The operating context

Economic and social scenario

THE ECONOMY AND THE FINANCIAL AND CURRENCY MARKETS

2014 saw moderate growth in economic activity and international trade. In the United States the recovery strengthened and the unemployment rate fell. The Eurozone emerged from the recession of 2012-13, but recovery weakened during the second and third quarters, also as a result of the Russia-Ukraine crisis. The inflation trend slowed everywhere due to the collapse of oil prices. Throughout the Eurozone, inflation was close to zero, well below forecasts.

Italy is the European country where the recovery is struggling the most to regain momentum. Industrial production recorded a gradual deterioration. From the middle of the year onwards many of the signs of recovery seen in previous months disappeared. Confidence has again diminished, exports slowed and the investment trend was negative. Consumption was positive, which benefited from an increase in real household disposable income. At the annual average level, GDP contracted by 0.4%. Despite the disappointing macroeconomic scenario, the public deficit remained under 3%; however, the progress that should have led to stabilisation of the debt came to a halt. Implementation of the ambitious programme of reforms announced at the beginning of the year also proved complex. The negative trend in economic activity highlighted weakness in the job market, though in recent months some signs of improvement were seen, among which the stabilisation of the number of employed people. The unemployment rate reached an all-time peak in 2014, over 13% in the final quarter, also due to the effect of the increase in the labour force. The difficult job market situation was confirmed by the generational dualism, high long-term unemployment and underuse of the labour force. New jobs were almost all of a temporary nature.

Monetary policies started to move in opposite directions. In the United States, the Federal Reserve completed its planned reduction in securities acquisitions and initiated the internal discussion on the programme that will lead to an increase in official rates in 2015. Going in the opposite direction, the European Central Bank cut official interest rates, bringing the rate on main refinancing operations to 0.05% and the rate on the deposit facility to -0.20%. In addition, new unconventional instruments were adopted, launching the targeted long-term refinancing operation (TLTRO) programme and a new purchase programme of covered bonds and securitisations. The ECB's expansionary monetary policy was the driver behind the decline in rates expectations on all maturities. The downwards pressure was intensified by signs that the ECB might introduce government security purchasing programmes, an expectation that became a reality after year-end. The ten-year yield spreads between Italy and Germany bonds opened the year at 214 bps and reached a low of 119 bps at the beginning of December, benefiting from increasing expectations of new extraordinary ECB measures. The second half of the year saw a considerable appreciation of the US dollar. The USD-EUR exchange rate, which at the end of June was close to 1.37, dropped to 1.21 by year-end.

THE CREDIT MARKET

Italian bank loans to the private sector declined for the third consecutive year in 2014. The decline slowed during the year, most clearly in the second half of the year. The persistence of the recession had a significant impact on the performance of loans to businesses, especially medium-/long-term loans, which were affected by the drop in investments. On the other hand, in the second half of the year short-term loans to businesses showed signs of improvement, with the rate of change climbing to just above zero from the highly negative values previously recorded. Loans to households remained more resilient, showing a very modest and slowing decline. In 2014 there were signs of a recovery in disbursements of residential mortgage loans, which, however, did not translate into an increase in the stock of loans.

Loan performance continued to be affected by weak demand, which, however, confirmed signs of improvement. In particular, during the year the rate of decline in demand from businesses first slowed, and then remained unchanged in the final months of the year. Demand appeared stronger from households, which throughout 2014 submitted increased applications for mortgage loans for house purchases, whereas consumer credit demand also recovered near the end of the year. Competitive pressure began to moderately encourage the easing of credit access conditions, whereas the restrictive impact of the perceived risk associated with the expectations for the economy in general and for particular sectors and businesses eased. The growth in gross doubtful loans slowed further, though confirming a strong growth rate of around 15% at year end. As a ratio to total loans, the stock of gross doubtful loans rose to 9.6% from 8.1% at the end of 2013. Therefore,

the bank lending market maintained a prudent attitude, although recording an improvement in the impressions of businesses with respect to credit access conditions.
The decline in market and monetary policy benchmark rates was gradually reflected in rates on loans. In the second half of the year, the average rate on new loans to non-financial companies decreased to a four-year low. There was a considerable decline in the rate on new loans of amounts up to 1 million euro to non-financial companies, indicating the easing of credit terms for smaller businesses. The easing of Italian rates is also significant when compared to the rest of Europe. In 2014 spreads between Italian rates on new loans to businesses and the average for the Eurozone narrowed. In the last part of the year, these spreads hit their lowest figures since October 2011 when, following the sovereign debt crisis, the increase in spreads began to be reflected significantly in bank rates. The decline in the average rate on new mortgage loans to households for house purchases also continued, standing at well below 3%.

SAVINGS AND BANK DEPOSITS

Italian households' appetite for savings increased in 2014 as a result of higher real disposable income. Along with the positive contribution of the financial markets, flows of savings therefore bolstered an increase in financial assets. In terms of investment approaches, in 2014 the trends intensified on the basis of an ongoing asset restructuring of investors' portfolios. Household investments tended towards demand components – particularly bank current accounts – and towards asset management instruments. Conversely, also as a result of banks' reduced funding needs, the collapse of bonds continued and, as expected, time deposits began a downturn after the strong development recorded in past years. Investments in government securities also reduced, penalised by low returns. Therefore, the context supported a lively trend in asset management instruments. In particular, in 2014 the Italian open-end mutual funds market achieved highly positive net deposits, reaching a new all-time record, and life insurance also saw a considerable acceleration in premiums collected, confirming the positive trend of the previous year.

Competitive positioning

Intesa Sanpaolo is an Italian leader with a European scale: its strength is based on long-term relationships with customers.

Ranking in Italy

1°	Loans	15.0%
1°	Deposits[1]	15.2%
1°	Life Premiums Collected	21.5%
1°	Asset Management[2]	21.5%
1°	Pension Funds	22.0%
1°	Factoring	30.1%

1. Include bonds
2. Mutual funds.

Figures as at 31 December 2014.