

Analysis. Capital markets

Italy's bad debts emerge as European weak spot

'MPS has caused the market to pause and look at whether some of these other solutions are actually going to work'

A long stagnation has eroded the ability of businesses and consumers to repay

THOMAS HALE AND DAN MCCRUM

When Lonestar, the US private equity firm, sold a batch of non-performing Irish housing loans late last month, it was a sign that a recovery in the country's property market was helping to ease the bad debts left by the financial crisis.

If the deal went down well in Dublin, it might have been met with more than a hint of frustration in Rome. The success of the sale only served to highlight the absence of similar activity in Italy — the European country that is still crying out for an answer to its vast stock of bad debt.

Italy's financial system remains one of the unresolved weak links in a European economy finally showing signs of recovery, with the government struggling in its effort to address a long stagnation that has eroded the ability of Italian businesses and consumers to repay debts.

Over the past year, bankers have worked vigorously to devise ways of selling off the exposure to non-performing loans held by banks using securitisation in which the loans are packaged up and sold on to investors.

However, significant securitisations of NPLs have failed to materialise and Italy's loan problem is barely improving. The overall stock of bad loans for 15 Italian banks fell in 2016 for the first time in the past eight years, according to DBRS, the Canadian rating agency, which analysed the lenders' results. Yet the proportion of so-called *sofferenze* — the worst class of bad loans, where banks are exposed to insolvent borrowers —

had risen slightly.

"The stock of NPLs is going down . . . but the second message we got from this analysis is the quality of the portfolio is deteriorating," said Nicola de Caro, a vice-president at DBRS. "There are still some sectors where borrowers are struggling."

While the Italian economy grew 0.9 per cent last year, its fastest pace since 2010, it will not return to pre-crisis levels for another decade, the IMF has said. With the legacy of bad debts weighing on the country's prospects, many analysts expect focus to sharpen on Italy given anti-euro sentiment is increasing ahead of expected elections next year.

DBRS also analysed data on the difference between NPL inflows — where good loans turn bad — and outflows. There were €58bn of gross NPL outflows across the 15 banks surveyed but only €9bn came from non-performing loans turning to performing, with the rest coming from write-offs, recoveries and sales. By contrast, €32bn of performing loans turned non-performing.

Amelia Colvin, head of NPLs and distressed at Cadogan Securities, said there were "significant underlying infrastructural issues that have not been addressed in Italy", and that recent events had delayed activity. Monte dei Paschi was expected to securitise a portion of its bad loans late last year.

"MPS, because it did not succeed, has caused the market to take a pause and look at whether some of these other solutions are actually going to work," she said. "A lot of distressed investors don't have a mandate to buy junior notes — their mandate looks like buy hard assets, use leverage."

Introduced in April 2016, the Italian government's Gacs scheme was designed to help persuade private investors to take part in securitisations of non-performing loans by providing a guarantee for the least risky tranche of the deal. However, the approach has floundered — its most prominent example came in the form of a small deal from regional lender *Banca Popolare di Bari*.

Given the lack of sales of non-performing loans, the question of whether Italian banks, already under increasing pressure from the ECB to clean up their balance sheets, will need capital injections, is likely to become more urgent.

"The strong will survive and can raise money, ergo UniCredit," said Barrington Pitt-Miller, an analyst for Janus Capital. "The weak cannot. These companies will just not be able to come back to the market, the market has reached a satu-

ration point unless we see higher rates."

Underwriting standards of most banks have "radically improved" since the crisis, he added, while the quality of the new loans had materially improved.

Analysts at Bank of America Merrill Lynch argued in a report last week that some Italian banks had "started making progress on bringing the stock down." Given renewed regulatory focus on legacy assets, they added, "banks will continue to provision heavily on the existing stocks".

Italy's lack of progress in tackling its bad loan problem is in striking contrast with other victims of the eurozone crisis. As well as the Irish NPL deals, private equity firm Blackstone has recently securitised a portion of Spanish mortgages it bought in 2014 from the debt, previously non-performing CatalunyaCaixa, had become reperforming.

Both Spain and Ireland benefited from government intervention in the form of aid from the EU and the establishment of "bad banks" specifically to deal with the problem of troublesome assets. In Italy, where there has been no bad bank, hope instead rests on the vaguer prospects of ECB and EU measures to address non-performing loans.

"The ECB's new guidance is going to help but investors are really wary of government risk," said Ms Colvin. "There's a lot of dry powder sitting around but they're still going to be cautious."

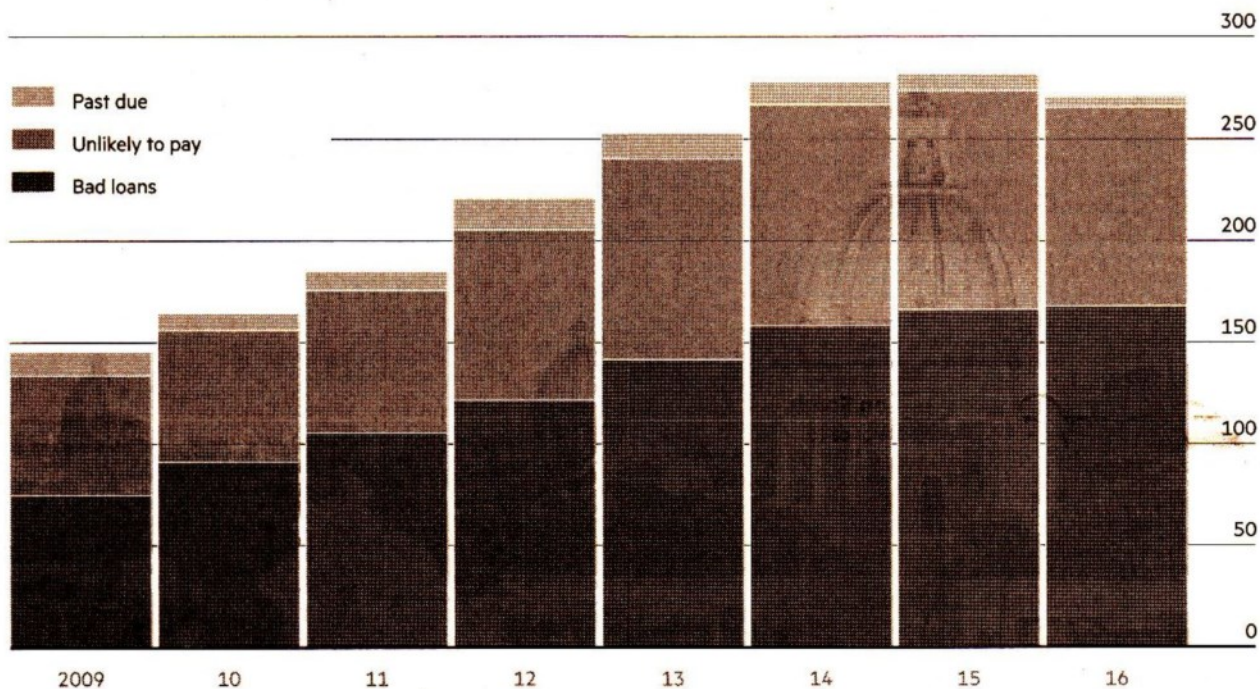
I crediti deteriorati dell'Italia emergono come il punto debole dell'Europa



Frustration in Rome

Evolution of gross non-performing loans* for Italian banks

€bn



Italian banks include UniCredit, Intesa SanPaolo, Banca Monte dei Paschi di Siena, Banco Popolare, Unione di Banche Italiane, Banca Popolare dell'Emilia Romagna, Banca Popolare di Milano, Credem, Banco Popolare di Sondrio, Banca Popolare di Vicenza, Veneto Banca, Banca Carige, Creval, Banca Sella Holding, Banca Popolare dell'Alto Adige

* Includes bad debts, unlikely to pay and past due loans. Unlikely to pay loans include restructured loans and watchlist for the period 2009-15

Source: DBRS