Italy on a narrow path

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Italy: key events until end-2018

- 26 September: 6M BOT auction
- 27 September: 5Y BTP, 10Y BTP & CCT auctions
- **27 September: update of the Stability Programme (DEF) with new public finance targets**
- 10 October: 12M BOT auction
- 11 October: 3Y BTP, 7Y BTP & >10Y BTP auctions
- **15-20 October: 2019 Budget Law submitted to EU Commission**
- 26 October : 2Y CTZ & BTPei auctions
- **26 October: rating review by S&P (BBB/ stable outlook)**
- **26 October: rating review by Moody's (Baa2/ negative rating watch)**
- 29 October: 6M BOTs auction
- 30 October: 5Y BTP, 10Y BTP & CCT auctions
- **30 October: 3Q18 GDP preliminary data**
- 12 November: 12M BOT auction
- 13 November: 3Y BTP, 7Y BTP & >10Y BTP auctions
- 27 November: 2Y CTZ & BTPei auctions
- 28 November: 6M BOT auction
- 29 November: 5Y BTP, 10Y BTP & CCT auctions
- **End-November: EU.Comm assessment of 2019 Budget**
- 12 December: 12M BOT auction
- 27 December: 6M BOT & 2Y CTZ auctions
- 28 December: 5Y BTP, 10Y BTP & CCT auctions
- **By 31 December: 2019 Budget Law approval**

Economic and Financial Document 2018 (April 2018)

		2016	2017	2018	2019	2020	2021
General Govt Borrowing Requirement							
		2.5%	**2.3%**	**1.6%**	**0.8%**	**0.0%**	**-0.2%**
	EUR Bn	42	40	28	15	0	-4
State Sector Borrowing Requirement							
		3.4%	**3.0%**	**2.7%**	**1.6%**	**0.7%**	**0.6%**
	EUR Bn	56	52	47	29	14	11
Public Debt		**132.0%**	**131.8%**	**130.8%**	**128.0%**	**124.7%**	**122.0%**
	EUR Bn	2,219	2,263	2,310	2,333	2,342	2,353
Public Debt net loans & EFSF		**128.6%**	**128.4%**	**127.5%**	**124.8%**	**121.6%**	**119.0%**
	EUR Bn	2,162	2,205	2,252	2,275	2,284	2,295
Interest expenditure (cash basis)		**3.9%**	**3.8%**	**3.5%**	**3.5%**	**3.5%**	**3.5%**
	EUR Bn	66	65	62	64	66	68
Primary balance		**1.5%**	**1.5%**	**1.9%**	**2.7%**	**3.5%**	**3.7%**
	EUR Bn	26	26	34	49	66	71
Privatisation		0.1%	0.0%	0.3%	0.3%	0.3%	na
Real GDP %		0.9%	1.5%	1.5%	1.4%	1.3%	1.2%
GDP Deflator %		0.8%	0.6%	1.3%	1.8%	1.7%	1.5%

Source: Ministero dell'Economia e delle Finanze, Intesa Sanpaolo

2019 budget close to «lower growth scenario» of DEF

- Compared to when the DEF was published, macroeconomic and financial market developments have restored the overall outlook very close to what the in DEF itself was defined as a “slow growth scenario”, namely a scenario in which GDP grows at a pace 0.5% slower than potential, and interest rates are higher by 100bps.
- Based on the sensitivity analysis run on public finance balances, the slow growth scenario outlines a worsening of the deficit by 0.2% of GDP in 2018 and by 0.7% in 2019 (table below), as well as a worsening of the debt/GDP ratio by over one per cent of GDP in 2018, and by almost three per cent in 2019 compared to the targets. In actual fact, the impact on public balances could be even stronger than indicated by the MEF’s analysis, as the 10Y forward rates currently priced in by the market for the end of 2019 are higher by around 100bps than they were last April, whereas on the 2Y segment, forward rates are higher by a hefty 220bps.
- In conclusion, the new scenario under unchanged legislation should include an increase in deficit from 1.6% to 1.8% of GDP this year, and from 0.8% to 1.5% of GDP in 2019. Debt should be up from 130.8% to 132% of GDP in 2018, and subsequently decline to 130.9% of GDP in 2019, compared to a previous target of 128%.

Economic and Financial Document 2018 (April 2018)(% PIL)

		2018	2019	2020	2021
Real GDP	Baseline scenario	1.5	1.4	1.3	1.2
	Low-growth scenario	**1.1**	**0.9**	**0.8**	**0.7**
General Govt Deficit	Baseline scenario	1.6	0.8	0.0	-0.2
	Low-growth scenario	**1.8**	**1.5**	**1.3**	**1.5**
Structural Deficit	Baseline scenario	0.9	0.4	-0.1	-0.1
	Low-growth scenario	**1.0**	**0.9**	**0.9**	**1.2**
Public Debt	Baseline scenario	130.8	128.0	124.7	122.0
	Low-growth scenario	**132.0**	**130.9**	**129.5**	**128.9**

Source: Ministero dell’Economia e delle Finanze, Intesa Sanpaolo

- If, as announced by members of the government in recent interviews, the deficit target for next year is kept below 2%, the government’s new expansionary measures will have to be entirely financed with saving measures/spending cuts.
- All the above is also based on the assumption that around 12.5 billion euros in additional revenue will be generated by the VAT hikes.

Refinancing risk is limited in the next months…

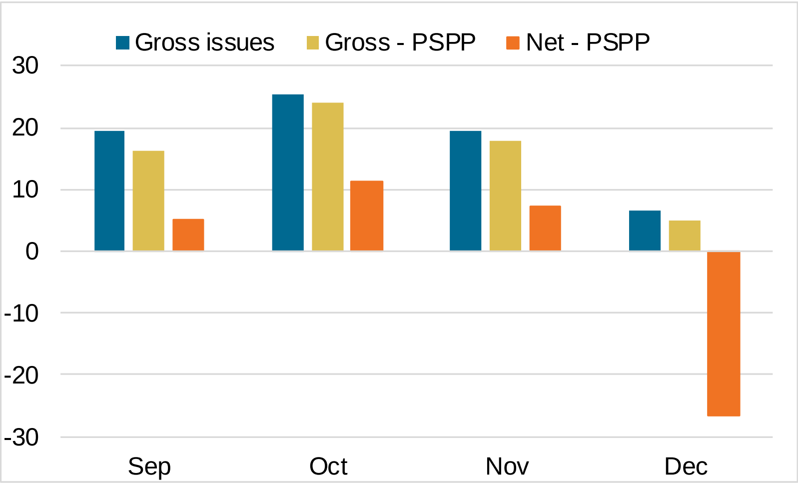
Remaining gross issuance expected in 2018 (EUR Bn)

		Sep	Oct	Nov	Dec	Total
BOTs		13.0	13.0	10.8	4.3	150
CTZs		2.5	3.0	2.0	-	28
CCTs		1.8	2.0	3.5	2.0	27
BTPs		12.5	9.8	11.3	4.5	153
of which	3 yr	1.5	2.0	3.5	-	29
	5 yr	3.8	2.0	2.5	2.0	31
	7 yr	4.0	2.0	2.0	-	30
	10 yr	2.3	2.5	2.5	2.5	36
	15 yr	1.0	0.8	-	-	6
	20 yr	-	0.5	-	-	12
	30 yr	-	-	0.8	-	7
	≥50 yr	-	-	-	-	1
BTP inflation		1.5	4.0	1.0	-	27
Eurobonds		-	-	-	-	-
TOTAL		31	32	29	11	384

Source: Bloomberg, Intesa Sanpaolo

- In the last four months of the year, ECB purchases may continue to offer support to the market: according to our estimates, ECB purchases of Italian government bonds will amount, between September and December, to around 8 bn/eur with respect of 5 bn/eur net issuance.
- So net issuance net of ECB purchases will ne negative by 3 bn/eur across the 4 mths

Italy: 2018 issuance ex BOTs (EUR Bn)



Source: Bloomberg, Intesa Sanpaolo

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… but will be challenging in 2019

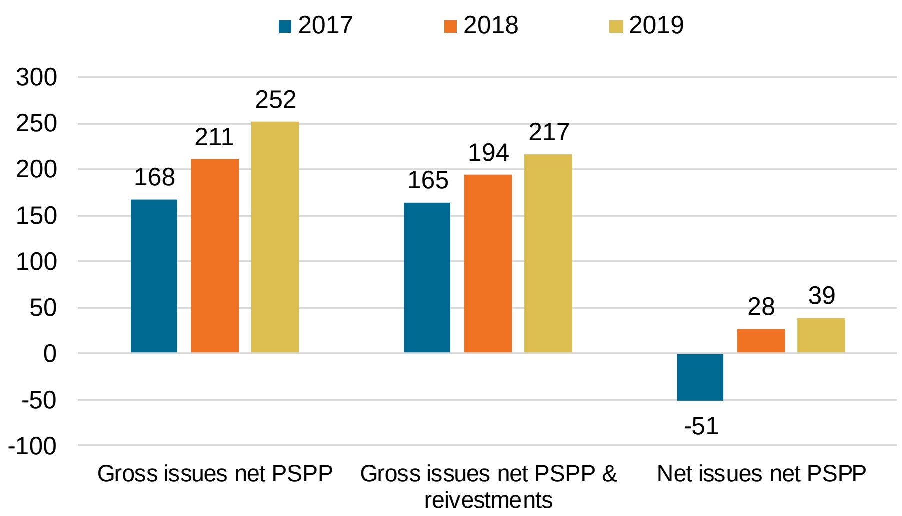
2019 Issuance (EUR Bn, ISP forecast*)

	1Q	2Q	3Q	4Q	Total
Redemptions	**87**	**76**	**97**	**100**	**360**
BOTs	40	37	39	33	147
CTZs	0	11	0	25	36
CCTs	0	0	0	13	13
BTPs	48	28	39	29	144
BTP inflation	0	0	17	0	17
Eurobonds	0	1	2	0	3
Gross Issuance	**127**	**98**	**93**	**83**	**400**
BOTs	46	37	37	29	149
CTZs	12	7	8	5	31
CCTs	7	8	6	10	31
BTPs	57	37	32	35	159
BTP inflation	6	10	11	4	31
Eurobonds	0	0	0	0	0
Net Issuance	**40**	**21**	**-3**	**-18**	**40**
BOTs	7	0	-2	-4	1
CTZs	12	-4	8	-20	-5
CCTs	7	8	6	-3	18
BTPs	9	9	-7	5	15
BTP inflation	6	10	-6	4	14
Eurobonds	0	-1	-2	0	-3

(*) Assuming a State Sector borrowing requirements of around 50 billion euros.

Fonte: Bloomberg, Intesa Sanpaolo

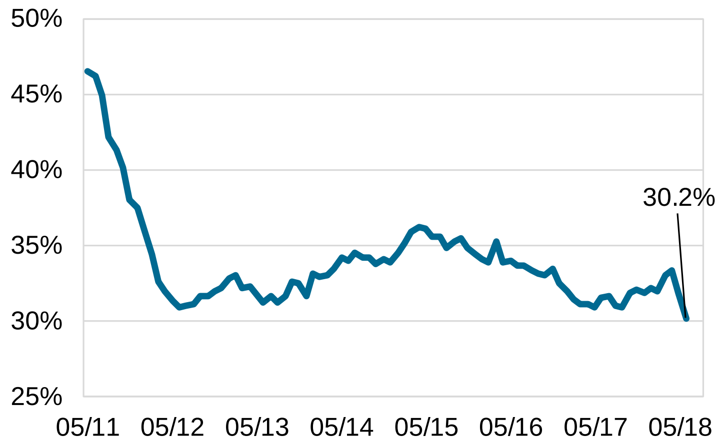
Issuance net of ECB purchases and reinvestments (EUR Bn, ISP forecast)



- In 2019, medium and long-term bond maturities will increase by around 29 bn/eur compared to this year and gross issuance are expected to increase to EUR 400 bn/eur, from 380bn/eur estimated in 2018.
- BTP's expected net issuance should be close to 30 bn/eur, of which 15 bn/eur of nominal BTPs and 14 bn/eur of inflation-linked BTPs.

Foreign investors important for refinancing in 2019

Italian government bonds held by the foreign sector % of total outstanding amount



Source: Bank of Italy, Bloomberg, Intesa Sanpaolo

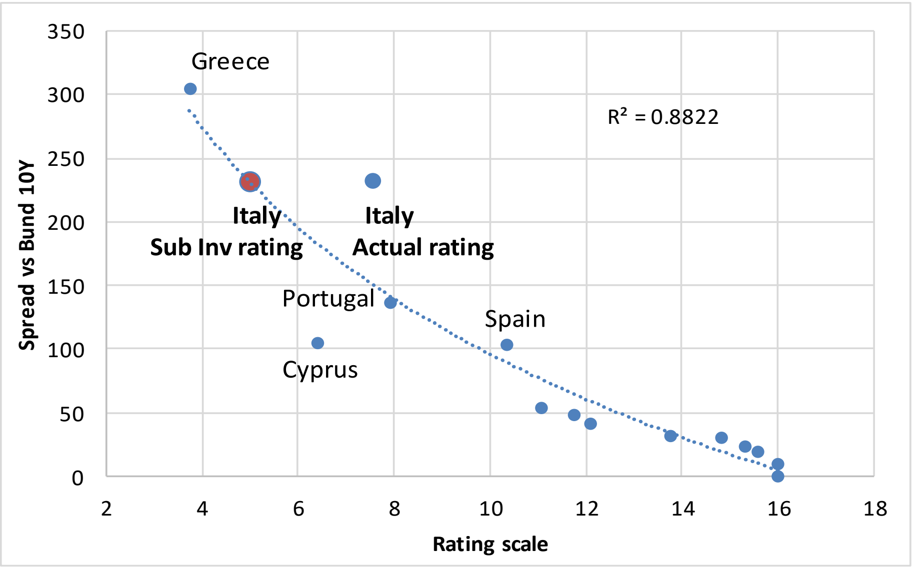
Italian Government bonds by holder

	Amount EUR Bn	% tot.
Bank of Italy	380	19%
ECB	70	4%
MFIs	387	20%
Other fin. intermediaries	444	23%
Households	93	5%
Foreign sector	490	25%
Foreign investment funds attributable to Italian investors	105	5%
Total	1969	100%

Source: Bank of Italy, Bloomberg, Intesa Sanpaolo

- Italian banks and monetary funds, together with insurance companies, will keep decreasing the share of government bonds in their portfolios and reducing the home bias in light of possible regulatory changes.
- In the past few years, Italian households have gone from being direct holders of government bonds to indirect holders via shares in mutual funds and other forms of asset management, in line with the behaviour of other Eurozone partners, and this trend is unlikely to reverse, even in a context of increasing yields.
- Since the launching of the PSPP, foreign investors have reduced their portfolios of Italian government bonds by 66 billion euros. Based on our estimates, the share of debt held abroad, excluding the Eurosystem, decreased to 30.2% of the total outstanding at the end of June 2018 from a 33.3% high in April (see chart). Of this share around 5% is held by foreign investment funds attributable to Italian investors, therefore the share of debt held abroad would be of close to 25%, a very low level with respect to pre-crisis situation.
- It is hard to forecast the evolution of demand for Italian government bonds generated by the foreign sector, as the latter includes very diverse investor types, guided by different investment logics

BTP-Bund spread prices in a downgrade to sub-inv

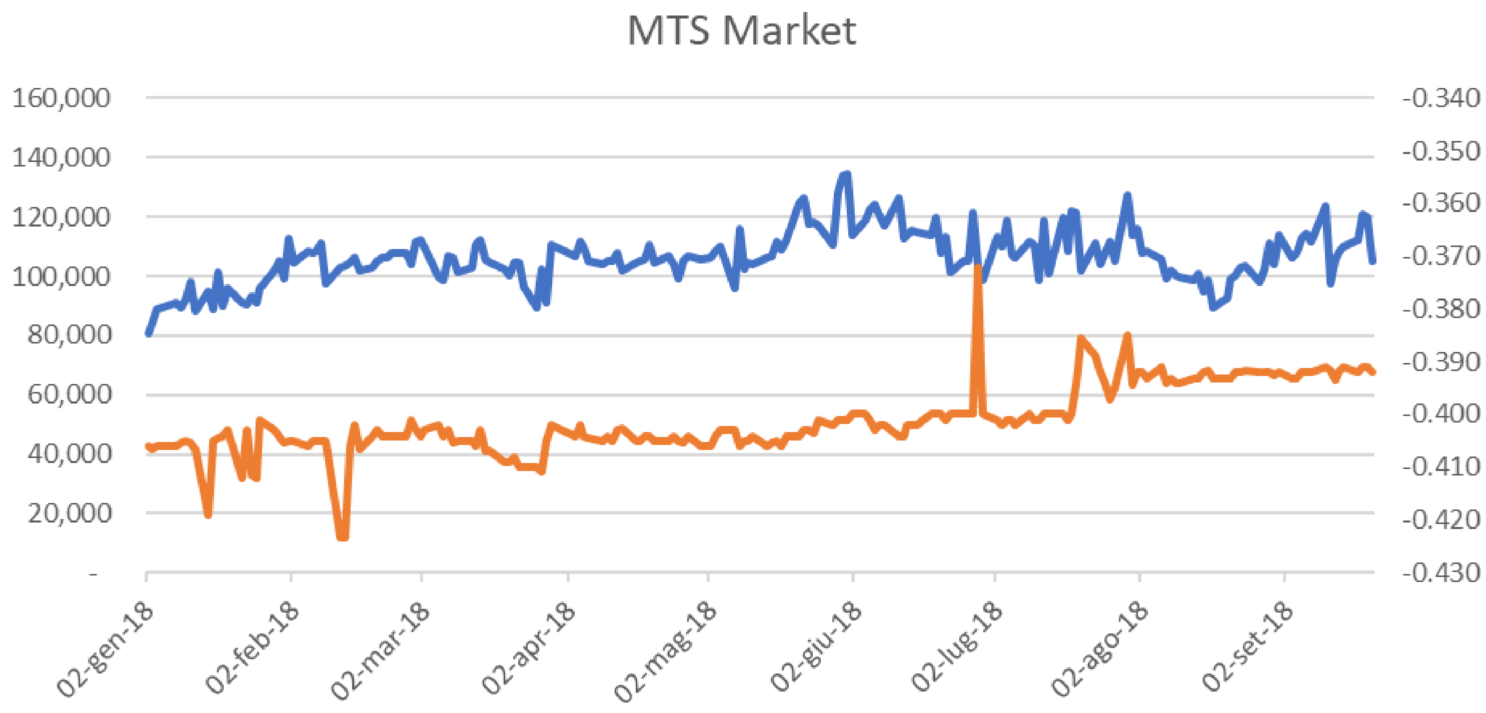


- Based on the simple relation between the government bond spreads and the rating scale, at current prices BTPs are already trading at sub-investment levels.

EMU credit ratings	MOODYS		S&P		FITCH		DBRS	
Austria	Aa1	STABLE	AA+	STABLE	AA+	POS	AAA	STABLE
Belgium	Aa3	STABLE	AA	STABLE	AA-	STABLE	AAH	STABLE
Finland	Aa1	STABLE	AA+	STABLE	AA+	POS	AAH	STABLE
France	Aa2	POS	AA	STABLE	AA	STABLE	AAA	STABLE
Germany	Aaa	STABLE	AAA	STABLE	AAA	STABLE	AAA	STABLE
Greece	B3	POS	B+	POS	BB-	STABLE	BH	POS
Ireland	A2	STABLE	A+	STABLE	A+	STABLE	AH	STABLE
Italy	Baa2	NEG	BBB	STABLE	BBB	NEG	BBBH	STABLE
Luxembourg	Aaa	STABLE	AAA	STABLE	AAA	STABLE	AAA	STABLE
Netherlands	Aaa	STABLE	AAA	STABLE	AAA	STABLE	AAA	STABLE
Portugal	Ba1	POS	BBB-	POS	BBB	STABLE	BBB	STABLE
Spain	Baa1	STABLE	A-	POS	A-	STABLE	A	STABLE
Slovakia	A2	POS	A+	STABLE	A+	STABLE	AH	STABLE
Slovenia	Baa1	STABLE	A+	POS	A-	STABLE	AH	STABLE
Cyprus	Ba2	STABLE	BBB-	STABLE	BB+	POS	BB	POS
Malta	A3	POS	A-	POS	A+	STABLE	AH	STABLE

Fonte: Bloomberg, Intesa Sanpaolo

MTS Market: volumes and rates show stability



Source: MTS, Intesa Sanpaolo

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