ACRI

Association of Italian Savings Banks

2017 World Savings Day

Address by the Governor of the Bank of Italy

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A strengthening economy

After five years of weak growth, world trade is again expanding at a steady pace and global GDP is clearly gaining strength. Despite geopolitical tensions, the outlook is favourable in most economies and financial market conditions are very relaxed, reflecting a reduced perception of risk.

Buoyed above all by expanding domestic demand, GDP growth is picking up in the euro area as well; the risks of deflation have disappeared. Excluding the most volatile components, price increases remain low at just over 1 per cent. This reflects rather modest wage growth in many economies, including Italy, owing to still high levels of underutilized labour.

Last week, in the ECB Governing Council we decided to continue making net purchases of government securities and private bonds until the end of September 2018, or beyond if necessary, recalibrating the monthly purchases to €30 billion as of January 2019. We stand ready to strengthen the programme if conditions become inconsistent with further progress on inflation. We expect official interest rates to remain at their present levels for an extended period of time, and well past the horizon of our net asset purchases. The principal payments on maturing securities will continue to be re-invested for some time after the end of the purchases, and in any case for as long as necessary. These decisions will allow a high degree of monetary accommodation to be maintained even going forward.

The cyclical indicators and the data gathered from surveys indicate that growth is continuing to gain strength in Italy too, thanks to reforms, international economic conditions and a strongly expansionary monetary policy. Employment has increased to levels close to those recorded before the global financial crisis and continues to rise.

The renewed growth in lending and the outlook for the banking sector

Economic expansion in Italy has been accompanied by an uneven recovery in lending, which has been concentrated among households and among those firms that have strengthened their financial position and are now ready to invest and expand their production capacity. Lending is once again increasing in manufacturing and services, while the construction sector continues to reduce its debt from the particularly high pre-crisis levels.

Our surveys on banks and firms point to a gradual upturn in demand for financing, driven by the recovery in investment and favourable credit access conditions. Interest rates remain very low and, since the second half of 2015, have been basically equal to the euro-area average.

Meanwhile, credit quality continues to improve. In the second quarter of this year the flow of new non-performing loans fell to 2 per cent of total lending, a level consistent with the average observed in the years prior to the global financial crisis. The stock of non-performing loans is also decreasing rapidly: net of write-downs, in June it had fallen to €150 billion, equal to 8.4 per cent of total loans, from the peak of €200 billion, or around 11 per cent of total loans, reached in 2015. The ratio of bad debts to total loans has declined from 4.8 to 3.9 per cent. Over the next few months, disposals and securitizations already under way and those recently announced by a number of banks will further drive down the stock of NPLs, which, net of existing write-downs, should fall below 8 per cent of total loans in the early months of 2018.

Banks' balance sheets need to be further bolstered to make them better able to withstand, now and going forward, the risks still weighing on the economic outlook. Banks are responding to this also by referring to the ECB's 'Guidance to banks on non-performing loans' issued in March 2017. The measures to reduce the burden of non-performing assets announced last July during the European Council are a step in the right direction. This is also the aim of the introduction, which should be gradual and properly calibrated, of a calendar approach to write-downs for future non-performing loans.

The reforms passed in Italy in recent years have shortened the duration of credit recovery proceedings; there is room for further action. The recent passage of the enabling law laying the ground for a comprehensive reform of legislation on corporate crises and insolvency proceedings will provide a major contribution to this. The principles and criteria set out in the enabling law must be implemented and translated into rules that can truly speed up credit recovery times, preserving as much as possible the value of companies that are still in sound condition.

Banks must make full use of the tools that have recently become available in the domain of out-of-court settlements with firms for the restructuring of debts and the transfer of assets. Moreover, having suitable and timely data on NPLs is indispensable for more effective internal management and to facilitate their sale on the market at adequate values. Despite the improvement observed following the survey we launched last year, banks still need to make progress in this area too.

The first six months of 2017 saw an improvement in the overall operating profitability of Italian credit institutions. The return on capital, net of extraordinary components and annualized, nevertheless still stands at around 2 per cent, reflecting the increase in write-downs caused by the securitization of non-performing loans. The CET1 ratio has risen from 11.5 per cent to 13.1 per cent, partly as a result of the precautionary recapitalization of Banca Monte dei Paschi di Siena carried out in July.

I discussed the steps needed to regain profitability and meet the challenges posed by regulation, digitalization and competition in my address at the Annual Meeting of the Italian Banking Association. Resolute action is required, restructuring where necessary and fostering consolidation where possible. Stronger signs of recovery and a favourable outlook for the economy are an opportunity that must be acted upon swiftly.

Italian households' saving and wealth

The saving rate of Italian households, which used to be high by international standards, is now below the average for the main euro-area countries. It has fallen from 19 per cent in the mid-1990s to 8.6 per cent in 2016. This is a reflection of changes in various domains; among them, the fast-paced development of the financial sector, which has increased households' ability to obtain loans and redistribute consumption over their lifetime, the sharp fall in interest rates, which has made those loans cheaper, and demographic trends.

During the years of the financial crisis, the decrease in the saving rate was partly due to low disposable income and households' attempts to limit the repercussions on consumption. Our surveys on household income and wealth show that the decrease was larger in the case of young people, who were hardest hit by the impact of the recession on the labour market. An increase in the ability to save therefore needs to be fostered by developing adequate supplementary pension schemes.

The total net wealth of Italians is almost nine times households' disposable income. In per capita terms, this is comparable to the other main European countries and, like them, the predominant share (almost two thirds) is in housing and other real assets. While the propensity to borrow has risen owing to the structural factors I mentioned earlier, it remains low by international standards. The total financial liabilities of Italy's households amount to 62 per cent of disposable income, compared with a euro-area average of nearly 100 per cent and even higher ratios in the English-speaking countries.

Today, households' investment in financial assets stands at more than €4,200 billion. These are a popular form of investment among the public and an important factor of social inclusion and integration. Over 90 per cent of households have at least one post office or bank account; in the mid-1960s, when the Bank of Italy instituted its sample surveys of household budgets, that share barely surpassed 25 per cent. Greater participation by households in the financial market has been accompanied by a gradual increase in portfolio diversification and in the share of savings invested in more risky assets.

Bank deposits and post office savings have long been the main form of investment (Figure 1). Since the 1970s, a large proportion of savings has been channelled into government bonds; the 1990s saw the first significant investments in private sector securities and, above all, in investment funds. Since then, pension funds and individual pension plans have been gradually included in households' portfolios, and at the end of last year individual savings plans were introduced, accompanied by tax incentives.

The ratio of cash and deposits to total assets, which at the start of this century had declined to 20 per cent, has since risen to nearly 30 per cent in response to the fall in market rates and to the insecurity sparked by the financial and sovereign debt crises. At about 8 per cent, or roughly €340 billion, the share of public and private sector bonds today stands at its lowest level since 1950. These securities include €110 billion worth of bank bonds, of which about €20 billion in the form of subordinated debt (Figure 2). Some 30 per cent of households' bonds will expire within a year, 70 per cent by 2020.

Since the end of the 1980s, the stock of shares and equity interests, investment fund units, insurance reserves, and pension funds has increased significantly (from 35 to 58 per cent of financial assets). Investment fund units have experienced particularly strong growth (from less than 3 per cent in 1990 to 12 per cent today) as have insurance reserves and pension funds (from 8 to 23 per cent). The share of savings invested in pension funds, however, remains below that recorded in mainland Europe.

The diversification of investments in assets bearing higher risks and returns remains a characteristic of the wealthiest households, although it is gradually spreading to broader swathes of the population. In Italy just 6 per cent of households hold investment fund units and 9 per cent insurance savings products and pension fund units; in Germany and France the percentages are 13 and 9 respectively for investment fund units, and 46 and 38 for insurance savings and pension funds.

The protection of savings

The wide range of instruments available and the numerous financial operators allow savers to make the choices best suited to their needs, to plan for the future, and to deal with unforeseen events. This is a victory that must be defended and extended. However, it can make decisions more complex, and increase counterparty, market and liquidity risks, which are often interrelated. The main criterion to be followed for proper investment management remains that of diversification. Savers should demand that this principle be followed, even when they rely on third-party advice.

Two broad categories of public policy contribute to safeguarding savings: that designed to guarantee the stability of the financial system and that aimed at protecting savers as consumers of financial services. This is a much more complex matter than it was in post-war Italy, when it was written into our Constitution; it requires the contribution of many different actors, including savers themselves.

Economic policies that can foster growth are essential for the protection of savings. The value of financial assets derives from that of real assets: a company's share and bond prices rise or fall according to its state of health. An economy that does not grow cannot generate the resources necessary to recompense the capital invested in companies, to bear the burden of public debt or to enable households to repay their debts. Weak economic growth has even more serious effects on financial wealth if there is also a surfeit of debt in some sectors. The recent financial crisis provides dramatic examples of how serious these risks are. In Italy it is precisely the combination of structurally low growth and high public debt that has exacerbated the problems of the banking sector.

A crucial safeguard for financial wealth is price stability. Several times in Italy's history, long periods of high inflation have led to unfair reallocations of wealth, above all to the detriment of small savers who are less able to guard against the erosion of the value of money. The return to monetary stability, following a loss of purchasing power of almost 90 per cent between 1973 and 1995, dates back just over twenty years. Most recently, the greatest threats have come from the risk of deflation. The fall in prices increases the real value of debts, propelling the economy towards recession and eventually undermining financial stability. The monetary policies implemented by central banks are a bulwark against this risk.

Macroeconomic policies go hand in hand with those designed to ensure the strength of the financial system overall and particularly that of the banking system. The crisis has led to more pronounced regulatory action at international level, aimed at reducing the riskiness of banks. This has resulted in an increase in the quantity and quality of banks' capital, the introduction of liquidity requirements and of constraints on maturity transformation, and the imposition of financial leverage limits. Corporate governance systems have been reinforced and additional prudential requirements have been adopted for systemically important institutions.

The banking crisis management system has also been overhauled, with the clear intention of placing the burdens primarily, if not entirely, on the holders of banks' liabilities, with the exception of depositors covered by guarantee schemes. The consequences of these changes have been particularly important in Italy, where tools such as the preventive use of deposit protection funds, which had long been used successfully in crisis management, have become unavailable according to the interpretation of the rules on State aid established at EU level.

Despite the greater constraints imposed by the new European regulatory framework during a far more serious economic recession, considerably fewer resources have been deployed in Italy to resolve banking crises than in almost all the other main countries. The events of these difficult years should be assessed according to the conditions existing at the time and the information actually available when decisions were made. At the end of 2013, the International Monetary Fund, following its periodical assessment of the Italian financial system (Financial Sector Assessment Program, FSAP), had carefully analysed the data on individual banks and judged that the Italian banking system was particularly resilient and that its supervision was strong and effective.

Banking supervision significantly reduces the chances of banking crises occurring, but it cannot entirely eliminate them. Supervisory inspections require accurate and complex analyses, both on- and off-site; they cannot use the powers that the law reserves for the judicial authorities and the police forces. In most of the difficult situations experienced by individual banks, an analysis of the data available, an examination of the risk factors, the complaints appraised and the inspections conducted made it possible to maintain sound and prudent management and to resolve tense situations in a determined yet restrained way.

Banks are businesses; under normal conditions, even difficult ones, the supervisory authority cannot assume the role of the corporate officers. Transactions executed rapidly in order to evade checks or to circumvent rules and restrictions may compromise a bank's stability. The most serious violations were identified in time and were promptly reported to the judicial authorities, even though this is not always enough to avoid a crisis.

Over the last few years, resolving banking crises has proved a lengthy process. This reflects the changes made to the regulatory framework and the multitude of authorities and institutions involved. We must take a closer look at the causes of the delays and work towards shortening the banking crisis management procedures.

Every type of investment is risky. Some instruments benefit from a guarantee scheme put in place in the public interest: this is the case for deposits below €100,000. This type of safeguard protects savings in their simplest and most accessible form, thereby contributing to financial stability, preventing bank runs, and minimizing the risk of contagion among banks. The protection of other forms of savings relies on different instruments but can never completely remove the risk of loss.

At the end of the 1980s, the Interbank Deposit Protection Fund (*Fondo interbancario di tutela dei depositi*) was established in Italy, flanking the mutual banks' deposit guarantee scheme. Thanks to these two funds, to the small proportion of non-deposit liabilities and to the use of public resources, until the entry into force of the new European regulations, Italian banking crises generated losses only for the shareholders of the institutions involved.

Immediately following the outbreak of the global financial crisis, European legislators rightly decided to strengthen and harmonize deposit guarantee schemes, making them obligatory. In 2014 they considerably restricted the protection of financial instruments other than deposits below €100,000 so as to prioritize the safeguarding of taxpayers over bank creditors. As I have remarked on several occasions, the transition to the new system was abrupt; banks were not given sufficient time to issue new debt instruments capable of absorbing losses in the event of a crisis, and instruments that had already been issued were not exempt from the new rules.

The protection of savings entails taking action to avoid the unintentional assumption of risk on the part of savers. The preventive tools employed to pursue this objective are the rules and checks on transparency and on the propriety of relations between banks and customers; the contribution of financial education campaigns is essential. A third tool is the ex post settlement of disputes both in court and out of court.

Customer relations must be underpinned by transparency and proper conduct; this applies both to traditional banking services (such as current accounts), where the Bank of Italy's monitoring ability has been enhanced since 2010, and to the offering of investment and insurance products and services, which is monitored by Consob and IVASS respectively. The Antitrust Authority contributes by countering the adoption of improper commercial practices. The presence of distinct authorities is a result of the specific features of, and regulations applicable to, the various regulated sectors and of the contractual risks and structures involved. In the current regulatory context, a close working relationship among the authorities is even more important to minimize overlaps and to avoid loopholes in the safeguard mechanisms.

In recent years, the Bank of Italy has strengthened the rules and controls relating to bank services and products, as well as the management of exposures and the support of alternative dispute resolution schemes. With regard to improper conduct, in addition to sanctions on banks for regulatory violations, we have taken steps to eliminate anomalies and called for the restitution to clients of amounts unduly paid: in the three years 2014-16 approximately €200 million were reimbursed.

The Banking and Financial Ombudsman (ABF) was established in 2009 to settle rapidly disputes between customers and financial intermediaries. The ABF works completely independently, with support from the Bank of Italy in terms of logistics and resources. In 2016 four new panels were set up in addition to the existing three; overall, their technical secretariats are staffed by over 100 Bank of Italy employees. Consob's Financial Dispute Arbitrator started work at the beginning of the year to resolve disputes involving financial investments.

Further instruments will soon be included in the transparency rules to stop products being proposed if they are not suited to customer needs. The new rules on the development, introduction and control of financial products placed on the market (product governance) and on the remuneration and bonuses of sales networks will help to prevent opportunistic behaviour on the part of financial intermediaries.

However incisive, legislative obligations and protection measures alone are not enough; we also need to protect consumers by increasing their capacity to sift through the information at their disposal. Financial education is not only a response to the crisis, it is an indispensable requirement in the face of changes in the investment instruments on offer. Basic financial skills are essential not only to defend against the risk of misconduct or fraud, but also to make the right choices in line with personal needs and financial circumstances.

In some countries the aim of expanding financial education has been explicitly included in the mandate of the authorities that protect savings, often in the context of a more general national strategy, as is the case in Italy today. The recent establishment of the Committee for the Planning and Coordination of Financial Education Activities is indicative of the importance that the Italian authorities give to the aim of increasing the public's awareness in the fields of finance, insurance and pensions.

The level of Italians' financial know-how and skills is one of the lowest for adults in the OECD countries. In Italy there is little knowledge of basic concepts such as the importance of portfolio diversification and how interest payments are calculated. The situation is better among young people: the latest OECD-PISA assessment, relating to 2015, indicates that the financial literacy of Italian 15-year-olds is in line with the European average and has clearly improved since the last survey. This is encouraging because it indicates that the work done in schools in recent years is starting to bear fruit. The Bank of Italy' financial education project reached more than100,000 students in the 2016-17 school year.

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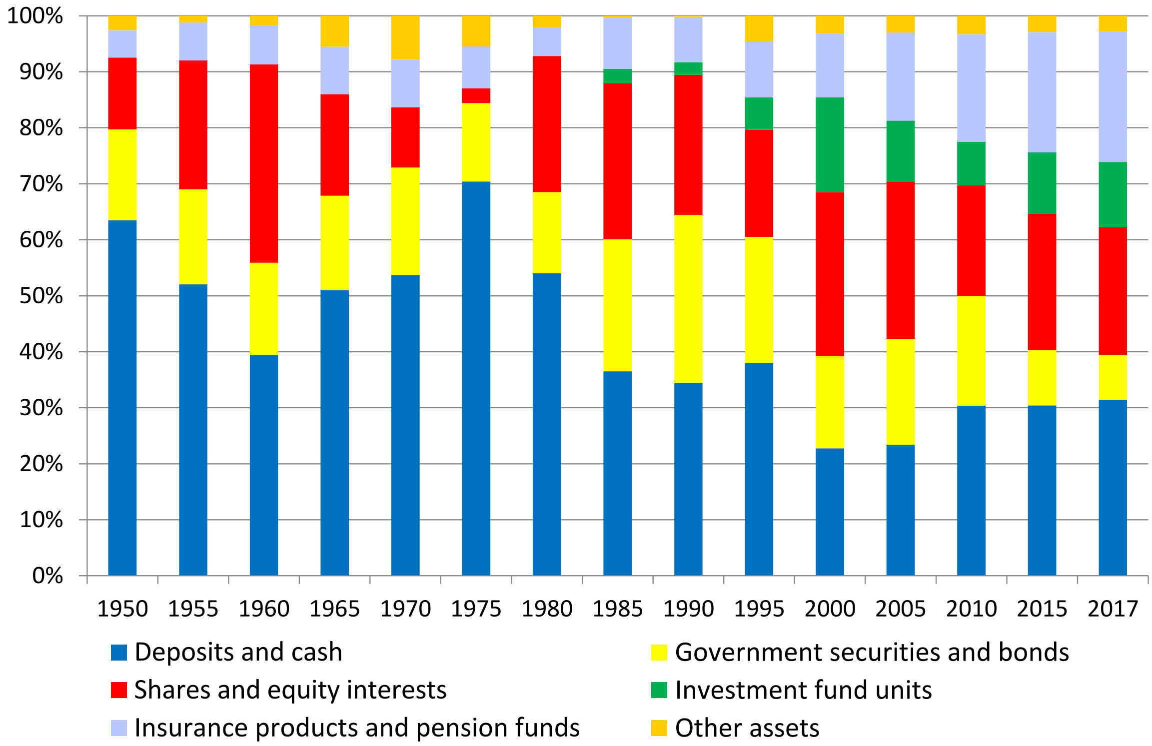
The composition of Italian households' financial wealth has changed greatly over time. New risks call for new forms of protection for different forms of investment. It would be unthinkable to try to limit savers' choices or unduly curtail the independence of financial operators; this would have a high cost in terms of the economic system's efficiency and people's wellbeing. We need to guarantee correct, transparent information and a regulatory framework able to embrace change. We need to step up financial education programmes and make people more aware that there is no such thing as a totally safe investment.

The protection of savings calls for monetary stability and financial stability. Through their decisions and actions the central bank and the supervisory authority pursue these aims vigorously; supervision of the conduct of individual banks is steadfast and intensive. We have no hesitation in giving an account of our actions to the Institutions and to the country.

Figure 1

Composition of households' portfolio of financial assets: 1950-2017 (1)

(end-of-period data; per cent)

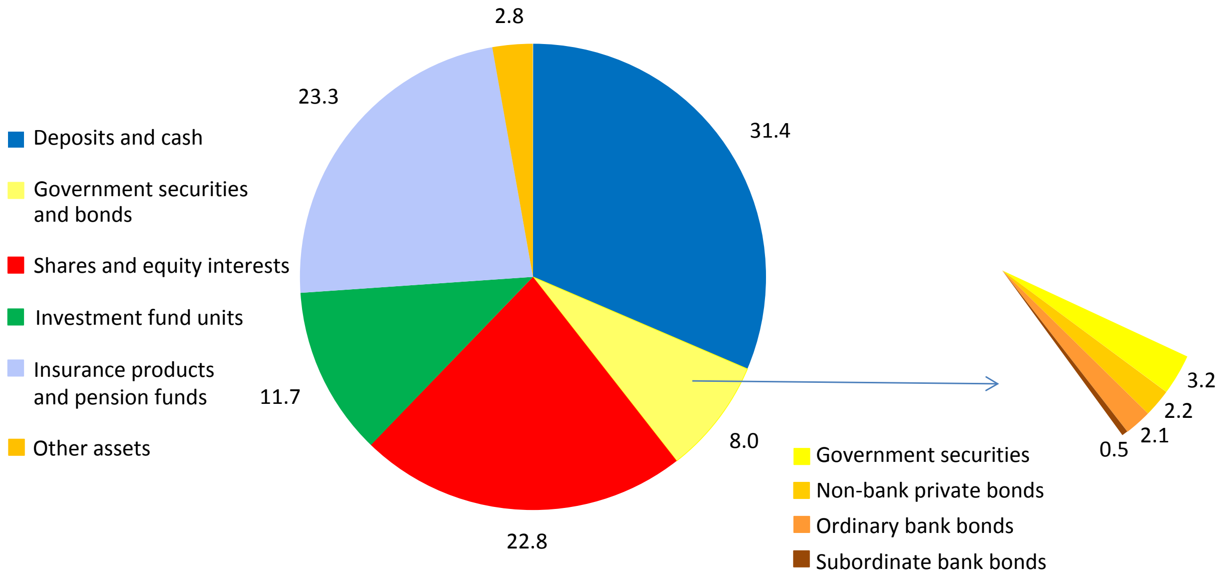


Source: Bank of Italy.
(1) For 2017, the data refer to June.

Figure 2

Composition of households' portfolio of financial assets: June 2017

(per cent)



Source: Bank of Italy.

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