) complained they received only one euro for every 8 euro in loans.¹¹

According to the Banca d'Italia statistics, between June 2012 and June 2015 access to credit for enterprises followed a constant downward trend. An index that uses June 2012 as a basis shows in June 2015, banks received 91.8 points of credit.

Figure 8: Trend of credits to families and enterprises between June 2012 and June 2015

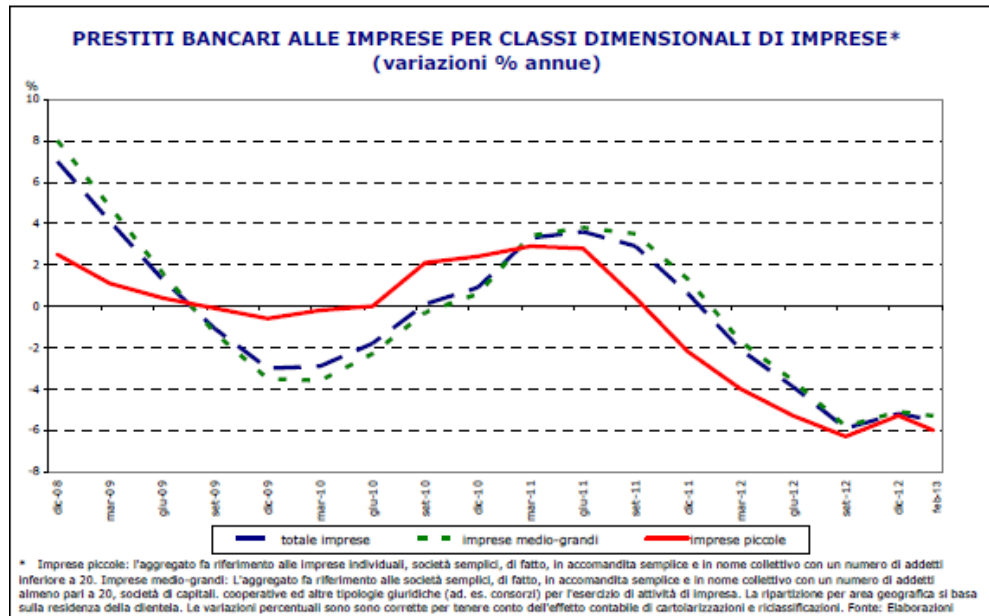


Source: Osservatorio permanente sui rapporti Banche-Imprese, Aprile 2013, p. 6

In addition, during the peak of the economic crisis (2008 and 2013), the percentage in the change of loans to enterprises shows the access to credits was restricted to both big and middle-small companies.

¹¹ F. Spini, Alle imprese 120 miliardi in meno, in 5 anni crollati i crediti alle banche, in La Stampa, 01/04/2017

Figure 9: Trend of credits to enterprises by size between 2008 and 2013



Source: Osservatorio permanente sui rapporti Banche-Imprese, April 2013, p. 6.

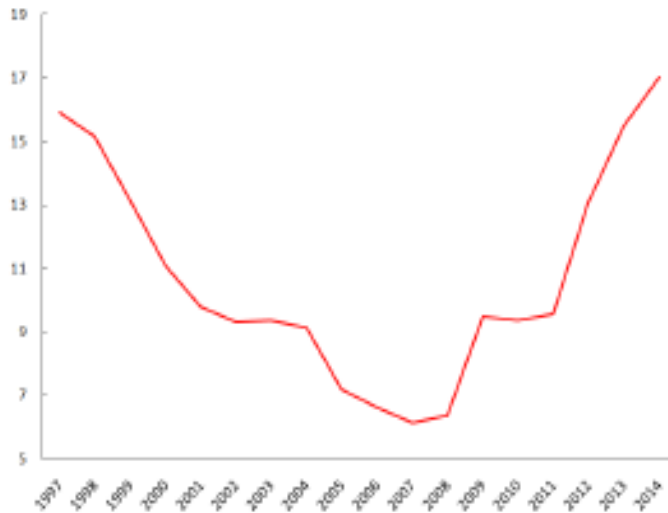
3: NPLs, the root of Italian financial instability

As recognized by principal economic organizations, NPLs are the problem issue in the Italian banking system. The IMF analyzed how the amount of NPLs in Italy might affect the economic growth of the country. From a theoretical point of view, NPLs may influence not only a bank's operations but also a national economy. High NPLs affect a bank in three ways: (i) They force the bank to focus on capital consolidation rather than providing new credits; (ii) They require the bank to allocate resources into provisions which reduce the liquidity for new operations; (iii) NPLs result in a misallocation of resources as the bank needs to allocate funds to cover its NPLs.

In June 2016, the value of NPLs in Italy reached the figure of 356 billion euro representing 18% of total loans of the country and 20% of the Italian GDP. To understand the full scale of the problem, Italian NPLs were 1/3 of the total NPLs in the Euro area. The amount of NPLs is so substantial that it is retarding Italian economic recovery.¹²

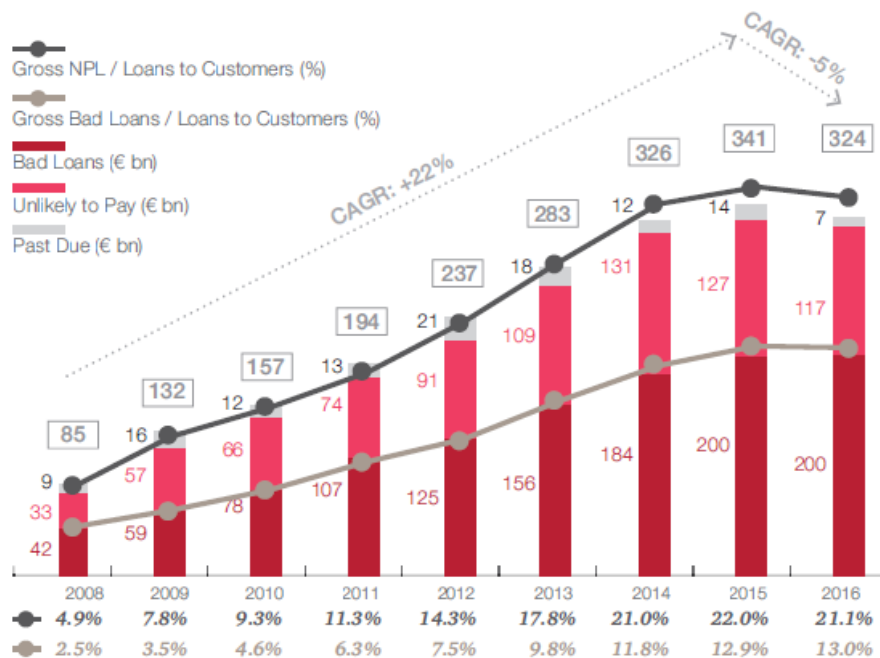
¹² The Italian NPL market, The Place to Be, PWC, July 2017, p.4

Figure 9: Evolution on NPL Ratio between 1993 and 2014



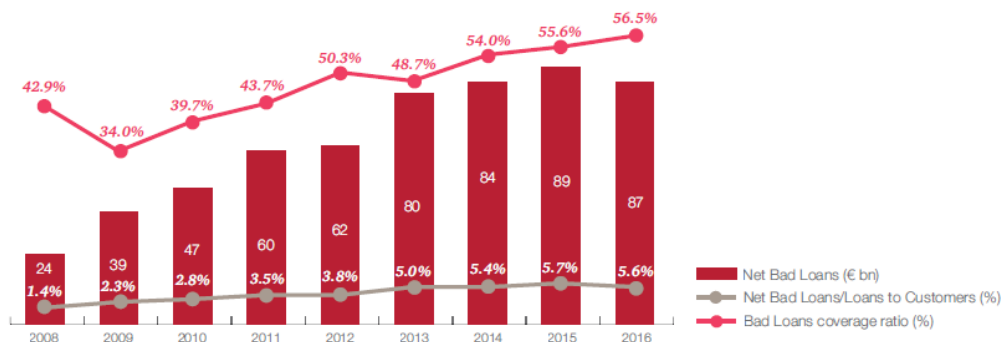
Source: K. Mohaddes, M. Raissi and A. Weber, Can Italy grow out its NPL overhang? A Panel Threshold Analysis, IMF Working Paper WP/17/66, March 2017, p.4

Figure 10: Analysis of bad loans between 2008 and 2016



Source: The Italian NPL market, The Place to Be, PWC, July 2017, p.17

Figure 11: Analysis of bad loans between 2008 and 2016



Source: The Italian NPL market, The Place to Be, PWC, July 2017, p.17

The sharp increase in NPL figures between 2008 and 2014 shows how fragile the Italian banking system is now. Most Italian businesses rely on loans to run their companies. They lack alternative sources of financing themselves. Until the issue of NPLs is solved, Italian enterprises cannot escape the consequences of restricted credit. If the issues with NPLs are not resolved, a large roadblock stands in the way of Italian economic recovery.

Conclusion

Before the financial crisis hit Italy, regulators and governments were not deeply concerned about the limits of the Italian banking system. Once its issues were disclosed, the Italian banking system has become a threat to the European banking sector. The three main specifics of Italian banking are:

- 1) The high number of bank holding companies in the country. Since the 1990s, governments have encouraged mergers between banks to increase the average size of Italian banks. Between 1996 and 2015, the number of banks decreased from 936 to 700.
- 2) The underdevelopment of the Italian stock market has created a special relationship between Italian banks and local enterprises. Due to the economic crisis of 2007-2008, banks and companies have drastically reduced the flow of money (deposits-loans), which allowed the system to work.
- 3) The high level of NPLs threatens the survival of the Italian banking system. NPLs not only decrease the sources available to a bank to finance new operations but they force banks to create allowances in order to cover their non-performing loans losses.

Bibliography:

Focus, Settimanale del Servizio Studi BNL, n.8 March 2017, BNL

Global Wealth Report 2015, Credit Suisse

Italy Country Report July 2016, International Monetary Fund

Navigating the Italian credit opportunity. Non-performing loans and new credit tools, Ernst & Young 2017

Osservatorio permanente sui rapporti Banche-Imprese, Rapporto Trimestrale, Aprile 2013

Questioni di Economia e Finanza, Le Banche locali e il finanziamento dei territori (2007-2014), March 2016, Banca d'Italia

Report on Financial Structures, October 2015, European Central Bank

The Italian NPL market, The Place to Be, PWC, July 2017, p.17

R. De Bonis, Al. F. Pozzolo and M. Stacchini, The Italian banking system: Facts and interpretations, in Economics & Statistics Discussion Paper No. 068/12

M. Hallerberg and C. Gandrud, How not to create zombie banks: lessons for Italy from Japan, Policy Contribution Issue n.6 2017, Bruegel

K. Mohaddes, M. Raissi and A. Weber, Can Italy grow out its NPL overhang? A Panel Threshold Analysis, IMF Working Paper WP/17/66, March 2017

F. Pavesi, Il paradosso delle due Italie: ricchezza private record e debito pubblico ai massimi, Il Sole 24 Ore 30/10/2014

L. Signorini, Banche e Imprese nella Crisi, Banca d'Italia 2012, p.1-3

F. Spini, Alle imprese 120 miliardi in meno, in 5 anni crollati i crediti alle banche, in La Stampa, 01/04/2017

M. Udland, Here's everything the FED is worried about right now, 17/007/2016, in UK Business Insider