Global media release

OVERVIEW

- On Oct. 26, 2018, S&P Global Ratings revised to negative from stable its outlook on the 'BBB/A-2' long- and short-term ratings on the Republic of Italy following the government's planned budgetary policy deviation and the related drag on the country's already weak budgetary position and economic prospects.
- Prolonged turmoil in the capital markets due to concerns about sovereign creditworthiness could impair the banks' funding profiles, potentially hiking up their cost of financing and thus reducing their profitability.

MILAN (S&P Global Ratings) Oct. 30, 2018--S&P Global Ratings said today that it took the following rating actions:

- Affirmed the long- and short-term issuer credit ratings on Istituto Credito Sportivo (Credito Sportivo; BBB-/A-3).

The outlook on Credito Sportivo remains stable. We believe that the recent spike of volatility due to increased concerns about the Italian Sovereign's creditworthiness could, in the longer term, constrain Italian banks' access to wholesale, affordable funding. Therefore, we anticipate that if market pressure were to rise further and for a prolonged period, this could erode the banks' already modest profitability and their funding profiles. Consequently, we have revised to negative the trend for our assessment of Italian banks' industry risk, under our Banking Industry Country Risk Assessment.

In this context, we acknowledge that the abundant liquidity provided to Italian banks by the European Central Bank (ECB) over the years, and the banking sector's very low external position--just 5% excluding ECB funding--have so far largely cushioned the effect of recent market turbulence on the banks' funding profiles.

This is also because in the past couple of years, Italian banks have taken advantage of the ECB's second series of targeted longer-term refinancing operations (TLTRO II) to contain their funding costs. Most banks have increased their reliance on this cheaper and more stable source of funding. As of June 2018, Italian banks' exposure to the ECB amounted to €250 billion, the highest in Europe.

In our view, however, banks will likely have to adjust their funding strategy in the following few months. Since TLTRO II loans have maturities of four years (mostly expiring in 2020 and 2021), Italian banks will need to gradually replace them with other funding sourcesm, or apply for other shorter-term ECB liquidity facilities. Alternatively, they may have to cut their exposure to government bonds, although the ECB might implement measures to cushion the effect of maturing TLTRO II loans.

While we consider Italian banks' external refinancing needs to be relatively contained, we expect systemically important institutions in Italy to be asked to comply with the new minimum requirements for own funds and eligible liabilities (MREL) over the next couple of years. MREL comprise not only senior unsecured debt, but also more expensive forms of subordinated debt. This could be a very costly exercise for Italian banks if difficult market conditions persist.

Furthermore, the government's policy reversal puts at risk the path of government debt in GDP terms, particularly because it may undermine Italy's ongoing economic recovery. Investor confidence is being eroded this year; external financial conditions have deteriorated in particular since late May and this deterioration will likely adversely affect economic agents, in our view.

We now project that real GDP will grow by about 1.1% this year and next, supported by domestic demand. We previously forecast 1.4% for the same period.

Stronger economic recovery in past quarters in Italy has spurred on Italian banks to reduce their stock of nonperforming exposures (NPEs), helped by a more developed secondary market for those assets. The overall gross stock of NPEs fell to €221 billion as of June, around 12.5% of customer loans compared with €340 billion in 2015, mainly thanks to disposals. If the economy progresses as we think, we anticipate the improving trend to continue, with the stock of NPEs falling below 10% in 2020. While this represents material progress, this stock would still represent a tail-risk if the Italian economy deteriorates materially. Partially cushioning this risk, we believe banks have considerably improved their underwriting standards in recent years and private sector creditworthiness, particularly that of corporations, has steadily progressed since the peak of the recession.

Thus, despite our now reduced economic growth forecast for Italy and the market turbulence weighing on the banking sector since May, we have affirmed our ratings on the bank. This action reflects both that the bank has been progressing remarkably in improving asset quality since 2016, and that the sharp increase in Italy’s sovereign borrowing cost has, in our view, not yet significantly affected economic activity.

Credito Sportivo

The stable outlook on Credito Sportivo factors in our view that the bank will preserve its very strong capital base over the next 18-24 months on the back of contained loan growth and stable organic capital generation, while making constant progresses in improving its asset quality.

We could lower the ratings if we perceived a diminished commitment from the Italian government toward Credito Sportivo, possibly reflected in a request of capital reduction, or lower funding or business support. We could also consider a downgrade if the workout of Credito Sportivo's stock of NPEs did not proceed in line with our expectations, with a projected NPE ratio below 13% by end-2020, from about 16.8% as of September 2018.

Alternatively, and providing that we revise the sovereign outlook to stable, we could consider raising the ratings if we observed a material reduction in ICS' NPE ratio to a level comparable with the domestic average, which we estimate at approximately 10% by year-end 2020. In addition to the NPE reduction, a positive action would also stem from the bank's ability to materially diminish the existing single-name concentration in its loan book, while other factors underpinning the bank's creditworthiness remain unchanged.