

Statistics and analyses

Risk Outlook

5

December 2012



CONSOB
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PER LE SOCIETÀ E LA BORSA

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The Risk Outlook is published regularly, every six months.
It analyses the current economic situation and the trends
characterising the evolution of the financial markets.
The document serves to identify the risk factors
in order to achieve Consob's institutional objectives.

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Trends and risks

During 2012, the Eurozone sovereign debt crisis intensified, fuelling a growing contagion effect which was reflected in the smaller role played by economic and fiscal fundamentals in determining sovereign bonds yields. For Italy, in particular, estimates show that in 2012 as much as 200 basis points of the Italian-German bond spread can be attributed, on average, to the contagion effect. In the second half of the year, however, sovereign risk premia declined in the Eurozone's peripheral countries, thanks to the initiatives undertaken by the European institutions in order to avoid the disintegration of the euro. Among them, the adoption by the ECB of a secondary markets bond purchase plan for the weakest countries and the approval of the financial assistance plan for the Spanish banking sector.

Nonetheless, there still remains a lot of uncertainty, mainly attributable to the dichotomy of economic cycles between core and peripheral countries: the former expect a positive albeit weak growth; the latter are already experiencing a recession with a significant credit crunch for the private sector and sovereign debt servicing costs on the rise.

In such a scenario, given the current levels of primary budget surplus/deficit, government debt sustainability may be jeopardized, even in a positive cyclical phase, as long as interest rates remain higher than the GDP growth rate. For instance, under the hypothesis of stable interest rates and GDP growth at 1%, the debt-to-GDP ratio might increase in countries with a primary deficit (such as Spain), and decrease in countries with a primary surplus (such as Italy and Portugal).

Therefore, even in a mild growth and constant yields scenario, the stabilization of public finance might require further measures of fiscal consolidation. For instance, some simulations show that, in order to bring the debt-to-GDP ratio down to a 60% level over the next 20 years, it would be necessary to run a primary surplus of around 4.8% of GDP for Italy (where some important structural reforms have already been passed into law by Parliament), 1.4% for France, 3.8 for Portugal, and 2.2% for Spain.

Since June, equity markets have followed a positive, although discontinuous, trend, in spite of the uncertainties over public finances and growth prospects in peripheral countries.

Moreover, with observed contagion phenomena subsiding in the first half of the year, stock prices bounced back to a level closer to fundamentals in main Eurozone countries.

The top Italian non-financial companies have exhibited a falling profitability (underperforming, on average, the European companies) and a greater vulnerability caused by higher leverage and interest charges on bank loans.

The equity ratio for top European banks has increased (especially German and British banks), albeit mainly because of a methodological revision in accounting for risk weighted assets, while credit quality has deteriorated, especially for Italian and Spanish banks. On average, however, banks' credit risk, as perceived by the market, has significantly declined.

Different equity ratios and bad loans incidence of the banks of the main European countries is nevertheless attributable to differences in business models and asset composition; German, British and French banks are more exposed to derivatives than Italian and Spanish banks, whose assets are more concentrated on loans to families and businesses.

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Sovereign risk indicator



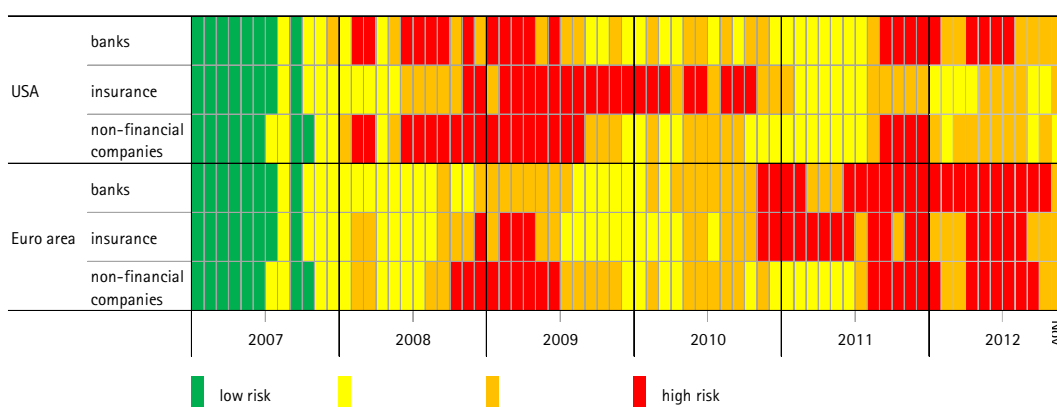
Source: calculations on Thomson Reuters data. The risk is computed on the basis of the historical distribution of 10-year sovereign yields.

Issuance activity indicator by sector



Source: calculations on Dealogic data. The absorption indicator is computed by comparing placements in the period with the historic distribution of placements and it is estimated by correcting for outliers.

Credit risk indicator



Source calculations on Thomson Reuters data. The risk level is computed on the basis of the historical distribution of CDS Thomson Reuters indexes.

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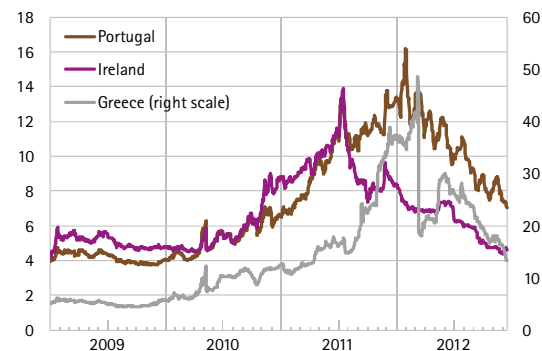
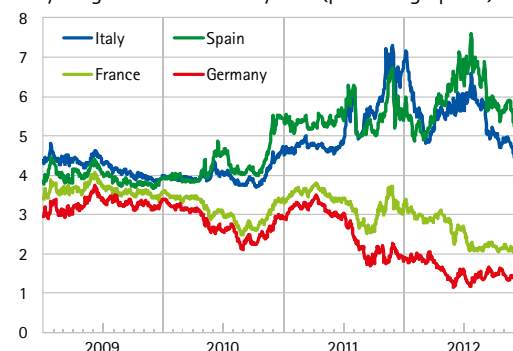
Macroeconomic background

In the second half of 2012, sovereign risk premia of peripheral countries decreased thanks to major policy decisions in the Euro area

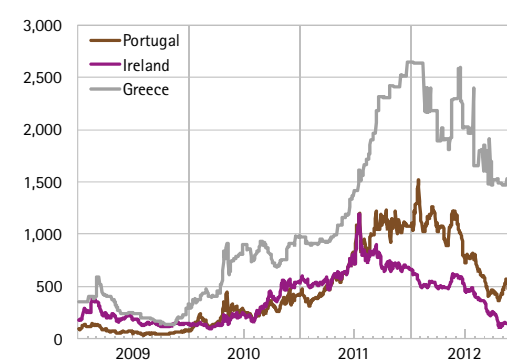
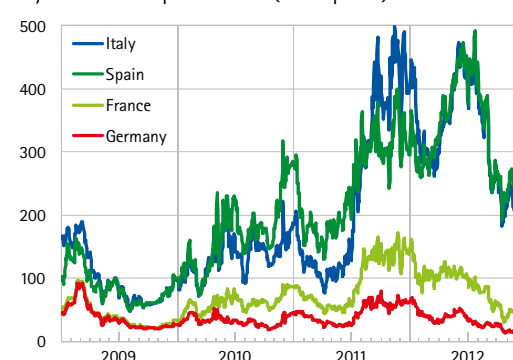
Since July 2012, sovereign risk premia of peripheral countries have decreased; in particular, Italian government bond yields fell from 6% in July 2011 to 4.6% on 14 December 2012. The sovereign bond market benefited from major policy decisions in the Euro area. First, in July, Eurozone finance ministers approved the terms of a bailout for Spanish banks and agreed to provide up to 100 billion in financial assistance. Later, in August, the Outright Monetary Transactions (OMT) support programme was launched. On the other hand, uncertainty also weighed heavily with regard to the last tranche of lending to Greece, 34 billion euro finally released in December. In spite of reduced tensions on peripheral countries' sovereign debt, core countries such as France and Germany continue to benefit from the flight-to-quality effect that led to a considerable reduction in their government bond yields. This phenomenon reflects the still intense degree of risk aversion that keeps on seizing up European debt markets. The greatest uncertainty lies in the economic outlook and the public finance managing in fragile Eurozone countries; moreover, the actual possibility of direct recapitalisation of banks by the European Stability Mechanism entered into force in October.

Figure 1.1 – Government bond yields and CDS on public debt in some Euro area countries
(daily data; 01/01/2009 – 14/12/2012)

10-year government bond yields (percentage point)



5-year CDSs on public debt (basis point)



Source: calculations on Thomson Reuters data.

Despite the reduced tensions on secondary markets for sovereign bonds in the Euro area, long-term yields are still high in peripheral countries

The Italian yield curve dropped by more than 200 basis points (almost 400 on one-year maturity) compared with November 2011; nevertheless, on the longest maturities it continues to stay close to the July 2011 level. For all the maturities Italian bond yields are lower than Spanish ones (70 – 150 basis points), which still stand at the July 2011 level and decreased only on the short end compared with November 2011. Flight-to-quality on core countries' bonds pushed down German and French yields, in particular on the rates for shortest maturities. The Portuguese curve, still inverted in November 2011, flattened significantly reflecting signs of recovery. The United Kingdom saw its curve progressively flatten, especially for the long-term bonds.

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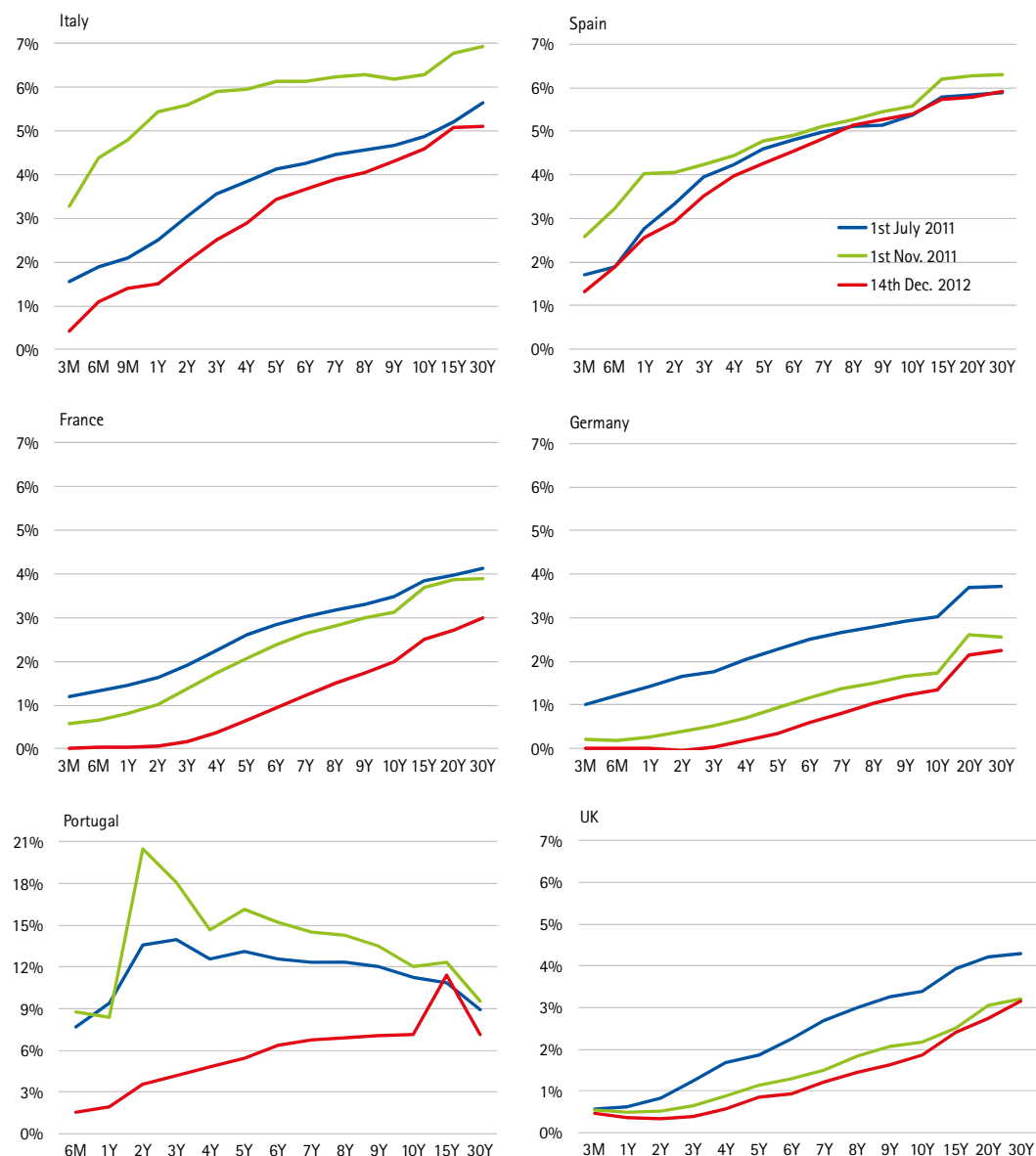
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Figure 1.2 – Yield curves



Source: calculations on Thomson Reuters data.

In most peripheral countries, contagion has a role comparable to fundamentals in explaining the level of spreads. In particular, in 2012, contagion explained more than 50% of the Italian spread

Since the outbreak of the 2007–2008 financial crisis, sovereign spreads in the Euro area have been driven by both fundamental – fiscal and macroeconomic – factors and contagion. According to analysis of the determinants of sovereign spreads in the Euro area, in 2012, in most peripheral countries contagion had a role comparable to fundamentals in explaining the level of spreads. For example, contagion accounts for an amount of 45% and 60% in Spain and Portugal respectively, while France, benefiting from a flight-to-quality effect, shows spreads lower than what is implied by fundamentals by roughly 70 basis points. As for Italy, fundamentals contributed to the reduction in the spread in 2007–2008; from 2009 onwards, as general economic conditions deteriorated, fundamentals are estimated to have raised the spread; later, as the sovereign debt crisis worsened, Italy experienced a rising contagion effect that in 2012 accounted for roughly 200 basis points (more than 50%) of the spread.

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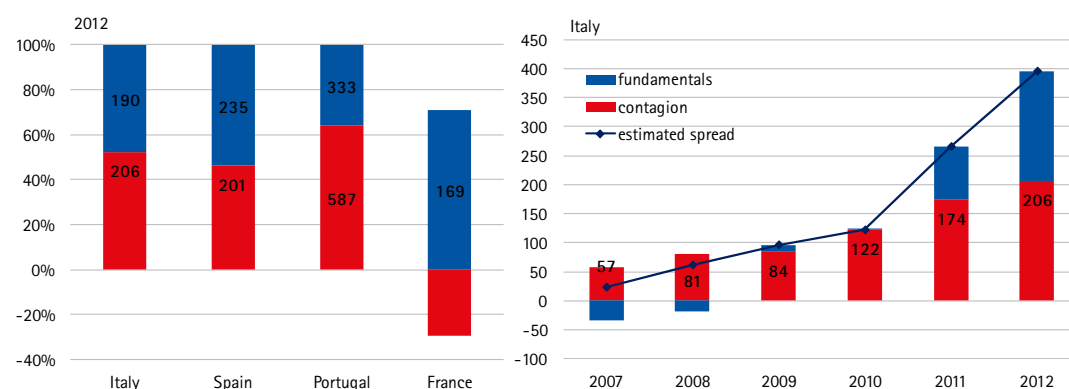
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Figure 1.3 – Contribution of fundamentals and contagion to the 10-year bond yield spreads of some Euro area countries



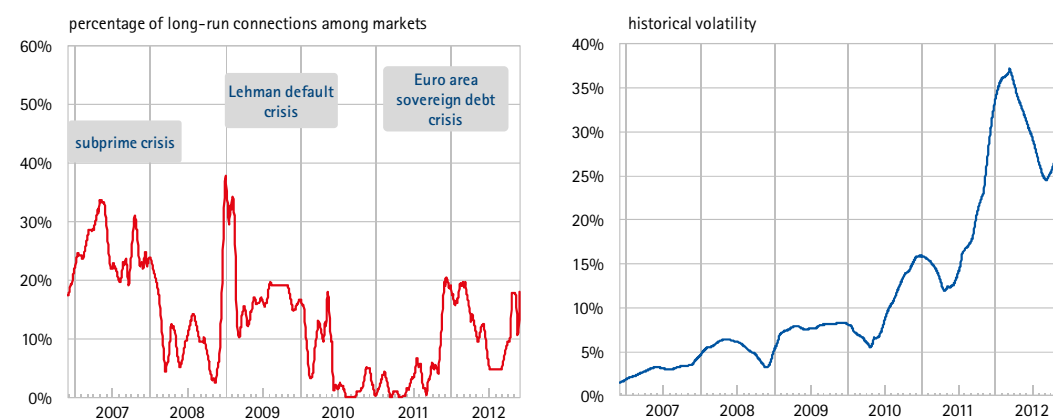
For the calculation methodology, see Giordano L, N. Linciano e P. Soccorso, "The determinants of government yield spreads in the Euro area", Consob working paper, no. 71, 2012. The left panel shows, for each country, the share (in basis points) of the annual average predicted spread due to fundamentals and to contagion; results are based on a feasible generalized least square estimator (FGLS) accounting for the presence of AR(1) autocorrelation within panels. The right panel shows the estimates of the contribution of fundamentals and contagion to the Italian government bond spread for 2007-2012. Calculations are based on Thomson Reuters, Eurostat, ECB and Fred data.

Contagion among European secondary markets for sovereign bonds slowed down during the first semester of 2012. However, in the second half of the year it started to rise

Contagion among European secondary markets for sovereign bonds, as summarised by the connections among markets unexplained by fundamentals, slowed down during the first semester of 2012. Since July, however, renewed spill-over effects have arisen, reaching at the end of September their highest levels since June 2011. Volatility in sovereign bond yields has also grown by remaining on values far higher than those recorded on average before 2011.

Figure 1.4 – Indicator of contagion and historical volatility of 10-year sovereign bond spreads for some European countries

(percentage values; daily data; 27/11/2006 – 30/11/2012)



For the methodology applied to construct the contagion indicator see Gentile M. and L. Giordano, "Financial contagion during the Lehman default and sovereign debt crisis: an empirical analysis on Euro area bond and equity markets", Consob working paper no. 72, 2012. The left graph reports the percentage of statistically significant long-run relations among sovereign bond spreads; the long-run connections have been detected by applying the bi-variate cointegration test of Johansen (1988) with a rolling window of 1,000 days on the stock return time series. The right graph reports the average value of the annualised historical volatility of sovereign bond spreads which has been estimated by applying a multivariate Garch model. The countries included in the sample are the UK, Germany, France, Italy, Spain, Greece, Portugal and Ireland. The sovereign spreads are computed by using US Treasury bond as the benchmark. Calculations are based on Thomson Reuters data.

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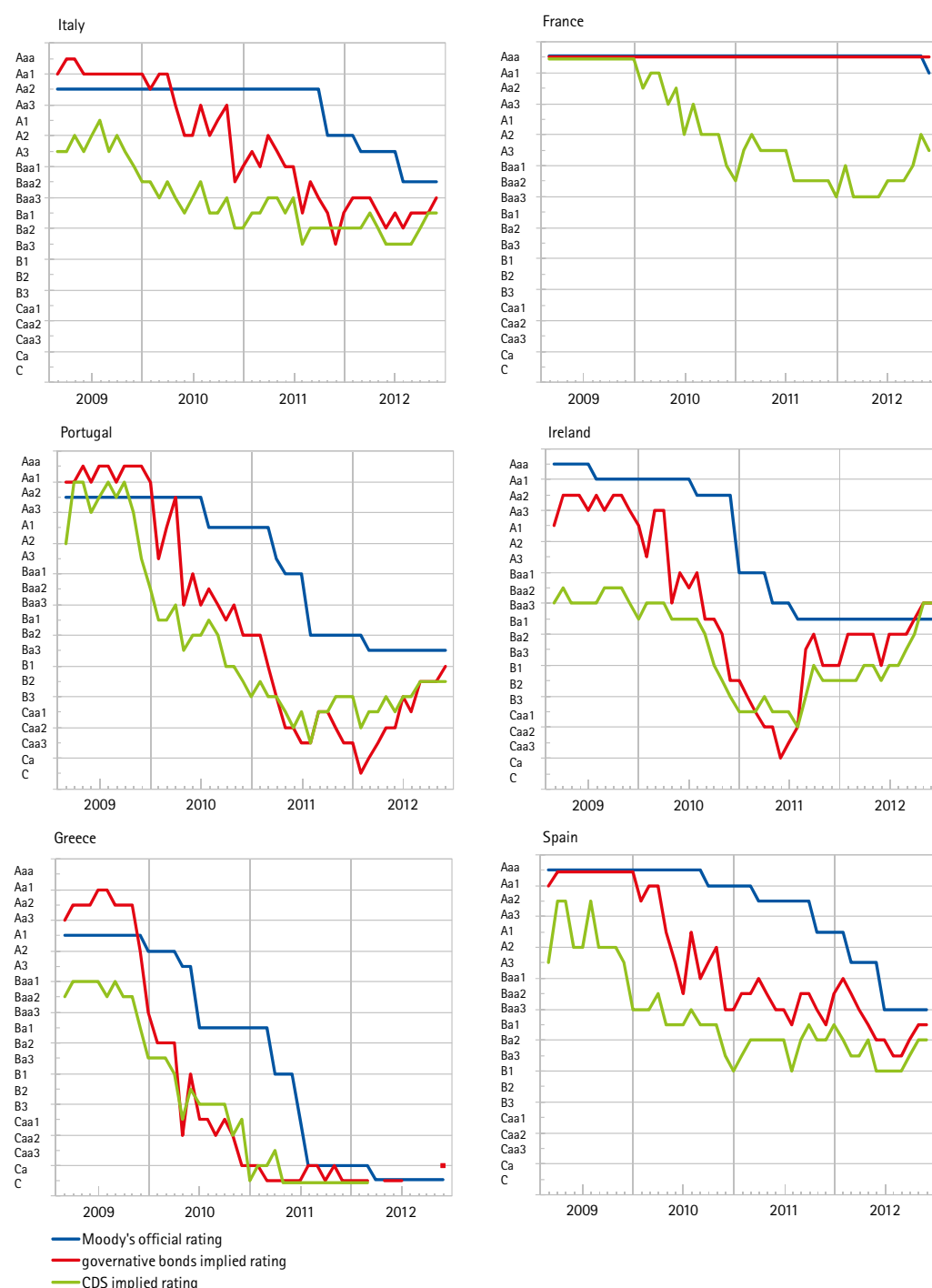
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In spite of the persistent fragile economic outlook, in the second half of 2012 market perception of sovereign risk improved for peripheral countries

In the second half of 2012, the gap between Moody's official rating and sovereign bond yields and CDS implied ratings decreased in some peripheral Eurozone countries, in particular Italy, Portugal and Spain. This trend reflects both the improvement in the market perception of the sovereign risk and the concurrent downgrading of the official ratings. Moody's rating still remains higher than the implied ratings in most peripheral countries; the official rating is slightly lower than the CDS-implied rating only in Ireland, where the latter increased significantly in 2012, reaching levels higher than those of Italian and Spanish CDS-implied ratings.

Figure 1.5 – Bond and CDS implied ratings in some Euro area countries
(monthly data; January 2009 – November 2012)



Source: calculations on Moody's data.

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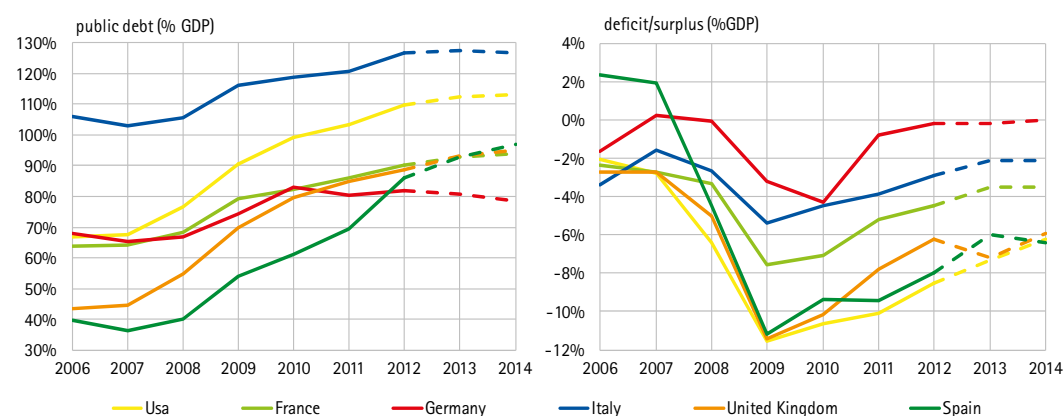
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In most advanced countries the public debt-to-GDP ratio is expected to increase in the next two years, due to the persistence of fiscal deficits

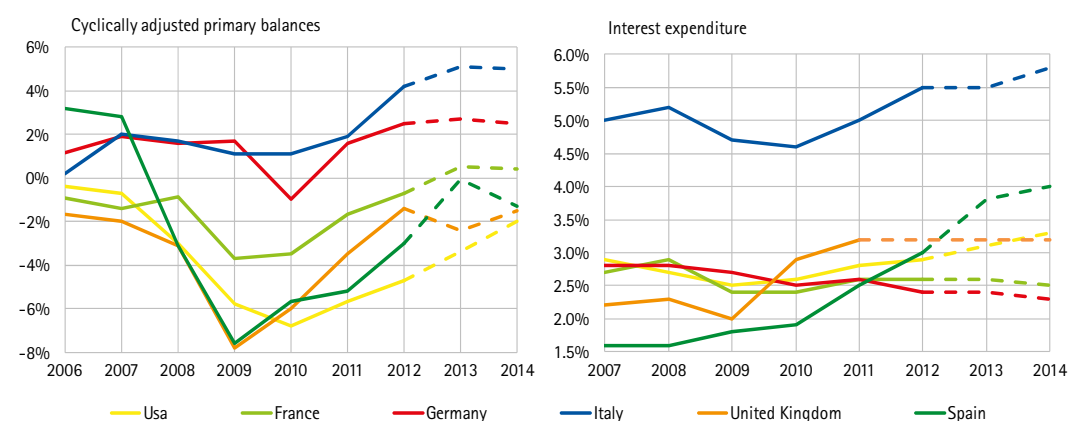
For 2012 fiscal deficits are expected to improve in the main Euro area countries as a result of the fiscal consolidation policies implemented in the course of the year. However, according to the EU Commission, this trend will level off in the next two years, because of the moderate or negative economic growth and the rise in interest expenditure as a percentage of GDP, which has significantly increased in the last year (mostly in Spain and Italy; see Risk Outlook no. 4, Figure 1.6). The persistence of fiscal deficits affects the trend of the public debt-to-GDP ratio, which has risen in Italy, France and Spain; the EU Commission forecasts indicate for Spain a public debt ratio slightly lower than 100% in 2014. Public finances are expected to worsen in the United Kingdom following the estimated increase in its primary deficit in 2013. In the United States, the deficit would decline by more than 4% of GDP were a compromise to avoid the fiscal cliff not achieved, and the tax cuts left to expire and the planned automatic spending cuts allowed to take hold. An even larger adjustment would be needed if the federal debt ceiling were not raised. If a political compromise to avert the fiscal cliff were found, the deficit-to-GDP ratio should increase by 1.2 percentage points, while the public debt-to-GDP ratio would result higher than 110%.

Figure 1.6 – Deficit and public debt in advanced countries



Source: EU Commission.

Figure 1.7 – Cyclically-adjusted primary balance and interest expenditure (% of GDP)



Source: EU Commission.

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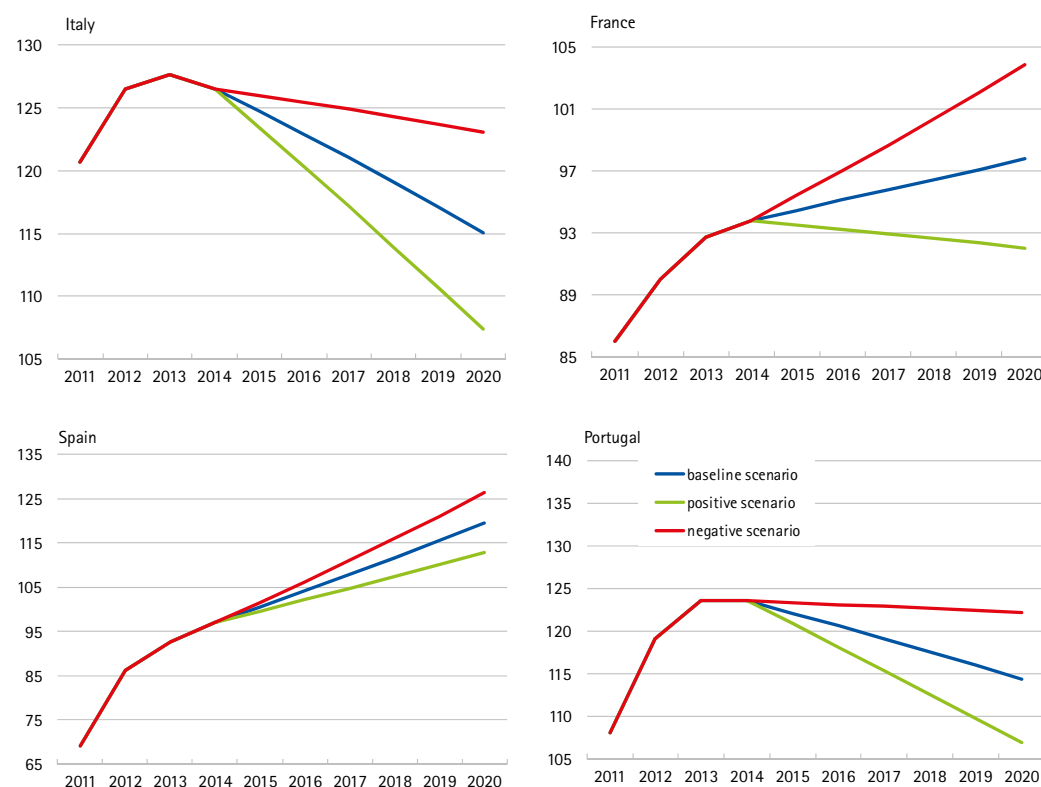
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Long-term fiscal sustainability in EU peripheral countries requires a significant fiscal adjustment, even in a positive scenario of modest growth and moderate interest rates

The assessment of the long-term sustainability of fiscal policy has become a key component of budgetary surveillance in the EU. Debt sustainability is difficult to reach without economic growth and with the high interest on public debt. In a zero-growth scenario with interest rates 100 basis points higher than now, the debt-to-GDP ratio would exceed 120% in Italy, Spain and Portugal in 2020. Instead, in a positive scenario with stable interest rates and economic growth of 1%, the debt-to-GDP ratio would decline in Italy, in Portugal and, to a lesser extent, in France, while it would increase in Spain. Given that in all considered scenarios interest rates are higher than economic growth rates, fiscal sustainability requires the achievement and maintenance of primary surpluses. The required primary balance depends on both the initial stock of public debt and the debt target (i.e. the desired decrease in the public debt ratio over a specific time horizon).

The additional adjustment of primary balance required to reduce the debt-to-GDP ratio to 60% in 20 years, in different scenarios, is between 0.6% and 2.6% of GDP in Italy, which has already implemented important structural reforms, while it is more significant in Spain, where it is between 5% and 7% of GDP. Portugal needs an additional adjustment of primary balance between 2.5% and 4.5% of GDP, according to different scenarios. France, which has not implemented significant fiscal consolidation plans yet, needs a correction of primary balance between 2% and 4% of GDP in different scenarios.

Figure 1.8 – Estimates of the dynamics of public debt-to-GDP ratios in some Euro area countries



The inter-temporal budget constraint of the government has been used to examine the dynamics of public debt. In the baseline scenario, interest rates are equal to those of 2012 and GDP economic growth is 0%. In the positive scenario interest rates are equal to those of 2012 and GDP economic growth is 1%. In the negative scenario interest rates are 100 basis points higher than those of 2012 and GDP economic growth is 0%. In all scenarios the cyclically-adjusted primary balance is equal to the EU Commission forecast for 2014, while the inflation rate is 2%. The source for all data is the EU Commission.

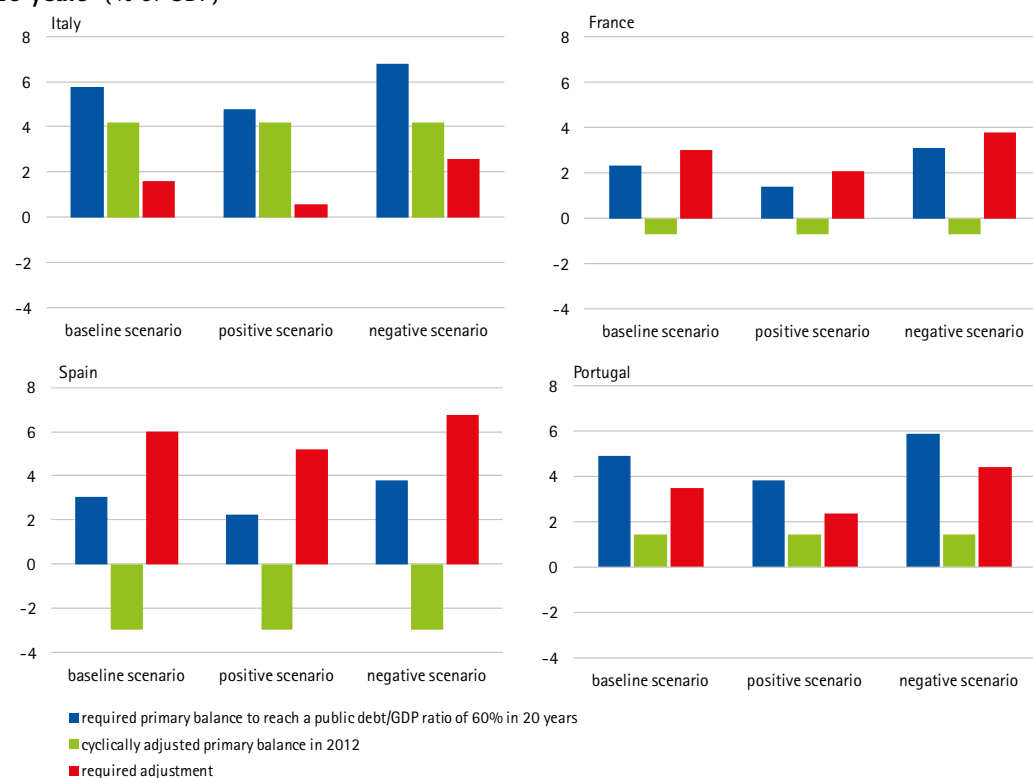
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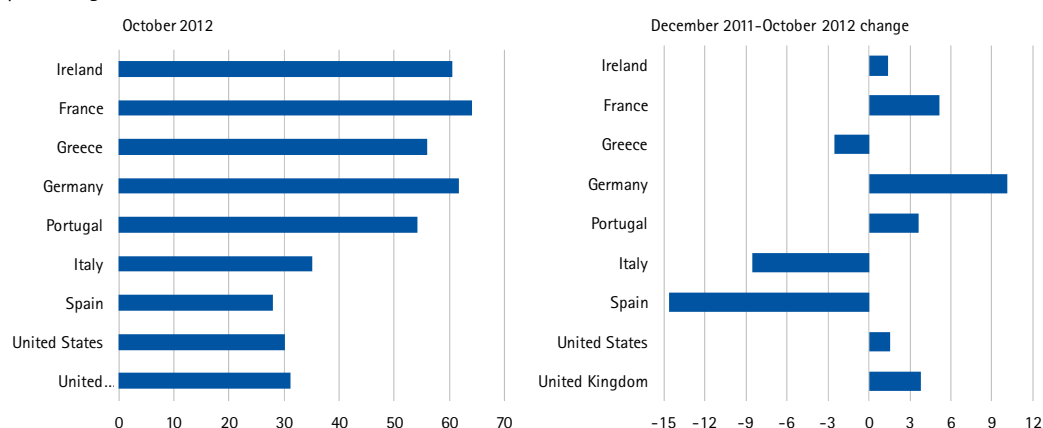
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Figure 1.9 – Primary balance adjustment required to lower the debt-to-GDP ratio to 60% in 20 years (% of GDP)

The inter-temporal budget constraint of the government has been used to examine the required primary balance to reach a public debt-to-GDP ratio of 60% in 20 years. In the baseline scenario interest rates are equal to those of 2012 and GDP economic growth is 0%. In the positive scenario interest rates are equal to those of 2012 and GDP economic growth is 1%. In the negative scenario interest rates are 100 basis points higher than those of 2012 and GDP economic growth is 0%. In all scenarios the inflation rate is 2%. The source for all data is the EU Commission.

Since the beginning of 2011, foreign investors have significantly reduced their exposure towards the government debt of peripheral countries, while they have increased their exposure towards the government debt of core countries

The Euro area peripheral countries have experienced a decrease in the non-resident holdings of general government debt, while the opposite is true for core countries which have benefited from the so-called flight-to-quality effect. In particular, the non-resident holdings of general government debt has decreased by 9 percentage points in Italy (passing from 44% to 35%) and by 14 percentage points in Spain, while it has increased respectively by 4 and 10 percentage points in France and Germany.

Figure 1.10 – Non-resident holdings of general government debt (percentage values)

Source: calculations on International Monetary Fund data.

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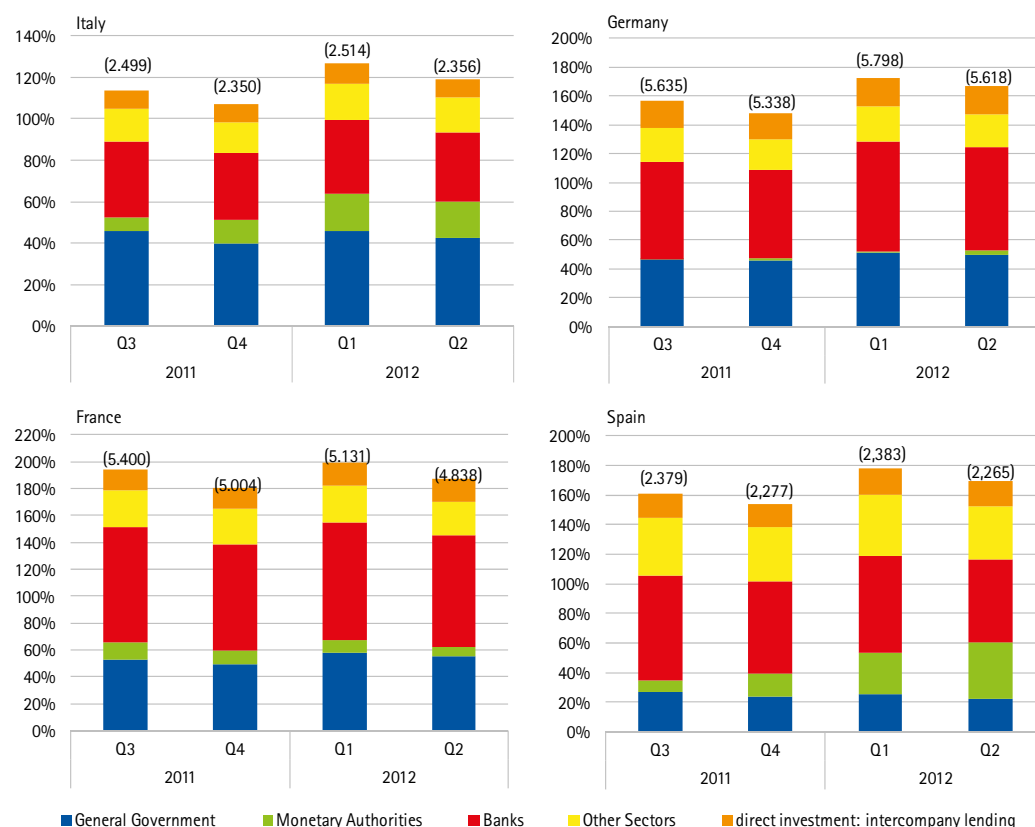
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The external debt-to-GDP ratio is lower in Italy than in France, Germany and Spain because of the lower private debt

In June 2012 the external debt-to-GDP ratio was about 120% for Italy, while it was approximately 170% for Germany and Spain and slightly lower than 190% for France. Public debt is about 40% of total external debt in Italy, 30% in Germany and France and only 15% in Spain. Nearly 40% of the external debt in Germany, France and Spain is composed of bank debt; in Italy the share is lower than 30%. Moreover, in June 2012 the external position of central banks was higher in Italy (about 20% of total external debt) and Spain (40% of the total), significantly increasing with respect to the third quarter of 2011. This increase reflects Target2 imbalances that have emerged since 2009, when central banks in Germany and Netherlands began to show positive balances towards other central banks of the Eurosystem, while the negative balances of the central banks of peripheral countries have grown (see Figure 1.15 of Risk Outlook no. 4, June 2012).

Figure 1.11 – External position of some Euro area countries by institutional sector
(amounts in % of GDP and billions of US dollars)



Source: calculations on data IMF, BIS and OECD.

Economic activity in the Eurozone should gradually recover in 2013, although at a modest pace

The macroeconomic global outlook remains fragile. Emerging economies are slowing down. In the Euro area, economic activity declined over 2012, with core countries witnessing very low growth rates and peripheral countries, except for Ireland, affected by recession. In particular, in the second quarter of 2012, in the Euro area and in Italy, GDP growth slowed down to 0.2% and 0.7%, respectively, due to poor consumer spending and delivering gross fixed capital formation; the negative impact from domestic demand weighed on GDP growth also in the third quarter. The fiscal consolidation in most Euro area countries that drag down the GDP growth rate induced the revision of the previous economic outlook: according to the latest European Commission estimates, the Eurozone is forecast to recover modestly in 2013 and more quickly in 2014, even if at a different pace among countries.

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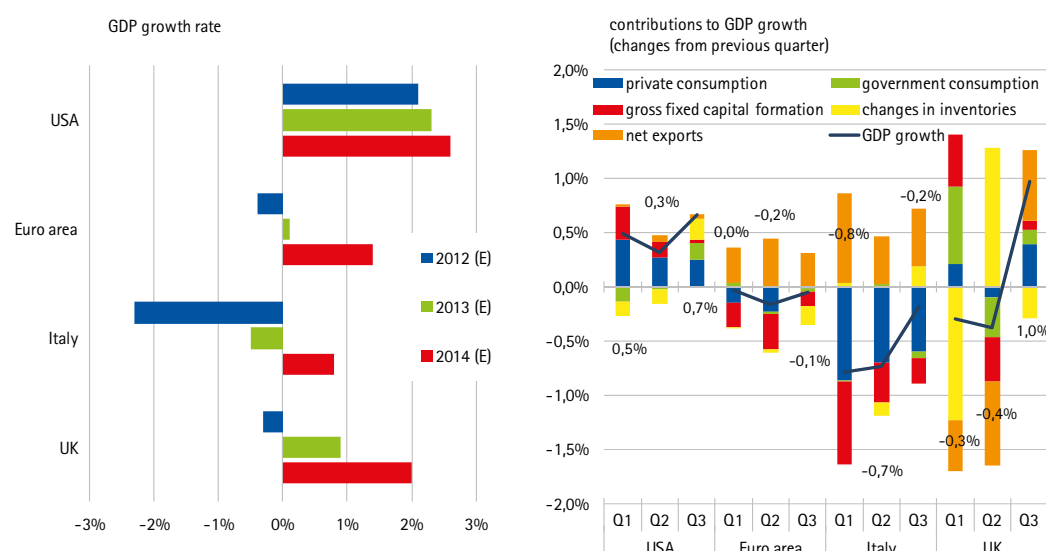
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In Italy, the slowdown is expected to continue until 2013, with higher unemployment and taxes continuing to reduce disposable incomes and domestic demand, while economic activity is expected to start growing again only in 2014. Public consumption, investments and net exports were the main contributors to the slowdown in the UK, where GDP declined by 0.4% in the second quarter, despite the huge increase in inventories; in the third quarter, instead, private consumption and net exports raised GDP by 1%; an increase from 0.9% in 2013 to 2% is forecast for 2014. In the third quarter of 2012, real GDP in the USA grew by 0.7% on an annual basis, compared with 0.3% in the second quarter; contribution to growth came from the increase in private and public consumption, only partially offset by the reduction in net exports; growth rates higher than 2% are expected for the next two years.

Figure 1.12 – GDP growth in some advanced economies



Source: calculations on Thomson Reuters and European Commission data.

In the Euro area cross-country divergences widened in 2012. Forecast for peripheral countries have become less accurate

Economic growth divergences between core countries (Germany and France) and peripheral countries (Italy and Spain) widened in 2012. Indeed, the subprime crisis caused a harsh economic recession in Germany and Italy in 2009, and, a lighter GDP contraction in France and Spain. However, in 2010, all the above-mentioned countries except Spain registered positive real GDP growth rates (4.2% in Germany and nearly 2% in France and Italy). Since the beginning of the sovereign debt crisis, cross-country growth differences have widened: more vulnerable countries such as Italy and Spain are both expected to be in recession for 2012 with an expected GDP contraction equal, respectively, to 2.3% and 1.4%, while Germany and France, which are not affected by tensions in financial markets, are projected to have a moderate economic growth, respectively, of 0.8% and 0.2%. As the crisis worsened, the forecasts of economic growth published by the main international organizations have become less accurate, in particular for peripheral countries, which experiencing wider economic cycles.

Forecast errors are particularly significant for economies undergoing fiscal consolidation such as Italy and Spain. This evidence corroborates the hypothesis that short-term negative effects of synchronised fiscal adjustment across numerous countries have been underestimated. Moreover, the financial determinants of the crisis and the difficult estimates of the effect of the credit crunch on economic growth further complicate the forecast.

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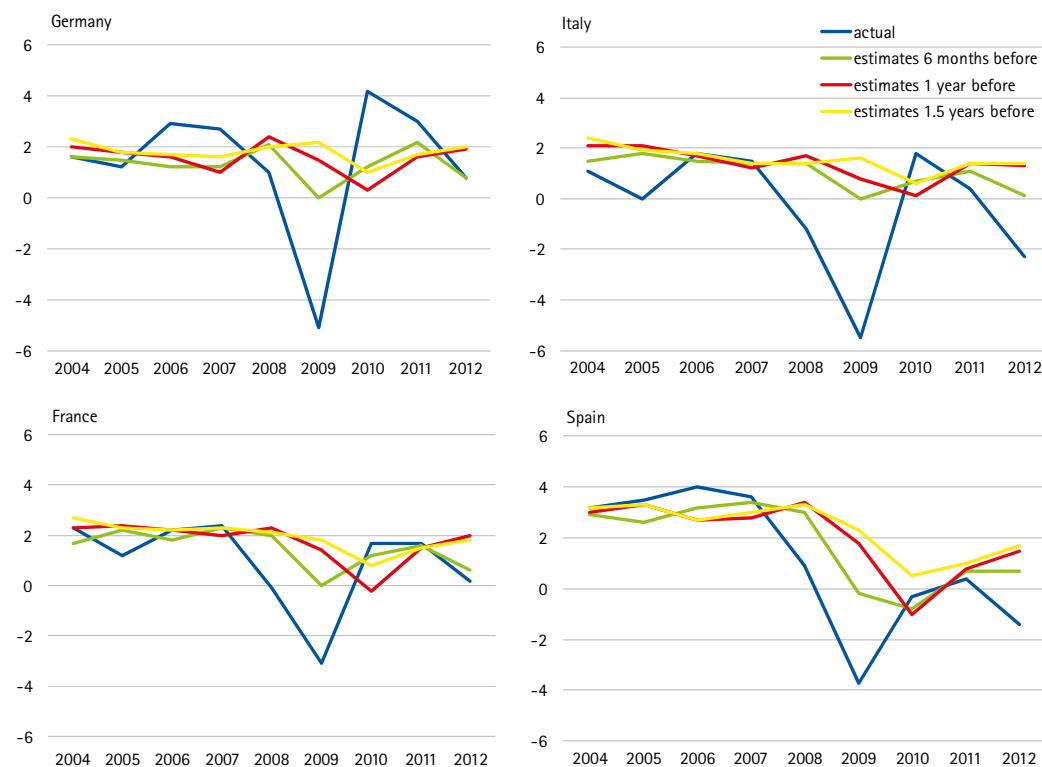
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Figure 1.13 – Comparison between estimated and actual economic growth

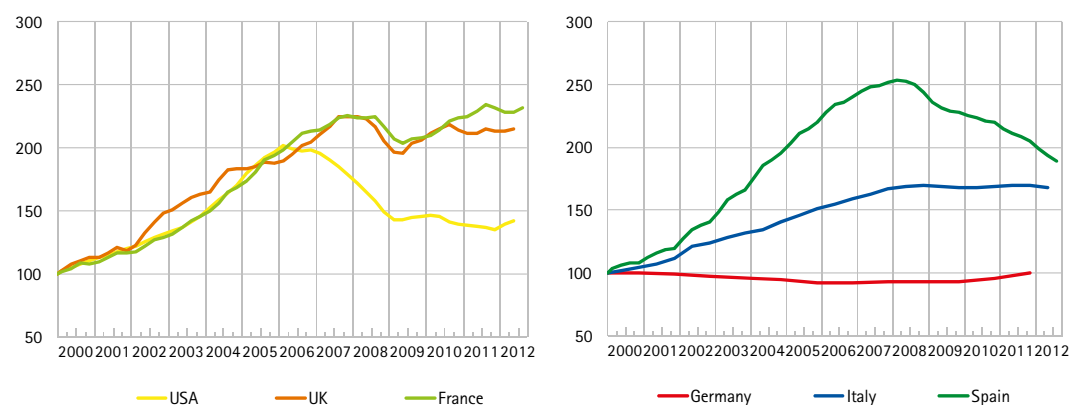


Source: calculations on EU Commission data.

The housing market
remains weak in most
advanced economies

The housing market remains weak in most advanced economies. House prices increased slightly only in the United States, where the Federal Reserve has recently launched the mortgage-backed securities purchase programme aimed at sustaining the mortgage loan market. In the Euro area, prices are rising moderately in Germany and still remain high in France; they are stationary or declining in other countries. Moreover, fiscal consolidation measures could drive down demand for housing in peripheral countries; therefore, the contribution of real estate to GDP growth is likely to be nil in the near future.

Figure 1.14 – House prices in some advanced economies



Source: Bank for International Settlements.

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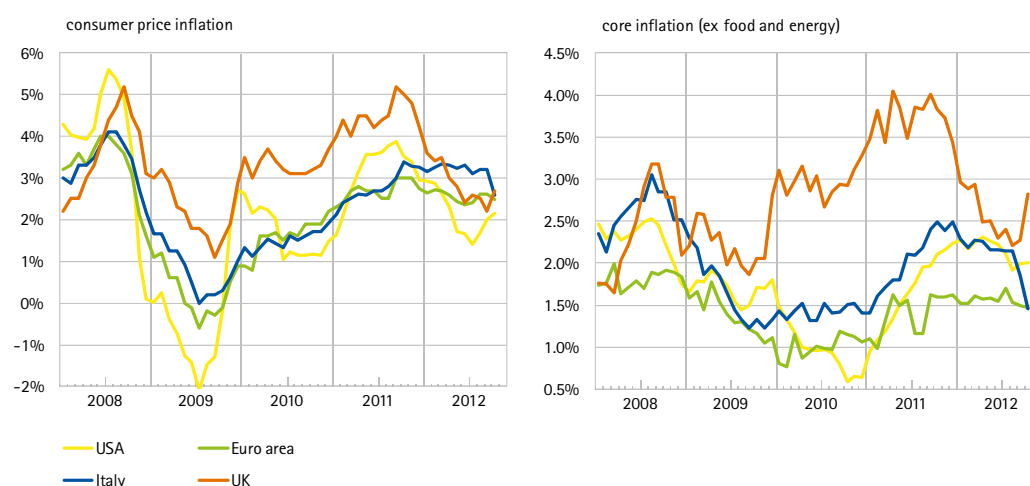
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Deterioration in European economic activity is expected to keep inflationary pressure weak

The increase in oil and food prices, experienced from the second half of 2012, has fuelled inflation in major advanced economies. In the USA, inflation rose from 1.4% in July to 2.1% in October, while in the Euro area it remains persistently high (over 2%) also due to the recent euro depreciation and the rise in indirect taxes. Nevertheless, deterioration in European economic activity and high unemployment rates are expected to keep inflationary pressure weak, with core inflation rates stable or falling in most economies (from 2.5% at the end of 2011 to 1.5% in the third quarter of 2012 in Italy). In the United Kingdom, core inflation rose by almost 0.5% in the second half of 2012, as higher university tuition fees pushed up the cost of living for households.

Figure 1.15 – Inflation

(percentage changes over 12 months)



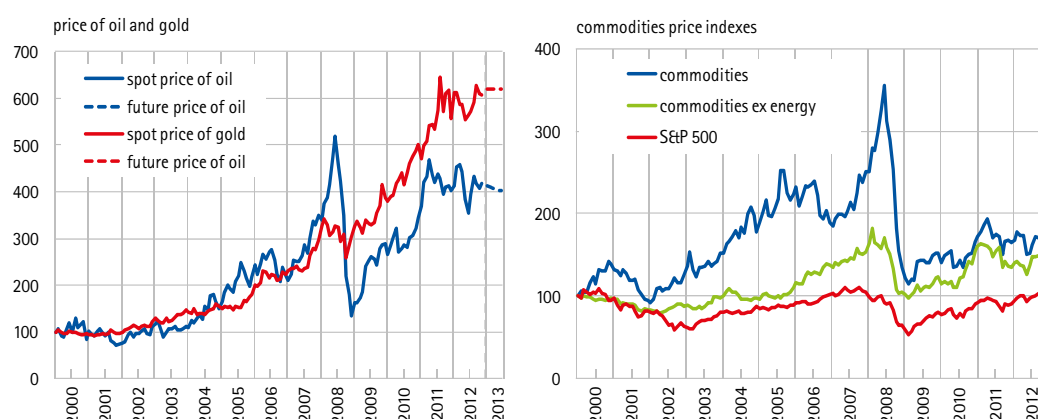
Source: Thomson Reuters.

Sluggish economic activity drags down global oil demand; the futures market indicates moderate price slowdown in the months to come

After declining in the first half of 2012, oil and gold prices rebounded in August. Gold returned to its end of 2011 level, because investors seeking refuge during the economic slowdown pushed up prices to new highs. Oil price rose, although not to the previous level, driven by geopolitical concerns and the Iranian embargo; nevertheless, sluggish economic activity drags down global oil demand and the futures market indicates a moderate price slowdown in the months to come. Furthermore, in addition, commodities price indexes are expected to remain stable or to decrease slightly, reducing their inflationary pressure.

Figure 1.16 – Oil, gold and commodity prices

(monthly data; January 2000=100)



Source: calculations on Thomson Reuters data.

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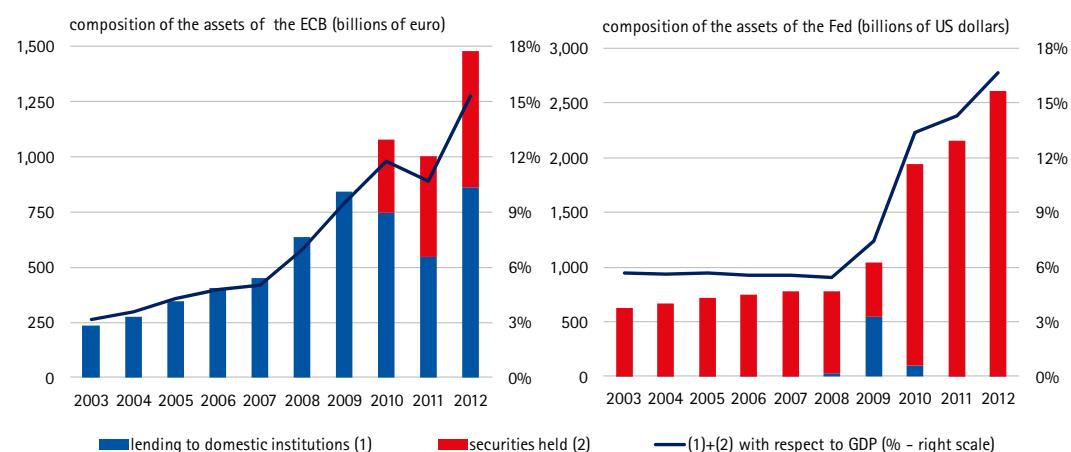
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The ECB and the Fed maintain a strongly expansionary monetary policy, with significant differences in the use of non-standard measures

Since the outbreak of the financial crisis, the ECB and the Fed have implemented the traditional instruments of monetary policy in an innovative way and, at the same time, introduced some non-standard measures. This has determined the enlargement of their balance sheets both in absolute value and with respect to GDP. The Fed has had a stronger expansive approach as shown by the composition of assets. The liquidity in the system supplied by means of open market operations and by longer-term refinancing operations at the end of 2012 was equal to 17% of GDP for the Fed and 15% of GDP for the ECB. The differences in the composition of their assets show the differences of instruments used to address the crisis.

The Fed, between 2008 and 2009, implemented liquidity programs for financial firms intended to affect the cost of credit to households and firms more directly; since 2009, instead, it has begun a series of purchases of longer-term securities issued by the US Treasury (and mortgage-backed securities), which at the end of 2012 represented more than 90% of total assets. The ECB has chosen to inject liquidity into the banking system in order to minimise the risk of a credit restriction, and it has always sterilized purchases of government securities: at the end of 2012 government securities represented about 20% of the assets of the ECB, while refinancing operations were nearly one-third of total assets. Last September the Governing Council of the ECB clarified the details of the Outright Monetary Transactions (OMTs) in the secondary market for government securities with residual maturity of between one and three years. The OMTs will be subject to strict conditionality for the countries concerned; no temporal or quantitative limits have been fixed for OMTs. As in the Securities Markets Programme, which has contemporaneously terminated, liquidity effects of OMTs will be sterilized.

Figure 1.17 – Composition of the assets of the ECB and the Fed



The recourse to financing of central bank by domestic institutions also includes, in the case of the Fed, the term auction facility, through which the central bank provided liquidity to the market in the period 2008-2010. Source: calculations on ECB and Fed data.

In the second and the third quarter of 2012 reliance on Eurosystem operations increased for more fragile countries, with the exception of Greece and Ireland

In the second and third quarter of 2012, the reliance on Eurosystem financing by the credit institutions increased with respect to the first quarter for all peripheral countries, with the exception of Greece, which experienced a decline in the second quarter (about 6% of total assets at the end of September compared to 15% at the end of March), and of Ireland (recording a substantially stable value of 6%). In Spain recourse to ECB financing was 11% of the total assets of credit institutions in the third quarter of 2012 (8.5% at the end of the first quarter); a similar increase was registered in Portugal, where recourse to ECB financing by the credit institutions in September was nearly 10% (8% at the end of March).

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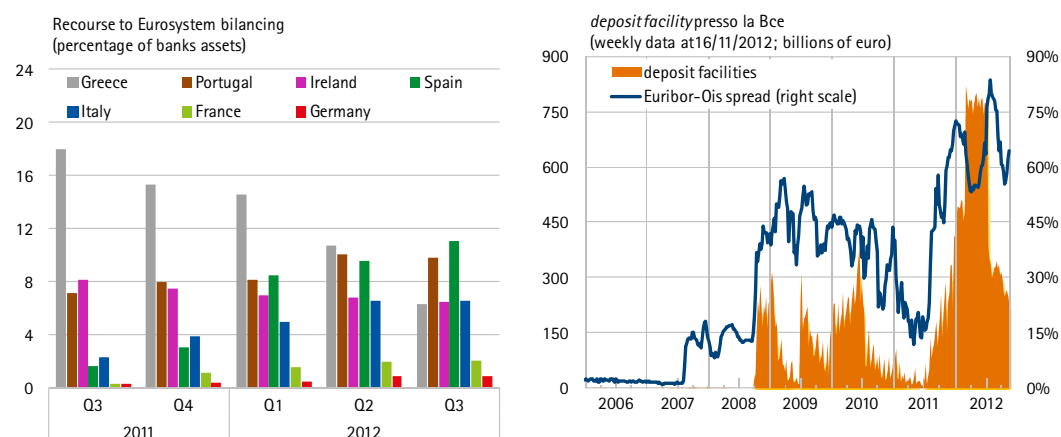
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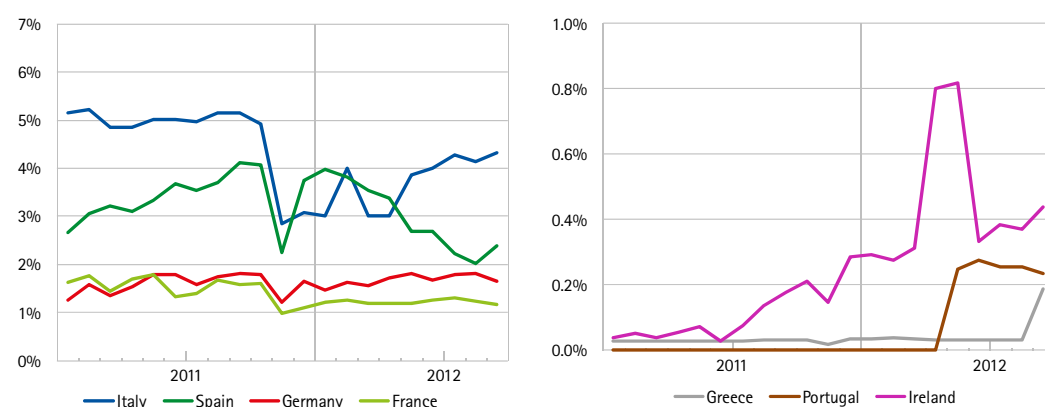
For Italian banks, the reliance on Eurosystem operations accounted for 6% of bank assets (5% at the end of the first quarter). In the second part of 2012 recourse to the deposit facility decreased, signalling an easing of tensions in the interbank market. The dynamics of repurchase agreements was heterogeneous across countries, being stable for credit institutions in the core countries and Portugal, declining in Spain (even if not continuously) and, conversely, increasing in Italy and Greece.

Figure 1.18 – Reliance on Eurosystem by credit institutions of some European countries and the ECB deposit facility



Spread Euribor-Ois is calculated with respect to Euribor. Source: the ECB and national central banks data.

Figure 1.19 – Repurchase agreements (% bank funding)



Source: calculations on ECB data.

From July to November 2012, the nominal exchange rate of the euro appreciated towards the other main currencies, signalling the easing of tensions related to the sovereign debt crisis

From July to November 2012 the nominal exchange rate of the euro with respect to the US dollar followed a discontinuous trend, appreciating in the first period and depreciating slightly since September; in the same period the single currency appreciated with respect to the yen by 4%. The dynamics of the effective exchange rate deflated using unit labour cost shows that in 2012 both core and peripheral countries gained competitiveness; in Germany the trend began in 2005 while for the other countries this represents a positive change with respect to the loss of competitiveness registered until 2009.

Risk dashboards

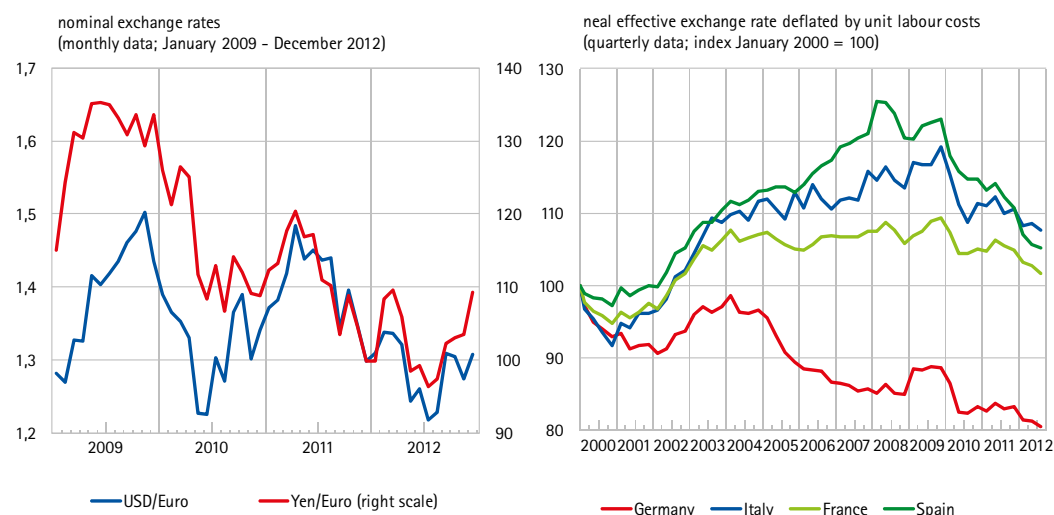
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Figure 1.20 – The exchange rate of the euro

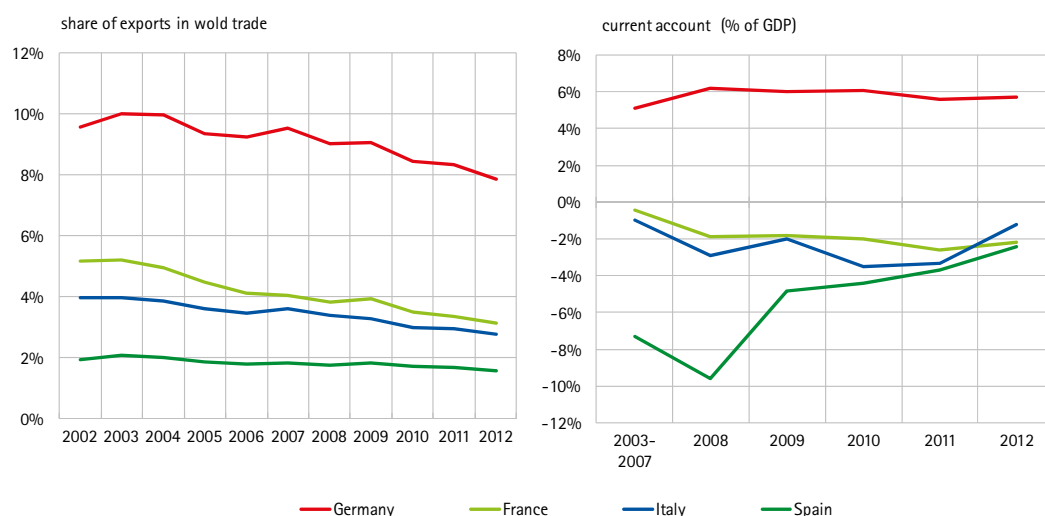


Source: Thomson Reuters.

The share of Euro area exports in total world trade continues to decline

The increasing weight of emerging markets on world trade was accompanied by the decline in the share of exports of (core and peripheral) Euro area countries. Germany continues, however, to record a significantly larger share of exports in world trade with respect to the other Euro area economies and to have a definitely positive current account balance. Current account balances continue to be negative in France, Italy and Spain, but they improved significantly in Italy and Spain as a result of the contraction of economic activity, the related decrease in imports and the potential improvement in competitiveness signalled by the dynamics of the real effective exchange rate.

Figure 1.21 – The share of exports in total world trade and current account balances



Source: calculations on EU Commission data.

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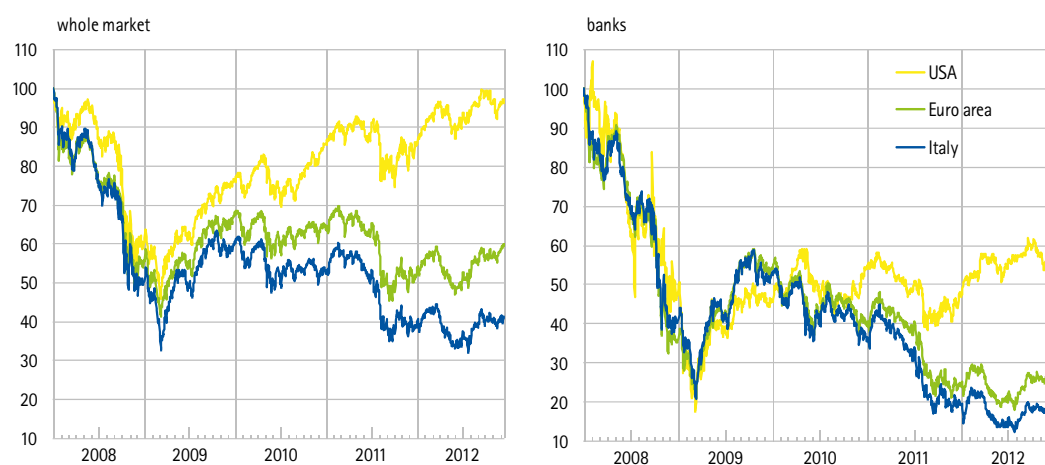
Markets

In the Euro area, market turbulence caused by the sovereign debt crisis, has progressively slowed down leading to an improvement of stock market performance

During the second half of 2012, main advanced countries stock indexes recovered, even if this improvement has not had the same intensity in all the markets. European blue chip's liquidity has increased as well to levels close to those observed in June 2011, i.e. before the exacerbation of sovereign debt crisis. From July to December 2012, indeed, the DJ Euro Stoxx increased by 15%; over the same period, in Italy the FTSE Mib rose by 11%. Looking at the US stock market, the S&P500's growth was lower, at approximately 4%. The improvement of stock market performance in the Euro area was driven mainly by the recovery of bank stock indexes: from July to mid December 2012, indeed, the DJ Euro Stoxx bank index increased by 22%, while the Italian banking sector by 18%. Stock indexes recovery, however, have been frequently interrupted by sudden surges in market turbulence, due to the growth of market uncertainty. Between July and September, political actions announced by European Institutions to prevent market turmoil linked to the sovereign debt crisis, improved investor expectations giving new strength to financial markets. Since October, however, stock index returns have slowed down because of persistent uncertainties concerning global economic recovery, Greek sovereign crisis and the difficult conditions of peripheral countries' financial sectors (the Spanish one in particular). Investor's perception of European bank credit risk remains indeed well above the levels observed in the US; moreover the main rating agencies have downgraded Spanish and French government bonds and some important banks in these countries. In the US market, investors' uncertainty increased especially in the second half of the year, because of the election process and worries concerning the possible coming into force of significant restrictive fiscal measures (the so-called fiscal cliff). These negative factors were only partially compensated by the positive signals coming from the labor and housing markets.

Figure 2.1 – Advanced countries stock indexes

(daily data; 01/01/2008 – 14/12/2012; 01/01/2008 = 100)



Source: Thomson Reuters Datastream. The indexes displayed are the S&P500 for the US, the Dow Jones Euro Stoxx 50 for the Euro area and FTSE Mib for Italy.

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1. Macroeconomic background

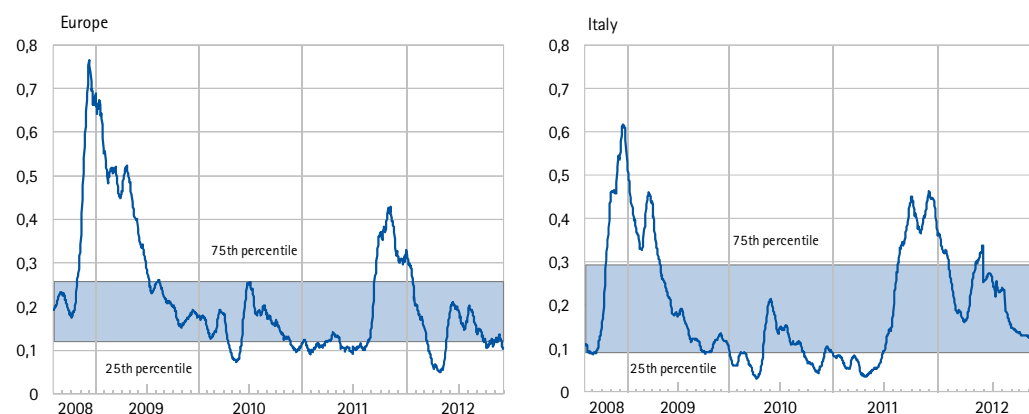
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Figure 2.2 – Indicator of stock market illiquidity

(daily data; 01/08/2008 – 30/11/2012)



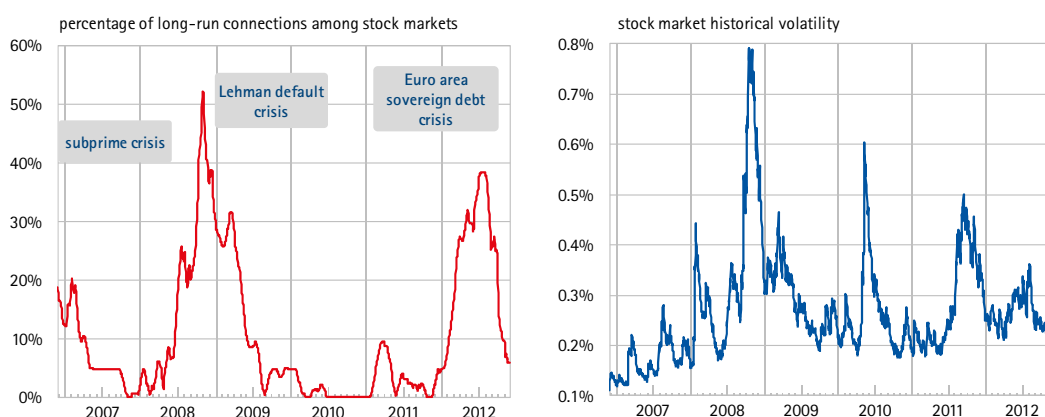
The graphs report the results of the application of principal component analysis (first factor, 20 days moving average) on price impact, implied volatility, bid-ask spread e range indicator time series. The indicator ranges from 0 (= high liquidity) to 1 (= low liquidity). Calculations are based on Thomson Reuters Datastream data.

Contagion among European stock markets slowed down and the volatility decreased in the second half of 2012.

Contagion indicators, based on the correlation among stock returns, have displayed a reduction in spill-over effects, which previously affected, instead, stock markets when the sovereign debt crisis erupted. From November 2011 to June 2012, the strength of links (co-integration) among stock markets not explained by financial and economic variables increased, while remaining lower than during the Lehman crisis. The following reduction in contagion, which is likely due to the already mentioned European Institutions' political actions have also led to a decrease of stock return historical volatility, which fell to levels lower than those observed in July 2011.

Figure 2.3 – Financial contagion and historical volatility in some European stock markets

(percentages; daily data; 27/11/2006 – 30/11/2012)



For the methodology applied to construct the contagion indicator see M. Gentile and L. Giordano, "Financial contagion during Lehman default and sovereign debt crisis: an empirical analysis on Euro area bond and equity markets", Consob working paper no. 72, 2012. In the left figure the percentage of statistically significant long-run relations is reported; the long-run connections have been detected by applying the bi-variate cointegration test of Johansen (1988) with a rolling window of 1,000 days on the stock returns time series. In the right graph the average value of the annualised stock return historical volatility is reported; the volatility has been estimated by applying a multivariate Garch model. The countries included in the sample are the UK, Germany, France, Italy, Spain, Greece, Portugal and Ireland. Calculations are based on Thomson Reuters Datastream data.

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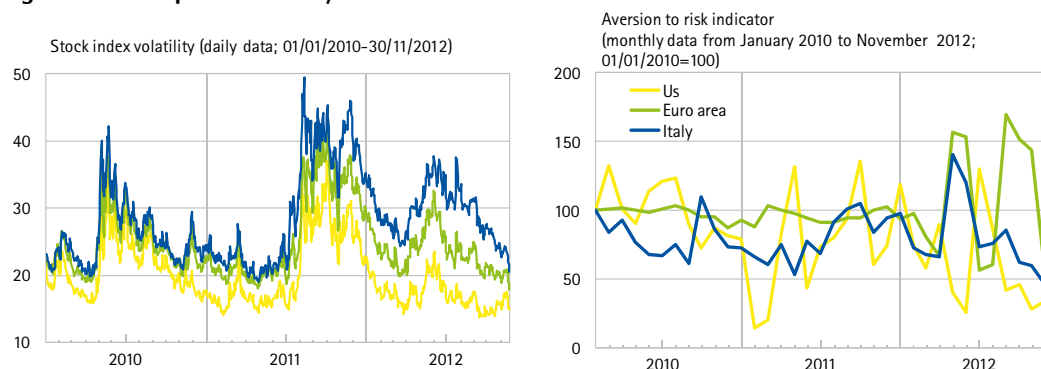
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In the Euro area, the volatility of stock markets and investor's risk aversion have been decreasing since June 2012; both indicators remain on higher levels than those for the US

In the second half of 2012, coherently with the reduction in the contagion phenomena which involved stock markets in the Euro area, implied volatility and risk aversion decreased significantly. This process, which can be considered as a consequence of market confidence improvement, was also characterized by a reduction in investors' propensity to adopt similar or imitative investment strategies (so-called herding behavior). Referring to some of the main stock markets in the Euro area, the intensity of herding behavior phenomenon reached its peak during the financial crisis of 2008. Since then, it has significantly decreased, although not continuously, until December 2012. Spain represents an exception, given that in this case the herding behavior process remained relevant until June 2012, when it began decreasing, while remaining well above the levels observed before the Lehman crisis.

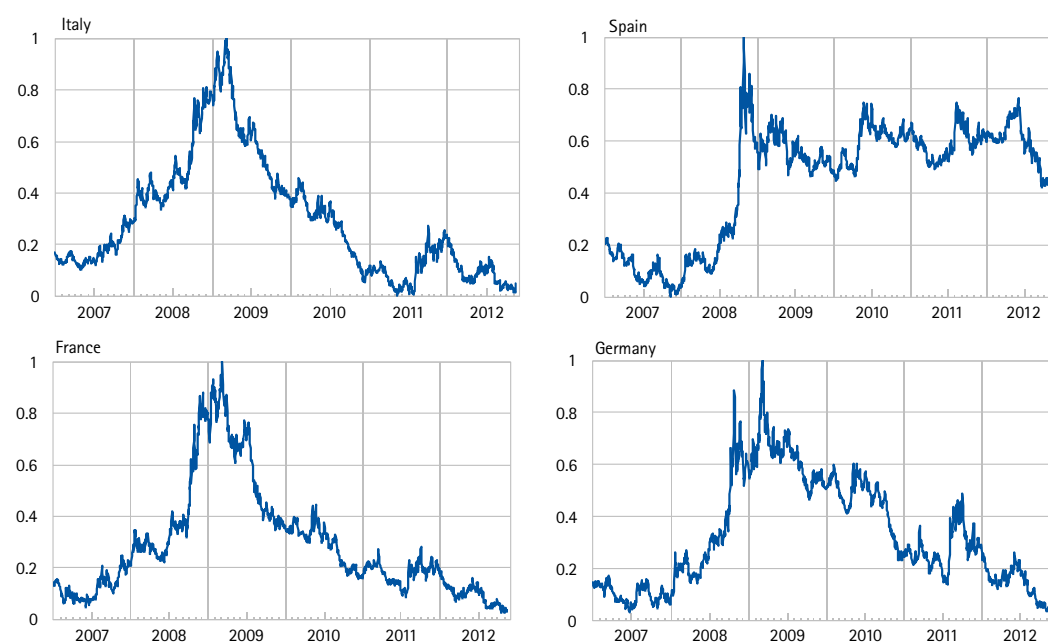
Figure 2.4 – Implied volatility and risk aversion indicator



The risk aversion indicator has been estimated by comparing the historical distribution of stock returns with the one implied by the prices of stock index options (for the methodology see Shimko, 1993); we report the 3 months - moving average. Calculations are based on Thomson Reuters Datastream data.

Figure 2.5 – Indicator of herding behavior on stock markets

(daily data; 31/12/2006 – 30/11/2012)



The indicator of herding behavior has been computed as the inverse of the cross-section standard deviation of the stock market returns of the main blue chips following the approach of Chang, E., Cheng, J. and Khorana, A. (2000). A less relevant dispersion (and, as a consequence, a higher level of the indicator) signals that the investors adopt more frequently investment strategies similar or imitative and, so, that the herding behavior phenomenon is more intense. The indicator of dispersion has been computed for the Euro area on the stocks included in the DJ Euro Stoxx 50 and for Italy on the stocks included in the FTSE Mib. The indicator has been normalized by scaling the indicator between zero and one. Calculations are based on Thomson Reuters data.

In the Euro area, the application of imitative strategies has become less frequent than at the start of sovereign debt crisis. In the Spanish market, herding behavior phenomena, however, remain relevant

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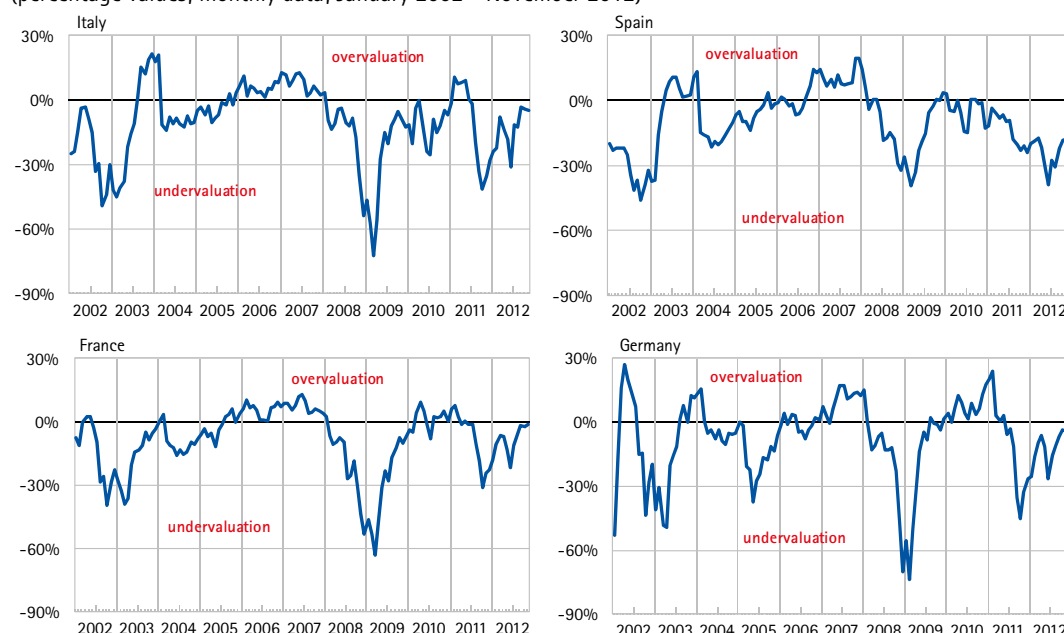
4. Banks

Since September, in the Euro area stock indexes have converged to values close to fundamentals. Strong discrepancies were recorded, instead, in the previous period during the upsurge of the sovereign debt crisis ...

Coherently with the reduction in contagion phenomena, in the main advanced countries stock indexes have exhibited convergence to their fundamental values, together with the weakening of the undervaluation phenomenon (that had been quite relevant during the most critical phases of the crisis). Evidence of this process was registered in Italy, France and Germany where, at the end of October 2012 and for the first time after May 2011, stock index prices neared to fundamental values estimated on the basis of expected earnings discounted by the risk-free interest rate plus the risk premium; in Spain, instead, the stock index undervaluation phenomenon still remains relevant. During the second half of 2012, the increase in the ratio between stock indexes and expected earnings confirms the renewed investor confidence towards the Euro area markets, even if net issue on the primary markets remained small.

Figure 2.6 – Difference between observed and theoretical values of stock indexes estimated on the basis of the dividend discount model

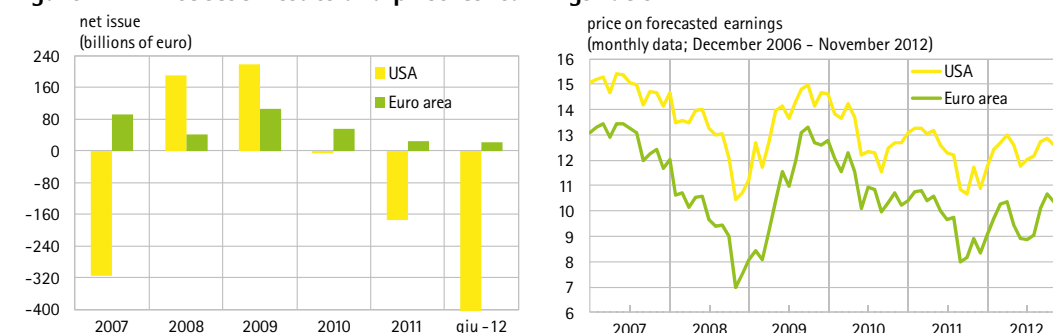
(percentage values; monthly data; January 2002 – November 2012)



In the graph we represent the percentage difference between stock indexes observed value and estimates based on the dividend discount model (Shiller, 2002; Campbell and Shiller, 1988; De Bondt, 2008). The long-run fundamental relation of the model was estimated by applying a co-integration VECM model on the time series of stock indexes, earnings per share, risk-free interest rate and equity risk premium. The earnings per share were extracted directly from the balance sheet; the equity risk-premium approximated as the difference between the earning yield (computed as the inverse of the P/E ratio) and the risk-free interest rate which was approximated by the 5-year interest rate swap. The model was estimated on MSCI stock indexes. Calculations are based on Thomson Reuters data.

... however, net stock issue remains at low level

Figure 2.7 – Net stock issues and price-to-earnings ratio



Source: Fed, ECB and Thomson Reuters and calculations on IBES data for the firms included in the S&P500 (USA), in the Dow Jones Euro Stoxx (Euro area) and in the FTSE Mib (Italy).

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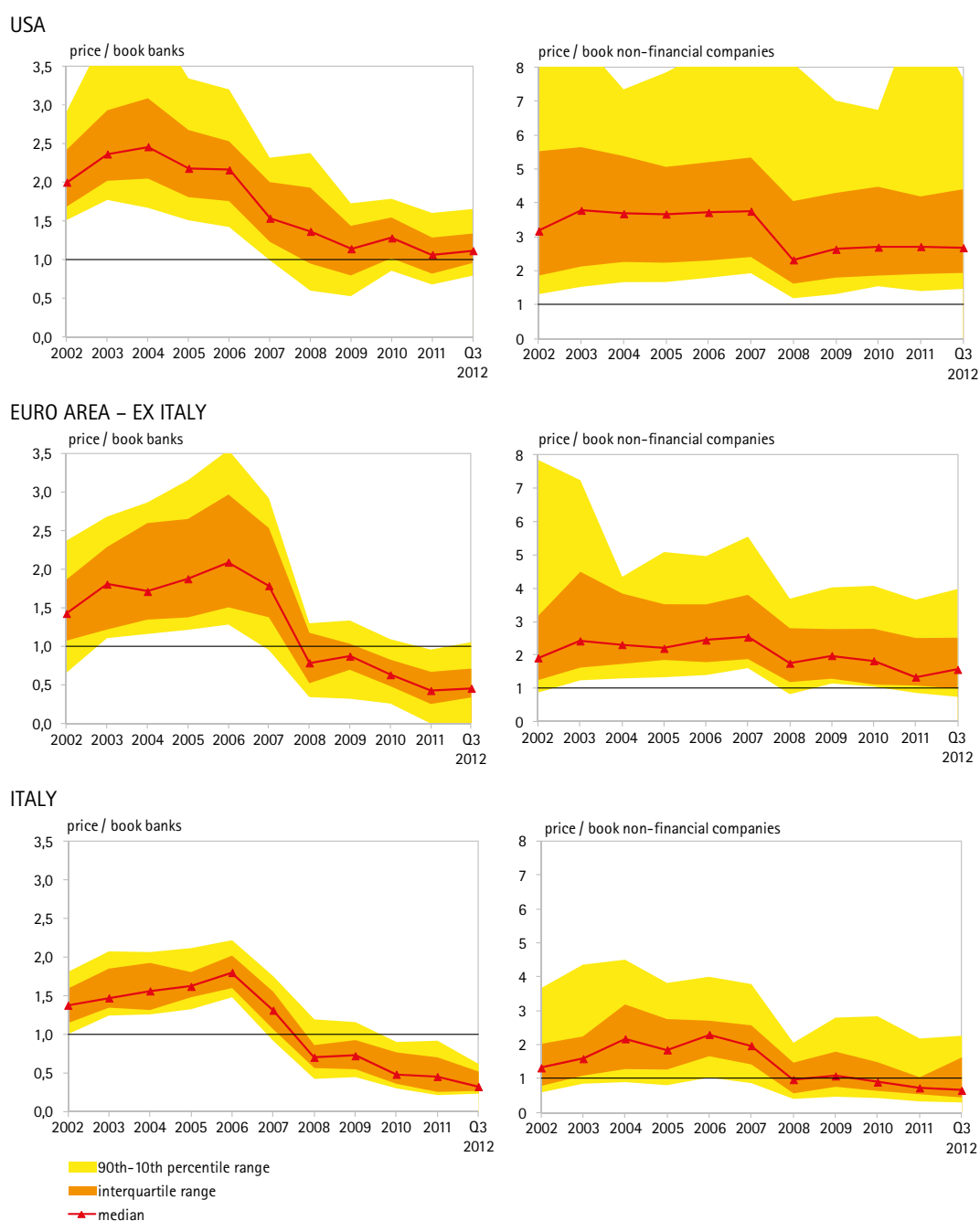
3. Non-financial companies

4. Banks

Notwithstanding the recovery of stock indexes, the European banking sector multipliers of the remain very low

The price-to-book ratio of the European banking sector remains at very low levels, which on average does not exceed the value of 1 for the main listed banks. This dynamics has been particularly relevant in Italy, where this empirical evidence refers also to the firms of the non-financial sector, contrary to what happens for the main Euro area non-financial firms, mainly characterized by a multiplier higher than one.

Figure 2.8 – Multipliers for listed companies in the advanced countries



Source: calculations on Worldscope data. The data refer to banks included in the S&P1500 Bank index for the USA, in the Dow Jones Euro Stoxx 50 Bank index for the Euro area (except for the Italian firms) and to all Italian listed banks, and to the non-financial firms included in the S&P 100 index for the USA, in the Dow Jones Euro Stoxx 50 index for the Euro area (except for the Italian firms) and to the main Italian listed groups. The figures for the third quarter of 2012 are partly estimated.

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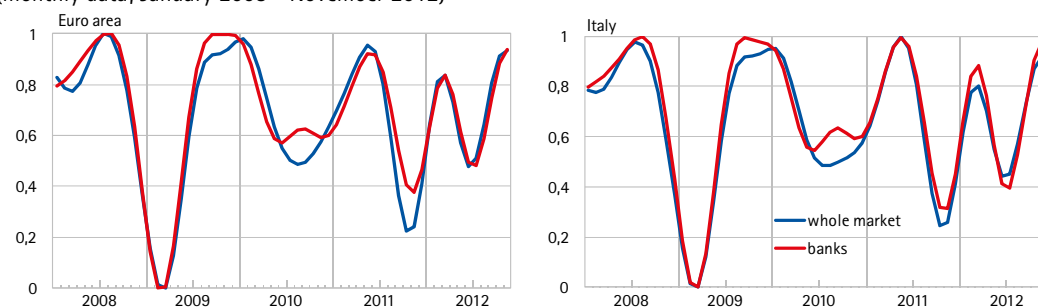
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Market sentiment about European economic recovery has improved, but expectations concerning stock market short-run dynamics remain uncertain

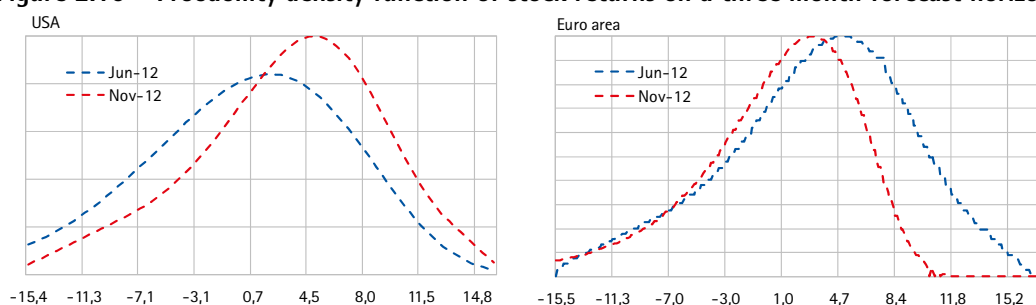
The estimate of the long-run stock return cyclical component for the Euro area, which can be considered as a measure of market sentiment, signals an improvement of investor's confidence on future economic trends, even if indicators based on the prices of stock index options signal, instead, a little worsening of expectations concerning stock market short-run dynamics. In the US, instead, option prices, compared with the first half of 2012, indicate a sharp improvement in investor's expectations on share prices. Analysts' forecasts for listed companies earnings have not significantly changed both in the Euro area and in the US. For the firms included in the FTSE Mib index, the expected earnings growth rate decreased from 15% at the end of June to 9% at the end of November 2012. Moreover, the level of the dispersion of earnings forecasts remains higher in the Euro area compared to the US.

Figure 2.9 – Investors' market sentiment as implied by stock market indexes dynamics
(monthly data; January 2008 – November 2012)



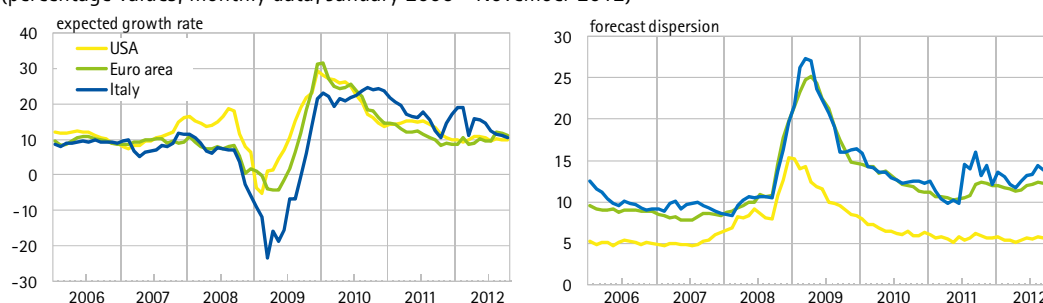
The market sentiment indicator was estimated by separating long-run stock return component from the short-run (more erratic and volatile) one. The cyclical component of each time series was normalized by scaling the indicator between zero and one. The indicator was computed by applying the Christiano Fitzgerald filter. The indexes taken into consideration were the FTSE Mib Banks for Italy and the Dow Jones Euro Stoxx 50 and the Dow Jones Euro Stoxx 50 Banks for Europe. Calculations are based on Thomson Reuters data.

Figure 2.10 – Probability density function of stock returns on a three month forecast horizon



In the graphs we report the probability distribution of the stock return on a three months horizon implied by stock indexes options prices estimated following the approach by Shimiko (1993). Calculations were made on Thomson Reuters data.

Figure 2.11 – Analysts' earnings forecasts referring to a 12 month horizon
(percentage values; monthly data; January 2006 – November 2012)



Weighted average of the growth rate of the earnings of the firms included in the S&P500 (USA), in the Dow Jones Euro Stoxx (Euro area) and in the FTSE Mib (Italy). Calculations are based on Thomson Reuters IBES data

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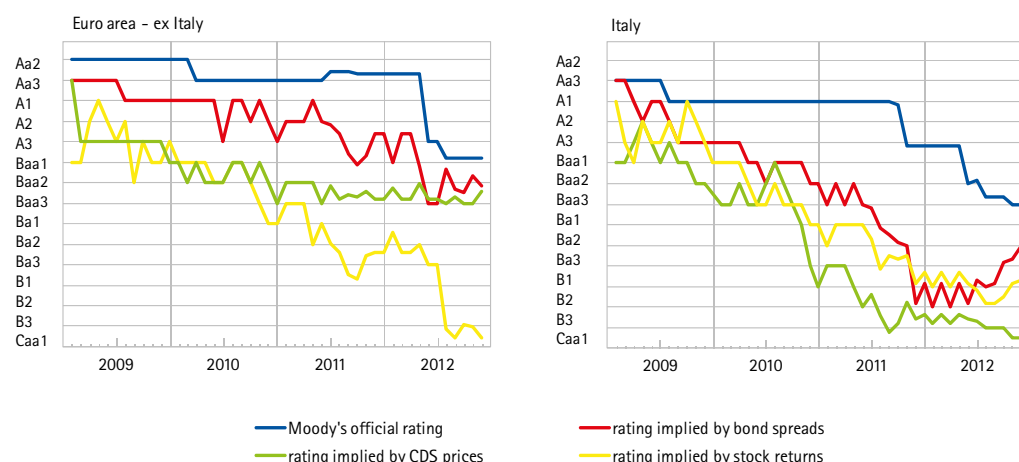
4. Banks

In the second half of 2012, for the largest European listed companies, the gap between credit risk measures implied by stock returns, CDS prices and bond spreads deeply widened, mainly in the banking sector

In the Euro area, in the second half of 2012, the divergence between credit risk signals implied by stock prices, CDS prices and bond spreads, deeply widened, especially for European banks. In particular, stock index prices implied levels of risk higher than those implied by the prices of other financial instruments and by Moody's official ratings. This empirical evidence is less relevant for main European non-financial companies, for which, indeed, the credit risk level implied by bond spreads was lower than that implied by official ratings. For the main Italian listed companies, instead, the level of credit risk implied by CDS prices has remained widely higher than that implied by stock returns and by bond spreads; moreover, it has been observed a worsening of official rating and CDS prices, not in line with the improvement of bond spread dynamics.

Figure 2.12 – Ratings implied by the price of the financial instruments of the main European and Italian listed banks

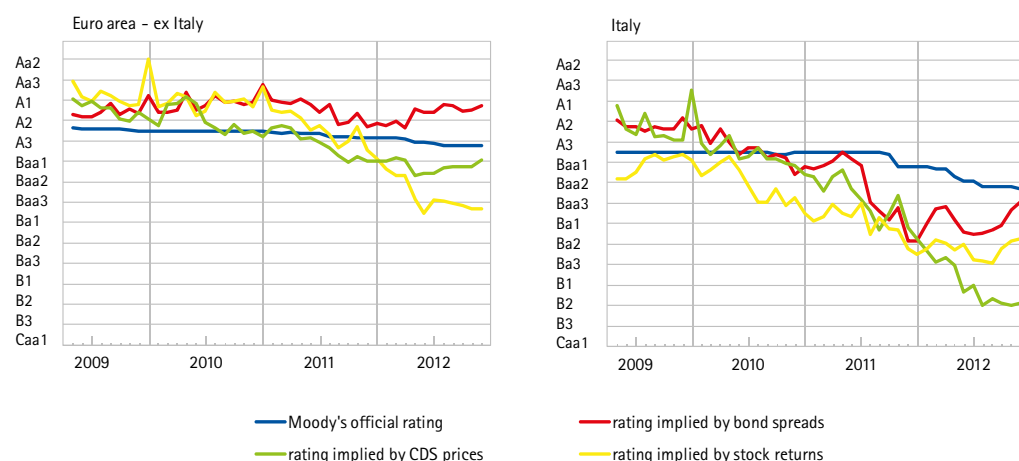
(monthly data; January 2009 – November 2012)



Source: calculations on Moody's data. Average values relative to the banks included in the Dow Jones Euro Stoxx 50 index for the Euro area (except for Italian banks) and the main Italian banks with a Moody's rating (Banca Popolare di Milano, Intesa, Mps, Unicredit, Ubi, Banco Popolare).

Figure 2.13 – Rating implied by the price of the financial instruments of the main European and Italian listed non-financial companies

(monthly data; April 2009 – November 2012)



Source: calculations on Moody's data. Average values on the non-financial companies included in the Dow Jones Euro Stoxx 50 for the Euro area (except for the Italian firms) and the main Italian non-financial firms.

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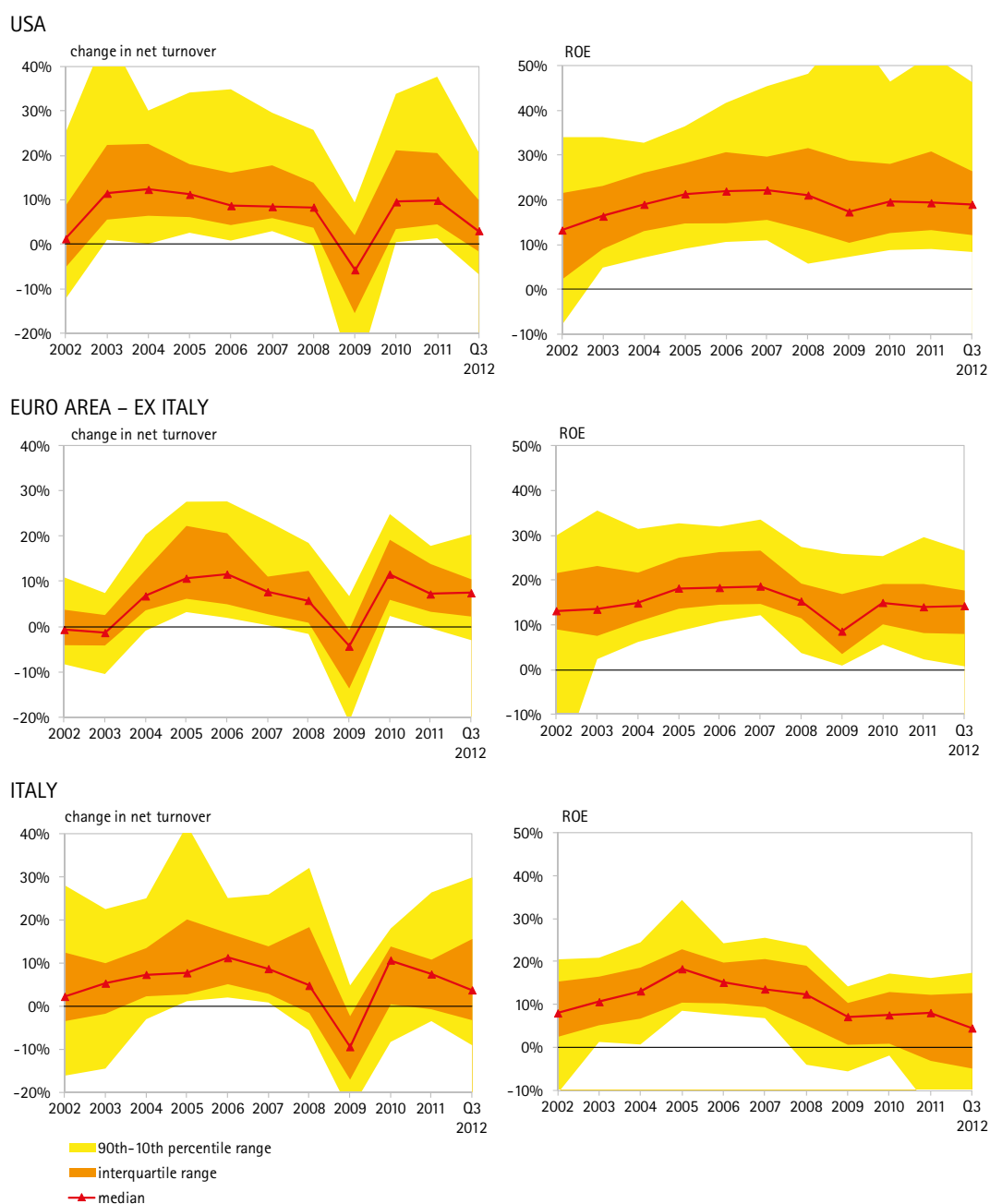
4. Banks

Non-financial companies

Profitability of top European and US listed companies looks stable relative to 2011, while top Italian listed companies exhibit declining growth in revenues and a falling return on equity

In the first nine months of 2012, the profitability of top US listed companies was – on average – unchanged year-on-year, although revenues growth slowed significantly. In Europe, the main companies exhibited stable profitability, coupled with slightly increasing revenues from sales. Top Italian listed companies, instead, continued to suffer from declining revenue growth and ROE. Non-financial companies, too, underperformed the European ones in terms of ROE.

Figure 3.1 – Growth of turnover and profitability of major non-financial listed companies



Source: calculations based on Worldscope data on companies in the S&P 100 index for the USA, in the Dow Jones Euro Stoxx 50 index for the Euro area (except for the Italian firms) and on major Italian listed groups. The annual change in turnover is calculated with respect to the restated figure for the previous year. The figures for the third quarter of 2012 are annualised and partly estimated.

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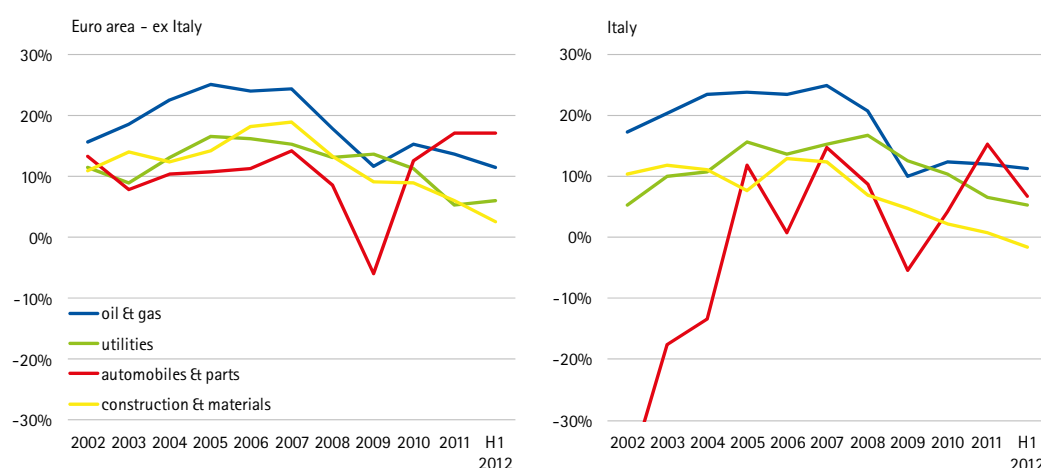
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The construction industry is one of those where margins are in contraction, both in Europe and in Italy, while returns appear more stable in the energy sector. The automotive industry manages to keep profitability constant in Europe, but this is declining in Italy. Overall, the data confirm top Italian companies are less profitable than the European ones in automotive and constructions sectors.

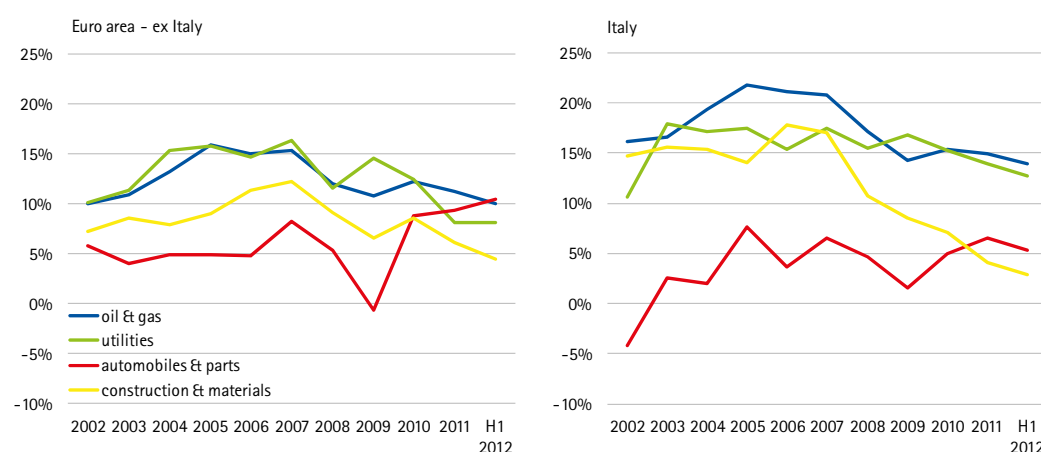
Figure 3.2 – ROE of major non-financial listed companies by industrial sector



Source: calculations based on Worldscope data.

The profitability gap between Italian and European companies is smaller in terms of EBIT margin (EBIT to revenues ratio), since this metric is not influenced by different tax regimes. In Europe, this measure confirms a fall in margins for the energy and constructions sectors while the automotive one shows an increase. Particularly significant, the fall in EBIT margin for the construction sector in Italy (since 2007, from 17% to less than 3%). This means that construction firms are facing increasing difficulties in generating income for given revenue levels, and a higher incidence of operating costs.

Figure 3.3 – EBIT margin of major non-financial listed companies by industrial sector



Source: calculations based on Worldscope data.

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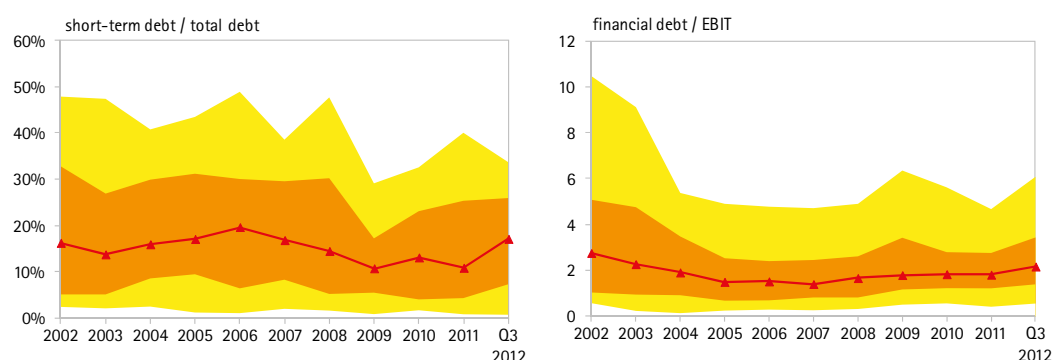
4. Banks

Short-term debts are rising in the US and Europe, while the Italian listed companies are facing increasing debt sustainability problems

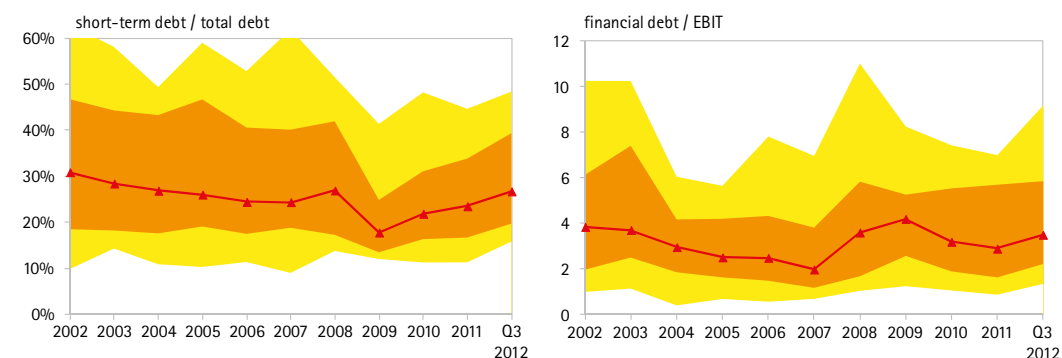
In the first nine months of 2012, the burden of short-term debts for top US listed companies increased, but still to a level lower than that for the European companies. The maturity profile of the Italian companies financial structure does not show significant changes relative to 2011. The financial debts to EBIT ratio has increased for main industrial companies, both in the US and Europe over the same period. For Italian companies, this is due both to a rise in financial debts and a fall in EBIT.

Figure 3.4 – Financial structure and sustainability of debt for major non-financial listed companies

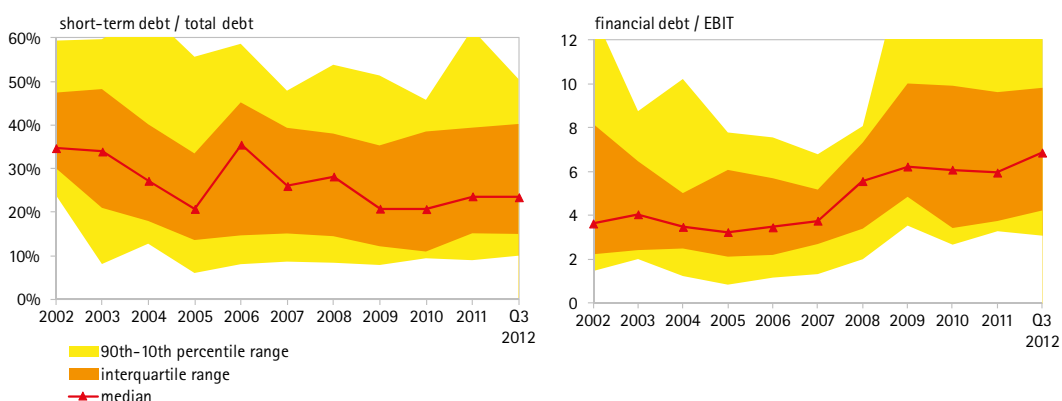
USA



EURO AREA – EX ITALY



ITALY



Source: calculations based on Worldscope data on companies in the S&P 100 index for the USA, Dow Jones Euro Stoxx 50 index for the Euro area (except for the Italian firms) and on major Italian listed groups. The ratio of financial debt/EBIT is only calculated for companies with positive EBIT. The figures for the third quarter of 2012 are annualised and partly estimated.

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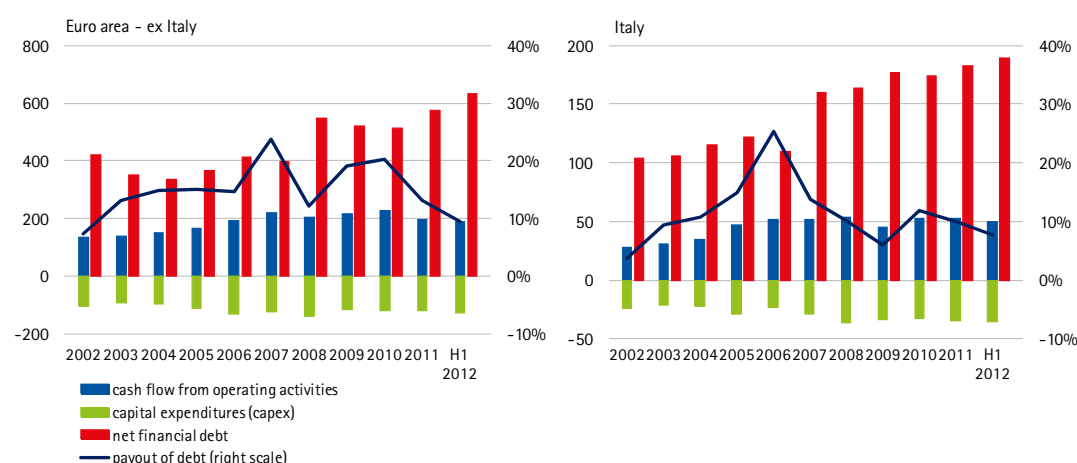
4. Banks

The debt payout ratio is declining for top European listed companies ...

In the first half of 2012, the debt payout ratio (i.e. the cash flow available for debt repayment to net financial debt ratio) declined slightly both in Europe and in Italy, in line with a trend begun in 2010. This dynamics, which has almost filled the gap between European and Italian companies, is mainly linked to an increase in net financial debt and, to a lesser extent, to a contraction in operational cash flow.

Figure 3.5 – Net debt and cash flow from operating activities for major non-financial listed companies

(amounts in billions of euro)



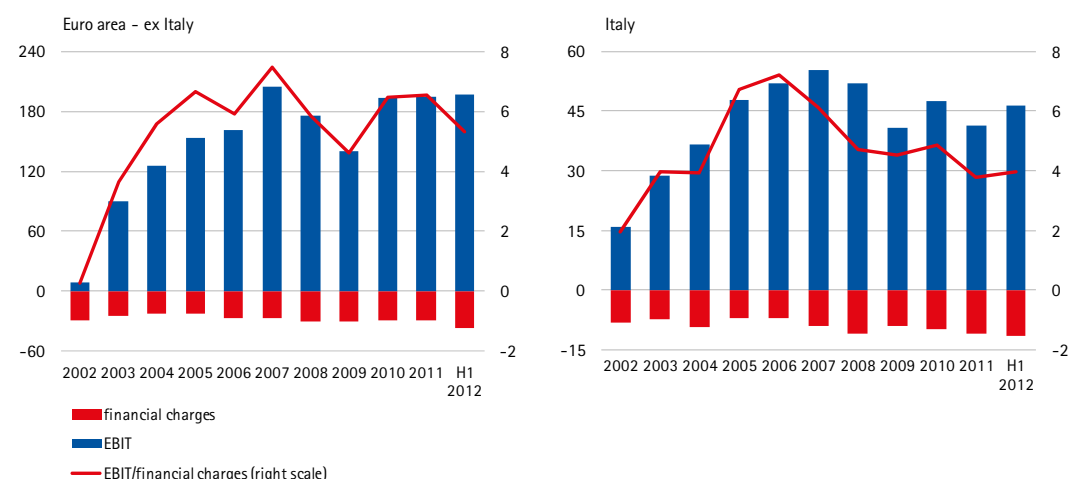
Source: calculations based on Worldscope data on companies in the Dow Jones Euro Stoxx 50 index for the Euro area (except for the Italian firms) and on major Italian listed groups. The payout of debt is calculated as the ratio of cash flow from operating activities, net of capital expenditures (capex), and net debt. Figures for the first semester of 2012 have been annualised.

... as well as the interest charges coverage ratio

The interest charges coverage ratio (EBIT to interest charges ratio) for European non-financial companies declined compared to 2011, essentially because of a rise in financial charges. In Italy, this ratio is almost stable, but lower than the Eurozone average.

Figure 3.6 – Interest charges coverage for major non-financial listed companies

(amounts in billions of euro)



Source: calculations based on Worldscope data on companies in the Dow Jones Euro Stoxx 50 index for the Euro area (except for the Italian firms) and on major Italian listed groups. Figures for the first semester of 2012 have been annualised.

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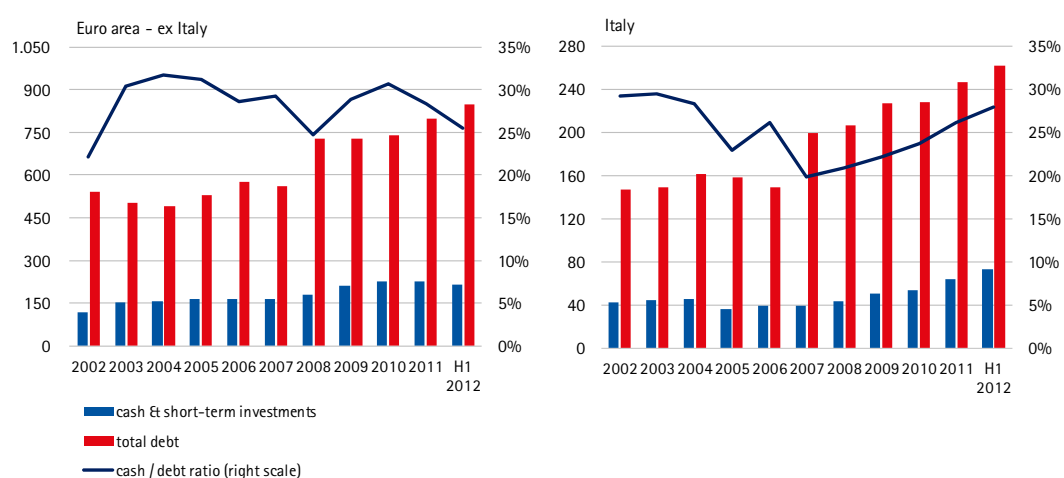
3. Non-financial companies

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The top Italian listed companies exhibit a higher liquidity ratio but also a leverage structurally higher than the European ones ...

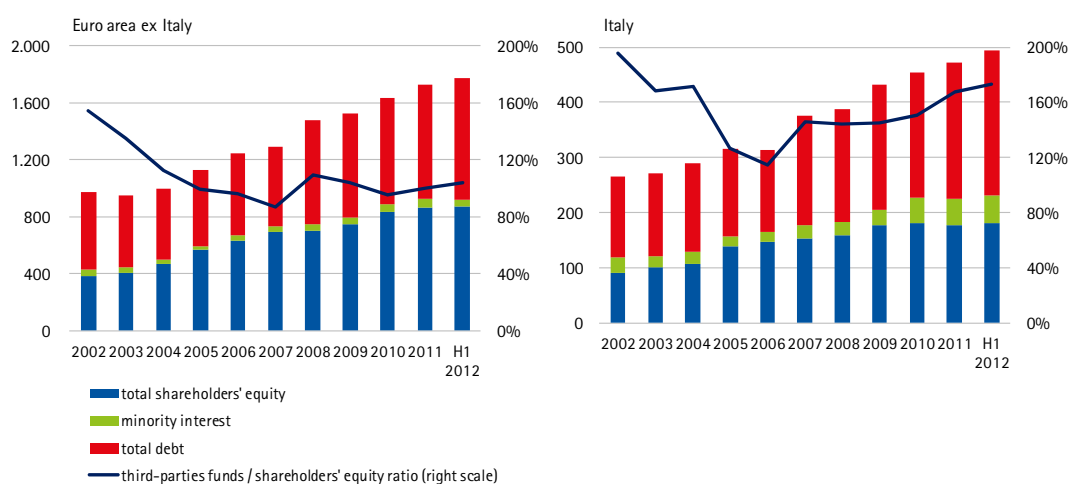
In the first half of 2012, liquidity of main Italian non-financial companies increased, while that of the European ones was stable. The liquidity to financial debt ratio for Italian companies is also higher than the European average (28% in Italy, vs 25% in Europe). In Italy, however, leverage (debt to equity ratio) is also higher than the European average, and constantly rising since 2006. At the end of June 2012, the leverage ratio was roughly 160% for main Italian non-financial companies, and just around 100% for the European ones.

Figure 3.7 – Cash holdings of major non-financial listed companies
(amounts in billions of euro)



Source: calculations based on Worldscope data on companies in the Dow Jones Euro Stoxx 50 index for the Euro area (except for the Italian firms) and on major Italian listed groups.

Figure 3.8 – Leverage of major non-financial listed companies
(amounts in billions of euro)



Source: calculations based on Worldscope data on companies in the Dow Jones Euro Stoxx 50 index for the Euro area (except for the Italian firms) and on major Italian listed groups.

... and also significantly higher costs in terms of bank credit interest charges

Since the second half of 2011, bank credit for non-financial companies was cheaper in Europe than in Italy; financial charges for new (euro denominated) bank loans were higher, indeed, for both large and small-medium Italian enterprises compared to 2011. For large companies, the cost of bank credit gap between Italy and the Eurozone average widened in 2012.

Risk dashboards

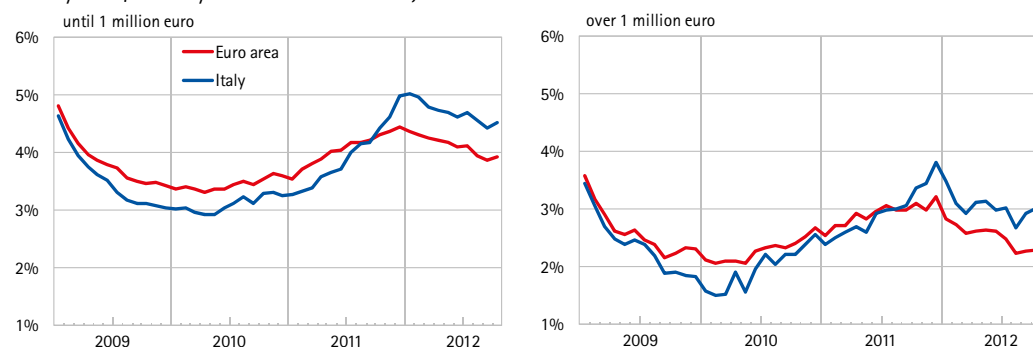
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Figure 3.9 – Banking interest rates on euro loans to non-financial companies
(monthly data; January 2009 – October 2012)



Source: ECB; interest rates on new loans.

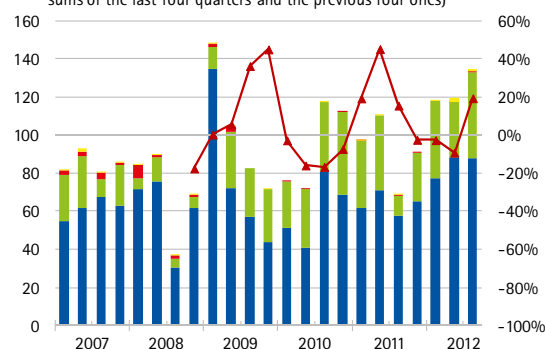
Corporate bond markets show signals of recovery in the US and Europe thanks to a reduction in returns asked for by investors ...

In the first nine months of 2012, corporate bond markets recorded a significant uptrend both in the US and Europe, with new overall debt issuances increasing by 100 billion euro compared to 2011 (although issuances in the first three quarters of 2012 were lower than the peak recorded in the last quarter of 2011). Moreover, issuances with a speculative rating (lower than BBB) were slightly less in Europe. Bond yields declined both in the US and Europe for all bonds rated BBB or higher.

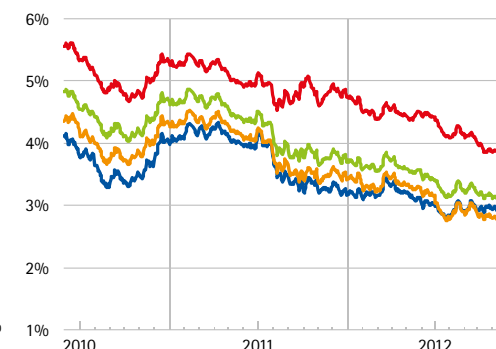
Figure 3.10 – Corporate bonds issues and yields

USA

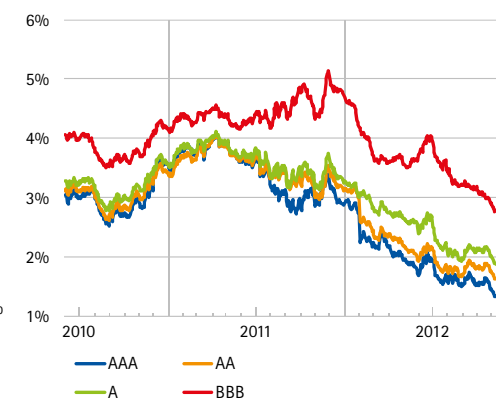
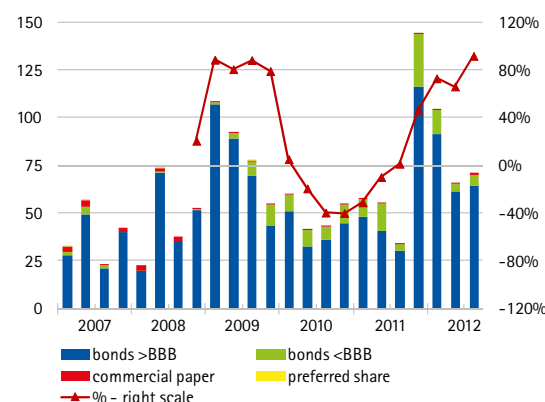
gross bond issuances for institutional investors
(quarterly data in billions of euro; % change between the rolling sums of the last four quarters and the previous four ones)



bond yields
(percentage values; daily data; 01/06/2010 – 30/11/2012)



EUROPE



Source: calculations on Dealogic, Consob, Kler's and Markit data. European issuance data refer to companies with registered office in Italy, France, Germany, Spain, the Netherlands and the UK and their subsidiaries (even those established in other countries).

Risk dashboards

1. Macroeconomic background

2. Markets

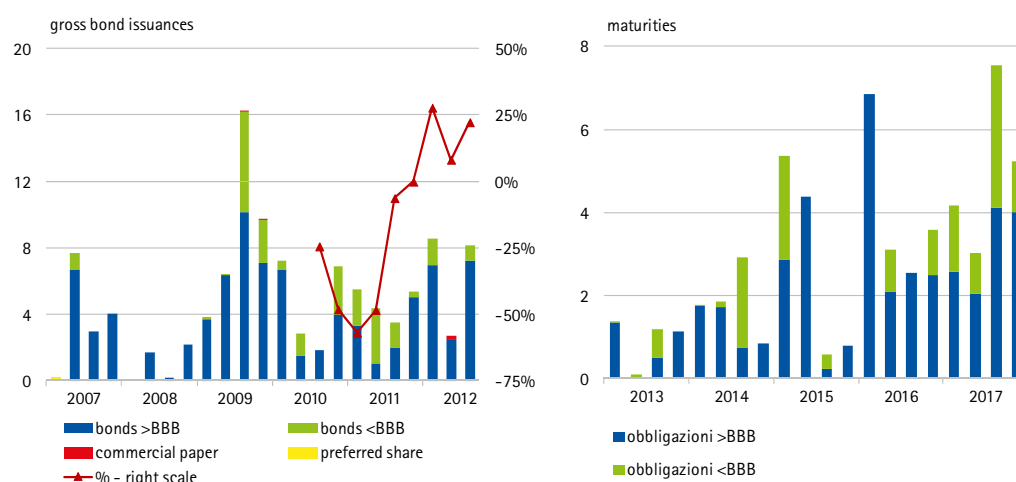
3. Non-financial companies

4. Banks

In Italy, the bond market for non-financial companies recovered slightly, although new issuances in the second quarter were lower than in the same period in 2011. In the short term, interest risk related to bond refinancing should be moderate, given the limited amount of bonds due in 2012.

Figure 3.11 – Italian corporate bonds

(quarterly data in billions of euro; % change between the sum of last four quarters and the sum of the previous four ones)



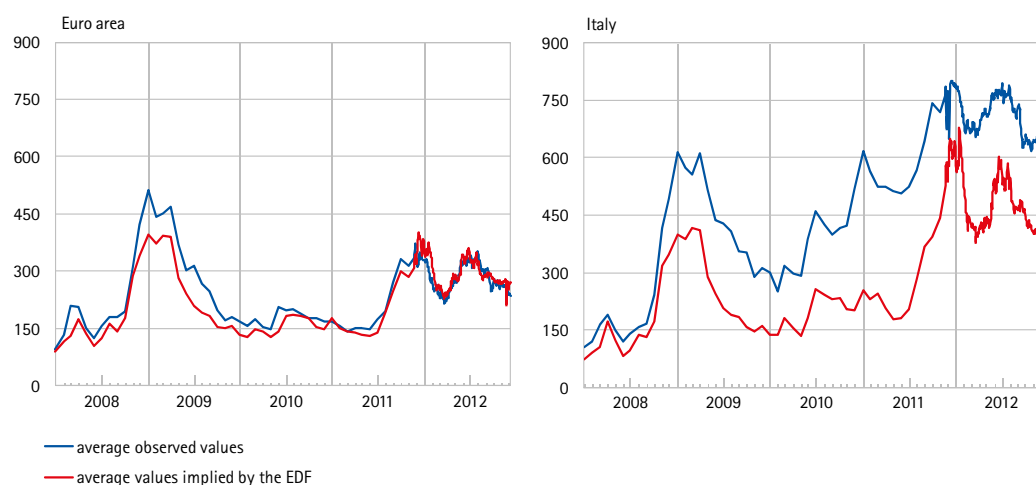
Source: calculations on Dealogic, Consob e Kler's data. Maturities refer to bonds issued since 2007.

... and because of a lower perception of credit risk

In the second half of 2012, non-financial firms CDS prices in the Euro area significantly decreased, converging to theoretical values estimated using balance sheet and market data. The Italian non-financial listed companies average CDS prices exhibited the same dynamics while remaining significantly higher than the theoretical ones.

Figure 3.12 – Prices of 5-year CDS observed and implied by the expected default frequencies (EDF) for the main non-financial listed firms

(basis point; daily data; 01/01/2008 – 30/11/2012)



Source: calculations on Thomson Reudaters and Credit Edge data. The data refer to a sample of 150 European listed firms selected by Thomson Reuters and to 9 Italian listed firms.

Risk dashboards

1. Macroeconomic background

2. Markets

3. Non-financial companies

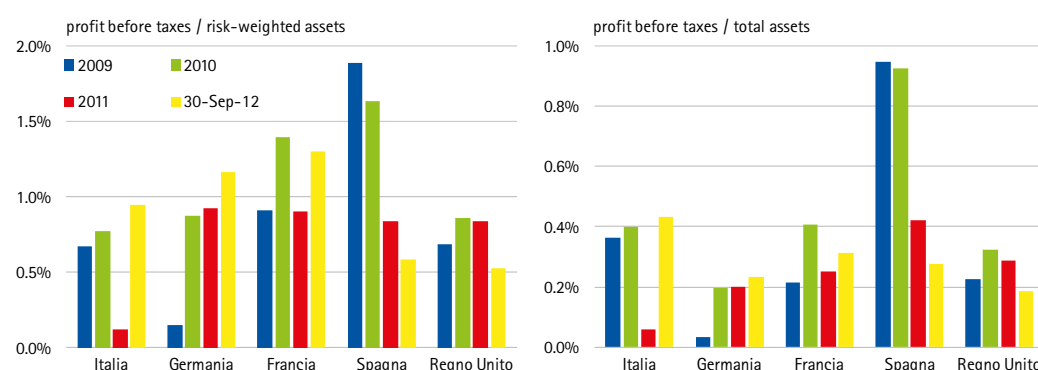
4. Banks

Banks

In the first nine months of 2012 the profitability of the main Italian, German and French banks increased while in Spain and the United Kingdom it remained subdued

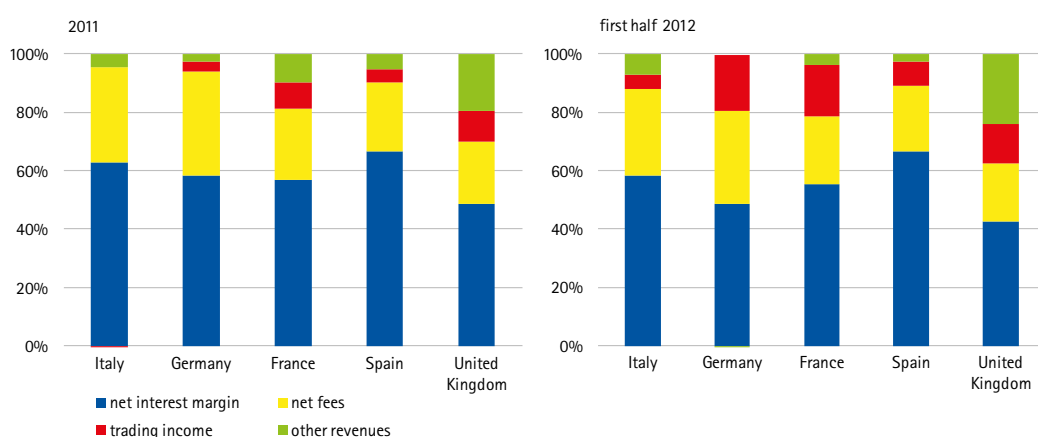
In the first nine months of 2012, the largest Italian, German and French banks showed a recovery in terms of profitability, while Spanish and English banks reduced their income before taxes (calculated excluding the goodwill impairment) on total assets. The Italian banks showed a lower return on risk-weighted assets than the major listed German and French banks, but a higher return on total non-weighted assets. This result reflects the different business model of Italian banks, that are more focused on activities with a higher risk weighting according to the banking sector regulation. The change in the composition of revenues in the first half of 2012 shows that profits from trading and investment activities increased for all the largest listed European banks, even though the Italian and Spanish ones continued to be characterized by a higher incidence of net interest income and commissions on total revenues.

Figure 4.1 – Trend in profitability of the main listed European banks



Source: calculations on data from consolidated annual and interim reports of the main listed European banks (Unicredit, Intesa Sanpaolo, Banca Monte Paschi, Banco Popolare, UBI Banca, Deutsche Bank, Commerzbank, Deutsche Postbank, Landesbank Berlin, Société Générale, Credit Agricole, BNP Paribas, Natixis, Credit Industriel et Commercial, BBVA, Santander, Bankia (since 2011), Caixa Bank, Banco Popular, Banco Espanol de Crédito, Banco de Sabadell, Barclays, HSBC, Lloyds e Royal Bank of Scotland). The profit before taxes is calculated excluding goodwill impairment. The figures as at 30 September of 2012 are annualised and partly estimated.

Figure 4.2 – Change in composition of revenues for the major listed European banks



Source: calculations on data from consolidated annual and interim reports of the main listed European banks (Unicredit, Intesa Sanpaolo, Banca Monte Paschi, Banco Popolare, UBI Banca, Deutsche Bank, Commerzbank, Deutsche Postbank, Landesbank Berlin, Société Générale, Credit Agricole, BNP Paribas, Natixis, Credit Industriel et Commercial, BBVA, Santander, Bankia, Caixa Bank, Banco Popular, Banco Espanol de Crédito, Banco de Sabadell, Barclays, HSBC, Lloyds e Royal Bank of Scotland).

Risk dashboards

1. Macroeconomic background

2. Markets

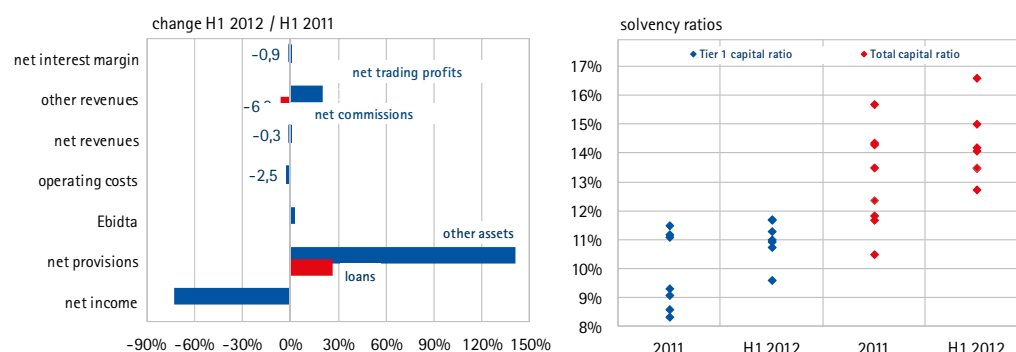
3. Non-financial companies

4. Banks

In the first half of 2012 the profitability of the largest Italian banks was negative compared to the first half of 2011, mainly as a result of the sharp increase in loss provisions for loans and others financial activities

In the first half of 2012 the profitability of the largest Italian banks was negative compared to the first half of 2011; this result is mainly due to the sharp increase in loss provisions for loans and others financial transactions linked to the worsening of credit quality in the current negative macroeconomic environment. This trend led to a decline in net income by 70%. Instead, capital adequacy improved for all Italian banks considered, with the minimum solvency ratios above 9% (for the tier 1 ratio) and 12% (for the total capital ratio). This result is mainly due to revisions in the methodologies for assessing the riskiness of assets for prudential purposes.

Figure 4.3 – Income statement and solvency ratios of major Italian banking groups

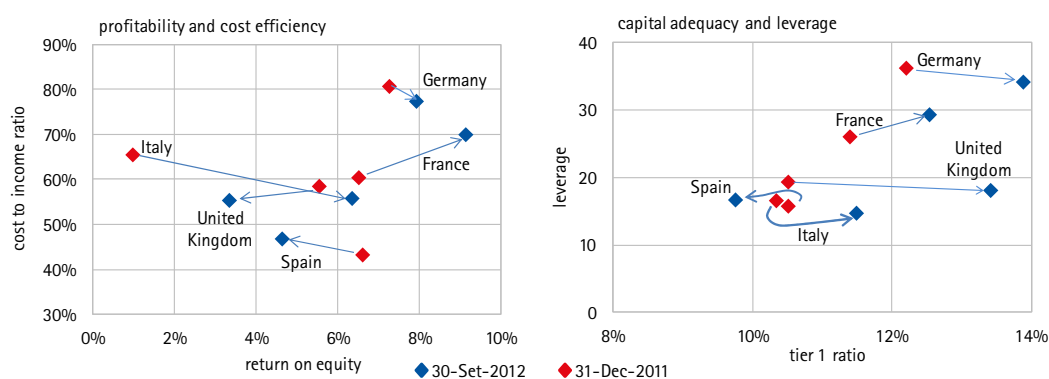


Source: calculations on data from consolidated interim reports. Data refer to the 8 largest banking groups by total assets.

In the first nine months of 2012 the capital adequacy improved for most major European banks except for the Spanish ones, but leverage remained high for German and French banks

The largest Italian and German banks showed an increase in both profitability and efficiency; in particular the Italian banks exhibited a sharp decline in the cost-to-income ratio (operating cost to gross banking income). Despite the worsening of the operating efficiency, French banks improved their return on equity while Spanish and English banks significantly reduced their profitability ratios. Tier 1 ratio rose for all European banks as a result of both an increase in capital and a decrease in risk-weighted assets, with the exception of Spanish banks that instead showed a tier 1 ratio below 10% at the end of September 2012. Italian Banks continued to be characterized by a lower tier 1 ratio than the German, French and English banks but, at the same time, they showed also a lower leverage, in particular compared to the German and French ones.

Figure 4.4 – Trends in profitability and capital adequacy of the main listed European banks in the first nine months of 2012



Source: calculations on data from consolidated annual and interim reports of the main listed European banks (Unicredit, Intesa Sanpaolo, Banca Monte Paschi, Banco Popolare, UBI Banca, Deutsche Bank, Commerzbank, Deutsche Postbank, Landesbank Berlin, Société Générale, Credit Agricole, BNP Paribas, Natixis, Credit Industriel et Commercial, BBVA, Santander, Bankia (since 2011), Caixa Bank, Banco Popular, Banco Espanol de Crédito, Banco de Sabadell, Barclays, HSBC, Lloyds e Royal Bank of Scotland). The profit before taxes is calculated excluding goodwill impairment. The figures as at 30 September of 2012 are annualised and partly estimated. ROE is calculated on total equity at the end of period.

Risk dashboards

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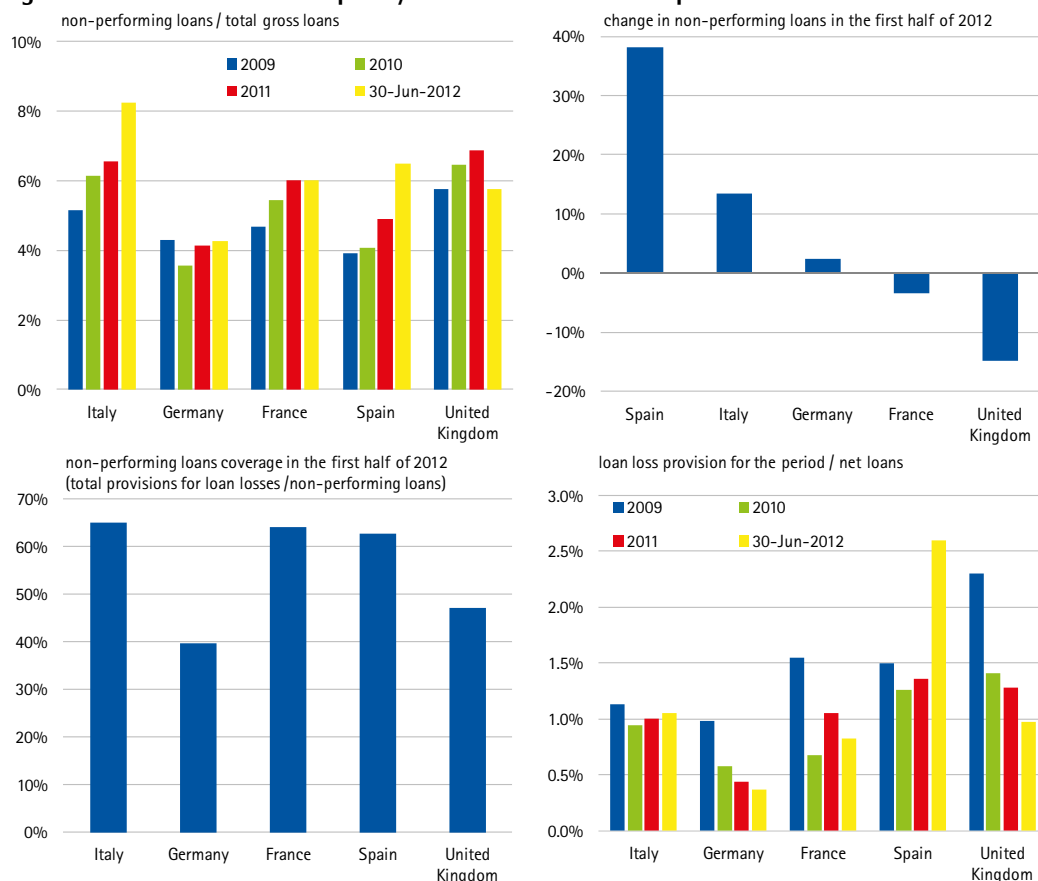
3. Non-financial companies

4. Banks

In the first half of 2012 credit quality worsened for the largest Italian and Spanish banks

In the first half of 2012 Spanish and Italian banks showed a significant worsening in the credit quality with the incidence of non-performing loans to total loans rising above 6% and 8% respectively. This result for Spanish banks reflects the greater contribution of the data from the two largest banks whose performance, given their significant cross-border activity, is less linked to the Spanish economic cycle. Gross non-performing loans increased by 38% for the largest listed Spanish banks and by 13% for the Italian ones. The non-performing loans coverage ratio (portion of gross non-performing loan already impaired) is above 60% for the main listed Italian, Spanish and French banks, while it is close to 50% and 40% for the English and German banks respectively. The cost of risk (loan loss provision for the period to total net loans) is above 2,5% for Spanish banks, while it is below 1% for all the largest banks of the other European countries.

Figure 4.5 – Trends in credit quality of the main listed European banks



Source: calculations on data from consolidated annual and interim reports of the main listed European banks (Unicredit, Intesa Sanpaolo, Banca Monte Paschi, Banco Popolare, UBI Banca, Deutsche Bank, Commerzbank, Deutsche Postbank, Landesbank Berlin, Société Générale, Credit Agricole, BNP Paribas, Natixis, Credit Industriel et Commercial, BBVA, Santander, Bankia (since 2011), Caixa Bank, Banco Popular, Banco Espanol de Crédito, Banco de Sabadell, Barclays, HSBC, Lloyds e Royal Bank of Scotland). The figures are annualised and partly estimated.

In the Euro area the credit standards for loans to enterprises worsened, mainly for loans to small and medium-sized firms, while they slightly improved for loans to households

According to the last data from the ECB Bank Lending Survey, in the second and third quarter of 2012 there was a net tightening of credit standards by Euro area banks for loans to small and medium-sized enterprises. The net percentage of banks contributing to tightening credit standards for loans to small and medium-sized firms increased from 1% in the first quarter of 2012 to 11% in the third quarter of 2012, while that of credit standards for loans to large firms remained stable around 17%. The net tightening of credit standards both for loans to households for home purchase and for consumer credit improved slightly in the third quarter of 2012. Turning to the factors explaining the dynamics of credit standard indicators, Euro area banks cited the negative expectations on general economic activity as the main factor contributing to tightening in the credit standards for loans to enterprises, while other factors were less frequently reported.

Risk dashboards

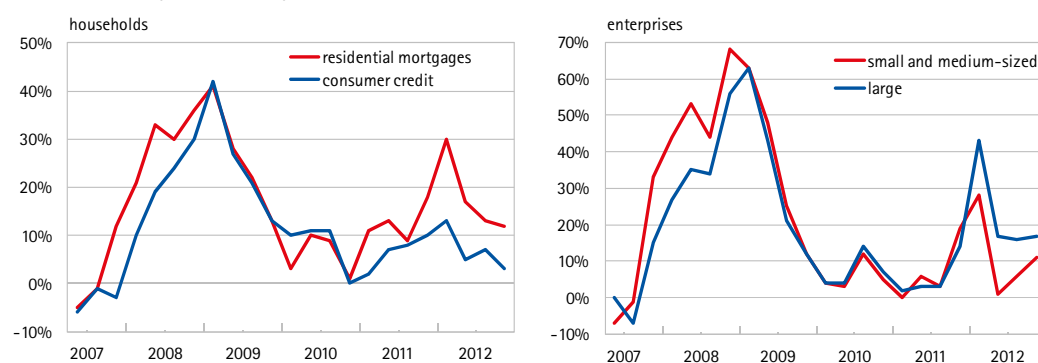
1. Macroeconomic background

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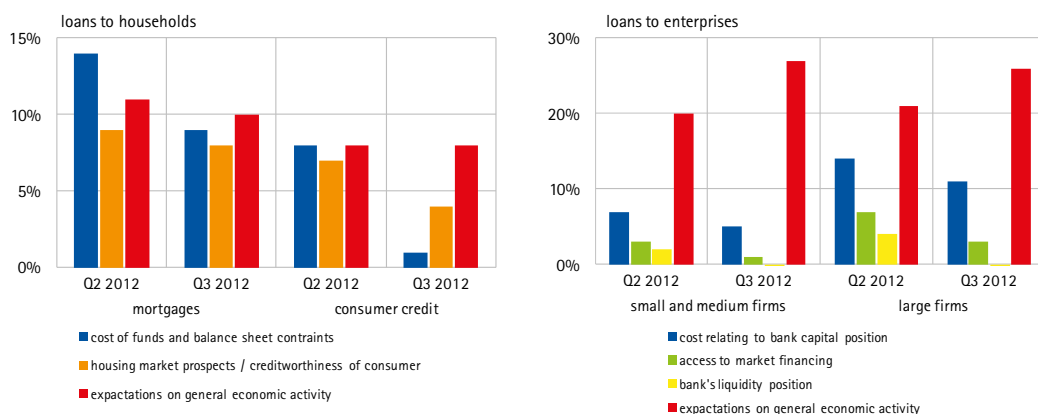
4. Banks

Figure 4.6 – Credit standard indicators for bank loans in the Euro area
(monthly data; April 2007 – April 2012)



Source: ECB. Net percentage of banks reporting a tightening in credit standards.

Figure 4.7 – Factors explaining the tightening in credit standards in the Euro area

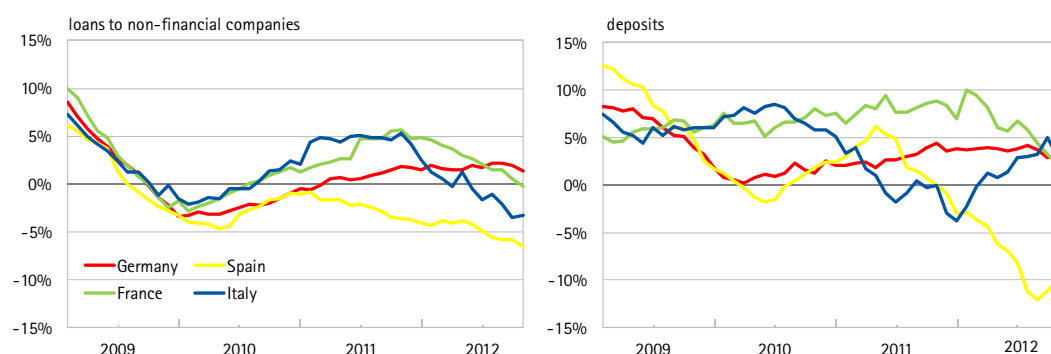


Source: calculations on data from ECB (Bank Lending Survey). Net percentage of banks reporting that a given factor contributed to a tightening in credit standards.

Loans to non-financial companies decreased in Spain and Italy

In 2012 the annual growth rate of loans to non-financial companies was negative in Italy and Spain, while it was positive (but declining) in France; in Germany the growth of loans to non-financial companies remained stable throughout 2012. The deposits continued to decline in Spain while in Italy their annual growth rate turned to positive values in the first months of 2012 after a decline in the second half of 2011. Turning to the core European countries, the annual growth rate of deposits remained positive and stable in Germany while it exhibited a gradual slowing in France. These dynamics highlight, therefore, a widening gap between core and peripheral countries in the Euro area, both in terms of bank lending to the real economy and in terms of evolution of funding.

Figure 4.8 – Annual growth rate of loans to non-financial companies and of deposits
(monthly data; January 2009 – October 2012)



Source: ECB.

Risk dashboards

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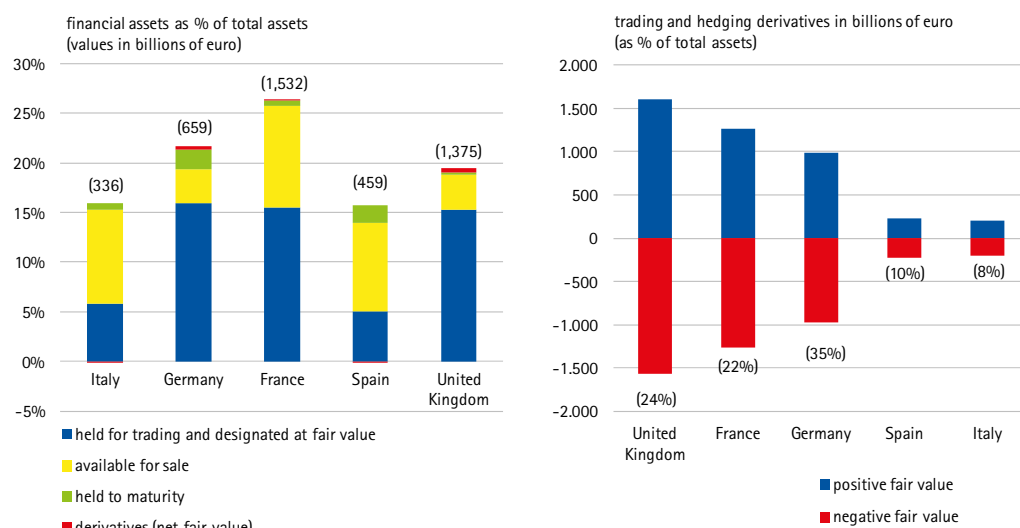
3. Non-financial companies

4. Banks

Italian and Spanish banks have a limited activity on financial assets and derivatives; that explains the structural differences of risk-weighted assets to total non-weighted assets compared to the banks of other major European countries

In the first half of 2012, financial assets and net fair value of derivative instruments were about 15% of total assets for the largest Italian and Spanish banks. This value is significantly lower than that shown by banks of the other major European countries (20% for German banks, 22% for France banks and 26% for English banks). The positive fair value of derivatives was about 25% of total assets for English and French banks and about 35% for the German ones; Italian and Spanish banks exhibit a much lower value (about 10% and 8%, respectively). These structural differences in balance sheet asset composition have an impact on the level of risk-weighted assets for prudential purposes: Italian and Spanish banks have a greater incidence of loans to the private sector (that has a higher risk weight according to prudential regulation) on total assets compared with that of major German, French and English banks; as a consequence, the former show risk-weighted assets that represent about 45% of total non-weighted assets while the latter exhibit a ratio around 34%, 25% and 20% respectively.

Figure 4.9 – Financial assets and derivative instruments of the main listed European banks in the first half of 2012



Source: calculations on data from consolidated interim reports of the main listed European banks (Unicredit, Intesa Sanpaolo, Banca Monte Paschi, Banco Popolare, UBI Banca, Deutsche Bank, Commerzbank, Deutsche Postbank, Landesbank Berlin, Société Générale, Credit Agricole, BNP Paribas, Natixis, Credit Industriel et Commercial, BBVA, Santander, Bankia, Caixa Bank, Banco Popular, Banco Espanol de Crédito, Banco de Sabadell, Barclays, HSBC, Lloyds e Royal Bank of Scotland).

The capital strengthening of the main European banks occurred largely through revisions of the methodologies assessing the riskiness of assets

In the last few years the ratio of risk-weighted assets on the non-weighted ones declined for all the major banks in Europe: compared to 2010 the largest Italians, Germans and French credit institutions have significantly reduced the risk-weighted assets while increasing the total non weighted assets. In the first half of 2012 this dynamics was exacerbated by the need to comply with EBA requirements to bring the minimum level of high-quality capital (so-called core Tier 1) to 9% by the end of June 2012. Major European banks have done so minimally by increasing their own funds and largely by reducing their exposure to some class of assets (in particular those with a higher risk-weight according to the banking sector regulation) and by revising the methodologies for the calculation of capital requirements for prudential purposes.

Risk dashboards

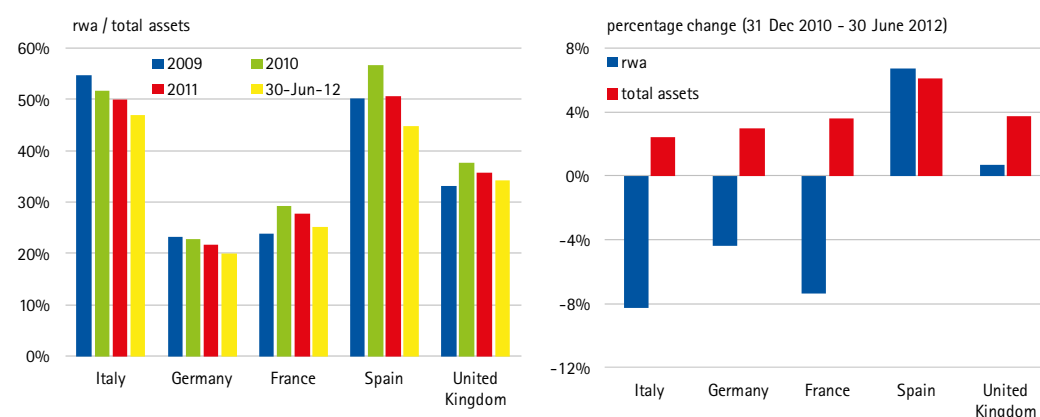
1. Macroeconomic background

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Figure 4.10 – Change in risk-weighted assets and total assets of the main listed European banks

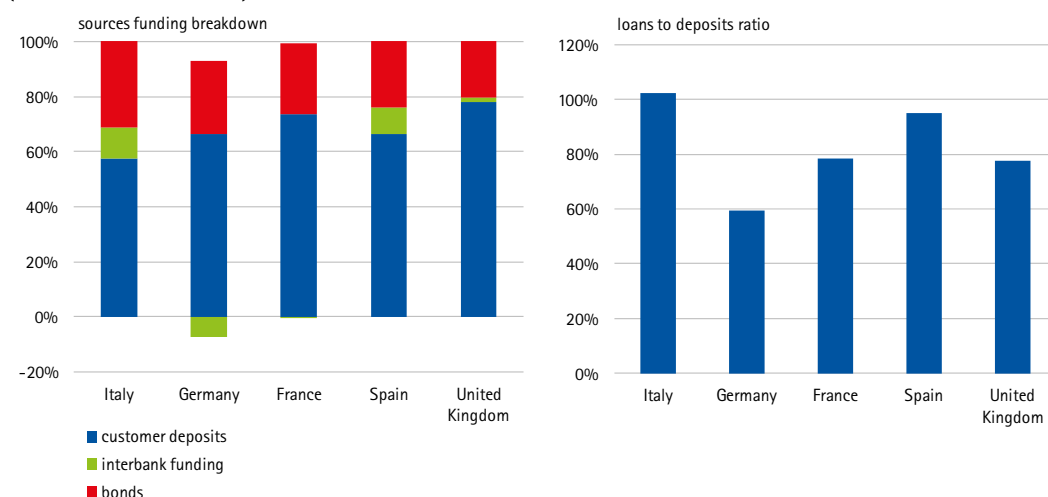


Source: calculations on data from consolidated annual and interim reports of the main listed European banks (Unicredit, Intesa Sanpaolo, Banca Monte Paschi, Banco Popolare, UBI Banca, Deutsche Bank, Commerzbank, Deutsche Postbank, Landesbank Berlin, Société Générale, Credit Agricole, BNP Paribas, Natixis, Credit Industriel et Commercial, BBVA, Santander, Bankia (since 2011), Caixa Bank, Banco Popular, Banco Espanol de Crédito, Banco de Sabadell, Barclays, HSBC, Lloyds e Royal Bank of Scotland).

The main Italian and Spanish banks show a higher incidence of interbank funding on total funding and a higher loan-to-deposit ratio

The main Italian listed banks are characterized by a higher recourse to bonds as a source of funding (that represents about 30% of total funding compared to average values between 20% and 25% for banks of the other major European countries) and by a higher interbank funding. Moreover, Italian and Spanish banks exhibit a higher loan-to-deposit ratio (ratio between customers loans and the sum of customers deposits and bonds issued). Therefore, the potential imbalance between illiquid investments and stable sources of funding seems to be greater for the Italian and Spanish banks than for German, French and English banks. However, these differences result from the more intense activity of Italian and Spanish banks in financing the real economy through loans to the private sector relative to the banks of the other main European countries.

Figure 4.11 – Sources of funding and loan-to-deposit ratio of the main listed European banks (data as of 30 June 2012)



Source: calculations on data from consolidated interim reports of the main listed European banks (Unicredit, Intesa Sanpaolo, Banca Monte Paschi, Banco Popolare, UBI Banca, Deutsche Bank, Commerzbank, Deutsche Postbank, Landesbank Berlin, Société Générale, Credit Agricole, BNP Paribas, Natixis, Credit Industriel et Commercial, BBVA, Santander, Bankia, Caixa Bank, Banco Popular, Banco Espanol de Crédito, Banco de Sabadell, Barclays, HSBC, Lloyds e Royal Bank of Scotland).

Risk dashboards

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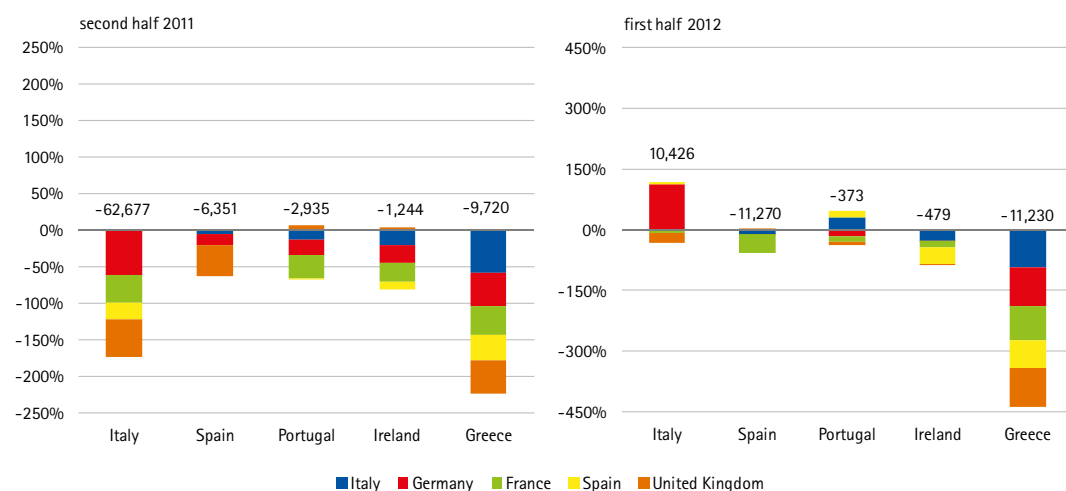
In the first half of 2012, there was a decline in outflows of investments by banks in core European countries from peripheral countries

In the first half of 2012, there was a decline in outflows of investments by banks in core European countries from peripheral countries. European banks increased their exposures to Italy by about 10 billion euro both in the public sector and in the private one. In the public sector that result derived from German banks investments of about 16 billion and French and English banks divestments of about 6 billion; instead, in the private sector, the net increase of investments derived from investments of French banks of about 16 billion and German and English banks divestments of about 7 billion. The exposures of banks from the major European countries to Greek, Spanish and Irish public debt continued to decrease while European banks investments in the private sector increased in Ireland (by about 60 billion) and, to a lesser extent, in Greece. At the end of June 2012, French and German credit institutions continued to be the most exposed to the sovereign debt of European countries with large public finance imbalances and the English banks maintained a significant exposure to the private sector in Ireland. The Italian banks continued to exhibit small investments in the other peripheral countries.

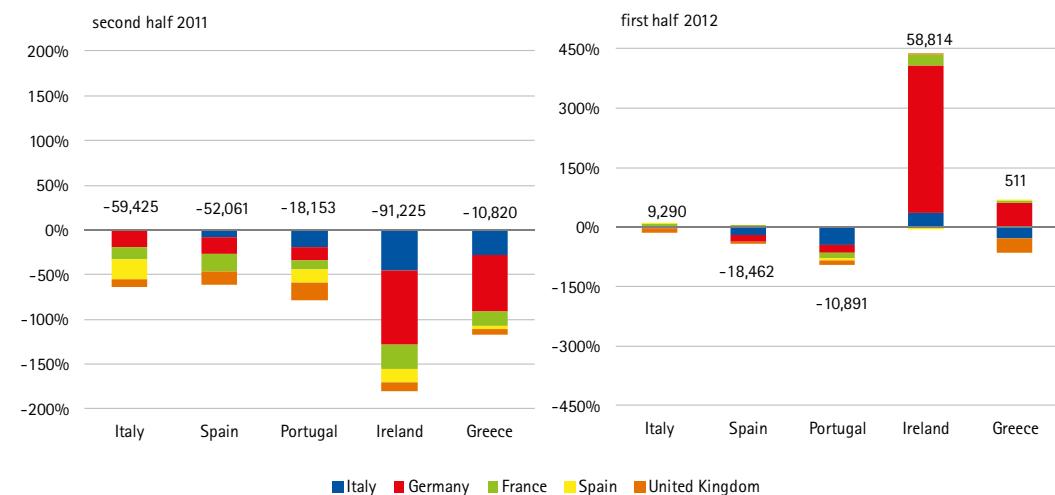
Figure 4.12 – Investments of banks of main European countries in peripheral countries of the Euro area in the last year

(first half of 2012; percentage change relative to the amount at the beginning of the period; amounts in millions of euro excluding domestic exposures)

PUBLIC SECTOR



PRIVATE SECTOR



Source: Bank of International Settlements. Data refer to total banking system of Italy, Germany, France, Spain and the United Kingdom.

Risk dashboards

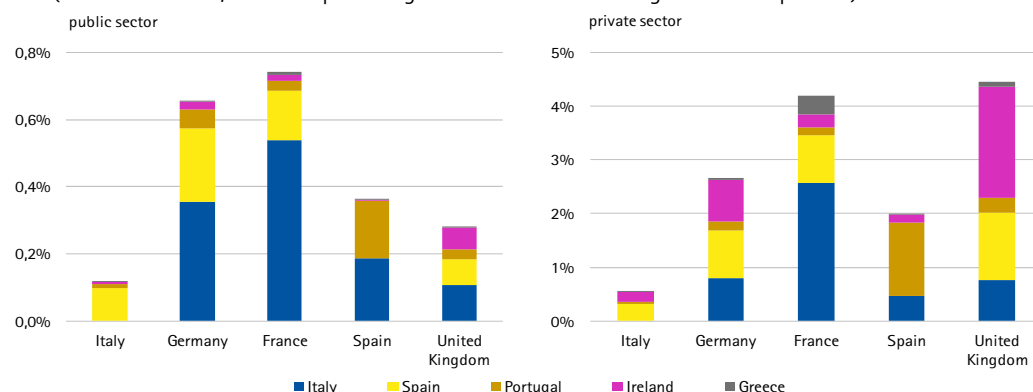
1. Macroeconomic background

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Figure 4.13 – Exposures of banks of main European countries to peripheral countries of Euro area (first half of 2012, values as percentage of total assets excluding domestic exposures)



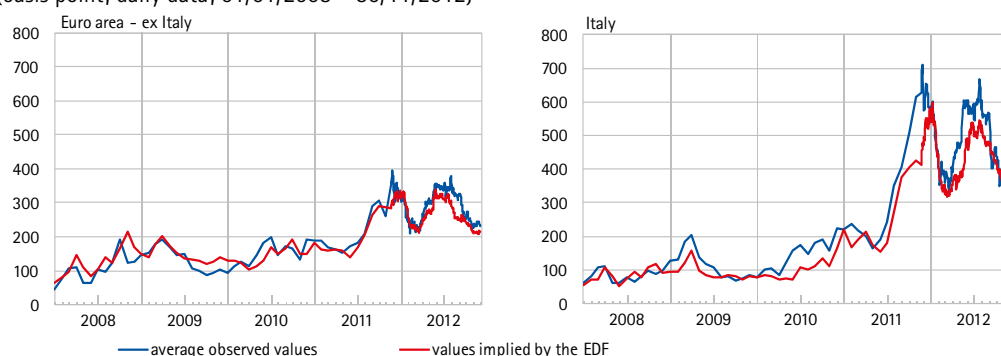
Source: calculations on data from Bank of International Settlements. Data refer to total banking system of Italy, Germany, France, Spain and the United Kingdom.

The perception of credit risk of the main European banks has significantly decreased in the second half of 2012 ...

In the second half of 2012, the 5-year financial institution CDS prices decreased on average by approximately 200 basis point. Analogous signals came from the theoretical CDS prices implied by probabilities of default computed by theoretical models based on market and balance sheet data. Moreover, the market perception of credit risk for Italian banks significantly decreased, as shown by the reduction in CDS prices by approximately 300 basis points in the second half of 2012, even if it remained significantly higher than the European average values.

Figure 4.14 – Average prices of 5-year CDS observed and implied by the expected default frequencies (EDF) for the main listed banks

(basis point; daily data; 01/01/2008 – 30/11/2012)



Source: calculations on Thomson Reuters e Credit Edge data. Referring to Italy, the banks included in the sample are Unicredit, Intesa Sanpaolo, Banca Monte Paschi, Banco Popolare, UBI Banca, while for the Euro area the banks taken into consideration are Deutsche Bank, Commerzbank, Deutsche Postbank Berlin, Société Générale, Crédit Agricole, BNP Paribas, Natixis, Crédit Industriel et Commercial, BBVA, Santander, Caixa Bank, Banco Espanol de Credito, Banco de Sabadell, Barclays, HSBC, Lloyds e Royal Bank of Scotland.

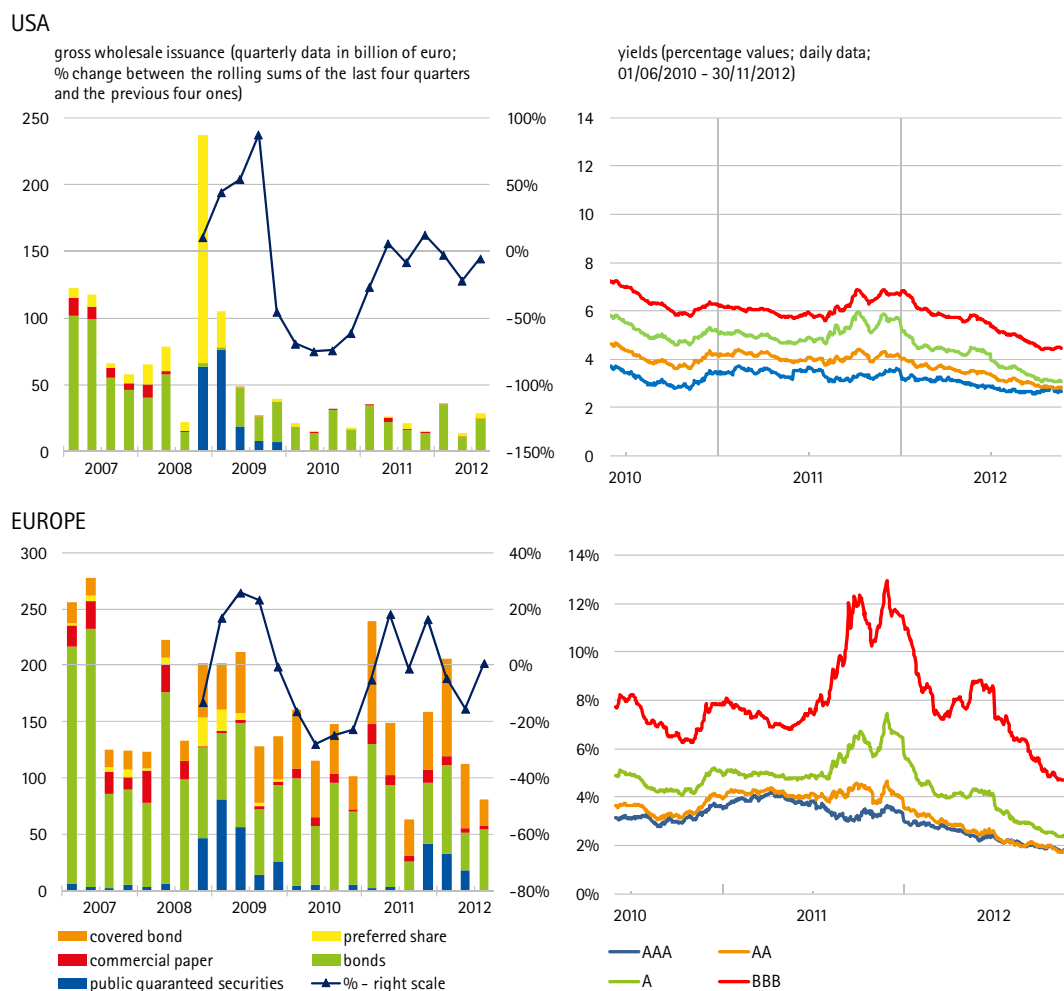
... but the bond market does not show a recovery yet

In the third quarter of 2012, bond issuance by banks does not show a recovery in the United States and Europe. In the first and second quarter of 2012 the recourse to covered bond from European banks was high while in the third quarter covered bond gross issuances declined, as a result of a decrease in market turmoil and the consequent improvement in the cost of non-collateralized bond funding. In the secondary market, bank bonds yields showed a decrease both in the United States and in Europe. That dynamics in Europe was stronger for bonds with rating close to the speculative grade (BBB); as a consequence, the spread over the highly rated bonds yields narrowed. In Italy, banks' bond funding showed a recovery in the third quarter; however, in the first nine months of 2012 bond issuance was lower than in the corresponding period of 2011 (-40%). The amount of bonds maturing in 2013 is large, equal to 158 billion euro (i.e. 14% of the amount outstanding).

Risk dashboards

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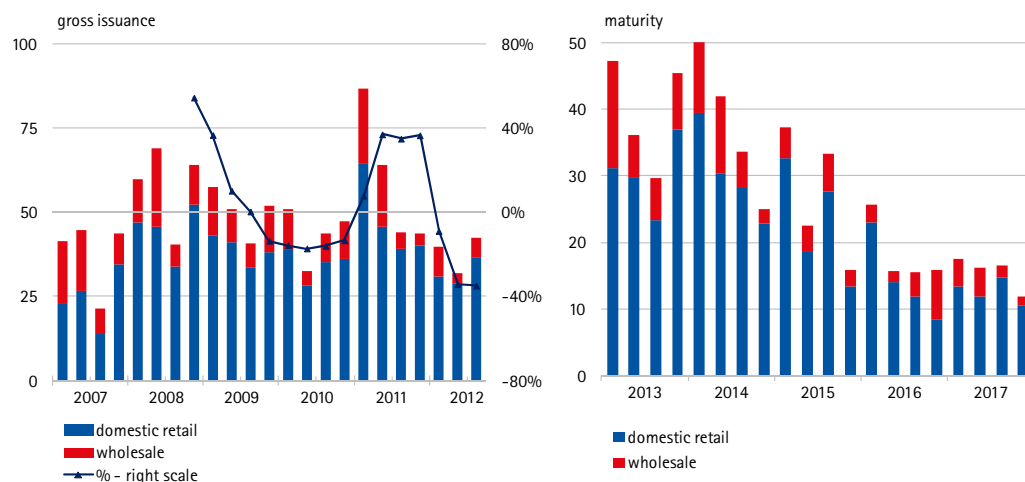
Figure 4.15 – Gross issuances and yields of banks bonds



Source: calculations on Dealogic, Consob and Kler's data. The data for Europe refer to placements of companies with registered office in Italy, France, Germany, Spain, the Netherlands and the UK and their subsidiaries (even if with headquarters in other countries).

Figure 4.16 – Italian banks bonds

(quarterly data in billions of euro; % change between the rolling sums of the last four quarters and the previous four ones)



Source: calculations on Dealogic, Consob and Kler's data. Maturities refer to bond issuances since 2007.

Risk dashboards

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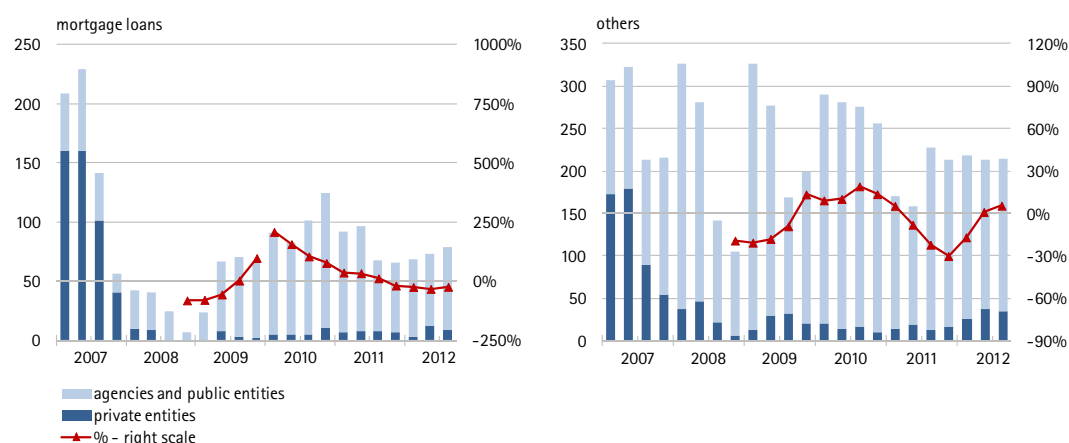
The activity on market for securitisations remained stagnant

The market for securitisations based on mortgage loans and other assets was stagnant in the United States. In Europe, as well, the amount of securitization issues linked to mortgage loans was small in 2012, while in Italy there were no new mortgage securitizations in the second and third quarter of 2012.

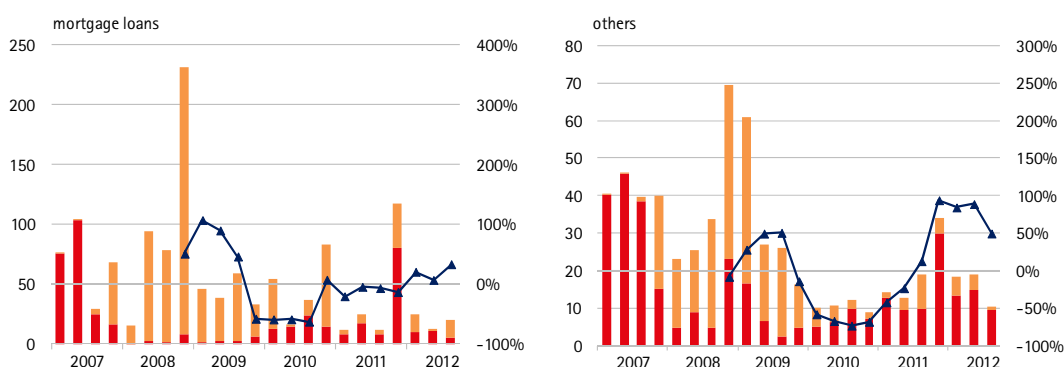
Figure 4.17 – Securitisation issuances

(quarterly data in billions of euro; % change between the rolling sums of the last four quarters and the previous four ones)

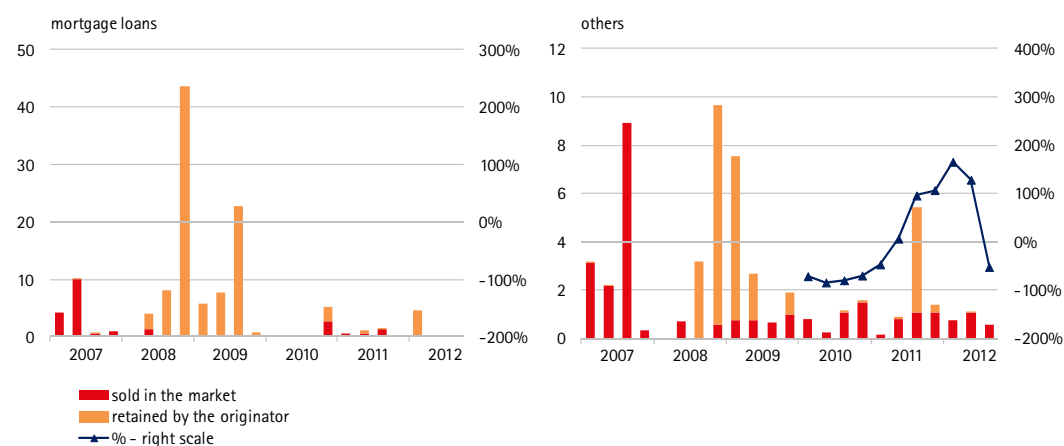
USA



EUROPE



ITALY



Source: calculations on Dealogic data. The data for Europe refer to companies with registered office in Italy, France, Germany, Spain, the Netherlands and the UK and their subsidiaries (even if with headquarters in other countries).