



Growth and development: which role for banks and finance

Elisabetta Gualandri

University of Modena and Reggio Emilia - CEFIN

G. R. O. Annual Conference 2014 «Investments and growth: a
face-to-face discussion with major players»

Modena 24 ottobre 2014

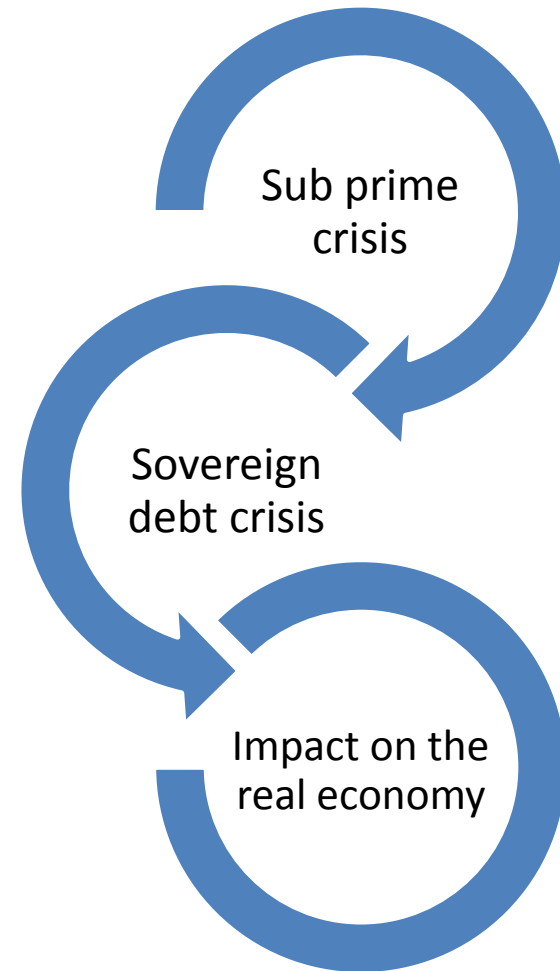
Agenda

- Financial crisis-banks-real economy- credit crunch
- Access to credit: a problem of demand and supply.
Key issues for Italy
 - Firms
 - Banks
 - The ECB action
- Where do we stand?
 - Economic perspectives
 - The actions: firms, banks and finance
- What about Europe?

Financial crisis-banks-real economic - credit crunch

Financial crisis-banks-economic recession- credit crunch

- The evolution
 - 2007: the sub prime crisis originates in the US, due to deregulation and extreme financial innovation
 - 2008-9: the crisis hits European banks and the economy. For Italian banks the public intervention is the lowest among EU countries
 - Since 2011: the sovereign debt crisis and the dramatic nexus sovereign debts-banks hit the EU peripheral countries
 - Since 2012: deep economic recession in Italy



Crisis and Italian banks

A tale of two crises: different impact of the two phases of the crisis on Italian banks, but limited public intervention

- **Sub prime crisis** → Italian banks are less hit, thanks also to their traditional banking business model
- **Sovereign debt crisis** → The sovereign risk affects and heavily hits Italian banks

Less risky and less innovative bankers and/or a more intrusive supervision?

The traditional business model turns from an advantage into a disadvantage.

A long period of low growth, the double deep recession and the increase in NPL and provisions → negative impact on bank profitability

Severe fragmentation of the single credit market along national lines and credit crunch

- A problem of access/availability and cost of credit: increasing gap between core and peripheral countries

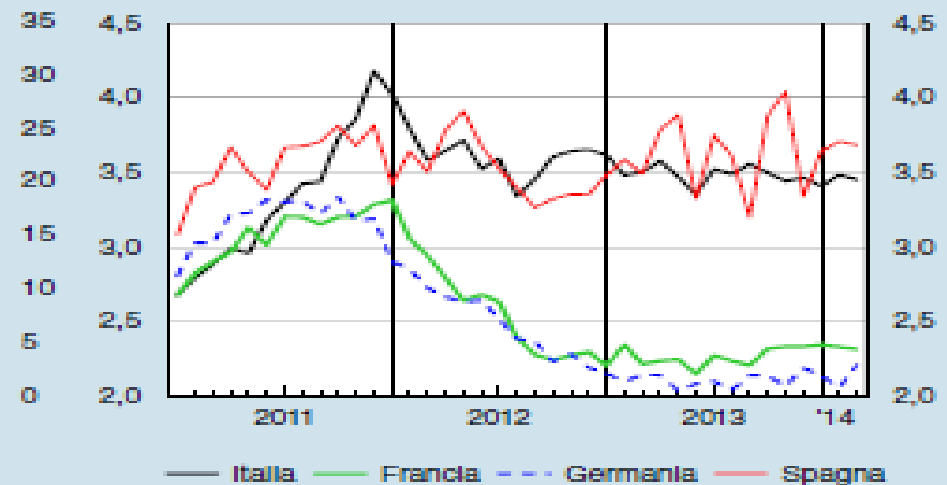
Figura 14.10

Accesso al credito nei principali paesi dell'area dell'euro (valori percentuali)

(a) difficoltà di accesso al credito



(b) tassi di interesse sui nuovi prestiti bancari (2)

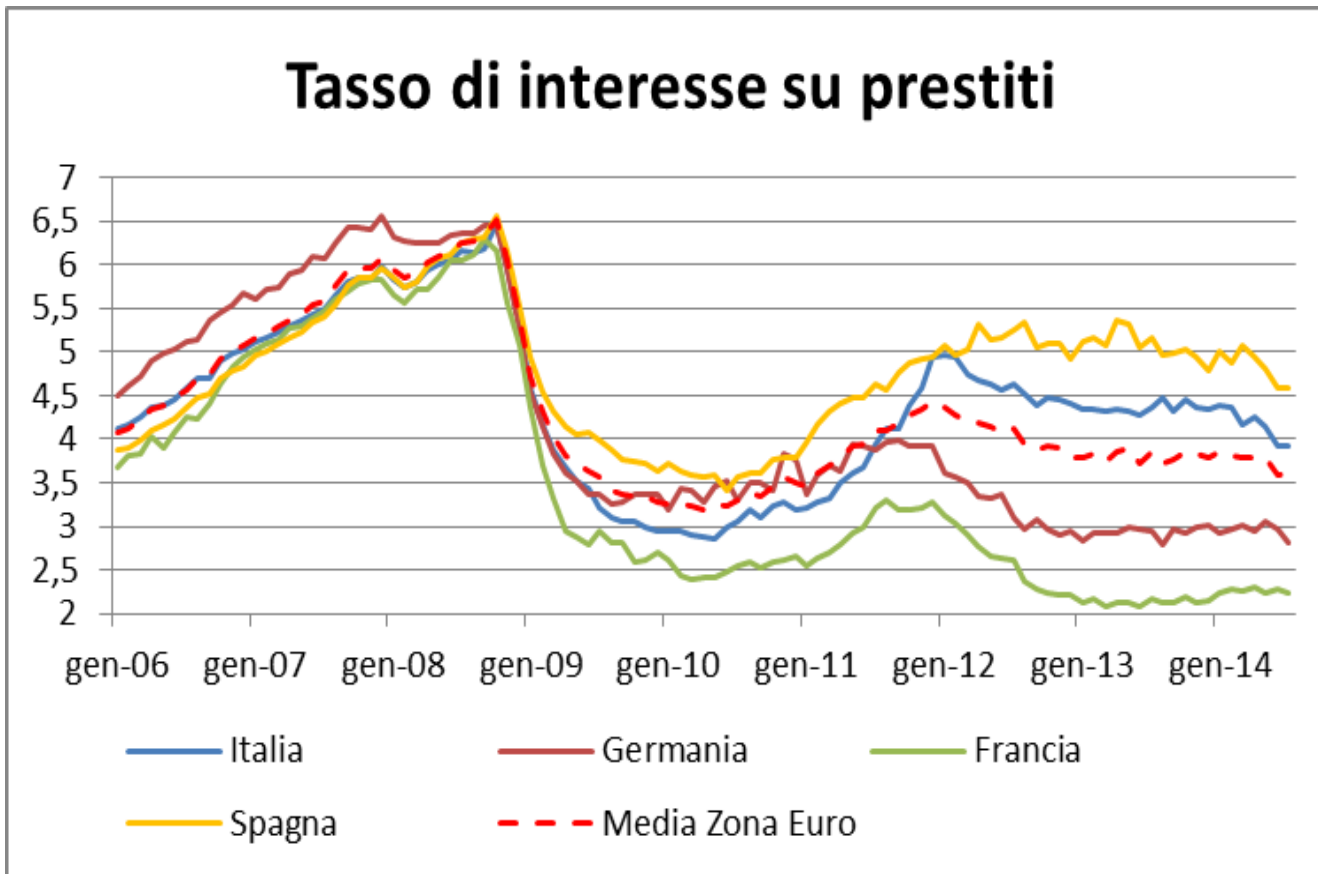


Fonte: BCE, *Survey on the access to finance of small and medium-sized enterprises in the euro area – October 2013 to March 2014* e segnalazioni armonizzate del SEBC.

(1) imprese che hanno dichiarato di non aver ottenuto l'intero ammontare del credito richiesto sul totale delle imprese che hanno domandato credito. – (2) Dati mensili. I dati non includono le erogazioni di prestiti in conto corrente. Per la definizione delle serie, cfr. nell'Appendice la sezione: Note metodologiche.

Severe fragmentation of the single credit market along national lines and credit crunch

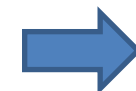
- Interest rates on loans: the SMEs situation is even worst



Interest rates: higher levels for small loans in Spain and Italy (above the euro area average), lower levels in Germany and France

Higher spread (risk premium) between lending rates on small and large loans to enterprises in Italy and Spain

Source : ECB – Statistical Data Warehouse.
Loans up to € 1 million and maturity till 1 year %

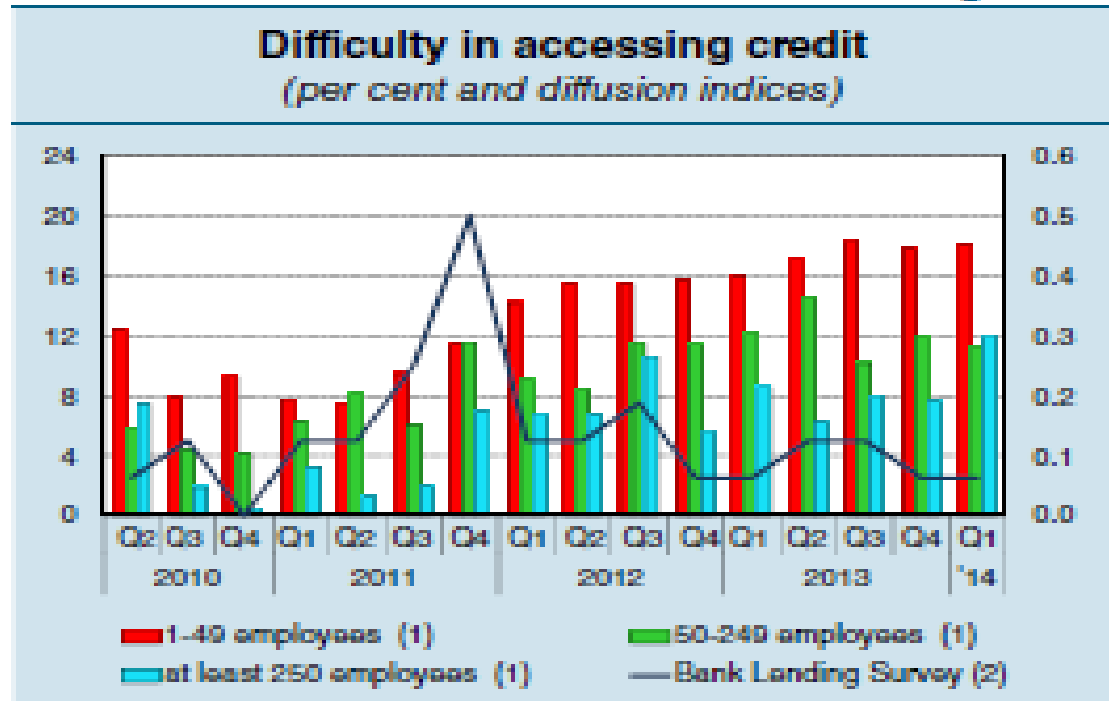


Italia SMEs and access to credit



- The SMEs long lasting problem of accessing credit dramatically worsened during the crisis

Figure 2.3



Sources: Bank of Italy and Istat.

(1) Monthly averages; share of manufacturing firms reporting that they had applied for but not obtained credit as a percentage of the total that had contacted banks or finance companies in the last three months. – (2) Right-hand scale. Quarterly data for Italian banks; positive values indicate a tightening of supply. The diffusion indices are built based on the following weighting scheme of the qualitative responses of banks: 1=substantial tightening, 0.5=moderate tightening, 0=basically stable, -0.5=moderate easing, -1=substantial easing.

Source: Bank of Italy, Financial Stability Report, /2014

Access to credit: a problem of
demand and supply.
Key issues for Italy

Demand side

- The negative economic perspectives curb firms' investments and the related credit demand
- Firms' financial fragility and the high level of risk reduce the supply of funds by banks. Key weak points in Italian firms' financial structure in comparison with other EU countries:
 - Undercapitalization
 - Higher bank debts → the high dependence from bank credit increases the negative affects of banks' *deleveraging*
 - Higher interest rates → the short term cost of funds for Italian firms is 0,31-1,68 pp higher than the cost for firms in the core euro area countries (ECB_EB July 2014)

Not only a fiscal wedge, but also a financial one

*Oltre al cuneo fiscale un **cuneo finanziario** (M. Onado, Il sole 24 ore 29-8-14)*

Even worst situation for SMEs

Supply side

- Regulation and *deleveraging* of banks
 - Basel 3 → *Capital adequacy and liquidity requirements*
- High level of *Non Performing Loans* – NPL at the end of 2013 16% of total exposures, less than 5% in 2007 → the reduction of banks' lending to businesses reflects the risk level their balance sheets are able to support. Need for value adjustments, provisions and sales.
 - Management of NPL
 - Sale prices

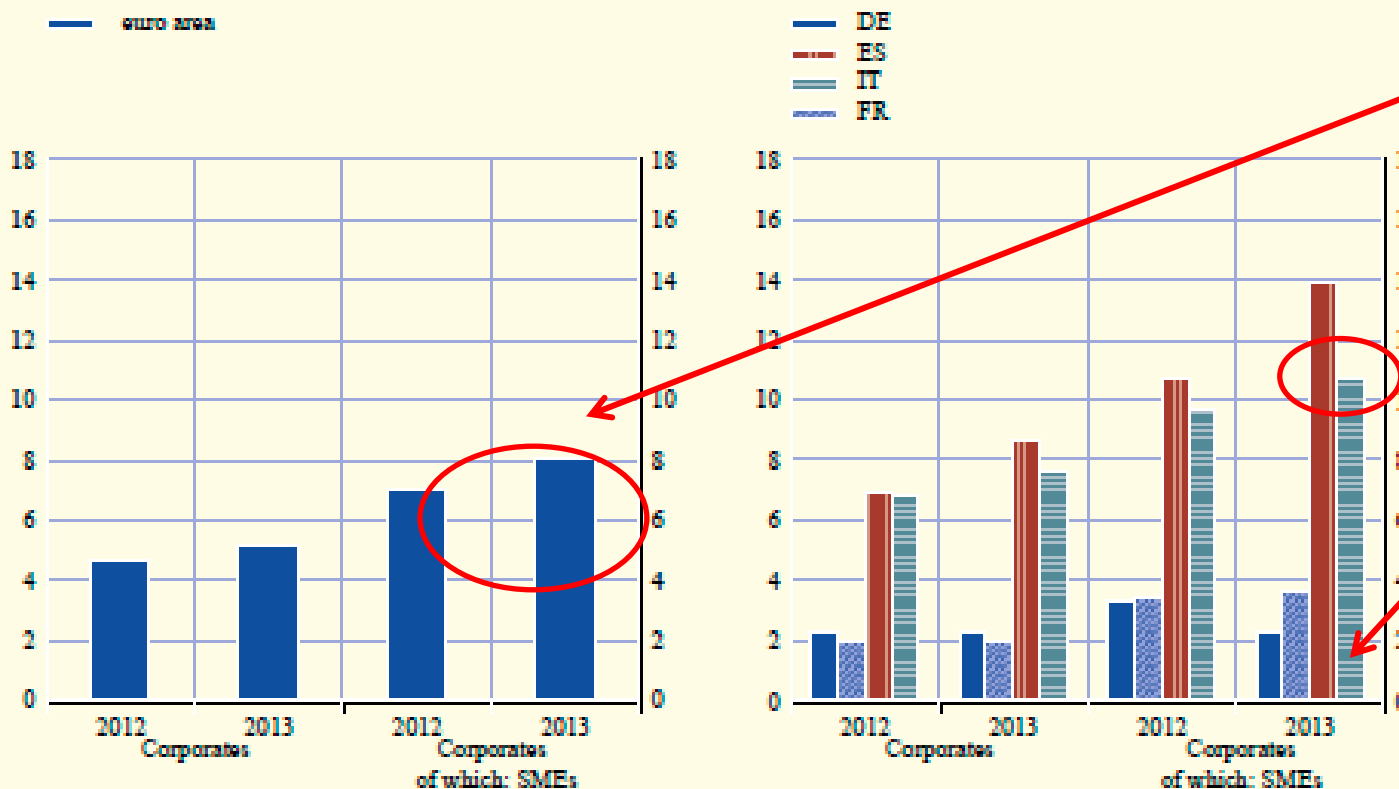
Deleveraging and balance sheet adjustment are pursued just when new financial resources are required to sustain economic growth

SSM → Comprehensive assessment- AQR

Non Performing Loans: value adjustments and provisions

Chart 3 Banks' value adjustments and provisions relative to gross domestic exposures to corporates and SMEs – euro area and large countries

(percentages)



Value adjustments and provision are growing more for SMEs in general and overall in Spain and Italy. Italy: the coverage ratio (provisions/NPs) at the end of 2013 was 41,7% (39% in 2012). NPLs: problems in the international comparison

Sources: EBA 2013 transparency exercise; own calculations.

Note: Value adjustments and provisions relative to respective gross domestic exposures for euro area banks covered in the EBA 2013 EU-wide transparency exercise.

Supply side

- Fears for firms fragility and for weak economic perspectives
 - Low demand for new investments, high demand for restructuring and cash flow needs
- In the past → non efficient credit allocation process
 - Evaluation procedures
 - Rating models
 - Start ups and Innovative SMEs: Tech Rating systems/Tech Index ?

Main problems: strategies, governance, organization, IRB models...?

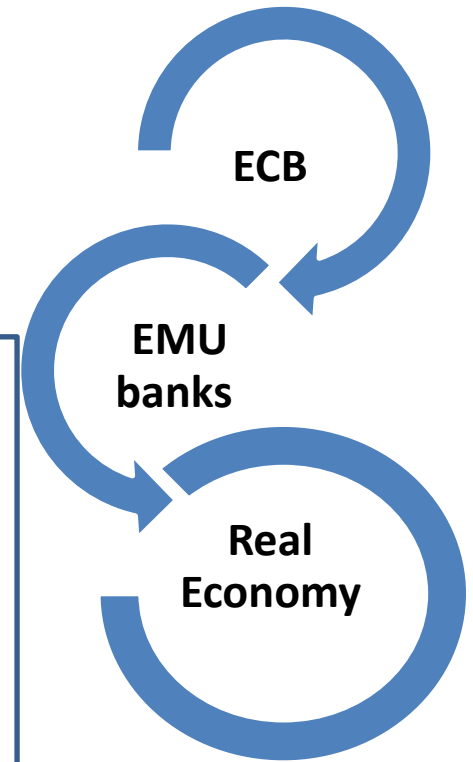
Do banks need to learn again how to grant credit?

ECB action: non-standard/unorthodox monetary policy measures

- The crisis has changed the monetary policy transmission mechanisms of the ECB
- Fragmentation of credit market in the euro area
 - Core vs peripheral countries
- SMP → «*lean against the financial cycle/the wind*» also to make up for:
 - Political shortcomings
 - Limits and obstacles in the working of euro area
 - Lack of a macroprudential policy-MAP

ECB interventions:

- Non standardised monetary policy operations
 - LTRO
 - TLTRO
 - Program of private sector asset purchases:
ABS and covered bonds



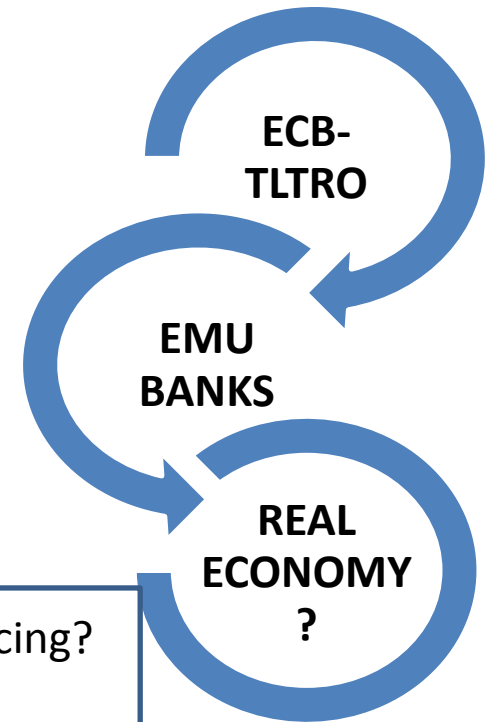
ECB action: TLTRO

- **Targeted Long-Term Refinancing Operation**

- Loans at +10bp on the main refinancing rate (fixed = 0,15%)
- Maturity: 4 years
- Max amount: 7% of loans excluding loans to households for house purchase, outstanding on 30 April (in 2014, 400 bil. for the euro area)
- Counterparties whose net lending to the euro area non-financial private sector is below the benchmark will be required to pay back borrowings in September 2016.
- 1 operation: 18 September 2014. Amount borrowed: 86,2 bil. (Italian banks 23 – available amount 75 bil.)

Impact on firms' financing?

- Amount
- Cost (-20/40 bp)



Other possible uses

- ✓ Reimbursement of LTROs
- ✓ Investments in Treasury bonds
- ✓ **Deposits at a negative rate with the ECB**

Very low penalties



Where do we stand?

EU: perspectives

Economic recovery



- Weak economic growth
- Deflation
- Negative trend of credit in the private sector in many countries
- Vicious circle: low growth-low investments-low credit
- *Deleveraging for firms*



Finance

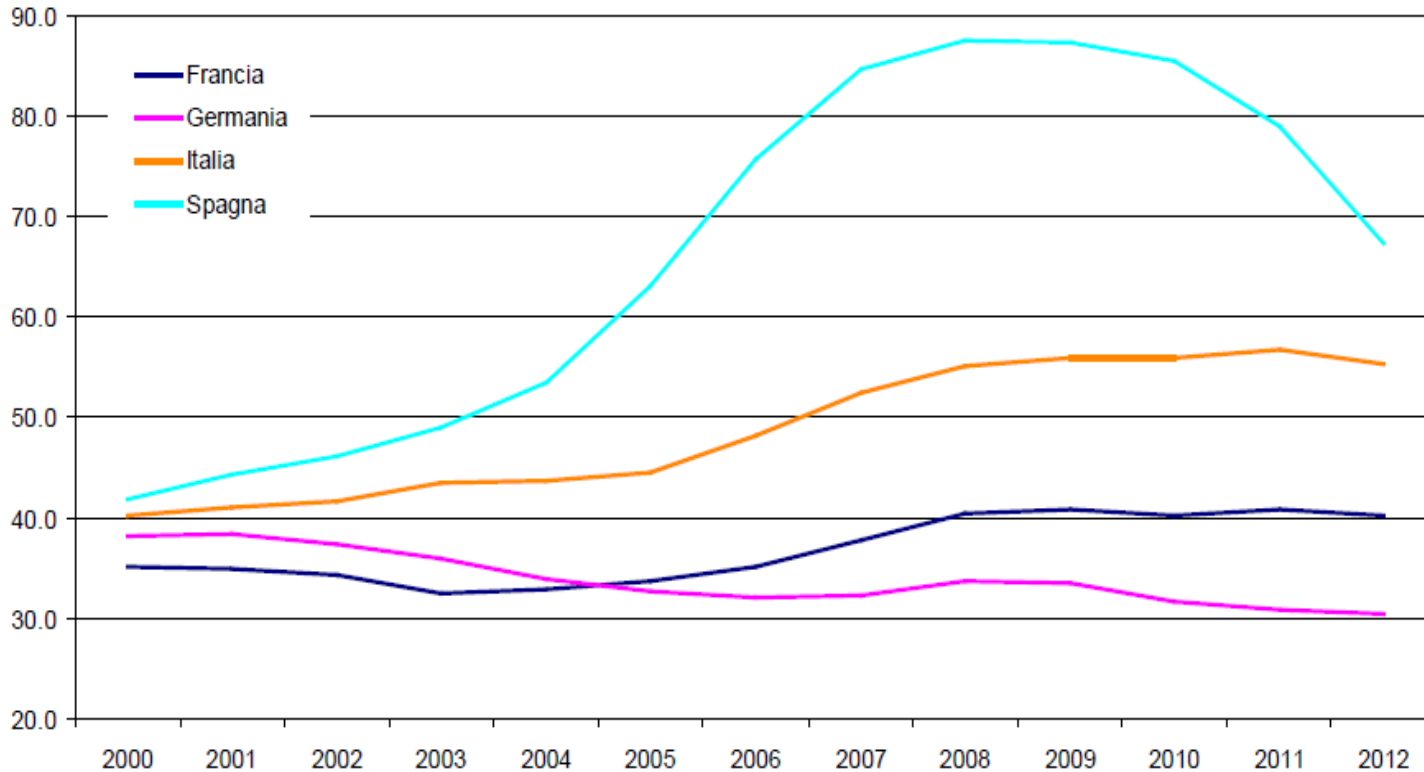


Euro area → bank based economy

- *Deleveraging* and structural changes in the banking systems:
 - Less risky business models
 - Funding more based on deposits
 - Increase in capital adequacy
- Need for a better mix of financing for firms with non bank-instruments and easier access to risk finance and capital
 - Diversification of funding in the bond markets, but only for suitable firms
 - Bond issues are more significant in those countries where banks have less problems → need for a single European bond and stock market
- Increased role of BA , Funds, Funds of funds and Crowdfunding

Prestiti bancari alle imprese nei principali paesi dell'area dell'euro (in percentuale del PIL)

Trend in banks loans



2000-2007
percentage
points

- Germany: -4
- France: +5
- **Italy: + 15**
- Spain: +46

Combined effect of a strong demand and a supply at favorable rates

Fonte: BCE ed Eurostat.

Source: F. Panetta, 2014

Italy: → 2004-2008 loans of non financial firms increased of 50 bp up to 178% of the value added

Euro area: Restructuring firms' bank loans and resolving insolvencies

- Restructuring firms loans: should be easier for banks after the result of the ECB asset quality review - AQR - and comprehensive assessment (D-day 26 October 2014)
- Need for more efficient procedures for debt restructuring and resolving insolvencies: national regimes vary quite a lot in the different countries
- *World bank: Doing business 2014*
Resolving insolvency (years)
 - Italy 1,8; France 1,9; Germany 1,2; Spain 1,5; The Netherlands 1,1, Ireland 0,4.

Italy: financial system and the financing of firms

The crisis has stressed the acknowledged weak points of the Italian financial system

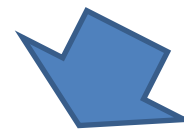
- Strongly bank oriented system
- Low development of bond and stock markets
- Lack of supply of financial instruments in addition to bank credit instruments
- Lack of specialized institutional investors: es. credit funds
- Low role of institutional investors (insurance companies and pension funds) in investing in firm stocks



In the negative phases of the cycle:

- ✓ Low financing and higher costs for firms
- ✓ Higher risks for banks and for financial stability
- ✓ Negative impact on the economic activity

Strong actions are needed in different areas: regulation, strategies, business/operative areas



***Above all...
Economic
recovery is
the key***

Italy: actions for firms

It must be taken as read that in the short term the Italian banking system is not capable of restoring the flow of credit companies need

Actions:

- ✓ reinforcement of firms' financial structure,
- ✓ introduction /reinforcement of financial instruments in addition to bank credit instruments
- ✓ facilities for the access to capital markets:
- ✓ fiscal incentives to go public
- ✓ elimination of fiscal distortions for the investment in corporate bonds
- ✓ introduction of new financial intermediaries allowed to grant credit to firms
- ✓ higher investments in firms for insurance companies and pension funds
- ✓ new discipline for securitization

**Difficulties
for SMEs and
start up to
access to the
capital
markets**



***Well known
reluctance of
Italian SMEs
to go public***



Decreto-legge 24 giugno 2014 n. 91 in materia di finanza d'impresa (G. Gobbi)

Financing beyond and with bank credit ...

Targets of actions	Access to ECB refinancing	Credit	Guaranties	Corporate bonds	Risk capital	Degree of efficacy in the short term on credit crunch	Potential impact on credit crunch
Corporate bonds - Mini bonds				X		+ SMEs +++ medium-large firms	+++
SME guarantee facility			X			++	+++
Cassa Depositi e Prestiti		X	X		X	++	+++
EIB/EIF			X		X	+	+++
Credit funds		X				+	+++
Insurance Companies		X				+	
Securitisation, ABS, Covered bonds	X	X		X		++	++
Venture capital & private equity					X	+	+++
Institutional investors				X	X	+	++
Crowdfundig					X	+	++ innovative start-ups

Source: E.Gualandri, V. Venturelli 2014

0 None + Low ++ Medium +++ High ++++ Very High

Italy: actions for banks

Operative

- TLTRO: reimbursement of LTROs and ...?
- New business models and profitability: focus on the intermediation margin
- The problem of NPL: provisions absorb a large share of the operating income (for banking groups 45% in 2008; 120% in 2013)
- Improvement of corporate governance
- Rethinking of the credit allocation processes
- Efficiency → *cost reduction* and increased role for ICT
- Overbranching
-

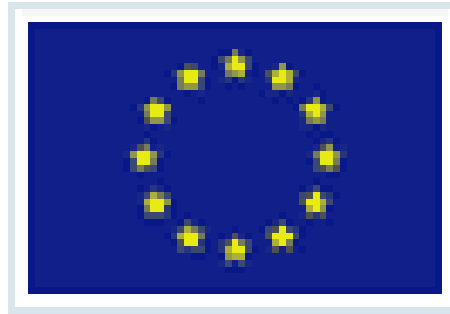
Regulatory

- AQR results: further increase of capital?

D-day AQR: 26 October 2014

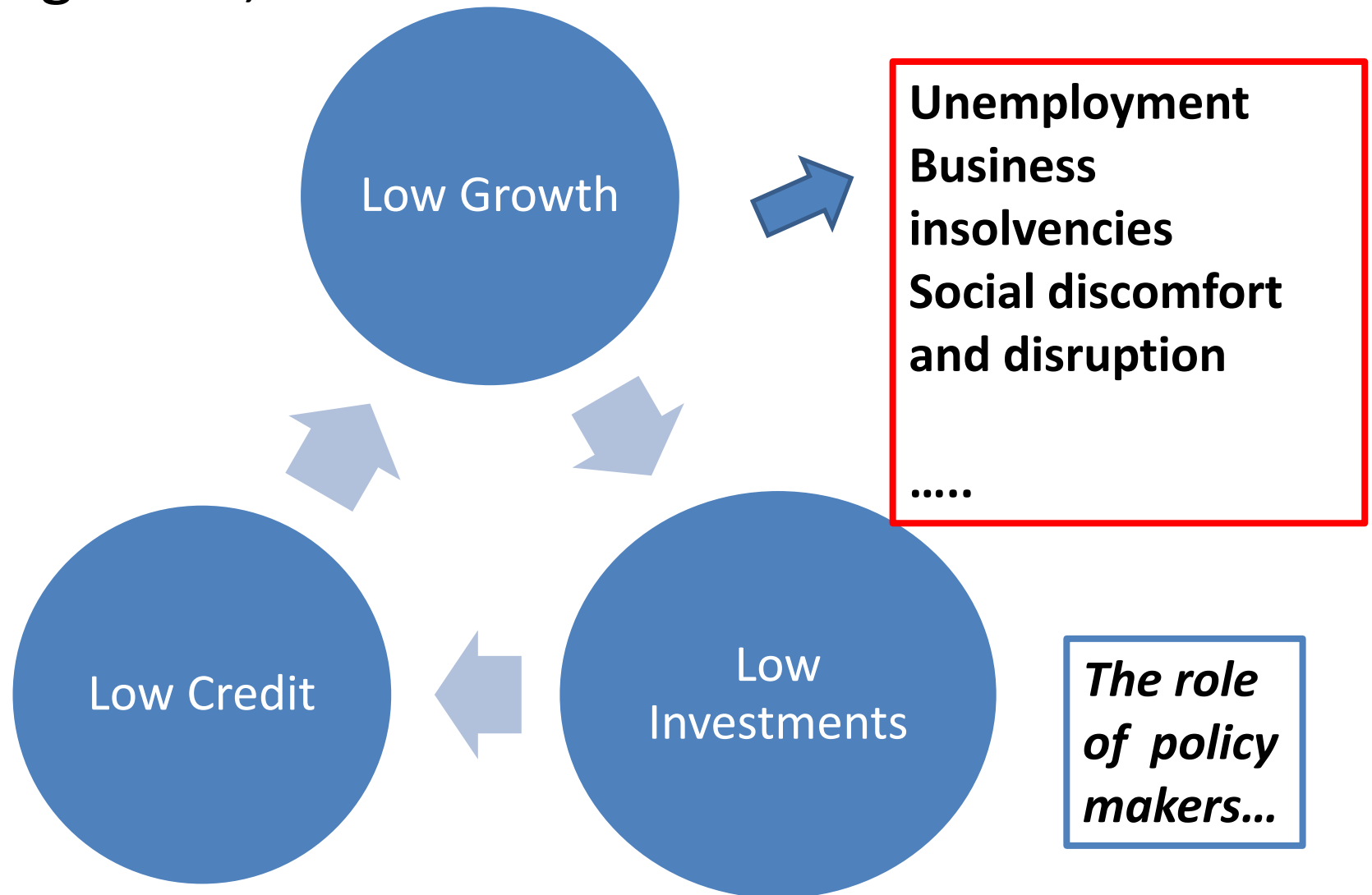
- SSM e comprehensive assessment
 - Single rule book
 - Single supervisory handbook
- Basel 3, *Liquidity standard*, SIFI, *governance* and internal controls Bank of Italy circ. 263
- ...

What about Europe?



europa.eu

EU: how to break the vicious circle of low growth, low investments and low credit?



Council conclusions on measures in support of investment in Europe

"The Council ...

2 SHARES the concerns on the decline of public and private investment in the EU since the onset of the financial crisis and STRESSES that it may be attributed to many different factors, including insufficient aggregate demand in some Member States, **overall macroeconomic uncertainty, low capacity utilisation, public and private sector deleveraging – the latter in the context of stricter regulation on financial institutions, institutional bottlenecks, and structural impediments to investment, job and growth.**

3. Against this background, **UNDERLINES that improving the conditions for both public and private investment is at the center of the EU level-response to promote growth potential and sustain demand.** STRESSES that investment policies stand at a strategic intersection where synergies can be achieved using different policy tools. The credibility of reforms and confidence over economic prospects are key ingredients to make policies work effectively. Moreover, investment is often cross-border and thus generates positive regional /European spillovers.

What about Europe?

Is the
Banking
Union
enough?

***Above
all...
Economic
recovery
is the key***

Oct 26th 2013



What about Europe?

The Sleepwalkers: How Europe Went to War in 1914, a 2012 book by Christopher Clark

May 15th 2013



Above all... Economic recovery is the key

Thank you for your attention

elisabetta.gualandri@unimore.it