OUTLOOK FOR BUSINESS OPERATIONS

2021, as already mentioned, marked the turning point in the progression of the pandemic, thanks to the full and widespread implementation of mass vaccination campaigns in many advanced economies, which contributed to the lively economic recovery in progress.
At the beginning of February, the favourable prospects that were evolving appeared to be destined to continue in the new financial year, supporting the activities of the banking sector as a whole. For the current year, the consensus scenarios indicated a lively and robust aggregate demand, also fuelled by the surplus savings accumulated during the lockdown, by a further boost expected by the launch of the NRRP and by the extension of several government credit support measures for the whole of the first half of 2022.
In terms of the Italian banking system, the favourable economic trend was expected to encourage a slight increase in the stock of business loans, even in the face of financial requirements limited by substantial liquidity buffers deposited with the banking system. Estimates also envisaged a more marked growth of household loans, thanks to the strengthening of the real estate market, which promotes the demand for mortgage loans. The level of risk of loans was expected to rise with respect to the very modest levels reached in 2021. The increase in flows of new non-performing loans was expected to be offset to a large extent by the continuation of assignments of Non-Performing Loans and by the active management of those in the portfolio, especially UTP and past due.
In terms of funding, the gradual termination of the support provided by the ECB was envisaged. Direct funding, particularly of households, was expected to increase, albeit to a lesser extent than last year, mainly sustained by the issue of term deposits and bonds.
The trend of money market rates, at system level, despite the cited less accommodative approach of monetary policy, was not expected to suffer excessive shocks. The mark-down was expected to continue to be negative, although with a very slight improvement, while the mark-up was expected to suffer a very slight downturn, resulting in a marginal reduction in the bank interest spread.
The forecast increase in volumes was expected to enable, nevertheless, customer margins to substantially resist, added to which a higher contribution of interest on securities was envisaged, which would have enabled a modest increase of net interest income at system level. Net fee and commission income was expected to increase, supported by investments in asset management products. The trend described enabled an increase of operating income to be envisaged, albeit modest.
The forecasts for operating costs indicated a further reduction, driven by the downturn in personnel expenses, and by the reduction in other costs, following further branch closures.
In the light of the above-illustrated trends, the profits of the banking system were expected to increase.
Lastly, adjustments to loans, according to the consensus scenarios, were expected to rise, given the gradual end of state support measures.

As regards the above-illustrated system scenario, Banco BPM Group drew up the following forecasts for its operations:

- growth of the fee and commission component, in particular of the asset management and Bancassurance segment;
- net interest income that reflects the lower contribution of both ECB funding, with the end of the extra remuneration period, and of the portfolio of financial assets;
- reduction of overall costs, due to the strong governance of the trend of operating expenses, which will continue to be one of the main focus areas, despite the impacts resulting from the unlikely repeatability of certain recoveries and reductions of expenses that characterised FY 2021, above all as regards personnel expenses, and the increases relating to the application of the national contract for the industry and the increase in IT investments and inflation;
- further progress in the direction of reducing the cost of credit launched in recent years, thanks to the conservative approach to measurement adopted in 2021 for both performing and non-performing exposures, albeit with an expected uptrend of flows of new non-performing loans with respect to the past year and promoting, in any event, the continuation of derisking and maintaining a solid level of coverage.

In summary, net of any significant deterioration of the scenario, the Group's overall performance in 2022, given the leverage of 2021's results that were better than expected, was envisaged to be consistent with the performance outlined in the Strategic Plan and with the relative medium-term targets.

The positive macroeconomic scenario outlined above underwent a sudden change at the end of February. The tension between Russia and Ukraine, which was escalating following extensive and prolonged military manoeuvres of the Russian and Belarus armed forces along a fair part of the Ukraine border, was transformed in the early morning of 24 February 2022, into Russia's announcement of a military operation in Donbass, which started the invasion of Ukraine.
The Russian aggression was immediately strongly condemned by both the European Union and by the United States and all NATO member countries. Said condemnation was followed by the approval of a large range of sanctions against Russia, including the block of technology exports, a ban on doing business with Russian state entities, strategic entities and those that produce gas and oil, as well as the block of the SWIFT system for Russian banks.
The sanctions generated an immediate crisis of the Russian financial systems, which led to a rapid and substantial loss of value of the rouble, the downgrading of the sovereign rating, the potential serious risk of bankruptcy of Russian banks and the collapse of the prices of stock issued by Russian companies.
The effects of the sanctions are, however, also going to impact the western countries that issued them and currently, macroeconomic prospects are very uncertain insofar as the influence of the above-described events on the same will greatly depend on the unforeseeable duration and outcome of the conflict under way.
Today, lower economic growth in Europe and in Italy is expected, due to the rise in energy and commodity prices, which will accentuate the rise in inflation that is already in progress. Assumptions relating to adopting a less accommodative monetary policy by the ECB now appear to be groundless, in light of the need to counter the negative effects of the sanctions and the increased cost of energy and commodities, and therefore expectations of an interest rate hike have consequently disappeared.
In this new context, Banco BPM is not expected to suffer any significant impact related to the Group's direct exposure to Russia and Ukraine. This is because said exposure is extremely limited, equal to less than 0.1% of total on-balance sheet assets and unsecured loans.
Given the extreme uncertainty that characterises a constantly-changing situation, it is premature to estimate any possible indirect economic implications resulting from the changed macroeconomic scenarios in which the Group operates. Therefore, Banco BPM will update the market on these aspects when the evolution of the international crisis and the potential repercussions on macroeconomic growth become clearer.

SIGNIFICANT EVENTS OCCURRING AFTER THE END OF THE FINANCIAL YEAR

In compliance with special instructions issued by the Bank of Italy, significant events occurring after the end of the financial year are illustrated in the Notes to the financial statements, part A, Section 4.

Milan, 1 March 2022

The Board of Directors