Italian banks: funding and liquidity solid against challenging backdrop

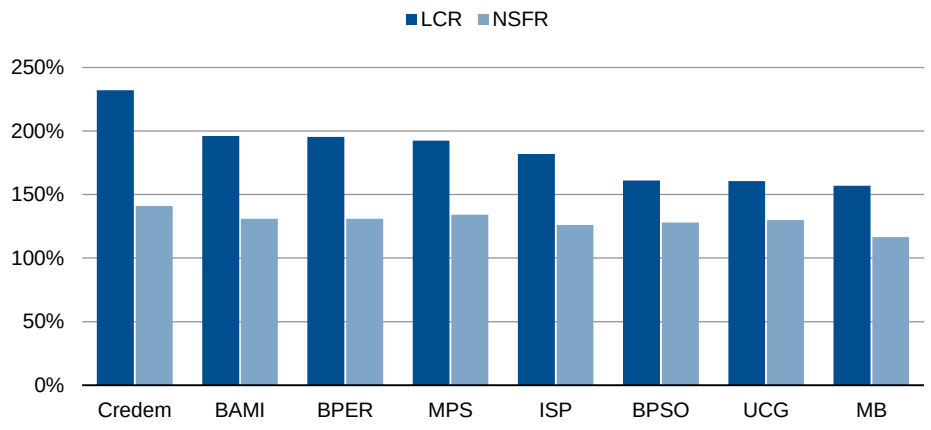
Italian banks' funding and liquidity profiles are sound, with a prevalence of stable retail deposits and conservative interest-rate risk management setting them apart from the recent banking turmoil. Low reliance on wholesale funding mitigates the impact even more.

Italian banks' liquidity ratios are above the EU average. The regulatory prism on funding and liquidity supports our constructive view. The Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) are well above the 100% requirements for Italian banks, and we expect them to remain at a safe distance above requirements.

Italian lenders have a much higher proportion of customer funds covered by the deposit guarantee scheme than the institutions that have recently faced high outflows. According to the latest data available (YE 2021), Italy's Interbank Deposit Protection Fund (FITD) covered 50% of all deposits in Italy.

We are not worried about the potential for unrealised losses on debt securities. Italian banks' High Quality Liquid Assets (HQLA) comprise a relatively high proportion of unencumbered government bonds for EU standards. However, banks hedge the sensitivity of their bond portfolio to changes in rates, limiting market losses. In any case, liquidity ratios consider securities at fair value, reflecting changes in market values.

Figure 1: Reassuring LCR and NSFR ratios as of YE 2022



Source: SNL, Scope Ratings
Note: BPSO and BPER as of Q3 2022

Large deposit base and low reliance on bond issuance softens funding pressure. Customer deposits remain close to the all-time high, which was reached in April 2022. So far, deposit repricing has been low, reflecting not only the abundance of deposit volumes but specific characteristics of the Italian savings market. For 2023, deposit beta should be around 20%-40% according to banks' conservative projections.

Although recent market volatility may hamper Italian banks' access to the wholesale market, issuance needs are low. The banks frontloaded part of their annual funding plans in the past two quarters, limiting their exposure to market turmoil.

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Regulatory funding and liquidity metrics well ahead of requirements

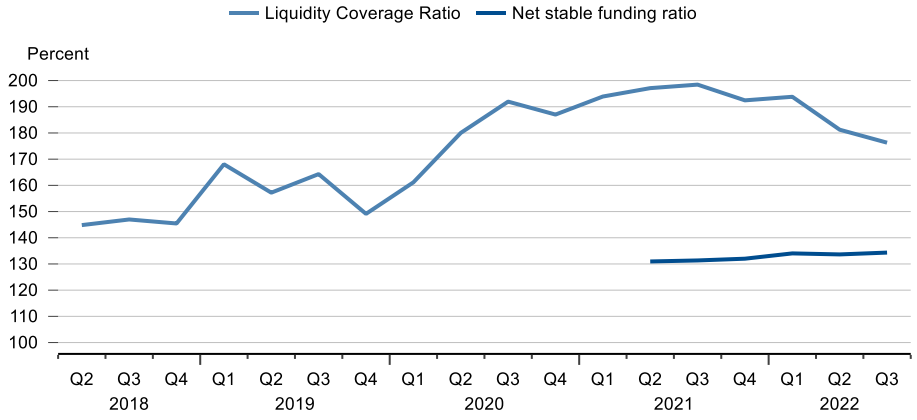
In our view, weak implementation in the US of Basel 3 rules on funding and liquidity played a role in the collapse of Silicon Valley bank, alongside poor risk management and a vulnerable business model. In Italy, funding and liquidity risks are tightly regulated and supervised within the EU Banking Union.

Italian lenders have historically maintained a significant buffer above minimum LCR requirements, at around c.200% on average, thanks mainly to TLTRO III. We expect LCRs to come to down to pre-pandemic levels by mid-2024 when Italian banks will have fully repaid their TLTRO III.

Banks keep their LCR well above the 100% requirement

However, the LCR will remain well above 100% across the board because banks are aware of how volatile this ratio is and have no appetite to test supervisory reactions to infringement. In addition, the need for banks to fund illiquid assets with long-dated stable sources of funding (for NSFR purposes) is an incentive to reduce short-term or less stable funding sources, which in turns supports the LCR. Italian banks typically run NSFRs of roughly 130%.

Figure 2: Italian banks' key liquidity indicators are well over the 100% requirement



Source: ECB, Macrobond, Scope Ratings
Note: banks started to disclose their NSFR in 2021

A closer look at Italian banks' LCR

On top of providing useful information about the short-term survivability of banks, LCR data provide useful disclosures around customer deposits.

Stable deposits make up almost 50% of Italian banks' total

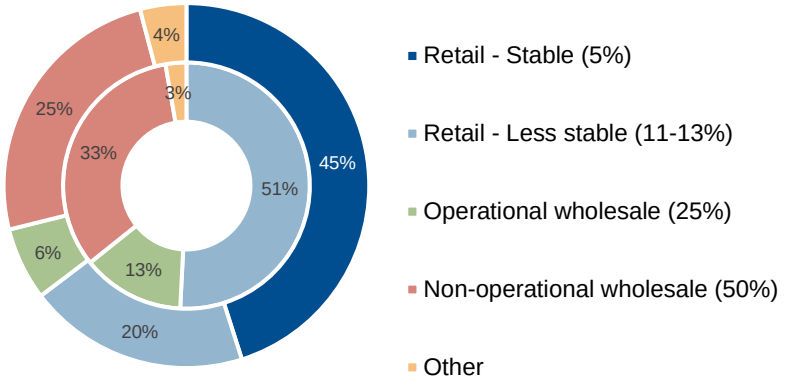
'Stable retail deposits' for the eight banks in our sample (Intesa Sanpaolo, UniCredit, Banco BPM, Banca MPS, BPER, Mediobanca, Credem, BP Sondrio) make up close to 45% of the total. By comparison, Credit Suisse had zero at YE 2022 (Figure 3). Stable retail deposits, defined as fully insured in transactional accounts and based on established relationships, are weighted at around 5%[1] on average in Italian banks' LCRs. Less stable retail deposits (uninsured, or more occasional customer relationships) are weighted at 12% on average in our sample.

More volatile wholesale deposits attract higher weights (25% for operational deposits and 50% for non-operational deposits) and are particularly demanding in terms of HQLA coverage; therefore, their run risk is well captured within the LCR framework.

[1] This means that under a 30-day liquidity stress scenario, banks calculate a maximum cash outflow from their 'Stable deposit' base of 5%.

The breakdown of deposits reflects banks' size, business model and reputation. Larger banks usually attract more uninsured deposits from SMEs and large corporates not only because of banking relationships but also because they are considered safer.

Figure 3: Italian banks (outer cycle) vs Credit Suisse (inner cycle) – Breakdown of customer deposits by type (including average weighting in LCR calculation) **



Source: Company data, Scope Ratings
**The higher the weight, the greater the assumed outflows in a 30-day stressed scenario
BAMI, UCG and ISP as of YE 2022. The others as of Jun-22

As of Q3 2022, around 60% of Italian banks' HQLA were either cash or reserves deposited at the central bank, in line with the EU average (Figure 4). Almost 30% was accounted for by government bonds, the highest among peer European banking sectors.

Following the collapse of SVB, concerns have arisen about hidden losses from banks' debt securities portfolios, most of which are held at amortised cost. In the LCR, securities are treated at fair value and selling them at a loss erodes earnings and capital.

We remain constructive on Italian banks for two main reasons:

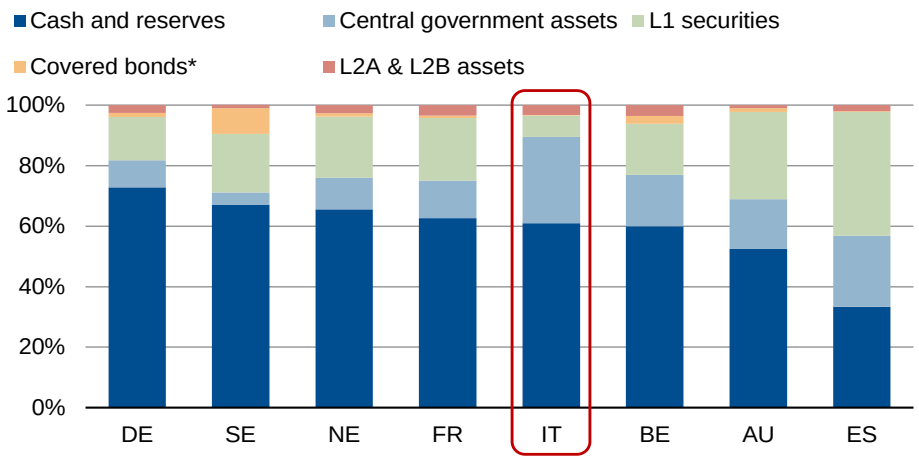
Interest risk on bond portfolio is hedged

1. Banks manage interest-rate risk in their banking book through the swap market or by buying more floating-rate bonds. As of YE 2022, the duration of Intesa's Italian sovereign bond portfolio, for instance, was cut to just 0.4 years from 6.1 years as a result of hedging activity.

   Italian banks do remain exposed to BTP-Bund spread widening. Over the past 12 months, the BTP-Bund spread has averaged about 200bp. As of early April 2023, the spread was 180bp.

2. Banks can use government securities as collateral to obtain funding via the private repo market and central bank funding facilities, thereby avoiding selling at loss.

Figure 4: European banks – breakdown of HQLA



Source: EBA, Scope Ratings
*Extremely high quality covered bonds

Competition for deposits is low in Italy

Two-thirds of Italian banks' funding derives from customer deposits. At country level, deposits peaked at EUR 2.42trn in April 2022, remaining close to that level in the following months. As of January 2023, they amounted to EUR 2.37trn.

Italian banks' deposit beta is one of the lowest in Europe

So far, banks have greatly benefited from rate hikes because deposit repricing has been muted while asset spreads have widening significantly. Italian banks' deposit beta is one of the lowest in Europe, standing at 6% as of January 2023.

There are three main factors behind such low deposit beta:

(i) banks still have plenty of liquidity from TLTRO III and from customer deposits, which increased materially during the pandemic due to high savings rates. For the time being, banks are not chasing deposits;

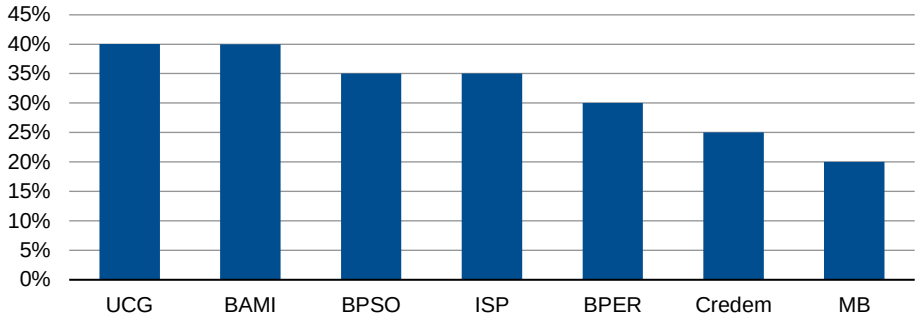
(ii) current accounts, which are not typically remunerated, make up 60% of total customer deposits;

(iii) there is no/little competition from money-market funds.

Against this backdrop, banks have provided rather conservative forecasts on deposit beta for 2023 of 20%-40% (Figure 5).

Q1 deposit volumes will be of primary interest to market participants. Although not strictly necessary for funding and liquidity, we believe that banks will try to avoid incurring a marked decline in customer funds considering the recent turmoil.

Figure 5: Italian banks – Management guidance on 2023 deposit beta

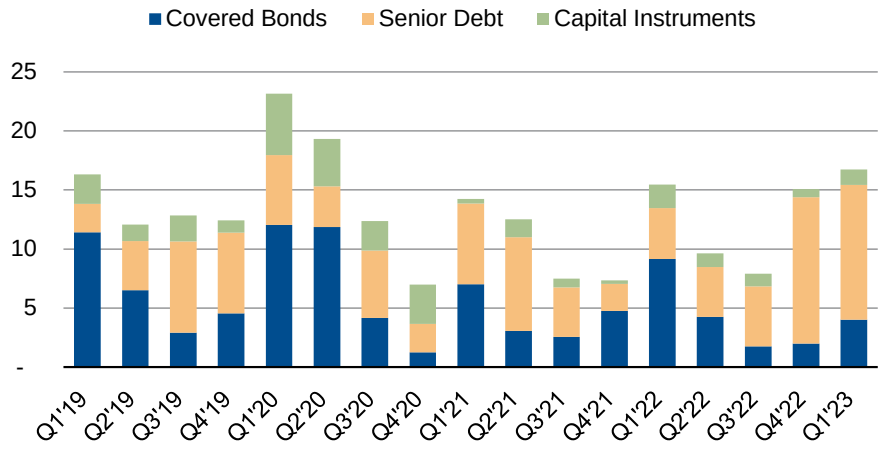


Source: Company data, Scope Ratings
Note: Intesa gave a 30-40% range

Little need for bond issuance lowers funding pressure in the coming quarters

After a muted year, issuance activity rebounded in 2022. Italian banks issued EUR 50bn of new debt (including retained issuance, particularly of covered bonds). Between Q4 2022 and Q1 2023, banks took advantage of benign bond market conditions to frontload their annual funding plans (Figure 6). Issuance was dominated by senior debt issuance for MREL purposes. Given the large deposit base and recent issuance activity, the need for wholesale debt remains low for the time being.

Figure 6: Italian banks* – Quarterly debt issuance, historical



Source: Company data, Scope Ratings
*Data refer to the eight banking groups in our sample, including subsidiaries, and include retained issuance

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