Overview of the Italian banking system

Research Department - Banking Sector Research
July 2019

The Italian banking system: stronger and resilient

Soundness and resilience

- **Very good results in de-risking**. The financing needs of Italian banks are still largely satisfied by customer deposits. Capital ratios increased significantly in 2017, then went slightly down in 2Q2018 due to the impact on regulatory capital of the drop in the price of government securities, and recovered a little in 2H.
- In the stress test exercise, Italian banks demonstrated resilience under the adverse scenario. The results acknowledge an overall strengthening in the soundness of the four Italian banks included in the sample.

The legacy of NPLs

- Improvement in asset quality. The default rate of loans has reduced even below pre-crisis. Since end-2016, **net bad loans have decreased by 62%** or 54Bn, to 33Bn in April – May 2019, and 1.9% of total loans. Risk reduction accelerated in 2018. NPL **cash coverage is well above European average.**
- The **creation of a market for NPLs** has made a great progress, thanks to several operations of sale and securitisation, while other transactions are in the pipeline.

Profitability

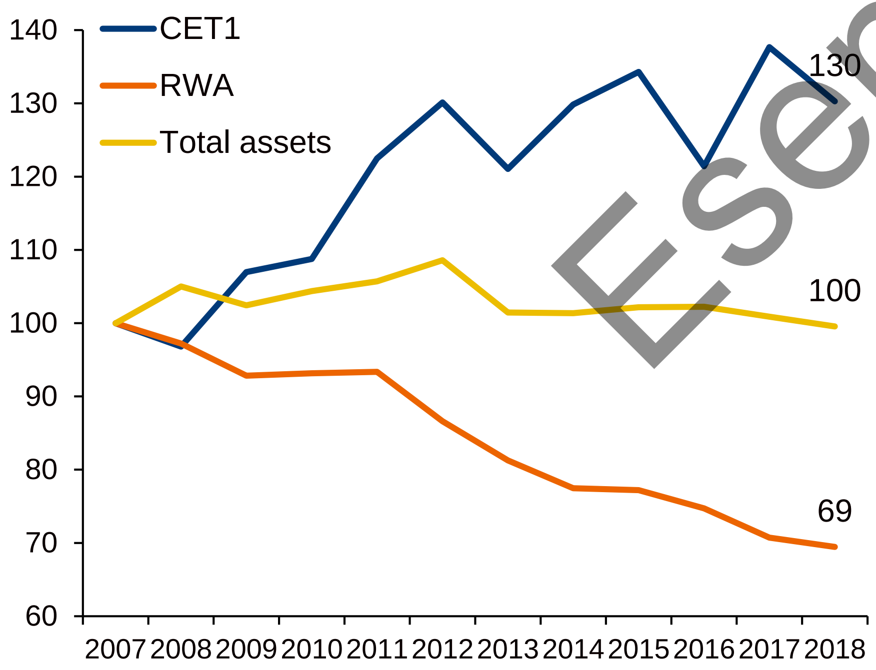
- **Profitability improved in 2017-18**: ROE rose to 6.2% in 2018 for significant banks, and to 5.7% for the sector overall, mostly thanks to fewer loan loss provisions and reduction in operating costs.
- **Credit conditions have turned less favourable**, as credit supply slightly tightened in 4Q18 and rates on new loans started increasing. Loans to households are growing at a constant pace while loans to non-financial companies plunged at the start of 2019, partly due to a base effect, but signs of weakness emerged in late 2018 too.
- Italian banks are in a better position than European peers in terms of **income diversification**. Anyway, more efforts on efficiency are needed.
- Corporate governance reforms enable consolidation, thus helping in achieving greater efficiency. **Two mutual banking groups were born in 2019**.

Agenda

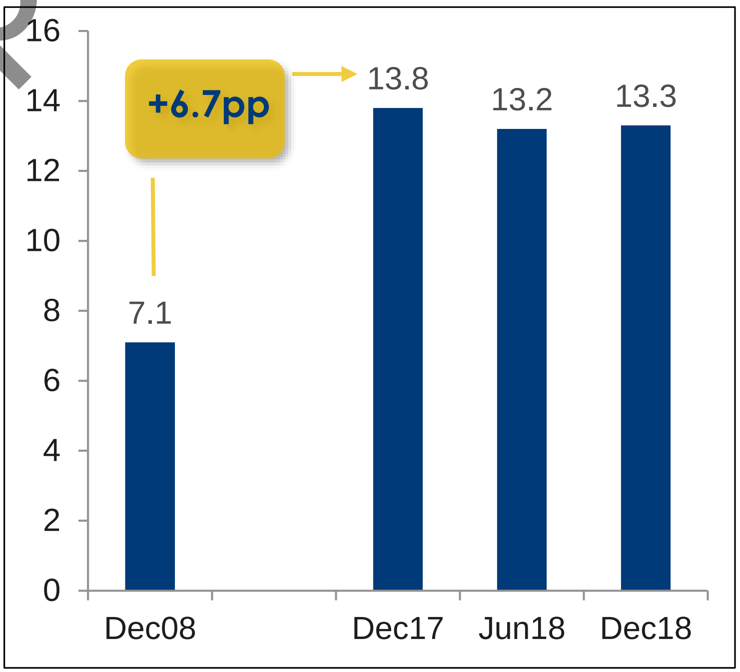
CET 1 ratio almost doubled in 10 years

- At end-2018, CET1 ratio amounted to 13.3%, up by 10bps vs. June. The increase was mainly related to less significant banks, whose CET1 ratio rose by about 30bps to 16.5%, partly on account of the reduction in RWAs resulting from the decline in NPLs.
- This improvement followed the drop in June 2018, when the CET1 ratio went down by -60bps vs. end-2017, partly due to the impact on capital of the decrease in prices of government bonds (-40bps in 2Q2018 for the sector).

Trend in CET1 and RWAs of Italian banks
(%, 2007=100)



CET 1 ratio (^) (%)



(^) Core tier 1 ratio at 2008

Source: Bank of Italy

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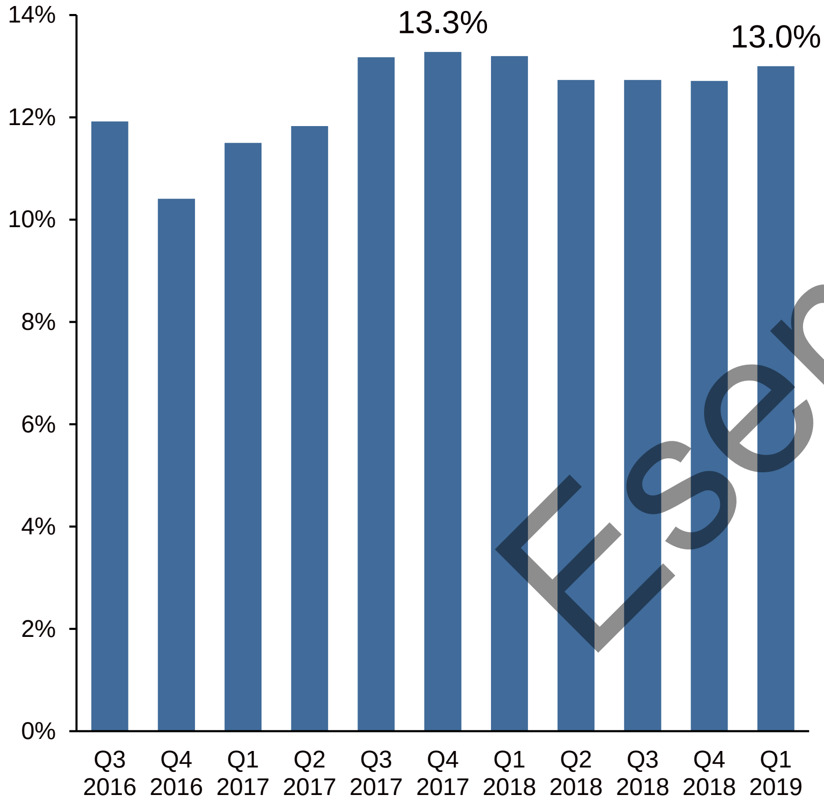
CET 1 ratio of significant banks back up to 13% in 1Q2019

CET 1 ratio of Significant banks



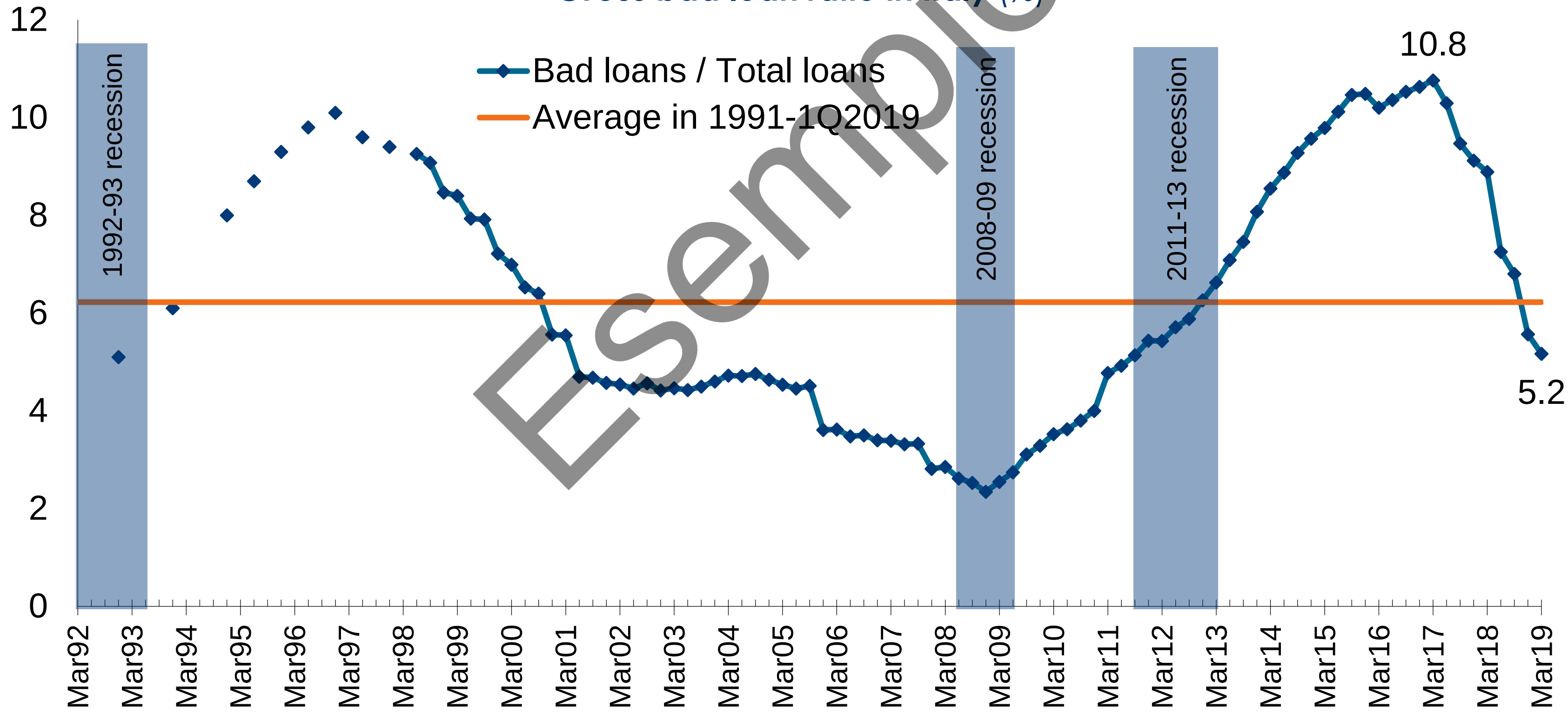
Source: ECB

- **CET1 ratio of significant banks back up to 13% in 1Q2019** following stability in 2H2018 at 12.7%.
- In 2Q2018 it went down by almost 50bps to 12.7% due to the drop in capital, which was affected by the decrease in prices of government securities. Differently, in 3Q2018 the impact of the reduction in the fair value of government securities was offset by the decrease in RWAs.

Bad loan ratio below long-term average

- Historical bad loan ratio equal to 6.2% gross of provisions (from 1991 up to date), in line with pre-crisis level (6% in 1991-2006). Currently, **bad loan ratio is below long-term average** and more than halved from the peak of 10.8% in March 2017.
- Without the double-dip recession the ratio would have remained at physiological level (the ratio was equal to 5.4% at end-2011).

Gross bad loan ratio in Italy (%)

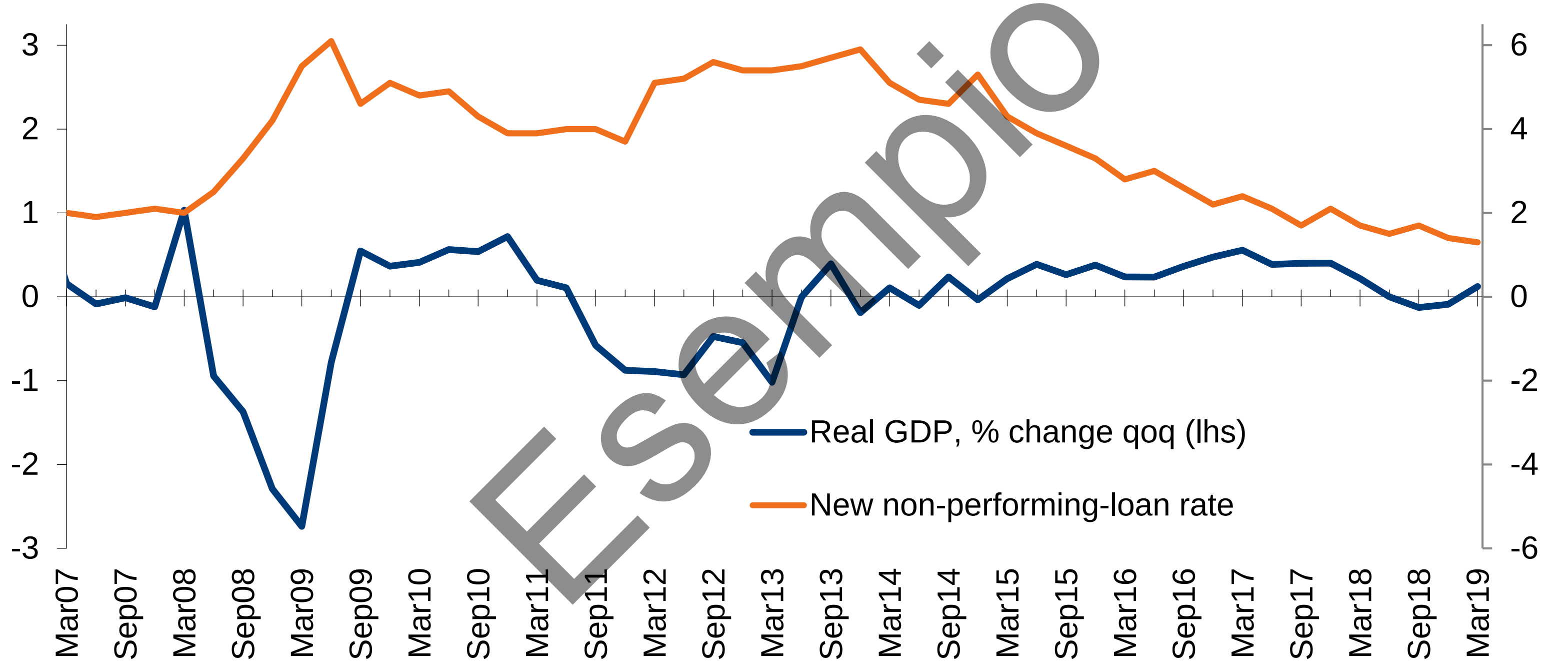


Source: Bank of Italy, Intesa Sanpaolo Research Department calculations

New NPL rate has declined to even below pre-crisis level

New NPL rate continued to decrease in 1Q2019, at the all time low of 1.3%, of which 1.9% for firms and 1% for households (1.6% on average in 2018).

Trend in the loan default rate and GDP (%) (*)



Note: (*) Flow of non-performing loans during a four-quarter period (past due exposures, other impaired exposures and bad loans) as a ratio to total performing loans twelve months before.

Source: Bank of Italy, Istat and Intesa Sanpaolo Research calculations

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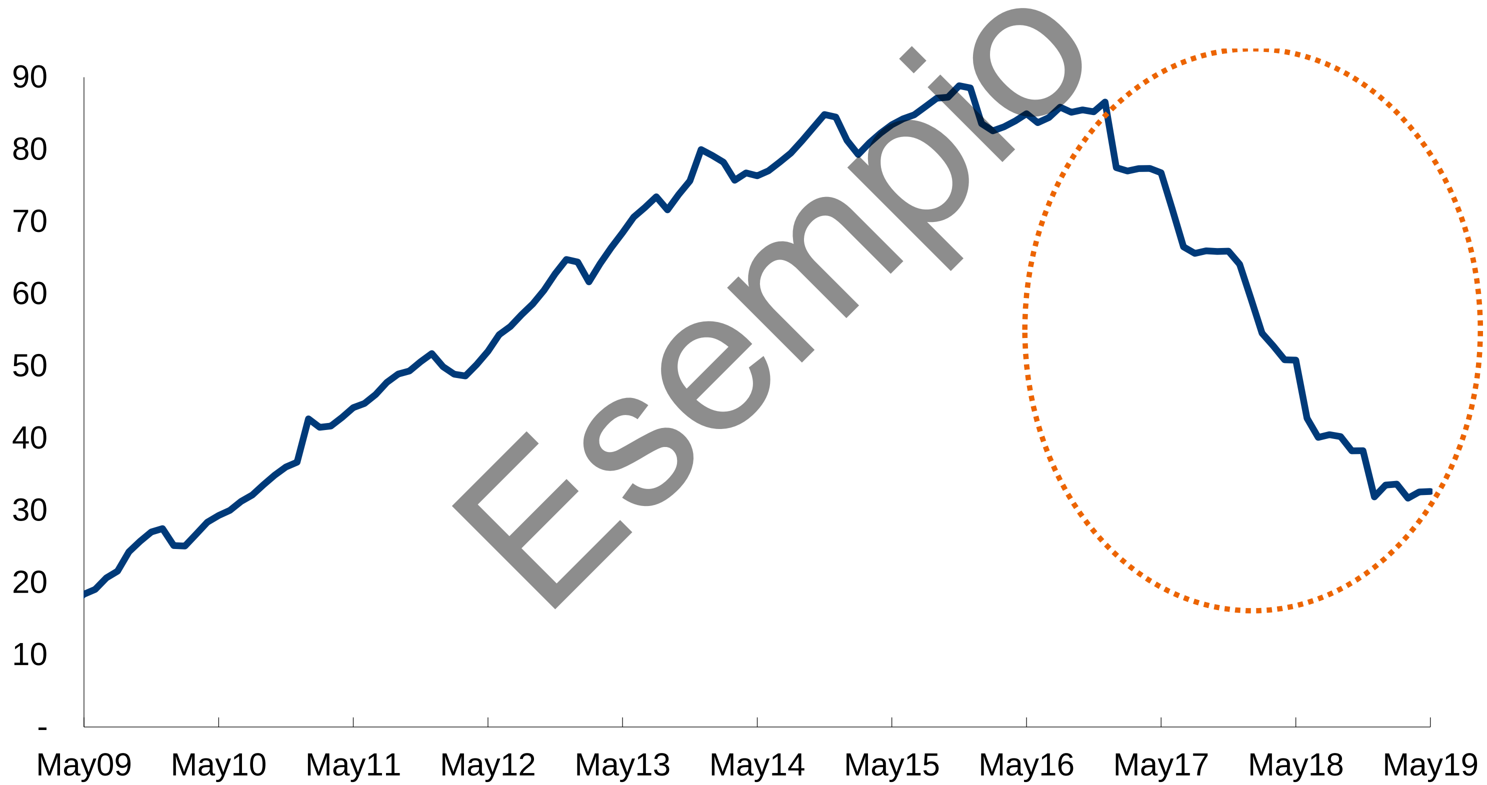
Stock of net bad loans down by almost 2/3 in two years

Since end-2016, the stock of net bad loans has fallen by 62% and 54Bn, to almost 33Bn in April and May 2019 and 1.9% of total loans, which is a low since September 2010 (-3.0 pp vs. end-2016).

Trend in net bad loans (EUR Bn)



Source: Bank of Italy

Overall, in 2018 the stock of NPLs declined by 71Bn gross of provisions and by 39Bn net of provisions

- NPL disposals carried out in 2018 exceeded the amount that banks had set out to sell at the start of that year.
- According to Bank of Italy estimates, based on banks' NPL reduction plans, the net NPL ratio will fall to 3.9% by the end of 2019 and to 3.1% in 2021.

Non-performing loans on a consolidated basis for banking groups and individually for the rest of the system

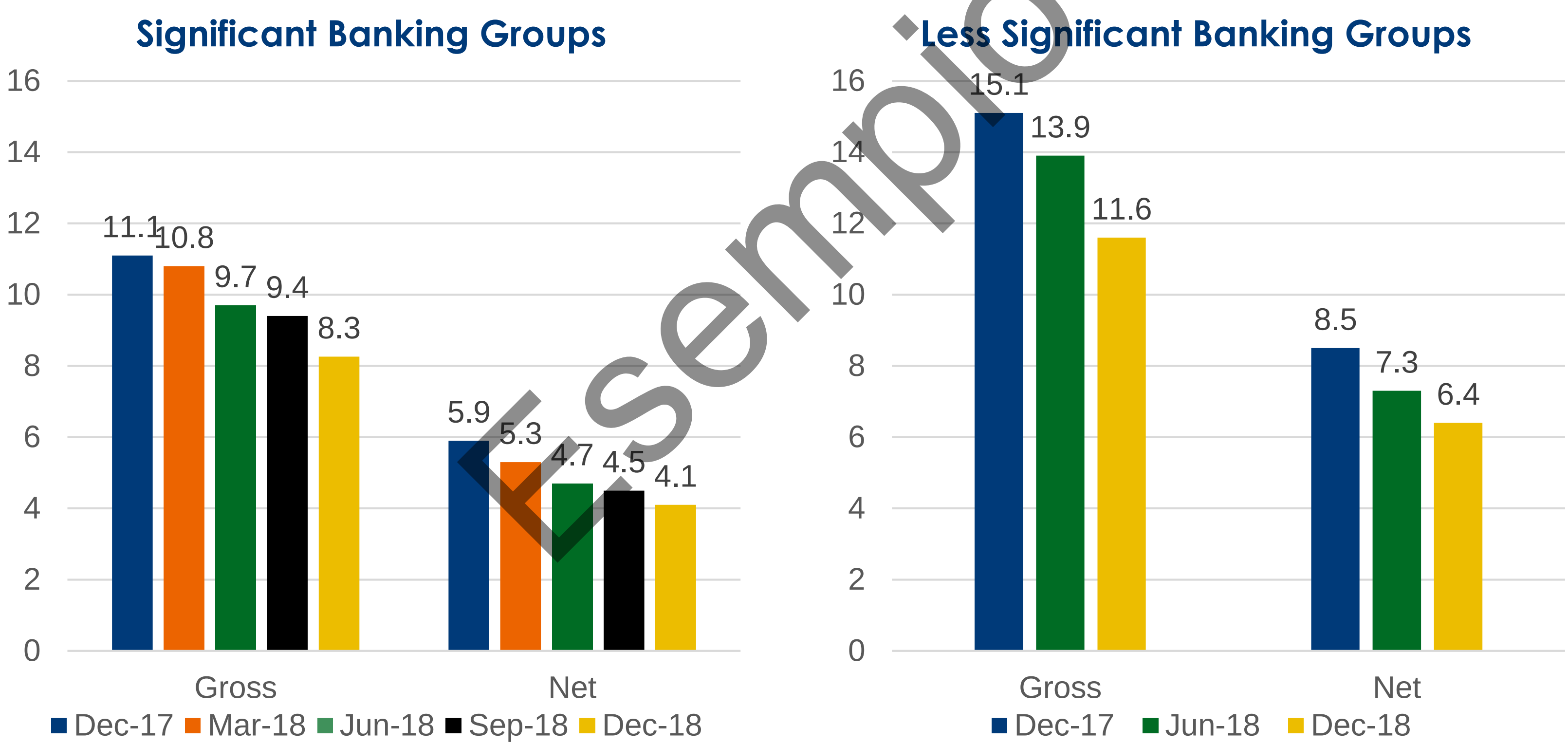
	Amount in EUR Bn						% on total loans						Coverage ratio		
	Gross			Net			Gross			Net					
	Dec-2017	Dec-2018	yoy % chg	Dec-2017	Dec-2018	yoy % chg	Dec-2017	Dec-2018	yoy chg	Dec-2017	Dec-2018	yoy chg	Dec-2017	Dec-2018	yoy chg
NPLs	260	189	-27.3%	129	90	-30.2%	11.5	8.7	-2.8	6.1	4.3	-1.8	50.2	52.7	2.5
Bad loans	154	102	-33.8%	59	35	-40.7%	6.8	4.7	-2.1	2.8	1.7	-1.1	61.6	65.4	3.8
Unlikely to pay	100	83	-17.0%	66	51	-22.7%	4.4	3.8	-0.6	3.1	2.4	-0.7	33.9	38.9	5.0
Past due	6	5	-16.7%	5	4	-20.0%	0.3	0.2	-0.1	0.2	0.2	0.0	21.4	23.2	1.8

Source: Bank of Italy and Intesa Sanpaolo Research

NPL reduction was sizable also for less significant banks

- The drop continued throughout the year:
  - in 1Q2018 especially in net terms, due to the adoption of IFRS9;
  - in 2Q and 4Q, largely due to sales and securitisations of bad loans, which were already heavily written down.

NPL ratio according to ECB methodology (*) (%)

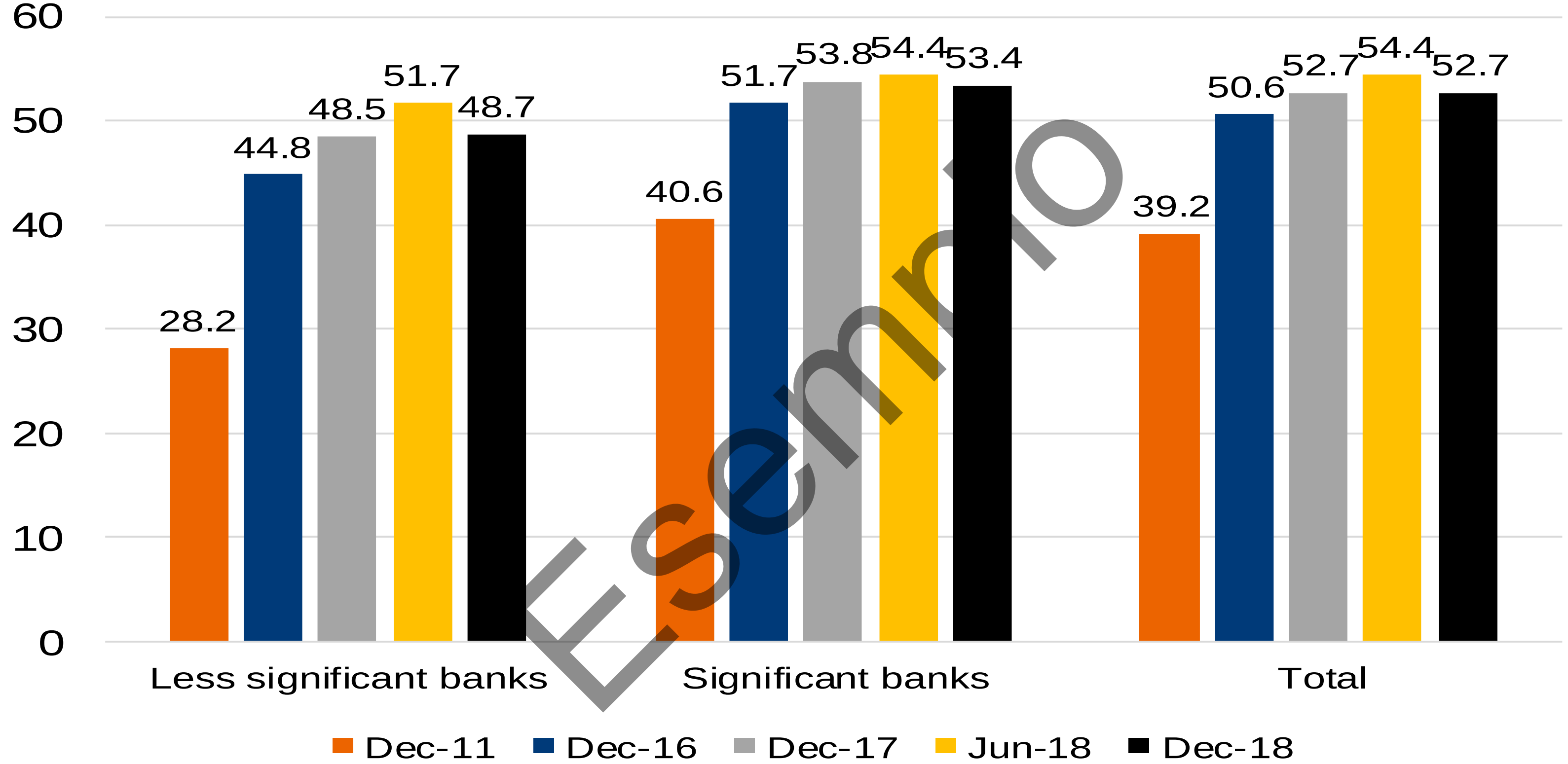


Note: (*) According to ECB methodology, the NPL ratio is lower than in previous publications by the Bank of Italy. In ECB methodology, interbank exposures and exposures to central banks are included while non-current assets and disposal groups held for sale are excluded.

Source: Bank of Italy

NPL coverage slightly decreased in 2H18 due to sales of bad loans …

NPL coverage ratios (%) (*) (**)



Note: (*) Significant banks are 11 banking groups under the direct supervision of the ECB; Less significant banks are those supervised by the Bank of Italy in close cooperation with the ECB. The total includes subsidiaries of foreign banks that account for about 10% of total gross customer loans.

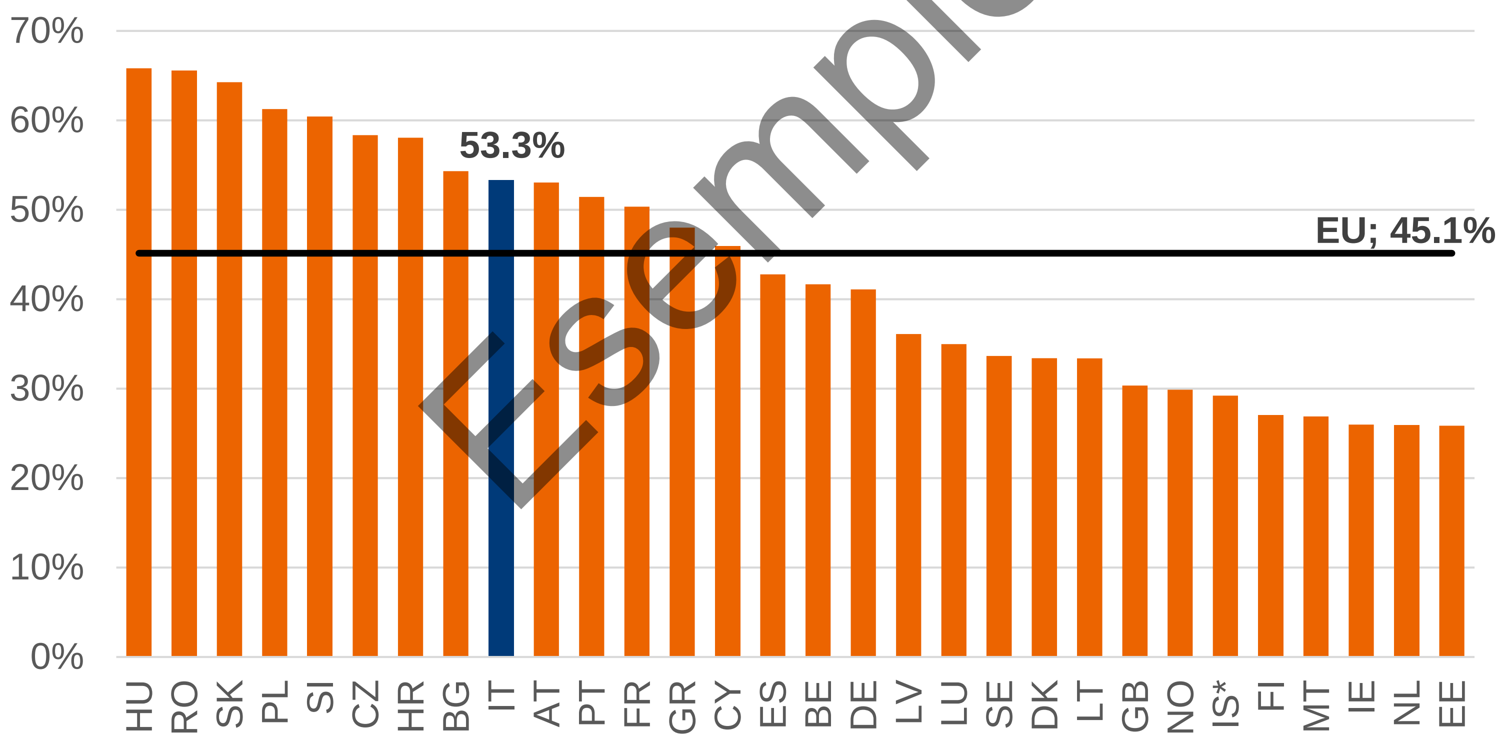
(**) NPL coverage since June 2018 is based on the ECB methodology, according to which interbank exposures and exposures to central banks are included while non-current assets and disposal groups held for sale are excluded from NPLs.

Source: Bank of Italy

… though remaining well above the European average

- The adoption of the new IFRS 9 as of 1 January 2018 led to a **marked increase in the coverage ratio** for NPLs, **which rose to 55.4% in the first quarter 2018**, from 50.6% at the end of 2017, calculated according to the ECB Methodology.
- In 2Q2018 and 4Q2018, as a result of NPL sales, the coverage ratio of the significant banking groups fell by 1.0 p.p. each quarter to 53.4%, then it remained **stable in 1Q2019**.

NPL coverage ratios 1Q 2019 (%)

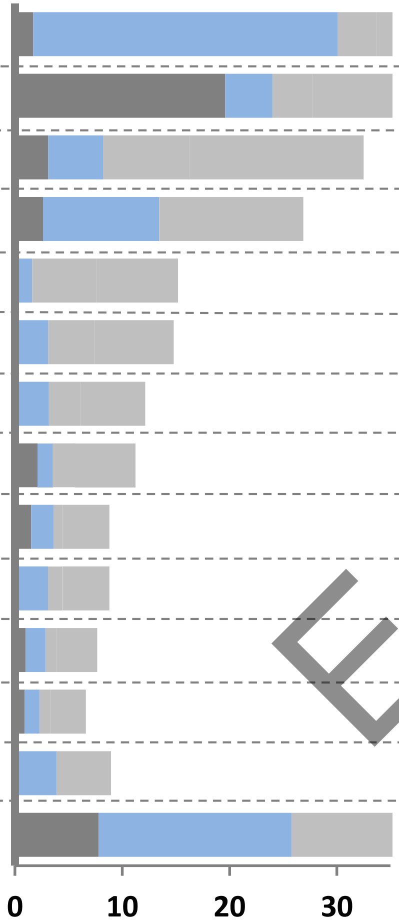


Source: EBA Risk Dashboard

Almost 90Bn of gross NPL sales and securitisations in 2018, more than double in 2017. Over 35Bn in the pipeline

Major NPL transactions closed in 2017-18 and announced for the coming years

Gross of provisions. EUR Bn



Bank	Closed in 2017	Closed in 2018	In the pipeline 2019-2021	ow in 2019
Monte dei Paschi di Siena	1.7	28.4	3.6	2.6
UniCredit	19.6	4.4	3.7	0.3
Banco BPM	3.1	5.1	8.1	7.4
Intesa Sanpaolo	2.6	10.8		0.2
Crédit Agricole	0.2	1.4	6	6
Gruppo bancario Iccrea	-	3.1	4.2	0.04
UBI Banca	-	3.2	2.9*	
Gruppo Banca Carige	2.1	1.4	2.1	2.1
Gruppo Bancario Credito Valtellinese	1.5	2.1	0.8	
BPER: Banca	0.1	3.0	1.3	1.3
BNL Gruppo BNP Paribas	0.9	1.9	1	1.0
Cassa Centrale Banca Gruppo Bancario	0.9	1.4	1.0-1.1	1.0
Other banks **	0.3	3.6	0.6	0.6
Failed / rescued banks ***	7.8	18.0		
Total	40.9	87.7	35.3	

Note: (*)Total reduction includes internal workout (**) Small-sized transactions by less significant banks: in 2017 Popolare di Bari (0.3 bn); in 2018 Banco Desio (1bn), Cassa di Risparmio di Volterra (0.3bn) and Banca Intermobiliare (0.6bn), Credem (0.08bn), multisecurization of 16 Popolari Banks (1.6bn); in 2019 Banca del Fucino (0.3bn), Banca Valsabbina (0.15), Centromarca (0.05), BCC Monsile (0.03), BCC Banca Centropadana (0.032)

(***) Transactions originated by failed/ rescued banks, including: in 2017 Banca Etruria, Banca Marche and Carichieti (4.0bn), Banca Carim, Carismi and Cassa Risparmio Cesena (3.0bn), and Carife (0.8bn), in 2018 Banca Popolare di Vicenza e Veneto Banca (18bn)

Source: Intesa Sanpaolo Research Department on Company data.

The creation of a market for NPLs has made a great progress

Major NPL transactions in 2019

Buyer	Type of transaction	Portfolio GBV EUR bn	# of transactions
ELLIOTT	Securitisation (95% junior & mezzanine tranche by Elliott)	7.4	1
BANCA IFIS	Disposals	1.4	n.a.
UnipolReC	Disposal	1.3	1
Banca Guber	1 Securitisation (minor part of junior tranche with Varde) + 4 disposals	1.0	5
BainCapital	Disposal	0.9	1
Värde Partners	2 Securitisations	0.8	2
illimity	3 disposals + 1 securitization	0.7	4
MBCredit Solutions	2 Disposalsl	0.2	2
Barclays	Securitisation (untranched assets with Varde)	0.1	1
B2Kapital	Disposal	0.0	1
Balbec Capital LP	Disposal	0.0	1
Total		**13.9**	

Major NPL transactions in 2018

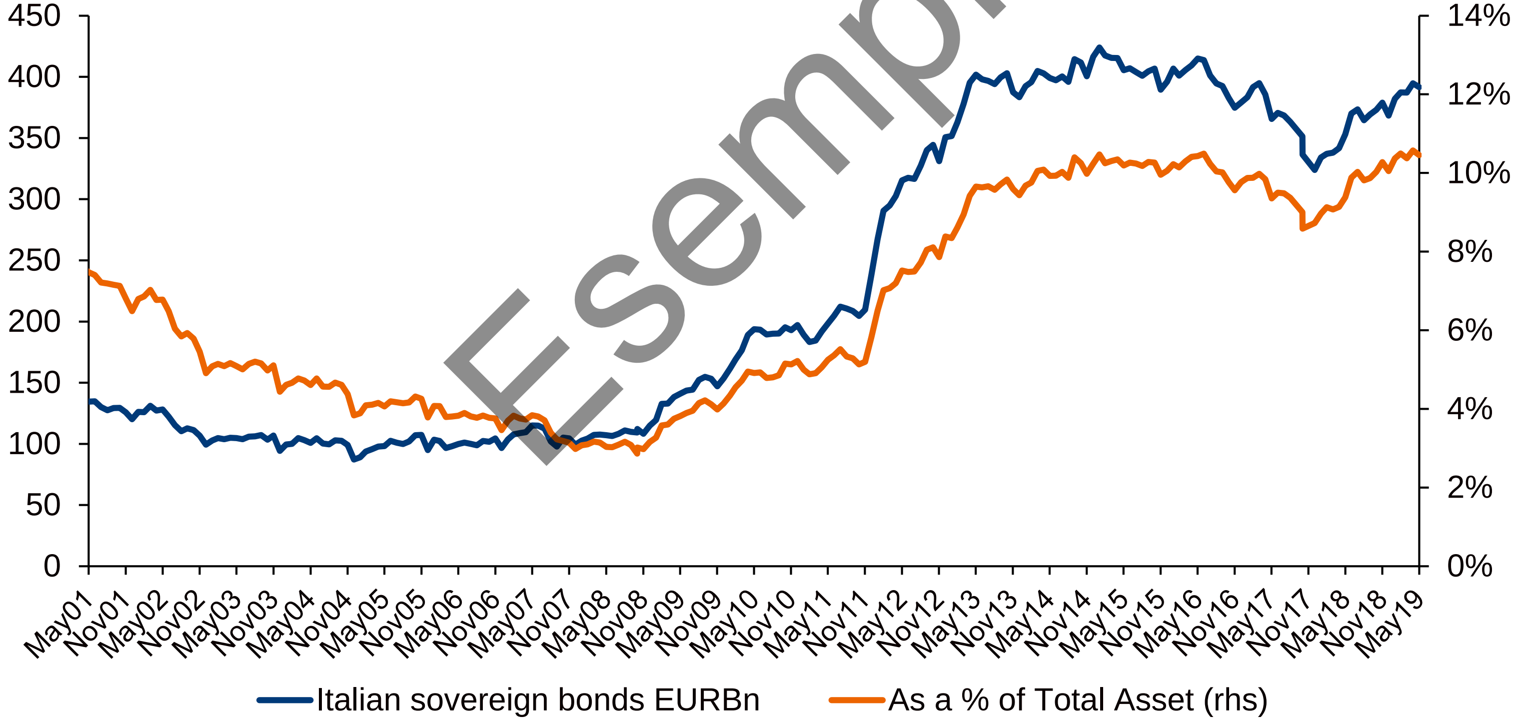
Buyer	Type of transaction	Portfolio GBV EUR bn	# of transactions
Quaestio Capital Management	Securitisation (95% junior & mezzanine tranche)	24.1	1
S.G.A. SpA	Disposal	18.0	1
intrum justitia	Securitisation (51% junior & mezzanine tranche)	10.8	1
Christofferson Robb & Company	Securitisation (95% junior & mezzanine tranche)	5.1	1
Banca IFIS	11 Disposals, 1 Securit.	3.5	12
MBCredit Solutions	Disposal	1.5	10
SPAXS	Disposal	1.2	5
BainCapital	Disposal	0.8	2
PIMCO	Securitisation (95% junior & mezzanine tranche)	0.7	1
Fortress	Disposal	0.7	1
Banca Guber	Disposal	0.6	2
Algebris Investments	Disposal	0.5	2
Värde Partners	Disposal	0.5	1
Barclays	Disposal	0.5	1
Total		**68.5**	

Source: Intesa Sanpaolo Research Department on Company data

Sovereign exposures continuously on the rise

- Since the beginning of 2018, Italian government bonds in banks' portfolio have increased, especially in May-June last year, followed by a more gradual rise (to 392Bn in May 2019 and 10.5% of total assets).
- This trend offset the reduction in 2017. At end-2017 domestic government bonds held by Italian banks amounted to 324Bn, -13.5% yoy and almost -24% from the peak in February 2015.

Italian government debt securities held by Italian MFIs (%)

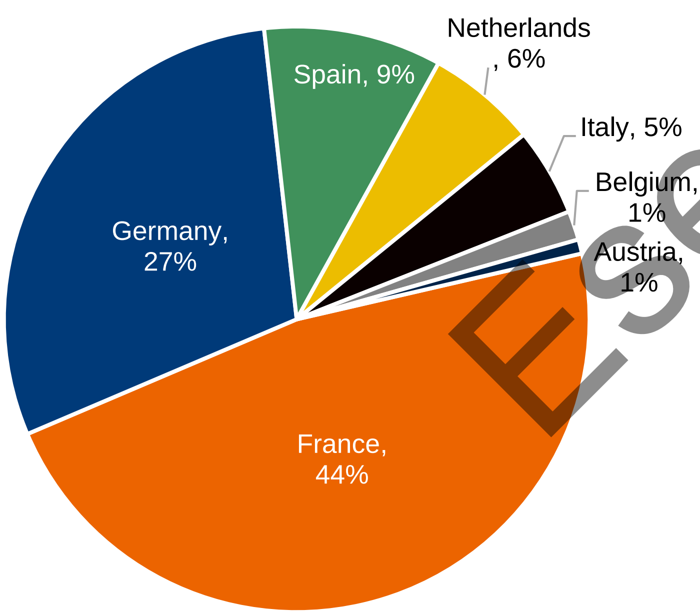


Source: Bank of Italy and Intesa Sanpaolo Research Department calculations

Italian banks have a very low exposure to L2 and L3 financial instruments

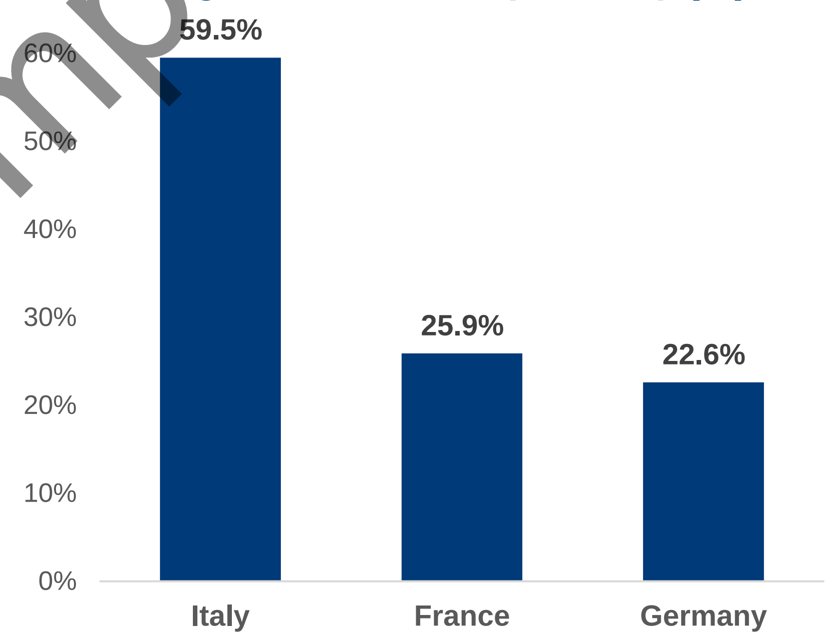
- Almost three quarters of L2 and L3 are in France and Germany, against a weight of the banking systems of these countries of around 50%, in terms of total assets. Italy only accounts for 5% of total.
- For significant Italian banks, the CET1 capital covers almost 60% of illiquid assets, including net NPE and L2 / L3 financial assets, versus just 23% for the German banks.

Distribution of L2 and L3 financial assets across SSM countries (% of total)



Source: ECB, Supervisory Banking Statistics, 4Q2018

CET1/Total Illiquid Assets at end-2018 (*) (%) Significant banks by country (**)



(*) Total illiquid assets = Net NPE, Level 2 and Level 3 financial instruments.
(**) Including: 11 banks for Italy, 20 for Germany, 11 for France.
Source: Intesa Sanpaolo calculations on ECB Supervisory Statistics

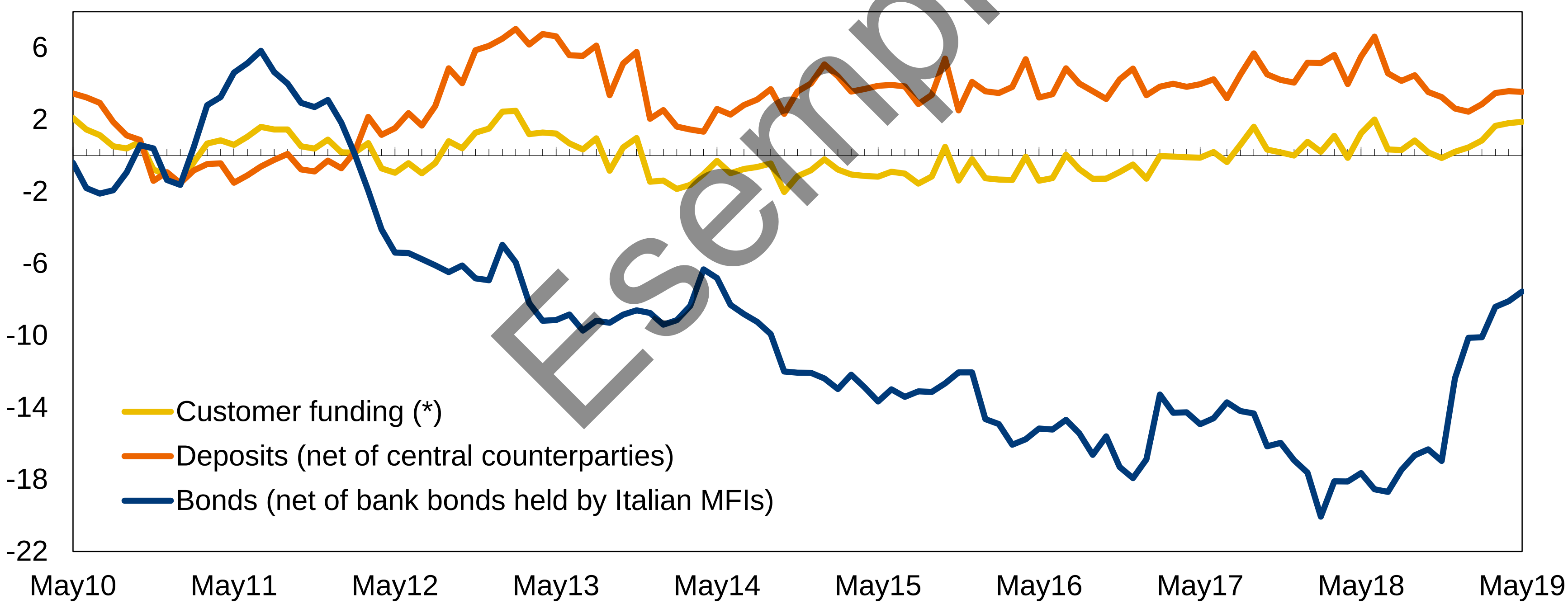
Agenda

1. Capital adequacy and asset quality
2. Bank funding
3. Trends in the lending market
4. Profitability

Seven years of growth in customer deposits …

- In 2019 **growth in customer deposits is still robust,** of +3.5% yoy in May, though slower than in 2018 (from +5.6% in 1H2018). Bonds continued to fall (-7.6% yoy in May), but less intensively than in 2014-18.
- Total **customer funding has resumed growth.** The increase is equal to +1.9% in May 2019, from an average of +0.6% yoy in 2018.

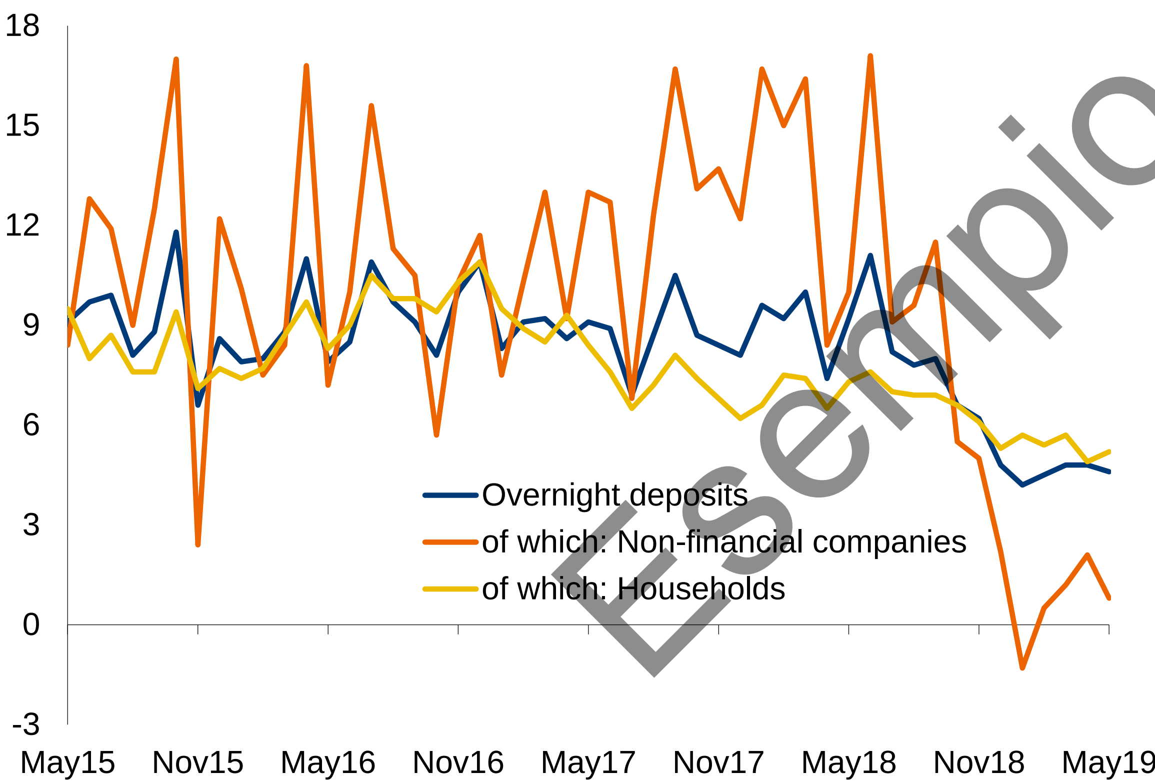
Customer funding at Italian banks (YoY % change) (*)



(*) Net of deposits with central counterparties and bank bonds held by Italian MFIs.
Deposits and total funding exclude liabilities related to loans sold and not cancelled.
Source: Bank of Italy, Intesa Sanpaolo Research Department calculations.

… driven by overnight deposits, which however slowed down recently …

Overnight deposits (*) (yoy % change)



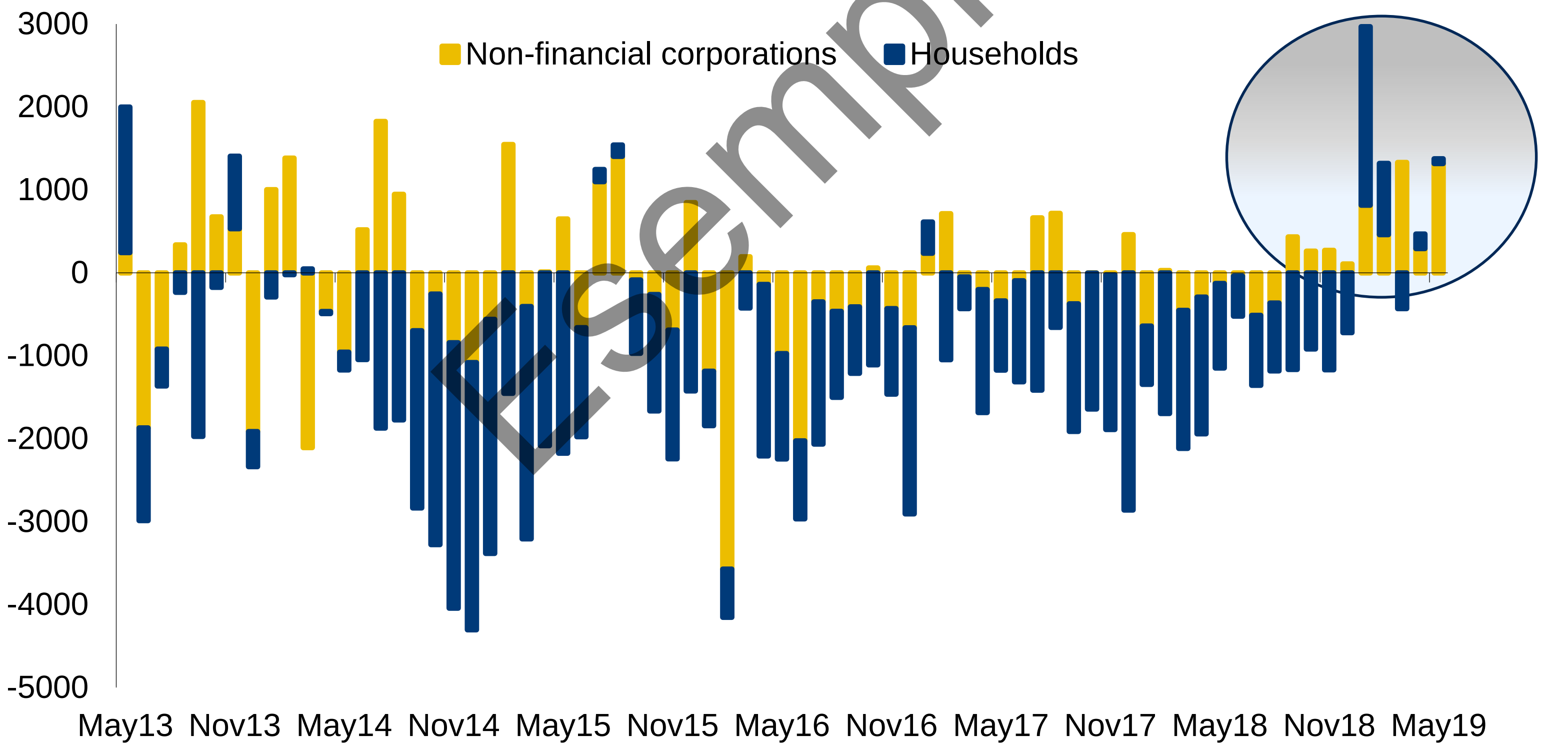
Source: ECB

- The positive trend of customer deposits is still driven by the **growth of overnight deposits, though slowed down** (+4.6% in May). Indeed, the more volatile component from non-financial corporations plunged at the start of 2019, reaching negative territory for the first time in over 6 years of growth, but then it has recovered slightly since February, to +0.8% yoy in May.

… meanwhile, the recovery in time deposits is ongoing

- Those of non-financial companies recorded positive net flows for the ninth consecutive month, equal to 1.3Bn in May and a rate of change of +31.8% yoy after returning to growth in January (1% yoy).
- Household time deposits also showed net inflows in the first part of 2019.
- This recovery is consistent with the rise in interest rates on new time deposits.

Deposits with agreed maturity (monthly flows in EUR M)



Source: ECB

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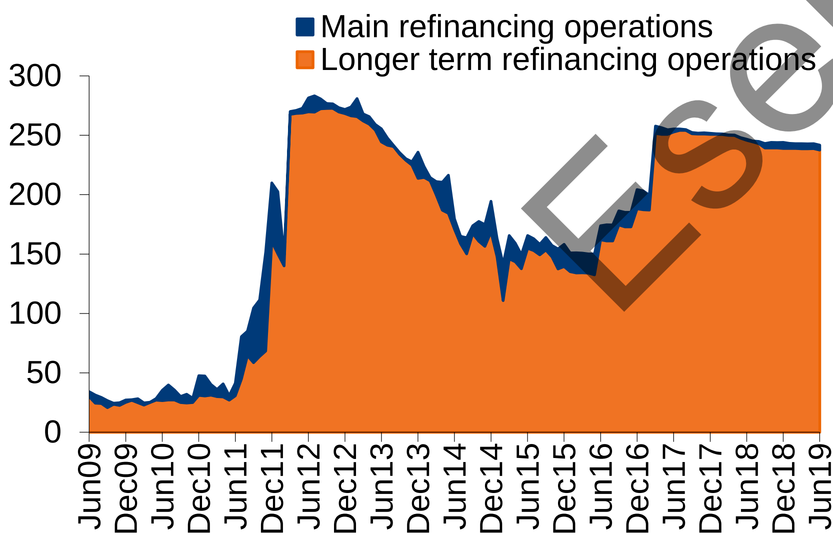
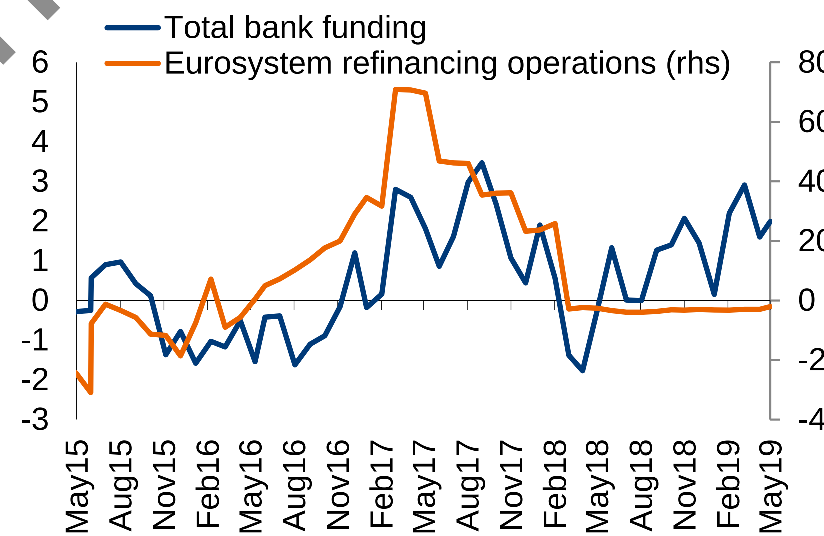
High reliance on ECB refinancing

- With the TLTRO2, the use of ECB refinancing reached 250Bn and the impact on total assets rose to 6.5% in March 2017, then decreased just slightly and it was equal to 6.2% in May 2019, standing at 242Bn (it was 3.8% in the first 5 months of 2016).
- In May 2019, ECB refinancing was 2.1% lower than a year before. Total funding rebounded to +2.9% yoy in March, followed by a more moderate +2.0% in May.

Use of Eurosystem refinancing transactions by Italian banks (EUR Bn)



Rates of change of total bank funding and Eurosystem refinancing (yoy % change)

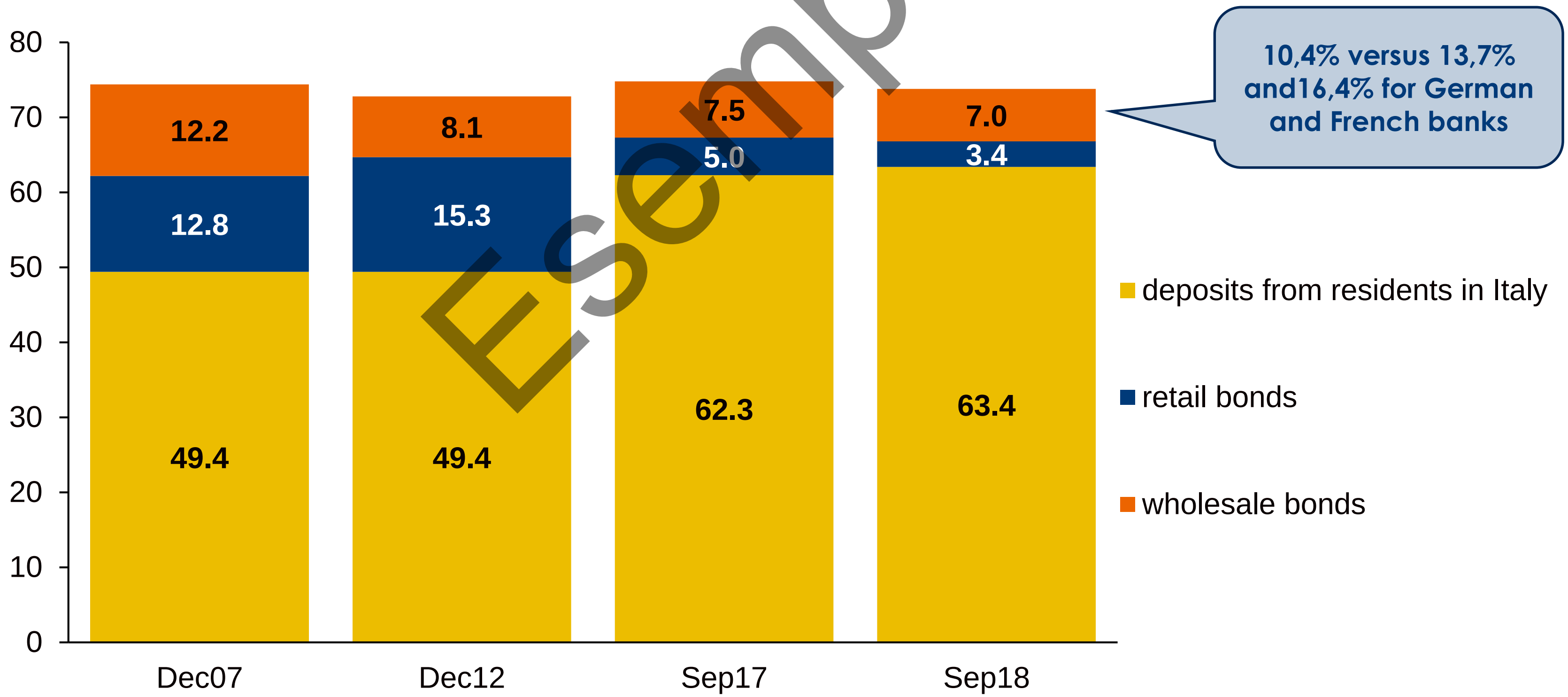


Source: Bank of Italy and Research Department calculations

Customer deposits have offset the decrease of bonds

- As a consequence, customer funding is **skewed towards sight components**, with a **decreasing diversification to market sources**.
- The fall of retail bonds continued, coupled with the drop in wholesale bonds, though by a lower extent.

Bank funding breakdown: % share of retail bonds, wholesale bonds and deposits

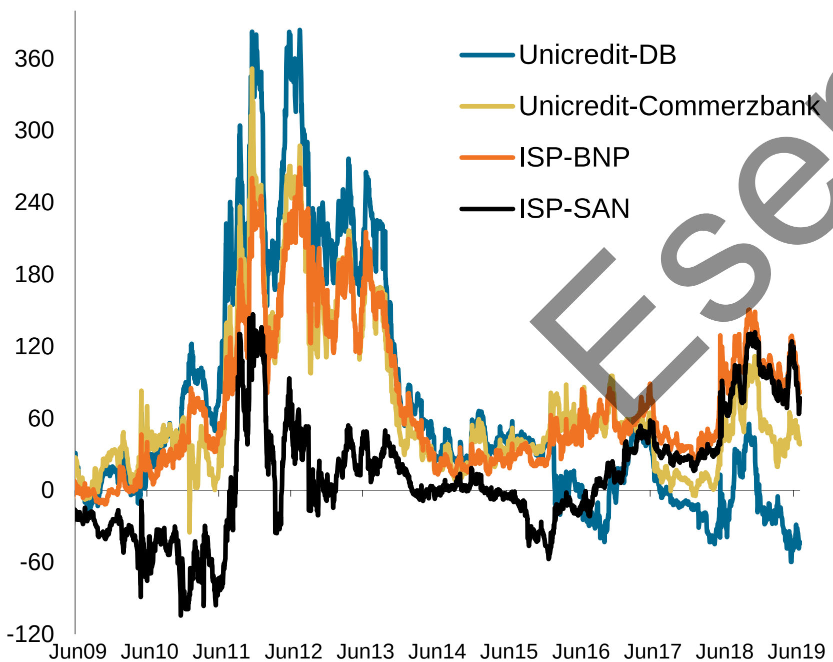


Source: Bank of Italy

Yields on Italian banks' bonds still higher than the Spanish ones …

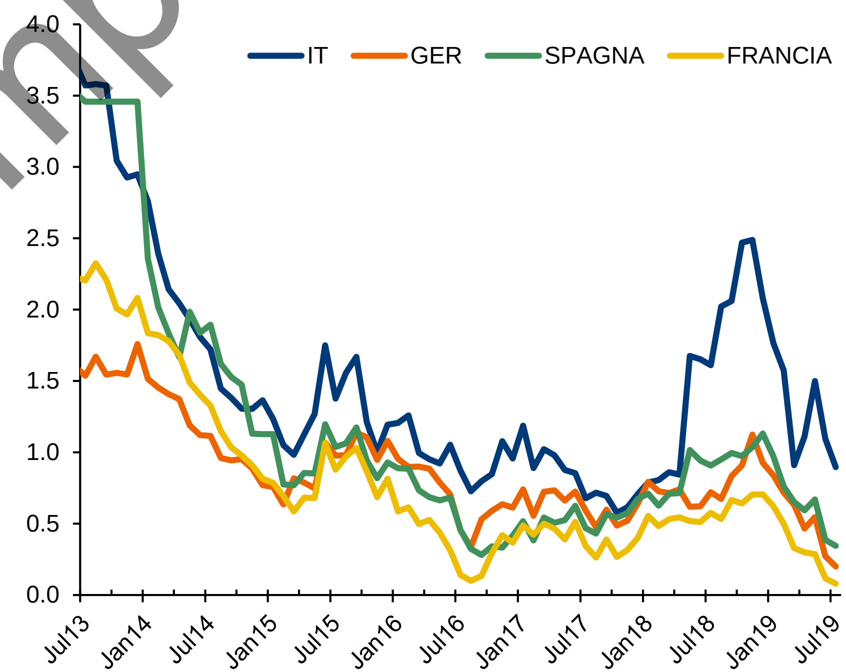
- Following recent improvements in the government bond market, **Italian banks access to international wholesale markets has recovered.**
- **However, Italian issuers are still penalised with respect to European peers in terms of market yields.** Note the significant increase in 2018 in the spread between Italian bank CDS and those of Spanish banks.

5y CDS on senior bonds: spread between those of major Italian banks and European peers



Source: Thomson Reuters-Datastream

Market yields of Italian banks' senior unsecured bonds with 5y residual maturity (%)

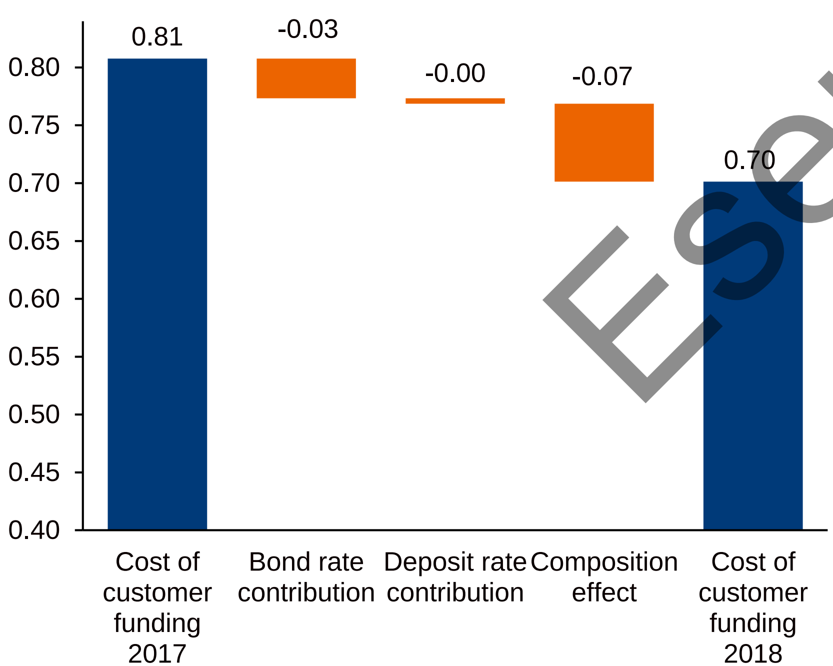


Source: Bloomberg. Figures as at 8 July 2019.

… but without effects on the overall cost of funding

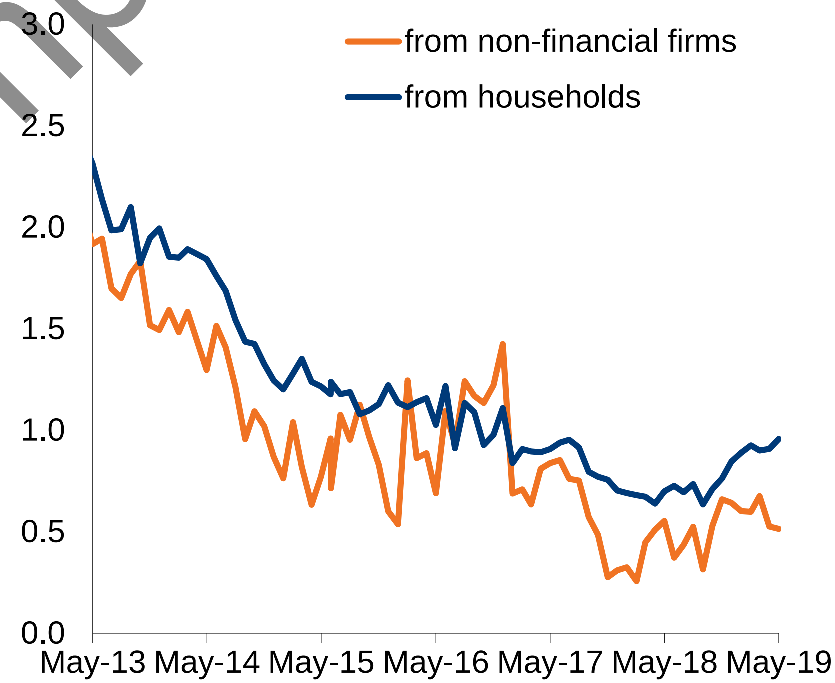
- …thanks to retail deposits, liquidity reserves and banks' ability to postpone the roll-over of maturing bonds.
- As a result, the overall cost of the stock of customer funding continued to decrease even in 2018, also owing to the composition effect. However, since October 2018, **higher cost of new time deposits**.

Factors contributing to changes in the average rate on customer funding in 2018 (%)



Source: Intesa Sanpaolo calculations on Bank of Italy data

Rates on new deposits with agreed maturity (%)

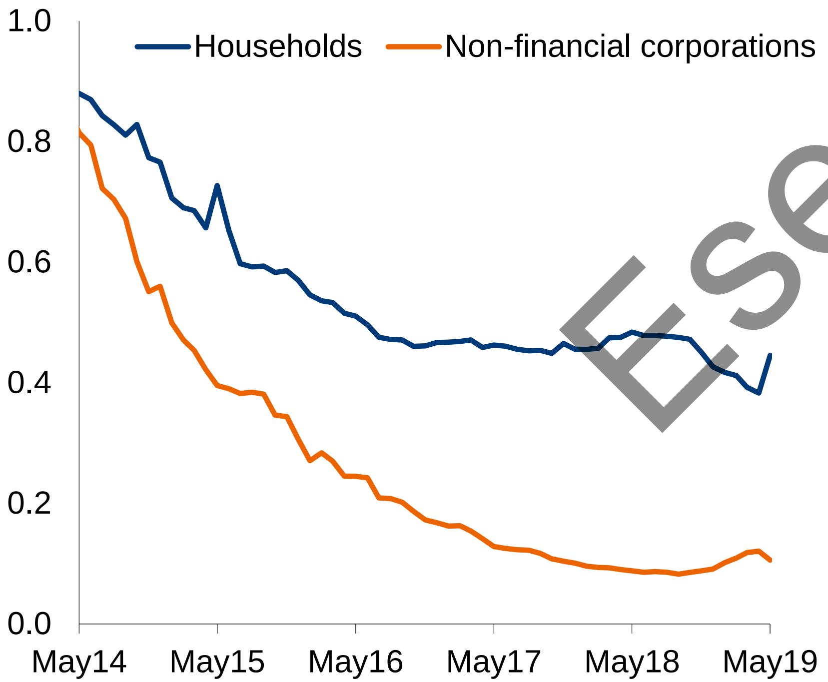


Source: Bank of Italy

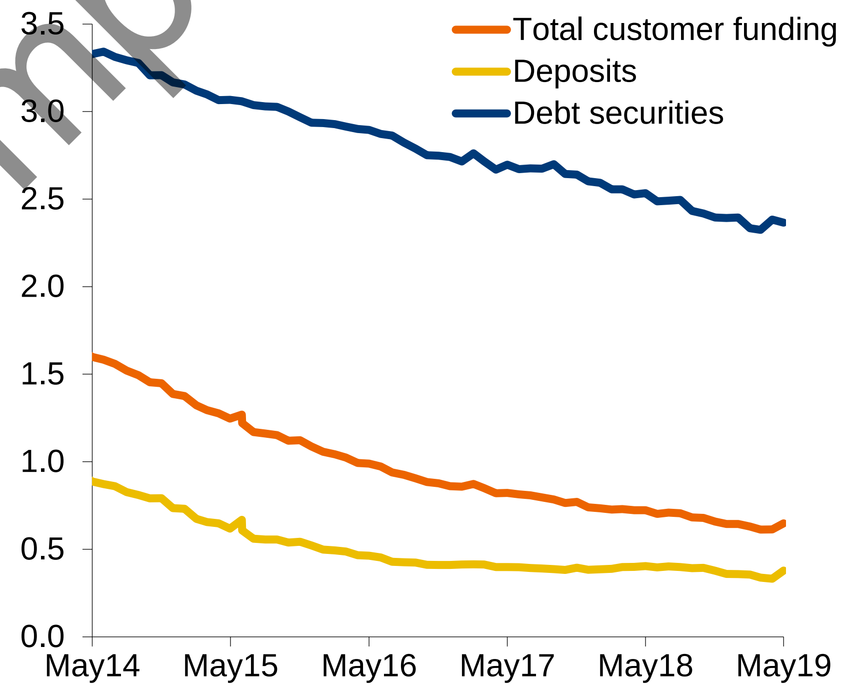
Overall cost of customer funding remains at record lows

- Total deposit rate back to 0.38% in May, following reduction to 0.33% in April 2019 and stability within 0.39-0.40% from April 2017 to October 2018. Among the components, rates on overnight deposits has flattened at 0.05% since mid-2018.
- Overall **cost of customer funding has remained at record lows** (0.65% in May), also thanks to the fall in the weight of more expensive components.

Rates on outstanding deposits (%)



Rates on outstanding bank funding (%)



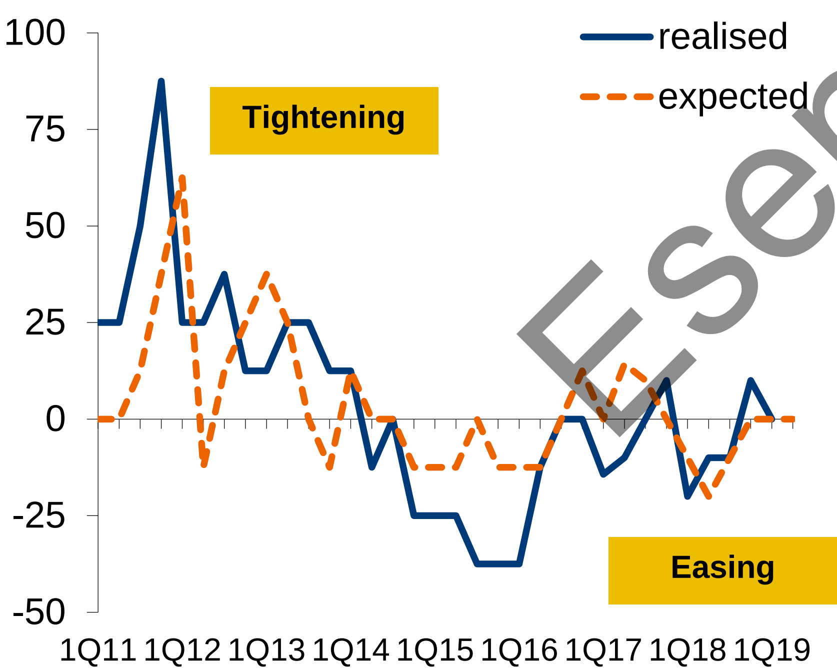
Source: Bank of Italy

Agenda

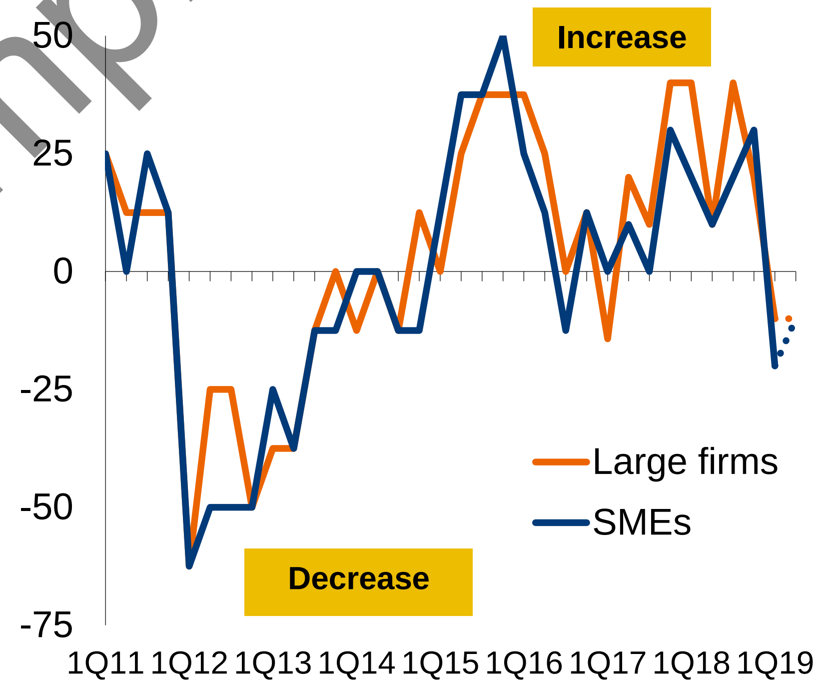
Credit supply for non-financial corporations remained stable, but demand decreased

Italian banks kept unchanged the standards applied to business lending in the 1st quarter 2019. Demand for loans decreased, in particular by SMEs and for short-term loans.

Change in standards applied to business lending (net %: tightening – easing)



Business demand for loans and credit lines by firm size (*) (net %: increase – decrease)

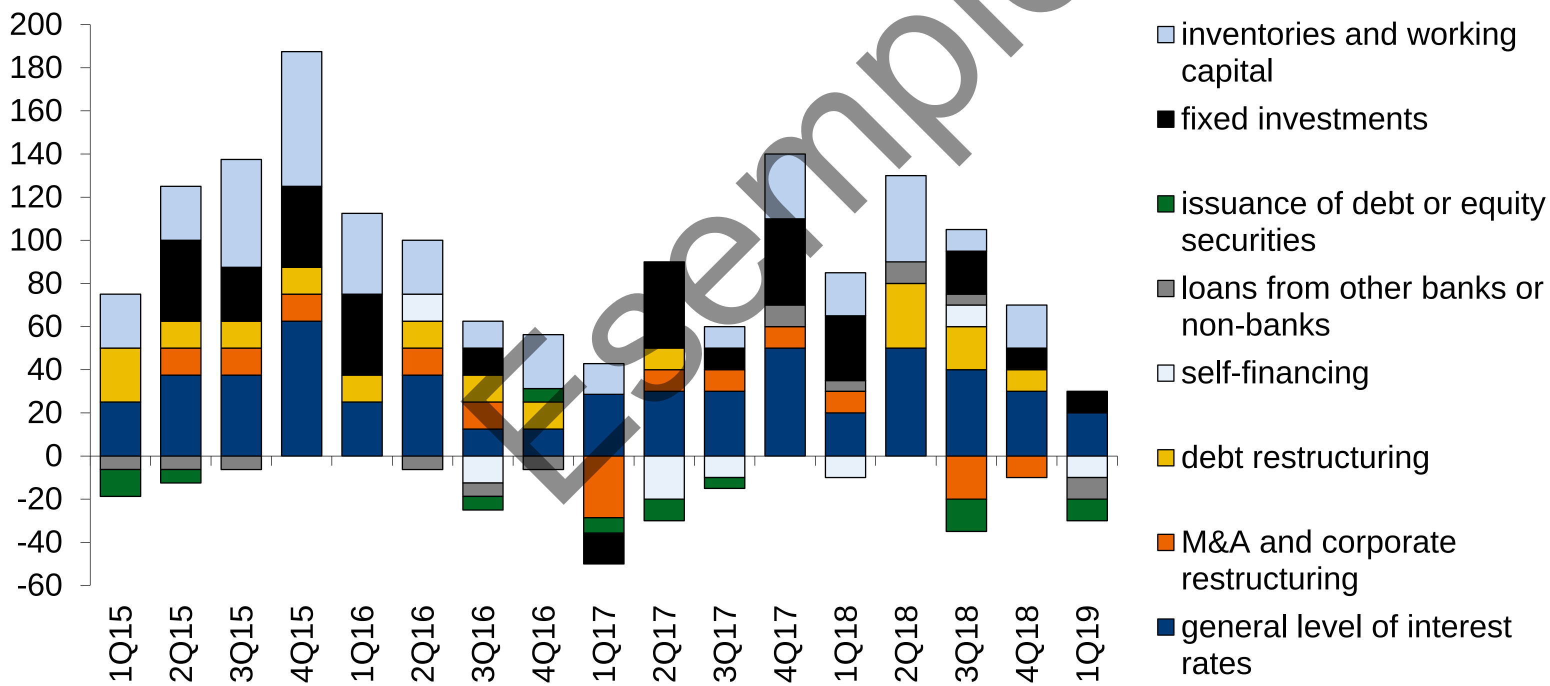


(*) The dotted part refers to expectations for the following quarter
Source: ECB, Euro Area Bank Lending Survey (BLS)

At the start of 2019, smaller impact of low interest rates and fixed investments on credit demand…

- …completely offset by loans offered by other banks or other institutions, self-financing and issuance of debt or equity securities.

Factors influencing business credit demand (net %) (*)

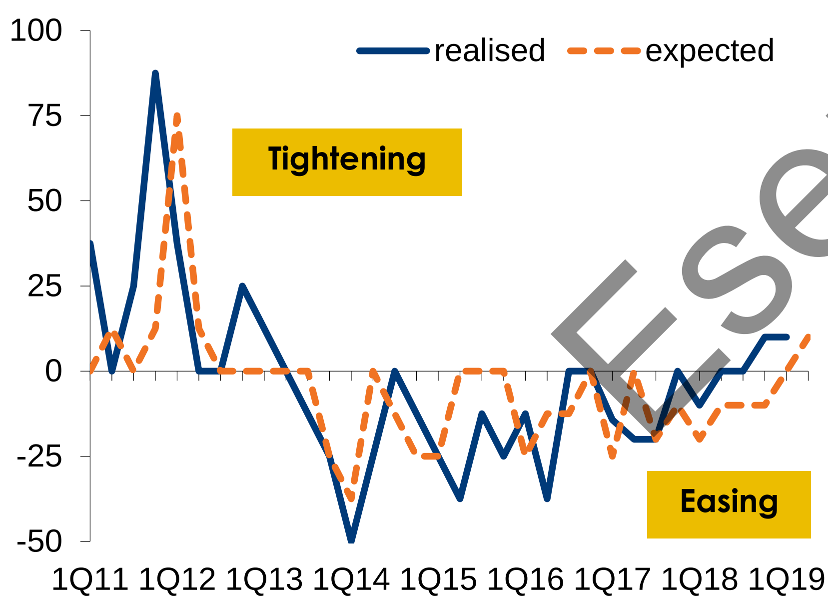


(*) a positive sign represents an increase in demand, a negative sign a decrease.
Source: ECB, Euro Area Bank Lending Survey (BLS)

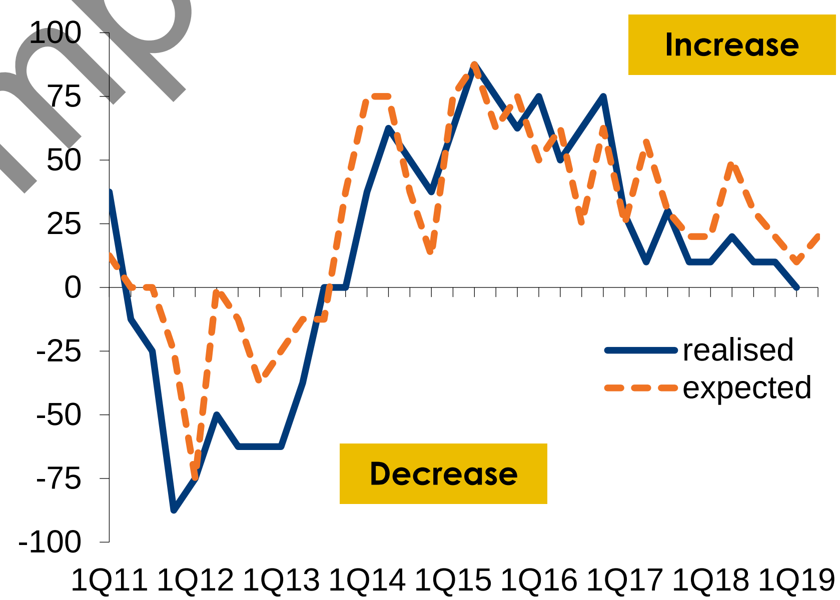
Household demand for mortgages stalled, following 5 years of growth

- Customer demand for loans for house purchase stalled at the beginning of 2019, after the continuing slight increase recorded till 4Q18.
- Credit standards applied to household mortgages slightly tightened.

Change in credit standards applied to households for house purchase
(net %: tightening – easing)



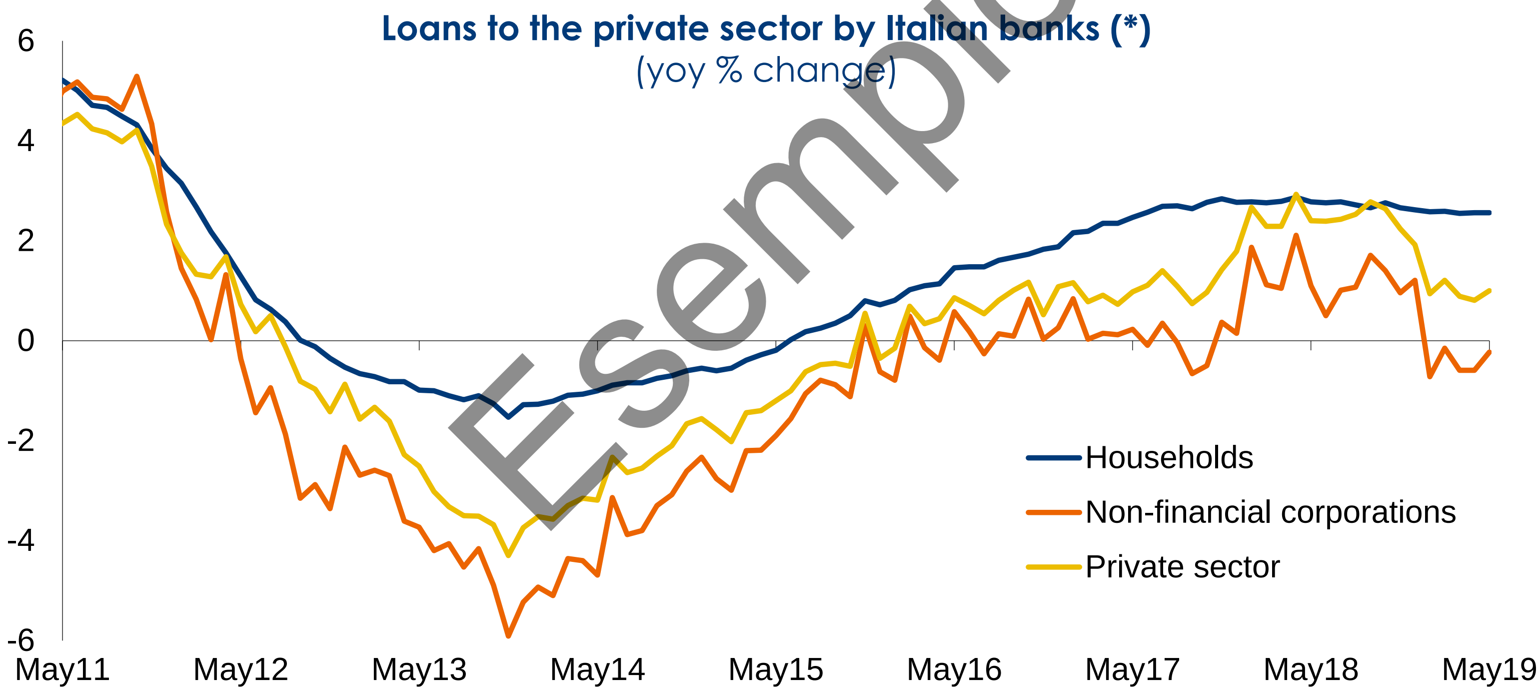
Change in household demand for loans for house purchase
(net %: increase – decrease)



Source: Bank of Italy, Quarterly Bank Lending Survey (BLS)

Loans to the private sector have slowed down

- **Robust growth in loans to households**, by 2.6% yoy in May for the 6th month in a row.
- **Loans to non-financial companies fell** by -0.2% in May, after -0.6% in March and April (adjusted for securitisations). The drop could be partly due to a base effect, as growth picked up in January 2018 (**) and then fluctuated around 1.2% on average in 2018.
- As a result, growth in total loans to the private sector remains subdued (+1% yoy in May from +0.8% in April, but lower than 2018 average of 2.4%).



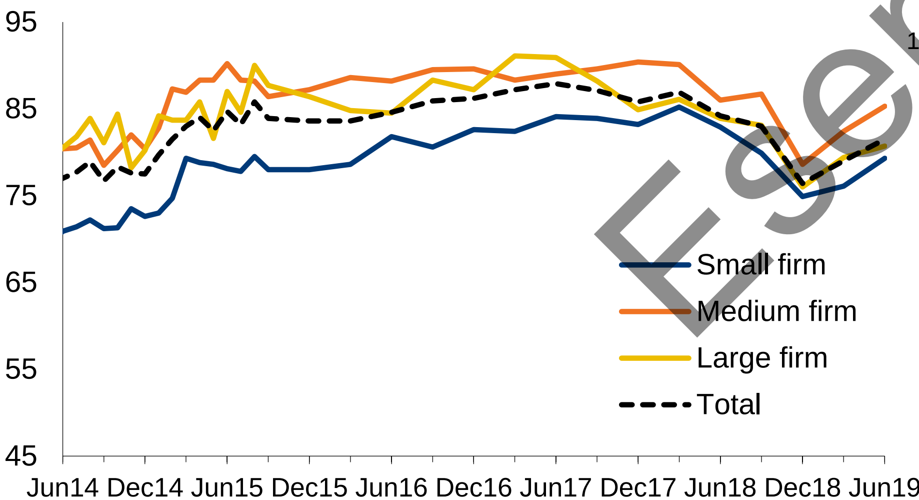
Note: (*) data adjusted to take into account securitisation and net of central counterparties.
Source: Bank of Italy

(**) This coincided with the expiry date of the reporting period of bank loans' trend, in accordance with the benchmark that allows to benefit from a favourable rate on TLTRO II refinancing, linked to that of the deposit facility.

Business view on credit access conditions improved, while liquidity remained abundant

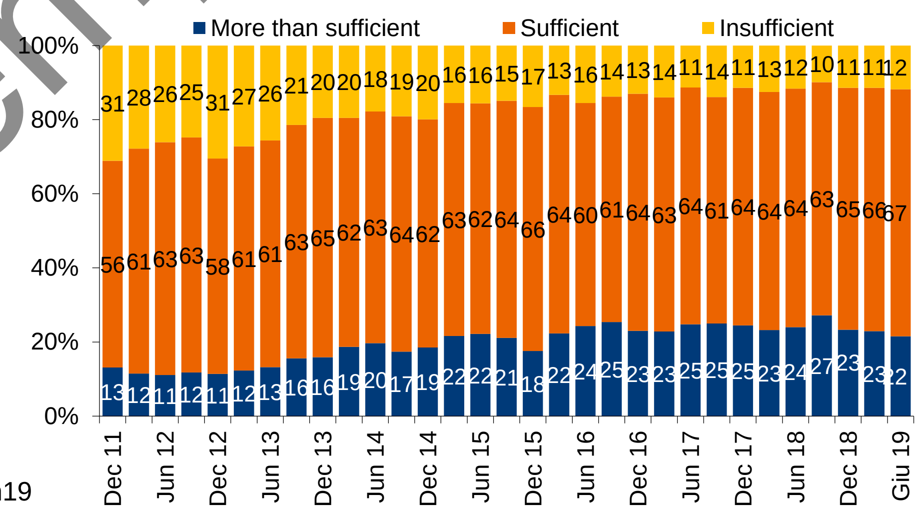
- **Views on credit access conditions got better**: in June 2019, 82% of manufacturing companies judged credit access conditions unchanged or more favourable compared to the previous three months, from 76% in December (and 79% in March).
- **Businesses confirmed a relaxed view on liquidity position in the short term**: in June 2019 the share of companies stating that liquidity will be sufficient or more in the next three months was at the highest (88%).

% of manufacturing companies with unchanged or more favourable view on credit access conditions compared to 3 previous months*



** Size breakdown defined by the number of employees: small 1-49, medium 50-249 and large ≥250*
Source: ISTAT

Opinions on overall liquidity position in the next 3 months
(% of companies, industrial and service sectors)

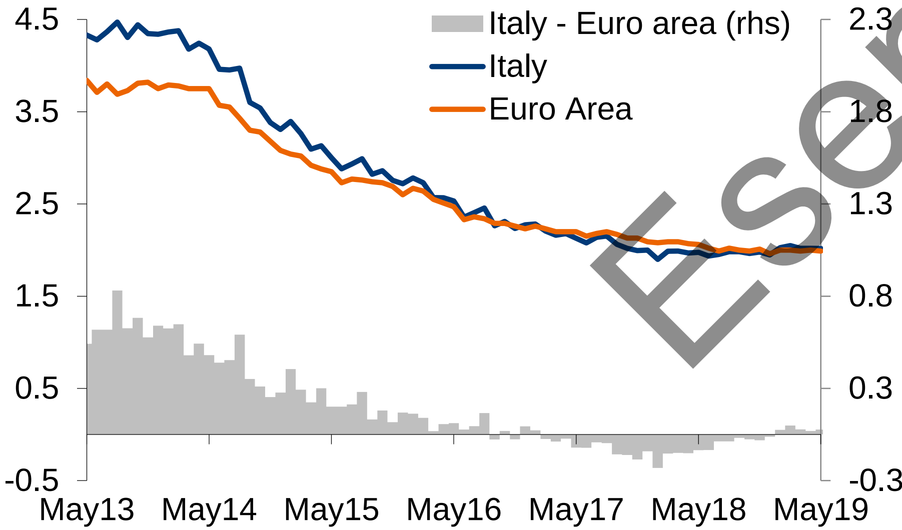


Source: Bank of Italy – Il Sole 24 Ore

Lending rates still very low, despite repricing

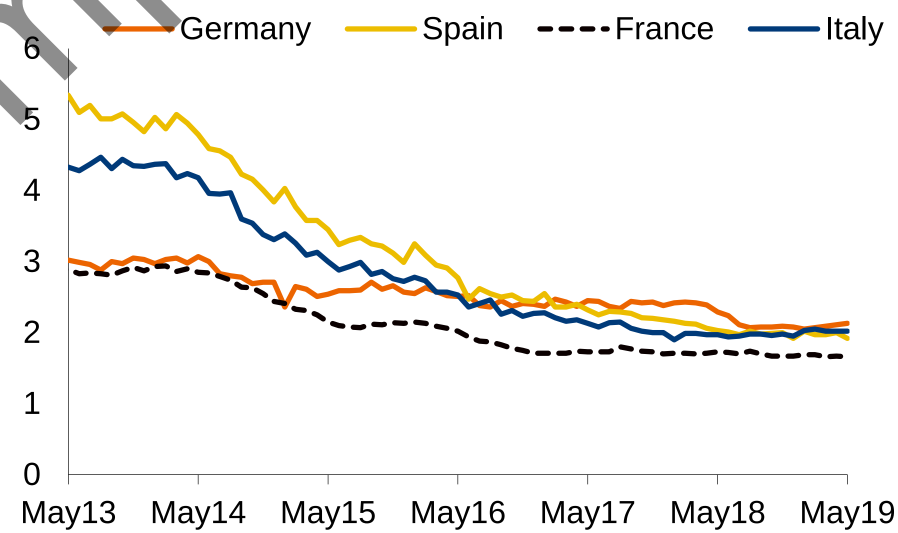
- For new loans of over 1M the rate was equal to 0.9% in May, lower than in 2018 (1.1% on average). On the contrary, **at the start of 2019 rates on new loans of up to 1M jumped above 2%, slightly higher than in 2018** (2.02% also in May vs.1.96% in 2018).
- At the start of 2019, the spread with the Eurozone turned slightly positive for loans of up to 1M, at 3bps in May, but it remained negative for new loans of over 1M (-25bps).

Rates on new loans of up to EUR 1M to non-financial businesses, Italy – Euro area comparison (%)



Source: ECB and Intesa Sanpaolo calculations

Rates on new loans of up to EUR 1M to non-financial businesses (%)

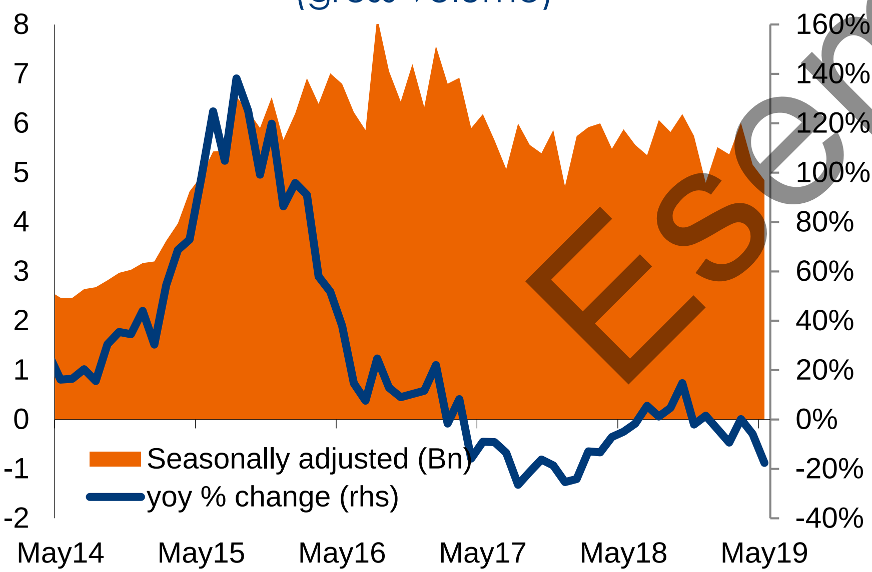


Source: ECB

Weakness in monthly flow of residential mortgages

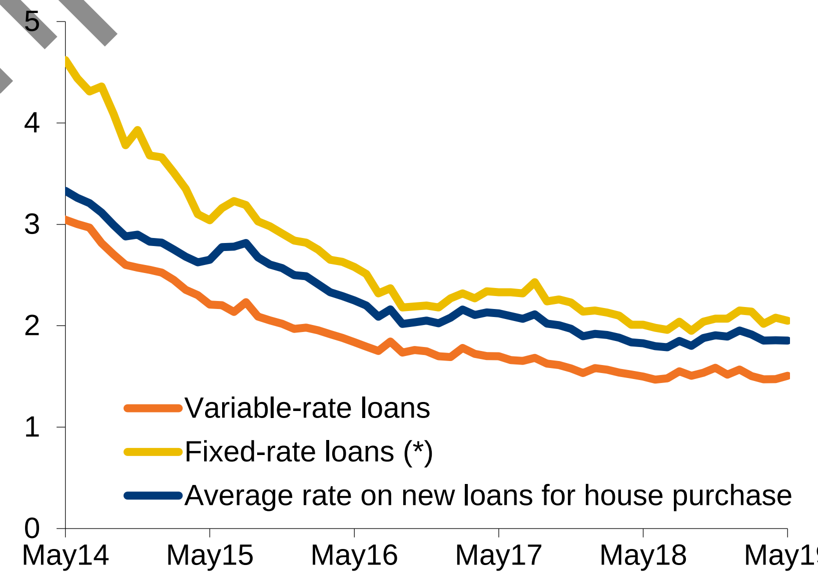
- Despite the **slight rise in rates on new mortgages** in late 2018 and the start of 2019, they remain low and financial conditions are still favourable for loans for house purchase.
- **Volume of disbursements again slightly down** at the start of 2019 (-17.5% yoy in May), while the year 2018 ended with a slowdown to +1.5%, following the return to growth in the summer 2018 and the jump in October (+14.7% yoy). Fixed-rate transactions remain predominant, equal to 66% of total in April-May.

New household loans for house purchase (gross volume)



Source: Bank of Italy and Intesa Sanpaolo calculations

Rates on new loans for house purchase (%)

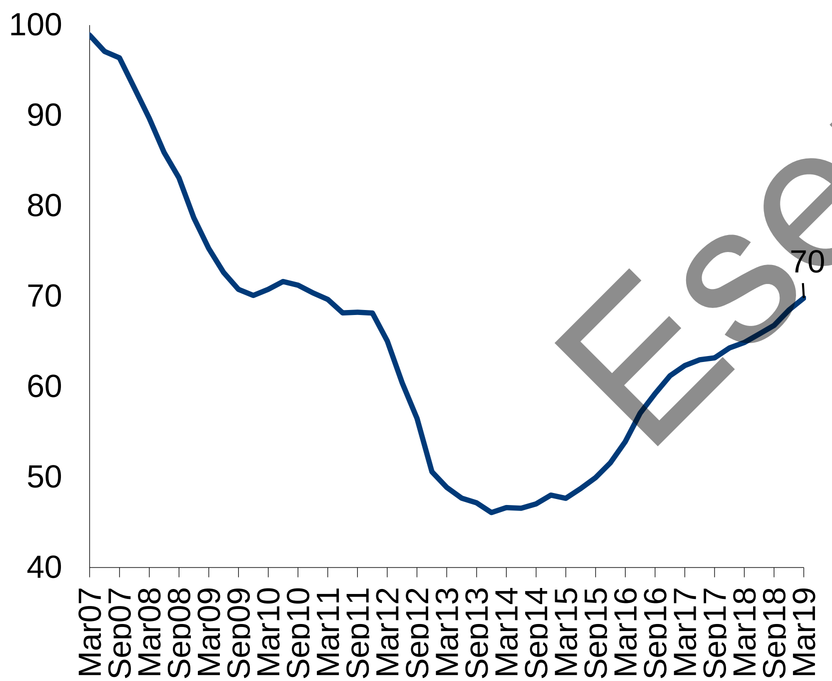


Note: (*) Initial rate fixation period over 10 years.
Source: Bank of Italy, ECB

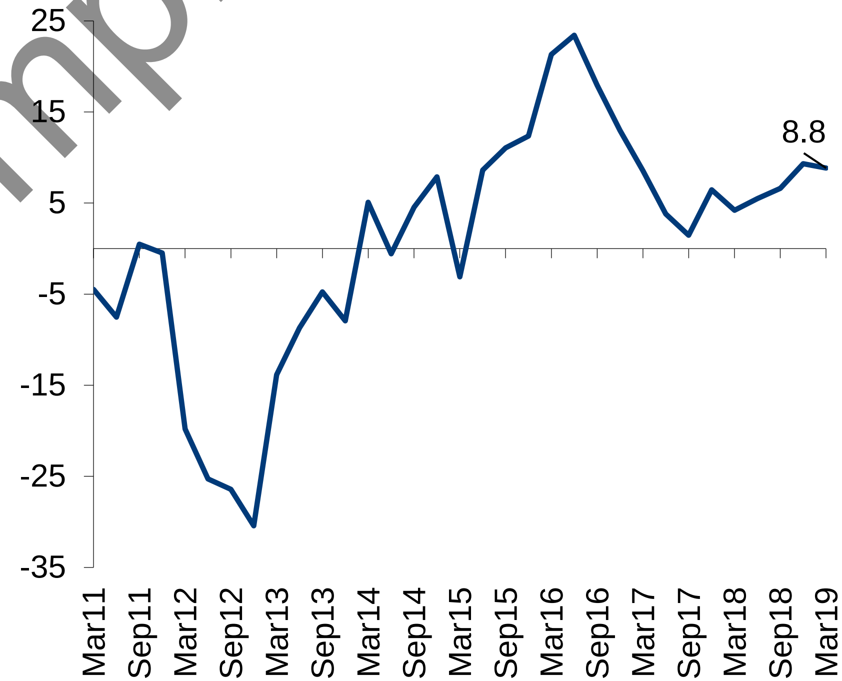
Ongoing growth in transactions of residential properties

- Transactions of residential properties have been recovering in volumes since June 2015. They exhibited a double-digit growth in 2016 followed by a slowdown and a moderate growth. **The first quarter 2019 reported a good result of +8.8% yoy.**
- Transaction numbers remain below their pre-crisis level, by 32% in 2018 over 2006.

Number of transactions of residential properties
(4-term moving avg., index base number 2006 = 100)



Yoy% change in transactions of residential properties

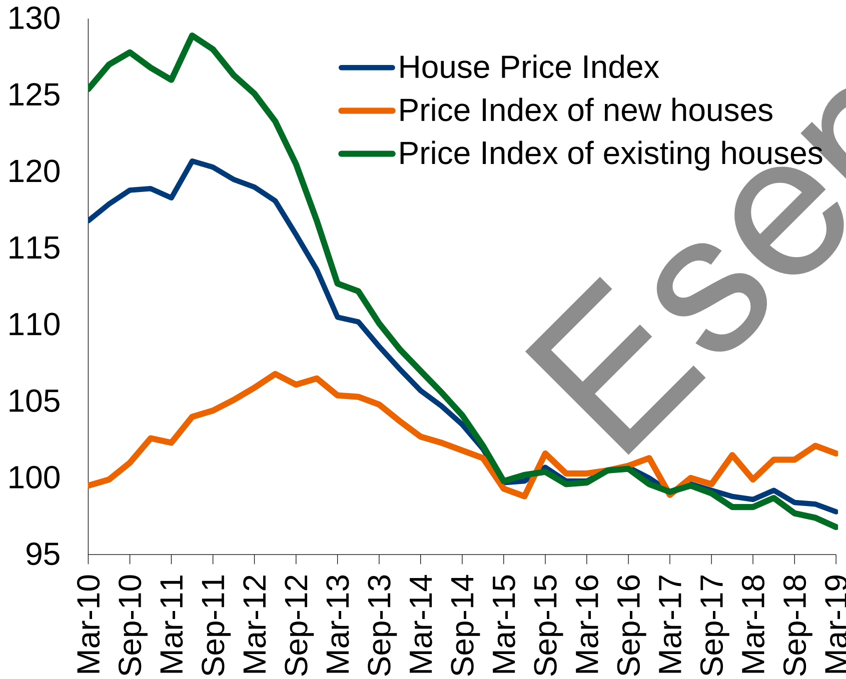


Source: OMI and Intesa Sanpaolo Research Department calculations

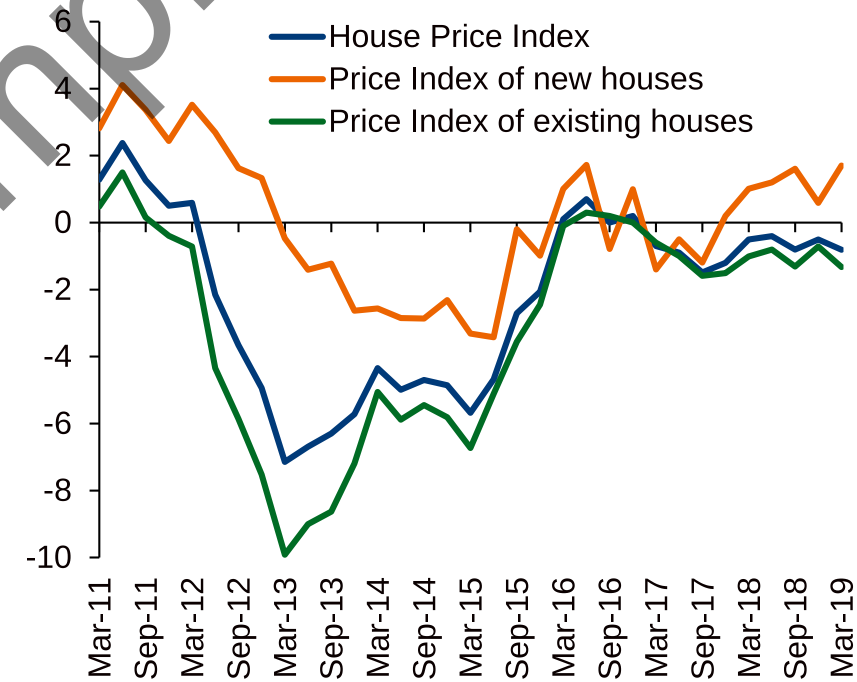
House prices continued to decline on average

- In 1Q2019 house prices decreased by -0.8% yoy and by -0.5 qoq.
- The yoy decrease is due to the existing house prices, down by -1.3%, while **prices of new houses increased by 1.7%.** The qoq change is negative for both existing houses (-0.6%) and new ones (-0.5%).

House Price Index
(index base number 2015=100)



Yoy % change of House Price Index

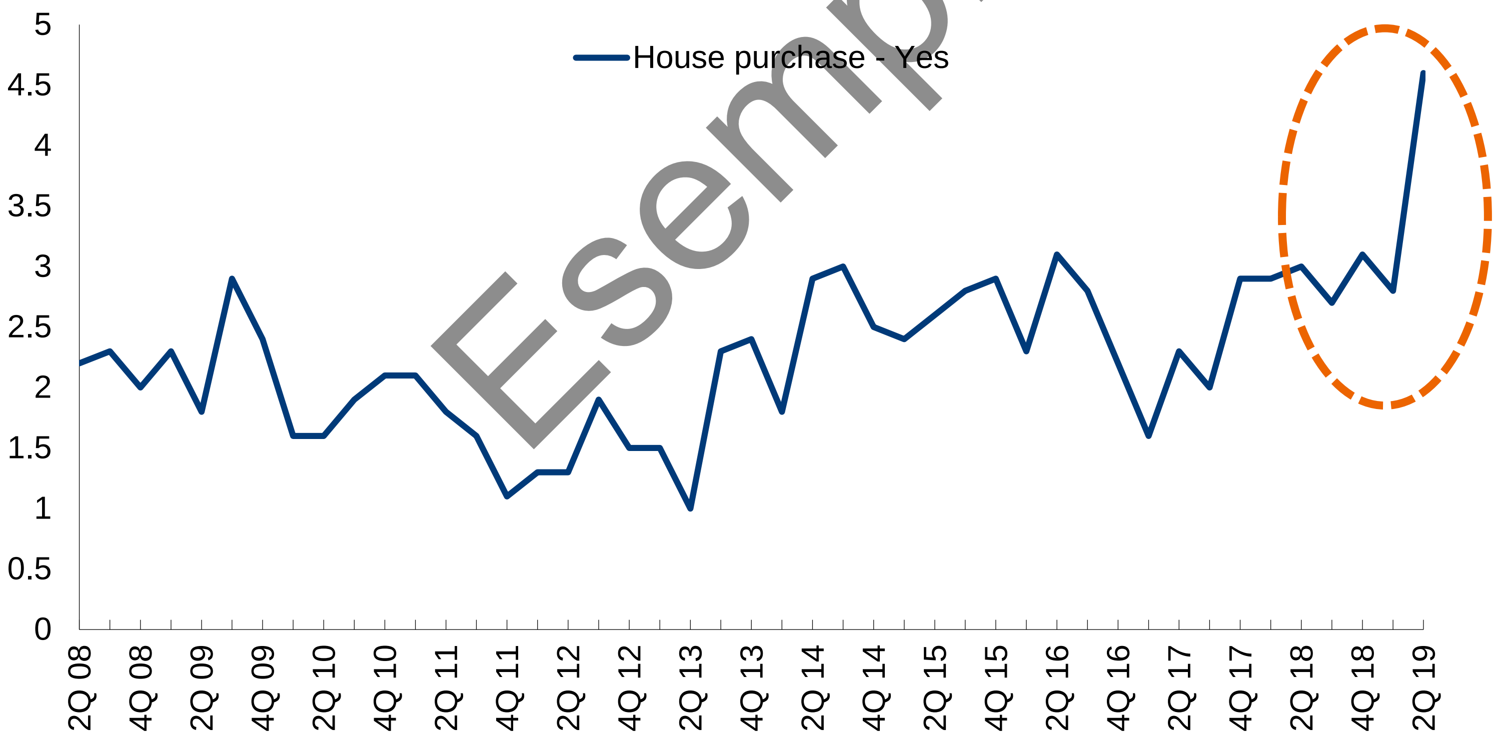


Source: Istat

Outlook for the real estate market: household purchase intentions improved…

- In April 2019, the percentage of consumers that stated they would like to buy a new house increased greatly to 4.6%, reaching the highest level from May 2005 (when it was 5.1%).

Consumer intention to buy a new house during the quarter
(% of total replies, survey conducted at the beginning of each quarter)



Source: Istat, Consumer and business confidence

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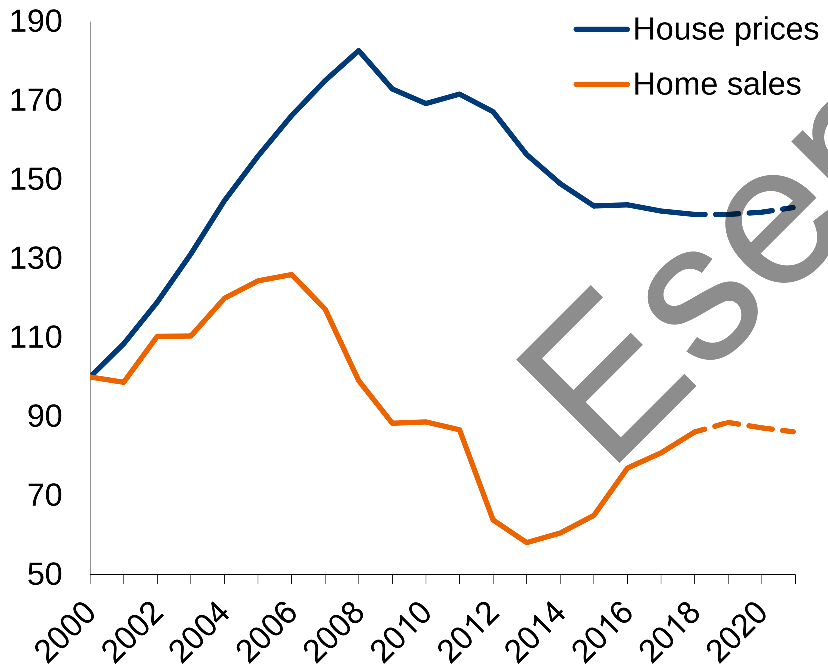
… but agent expectations are more cautious

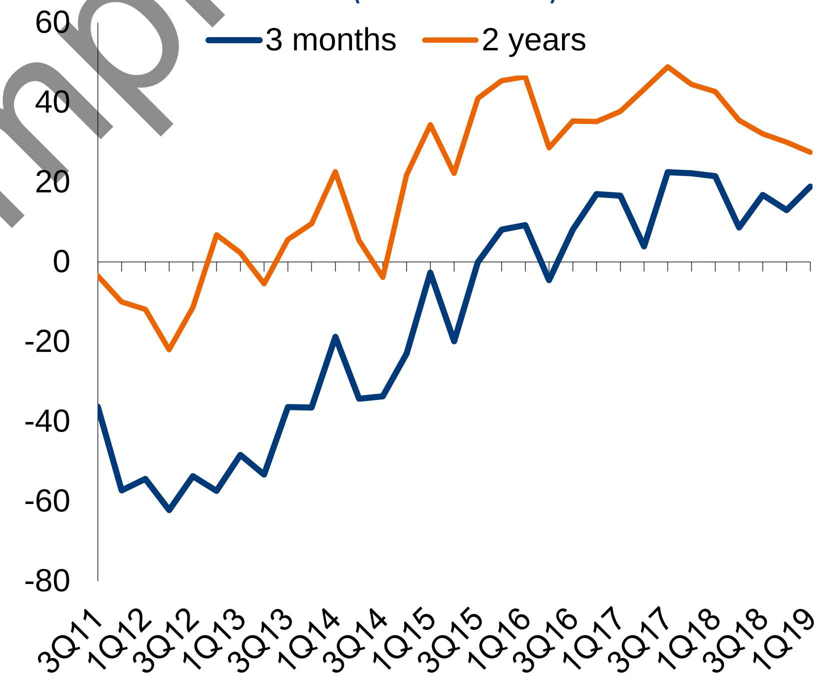
- The real estate market has improved, as shown by the rise in the number of sales. However, in 2018 and the beginning of 2019 real estate agents' expectations were more cautious, particularly long term ones, after having been at their highest in 2017.
- For the aggregate of 13 large cities, house prices are forecast to be stable in 2019 and slightly on the rise in 2020 (+0.4%).

Residential sector: number of sales and prices
(2000=100)



Source: ISTAT and OMI – Nomisma forecasts and Intesa Sanpaolo calculations

Expectations about the real estate market
(balances*)

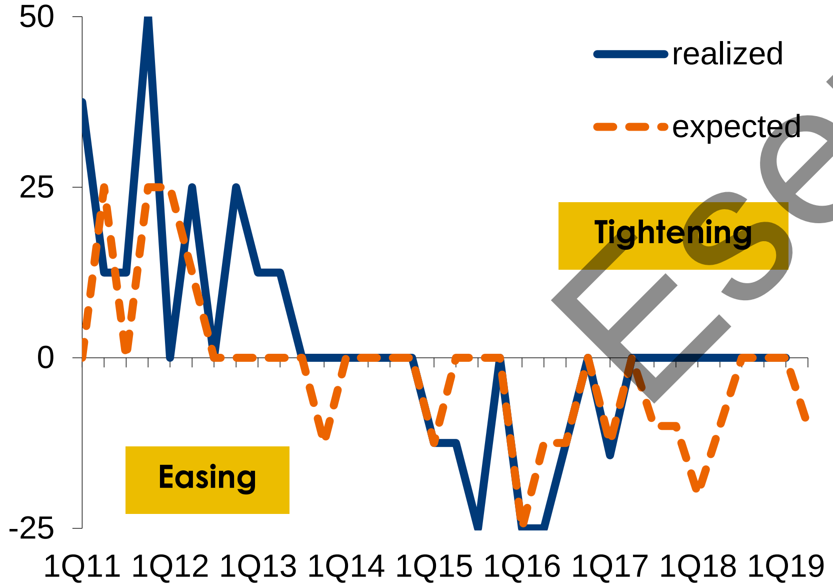


** Balance of positive and negative sentiment expressed by estate agents. Source: Bank of Italy*

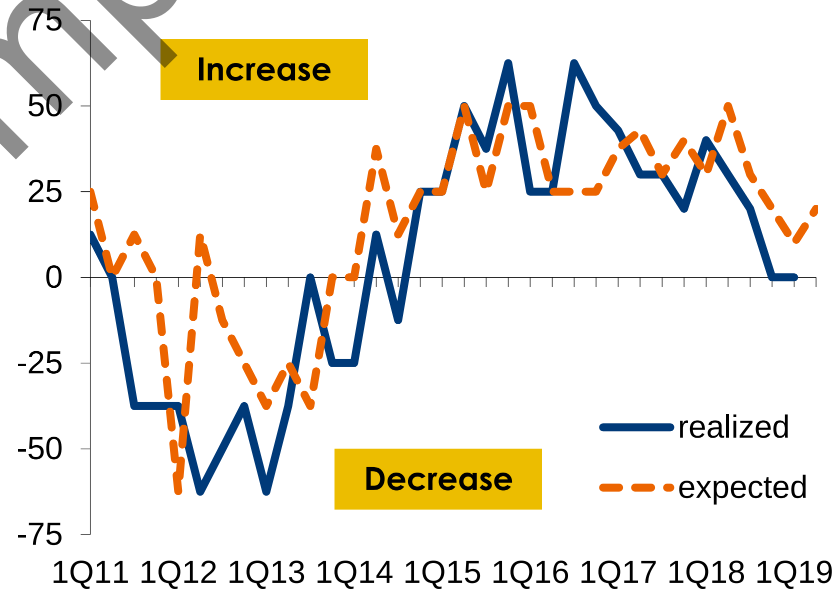
Credit standards applied for consumer credit has remained unchanged since two years

Demand for consumer credit remained unchanged in 1Q19.

Change in credit standards applied to households for consumer credit
(net %: tightening – easing)



Change in household demand for loans for consumer credit
(net %: increase – decrease)



Source: Bank of Italy, Quarterly Bank Lending Survey (BLS)

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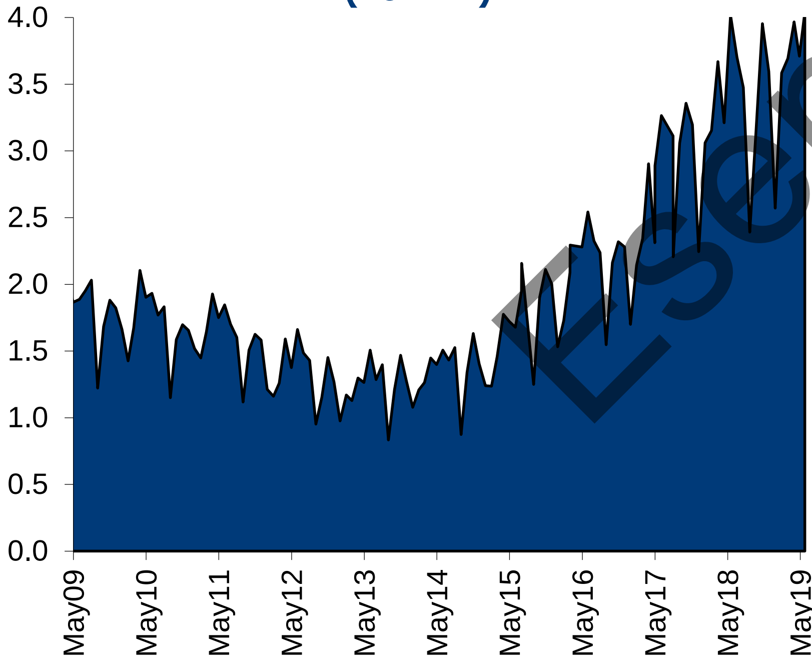
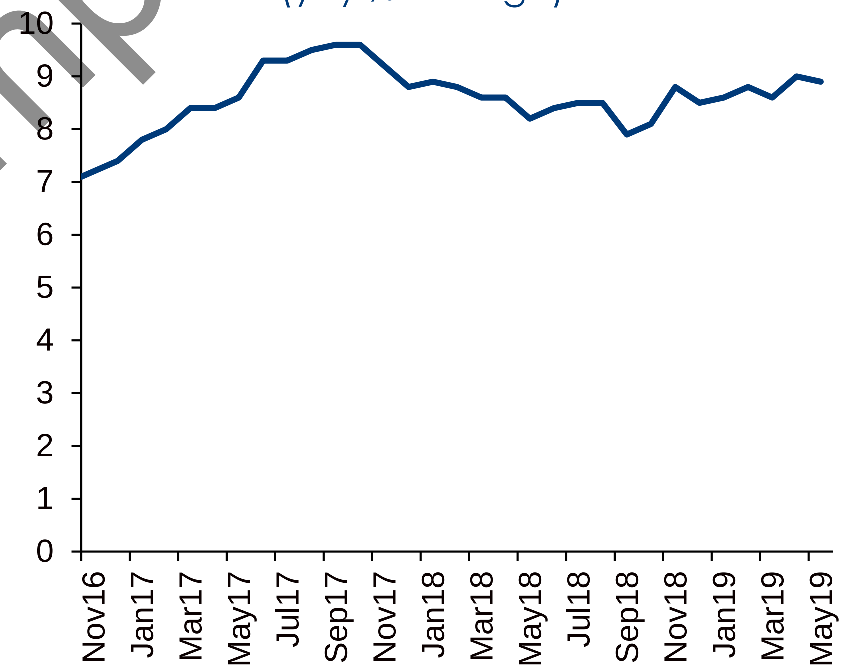
Consumer credit is particularly dynamic

- **Growing volumes of monthly transactions**, by 15% yoy in 4Q2018, 14% in 1Q2019 and 8% on average in the two month period April-May.
- **Strong rise in outstanding amounts**: in 2018, consumer credit granted by banks increased on average by +8.5% yoy (based on raw data). Growth remained solid in the first part of 2019, by 8.9% yoy in May.

Disbursements to households for consumer credit (EUR Bn)



Credit for consumption (yoy % change)



Source: Bank of Italy and ECB

Agenda

1. Capital adequacy and asset quality
2. Bank funding
3. Trends in the lending market
4. Profitability

1Q2019 results show further progress in reduction of operating costs and loan loss charges

Profit & Loss (EUR M)	TOP 5 Banking Groups		
	1Q19	1Q18	Δ %
Net interest income	5,765	5,937	(2.9)
Non interest income	6,364	6,949	(8.4)
Net fee and commission income	4,721	5,064	(6.8)
Income from insurance business	295	299	(1.7)
Profits on financial assets and liabilities at fair value	1,056	1,189	(11.1)
Other operating income (expenses)	292	397	(26.4)
Operating income	**12,128**	**12,887**	**(5.9)**
Personnel expenses	(4,123)	(4,251)	(3.0)
Other admin. exp.	(2,497)	(2,640)	(5.4)
Operating costs	**(6,619)**	**(6,891)**	**(3.9)**
Operating margin	**5,509**	**5,995**	**(8.1)**
Net provisions for risks and charges	(1,029)	(1,657)	(37.9)
Net adjustments to loans	(1,282)	(1,562)	(17.9)
Other income (expenses)	402	12	3223.2
Income (Loss) from discontinued operations	1	180	(99.4)
Gross Income (Loss)	**4,883**	**4,531**	**7.8**
Taxes on income	(1,215)	(803)	51.4
Net Non Recurring Income (Loss)	(908)	(789)	15.1
Net Income (incl. Minority interests)	2,760	2,939	(6.1)
Net income (loss)	**2,698**	**2,893**	**(6.7)**

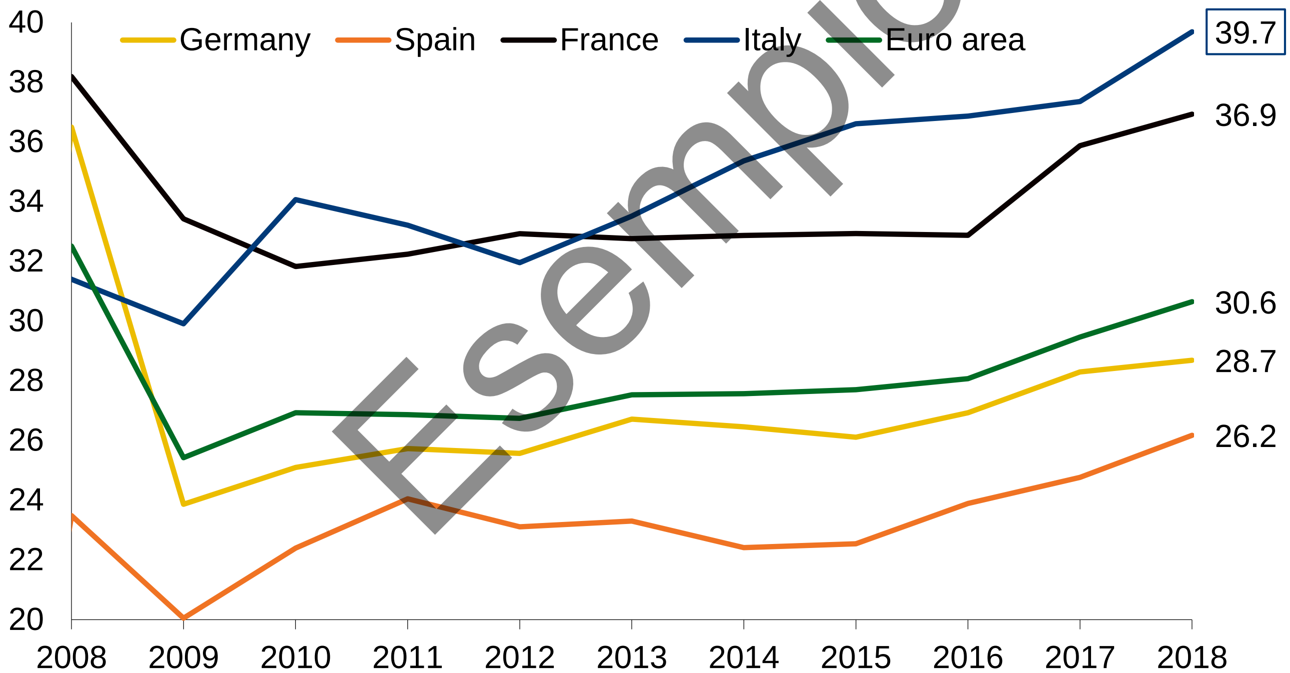
Top banking groups: Intesa Sanpaolo, Unicredit, UBI, Banco BPM, MPS.

Source: Intesa Sanpaolo on company data

Italian banks are well positioned in terms of income diversification …

Contribution to total income from fees and commissions has increased, at the highest among major European banking sectors since 2013.

Net fee and commission income (% of total income)
Banking system (Domestic banking groups and stand-alone banks)



Source: ECB

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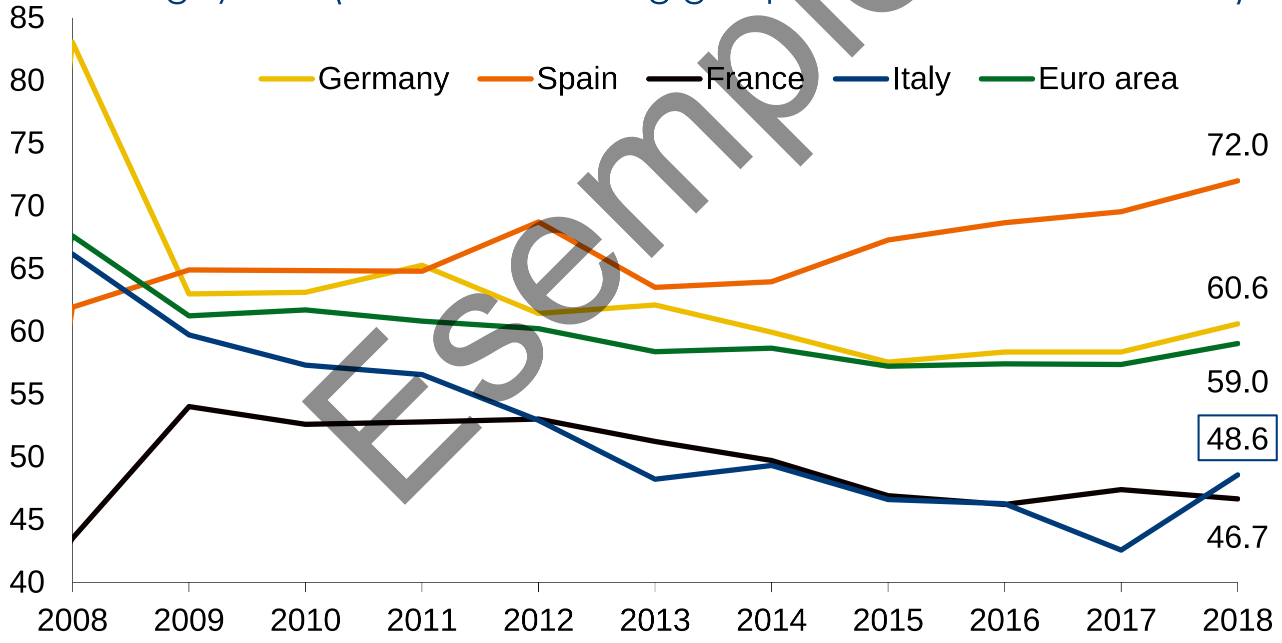
… while the contribution from net interest income is below 50%

- This means a lower exposure of Italian banks to the low interest rate environment.
- Opposite to Italian banks, the business model of Spanish banks and even German banks still relies mainly on interest income.

Net interest income (% of total income)

Banking system (Domestic banking groups and stand-alone banks)



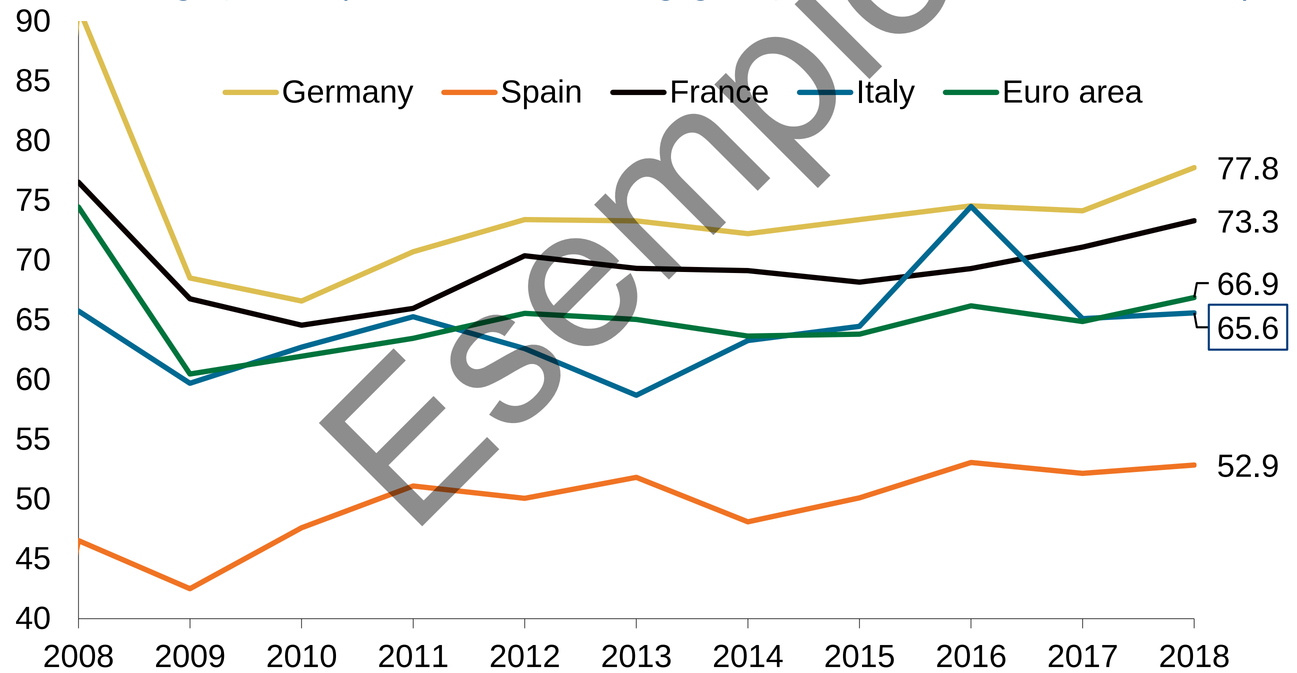
Source: ECB

Cost / income below the French and the German ratios, and in line with the Euro area average

- High dispersion among Italian banks, with best in class results in a few cases and room for improvements in others.

Cost income (%)

Banking system (Domestic banking groups and stand-alone banks)



Source: ECB

Cost cutting: bank branches down to below the number of the year 2000, but further closures are expected

- Bank branches down by 25% and about 8500 in terms of number with respect to the peak reached in 2008.
- Prometeia estimates almost 3000 branch closures in the three years 2019-21.

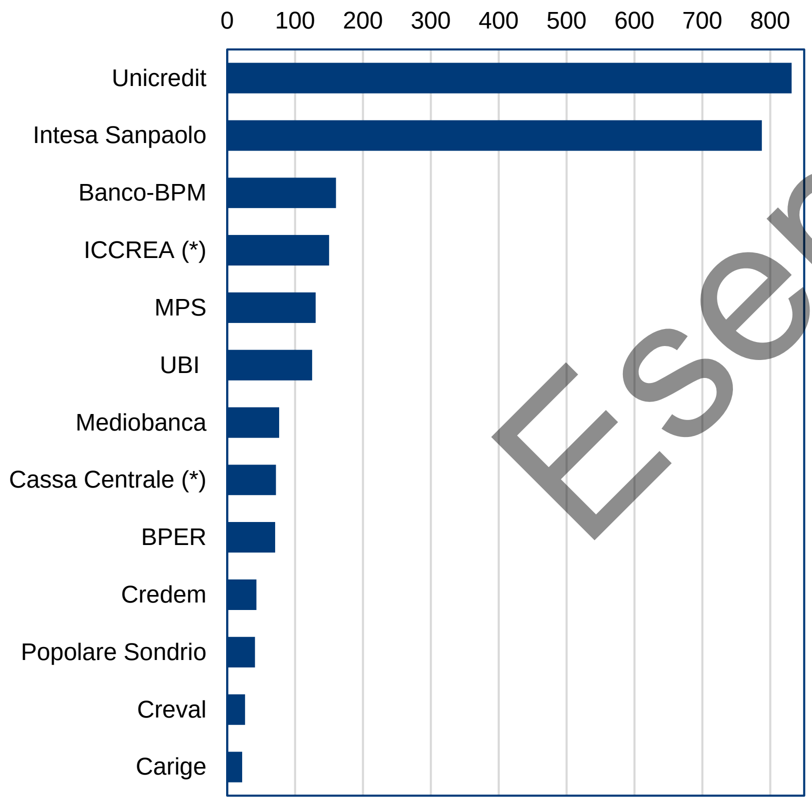
Number of bank branches and % change 2008/2000 and 2018/2008

Source: Bank of Italy and Intesa Sanpaolo Research Department calculations

Consolidation and reduction in the number of banks as a result of the mutual bank reform

- **2 new banking groups were established** in 1Q2019.
- Following the concentration of mutual banks, **the market share of significant banks is now equal to 81%** of the Italian banking sector total assets, from 74% of the previous 11 significant banks at end-2018.

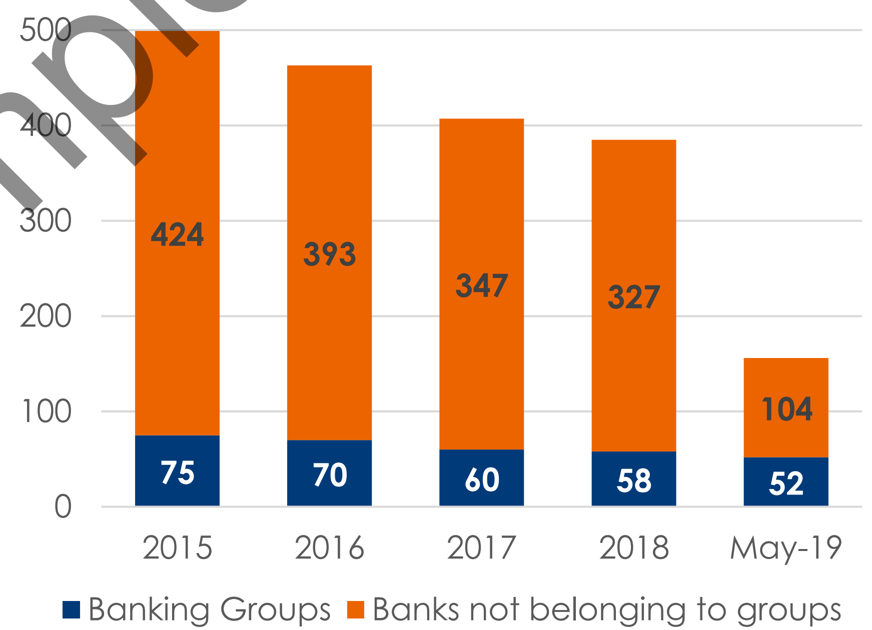
Significant banks by total assets at end-2018, including the new mutual bank groups (*) (EUR Bn)



Note: (*) Pro-forma figures for the new mutual bank groups which started operations in 2019

Source: Company data

As a result of the establishment of mutual banking groups, the n. of Italian banks went down to 156 (number of Banking Groups and stand-alone banks)



Source: Bank of Italy

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