

# ACRI

## 84<sup>th</sup> WORLD SAVINGS DAY

*“Productivity, savings, growth”*

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*(President of the Italian Banking Association)*

*(31 October, 2008)*

*Honorable Minister of Economy, Governor of the Bank of Italy,  
President of ACRI, representatives, ladies and gentlemen,*

We are going to celebrate the 84<sup>th</sup> World Savings Day in one of the most difficult periods that the world of economy and finance has faced in the last eighty years.

The financial crisis leads to increased uncertainty: the world GDP growth has slowed down and many developed countries have shown signs of setback in productivity. The probability that the economic stagnation and the slowdown of the economy will turn into a recession is increasing: this must be prevented.

The role of economic policies is to ensure that a combination of distrust, lower income and impoverishment perceived by individuals does not lead to a drastic drop in consumption and investment: this may extend and amplify the crisis and risks paving the way to a long-lasting depression.

In the past weeks, governments and monetary authorities have reacted positively and firmly.

By this meeting, the banking industry sends a message of confidence to the manufacturing sector and savers that the markets will soon start to function more normally and that the financial difficulties we are currently facing will not turn into a long-lasting crisis involving Main Street.

## **1. The crisis: where it originated and how it spread**

Approximately fifteen months after the start of the financial crisis, the implications related thereto are clear: this is not just any setback but the worst crisis since the 1930's. It is also the result of an accumulation of grave abnormalities in the business model.

In a macroeconomic environment characterized by low interest rates, abundant liquidity and a hunt for yield, incentives were created to lend to

parties with low creditworthiness. This was done with the full knowledge that the risk would be fragmented and distributed to a vast number of market players.

This is what essentially happened in the United States. A great deal of information can be given on the abnormally rapid growth in these transactions in the US; we note that only between 2000 and 2006, the number of *subprime* mortgages granted on a yearly basis more than tripled and the securitized share of these mortgages reached 75%. In other *non-prime* sectors of the mortgage market (such as the *Alt-A* mortgage sector) the percentage of mortgages granted and securitized shot up from 19 to 91%.

The primary culprit of this crisis clearly is the US housing market, which enjoyed a speculation bubble with prices significantly higher than they should have been if based on market fundamentals, prices which are now dropping at record pace.

There are many market participants to blame including not only the banks and financial institutions (regulated and non-regulated) that originated the credit and securitized the loans which today are referred to as “toxic”, but also credit rating agencies that ranked the bonds deriving from the original credit, the authorities that designed and imposed accounting methods as well as oversight and supervisory authorities in the countries where the phenomenon started.

The clearest symptoms of the market diseases are now well known: an abnormal increase in aggregate debt; a deep crisis in the inter-bank market and liquidity; the consequent unusual widening of the difference between interest rates set by policies and those of the monetary market; the generalized *repricing* of risk, whose sometimes exorbitant prices of *credit default swaps* are more revealing signs.

These factors briefly outlined thus far above are the global characteristics with which we have become familiar up to the August of this year.

Starting from September, everything collapsed. And this occurred suddenly.

The effects on the European economy became evident at the beginning of September, when the US authorities decided not to save *Lehman Brothers*. This decision had serious repercussions: the drying up of the already arid US inter-bank market; the sharp increase in *credit default swaps* premium; panic intensified and spread engulfing financial operators all over the world.

The crisis has rapidly spread, in an environment of epoch-making events that are well known: bailouts, the disappearance of major investment banks and Paulson's Plan.

Few figures reveal how we moved from the first to the second phase of the crisis: between August 1, 2007 and August 31, 2008, the stock index pertaining to the banking sector in Italy went down 17 points less than the average of the US, UK, German and French indexes. Between September 1 and October 29, 2008 they practically all went down by the same percentage (approximately 35%).

## **2. The crisis and Italian banks**

The business model that led to this situation is a model that is foreign to Italian banks, which, in the past years, have been criticized for being behind the times and for focusing on business strategies considered too traditional!

While financial innovation assumed a deadly character, which today is criticized by all, our banks were deeply committed to consolidating the changes made starting from the early '90s, to strengthening their relationship

with their depositors and Italy as well as to increasing their influence on the European markets.

Italian banks are, therefore, impacted indirectly by the crisis; this is due to their participation in the markets, such as liquidity markets, which are global.

The fact that they have been indirectly impacted did not prevent them from feeling the repercussions, in terms of losses in the stock markets. Experience has proven that being the only “sound” banking system is not sufficient.

There are many differences between the Italian banking market and other markets, resulting from the decisions, in terms of business models, made by Italian banks over the years, from social and cultural factors, customer preferences, as well as regulatory approaches and effective policies.

The composition of assets of our banks reveals that almost the majority of Italian bank assets are constituted in funding to resident customers: it accounts for almost 50% of total assets, while the Euro Area average stands at 36%. The percentage pertaining to direct deposits (resident deposits and bonds) exceeds 50%, compared with the Euro Area average of 45%.

Actually, the aggregate data in our possession, leads us to believe that currently there are no indications of a tightening of credit neither with respect to the amount of funding nor the prices related thereto.

Naturally, the banking industry has given due consideration to entrepreneurs’ concerns regarding a possible reduction in credit flows and a consequent increase in the cost of credit. We’ve already discussed these issues with trade union executives at a meeting which has proved to be productive. We will meet again this afternoon and over the following days. Many initiatives are under discussion. We believe in dialogue and have confidence in our ability to find the right solutions.

Our data tells us that fortunately there is as yet no evidence to corroborate the concerns regarding a potential credit squeeze.

In the trimester May to August 2008, the long-term growth rate of lending to firms was on average approximately 11.5%, a slight reduction with respect to the highs (+14.5%) recorded at the end of 2007, but notably higher than that recorded in the period January 2004 – July 2008 (+8.8%). The first estimates issued in September also confirm this trend.

In the last five-year period, the ratio between credit used and credit granted appears to be relatively stable. This data, valid for all firms, is even valid for small and medium-sized enterprises, which are potentially the most vulnerable ones. It must be noted that in the last few months, Italian small and medium-sized enterprises were not penalized in terms of the interest rates applied.

### **3. Initiatives**

We agree with the measures issued by the Italian government, after having consulted the Bank of Italy, other EU countries and the ECB.

In Italy, the inter-bank deposit protection fund guarantees deposits up to 103 thousand euros per depositor, the highest amount in the EU. We agree with the government's decision to raise the already high level of deposit protection provided by the inter-bank fund by envisaging an additional protection provided by the government. This is in order to protect customers further and, also, to restore trust in the Italian banking system that, in our opinion, has never diminished.

For what regards the measure already issued by the government, aimed at helping banks facing difficulties, we consider this to be a further safety net and prudential tool which, nonetheless, we believe it will not be necessary to utilize.

The Italian banking system is solid and banks have adequate capital ratios, as also proven by the supervisory authority. Under normal market conditions, when both the economy and markets function normally, there is no need for intervention in our banking industry. Under the current abnormal circumstances and in view of banks' renewed commitment to supporting the economy, we welcome any further useful measure aimed at strengthening banks' capital base.

We believe that envisaging an intervention scheme able to guarantee the private nature of the Italian banking system is essential.

We also agree with Law Decree no. 157 and consider it to be a useful tool, aimed at unblocking the inter-bank market and supporting medium and long-term funding.

We can learn many lessons from this crisis. A general lesson first of all is that we must avoid excesses. This crisis will also allow us to return, globally, to greater equilibrium between Main Street and Wall Street; to reduce the level of debt that in these years has increased exponentially and to increase the level of capitalization of companies. It will also allow us to redraft the system of rules so as to make it more suitable for the changing markets.

On the matter, among the various issues that need to be addressed, the issue pertaining to supervisory schemes is crucial. On 1 October, the European Commission published its proposal to review the Capital Requirements Directives to reinforce financial stability. The proposal is currently under the examination of the European Parliament and Council and should be adopted within April 2009.

The suggestions in part are a response to the recent recommendations of the Financial Stability Forum, chaired by the Governor of the Bank of Italy, and are aimed at improving the agreements on supervision of cross-

border banking groups and cooperation amongst national authorities, as well as strengthening risk management practices for securitized products, for hybrid capital instruments and for large exposures.

National barriers within the single market are a serious obstacle in situations of crisis. Increased cooperation amongst monetary and supervisory authorities is a key element to handling the cross-border crisis; one of the greatest difficulties the European Central Bank faced was the absence of consolidated information to support the Eurozone monetary policies.

The first step should be that of achieving full convergence of the supervisory practices and rules, by removing national discretions contained in the CRD and favoring the consistent implementation of the guidelines published by the European committee uniting national supervisory authorities (CEBS).

The amendments proposed by the Commission favor the further strengthening of the legal supervisory framework (Basel 2) whose potential has not yet been achieved, as banks are still in the process of completing the complex implementation. Substantial overhauls are not necessary but simple improvements are, these must be aimed at resolving the problem of procyclicality and the conflict of interest of credit rating agencies.

For this purpose, the Commission's proposals are particularly useful. They are aimed at better centralizing supervisory functions; currently there is a need for a comprehensive overview of cross-border banking groups in order to better proceed to reliable supervision over systematic and solvency risks in the European single market for financial services.

The second step should be that of, on the other hand, harmonizing financial reporting at the EU level. Preparing standard supervision statement reports at the EU level could prove to be insufficient if they are not accompanied with definitions using one language that would guarantee a consistent information framework, at least in Europe.

#### **4. Financial development, savings, economic growth**

The financial crisis that we are going through is a deep, structural and global crisis. We must note that there are many risks brought on by this crisis but there are also opportunities that have arisen. Italy has the necessary resources and the ability to minimize the former and seize the latter.

The costs, in terms of decreased growth, arising from the crisis that the Italian economy will be called to pay are difficult to quantify. If these costs are estimated by referring to the difference between growth forecasts prior to the crisis and those of today (a method that does not take into account that a part of the slowdown would have occurred anyway due to cyclical reasons), the loss in real terms may be estimated as equal to approximately 3 GDP points in only the two-year period 2008-09.

But this can and must be prevented. The gross household savings rate in Italy is still high: it exceeds 15% of the available income, according to the European Commission (and is equal to the average of France, Germany and Spain). Italy's inclination to save is one of its main drivers, which allows for future investments and, therefore, future growth.

It must be acknowledged that the banking system's stability and soundness as well as higher and more stable long-term growth rates are necessary in order to protect the ability to save.

We must therefore tackle the underlying diseases that in recent years have damaged Italy's production: first of all, the scarce overall productivity. The data provided by the European Commission shows that it has remained more or less unchanged in the three-year period 2005-07. In this period, in France the average annual growth rate was 0.5% while in Germany it was 1.3%.

For productivity to grow at an adequate pace, we must focus on human capital, research and technological innovation.

A great deal can be done by achieving a higher quality of public spending and by, first of all, re-launching infrastructures, a field where the gap between Italy and its EU partners is still wide. The benefits of increasing public investments as an anti-cyclical fiscal policy lever regard the possibility of strengthening, at the same time, the domestic short-term demand and the supply side, by increasing the stock of physical capital.

*Mister President, representatives, ladies and gentlemen,*

Households, firms and the savings world at large, banks above all, have been facing uncertainty and difficulties for months. But these difficulties can be overcome.

In Italy, the percentage of financial wealth held by households that is fully protected against adverse market trends is higher than in other countries: if one considers current assets, bank and postal deposit accounts, government and bank bonds and severance indemnities, we note that more than 50% of the financial assets of Italian households is invested in very low or zero risk investments. This percentage is higher than in other countries. Being aware of this is important.

Yet it certainly isn't enough. Also banks, with their daily conduct and their relationship with their customers, can and must act to prevent the worsening of this climate of fear and distrust. Banks are aware of this, and they know that there are many more challenges that they will have to face: further consolidating their relationship with Italy is one of the major challenges.

Among the long-term challenges, financial education is key. In an environment of increased complexity where a multiplicity of products are offered, individuals that, on a daily basis, make decisions regarding current accounts, credit cards, fixed or variable rate mortgages, allocation of savings,

must be able to make informed choices. Important initiatives proposed by the industry move in this direction.

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The phenomena triggering the financial crisis: easy credit; excess of structured finance and off-balance sheet vehicles are foreign to Italian banks.

There is a growing belief that a closer relationship between Main Street and Wall Street is needed, in order to restore a model that puts finance at the service of companies. Italian banks have proven to be solid because they were already aware that this model was essential.

We are satisfactorily handling the difficulties caused by globalization of the financial disaster thanks to the strengths of the Italian banking sector and the national economic system: absence of *subprime* investments; traditional model of retail banking; low debt load of Italian households; good quality assets.

Moreover, thanks to these strengths, over the following weeks we will work on reasserting ourselves as a point of reference for Italian companies, so as to ensure that they have the funds necessary, as we have done thus far.

We are perfectly aware that, at a time of crisis as the one we are currently facing, our commitment to specifically supporting small and medium-sized companies must be stronger than in the past. It's a promise we will keep.