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Insight

Stress tests: pass marks for the Tricolour

Italian banks have passed the 2018 stress tests conducted by the European Banking Authority (EBA) and the European Central Bank (ECB). Intesa Sanpaolo, Unicredit, UBI and Banco BPM, the only Italian banks tested, had CET 1 levels higher than the minimum required to face adverse macroeconomic conditions (5.5%). Danièle Nouy, Chair of the ECB Supervisory Board, said that the Italian banks, led by Intesa Sanpaolo with the best results, had done a good job in reducing non-performing loans.

Italian banks at risk if the spread widens any further

The widening spread is fuelling fears for Italian banks, which – with the loss of value of government bonds in their portfolios – are seeing their assets shrink. What's the level beyond which Italian banks could face serious problems?

The stress tests, which Italian banks passed successfully, are an important gauge of the stability of the system because they more or less priced the current spread. So the results tell us that the main Italian banks can resist even the widening of the spread that's already been present since early 2018, comments Francesco Castelli, head of fixed income at Banor Capital. In practice, at these levels banks can survive, as shown by the quarterly results published so far. "But it's also true that, as the Bank of Italy has pointed out, there's a level beyond which there is a risk of incidents: it might be above 350, or 400. It's complicated to set a threshold with certainty because there's a specific one for each bank", adds Castelli.

The problem is that the spread, or more precisely the rise in yields on Italian government paper, involves losses in capital account for banks holding these securities. As a consequence, their regulatory capital is getting too close to the minimum level, which means that they may need to recapitalise. "But in a period of very wide spreads, market conditions are definitely not favourable for capital increases, so this would be a dangerous scenario", underscores Castelli.

Banor Capital's expert points out that the current regulations and the supervisory authorities' preferences have been "driving banks to ensure that their balance sheets are less and less exposed to securities issued by

their own governments, to weaken the link between country risk and banking risk". Given this factor, the bigger banks in particular have already reduced the share of BTPs [Treasury bonds] they hold and diversified by buying safer securities, for example German and French bonds, with a view to hedging.