

Italy outlook report

Second quarter of 2023



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The objective of Italy’s quarterly report is to provide a comprehensive and summarized overview of the main indicators of the country's banking sector, as well as the macroeconomic situation at the end of each quarter.

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1. International overview

In 2023, the global economy slowed down because of persistent inflation - especially core inflation - and the resulting tightening of monetary policy by major central banks. Growth is expected to be subdued in 2023 and inflation to reach target levels by the end of 2025.

Macroeconomic outlook

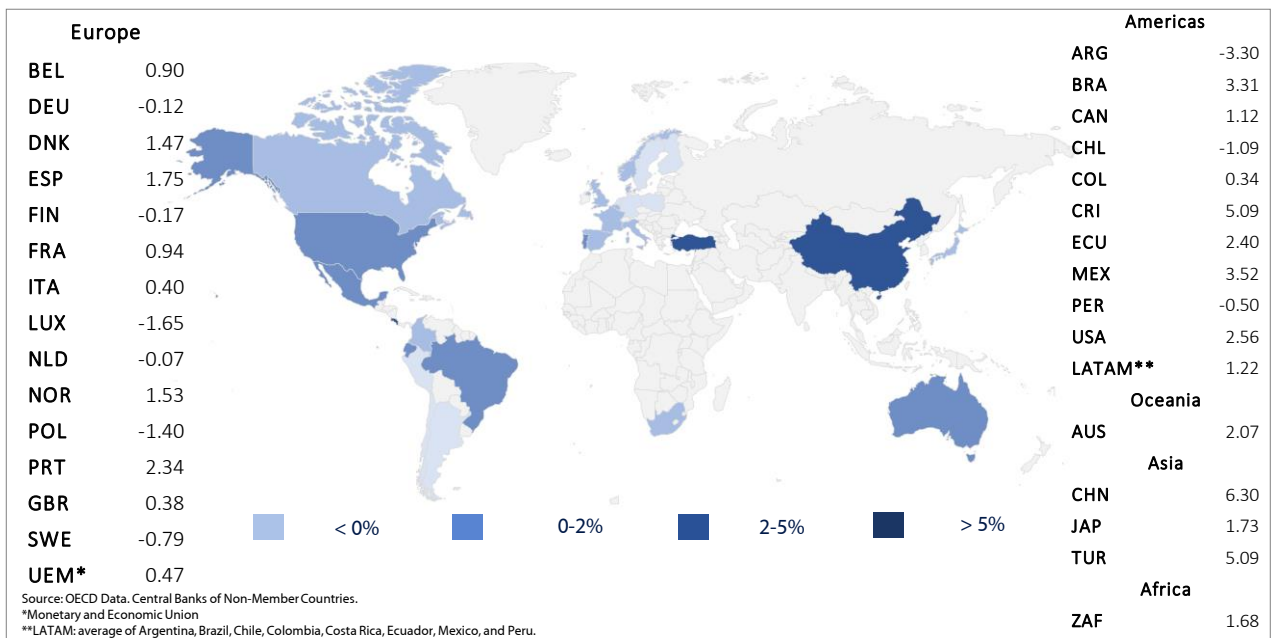
- ▶ During 2023, the euro zone registered growth of 0.47%, compared to 1.30% in 1Q23, consolidating the economic stagnation of the area. Of note is the case of Germany, which recorded a decline for the second consecutive quarter and high inflation. The euro zone's average CPI fell to 6.20%, almost 2 p.p. less than in 1Q23 (8.01%), although concerns remain about the persistence of core inflation, while the average unemployment rate declined slightly to 6.4%.
- ▶ Of note in the Americas was the slowdown in the Latam¹ region compared to the previous quarter (1.22% vs. 2.12%), with countries with negative growth rates such as Argentina, Chile and Peru. In contrast, the US continued to stand out, consolidating its growth with a rate of 2.56% (1.62% in 1Q23). Inflation in the US fell to 3.97%, while the Latam¹ average was 20.31% (excluding Argentina (113%), the average was 7.07%). On the continent, unemployment rates were generally stable compared to the previous quarter's reference values.
- ▶ In the Asian region, the reopening of China after the removal of Covid-19 restrictions strengthened economic growth in the region. The growth rate in China was 6.30% (4.50% in 1Q23) and 1.73% in Japan (1.79% in 1Q23).
- ▶ Australia recorded growth of 2.07% (2.27% in 1Q23), continuing its economic slowdown, with a relatively stable unemployment rate of around 3.6% and falling but still high inflation, which closed the second quarter of the year at 6.03%.
- ▶ South Africa, on the other hand, recovered from the decline in its growth rate to 1.68% (compared to 0.18% in the previous quarter), with inflation down at 6.45% and unemployment high at almost 35%.
- ▶ The IMF expects global growth to slow from the recorded 3.5% in 2022 to the 3.0% estimated by the organisation for both 2023 and 2024, in the face of the economic drag from central banks continuing to raise policy rates to combat inflation. Global inflation is projected to fall from 8.7% in 2022 to 6.8% in 2023 and 5.2% in 2024, while core inflation is expected to decline more gradually. Inflation is expected to reach target levels by the end of 2025.
- ▶ ECLAC expects the region's economies to maintain low levels of growth this year and next, affected by a negative global and very complex regional economic outlook, estimating regional average GDP growth of 1.7% in 2023, while for 2024 it projects a slight decline to 1.5%. By sub-region, South America is estimated to grow by 1.2%, Central America and Mexico by 3%.

Other indicators and main risks

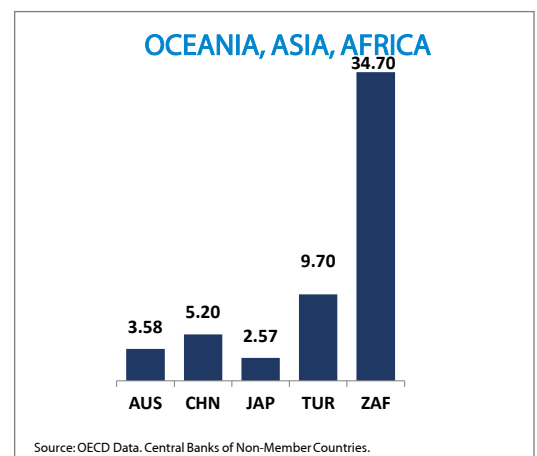
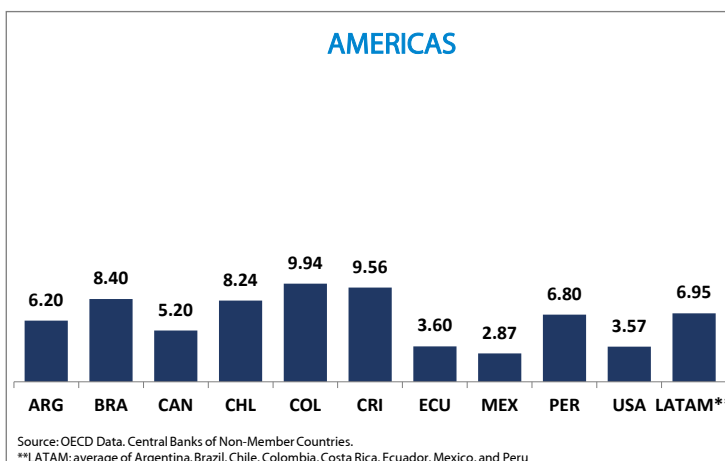
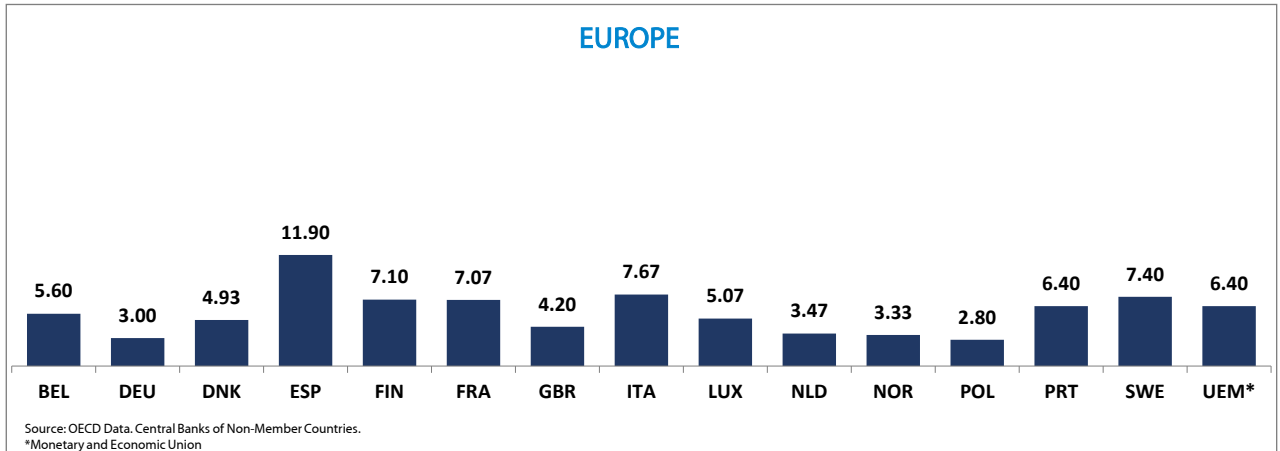
- ▶ The euro consolidated its recovery against the dollar from its decline in 2022. The dollar has become less attractive against the euro because of the interest rate hike cycle of both central banks, the outlook for economic recovery in both regions (expected to be slower in the US) and the government's plan to reduce the US fiscal deficit by raising taxes.
- ▶ The main Latin American currencies also strengthened against the dollar, except for the Argentine peso, whose exchange rate rose from 1Q23 to 239.33 pesos per dollar, a consequence of the region's runaway inflation.
- ▶ The IMF warns that global debt reached 238% of world GDP (+9 p.p. since 2019) and urges governments to take urgent action to reduce long-term debt vulnerabilities and offers specific recommendations for public and private sector debt.

¹ The average for Latam countries is composed from macroeconomic data for the countries of Argentina, Brazil, Chile, Colombia, Costa Rica, Ecuador, Mexico and Peru.

GDP (% , year-on-year growth)

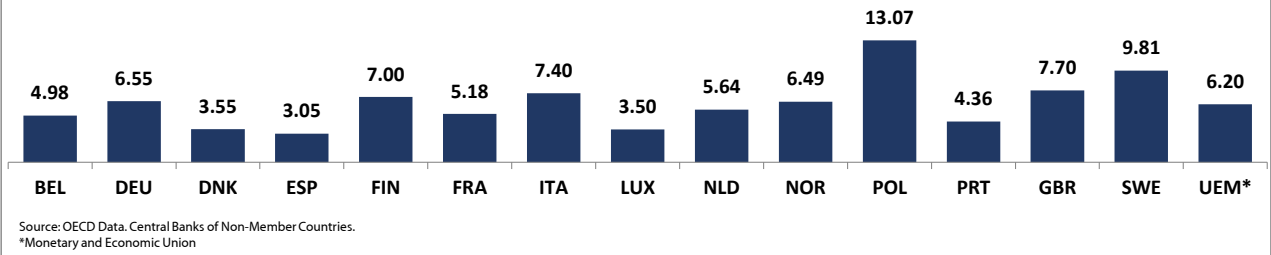


Unemployment rate (%)

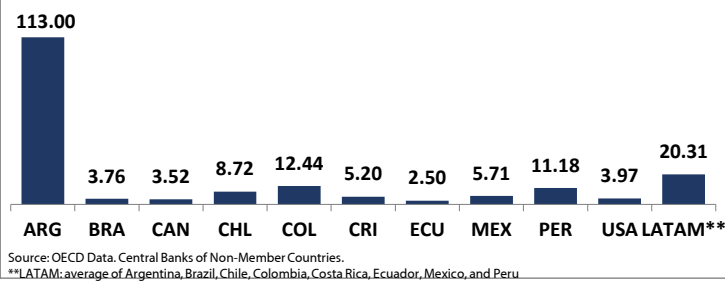


Inflation rate (%)

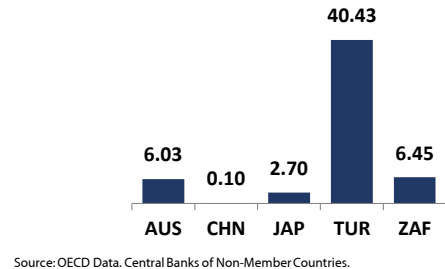
EUROPE



AMERICAS



OCEANIA, ASIA, AFRICA



Global Ratings and Exchange Rates

LONG-TERM RATES 2Q23

	MOODY'S	S&P	Fitch
EUROPE			
DEU	Aaa	AAA	AAA
BEL	Aa3	AA	AA-
DNK	Aaa	AAA	AAA
ESP	Baa1	A	A-
FIN	Aa1	AA+	AA+
FRA	Aa2	AA	AA-
ITA	Baa3	BBB	BBB
LUX	Aaa	AAA	AAA
NLD	Aaa	AAA	AAA
NOR	Aaa	AAA	AAA
POL	A2	A-	A-
PRT	Baa2	BBB+	BBB+
GBR	Aa3	AA	AA-
SWE	Aaa	AAA	AAA
AFRICA			
ZAF	Ba2	BB-	BB-
OCEANIA			
AUS	Aaa	AAA	AAA
ASIA			
CHN	A1	A+	A+
JAP	A1	A+	A
TUR	B3	B	B
AMERICAS			
ARG	Ca	CCC-	C
BRA	Ba2	BB-	BB-
CAN	Aaa	AAA	AA+
CHL	A2	A	A-
COL	Baa2	BB+	BB+
CRI	B2	B+	BB-
ECU	Caa3	B-	B-
MEX	Baa2	BBB	BBB-
PER	Baa1	BBB	BBB
USA	Aaa	AA+	AAA

▲ Increased from 1Q23

▼ Decreased from 1Q23

Source: Investing.

EXCHANGE RATES 2Q23 (\$*)

EUROPE	2Q22	3Q22	4Q22	1Q23	2Q23	2023
EUR	0.94	1.00	0.97	0.93	0.92	0.92
DKK	7.10	7.59	6.95	6.91	6.85	6.86
NOK	9.85	10.91	9.80	10.27	10.81	10.56
SEK	10.24	11.09	10.45	0.10	10.63	10.35
GBP	1.22	1.12	1.21	0.82	0.80	0.81
PLN	4.48	4.96	4.38	4.36	4.15	4.23
AMERICAS	2Q22	3Q22	4Q22	1Q23	2Q23	2023
ARG	117.95	135.79	176.71	197.70	239.22	219.09
BRL	5.23	5.41	5.29	5.10	4.94	5.00
CLP	928.98	965.90	849.41	805.80	805.20	796.01
COP	4,161.04	4,597.52	4,849.39	4,725.30	4,438.83	4,611.09
PER	3.79	3.99	3.80	3.79	3.66	3.71
MXN	20.13	20.10	19.50	18.38	17.59	17.88
AFRICA	2Q22	3Q22	4Q22	1Q23	2Q23	2023
ZAR	16.27	18.15	17.00	17.76	18.94	18.82
OCEANIA	2Q22	3Q22	4Q22	1Q23	2Q23	2023
AUS	1.45	1.56	1.47	1.47	1.51	1.49
ASIA	2Q22	3Q22	4Q22	1Q23	2Q23	2023
RMB	6.70	7.11	6.90	6.85	7.09	6.93
TRY	16.33	18.21	18.62	18.94	22.09	19.40

Source: Investing, OECD projections, June 2023.

*The base currency used is the US dollar against each local currency quoted.

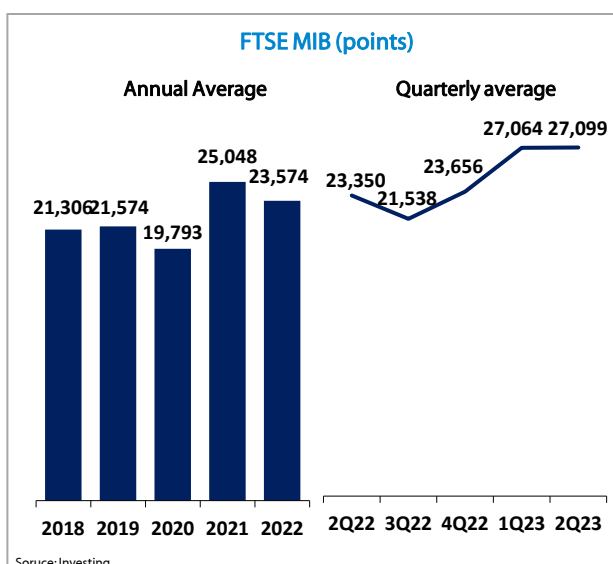
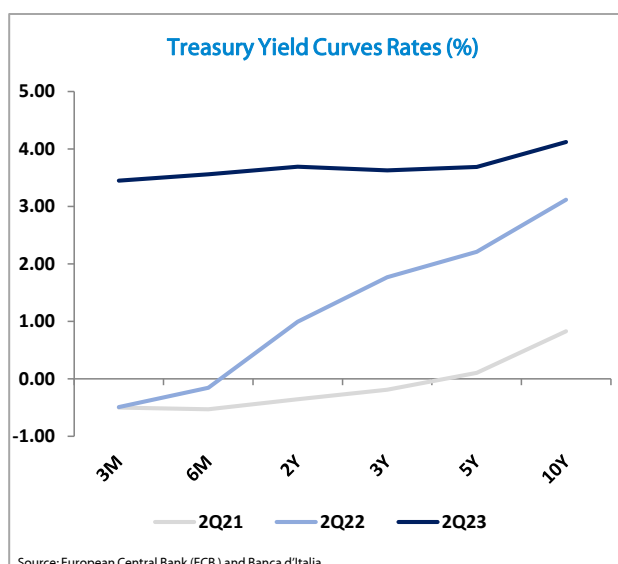
2. Macroeconomic view

During 2Q23, the Italian economy registered a YOY growth rate of 0.40%. However, the growth rate 1.5 p.p. lower than the growth rate of 1Q23. The inflation stood at a level of 7.40% during 2Q23, while in the labour market the unemployment rate stood at a level of 7.67%.

Main Macroeconomic Indicators (%)									
ACTIVITY	2Q22	3Q22	4Q22	1Q23	2Q23	Var. p.p.1Q23	Var. p.p.2Q22	2023	2024
GDP	5.03	2.48	1.48	1.90	0.40	-1.50	-4.64	1.16	1.02
DOMESTIC DEMAND	4.23	2.74	1.05	2.54	0.96	-1.58	-3.27	0.40	0.70
HOUSEHOLD CONSUMPTION	5.65	3.82	1.67	3.36	1.34	-2.02	-4.32	0.89	0.85
PUBLIC CONSUMPTION	0.11	-0.50	-0.79	0.17	-0.15	-0.32	-0.26	0.68	-1.19
CAPITAL FORMATION	13.43	10.17	-1.98	-3.49	-3.57	-0.08	-17.00	2.72	1.67
EXTERNAL DEMAND									
EXPORTS	10.97	7.92	9.35	2.09	0.36	-1.73	-10.62	1.61	3.75
IMPORTS	15.13	14.26	6.09	0.33	-0.42	-0.75	-15.54	-0.29	2.96
INFLATION									
CPI	6.91	8.39	11.75	8.90	7.40	-1.52	0.48	6.43	2.96
LABOUR MARKET									
UNEMPLOYMENT RATE	8.10	8.03	7.90	7.90	7.67	-0.23	-0.43	8.12	8.13
EMPLOYMENT*	2.25	1.32	1.33	2.21	1.01	-1.20	-1.24	0.99	0.65

*The employment variable represents the year-on-year change in employment growth.
Source: Organisation for Economic Co-operation and Development (OECD). OECD projections June 2023.

- ▶ During 2Q23, Italy's year-on-year growth rate stood at 0.40%, 1.50 p.p. lower than in 1Q23. This decline was due to a significant reduction in domestic demand, mainly due to private consumption (-2.02 p.p.). As for external demand, commercial exports registered a growth rate of 0.36%, while a negative growth rate (-0.42%) was observed for total imports.
- ▶ During 2Q23, inflation has further decreased compared to the previous quarter, reaching 7.40%, while the unemployment rate has decreased compared to the level of 1Q23, reaching a level of 7.67%.
- ▶ The Treasury yield curve rate reached 4%, exceeding the 3% benchmark for the most relevant yields. The FTSE MIB index stood at 27,099 points, registering a small appreciation compared to the level of the index in the previous quarter, meaning a percentage change of 0.13%. Compared to 2Q22, the index recorded a year-on-year growth of 16.06%.



3. Banking sector

During 2Q23, total loans and deposits growth rates decreased compared to 1Q23 and 2Q22, reaching their lowest level since 1Q20. The efficiency ratio improved compared to 2Q22. Italy risk ratios improved their performance compared to 2Q22, the same as CET 1 and leverage ratios, while LCR ratio decreased compared to 2Q22 and 1Q23.

BANKING SITUATION 2Q23 (%)							
BUSINESS	2Q22	3Q22	4Q22	1Q23	2Q23	Var p.p. 1Q23	Var p.p. 2Q22
TOTAL LOANS*	2.09	2.59	0.15	-0.97	-2.45	-1.48	-4.54
TOTAL DEPOSITS *	3.03	1.92	-0.33	-2.59	-3.99	-1.40	-7.02
LTD RATIO	85.08	85.84	84.46	83.32	85.59	2.27	0.51
EFFICIENCY							
EFFICIENCY RATIO	61.21	64.19	62.87	54.59	52.11	-2.49	-9.10
EU AVERAGE	61.39	61.00	60.56	59.51	56.54	-2.97	-4.85
RISK							
NPL RATIO	2.57	2.55	2.44	2.43	2.41	-0.02	-0.15
EU AVERAGE	1.81	1.76	1.80	1.77	1.81	0.04	0.00
COVERAGE RATIO	52.71	53.91	53.51	54.42	54.08	-0.34	1.37
EU AVERAGE	43.81	44.07	43.51	43.64	42.93	-0.71	-0.88
SOLVENCY							
CET 1**	14.32	14.10	15.10	15.27	15.79	0.52	1.47
LEVERAGE RATIO**	5.18	5.16	5.61	5.57	5.83	0.26	0.65
LCR	181.23	176.29	185.24	186.80	166.43	-20.37	-14.80
ECB INTEREST RATES							
INTEREST RATES	0.00	0.50	2.50	3.50	4.00	0.50	4.00

Sources: Banca d'Italia, European Banking Authority (EBA).
 *Note: Total loans and deposits reflect year-on-year growth rates.
 **Note: CET1 ratio measured as fully-loaded and Leverage ratio as fully phased-in definition of Tier 1.

- ▶ Total loans growth rate of the Italian banking sector stood at -2.45% in 2Q23. It obtained a year-on-year decrease rate of 4.54 p.p. and of 1.48 p.p. compared to 1Q23. Total deposits growth rate fell to -3.99%, meaning a decrease of 7.02 p.p. compared to 2Q22 and a decrease of 1.40 p.p. compared to the previous quarter.
- ▶ The efficiency ratio stood at 52.11% during the second quarter of the year. The ratio improved by 9.10 p.p. compared to the same quarter of the previous year, and 2.49 p.p. compared to the previous quarter. Compared to the EU situation, the efficiency ratio of Italy's banking sector is 4.43 p.p. better than the average of the European countries.
- ▶ The NPL ratio continued the downward trend initiated in 4Q21, reducing from a rate of 2.57% during 2Q22 to a rate of 2.41% during the second quarter of 2023. This value means an improvement of 0.02 p.p. compared to 1Q23 and 0.15 p.p. compared to 2Q22. However, Italy NPL ratio was still above the EU average (1.81%). The coverage ratio decreased by 0.34 p.p. compared to 1Q23, but it increased by 1.37 p.p. if compared to the same quarter of the previous year. Thus, the ratio remained at 54.08%, 11.15 p.p. above the EU average.
- ▶ Regarding solvency ratios, CET1 ratio increased by 0.52 p.p. and by 1.47 p.p. compared to 1Q23 and 2Q22, respectively. Leverage ratio also increased year-on-year by 0.65 p.p. and by 0.26 p.p. compared to the previous quarter, whereas LCR decreased significantly both year-to-year and compared to the first quarter, down to a level of 166.43%.
- ▶ Interest rates in 2Q23 were set at 4.00%. This represented an increase of 0.50 p.p. compared to the previous quarter.

4. Glossary

- ▶ **BUSINESS VOLUME:** The business volume is the set of activities that generate income for a bank, formed by financing (loans) plus customer resources (deposits).
- ▶ **COVERAGE RATIO:** It is a ratio that informs us about the protection that financial entities have against the unpaid loans of their clients. It is represented as the total provisions that the entity has over the total doubtful loans.
- ▶ **CPI:** The consumer price index is an indicator that measures the variation of prices of a basket of goods and services in a specific location during a certain period of time.
- ▶ **EFFICIENCY RATIO:** It is a ratio that measures the productivity of an entity. It is the result of the quotient between operating expenses and gross margin. In other words, it relates the income obtained with the expenses necessary for its achievement. As a conclusion, an entity will be more efficient the lower its efficiency ratio.
- ▶ **GDP:** Gross Domestic Product (GDP) is an economic indicator that reflects the monetary value of all final goods and services produced by a territory in a certain period of time. It is used to measure the wealth generated by a country.
- ▶ **GM/ATAs:** Gross Margin / Average Total Assets. Gross margin is composed of the set of revenues generated by a financial entity in its activity.
- ▶ **LEVERAGE RATIO:** The Tier 1 leverage ratio measures a bank's core capital relative to its total assets. The numerator consists of the most stable and liquid capital, as well as the most effective at absorbing losses during a financial crisis or recession. The denominator is a bank's total exposures, which include its consolidated assets, derivative exposures and certain off-balance sheet exposures.
- ▶ **LCR (Liquidity Coverage Ratio):** this ratio measures a bank's liquidity. It is calculated as the institution total liquid assets divided by its short-term obligations.
- ▶ **LTD RATIO:** The loan-to-deposit ratio (LDR) is used to evaluate a bank's liquidity by comparing the total loans of a bank with the total deposits during the same period.
- ▶ **NON-PERFORMING LOANS (NPL) RATIO:** The non-performing loan (NPL) ratio is an indicator used to measure the volume of operations that have been considered non-performing, in relation to the volume of loans and credits granted by said entity.
- ▶ **OE/ATAs:** Operating Expenses / Average Total Assets. Operating expenses are those that an entity incurs during the exercise of its activity.
- ▶ **OECD:** Organization for Economic Cooperation and Development.
- ▶ **p.p.:** percentage points.
- ▶ **ROA:** An indicator that measures the profitability of a company in relation to its total assets. It indicates the return that is being obtained for its assets. It is calculated as the quotient between profit and total assets. The profit used is that obtained before taxes and interests.
- ▶ **ROE:** Financial profitability is also known as return on equity, which relates the net profits obtained in a given investment operation with the own resources.

5. Appendix

MACROECONOMIC OVERVIEW

- ▶ Banca d'Italia:
<http://www.bancaditalia.it>
- ▶ Borsa Italiana:
<https://www.borsaitaliana.it/>
- ▶ European Banking Authority (EBA):
<https://european-union.europa.eu/>
- ▶ European Central Bank (ECB):
<https://www.ecb.europa.eu/>
- ▶ Investing:
<https://www.investing.com/>
- ▶ Organisation for Economic Co-operation and Development, (OECD):
<http://www.oecd.org/>
- ▶ The National Institute for Statistics, Istat:
<http://www.istat.it/en/>

FINANCIAL SECTOR

- ▶ European Banking Authority (EBA):
<https://european-union.europa.eu/>
- ▶ Banca d'Italia:
<http://www.bancaditalia.it>

ACRONYMS

- | | | | | |
|-----------------|-----------------------|--------------------|----------------------|--------------------------------|
| ▶ DEU - Germany | ▶ LUX - Luxembourg | ▶ TUR - Turkey | ▶ ECU - Ecuador | ▶ ZAF - South Africa |
| ▶ BEL - Belgium | ▶ NLD - Netherlands | ▶ ARG - Argentina | ▶ MEX - Mexico | ▶ UEM- European Monetary Union |
| ▶ DIN - Denmark | ▶ NOR - Norway | ▶ BRA - Brazil | ▶ PER - Peru | |
| ▶ ESP - Spain | ▶ POL - Poland | ▶ CAN - Canada | ▶ USA- United States | |
| ▶ FIN - Finland | ▶ PRT - Portugal | ▶ CHL - Chile | ▶ AUS - Australia | |
| ▶ FRA - France | ▶ GBR- United Kingdom | ▶ COL - Colombia | ▶ CHN - China | |
| ▶ ITA - Italy | ▶ SUE - Sweden | ▶ CRI - Costa Rica | ▶ JAP - Japan | |



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