OUTLOOK FOR BUSINESS OPERATIONS

The economic situation that characterised 2022 towards the end of the year, described in the section on the economic scenario of this report, is expected to continue, at least for a part of the new year. Although inflationary pressure has eased in recent months, it is likely to persist, pushing Central Banks to maintain a restrictive stance. The generalised economic slowdown, exacerbated by weakness of China, should translate into a phase of substantial stagnation in 2023.
The year began with short-term rates under tension due to the expectation that the Central Banks on both sides of the Atlantic would increase the official interest rates again at the next meetings. The pressure on the medium/long-term segment of the yield curve moderately eased as long-term inflation prospects took hold. The tensions that emerged on the BTP-Bund spread in the summer months were partially reduced, but the level at year-end showed a certain financial market prudence given the decisions of the ECB to gradually reduce the monthly purchases of the Asset Purchase Programme (APP).
In these conditions, loans to businesses and households will continue to grow in Italy, despite the weakening of development prospects, but at rates lower than those recorded in 2022. The drop in real disposable income, affected by the significant tension on consumer prices, translates into greater needs of households to meet the real estate investments undertaken, or to be undertaken, and consumption. The demand for business loans will be fuelled by the effect of inflation on input prices - primarily on the prices of semi-finished goods and raw materials - and by the consequences of higher investments linked to the NRRP.
The slowdown in economic activity and the pressure exerted by the inflationary trend and the increase in financial charges on household and business budgets will result in a moderate deterioration, especially for energy-intensive companies, of the loan default rate. At the same time, the cost of risk, incorporating the extraordinary adjustments relating to the sale of NPLs on the market and the worsening of the economic scenario, is expected to rise.
On the funding side, the lack of support provided by the ECB through TLTRO operations will result in less support to the banking system in terms of direct funding and will therefore create the need to increase the medium/long-term component with more costly bond issues.
The outlook for banking market rates, stimulated by the continuation of inflationary tension and the aforementioned more restrictive policies, is set to rise at least in the first quarters of 2023, impacting the change of the banking spread, which is expected to increase appreciably compared to 2022. The combined provision of moderately-expanding volumes of loans disbursed and the opening of the banking spread has led an expected increase in the customer margin which, associated with an increase in interest on securities (coupon flow), will lead to an increase in net interest income in the current year, compared to 2022.
Despite the worsening of the confidence level of households and businesses and the reduction in the propensity to save, the expected stabilisation of the financial markets together with bond yields at higher levels than the recent past will be reflected by moderate growth prospects for indirect funding and, therefore, asset management fees. A boost to the fee and commission component is also expected from the support to companies in the implementation of projects related to the NRRP. The above trends will result in an increase in operating income.

Given the context, also in 2023, the external variables will likely continue to be the main influences on the operating performance of the Group.
Despite the deterioration in the conditions of ECB funding in the form of TLTRO, net interest income will benefit from the increase in the short-term rates, specifically in the commercial component. Indeed, the Group maintains significant sensitivity of approximately 160 million in a scenario of a parallel shift of +100 basis points in interest rates.

Fee and commission income, though still in a scenario of high volatility, which specifically impacts up front and running fees and commissions, connected with investment products, will be supported by the trend in those relating to typical commercial banking operations.
The trend in operating expenses, which will continue to be one of the main focuses of managerial action, may be affected at least in part by inflationary pressure and by the effects of a sustained investment policy to support the development initiatives envisaged in the Strategic Plan.
The trend of default flows during the year could increase due to the economic slowdown, with an impact on the cost of credit, for which a prudent approach will be maintained, in the absence of improvements of the macroeconomic framework.

Healthy levels of coverage are expected to be maintained, also thanks to the conservative approach to valuations adopted in the last few years and confirmed in 2022, on both performing and non-performing exposures.
For the whole of 2023, a significant improvement is expected in the Group's net profit compared to the previous year, with a trend that, also in forecasts, will exceed both the trajectory of profitability and the overall targets outlined in the Strategic Plan.

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 consolidated financial statements, part A, Section 4.

Verona, 7 March 2023

The Board of Directors