Italian Bank Quarterly

After a solid first quarter, banks are well positioned to weather economic headwinds

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The outlook for Italian banks remains favourable. While risks from deteriorating economic conditions persist, their impacts may materialise not before 2026. M&A may reshape the sector, though execution risks are rising.

Sector consolidation credit positive but not without risks. Although we consider consolidation to be credit-positive, competitive and strategic dynamics could result in higher execution risks. Political involvement adds further burden to some deals.

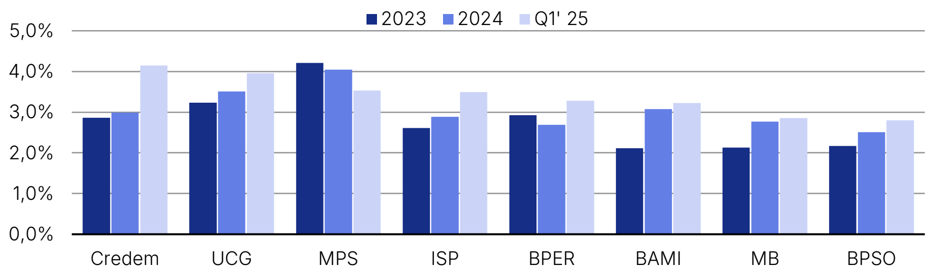
Strong Q1 performance sets positive tone for 2025. Italian banks are among the most profitable financial institutions in Europe supported by relatively high interest margins, efficiency gains and improved asset quality. Q1 results were boosted by unusually high trading income and low cost of risk conditions unlikely to persist, however. A more moderate performance is anticipated driven by declining net interest income amid falling margins and loan losses. Geopolitical tensions, including a potential trade war with the US, pose downside risks through lower economic growth, higher corporate insolvencies, and financial market volatility.

Solid asset quality; minimal deterioration expected in 2025. Adverse economic developments could affect asset quality but likely not before 2026. The average gross NPL ratio stood at the record low of 2.8% at the end of Q1, while quarterly default rates remained subdued at around 1%.

Low solvency and liquidity risks underpinned by accumulated buffers. The first-time application of final Basel III rules had a limited and mixed impact on banks' capital ratios, which continue to be supported by earnings. Despite the full repayment of the ECB's TLTRO III funds and the decline in deposit volumes since 2022, Italian lenders maintain comfortable funding positions.

Public rating Outlooks. Our stable Outlooks on Italian banks - UniCredit (A/Stable), Intesa (A/Stable), Banca Popolare di Sondrio (BBB/Stable) - indicate that risks are broadly balanced in 2025.

Figure 1: Italian banks' annualised return on risk weighted assets*



Source: Company data, SNL, Scope Ratings.
* This is a proxy for capital generation before distribution, although there are certain items that are deducted from capital.
Note: results were not corrected for non-recurring items.

Our expectations of 2025 trends by key area for Italian banks		
Profitability	↘	Moderately lower due to margin erosion
Asset quality	→	Minimal deterioration expected
Capital position	↘	Lower buffers due to distributions and higher requirements
Funding and liquidity	→	Comfortable position as funding pressure remains muted

Amid M&A fever, risk of sub-optimal acquisitions has risen

Italian banking is experiencing a surge in M&A announcements with potential to reshape the sector. Several institutions are involved: UniCredit, Banco BPM, MPS, Mediobanca, BPER, Banca Popolare di Sondrio, and Banca Generali. Intesa, which has ruled out further domestic M&A following its acquisition of UBI in 2020, and the co-operative groups are notable exceptions to the current wave of deal-making.

Mediobanca's voluntary public exchange offer for Banca Generali, the banking arm of Assicurazioni Generali, aims to create a leading wealth management group. Its offer would see the EUR 6.3bn price tag settled entirely in shares that Mediobanca holds in Generali. Strategically, the transaction has clear industry logic, given the similarities between the two franchises.

Mediobanca's move paves the way for the creation of a leading player in wealth management

Both banks focus on the high end of the wealth management market and there are clear synergies with Mediobanca's corporate and investment banking activities. The merged group's business model would be heavily geared toward wealth management, which would account for around 50% of revenues, and the combination would boast more than EUR 170bn in assets under management and custody.

We continue to view in-market consolidation as supportive of banks' credit profiles, by leading to greater economies of scale, increased market power, and improved medium-term financial performance. However, execution risks, such as overpaying for targets or entering into sub-optimal combinations, are rising, particularly as takeover defences, competitive positioning, and market share considerations increasingly influence strategic decisions.

The scale and potential impact of the pending takeovers have drawn the attention and scrutiny of Italian authorities. The government has long expressed a desire to establish a large third banking group to rival Intesa and UniCredit. Its support for a potential MPS–Mediobanca tie-up came as no surprise.

Political interference adds to uncertainty

Conversely, the government has imposed several conditions and exercised its so-called golden power in response to UniCredit's voluntary exchange offer for Banco BPM. Conditions include a rapid exit from Russia, a five-year loan-to-deposit target within the Italian perimeter, and restrictions on rights to sell stakes and manage the assets of asset manager Anima, over which BPM had separately launched a takeover prior to UniCredit's bid for BPM.

We do not expect these conditions to be final, as they are likely to be the subject of negotiations. Additionally, the government may need to seek approval from the European Commission, which will assess whether the 'public interest' rationale on the deal aligns with the general principles of EU law.

The government's actions follow a series of setbacks in UniCredit's acquisition of Banco BPM. These include the requirement to set aside approximately EUR 800m in loan-loss provisions to bring Banco BPM's asset quality in line with UniCredit's, and unfavourable rulings from the EBA and ECB regarding the application of the Danish compromise to the acquisition of Anima by BPM's insurance subsidiary. Given UniCredit's "disciplined approach" to M&A— focusing on risk-adjusted value for shareholders – these hurdles could lead a withdrawal of the offer for BPM. On a recent analyst call, UniCredit's CEO downplayed the importance of M&A, emphasizing that organic growth drivers will sustain performance over the next three to four years.

Should the acquisition fail, Banco BPM could re-emerge as a potential market consolidator. The group recently secured around 90% of the shares in Anima, Italy's largest independent asset manager, to create the second largest national bancassurance group (behind Intesa) with one of the most diversified revenue profiles in the sector.

Another record quarter for Italian banks paves the way for a solid 2025

Our sample of eight Italian banks – Intesa Sanpaolo, UniCredit, Banco BPM, Banca Monte dei Paschi di Siena, BPER Banca, Mediobanca, Credito Emiliano and Banca Popolare di Sondrio – posted record first quarter results, achieving a return on average equity of 15.7%, compared to 14.5% in Q1 2024 and 11.2% in Q4 2024.

Net interest income fell by more than 5% across the board, as falling ECB rates took their toll on margins despite the hedges in place. Once again, BPSO bucked the trend, reporting YoY growth in net interest income on the back of higher loan volumes (c. +7%). The three banks subject to takeover offers – Banco BPM, Mediobanca, and BPSO – reported the highest loan expansion mainly driven by the corporate segment in Q1.

Several factors backed banks performance, more than compensating for the decline in net interest income:

1) Fee and commission income grew by 7.5% YoY on average, reflecting banks' efforts to boost activities that generate non-interest revenue. Net inflows of assets under management amounted to almost EUR 8bn (vs negative EUR 4.5bn in Q1 2024[1]). For Mediobanca, BPSO, UniCredit and BPER, fee expansion more than offset the decline in the net interest income (Figure 2).

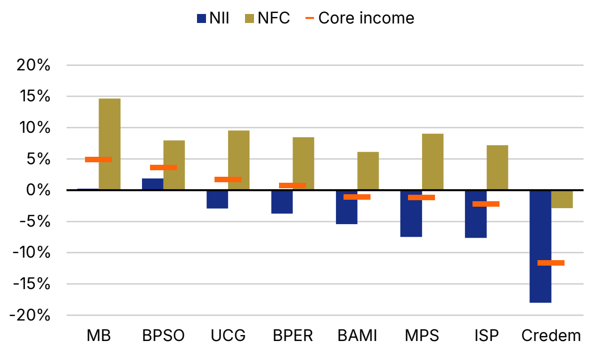
2) While some banks recorded strong trading income, both client and treasury-driven, we do not expect this to be repeated in coming quarters.

3) Costs rose by roughly 1% for our sample of banks due to business growth, IT investments, and new labour contracts. However, banks no longer had to book charges to finance the Interbank Deposit Protection Fund, which reached its legal target level of 0.8% of member banks' covered deposits in July 2024.

4) The average cost of risk reached a new low of 26bp, a decrease of 7bp compared to Q1 2024. Contained default rates, stronger balance sheets, and management overlays accumulated in previous years provide key support for banks' provisioning.

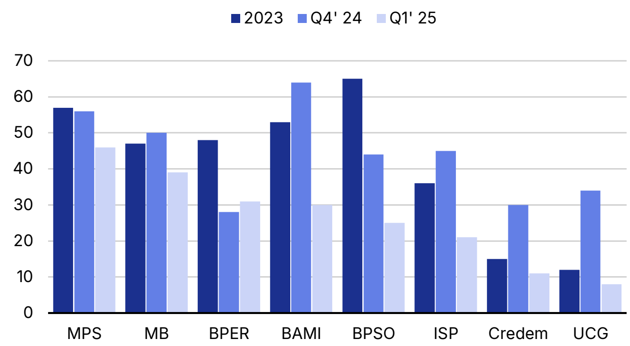
   Alongside Credem, which has historically had superior asset quality, UniCredit now stands out thanks to its low cost of risk, which is down to its focus on large corporates and strong presence in Germany and Austria. The group has guided for a cost of risk in line with the 2024 level of around 15bp for 2025.

Figure 2: Core revenues, YoY quarterly comparison*



*Q1 2025 vs Q1 2024
Source: Company data, Scope Ratings

Figure 3: Cost of risk (bp)



Source: Company data, Scope Ratings

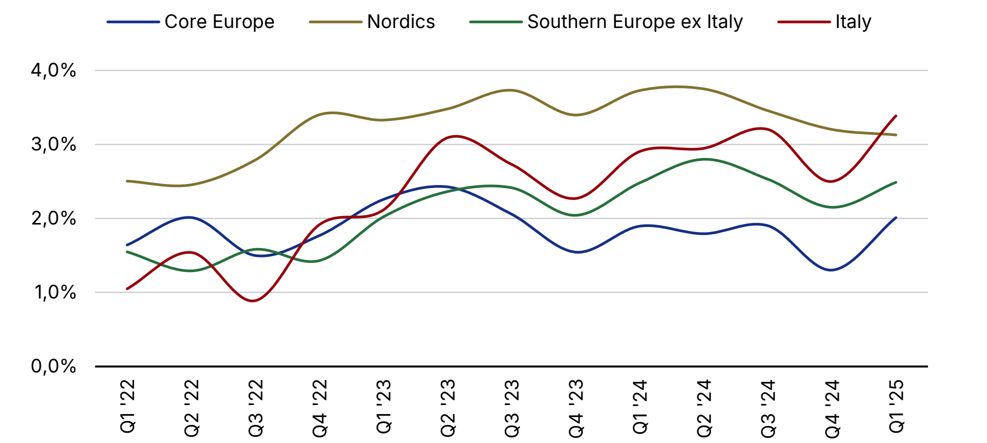
[1] Source: Assogestioni

Political interference adds to uncertainty

Following their long streak of rising quarterly results, Italian bank Q1 profitability outperformed European peers (Figure 4). Although net interest income is declining, margins in Italy remain significantly higher than in most other European countries, notably Germany and France. This is partly motivated by the greater proportion of retail, stable and ultimately cheap deposits in Italian banks' funding structures. Furthermore, Italian lenders' cost efficiencies have improved considerably through digital investment and the downsizing of physical branch networks and headcount. Improvements in credit risk management and the sale of non-performing loans (NPLs) has led to a significant reduction in loan loss provisions, as has Italy's favourable economic performance since the pandemic.

Italian banks remain strongly committed to increasing non-interest income and making their business models more resilient to interest-rate cycles. Most strategies are targeting the large amount of unmanaged financial wealth held by Italian households through bancassurance and wealth management solutions for all income brackets. As the trend in fee and commission income shows, these strategies are paying off.

Figure 4: Annualised quarterly return on risk weighted assets, international peer comparison



Note: "Italy" refers to the median for the eight sampled banks. The other peer groups comprise the largest listed banks from Spain, Greece and Portugal (Southern Europe ex Italy); UK, Switzerland, France, Germany, Austria, Belgium and the Netherlands (Core Europe) and; Norway, Sweden, Finland, and Denmark (Nordics).
Source: SNL, Scope Ratings

We expect softer quarters ahead

The first quarter of 2025 set the foundations for another strong year even if we anticipate lower profits in upcoming quarters, given that Q1 was exceptionally strong, particularly with regard to trading income and cost of risk.

Net interest income will continue to fall as the ECB cuts rates to below 2%. We also caution that rates could be lower than those currently forecast by the market, if macro uncertainties persist amid geopolitical tensions and trade wars.

Financial market volatility has boosted the trading activity of the large banks' clients, in turn supporting revenues. Stock markets have now recovered from the shock that followed the announcement of US tariffs. Nevertheless, we continue to highlight the risk of a more severe and persistent market correction, which could negatively impact banks' trading profits and, more importantly, sales of wealth management products.

While loan performance has remained solid so far, we project a normalisation in banks' cost of risk over the next few quarters. A worsening economic outlook in 2026 could force some banks to increase loan-loss coverage.

Strengthened balance sheets amid geopolitical uncertainty

The average gross non-performing loan ratio remained stable at 2.8%, unchanged quarter-on-quarter. The loan default rate was below 1% for the banks that reported the data.

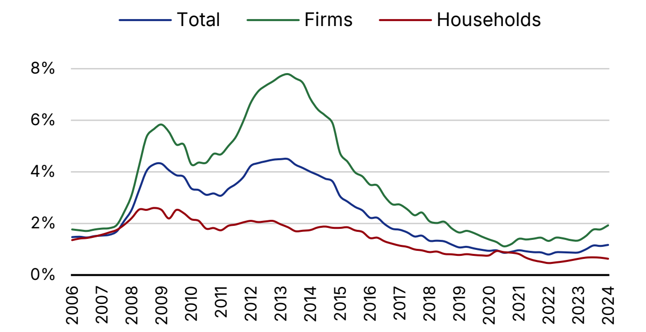
After spiking during the pandemic, the average Stage 2 loan ratio has continued to decline. Most were moved back to Stage 1. The Stage 2 ratio now stands at 8.7% for our sample of Italian banks. This primarily reflects the resilience of the Italian economy, particularly households, evidenced by robust employment data. System-level data shows that the loan delinquency rate for non-financial companies started to increase in 2024, although it remained close to record lows for households (Figure 5).

Trade war with the US a tangible concern for asset quality

For 2025, we expect limited asset-quality deterioration, medium term risk are rising. If implemented, US tariffs could directly impact on the growth outlook and this will negatively affect the banks' clients. As we recently stated (see Trade wars likely to weigh on European banks' asset quality), we expect the primary driver of asset-quality deterioration to emerge on the corporate side, which may deteriorate more quickly than anticipated as EU exporters face material pressure as they adapt to a new environment of higher trade barriers. While the Italian banking sector is highly geared towards corporate lending, second-round effects could spread to other credit segments.

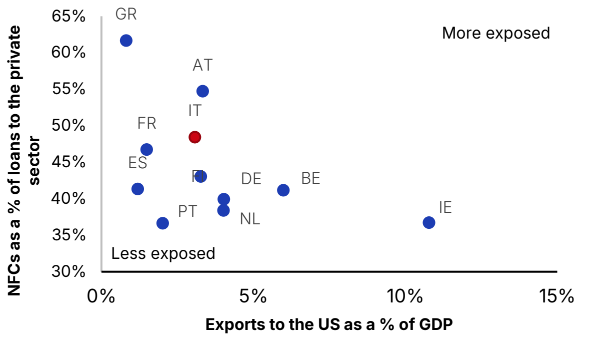
The US is Italy's second largest export market, representing more than 10% of total exports and around 3% of GDP in 2024. Tariffs announced to-date would impact the economy unevenly, at least initially, with food and beverage, automotive, pharmaceuticals and industrial machinery among the most affected sectors. Small and medium-sized enterprises could be more severely affected given the limited resources at their disposal to change business strategies. Lenders with a skew towards SME loans (i.e. mainly small, regional players) would suffer the most in a scenario of a trade war with the US.

Figure 5: Annualised quarterly flows of NPLs in relation to the stock of performing loans



Note: Firms exclude producer households.
Source: Bank of Italy, Central Credit Register, Macrobond, Scope Ratings

Figure 6: Vulnerability to the US tariffs, if confirmed after the 90-day pause



Note: Firms exclude producer households.
Source: Bank of Italy, Central Credit Register, Scope Ratings

Limited impact from Basel III finalization as capital buffers remain comfortable

Record results and careful capital allocation strategies will allow banks to maintain high pay-out ratios and absorb headwinds from new regulations. As of March 2025, the eight banks in our sample reported an average CET1 ratio of 15.6%, 10bp higher than December 2024 and just 30bp lower than the peak reached in Q3 2024.

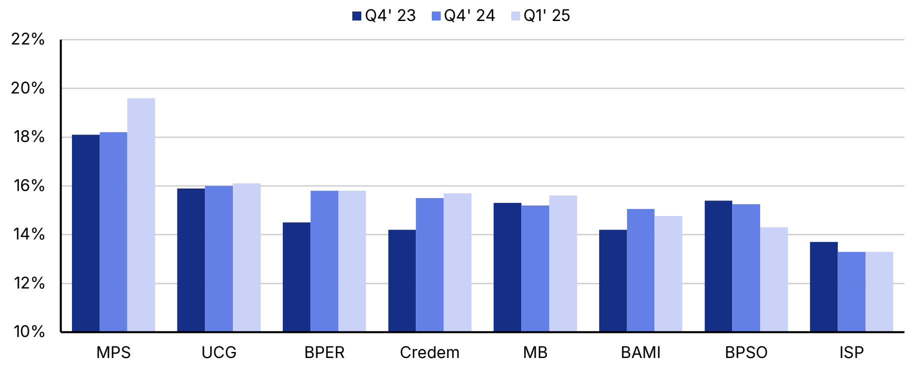
The first phase of the implementation of the final Basel III standards had a mixed impact on banks' capital ratios, ranging from an estimated positive of 100bp for MPS to a negative 60bp for BPSO.

The robust solvency of Italian banks provides an important buffer against unexpected credit deterioration at a time when unpredictable US trade policy is impacting Europe's growth and interest-rate outlook. The average CET1 buffer calculated on the end-June requirements[2] stands at a comfortable 6.3%.

Capital ratios unlikely to come down in the short term

Despite banks' generous pay-out ratios and lively M&A activity, we do not expect banks capitalisation to decline significantly in the short term. This takes into account low pressure to reduce equity to boost shareholder returns at a time of very high profitability, the supervisor's cautious stance and the uncertainties that persist at an economic level.

Figure 7: CET1 ratios



Source: Company Data, Scope Ratings

Strong liquidity position despite changes in the funding mix

The rapid change in the interest rate environment in the past three years, together with the end of the TLTRO III programme, led to important shifts in the balance sheet structure of Italian banks, though impacts on funding and liquidity ratios have been limited. Partly supporting banks' funding has been low loan demand due to high interest rates, low GDP growth and ample business liquidity accumulated during the pandemic.

Deposits have contracted due to competition from Italian sovereign bonds and other higher-yielding assets. As of March 2025, deposits were some EUR 60bn below the peak reached in 2022. The recourse to term deposits partly mitigated outflows from current accounts. However, fixed-maturity deposits have not grown since January 2024, an indication of low competition among banks since the end of the monetary tightening cycle.

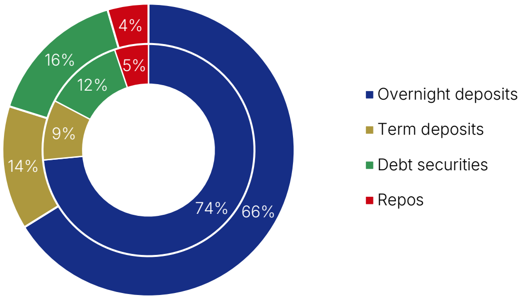
MREL-driven issuance activity

Bond issuance has materially increased over the past three years, particularly during the favourable window between H1 2023 and H1 2024 (Figure 9). Most unsecured bond issuance by Italian banks was driven by the need to meet MREL requirements. Issuance cooled in Q1 as banks brought forward most of their annual funding plans in 2024.

[2] When the 1% systemic risk buffers on Italian credit and counterparty risk exposures is fully implemented.

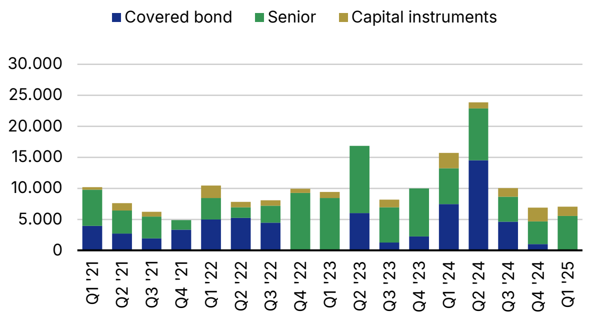
The average Liquidity Coverage Ratio and Net Stable Funding Ratio of the eight banks in our sample were c. 156% and 127% respectively at the end of Q1, well above requirements.

Figure 8: Italian banking sector – Customer funding breakdown (inner circle: July '22 – Outer circle: March '25)



Source: Bank of Italy, Macrobond, Scope Ratings

Figure 9: Quarterly debt issuance, historical (EUR m)



Note: Issuance activity of all the Italian banks, excluding international subsidiaries. Only above EUR 300m ticket and issues predominantly in EUR, USD, and GBP.
Source: Capital IQ, Scope Ratings

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