Italy Banks in Bad-Loan Spiral Underline Southern Europe Malaise

2013-07-31 22:01:00.3 GMT

By Sonia Sirletti and Francesca Cinelli

Aug. 1 (Bloomberg) -- Italian banks are more reluctant to lend as a recession saddles them with mounting bad debt, highlighting a growing malaise in southern Europe's finance industry.

Growing non-performing loans may mean second-quarter profit at Intesa Sanpaolo SpA, Italy's second-biggest bank, slides to 189 million euros ($250 million) from 470 million euros a year ago when it reports tomorrow, according to the average estimate of four analysts surveyed by Bloomberg. Bailed-out Banca Monte dei Paschi di Siena SpA is expected to announce its fifth-straight quarterly loss next week.

Intesa is among banks in southern Europe reporting a drop in earnings. At the heart of the problem is a debt crisis that ravaged the region's finances, forcing firms to sell assets and pare back lending to stay afloat. Standard & Poor's cut the ratings of 18 Italian banks last week, saying the economic recession will be longer than expected. Increasing non-performing loans may hurt credit ratings in Spain, Moody's Investors Service said last week.

"The spiral of less lending and higher bad-loans is deepening and still needs time to be broken," Jacopo Ceccatelli, a London-based partner at financial advisory firm JC & Associati SIM, said in a telephone interview. "Until the economy starts to recover and banks complete their balance-sheet clean-up, I expect profitability will remain well below pre-crisis levels."

Lending Struggle

Italy is immersed in its longest recession in more than 20 years as businesses and households struggle to repay debt and find new credit lines. Finance Minister Fabrizio Saccomanni said two weeks ago that banks aren't lending enough to help boost a recovery. In France, President Francois Hollande's government is calling for more lending to help end the recession, while in Spain, which sought a bailout for its banking system last year, Economy Minister Luis de Guindos said banks should justify decisions to cut financing to companies.

BNP Paribas SA, France's biggest bank, said yesterday that second-quarter profit fell 4.7 percent to 1.76 billion euros, hurt by an increase in loan loss provisions in Italy.

Non-performing loans surged 22 percent in May from the same month of 2012 to 135.5 billion euros, according to the Italian

Banking Association. Lending by Italian banks to the private sector dropped 3.3 percent in June from a year ago to 1.6 trillion euros, the association said in a report last month.
Banks were more reluctant to lend in the second quarter because of the unfavorable prospects for economic activity and higher credit risk, the Bank of Italy said last week.

Stricter Rules

Higher capital requirements are also forcing banks in Italy and elsewhere to reduce risk, pare lending and set aside more money to cover risky loans. The Spanish government should make banks bolster their capital by issuing stock and curbing dividends, the International Monetary Fund said last month.
Regulators are now looking at leverage in addition to capital measures based on risk weightings, to ensure a banking collapse that followed the 2008 financial crisis isn't repeated.
"We are moving away from the rules of capitalism to comply with regulators, and this is penalizing commercial banks such as Italian banks in particular," Carlo Alberto Carnevale Maffe, professor of business strategy at Milan's Bocconi University, said in an interview. "Balance sheets are under a form of automatic 'budget sequester' which is dramatically reducing their room for maneuver."
The European Central Bank, taking over supervision of the banking industry next year from national regulators, will conduct an "asset quality review" that may lead to further writedowns and capital raising.

'Forced Actions'

The Bank of Italy extended asset quality inspections started last year on eight of 20 banks to take a closer look at their books as the recession drives up bad loans, it said earlier this week.
The Italian central bank says lenders must boost capital by selling non-strategic assets, curbing operating costs, dividends and executive pay. In the fourth quarter the bank regulator forced them to set aside additional provisions after coverage ratios declined compared to previous years.
"Reductions in collateral values and discussions of a European banking union are likely to cause further forced actions," Alberto Cordara, an analyst at Bank of America Merrill Lynch in London, wrote in an e-mailed report to clients last month.

'Deeper Recession'

Standard & Poor’s downgraded 18 Italian banks a week ago, including Banco Popolare SC and Unione di Banche Italiane SCPA, citing rising economic risk.

Italian banks “are now more exposed to a deeper and longer recession than we had previously anticipated,” the New York-based ratings company said in a statement. S&P didn’t cut UniCredit SpA and Intesa Sanpaolo SpA, the country’s two biggest lenders, which had their ratings confirmed.

S&P cut the country’s credit rating to BBB+, two steps from junk, on July 10 because of the weakening economy and an impaired financial system.

Banks in Italy also tend to invest cash in sovereign debt rather than lend to industry. The lenders, which borrowed more than 255 billion euros from the ECB’s longer-term refinancing operations during the financial crisis, increased their holdings of Italian sovereign debt by 31 percent in the 12 months ending May to 395 billion euros.

Last month, the IMF cut this year’s growth outlook for the country, saying gross domestic product will shrink 1.8 percent, compared with its April forecast of 1.5 percent.

Gross non-performing loans as a proportion of total lending across the industry increased to 6.9 percent in June from 5.6 percent a year earlier, according to data published by the Italian Banking Association. That’s the highest level since 2000 and up from 3 percent in June 2008.

Mixed Results

A one-time gain of 258 million euros from a bond buyback means UniCredit may post second-quarter profit of 349 million euros when it reports on Aug. 6 compared with 169 million euros a year earlier, according to the average of 21 analysts surveyed by the bank.

Deutsche Bank AG and Keefe, Bruyette & Woods are among brokerages that have cut their forecasts for 2013 earnings of Italian banks. Deutsche Bank lowered its earnings-per-share estimates for this year by an average 10 percent to factor in lower income from lending, it said on July 17.

Analysts have reduced 2013 median earnings-per-share estimates for Italy’s 13 biggest banks by 39 percent on average since the beginning of this year, according to data compiled by Bloomberg.

Spain Troubles

In Spain, the impact of bad loans on banks’ balance sheets is persisting. Non-performing loans as a percentage of total loans climbed to 11.2 percent in May and lending shrank an

annual 13 percent.
Banco Popular Espanol SA said profit in the second quarter fell to 66.1 million euros from 75.4 million euros a year earlier as lending slid 4.5 percent. CaixaBank saw second-quarter profit slide to 73 million euros from 118 million euros on charges for covering refinanced loans.
"I'm still waiting for more evidence of an inflection point or real change of trend in Spain," Neil Smith, an analyst at Bankhaus Lampe in Bielefeld, Germany, said in a phone interview. "There are still too many uncertainties."
De Guindos said last week that the government must continue to overhaul the fourth-largest economy in the euro region to consolidate a "fragile" recovery. Four years of budget cuts have sapped domestic demand, hindering an exit from a slump triggered in 2008 by the end of a real-estate boom that lasted over a decade.
Second-quarter profit at Banco Santander SA, Spain's biggest bank, climbed to 1.05 billion euros after charges of 1.3 billion euros on its real estate portfolio weren't repeated. Bad loans as a proportion of total lending rose to 5.18 percent from 4.76 percent in March as it booked 2 billion euros of loans as "doubtful" to comply with new Bank of Spain rules, Santander said two days ago.

For Related News and Information:
Italy Bad Loans Seen Rising to Mid-2014, ABI's Sabatini Says
NSN MNO0KD6JIJV0 <GO>
Saccomanni Says Italy Considering Steps to Revive Lending
NSN MQ672I6S9728 <GO>
Italy's Economic Recovery Still Faces Headwinds, IMF Review Says
NSN MPF4C06TTDSP <GO>

Top News: TOP <GO>
News on UniCredit: UCG IM <Equity> CN <GO>
News on Intesa: ISP IM <Equity> CN <GO>
World Bond Prices: WBX <GO>

-- With assistance from Dan Liefgreen and Jerrold Colten in Milan, Chiara Vasarri in Rome, Charles Penty in Madrid. Editors: Mark Bentley, Dylan Griffiths

To contact the reporters on this story:
Sonia Sirletti in Milan at +39-02-8064-4206 or
ssirletti@bloomberg.net
Francesca Cinelli in Milan at +39-02-80644-252 or
fcinelli@bloomberg.net

To contact the editor responsible for this story:

Frank Connelly at +33-1-5365-5063 or
fconnelly@bloomberg.net