SCOPE | Ratings

Italian Bank Quarterly

Amid surging M&A, banks project another record year, but caution is warranted

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Table of contents

With valuations at their highest levels since the global financial crisis and interest rates falling, Italian banks are actively looking for new levers of value creation. This has fuelled an acceleration in M&A activity across Italy as well as upbeat financial forecasts. In this context, we caution that increased risk-taking could pose challenges.

Surging M&A deals amid risks and opportunities. UniCredit's bid for Banco BPM sparked a rush among Italian banks to improve or at least maintain their market positions. While consolidation can improve efficiency and scale, competitive deal-chasing raises concerns of overpaying or entering into sub-optimal mergers.

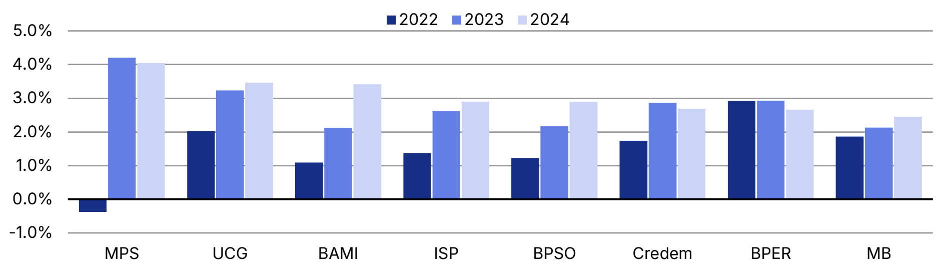
Resilient bank performance in 2025, but caution is needed. Banks closed another record year in 2024 thanks to higher average interest rates, low funding costs, rebounding fees and strong asset quality. But replicating these results in 2025 will be challenging amid falling margins, weak loan growth and rising cost pressures. While banks have guided to equally strong results in 2025, faster or deeper-than-expected ECB rate cuts represent a key risk.

Optimistic projections beyond 2025. Banco BPM, UniCredit and BPER are all projecting high double-digit returns (RoTE >16%). We deem these forecasts to be overly optimistic and subject to downside risks given uncertain economic and monetary conditions.

Asset quality remains strong, reflecting low default rates. The average gross NPL ratio hit a record low of 2.7% at the end of 2024 on the back of further sales of NPLs. In 2025, we expect stable asset quality thanks to supportive conditions for both retail and corporate credit.

Balancing strong capital generation with rising payouts. Amid resilient earnings and investor pressure, Italian banks increased their payout ratios. Meanwhile, although SREP requirements are increasing due to the phasing in of the systemic risk buffer, strong capital generation keeps this manageable.

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 are affected by one-off items.

Our expectations of 2025 trends by key area for Italian banks		
Profitability	↘	Moderately lower due to margin erosion
Asset quality	→	Minimal deterioration
Capital position	↘	Lower buffers due to distributions and higher requirements
Funding and liquidity	→	Comfortable position thanks to growing deposits

Banking consolidation positive for the sector, but execution risks lurk

If successful, the current deals will reshape the banking sector

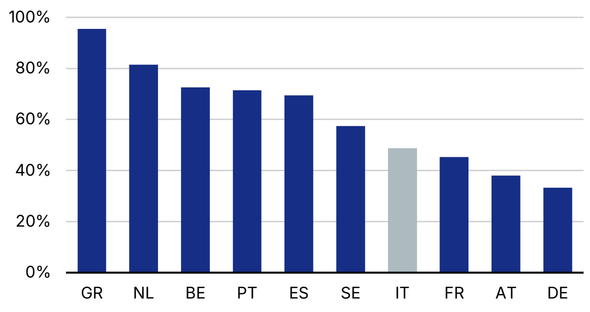
UniCredit (A/Stable)'s bid for Banco BPM triggered a chain reaction in the Italian banking sector. Mid-sized players are rushing to secure deals not just to expand their operations but also to defend their market positions. Most of the major Italian players are involved: UniCredit, Banco BPM, MPS, BPER and Mediobanca. Intesa (A/Stable), which has ruled out further domestic M&A activity after the acquisition of UBI in 2020, and the co-operative groups are notable exceptions.

Crédit Agricole, which views Italy as its second home market, is not sitting on the fence: the group increased its stake in Banco BPM from 9.9% to 15.1% to protect its ability to distribute its products in the country through partnerships (including with UniCredit via Amundi).

The M&A wave could accelerate the secular consolidation trend of the Italian banking sector, which remains one of the most fragmented in Europe at present. As of YE 2023, 428 banks were operating in the country, with the top five controlling less than half of the country's total assets. This is much less than in more concentrated markets such as France, Spain, the Netherlands, Portugal and Greece (Figure 2).

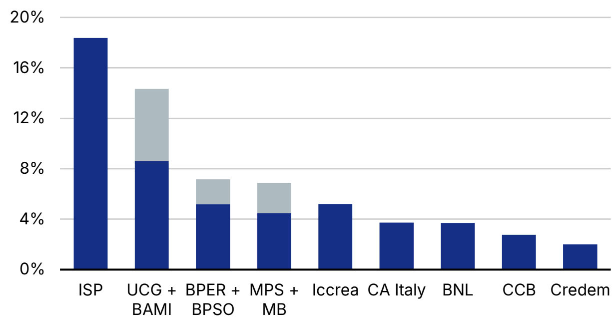
Consolidation is generally supportive of banks' credit profiles as it leads to greater economies of scale, increasing market power, and improving medium-term financial performance. But risks of overpaying for targets or entering into sub-optimal tie-ups have become more likely as competitive positioning and market share considerations become main consolidation drivers. The acceleration in M&A activity in Italy has partly been triggered by a fear of missing out.

Figure 2: Shares of the 5 largest banks in total assets (C5), YE 2023



Note: based on unconsolidated data.
Source: ECB, Company data, Scope Ratings

Figure 3: Theoretical Italian loan market shares, post M&A



Note: estimated market shares on customer loans, net of repos, as of H1 2024. BNL as of YE 2023
Source: Bank of Italy, Company data, Scope Ratings

Further consolidation inevitable in the long term

In the longer term, we see growth in scale and a decline in the number of banks as inevitable along with the commoditisation of banking products and the de-materialisation of customer interactions. Incumbent banks will face increasing competition from digitally advanced players, including fintech firms that offer seamless, data-driven services. At the same time, limited credit growth opportunities will continue to force banks to further differentiate their offerings, including in wealth management and insurance. These activities, in turn, require scale amid strong competition, especially from foreign players, and narrowing margins.

Small, specialised players can still thrive in capital-intensive market niches, as has been the case in the past decade in NPL servicing/investment, factoring and salary-backed lending. More traditional banking players, such as co-operative banks with strong local market shares, can survive, at least in the medium term, thanks to deep-rooted relationships with clients and well-recognised franchises.

Another record year for profits. Q4 results impacted by one-offs

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 a return on average equity of 11.2% in the fourth quarter of 2024 markedly lower than the 16.6% in the previous quarter and 17.3% in Q4 2023. This was due to one-off items, mostly restructuring costs to enhance future profitability.

In Q4, net interest income (NII) continued to decline as the fall in three-month Euribor (-56bp to 2.714% in Q4) eroded spreads. On average, NII was 2.4% lower than a year ago, albeit with some variation among banks. BPSO and UniCredit were the only two banks to report an increase year-on-year.

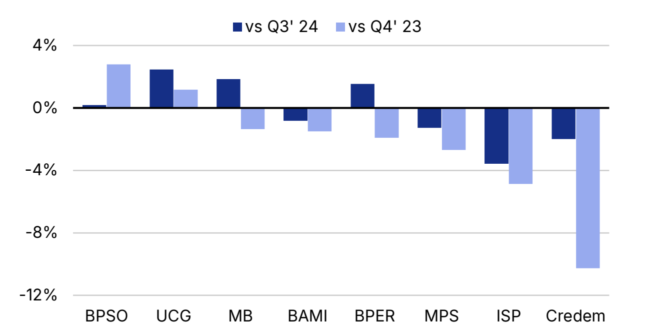
Fee income drives performance

However, strong growth in fees and commissions more than offset margin compression. Falling interest rates and bullish financial markets boosted sales of asset management products in 2024, including in Q4, while competition from Italian government bond auctions declined. We estimate that assets under management grew by 11% in 2024 (Figure 4). Mediobanca reported the strongest fee growth, both quarter-on-quarter and year-on-year, driven by strong advisory, DCM and large-corporate activity in Italy and Spain.

As expected, variable compensation weighed on banks' Q4 underlying expenses. As in the previous quarter, renewed labour contracts and investments in digital innovation affected YoY comparisons in operating costs (+3%). The quarterly average cost-income ratio increased to 47% in Q4 2024, from 43.6% in Q3 2024.

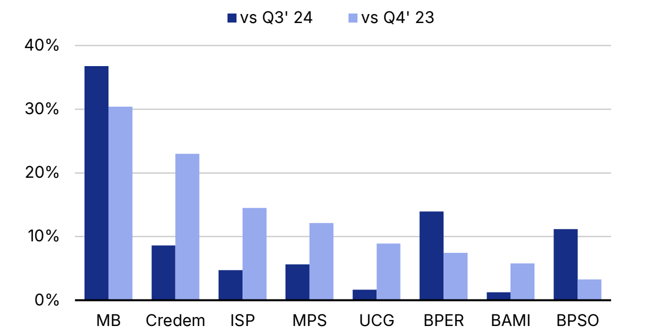
Despite an uncertain, macroeconomic outlook, the solid credit performance kept the cost of risk contained at 44bp on average.

Figure 4: Net interest income



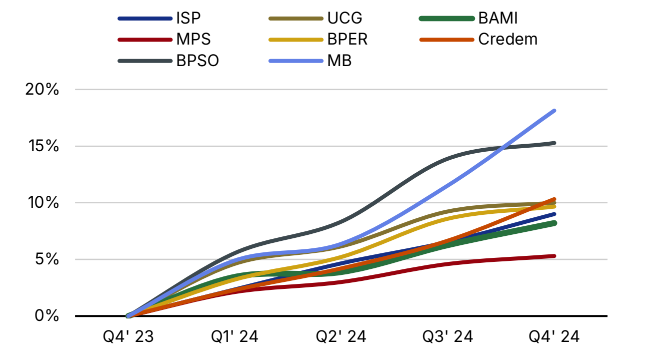
Source: Company data, Scope Ratings

Figure 5: Net fees and commissions



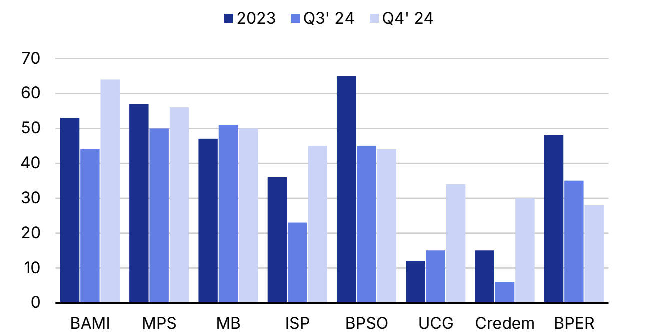
Source: Company data, Scope Ratings

Figure 6: Cumulative growth in managed assets* during 2024



*Asset under management, including distributed products and excluding insurance. MPS includes life insurance premiums
Source: Company data, Scope Ratings

Figure 7: Cost of risk (bp)



Source: Company data, Scope Ratings

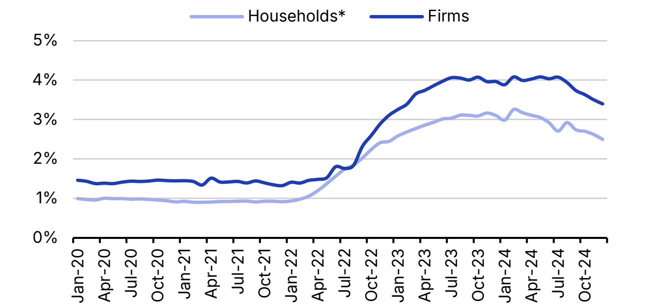
Banks' guidance on profitability should be treated with caution

Last year was another remarkable year for the Italian banking sector. Lenders exceeded 2023 profits thanks to a more favourable interest-rate environment than previously forecast (average 3-month Euribor was 3.58%, compared with 3.43% in 2023), growth in customer deposits (which reduced pressure on commercial spreads) and solid asset-quality dynamics.

It will be challenging to repeat 2024 results

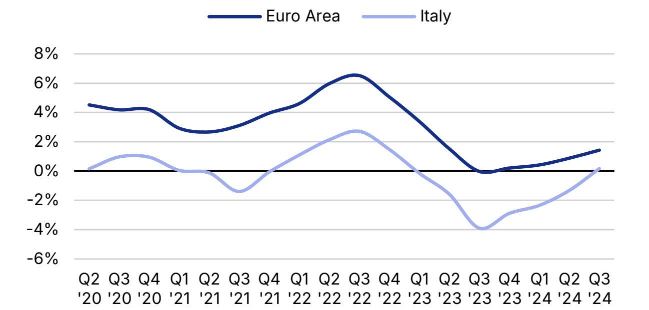
However, it will be increasingly difficult to repeat let alone improve on record results in a lower interest-rate scenario with limited opportunities for loan growth. In Italy, front-book mortgage spreads have already fallen by around 68bp and corporate loan spread by around 76bp from their peaks (Figure 8). We expect this trend to continue in 2025. At the same time, loan growth in Italy has been weak and the outlook does not look any better: Banco BPM, which updated its standalone targets, foresees a 1.7% CAGR in lending until 2027, much lower than the 3% envisaged by BPER[1].

Figure 8: Italian banks – Front book commercial spreads



*Spread between composite interest rate for new mortgages and average rate on retail deposits
Source: Bank of Italy, Macrobond, Scope Ratings

Figure 9: YoY growth in adjusted* loans to the private sector



*Adjusted for sales and securitisations.
Source: ECB, Macrobond, Scope Ratings

As outlined in our 2025 European Bank Outlook, we see profitability declining, under pressure from higher cost/income ratios and cost of risk. In our base case, we expect the same for Italian banks. By contrast, most Italian lenders remain confident that 2025 will bring similar, if not better, results. This is based on a key assumption of revenue stability or even growth, underpinned by:

(i) growth in non-interest income, supported by wealth management and insurance activities;
(ii) strong trading income, which we take with a pinch of salt;
(iii) lower revenue sensitivity to interest rates, mitigating the impact of interest-rate cuts and;
(iv) expansion in customer deposits and soft loan demand reducing the need for bond issuance, which is positive for bank margins.

According to management projections, cost of risk will not significantly increase from low 2024 levels. Banks still have a cushion of unused management overlays built up in recent years that can be used in the event of a sudden deterioration in credit quality.

The risk of the ECB cutting rates more quickly than currently forecast remains the main downside risk to banks' results. The euro-area economy stagnated in the fourth quarter and the outlook for 2025 looks increasingly unpromising, with looming US tariffs potentially weighing on growth. In this context, a return to monetary stimulus cannot be ruled out.

[1] BPER presented its business plan in October 2024

Figure 10: Italian banks' guidance on 2025 P&L items vs 2024

FY 2025 guidance vs FY 2024	ISP	UCG	MB	BAMI	BPER	MPS	Credem
Net interest income	↘	↘	↗	↘	↘	↘	↘
Fees & commissions	↗	↗	↗	↗	↗	↗	↗
Revenues	↗	/	↗	/	/	/	/
Operating costs	↘	→/↘	↗	/	/	↗	↗
Loan loss provisions	/	→	→	↘	↗	↘	↗
Net income	↗	→	↗	↗	→/↗	→/↗	/

Note: Only explicit guidance was considered. Mediobanca's guidance refers to its fiscal period ending on 30 June 2025. BPSO has not provided a guidance for 2025 yet.
Source: Company data, SNL, Scope Ratings.

Beyond 2025, banks expect resilient financial results, backed by a combination of further expansion in non-interest income, cost efficiency initiatives and stable credit quality. In their 2026 and 2027 forecasts, Banco BPM, BPER and UniCredit expect their returns to remain robust, if not improve, compared to 2024, with returns on tangible equity (RoTE) above 16%. Banco BPM, in particular, is targeting a RoTE of over 24%, leveraging on synergies from its potential acquisition of Anima. Banks will need supportive operating conditions to be able to achieve these ambitious targets.

Ambitious projections beyond 2025

Asset quality will continue to be solid in a soft economic environment

Asset quality in Italy continues to surprise on the upside. As of December 2024, the average gross NPL ratio of our sample declined by 30bp to a new record low of 2.7%. This reflects both strong credit performance (delinquency rates are near their lowest levels) and banks' ongoing sales of legacy NPLs.

No signs of deterioration

Strong credit performance is based on a mix of supportive elements: a high proportion of fixed-rate mortgages that have shielded retail borrowers from rising interest rates; companies using liquidity buffers accumulated during the pandemic to reduce leverage and absorb the impact of higher cost of goods and energy; and improved origination and monitoring standards.

We do not expect asset quality to deteriorate significantly in 2025. With borrowing costs easing and employment at record highs, we see the retail loan book performing well. At the same time, low but positive economic growth should support corporate credit quality.

Banco BPM expects default rates to remain subdued at around 0.9%-1% over a three-year horizon. Consequently, the group's gross NPL ratio will be close to the FY 2024 level of 2.8% (precisely 3%).

Figure 11: Gross NPL ratio heatmap

Country	Q4' 22	Q1' 23	Q2' 23	Q3' 23	Q4' 23	Q1' 24	Q2' 24	Q3' 24	Q4' 24	Quarterly change	3 months	6 months	12 months
BPSO	4.3%	4.3%	4.2%	4.3%	3.7%	3.8%	3.8%	4.0%	2.9%		-1.1%	0.2%	-0.8%
BPER	3.2%	3.3%	2.7%	2.8%	2.4%	2.6%	2.8%	2.8%	2.4%		-0.4%	0.2%	0.0%
MPS	4.2%	4.1%	4.3%	4.4%	4.4%	4.5%	4.6%	4.8%	4.5%		-0.3%	0.3%	0.1%
BAMI	4.2%	4.2%	3.8%	3.5%	3.5%	3.3%	3.3%	3.1%	2.8%		-0.3%	-0.5%	-0.7%
Credem	2.1%	2.1%	2.0%	2.1%	1.9%	2.0%	1.9%	1.9%	1.8%		-0.1%	-0.1%	-0.1%
MB	2.4%	2.4%	2.5%	2.6%	2.4%	2.5%	2.5%	2.6%	2.5%		-0.1%	0.1%	0.1%
UCG	2.7%	2.7%	2.6%	2.7%	2.7%	2.7%	2.6%	2.7%	2.6%		-0.1%	0.0%	-0.1%
ISP	2.3%	2.4%	2.3%	2.4%	2.3%	2.3%	2.2%	2.2%	2.3%		0.0%	-0.1%	0.0%

Source: Company data, Scope Ratings
Note: BPSO' gross NPL ratio was pro forma a EUR 109m net asset disposal.

Strong organic capital generation supports banks' increasing pay-outs

Italian banks' continue to maintain strong capital positions despite record pay-outs and higher capital requirements. At the end of 2024, the average fully loaded CET1 ratio was 15.5%, up almost 40bp YoY.

Resilient operating performance, a lack of opportunities for organic growth and the need to defend share prices have induced Italian banks to increase future pay-out ratios. Banco BPM is pledging a cash pay-out of 80% (from 67%), excluding additional extraordinary distributions for EUR 1bn. BPSO raised its pay-out to 63%, starting from FY 2024 results, up from 55% in 2023. MPS has proposed a 75% pay-out ratio, up from 50% previously. BPER expects to pay 75% of its net profits over its plan horizon, higher than the 61% on 2024 profits.

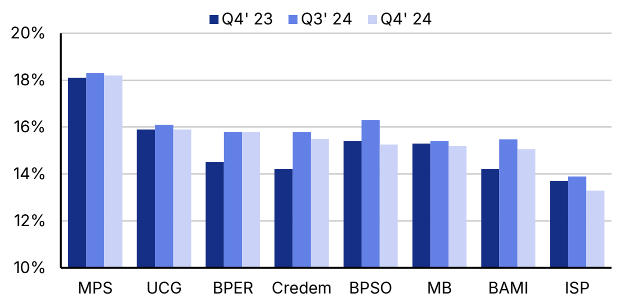
Against this backdrop, SREP requirements will increase by about 58bp[2] across our sample of banks. This is mainly driven by the phase-in of the new 1% systemic risk buffer on Italian credit and counterparty risk exposures. UniCredit will be the least impacted (c.40bp) due to its strong geographic diversification. In addition, BPER and Mediobanca are subject to a 0.25% O-SII buffer from 1 January (from 0.125% in 2024).

Growth in capital requirements is credit positive

Overall, we view these higher capital requirements as credit positive, as they provide additional resilience while remaining relatively inexpensive given banks' current strong capital generation.

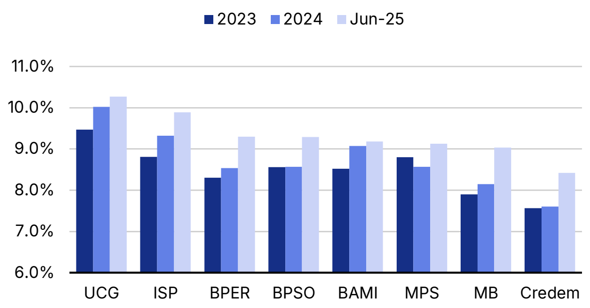
Following the 2024 SREP exercise, the ECB has kept banks' average pillar two requirement broadly stable, with the average decline of 10bp mainly reflecting technicalities[3]. Among the largest EU financial institutions, Intesa holds the lowest P2R (1.5%), a testament of the group's business model resilience and solid risk management.

Figure 12: Fully loaded CET1 ratio



Source: Company data, Scope Ratings

Figure 13: CET1% SREP requriements



Source: Company data, Scope Ratings

[2] SREP requirements by 1 July 2025, post-phasing in of the 1% risk buffer on Italian credit risk exposures.
[3] Add-on on NPE coverage shortfall being directly deducted from capital rather than counted in the requirement.

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