28th ASSIOM FOREX Congress

Speech by the Governor of the Bank of Italy

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Parma, 12 February 2022

Economic outlook, inflation and monetary policy

In 2021, the world economy recovered more than expected. Economic activity delivered a positive surprise in Italy as well, with GDP growing by 6.5 per cent. In recent months, growth has been curbed by the new wave of infections, but it is expected to pick up again starting in the spring with the gradual improvement in the health situation. At global level, according to the latest scenario published by the International Monetary Fund (IMF), GDP will expand by 4.4 per cent in 2022, half a percentage point less than was forecast in October. In the short term, risks are mainly on the downside; besides being influenced by the course of the pandemic, these risks stem above all from the ongoing geopolitical tensions and the impact they could have on the cost of commodities, especially energy products, and on trade in intermediate inputs along global value chains. According to our latest estimates, Italy's GDP growth will near 4 per cent this year on average, and will then slow in the next two years.

Since the second half of 2021, a significant, and for the most part unexpected rise in inflation has been observed in several countries. On the supply and cost side, this has been due above all to the steep increase in fossil fuel energy prices, supply chain bottlenecks and the rise in international transport costs. In the United States, a role was played by the strong growth in demand and the rise in wages, in part connected with the exit of many previously employed persons from the labour force. Pressures on the final prices of goods and services will likely be stronger than initially estimated, but should abate in 2023.

In the euro area, twelve-month inflation reached 5.1 per cent in January, the highest level since the start of the monetary union. Rising energy prices contributed directly for more than half of this figure: even net of the most volatile components, the increase recorded since the second half of 2021 has largely reflected higher energy costs. Differently than in the United States, consumer price pressure due to the recovery in production activity, which today is not far from 2019 levels, has been modest so far. The rise in natural gas prices has been exceptional; though they declined after peaking in December, in Europe they are still almost seven times what they were in early 2020. This is a far more pronounced rise than that recorded in the United States, a clear sign of the very serious difficulties, in both industrial and international policy terms, experienced in Europe. Oil prices, which as early as last spring had recouped the drop recorded in 2020, continued to rise, against a backdrop of high volatility.

The pass-through of the increases in energy commodities to retail electricity and gas prices is spurring the governments of euro-area countries to take measures aimed primarily at mitigating the repercussions for households and firms. In Italy, an intervention equal to more than €5 billion in 2021 made it possible to limit the increases in electricity and gas bills by around one third for customers in the 'protected market' (*mercato tutelato*), which were equal to 12 and 10 per cent, respectively, as a yearly average. Owing to the widespread adoption of fixed-price plans in the 'free market' (*mercato libero*), the overall increase in electricity and gas prices in 2021 was likely less marked for households as a whole. However, the rise in costs intensified early this year: despite the further support measures approved in December, electricity and gas bills are expected to rise by 55 and 42 per cent respectively in the first quarter of this year compared with the last three months of 2021. As we know, the government has already adopted some additional measures and is considering new ones.

The Eurosystem staff projections published last December indicated that inflation would be above 3 per cent on average in 2022, reflecting the sharp rise in energy prices. It was, therefore, expected to decrease over the course of the year, eventually returning to just below the ECB's objective of 2 per cent. This level is in line with the expectations reported in January by the participants in the Survey of Professional Forecasters and with the indications implied by the prices of index-linked financial assets, which – while factoring in the latest unexpected rise in prices – continue to signal inflation expectations of around 2 per cent from 2023 onwards.

However, price dynamics in recent months have differed from the December forecast, and tensions on the energy front have not let up yet. Though it is likely that the projected slowdown will be confirmed in the coming months, in the short term, the risks of a de-anchoring of expectations and of entering into a wage-price loop, of which there is nevertheless currently no evidence, must be monitored carefully. The rise in energy commodity prices is currently leading to a negative change in the terms of trade and, therefore, to a reduction in purchasing power in the euro area. In 2021 as a whole, the loss associated with the deterioration in the terms of trade was limited to around 1 per cent, though it rose over the course of the year, surpassing 2 per cent in the fourth quarter. This is essentially a tax, probably temporary for the most part, whose distortionary effects may be offset, where possible, by drawing on the public purse. The rise in costs, however, must not turn into a prolonged inflationary spiral.

Last week, the Governing Council of the ECB therefore confirmed its December decision to discontinue net asset purchases under the pandemic emergency purchase programme (PEPP) at the end of the current quarter. To ensure a step-by-step reduction in the pace of total net asset purchases, at that time, it had been decided to increase those conducted under the asset purchase programme (APP) from the current monthly pace of €20 billion to €40 billion during the second quarter of 2022, €30 billion during the third quarter, and to then continue at a pace of €20 billion, ending the purchases shortly before the first rise in the key ECB interest rates. This sequence is aimed at guaranteeing an orderly and controlled reduction of monetary stimulus.

At the moment, I do not believe that the overall picture underlying this stance has changed significantly, though it must be recognized that, in the short term, there has been an increase in the risk of consumer prices growing faster than expected and production activity growing more slowly. At the Council's March meeting, these developments and their possible consequences will have to be analysed and discussed in depth. In any case, the monetary policy stance remains expansionary, though the gradual normalization will continue at a pace consistent with the economic recovery and changes in the outlook for prices. At the same time, as indicated by the findings of the ECB's monetary policy strategy review presented last July, it is crucial that the decisions be incremental and carefully thought through, also to avoid creating any uncertainty that could destabilize the financial markets and the economic recovery. Flexibility will remain a further key element of monetary policy: alongside a constant monitoring of inflation, the Governing Council stands ready to counter risks stemming from an unwarranted fragmentation of financial conditions across euro-area economies.

In any case, the main response to the rise in energy prices – a clear, unexpected supply-side shock – should not come from monetary policy, especially in the absence of a wage-price loop and given inflation expectations that remain firmly anchored to the central bank's objective. While both monetary and fiscal policy may counter the inflationary effects of energy costs, only the latter is able to act directly on these costs, offsetting – at least to a certain extent – the loss in disposable income and limiting their impact on the economy.

Looking beyond the cyclical horizon, the necessary transition to a sustainable economy may bring about significant effects on economic activity but also on the relative prices of energy produced from various sources, with a possible impact on inflation rates. The eventual reduction of net carbon emissions to zero requires an increase in the ratio of fossil fuel energy costs to renewable energy costs, but it is still unclear how this might be achieved, including, for example, in terms of what impact a gradual increase in taxation will have on the former and what impact technological progress and greater investment will have on the latter. When taking into account the broader effects of the measures adopted to facilitate the transition, it cannot be ruled out that the repercussions for economic activity might be deflationary, at least for some time to come.

The increases in the relative prices of fossil fuel energy sources, which are necessary to respond to the momentous challenge of climate change, must not occur in an uncontrolled way: they can be calibrated through the adoption of adequate measures, for example, under a suitable tariff policy. Nevertheless, this signals the importance of swiftly coming up with a strategy, particularly at European level, that considers the problem of the diversification of energy sources, their storage and the identification of common resources for managing energy crises. Only this way will it be possible to coherently address a problem that will be difficult to solve through cyclical economic policies.

The Italian economy: growth and the public accounts

Since the start of the pandemic crisis, our economy has demonstrated that it has a strong ability to recover, sending encouraging signals about its underlying conditions. Industrial production had already returned to pre-pandemic levels last spring, GDP is expected to return to these levels by mid-2022, and employment towards the end of the year. The economy has benefited greatly from the support measures which, by protecting the production system and employment during the most acute stages of the pandemic, allowed economic activity to recover rapidly once the containment measures were eased.

In the current context of progressive recovery, limited emergency measures may still be warranted, for example in order to address the energy crisis or if the number of COVID cases continues to hold back consumption and production, such as in the services connected with tourism, restaurants, and leisure activities. However, generalized stimulus measures could lead to price tensions, besides the risks for the public accounts. Efforts must now, above all, be concentrated on facilitating the structural changes that have been accelerated by the pandemic itself.

Employment policies, both active and passive, can play an important role. The social safety net system has undergone sweeping reforms in the last decade and today universal access is guaranteed. Although the design of the income support instruments could be improved, they are comparable to those in force in the major European countries in terms of structure and resources. However, they lag behind in worker training and upskilling policies and, ultimately, in actively developing new business initiatives. In this regard, rapid improvements are needed, also given the firm restructuring and worker reallocation processes that will follow the double (green and digital) transition. Italy spends significantly less than Germany and France on training and job-seeker support, but it is not simply a question of increasing resources: we need to rationalize our set of policies and services in order to develop a system that is fit for purpose in all parts of the country.

The strong recovery of the economy has been decisive in halting the increase of the public debt-to-GDP ratio, which might have fallen to around 150 per cent at the end of 2021 (from about 156 per cent in 2020), a level that is markedly lower than that forecast at the beginning of last year and also than the official government assessments published last autumn. Given that the primary balance is better than expected but still broadly in deficit, the fall in the debt burden compared with 2020 is the result of the large differential, which is negative by more than 5 percentage points, between the average cost of the debt and nominal GDP growth. This result, even though the circumstances that produced it were exceptional both in terms of the recovery of activity levels after the deep recession and of the extremely expansionary monetary conditions, clearly shows the importance of economic growth in gradually bringing down the debt burden.

Compared with the current legislation scenario, the budget raises net borrowing by about 1.3 per cent of GDP on average in each of the three years 2022-24. In a phase that is still characterized by high uncertainty about how the pandemic will play out, an expansionary budget was deemed necessary to limit the risk of a premature reduction of fiscal stimulus having negative repercussions on potential growth. As the recovery consolidates, it will nevertheless be necessary to rebalance the structure of the public accounts gradually and steadily, also to avoid stoking tensions on the government bond market. The need to place securities worth €400 billion every year continues to expose us to high risks. In more recent years, these risks have been mitigated by the ECB’s very substantial asset purchase programmes intended to counter deflationary pressures and the economic fallout from the pandemic crisis.

Over the next decade, the gap between the average debt burden and GDP growth will gradually have a less positive effect on the debt ratio, due to the inevitable normalization of the growth rate of the economy and of short- and long-term interest rates. In addition, the ageing of the population will exert upward pressure on current primary expenditure. To counterbalance these trends, it will be necessary, on the one hand, to increase growth potential and, on the other, to improve the primary balance gradually and in structural terms. Both of these approaches could help to steadily reduce the yield spread between Italian government securities and those of the other major euro-area countries. The greater the rate of growth, the lower the adjustment of the public accounts needed to facilitate the gradual reduction of the debt-to-GDP ratio.

Istat's most recent population projections for the next 20 years suggest a fall of almost one fifth of the population aged between 15 and 64 years, i.e. a drop of almost 7 million people compared with the current level. In the longer term, therefore, healthy growth rates could only be achieved by a large increase in labour market participation and employment levels and a sharp acceleration in productivity compared with the disappointing trend of the last quarter century.

The importance of implementing promptly, fully and effectively the investments and the reforms set out in the National Recovery and Resilience Plan (NRRP), as defined under the Next Generation EU programme (NGEU), has clearly emerged. The NRRP addresses the main structural weaknesses of the country in the context of a European strategy that takes on the challenges posed by climate change and the digital revolution and that will require an increase in public and private investment, upskilling of workers and the enhancement of the technological and organizational capacities of firms and the public administration.

According to the assessments I outlined in my Concluding Remarks last May, the investments planned under the NRRP could raise the level of GDP by more than 3 percentage points by 2026. A further impact, of up to 6 points in a decade, could arise from the reforms and the plans to incentivize research and innovation. This would add almost 1 percentage point to Italy's economic growth potential.

These estimates are obviously subject to a high degree of uncertainty. Actually carrying out the planned projects will require an exceptional effort in order to meet the 527 intermediate and final targets (of which 100 targets this year alone) – the condition for the disbursement of the European funds. While this task is extraordinarily difficult, we must also recognize that the country cannot afford to dissipate the great opportunity that the NGEU programme offers to Italy and to all the EU economies to help them emerge from the crisis with the prospect of more rapid, sustainable and inclusive growth.

Europe has given proof of its cohesion and farsightedness in designing a common strategy that looks to the future of the new generations. However, the double transition will require a great capacity to adapt and very substantial investments on the part of all our countries, and far beyond the time horizon of this programme. The commitment and the spirit of cooperation shown in these circumstances must be renewed, strengthening the role of the European Union in guiding and encouraging the transformations under way.

Changes in the financial industry: opportunities and risks

The changes under way in the economic system are also affecting the structure of the financial system. The transformations imposed by technological change, especially by digital innovation, are profoundly altering the organizational structures of intermediaries and how they distribute financial services. The supervisory authorities are increasingly engaged in identifying and monitoring the risks that these changes may generate, reassessing the adequacy of the boundaries of their mandate, carrying out controls on a broader and more diversified range of entities and activities, and coordinating supervisory rules and practices with other authorities at national and international level.

The Bank of Italy currently supervises 54 banking groups and 167 stand-alone banks, 284 asset management operators (investment firms, asset management companies and fixed capital investment companies), 153 other financial intermediaries and 51 payment or electronic money institutions. These are flanked by hundreds of EU entities subject to supervision in their home countries, which can operate under the freedom to provide services.

Traditional banks and financial companies are making ever more use of digital distribution channels. The number of intermediaries managing the whole life cycle of a product entirely at a distance – marketing, acquiring new customers, providing services – is on the increase. Business models that envisage collaboration between different kinds of financial intermediaries or between intermediaries and non-financial corporations are spreading; there is a marked rise in the use of 'platforms' that give techno-financial conglomerates the chance to offer customers access to a growing variety of services, such as the outsourcing of corporate functions, including key ones.

The asset management industry is dominated by open-end funds (with more than €1,200 billion of assets under management), especially by investment funds incorporated abroad, which represent almost 80 per cent of the total undertakings for collective investments in transferable securities (UCITS) located in Italy. Of these funds, known as ‘roundtrip’ funds, nearly two fifths are owned by Italian groups that have transferred most of their managed assets to other EU countries, mainly for industrial, regulatory or tax reasons (especially to Ireland and Luxembourg). Closed-end alternative funds mainly reserved to professional investors – credit, private equity and venture capital funds – have increased strongly, though with a still modest amount of assets under management.

The greater recourse to technological innovations may bring significant benefits to operators, intermediaries and, looking ahead, to firms and households as well. Intermediaries in particular will be able to exploit the advantages linked to digitalization in order to reduce their costs and improve the quality of the services they provide. Using digital solutions makes it possible to broaden the range of products and better define their features according to customer needs, to improve creditworthiness assessment, and to promote inclusion, guaranteeing easy access to financial services at low cost for those who make little or no use of the traditional system.

Alongside the opportunities provided, the digital transition also poses considerable challenges for intermediaries and the regulatory and supervisory authorities. The former have to increase investment in order to limit financial, operational and reputational risks. The latter, which continue to coordinate closely within the forums for international cooperation, are engaged in updating the regulatory framework and the monitoring tools designed to balance the need to promote innovation with preserving the overall stability of the system and protecting savings.

Digitalization has increased exposure to cyber attacks, fraud and the misuse of personal data. Italian banks reported 14 serious incidents in 2021, up from 4 in 2018. The damage was contained thanks in part to the effectiveness of the regulatory and supervisory safeguards to counter technological risks; however, intermediaries must continue to strengthen protection, given the greater technological content of their business and in order to deal with the intensification of cyber threats.

The negative implications for the stability of the financial system linked to the growing use of new technologies must be resolutely countered, without reducing their adoption. The outsourcing of IT services to a limited number of operators not subject to supervision increases the danger that if service is interrupted by one or more suppliers, it could have systemic consequences, hence the need to come up with new kinds of supervision and intervention. The spread of applications that make use of artificial intelligence, supporting both internal processes and the supply of services to users, produces several qualitative and quantitative benefits (in areas ranging from back-office processes to the analysis and management of credit, cyber and operational risks, and from marketing to financial investment advisory services). Nevertheless, this means that intermediaries have to monitor the processes adequately, offsetting the complexity and opaqueness of the algorithms and preventing the mechanical adoption of such processes from jeopardizing the interpretability of the results of the analysis and from leading to uses that may also be involuntarily wrong.

These risks are flanked by those caused on the one hand, by an unchecked development of increasingly significant phenomena such as decentralized finance – which, by using distributed ledger technology (DLT) and smart contracts, allows transactions to be carried out without using an intermediary or a 'centralized' process – and on the other hand, by the growth of crypto-asset markets, especially those other than stablecoins (which must nonetheless comply with important legal, regulatory and supervisory requirements – as reiterated by the G7 Finance Ministers and central bank governors). The marked volatility of the value of instruments traded on crypto-asset markets – whose capitalization at global level has halved in the last few weeks compared with the peak of around $3,000 billion reached last November – not only creates serious dangers for investors, as we have pointed out many times, but may also have significant implications for financial stability in the future.

In this context, the action of supervisory authorities aims to ensure the efficacy of the rules guaranteeing the protection of investors, the correct functioning of market infrastructures and the security of the financial system and of the economy as a whole. The principle inspiring regulatory and supervisory action is the one according to which the same regulatory safeguards must be applied to the same activities, regardless of who carries them out. In cases where the use of more innovative technologies does not allow adequate legislative and supervisory requirements to be applied, the authorities are called upon to inform the public of the dangers encountered when investing in these instruments or using them as a means of exchange, and they must also adopt the initiatives necessary for avoiding any direct or indirect exposure of supervised entities to these markets.

An important initiative for adapting the regulatory framework is under way in the European Union, in which we are active participants. The Regulation on Markets in Crypto-Assets (MiCAR) for governing crypto-asset markets and digital services is being finalized, as is a pilot regime for defining temporary deviations from European legislation in order to allow the controlled provision of trading and settlement services for financial instruments via DLT-based market structures.

In order to promote the balanced development of digital services, by ensuring adequate limits on the risks stemming from greater use of technologies, a new digital operational resilience act (DORA) is upcoming. This will strengthen and harmonize the safeguards for technical security and corporate governance in the financial sector; there will also be a European regime for the direct supervision of critical providers of ICT services. The revised Payment System Directive (PSD2) and the Directive on Security of Network and Information Systems (NIS) are currently being reviewed to strengthen the security measures for electronic payments and to raise the level of IT security by means of requirements for market operators and general government, within a framework of cooperation among Member States. Lastly, the revision of the Regulation for the electronic identification systems provided to private citizens and firms (electronic IDentification, Authentication and trust Services, eIDAS) aims to guarantee the availability of reliable, secure digital identities that are fully interoperable between different countries, thereby contributing to the fight against money laundering and the financing of terrorism, including in processes managed entirely at a distance.

Exchanging information in the event of attacks, disseminating best practices, developing risk assessment methodologies, organizing simulations and promoting communication campaigns for the general public all complement the regulations for combating threats to IT security. We are contributing to these activities, presiding, together with the Italian Banking Association, over the computer emergency response team for the financial sector (CERTFin), in which the other sectoral authorities and the most important financial and technological operators participate. Yet cyber risks cut across all boundaries at geographical, sectoral and individual organization level and therefore require collective action. From this point of view, international cooperation both between private entities and between authorities is of crucial importance.

There are ongoing and important market initiatives that could favour the development of innovative financial services for the benefit of citizens and firms, and contribute to Italy's digitalization strategies. At the start of this year, the merger began between NEXI and SIA, two important Italian groups that operate in the payments sector, especially in card transactions, clearing services for national and European interbank services, and connectivity services for the financial system. The new entity thereby acquires a leading position on the European scene. The significant expansion in terms of size and geography it intends to pursue will require careful monitoring of the risks. We are following the implications of these developments closely, in terms of both prudential supervision and payment systems oversight, activating appropriate forms of cooperation with foreign authorities when necessary.

Following its acquisition of Borsa Italiana in April 2021, Euronext is now proceeding with organizational and business integration, which for Italy involves both the equity and government bond markets and the guarantee systems for trade and for securities settlement. Among the projects designed to strengthen the pan-European nature of the infrastructures managed, one important one is awarding the former Cassa di Compensazione e Garanzia, now rebranded as Euronext Clearing, the central counterparty services for all the trading in shares and in derivatives on financial instruments and on commodities managed by the group. Euronext's primary data centre will move to Italy. In this case too, together with Consob, we are closely following the regulatory and supervisory implications of the new projects, via close contact with the supervised firms and the controlling shareholder.

The changes associated with the digitalization of financial services are accompanied by those caused by the environmental transition. The need to make the global economy more sustainable requires a strong commitment from governments, supervisory authorities, central banks and intermediaries in order to face the challenges posed by such a transition. Those operators able to integrate sustainability objectives into the production and provision of financial services will be able to improve their ability to compete effectively on the market. The regulatory and supervisory authorities, for their part, will continue to adopt coordinated actions designed to encourage intermediaries to equip themselves with suitable safeguards in order to address the ongoing changes more effectively.

In the last few days, the ECB has begun a stress test on climate-related risks that will involve almost all the significant banks. The exercise comprises three modules of increasing complexity, the last of which – for the biggest and most well-equipped intermediaries – requires banks to draw up projections for their financial and profitability situation under various climate-related scenarios, including very severe ones. Given the current unavailability of data, exposures towards small and medium-sized enterprises will be excluded from the exercise. Looking ahead, however, smaller firms will also have to provide intermediaries with detailed information about their carbon footprint in order to continue to have access to bank lending with no penalties. The results of the stress test, which should be seen above all as a chance for banks and supervisors to develop the skills necessary for managing climate change risks, will have no direct implications for the capital requirements set by the supervisor, but could contribute to the Supervisory Review and Evaluation Process (SREP). The need to prepare banks and the other supervised intermediaries for the management of these risks is a priority for our supervisory action too.

Italian banks

The improvement in the cyclical situation, together with the support measures still in force, has had a positive impact on the condition of Italian banks. As at the end of last September, their capital situation remained solid: the ratio of common equity tier 1 to risk-weighted assets (CET1 ratio) was 15.2 per cent, i.e. 1.3 percentage points above pre-pandemic levels. The rise was due both to the increase in capital and the decrease in risk-weighted assets, also following the disbursement of loans backed by public guarantees.

Once the extraordinary needs connected to the pandemic were over and the supervisory authorities' recommendations on dividends and share buy-backs had been lifted, the extraordinary distributions of profits referring to 2019-2020 conducted by some banks since last October have not had a significant impact on their capital adequacy. The ECB and the Bank of Italy are engaged in verifying that distribution policies remain geared to prudence, also in light of the uncertainty that still affects the macroeconomic outlook.

In the first nine months of 2021, annualized ROE more than doubled year-on-year, reaching about 8 per cent. The recovery in profitability has been confirmed by the preliminary results for the full year disclosed by listed banks in recent days. The rise was largely due to the flow of loan loss provisions – which were very in high in 2020 – being halved, reflecting the strong rebound of the Italian economy recorded last year.

Credit quality continued to improve, also benefiting from the support measures. While increasing slightly, the flow of new non-performing loans remained low in the fourth quarter, standing at 1.3 per cent of total loans, well below the highs recorded during the global financial crisis and the sovereign debt crisis. Moreover, the stock declined further: net of provisions, the ratio of non-performing loans to total loans was 1.9 per cent in September, 0.3 percentage points lower than at end-2020.

In this phase, supervisory authorities are focused on lending for which repayment has been suspended and on that backed by state guarantees. As at the end of last year, banks had granted non-financial corporations loans backed by the guarantee schemes activated by the Guarantee Fund following the pandemic for a total of about €150 billion. No particular tensions on the credit quality front have been recorded for these loans: according to the latest supervisory reports, referring to the end of September, a mere 0.5 per cent are classified as non-performing.

As regards the moratoriums provided for by the 'Cure Italy' decree and discontinued at the end of last year, the gradual phasing-out of the measures to support the economy might lead to an increase in the flow of non-performing loans over the coming months, with the consequent need to enter the corresponding losses in the profit and loss statement. However, the growth in insolvencies will likely be well below that registered during previous recessions. At the end of 2021, loans to firms that were still benefiting from these moratoriums amounted to around €33 billion, less than one fourth of the total granted since March 2020. In September, the latest date for which more detailed information is available, loans with an expired moratorium and those for which the moratoriums were still active had a default rate of 2.4 and 4.6 per cent respectively, compared with 0.9 per cent for loans that did not benefit from any support measures.

For a sample of banks that fall under our direct supervision, we have conducted an in-depth analysis of the main exposures for which moratoriums were activated, in order to verify the accounting and prudential classifications and ensure the correct evaluations. About 20 per cent of the exposures examined had potential classification issues. The results were communicated to the banks concerned for careful re-examination. An ad hoc statistical survey initiated last summer of all less significant banks will enable us to intervene further with requests for additional information, including through on-site inspections, and we will send warning letters should it emerge that banks are underestimating these risks. We therefore now have a situation that does not seem to require any new generalized government measures. Two years on from the start of the pandemic, banks can assess for themselves the possibility of restructuring their loans to firms that are able to overcome temporary difficulties, by analysing individual exposures and taking on the related risk.

Although the banking system as a whole is not in a bad condition, there are still some cases of fragility, mainly concerning small and medium-sized banks with a traditional business model. For many of these, low credit quality adds to the difficulty of curbing costs and responding to the challenges of technological innovation.

Last year, as I announced at this very meeting, we conducted a survey on a broad sample of the banks under our supervision, asking them to provide a self-assessment of the sustainability of their business models. The responses returned a diverse picture. Most banks have balanced financial conditions, together with a sufficiently clear and informed view of the trends, risks and opportunities of the current market situation. For a non-negligible number of them, there were some uncertainties at strategic level and some weaknesses around their ability to generate adequate income flows, sometimes associated with low capitalization.

In our experience, the corrective action requested by the Bank of Italy is all the more effective the faster the banks react. For some of the less proactive banks with managerial shortcomings, the weaknesses could result in a crisis in the absence of suitable corrective measures; therefore, they were asked to make a rapid assessment of possible options to prevent deterioration and to return to the path of full sustainability. These issues will remain central to discussions with the Bank of Italy in the months to come and more incisive interventions could be made if there are any uncertainties and delays in taking the necessary corrective action.

The European Commission is currently revising the Bank Recovery and Resolution Directive (BRRD). In the public consultation, together with the Ministry of Economy and Finance, we underlined the importance of a greater harmonization of the national insolvency rules for non-systemically important banks in order to avoid disorderly liquidations that might provoke an unjustified loss of value and contagion risks. Taking inspiration from the experience of the Federal Deposit Insurance Corporation in the United States, and in line with the crisis management arrangements traditionally adopted in Italy in the years preceding the adoption of the BRRD, greater scope for intervention by deposit guarantee funds would be desirable to facilitate the transfer of assets, liabilities, branches and legal relationships from the bank in liquidation to a third-party acquirer. To this end, it would be necessary to remove the priority accorded to the funds for recoveries in liquidation (the super-priority rule), which makes it difficult, and often impossible, to comply with the least cost criterion.

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The unexpected increase in inflation recorded in the euro area in the last few months is largely the result of a supply-side shock. If no wage-price spirals are triggered and if expectations remain firmly anchored to the ECB's inflation objective, as is happening at the moment, the effect of the energy price rises will mostly be reabsorbed in 2023. As the recovery consolidates, a gradual normalization of monetary policy therefore remains the most appropriate strategy.

The expected slowing down of net asset purchases by the ECB over the course of this year and their eventual suspension are not such as to warrant a significant worsening in financing conditions on the bond market in Italy. The burden of public debt has fallen markedly and it will probably be about 10 percentage points lower compared with forecasts that put it close to 160 per cent of GDP at the end of 2021. The downward trend must continue over the coming years. A small rise in market rates will have no significant effects on the cost of the debt, whose average duration is just under eight years. If fiscal policy is able to ensure a gradual rebalancing of the accounts and the NRRP is promptly, fully and effectively implemented, any increase in interest rates will be offset by the economy's return to paths towards higher and long-lasting growth.

The success of the NRRP will also be crucial in allowing Italy to overcome the challenges posed by the digital and the green transition, from which no sector of the economy is exempt. For banks and financial intermediaries in particular, investment in technology and effective management of risks, including those linked to climate change, are not merely instruments for tackling the growing competition; they are fundamental levers for lowering brokerage costs, increasing the quality of services on offer, improving profitability and, ultimately, giving the economy the support it needs.

Designed and printed by the Printing and Publishing Division of the Bank of Italy