



ITALY

FINANCIAL SECTOR ASSESSMENT PROGRAM

TECHNICAL NOTE ON SYSTEMIC RISK ANALYSIS AND STRESS TESTING

This Technical Note on Systemic Risk Analysis and Stress Testing for the Italy FSAP was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on July 2026.

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ITALY

FINANCIAL SECTOR ASSESSMENT PROGRAM

July 30, 2026

TECHNICAL NOTE

SYSTEMIC RISK ANALYSIS AND STRESS TESTING

Prepared By
Monetary and Capital Markets
Department

This Technical Note was prepared by IMF staff in the context of the Financial Sector Assessment Program mission in Italy. It contains technical analysis and detailed information underpinning the FSAP's findings and recommendations. Further information on the FSAP can be found at <http://www.imf.org/external/np/fsap/fssa.aspx>

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Glossary

AC	Amortized cost
BdI	Banca d'Italia
CBC	Counterbalancing Capacity
CCoB	Capital Conservation Buffer
CCP	Central Counterparty
CET1	Common Equity Tier 1
DTA	Deferred tax assets
DTI	Debt-to-Income
DSTI	Debt Service-to-Income
EA	Euro Area
EBA	European Banking Authority
EC	European Commission
ECB	European Central Bank
EU	European Union
FSAP	Financial Sector Assessment Program
GACS	State Guarantee on NPL Securitization
HQLA	High Quality Liquid Asset
IFRS	International Financial Reporting Standards
ITS	European Commission Implementing Technical Standards
LCR	Liquidity Coverage Ratio
LE	Large exposures
LGD	Loss Given Default
LSI	Less Significant Institution
NBFI	Non-bank Financial Institutions
NFC	Non-financial Corporate
NII	Net interest income
NLP	Net Liquidity Position
NPL	Nonperforming Loan
NRRP	National Recovery and Resilience Plan
P2R	Pillar 2 Requirement
ROE	Return on equity
O-SII	Other Systemically Important Institution
PD	Probability of Default
pp	Percentage points
RWA	Risk-weighted assets
SI	Significant Institution
SSM	Single Supervisory Mechanism
SyRB	Systemic Risk Buffer
TLTRO	Targeted Longer-Term Refinancing Operations
USD	US dollars

EXECUTIVE SUMMARY¹

The Financial Sector Assessment Program (FSAP) for Italy conducted a comprehensive assessment of systemic risks and the resilience of the banking sector. The analysis examined key vulnerabilities, sectoral exposures and risks related to corporates and households and included a detailed assessment of banks' solvency and liquidity using a comprehensive stress testing framework. The FSAP also assessed cross-sectoral and cross-border interconnectedness, as well as large exposures, to identify potential contagion channels and risks arising from common exposures.

Most of the FSAP work was conducted prior to the outbreak of the war in the Middle East. Given the program's focus on medium-term challenges and vulnerabilities, however, many of its findings and recommendations aimed at strengthening policy and institutional frameworks remain pertinent. Moreover, the systemic risk assessment relies on adverse scenarios that provide key insights into the potential implications of an escalation of the conflict for the solvency and liquidity of the banking system.

Italy's financial system remains broadly sound and has demonstrated resilience in a challenging macrofinancial and geopolitical environment. This resilience is supported by solid capital and liquidity buffers, strong bank profitability, and improved sovereign market sentiment. The banking sector has benefited from the higher interest-rate cycle and sustained improvements in asset quality, while its reliance on central bank funding has declined. Upgrades to the sovereign credit profile and compressed spreads have supported market confidence and facilitated some easing of the sovereign-bank nexus. The insurance and the broader non-bank sectors remain broadly stable.

At the same time, longstanding structural vulnerabilities continue to weigh on medium- to long-term growth and financial stability. Public debt remains high, potential growth subdued, and demographic trends adverse, constraining Italy's policy space. The sovereign-bank nexus has moderated but remains sizeable relative to peers, with less significant institutions (LSI) particularly exposed to domestic government securities, loans to public entities, and public guarantees. A large stock of NPLs transferred off bank balance sheets remains unresolved, reflecting still slow debt resolution processes that delay corporate restructuring, credit restoration and efficient reallocation of capital. Against this backdrop, risks remain elevated. Heightened geopolitical tensions—including the war in the Middle East—pose risks to a trade-oriented, energy-importing economy, while climate and cyber risks are intensifying as shocks become more frequent and severe.

Corporate and household vulnerabilities remain contained, with important heterogeneities across sectors and borrower groups. Aggregate corporate default risk declined sharply after the

¹ This Technical Note was prepared by Angelica Lizarazo (lead), Natalia Novikova, Aleksandra Babii (all MCM), and Yueling Huang (EUR) with contributions from Laura Valderrama (household analysis), Alain Kabundi (interconnectedness analysis), Jakab Zoltan and Ruy Lama (macrofinancial scenarios), and Elina Paraschou (all MCM). The analysis has benefitted from discussions with the staff of Banca d'Italia and the Italy FSAP team.

sovereign debt crisis and has remained low since 2020. Although corporate leverage is moderate overall, vulnerabilities are uneven and more pronounced among small and medium-sized enterprises, firms located in Southern Italy, and specific industries—particularly construction, transport, and low-skill services. While aggregate corporate probabilities of default (PDs) rise materially under adverse scenarios, they remain below levels observed during the European sovereign debt crisis, reflecting the gradual strengthening of Italian non-financial corporates' balance sheets since then, with notable improvements in profitability, solvency, and liquidity. For households, aggregate indebtedness remains moderate, but vulnerabilities persist among lower-income borrowers and those exposed to variable-rate mortgages. The analysis shows that lower-income households and renters account for a relatively larger share of households at risk, while debt at risk is more concentrated among higher-income households.

Solvency stress tests indicate that the Italian banking system appears resilient to severe macrofinancial shocks. Results suggest that the banking system can absorb severe macrofinancial shocks while remaining above regulatory minima, supported by strong starting capital positions and sustained profitability. Capital depletion is driven primarily by credit losses, while market risk losses remain contained given the limited size of fair value portfolios. However, vulnerabilities are unevenly distributed. A subset of LSIs—particularly those with specialized business models on consumer credit or NPL management or dependence on higher-cost funding sources—exhibit weaker resilience under adverse scenarios. Under the most severe scenario, the geopolitical scenario, the aggregate total capital ratio declines to 16.5 percent by end-2027, corresponding to a reduction of 3.5 percentage points relative to the starting point and 4.0 percentage points compared to the baseline scenario. Banks that fall below the minimum requirements and/or the Capital Conservation Buffer (CCoB) account for 9 percent of total assets in the Italian banking system.

Liquidity risk analysis reveals that the liquidity position of Italian banks is adequate. Structural indicators point to generally comfortable liquidity buffers, while stress tests suggest banks can withstand significant liquidity outflows. Nonetheless, a few SIs may fall into negative liquidity position in a very short timeframe under idiosyncratic funding shock, while some specialized LSIs potentially facing liquidity shortfalls under mild shock and the shortfalls emerging faster under idiosyncratic shocks. Funding concentration poses an additional risk for some banks, particularly among specialized LSIs, and the high share of Italian sovereign bonds in banks liquidity buffers could be a source of contagion. The analysis highlights the need to continue close monitoring of liquidity risks. For LSIs, particular attention should be given to ensuring that funding structures are always appropriately diversified, especially in the case of specialized institutions. For SIs, continued monitoring—coordinated with the European Central Bank (ECB)—of liquidity risks related to USD balance sheets and contingent commitments is essential.

Italy's intersectoral network remains large and centered on banks, households and the sovereign, with cross-border linkages rising. Banks continue to play a central intermediation role, although lending—particularly to deleveraging NFCs—has declined. Households remain the main surplus sector, while the government is the primary net borrower, increasingly reliant on foreign and retail investors as quantitative tightening proceeds and domestic financial institutions reduce

sovereign exposures. Sovereign debt remains a key channel of cross-sector contagion, with gross holdings at about 115 percent of GDP. Cross-border linkages also remain important, reflecting foreign holdings of government debt, foreign deposit funding of banks, and rising domestic investment in foreign assets. Consolidated data highlight strong financial ties with major European Union (EU) economies across sectors, while bank– Non-bank Financial Institutions (NBFI) cross-border exposures have increased but remain small in nominal terms. Italian banks are most exposed to NBFIs in Luxembourg and Ireland, whereas Italian NBFIs have greater exposures to banks in the United States and France.

Banca d'Italia (BdI) should continue to incorporate emerging risks and the evolving macroeconomic environment into its stress-testing framework. Future stress tests should reflect heightened macro-financial volatility and assess implications for financial stability in a timely manner. BdI should also continue developing the system-wide stress test framework by leveraging the comprehensive and highly granular dataset recently constructed to assess risk arising from sovereign exposures common to all financial intermediaries, and to use the results for macroprudential purposes.

Table 1. Italy: Key FSAP Recommendations

Recommendations	Authorities	Timeline ¹
Systemic Risk Assessment		
1. Advance the development of the system wide stress test framework by leveraging the comprehensive and highly granular dataset recently constructed to assess key risks arising from sovereign exposures common to all financial intermediaries, and to use the results for macroprudential purposes.	BdI	MT
2. Continue to assess and incorporate the potential impact of emerging risks and the evolving macroeconomic environment in its stress testing framework. Future stress tests should reflect short-term changes in macro financial conditions and evaluate their implications for financial stability in a timely manner.	BdI	C
3. Further strengthen the assessment of vulnerabilities and close monitoring of liquidity risks. For LSIs, particular attention should be given to ensuring that the funding structures are appropriately diversified, especially in the case of specialized institutions. For SIs, continued monitoring—coordinated with the ECB—of liquidity risks related to USD balance sheets and contingent commitments is essential.	BdI	ST
4. Expand the granular network dataset to address key data gaps, covering major funding markets (including repos), derivatives, cross-border exposures, and foreign investment funds.	BdI	MT
5. Collaborate with relevant European authorities to improve the availability and quality of data on banks' market risk sensitivities and hedging strategies.	BdI	ST
6. Collaborate with relevant European authorities to ensure that the large exposures data is carefully validated.	BdI	ST
¹ C = Continuous; I = Immediate (within one year); ST = Short Term (within 1–2 years); MT = Medium Term (within 3–5 years)		

INTRODUCTION

A. Macrofinancial Context

1. Italy's economic growth has remained stable but subdued, while recent fiscal consolidation has improved market sentiment. Real GDP growth slowed to 0.5 percent in 2025, from 0.7 percent in the preceding two years, with activity still partially supported by investment linked to the National Recovery and Resilience Plan (NRRP). The labor market remained robust and inflation below target, although expectations have edged up amid higher energy costs linked to developments in the Middle East. The primary balance turned positive in 2024 and strengthened further to 0.7 percent of GDP in 2025, bolstering investor confidence and compressing sovereign spreads to multi year lows.
2. Longstanding structural constraints continue to weigh on medium- to long-term growth and are increasingly compounded by geopolitical headwinds. Public debt remains high, at 137.1 percent of GDP in 2025, while medium-term growth prospects are subdued, with output expected to hover around 0.5 percent annually. Weak growth and adverse debt dynamics reflect persistent productivity stagnation and unfavorable demographic trends. The outlook could deteriorate further amid geopolitical tensions, particularly in a trade oriented and energy importing economy where imported fossil fuels account for more than 70 percent of energy consumption.
3. Italy's private sector indebtedness remains limited. As of November 2025, household debt stood at approximately 36 percent of GDP and corporate leverage at 59 percent—well below the euro area (EA) averages of 51 and 105 percent, respectively (Figure 1).² Household net financial wealth is robust, with retail investors increasing holdings of Italian public debt and more complex products, particularly bank-issued securities (certificates). Although the large weight of manufacturing makes Italian firms somewhat more exposed to U.S. tariffs, evidence from Banca d'Italia (BdI) indicates that the impact to date has been modest and concentrated in a small number of machinery and transport-equipment producers. Real estate risks remain moderate as property prices stay broadly stable.
4. Weak credit dynamics weigh on banks' long-term profitability and constrain investment and productivity growth. Despite accommodative lending standards, extensive government loan guarantees, and strong bank capital and liquidity buffers, credit expansion remains historically subdued. European Central Bank (ECB) lending surveys suggest that demand-side factors are at play, including muted investment plans, geopolitical uncertainty, and firms' reliance on internal financing. Slow mechanisms for resolving nonperforming loans—now largely held by investors—also weigh on SME credit demand by delaying write-offs and debt restructuring that could otherwise revive corporate activity, investment, and credit.

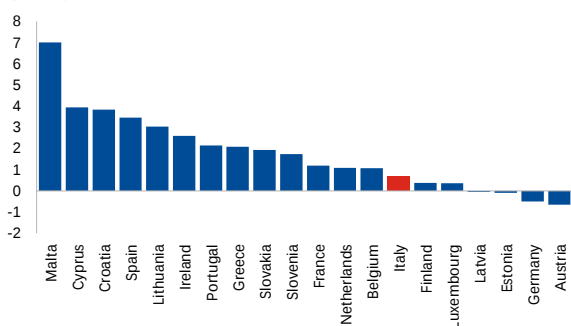
² Although households in Italy hold lower debt compared to the EA, indebted households tend to be more financially stretched (see Household and Corporate Vulnerability Assessment).

Figure 1. Italy: Macroeconomic Context and Financial Market Indicators

Italy's GDP growth is among the lowest in the euro area...

Euro Area: Real GDP Growth, 2025

(percent)

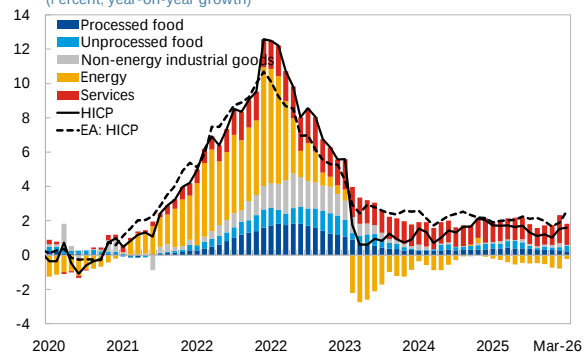


Sources: Eurostat and Haver Analytics.

... and inflation remained low prior to the Middle East conflict.

Composition of Inflation

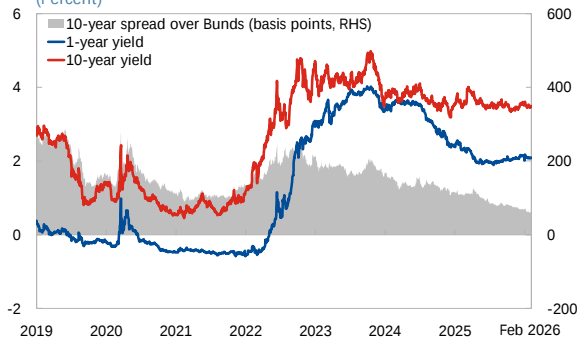
(Percent, year-on-year growth)



Italian spreads narrowed notably, even while government bond yields rose with the monetary cycle.

Government Bond Yields

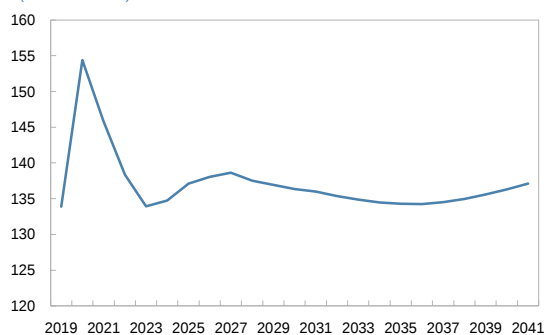
(Percent)



Public debt remains high, and is subject to significant long-term pressures from aging population.

General Government Gross Debt

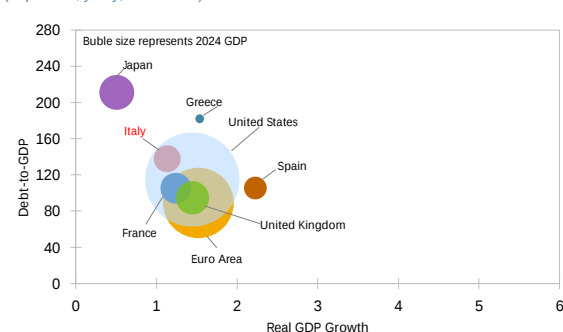
(Percent of GDP)



Italy combines a high debt-to-GDP ratio with relatively weak growth.

Real GDP Growth and Debt-to-GDP

(in percent, y-o-y, 2015-2024)



Private sector indebtedness is lower compared to peers.

Household and Non-Financial Firms Debt

(percent of GDP, 2025Q2)

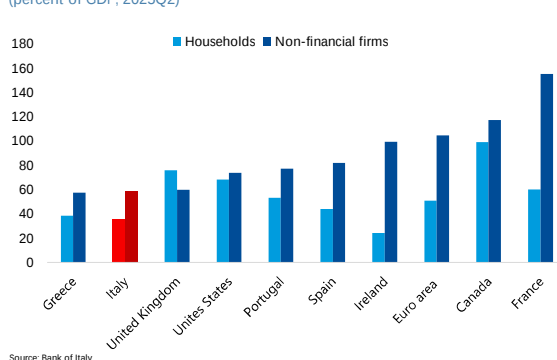
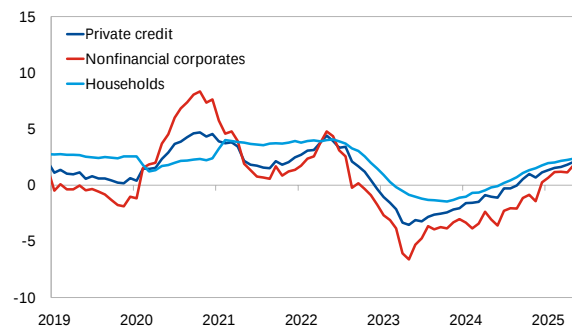


Figure 2. Italy: Credit, Corporate and Household Indebtedness

The credit provision returned to growth in late 2025, after a period of contraction...

Private Sector Credit Growth

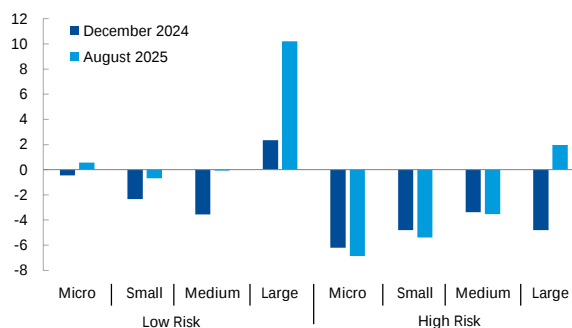
(Percent, year-on-year growth)



...that was more pronounced for smaller and higher-risk firms.

Loans By Risk Class And Firm Size

(Percentage changes, y-o-y)

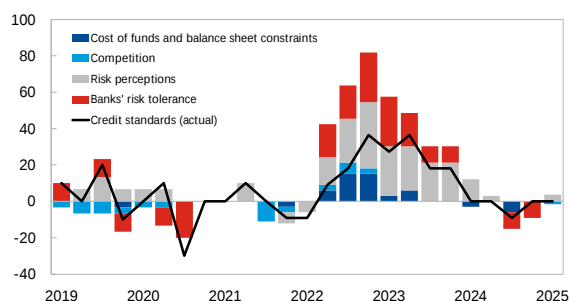


Source: Bank of Italy Financial Stability Report. The chart is based on Figure 1.15 (b)

Banks relaxed lending standards since 2024...

Tightening of Bank Lending Standards

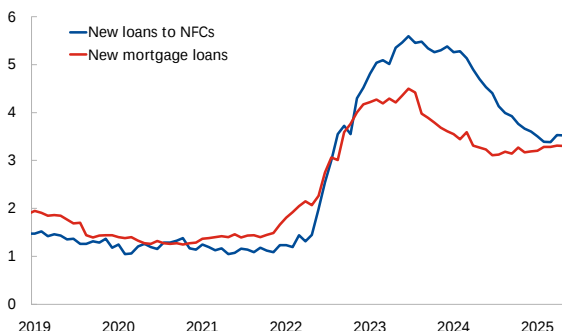
(Net percentages of banks reporting a tightening of lending standards and contributing factors)



...and interest rates on bank loans fell following the start of the ECB easing cycle in mid-2024.

Interest Rates on Bank Funding

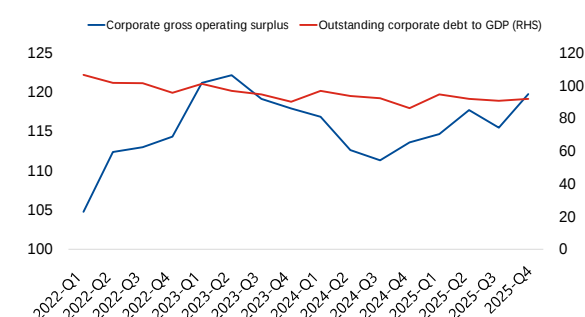
(Percent)



While corporate leverage has gradually declined, profitability peaked in 2023.

Corporate: Gross Operating Surplus and Outstanding Debt

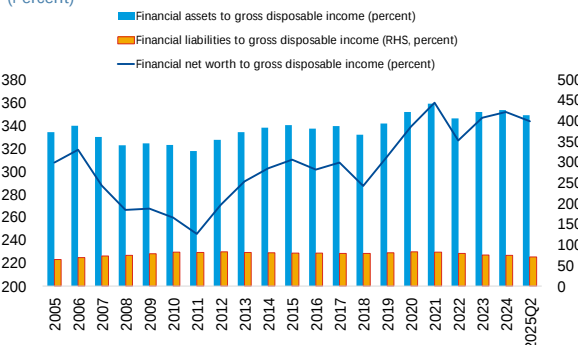
(Left: billions of euros, Right: percent of GDP)



Household balance sheets remain strong, with financial net worth continuing to rise as liabilities decrease.

Household Balance Sheet

(Percent)



Sources: Haver Analytics, Bank of Italy, ISTAT, ECB, IMF Staff Calculations

Notes: Panel 2 is based on Bank of Italy's Financial Stability Report Figure 1.15(b). Gross operating surplus for panel 5 is seasonally adjusted.

B. Financial Sector Structure

5. Italy's financial system remains bank-dominated. The system represents about 285 percent of GDP as of 2025 and is relatively small compared to other major economies (Figure 3). Nonetheless, it includes two of the top ten banks and one of the three largest insurance companies in the EA. The banking sector accounts for more than half of the system assets although its size relative to GDP has significantly declined since 2020. As of June 2025, it comprised 12 significant institutions (SIs), five subsidiaries of foreign SIs, and over a hundred LSIs. SIs hold 88 percent of total assets—slightly above the EA average of 84 percent. The number of LSIs has declined sharply in recent years, partly reflecting sustained supervisory efforts to consolidate weaker institutions.

6. The LSI sector is heterogeneous, shaped by differences in legal form, business models, and regional footprint. This in turn shapes risk profiles, funding structures, and supervisory priorities (Table 2). Although cooperative and popolari banks account for nearly half of institutions by number, joint-stock companies dominate the market with 77 percent of assets. From a business-model perspective, specialized lenders represent 22 percent of LSI assets and include banks focused on non-performing loan (NPL) management, which largely explains their higher NPL ratios. Regional disparities further characterize the sector: LSIs in northern and central regions, where per capita income is higher, account for a larger share of lending and deposit activity and tend to benefit from stronger credit demand and lower NPL ratios.³

**Table 2. Italy: Less Significant Institutions
(Q1 2025, in percent)**

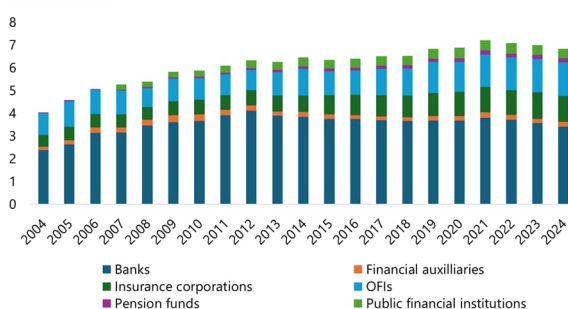
	# LSI	Assets	CET 1	NPL ratio	ROE
Legal Model					
Joint stock companies	57	77.3	18.0	7.4	11.0
Popolari banks	16	14.5	22.0	4.5	9.2
Cooperative banks	39*	4.9	31.8	3.7	9.8
Business Model					
Traditional banking	81	62.1	19.9	3.9	9.9
Specialized lending**	16	22.3	14.9	18.4	9.6
Asset Management	15	12.2	19.5	2.5	16.6
Third country branches	6	3.3			
Total	118	100.0	18.7	6.6	10.7
Sources: Bdl and IMF staff calculations and estimates.					
Notes: * All are part of Raiffeisen Institutional Protection Scheme.					
** It includes LSI specialized in NPL acquisition and management.					

³ Bdl (2024), [The Economy of the Italian Regions: Recent Trends and Structural Features](#), *Economie regionali*, No. 22, November.

Figure 3. Italy: Financial System Structure

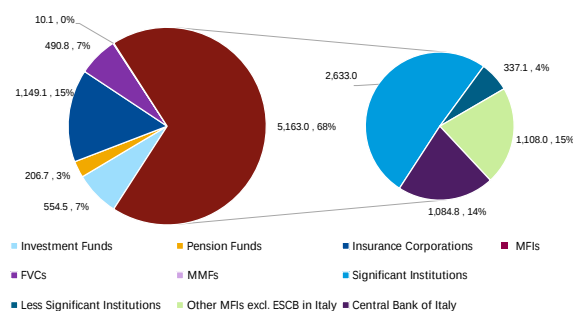
Financial system assets stabilized at around three times the GDP...

Financial Sector Structure, 2004-2024
(USD, trillions)



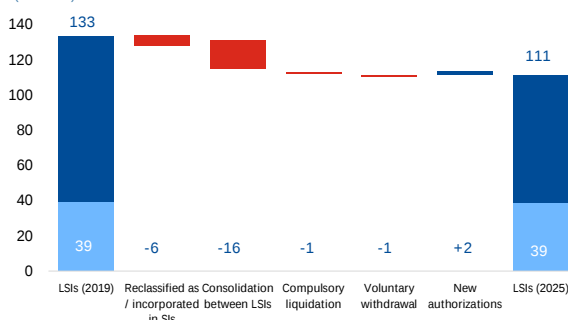
Non-bank financial intermediaries account for almost one third of total financial system assets ...

Total Assets of Financial Sector, 2025Q4
(Euros billion, percent of Assets)



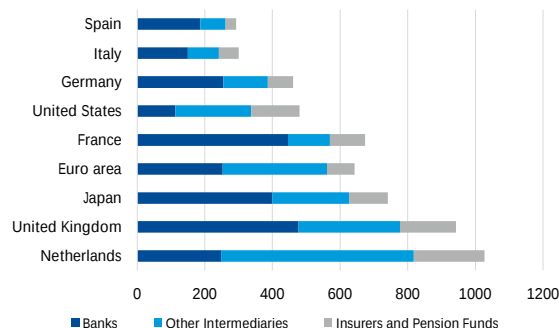
The number of LSIs declined significantly since 2019 due mostly to mergers...

Italian LSIs: Changes 2019-2025 (Q3)
(number)



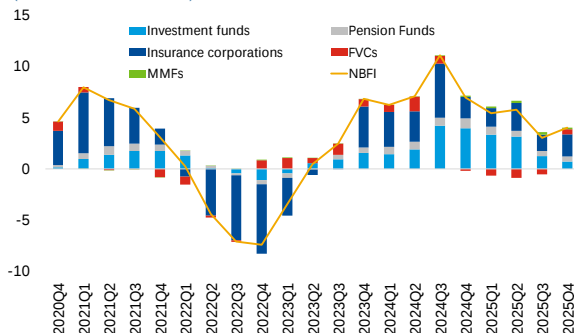
...and remains smaller compared to those of other advanced economies.

Total Assets of Financial Institutions
(as % of GDP, December 2024)



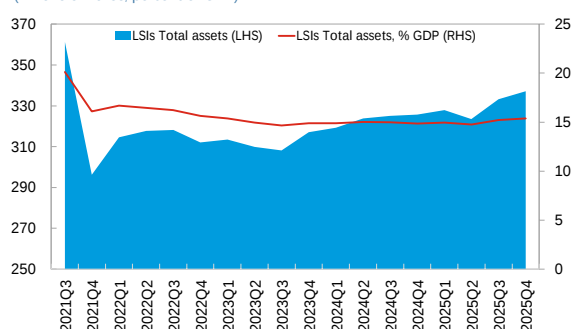
...and have been expanding since 2023 driven by insurance corporations, and more recently investment funds.

Total Assets of NBFIs
(Year on Year Growth Rate)



... and LSI assets fell in 2021 due to reclassification; growth since then kept pace with GDP.

LSIs Total Assets
(Billions of Euros, percent of GDP)



Source: ECB

Sources: Financial Stability Board, Bank of Italy, ECB, IMF staff estimates.

Notes: Panel 1 - Financial auxiliaries are corporations or quasi-corporations that are engaged primarily in auxiliary financial activities, e.g. insurance brokers, investment advisors and corporations providing infrastructure for financial markets. Panel 2 - Other intermediaries is the sum of Public Financial Institutions, other financial intermediaries and Financial Auxiliaries.

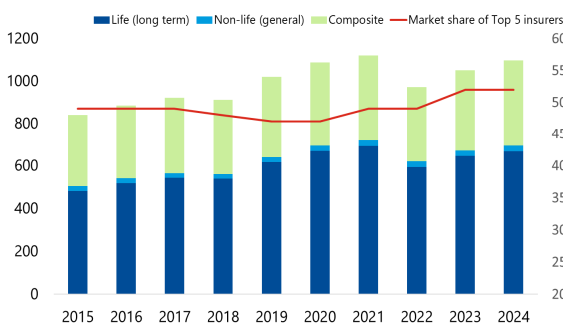
7. A consolidation wave is underway in Italy's banking sector, with some developments shaped by government decisions. The number of LSIs has declined sharply since last FSAP, partly reflecting sustained supervisory efforts to consolidate weaker institutions. More recently, consolidating has extended to SIs. Since late 2024, five of the six largest banks have entered merger discussions, reflecting efforts to use excess capital positions to diversify revenue streams and improve efficiency in an environment of narrowing interest margins, subdued credit, and limited organic growth opportunities. In this context, the government has invoked its “golden power” in some transactions (see Box 1, FSSA). Monte dei Paschi di Siena, still partially state-owned following its 2017 recapitalization, obtained control of another SI, creating Italy's third-largest banking group and acquiring a strategic stake in the largest insurer.⁴

8. NBFIs play an increasingly important role in Italy's financial landscape. Insurance sector assets amount to about 50 percent of GDP, with roughly 60 percent held by life (long-term) insurers (Figure 4). The number of insurers has declined from 100 in 2018 to 89, reflecting consolidation and increasing concentration among a few large groups. Life insurance penetration (5.5 percent) exceeds the EA average and tends to decline in rising interest-rate cycles reflecting competition from alternative savings products, while non-life penetration remains low at 1.9 percent, pointing to a significant insurance gap in property and health lines. The investment fund sector reached around 66 percent of GDP at end-2024 and is dominated by foreign-domiciled funds, mainly in Luxembourg and Ireland. Domestic funds are predominantly open-ended, invest largely in listed financial instruments, and are mostly held by retail investors. Closed-end funds—primarily targeted at institutional investors—are heavily concentrated in real estate (67 percent), leaving the sector exposed to real estate-related risks.

Figure 4. Italy: Non-Bank Financial Institutions

Insurance sector assets recovered in recent years, driven by the life insurance segment, with concentration increasing amid consolidation.

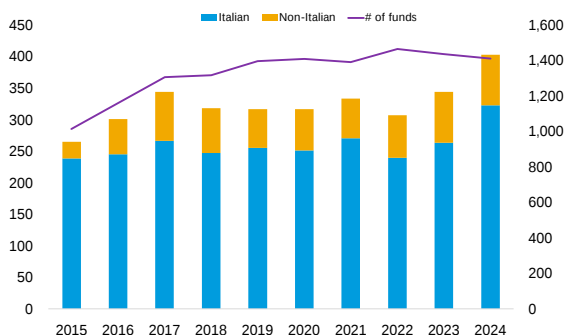
Insurance: Total Assets
(billions of euros, percent)



Sources: Bank of Italy

Italian open-ended investment fund assets rebounded strongly after 2022, driving total AUM to a new peak in 2024.

Open Ended Investment Funds: Assets Under Management
(billions of euros, number)



⁴ At end-2025, the Ministry of Economy and Finance held a 4.86 percent stake in Monte dei Paschi di Siena—valued at around €1.4 billion—and maintained representation on the bank's board.

C. Financial Sector Developments

9. Italian banks remain predominantly domestically oriented. As of 2025, total banking sector assets stood at €3.5 trillion, still below the €3.6 trillion peak reached in 2021⁵ (Figure 5). Following post-pandemic balance-sheet contraction, asset growth resumed in 2024, driven mainly by increased holdings of debt securities, while loan portfolios remained broadly stable. As a result, the share of loans in total assets declined to about 60 percent in 2025, down from a peak of 67 percent in 2017. Nearly 94 percent of bank lending is to domestic counterparts, and the share of non-Italian loans increased only marginally over the last decade. Debt securities holdings have risen since 2022 and accounted for 23 percent of total assets as of June 2025, roughly half of which are Italian sovereign bonds. Less than 5 percent of securities holdings are denominated in foreign currencies—predominantly U.S. dollars—including about 15 percent of foreign sovereign securities and 13 percent of corporate securities. Material U.S. dollar exposures are concentrated in a small number of banks, including the two largest SIs.

10. Corporate lending accounts for the largest share of banks' loan portfolios, despite a continued decline in outstanding corporate loans (Figure 5). While the recovery in private sector credit continued and broadened to the corporate sector in June 2025, overall credit expansion remains subdued. Corporate loans represent about 40 percent of total lending, followed by mortgages at around 27 percent. While lending to large corporates and the most financially sound smaller firms shows some signs of recovery, credit to riskier firms, especially small and medium-sized enterprises, continues to contract.

11. Banks maintain solid capital and liquidity buffers (Figure 6). As of December 2025, Common Equity Tier 1 (CET1) ratios remained strong at 15.9 percent for SIs and 18.6 percent for LSIs.⁶ Liquidity conditions are robust, with high Liquidity Coverage Ratios (LCR) and Net Stable Funding Ratios (NSFR), and reliance on ECB funding has declined following the phase-out of TLTRO operations. Funding costs remain contained, supported by compressed sovereign spreads and continued access to stable, low-cost retail deposits, with only partial pass-through of policy rate increases.⁷

⁵ Since the Global Financial Crisis, the banking sector assets increased by about 2 percent in nominal terms, however, relative to GDP banks' assets declined from 214 percent in 2010 to 156 percent by the end of 2025.

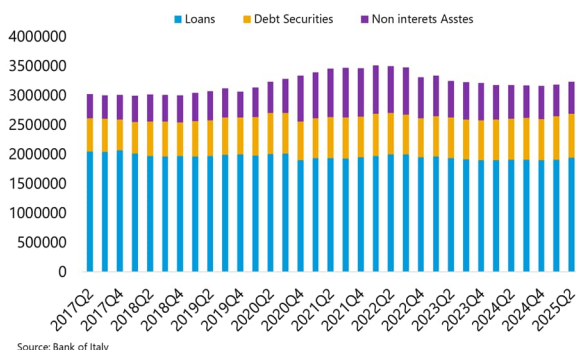
⁶ The aggregate CET1 ratios for EA banks stood at 16.1 percent for SIs with universal and investment bank business models and at 18.4 percent for LSIs.

⁷ Bdl estimates suggest that, in the most recent easing cycle, interest rate pass-through to deposits (betas) remained low for overnight deposits at 10 percent and more responsive for term deposits at 70 percent, similar to EA patterns (10 and 80 percent, respectively).

Figure 5. Italy: Banking Sector Assets

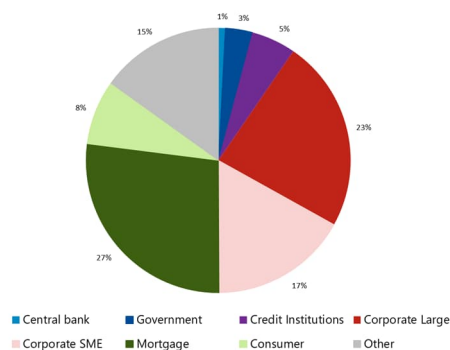
Assets growth resumed in 2024 after several quarters of contraction, with loan portfolio broadly flat.

Bank Assets (billions of euros)



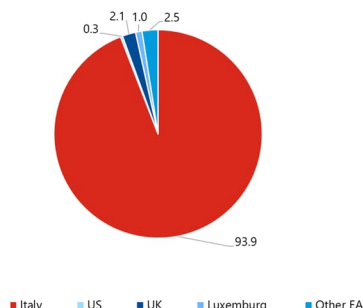
Corporate loans represented about 40 percent of bank total loans, followed by mortgages at 27 percent.

Bank Loans: by Type of Borrower (percent of total loans, 2025Q2)



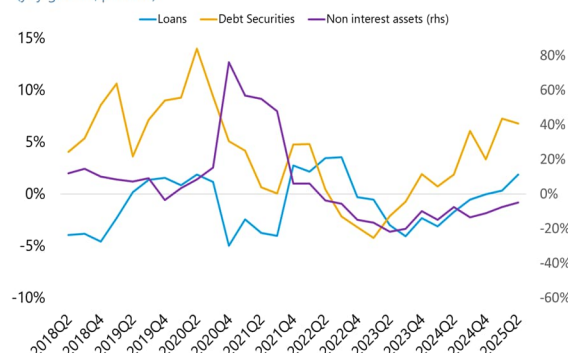
Italian banks remain predominantly domestically focused, with the share of local exposures close to 94 percent.

Bank Loans: by Jurisdiction of Counterparts (percent, 2025Q2)



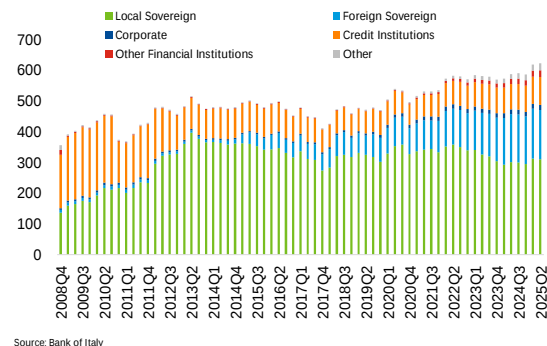
Holding of debt securities increased over the past several years and constitute almost a quarter of total bank assets.

Bank Assets (yoy growth, percent)



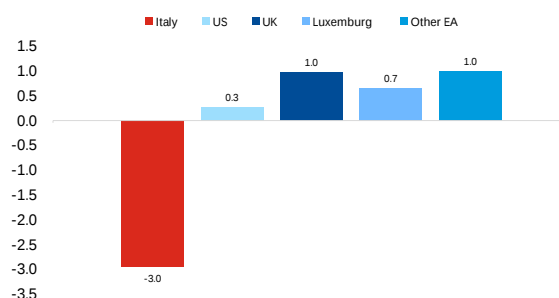
About half of securities holdings are Italian sovereign bonds.

Debt Securities by Type (billions of euros)



Foreign exposures increased by about 3 percentage points since 2015 driven by the UK and EA.

Drivers of Change in Loan Shares (percent, 2015Q1-2025Q2)

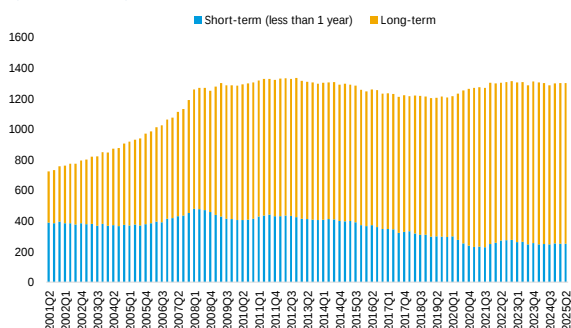


Sources: Bdl, IMF staff calculations.

Figure 5. Italy: Banking Sector Assets (concluded)

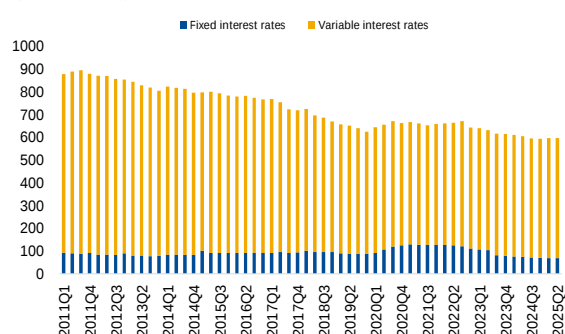
NFC long-term lending has steadily increased over time, while short-term loans have remained relatively stable and declined in recent years.

NFC Loans: Term Structure
(billions of euros)



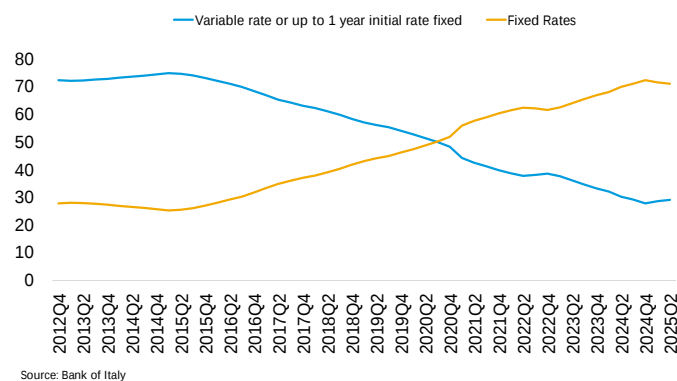
The share of corporate loans at variable rates has been consistently high...

NFC Loans: Type of Interest Rate
(billions of euros)



... while for mortgages there is a steady shift from variable- to fixed-rate over time, with variable-rate lending declining significantly after the pandemic inflation shock in 2020.

Mortgage Loans: Type of Interest Rate
(percent)



Sources: Bdl, IMF staff calculations.

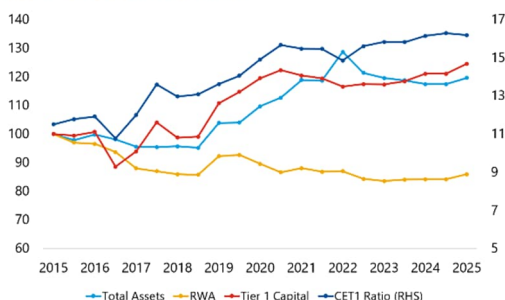
12. Bank profitability reached record levels in 2025. As of June 2025, return on equity (ROE) stood at 16.3 percent for SIs and 9.1 percent for LSIs, driven by elevated net interest income, earlier cost-efficiency gains, and strong fee-based revenues. Banks benefited from a loan portfolio with a high share of variable-rate loans prior to the pandemic-related inflation shock (Figure 5). Given the uncertainty about the interest rate cycle, banks are expected to intensify their strategic focus on consolidation and expansion in fee-generating activities, such as asset management and insurance. Additional headwinds arise from fiscal measures, as the use of convertible deferred tax assets (DTAs) for 2025–2026 has been deferred up to 2029 and the 2026 Budget included a tax rise for banks and insurers.

Figure 6. Italy: Banking Sector Developments

Banks' capital position remains strong...

CET1 and Risk-Weighted Assets of Italian Banking System

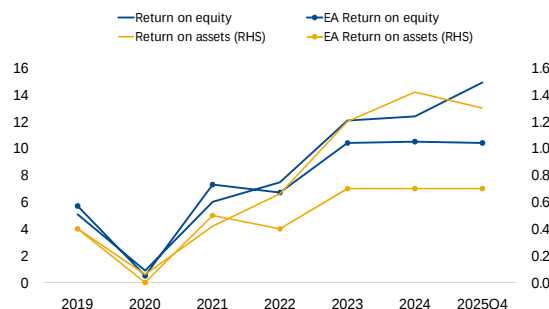
(LHS: Index 2015Q2=100, RHS: Percent)



...supported by recovery in profitability over the last few years.

Banks' Profitability Indicators

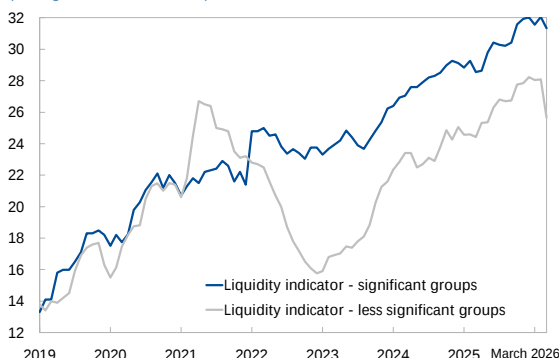
(Percent)



Liquidity is improving for both SIs and LSIs....

Net Liquidity Position

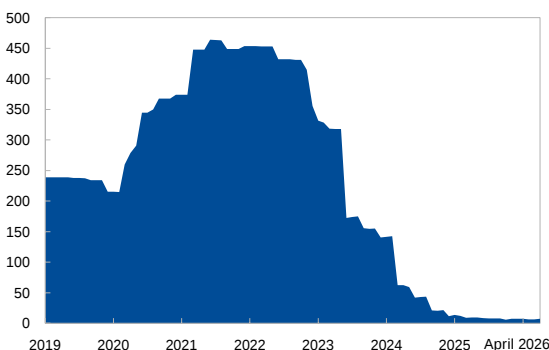
(Average share of total assets)



...and reliance on ECB funding was largely phased out.

Outstanding Borrowing Under LTROs

(Billions of euros)



Sources: Bank of Italy, Haver Analytics, EBA Risk Dashboard, IMF staff estimates.

Notes: Panel 1 – Based on semiannual data. Panel 4 – The liquidity indicator is calculated by the Bank of Italy as the (positive or negative) difference between the holdings of freely available assets eligible for use as collateral for Eurosystem refinancing operations (counterbalancing capacity) and the cumulative expected net cash flows over the next 30 days.

13. Asset quality has also improved markedly since the 2020 FSAP, though residual vulnerabilities persist, especially among LSIs. The NPL ratio declined to 2.4 percent at the end of 2025 from a peak above 16 percent in 2014, supported by the supervisory pressure, the development of an active NPL market and the use of government-guaranteed securitization.⁸ While this progress has strengthened bank balance sheets, some LSIs are still facing idiosyncratic challenges, including higher NPL ratios (averaging 6 percent), lower coverage, weaker profitability, and operational inefficiencies. These LSIs remain subject to intensified supervisory scrutiny. Moreover, about €287 billion in gross nonperforming exposures—around 75 percent of the 2015 peak—remain in the economy. While they are now largely transferred off banks' balance sheets to

⁸ GACS securitization scheme supported 46 transactions covering €117.8 billion in gross book value—about one-third of Italy's peak NPL stock. A state-owned asset management company AMCO is currently managing €29.4 billion. For more details see Financial Stability Board (2024) *Peer review of Italy*: <https://www.fsb.org/2024/01/peer-review-of-italy-2/>.

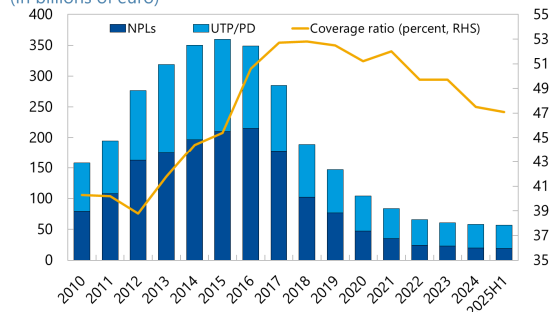
investors—following large price haircuts and impairment recognition, their final resolution is still hindered by inefficient insolvency, restructuring and enforcement procedures (Figure 7).

Figure 7. Italy: Non-performing Loans

Aggregate NPLs on banks' balance sheets declined significantly since their peak in 2016...

Non-Performing Loans and Coverage Ratio 1

(In billions of euro)

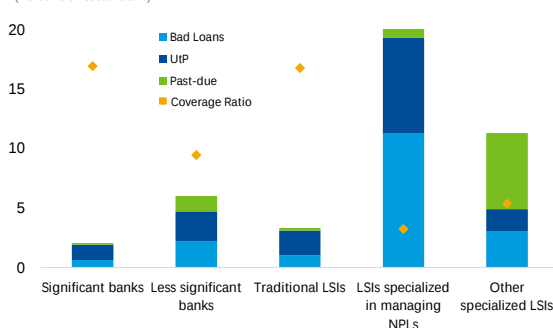


Source: Bdl

Asset quality and coverage are overall strong but with heterogeneity across entities.

NPL Rates and Coverage Ratios by Bank Business Model, 2025Q4

(Percent of total loans)

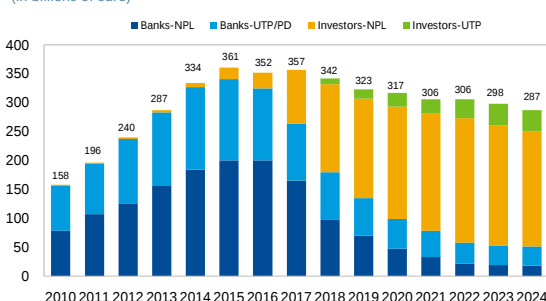


Notes: Panels 1 and 2 - NPLs or 'bad loans' refer to exposures to debtors that are insolvent or in substantially similar circumstances. Unlikely-to-pay exposures (UTP) refer to exposures in respect of which banks believe the debtors are unlikely to meet their contractual obligations in full unless action such as the enforcement of guarantees is taken. Past-due (PD) exposures are those that are overdrawn and/or past-due by more than 90 days and for above a predefined amount.

... but they remain largely unresolved, held by investors.

NPE Stock in the Italian Market

(In billions of euro)

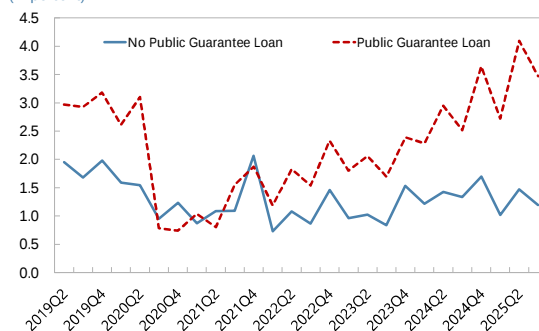


Source: PWC/AMCO

Gap in default rates between guaranteed and non-guaranteed loans is widening

Public Guarantee Loan Default Rate

(In percent)



Source: Bank of Italy.

14. The NBFIs sector remains broadly stable, though sector-specific risks warrant close monitoring. Insurance companies maintain strong capital and solvency positions however their exposure to domestic sovereign debt remains relatively high at about 29 percent of assets (see TN on Insurance Sector). Liquidity conditions are ample and surrender ratios in life insurance continue to decline following the 2023 peak. Non-life insurers face rising climate-related claims, though balance-sheet impacts have been contained through pricing and underwriting adjustments. In asset management, leverage is low and liquidity risks appear manageable, with funds most vulnerable for redemption pressures accounting for less than 2 percent of assets.

SYSTEMIC RISK ASSESSMENT

A. Key Systemic Vulnerabilities and Risks

15. Since the last FSAP, the sovereign–financial sector nexus has eased somewhat but remains substantial (Figure 8). As of September 2025, Italian banks' holding of domestic government securities declined to 8.6 percent of their total assets, from 10 percent in 2020, though still well above the EA average of 3.2 percent. Concentration is considerably higher among cooperative banks, where such exposures reach about 23 percent of assets. Lending to the public sector is also substantial—around 6 percent of total assets—and markedly more concentrated than among peers within the Single Supervisory Mechanism (SSM). By contrast, two channels of indirect sovereign exposure—both legacies of the banking crisis—have been steadily unwinding. The stock of convertible DTAs has fallen from the peak of 23 percent of CET1 in 2016 to 6 percent in 2025.⁹ In addition, the volume of government-guaranteed GACS securities has declined to roughly €8 billion in 2024, from €21.5 billion at issuance (2017–2022).

16. The extensive use of government guarantees on bank loans amplifies sovereign–bank linkages and creates distortions in the prudential framework. As of June 2025, such guarantees cover about 23 percent of total performing corporate loans, with default rates recently rising relative to non-guaranteed portfolios. Its use varies widely across institutions, with some LSIs anchoring business models on the advantages conferred by these schemes in terms of regulatory capital—zero risk weighting—and risk pricing. While emergency guarantees during the pandemic are gradually amortizing, expansion of non-emergency targeted schemes has kept the overall public guarantees stock elevated. Such guarantees risk distorting prudential oversight—including through zero risk weighting—and credit allocation. To mitigate these distortions, a timebound and well communicated phaseout strategy toward at least pre-pandemic levels would help mitigate these risks. In parallel, Bdl should assess institution specific impacts, particularly among LSIs.

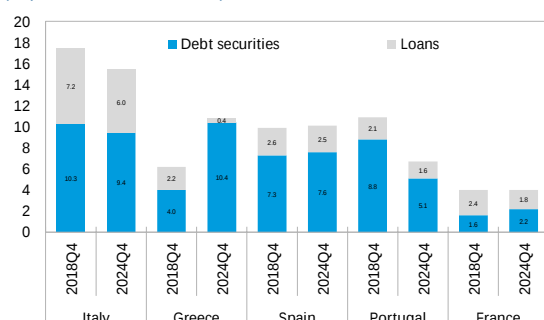
17. In the current macroeconomic and geopolitical environment, the materialization of adverse risks could pose challenges for the financial system. Adverse macrofinancial developments or heightened geopolitical tensions could test the financial sector's resilience, with potential pressures further amplified by sizeable sovereign exposures, sensitivity of the economy to global trade and energy conditions, elevated public debt, and limited policy space. While the recent Middle East conflict has so far had limited direct impact on the financial sector, in more acute or prolonged scenarios, stress could transmit through growth prospects and tighter financial conditions ultimately leading to a deterioration in asset quality, strains in core financial markets, and spillovers from the NBFIs sector.

⁹ For LSI accounted 2 percent of CET1. Convertible DTAs originate from loan loss provisions and goodwill or intangible asset impairments recognized on banks' balance sheets until December 2015. Under the current regulatory schedule, DTAs are projected to be fully utilized by 2029.

Figure 8. Italy: Sovereign-Bank Nexus

The sovereign-bank nexus declined slightly since 2018 though remains elevated compared to peers...

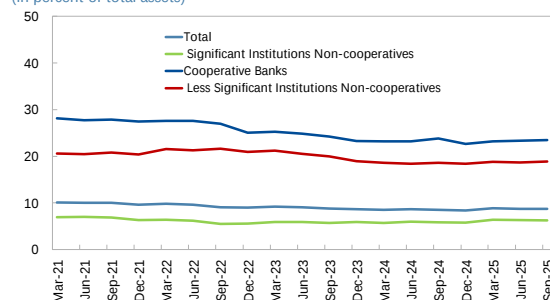
Share of Domestic Government Assets by Instrument
(In percent of banks assets)



Source: IMF, Monetary and Financial Statistics (MFS) database.

...with cooperative banks and LSI disproportionately concentrated in government bonds

Exposure of the Banking System: Government Debt Securities Issued
(In percent of total assets)

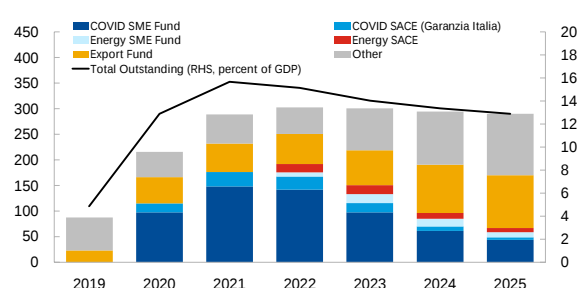


Source: Bank of Italy

Note: All public sector securities, including those issued by local authorities. Total is calculated as public sector securities/total assets.

The stock of public guarantees is elevated at about 13 percent of GDP...

Outstanding Stock of Public Guarantees
(Billions of euros, as of end-September 2025)

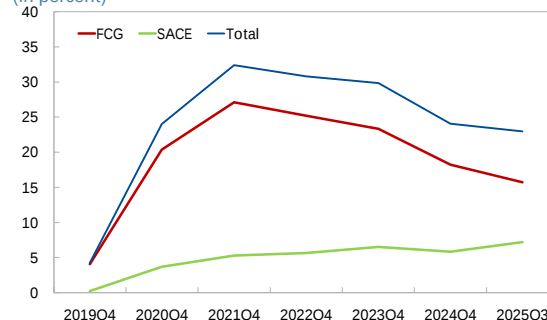


Sources: MEF and Italian Budgets.

Note: "Other" includes the guarantee schemes outside of COVID-19, energy-crisis programs and the Export Fund.

... and nearly a fourth of loans to NFC are backed by public guarantees.

Share of Loans to NFC with Public Guarantees 1/
(In percent)



Source: Bank of Italy.

1/ Loans equal only performing loans. FCG: Fund for the Guarantee of Companies, SACE: Italian Export Credit Agency.

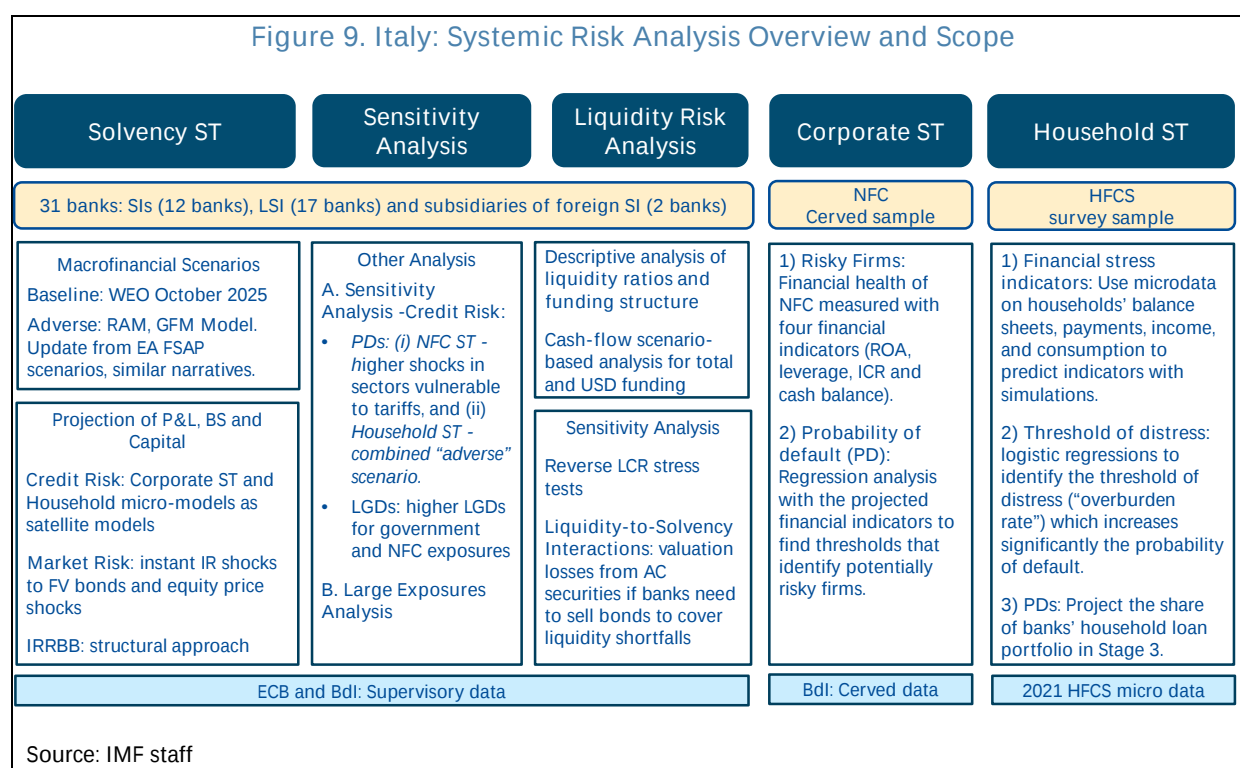
B. Scope of the FSAP Analysis

18. The FSAP assessed the resilience of the banking system to severe but plausible shocks through five main analytical exercises (Figure 9). The analytical framework comprises (i) corporate stress tests; (ii) household sector analysis, (iii) bank solvency stress tests assessing resilience to credit, interest rate, and market risks; (iv) bank liquidity risk analysis; and (v) interconnectedness analysis. Notably, this is the first Italy FSAP to conduct fully fledged solvency and liquidity stress tests on the recently consolidated cooperative banks and a representative sample of LSIs, expanding the assessment coverage to 98 percent of banking system total assets¹⁰. This comprehensive set of analyses (see Appendixes for technical details) examines the risks identified in the Risk Assessment Matrix (RAM, Appendix I). The main objective is to evaluate the potential impact of adverse

¹⁰ The 2020 Italy FSAP solvency stress test covered only 9 SIs, accounting for 68 percent of banking sector total assets. Single-factor sensitivity analysis was conducted for a sample of LSIs, representing about 9 percent of total assets.

macroeconomic and financial shocks on the stability of the Italian financial system and to identify key areas of vulnerability.

19. In addition, the FSAP assessed specific risks through a set of sensitivity analyses. These included: (i) evaluating the impact of combined shocks underpinning the household vulnerability model, as well as more severe shocks to tariff-exposed sectors in the corporate stress test model, integrating sector-specific assessments with the broader banking stress tests; (ii) given the important role of government guarantees for some banks, conducting sensitivity analyses assuming higher loss-given-default (LGD) rates—ranging from an additional 10 to 30 percentage points—for government and nonfinancial corporate (NFC) exposures; (iii) conducting LCR-based reverse stress tests, and (iv) assessing liquidity-to-solvency interactions by integrating liquidity cash-flow analysis with the banking stress tests.



C. Scenarios

Macrofinancial Scenarios

20. The systemic risk analysis was based on three macrofinancial scenarios that capture both global and domestic risks. The baseline scenario is aligned with the October 2025 World Economic Outlook (WEO), while the two adverse scenarios are drawn from the EA FSAP. Both adverse scenarios were simulated using the Global Macrofinancial Model (GMM), a structural macro-econometric model of the global economy disaggregated into forty national economies.¹¹ Under the adverse scenarios, the GDP shock—measured as cumulative growth over the first two years—is equivalent to 2.3 standard deviations of the historical distribution in the geopolitical scenario and 2.7 standard deviations in the recessionary scenario.

21. Although specified prior to the outbreak of the Middle East war in March 2026, the adverse scenarios remain relevant. They are considerably more severe than the recent downgrades to economic forecasts, which reflect more moderate growth slowdowns and higher inflation. Both scenarios incorporate a two-year GDP contraction. In particular, the geopolitical scenario features an inflation profile broadly comparable to the April 2026 WEO severe scenario, while being markedly more severe in terms of other key macroeconomic variables (Figure 10).

22. The baseline scenario is anchored in the October 2025 World Economic Outlook (WEO). It assumes a mild economic recovery, supported by a gradual increase in private consumption and exports, which partially offsets a still-weak external environment. Real GDP growth is projected to temporarily rise to 0.8 percent in 2026, before moderating thereafter. Inflation is expected to remain broadly contained and within the ECB's target range throughout 2026–2028, reflecting easing price pressures and well-anchored inflation expectations.

23. The geopolitical scenario is characterized by heightened financial market stress stemming from escalation of geopolitical conflicts. The intensification of regional tensions triggers successive supply disruptions and demand fluctuations, increasing commodity price

Table 3. Italy: Statistics of GDP Growth
(in percent, 1980 – 2025)

	1-year growth	2-year cum.
Mean	1.3	2.6
SD	2.7	4.0
2SD	5.3	7.9
Mean - 2SD	-4.0	-5.4
5th pctl.	-2.8	-4.7
2.5th pctl.	-5.0	-6.1
1st pctl.	-7.3	-7.5
<i>FSAP</i>		
Baseline	0.7	1.3
(Percentile)	26.2	29.7
Geopolitical	-4.3	-7.6
(Percentile)	3.2	0.9
Recessionary	-5.3	-9.4
(Percentile)	2.2	0.0

Source: WEO database, IMF staff calculations.

¹¹ The GMM is a panel dynamic stochastic general equilibrium model that features a range of nominal and real rigidities, extensive macrofinancial linkages with both bank and capital market based financial intermediation, and diverse spillover transmission channels.

volatility. Deepening fragmentation disrupts established global production chains, exerting downward pressure on global economic activity through large adverse trade and price shocks. In addition, tariff increases and retaliatory measures among major regions further weigh on global trade. Surging energy prices weaken the external positions of countries with a high dependence on energy-intensive industries. The deteriorating economic outlook and tighter financial conditions trigger a stock market sell-off driven by profitability concerns and reduced risk appetite, with real equity prices declining across the EA, China, the UK, and the US over a two-year horizon, alongside a sizable correction in real estate prices. Persistently higher interest rates and declining household incomes further contribute to downward adjustments in residential real estate markets.

24. This scenario is amplified by heightened uncertainty. In particular, heightened uncertainty regarding the nature of future international trade and financial arrangements induces firms and households to postpone their expenditures, reducing private investment and consumption. Under this stress test scenario, measures in Europe and the United States ultimately generate secular stagnation. Despite fiscal policies (in countries with fiscal space) try to counteract the fall in demand, monetary policy partly offsets by fighting the inflationary pressures. The measures and lack of structural reforms undermine the efficiency gains from specialization and exchange, inducing persistent weakness in aggregate demand and supply, while disproportionately reducing trade flows. In particular, confidence losses concentrated in Europe and the United States induce firms and households to postpone their expenditures, reducing private investment and consumption. In addition, higher trade barriers concentrated in Europe, China and the United States contribute to reductions in exports and imports.

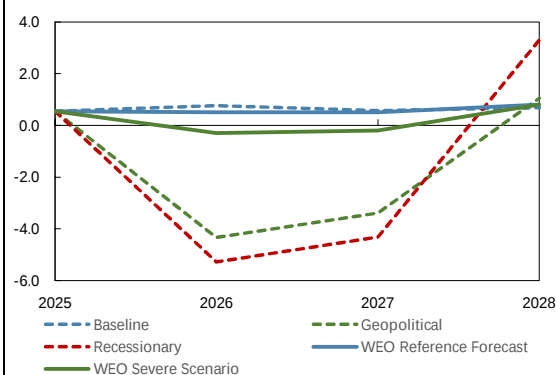
25. A disorderly adjustment is compounded by an aggressive reappraisal of market expectations on interest rates. Amid high economic uncertainty, strong and repeated inflationary pressures elevate inflation expectations, triggering a wage-price spiral, resulting in higher and more persistent inflation and a de-anchoring of expectations. This, in turn, leads to abrupt adjustments in financial markets. In this environment, high and protracted inflation coexists with negative growth. Impacts are compounded by Italy's fiscal space being at risk, expected monetary tightening, and a weakening external position amid higher energy costs and lower tourism revenues. Real GDP declines by 4.3 percent in 2026 and 3.4 percent in 2027, with unemployment rising to 11.6 percent (Figure 10, Appendix V).

26. The recessionary scenario features financial market stress arising from a synchronized sharp global slowdown amplified by sovereign debt distress. Political uncertainty increases the risks to fiscal consolidation triggering a wave of sovereign rating downgrades. Flight to quality rebalancing of bond portfolios trigger sudden stops in high-debt economies and emerging markets. The high debt levels built up during the decade of low interest rates and the pandemic raise concerns of the so-called "sovereign-bank nexus" which leads to speedier transmission of shocks between sovereign and banks. At the same time, term premium decompression in Europe and the United States, together with the re-emergence of sovereign stress in high spread EA economies, raises short term government bond yields.

Figure 10. Italy: Key Macro Variables Stress Test Scenarios

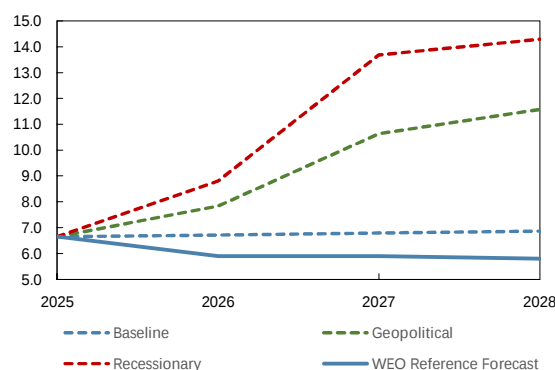
Real GDP growth contracts by 5.3 (R)^{1/} and 4.3 (G) percent in 2026, with a two-year cumulative decline of 9.4 (R) and 7.6 (G) percent....

Real GDP Growth (percent)



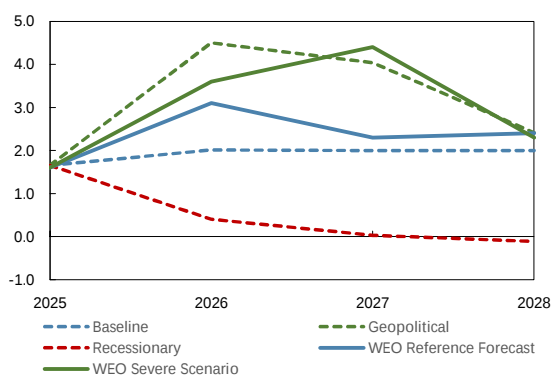
...and unemployment rises, peaking at 14.3 percent (R) 11.6 percent (G)

Unemployment (percent)



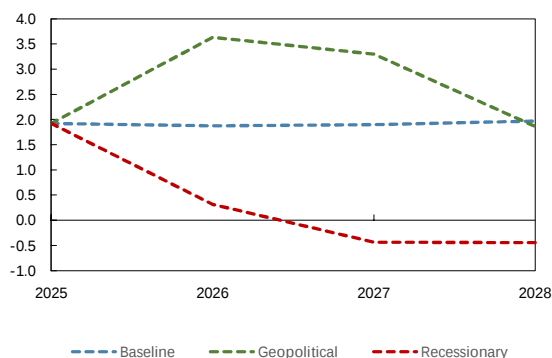
Inflation falls to 0.4 percent (R) in the recessionary; and rises to 4.5 percent (G) in the geopolitical scenario in 2026

Inflation (percent)



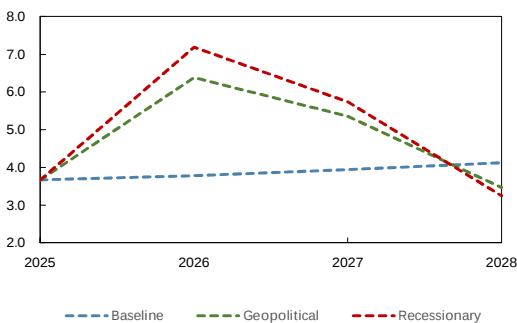
As a result, the short-term rate drops to 0.3 (R) and increases to 3.6 percent (G) in the same year...

Short Term Rate (percent)



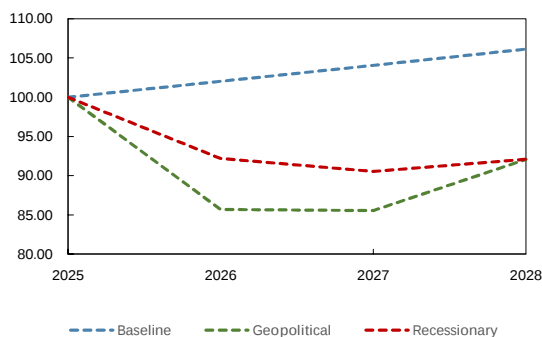
... while long-term rates spike in both scenarios to 7.2 percent (R) and 6.4 percent (G)...

Long Term Rate (percent)



Higher-for-longer interest rate amplifies house price shock under the geopolitical scenario.

House Price Index (units)



Sources: IMF and WEO database, IMF staff estimates.

^{1/} R = Recessionary scenario; G = Geopolitical scenario.

27. Under this scenario, pro-cyclical fiscal responses and policy limitations amplify economic shocks. The measures and lack of structural reforms undermine the efficiency gains from specialization and exchange, inducing persistent weakness in aggregate demand and supply, while disproportionately reducing trade flows. In addition, as in the geopolitical scenario, higher trade barriers concentrated in Europe and the United States contribute to reductions in exports and imports. Finally, the model allows automatic fiscal stabilizers to operate fully but includes pro-cyclical fiscal consolidation to restore market confidence over debt sustainability concerns in middle and high-risk EA countries and emerging markets.

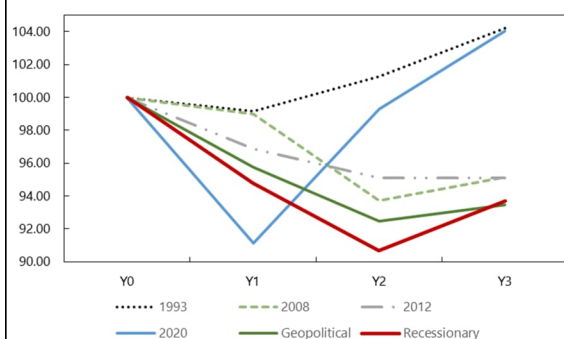
28. A limited monetary policy response is envisaged. In this context, conventional monetary policy returns to the effective zero lower bound in the systemic advanced economies, while the calibration of global financial market adjustments is interpreted as net off the effects of unconventional monetary policy responses where warranted, in particular in the EA and Japan. Under this scenario, Italian real GDP contracts by 5.3 percent in 2026 and 4.3 percent in 2027, while the unemployment rate rises to 14.3 percent (Figure 10, Appendix V).

29. The Italy FSAP scenarios exhibits a level of severity similar to the 2025 EA FSAP and are broadly comparable to the EBA scenario for the 2025 stress test (Figure 11). The EBA scenario is closest to the geopolitical scenario, particularly with respect to inflation dynamics, but is more severe in terms of unemployment and GDP shocks. This comparison underscores the overall severity of the FSAP scenarios, especially along these dimensions: under the recessionary scenario, unemployment approximately doubles over a short period within the three-year stress-test horizon, while GDP shocks fall within the extreme tail of the historical distribution.

Figure 11. Italy: Adverse Scenario Benchmark

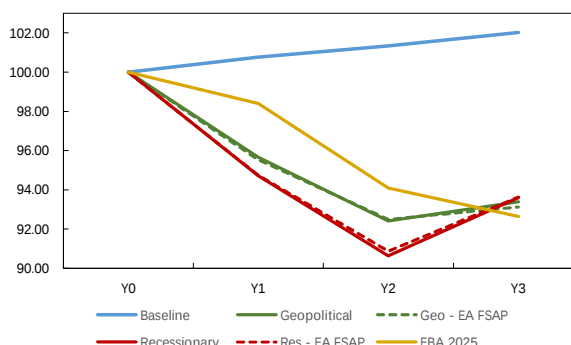
GDP shocks under the FSAP scenarios are broadly comparable to the one experienced during the COVID-19 crisis, but they are assumed to be more protracted.

Benchmark: Italian Crisis
(GDP Index)



The severity of the scenarios is aligned with the 2025 EA FSAP, which is more severe to the 2025 EBA stress test scenario.

Italy FSAP vs. 2025 EA FSAP and EBA Stress Test
(GDP Index)



Source: IMF staff calculations.

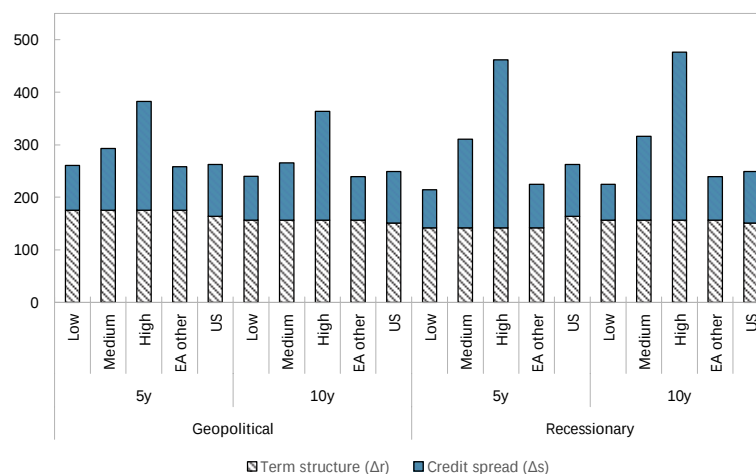
Market Risk Scenario

30. Market risk analysis was conducted using two short-term market stress scenarios. Based on the market scenario of the 2025 EA FSAP, these scenarios were calibrated to capture high-frequency movements in market prices and volatility, using the 0.1 percent expected shortfall of the marginal distributions of key market risk factors. The first scenario is aligned with the geopolitical macro scenario and features increases in interest rates—particularly at the short end of the euro-area yield curve—alongside higher commodity prices and credit spreads, as well as a sharp contraction in equity prices. The second scenario is aligned with the recessionary macro scenario and is characterized by declines in commodity and equity prices, a larger widening of credit spreads for mid- and high-risk euro-area sovereigns, and a relatively muted response at the short end of the euro-area yield curve (Figure 12, Appendix V).

Figure 12. Italy: Market Risk Scenarios

The scenarios assume sizeable interest-rate shocks, averaging about 340 basis points under the geopolitical scenario and 400 basis points under the recessionary scenario.

Market Risk Shocks (bsp)



Source: IMF staff calculations.

Note: Instantaneous shocks in the first year of the stress test scenario are applied to bank-level sovereign and corporate debt securities by issuing country. Countries are grouped into risk buckets based on the 2025 EA FSAP classification (see country groupings in Table AVII.1).

CORPORATE AND HOUSEHOLD ASSESSMENT

A. Corporate Analysis

Scope and Methodology

31. The analysis uses NFC data from Cerved, which provides detailed balance sheet and income statement information for nearly the entire population of Italian NFCs. In particular, Cerved offers more comprehensive coverage of micro-enterprises than other commonly used databases, such as Orbis. This is especially relevant for Italy, where micro firms account for nearly 95 percent of firms in the business sector, according to Eurostat. The sample period spans 2000–2023; owing to lags in data availability, financial indicators for 2024 and 2025 were imputed. The analysis excludes firms in the financial and insurance sectors as well as the public sector. Partnerships and sole proprietorships are also excluded due to limitations in data reliability (Appendix III provides further details on sample selection and models).

32. Potentially risky firms are identified using four financial indicators. The assessment of the financial health of the companies is based on four financial indicators. The Return on Assets (ROA) is a standard measure of profitability. Leverage, defined as the Debt-to-Assets (D/A) ratio and the Interest Coverage Ratio (ICR), both capturing solvency. The Cash-to-Current Liabilities ratio measures liquidity. Potentially risky firms are defined as those with: (i) negative ROA, (ii) leverage above 0.8 (which implies at Debt-to-Equity ratio above 4 or below 0), (iii) ICR below 1, or (iv) negative cash ratio.

33. The financial indicators are projected following the approaches from [Ebeke and others \(2021\)](#) and [Tressel and Ding \(2021\)](#). The projection follows a three-step approach. First, linear regressions (winsorized at 1 percent) targeting ROA, leverage, and EBIT growth as dependent variables with sector and region fixed effects are estimated. A sensitivity analysis for sectors vulnerable to tariffs (agriculture, mining, manufacturing) are conducted by further lowering the projected EBIT by 20 percent under the geopolitical scenario. Second, equipped with the estimated elasticities, fixed effects, and macro variables in the baseline and adverse scenarios, ROA, leverage, and EBIT are projected dynamically for 2024 to 2028. Third, the remaining financial variables (i.e., ICR, cash ratio) are projected based on accounting identities and using the projected indicators from the second step.

34. Firm's probability of default (PD) is predicted based on projected financial indicators and later used as input in the bank solvency stress test. Given the discrepancy of PDs between the reported aggregate data by banks and Cerved data, the one-year expected probability of default is scaled to match the values in the bank's aggregate data. A logistic regression examines the relationship between the four financial indicators and scaled one-year expected probability of default from Cerved from 2006 to 2023.¹² The estimated coefficients are then combined with the

¹² The regression starts from 2006 as it is the starting year of the aggregate PD data.

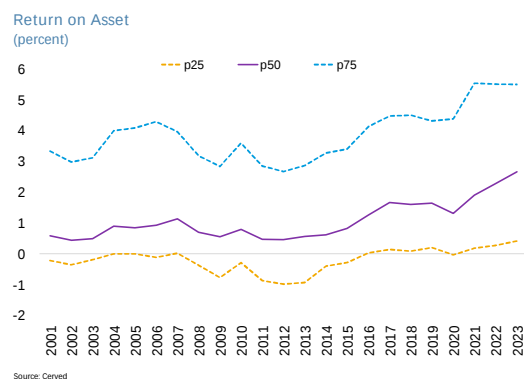
four projected financial indicators to predict the PD for each firm over 2025 to 2028. The predicted average PDs for SMEs and large corporates under the baseline and two adverse scenarios and sensitivity analysis serve as key inputs in assessing credit risks in the bank solvency stress test.

Results

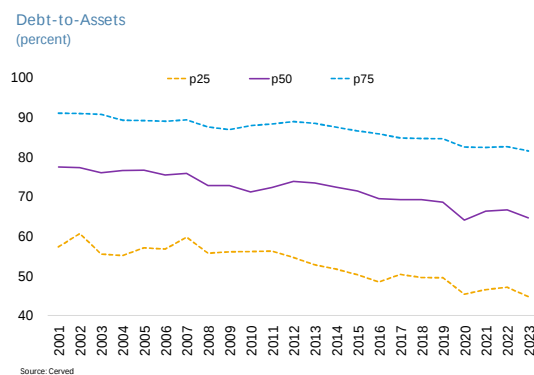
35. Italian NFCs have gradually strengthened their balance sheets, with marked improvements in profitability, solvency, and liquidity. Profitability has strengthened on a sustained basis, while leverage has declined steadily. The interest coverage ratio dropped slightly towards the end of the sample due to the tighter monetary policy environment. Liquidity buffers have improved, supported by policy measures during the pandemic. As a result, aggregate default risk fell markedly after the European sovereign debt crisis and remains low since 2020. Corporate vulnerabilities remain heterogeneous across firm size, regions, and sectors. SMEs, Southern firms, and those in construction, transport, agriculture, information, and entertainment display higher PDs. Overall, the corporate sector entered the current tightening cycle from a stronger position, though pockets of vulnerability persist for a subset of NFCs (Figure 13).

Figure 13. Italy: Corporate Financial Indicators

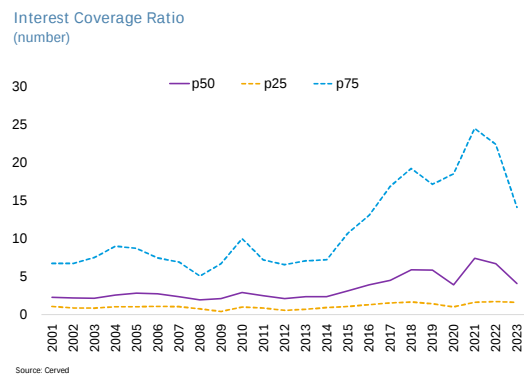
Profitability increased over time.



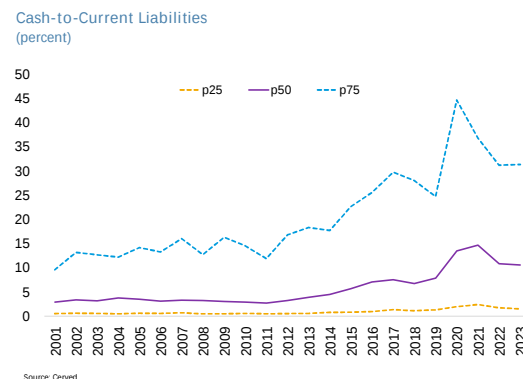
Corporate leverage gradually declined.



ICR steadily increased, though it dropped slightly towards the end of the horizon due to the tighter monetary policy.



Liquidity buffers have improved, supported by policy measures during the pandemic



Sources: Cerved and IMF staff calculations.

36. While aggregate corporate default probabilities rise materially under adverse scenarios, they remain below levels observed during the sovereign debt crisis. This suggests that the improved starting position of the corporate sector helps contain system wide risks, albeit with important heterogeneity. On average, PDs increase by about 275 basis points compared to 2025 under the geopolitical shock and by 95 basis points under the recessionary scenario. This is because the short-term interest rate cut as a response to the recessionary scenario reduces interest expenses and mitigates the adverse impact on earnings. By contrast, short-term interest rate rises sharply under the geopolitical scenario, further worsening the negative earnings effect through higher interest expenses (Figure 14).

37. Corporate vulnerabilities are uneven. SMEs and Southern firms experience a larger increase in default probabilities than large and Northern firms, reflecting thinner buffers and higher sensitivity to earnings and financing shocks. Industry results point to elevated stress in construction, transport, agriculture, accommodation and food, entertainment, and other services, while mining and utilities remain comparatively resilient.

B. Household Analysis

Scope and Methodology

38. The analysis leverages microdata from the Household Financial and Consumption Survey (HFCS). The HFCS provides household balance sheet information for 83,000 households and 200,000 personal files across 22 countries (20 EA countries, Czech Republic, and Hungary). As the latest HFCS vintage is 2021, a matching procedure is applied to “age forward” households financials and project their positions to 2024. The framework simulates the impact of income and price shocks¹³ on household balance sheets, income, consumption, and payments under the baseline and adverse scenarios.

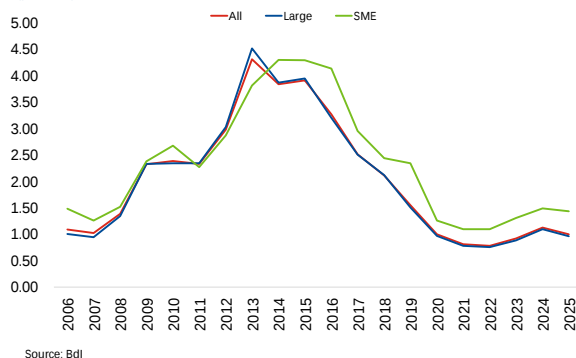
39. A battery of logistic regressions suggests cost-of-living adjusted debt service to income (DSTI) ratio as the best performing financial stress indicator. Default is proxied by being on arrears over 90 days (stage 3 loans, “credit impairment”) or less than 90 days (stage 2 loans, “credit event”). Households are classified as vulnerable if debt services with essential consumption (food and energy costs) and rents to income ratio is above a certain threshold. A horse race across adjusted DSTI thresholds finds that for most countries, the relative increase PD is the highest when the borrower’s adjusted DSTI exceeds 70 percent of disposable income (“overburdened” household). Estimated household vulnerabilities are translated into PDs and integrated into banks’ retail credit risk assessment (Appendix IV).

¹³ Income shocks are modeled through changes in employment status and wage dynamics, while price shocks affect essential expenditures such as food, energy, and housing.

Figure 14. Italy: Corporate Vulnerability Assessment

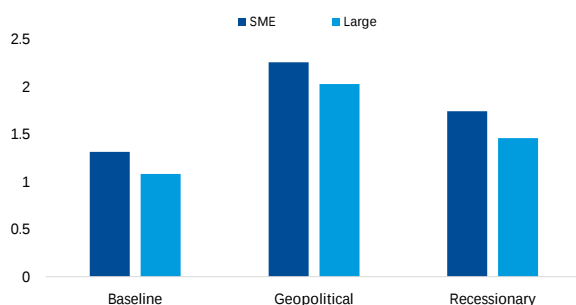
Average PD fell markedly after the sovereign debt crisis and remained low since Covid-19.

Mean PD over Time
(percent)



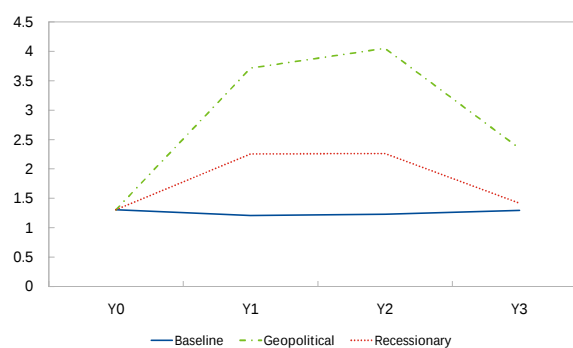
Average PD is higher for SME than large firms under the baseline and adverse scenarios.

Mean PD by Firm Size
(percent)



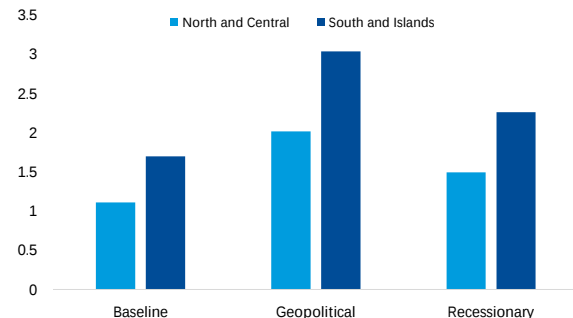
Average corporate PD is much higher than in 2025 under the geopolitical scenario than under the recessionary scenario.

Corporate Stress Test Model: PD results
(percent)



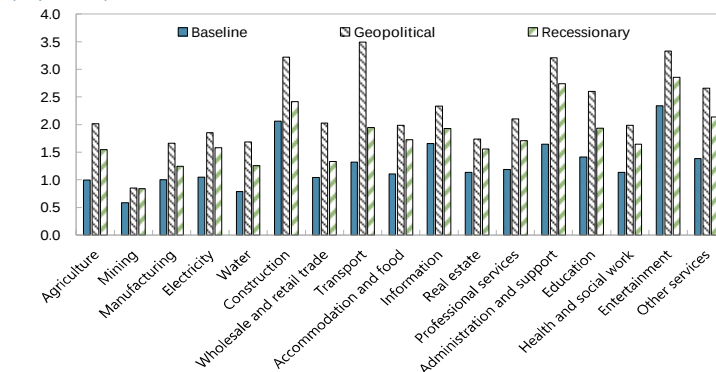
Average PD is higher for firms in Southern Italy than Northern Italy under the baseline and adverse scenarios.

Mean PD by Region
(percent)



Average PDs are substantially higher for construction, transport, agriculture, administration and support, entertainment, and other services under adverse scenarios.

Mean PD by Industry
(In percent)



Sources: Bdl, Cerved, and IMF staff calculations.

Results

40. While Italian households exhibit moderate aggregate indebtedness, there are some pockets of vulnerability, particularly among lower income groups. Although a smaller share of Italian households held debt than in the EA in 2021, indebted households appear to be more financially stretched. Debt-to-income (DTI) and debt service burdens were above EA peers for middle- and lower-income households. The adjustable-rate mortgages at around 40 percent of outstanding mortgages in 2021 (down to 26.1 percent in December 2025) increase sensitivity to interest rate hikes, while pre-existing arrears are higher than the EA average. These factors point to heightened vulnerability among a small portion of households with low savings, variable rate debt, and weaker income prospects.

41. Lower-income households and renters are more likely to be at risk under adverse scenarios, whereas high-income households account for a larger share of debt at risk. Average household Probability of Default (PDs) increase by similar magnitudes under the geopolitical (129 basis points) and recessionary (111 basis points) scenarios relative to 2025 levels.¹⁴ Under the geopolitical scenario, the share of vulnerable households and debt at risk could reach over 17 and 18 percent, respectively. Household vulnerabilities are heterogeneous. Around 45 percent of low-income households are at risk, compared to 8 percent of median-income households and 1 percent of high-income households. The share of households at risk increases by more for renters (10 percentage points higher than in 2021) than for mortgage owners (7 percentage points). By contrast, the 18-percent debt at risk in Italy is more concentrated among high-income households, which account for 37 percent of the total debt at risk, compared with 30 percent in the EA. Correspondingly, low-income households account for smaller shares of debt at risk than in the EA (25 versus 34, Figure 15).

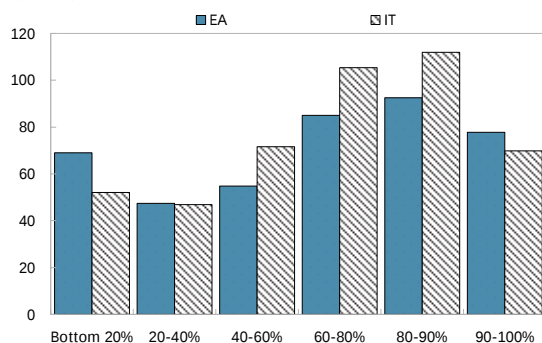
42. Additional sensitivity analyses point to around 3 percent of default risk, while around 5 percent of consumption is at risk. Several sensitivity analyses are considered: *200 bps* considers a 200 basis points further increase in the lending rate; *-10% inc & unem* corresponds to a 10 percent decline in gross nominal household disposable income over baseline projections; *cost of living* scenario considers combining the 200 bps scenario with a 20 percent increase in food and energy prices; and (iv) *adverse* corresponds to combining the 200 bps scenario with a 10 percent decline in gross nominal household disposable income. Household PD stays at around 3 percent across alternative adverse scenarios. A household is classified as *economically overburdened* (i.e., at risk of cutting consumption), if its debt service and total consumption exceed gross income. The analysis suggests that the share of consumption of economically overburdened households represents around 5 percent of aggregate consumption.

¹⁴ The household model project PDs relative to 2020 levels (2.7 percent), which is higher than household PDs observed in 2025 (1.8 percent).

Figure 15. Italy: Household Vulnerability Assessment

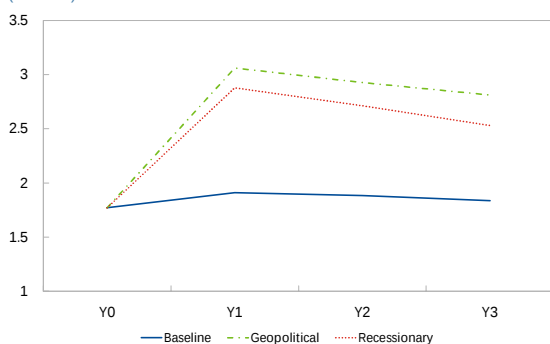
Median DTI is higher than EA peers, particularly for middle income households.

Median DTI by Income Group
(Percent)



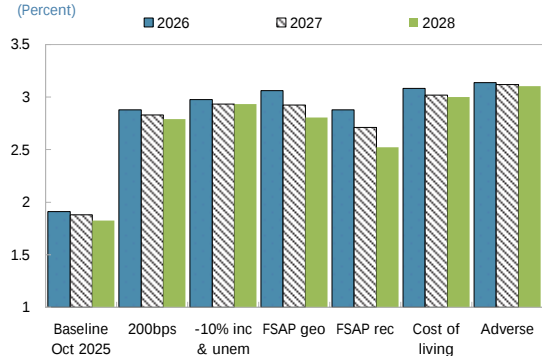
Households PD projection is slightly higher under the geopolitical scenario than the recessionary scenario.

Household Stress Test Model: PD Results
(Percent)



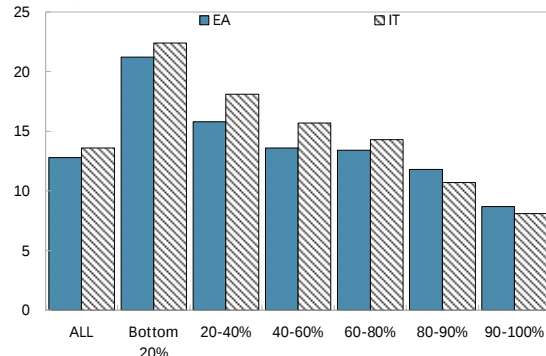
Sensitivity analyses indicate that household PD is at around 3 percent.

PD - Retail Portfolio
(Percent)



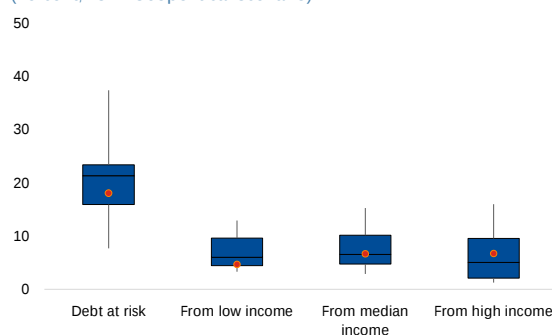
Median Debt Service-to-Income (DSTI) is higher than EA peers, particularly for lower income households.

Median DSTI by Income Group
(Percent)



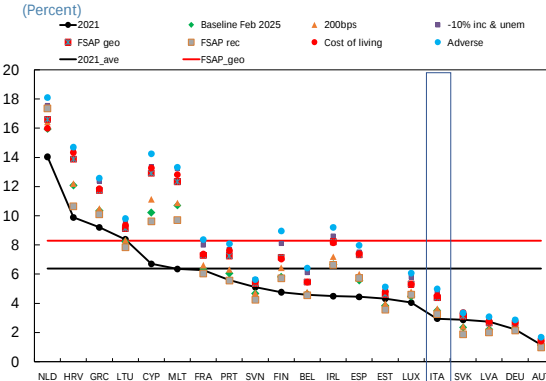
High-income households account for 37 percent of total debt at risk, compared to 30 percent in the EA.

Debt At Risk By Income Tercile - 2026
(Percent, FSAP Geopolitical Scenario)



Around 5 percent of consumption could be reduced, as it exceeds income under adverse scenarios.

Consumption Fragile (2026)
(Percent)



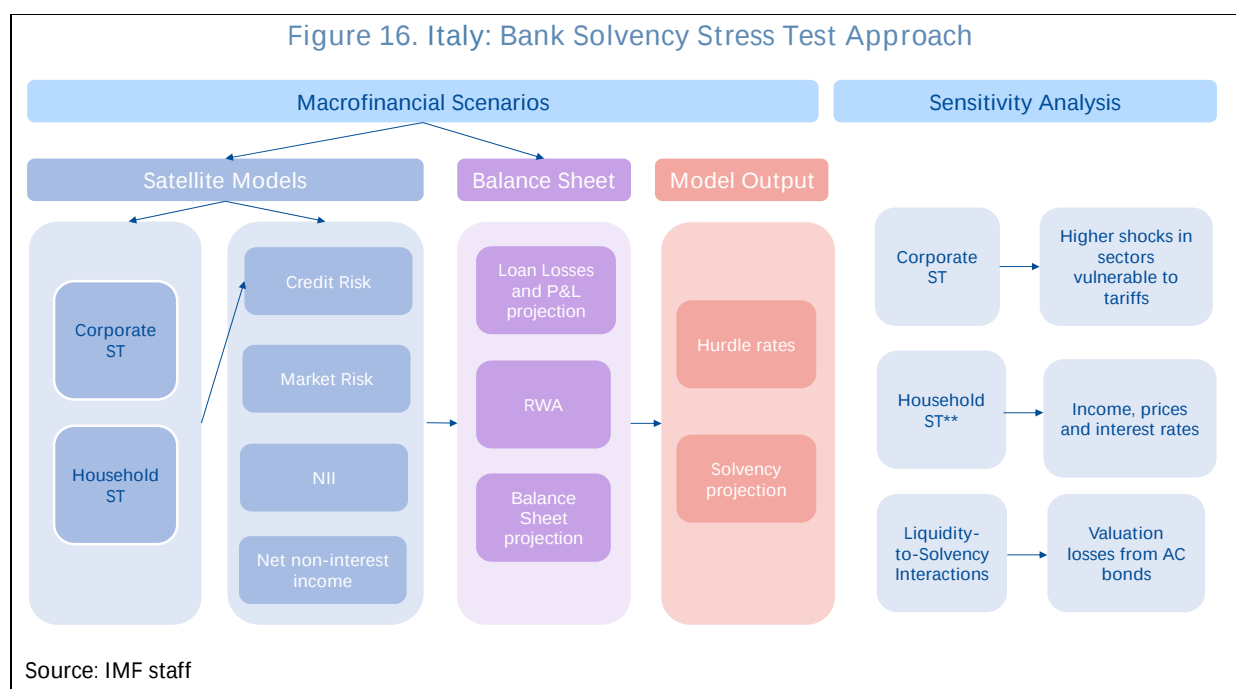
Sources: HFCS and IMF staff calculations.

BANK SOLVENCY STRESS TESTS

A. Scope and Approach

43. The FSAP solvency stress test covered 31 banks, representing 98 percent of total assets in the Italian banking sector. Of these, 12 are SIs, accounting for 86 percent of total banking assets; two are subsidiaries of foreign SIs, representing 6 percent of total assets; and 17 are LSIs, accounting for a further 6 percent of banking assets. The LSI sample includes a range of business models, comprising 11 traditional banks, two banks specializing in asset management, two banks focused on NPL management, and two banks with a specialized credit focus.

44. The stress tests examine the resilience of the banking system to a comprehensive set of risks based on supervisory data. The top-down solvency stress test measures the effects of the macroeconomic shocks on individual banks' profitability and capitalization, through satellite models and methodologies. The exercise is based on the IMF's internally developed solvency stress-testing framework including a comprehensive set of risks (Figure 16). The credit risk component relies on the projection of the PDs from the micro-models for households and corporates. The market risk component estimates valuation losses and gains arising from interest rate and equity price shocks affecting banks' investment portfolios measured at fair value. The net interest income (NII) component is based on a granular structural model that assesses the impact of interest rate shocks on interest income and expenses using a repricing ladder and projected interest rates on new and repriced assets and liabilities. Other P&L components (net fee and commission income and non-interest income) are modeled using a mix of satellite models linked to macroeconomic variables and historical approach (see details in Appendices II, V, VI and VII).

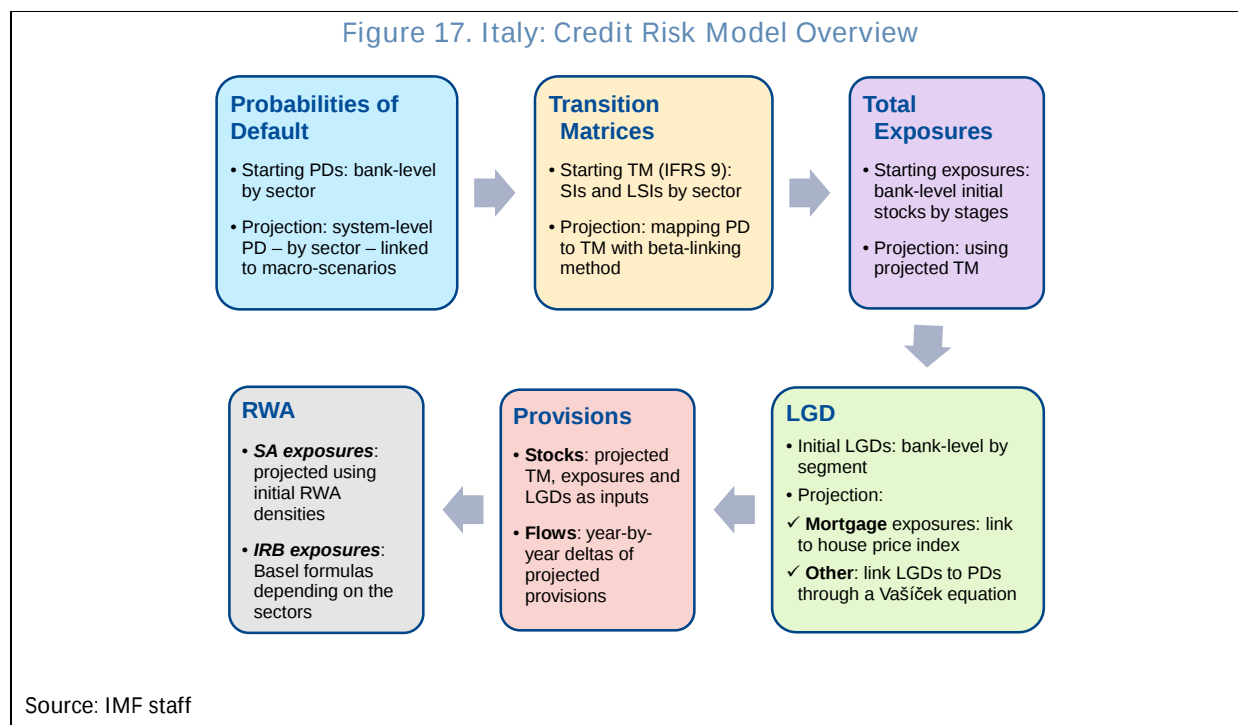


B. Methodology

45. The projections of revenues, expenses, loan losses, and valuation losses are based on bank-by-bank and portfolio-level simulations of balance sheets over the scenario horizon. Where available, consolidated data was used for SIs and LSIs, while individual-level data is employed for foreign subsidiaries. The stress-test cut-off date is June 2025, and the primary data sources are Implementing Technical Standards (ITS) supervisory data collected under the Financial Reporting (FINREP) and Common Reporting (COREP) standards, complemented by supervisory data from the Banca d'Italia. Most model components are projected using balance-sheet information at the cut-off date and historical data on revenues and operating and other non-credit-related expenses, relying on a combination of regression-based and structural modeling approaches

Credit Risk

46. Provisions are calculated as expected credit losses (ECLs) for all asset classes with exposure at default. The key risk parameters include the distribution of exposures across stages, probabilities of default (PDs), loss-given-default (LGD) assumptions, and risk-weighted assets (RWAs), broken down by exposure class for the four main portfolios: household mortgages and consumer loans, nonfinancial corporate (NFC) loans, financial institutions (FIs), and government exposures (Figure 17).



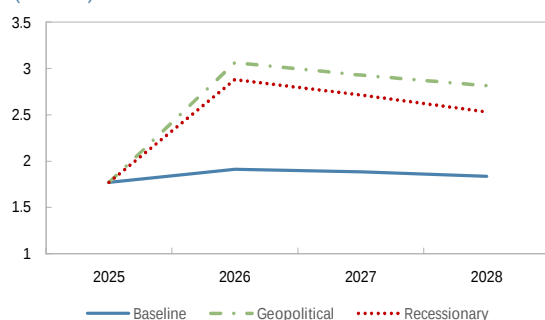
47. Projections of PD parameters are derived using microdata-based models for corporates and households. The corporate stress tests rely on firm-level microdata for Italian companies from the *Cerved* database and link the vulnerability analysis—which projects firms'

financial indicators under stressed scenarios—to probabilities of default (PDs) using regression models (see Appendix III). The household analysis identifies vulnerable households at risk of default using data from the 2023 Household Finance and Consumption Survey (HFCS) and estimates the relationship between financial vulnerability—defined as a debt service plus essential consumption to income ratio (DSTI) above 70 percent—and default probabilities at the individual household level, drawing on the Survey of Income and Living Conditions (SILC, see Appendix IV).¹⁵ Probabilities of default for sovereign were projected using the Merton approach which translate credit spread under stress to PDs, and for financial institutions the FSAP team relied on the projections applied in the 2025 EA FSAP (see appendix V, Figure 18).

Figure 18. Italy: PD Satellite Models Results

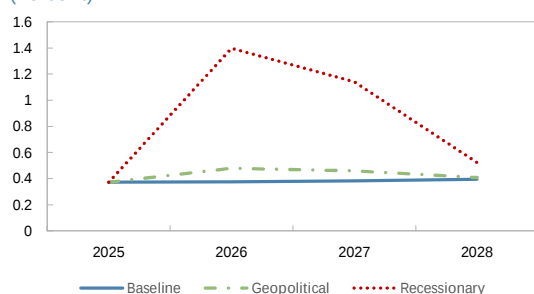
Households PD projection is slightly higher under the geopolitical scenario than the recessionary scenario...

Household Stress Test Model: PD Projection (Percent)



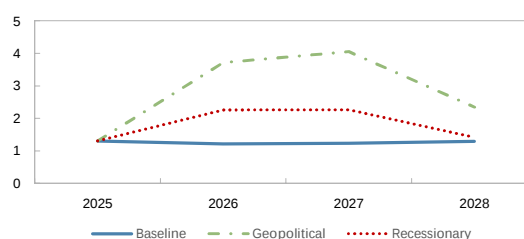
Higher PDs for public-sector exposures under the recessionary scenario reflect the sharp widening of sovereign spreads, relative to the geopolitical scenario.

Public Sector Exposures: PD Projection (Percent)



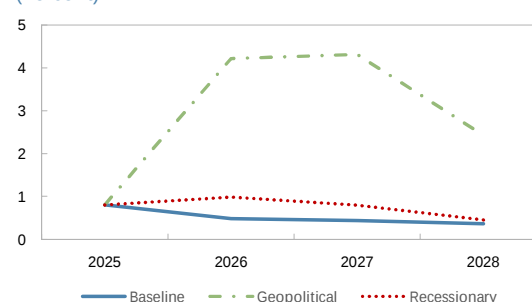
... while corporate PDs are significantly higher under the geopolitical scenario than under the recessionary scenario.

Corporate Stress Test Model: PD Projection (Percent)



PDs for financial institutions are elevated under the geopolitical scenario, with only a limited increase projected under the recessionary scenario.

FI Exposures: PD Projection (Percent)



Source: Bdl and Cerved data, and IMF staff calculations.

¹⁵ Analysis based on Valderrama et al. (2023).

48. Credit quality dynamics for loan portfolios are modeled using an IFRS9 consistent framework. For the NFC loan portfolio, PDs from the corporate stress test are mapped to bank-level PDs based on each bank's exposure profile by sector, firm size, and region. For household loans, aggregate PD projections derived from the household micro-models are applied to all banks. The resulting PD path is then adjusted to reflect the bank- and segment-specific starting point-in-time (PiT) PD, using the distance-to-default formula to scale PDs (Figure 19). Starting PDs are calculated as the weighted average of observed transition probabilities from stage 1 to stage 3, and stage 2 to stage 3, weighted by total balances in each stage. The adjusted PD path, together with the initial transition matrix, serves as input to the Beta-linking methodology¹⁶, which is used to derive IFRS 9-compliant transition matrices for each bank and lending segment (see details in Appendix VI).

49. Loan stocks and stage distribution are projected based on the transition matrices projection. Performing and non-performing exposure stocks are projected based on flows implied by the transition matrices. While the framework allows for write-offs, asset sales, and cure flows from Stage 3 to Stages 1 and 2, write-off and asset sale rates are assumed to be zero, consistent with the static balance-sheet assumption used for this FSAP (Figure 20).

50. LGDs are calibrated using scenario-consistent approaches that account for collateral values, cyclical dynamics, and exposure-specific characteristics. For collateralized lending LGDs are calibrated by assuming a linear relationship between property price and recovery values, using reported starting-point LGDs and house price paths from the macroeconomic scenarios. For other portfolios, LGDs are calibrated using the Frye–Jacobs method, which captures the cyclical sensitivity of recoveries to PDs and macro-financial conditions.¹⁷ LGDs for all other exposure classes are assumed to remain constant over the scenario horizon.

51. Credit risk RWAs are updated in line with the regulatory treatment of each portfolio. For exposures under the Standardized Approach (STA), credit risk charges are estimated using RWA densities observed at the cut-off date. Non-performing exposures (NPEs) are first subtracted from initial RWAs, assuming a risk weight of 100 percent. The ratio of RWAs to performing exposures is then calculated and applied to projected performing exposures over the scenario horizon. RWAs for NPE are added separately, using the corresponding RWA density. This calculation is performed at the bank level to reflect heterogeneity in exposure composition and RWA profiles. For exposures under the Internal Ratings-Based (IRB) approach, the asymptotic single risk factor model for unexpected losses is implemented for each loan type (following Basel III). This model incorporates projections of point-in-time default rates to derive through-the-cycle probabilities of default (PDs). Downturn LGDs are updated only when stressed LGDs exceed banks' reported values; otherwise, they are assumed to remain constant over the scenario horizon (Figure 21).

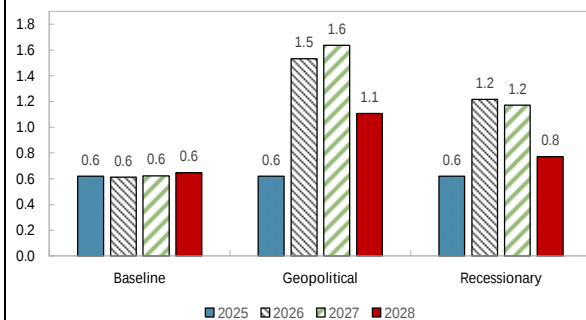
¹⁶ Gross et al. (2020).

¹⁷ J. Frye and M. Jacobs (2012).

Figure 19. Italy: PDs Mapped to Bank-Specific Portfolio Level Starting Points

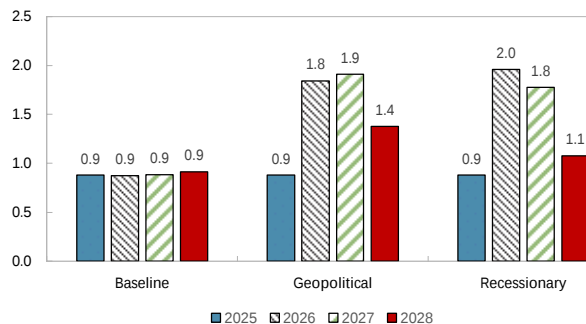
SI banks exhibit, on average, lower starting PDs than LSI banks in the sample...

Scaled PDs: Total Exposures - SI Banks
(percent, weighted average)



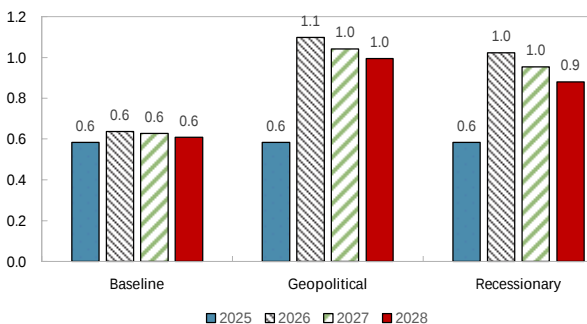
... and LSI banks have a higher overall PD under the recessionary scenario.

PDs: Total Exposures - LSI Banks
(percent, weighted average)



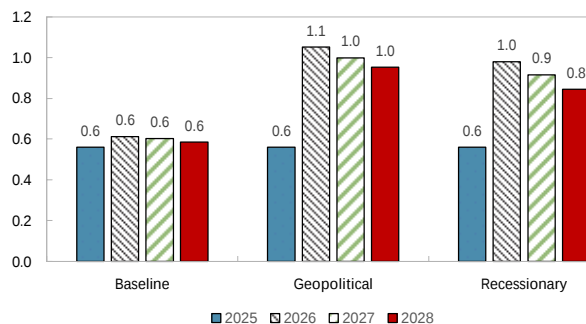
Starting PDs for household exposures are similar for both SIs and LSIs banks...

Scaled PDs: Household Loans - SIs
(percent, weighted average)



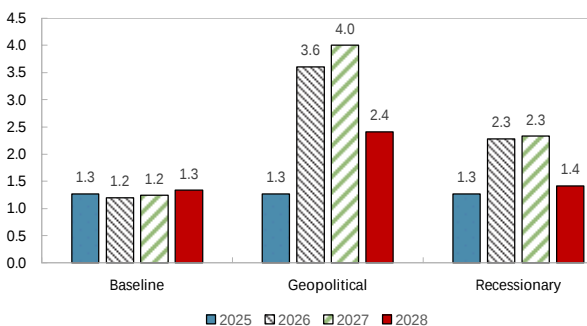
... as well as the projected scaled PDs for the stress test horizon.

Scaled PDs: Household Loans - LSIs
(percent, weighted average)



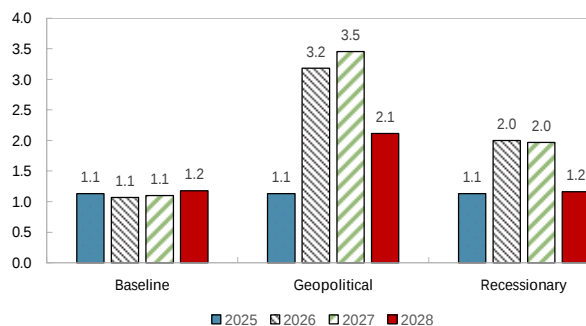
Starting PDs for corporate exposures are higher for SIs, compared to LSI...

Scaled PDs: NFC - SIs
(percent, weighted average)



... resulting in lower average corporate PDs under the geopolitical scenario for LSI banks.

Scaled PDs: NFC - LSIs
(percent, weighted average)

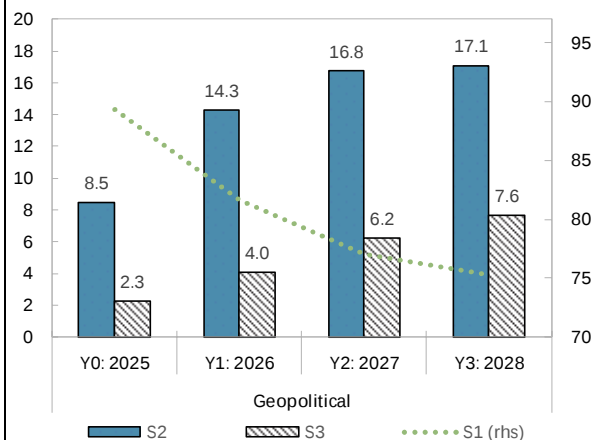


Source: Bdl and ECB data, IMF staff calculations.

Figure 20. Italy: Stage Distribution Projection

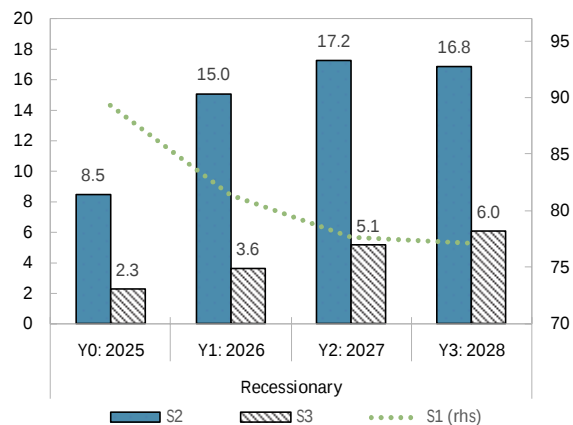
While SI banks on aggregate start with lower NPL ratios compared to LSI, Stage 2 exposures are higher ...

Total Exposures: Geopolitical - SI Banks (percent)



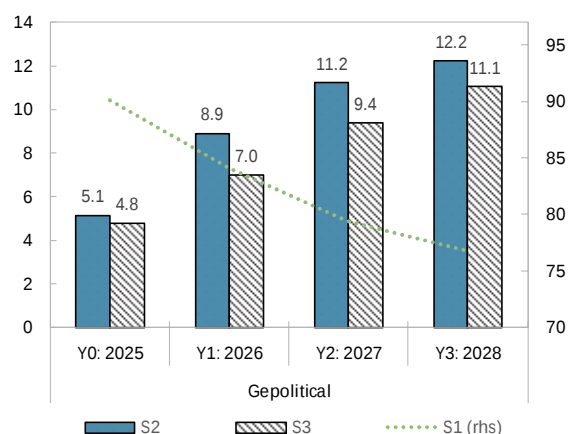
... and spike in the second year of the ST in the recessionary scenario.

Total Exposures: Recessionary - SI Banks (percent)



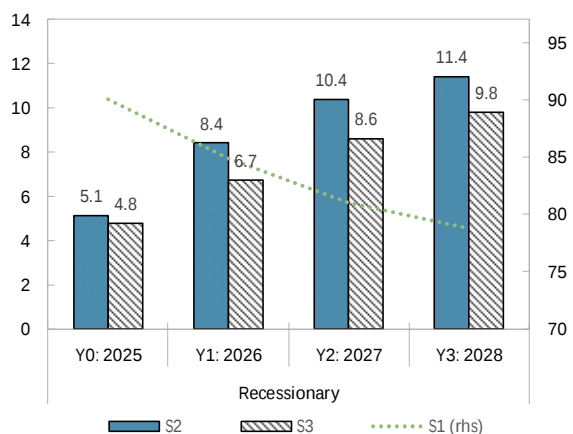
Specialized banks, particularly those in NPL management business, contribute to higher starting NPL ratios for LSI in the sample.

Total Exposures: Geopolitical - LSI Banks (percent)



The overall increase on NPLs and Stage 2 loans is similar under both adverse scenarios, with milder impact under the recessionary scenario.

Total Exposures - LSI Banks (percent)

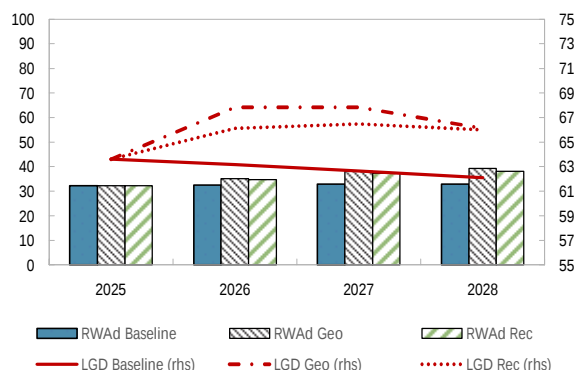


Source: Bdl and ECB data, IMF staff calculations.

Figure 21. Italy: LGDs and RWA Projection

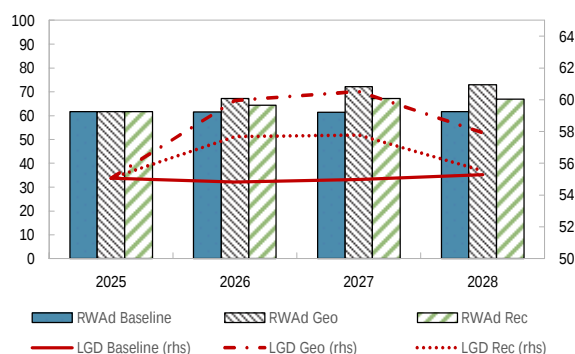
Households LGDs increase in line with the house price shocks...

Household Exposures (percent)



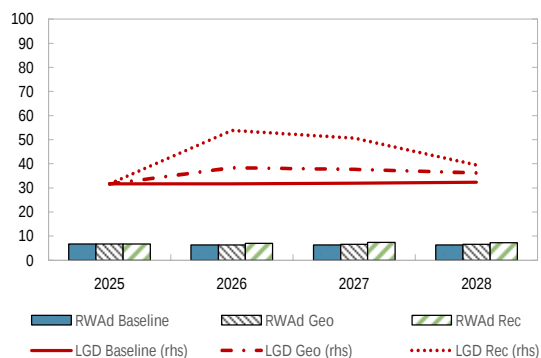
... while for all other exposures LGDs captures the cyclical sensitivity of recoveries to PDs.

NFC Exposures (percent)



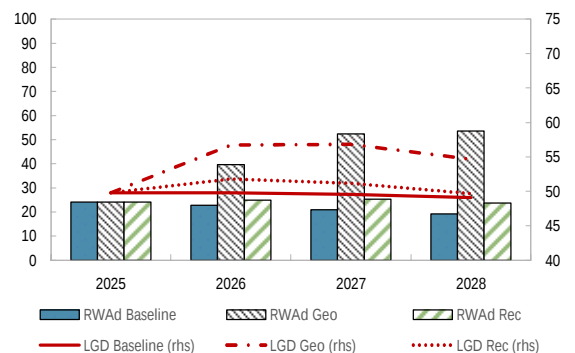
Public sector exposures exhibit very low RWA as well reported LGDs.

Public Sector Exposures (percent)



The rise in RWAs for financial-institution exposures under the geopolitical scenario mainly reflects the sharp increase in PDs.

Financial Institutions Exposures (percent)



Source: Bdl and ECB data, IMF staff calculations.

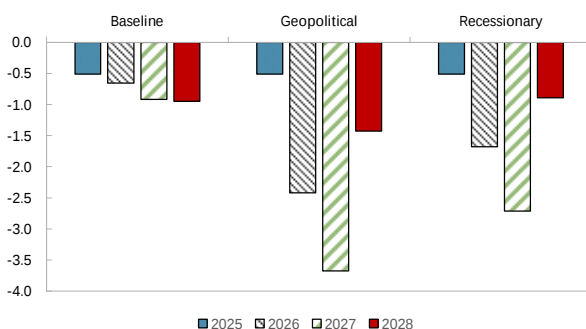
52. Loan loss provisions reported in the balance sheet and credit impairments recognized in the P&L statement are estimated in accordance with IFRS 9. Provisions are calculated on a 12-month basis for stage 1 exposures and on a lifetime basis for stage 2 and stage 3 exposures, with stage 3 PDs assumed to be 100 percent. A static balance sheet approach is applied, whereby matured loans are assumed to be reinitialized in the same stage as at maturity. No write-offs are assumed; hence, stage 3 defaulted exposures either remain in default or cure and migrate to stage 1 or stage 2 based on the projected transition matrix. As a result, credit impairments in the P&L correspond directly to the annual change in the stock of provisions (Figure 22).

Figure 22. Italy: Loan Loss Provisions

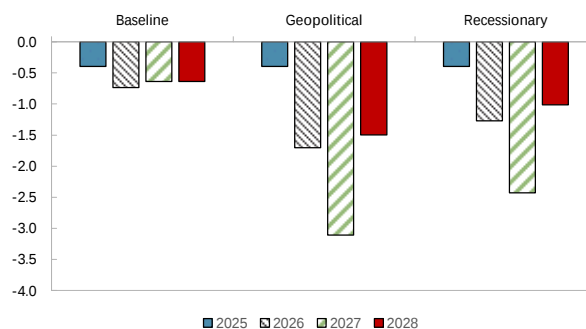
SI and LSI banks exhibit broadly similar dynamics, but loan loss impact is on average higher for SI banks compared to LSIs.

... which is in part explained by a lower RWA increase for LSIs given that its entire portfolio is under SA approach.

Loan Loss Provisions: SIs
(percent of RWA)

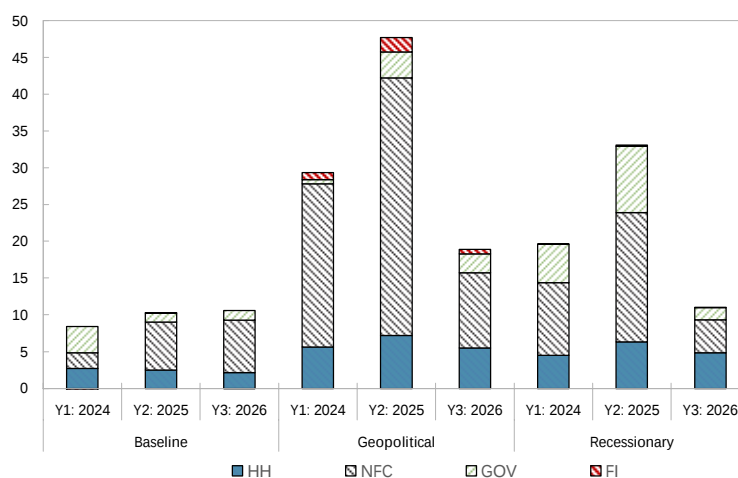


Loan Loss Provisions: LSIs
(percent of RWA)



Loan losses spike in the second year of the stress-test horizon, particularly under the geopolitical scenario, reaching about €48 billion, with corporate loan losses accounting for roughly 70 percent of total losses.

Loan Loss Provisions by Loan Type - All Banks
(EUR billion)



Source: Bdl and ECB data, IMF staff calculations.

Market Risk

53. The market risk component estimates valuation losses arising from key market risk factors for Italian banks. This includes credit spread risk (CR), interest rate risk (IR), and equity risk (EQ). Market risk losses on securities portfolios measured at fair value through profit and loss (FVPL) and fair value through other comprehensive income (FVOCI) are assessed using a modified duration approach, with the interest-rate shocks described in the scenario section. Losses on FVOCI securities are reflected in accumulated OCI, while losses on FVPL securities directly affect net profits. Equity exposures are revalued using scenario-specific equity index paths corresponding to each macroeconomic scenario. Securities measured at amortized cost (AC) are not included in this

module, in line with accounting standards; however, a sensitivity analysis is conducted to assess the magnitude of potential unrealized losses (see ¶87-88).

54. The impact of market risk on bank capital is incorporated into the broader solvency stress test as a one-off shock in the first year. Supervisory reporting on sovereign exposures serves as the primary source for banks' positions.¹⁸ For significant institutions (SIs), duration is approximated using the midpoint of each maturity bucket across different classes of fixed-income securities, based on seven maturity buckets.¹⁹ For less significant institutions (LSIs), duration data was provided directly at the portfolio level for all banks in the sample. The estimated valuation losses were added as a one-off shock in the first year and not reversed in subsequent years. This approach is designed to capture the effects of short-term market distress episodes that may materialize at any point during the stress-testing horizon.

55. The FSAP methodology for estimating market losses in the banking book may overstate actual losses due to the lack of data on hedging positions at the portfolio level. Given the absence of detailed supervisory information from Bdl on hedging at the portfolio level, hedging is partially captured using a proxy benchmarked against the market risk results from the 2025 EA FSAP. This benchmark exercise was feasible only for Italian banks included in the EA FSAP sample (the 12 SIs)²⁰. Accordingly, the FSAP adopts a conservative adjustment: when market risk losses relative to total RWAs estimated using the duration-based approach exceed the corresponding EA FSAP results, a hedging ratio is applied, capped at 50 percent of market risk losses.

56. The total market risk capital impact across all banks in the sample is EUR 56 billion and EUR 67 billion in the geopolitical and recessionary market stress scenarios, respectively. Market RWA was updated based on the RWA composition across the different components, assuming that the current market risk contribution to total RWA for each bank is constant during the stress test horizon (Figure 23).

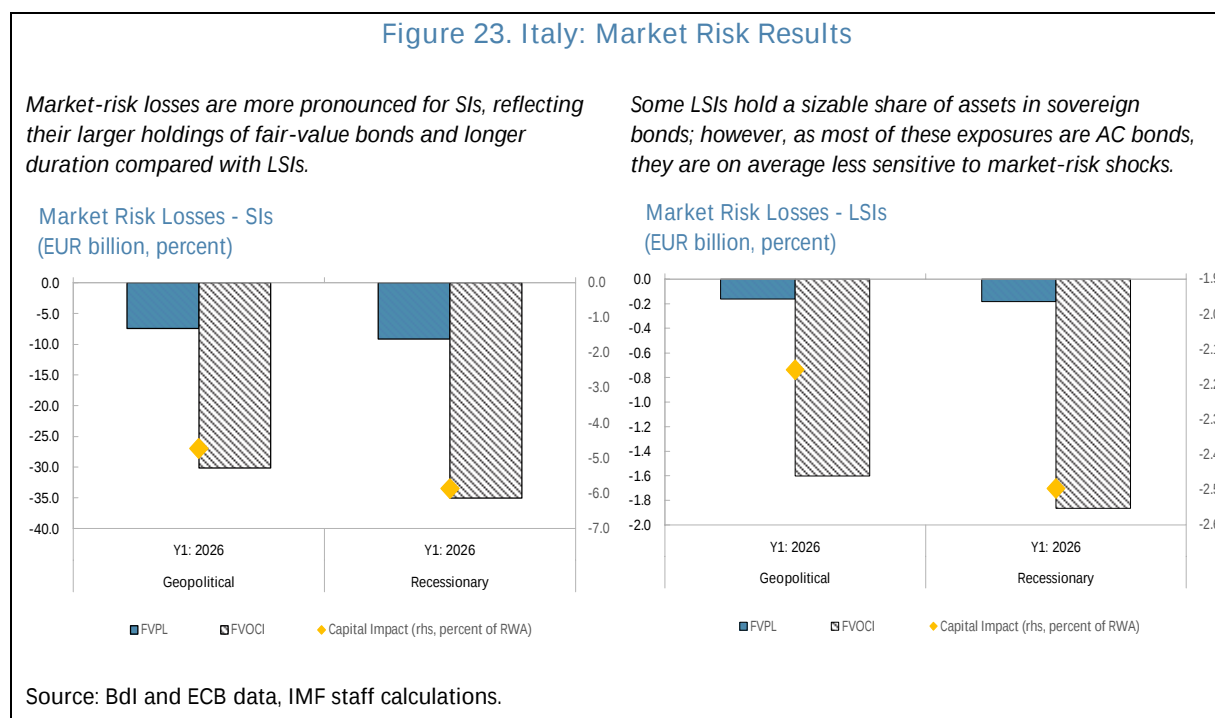
¹⁸ Specifically, COREP C33.00 reported as of 2025Q2, complemented by Bdl's supervisory data.

¹⁹ These are: below three months, between three months and one year, between one and two years, between two and three years, between three and five years, between five and ten years, above five years.

²⁰ This hedging proxy is subject to important caveats, reflecting differences in methodological approaches and data cut-off dates. While the 2025 EA FSAP relied on bank-specific sensitivities to risk factors reported in the ECB's stress test exercise conducted in the context of the Supervisory Review and Evaluation Process (SREP) with a cut-off date of 2023Q3, the Italy FSAP team considered inaccurate to continue using these sensitivities to assess market risk as of 2025Q2. Accordingly, the analysis adopts a duration-based approach, which is deemed more consistent with the available data and the timing of the exercise.

Net Interest Income

57. The scope of the Net Interest Income (NII) module covered all interest-earning assets and interest-bearing liabilities, except for derivatives. The scope only covered on-balance sheet items and derivatives were excluded due to data limitations. Non-performing exposures were assumed to generate no interest income. Although in practice banks may be able to collect some interest income from NPLs, their income was set to zero in the stress test, both to be more conservative and due to data challenges for calibrating collection rates for NPEs.



58. Interest income and interest expense for each portfolio segment are projected using a structural model and repricing gap methodology (Figure 24). A granular portfolio segmentation is applied, with interest-earning assets and interest-bearing liabilities broken down by instrument type and counterparty sector (Table 4). The structural model relies on two key data inputs for each portfolio segment: (i) the repricing structure at the cut-off date (the “repricing ladder”); and (ii) time series of interest rates for newly originated assets and liabilities (“interest rates on new business”). Interest rates on new business are first projected for each portfolio segment using satellite models. Bank-specific NII projections are then derived based on: (i) initial interest-earning exposures and interest-bearing liabilities; (ii) the repricing ladder, constructed from IRRBB and maturity reporting templates and assumed to remain constant over the stress-test horizon; (iii) initial effective interest rates; and (iv) projected interest rates on new business (see model details in Appendix VII).

59. The projected new business rates were scaled relative to bank and portfolio specific average interest rates. The average interest rates on the outstanding stock at the cut-off date for the corresponding segment were calculated and then new business rate projections were scaled taking into account bank-specific starting points.

Table 4. Italy: NII Portfolio Segmentation

<i>Assets</i>	<i>Liabilities</i>
Debt Securities – Government	Debt Securities issued
Debt Securities – Other	Sight deposits – Credit Institutions
Loans – HH Consumer	Sight deposits – Other
Loans – HH Mortgages	Sight deposits – HH
Loans – NFCs	Term deposits –Credit Institutions
Loans – Government	Term deposits – Other
Loans – Financial Institutions	Term deposits – HH
Other interest-earning assets	Other interest-bearing liabilities

Source: IMF staff

Other Profit and Loss Items

60. The ratio of net fee and commission income (NFCI) to total assets was projected using results from the econometric approach estimated for the EA FSAP. The econometric specification was similar to Kok, Mirza and Pancaro (2017). The team used a panel regression with bank-specific fixed effects based on historical public balance sheet data for euro area SIs, considering the following set of regressors: the first lag of the NFCI ratio, real GDP growth, stock market returns, CPI inflation, residential housing price inflation, the first difference of the 1-month EURIBOR rate, and the first difference of the yield of 10-year sovereign bonds. Additionally, two global variables were considered: the EUR/USD FX depreciation, and the growth in US stock prices.²¹ For all regressors, up to one annual lag was allowed. A LASSO methodology was applied to help select relevant regressors and almost all the regressors were identified as relevant with this methodology (see Appendix IX for estimation results).

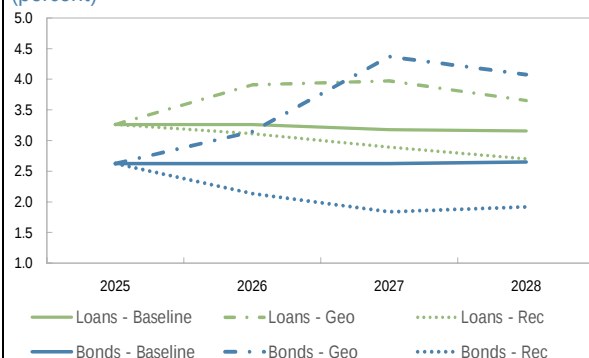
61. NFCI is projected at the aggregate level using country-level model results. The underlying model is estimated separately for large banks and for small and medium-sized banks to capture differences in the sources of fee and commission income across business models, which are typically correlated with bank size. For the Italy FSAP, however, average country-level projections are applied. Under the baseline scenario, NFCI is projected to increase by 4.4 percent over the three-year stress-test horizon. Under adverse scenarios, results suggest a cumulative decline of 7.7 percent under the geopolitical scenario and 10.6 percent under the recessionary scenario.

²¹ Market volatility captured in the Itraxx and VIX were considered in the regressions, but the coefficients were not statistically significant.

Figure 24. Italy: Net Interest Income Results

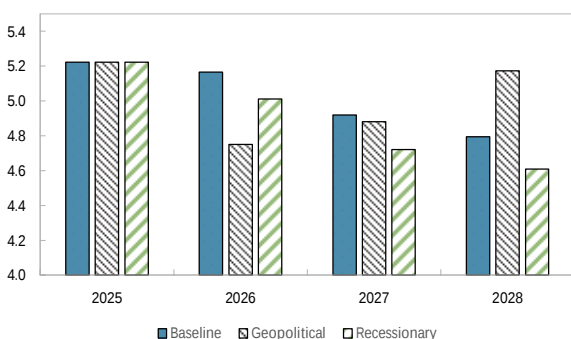
Banks benefit from higher interest rates on loans and securities investments in the geopolitical scenario...

Effective Interest Rates - Assets (percent)



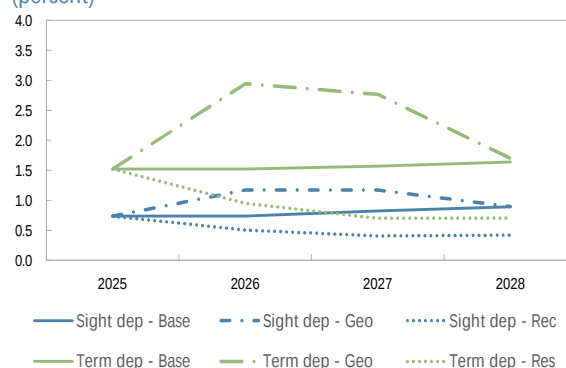
SI banks record higher initial NII compared with LSIs, but aggregate NII projections are broadly comparable for both groups across the three scenarios....

Net Interest Income: SIs (percent of RWA)



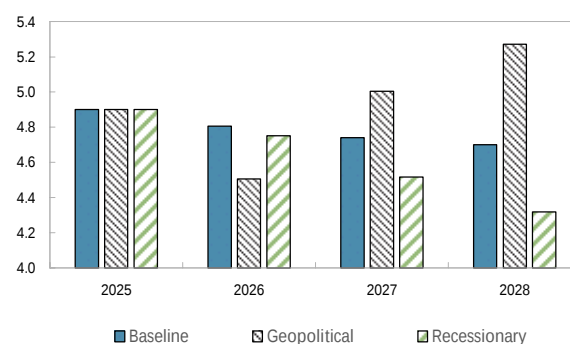
... while greater reliance on low-cost sight deposits is a key driver of heterogeneity in results across banks.

Effective Interest Rates - Liabilities (percent)



NII declines sharply under the recessionary scenario, while higher interest rates under the geopolitical weigh on NII in the first year before boosting it in subsequent years.

Net Interest Income: LSIs (percent of RWA)



Source: Bdl and ECB data, IMF staff calculations.

62. Some fee and commission income from trading activities are reported as net trading income (NTI) rather than NFI and are therefore not captured in the analysis described above. Given that NTI represent an important source of income for some Italian banks, the FSAP explicitly accounts for this component. Under the baseline scenario, NTI is assumed to grow in line with banks' business activity, with the ratio of NTI to total assets kept constant. Under the two adverse scenarios, NTI is set equal to the historical mean minus one standard deviation, computed over the past five years—using bank-specific historical distributions for SIs and aggregate time series for LSIs. This approach may over- or underestimate client-driven revenues, as NTI also includes valuation effects from fair-value instruments. However, averaging over a sufficiently long historical period helps mitigate potential biases, as valuation gains and losses tend to offset each other over time.

63. Other operational income and expenses are assumed to remain constant as a share of total assets across all scenarios. These remaining items consist mostly of non-interest expenses, such as wages and other costs associated with operating branches. These P&L items were kept at the same level in the stress scenarios as in the baseline. Extraordinary items and minority interest are assumed to be equal to zero.

Balance Sheet and Capital Projection

64. Balance-sheet components are projected under a static balance-sheet assumption. All balance-sheet items are assumed to have zero growth, consistent with the very low or negative credit growth observed in Italy in recent years. The composition of banks' assets remains constant over the stress-test horizon, and capital is built exclusively through retained earnings, with no new capital injections assumed. Therefore, the model does not consider any new share issuances or share repurchases over the stress-test horizon.

65. The tax and dividend rates assumptions are calibrated using bank-specific median effective rates observed over the past five years. Dividend payouts are assumed only for well-capitalized banks – those banks with capital ratio above hurdle rates - and are paid out of net income after taxes, in compliance with supervisory capital requirements. If a bank is not well capitalized or records negative net income, no dividend payout is assumed.

66. Minimum capital requirements used as hurdle rates are consistent with Italian regulatory standards aligned with Basel III requirements. The stress-test hurdle rates accounts for the Common Equity Tier 1 (CET1) regulatory minimum of 4.5 percent under Pillar 1, bank-specific Pillar 2 requirements, and the Capital Conservation Buffer (CCoB) of 2.5 percent. The systemic risk buffer (SyRB) is not included in the hurdle rate under either the baseline or adverse scenarios. For the leverage ratio the hurdle rate of Pillar 1 requirement was considered, corresponding to 3 percent.

C. Solvency Results

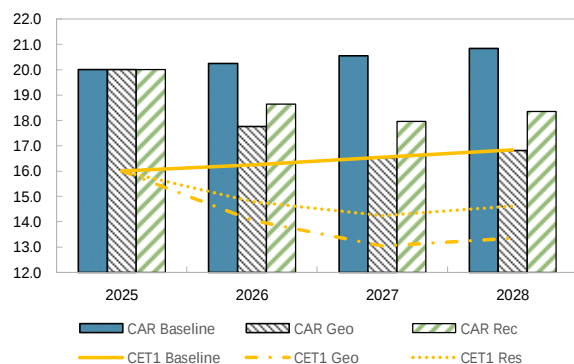
67. The Italian banking system exhibits high capital buffers, and banks appear resilient to severe macro-financial shocks (Figure 25). Under the baseline scenario, the aggregate total capital ratio follows an upward trajectory, despite a slight decline in revenue-generating capacity from NII. Under the geopolitical scenario, the aggregate total capital ratio declines to 16.5 percent by end-2027, corresponding to a decline of 3.5 percentage points (pp) relative to the starting point and 4.0 pp compared to the baseline scenario. The capital depletion is more pronounced for SIs with a decline of 3.6 pp from the starting point, compared to 2.2 pp for LSIs. In this scenario, four banks (one foreign subsidiary and three LSIs) would fall below minimum capital requirements, while three additional banks would meet minimum requirements but fail to comply with the Capital

Conservation Buffer (CCoB).²² Under the recessionary scenario, the aggregate total capital ratio declines to 18 percent by end-2027, and only one LSI falls below the minimum capital requirements.

Figure 25. Italy: Solvency Stress Test Results

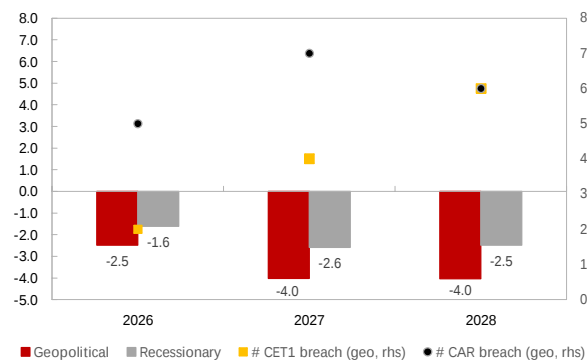
Total capital and CET1 capital of the banking system sufficiently cover losses under adverse scenarios.

Capital Ratios: All Banks (percent)



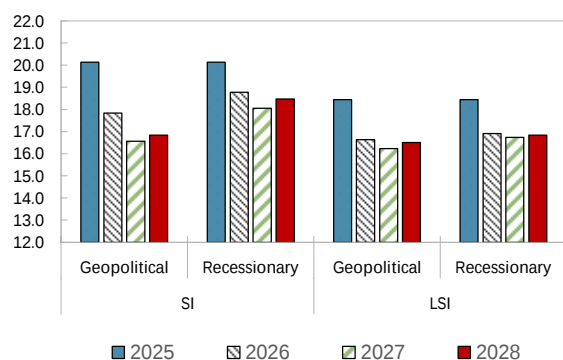
In the geopolitical scenario, four banks fall below minimum capital requirements, while three additional banks fail to comply with the CCoB.

CAR: Baseline - Adverse Scenarios: All Banks (percentage points, number of banks)



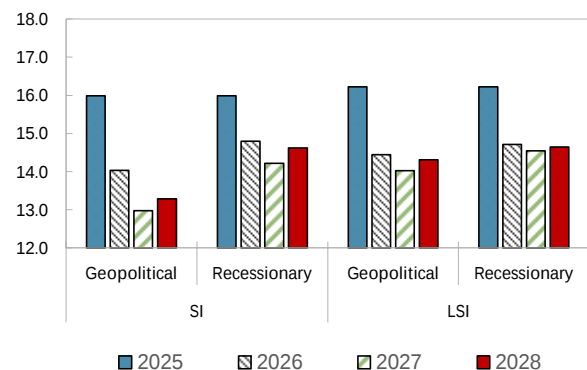
While capital declines are more pronounced for SIs relative to LSIs, SI banks start with higher capital buffer.

Capital Ratio - SI vs LSI (percent)



In the geopolitical scenario, the CET1 ratio declines to 13 percent for SI and 14 percent for LSIs in the trough.

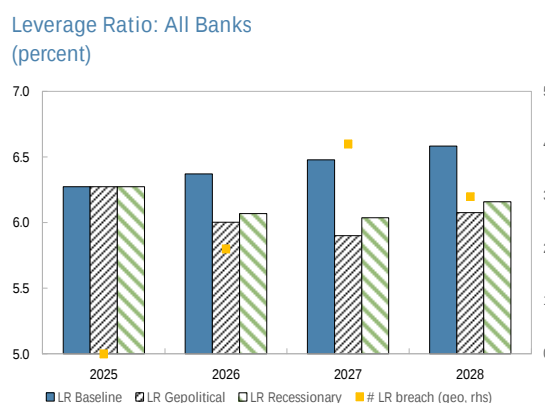
CET1 Ratio: SI vs LSI (percent)



²² Banks that fail to meet the minimum requirements and/or the CCoB account for 9 percent of total assets in the Italian banking system.

Figure 25. Italy: Solvency Stress Test Results (Concluded)

Leverage ratio is also on a downward trajectory, but the system remains well above the hurdle rate of 3 percent.



Sources: ECB and Bdl supervisory data, IMF staff calculations.

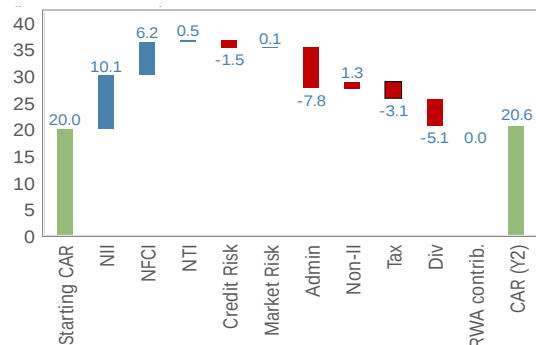
68. Credit impairments are the main driver of the decline in profitability under the geopolitical scenario. Loan loss provisions are more pronounced under the geopolitical scenario, reflecting higher projected PDs across all credit portfolios, with the exception of government exposures. Despite sizeable interest rate shocks—averaging 340 basis points under the geopolitical scenario and 400 basis points under the recessionary scenario—market risk losses remain contained, owing to the relatively small share of investment portfolios measured at fair value. Nevertheless, most LSI banks and some SI banks exhibit high concentrations of sovereign bond holdings in the amortized cost (AC) portfolio, highlighting potential vulnerabilities related to the sovereign–bank nexus. Strong net interest income generation, particularly in the high-interest-rate environment of the geopolitical scenario, helps mitigate the impact of credit and market risk losses for many banks (Figure 26).

69. The capital depletion under adverse scenarios across SI and LSI banks is not homogeneous. The extent of variability appears to hinge on the specific composition of credit risk exposures and banks' capacity to compensate high credit risk losses in the geopolitical scenario with higher interest income benefiting from shorter repricing profile and low-cost funding sources. Market losses exhibit a highly heterogeneous pattern across banks reflecting the differences in the size of fair value securities portfolio.

Figure 26. Italy: Risk Drivers in the Solvency Stress Test

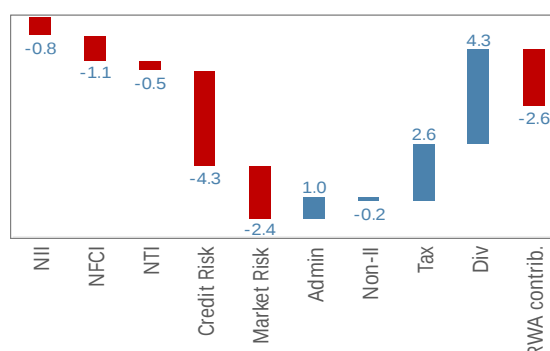
Under the baseline scenario, the aggregate total capital ratio increases, despite a slight decline in NII.

Baseline: Cumulative Impact Up to 2027 - All Banks
(Percent of RWA)



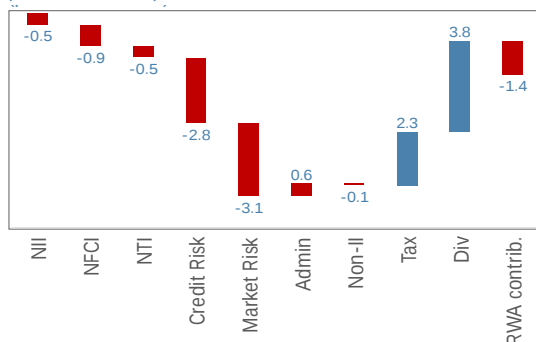
Credit impairments are the key factor underpinning the profitability decline in the geopolitical scenario...

Geopolitical - Baseline: Cumulative Impact Up to 2027
(Percent of RWA)



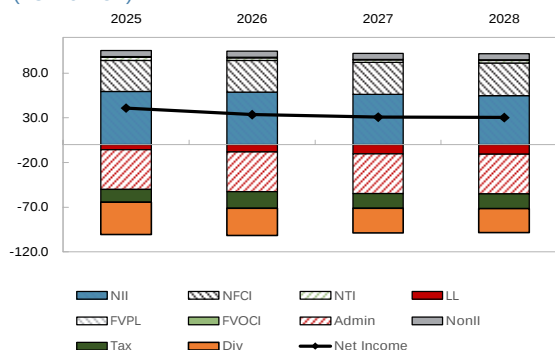
... while in the recessionary scenario, the main driver is market risk due to higher sovereign spreads.

Recessionary - Baseline: Cumulative Impact Up to 2027
(Percent of RWA)



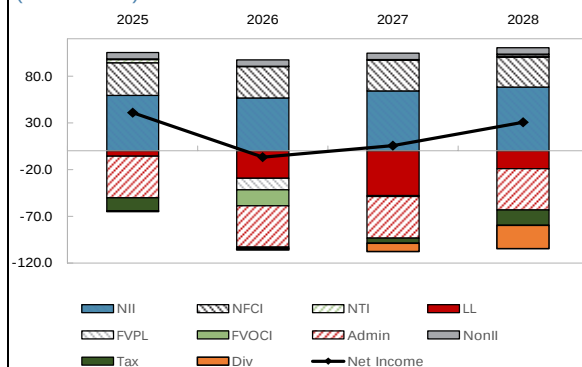
In the baseline, net income has a downward trajectory given the decline in NII with lower interest rates.

P&L Components: Baseline - All Banks
(EUR billion)



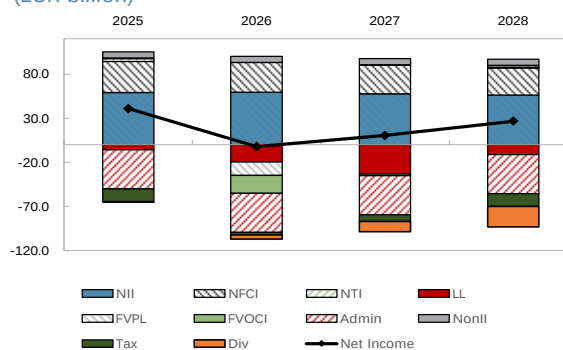
The banking sector records losses in the first year, followed by a recovery, as higher interest income partly offsets increased deposit costs and market risk losses.

P&L Components: Geopolitical - All Banks
(EUR billion)



Net losses in the system are lower under the recessionary scenario, despite market risk losses weighing on profitability.

P&L Components: Recessionary - All Banks
(EUR billion)



Sources: ECB and BdI supervisory data, IMF staff calculations.

70. Despite important differences in scope and design, the FSAP and EBA stress tests yield broadly consistent results for SIs. While scenarios, methodologies, starting points (end-2024 for the EBA stress test versus June 2025 for the FSAP), and sample coverage differ²³, SI results are broadly aligned with those of the 2025 EBA stress test. Considering that the EBA scenario is closest to the geopolitical scenario, the CET1 ratio declines by 2.5 percentage points (from 15.1 to 12.6) in the EBA exercise, compared with a 3.0 percentage point decline (from 15.9 to 12.9) under the FSAP geopolitical scenario.

D. Sensitivity Analysis

71. Sensitivity analyses were conducted for the credit risk component of the solvency stress test, including higher shocks to sectors vulnerable to tariffs. One additional analysis considered combined shocks underpinning the household vulnerability model, as well as more severe shocks to tariff-exposed sectors in the corporate stress test model. An additional cumulative shock of 57 basis points to household PDs and 11 basis points to NFC loans was applied relative to the geopolitical scenario, based on micro-model results. Results indicate that the additional capital depletion is contained, reflecting the relative resilience of Italian NFCs that could potentially be affected by tariff measures. In addition, given the important role of government guarantees for some banks, a set of sensitivity analysis assuming higher Loss Given Defaults (LGDs)—ranging from an additional 10 pp to 30 pp—for government and NFC exposures was performed. The results indicate that SI face limited capital impact under higher LGD assumptions, whereas LSI are more adversely affected by higher LGDs, reflecting the stronger reliance of LSI business models on government exposures and NFC credit, often supported by public guarantees (Figure 27).

72. Evidence from the most recent energy shock in Europe suggests that the impact of the Middle East conflict on bank credit risk is likely to remain contained. Bdl analysis shows that, despite a sizable increase in firms' unit costs, the 2022 energy shock stemming from the war in Ukraine did not result in a broad deterioration in asset quality, with NPL ratios in energy-intensive sectors remaining broadly stable.²⁴ While banks increased coverage ratios in vulnerable sectors such as chemicals, metallurgy, and transport, the overall system impact remained limited, reflecting both the small exposure and the stronger financial positions of affected firms. This suggests that any renewed pressures are likely to be concentrated and manageable, absent a more severe or prolonged shock.²⁵

73. Additional sensitivity analysis indicates that the impact of Middle East war on Italian households is less adverse than the EA average. The Middle East scenario applies the WEO April 2026 severe scenario shocks to the October 2025 WEO baseline. Results indicate that the share of

²³ EBA covers the six largest SIs, while the FSAP covers 31 banks, including all SIs, major LSIs, and large foreign subsidiaries

²⁴ Banca d'Italia (2023), Financial Stability Report, No. 1, Box "The effects of rising energy costs on credit risk in the main euro-area countries."

²⁵ However, the ECB has stated that a direct comparison between the 2022 energy shock and the current shock comes with important caveats: the former is considered a local energy shock, while the latter is a global one. The current shock is potentially more inflationary, as—unlike in 2022—Europe cannot rely on imports of goods and services unaffected by the shock.

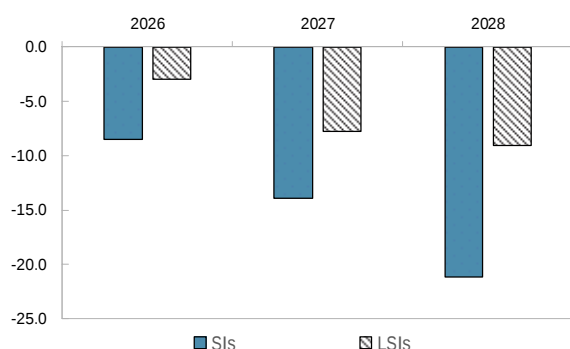
vulnerable household and bank debt-at-risk increases by 12 and 3 percentage points, reaching around 29 percent and 21 percent, respectively. Lower-income households are more adversely impacted, though the difference is not significant. These levels remain below the EA average of around 32 and 29 percent. In turn, CET1 capital depletion relative to the starting point is at 97 basis points, around 31 basis points below the EA average (Figure 27).

Figure 27. Italy: Sensitivity Analysis Results

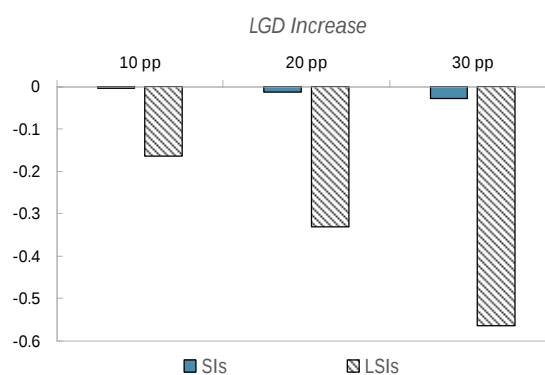
Additional capital depletion is contained, reflecting the relative resilience of Italian NFCs that could potentially be affected by tariff measures.

SI banks face limited capital impact under higher LGD assumptions, while LSI banks are more adversely affected by higher LGDs

Additional Capital Depletion: PD Sensitivity Analysis
(basis points, Geopolitical scenario)

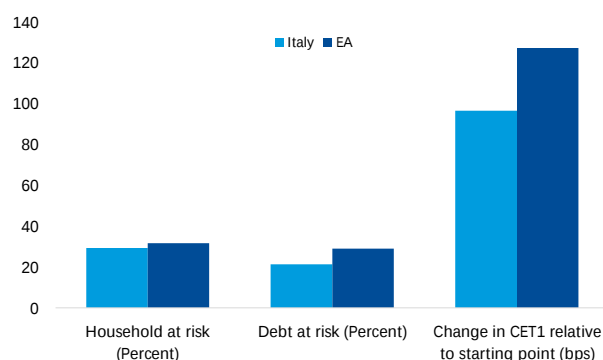


Additional Capital Depletion: LGDs Sensitivity Analysis
(percentage points, Recessionary scenario)



Under the April 2026 WEO severe scenario shocks, vulnerable households and bank debt-at-risk rise, though they remain below euro area averages.

Sensitivity Analysis on Households
(percent, basis points)



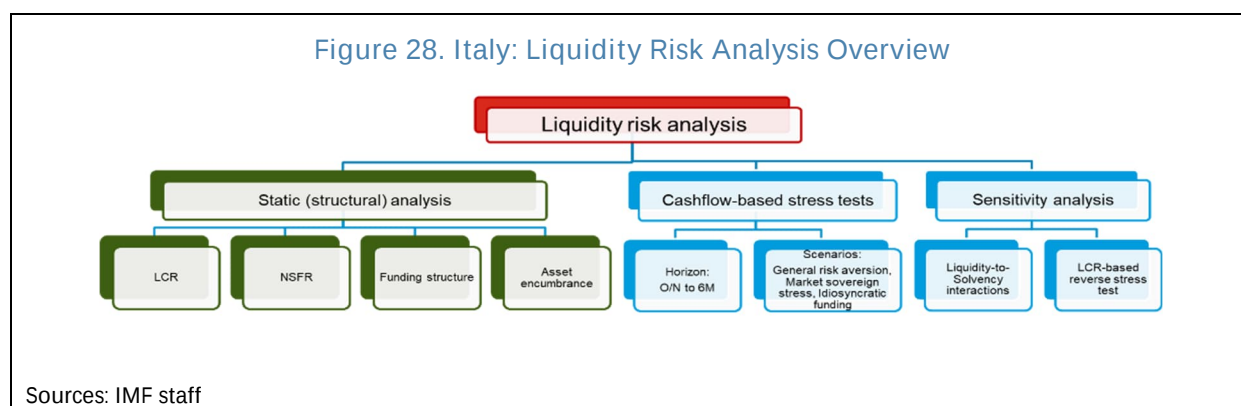
Source: HFCS and IMF staff calculations

Sources: ECB and BdI supervisory data, IMF staff calculations.

BANK LIQUIDITY RISK ANALYSIS

A. Overview and Key Findings

74. The FSAP included a comprehensive assessment of liquidity risks in Italian banks, including a structural analysis of key liquidity ratios and a suite of stress tests (Figure 28). The assessment aimed to identify vulnerabilities stemming from funding structures, maturity mismatches, and the adequacy of liquidity buffers. The analysis focused on the system vulnerabilities as well as on heterogeneity across banks, reflecting differences in size and business models.



75. The analysis suggests that the liquidity position of Italian banks is adequate, although a tail of banks is potentially vulnerable to idiosyncratic funding shocks. Banks aggregate liquidity buffers appear ample, supported by a decline in asset encumbrance in recent years. Stress test results suggest that banks can withstand significant liquidity outflows, with SIs preserving positive net liquidity positions (NLPs) under mild-to-severe shocks. LSIs are relatively more vulnerable, though they remain resilient overall. A small number of SIs may face liquidity shortfalls over very short horizons under idiosyncratic scenarios, while some specialized LSIs may experience shortfalls even under mild shocks, with pressures materializing more rapidly under idiosyncratic stress. Most banks would remain compliant with liquidity coverage ratio (LCR) requirements even under substantially higher deposit run-off rates. Funding concentration poses an additional source of risk for a subset of banks, particularly specialized LSIs and SIs with material U.S. dollar (USD) operations.

B. Structural Analysis

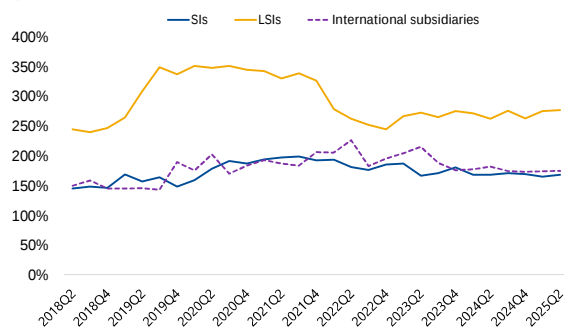
76. Structural indicators point to generally comfortable liquidity buffers across the banking system. As of June 2025, all banks meet the regulatory minimum requirements for both LCR and net stable funding ratio (NSFR), with banking system averages of 179 percent and 134 percent, respectively. Most banks maintain substantial buffers above the regulatory floors. Across liquidity indicators, LSIs tend to report higher ratios than SIs (Figure 29). Subsidiaries of foreign SIs exhibit relatively tighter liquidity buffers overall, although these indicators do not capture potential

liquidity backstop support from parent banks. Asset encumbrance has declined as banks repaid ECB funding, with the aggregate encumbrance ratio falling to 19.2 percent in Q2 2025, down from pandemic-era peaks. Over 60 percent of unencumbered eligible securities available for Italian banks outside the collateral pool are government bonds.

Figure 29. Italy: Banks Liquidity Indicators

All banks meet LCR requirements, and most banks have substantial buffers about the 100 percent minimum.

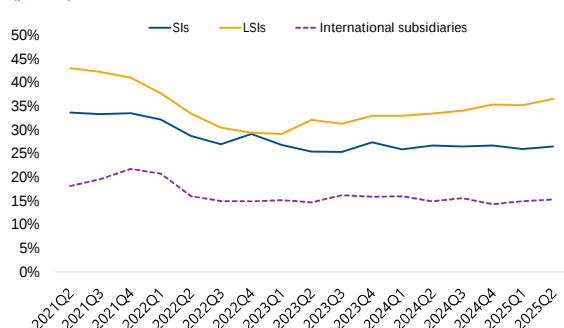
Liquidity Coverage Ratio
(percent)



Source: Bank of Italy

Liquid assets cover over one third of short-term liabilities in SI and LSI, with foreign subsidiaries reporting tighter positions

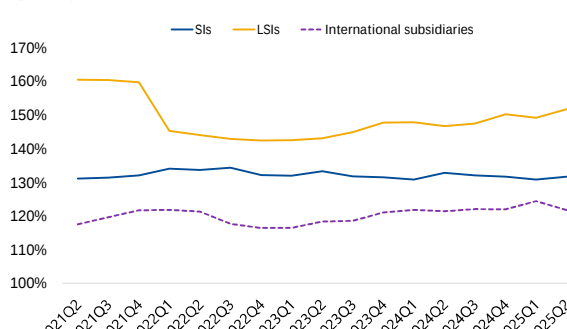
Liquid Assets to Short-Term Liabilities
(percent)



Source: Bank of Italy

All banks meet NSFR requirement; LSIs tend to have even larger buffers against the minimum.

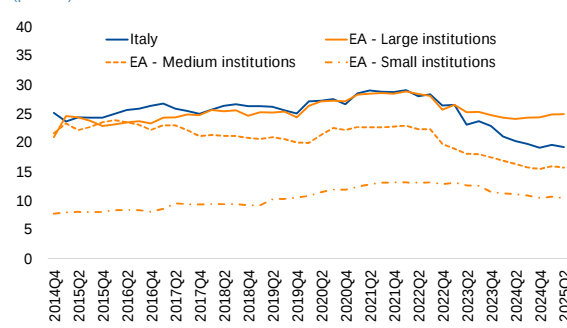
Net Stable Funding Ratio
(percent)



Source: Bank of Italy

The asset encumbrance ratio declined from the pandemic era and now stands below the EA average.

Asset Encumbrance Ratio
(percent)



Source: ECB

Sources: Bdl, ECB, and IMF staff estimated. Notes: The data covers all Italian SIs, foreign subsidiaries, and LSIs operating at each reporting date. The declines in LCR and NSFR indicators for LSIs in 1Q 2022 reflect reclassification of two banks as SIs.

77. Household and corporate deposits account for more than 60 percent of banks' total funding. Since the previous FSAP, the shares of both household and corporate deposits in total funding have increased, while the volume and contribution of other funding sources have declined. The stock of household deposits has remained broadly stable since 2021, whereas corporate deposits have continued to grow steadily.

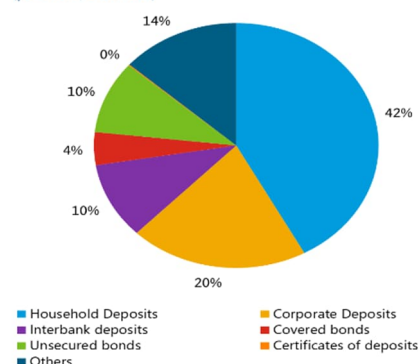
78. Funding concentration could be a source of vulnerability for some banks, especially among specialized LSIs. The top ten funding sources account for about 9 percent of total funding

in SIs and 17 percent in LSIs, with some banks exhibiting a high reliance on single funding sources, notably among specialized LSIs. In addition, a small number of common funding sources account for around 6 percent of SIs' total funding, which could amplify vulnerabilities for banks with elevated funding concentration.

Figure 30. Italy: Funding Structure

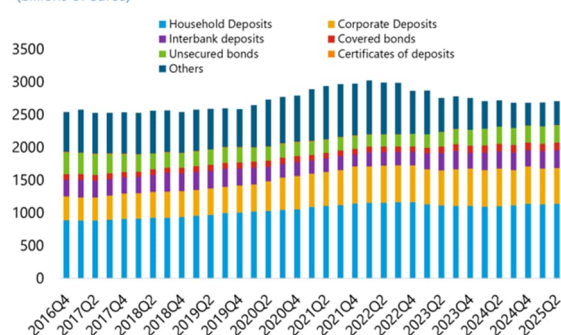
Deposits constitute almost 70 percent of banks' total liabilities.

Funding Structure of the Banking Sector
(percent, 2025Q2)



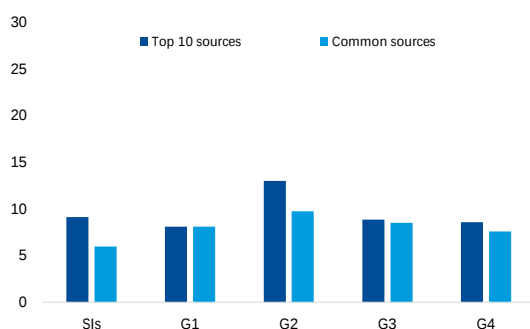
The share of household and corporate deposits increased in recent years.

Funding Structure of the Banking Sector
(billions of euros)



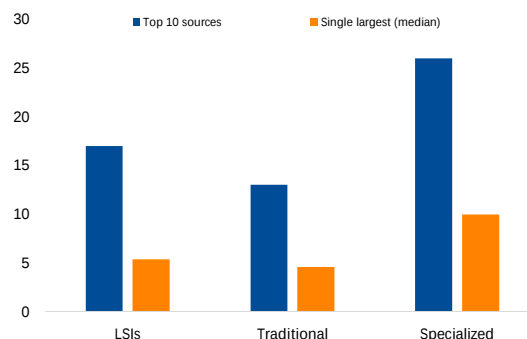
Common funding sources account for about 6 percent of SIs' total funding.

SIs: Funding Sources
(Percent of total funding)



Funding concentration is high in some banks, especially among LSIs.

LSIs: Funding Sources
(Percent of total funding)



Sources: Bdl, ECB, and IMF staff estimated.

Note: On panels 1 and 2, The data covers all Italian SIs, foreign subsidiaries, and LSIs operating at each reporting date. On panels 3 and 4, SI sample includes 12 Italian SIs and two subsidiaries of foreign SIs. LSI sample includes 17 banks. For definitions of SI groups G1-G4 see Appendix X. Data as of June 2025. Common funding sources are defined as sources reported among top 10 by three or more banks. by at least 3 banks in the sample. Some of such common sources are used by more than 3 banks.

C. Cash Flow-Based Stress Tests

79. Cash-flow-based liquidity stress tests (CFLST) were used to estimate potential liquidity needs at both the individual-bank level and for the banking sector as a whole. The analysis relies on the same sample of SIs and LSIs as the solvency stress test and is based on supervisory

data reported by banks through the maturity ladder template (COREP C66) as of June 2025. The CFLST framework estimates potential liquidity shortfalls²⁶ for each bank across time buckets ranging from overnight to six months, under the assumptions that banks are unable to influence funding flows through pricing and that no migration of funding occurs across institutions.

80. Both SIs and LSIs maintain substantial counterbalancing capacity (CBC) on aggregate with significant share of liquidity buffers composed of Italian sovereign bonds. Initial CBC levels vary across bank types and business models (Figures 31 and 32). On average, LSIs report higher initial CBC, at around 34 percent of total assets, compared to about 29 percent for SIs. In both groups, banks with an asset-management-oriented business model tend to exhibit higher initial CBC levels. By contrast, some specialized LSIs report initial CBC below 20 percent of total assets, with some institutions facing negative contractual net outflows within a few months after the reporting date. Level 1 assets account for around half of CBC in SIs—reflecting more diversified asset holdings—and over 60 percent in LSIs. For both bank groups, Level 1 assets are predominantly composed of credit quality step (CQS) 2–3 assets, which include Italian government bonds.

81. Liabilities with open maturity and payments due overnight exceed 200 percent of CBC for SIs and some LSIs. Within 30-day horizon, withdrawable liabilities stood at about 270 percent of CBC on average across SIs and exceeded 500 percent of CBC in some specialized LSIs. The predominant share of liabilities withdrawable overnight are deposits (about 85 and 95 percent for SIs and LSIs, respectively), of which about half are stable and operational deposits.

82. Most of contractual inflows, including loans, are expected beyond six months period. During the first 30 days, inflows cover about one third of withdrawable liabilities in SIs and about one quarter in LSIs.

83. CFLST covered three scenarios with increased severity to capture uncertainty and possible combinations of parameters under a range of shocks²⁷:

- General risk aversion shock (*Mild*): Implies a mild tightening of funding conditions (affecting the stock of CBC), mild deposit outflows and partial drawdown of liquidity facilities.
- Sovereign distress shock (*Severe*): Assumes a macro shock due to sovereign distress resulting in large haircuts to CBC, modest deposit outflows, and severe drawdown from liquidity facilities.
- Idiosyncratic funding shock (*Idiosyncratic*): Simulates bank-specific funding stress, where loss of confidence leads to severe outflows.

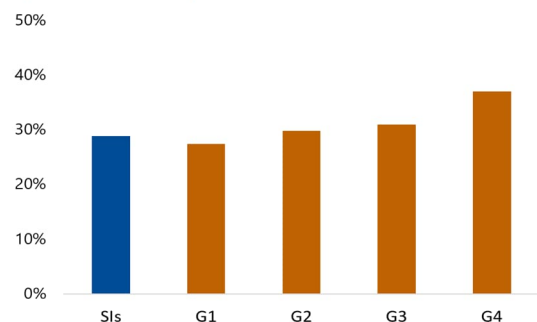
²⁶ A bank experiences a liquidity shortfall when it faces a negative liquidity position, i.e. when its CBC is insufficient to cover the gap between cash outflows and cash inflows.

²⁷ Scenarios align with the 2025 Euro Area FSAP (IMF Country Report No. 25/210; July 2025) and capture severe but plausible shocks. Impact of tail events is assessed bank-by-bank, assuming limited ability to reprice deposits upward to stem outflows and no interbank deposit reallocation.

Figure 31. Italy: Counterbalancing Capacity and Balance Sheet Structure
Significant Institutions

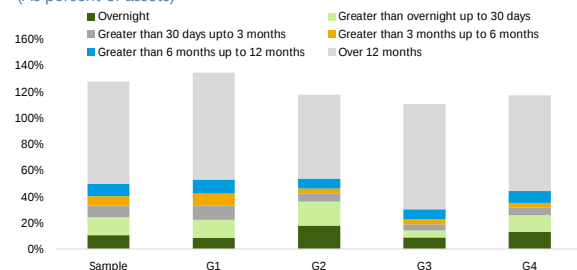
Initial CBC stock stood at 29 percent of assets on average.

Initial CBC
(Percent of assets)



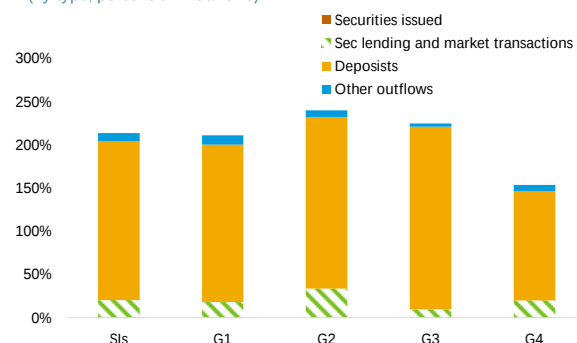
Contractual inflows expected within a 30-day period were about 25 percent of total assets (84 percent of CBC).

Assets: Composition of Inflows by Time Bucket
(As percent of assets)



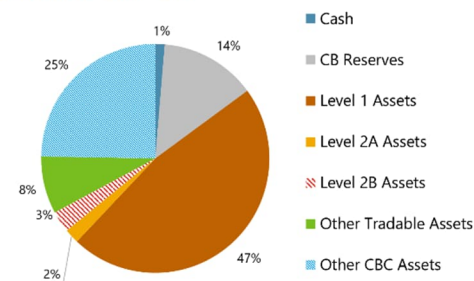
Over 85 percent of liabilities with open maturity and payments due overnight are deposits...

Liabilities with Open Maturity and Overnight Outflows
(By type, percent of initial CBC)



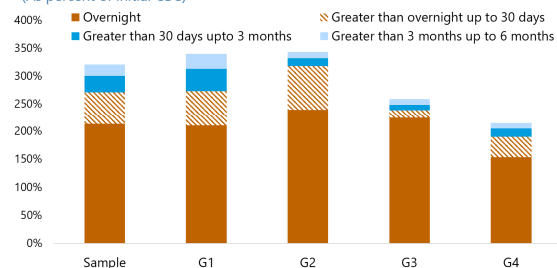
Level 1 assets constitute about half of sample CBC.

Composition of Initial Stock of CBC
(As percent of total CBC)



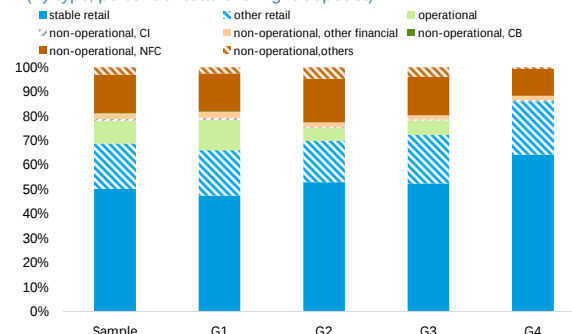
Liabilities with open maturity and payments due within 30 days stood at about 270% of CBC for the sample

Liabilities with Open Maturity and Outflows within 6 months
(As percent of initial CBC)



.. of which about half are stable and operational deposits.

Deposits with Open Maturity and Due Overnight
(By type, percent of total overnight deposit)

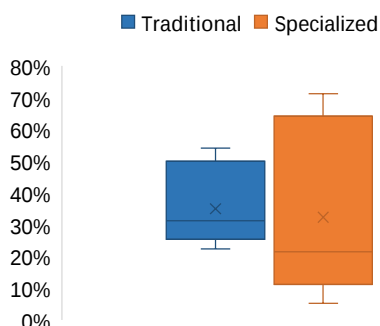


Sources: ECB supervisory reports, IMF staff estimates. SI sample includes 12 Italian SIs and two subsidiaries of foreign SIs. For description of SI groups G1-G4 see Appendix X.

Figure 32. Italy: Counterbalancing Capacity and Balance Sheet Structure
Less Significant Institutions

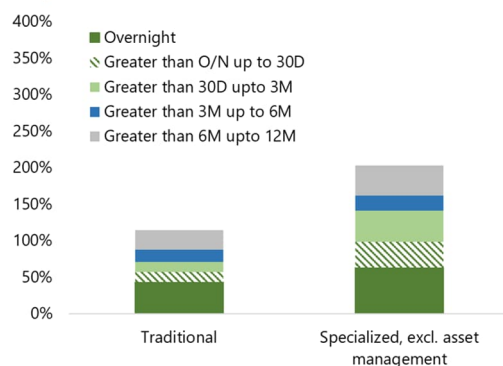
Initial CBC stock stood at 34 percent of assets on average, with higher levels in LSIs focused on asset management

LSIs: Initial CBC Stock
 (Percent of assets)



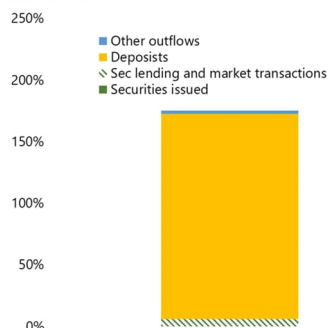
Contractual inflows within 30 days cover about a quarter of liabilities withdrawable during the same period, ...

LSIs: Inflows By Time Bucket
 (As percent of initial CBC)



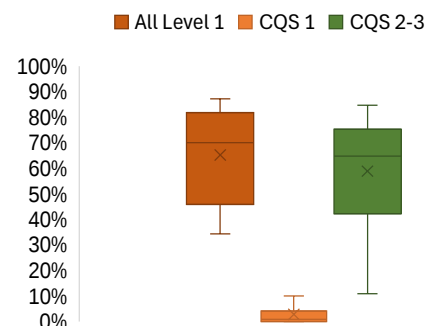
Almost 95 percent of liabilities with open maturity and payments due overnight are deposits...,

Liabilities Withdrawable Overnight
 (By type, percent of initial CBC)



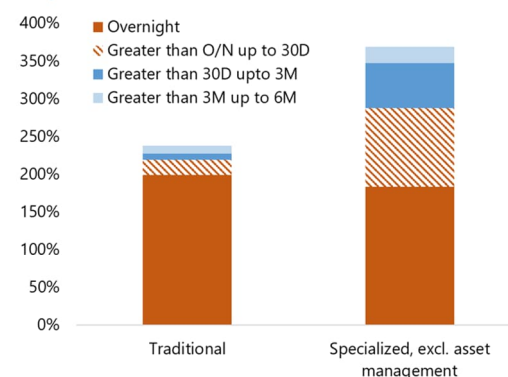
Level 1 assets constitute over 65 percent if CBC including higher shares of Italian government bonds.

LSIs: CBC Compositions
 (Asset type, percent of CBC stock)



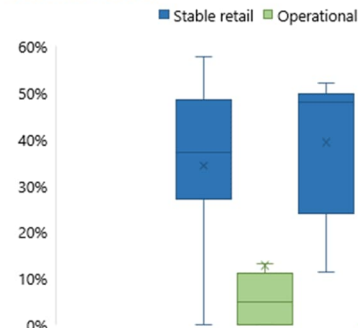
... with some LSIs facing potentially larger gap due to significant outflows.

Liabilities Due Within 6 Months
 (As percent of initial CBC)



.. of which about half are stable retail and operational deposits.

LSIs: Overnight Deposits
 (Percent of total)



Sources: Bdl and ECB supervisory reports, IMF staff estimates. Note: LSI sample includes 17 banks. Overnight deposits include deposits with open maturity and those due overnights.

84. Each scenario incorporates assumptions affecting cash-inflows and cash-outflows, market value of CBC assets, and materialization of contingencies. The calibration of the shocks is consistent with the 2025 Euro Area FSAP and reflects the following conceptual approach, which emphasizes conservatism in stress design (Figure 33)²⁸:

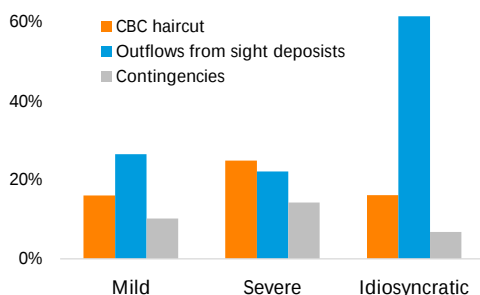
- **Haircut on CBC assets:** No haircut is applied to central bank reserves. For other assets the haircuts range from two to 38 percent of the initial asset value under *Mild* and *Idiosyncratic* scenarios, and up to 50 percent under “Severe” scenario. Across scenarios, less liquid and riskier assets are assumed to lose more value.
- **Cash-inflows:** Weights applied to cash-inflows are equivalent across scenarios. Inflows from retail loans and loans to non-financial corporates are set close to zero reflecting the assumption that banks would reinvest loan portfolio inflows to retain market share despite stress. Weights on other inflows from secured transactions were set to 100 percent.
- **Cash-outflows:** Cash flow rates applied to bank liabilities are set higher for less stable sources of funding. The rates are overall higher under idiosyncratic scenario. The same cash flow rates are assumed in all time buckets.
- **Contingencies:** Outflows related to committed credit lines are frontloaded and take place overnight. Like in case of loan inflows, banks allow to draw committed facilities to preserve franchise.

Figure 33. Italy: Cash-Flow-Based Liquidity Stress Test – Impact of Assumptions

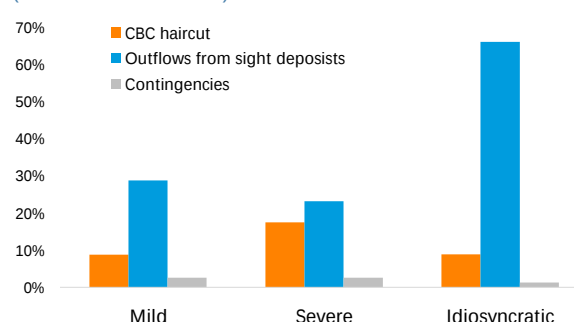
Outflows from sight deposits reach exceed 60 percent of initial CBC under “Idiosyncratic” scenario.

LSIs are on average less affected by CBC haircuts and shocks to contingent liabilities.

SI: Impact across Scenarios
(Percent of initial CBC)



LSI: Impact across Scenarios
(Percent of initial CBC)



Range Sources: ECB supervisory reports, IMF staff estimates

²⁸ For detailed parameters see Appendix XI.

85. Additional analysis was conducted to capture recent cases of term deposit outflows and bank behavioral assumptions on loan rollovers. First, a sensitivity analysis was conducted to assess the impact of more stringent assumptions on retail stable term deposits with the weights for this category increasing to 10 percent.²⁹ Second, a sensitivity analysis assuming higher inflows from loan books was conducted to illustrate the case when banks cut some of their lending activity in response to a liquidity shock. Therefore, rollover rates for household and corporate loans were reduced from 98 percent to 50 percent.

86. CFLST results suggest SIs can withstand severe shocks to outflows combined with significant decline in assets market values (Figure 34). All SI banks preserve positive net liquidity position even under *Mild* and *Severe* scenarios, as well as in case of higher rates applied to term deposits. Under “Idiosyncratic” scenario, three banks (together holding about 9 percent of sample assets) would face liquidity shortfalls either immediately or within 2-days period. Seven banks would have shortfalls within 3 months; however, an aggregate liquidity shortfall would remain below 2 percent of SI sample assets, mainly driven by banks included in group G1 (see Appendix X for SI’s groups description). Higher inflows from loans would significantly improve the outcomes for the SIs system, with the aggregate shortfall declining to 0.3 percent of assets. However, two banks would continue to report shortfalls overnight, while two other banks would show temporarily negative liquidity position between 30 days and 4 months period.

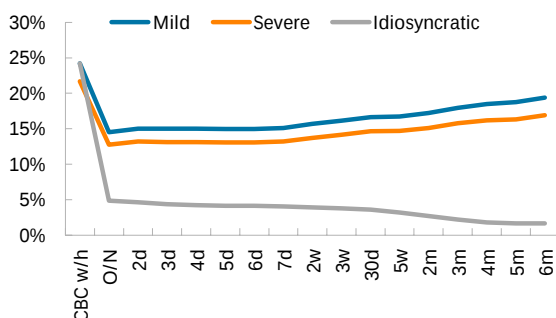
87. LSIs appear more vulnerable to liquidity shocks, but resilient overall (Figure 35). Under mild-to-severe shocks, system NLP declines modestly and stabilizes around 25 percent of assets. Two specialized banks (together holding 12 percent of LSI sample assets) would show liquidity shortfalls under all three scenarios. Under *Idiosyncratic* scenario, two traditional banks (together holding 10 percent of LSI sample assets) would have negative liquidity positions overnight. By month six, total liquidity shortfall would reach about 6 percent of the initial CBC stock for the sample. An additional increase in term deposit outflows would lead to only marginally lower NLP for individual banks and the sample. Higher inflows from banks’ loan books would mitigate stress under a mild shock but may be still insufficient to cover funding pressures for some banks under *Idiosyncratic* stress. One specialized bank would still report shortfalls under *Severe* and *Idiosyncratic* scenarios. In addition, under the *Idiosyncratic* scenario, two traditional banks would fall into negative NLP immediately, and one specialized bank would have a small shortfall within 2 weeks.

²⁹ Based on a sample of 17 LSIs, during Q1 2018- 2Q 2025, the largest monthly outflow across all deposits ranged between 2-11 percent. Monthly outflow rates for household term deposits tend to be higher than rates observed for sight deposits (with a median rate of about 10 and 3 percent respectively).

Figure 34. Italy: Cash-Flow-Based Liquidity Stress Test – Significant Institutions

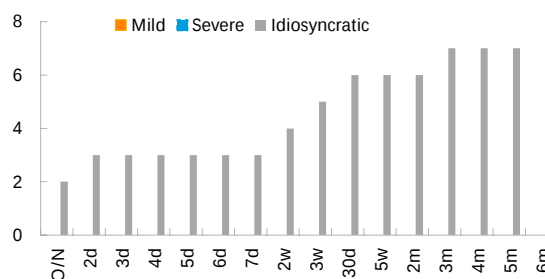
System NLP start improving immediately after mild-to-severe shock.

SIs: Sample Net Liquidity Position
(Percent of assets)



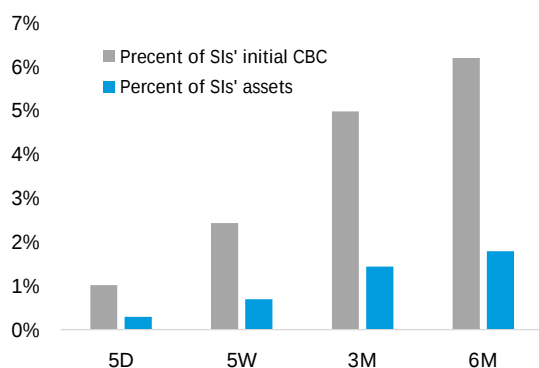
Under idiosyncratic shock, three (seven) banks would face liquidity shortfalls within two days (three months).

SIs: Banks with Negative NLP
(Number of banks overtime)



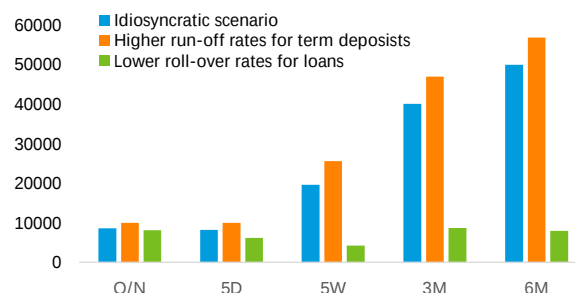
Aggregate liquidity shortfall would reach about 1.8 (6) percent of sample assets (CBC) within 6 months period.

SIs: Liquidity Shortfall Under
Idiosyncratic Scenario



Relaxing assumption on loan roll-over would limit the build-up of shortfalls over time.

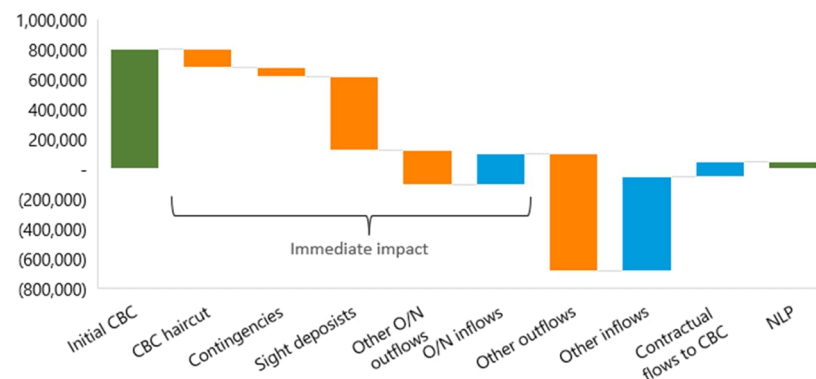
SIs: Shortfall under Alternative
Assumptions under Idiosyncratic Shock
(Euro millions)



About 60 percent of liquidity drains come from non-operational sight deposits and other outflows due overnight. Contingencies impact is significant for some banks. Over time, other outflows (mainly unspecified expected contractual payments) become a major liquidity drain.

SIs: NLP Drivers Under Idiosyncratic Scenario

(Euro million, within 6 months)

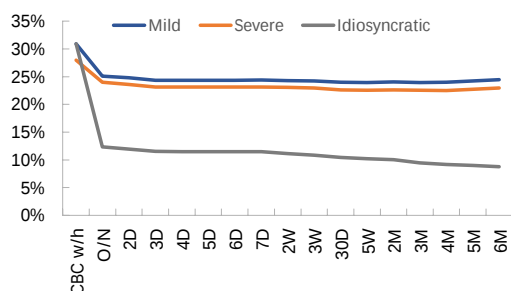


Sources: ECB supervisory reports, IMF staff estimates. Note "O/N" stands for overnight and covers liabilities with open maturity and payment due overnight. SI sample includes 12 Italian SIs and two subsidiaries of foreign SIs.

Figure 35. Italy: Cash-Flow-Based Liquidity Stress Test – Less Significant Institutions

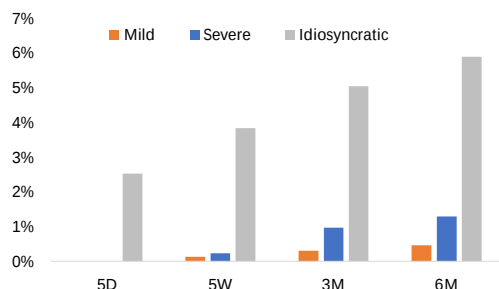
System NLP stabilizes around 25 percent under mild-to-severe shock.

LSIs: System Net Liquidity Position
(percent of assets)



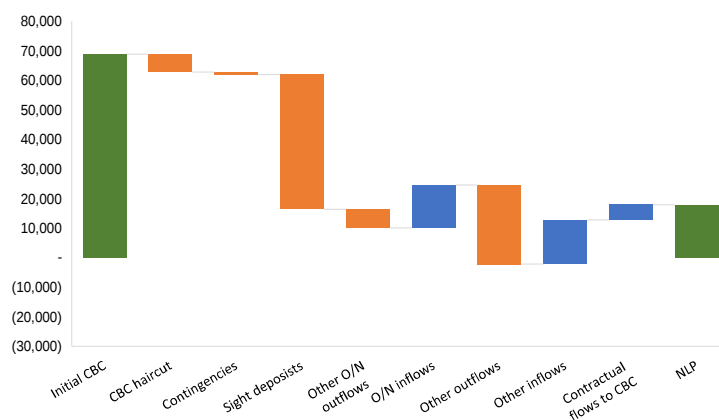
Under “Idiosyncratic” scenario, aggregate shortfall across 5 banks reaches 6 percent of CBC within 6 months period.

LSIs: Liquidity Shortfall
(percent of total sample CBC)



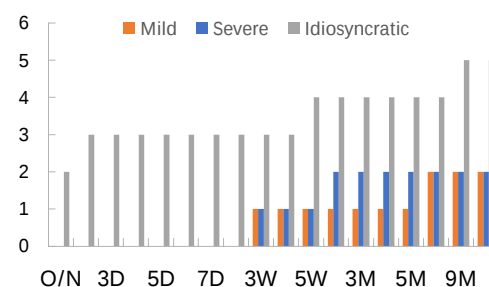
Under all scenarios, the shock to deposits materializes mainly overnight, driven by high share of sight deposits. Overtime, other outflows (mainly unspecified expected contractual payments) become a major source of liquidity drain.

LSIs: NLP Drivers Under Idiosyncratic Scenario
(Euro million, within 6 months)



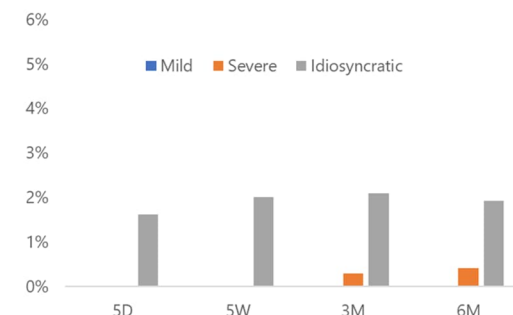
The number of banks with shortfalls increases across scenarios.

LSIs: Banks With Shortfalls
(number of banks)



A few banks face shortfalls even under assumptions of loan roll-over rates are relaxed.

LSIs: Shortfall Under High Inflows
(percent of total reported CBC)



Sources: ECB supervisory reports, IMF staff estimates.

Notes: LSI sample includes 17 banks. “O/N” stands for overnight and covers liabilities with open maturity and payment due overnight.

88. Liquidity analysis highlighted potential vulnerabilities in selected banks. Banks with high reliance on liabilities with open maturity and non-operational deposits, a large share of CBC assets exposed to higher market valuation losses under stress, or liabilities withdrawable overnight exceeding readily available CBC are more prone to rapid depletion of liquidity buffers. For some SIs, contingent commitments could be a material source of liquidity drains. In addition, the high share of Italian sovereign bonds in banks' liquidity buffers may act as a channel of contagion.

89. Analysis of USD liquidity risks was conducted for three Italian SIs reporting a maturity ladder in USD (Figure 36). Under the *Mild* and *Severe* scenarios, all banks maintain positive liquidity positions beyond a six-month horizon; the aggregate NLP recovers quickly following the initial shock and continues to strengthen over the horizon period. Under the *Idiosyncratic* scenario, however, two banks experience liquidity shortfalls, causing the aggregate NLP to turn negative by the end of the two-month horizon. While overall resilience to U.S. dollar liquidity shocks is indicated, the analysis also identifies vulnerabilities in these banks, including a high share of runnable liabilities (with overnight non-operational deposits accounting for about 50 percent of CBC) and concentrated funding structures, with approximately 11 percent of U.S. dollar funding sourced from the three largest counterparties.

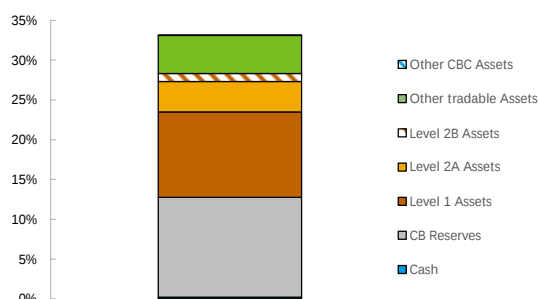
D. Reverse LCR-based Stress Test

90. LCR-based reverse stress test was conducted to identify the size of shocks that would lead individual banks to fall below 100 percent LCR requirement. CFLST results discussed above highlight deposit outflows as a main potential source of liquidity drains for both SIs and LSIs. Incremental sensitivity analysis on LCR coefficients was applied to retail and wholesale deposits to illustrate potential impact the impact of deposit runs on banks' ability to comply with regulatory requirements. Full inflows and full high quality liquid assets (HQLA) were assumed (in line with LCR Basel-recommended weights). For SIs, one bank would fall below the LCR requirement if weights on deposit outflows were increased by 50 percent compared to Basel-recommended weights, rising to six banks under a 75-percent increase. LSIs had on average higher starting LCR ratios, therefore two (eight) banks fell below the threshold when deposit run-off rates were raised by 75 (125) percent (Figure 37).

Figure 36. Italy: USD Cash-Flow-Based Liquidity Stress Test – Significant Institutions

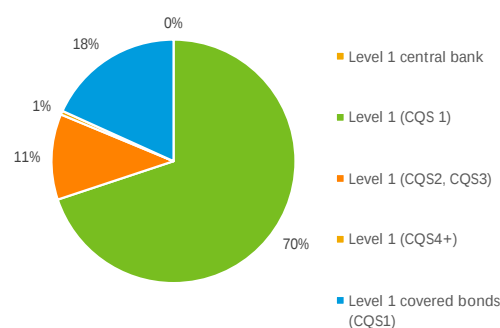
Reported CBC was about 30 percent of USD assets with some different across the banks

Composition of Initial Stock of CBC
(As percent of total estimated USD assets)



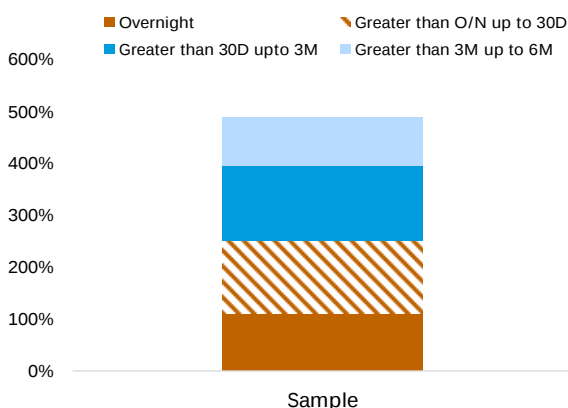
Most of Level 1 assets are instruments with Credit Quality Step 1

Composition of Level 1 Assets
(As percent of total CBC)



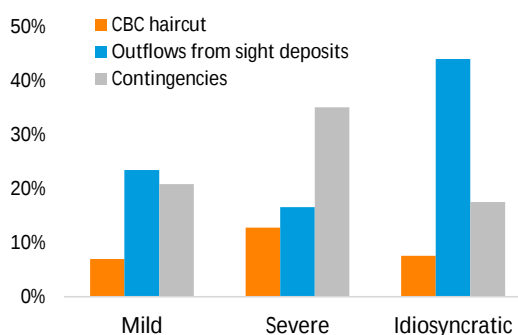
Liabilities with open maturity and payments due within 30 days stood at about 250 percent of CBC

Liabilities Withdrawable within 6 Months
(As percent of initial CBC)



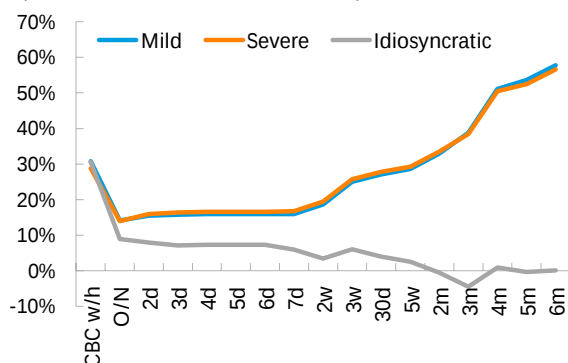
Outflows from sight deposits exceed 40 percent of CBC under "Idiosyncratic" shock, due to high share of non-operational deposits

Impact Of Assumptions Across Scenarios
(Percent of initial reported CBC in USD)



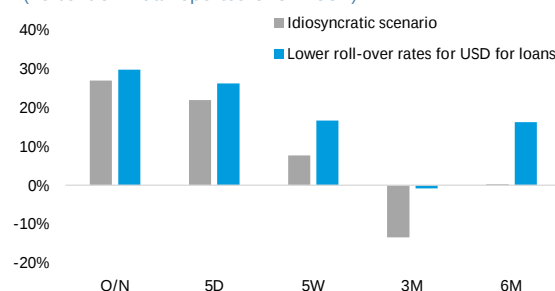
Under "Mild" and "Severe" scenario, system-wide NLP recovers quickly to initial level.

SI: USD Net Liquidity Position (NLP)
(Percent of estimated USD assets)



System NLP remains positive for at least two months after the idiosyncratic shock.

System NLP Under Alternative Assumptions
In Idiosyncratic Scenario
(Percent of initial reported CBC in USD)

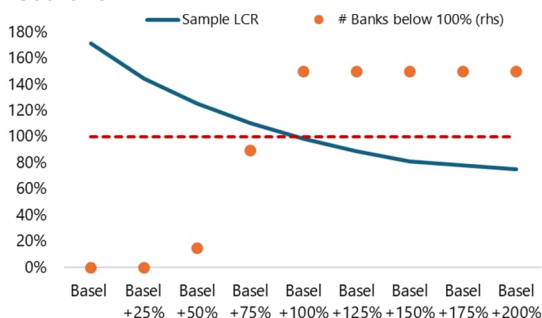


Sources: ECB supervisory reports, IMF staff estimates.

Figure 37. Reverse LCR-based Stress Tests

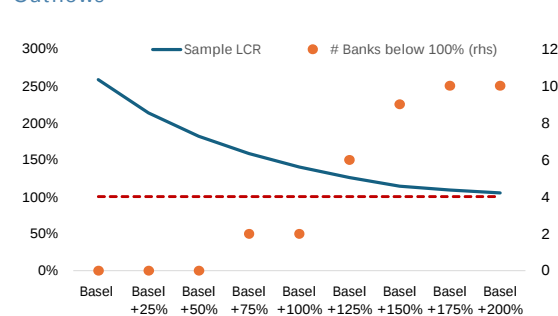
Aggregate LCR for SIs falls below 100 percent threshold when Basel coefficients are doubled

LSIs – LCR Under Stress on Deposit Outflows



Most LSI remain above LCR regulatory threshold even if Basel coefficients are doubled

LSIs – LCR Under Stress on Deposit Outflows



Sources: ECB supervisory reports C.72-76, IMF staff estimates.

Notes: SI sample includes 12 Italian SIs and two subsidiaries of foreign SIs. LSI sample includes 17 banks. The starting Basel weights were equivalent for all banks and were set at a minimum level for each category of deposits. Each simulation reflects an increase in weight by an equivalent percentage across all categories. For example, doubling of weights implies an increase in run off rates for retail category 1 deposits from 10 to 20 percent and for operational deposits not covered by deposit guarantees from 20 to 40 percent. For some banks in both samples, the weight applied in LCR calculations for regulatory purposes used higher values of run of coefficients than the starting Basel weights used in this exercise.

E. Liquidity-to-Solvency Interactions

91. The sensitivity analysis explores a tail-risk scenario in which liquidity stress propagates to solvency when banks are forced to sell assets under adverse conditions. The analysis simulates a hypothetical scenario in which banks experiencing funding stress are unable to pledge their bond holdings with the central bank to obtain liquidity and therefore need to sell bonds held at AC to cover the liquidity shortfalls identified in the cash-flow analysis. This exercise provides useful insights into the potential transmission of liquidity stress to solvency outcomes in cases where banks face operational failures during liquidity crisis.³⁰

92. Capital impacts from liquidity shortfalls are assessed using the market-risk component of the solvency stress test. The analysis uses as inputs the simulated liquidity shortfalls from the cash-flow stress tests over three-week, one-month, and three-month horizons, excluding amortized-cost (AC) portfolios.³¹ The capital impact is estimated using the same duration-based approach from the solvency stress test and the instantaneous market-risk shocks specified under the

³⁰ It is worth noting that in Italy all banks have full access to central bank liquidity facilities and most of the AC portfolio bonds are eligible as central bank collateral. Moreover, this analysis does not incorporate any assessment of individual banks' operational readiness.

³¹ For the purposes of this sensitivity analysis, net liquidity shortfalls are calculated excluding a proxy for Italian sovereign bonds at amortized cost (AC) from Level 1 AC assets, using bank-level shares of AC sovereign bonds in total bond portfolios.

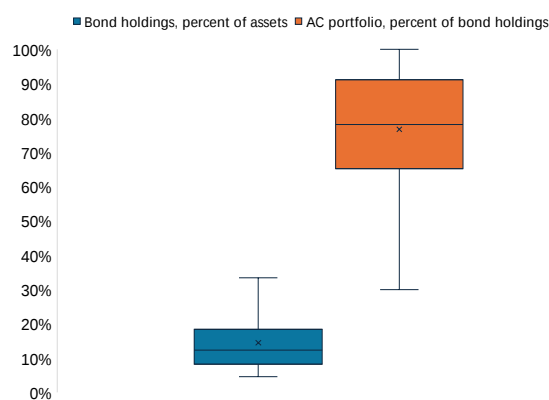
market risk adverse scenario. Each scenario is treated as a standalone event and assumes an outright sale of the AC portfolio, rather than a reclassification to FVPL.

93. Results illustrate continued vulnerabilities stemming from the sovereign–bank nexus in Italy. Under the assumption that banks are required to sell AC bonds to cover liquidity shortfalls the additional impact on the aggregate capital ratio could reach up to 2.5 percentage points for SIs and 3.7 percentage points for LSIs (Figure 38). Both bank-level and aggregate results indicate that LSIs are particularly vulnerable to losses from forced sales of AC bonds under heightened market stress, since two additional LSIs fall below minimum capital requirements, while other three banks would fail to meet the CCoB.

Figure 38. Italy: Liquidity-to-Solvency Interaction Results

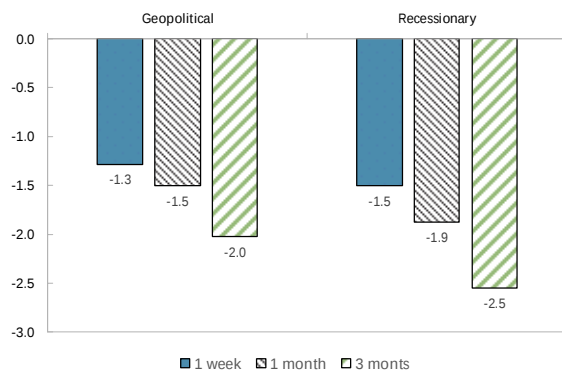
For most SIs, the share of Italian bonds holdings classified as AC exceeds 60 percent.

SIs: Holdings of Italian Sovereign Bonds



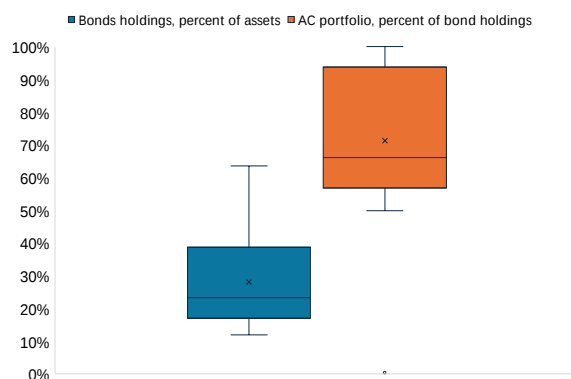
Impact on the aggregate capital ratio from sale of AC bonds due to liquidity stress could reach 2.5 pp for SIs.

SI: Selling AC Bonds to Cover Liquidity Shortfalls (percent of RWA)



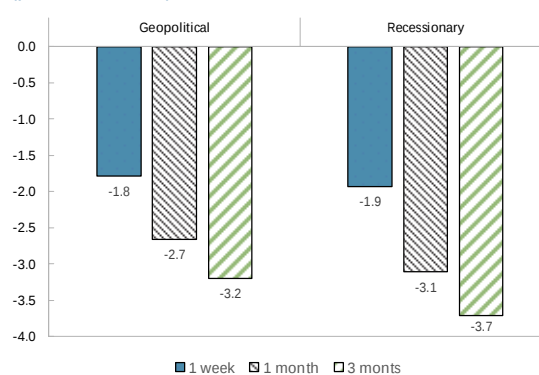
In addition, LSIs hold more Italian bonds as a share total asset.

LSIs: Holdings of Italian Sovereign Bonds



LSIs appear more vulnerable with capital impact estimated at up to 3.7 pp.

LSI: Selling AC Bonds to Cover Liquidity Shortfalls (percent of RWA)



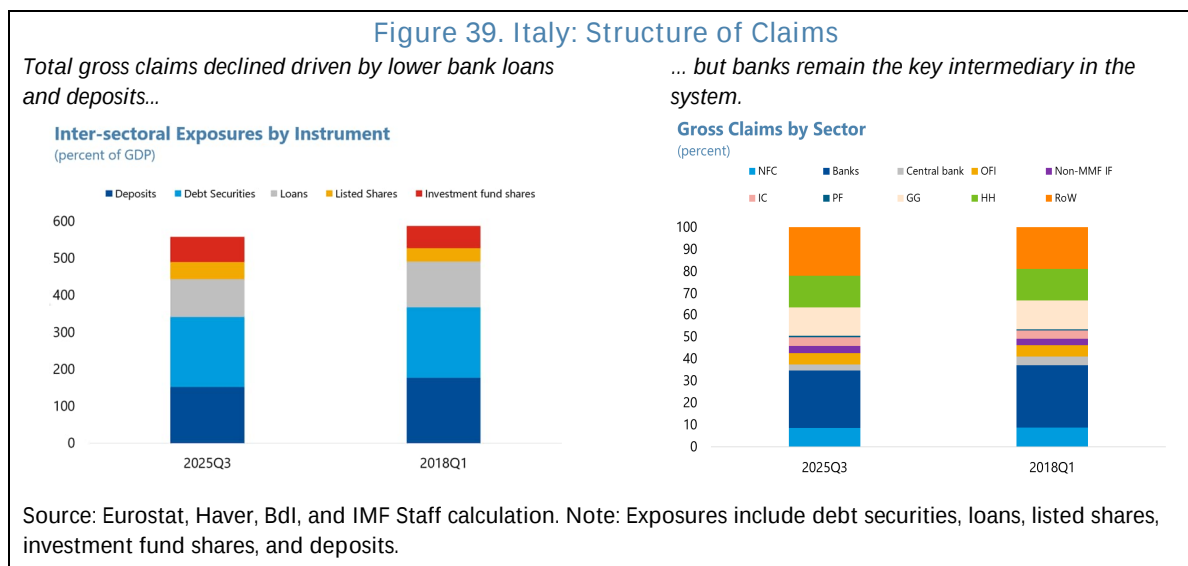
Source: EBA Transparency Exercise 2025, ECB and BdI supervisory data, IMF staff calculations. Notes: SI sample include 12 Italian SIs and two subsidiaries of foreign SIs. LSI sample includes 17 banks.

INTERCONNECTEDNESS ANALYSIS

A. Inter-sector Financial Linkages

94. The interconnectedness analysis examined inter-sectoral financial linkages based on Eurostat flow-of-funds data (Figure 39). The dataset covers balance sheet exposures among nonfinancial corporations (NFC), general government (GG), households (HH), the Bank of Italy (CB), other monetary financial institutions (Banks), insurance corporations (IC), pension funds (PF), non-money market fund investment funds (non-MMF IF), other financial intermediaries (OFI), and the rest of the world (RoW).³² The network analysis covers exposures through deposits, debt securities, loans, listed shares, and investment fund shares. Other instruments, such as equity, unlisted shares, as well as insurance, pension, and standardized guarantee schemes among others, are hence not included.^{33,34} The analysis considers the latest available data point (2025Q3) and the latest time period covered in the previous FSAP (2018Q1).

95. Domestic interlinkages and cross-border interconnectedness remain significant. Although total inter-sectoral claims have declined since the previous FSAP, they amount to 558 percent of GDP. The network is centered on banks, households, general government, and the rest of the world, which are the main hubs on both the asset and liability sides. By instrument, the network is dominated by debt securities and deposits, followed by loans, while fund shares and listed shares play a smaller role (Figure 39).



³² “HH” also includes non-profit institutions servicing households. “Other monetary financial institutions” include money market funds and exclude central bank. Non-MMF IF issue investment fund shares or units and invest primarily in long-term financial assets and non-financial assets, usually real estate.

³³ The classification of the financial instruments and sectors is determined by European System of Accounts (ESA 2010).

³⁴ Eurostat data do not include domestic sectors’ deposit claims on the rest of the world. Banks’ deposit claims on the rest of the world were therefore supplemented using authorities’ data.

96. Banks remain the key intermediary in the system. On the liability side, they are funded mainly through deposits - especially from households and NFC- and the rest of the world, including interbank funding (¶196). On the asset side, their largest exposures are loans to NFC and households. Banks also hold a meaningful stock of debt securities, mainly domestic government bonds and foreign debt securities. At the same time, banks' balance-sheet intermediation has weakened relative to the previous FSAP. On the asset side, bank lending declined, with the largest drop in lending to NFC (Figure 42). On the liability side, deposit funding also decreased, driven primarily by a marked reduction in central bank funding, alongside declines in deposits from OFIs, households, the government, and the rest of the world.

Figure 40. Italy: Network of Cross-Sectoral Financial Exposures
(In percent of GDP, 2025Q3)

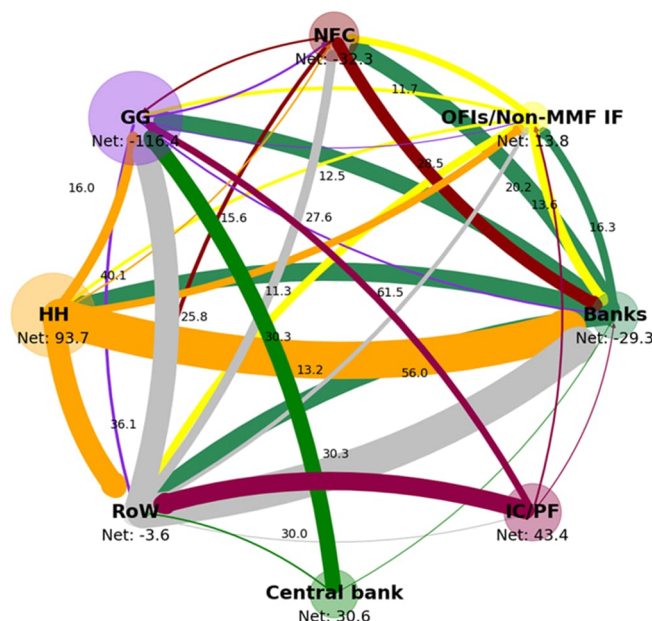
Domestic interlinkages remain significant, with households as largest net lender, government as largest net borrower, ...

Creditor/Debtor	NFC	Banks	Central bank	OFI	Non-MMF IF	IC&PF	GG	HH	RoW	Total
NFC		20.2	0.0	0.2	0.7	0.5	3.5	0.0	6.6	32
Banks	28.5		0.0	12.4	1.3	0.8	27.6	30.3	30.3	131
Central bank	0.7	1.3		0.0	0.0	0.0	25.8	0.0	2.8	31
OFIs	10.9	14.5	0.0		0.1	0.3	3.6	5.4	4.0	39
Non-MMF IF	0.8	1.9	0.0	0.3		0.1	2.5	0.0	9.3	15
IC&PF	0.8	1.8	0.0	0.1	3.3		11.3	0.0	30.0	47
GG	3.8	3.4	0.0	1.1	0.7	0.1		0.1	5.0	14
HH	2.8	61.5	0.0	0.2	12.3	0.6	16.0		36.1	130
RoW	15.6	56.0	0.0	4.9	2.2	1.6	40.1	0.0		120
Total	64	160	0	19	21	4	130	36	124	

Source: Eurostat, Haver, Bdl, and IMF Staff calculations

Exposures include debt securities, loans, listed shares, investment fund shares, and deposits.

... and banks as the key intermediary in the system.



Source: Eurostat, Haver Analytics, Bdl, and IMF Staff calculation.

Note: Exposures include debt securities, loans, listed shares, investment fund shares, and deposits. The arrowheads correspond to the recipient of the funds (debtor) from the source (creditor). The thickness of the arrows indicates the relative size of each sector's financial exposure to its different counterparts.

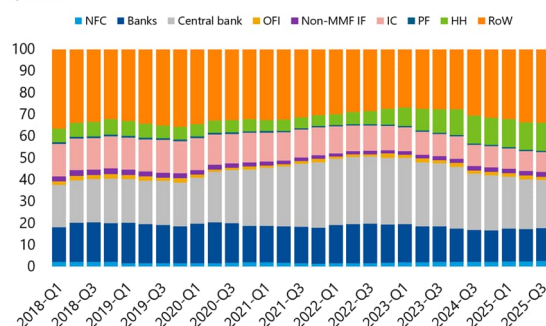
97. Households continue to be the main net lenders in the system. Their financial assets are concentrated in bank deposits, domestic and foreign investment fund shares, and debt securities, mainly government paper.³⁵ Their liabilities, by contrast, consist almost entirely of loans. While households remain the main surplus sector, their portfolio allocation has shifted somewhat away from deposits and toward sovereign paper and other market-based instruments (Figure 40).

98. General government remains the main net borrower, with liabilities amounting to 130 percent of GDP, and maintains strong linkages with the financial sector, households, and foreign investors (Figure 41). Italy's sovereign debt investor base shifted markedly between 2018 and 2022, as foreign investor holdings declined and the share held by the Bank of Italy increased, largely reflecting ECB asset purchases. Since 2023, this trend has partly reversed: foreign investors and households—supported by higher yields and the expansion of retail-oriented instruments—have increased their holdings, partly replacing NBFIs and the Bank of Italy as its portfolio has declined amid quantitative tightening.

Figure 41. Italy: Government Debt Holdings

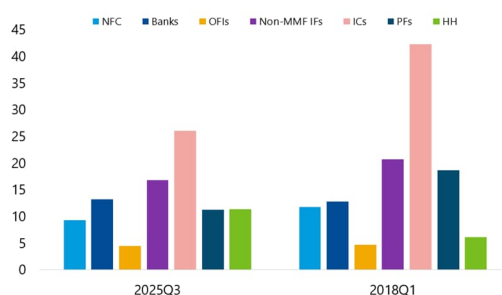
Sovereign debt investor base shifted to foreign and retail investors once the Bdl started quantitative tightening...

Government Debt Holdings by Sector
(percent)



... but sovereign debt plays an important role in all sectors' cross-sectional assets portfolios.

Share of Government Debt in Total Cross-Sectional Assets
(percent)



Source: Eurostat, Haver, Bdl, and IMF Staff calculation.

Note: Exposures include debt securities, loans, listed shares, investment fund shares, and deposits.

³⁵ Households' claims on insurance companies and pension funds are understated in this analysis, since the Eurostat data exclude holdings of insurance, pension, and standardized guarantee schemes, which constitute the main liabilities of these sectors. Households' claims on NFCs are likewise understated because the dataset does not include unlisted shares and other equity. Accordingly, the reported liabilities of NFCs, insurance companies, and pension funds are understated.

99. Insurance companies have become less concentrated in sovereign holdings and more exposed to cross-border assets (Figure 42). Their exposure to general government declined markedly, from about 18 to 10 percent of GDP, while their exposure to the rest of the world through holding of investment fund shares and debt securities increased from about 20 to 24 percent of GDP.

100. NFC have deleveraged with a sizeable decline in bank loans. On the liability side, NFCs are still funded primarily through loans, amounting to about 38 percent of GDP, especially from banks and OFI, with additional financing through listed shares and debt securities, much of it held by the rest of the world. Relative to the previous FSAP, NFC sector is less indebted within the inter-sectoral network. This reflects a marked decline in loan financing, driven almost entirely by the sharp fall in bank lending to NFC, while debt securities and listed-share financing remained broadly unchanged.

Figure 42. Italy: Changes in Cross-sector Exposures
(percent of GDP)

Since the previous FSAP, Italy's inter-sectoral network has become less dominated by domestic bank credit and more tilted toward cross-border exposures.



Source: Eurostat, Haver, Bdl, and IMF Staff calculation.

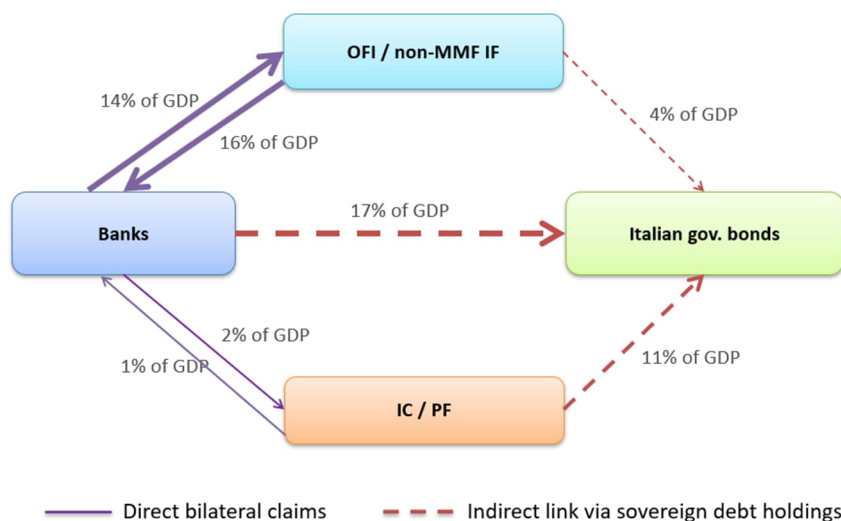
Note: Exposures include debt securities, loans, listed shares, investment fund shares, and deposits. Numbers in colored squares show changes in total cross-sectional claims between 2018Q1 and 2025Q3. Empty squares correspond to values close to zero. Callouts indicate the main drivers of changes in total claims between sectors from 2018Q1 to (->) 2025Q3.

101. Banks are indirectly linked to NBFIs through common holdings of sovereign debt, especially by insurance companies, while direct linkages are concentrated in OFIs (Figure 43).

- Bilateral gross claims between banks and IC/PF are small. The more important connection is indirect, through common holdings of Italian government bonds. Banks hold about 17 percent of GDP in government debt securities, while ICs and PFs together hold about 11 percent of GDP. However, this common exposure has weakened relative to the previous FSAP, as the combined holdings of government debt by banks, insurers, and pension funds declined from about 39 to 29 percent of GDP.
- By contrast, the direct linkages between banks and OFIs/non-MMF investment funds are more material. In 2025Q3, banks' direct claims on this group amounted to about 14 percent of GDP, mainly through loans to OFIs and holdings of OFI debt securities. In the other direction, OFI and non-MMF investment funds held claims on banks of about 16 percent of GDP, concentrated primarily in OFI deposits placed with banks.^{36,37} Their indirect linkage through common government bond holdings is more limited, as OFIs and non-MMF investment funds together held about 4 percent of GDP in government debt securities.

Figure 43. Italy: Banks and NBFIs Interlinkages

Banks have stronger direct links with Other Financial Intermediaries and indirect linkages through sovereign debt holdings with Insurance Companies.



Source: Eurostat, Haver, and IMF Staff calculation.

Note: Exposures include debt securities, loans, listed shares, investment fund shares, and deposits. Arrows denote the direction of funds.

³⁶ Direct gross claims between banks and non-MMF investment funds are relatively small and amount to 3 percent of GDP.

³⁷ The reported inter-sectoral exposures data could overstate contagion channels between banks and OFIs because: (1) OFIs include central counterparties (CCPs); hence, inter-sectoral loans and deposits include interbank transactions intermediated through CCPs; (2) a share of banks' exposures to OFIs reflects intra-group exposures; (3) OFI debt securities held by banks include senior tranches of asset-backed securities repurchased by the originating banks.

102. Cross-border linkages remain large and systemically important. Domestic sectors' claims on the rest of the world amount to about 124 percent of GDP, while the rest of the world claims on domestic sectors are about 120 percent of GDP, leaving the external position broadly balanced. On the domestic asset side, the main holders of foreign assets are households, banks, and insurance companies. These foreign assets holdings are concentrated on investment fund shares and debt securities. On the liability side, the rest of world claims on Italy are concentrated in government debt securities, bank deposits, and listed shares (Figure 40).

B. Banks' Cross-border Linkages

103. The analysis of the structure of cross-border linkages was conducted using the BIS Consolidated Banking Statistics (CBS). BIS CBS data on ultimate risk basis³⁸ are used to map Italian banks' outward exposures to key partner countries and the exposures of foreign financial systems to Italy.

104. Foreign banks' claims on Italy are concentrated in the corporate, household, and official sectors (Figure 44). Total foreign bank exposure to Italy rose from 33 percent of Italian GDP in 2018Q1 to 41 percent in 2025Q3, reflecting growth across all sectors. The largest share of these claims is accounted for by corporates and households (44 percent), followed by the public sector (37 percent), with smaller shares held against banks and the non-bank financial sector. Foreign banks hold a significant share of foreign investors' claims on the public sector (around €344 billion). These holdings of Italian government liabilities remain heavily concentrated in France and Spain, which together account for more than half of total claims. Over the same period, Japan increased its exposure, while Germany reduced its holdings.

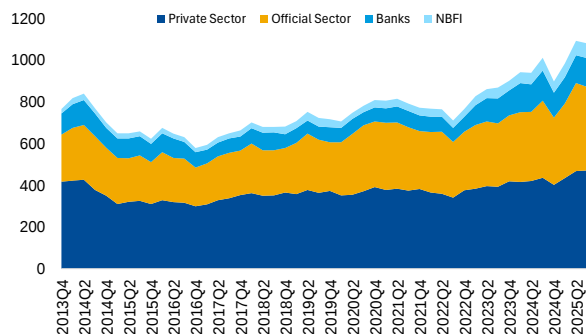
105. Foreign bank claims on Italian banks and NBFIs increased over the last few years to about €180 billion. Claims on Italian banks increased by almost 90 percent since 2018Q1 to about €117 billion, though remain less than half of the amounts reported before the Global Financial Crisis. Such claims constitute about four percent of Italian banks' funding. Top five foreign banking systems hold about 86 percent of these exposures. Claims in NBFIs have doubled since 2020, driven by banks headquartered in the US and France (half of all claims).

³⁸ BIS CBS data on ultimate risk basis reallocates exposures to the country where the final credit risk resides after accounting for guarantees and other risk transfers.

Figure 44. Italy: Foreign Bank Claims

Foreign banks exposures to Italy are dominated by claims on non-financial sectors, ...

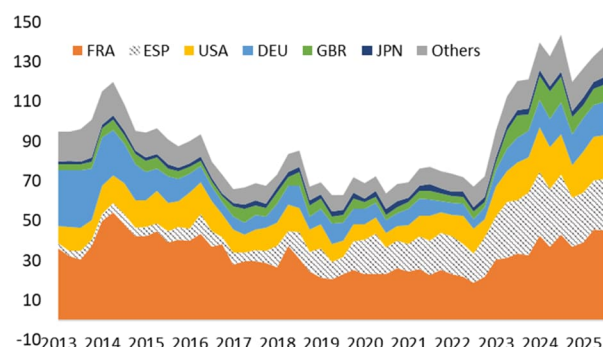
Foreign Banks Claim on Italy
(USD, billions)



Note: The composition is Banks, Private Sector (households and firms), Official Sector and NBFIs

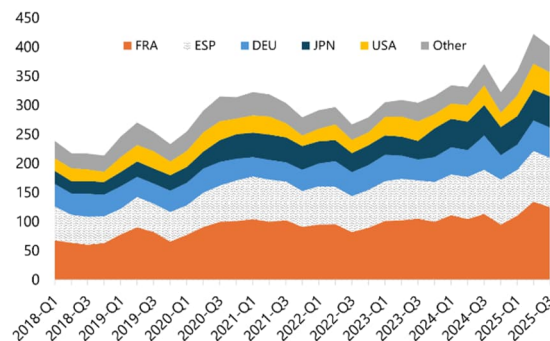
Foreign banks claims on Italian banks increased sharply after 2022, with significant contribution from Spain.

Foreign Banks' Claims on Italian Banking Sector
(USD, billions)



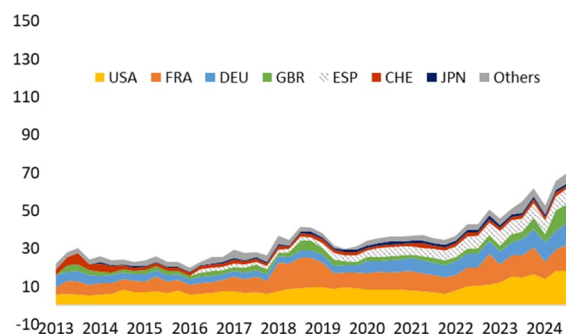
...including 15 percent of Italian GDP of claims on sovereign, half of which is held by France and Spain.

Foreign Banks Claim on Official Sector
(USD, billions)



Claims on NBFIs also accelerated initially driven by the US in 2022, and a wide group of banks after 2024.

Foreign Banks' Claims on NBFIs
(USD, billions)



Source: BIS CBS, Haver Analytics, IMF staff estimates. Notes: Claims on ultimate risk basis.

106. Italian banks significantly increased their holdings of claims on foreign public sector (Figure 45). Total consolidated foreign claims reached €958 billion and are mainly concentrated in non-financial private (44 percent of total) and public sectors (31 percent). An increase in foreign claims relative to the previous FSAP was mainly driven by the growth in holdings of public liabilities including those issued by France and Spain. Exposure to foreign non-financial private sector is concentrated in Germany and Austria (39 percent), while the exposure to the USA is only about 6 percent.

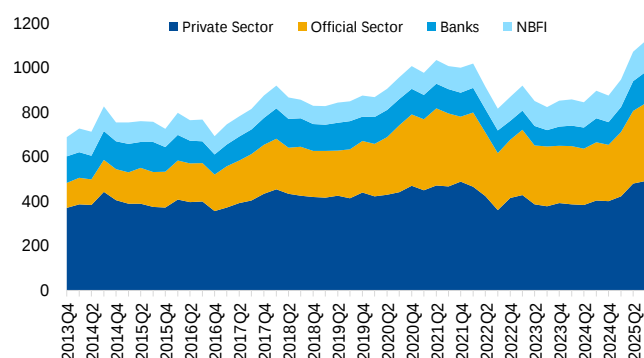
107. Italian banks' cross-border claims on financial sector increased overall, with a persistent upward trend in claims to NBFIs in a few jurisdictions. An increase in bank-to-bank claims, including a sharper rise after 2024, was driven by exposures to Germany and France. Together with Spain these jurisdictions account for 67 percent of total bank claims. Exposures to foreign NBFIs expanded driven by claims on Ireland and Luxembourg – both investment fund

international hubs – while exposure to the UK and Germany remained broadly stable. Top 6 countries account for over 80 percent of such claims.

Figure 45. Italy: Foreign Claims of Italian Banks

Italian banks significantly increased their holdings of claims on foreign public sector ...

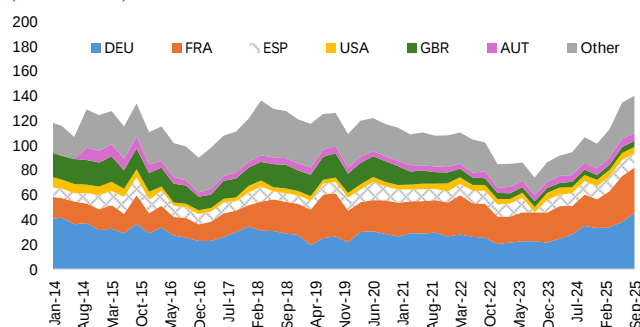
Italian Banks: Claims on Foreign Sectors
(USD, billions)



Note: The composition is Banks, Private Sector (households and firms), Official Sector and NBFIs

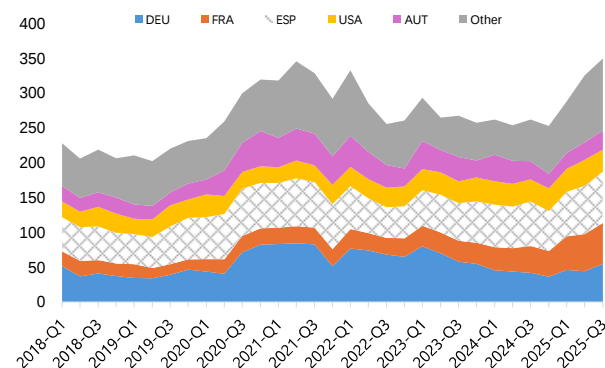
Claims on foreign banks recovered back to 2018 levels after a period of decline.

Italian Banks: Claims on Foreign Banks
(USD billion)



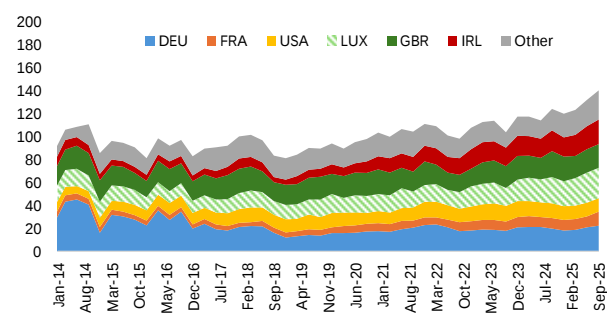
... including the rise of those issued by France and Spain.

Italian Banks: Claims on Foreign Official Sector
(USD, billions)



Ireland and Luxembourg account for about 40 percent of claims in foreign NBFIs, mainly funds.

Italian Banks: Claims on Foreign NBFIs
(USD billion)



Source: BIS CBS, Haver Analytics, IMF staff estimates. Notes: Claims on ultimate risk basis

C. Large Exposures and Common Exposures Analysis

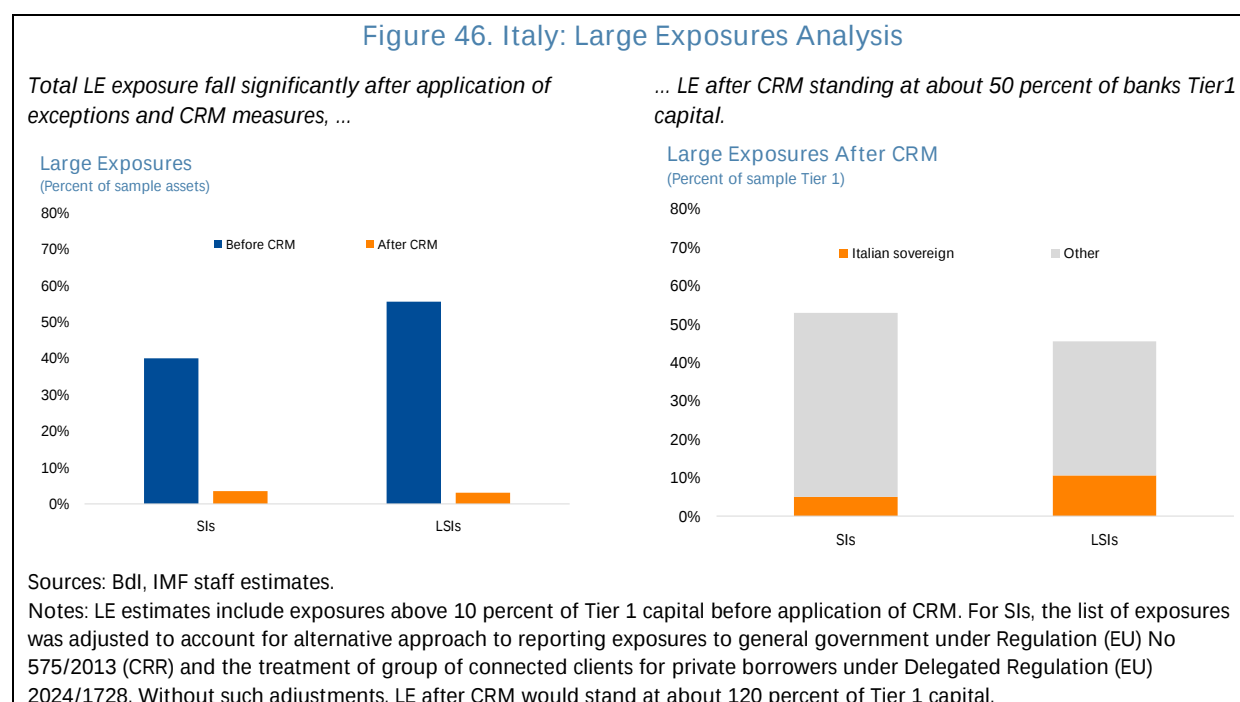
108. Granular data reported under large exposure (LE) templates provides useful insights into credit risk concentration and overlaps in banks' asset portfolios. The analysis was applied to the same sample of 31 banks used for solvency and liquidity analysis (12 Italian SIs, two subsidiaries of foreign SIs, and 17 Italian LSIs). The assessment is based on COREP templates C.27, C.28, and C.29.³⁹

³⁹ The templates are defined by the EBA to operationalize the reporting requirements set out in Article 394 of Regulation (EU) No 575/2013 (CRR); specifically, LE supervisory reporting, is intended to allow supervisors to assess compliance with prudential

(continued)

109. Exposures to the Italian public sector are significant share of banks' LE (Figure 46). Total LE before application of exceptions and credit risk mitigation (CRM) measures are estimated at about 40 and 56 percent of assets across the samples of SIs and LSIs, respectively. A predominant share of such exposures are exposures to the Italian and other European sovereigns (including France and Spain), which decline by 98-100 percent after application of CRM.⁴⁰ About half of top 10 large exposures (LE) in SIs and over 70 percent of top 10 LE in LSIs are related to the Italian sovereign. As a result, LE adjusted for credit risk mitigation stands at about 53 and 46 percent of Tier 1 capital in SIs and LSIs respectively.

110. Analysis of individual exposures reported by SIs highlights other sectors and jurisdictions, where most banks have significant exposures.⁴¹ This analysis covers exposures to NFCs and financial institutions which together account (before application of CRM) for about 50 percent of total assets in the sample. Nearly half of exposures after CRM to the NFC sector are to Italian counterparties, with manufacturing and professional services accounting for over 45 percent of these exposures, followed by firms in the energy and utilities sectors. Outside Italy, at least six of the fourteen banks report material exposures to corporate and financial counterparties in the United States, Germany, and France, amounting in aggregate to about 60 percent of Tier 1 capital (Figure 47).



requirements (i.e., LEs are expected to remain below 25 percent of Tier 1 capital). Moreover, under CRRa bank's exposure to a client or a group of connected clients is considered a LE when its value is equal to or exceeds 10% of the institution's Tier 1 capital, most institutions report in the C.28 template also exposures under this threshold according to CRR and the ITS reporting instructions. According to the regulatory definition of large exposures include, in specific cases exposures that fall below the LE threshold of 10 percent of Tier 1 capital.

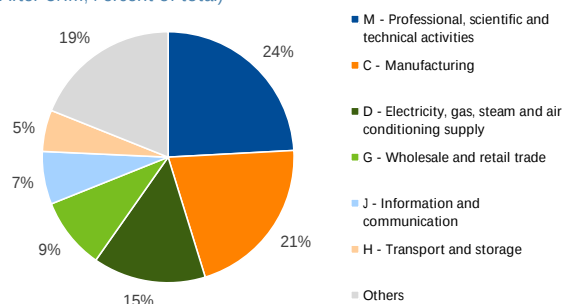
⁴⁰ The main drivers contributing to the CRM impacts relate to the amounts exempted, according to Article 400 of the Capital Requirements Regulation (CRR3), and to funded credit protections other than substitution effects as per Article 401 CRR3.

⁴¹ This analysis includes exposures that fall below the LE threshold of 10 percent of Tier 1 capital.

Figure 47. Italy: Common Exposures Analysis

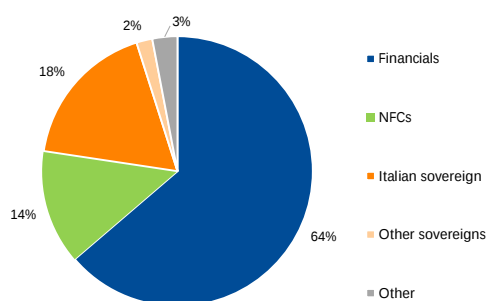
On individual basis, almost half of SIs' exposures to NFCs are Italian, of which 60 percent are in three sectors.

SIs: Exposures after CRM to Italian NFCs
(After CRM; Percent of total)



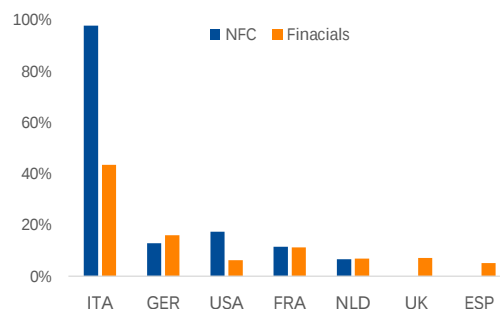
Financials account for about 64 percent of LSIs' top 20 exposures...

LSIs: Exposure after CRM by Sector
(Percent of Top 20)



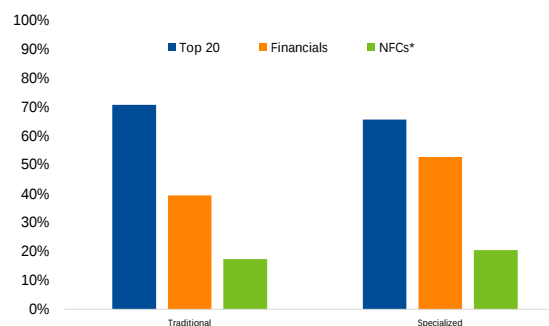
Germany, the US, and France are most common among banks' exposures to NFC and financials.

SIs: Selected Sectors and Countries
(Exposure after CRM, percent of Tier 1)



.. while NFC exposures are concentrated in traditional and two out of six specialized banks.

LSIs: Exposures after CRM
(Percent of Tier 1)



Sources: Bdl and ECB supervisory reports, IMF staff estimates.

Notes: (i) For SIs, the estimates rely primarily on COREP template C.29 and include all available data reported by the banks as part of LE reporting requirements including exposures below the LE threshold of 10 percent of Tier 1 capital. The reported data was adjusted for duplicated data points, mismatches between C.28 and C.29 templates, and, in some cases, for differences in NACE code classifications. These adjustments resulted in overall significant decline in total exposures compared to reported values. (ii) For LSIs, the analysis covers top 20 exposures reported in C.28 template regardless of the 10 percent Tier 1 capital threshold. On panel 4, exposures to NFC are compared to Tier 1 capital of banks with non-zero exposures.

Appendix I. Risk Assessment Matrix

Sources of Risk	Relative Likelihood ¹	Impact If Realized	Policy Responses
Global Risks – Conjunctural			
Geopolitical tensions and intensification of conflicts. Rising geopolitical tensions, and a weakening of multilateralism, raise the risk of an escalation in military conflicts, accompanied by damage to key physical and financial infrastructure, disruptions in major transit routes and supply chains, higher migration pressures, additional financial frictions and market volatility.	High	High: Higher energy and food prices given Italy's energy dependence. Input shortages negatively impact the manufacturing sector. Financial market volatility and increasing debt service costs. Defense needs may increase. A refugee influx could further stretch domestic absorption capacity. Potential higher tourism inflow from rerouting could partly mitigate these negative impacts.	• Ensure any support is budget neutral, temporary, and well-targeted, and does not distort price signals from higher prices. • Scale up renewable energy generation, expanded energy storage, and deepen electricity market integration domestically and at the European level, scaling up investment to meet the 2030 electricity integration target. • Consider strategies to increase resilience to shocks, such as increasing inventories and diversifying suppliers of critical commodities. • Improve labor market integration of foreign workers.
Commodity price volatility. Supply and demand imbalances—triggered by geopolitical tensions, coordinated production decisions, shifts in investor preferences, or structural changes in demand—fuel commodity price swings, amplifying external and fiscal pressures, social unrest, and macro instability.	High	High: Italy is a large commodity importer, including energy products. Supply disruptions and/or price spikes could significantly impact business profitability and output, real incomes, and the current account.	• Allow domestic commodity prices to increase to encourage energy conservation, while providing budget neutral, temporary, and well-targeted support to the most vulnerable. • Encourage inventory accumulation and more efficient consumption. • Promote investment in innovative energy systems, including renewables, battery storage, and associated grid infrastructure.
Trade-related risks • Protectionism and trade disruptions. Tariff and nontariff measures disrupt global supply chains, weighing on activity while increasing inflation. Trade diversion triggers broader protectionism. • New trade agreements. Tangible progress in trade talks reduces uncertainty and trade barriers. Wider cooperation on services, FDI, and taxation boosts investment and bolsters public finances.	High Low	Medium: Given Italy's openness, integration in the global value chains, and importance of the manufacturing sector, higher trade barriers negatively impact export growth both directly and indirectly through adverse impacts on trading partners. However, these adverse effects can be mitigated if trade within the EU and with the rest of the world remains open.	• Continue support for reducing barriers to trade and enhancing investment within the EU and with the rest of the world; ensure opportunities to diversify export products and destinations. • Accelerate the structural reform agenda to boost productivity and competitiveness. • Facilitate worker reallocation and reskilling/upskilling, while providing an adequate social safety net.

Sources of Risk	Relative Likelihood ¹	Impact If Realized	Policy Responses
Fiscal vulnerabilities and higher interest rates. Higher public debt and deficit levels put further upward pressure on long-term interest rates, sharply tightening global financial conditions, amplifying currency volatility, and reducing consumption and investment that exacerbate adverse debt dynamics. Disruptions are amplified by increased role of price-sensitive investors and leveraged NBFIs in sovereign debt markets, limited market absorption capacity when NBFIs offload debt securities, higher roll-over needs on shorter sovereign debt maturities, and strong sovereign-financial nexus. Concurrently, capital outflows from emerging and developing economies elicit a sharp increase in short-term rates.	High	High: Higher sovereign borrowing costs and a shift in risk sentiment would cause repricing of government, bank, and non-financial corporate bonds, curtail credit activity, and strain leveraged corporates and households. Loan quality would deteriorate. Insolvencies would increase, deteriorating bank balance sheets and profitability. An increase in sovereign borrowing costs would further deteriorate public debt dynamics.	• Ensure commitment to a credible medium-term fiscal consolidation path that embeds structural reforms and productivity-boosting investments. • Stay agile in reassessing the appropriateness of the Systemic Risk Buffer. Rely on bank resolution systems to address unsound banks. • Closely monitor banks' loan classification practices, including for publicly guaranteed loans.
Policy uncertainty. Elevated and wide-ranging policy uncertainty weighs on sentiment and holds back consumption and investment. Political interference in independent economic institutions erodes public confidence and trust and raises the risk of policy mistakes.	High	High: Precautionary saving would rise and durable spending delayed despite increasing disposable income. Uncertainty also depresses investment and hiring, weakening growth.	• Strengthen policy predictability and communication (medium-term fiscal/structural plans with clear timelines) to reduce uncertainty premiums. Safeguard the independence of economic institutions and preserve transparent, rules-based decision-making.
Disorderly AI correction. An abrupt revision in expectations of strong AI-led productivity gains causes a sharp market correction, investment decline, and wealth loss, which suppress demand and tighten financial conditions globally.	High	Medium: The main channels would be (i) household wealth effects (e.g., indirect exposure via funds/pensions/insurance products) and (ii) tighter global financial conditions and weaker external demand in a broader risk-off episode. Overall impact is highly uncertain but could increase if accompanied by a generalized repricing of risk that widens sovereign spreads and tightens credit.	• Financial stability monitoring: Intensify monitoring of household/NBFI exposures (investment funds, unit-linked products) and liquidity risks; ensure banks maintain prudent provisioning and capital planning, and be ready to deploy macroprudential tools if stress broadens.

Sources of Risk	Relative Likelihood ¹	Impact If Realized	Policy Responses
Global Risks – Structural			
Labor shortages and remittances. Tighter immigration policies exacerbate labor shortages in aging destination economies, reducing potential output, fueling inflation, and straining fiscal balances through lower revenues. Origin countries see depressed remittances and incomes, and worsening external balances, though a larger labor force could partly offset the remittance decline over the medium term.	High	Medium: Immigrant labor shortages would significantly amplify existing demographic headwinds, posing risks to medium-term growth and potential output. Worsening labor shortages would constrain production capacity, add to inflationary pressures, and weaken fiscal balances through lower employment and revenue bases.	• Enhance coordination at the EU level on immigration policies to better align labor supply with demographic and sectoral needs. • Ensure faster and more effective labor market integration of immigrants, including recognition of skills, language training, and targeted active labor market policies. • Facilitate labor reallocation across sectors and regions to ease bottlenecks and raise aggregate productivity.
Cyberthreats. Cyberattacks on physical or digital infrastructure, technical failures, or misuse of AI technologies could trigger financial and economic instability.	High	High/Medium: While digitalization is advancing in Italy, cyberattacks could still impair the functioning of the financial system, public services, and overall economic activity.	• Raise awareness and enhance monitoring of cyberattacks. • Urge businesses and institutions to have robust cyber defenses and business continuity plans. • As per the FSAP recommendation, continue to strengthen the Bank of Italy's monitoring and oversight of the financial sector's IT resilience and cyber risk defenses.
Climate change. Extreme climate events and rising temperatures could cause loss of life, damage to infrastructure, food insecurity, supply disruptions, and heighten economic and financial instability.	Medium	Medium: Climate-related losses could reduce real GDP and increase fiscal costs. EU member states may experience increased migration flows from economies severely affected by climate disruptions.	• Leverage EU funds to make infrastructure more resilient to natural disasters. • Work with EU partners on region-wide response to migration. • Scale up renewable energy generation, expanded energy storage, and deeper electricity market integration domestically and at the European level, scaling up investment to meet the 2030 electricity integration target.
AI acceleration. Rapid AI adoption significantly improves productivity, boosts growth, and revives business dynamism. Realizing these gains requires complementary policies to manage energy constraints, scale critical inputs, and support labor market transitions.	Medium	Medium: Rapid AI adoption would raise productivity and potential growth, supporting business dynamism and fiscal sustainability in an aging economy. Gains may be uneven across firms and regions, while rising energy demand and skill mismatches could limit the aggregate payoff absent complementary policies.	• Accelerate AI diffusion, especially among SMEs. • Address energy and infrastructure constraints to support higher digital demand. • Support labor market transitions through reskilling and worker reallocation.

Sources of Risk	Relative Likelihood ¹	Impact If Realized	Policy Responses
Domestic Risks			
Lack of a post-NRRP reform strategy. Failure to assess and build upon NRRP policy instruments and strategies could weaken the reform and investment momentum needed to sustain medium-term growth after NRRP funding ends.	Medium	High: Loss of NRRP-related productivity and growth gains. Ineffective or fiscally costly instruments persist, while successful reforms are not scaled up. Weak continuity in outcome-based conditionality could lower investment efficiency and weigh on fiscal sustainability.	• Conduct targeted ex-post evaluations of NRRP instruments and reforms. • Embed NRRP lessons in the next MFF, preserving outcome-based conditionality and aligning resources with administrative capacity, supported by technical assistance. • Maintain and strengthen NRRP public investment data and monitoring systems to support transparency and effective project selection.
Ineffective tax reform. A more regressive tax system or one that relies on ad hoc rate cuts while preserving large policy gaps.	High	High: Relying on a supply-side response from tax cuts to boost revenue could disappoint, particularly in the context of the current strong labor market. Reducing progressivity would further raise inequality and raise the need for costly social transfers. Inability to raise revenues risks resulting in under-delivery on much-needed fiscal consolidation.	• Ensure reforms are guided by the principles of reducing complexity and broadening the tax base to promote vertical and horizontal equity. • Reduce tax expenditures and continue to strengthen tax compliance.
Failure to put public debt firmly on a downward path. Debt-to-GDP and gross financing needs are expected to remain elevated. More acute spending pressures on defense and energy security amid ongoing geopolitical tensions. Proliferation of public loan guarantees.	Medium	High: With already elevated public debt and gross financing needs, any further macro-financial shocks would increase Italy's already high borrowing costs, potentially triggering the need for a sharp fiscal adjustment. High borrowing costs could also lead to financing constraints for banks and a credit crunch. The increasing use of public loan guarantees is adding to contingent liability and medium-term fiscal risks.	• Lean into continued fiscal overperformance. • Promote high-quality public investment and comprehensive fiscal and structural reforms to secure a stable source of revenues and lift potential growth.

Sources of Risk	Relative Likelihood ¹	Impact If Realized	Policy Responses
Stronger spillovers from European infrastructure and defense spending. Larger-than-expected infrastructure and defense spending in Europe, especially Germany, could generate stronger positive spillovers to Italy through tightly integrated industrial supply chains.	Low	High: Given Italy's strong production linkages with Europe, particularly Germany, higher public investment could boost Italian industrial output, exports, and investment, particularly in manufacturing and capital goods. Stronger external demand would support growth, employment, and fiscal revenues, improving the near-term outlook.	• Facilitate firm participation in cross-border supply chains linked to European countries' public investment. • Address domestic bottlenecks (skills, logistics, permitting) to maximize growth spillovers. • Save revenue windfalls during stronger-than-expected growth and avoid procyclical fiscal easing.

¹The Risk Assessment Matrix shows events that could materially alter the baseline path. The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more).

Appendix II. Stress Testing Matrix (STeM)

Domain		Assumptions
		Top-down by FSAP team
Banking Sector: Solvency Stress Test		
1. Institutional Perimeter	Institutions included	- Stress tests will cover 31 banks, including: - All Italian Significant Institutions (SIs): 12 banks accounting for 86 percent of total banking assets, of which seven SIs are identified by the Bank of Italy (BdI) as Other Systemically Important Institutions. - Foreign subsidiaries of SI banks: 2 banks accounting for 6 percent of total banking assets. - Less Significant Institutions (LSIs): 17 banks accounting for an additional 6 percent of banking assets.
	Market share	About 98 percent of banking system assets and 53 percent of total financial system assets.
	Data source and starting date	- Data Sources: Balance sheet and supervisory returns (COREP and FINREP), supervisory data from Bank of Italy including the credit registry and Cerved data for corporate sector analysis, and publicly available data (ECB statistical data and household survey data such as HFCS and EU-SILC micro data for households analysis). - Baseline date: Balance sheets as of June 2025. - Scope of consolidation: Consolidate basis for domestic SIs (banks with their headquarters in Italy) and individual basis for other banks (LSIs and foreign SI banks).
2. Methodology	Overall framework	- Credit risk assessed with scenario-based, top-down, bank-level stress test model complemented with sensitivity analysis. - Credit portfolio in four main categories: households, corporate, financial institutions, and government.
	Satellite models for macro-financial linkages	- Credit risk: Satellite models linking bank-specific probability of defaults (PDs) for each credit type to a set of macroeconomic variables comprising GDP growth, interest rates, unemployment, and other macro variables. Alternatively, micro-models for households (projection of household DSTI ratios and PDs), and corporates (projection of PDs link to key financial indicators from the corporate stress test) will be used as credit risk parameters. - Market risk: valuation losses/gains due to the impact of interest rate shocks on banks' investment portfolio at fair value. - Net interest income: interest-rate projections for new business on assets and liabilities linked to macroeconomic scenarios.
	Stress test horizon	3-years (2025Q2-2028Q2).
	Assumptions	Balance-sheet assumptions: (i) static balance-sheet assumption in line with the very low or negative credit growth rates in the last five years; (ii) the composition of banks' assets remains constant throughout the stress test horizon; (iii) banks build capital only through retained earnings, no new capital injections are assumed; and (iv) bank deposits adjust as needed to close the accounting identity.

Domain		Assumptions
		Top-down by FSAP team
		- The tax rate is set at the bank-specific median effective tax rate across the past five years for the stress testing horizon in case of positive net income and zero otherwise. - Dividends are assumed to be paid out of each period net income after taxes in compliance with supervisory capital requirements. The payout ratio is based on the bank's median dividend payout over the past five years. Banks that are not well-capitalized or have negative income are assumed to pay no dividends.
3. Type of analyses	Scenario analysis	- Scenario-based stress tests focus on the impact of macroeconomic variables on credit, market, and interest rate risks. - Three macroeconomic scenarios simulated with yearly frequency: a baseline scenario and two adverse scenarios consistent with those used in the 2025 Euro Area FSAP. The adverse scenarios rely on the GFM, a structural macro-econometric model of the world economy, disaggregated into forty national economies, documented in Vitek (2018). - Baseline scenario: In line with the World Economic Outlook (WEO) projections of the global economy and financial conditions for the October 2025 publication. The scenario considers the dynamics of GDP growth, unemployment, headline inflation, housing prices, labor costs, and oil price, which affect bank profitability and risk-weighted assets through various channels. - Geopolitical scenario: Features the materialization of a further escalation of geopolitical conflicts, heightening commodity price volatility and disrupting global production chains, with large adverse trade, price, and tariff shocks ("trade wars") slowing growth. In this scenario the inflationary impact of production chain disruptions leads to monetary policy tightening. - Recessionary scenario: Considers a synchronized global slowdown amplified by sovereign debt distress in the EA, the widening of credit spreads, term premium decompression, and confidence losses impacting aggregate demand. Under this scenario, accommodative monetary policy mitigates the adverse impact on aggregate demand.
	Sensitivity analysis	- Sensitivity analyses to complement the scenario-based analysis. - Credit risk assessed with additional scenarios in the household and corporate micro-models, focusing on economic sectors vulnerable to tariffs. - Concentration risk assessed with a separate assessment of individual bank exposures to their 10 largest borrowers. - Liquidity-solvency interaction to assess the potential effect of liquidity stress on solvency due to lack of access or operational failures during liquidity crisis) and need to sell AC bonds at depressed prices to cover liquidity shortfalls.
4. Risks and Buffers	Risks assessed	- Credit risk and sovereign risk: IFRS approach. - Market risks in the trading book: valuation losses/gains due to the impact

Domain		Assumptions
		Top-down by FSAP team
		of interest rate shocks on banks' investment portfolio at fair value Interest rate risk in the banking book: structural model to estimate the impact of interest rates shocks on interest income and expenses using the repricing ladder structure and projected interest rates on new/repriced assets and liabilities.
	Buffers	- Existing loan loss provisions and capital buffers. - Internal capital generation (i.e., income after taxes).
5. Regulatory Standards	Regulatory Standards	- Bank-specific (STA/IRB). - Hurdle rates consistent with the Italian capital regulatory standards that reflect Basel III capital requirements. The hurdle rate applied in the stress test accounts for Common Equity Tier 1 (CET1) regulatory minimum of a 4.5 percent Pillar 1 requirement, bank-specific Pillar 2 requirements, the Capital Conservation Buffer (CCoB) of 2.5 percent and the bank specific O-SII buffers. For the leverage ratio the hurdle rate of Pillar 1 requirement was considered, corresponding to 3 percent.
6. Reporting Format for Results	Output presentation	- System capital shortfalls from a macroprudential perspective. - Number of banks and percentage of banking system assets below hurdle rates. - Impact of shocks on key P&L components.
Banking Sector: Liquidity Stress Test		
1. Institutional Perimeter	Institutions included	All Italian SIs (12 banks, 86 percent of total banking assets) and biggest LSIs (17 banks, 6 percent of banking assets).
	Market share	About 92 percent of the banking system assets.
	Data and Starting position	- Cut-off date: June 2025. - Data Source: supervisory data from FINREP and COREP (LCR, NSFR, and ALMM Maturity Ladder template).
2. Methodology	Overall framework	- Cash-flow-based liquidity stress test: Assess the ability of banks to withstand a sequence of liquidity shocks in different maturity buckets (from one day to one year), incorporating both contractual and behavioral assumptions (where available). - LCR-based (30-day horizon) reverse stress tests: Identify the size of shocks that would lead individual banks to fall below 100 percent LCR requirement. - Currency: euro.
3. Type of analyses	Scenario analysis	- Various stress scenarios are considered, with varying intensity of adverse liquidity conditions. Main risks analyzed are tightening of market liquidity conditions (linked to solvency adverse scenario, where possible), deposit run-offs and outflows from top funding sources. - The run-off rates are calibrated to reflect scenarios of deposit runs for the aggregate of the banking system and a dry-up of unsecured wholesale and retail funding, following historical events, recent international experience in liquidity crises and IMF expert judgment.

Domain		Assumptions
		Top-down by FSAP team
		Outflow/inflow weights, the haircuts of high-quality liquid assets (HQLA) are aligned with EA 2025 FSAPs. Additional sensitivity analysis is used to assess the impact of higher outflows from term deposits based on Italian historical data.
4. Risks and Buffers	Risks	- Funding liquidity. - Market liquidity.
	Buffers	The counterbalancing capacity includes liquidity obtained from markets and/or the central bank's facilities. Expected cash inflows are also included in the cash-flow based and LCR analyses.
5. Regulatory Standards	Regulatory Standards	Consistent with Basel III regulatory framework and domestic regulation.
6. Reporting Format for Results	Output presentation	- System liquidity ratios and liquidity shortfall by groups of banks. - Number of institutions with LCR below regulatory limits - Net Liquidity Position and the survival period for cashflow based analysis.
Corporate Stress Test		
1. Institutional Perimeter	Entities included	All firms with available financial information in CERVED data source, including small and medium-sized enterprises (SMEs). Sample period covers 2000-2023, with about 500 thousand firms per year.
	Data	Cerved financial database on corporations, including balance sheets and profit and loss statements. By number of firms, 68 percent are micro, 25 percent are small, 6 percent are medium, and 1.5 percent are large. By turnover, micro firms account for 6 percent, small firms for 15 percent, medium firms for 19 percent, and large firms for 61 percent.
	Time Horizon	Corporate-level data in 2024 will be used as a starting point. Firms without 2024 data will be imputed by using growth rate of other firms with the same sector and firm size. The data will be projected to 2026 using the bank solvency stress test scenarios.
	Overall framework	- Liquidity and solvency of companies will be tested based on the four indicators (Return on Asset (ROA), Interest Coverage Ratio (ICR), cash balance, and leverage (debt to assets, D/A), conditional on the baseline and adverse scenarios applied to the bank stress tests. - Individual firms are classified by their economic activities and subject to the adverse scenarios used in the bank solvency stress tests. The shocks include an increase in interest expenses on short-term debt, a drop in turnover, and an increase in costs, estimated from the baseline and adverse scenarios.
	Scenarios	- The analysis applies the same baseline and distressed scenarios used in the bank stress tests. The corporate stress test uses the sectoral estimated scenarios and shocks to interest rates to apply firm-specific shocks consistent with the bank stress tests. - Sensitivity analysis will be conducted by assuming additional negative shocks to sectors vulnerable to tariffs (manufacturing, machinery, and transport equipment) and CRE-related sectors (construction & real estate activities).

Domain		Assumptions
		Top-down by FSAP team
2. Risks and Buffers	Risks	• Insolvency risk.
	Buffers	• EBIT (earnings before interest and taxes) and capital.
3. Reporting Format for Results	Output presentation	• Total debt, and number of riskier firms (such as firms with ROA below 0 percent, ICR below 100 percent, negative cash balance, and negative equity). • Default probability by economic sectors, firm sizes, and macro region, under baseline and adverse scenarios.
Interconnectedness Analysis		
1. Institutional Perimeter	Institutions Included	• Aggregate cross-sectoral and cross-border analysis.
	Data	• Eurostat counterparty sectorial exposure through financial accounts (whom-to-whom) information. • Inter-sectoral exposures and interconnectedness analysis. • It covers the following sectors: Banks, NBFIs (insurance and investment funds), general government, non-financial corporations, households, and the Rest of the World (USA, EU, and others). • The analysis encompasses the following financial instruments: loans, debt securities, listed shares, investment fund shares, transferrable deposits, and other deposits. • To assess contagion risks arising from the global financial system, the analysis will include the following variables: VIX, policy uncertainty indicator, geopolitical fragmentation.
2. Methodology	Overall framework	• The analysis maps the network topology of the Italian financial system using Eurostat data to identify systemic risks and vulnerabilities.
3. Risks	Risks	• Direct risks (domestic credit and lending risks) and indirect risks (common exposure to sovereign risks).
4. Reporting of Results	Output presentation	• Map the network topology of the Italian economy consisting of sectoral direct and indirect exposure. • Identify banking system risks through direct interconnectedness. • A dynamic measure of interconnectedness is constructed to evaluate changes in the network topology over time.

Appendix III. Corporate Stress Test Methodology

Data

1. Several criteria are applied to clean the sample. First, firms with missing or negative total assets, tangible fixed assets, debts, and sales are dropped. Second, the sample excludes firms with outlier variables. For example, firms with either decrease or increase in total assets by more than 50 times or effective interest rate above one (interest expense to total debt) are dropped. Third, firms with zero interest expenses but positive financial debt for two consecutive years are considered to have misleading observations and are therefore not included. The linear regressions are estimated by winsorizing all variables at one percent level.

Methodology

2. The four financial indicators are summarized in Table AIII.1:

Appendix III. Table 1. Italy: Financial Indicators

Indicator	Variable	Definition	Proxy using Bdl CERVED variables
Profitability	Return on Assets (ROA)	$\frac{\text{Net Income}}{\text{Total Assets}}$	$\frac{52. \text{Net Adjusted Result}}{13. \text{Total Assets}}$
Solvency	Leverage (Debt to Asset, D/A)	$\frac{\text{Total Liabilities}}{\text{Total Assets}}$	$\frac{13. \text{Total Assets} - 25. \text{Net Equity}}{13. \text{Total Assets}}$
Solvency	Interest Coverage Ratio (ICR)	$\frac{\text{EBIT}}{\text{Interest Expense}}$	$\frac{49. \text{Current Profit before Financial Charges}}{50. \text{Financial Charges}}$
Liquidity	Cash Ratio (Cash)	Cash Ratio	$\frac{10. \text{Cash Availability}}{38. \text{Total Current Liabilities}}$

3. The financial indicators are projected following the approaches from Ebeke and others (2021) and Tressel and Ding (2021) in three steps.

Step 1: Estimate linear regressions (winsorized at 1 percent) targeting ROA, leverage, and EBIT growth as dependent variables with sector and region fixed effects:

$$Y_{i,t} = \alpha \cdot Y_{i,t-1} + \beta \cdot \{Firm\}_{i,t-1} + \gamma \cdot \{Macro\}_t + d_s + \pi_r + v_{i,r,t}$$

where i indicates firm, t is year, s is sector (17 NACE Rev. 2 Sections A to S, excluding K, O, U), r is macro-region (Northwest, Northeast, Central, South and Islands). $\{Firm\}_{i,t-1}$ refers to firm-level explanatory variables from the previous year, including ROA, leverage, size dummy (micro, small, medium, large), asset tangibility (ratio of fixed assets to total assets), cash flow generation capacity (ratio of turnover to total assets). $\{Macro\}_t$ includes real GDP per capita and the pandemic dummy (for the years 2020 and 2021). $v_{i,r,t}$ is the error term and clustered at the region-year level to account for within-group correlation.

A sensitivity analysis for sectors vulnerable to tariffs (agriculture, mining, manufacturing) are conducted by further lowering the projected EBIT by 20 percent under the geopolitical scenario.

Step 2: Project ROA and leverage dynamically for 2024-28. Also project EBIT for 2024-2028. Specifically, equipped with the estimated coefficients and fixed effects from Step 1, ROA and leverage are projected according to:

$$\hat{Y}_{i,t} = \hat{\alpha} \cdot \hat{Y}_{i,t-1} + \hat{\beta} \cdot \{Firm_{Invariant_{i,2023}}, \widehat{Firm_{Varying}_{i,t-1}}\} + \hat{\gamma} \cdot \{Macro\}_t + \hat{d}_s + \hat{\pi}_r$$

where the $\{Firm\}_{i,t-1}$ is divided into a set of structural attributes, denoted $Firm_Invariant_{i,2023}$ and fixed at 2023 (size, asset tangibility, cash generation ratio), and a set of time-varying attributes, denoted $\widehat{Firm_Varying}_{i,t-1}$ and projected dynamically (ROA, leverage). $\{Macro\}_t$ is taken from the baseline and adverse scenarios.

Similarly, given the projected EBIT growth $\Delta EBIT_t := \frac{EBIT_t - EBIT_{t-1}}{|EBIT_{t-1}|}$, projected EBIT is therefore:

$$EBIT_t = EBIT_{t-1} + |EBIT_{t-1}| \times \Delta EBIT_t$$

Step 3: Project the remaining financial variables (ICR, cash ratio) based on accounting identities and projected leverage and EBIT from Step 2.

Assume that taxes are kept the same as in 2023:

Interest Expense_{i,t}

$$= \{Effective\ Interest\ Rate_{i,2023} + [(LTD/TD)_{i,2023} \cdot \Delta scenarioLT_t + (STD/TD)_{i,2023} \cdot \Delta scenarioST_t]\} \cdot TD_{i,t-1}$$

$$Effective\ Interest\ Rate_{i,2023} = \frac{Interest\ Expense_{i,2023}}{Total\ Liabilities_{i,2023}} = \frac{Interest\ Expense_{i,2023}}{TD_{i,2023}}$$

$$ICR_{i,t} = \frac{EBIT_{i,t}}{Interest\ Expense_{i,t}}$$

where *LTD* is long-term debt, *STD* is short-term debt, *TD* is total debt. $\Delta scenarioLT_t$ and $\Delta scenarioST_t$ are the interest rate shocks from the baseline and adverse scenarios relative to 2023.

As for the cash ratio, assume that: (i) firms do not pay dividends and invest to maintain the current capital stock (so that depreciation + amortization = CAPEX); (ii) highly leveraged firms ($D/A > 0.8$)

do not rollover their short-term debt in adverse scenarios over the projection horizon 2026-28, the cash balance evolves according to:

$$\begin{aligned} & \text{Cash Balance}_{i,t} \\ = & \begin{cases} \text{Cash Balance}_{i,t-1} + \text{EBIT}_{i,t} - \text{Taxes}_{i,2023} - \text{Interest Expense}_{i,t}, & t < 2026 | \text{Baseline} | (D/A)_{i,t} \leq 0.8 \\ \text{Cash Balance}_{i,t-1} + \text{EBIT}_{i,t} - \text{Taxes}_{i,2023} - \text{Interest Expense}_{i,t} - \text{STD}_{i,t-1}, & \text{otherwise} \end{cases} \end{aligned}$$

$$TD_{i,t} = \begin{cases} TD_{i,t-1} - \text{Cash Balance}_{i,t}, & \text{Cash Balance}_{i,t} < 0, t < 2026 | \text{Baseline} | (D/A)_{i,t} \leq 0.8 \\ TD_{i,t-1}, & \text{Cash Balance}_{i,t} \geq 0, t < 2026 | \text{Baseline} | (D/A)_{i,t} \leq 0.8 \end{cases}$$

$$TD_{i,t} = \begin{cases} TD_{i,t-1} - \text{Cash Balance}_{i,t} - \text{STD}_{i,t-1}, & \text{Cash Balance}_{i,t} < 0, \text{ otherwise} \\ TD_{i,t-1} - \text{STD}_{i,t-1}, & \text{Cash Balance}_{i,t} \geq 0, \text{ otherwise} \end{cases}$$

$$\text{STD}_{i,t} = \frac{\text{STD}}{\text{TD}_{i,2023}} \cdot \text{TD}_{i,t}$$

$$\text{Cash}_{i,t} = \frac{\text{Cash Balance}_{i,t}}{\text{STD}_{i,t}}$$

4. Firm's probability of default (PD) is predicted based on projected financial indicators in three steps.

Step 1: Given the discrepancy of average corporate PD for SME and large firms between the aggregate data and Cerved, the one-year expected probability of default in the Cerved microdata is scaled to match the values in the aggregate data according to:

$$PD_{b,t} = \Phi[\Phi^{-1}(PD_{\text{Cerved}}) + (\Phi^{-1}(PD_{\text{Aggregate}}) - \Phi^{-1}(PD_{\text{Cerved}}))]$$

where Φ and Φ^{-1} denote the normal and inverse normal distributions. Figure AIII.1 shows that this scaling procedure substantially improves the consistency between Cerved and aggregate data.

Step 2: Estimate a logistic regression linking the scaled one-year expected probability of default with the four projected financial indicators.

$$\begin{aligned} \text{Logit}(PD_{i,t}^h) = & \alpha + \beta_1 \cdot \text{ROA}_{i,t} + \beta_2 \cdot \text{Leverage}_{i,t} + \beta_3 \cdot \text{ICR}_{i,t} + \beta_4 \cdot \text{Cash_Ratio}_{i,t} + \delta_s + \mu_r \\ & + \varepsilon_{i,s,r,t} \end{aligned}$$

Appendix III. Figure 1. Italy: Scaling Probability of Default

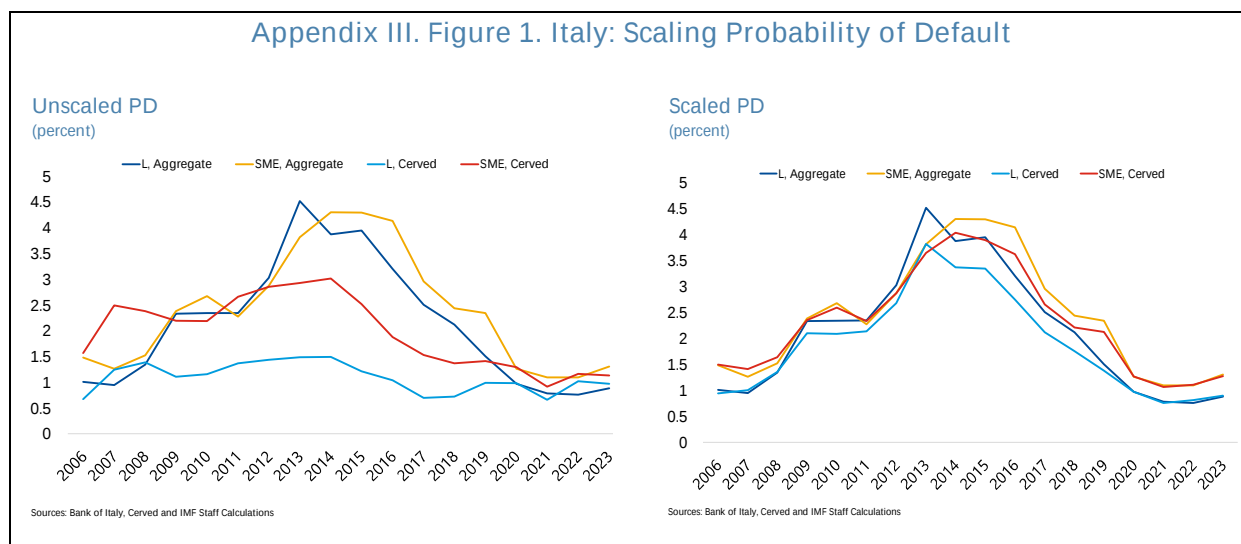


Table AIII.2 reports the estimated coefficients. The results are intuitive: PD increases with leverage and decreases with ROA, ICR, and cash ratio.

Appendix III. Table 2. Italy: Estimated Coefficients for PD Analysis

	PD
ROA	-1.014*** (0.00660)
Leverage	2.178*** (0.00306)
ICR	-0.0167*** (4.95e-05)
Cash ratio	-0.919*** (0.00316)
Constant	-5.507*** (0.00465)
Observations	7,529,226
Robust standard errors in parentheses	
*** p<0.01, ** p<0.05, * p<0.1	

Step 3: Project the PD for each firm based on the estimated coefficients and fixed effects and projected financial indicators over the horizon 2026-28.

Appendix IV. Household Stress Test Methodology

Data and General Approach

1. The household vulnerability analysis uses micro data from the Household Finance and Consumption Survey (HFCS) and EU statistics on income and living conditions (EU-SILC) to conduct simulations of macroeconomic shocks to household balance sheet. This allows to identify vulnerable households who may be at risk of default by computing, under different scenarios, household vulnerability measures based on DSTI and essential consumption on food, utilities, and rents (for more details see Valderrama et al, 2023). The methodology follows a three-step procedure:

- i. First, HFCS data on households' balance sheets, payments, income, and consumption is used to predict household financial stress using a simulation approach.
- ii. Second, the link between being financially vulnerable and the likelihood of default is estimated at the individual household level. For this, the model relies on the EU-SILC micro data, which contains information on housing costs, the minimum income needed to pay for essential expenses, and whether the household is in arrears (on mortgage loans or other loan obligations).
- iii. Third, the simulated increase in the share of financially vulnerable households is used to estimate the increase in the average PDs. The PD for households with DSTI above 70% ($PD_{DSTI=1}$) and for households with DSTI below 70% ($PD_{DSTI=0}$) is estimated with the logistics regressions.

Results from this micro model are used to estimate loan stage distribution in the retail loan portfolio for the solvency ST (see Appendix V).

Definition of Household Vulnerability

2. Two definitions of household vulnerability are considered: DSTI greater than or equal to 40 percent, and debt service plus consumption of food, utilities, and rents exceeding 70 percent of household income (debt-service-and-essential-consumption-to-income-ratio, DSECTI>0.7).
3. The impact of shocks on household finances is highly non-linear. The following equations show the channels through which macrofinancial shocks affect households' ability to fulfil their debt service obligations and afford essential consumption.

$$DSTI_{T,j}^h = \frac{\sum_{k=1}^N (P_{t,k}^h + O_{t,k}^h \times i_{t,k}^h) + \sum_{s=1}^M (O_{t,s}^h \times \Delta i_{T-t,j}^s | s = \text{variable})}{I_t^h \times (1 + \Delta inc_{T-t,j})} \times gD_{T-t,j}$$

$$DSECTI_{T,j}^h = DSTI_{T,j}^h + \frac{food_t^h \times (1 + \Delta CPI_{T-t,j}^{food}) + utilities_t^h (1 + \Delta CPI_{T-t,j}^{energy}) + rent_t^h \times (1 + \Delta CPI_{T-t,j})}{I_t^h \times (1 + \Delta inc_{T-t,j})}$$

Where $\Delta i_{T-t,j}$ as the interest rate shock from time t to T , I_t^h stands for household h gross household income, $P_{t,k}^h$ is the principal repayment of outstanding loans, $O_{t,s}^h$ is the amount of outstanding debt, $i_{t,k}^h$ is the lending rate, $gD_{T-t,j}$ is the outstanding debt growth, ΔCPI is the change in the corresponding consumer price index, $\Delta inc_{T-t,j}$ stands for household's income growth, N is the total number of loans, M is the number of loans with interest rates to be re-set over the next two years, T is the year, and j the country

Application of Macroeconomic Shocks

4. Given the latest HFCS for Italian household was conducted in 2021 and households' liabilities and consumption patterns could have changed since then, the model applies the observed cumulative changes in the macroeconomic conditions from 2021 to 2025 and the scenario projections from 2026 to 2028 to assess the health of household balance sheet during the ST horizon. The application of each macroeconomic variable to individual household balance sheet follows Valderrama et al. (2023):

- **Income.** From 2021 to 2025, extrapolate each household's income growth using the cumulative growth in disposable income per capita. For 2024 onwards, projected wage growth to proxy for household income growth is used. The same growth rate is applied to each household.
- **Debt.** The model applies the same ratio of debt growth to all households following the sectoral wide growth rate. This simplifying assumption may not reflect specific debt evolution, since some households may offset principal repayment since 2021 with new borrowing, while others may fully amortize debt and be replaced by new borrowers. Moreover, as interest rate increases, households with sufficient financial assets may choose to repay their variable-rate loans early.
- **Interest payments.** For simulations up to 2025, the model assumes that adjustable-rate loans had not been repriced. For 2024 onwards, interest rate changes are assumed to be fully passed through to variable-rate loans and fixed-rate loans are not affected.
- **Consumption.** No change to the structure of the real consumption basket is assumed.
- **Prices.** Changes in the price of food and energy follow global wholesale prices sourced from IMF's WEO, while the value of rents, non-essential goods, and services is adjusted by core inflation.
- **Unemployment rate.** Changes of unemployment rate are assumed to apply evenly to anyone who is currently in the labor force. When a worker changes from employed to unemployed, its wage income will become the average social benefits available to unemployed (unemployment benefit, unemployment assistance, private insurance, and ERTE). Similarly, when an unemployed worker becomes employed, it will lose all the unemployment-related social benefits but started to earn an average wage income.

Appendix V. Stress Test Scenarios

Appendix V. Table1. Italy: Key Variables Macrofinancial Scenarios
(Percent change, unless otherwise indicated)

(in percent)	Est.	Proj.		
	2025	2026	2027	2028
Real GDP growth				
Baseline	0.5	0.8	0.6	0.7
Geopolitical	0.5	-4.3	-3.4	1.1
Recessionary	0.5	-5.3	-4.3	3.3
Inflation rate				
Baseline	1.7	2.0	2.0	2.0
Geopolitical	1.7	4.5	4.0	2.4
Recessionary	1.7	0.4	0.0	-0.1
Unemployment				
Baseline	6.7	6.7	6.8	6.9
Geopolitical	6.7	7.8	10.6	11.6
Recessionary	6.7	8.8	13.7	14.3
Short Term Rate				
Baseline	1.9	1.9	1.9	2.0
Geopolitical	1.9	3.6	3.3	1.9
Recessionary	1.9	0.3	-0.4	-0.4
Long Term Rate				
Baseline	3.7	3.8	3.9	4.1
Geopolitical	3.7	6.4	5.4	3.5
Recessionary	3.7	7.2	5.7	3.3
House Price Index				
Baseline	100.0	102.0	104.0	106.1
Geopolitical	100.0	85.7	85.5	92.1
Recessionary	100.0	92.2	90.6	92.1
Stock Index				
Baseline	100.0	100.0	100.0	100.0
Geopolitical	100.0	61.5	55.4	65.3
Recessionary	100.0	53.0	44.2	53.2
Exchange Rate (EUR per USD)				
Baseline	0.9	0.9	0.9	0.9
Geopolitical	0.9	0.9	0.9	0.9
Recessionary	0.9	0.9	1.0	1.0
Source: IMF staff estimates				

Appendix V. Table 2. Italy: Market Risk Scenario Shocks
(basis points)

Geopolitical Scenario

<i>Term</i>	IR	CR			TOTAL		
		<i>low</i>	<i>medium</i>	<i>high</i>	<i>low</i>	<i>medium</i>	<i>high</i>
EUR-1M	148.7	21.4	29.5	51.7	170.1	178.2	200.4
EUR-6M	160.4	42.8	58.9	103.4	203.2	219.3	263.8
EUR-1Y	178.7	42.8	58.9	103.4	221.5	237.6	282.1
EUR-5Y	175.4	85.5	117.8	206.8	260.9	293.2	382.2
EUR-10Y	156.6	83.2	108.9	206.8	239.8	265.5	363.4
EUR-20Y	131.0	83.2	108.9	206.8	214.2	239.9	337.8
EUR-30Y	131.0	83.2	108.9	206.8	214.2	239.9	337.8
USD-1M	155.8	21.4			177.2		
USD-6M	158.8	42.8			201.6		
USD-1Y	171.4	42.8			214.2		
USD-5Y	164.2	98.3			262.5		
USD-10Y	151.0	98.3			249.3		
USD-20Y	127.2	98.3			225.5		
USD-30Y	112.4	98.3			210.7		

Recessionary Scenario

<i>Term</i>	IR	CR			TOTAL		
		<i>low</i>	<i>medium</i>	<i>high</i>	<i>low</i>	<i>medium</i>	<i>high</i>
EUR-1M	0.0	18.0	42.2	79.8	18.0	42.2	79.8
EUR-6M	49.6	36.1	84.4	159.7	85.7	134.0	209.3
EUR-1Y	120.8	36.1	84.4	159.7	156.9	205.2	280.5
EUR-5Y	142.2	72.1	168.8	319.3	214.3	311.0	461.5
EUR-10Y	156.6	68.3	159.6	319.3	224.9	316.2	475.9
EUR-20Y	164.4	68.3	159.6	319.3	232.7	324.0	483.7
EUR-30Y	172.7	68.3	159.6	319.3	241.0	332.3	492.0
USD-1M	155.8	21.4			177.2		
USD-6M	158.8	42.8			201.6		
USD-1Y	171.4	42.8			214.2		
USD-5Y	164.2	98.3			262.5		
USD-10Y	151.0	98.3			249.3		
USD-20Y	127.2	98.3			225.5		
USD-30Y	112.4	98.3			210.7		

Source: IMF staff estimates

Appendix VI. Solvency Stress Test - Credit Risk

1. All financial institutions in the solvency stress test have adopted IFRS9 standards and credit impairments are calibrated in accordance with this accounting framework. Due to the lack of a long historical time-series of credit risk transition matrices (TM), scenario TM projections are estimated through Beta-linking (Gross et al., 2020), where an aggregate probability of default is projected and adapted to stage 1 and stage 2 exposures according to the most recently observed transition matrices. Starting transition matrices required for this model are constructed with data from FINREP (F04.04.1 for balance stocks and F12.02 for flows between stages) for every bank and lending segment.

PD and Transition Matrices

2. Aggregate probabilities of default (PDs) are scaled to bank- and portfolio-level starting points. Aggregate PD projections obtained from micro-models and other satellite models are rescaled to ensure consistency with bank- and portfolio-specific initial PD levels. This scaling preserves the relative dynamics of the aggregate PD paths while anchoring projections to each bank's observed starting position. The rescaling is implemented using the following formula:

$$PD_{b,t} = \Phi[\Phi^{-1}(PD_{b,0}) + (\Phi^{-1}(PD_t) - \Phi^{-1}(PD_0))]$$

where Φ and Φ^{-1} denote the normal and inverse normal distributions:

3. Transition matrix $\mathbf{TM}_t^{ij}$ entries are updated simultaneously with the stocks S_t^i , in three steps:

- Step 1: $\mathbf{TM}_t^{13}$ and $\mathbf{TM}_t^{23}$ are derived from $\mathbf{PD}_t$ path:

$$\begin{aligned} \mathbf{TM}_t^{23} &= \Phi\left(\Phi^{-1}(\mathbf{TM}_0^{23}) + (\Phi^{-1}(\mathbf{PD}_t) - \Phi^{-1}(\mathbf{PD}_0))\right) \\ \mathbf{TM}_t^{13} &= \min\left(1, \max\left(0, \frac{\mathbf{PD}_t \cdot (S_{t-1}^1 + S_{t-1}^2) - \mathbf{TM}_t^{23} \cdot S_{t-1}^2}{S_{t-1}^1}\right)\right) \end{aligned}$$

- Step 2: project other $\mathbf{TM}_t^{ij}$, $i \neq j$ based on sensitivity to shock in distance-to-default space ($\mathbf{DD}_{ij}$):

$$\begin{aligned} \mathbf{TM}_t^{ij} &= \Phi\left(\Phi^{-1}(\mathbf{TM}_0^{ij}) + \mathbf{DD}_{ij}\left(\Phi^{-1}(\mathbf{TM}_t^{i3}) - \Phi^{-1}(\mathbf{TM}_0^{i3})\right)\right), \quad i \neq 3 \\ \mathbf{TM}_t^{3j} &= \Phi\left(\Phi^{-1}(\mathbf{TM}_0^{3j}) + \mathbf{DD}_{3j}\left(\Phi^{-1}(\mathbf{TM}_t^{23}) - \Phi^{-1}(\mathbf{TM}_0^{23})\right)\right) \end{aligned}$$

- Step 3: Derive diagonal terms $\mathbf{TM}_t^{ii}$ to have rows summing up to 1.

Loan Stocks Projection: IFRS9

4. Performing and non-performing exposure stocks are projected based on flows implied by the transition matrices. While the framework allows for write-offs, asset sales, and cure flows from Stage 3 to Stages 1 and 2, write-off and asset sale rates (WRO_t) are assumed to be zero, consistent with the static balance-sheet assumption. Accordingly, stocks of Stage 2 and Stage 3 exposures are simulated as follows:

$$S2_t = S2_{t-1} + TM_t^{12} S1_{t-1} + TM_t^{32} S3_{t-1} - TM_t^{21} S2_{t-1} - TM_t^{23} S2_{t-1} - M_t^2 S2_{t-1}$$

$$S3_t = S3_{t-1} + TM_t^{13} S1_{t-1} + TM_t^{23} S2_{t-1} - TM_t^{31} S3_{t-1} - TM_t^{32} S3_{t-1} - WRO_t S3_{t-1}$$

The stock of Stage 1 exposures is implied by total loans—projected using the loan growth rate, which is also assumed to be zero—and by the simulated stocks of Stage 2 and Stage 3 exposures. As a result, new business origination and repayment flows remain implicit in the framework:

$$S_t = (1 - g_t) \cdot S_{t-1}$$

$$S1_t = \text{Max}(0, S_t - S2_t - S3_t)$$

Loss Given Default (PiT)

5. LGD for unsecured lending is calibrated through the Frye and Jacobs (2012) method. Both secured and unsecured LGDs have been calibrated at the bank-specific portfolio level. For all portfolios, except mortgages, a link of LGDs to PDs was established through a Vašíček equation. The equation is derived based on the premise that there is an inherent link, a positive association, between PDs and LGDs. The LGD is expressed as a function of PDs as follows:

$$LGD_{b,t0+h} = \frac{\Phi(\Phi^{-1}(PD_{b,t0+h}) - k)}{PD_{b,t0+h}}$$

where Φ and Φ^{-1} denote the normal and inverse normal distributions, and k is a bank-portfolio specific parameter computed at the outset and kept fixed thereafter, involving a correlation coefficient ρ (set judgmentally, additional subscripting for each portfolio is omitted for brevity).

$$k = \frac{\Phi^{-1}(PD_{t0})\Phi^{-1} - (PD_{t0} \cdot LGD_{t0} \cdot f)}{\sqrt{1 - \rho}}$$

The factor f is implied such that LGD matches the bank-portfolio specific observed LGDs.

6. For mortgages, LGDs are projected assuming a linear relation between house price index (HP) and recovery value. Notably, under both adverse scenarios, the decline in property values materially affects the LGD of secured lending. This, in turn, has a consequential impact on the credit risk charges associated with mortgage lending.

$$LGD_t = 1 - (1 - LGD_0) \cdot \frac{HP_t}{HP_0}$$

Provisions

7. Loan losses are computed by projecting first provision stocks by stage under the expected credit loss (ECL) framework. For Stage 1 exposures, ECLs are calculated over a 12-month horizon. For Stage 2 exposures, ECLs reflect lifetime expected credit losses, based on simulated credit migration paths. For Stage 3 exposures, ECLs are computed using LGD over the remaining expected time to collateral sale, assuming a probability of default equal to one.

$$PROV_t^{S1} = TM_t^{13} \cdot LGD_t \cdot S1_{t-1}$$

$$PROV_t^{S2} = \sum_{s=t+1}^L \frac{TM_s^{23,*} \cdot LGD_s \cdot S2_{s-1}}{(1+r)^s}$$

$$PROV_t^{S3} = LGD_t \cdot S3_{t-1}$$

8. Loan loss projections (provision flows) for the first year of the stress-test horizon are based on the provision stocks implied by the model under the baseline scenario. These baseline provision stocks serve as the starting point for the stress-test exercise, ensuring comparability across baseline and adverse scenarios projections in all years.

$$PROV_t^k = PROV_t^{S1} + PROV_t^{S2} + PROV_t^{S3}$$

$$LL_t = PROV_t - PROV_{t-1}$$

Risk Weighted Assets

Standardized Loan Portfolios (STA):

9. RWA for performing exposures are projected using the RWA densities at the cut-off date (ρ), which are assumed constant over the scenario horizon. RWA densities per portfolio/segment 'e' and RWA projection are defined as follows:

$$\rho_e^{PE}[0] = \frac{RWA(STA)_e^{PE}[0]}{EAD(STA)_e^{PE}[0] - PROV(STA)_e^{PE}[0]}$$

$$RWA(STA)_e^{PE}[t] = \rho_e^{PE}[0] \cdot (EAD(STA)_e^{PE}[t] - PROV(STA)_e^{PE}[t])$$

10. The same assumption is used for non-performing loans.

$$\rho_e^{NPE}[0] = \frac{RWA(STA)_e^{NPE}[0]}{EAD(STA)_e^{NPE}[0] - PROV(STA)_e^{NPE}[0]}$$

$$RWA(STA)_e^{NPE}[t] = \rho_e^{NPE}[0] \cdot (EAD(STA)_e^{NPE}[t] - PROV(STA)_e^{NPE}[t])$$

Internal Ratings-based Loan Portfolios (IRB)

11. RWA projection for performing exposures for IRB portfolios use the Basel III formulas. PD through-the-cycle (TTC) and downturn LGD (DT) are projected as follows:

- i. PD TTC: given that no historical information on PD PiT is available at the bank-specific portfolio level, but PD PiT and PD TTC are known at the cut-off point, then a formula that mimics a moving average is used.

$$PD\ TTC[t] = \frac{(TTC\ Window - (t + 1)) \cdot \frac{PD\ TTC[T_0] \cdot TTC\ Window - PD\ PiT[T_0]}{TTC\ Window - 1} + \sum_{k=0}^{k=t} PDPiT[k]}{TTC\ Window}$$

This have the implicit assumption that TTC is a simple cycle average, which ignores any conservatism when banks do not update downwards PD TTCs during boom cycles.

- ii. LGD DT:

$$LGD\ DT_e[t] = \max(LGD\ PiT_e[t], LGD\ DT_e[T_0])$$

12. RWA projection for non-performing exposures for IRB portfolios are projected as follows:

$$\begin{aligned} RWA(IRB)_e^{NPE}[t] &= EAD(IRB)_e^{NPE}[t] \cdot (LGD\ T_e[t] - ELBE_e[T_0]) \cdot 12.5 \cdot RWA(IRB)_e^{NPE}[t] \\ &= EAD(IRB)_e^{NPE}[t] \cdot (ELBE_e[T_0] - LGD\ T_e[t]) \cdot 12.5 \end{aligned}$$

where $ELBE_e$ is the expected loss best estimate for a given portfolio/segment 'e'.

Appendix VII. Solvency Stress Test - Market Risk

1. Market risk is assessed by estimating valuation effects on debt securities measured at FVPL and FVOCI, separately for government and corporate bonds, using a duration-based approach and interest-rate shocks. Instantaneous shocks (ΔY_t) in the first year of the stress test scenario are applied to bank-level sovereign and corporate debt securities by issuing country. Countries are grouped into risk buckets based on the 2025 EA FSAP classification (Table AVII.1).

Appendix VII. Table1. Italy: Country Risk Grouping for Market Risk Shocks

Risk Classification		
Low	Medium	High
Austria	Belgium	Cyprus
Germany	France	Spain
Estonia	Croatia	Greece
Finland	Ireland	Italy
Luxembourg	Lithuania	
Netherlands	Latvia	
Norway	Malta	
	Portugal	
	Slovenia	
	Slovakia	
	Others	

Source: IMF staff

Note: Exposures with issuing country outside of this list are classified as “medium” risk.

2. Valuation losses/gains (VL_t) are estimated using a duration-based approach that links changes in market risk factors to portfolio values. Under this framework, valuation losses are calculated by multiplying the modified duration of each portfolio by changes in benchmark risk-free rates and credit spreads, scaled by the corresponding portfolio valuation (FV_{t-1}). The underlying interest-rate shock captures changes arising from two components: (i) movements in the risk-free rate (ΔIR_t) and (ii) changes in sovereign credit spreads (ΔCR_t). Securities are grouped by duration and maturity buckets, and the relevant segment-specific interest-rate shock is applied accordingly:

$$FV_t = FV_{t-1} \cdot \left(1 - \frac{D}{1 + Y} \cdot \Delta Y_t \right)$$

$$\Delta Y_t = \Delta IR_t + \Delta CR_t$$

$$VL_t = FV_t - FV_{t-1}$$

Appendix VIII. Solvency Stress Test - Net Interest Income

1. The data sources used to obtain the inputs for equation below were the following:
 - a. The NII in the year before the cut-off date, $NII_{b,t=0}$, was obtained from FINREP (F16.01).
 - b. Exposures and liabilities for each segment—that is, by portfolio type and counterparty—were obtained from FINREP (F20.04).
 - c. The repricing ladder for each segment was obtained by combining several sources: STE templates for interest rate risk in the banking book (IRRBB) and template J05.00 from the supervisory IRRBB module were the preferred sources but were complemented with COREP C66.01 whenever the other sources were not available.⁴²
 - d. Projections for the new business rate were obtained from satellite models estimated using Bdl historical data at the system-level.
2. All formulas in the following apply at the bank-segment level; the notation omits these subindices for simplicity. The model requires two key inputs:
 - i. A repricing ladder at T0, given by the value of exposures in each repricing bucket $[k, k + 1]$ (i.e., exposures with time-to-repricing between k and $k + 1$ years), denoted as $E_0^{[k,k+1]}$. The corresponding fraction of total exposures in that bucket is denoted as $\theta_0^{[k,k+1]}$. This is summarized in the following table:

Repricing Buckets	Value of Exposures	Share of Exposures
[0;1] yrs	$E_0^{[0,1]}$	$\theta_0^{[0,1]} = E_0^{[0,1]} / E_0$
[1;2] yrs	$E_0^{[1,2]}$	$\theta_0^{[1,2]} = E_0^{[1,2]} / E_0$
[2;3] yrs	$E_0^{[2,3]}$	$\theta_0^{[2,3]} = E_0^{[2,3]} / E_0$
[3;4] yrs	$E_0^{[3,4]}$	$\theta_0^{[3,4]} = E_0^{[3,4]} / E_0$
 - ii. Any exposure with time-to-repricing larger than three years can be allocated to the [3;4] year bucket. This is without loss of generality because those exposures will not reprice within the three-year horizon of the stress test.
 - iii. Scenario-specific projections for the interest rate on new business, denoted as r_t^{nb} .

3. The model calculations are conducted in four steps:

Step 1: *Simulate the exposures originated/repriced in each bucket and period*

⁴² Template C 66.01 was not the preferred source because it provides a *maturity*, rather than a *repricing*, ladder. Maturity and repricing do not coincide in the case of floating rate instruments.

The model simulates the “law of motion” of exposures across buckets. Consider the value of exposures in bucket $[k - 1, k]$ at the end of year-1. The exposures in that bucket will correspond either to exposures that at end of year-0 were in bucket $[k, k + 1]$ (so one year later they have moved to the bucket with 1-year lower time-to-repricing), or to exposures that have been newly issued/repriced during year-1. The corresponding equation for this is:

$$E_t^{[k-1,k]} = E_{t-1}^{[k,k+1]} + I_t^{[k-1,k]}$$

where $I_t^{[k-1,k]}$ are the newly issued/repriced loans in bucket $[k - 1, k]$ during year- t . In order to obtain the value of $I_t^{[k-1,k]}$, the key assumption is that the shares of exposures across buckets are constant over time, which is consistent with the static balance sheet used throughout the stress test:

$$I_t^E = \sum_{k=0}^5 I_t^{[k,k+1]} \quad ; \quad \theta_t^{[k,k+1]} = \theta_0^{[k,k+1]}$$

Step 2: Simulate recursively new/repriced exposures and average interest rates

The projection of the YTM for each bucket is based on simulating how the exposures move through the repricing ladder over time. For example, if at the end of year-0 an exposure has $[2;3]$ years remaining until repricing, then at the end of year-1 it must have $[1;2]$ years remaining. This is captured by the following equation:

$$I_t^{[k-1,k]} = E_t^{[k-1,k]} - E_{t-1}^{[k,k+1]} \left(1 + r_{t-1}^{[k,k+1]} \right) \text{ for } k = 1, 2, \dots, 5$$

Note that the exposures $E_{t-1}^{[k,k+1]}$ are multiplied by $\left(1 + r_{t-1}^{[k,k+1]} \right)$ because, although they do not generate any cashflow, they accrue interest through an increase in their book. For the last bucket we simply define:

$$E_t^{[T-1,T]} = I_t^{[T-1,T]}$$

Denote as $r_{t-1}^{[k,k+1]}$ the average interest rate of the exposures that at end of year $(t - 1)$ were in bucket $[k, k + 1]$. This interest rate can be calculated recursively:

$$r_t^{[k-1,k]} = \frac{E_{t-1}^{[k,k+1]} \left(1 + r_{t-1}^{[k,k+1]} \right)}{E_t^{[k-1,k]}} r_{t-1}^{[k,k+1]} + \frac{I_t^{[k-1,k]}}{E_t^{[k-1,k]}} r_t^{E,nb} \text{ for } k = 1, 2, \dots, 5 \quad (4)$$

$$r_t^{[T-1,T]} = r_t^{E,nb}$$

The recursive definition requires an initial condition, $r_0^{[k,k+1]}$, so we make the simplifying assumption that $r_0^{[k-1,k]} = \Pi r_0$ for all k , meaning that all the exposures in the portfolio at the cut-off date were issued/repriced at the same interest rate Πr_0 .

Step 3: Calculate the interest income

Interest income in year- t (II_t) takes the following form:

$$II_t = r_{t-1}^E E_{t-1} + (1 - \omega) \left(r_t^{E,nb} - r_{t-1}^{[0,1]} \right) E_{t-1}^{[0,1]} + \frac{1}{2} r_t^{E,nb} \left(I_t^E - E_{t-1}^{[0,1]} \right)$$

$$\omega = \frac{\text{avg days to repricing}}{365}$$

The three terms in the equation capture the following effects:

- (i) the first term is the base rate, which is determined in year- $(t - 1)$ and is therefore not affected by the year- t interest rate shock.
- (ii) the second term captures the effect of the year- t interest rate shock on the interest income from exposures that reprice during that year. That is, the exposures that reprice during year- t will, on average, continue to earn the old interest rate $r_{t-1}^{[0,1]}$ during the fraction of average days to repricing, and during the remaining fraction of the year their rate will change by a magnitude $r_t^{E,nb} - r_{t-1}^{[0,1]}$.
- (iii) The third term captures the interest income from issuance/repricing of exposures over and above those needed to replace $E_{t-1}^{[0,1]}$. These newly issued/repriced exposures earn an interest rate $r_t^{E,nb}$, which is multiplied by $\frac{1}{2}$ because we assume that these exposures enter the portfolio at the midpoint of the year, on average.

For interest expenses, the model does exactly the same, just replacing exposures for liabilities. For demand deposits, all liabilities are assigned to the overnight repricing bucket.

Step 4: Incorporate NPLs into the model

Finally, in order to incorporate defaults and NPEs into the model, we multiply the interest income II_t obtained from the structural model by the share of (average) performing exposures:

$$II_t = \left(1 - \frac{\text{av}\{NPER_t \cdot E_t; NPER_{t-1} \cdot E_{t-1}\}}{\text{av}\{E_t; E_{t-1}\}} \right) \cdot II_t^{\text{non-adj}}$$

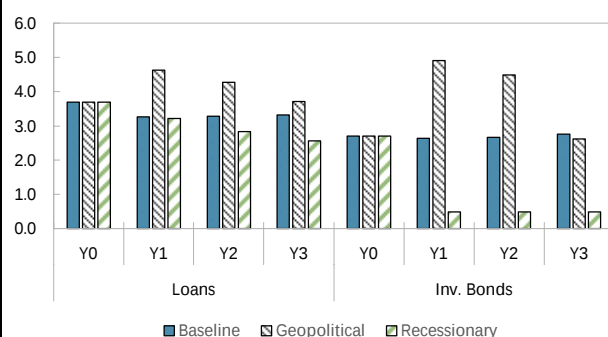
4. For each bank, assets and liabilities are divided into 16 portfolio categories. On the asset side, portfolios include government and other debt securities; household mortgages and consumer loans; nonfinancial corporate loans; government loans; financial institution loans; and

other interest-earning assets. On the liability side, portfolios comprise issued debt securities; sight deposits from financial institutions, households, and other sectors; term deposits from financial institutions, households, and other sectors; and other interest-bearing liabilities.

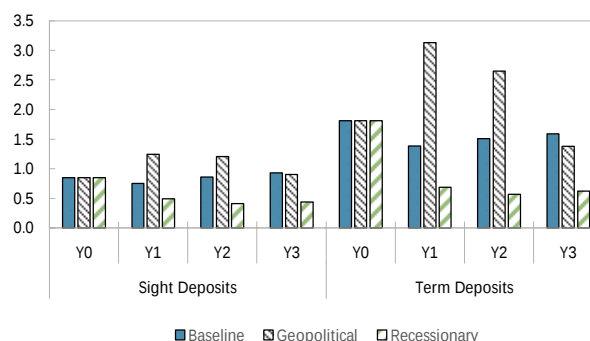
5. While the structural model is implemented at the bank-by-bank level, interest rates on new loans and deposits are projected at the system level using supervisory historical data provided by Bdl. The interest rates on new business ($r_t^{E,nb}$) were projected using a time-series regressions by segment to estimate the relation between interest rates on new or repriced business to short- and long-term interest rates. The projections apply the estimated pass-through coefficients to the short- and long-term interest rates under each macroeconomic scenario (Figure AVII.1)

Appendix VIII. Figure 1. Italy: Interest Rates on New Business Projection

Interest Rates on New Business: Assets
(percent)



Interest Rates on New Business: Liabilities
(percent)



Source: ECB and Bdl supervisory data, IMF staff calculations.

Appendix IX. Solvency Stress Test - NFCI

1. Net fee and commission income (NFCI) is projected using results from the model estimated by the 2025 EA FSAP team. This appendix summarizes the results from the underlying econometric approach. The model specification follows Kok, Mirza, and Pancaro (2017) and is estimated using a panel regression with bank-specific fixed effects. The analysis relies on historical public balance-sheet data for EA SIs. The set of explanatory variables reported in Table AIX.1.
2. Regression results indicate that macroeconomic and financial variables play a significant role in explaining net fee and commission income (NFCI) dynamics. Real GDP growth and changes in the EURIBOR rate are statistically significant across specifications, with positive and negative coefficients, respectively. Stock price growth is statistically significant only for large banks and enters with a positive coefficient (see regression results below).
3. These signs are economically intuitive. Higher real GDP and stock price growth reflect stronger real and financial economic conditions, which tend to support an expansion of financial services that generate fee and commission income. The stronger role of stock prices for large banks likely reflects their business models, which generate a larger share of NFCI from activities such as securities trading, corporate finance, and asset management that are closely linked to financial market developments. The negative coefficient on the EURIBOR rate may reflect the association between higher interest rates and lower transaction volumes, which can dampen fee and commission income from payment services related to current accounts and credit cards.

Appendix IX. Table 1. Italy: Net fee and Commission Income Model

	Large banks			Small/Medium-sized banks		
	All regressors	Lasso-selected regressors	Arellano-Bond estimator	All regressors	Lasso-selected regressors	Arellano-Bond estimator
	(1)	(2)	(3)	(1)	(2)	(3)
NFCIR (t-1)	0.707***	0.707***	0.623***	0.717***	0.714***	0.463***
RGDP growth	0.00891***	0.00862***	0.00880***	0.00700***	0.00612**	0.00584***
RGDP growth (t-1)	0.00186	0.00174	0.00277*	0.000274	0.000286	0.00188
Stocks growth	0.00189**	0.00190**	0.00222***	0.000349	0.000204	0.000523
Stocks growth (t-1)	0.0000981	0.0000929	0.000262	0.000439	0.000703	0.000685
D.EURIBOR	-0.0270***	-0.0270***	-0.0295***	-0.0162**	-0.0177***	-0.0184**
D.EURIBOR (t-1)	-0.00566	-0.00464	-0.00991	-0.0398**	-0.0360**	-0.0373***
10y sov yield	0.0140	0.0137	0.0112	0.00125		
10y sov yield (t-1)	-0.0158	-0.0158	-0.00758	0.00638	0.00672	0.00525
CPI inflation	-0.000760			-0.00434	-0.00259	-0.00337
CPI inflation (t-1)	0.00739*	0.00764*	0.00501	0.00626*	0.00652**	0.00577**
HPI inflation	-0.000626			-0.00173*		
HPI inflation (t-1)	0.00237	0.00184*	0.00225**	0.00287***	0.00170	0.00217
US stocks growth	-0.00162	-0.00161	-0.00226*	0.000506	0.000854	0.000379
US stocks growth (t-1)	0.000516	0.000480	0.000327	0.000687		
EUR/USD FX change	-0.000281	-0.000248	-0.000919	0.000684		
EUR/USD FX change (t-1)	0.00156	0.00158	0.00163	0.000540	0.000520	0.000889
r ²	0.609	0.609		0.608	0.605	
N	595	595	568	942	942	867
*** p<0.01 ** p<0.05 * p<0.10						
All variables are expressed in percentages.						

Source: 2025 EA FSAP, IMF staff estimates.

Appendix X. Cash Flow-based Stress Test Results – Groups Description

Appendix X. Table 1. Italy: Bank Stress Test Results – SIs Groups Description

Group	Number of banks	Description	Total assets of banks in the SI group, euro billion (% of total sample)
G1	4	Two universal banks with significant international operations and two foreign subsidiaries, including the one classified as O-SII by the Bdl.	1,775.30 64%
G2	4	Universal and commercial banks with operations mainly in Italy.	519.1 19%
G3	3	Commercial banks operating mainly in Italy but also having regional focus within Italy. This group includes two cooperative groups.	313 11%
G4	3	Investment banks and banks with significant focus on asset management.	179.6 6%
Total	14		2,787

Source: 2025 IMF staff.

Appendix XI. Cash Flow-based Stress Test Assumptions

Appendix XI. Table 1. Italy: CBC Parameters (percent)

Parameter	Scenarios 2026 FSAP		
	Mild	Severe	Idiosyncratic
Level 1 central bank	100	100	100
Level 1 (CQS 1)	98	90	98
Level 1 (CQS2, CQS3)	95	85	95
Level 1 (CQS4+)	75	60	75
Level 1 covered bonds (CQS1)	97	90	97
Level 2A corporate bonds (CQS1)	85	80	80
Level 2A covered bonds (CQS 1, CQS2)	85	80	80
Level 2A public sector (CQS1, CQS2)	85	80	80
Level 2B ABS (CQS1)	75	60	75
Level 2B covered bonds (CQS1-6)	75	60	75
Level 2B corporate bonds (CQS1-3)	75	60	75
Level 2B shares	75	60	75
Level 2B public sector (CQS 3-5)	75	60	75
Other tradable assets	75	60	75
Non tradable assets eligible for central banks	62	50	62
Own issuances eligible for central banks	62	50	62

Sources: IMF staff

Appendix XI. Table 2. Italy: Outflow Parameters (percent)

Parameter	Scenarios 2026 FSAP		
	Mild	Severe	Idiosyncratic
Stable retail deposits	5	5	8
Other retail deposits	10	10	40
Operational deposits	25	15	49
Non-operational deposits from credit institutions	100	50	100
Non-operational deposits from other financial customers	75	50	100
Non-operational deposits from central banks	0	0	0
Non-operational deposits from non-financial corporates	25	25	76
Non-operational deposits from other counterparties	25	25	76
FX-swaps maturing	50	50	100
Derivatives amount payables other than those reported in 1.4	50	50	100
Other outflows	50	50	100

Sources: IMF staff

Appendix XI. Table 3. Italy: Inflow Parameters (percent)

Parameter	Scenarios 2026 FSAP
Retail customers	2
Non-financial corporates	2
Other financial customers	100
Cther counterparties	3

Sources: IMF staff

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