Fabio Panetta: A financial system for growth

Speech by Mr Fabio Panetta, Deputy Director General of the Bank of Italy, at The Adam Smith Society, "Italians' savings are in support of growth", Milan, 27 January 2014.

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1. Introduction

The economic and social costs of the double-dip recession that hit Italy over a brief period of time are very great. GDP has fallen by 9 per cent since 2007, industrial output by 25 per cent. There are fewer job opportunities: the number of persons in employment has fallen by 1 million, the unemployment rate is nearly 13 per cent, and more than 41 per cent among young people. The inequality indices have worsened: in 2012 the richest 10 per cent of households held 46.7 per cent of the country's wealth, up from 44.3 per cent in 2008. The consequences of the crisis mainly affect the young, whose prospects are dim compared with past generations.

The crisis originated abroad, but its effects have been accentuated by the structural weaknesses of the Italian economy, the first of which are the high public debt and the delayed response of industry and the institutional structure to technological progress, globalization and the introduction of the euro.

Italian banks successfully withstood the first wave of the crisis, which was financial in nature. However, the persistence of the recession and the sovereign debt crisis caused a worsening of the conditions for wholesale funding and credit quality, especially as regards business loans, which then undermined banks' balance sheets.

The increase in the amount of non-performing loans has been magnified by the financial fragility of firms. The low level of equity and the consequently high debt burden have squeezed business profitability, reducing resistance to external shocks. The pre-eminent role of credit compared with market financing has rendered firms vulnerable to a tightening of bank credit. These weaknesses were already present in the previous decade but have come to the fore during the recession.

The crisis has revived the unresolved problems of the Italian financial system: the dependence on banks, the lack of developed equity and bond markets, the inability to provide the productive system with resources other than credit. During negative phases of the cycle, this situation limits lending to business and makes it more costly, entailing high risks for banks, financial stability and economic activity.

But the crisis also provides incentives to strengthen the role of the capital market and make the structure of the financial system more balanced. In the following pages, I will analyse the salient points of these themes and possible ways of overcoming the financial constraints which are still weighing on the Italian economy.

2. Business credit and the financial crisis

In 2000, following the start of monetary union, the ratio between banks' business lending and GDP was at a similar level in the four leading euro-area countries, on the order of 35–40 per cent (Figure 1).

Significant gaps emerged in the following years up to the global financial crisis: against a fall of 4 percentage points in Germany, the ratio increased by 5 points in France, 15 points in Italy and 46 points in Spain.

In Italy, the growth of business lending was fostered both by strong demand and by favourable supply conditions. With the adoption of the euro, bank lending rates fell, eliminating the spreads relative to countries with a longer tradition of price stability. The availability of low-cost wholesale funding allowed banks to separate the growth of lending from that of retail funding. The share of loans not funded by retail deposits and retail bonds (the funding gap) rose from 10 per cent in the first few years of the century to 21 per cent in 2008.

During the financial crisis, credit conditions worsened. Since the autumn of 2008 growth in bank lending to the private sector has gradually slowed, becoming negative for the first time in the course of 2009 and again from the end of 2011 to the present.[1] The contraction in the last two years has been marked as regards lending to business, which declined by €98 billion against a reduction of lending to the private sector of €114 billion (Figure 2).

Besides the fall in demand connected with the recession, the contraction in lending reflects banks' restrictive lending standards.[2] It is estimated that, in 2012, the more stringent lending criteria determined an 8 per cent contraction in the stock of loans and an increase of 2 percentage points in lending rates.[3] The credit strains had negative repercussions on investment and therefore on growth;[4] hardest hit were small firms and new business initiatives: in the first three months of 2013 the balance of business start-ups and closures (7,700 firms) was eight times lower than in the three-year period before the crisis.

With tensions on the funding side resolved following intervention by the Eurosystem, supply constraints reflect, above all, the deterioration in the creditworthiness of non-financial firms. Loans to firms with repayment difficulties ("non-performing loans") account for almost a quarter of all credit to the sector, increased by 10 percentage points in only two years; within this aggregate, the component with the highest probability of loss for the banks ("bad debts") accounts for 12 per cent of loans (Figure 3). Credit losses absorb a large part of banks' operating profits.

The scarcity of credit is set to continue in the months to come. Empirical evidence indicates that the deterioration in loan quality tends to extend well beyond the start of a cyclical recovery.[5] Moreover, banks are reducing the size of their balance sheets in response to factors of a structural nature, such as market pressure to reduce leverage and the tightening of the capital and liquidity requirements under international regulations (Basel III).

In the euro area, the banks' caution is also fueled by the transition to the Single Supervisory Mechanism. Once the mechanism is operational, it will help to dissipate fears about banks' soundness and eliminate the financial and regulatory segmentations and constraints that now weigh on the European credit market. In particular, the comprehensive assessment of banks' balance sheets by the ECB and national supervisory authorities will increase the information available and strengthen banks' capitalization.

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1 There was a 5.6 per cent annualized contraction in credit in the three months ending in November 2013.

2 Credit supply tensions during the crisis are documented both in empirical studies and by surveys of banks and businesses. See F. Panetta and F. M. Signoretti, "Credit demand and supply in Italy during the financial crisis", *Occasional Papers,* No. 63, Bank of Italy, April 2010; P. Del Giovane, A. Nobili and F. M. Signoretti, "Supply tightening or a lack of demand? An analysis of credit developments during the Lehman Brothers and the sovereign debt crises", *Working Papers,* No. 942, Bank of Italy, November 2013.

3 See Del Giovane, Nobili and Signoretti, ibid.,

4 See E. Gaiotti, "Credit Availability and Investment: Lessons from the Great Recession", *European Economic Review,* Vol. 59, April 2013; F. Busetti e P. Cova, "The macroeconomic impact of the sovereign debt crisis: a counterfactual analysis for the Italian economy", *Occasional Papers,* No. 201, Bank of Italy, September 2013.

5 See M. Bofondi and T. Ropele, "Macroeconomic determinants of bad loans: evidence from Italian banks", *Occasional Papers*, No. 89, Bank of Italy, March 2011.

The exercise will be conducted with uniform rigorous standards in all the member states; all the main sources of risk will be evaluated, avoiding excesses that instead of reassuring the markets would only reinforce the spiral between sovereign debt and bank risk.

The path to the Single Supervisory Mechanism is not without risks, however. In the short run, uncertainties about how the comprehensive assessment is to be conducted could heighten banks' caution, thereby compressing credit supply. A transparent policy of communication can mitigate these uncertainties but cannot eliminate them entirely, since the enormous complexity of the exercise makes it impossible to shorten the time needed to complete the comprehensive assessment. During the construction of Banking Union, moreover, its incomplete structure might not be sufficient to protect the economy and the public finances from the consequences of banking crises.

3. Firms' financial fragility

A reflection is necessary on the origin of the constraints on lending to businesses and on how they may be overcome. Analysis must focus in particular on the factors that together with the recession increase credit risk which, as we have seen, is a powerful obstacle to the supply of loans. The recent financial tensions have generally been viewed in relation to the problems of the banks, which in turn are connected to the recession and the sovereign debt crisis. While such an approach was comprehensible at the height of the crisis, it overlooks the problems deriving from firms' financial fragility.

The rapid expansion of bank lending between 2000 and 2008 had its counterpart in that of the debt of non-financial corporations (Figure 4), which rose as a proportion of value added by more than 50 percentage points, to 178 per cent.

The growth in corporate debt was not paralleled by a strengthening of firms' ability to support its cost: productivity stagnated, profitability worsened (Figure 5); the portion of investment covered by self-financing fell to the historic low of 38 per cent. Above all, firms' equity did not keep pace with their indebtedness: their leverage ratio[6] rose from 34 to 43 per cent, and this helped drive up their net interest expense in relation to gross profits.

Italian firms' leverage is also relatively high by international standards (Figure 6). According to the financial accounts, in 2012 it exceeded the euro-area average and the figure for Germany by 6 percentage points and was 14 points higher than in France. Comparable gaps existed in the years before the crisis. The results do not change when firm-level data are used.[7] Based on a sample of 600,000 euro-area companies, in 2010 Italian firms' leverage was higher than the others' in nearly every sector and size class (Figures 7 and 8).[8]

These differences do not reflect composition effects. According to econometric analyses that take account of the main firm characteristics bearing on indebtedness,[9] Italian firms' leverage is 11 percentage points higher than the average for the other countries. The gap is wider for smaller companies, while it is virtually nil for very large companies (assets of more than €300 million).

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6 Financial debts in relation to the sum of shareholders' equity and financial debts.

7 The financial accounts do not allow us to tell if the differences between countries reflect the composition of the productive economy by sector and firm size. In addition, they include shareholders' equity at market prices, which makes international comparisons depend on the performances of the stock markets.

8 The data are from the Amadeus database, which includes financial statement information for companies of 46 countries.

9 Leverage was analyzed by means of panel regressions, including a dummy for Italian firms among the independent variables. The control variables included dummies for sectors, size classes and age groups, as well as financial statement variables (profitability, technical fixed assets, liquidity and sales growth).

4. Towards a more diversified financial system

A continuation of the present financial tensions would entail high risks for the Italian economy. The exit from a recession is slower in the presence of a financial crisis or a credit squeeze; in such situations, lending normally begins to revive half a year after GDP.[10] In Italy, as elsewhere, lending to businesses has lagged the real economy and been influenced by the presence of restrictions on credit supply (Figure 9).

In order to ensure the full functionality of the financial system and provide adequate resources to Italian firms in view of the cyclical upturn, both short-term and structural measures are needed. The tensions in the credit market and the financial fragility of firms reflect contingent factors – the recession and the sovereign debt crisis – but are closely bound up with the weaknesses of the Italian financial system: the over-reliance of firms on bank credit and insufficient direct fund-raising on the markets. A financial set-up of this kind is especially penalizing in the present conjuncture.

The negative effects on credit supply of the high risk of default must be counteracted. Looking further ahead, it is necessary to foster the development of a diversified financial system in Italy in which the role of the capital markets and institutional investors is on a par with that in the other main countries. These issues are addressed in the following pages.

4.1 Bank credit

The instruments best suited to tackling the "market failure" at the root of the current malfunctioning of the credit market[11] are based on systems that guarantee bank loans to firms, and to smaller firms in particular.[12]

Since the onset of the recession the Guarantee Fund for small and medium-sized enterprises has been appropriately reinforced, through an increase in its endowment, the widening of the range of potential beneficiaries, and the broadening of the eligibility criteria. A government backstop guarantee was introduced, relieving banks from capital charges for loans covered by the Fund. Thanks to the leverage effect and to diversification, the interventions weigh only moderately on the public finances.

In recent years the flow of loans guaranteed by the Fund has risen rapidly. Between 2009 and 2012 guaranteed loans amounted to €31 billion, assigned to 127,000 mostly small firms. At the end of 2012 the stock of such loans accounted for 3.5 per cent of loans to firms with less than 20 workers in the sectors where the Fund operates. In the first ten months of 2013 guaranteed loans amounted to €8.5 billion (Figure 10), up by 23 per cent from the same period in 2012.

According to preliminary analyses conducted by the Bank of Italy, the guarantee provided by the Fund supported the growth in bank lending to the beneficiary firms.[13] The effects on the cost of lending appeared instead less clear-cut; this may be attributable in part to how the Fund operated in the past, when it allowed banks to obtain a guarantee after the loan had been disbursed, and therefore after its terms had been defined.

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[10] See C.M. Reinhart and K.S. Rogoff, *This Time is Different: Eight Centuries of Financial Folly*, Princeton University Press, 2009; S. Claessens, M.A. Kose and M.E. Terrones, "What happens during recessions, crunches and busts?", *Economic Policy*, Vol. 24, 2009; A. Abiad, G. Dell'Ariccia and B. Li, "Creditless Recoveries", IMF Working Paper 11/58, 2011.

[11] The current situation in credit markets is well documented in economic analysis, whereby the high risk of default and the difficulty of assessing the solidity of borrowers leads to adverse selection and increases intermediaries' risk aversion, giving rise to credit rationing. See J. Stiglitz, and A. Weiss, "Credit Rationing in Markets with Imperfect Information" (1981), *The American Economic Review*.

[12] OECD, Financing SMEs and Entrepreneurs: An OECD Scoreboard, OECD Publishing (2013).

[13] Conducted on a sample of manufacturing firms that benefited from the Fund's intervention between 2005 and 2010.

Over the coming months the Fund's activities may benefit from the changes introduced under Law 98/2013 and the 2014 Stability Law. However, these must be implemented rapidly: some of the changes, in particular those designed to facilitate the granting of guarantees to firms whose balance sheets have been weakened by the recession, are still awaiting implementing decrees. Moreover, the prospect that a portion of the funds assigned by the Stability Law could be channelled to other areas of activity and for purposes other than supporting firms, risks dissipating the Fund's resources and eroding its effectiveness. Finally, to stimulate the supply of loans there is a need to introduce mechanisms that reward banks with the highest rates of increase in total lending.

Further interventions to support credit have been made by the public sector through the Cassa Depositi e Prestiti.[14] In the private sector, the moratoriums agreed between the Italian Banking Association and firms' associations have enabled many SMEs to weather difficult times.

But to get the credit channel working again, banks must first and foremost commit to taking full account of their customers' growth potential. The pressure on banks to deleverage and, in the years leading up to the crisis, the growing importance of types of financing that can be sold on the market may have impaired the ability and incentives for banks to analyze the prospects of the various business sectors and carefully assess borrowers' creditworthiness.

This negative trend must be halted, by intensifying efforts to examine the characteristics of firms, and of smaller firms in particular. Banks must be aware of the negative effects for the entire Italian economy, and for themselves, of an indiscriminate credit crunch.

4.2 Equity capital

In addition to credit, Italian firms require equity capital, in order to support the economic recovery and ensure more stable financial conditions.

It is estimated that in order to bring the leverage of Italian non-financial companies in line with the European average would require the conversion into equity of debt totaling between €150 and €220 billion.[15] Such an operation would be considerable in scope but feasible over the medium term: if completed within five years it would require the transformation into equity every year of debts corresponding to 3 per cent of the total; it would be less arduous during a period of economic growth, above all if accompanied by the reinvestment in firms of a large portion of the earnings distributed every year to shareholders in the form of dividends (€60 billion on average in 2011–12, based on Istat data).

The rebalancing of the sources of financing requires interventions on several fronts. First, incentives for incurring debt must be eliminated. Of these, high taxation plays a non-negligible role, both directly and indirectly.

Heavy taxation of firms' earnings increases the advantages of borrowing with respect to other forms of financing, owing to the deductibility of interest payments from annual earnings. Italy's high tax rates enable firms to deduct a larger proportion of financial costs from taxable income than is possible elsewhere. It is estimated that this explains much – about one fourth – of Italy's unfavourable leverage gap with respect to other European countries.[16]

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[14] Since the onset of the crisis the CDP has constituted funds on which banks can draw at a low cost in order to provide medium and long-term credit to SMEs. The SME credit line, set up in 2009 with an endowment of €8 billion, has been fully exhausted; the "new SME credit line", operational since 2012, has an endowment of €10 billion, most of which has not yet been disbursed to firms.

[15] This estimate is based on the data discussed in Section 3, which maintains unchanged the total value of firms' financial liabilities (i.e. only modifying the debt-to-capital ratio).

[16] A. De Socio and V. Nigro, "Does corporate taxation affect cross-country firm leverage?", Bank of Italy, Working Papers No. 889 (2012).

High taxation also increases firms' reluctance to tap the markets. In Italy the underdevelopment of the stock exchange does not stem from a lack of listable companies.[17] It mainly reflects the choices of firms themselves:[18] Italian firms, characterized by a high degree of concentration of equity in the hands of a few people, often linked by family ties, are reluctant to open up. Increasing firms' size and turning to the markets imply costs associated with greater exposure to supervisory authorities, minority shareholders, and above all the taxman, given the excessively burdensome level of taxation.

One reason for the lack of interest in stock exchange listing is the strong desire to retain control of the firm, sometimes even at the cost of doing without the financial and management resources needed to stay ahead of international competition. This goes against what empirical analyses tell us. After a firm has been admitted to the stock exchange, its financial structure becomes sounder, with a bigger share of bond issues and a smaller share of short-term loans. Listing also allows the firm to cut the cost of bank loans by improving its risk profile and its reputation.[19]

Signs of renewed interest in the stock exchange have emerged in recent months. Some twenty Italian companies have gone public since January last year, the largest number since 2007; others have announced similar plans. Most of these firms are small and medium-sized non-financial companies that decided to list on the alternative investment market (AIM) where listing costs and regulatory requirements are lower than on the main stock exchange.

Tax incentives for company listing or equity finance have been used on several occasions in the past to promote the growth of the stock exchange.[20] The measures had limited success because of the temporary nature of the tax benefits, which meant they could not fully offset the firm's perceived cost of listing, including the cost of transparency.

The tax allowance for corporate equity introduced in 2011 as part of the package of measures to aid economic growth reduces the tax advantage of debt relative to equity capital and will hopefully go some way to overcoming the above-mentioned limits. However, our research indicates that so far the effects have been limited: fewer than 2 per cent of firms report they increased their shareholders' equity in 2012–13 to take advantage of the allowance. This result may be due not only to the lack of profits available to reinvest in the firm, but also to the small size of the incentives, which need to be sufficiently large and permanent in the eyes of the firm if they are to be effective.[21]

[17] See the Technical Planning Document drawn up by the Working Group for the admission to listing of SMEs (March 2013). Based on a comparison with France, where the productive system differs from the Italian one, it is estimated that as many as 500 Italian companies are eligible for listing.

[18] See F. Panetta, "Banks, Finance, Growth", speech delivered at the conference "Beyond the crisis: What lies in store for Italian banks?", organized by the Associazione per lo Sviluppo degli Studi di Banca e Borsa in conjunction with the Università Cattolica del Sacro Cuore of Milan (2013). See also Pagano, Panetta and Zingales, "Why Do Companies Go Public?", *Journal of Finance* (1998).

[19] See Pagano, Panetta and Zingales, ibid.

[20] Incentives were granted for equity finance and company listing under the Visentini Law (1983), the Tremonti Law (1994), the Dual Income Tax measure (1997) and the Tecno-Tremonti Law (2003).

[21] The advantage of borrowing in terms of taxation can be eliminated quite simply by bringing the notional rate of the tax allowance for corporate equity into line with the long-term risk-free interest rate. See R. Broadway and N. Bruce, "A General Proposition on the Design of A Neutral Business Tax", *Journal of Public Economics*, 1984, and R. De Mooij, "Tax Biases to Debt Finance: Assessing the Problem, Finding Solutions", *Fiscal Studies*, 2011.

The larger tax allowance introduced under the Stability Law for 2014–16 is a step in the right direction. Other incentives covering a longer time frame could be offered to newly listed firms without encroaching too much on government revenue.[22]

4.3 Non-bank financing

During the financial crisis Italian firms turned increasingly to the bond market. Placements have averaged €30 billion a year since 2009, with peaks of over €35 billion in 2009 and 2012, when it was hardest to access bank credit (Figure 11). Issuance was substantial in 2013 as well, amounting to €29 in the first nine months.

While bond issuance continues to lag behind the levels of other advanced countries and its costs remain relatively high, the upturn is a clear step forward with respect to the pre-crisis period (bond issues averaged €19 billion a year in 2005–07). Thanks to their bond placements firms have become less dependent on bank lending: out of the 250 main Italian industrial groups, the 80 that made bond issues in 2009 also reduced their bank borrowing by a third, while the others increased it by 12 per cent.

The progress in overall bond issuance masks differences between the various size groups of firms, however. In fact the increase in placements concerns only a small number of large firms, while the value and volume of placements by small and medium-sized firms has declined (Figure 12).[23] The number of small firms going to the bond market for the first time has progressively diminished and the number of medium-to-large firms has remained stationary.

Last year, issuance by unlisted companies was encouraged by the tax benefits offered under the economic growth decree of June 2012 which created so-called minibonds. Twenty or so of these issues were placed for a total value of about €5 billion. Once again, small firms took little advantage of the opportunity.

The difference between placements by large and small firms mirrors the difficulty SMEs have in placing small-value, and hence illiquid, bond issues and in approaching major investors, particularly from abroad. A further problem is the difficulty of assessing the creditworthiness of small firms, particularly during the current recession. These factors lead to placements of illiquid, high-yield securities.[24]

The problems SMEs encounter in accessing the bond market opens up a range of opportunities for specialized intermediaries able to assess the credit rating of small firms and practice investment strategies designed to diversify idiosyncratic risk over the medium-to-long term.

Several projects are under way to create instruments for investing in bonds or loans of unlisted companies, most of them based on the creation of closed-end credit funds. This may help to channel funds rapidly to issuers and create a market that could, as it reaches a suitable size and becomes sufficiently liquid, attract even major institutional investors. The success of such projects depends on a high degree of transparency, simple structures, low leverage, and limited maturity mismatching.

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[22] See A. Franzosi and E. Pellizzoni, “Gli effetti della quotazione. Evidenza dalle mid & small caps italiane”, *BIt Notes*, 2005; G. Giudici and S. Paleari, “Should Firms Going Public Enjoy Tax Benefits?”, *European Financial Management*, 2003; M. Geranio and E. Garcia, *Come sarebbe l’Italia con 1.000 società quotate?*, 2012, mimeo, Bocconi.

[23] The data in the text are obtained by combining the public information provided by Dealogic Ltd. with information from the Bank of Italy’s register of securities. The latter source also includes small value bond issues.

[24] The average yield on the five smallest value issues is about 7.5 per cent.

Credit funds can make a far from negligible contribution to diversifying firms' funding sources, particularly the medium-to-long-term component.

4.4 Securitizations

The transformation of Italy's "bank-centred" financial system to one in which firms, including smaller firms, can directly tap market financing is an ambitious objective, attainable over a lengthy time horizon. It may require significant legal and fiscal adjustments. It presupposes changes in the behaviour of banks and firms. In the transition between these two models of corporate finance, consideration should be given to the possibility of exploiting synergies from combining intermediaries' activities with those of the markets.

One such possibility is offered by securitizations, which allow the separation of the typical banking functions – screening borrowers and originating loans, which continue to be performed by the bank – from financing proper, which is shifted to the market. In practical terms, the securities generated constitute the synthetic replica of a bond portfolio, but with the significant difference that the task of debtor selection and screening is left to the bank, not to the final investor, as in the case of corporate bonds. The senior tranche of an asset-backed security, unlike the underlying loan, can be sufficiently transparent and liquid to be placed with unsophisticated investors.

Securitizations accordingly enable firms to reach institutional investors without bearing the costs of stock exchange listing or bond issues. They enable purchasers to delegate the task of procuring information to banks, which are in a better position to perform it. In addition, securitizations can alleviate the problem of mismatching of demand and supply that can arise in illiquid markets when companies have trouble issuing securities because "there's no demand" while demand itself is slack because the scarcity of outstanding securities means that for investors "it's hard to diversify".

With the crisis, the securitization market has practically dried up. I won't go into the reasons for this collapse – the potential risks of a perverse intermingling of intermediaries, markets and securitizations are known well enough. But Italy's experience in recent years shows that attentive banking supervision makes it possible to combine the two functions in virtuous fashion, providing the right incentives to banks and mitigating information asymmetry.[25]

In the decade preceding the crisis, in a favourable economic environment, Italian banks reduced the impaired loan assets in their portfolio, among other things through substantial securitizations. In coming months the volume of such operations may be fueled by several factors: the cyclical recovery will improve borrowers' creditworthiness, bolstering specialized intermediaries' demand for impaired assets; an analogous effect will continue to come from the concomitant reduction of "Italy risk", as evidenced by the narrowing of the spreads on government bonds. The supply of impaired loan assets by banks should also grow, owing to the increase in value readjustments and the recent regulatory changes bringing less unfavourable tax treatment of write-downs and loan losses. The resumption of securitizations will interact positively with the need to diminish the stock of impaired loans in order to free up resources to finance economic activity.[26]

5. Conclusion

The Italian economy, after protracted recession, is heading towards a cyclical upturn. The signs of improvement that emerged last spring are strengthening. Last summer the decline in GDP came to a halt, and in the fourth quarter industrial production apparently gained around

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[25] U. Albertazzi, G. Eramo, L. Gambacorta and C. Salleo, "Securitization is not that evil after all", Bank of Italy Working Papers No. 796, February 2011.

[26] Bank of Italy, *Financial Stability Report* No. 6, November 2013.

one per cent. The quarterly change in GDP appears to have been positive for the first time since mid-2011.

Italy's financial markets are benefiting from the decreasing financial fragmentation of the euro area. The revival of foreign investors' appetite for Italian assets has been reflected in a reduction in the Bank of Italy's debtor position with the TARGET2 payment system, which has diminished by a third from the high mark of €290 billion registered during the summer of 2012.

The economic picture nevertheless remains fragile. International financial tensions are again threatening global market stability. The Italian economy is improving only slowly, with considerable unevenness both geographically and by sector.

To maintain the recent positive signs and convert them into sustained, robust economic growth that can cut significantly into Italy's high unemployment will require the country to finally tackle and begin solving a series of well-known structural problems on which action has been deferred for too long.

Another necessity is adequate financial support for firms. There can be no return to growth without the contribution of banks and markets.

Past efforts to foster the development of a more diversified financial system – one in which the importance of markets and institutional investors is comparable to the other leading countries – have not yielded the hoped-for results. The recession, the increase in credit risk and the resulting credit supply strains have nevertheless created incentives for firms and banks to renew those efforts, to make them more effective and to expand direct finance to the productive economy.

In recent months Italian firms have shown a greater propensity to turn to the capital market. Both bond issues and new stock exchange listings have increased. But market recourse remains modest and for the most part limited to larger companies. Small businesses have not taken proper advantage of the opportunities for direct financing.

Banks can be essential in encouraging direct access to the markets for larger firms and pointing smaller ones in the same direction. If they accompany firms with good growth prospects into the market, developing corporate finance services that take less capital and liquidity, they can curb risks and improve earnings. To attain these objectives they need to strengthen relationships with firms and avoid conflicts of interest.

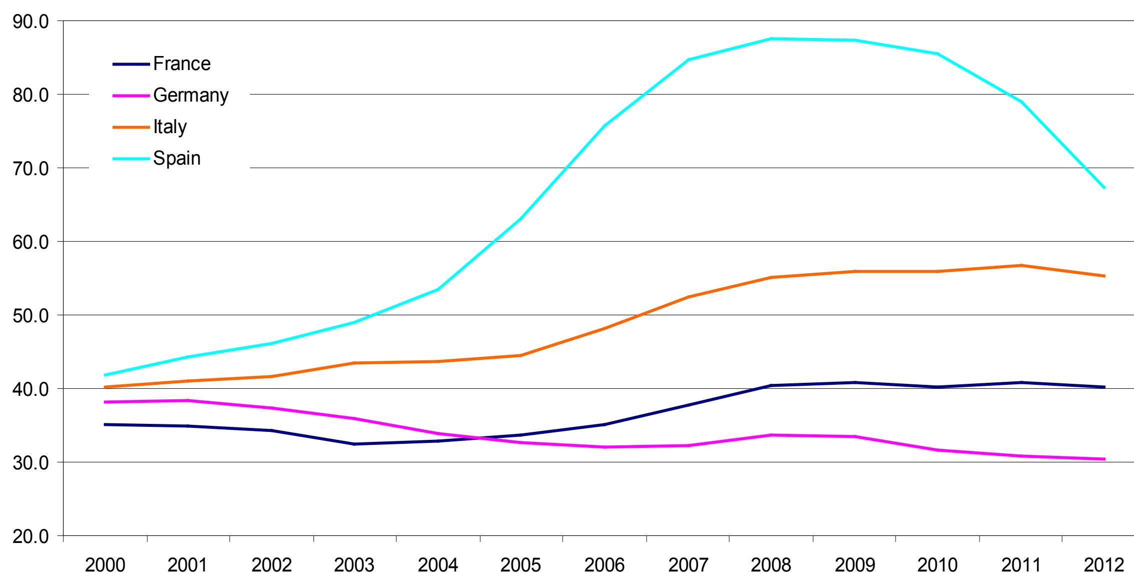
Firms too must contribute to the development of the capital market. Corporate financing needs cannot be met by bank credit alone. Diversifying funding sources will require a commitment to greater accounting transparency, openness to outside parties, and above all capital strengthening. In order to gain the support of banks and investors, entrepreneurs will have to be the first to demonstrate their own faith in the prospects for their business.

The task of economic policy is to remove the obstacles, to provide incentives to ensure that the development of the capital market gathers momentum and, above all, that it does not flag as in the past. Like the rest of the Italian economy, this process would benefit from an easing of the tax burden on firms.

Figure 1

Bank loans to firms in the main euro-area countries

(as a percentage of GDP)

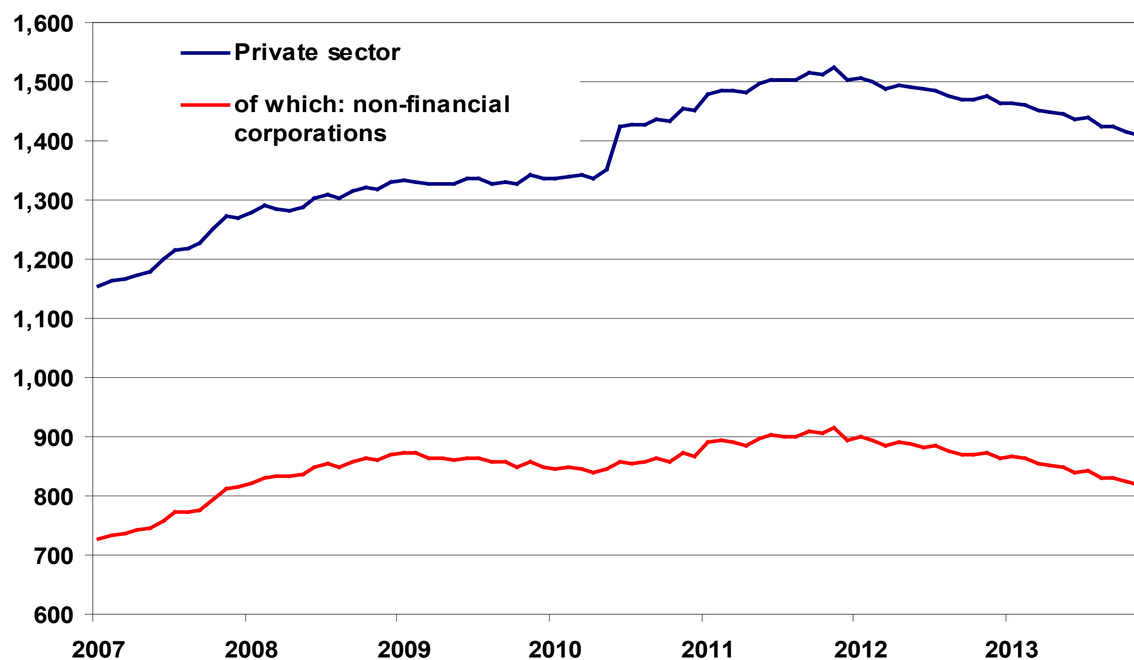


Sources: ECB and Eurostat.

Figure 2

Bank loans in Italy (1)

(stocks in billions of euros)

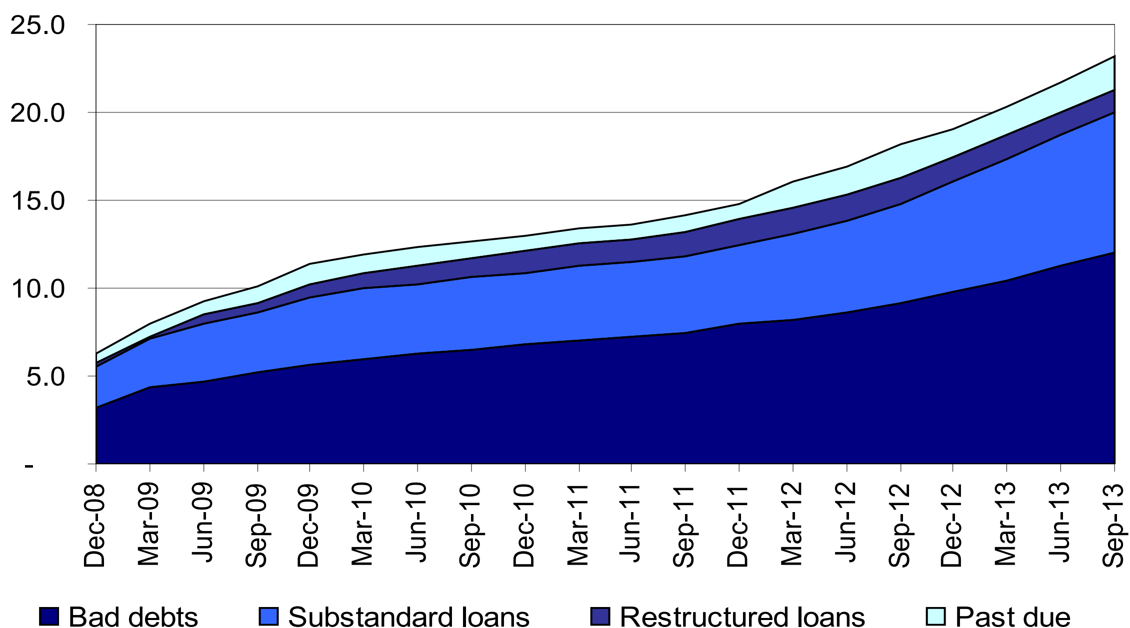


Source: Bank of Italy. (1) Data not adjusted for seasonal factors or securitizations.

Figure 3

Non-performing loans to firms

(as a percentage of loans to firms)

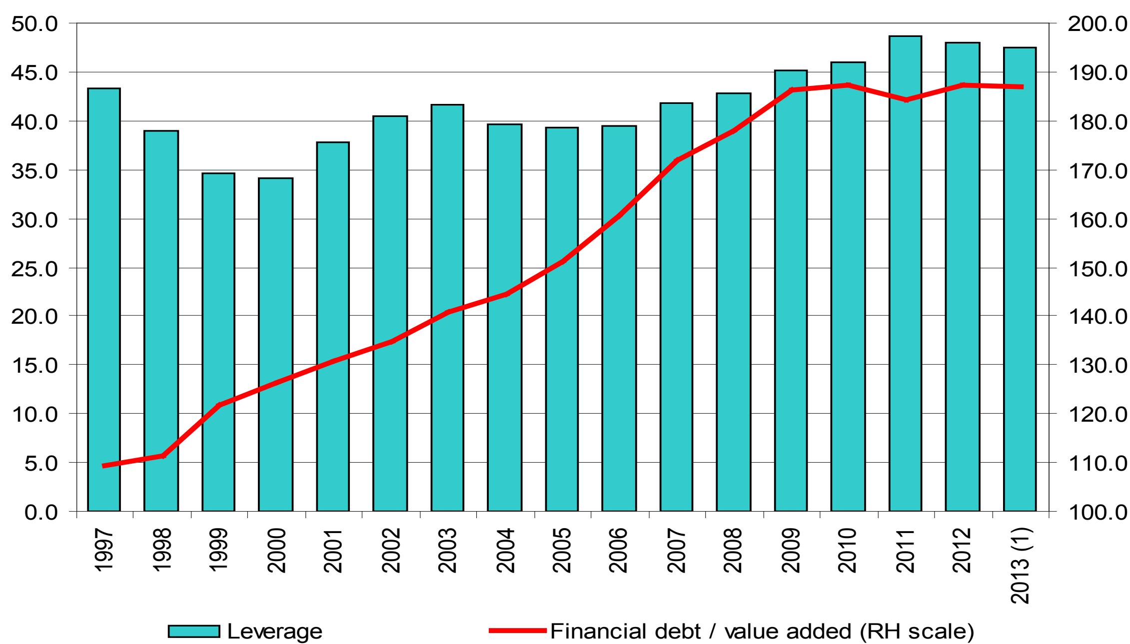


Source: Bank of Italy.

Figure 4

Firms' financial debt

(per cent)

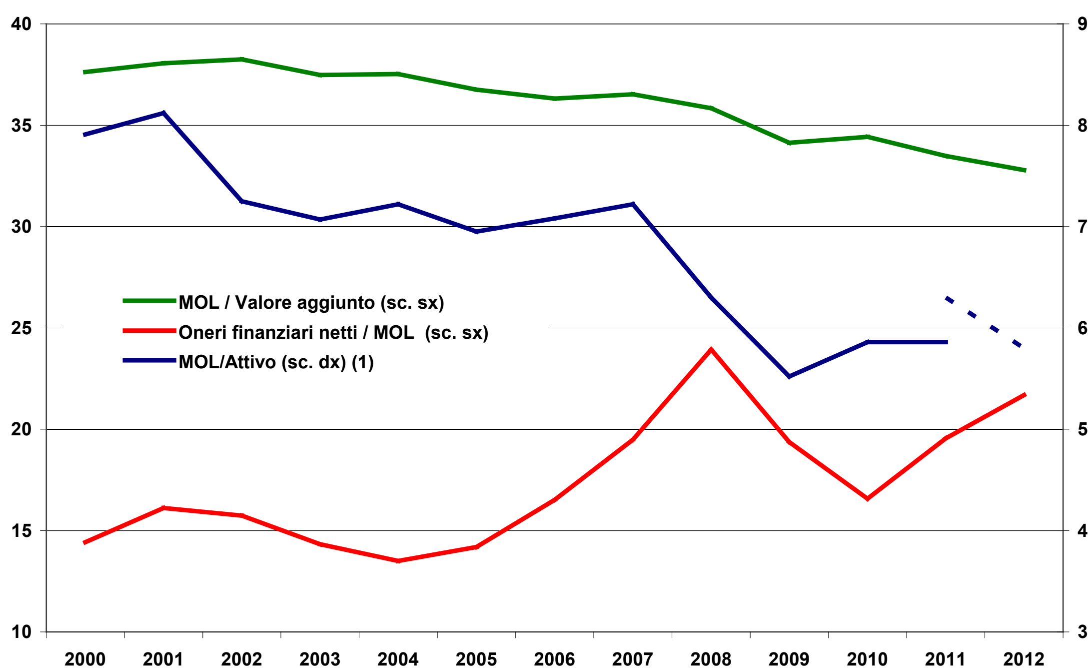


Sources: Bank of Italy and Istat. (1) With reference to June 2013.

Figure 5

Firms' profitability

(per cent)

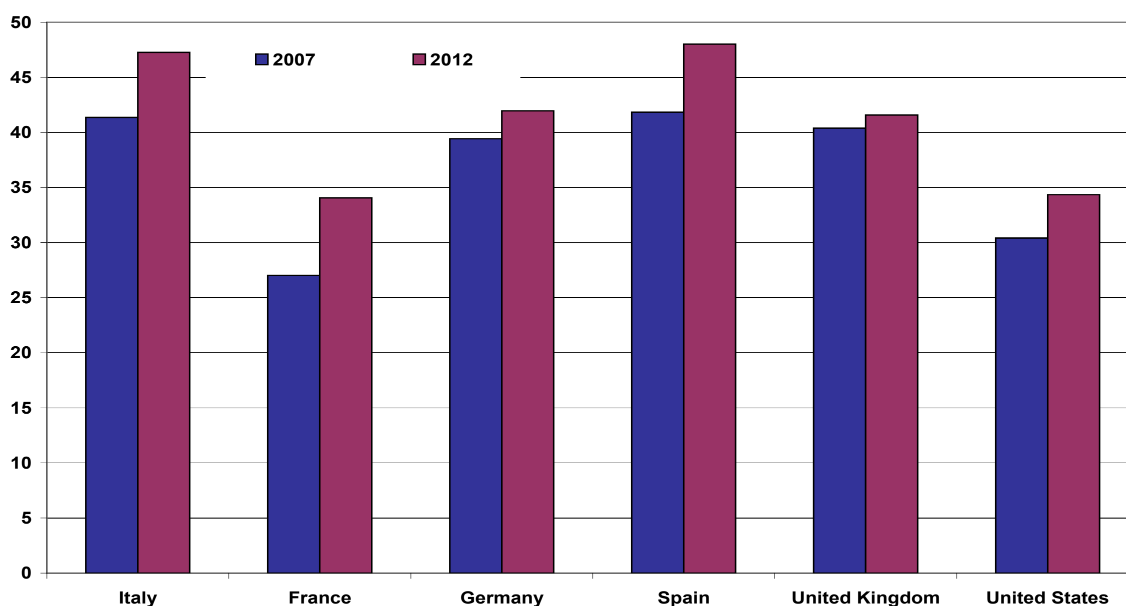


Sources: Bank of Italy, Istat and Cerved Group. (1) Provisional data for 2012; the broken line refers to a sample of firms with balance sheets for both years.

Figure 6

Firms' leverage in Italy and the other leading countries

(per cent)

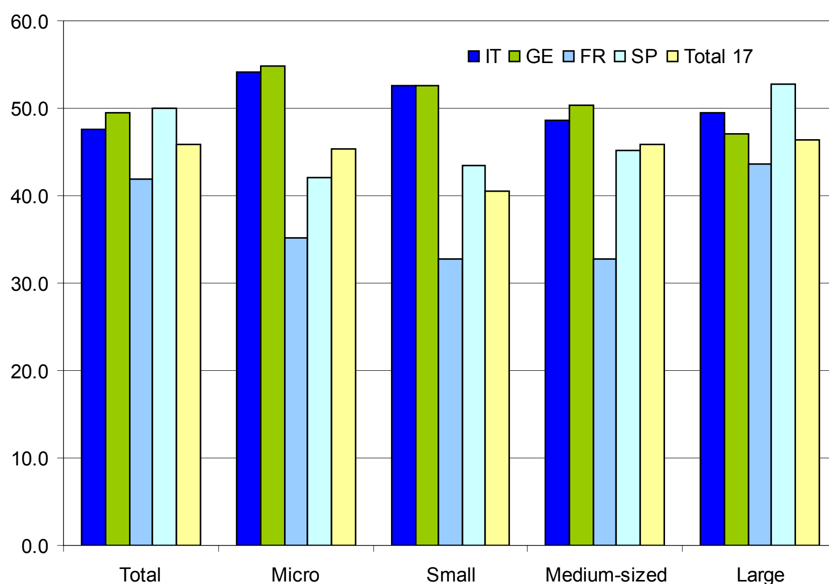


Sources: ECB, Bank of England and Federal Reserve System.

Figure 7

Leverage by size class

(weighted averages; 2010; only indebted firms)

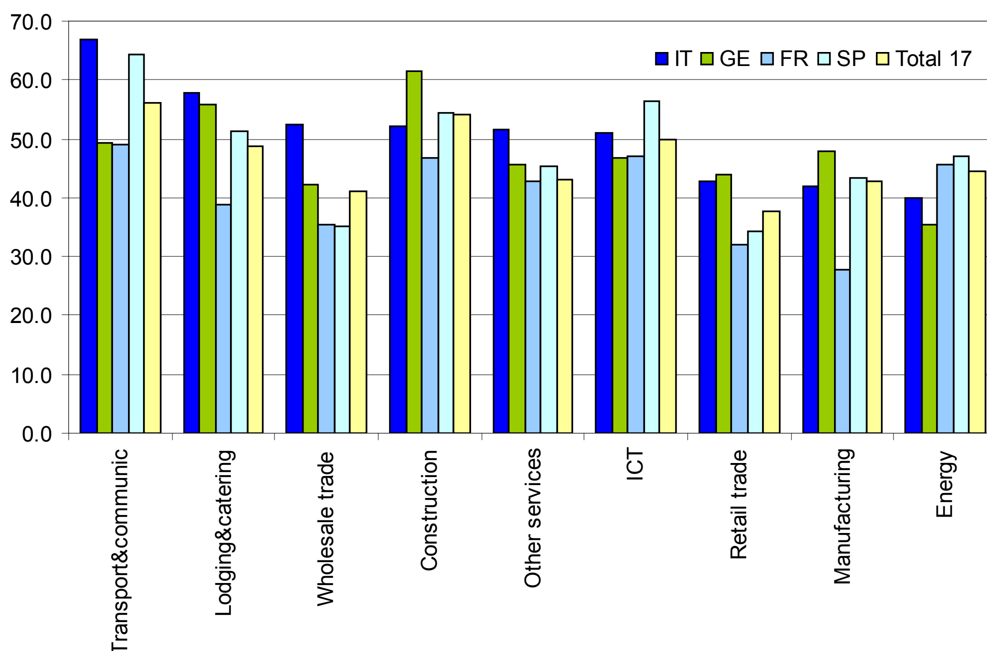


Source: Amadeus.

Figure 8

Leverage by sector of economic activity

(weighted averages; 2010; only indebted firms)

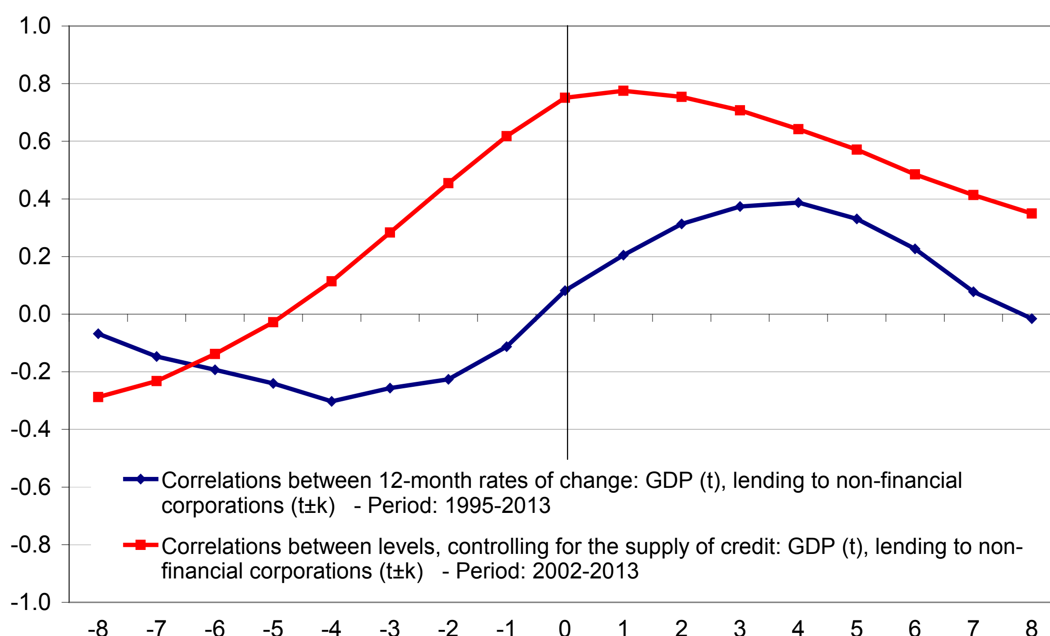


Source: Amadeus.

Figure 9

Correlation between GDP and lending to non-financial corporations (1)

(in real terms; different leads/lags)

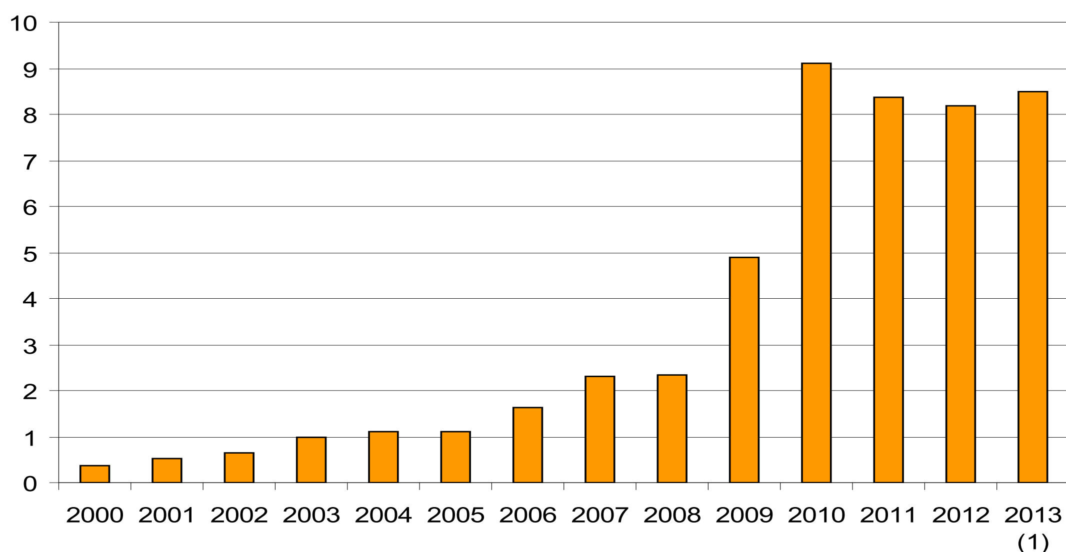


Sources: Bank of Italy and Istat. (1) The correlations that take account of the supply of credit are based on the residuals of regressions of the time series of GDP and of lending to firms on the indicator of the supply of credit drawn from the Bank Lending Survey.

Figure 10

Loans guaranteed by the Guarantee Fund for SMEs

(annual flows in billions of euros)

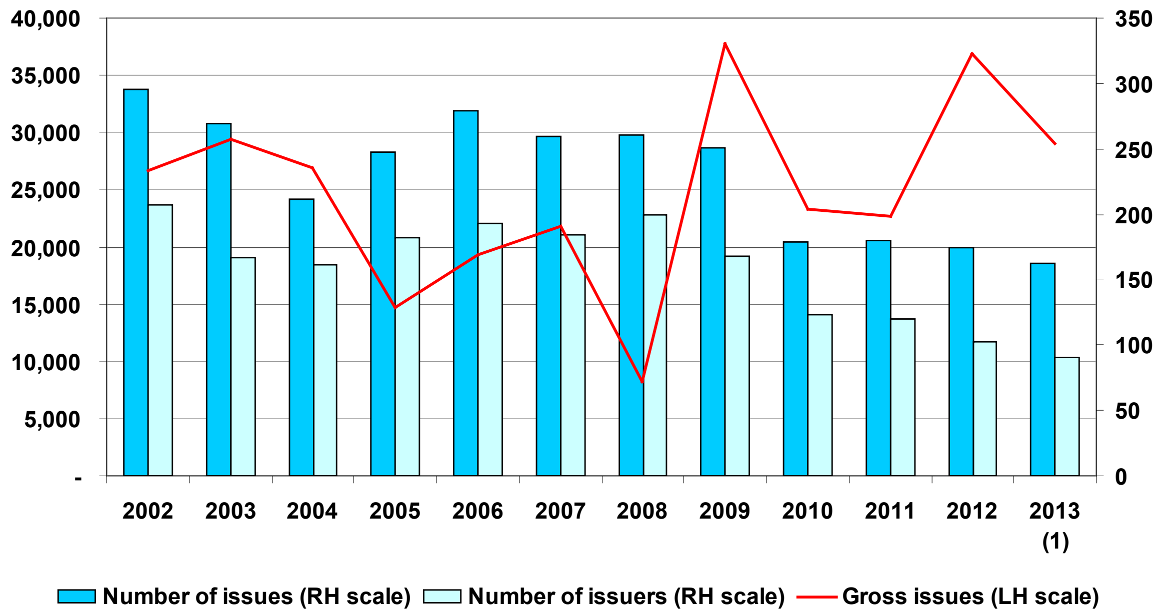


Source: Management Committee of the Guarantee Fund for SMEs. (1) With reference to the period January–October.

Figure 11

Gross bond issues by Italian non-financial corporations

(millions of euros and numbers)

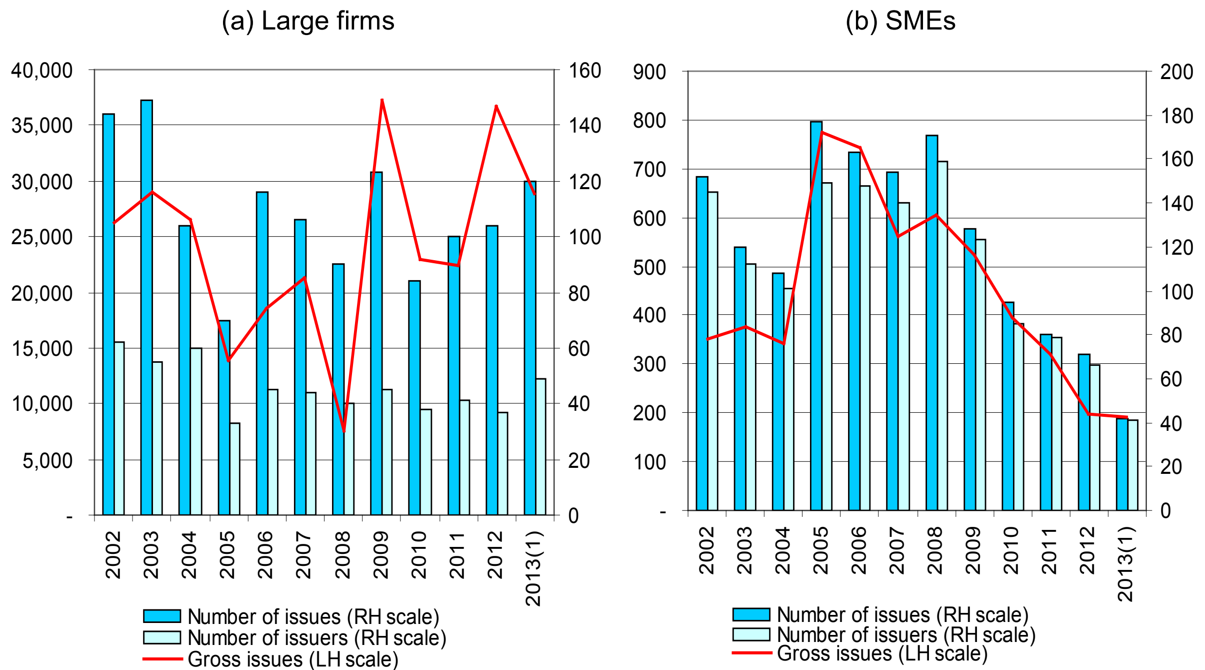


Sources: Bank of Italy and Dealogic. (1) With reference to the period January–September.

Figure 12

Gross bond issues by firm size

(millions of euros and numbers)



Sources: Bank of Italy and Dealogic. (1) With reference to the period January–September.