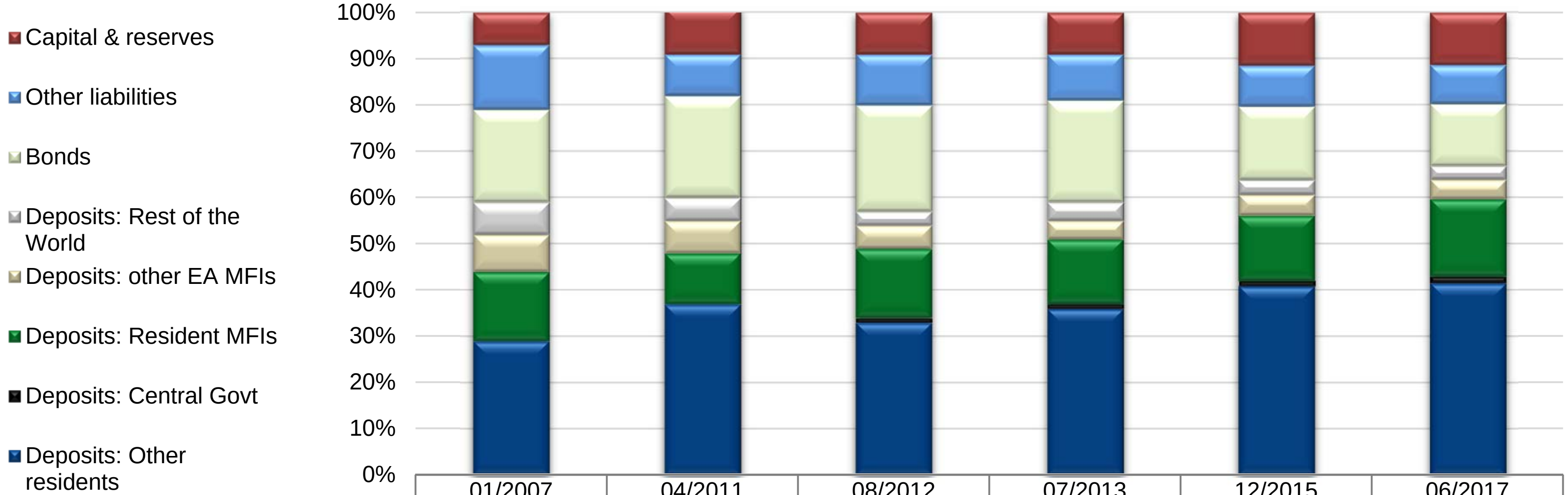
Excess Liquidity: drivers and costs
An Italian Perspective

ECB MMCG
Frankfurt, 26 September 2017

The main drivers of the excess cash (1)

The liability side of resident banks' balance sheets is still changing (< bonds and RoW; >direct depos and domestic)



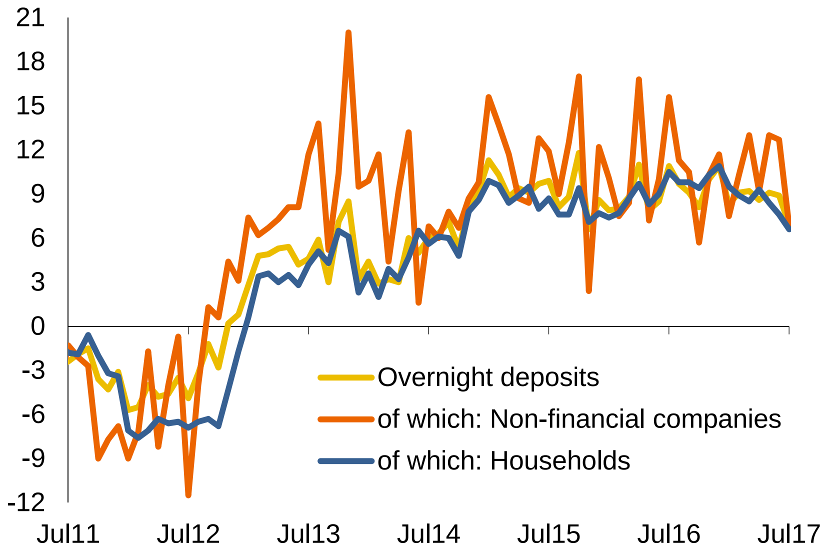
	01/2007	04/2011	08/2012	07/2013	12/2015	06/2017
Capital & reserves	7%	10%	9%	9%	11%	11%
Other liabilities	14%	9%	11%	10%	9%	8%
Bonds	20%	22%	23%	22%	16%	13%
Deposits: Rest of the World	7%	5%	3%	4%	3%	3%
Deposits: other EA MFIs	8%	7%	5%	4%	4%	4%
Deposits: Resident MFIs	15%	11%	15%	14%	14%	17%
Deposits: Central Govt	0%	0%	1%	1%	1%	1%
Deposits: Other residents	29%	37%	33%	36%	41%	42%

Source: ECB, Bloomberg, Intesa Sanpaolo.

The main drivers of the excess cash (2)

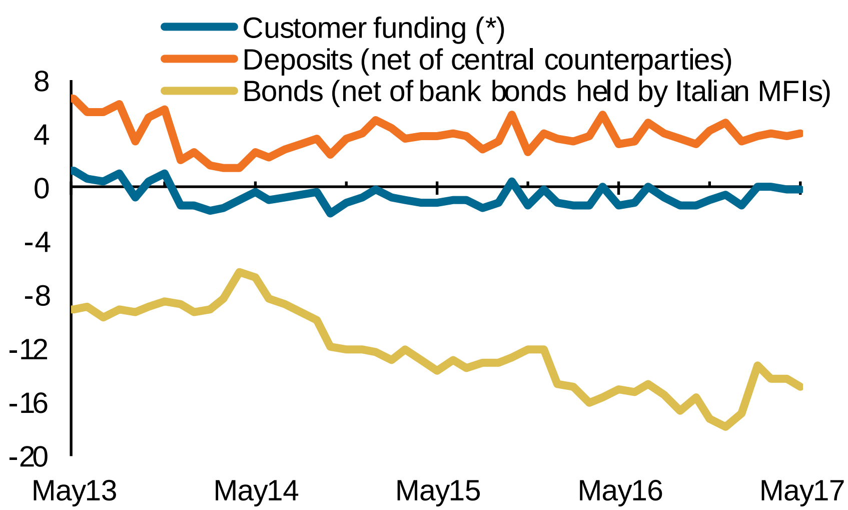
Household deposits are stabilizing, against the backdrop of more relaxed liquidity conditions

Overnight deposits (yoy % change)



Note: data referred to the liabilities of Italian MFIs towards Euro zone residents.
Source: ECB.

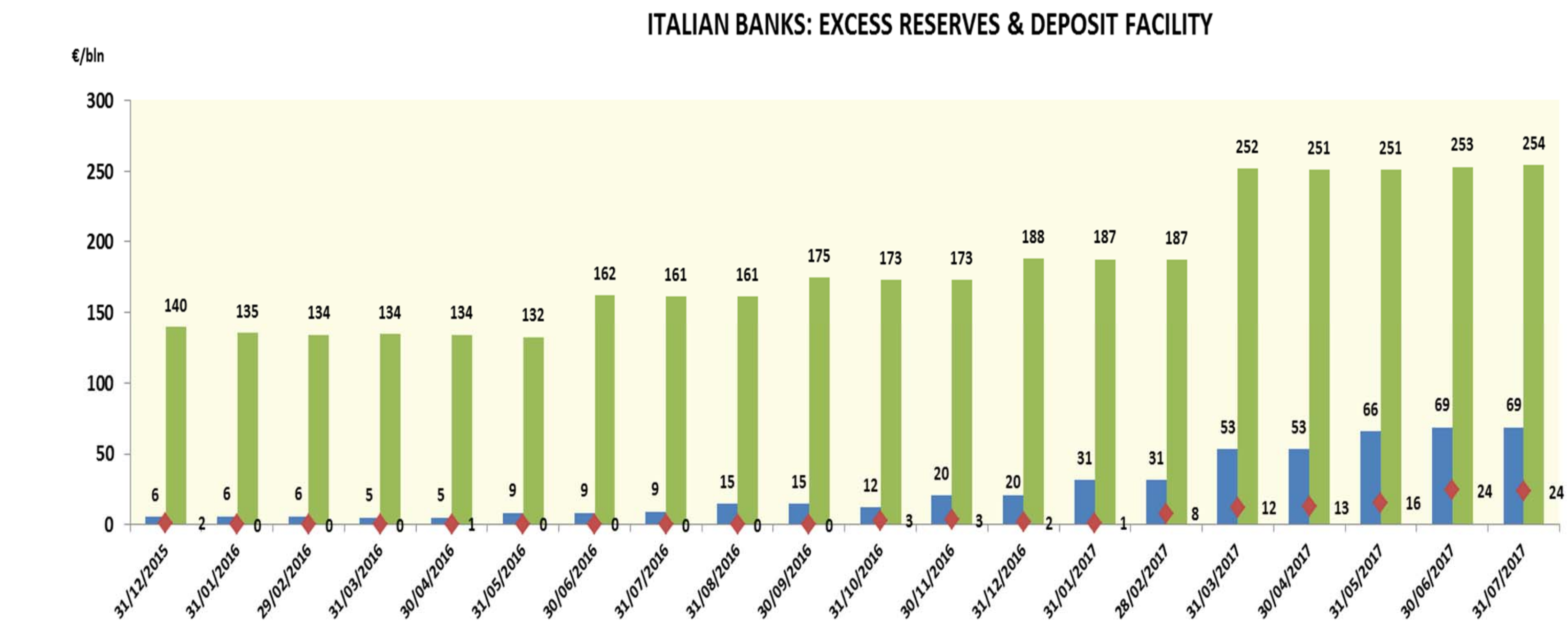
Customer funding at Italian banks (yoy % change) (*)



Note: excluding deposits with central counterparties and bonds purchased by Italian MFIs. Deposits and total funding exclude liabilities related to loans sold and not cancelled.
Source: Bank of Italy, Intesa Sanpaolo.

The main drivers of the excess cash (3)

TLTROs: a still cheap liability , in the process of being deployed

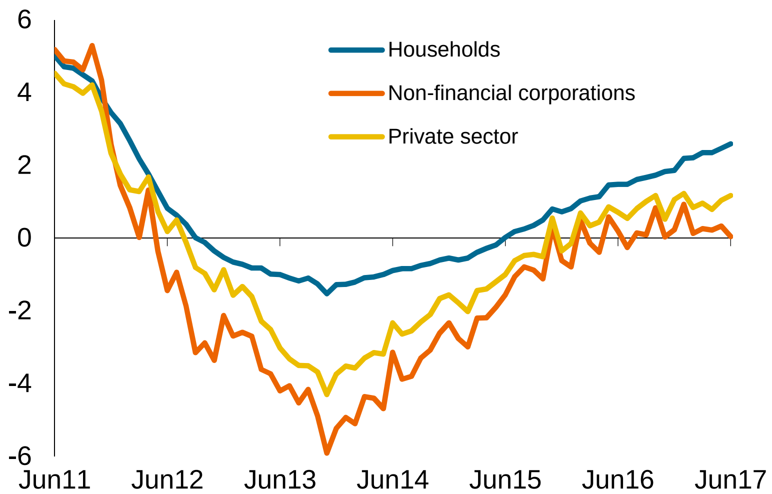


Source: Bank of Italy, Intesa Sanpaolo

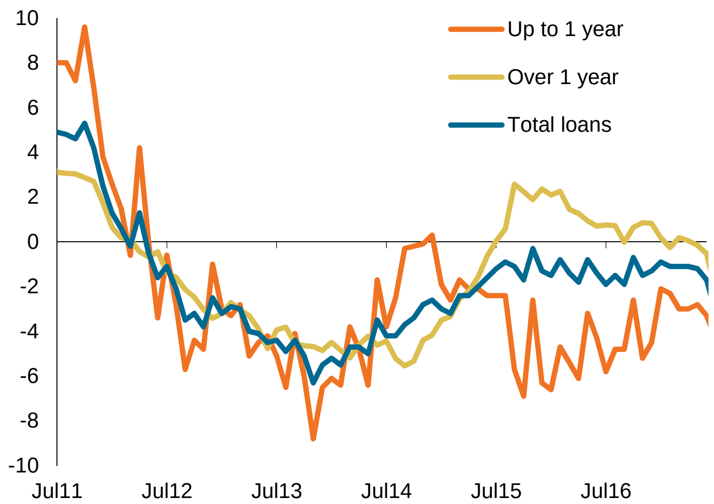
The main drivers of the excess cash (4)

A clear uptrend for households
A blurred picture for NFCs

Loans to the private sector resident in Italy (Data adjusted for securitisations and net of central counterparties, yoy % change)



Loans to non-financial businesses by duration (Data referring to Italian bank customers residing in the Euro area, yoy % change)

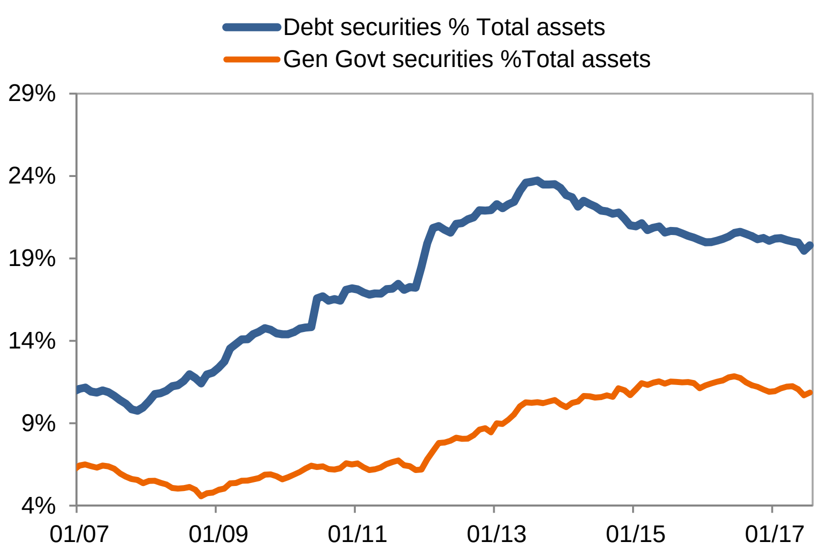


Source: ECB, Bloomberg, Intesa Sanpaolo.

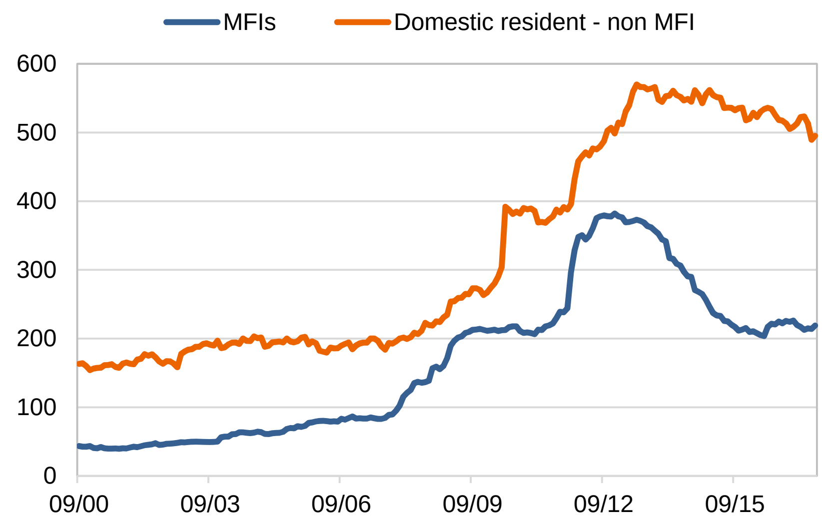
The search for safe and remunerative alternatives…a mission impossible ? (1)

The somewhat bumpy but steady road towards lower domestic debt holdings.

Italian MFIs: holdings of debt securities (% of assets)



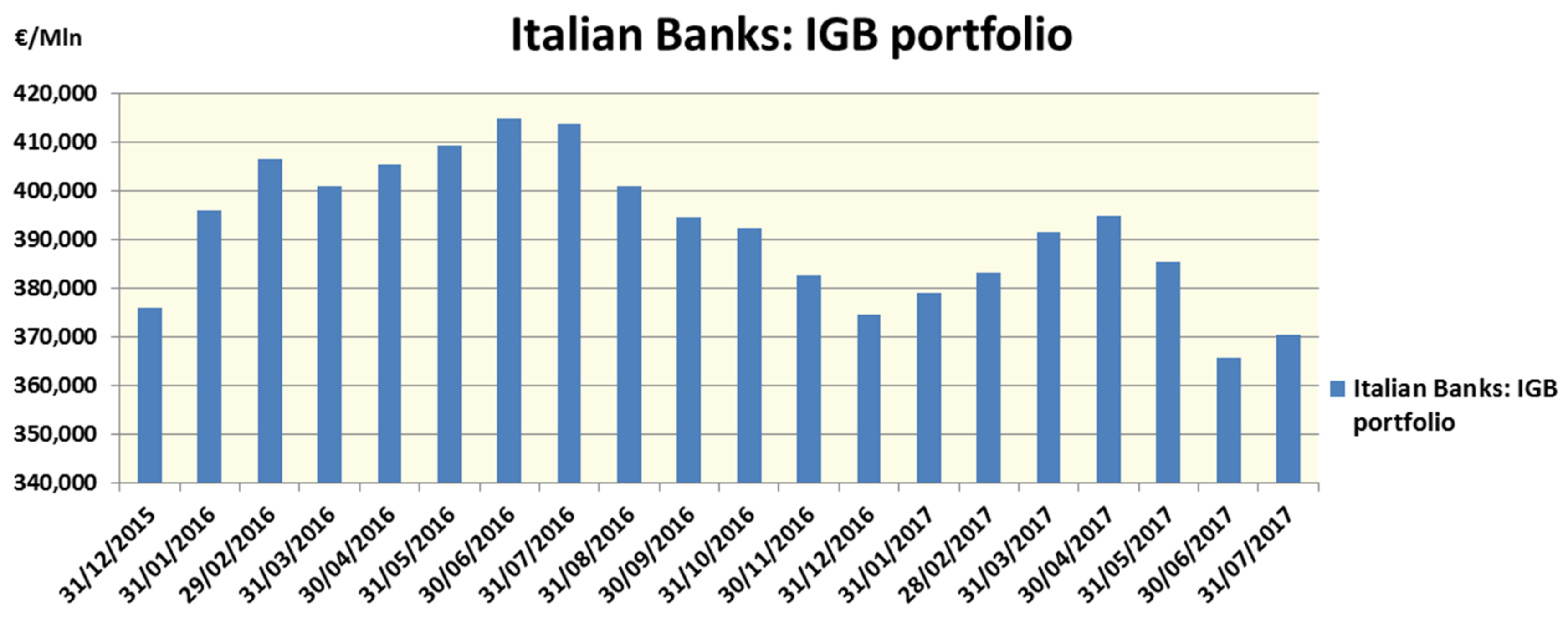
Italian MFIs: holdings of debt securities issued by domestic residents (EUR billion)



Source: ECB, Bloomberg, Intesa Sanpaolo.

The search for safe and remunerative alternatives…a mission impossible ? (2)

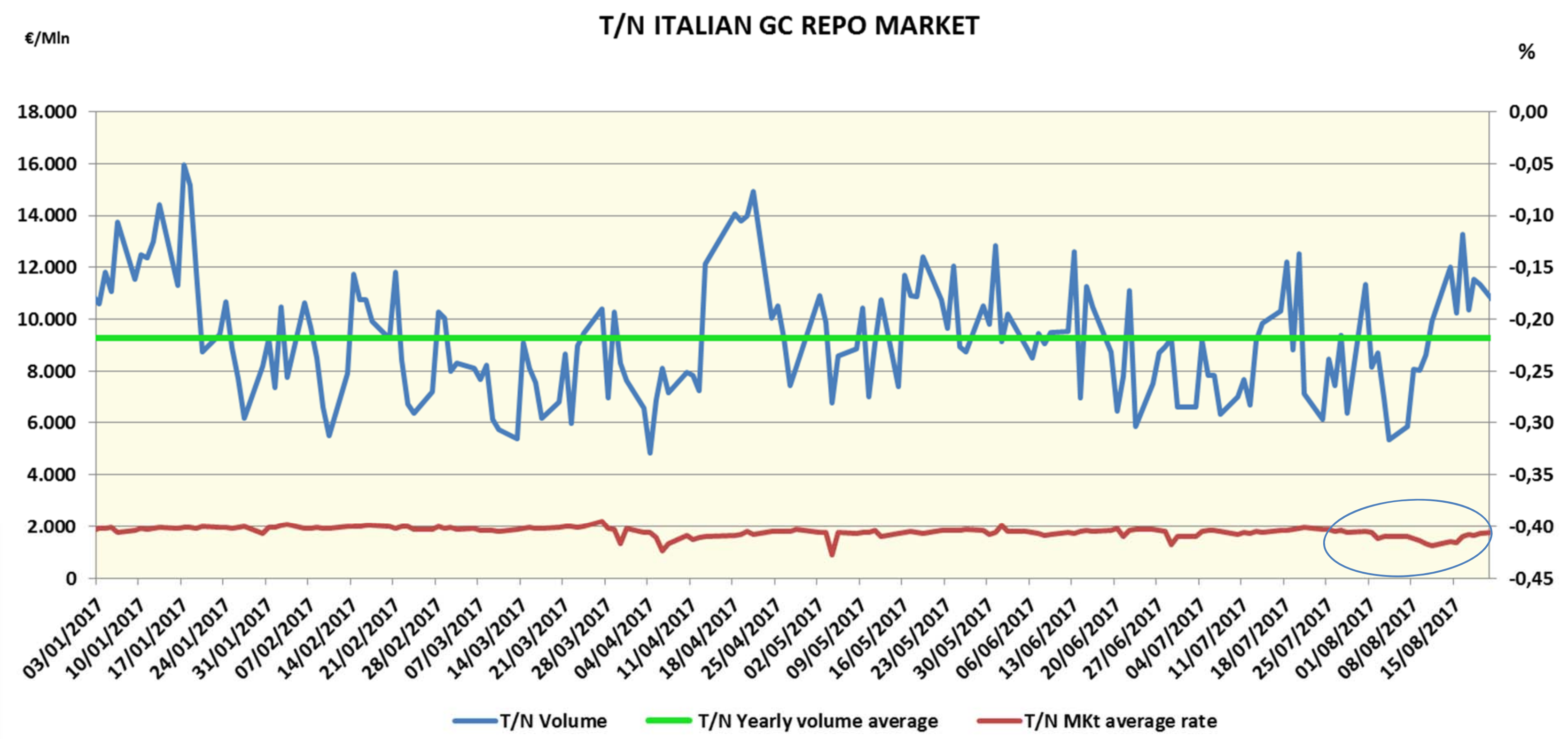
The somewhat bumpy but steady road towards lower domestic debt holdings.



Source: Bank of Italy statistic bulletin- Banche e Moneta- July 17

Safer, shorter but finally «giving in» to below the DF rate..

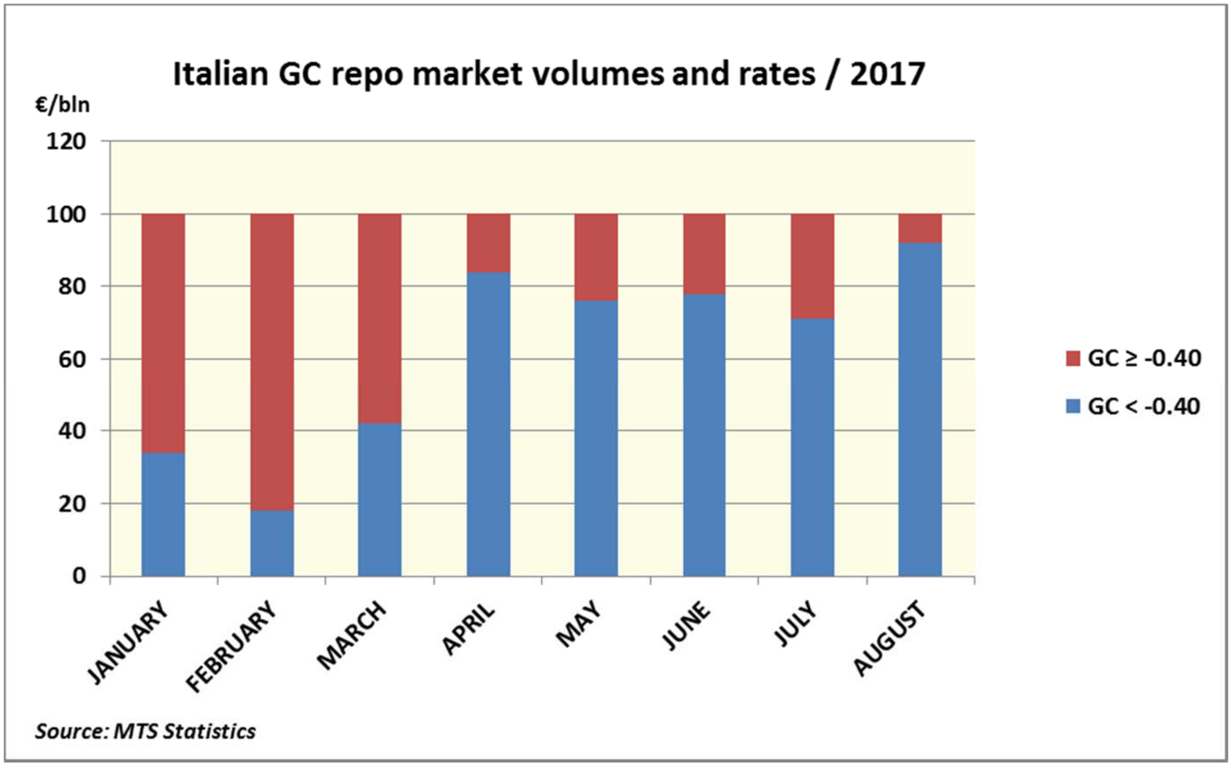
The evolution of MTS GC market



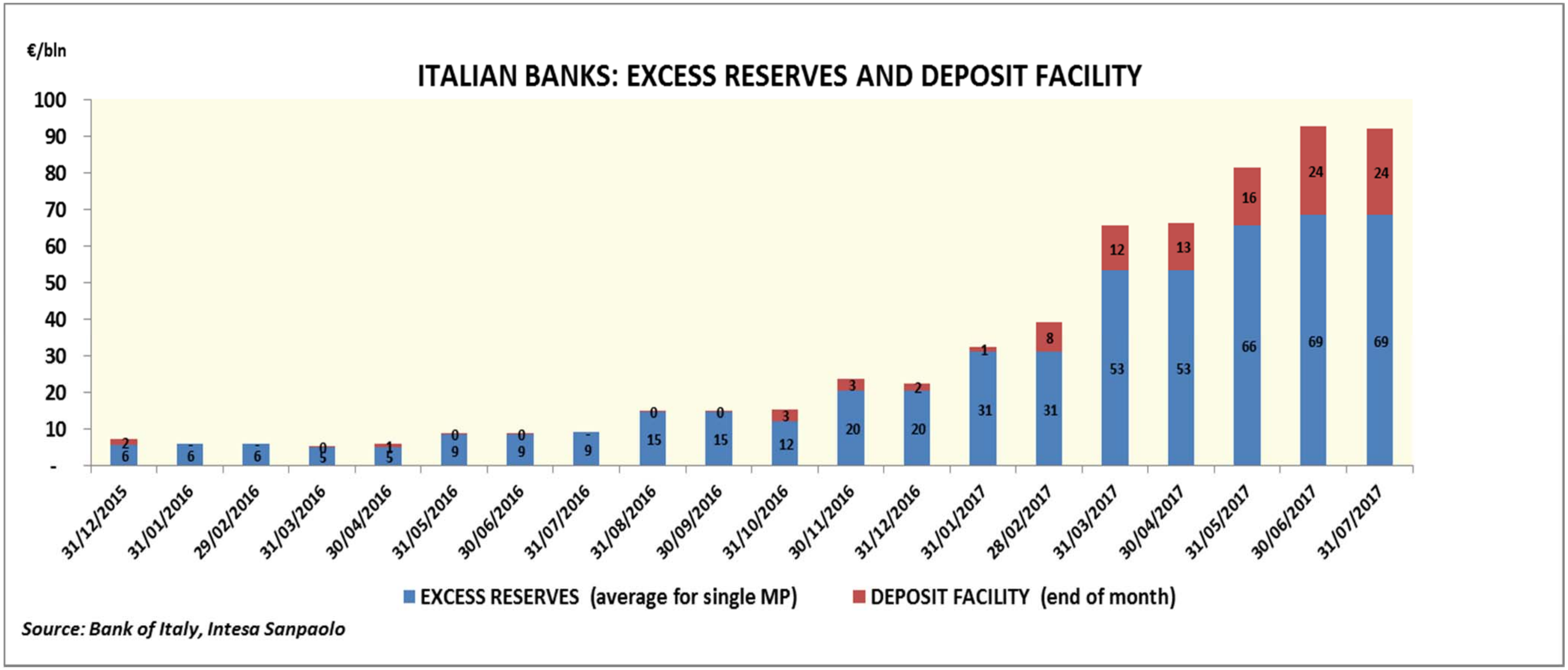
Source: MTS Statistics

Safer, shorter but finally «giving in» to below the DF rate..

The evolution of MTS GC market

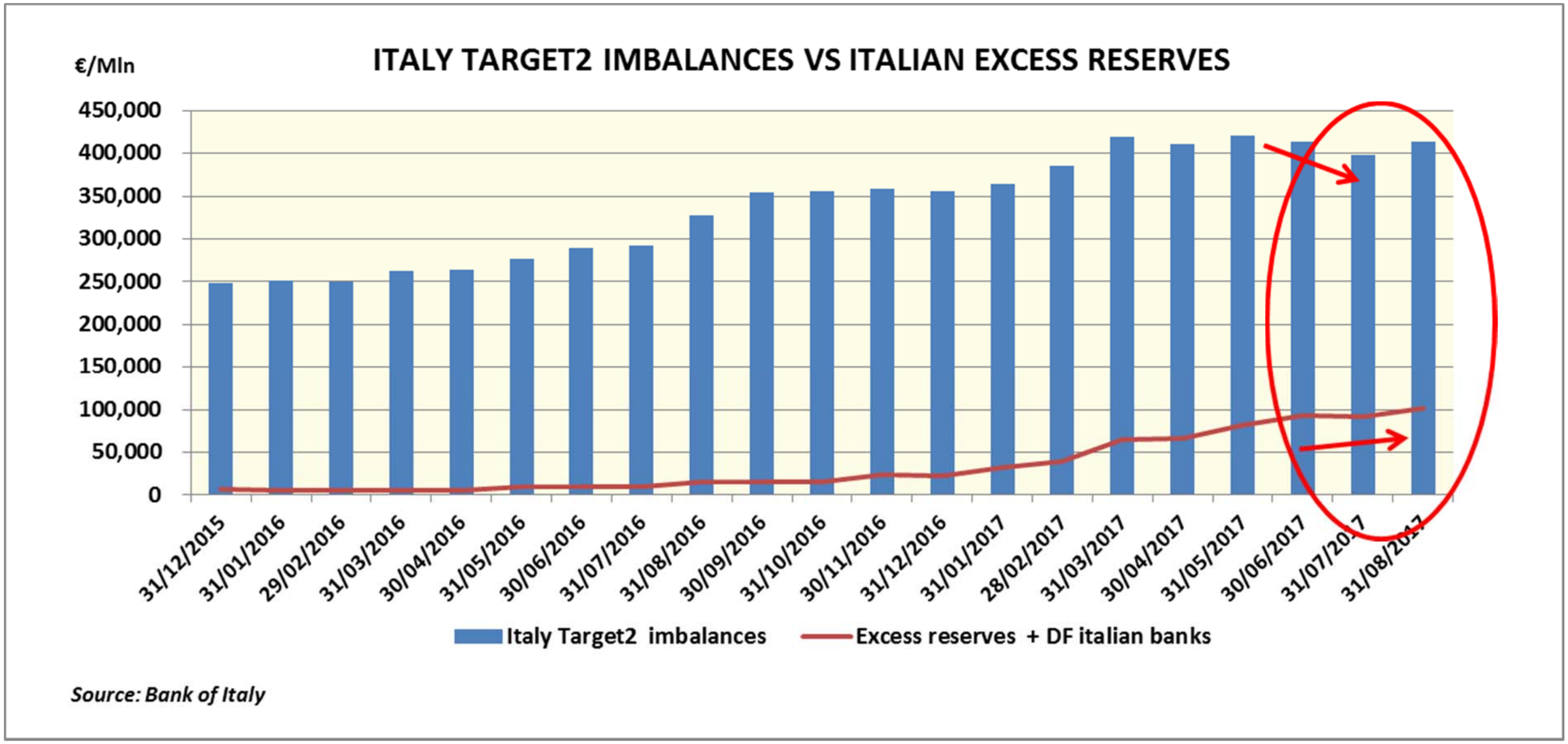


Summing-up: the unavoidable consequences of the surplus liquidity moving south..



Summing-up: .. with one notable «silver lining».

Target 2 imbalances partially in retreat



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Implications for liquidity metrics

- Stable deposits (Retail and SMEs):a funding source on which most banks have historically relied upon, even more since the onset of the gov. crisis (2011). They still entail a nice cost/benefits trade-off, despite their IR floored at zero (90/95% ASF; 5% LCR runoff)

- Corporate deposits: less appealing (50% ASF-40% LCR o/flows) and bound to create noise for intraday liquidity management

- Central Bank Reserves: so well above the mandatory levels, they're heavily compressing all intraday metrics , from «Available Liquidity at the start of the business day» to «Intraday Liquidity usage ratio»

- TLTROs will start maturing from mid-2020 (139 bn/eur the take-up of IT banks in TLTRO2/1 and 67 bn/eur in TLTRO2/4) and their attractiveness is easily explained by their rate and by the low-quality of the collateral pledged

- Portfolio diversification is fostering/intensifying the access to different repo markets , alleviating concerns of excessive concentration (a «plus» for intraday Liq. Mgmt)

- Risk Factors:
    - The proven stickiness of retail depos may be challenged by the «hunt for fees/commissions»;
    - The reliance on TLTROs will have to be carefully assessed and factored into the next strategic plans

Conclusions

- The persistence of negative rates and the impossibility for banks to charge negative rates on retail deposits are representing a big hurdle for MFIs, now even in the periphery

- Memories of the 2011 nasty developments, the risk of political instability next year and the perceived vulnerability of some parts of the Italian banking industry may represent factors justifying risk-aversion…

- ...but household disposable income and spending are at 5-year high, business confidence at 10-year high and residential real estate transactions continue to rise unabated since 2015 (prices of existing homes are stabilising)

- In this environment, net borrowers are benefiting at the detriment of net savers who are «trapped» into the zero- interest rate landscape

- Domestic banks are changing their business models, albeit gradually:

    - a big switch from «direct deposits» into AuM is ongoing and is generating a sizeable growth in commissions;

    - TLTROs still bear a good cost-opportunity trade-off;

    - Fixed-income portfolio diversification has become a priority both in terms of countries and asset classes.