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Italy's Lending Recovery at Risk as Renzi Bad Bank Plan Stalls



- ▶ Savers are ditching bank bonds to avoid possible losses
- ▶ Lack of quick solution to NPL issue is scaring away investors

Italy's nascent lending recovery may be short lived.

With non-performing loans touching a record high of 201 billion euros (\$219 billion) in November and delays in creating a bad bank even as the European Central Bank ups its scrutiny, lenders may be reluctant to make new loans.

"The lending recovery is at risk," said Jacopo Ceccatelli, chief executive officer at Marzotto SIM SpA, a Milan-based brokerage. "The central bank's credit review may result in extra provisions and higher cost of funding in a deteriorating environment."

So far, the ECB's bond purchase program, known as quantitative easing, has shielded government bonds from the country's banking woes, with the yield on 10-year debt stable at 1.56 percent compared with a euro-era high of 7.5 percent in November 2011. Italy pays just 101 basis points more than German bunds to borrow for a decade.

Italian bank stocks and bonds, however, have not been spared. Lenders' shares dropped for a fifth consecutive day Wednesday, with Banca Monte dei Paschi di Siena S.p.A. losing half its value since the beginning of the year. Italian savers, who tend to treat bonds like high-yield deposit accounts, ditched 75 billion euros of bank bonds in the year ended September, a trend that may worsen after losses at four small lenders that are being bailed out made more people aware that the investments are risky.

Italy Banks Easing Lending to Business The Most Since 2003



Source: Bloomberg News calculation based on European Central Bank data

Note: Percentages are calculated with reference only to banks that report a change in credit standards for lending to enterprises.

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Bad Bank

The banking concerns come just as lending had begun picking up. ECB data shows that Italy is the euro-area country where credit standards for loans to businesses eased the most in the fourth quarter of 2015.

To further grease the wheels of the economy by speeding up disposals of non-performing loans and free up more resources for credit to companies and households, Italian Prime Minister Matteo Renzi's government has been trying to win approval at the European level for the creation of a bad bank.

The plan has been delayed several times and investors fear recent quarrels between European Commission President Jean-Claude Juncker and Renzi over an alleged lack of budget flexibility won't make things easier. Without the backstop of a bad bank or another mechanism to tackle the issue, investors worry even more about the outcome of the ECB's credit quality assessment.

Greater Scrutiny

The central bank's oversight arm, the Single Supervisory Mechanism, is seeking more information about bad loans of several Italian lenders including UniCredit, Banco Popolare SC, Banca Popolare di Milano and Banca Carige SpA.

"If there is a bail-in event this year, Italy is one of the countries where that is most likely to happen," said Alberto Gallo, head of macro-credit research at Royal Bank of Scotland Group Plc.

Italian Banks' Bad Loans Keep Rising



Source: Bank of Italy

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The European Union's Bank Recovery and Resolution Directive, which came into force in January, aims to ensure stakeholders rather than taxpayers bear the burden of bank failures. The new rules make bonds less appealing and risk increasing funding costs, investors say.

Bonds Hit

"Many banks, deprived of a cheap source of funding such as subordinated bonds and having to repay the loans they got from ECB, may find themselves with a reduced liquidity at disposal to boost lending," Gianluca Ziglio, executive director of fixed-income research at Sunrise Brokers LLP in London, said by phone.

Subordinated and senior bonds in troubled banks including Monte dei Paschi, Banca Popolare di Vicenza and Veneto Banca have slumped to record lows this month.

"Gone are the days when concerns about NPLs could be simply swept under the carpet," said Wolfgang Piccoli, managing director of Teneo Intelligence in London.