

PRESS RELEASE

GDP: ABI, economy still weak in 2009 but signs of recovery starting 2010

AFO forecasts presented: economic distress in Italy in 2008-2009, GDP expected to fall -0.3 and -0.8%; first signs of growth starting 2010, estimated at +0.7%. Despite Italian banks' ability to weather the ongoing crisis, net profits are forecasted to fall, owing to the recession, but no credit crunch is expected to hit companies.

We're starting to see significant effects of the ongoing downturn caused by the international market crisis also in Italy; among the various signs of economic downturn are the following: a drop in industrial production, a decrease in all confidence indicators and the fact that the country is showing evidence of its structural weaknesses. Over the two-year period 2008-2009, GDP should fall by -0.3 and -0.8%. First signs of recovery are expected to start in 2010, with a +0.7% increase, but still below both the potential and the forecasted level for the euro area. Italian banks are weathering the US crisis relatively well, better than other advanced countries. Therefore, no credit crunch is expected to hit companies, despite a drop in investments and in credit demand being inevitable. These are the credit and financial world's forecasts for 2009-2010 presented by ABI today and illustrated in the AFO Financial Outlook Report.

Macroeconomic overview of Italy

The Italian economy has been facing a recession since the beginning of the second quarter 2008. Italian GDP fell 0.4% between March and June and 0.5% in the third quarter. Given the trends in industrial production (a -6.1% annual decrease in October) and in retail sales (a -3.8% decrease in September, year on year), 2008 is likely to end with a -0.3% annual GDP decrease. The economic downturn is expected to continue throughout the entire first half of 2009; thereby national income will fall for 5 quarters, overall. The economy is expected to recover starting the third quarter of 2009, but it is likely to be a weak recovery, compared to the negative results for the two previous quarters. Therefore, taking carry-over effects into account, the average GDP growth rate is estimated at -0.8% in 2009, while in 2010 annual growth should be approximately +0.7%, and, at the end of the period, it should exceed 1%, with respect to the same period the previous year.

Investments

Investment prospects, in terms of domestic demand, look bleak. For the first time in several years all components of gross fixed investments dropped between July and September. Specifically, a sharp drop (3.5%) in machinery and equipment was recorded and, in addition, recession hit the construction sector, accounting for approximately half of total investments. Therefore, a downward revision with regard to investment choices was recorded, inevitably affecting credit demand: despite the fact that interest rates are falling and as the prospect for future credit demand is weak and there is a lack of trust by companies in the market, this will not allow a significant upward trend in performance. This year is likely to end with an average annual fall of 1.3%, dropping to 3% in 2009. We may see a recovery, although weak, (+0.2%) in 2010.

The Italian banking industry

In light of the fact that investments are expected to drop and given an environment in which all data related to the current economic situation show that the Italian economic scenario is expected to worsen, annual growth rates regarding bank **lending** to non-financial companies will continue to be above the average of the past ten years (the annual growth rate in October was +8.4%, while in September it was +10.7%). The annual growth rate averaged +10.8% between May and October 2008. The last “Economic survey regarding industrial and service companies” by the Bank of Italy reveals that the number of companies that already have revised downward their prior plans to increase their production capacity and those that are planning to invest less in the next year, is increasing. Therefore, companies’ demand for loans is expected to decrease, while the growth rate of funding offered by banks should be more or less stable.

Therefore, the slowdown in banking activities recorded in 2008 owing to the economic recession should continue and worsen in 2009, while bank lending should grow in 2010. Total lending, which grew by 9.9% in 2007, is expected to grow by 5.9% and 5.5% in 2008 and 2009, respectively, while the growth forecast for 2010 is 7.6%.

Despite the fact that lending is on the decline, the turmoil brought about by the financial crisis may lead to an increase in **savings** in 2008, higher than in the previous year (8% this year versus 6.6% in 2007). Over the next two years, total domestic lending should gradually slow down to 6.1% in 2010. Moreover, deposits are expected to increase by approximately 3%, on average and on an annual basis, over the next two years, while the number of bonds issued should significantly increase, by 14.2%, in 2008 and by approximately 10% over the next two years.

For what concerns the other main balance sheet items, **non-performing loans**, net of impairment, should remain more or less stable in 2008 (+0.1%) and are expected to rise to approximately 3.7% in the period 2009-2010. With respect to lending, net non-performing loans /net non-performing loans to loans should remain more or less stable with respect to the previous year (1.1%) both in 2008 and over the next two years. The ongoing financial crisis and economic recession, therefore, should not have a significant impact on the quality of credit in Italy.

According to forecasts, **net profit** should decrease by 30.4% in 2008, which clearly shows how the macroeconomic environment and the ongoing financial crisis also hit Italian banks. If the crisis continues, it will also affect 2009, with a 16.6% decrease in net profit. We will see the first signs of a turnaround starting 2010, with a growth rate of 10.3%. In such an environment, this would significantly affect ROE, which would fall from 9.7% in 2007 to 6.1% in 2008, dropping to 4.6% in 2009 and then increasing again to 4.7% in 2010.

For what regards **interest margin**, 2008 is likely to end with a growth rate of 3.9%, 3.5 percentage points lower than in 2007; owing to the cyclical slowdown, but later than expected, growth should slow down in 2009-2010 (to 1.8% and 2.1%, respectively). The financial crisis, on the other hand, has a greater impact on other net proceeds (from provision of services or other) in 2008 and 2009 (-4.5 and -1.5%, respectively, while net proceeds in 2007 were -3.2 percentage points), while a turnaround may be expected in 2010 (+5%), after the financial market turmoil is definitively over. For what regards **brokerage margin**, which increased by 1.8% in 2007, this year is likely to end with a slightly negative figure (-0.3%); then it is expected to be more or less stable (+0.2%) in 2009 and to grow by 3.5% in 2010. Given the stability of operating costs with respect to a growth trend that is expected to be slightly below 2% on average per year over the three-year period, **gross operating profit** should decrease by 3.2% and 2.2% in 2008 and 2009, respectively (it was -0.6% in 2007) and should start growing, by 5.8%, again in 2010.

Public finance

For what concerns public finance, the economic situation is showing the first signs of worsening conditions, which inevitably occurs in times of difficulty, as well as a relevant decrease in taxable income. With respect to future prospects, the deficit/GDP ratio should be approximately 2.6% this year while, in 2009, it is expected to slightly exceed the limit set out by the Maastricht Treaty. The ratio is expected to be kept within these limits again the following year and is estimated at 2.9%. In this environment, a slight decrease in the interest rates/GDP ratio would lead to a decrease in primary surplus: in 2007 it was 3.1%, while this year it should be approximately 2.5%; it is expected to fall to 2.1% in 2009 and then to rise again to 2.3% in 2010. These trends would negatively affect the debt/GDP ratio, which would start growing again for two years (in 2008 and 2009) and then decrease again starting 2010.

Italia - Scenario di base: principali variabili				
(var %)	2007	2008	2009	2010
Crescita reale Pil	1,5	-0,3	-0,8	0,7
Crescita reale investimenti	1,2	-1,3	-3,0	0,2
Deficit/Pil (in %)	-1,9	-2,6	-3,1	-2,9
Prezzi al consumo	1,8	3,6	2,1	1,9
Prezzo del petrolio (in \$)	72,5	99,5	68,3	82,5
Tasso riferim. BCE (*)	4,00	2,50	1,50	1,75
Tasso sugli impieghi (**)	5,8	6,3	5,3	4,7
Tasso sui depositi (**)	1,8	2,1	1,4	1,2
Impieghi a residenti (***)	9,9	5,9	5,5	7,6
Sofferenze nette (***)	-2,4	0,1	3,8	3,6
Depositi da residenti (***)	2,4	3,2	3,3	4,1
Obbligazioni emesse (***)	12,1	14,2	10,4	9,2
Margine d'interesse	7,4	3,9	1,8	2,1
Margine d'intermediazione	1,8	-0,3	0,2	3,5
Costi operativi	3,7	1,8	1,8	2,0
Risultato lordo di gestione	-0,6	-3,2	-2,2	5,8
Utile netto	5,2	-30,4	-16,6	10,3

(*) dati di fine periodo. (**) relativo alle famiglie e alle società non finanziarie. (***) var % sulle consistenze di fine periodo.

Fonte: Istat - Banca d'Italia - BCE e ns. previsioni

Italy - Basic scenario: main variables				
(var. %)				
	2007	2008	2009	2010
Real GDP growth	1.5	-0.3	-0.8	-0.7
Real investment growth	1.2	-1.3	-3.0	0.2
Deficit/GDP (as a %)	-1.9	-2.6	-3.1	-2.9
Consumer prices	1.8	3.6	2.1	1.9
Oil prices (in USD)	72.5	99.5	68.3	82.5
ECB reference rate (*)	4.00	2.50	1.50	1.75
Lending rates (**)	5.8	6.3	5.3	4.7
Deposit rates (**)	1.8	2.1	1.4	1.2
Lending to residents (***)	9.9	5.9	5.5	7.6
Net non-performing loans (***)	-2.4	0.1	3.8	3.6
Deposits from residents (***)	2.4	3.2	3.3	4.1
Bonds issued (***)	12.1	14.2	10.4	9.2
Interest margin	7.4	3.9	1.8	2.1
Brokerage margin	1.8	-0.3	0.2	3.5
Operating costs	3.7	1.8	1.8	2.0
Gross operating profit	-0.6	-3.2	-2.2	5.8
Net profit	5.2	-30.4	-16.6	10.3
(*) data refers to the end of period ; (**) figure refers to households and non-financial companies; (***) variation as a % of amounts at the end of period.				
Source: ISTAT – Bank of Italy – ECB and ABI forecasts				

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