WORLD ECONOMIC FORUM

c/o ABI / DISCORSO PRESIDENTE 7/11/90

First of all, a warm welcome to you on behalf of the Associazione Bancaria Italiana.

During the last days you have been discussing the issues of European integration in the perspective of 1992. I presume that you analysed the implications of the decisions taken at the recent meeting in Rome.

These discussions take place in a difficult period: the Gulf crisis casts a shadow of uncertainty on every comment and forecast.

I do not pretend to bring any explanation on the nature of the international political crisis, and I do not want to add other remarks to the ones you developed on the subject of Europe '92.

I shall only deal with some issues on the banking systems, with special regard to the Italian one.

I shall begin with some remarks on the US and the Japanese banking systems. In 1990, the long and apparently endless crisis of some American banks (the Savings and Loans Associations) has been followed by widespread difficulties in the rest of the banking sector. On the other hand, the fall of share prices caused problems to Japanese banks, which are in search of 14 billion US dollars to rebuild adequate capital ratios.

Those events restated the importance of the "stability" of the banking systems and are giving way to debates on deregulation, on the opportunity of regulation and on re-regulation. More in general, the questions of the most effective means to assure stability, such as higher capitalization, greater separation between different activities and direct supervision, are taken into consideration again.

Within this framework, the present debate on the future of international financial systems develops itself following a line relatively different from the one followed in recent years. Stability seems to receive once again the same relevance as efficiency and competition.

The Italian banking system, as other European banking systems, has been characterized by a high degree of stability in the recent times.

The profitability of banks has remained relatively high: in the last 4 years, gross operating income has been stable around 1.6% of intermediated funds. Total own funds of banks have grown at a rate of 12.5% p.a., nearly 6-7% higher than the inflation rate. The last available data show that total own funds of banks exceed the minimum required solvency ratios by 15.4 billion US $, as resulting from an excess of 17.7 bln. US $ and from a deficiency of 2.3 bln. $.

In spite of the changes in the economic situation, bank assets as a whole do not show relevant amounts of bad loans.

I will now summarize the external factors that help determining this situation. Firstly, Italian banks, as in other European countries, have a relatively low cost of funding (the average effective annual interest rate on customers' deposits is 5-6% lower compared to the average gross yield on a 1-year Treasury bill). That differs from the situation in other countries, for instance in the USA, where the higher relative cost of funding seems to have led banks to choose more profitable but also riskier activities, by operating in more unstable markets; that is a partial explanation of the problems in the US banking sector.

Secondly, in Italy the government has played a key role in financial intermediation by supporting the intermediation of funds (the state sector borrowing requirement amounts at 122,000 billion Lire - 94 bln. US $ -, while the annual growth of total domestic credit is 230,000 billion Lire - 177 bln. $).

On the one hand, the self-financing of Italian firms remains high. On the other hand, the high degree of separation between the banking and the industrial sector prevents the system from taking risks in the stock market.

Some important sectors as the real estate and the building industry show a high degree of instituzionalization; in Italy, as for example in Germany, they are not characterized by large fluctuations in prices and business activity, as in the British and the US markets.

The involvement of Italian banks in lending to high-indebted countries is also relatively low.

The securitization process in Italy is still mainly based on the activity of a group of financial intermediaries which, in addition to their securities issues, assure a professional skill in dealing with customers, provide protection to the system through their own funds and are able to cope with the borrowers' problems, should difficulties arise.

In the last years, Italian banks took control, directly or indirectly through subsidiaries, of the largest part of the leasing, factoring, securities trading, underwriting and portfolio management business. This concentration of activities was also caused by some non-favourable examples in non-banking intermediation.

Bank branches form a powerful distribution network that reaches directly households' savings; the regional feature, still a peculiarity of a large part of the Italian banking sector, assures a strong link with the customer, based on loyalty and reliability.

The Italian banking system is undergoing a deep organizational and structural change, with a sort of balance between tradition and modernization.

New pressures for quicker change will depend first of all on the the scale with which the diffusion of new deposit management techniques might take place and the consequent effects that these new relationships with depositors will have on the relative cost of deposits.

That is a very important issue on which all Italian banks, and non-Italian banks as well, are shaping their strategies.

It must be noticed by the way that also a decline in the average level of prevailing nominal interest rates will necessarily lead to a reduction in the differentials in the nominal interest rates on assets and liabilities.

A discussion is alive on whether a differentiation should be introduced between interests paid on current accounts and interests paid on time deposits; whether the regional and local characteristic should be maintained; whether the branch network should be developed on a national scale; whether mergers and acquisitions of banks should be pursued, and so on.

All those strategies are present, at a different level, in every banking group.

An increasing competitive pressure is also expected on the side of the credit activity.

May I remind some of the recent developments in the Italian economy. They can be summarized as the results, mainly, of a policy of exchange rate stability in a country with a high inflation rate.

To that fundamental decision, the export-oriented Italian economy reacted extremely well, achieving a real economic miracle, with productivity increases higher than the ones realized in all its main competitors in Europe.

After years of deep restructuring, the domestic inflation rate is still high. In a context of a less favorable international economic trend, the exchange rate constraint will have tighter effects than before, inducing some changes in the borrowers' conditions.

That could lead to more bank financing to the manufacturing sector, but also to higher risks in undertaking more complex activities.

Italian banks are aware of potential competition in dealing with customers, especially large ones, from foreign banks which do not need a local broad network.

As long as the international activity of Italian banks is concerned, the recent liberalization of capital flows has given rise to many new opportunities. The international presence could be partially limited in some cases by the small dimension of banks and in general by the characteristics of our industrial system, where fewer large-scale financings take place and fewer opportunities for securities issues on financial markets arise.

The problem of creating operating skills on international financial markets cannot be solved in the short run. The large network of Italian banks in their territory could be a barrier to entry for foreign banks' networks. The long-established experience and the activity on the international market acquired by international banks could be on its side a barrier to expansion (it seems to me to be a good example the choice made by Deutsche Bank: in Italy has decided to acquire a bank specialised in retail banking and in London a merchant bank of long tradition).

I already mentioned the important role that banks played in financing the Italian industry. The manufacturing sector was also helped by the legal and tax framework in maintaining the identity between ownership and management. In the future, Italian firms will have to face new problems at an international level: that could force some changes and perhaps a different degree of institutionalization of shareholding will be needed.

Through the development of special entities this task might be performed without injuring the principle of separatedness between banks and industry that is still considered a fundamental feature of the Italian banking system.

I did not intend to give you a fully comprehensive description of the features and the problems of our banking system, but only a sketchy description of some of them, in any case expanding no more than what can be done fruitfully in a 4-page speech and in the interval.