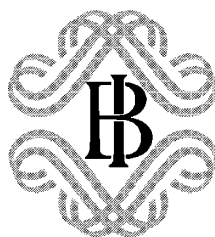


BANCA D'ITALIA

**ORDINARY
GENERAL MEETING
OF SHAREHOLDERS**

HELD IN ROME ON 30 MAY 1998



**ABRIDGED REPORT
FOR THE YEAR
1997**

C O N T E N T S

	Page
THE WORLD ECONOMY	9
Economic and Monetary Union and the launch of the euro	13
Recent developments and economic policies	17
Exchange rates and the international financial markets	26
World trade and the balance of payments	29
THE ITALIAN ECONOMY	34
Demand	44
Domestic supply	53
The labour market	61
Prices	71
The balance of payments and Italy's net external position	83
THE PUBLIC FINANCES	93
Budgetary policy in 1997 and the results for the year	99
Revenue and expenditure	105
The outlook	114
MONETARY POLICY AND THE MONEY AND FINANCIAL MARKETS ..	122
Households and enterprises	141
Banks and other credit intermediaries	149
Institutional investors	162
The securities market	172
THE PAYMENT SYSTEM	187
SUPERVISORY ACTIVITY	199
The regulatory framework	203
The structure of the financial system	209
Risks, profitability and capital adequacy of intermediaries	214
Supervisory controls	221
The protection of competition in the banking sector	227
THE GOVERNOR'S CONCLUDING REMARKS	231
The world economy	232
The Italian economy	239
Banking and finance	252
STATISTICAL APPENDIX	263
BALANCE SHEET AND PROFIT AND LOSS ACCOUNT	309
Notes to the accounts	319
Allocation of the net profit	332
ADMINISTRATION OF THE BANK OF ITALY	333
List of abbreviations	335

LIST OF TABLES

	Page
1. Demand and gross domestic product in the leading industrial countries	18
2. Current account balances of major countries or country groups	31
3. Foreign financing to developing countries, Central and Eastern Europe and countries of the former USSR	32
4. Resources and uses of income	37
5. Households' consumption	45
6. Gross disposable income and average propensity to save	46
7. Gross saving and investment	47
8. Fixed investment	48
9. Exports and imports of goods and services in the national accounts	51
10. Percentage distribution of employees in Italian manufacturing groups by sector and geographical area	54
11. Value added of agriculture and industry at factor cost	55
12. Value added of market services at factor cost	57
13. Main privatizations in Italy between 1 July 1996 and 1 December 1997	58
14. Employment	61
15. Unemployment rates in Europe in 1997 by age and gender	66
16. Labour costs and productivity	68
17. Harmonized index of consumer prices: components	74
18. Unit variable costs and final prices	78
19. Balance of payments	83
20. Current account of the balance of payments	85
21. Italy's net external position	88
22. Financial flows and Italy's net external position	89
23. Stocks and changes in the external position, domestic position in foreign currency and overall position in foreign currency of Italian banks	91
24. Main indicators of the general government income statement	100
25. General government balances and debt	103
26. General government fiscal revenue	106
27. General government expenditure	108
28. Monetary base and money supply	128
29. Monetary base	128
30. Credit, money and financial assets	130
31. Financial assets of the non-state sector	131
32. Financial balances	141
33. Financial assets and liabilities of households	143
34. Financial assets and liabilities of enterprises	146
35. Main items in banks' balance sheets	150
36. Profit and loss accounts of banks	158
37. Consumer credit	161
38. Institutional investors: net fund-raising	162
39. Institutional investors: net assets as a percentage of households' financial assets	163
40. Italian investment funds: fund-raising and securities portfolio	164
41. Rates of return of investment funds and alternative investments	165
42. Portfolios of securities firms	168
43. Insurance companies: assets and liabilities	169
44. Insurance companies: securities portfolio	170
45. Pension funds: main assets	171
46. Bonds and government securities: issues and stocks	174
47. Net purchases and stocks of securities	178
48. Main indicators of the Italian stock exchange	183
49. Bank payment instruments in 1997	192
50. Credit and debit cards: circulation and transactions in 1997	193
51. Clearing and settlement of interbank payments	194
52. Flow of funds through the settlement systems	195
53. The Italian banking system	210
54. Undertakings for collective investment	212
55. Italian securities firms' activities	213
56. Banks: bad and doubtful debts and total loans	215
57. Selected indicators for Italian banks by geographical area	217

LIST OF FIGURES

	Page
1. Official and short-term interest rates	20
2. Consumer price indices	36
3. Industrial output, demand and stocks	38
4. Climate of confidence among consumer households	47
5. Index of capacity utilization in industry and investment in machinery equipment ...	49
6. Per capita GDP in Italy and the EU	60
7. Employment according to the labour force survey	62
8. Employment rate by gender and geographic area	64
9. Unit labour costs and dispersion of hourly labour costs between branches of manufacturing industry	69
10. Harmonized index of consumer prices excluding food and energy products	73
11. Index of consumer prices for the population as a whole excluding food and energy products and items subject to official control	74
12. Ratio between the prices of services and the prices of goods	75
13. Index of the producer prices of manufactures for the domestic market, excluding energy products and items subject to official control	76
14. Unit labour costs in manufacturing	79
15. Share of profits in value added and real wages	80
16. Forum-ME survey of expectations of consumer price inflation in the subsequent two quarters	81
17. Professional forecasters' inflation expectations for 1998 and 1999	81
18. Professional forecasters' long-term inflation expectations	82
19. Changes in general government revenue and primary expenditure in EU countries ..	97
20. Primary current expenditure and total revenue in the period 1985-1997	98
21. General government revenue and expenditure	99
22. Tax revenue and social security contributions	105
23. Expenditure excluding interest payments	109
24. Average cost of the debt and average gross Treasury bill yield	110
25. Adjustment of the average cost of the debt to a one-point rise in market rates	111
26. The main aggregates in the Economic and Financial Planning Documents for the periods 1998-2000 and 1999-2001	118
27. Official interest rates and money and financial market rates	123
28. Real interest rate and real effective exchange rate	124
29. Expected and actual rates on three-month Eurolira deposits	125
30. Lira/DM exchange rate: spot and implied forward at 1 January 1999	125

	Page
31. Term structure of Eurolira/Euromark yield differentials	126
32. M2 money supply	129
33. Monetary and credit aggregates	130
34. Rates on futures on three-month Euromarket deposits in the leading EMU countries .	134
35. Distributions of the three-month rate on futures for settlement in December 1998 ...	135
36. Three-month real interest rates: historical values and forecasts	136
37. Corporate debt and gross operating profit as a percentage of value added	145
38. The borrowing requirement of firms	145
39. Interest rates and interest rate differentials	151
40. Banking indicators	152
41. Italian investment funds: rate of return and volatility of equity funds	166
42. Average maturity and duration of government securities	175
43. Gross 10-year yields in lire and marks	177
44. Yield differentials between bonds issued by the Italian Treasury and other issuers ...	179
45. Implied volatility of BTPs and Bunds listed on LIFFE	179
46. Turnover and open interest	181
47. Price ratios of expected earnings and dividends in selected countries	184
48. Italian stock exchange: indices of total return	185
49. Italian stock exchange: spot and futures markets	186

THE WORLD ECONOMY

On 3 May 1998 the European Council, meeting in the composition of Heads of State or Government, confirmed that the third stage of Economic and Monetary Union will commence on 1 January 1999 with eleven participating countries, including Italy. On that date exchange rates will be irrevocably fixed and the single currency, the euro, will be adopted. The single monetary policy will be entrusted to the European System of Central Banks, comprising the European Central Bank and the national central banks of the participating countries. The ECB will have responsibility for setting monetary policy guidelines, while the national central banks will implement monetary policy and continue to perform the functions that fall outside the competence of the ESCB, such as supervision of the banking system and the surveillance of financial markets.

The countries of the European Union made important progress towards economic convergence last year, as was recognized in the convergence reports of the European Commission and the European Monetary Institute. In addition to a considerable narrowing of differentials for inflation and both short and long-term interest rate, the redoubling of efforts to adjust the public finances enabled all the member states except Greece to reduce the ratio of their budget deficit to GDP to no more than 3 per cent, the reference value specified in the Maastricht Treaty. A large majority of countries had failed to meet this criterion in 1996; the results achieved last year bear witness to the governments' determination to attain the degree of convergence that will allow the single currency to be launched in an environment of stability and with the participation of eleven member states from its adoption in 1999.

From the summer onwards the world economy was beset by the crisis in some of the East Asian countries. The crisis began in Thailand, with serious balance-of-payments deficits and disarray in the banking and financial system. It rapidly spread to other countries in the area - South Korea, Indonesia, the Philippines and Malaysia - causing violent strains in the foreign exchange and stock markets. The international financial markets became aware of the fragile aspects of the region's economic development: the balance of payments deficits on current account, the intrinsic weakness

of their fixed exchange rate regimes, the accumulation of external debt in foreign currency, mostly at short term, and the structural and regulatory inadequacies of the banking and business sectors. The intensity and breadth of the crisis were such that the international community had to intervene to restore confidence and check the contagion. The scale of financial aid required was exceptional and tested the IMF's resources and instruments to the limit; it again posed the problem of how best to tackle liquidity crises in individual countries without offering banks and other private creditors even an implicit guarantee against loss as a result of the collapse; it confirmed the need to strengthen financial systems, reinforce the regulation of credit and finance and make banking supervision more efficient in the emerging economies; it again focused attention on the fundamental but still unsolved questions posed by an international monetary system based on fiat money, free capital movements, highly integrated markets and volatile expectations.

World output nonetheless grew by an average of 4.1 per cent in 1997, the same as in the previous year; a slight acceleration in economic activity in the industrial countries as a whole was accompanied by a fall in the rate of growth of the developing countries, from 6.6 to 5.8 per cent. The international organizations all predict that the rate of growth of the world economy will slow down by 1 percentage point this year, mainly as a result of the full unfolding of the effects of the Asian crisis; there is also a risk that the outcome will be worse if the expected slowdown in the US economy is accompanied by deflation and recession in Japan.

In 1997 the United States recorded strong growth for the sixth year in succession. The increase of 3.8 per cent in GDP, which was better than had been expected, was the result of brisk domestic demand owing to low unemployment and the associated increase in disposable income, the substantial rise in share prices and high corporate profits.

In the European Union growth accelerated by almost 1 percentage point, to 2.7 per cent, thanks not only to the contribution from countries where the upturn has been under way for some time, such as the United Kingdom and the Netherlands, but also to that from others where growth is now being sustained not only by exports but also by a recovery in domestic demand, such as Germany and France. The transatlantic growth differential will tend to decrease this year: according to current estimates, growth in the United States will decline to 2.9 per cent, while in the EU it will remain unchanged at 2.7 per cent owing to an expected acceleration in Germany, France and Italy and a slowdown in the United Kingdom. The disparities in unemployment rates will remain wide, with that in the United States forecast to fall to 5.0 per cent, compared with an average of 10.2 per cent in the EU.

The performance of the Japanese economy was again disappointing last year, with growth of less than 1 per cent. Activity has yet to recover from the collapse of share and property prices nine years ago, which seems to have marked a break in the growth potential of the most dynamic economy of the post-war era. Despite the contribution from exports, the fragility of the recovery that had begun in 1996 was revealed as early as the second quarter of last year by an abrupt decline in activity. The economic situation worsened in the second half of the year and remains very uncertain. The causes of the weakness of domestic demand are numerous and deep-seated: in a climate of depressed business and consumer sentiment, the tax increases introduced in April 1997 had a marked damping effect on the propensity to consume; the banking and financial system has been shaken by serious cases of instability; and confidence has also been eroded by the Asian crisis, given the close trade and financial links between Japan and the countries most involved. In recent months the Japanese authorities have responded to the deteriorating situation and exhortations from the international community by providing public funds to support the banking system and, in April, by adopting fiscal measures to stimulate the economy; the scale of the package is substantial, equal to around 3 per cent of GDP, but its composition is still not known in detail.

Although the financial turbulence abated in the spring of 1998 in most of the countries concerned, the full effects of the Asian crisis on economic activity have still to emerge. In the countries directly involved, production is contracting after a long period of intense growth; in Indonesia, in particular, the economic crisis has led to open political and social conflict. The industrial economies will be affected as the current account position of the five hardest-hit countries in the region turns positive: it is forecast to swing from a deficit of \$55 billion in 1996 to a surplus of around \$20 billion in 1998. As the United States is expected to absorb the largest share of this adjustment, the US current account deficit this year is likely to amount to \$230 billion, equal to almost 3 per cent of GDP. This will further exacerbate the long-standing imbalances between the major economic regions of the world, which increased in 1997 owing to the reappearance of a cyclical disparity between the United States and Japan.

Movements in the exchange rates of the main currencies contributed to the worsening of payments imbalances. Last year the dollar appreciated, albeit with pronounced fluctuations, whereas the yen weakened: between January 1997 and April 1998 the price competitiveness of US products deteriorated by 2.3 per cent and that of Japanese goods improved by 2.5 per cent. During the period of exchange rate volatility following the Asian crisis, the dollar gained strength from its role as an international reserve currency.

Thanks in part to the moderate rise in unit labour costs and the fall in the prices of raw materials, the rate of consumer price inflation in the main

industrial countries was equal to 2 per cent, slightly less than the already low level recorded in 1996. Monetary policies were tightened in the first few months of the year but were then able to revert to a generally relaxed stance in view of the deflationary and recessionary effects of the Asian crisis. In Japan the expansionary monetary policy proved to be of limited effectiveness; in an economy with a depressed climate of confidence and banks in acute difficulties, it was unable by itself to trigger reflation, but it greatly increased liquidity in the international financial markets.

Enduring price stability, in conjunction with very low short-term interest rates, created the conditions for long-term rates to come down nearly everywhere. In real terms they reached the lowest values since the early eighties. The fall in nominal yields in 1997, amounting to 0.8 percentage points in the United States, 1.0 in Japan, 0.6 in Germany, 2.0 in Italy and 1.5 in the United Kingdom, was also encouraged by special circumstances, namely the reallocation of portfolios towards less risky markets in response to the Asian crisis and the abundance of liquidity in the international markets. Everywhere the decline in yields went hand in hand with a flattening of the yield curve; in Europe it was also accompanied by a marked reduction in yield differentials vis-à-vis bonds denominated in German marks.

An important factor in the decline in long-term interest rates was the progress made towards restoring sound public finances. The general government deficit of the industrial countries as a group amounted to 1.4 per cent of output, half the ratio recorded the previous year. This achievement is the result of a process of deficit reduction and the institutionalization of strict fiscal discipline, as exemplified by the medium-term plan to balance the budget in the United States and the Stability and Growth Pact in Europe.

ECONOMIC AND MONETARY UNION AND THE LAUNCH OF THE EURO

On 3 May 1998 the European Council decided that eleven member states of the EU complied with the criteria laid down for adoption of the single currency, the euro. As well as Italy, they comprise Austria, Belgium, Finland, France, Germany, Ireland, Luxembourg, the Netherlands, Portugal and Spain. Greece, which has also made substantial progress towards economic adjustment, does not yet meet the necessary conditions. The United Kingdom and Denmark have notified their intention not to adopt the single currency in 1999, invoking the option provided for in the Maastricht Treaty. Sweden is not a member of the Exchange Rate Mechanism and is thus precluded from adopting the single currency for the time being. The third and final stage of EMU will begin on 1 January 1999, when the irrevocable conversion rates against the euro will come into force and the single monetary policy will be launched.

With the adoption of the euro, monetary policy will no longer be conducted by individual countries: it will be formulated by the Governing Council of the ECB, which comprises the Governors of the national central banks and the members of the Executive Board. Most of the decisions taken by the Council will be adopted on the basis of one member, one vote. The national central banks will, on the one hand, have a part in formulating monetary policy for the area through their participation in the decisions of the Governing Council and, on the other hand, implement those decisions in their own countries. This arrangement reconciles the need for a single monetary policy with the principle of subsidiarity that pervades the ESCB Statute, which aims for maximum decentralization at the operational level.

The fixing of conversion rates against the euro. - In order to ensure certainty in the financial markets by firmly guiding exchange rate expectations, the authorities of the eleven countries that are to form the euro area have already announced the bilateral exchange rates between the participating currencies, on the basis of which the conversion rates against the euro will be irrevocably fixed on 1 January 1999. The bilateral exchange rates were chosen with reference to the current central rates within the ERM;

these are consistent with the fundamentals and competitive positions of the economies concerned, as confirmed by the stability of market exchange rates around these levels for some time.

It was not possible, however, to fix the conversion rate of each participating currency against the euro, for two reasons. First, the Maastricht Treaty states that the setting of conversion rates shall not by itself modify the external value of the ecu, in other words its exchange rate against all other currencies, whether EU members or not; since it has been decided that the ecu will be replaced by the euro in the ratio of one to one, the conversion rates will have to be based on the market exchange rates against the ecu quoted on 31 December 1998. Secondly, the ecu currency basket includes the currencies of three countries that will not be joining the euro area on 1 January 1999, namely the Danish krone, the Greek drachma and the pound sterling; consequently, the market exchange rates of the ecu against participating currencies on the last day of 1998 will also reflect the performance of these three currencies.

The central banks of the participating countries will ensure that on 31 December 1998 the bilateral market exchange rates correspond to the ERM central rates. The exchange rates against the ecu determined on 31 December in accordance with the usual procedures will be adopted on 1 January 1999 as the irrevocably fixed conversion rates of the participating currencies against the euro.

Although national authorities will remain responsible for the monetary policies of the participating member states during the months preceding the launch of EMU, they will need to coordinate more closely; this will also be necessary to ensure the orderly convergence of short-term interest rates towards the uniform level considered most appropriate for the area at the time when the euro is adopted.

The ECB and the single monetary policy. - The ECB will be established in June 1998, when the members of the Executive Board will be appointed. During the run-up to the launch of the single currency the Bank will complete the necessary preparations for performing its institutional tasks; it will finalize the instruments and procedures necessary for carrying out a single monetary policy, as well as establishing the necessary information system and statistical infrastructure.

From 1 January 1999 onwards the ECB will define and implement the single monetary policy of the euro area, the primary objective of which will be to maintain price stability; it will formulate guidelines for the management of the official foreign reserves transferred by the member states, promote the smooth operation of the payment systems of countries

belonging to the euro area and, by 1 January 2002 at the latest, issue banknotes in euros that will be legal tender. For purely operational and analytical purposes, a consolidated balance sheet of the ESCB will be drawn up, comprising all the assets and liabilities of the national central banks, including those items not directly connected with the activities of the ESCB.

Within the ESCB the ECB will be responsible for formulating guidelines on monetary policy, including the timing and manner of implementation. This task is entrusted to the main decision-making body, the Governing Council. The Executive Board, comprising the President, the Vice-President and four other members, will be responsible for the day-to-day conduct of monetary policy, giving operational effect to the decisions of the Council. Monetary policy decisions will normally be implemented by the national central banks.

The operational framework of the single monetary policy will have to allow the ECB to control its operational target effectively; this will normally be the short-term interest rate. The ECB may introduce a system of minimum reserves; a decision on this matter will be taken by the Governing Council in the coming weeks. Since commercial banks will maintain their accounts with the national central bank of the country in which they are resident, the scale of recourse by national banking systems to the refinancing offered by the ECB will be reflected in the balance sheets of the national central banks, which may expand or contract proportionately; the ECB will have no control over these movements, which will depend solely on the ability of each country's banks to compete with those of other countries in securing funds in euros (for a more detailed description of the instruments and procedures of the single monetary policy, see the introduction to the Chapter *Monetary Policy and the Money and Financial Markets*).

Although the operational arrangements described above can be used in a number of monetary policy strategies, it appears that the ECB intends to adopt a combination of two stylized behavioural models: the pursuit of an intermediate objective expressed in terms of monetary aggregates and direct inflation targeting. The decisions taken by the Governing Council of the ECB in this field will reveal the emphasis placed on monetary aggregates and inflation forecasts respectively.

The introduction of the euro. - In Italy the changeover from the lira to the euro is being coordinated by the Euro Committee at the Ministry of the Treasury. The Committee has transposed the general guidelines given in Community regulations and identified the ways of implementing the changeover in four particularly important areas: the banking and financial sector (the measures to be taken regarding payments, markets, financial

instruments and statistics are described in the National Financial Changeover Plan; see the Article The National Financial Changeover Plan: the transition to the euro in the Italian financial system, in Economic Bulletin, No. 26, February 1998), the public sector, information technology and the business sector. As regards the banking and financial sector, trading on the money and financial markets will be conducted in euros from 1 January 1999 onwards. All government debt instruments will be issued in euros from then onwards, and all outstanding government securities and other forms of negotiable public debt will be converted into euros on that date.

RECENT DEVELOPMENTS AND ECONOMIC POLICIES

Economic developments in the industrial countries

In the United States the rate of GDP growth rose from 2.8 per cent in 1996 to 3.8 per cent last year (Table 1). There was a substantial increase of 4.1 per cent in domestic demand, involving both consumption and investment; within the latter, expenditure on machinery rose by more than 10 per cent for the fifth consecutive year. The increase in households' disposable income and financial wealth led to growth of 3.3 per cent in private consumption.

In Japan GDP increased by only 0.9 per cent, despite a significant contribution from export demand. The rapid growth recorded in 1996 ended in the second quarter with an abrupt downturn in April, when the rate of value added tax was raised from 3 to 5 per cent. The intensity of the economy's reaction to the fiscal tightening is attributable to the protracted stagnation of productive activity and the difficulties of the banking system, which led to a lack of confidence among households and firms that was aggravated during the autumn by the failure of several financial institutions and the adverse economic impact of the Asian crisis.

The GDP of the European Union grew by 2.7 per cent; that of the eleven member states that will adopt the euro rose by 2.5 per cent.

In Germany GDP growth of 2.2 per cent was sustained by net exports and stock building. Disposable income stagnated, curbing household consumption which increased by only 0.2 per cent, as did investment. For the first time since unification, GDP in the eastern Länder grew more slowly than in the western part of the country, owing both to the waning of the construction boom generated by unification and to large cuts in public subsidies. The growth in economic activity also picked up in France, to 2.3 per cent. Private consumption increased only modestly (by 0.9 per cent) but gained momentum in the second half of the year owing to growth in disposable income and an improvement in confidence, thus offsetting a decrease in the contribution from export demand.

Table 1

**DEMAND AND GROSS DOMESTIC PRODUCT
IN THE LEADING INDUSTRIAL COUNTRIES (1)**
(annualized percentage changes on the preceding period)

	1995	1996	1997	1997	
				H1	H2
United States					
GDP	2.0	2.8	3.8	4.3	3.3
Domestic demand (2)	1.9	3.0	4.3	4.6	4.1
Net exports (2)	0.1	-0.2	-0.5	-0.3	-0.8
Japan					
GDP	1.5	3.9	0.9	2.3	-1.4
Domestic demand (2)	2.3	4.7	-0.5	0.7	-2.8
Net exports (2)	-0.8	-0.8	1.4	1.6	1.4
Germany					
GDP	1.8	1.4	2.2	2.0	2.6
Domestic demand (2)	2.0	0.8	1.2	1.6	0.4
Net exports (2)	-0.2	0.6	1.0	0.4	2.2
France					
GDP	2.1	1.6	2.3	1.9	3.6
Domestic demand (2)	1.8	1.0	0.9	0.1	2.7
Net exports (2)	0.3	0.6	1.4	1.8	0.9
Italy					
GDP	2.9	0.7	1.5	1.6	3.4
Domestic demand (2)	2.2	0.3	2.4	3.8	3.0
Net exports (2)	0.7	0.4	-0.9	-2.2	0.4
United Kingdom					
GDP	2.7	2.2	3.3	3.7	2.7
Domestic demand (2)	1.8	2.7	3.7	4.2	3.6
Net exports (2)	0.9	-0.5	-0.4	-0.5	-0.9
Canada					
GDP	2.2	1.2	3.8	4.2	4.0
Domestic demand (2)	1.3	0.9	5.2	5.2	5.8
Net exports (2)	0.9	0.3	-1.4	-1.0	-1.8
Total for the seven leading industrial countries					
GDP	2.0	2.5	2.8	3.3	2.4
Domestic demand (2)	2.0	2.8	2.6	3.0	2.4
Net exports (2) .....	..	-0.3	0.2	0.3	..
EU					
GDP	2.5	1.8	2.7	2.5	3.6
Domestic demand (2)	2.2	1.4	2.3	2.2	3.1
Net exports (2)	0.3	0.4	0.4	0.3	0.5

Sources: OECD, European Commission and national statistics.

(1) At constant prices. Domestic demand includes changes in stocks. - (2) Contribution to the increase in gross domestic product, in percentage points.

Among the countries not adopting the single currency, the United Kingdom achieved particularly rapid growth of 3.3 per cent, fueled by domestic demand. A significant rise in household income and the wealth effects of rising share and house prices resulted in an increase of 4.6 per cent in private consumption.

In the United States the unemployment rate fell to 4.7 per cent in December, its lowest level since the beginning of the seventies; it averaged 5 per cent over the year. Non-farm payroll employment rose by nearly 3 million, or 2.3 per cent, bringing the increase in the number of jobs in the last six years to almost 16 million. Despite the rapid growth in employment, wage pressures were moderate.

The employment picture also improved further in the United Kingdom last year, with the unemployment rate declining from 6.5 to 5 per cent. In the eleven euro countries, by contrast, the problem of unemployment remains extremely grave, despite the general recovery in output. Using the harmonized Eurostat definition, the unemployment rate was 11.7 per cent in 1997. In Germany the number of persons out of work continued to rise during the year, bringing the seasonally adjusted total on the basis of national statistics to 4.5 million in December, or 11.8 per cent of the labour force. Unemployment rates in Italy and France remained at the high levels reached in 1996 (12.3 and 12.5 per cent respectively). Significant reductions occurred in the course of the year in Spain, Finland, Ireland, the Netherlands and Portugal.

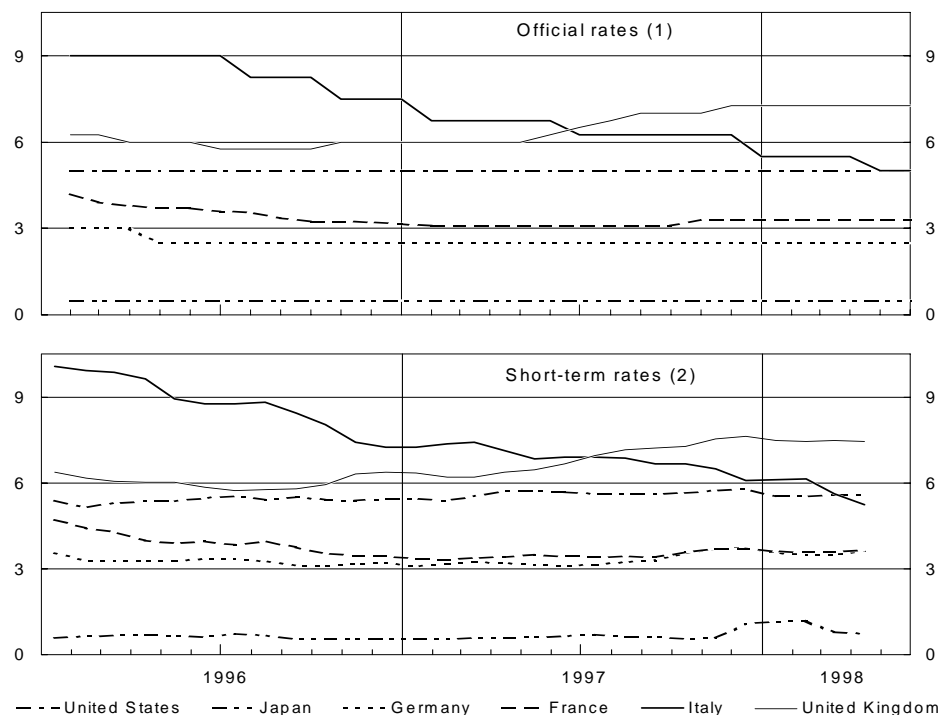
Inflation in the United States remained low. Considerable productivity gains offset wage growth, while the massive investment of recent years in machinery and equipment has eased capacity constraints. The appreciation of the dollar and heightened competition in product markets owing to increased trade within NAFTA helped to contain inflationary pressures.

The rate of price increase declined further in the European Union. The aggregate consumer price index for the fifteen member states rose by an annual average of 1.9 per cent, compared with 2.5 per cent in 1996; the corresponding figures for the countries adopting the euro were 1.7 and 2.3 per cent. The most pronounced slowdowns among the latter were in Italy (2 percentage points), Spain (1.6 points) and Portugal (0.9 points). Domestic prices in Germany were driven upwards in the summer by higher import prices owing to the depreciation of the mark, but the rate of increase slowed down from August onwards, particularly as regards producer prices. In France slow wage growth resulted in a decline in unit labour costs, helping to bring inflation down to an annual average of 1.2 per cent. In the United Kingdom the appreciation of sterling and a series of increases in official interest rates (Figure 1) combined to relieve the price pressures stemming from the strong growth in domestic demand and rising unit labour costs.

The retail price index, excluding mortgage interest payments, rose by 2.8 per cent on average for the year.

Figure 1

OFFICIAL AND SHORT-TERM INTEREST RATES



Source: National statistics.

(1) End-of-period data; for May 1998 latest available data. For France, intervention rate; for the United Kingdom, base rate; for other countries, discount rate. - (2) Average data. For the United States, rate on 3-month certificates of deposit; for Japan, 3-month call rate; for Germany, 3-month bank lending rate; for France, Italy and the United Kingdom, 3-month interbank rate.

In late 1997 and early 1998 the economic situation was altered by the impact of the Asian crisis. Japan has been the worst affected among the industrial countries. The United States will record slower growth this year than in 1997, owing to the appreciation of the dollar, a decline in exports to Asia and the high level of stocks. In continental Europe, where the direct effects of the Asian crisis are limited owing to the relatively small volume of trade between the two areas, growth should accelerate, favoured by the decline in interest rates.

Economic policies in the industrial countries

Fiscal policies. - In the United States the federal budget deficit fell from 1.4 to 0.3 per cent of GDP for the fiscal year ending in September 1997; this was the lowest level since 1970. The budget for the current fiscal year should

be virtually in balance. The adjustment of the federal finances, which was begun in 1993 with a long-term programme to curb expenditure, has benefited considerably from the long period of economic growth.

Japan's budget deficit for the fiscal year ending in March 1998, net of the surplus of the social security system, is estimated to have decreased by 0.7 percentage points to 5.9 per cent of GDP as a consequence of measures contained in the medium-term fiscal adjustment plan designed to cut the deficit to less than 3 per cent of GDP by 2003. However, the deterioration in the climate of confidence and the curtailment of the economic recovery necessitated a shift to a less restrictive fiscal stance. Accordingly, in February Parliament approved a supplementary budget comprising income tax cuts and an increase in public investment. At the end of April the Government responded to the worsening economic crisis by announcing an additional programme of economic stimulus amounting to nearly ¥17 trillion. The plan provides for income tax cuts worth about ¥4 trillion over the next two years and increases of ¥8 trillion in public investment. Details on the remainder of the package have not yet been released.

Within the European Union efforts to adjust the public finances were stepped up considerably in 1997 with a view to meeting the convergence criteria for the adoption of the single currency. The general government deficit of the eleven euro countries was reduced by 1.6 percentage points to 2.5 per cent of GDP. Gross public debt remained unchanged at 75.2 per cent.

Germany's budget deficit amounted to DM96.5 billion, or 2.7 per cent of GDP, compared with 3.4 per cent in 1996. In the first three quarters it remained at the same level as in the previous year, despite faster economic growth, owing to a fall in tax revenue and a worse-than-expected deterioration in labour market conditions. In the fourth quarter an increase in revenue and further curbs on spending by central and local authorities, enacted in July, produced a significant improvement. The budget for 1998 projects a deficit of 2.5 per cent of GDP.

In France the general government deficit fell from 4.1 to 3.0 per cent of GDP, thanks in part to corrective measures approved in July totaling FF32 billion, or 0.4 per cent of GDP. The Government's deficit target for 1998 is 3 per cent of GDP.

Monetary policies. - In the United States, concern about possible inflationary pressures due to the prolonged economic expansion, which led the Federal Reserve to raise the federal funds rate by 25 basis points at the end of March, proved unfounded. The risk diminished further towards the end of the year owing to the disinflationary effects of the Asian crisis and the appreciation of the dollar. The fear of an abrupt stock market correction contributed to the decision not to adjust official rates.

In the United Kingdom the Bank of England progressively raised its base rate to 7.25 per cent in order to curb price pressures stemming from a surge in domestic demand. The Bank's powers to set interest rates were enhanced, and the functions of banking supervision and public debt management were transferred to other bodies.

In Japan the weakness of economic activity, the absence of price pressures and the worsening of the crisis in the financial system, which impeded the supply of credit to the economy, persuaded the central bank to keep the discount rate at the very low level at which it has stood for the past three years (0.5 per cent).

Confidence in the soundness of the Japanese financial system was further shaken in the autumn, when a number of financial institutions filed for bankruptcy and many others disclosed the extent of the problems in their balance sheets. In the last few months of the year there was an increase in the risk premium paid by borrowers, including banks, and the fall in share prices led to a significant deterioration in the banks' capital adequacy ratios. As a result, many banks were more reluctant to lend, which exacerbated the financing difficulties of small and medium-sized firms. The experimental use of new criteria for assessing the scale of bad loans revealed a total of about ¥77 trillion for the banking system as a whole, or more than 12 per cent of total outstanding loans and guarantees. In the first few months of 1998 the authorities decided to make a massive injection of public funds into the banking system totaling ¥30 trillion, equal to 6 per cent of GDP, in order to protect depositors and strengthen the capital bases of the most heavily exposed banks.

In October, in response to signs of a pick-up in inflation, the Deutsche Bundesbank, followed by the Austrian, Belgian, French and Dutch central banks, raised the cost of refinancing by 0.3 points to 3.3 per cent. In Italy, Spain and Portugal the pronounced slowdown in inflation was conducive to a lowering of official rates by 2.5, 2 and 2.2 percentage points respectively between January 1997 and May 1998 (Figure 1).

During the delicate period of transition preceding the launch of the single currency, movements in monetary aggregates and interest rates are already significant for price stability in the future euro area, given the lags in policy transmission mechanisms. With the transition to EMU, evaluating monetary indicators for the area as a whole will be made more difficult by potential instability in the demand for money and by the greater liquidity of money and of the entire range of euro-denominated financial instruments. In 1997 the growth in the broadest monetary aggregate, harmonized M3, marginally exceeded the increase in the euro area's nominal GDP; the growth of the narrower aggregates was considerably faster.

The developing countries, Central and Eastern Europe and the former USSR

Economic activity in the developing countries increased at a rate of 5.8 per cent in 1997, compared with 6.6 per cent in 1996. The depressive effects of the Asian crisis will impinge fully on these countries this year; international organizations forecast that growth will not be more than 4.5 per cent.

Growth slowed down everywhere in Asia; the reduction was slight in the group of newly industrialized economies of South Korea, Hong Kong, Singapore and Taiwan (from 6.4 to 6.1 per cent) and more marked in the rest of the continent (from 8.3 to 6.7 per cent). China remained the fastest-growing economy in the region, with growth of 8.8 per cent, compared with 9.7 per cent in 1996. The slowdown was pronounced in the countries at the centre of the financial crisis, which had been growing at average annual rates of 8 per cent in the nineties. In South Korea and Indonesia growth came to 5 per cent, while in Thailand it was nil. The immediate prospects for growth are seriously jeopardized by the impact of the financial and currency crisis, via the worsening of the terms of trade, the fall in securities and property prices, the failure of many firms and financial institutions and the deterioration in consumer and investor confidence. The IMF estimates that output in South Korea, Indonesia and Thailand will fall by 1, 5 and 3 per cent respectively in 1998. A recovery in exports will be crucial to pull out of the recession; macroeconomic policies must therefore be directed towards curbing the inflationary pressures generated by the precipitous depreciation of currencies. Implementation of the necessary structural reforms, especially in the banking and financial system, is a *sine qua non* for sustained growth in the medium and long term.

In Latin America the recovery that began after the crisis of 1994-95 continued, with the growth rate rising from 3.5 to 5 per cent. This year, however, the region will be affected by the interest rate increases required to counter the capital outflow provoked by the Asian crisis. Regional growth is likely to slow down to about 3 per cent. In Brazil, where the contagion was most acute, it is expected to fall from 3 to 1.5 per cent. Further progress was made in reducing inflation, which is down to single figures in many countries. In Mexico consumer price inflation was about 20 per cent but should decline to 13 per cent this year. Venezuela, which had an inflation rate of 50 per cent in 1997, the highest in the region, should also record a significant improvement.

Growth in the Middle East declined from 5 to 4.4 per cent, owing mainly to the cyclical slowdown in Iran and Turkey. In Turkey, where more determined efforts to reduce inflation from its present rate of nearly 90 per

cent are essential, growth fell below 6 per cent, compared with over 7 per cent in 1996, and the decline is expected to continue this year. In Egypt activity continued to expand at a sustained rate of 5 per cent, thanks to renewed commitment to macroeconomic stabilization and structural transformation of the economy.

Growth rates in Africa declined from over 5 to 3 per cent owing to a number of factors that affected individual economies to differing degrees, such as the fall in commodity prices, the aftermath of military conflicts, political uncertainties and poor climatic conditions. While the consequences of events in Asia will be indirect and modest, consisting mainly in a reduction in the inflow of investment from some Asian countries, a continued downward trend in commodity prices would be a much more serious cause for concern about Africa's growth prospects.

In the countries of Central and Eastern Europe and the former Soviet Union the progress in the transition to the market economy is having increasingly beneficial effects on activity. Output in these countries as a group increased for the first time since the start of the transition, rising by 1.7 per cent. The fastest growth was achieved in the economies that are most advanced in the reform process, notably Poland (6.9 per cent), Hungary (4.0 per cent), Croatia (6.3 per cent) and Slovakia (5.7 per cent). Russia recorded a positive growth rate for the first time (0.4 per cent). According to the IMF, the trend will strengthen in 1998, when growth should approach 3 per cent in the area as a whole and exceed 1 per cent in Russia.

The financial turmoil in Asia spread to many of the economies in the region, putting intense downward pressure on currencies and shares. Speculators targeted the countries with fixed exchange rate regimes and less sound macroeconomic conditions. The hardest hit were Russia, Ukraine and the Baltic republics, especially Estonia. In Russia the rouble and share prices plunged in October and November and again in January. The authorities intervened by drastically increasing reserve requirements and reference interest rates. The adjustment of the public finances in Russia is proving particularly difficult, mainly because of problems in obtaining adequate tax revenues.

In Ukraine output contracted further in 1997, falling by more than 3 per cent. The economic situation remains precarious. In August the IMF agreed a standby facility on condition that a rigorous programme of adjustment and economic reform be adopted. Implementation of the programme ran into increasing difficulty around the turn of the year, however, owing in part to the turmoil in the international financial markets, which necessitated a tightening of monetary conditions. The programme was therefore revised in January. The latest economic forecasts for 1998, which are obviously subject

to considerable uncertainty, are not entirely negative, indicating at least the end to the contraction in output.

In Albania, Bulgaria and Romania the transition remains extremely uncertain and difficult. Output declined by about 7 per cent in 1997. In Albania and Bulgaria, which suffered severe financial crises, the situation now appears to have stabilized, at least in part. Albania recently concluded an agreement with the IMF for a three-year ESAF loan, pledging to carry out a broad programme of reform. In Romania the process of adjustment and reform was halted by severe political uncertainties; inflation soared to 150 per cent, compared with 40 per cent in 1996.

EXCHANGE RATES AND THE INTERNATIONAL FINANCIAL MARKETS

Exchange rates

The dollar strengthened significantly against the other major currencies last year, confirming the trend that had begun in the spring of 1995. Whereas in 1996 the appreciation had been continuous, the pattern was more irregular last year, with wider fluctuations in May and June against the Japanese yen and in the autumn against the German mark. As a result, exchange rate volatility was 50 per cent higher than the historically low average recorded in 1996. In the course of the year the dollar appreciated by 11.8 per cent in nominal effective terms while the mark and the yen depreciated by 2.6 and 2.0 per cent respectively.

The dollar continued to appreciate against the mark until the beginning of August, reaching peaks of DM1.89. In May there was a pause in its rise against the yen following the statement by the Group of Seven countries that any further depreciation of the yen would impede the adjustment of the US and Japanese current account imbalances.

The appreciation of the dollar against the mark resumed in the last two months of the year, particularly after the worsening of the financial crisis in Asia, which fueled a massive shift of capital into the US market. The effective depreciation of the yen grew more pronounced as a result of the deterioration in cyclical conditions and the increasingly difficult situation of the banking system.

The dollar/DM exchange rate remained relatively stable in the early months of 1998. The US currency fluctuated more widely against the yen, however, owing mainly to uncertainty about the resolution of the Japanese authorities to tackle the country's serious economic problems. The yen rallied briefly in the first few weeks of this year but began to weaken again in mid-February. The downward pressure intensified in April, notwithstanding substantial, albeit intermittent intervention in the foreign exchange markets by the Bank of Japan and the appreciation expressed at the G7 meeting in Washington for the fiscal package announced by the Japanese government to stimulate domestic demand. The markets' adverse reaction

may have been due in part to the absence of a more explicit undertaking by the industrial countries to defend the yen, even by means of coordinated intervention. By mid-May the yen had fallen to ¥134 against the dollar, compared with an average of ¥120.80 in 1997.

The international financial markets

Long-term interest rates came down significantly in the leading industrial countries during 1997. In Europe the fall in yields on DM-denominated assets was accompanied by much larger reductions in Italy, Spain and the United Kingdom. The decline was aided by the persistence of fairly low rates of both actual and expected inflation despite the maintained or even accelerating pace of growth; a number of temporary factors associated with the Asian crisis contributed in this regard, such as expectations of a slowdown in economic activity worldwide and the transfer of funds into the bond markets of the industrialized countries. The fall in yields in Japan was attributable mainly to the dramatic deterioration in economic conditions, which led both to a downward revision of the medium-term growth forecast and to expectations that the period of expansionary monetary conditions would continue.

At the end of last year long-term yields stood at 5.8 per cent in the United States, 5.3 per cent in Germany and France, 1.7 per cent in Japan, 5.6 per cent in Italy and 6.4 per cent in the United Kingdom; these were historically low levels in all the countries except the United States, where they were still higher than in the autumn of 1993.

The decline in bond yields in the European countries fostered a marked convergence with yields on DM assets. In relation to German bond yields, the long-term interest rate differentials in lire and pesetas narrowed from respectively 1.64 and 1.00 percentage points at the beginning of 1997 to 0.28 and 0.27 points at the end of the year, reflecting on the one hand progress in countering inflation and in adjusting the public finances and, on the other, growing confidence that the euro would be launched on schedule with a large number of participants.

The early months of this year have been marked by a renewed sharp increase in bond prices, presumably owing to the particularly favourable macroeconomic conditions in the United States and Europe, where inflation has fallen further and the relaxed monetary stance is expected to be maintained.

Stock markets performed extremely strongly last year, with the share price indices rising by about 30 per cent in the United States and France, 40

per cent in Germany, 20 per cent in the United Kingdom and 60 per cent in Italy. The exception was Japan, where share prices fell by almost 20 per cent. After a sharp but brief correction at the end of October in connection with the deepening of the Asian crisis, the US and European stock markets benefited in November and December from the outflow of funds from the affected region and, to a lesser extent, from other emerging economies. In the first four months of this year the rise in share prices has been even more pronounced, with increases of 12 per cent in the United States, between 15 and 28 per cent in the United Kingdom, Germany and France and 38 per cent in Italy.

International bond issues reached a new peak of \$832 billion in 1997, benefiting mainly from the decline in long-term interest rates. The flow of new issues was concentrated in the first three quarters of the year, the increased risk associated with the Asian crisis leading to a sharply reduced issue volume in the last quarter. The growth occurred in all segments of the market: issues of fixed rate bonds rose by 17 per cent over the year to \$546 billion, floating rate issues by 29 per cent to \$213 billion and issues of convertible bonds and bonds with warrants by 13 per cent to \$39 billion.

The rapid growth in the use of financial derivatives resumed. The volume of outstanding futures contracts rose by about 26 per cent, compared with only 1.7 per cent in 1996; options increased by 20.2 per cent. At the end of last year the notional value of futures and options stood at \$7.8 trillion and \$4.4 trillion respectively, compared with \$6.2 trillion and \$3.7 trillion at the end of 1996.

International banking activity picked up, increasing by 8.5 per cent in 1997. Lending expanded by \$530 billion overall to total \$9 trillion; net of interbank loans it rose by \$420 billion to \$5.3 trillion. The growth in cross-border deposits also accelerated, from 3.4 to 9.1 per cent; at the end of the year the volume outstanding amounted to \$8.8 trillion, or \$2 trillion net of interbank deposits.

WORLD TRADE AND THE BALANCE OF PAYMENTS

World trade and the prices of raw materials

The growth in the volume of world trade in goods and services rose from 6.6 per cent in 1996 to 9.4 per cent in 1997; this was one of the fastest rates of increase since the beginning of the seventies and reflected an acceleration in the foreign trade of both industrialized and developing countries. Merchandise trade alone grew by 9.6 per cent.

Merchandise exports by the developing countries as a whole rose by almost 11 per cent; the rate of increase for the Asian economies, which had slowed down in 1996, rose to 13.5 per cent, near to the average for the nineties, boosted by the large devaluation of the currencies of some of the countries in the region.

The rate of growth of world trade in services, expressed in current dollars, fell from more than 5 per cent in 1996 to 2.5 per cent. The share of the developing countries increased further, to around 20 per cent of the total. Overall exports of services amounted to over \$1.3 trillion, more than one fifth of world trade.

In 1998 world trade will be affected by the fall in output in the Asian economies in crisis, economic stagnation in Japan and slower growth in the other developing countries, especially those in Latin America; it will be sustained by the economic expansion under way in Europe and the United States. According to forecasts from international organizations, the overall increase in trade in goods and services will exceed 6 per cent in volume terms; while this figure is more than 3 percentage points lower than that recorded in 1997, it is not dissimilar to the average for the first half of the nineties.

The average price of the three main grades of crude oil was \$19.20 a barrel in 1997, more than 6 per cent less than a year earlier. Prices were affected by oversupply, which in turn was attributable partly to non-compliance with the production quotas set by OPEC and the strong

expansion in supply by other producers, and partly to lower than expected demand due both to particularly favourable climatic conditions and the consequences of the Asian crisis.

The index of prices of non-fuel raw materials fell by an annual average of just under 4 per cent, with most of the decline occurring in the second half of the year in connection with the Asian crisis. The fall in the prices of food and agricultural products, by 10 and 8 per cent respectively, more than offset the rise of 3 per cent in the prices of metals and that of 32.6 per cent in the prices of beverages, which were affected by poor harvests. The index continued to fall during the first quarter of this year, when it was 4.4 per cent lower than in the preceding quarter, on account of the persistent weakness of world demand and the further appreciation of the dollar. The IMF estimates that the index will decline by about 7 per cent on average in 1998.

The balance of payments

The current account imbalances of the United States and Japan increased further in 1997, reflecting primarily the re-emergence of a cyclical disparity between the two economies. So far as the balances of the main groups of countries are concerned, the surplus of the industrial economies vis-à-vis the rest of the world increased from \$25 to 42 billion, the deficit of the developing countries rose from \$74 to 82 billion and that of the countries of Central and Eastern Europe and the former USSR increased slightly to \$26 billion (Table 2). The current account deficit of the five Asian economies worst affected by the crisis (South Korea, the Philippines, Indonesia, Malaysia and Thailand) fell from about \$55 billion in 1996 to \$27 billion last year as a result of the dramatic depreciation of their currencies and, above all, the sharp fall in domestic demand.

The current account deficit of the United States reached \$166 billion last year, equal to 2.1 per cent of GDP. Japan's current account surplus, which had declined briefly in 1996, increased substantially to \$94 billion and from 1.4 to 2.2 per cent of GDP; the growth was due mostly to an increase in the trade surplus from \$84 to 101 billion, after three years of decline. In the European Union strong export growth led to a further slight increase in the current account surplus, from \$91 to 116 billion, or 1.4 per cent of GDP, notwithstanding the pick-up in domestic demand.

In 1998 the need for the crisis-stricken Asian economies to reduce their current account deficits in order to offset the contraction in inflows of capital will have a serious impact on the current accounts of the rest of the world. The latest IMF forecasts, which assume a gradual, albeit

modest recovery in inflows of private capital in the second half of the year, indicate that the current account balances of the five worst affected economies will improve by almost \$50 billion compared with 1997; more than half this figure is likely to be attributable to South Korea alone, where the current account is expected to swing from a deficit of \$9 billion to a surplus of \$15 billion.

Table 2

**CURRENT ACCOUNT BALANCES
OF MAJOR COUNTRIES OR COUNTRY GROUPS**

	Billions of dollars				As a percentage of GDP			
	1995	1996	1997	1998 (1)	1995	1996	1997	1998 (1)
Industrial countries	34.5	25.1	41.9	-27.6	0.2	0.1	0.2	-0.1
<i>United States</i>	-129.1	-148.2	-166.4	-227.8	-1.8	-1.9	-2.1	-2.7
<i>Japan</i>	111.4	65.8	94.1	120.8	2.2	1.4	2.2	3.0
<i>EU</i>	53.3	90.9	115.8	92.8	0.6	1.1	1.4	1.1
<i>Germany</i>	-22.6	-13.8	-1.4	-0.4	-1.0	-0.6	-0.1	..
South Korea	-8.9	-23.7	-8.9	15.4	-2.0	-4.9	-2.0	5.5
Developing countries	-94.4	-74.3	-82.1	-87.2	-2.0	-1.4	-1.5	-1.5
<i>Asean-4 (2)</i>	-31.9	-30.7	-18.2	4.1	-6.0	-5.2	-3.2	1.4
Countries of Central and Eastern Europe and the former USSR	-3.9	-19.4	-25.6	-33.0	-0.5	-2.1	-2.7	-3.3
Sources: IMF and national statistics. (1) Forecasts. – (2) Indonesia, Malaysia, the Philippines and Thailand.								

According to the IMF forecasts, the United States will absorb most of the additional exports on account of the real appreciation of the dollar and the persistence of a growth differential in domestic demand vis-à-vis Europe and Japan. As a result, the US current account deficit is expected to rise to around \$230 billion, or 2.7 per cent of GDP. The surplus of the EU is likely to decline only slightly, from 1.4 to 1.1 per cent of GDP. In Japan the adverse balance-of-payments effects of the fall in exports to the Asian economies in difficulties, which account for almost 20 per cent of Japan's total sales abroad, should be more than offset by the impact of the persistent weakness of domestic demand; the current account surplus is forecast to increase significantly, to \$121 billion, or 3 per cent of GDP. Viewed in global terms, the result is expected to be a widening of the disparity in the net external positions of the two leading world economies, bringing a risk of tensions in the international pattern of exchange rates or in trade relations.

Financial flows to the non-industrialized countries

In 1997 net financial flows to the non-industrialized countries amounted to \$244 billion, slightly less than in the previous year (Table 3). The flow of funds to Asia fell by about \$40 billion, while those to Latin America and the economies of Central and Eastern Europe and the former USSR rose slightly.

Foreign lending declined from \$108 to 90 billion. The decrease disguises contrasting trends in the main components, however; net official financing swung from an outflow of about \$8 billion in 1996 to an inflow of more than \$21 billion last year, whereas private lending by banks and other lenders fell sharply from \$116 to 69 billion.

Table 3

FOREIGN FINANCING TO DEVELOPING COUNTRIES, CENTRAL AND EASTERN EUROPE AND COUNTRIES OF THE FORMER USSR (net flows in billions of dollars)

	1993	1994	1995	1996	1997	1998 (1)
Total net financing (2)	190.5	163.4	254.1	246.5	244.1	195.8
Africa	12.0	21.2	21.4	19.1	20.1	19.2
Latin America	69.8	63.5	79.2	81.7	101.9	87.4
Asia	71.3	72.6	104.6	114.7	73.4	34.0
Middle East (3)	22.0	1.3	9.4	13.9	14.3	19.2
Central and Eastern Europe and countries of the former USSR	15.5	4.9	39.6	7.2	34.4	36.1
Foreign loans (2)	99.2	60.5	144.8	107.8	90.3	54.2
From official creditors	24.4	-0.3	53.1	-8.1	21.5	32.1
From banks	-5.1	-27.7	4.8	19.4	-3.0	-12.4
From other lenders	79.8	88.5	86.9	96.6	71.8	34.7
Other flows (2)	91.3	103.0	109.3	138.7	153.7	137.8
Capital transfers (4)	7.3	3.6	0.6	8.2	4.9	7.4
Direct and portfolio investment	84.0	99.4	108.7	130.6	148.8	130.4

Source: IMF.

(1) Forecasts. - (2) Rounding may cause discrepancies in totals. - (3) Including Cyprus, Malta and Turkey. - (4) Including debt cancellation and other transfers, as defined in the fifth edition of the IMF Balance of Payments Manual.

These developments were the result of the geographical redistribution of private portfolios in the wake of the Asian crisis on the one hand and the aid packages put together last year to tackle the crisis on the other. The IMF

coordinated substantial support measures for the three countries worst affected, namely South Korea, Indonesia and Thailand. The international community's commitments in this context total about \$110 billion; more than \$50 billion will be provided under bilateral agreements, including \$19 billion from Japan alone, and the remainder will come from the IMF, the World Bank and the Asian Development Bank. The IMF has granted loans totaling \$35 billion, almost \$22 billion of which had been paid out by mid-May.

THE ITALIAN ECONOMY

Despite the rapid and large reduction in the budget deficit, which was brought below the threshold for participation in European monetary union, the pace of economic growth returned to an appreciable level in 1997, benefiting from the recovery in international economic activity and the curbing of inflation. The prudent monetary stance and continued cooperation between employers and trade unions helped to strengthen expectations of price stability.

Output rose by 1.5 per cent. The increase in consumer prices was kept below 2 per cent, despite brief periods of upward pressure. As the year progressed, labour contracts gradually took account of the improvement in expectations. Gross fixed investment stagnated. Household consumption increased by 2.4 per cent, partly owing to government incentives for the purchase of motor vehicles. Employment in industry reacted fairly rapidly to the pick-up in demand, but the unemployment rate still rose slightly from an already very high level. Although slightly smaller than in 1996, the large surplus on the current account of the balance of payments virtually completed the elimination of Italy's net external debtor position.

Disinflation

The reduction in inflation became more pronounced in 1997. The harmonized consumer price index increased by an annual average of 1.9 per cent, 2.1 percentage points less than in 1996. Italian inflation had not been so low since 1968.

The inflation differential in relation to the average for the eleven countries that will form the euro area in January 1999 was virtually eliminated, falling from 1.7 percentage points in 1996 to 0.3 points last year. The differentials vis-à-vis France and Germany were 0.6 and 0.4 points

respectively. Since last July Italy has met the convergence criterion for prices laid down in the Maastricht Treaty.

The rise in the general consumer price index was virtually the same as that in the harmonized index: 2.0 per cent, compared with 4.0 per cent in 1996. The household consumption deflator for the national accounts also declined, from 4.4 to 2.4 per cent.

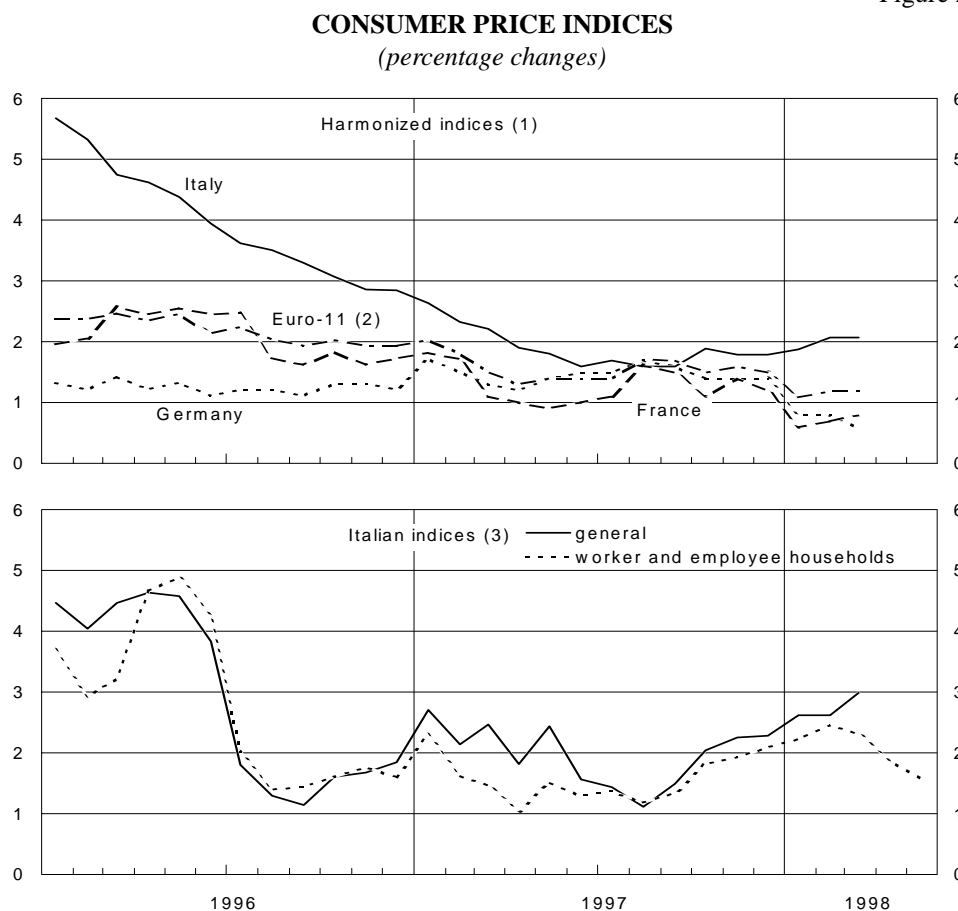
The slowdown in prices was not uniform during the year. Inflation fell sharply until the summer; in the second half of the year, however, it rose slightly, whereas in the other European countries it fell owing to extremely slow wage growth. Inflation differentials therefore began to widen again, having narrowed in the first half of the year (Figure 2). The appreciation of the dollar, the difficulties in reaching agreement on the labour contract for metal and engineering workers in the early part of the year and the partial restoration of purchasing power eroded in previous years were the main causes of the modest and temporary increase in inflation. Another factor was the adjustment of VAT rates in the autumn, although the impact was smaller than expected. However, these developments did not jeopardize the underlying disinflationary trend that had begun in the spring of 1995. The stabilizing effect of the firm monetary policy stance on expectations meant that progressively smaller wage increases could be agreed in the remaining private sector labour contracts.

The producer prices of manufactures were the first to reflect the impact of the temporary inflationary pressures. Nevertheless, the tensions had already begun to ease in December of last year, when the annualized and seasonally adjusted three-month rate of increase declined to 2 per cent.

The prices of manufactures sold in the domestic market rose by an annual average of 1.3 per cent, 0.6 points less than in 1996. Manufacturers' unit variable costs rose by 1.2 per cent, compared with 3.8 per cent the previous year. The prices of foreign inputs fell by 0.7 per cent, while those of domestic inputs rose by only 0.7 per cent, far less than in 1996, largely reflecting the behaviour of prices in the service sector. The rate of increase in unit labour costs fell from 6.0 to 2.4 per cent as the impact of rising wages, especially in the first half of the year, was offset by continued productivity gains.

The difference between the average annual increase in costs and that in prices caused profit margins to narrow, although they remained high in historical terms. As the recovery progressed, firms passed some of the increase in costs through to prices, reducing the erosion of margins suffered in the first half of the year.

Figure 2



Sources: Based on Eurostat and Istat data.

(1) 12-month percentage changes. - (2) The weighted average of the indices of the 11 countries that will adopt the euro. The weights are based on final consumption in 1996 translated into the same currency using the bilateral conversion rates announced on 2 May 1998. The weights are adjusted each January by Eurostat on the basis of the percentage change in the harmonized consumer price index the previous December. - (3) Annualized and seasonally adjusted 3-month percentage changes. The index for worker and employee households excludes tobacco products.

The lira prices of exported manufactures, which had increased by almost 3 per cent in 1996, fell by an annual average of 0.9 per cent last year. The difference in relation to prices of manufactures sold in the domestic market diminished, reflecting firms' efforts to regain market share eroded by the loss of competitiveness the previous year. As a result, firms producing for export saw their profit margins narrow more sharply than firms producing for the domestic market.

Short-term inflation expectations improved throughout the year, although they continued to underestimate the size of the effective decline in inflation, as they had in 1996. The picture is confirmed by the behaviour of 1-year forward rates nine years ahead, which are less affected by the impact of short-term factors on inflation expectations. In 1997 this indicator rapidly

converged towards the corresponding German rate, and by the end of the year the differential had been virtually eliminated.

The recovery

Gross domestic product grew by 1.5 per cent in 1997, compared with 0.7 per cent in 1996 (Table 4). The delayed start of the recovery in Italy meant that growth was slower than in the other EU countries for the second consecutive year. The behaviour of the index of industrial production, seasonally adjusted and corrected for the number of working days, shows a weakening of the expansion that occurred in the industrial sector at the beginning of the year, as had been correctly predicted by the surveys of the trend in orders (Figure 3).

Table 4

RESOURCES AND USES OF INCOME

	1996			1997		
	Percentage changes		Contribution to GDP growth at constant prices	Percentage changes		Contribution to GDP growth at constant prices
	Values at constant prices	Deflators		Values at constant prices	Deflators	
Resources						
Gross domestic product	0.7	5.0	0.7	1.5	2.6	1.5
Imports of goods and services	-2.0	-1.8	0.4	11.8	-0.5	-2.5
<i>of which: goods</i>	-2.9	-1.4	0.6	11.2	-0.8	-2.1
Uses						
Domestic demand	0.3	4.2	0.3	2.5	2.6	2.4
Household consumption	0.8	4.4	0.5	2.4	2.4	1.4
Collective consumption	0.2	7.2	..	-0.7	4.8	-0.1
Gross fixed investment	0.4	3.1	0.1	0.6	1.7	0.1
<i>of which: machinery, equipment and transport equipment</i> ...	-0.3	3.6	..	2.6	1.0	0.2
<i>buildings</i>	1.1	2.5	0.1	-1.6	2.6	-0.1
Change in stocks (1)	-	-	-0.3	-	-	1.0
Exports of goods and services	-0.2	2.2	-0.1	6.3	-0.1	1.6
<i>of which: goods</i>	-0.1	2.1	..	5.1	-0.6	1.1
Source: Istat. (1) Includes statistical discrepancies.						

The recovery in output was sustained by the growth in exports, household consumption and, following an initial reduction, the replenishing of stocks to meet higher demand. Investment continued to stagnate, partly owing to the decline in residential construction. Nevertheless, much of the

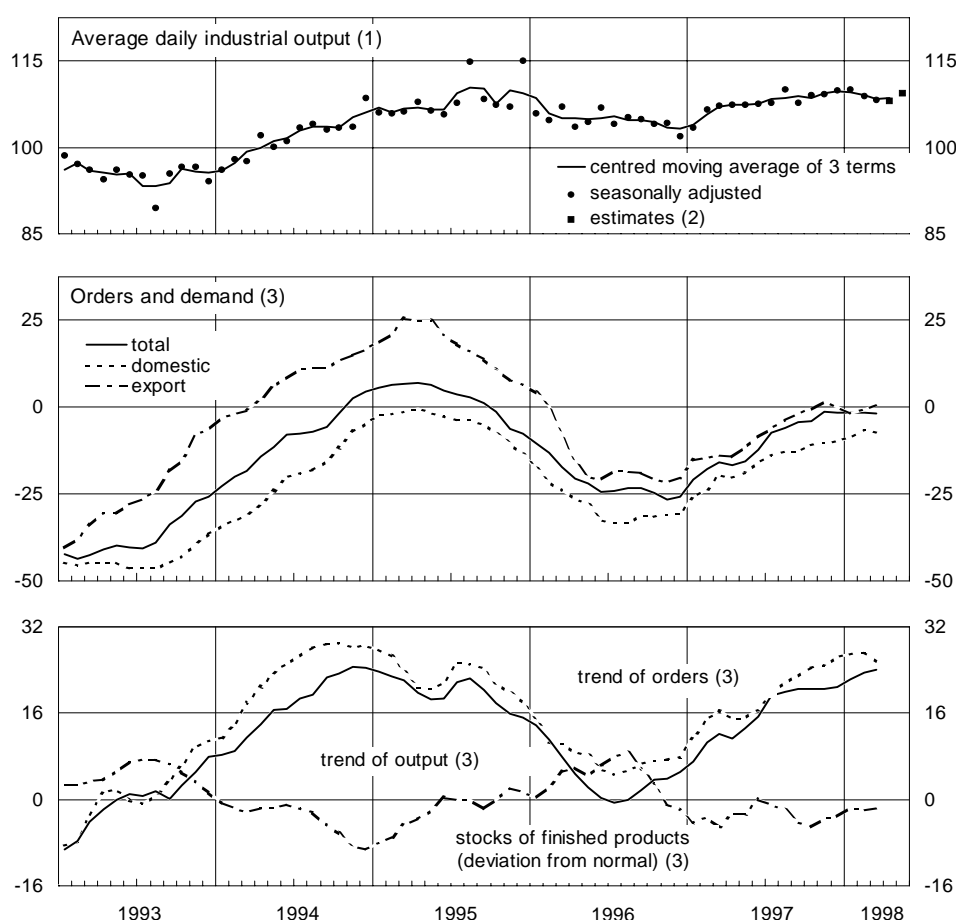
strong stimulus from domestic and foreign demand fed through to imports, so that net exports cropped about 1 percentage point off GDP growth.

Real household consumption increased by 2.4 per cent, of which 1 percentage point was due to the increase in spending on motor vehicles; its contribution of 1.4 points to GDP growth was the largest recorded since 1991.

Households' real gross disposable income, corrected for the reduced erosion of the purchasing power of net financial assets, increased by 1.8 per cent. It was boosted by the increase in wages and salaries made possible by monetary stability, while the measures that had to be taken to reduce the budget deficit worked in the opposite direction. The weakening of corporate profits led to a slight fall in the disposable income of the private sector as a whole.

Figure 3

INDUSTRIAL OUTPUT, DEMAND AND STOCKS



Sources: Based on Istat and Isco data.

(1) Index, 1990=100. Data adjusted for the different number of working days in the month. - (2) Based on electricity consumption and Isco indicators. - (3) Three-month moving averages of the difference between positive replies ("high", "increasing") and negative replies ("low", "decreasing") to Isco surveys of businessmen. Seasonally adjusted except for stocks of finished products.

The saving ratio of consumer households, calculated on the basis of income corrected for inflation expected during the year, fell from 10.9 per cent in 1996 to 10.5 per cent in 1997, a new low. The saving ratio of the private sector as a whole declined by 2 percentage points.

Excluding the effect of government incentives, which are estimated to have been responsible for about half of the increase in purchases of motor vehicles, the average propensity to save would have been virtually the same as in 1996, as households probably used part of the income initially earmarked for saving to take advantage of subsidies for the purchase of a durable good. Excluding temporary factors, the stability of the propensity to consume reflects households' continued uncertainty about their future spending capacity.

The aggregate behaviour of consumption probably masked differences in spending according to income level. Isco data show that persons in low and middle-income brackets saw a reduction in their room for manoeuvre in saving decisions, expressed as the difference between net monthly income and the income households considered necessary to maintain their standard of living.

Collective consumption fell by a further 0.7 per cent, bringing the decline in the last four years to 2.0 per cent. By reducing the budget deficit, the restrictive fiscal measures compensated for the decline in private sector saving. As a result, the propensity to save in the economy as a whole did not vary significantly.

The rise in purchases of transport equipment also involved firms, which increased their investment in this segment by about 8 per cent. They also stepped up spending on machinery and equipment, which stagnated in the first half of the year but accelerated considerably thereafter, increasing by 2.6 per cent in 1997 as a whole as a consequence of the consolidation in the level of industrial output and the fall in nominal and real interest rates. Greater investment in public works and non-residential buildings also made a positive contribution. By contrast, investment in residential buildings again fell, continuing a long-term downward trend associated primarily with the decline in the birth rate that has been evident in Italy and most of the other industrial countries for some time now; in 1997, however, the negative divergence from the downward-sloped trend line was considerable (-4.4 per cent). Consequently, the overall increase in gross fixed investment amounted to only 0.6 per cent, little more than in 1996.

The capacity utilization index equalled the peak recorded at the end of 1995, although some unused capacity remained. In particular, sectors producing intermediate goods appear to have run into capacity constraints.

The increase in capacity utilization, the recovery in domestic and foreign demand, the need to adjust stocks of raw materials, semi-processed

goods and finished products and the attractiveness of subsidies for the purchase of imported as well as domestically produced transport equipment gave a considerable boost to imports, which increased by 11.8 per cent according to current national accounts estimates. Exports also grew rapidly (by 6.3 per cent), benefiting from the recovery in economic activity and world trade. The increase was smaller than that recorded by Italy's main competitors, primarily owing to the loss of competitiveness in the previous two years.

The surplus on the current account of the balance of payments remained very large, although it fell from 3.4 to 3.2 per cent of GDP. The decline was attributable to a fall in the surplus on merchandise trade from 93.8 to 79.9 trillion lire *fob-fob*, or from 5.0 to 4.1 per cent of GDP. The deficit on invisibles declined by nearly half, from 30.4 to 17.4 trillion lire, thanks to an improvement in the balance on unrequited public transfers vis-à-vis the EU and on investment income. By the end of the year Italy's net external debtor position, at current prices and exchange rates, had been practically eliminated, whereas barely five years previously it had been equivalent to 11 per cent of GDP.

Employment was still declining in January 1997, but it subsequently staged a hesitant recovery that did not gain momentum until January 1998. There was no change over the year as a whole. Only a fraction of the jobs lost since mid-1992 has been recouped over the last three years. The average unemployment rate rose from 12.1 in 1996 to 12.3 per cent last year. Once again the service sector offset the fall in employment in the other sectors, albeit not completely. There were significant variations in employment according to region and type of employment. In particular, self-employment contracted by 0.6 per cent in terms of full-time equivalent positions. The reduction, which was concentrated in the distributive trades, does not alter one of the most distinctive features of Italian employment: self-employment still accounts for more than 31 per cent of total standard labour units, compared with an average of 10 per cent in the rest of the EU.

In March 1998 the Government tabled a bill that provides for setting the normal working week in firms with more than 15 employees at 35 hours from 2001 onwards. Actual working hours will be determined by negotiation between employers and trade unions. A preliminary evaluation based on a variety of assumptions regarding trends in contractual and de facto working hours in manufacturing (which historically have differed quite considerably) indicates that, for a given level of per capita contractual wages and the present wage setting mechanisms, the new working hours would result in a significant increase in labour costs and have adverse effects on employment. Agreement between employers and trade unions on flexibility in the utilization of labour could significantly reduce the extra cost. In that case, the employment impact would be uncertain but not very large. The

extension of shift working, part-time jobs, fixed-term contracts and temporary employment in recent years are manifestations of a tendency towards greater flexibility in the deployment of labour in the production process.

According to the Association for Industrial Development in Southern Italy, the economic recovery spread to the South last year but growth was considerably slower than in the Centre and North (0.9 per cent, as against 1.7 per cent). The behaviour of participation and employment rates underscored the differences in the efficiency of local labour markets. Whereas in the Centre and North the annual average unemployment rate remained unchanged at 7.6 per cent, in the South it rose from 21.7 to 22.2 per cent. By contrast, the average unemployment rate in the European Union declined slightly, from 10.8 to 10.6 per cent. The January 1998 labour force survey showed that the differential between the two parts of Italy widened further, from 13.7 to 14.9 percentage points. The only counterpoint, which is confirmed by preliminary indicators of output and investment, is the renewed creation of jobs in manufacturing industry, which in some districts of the South appears to be emulating the successful pattern of development of local networks of firms in the Centre and North. The coincidence of unemployment and regional underdevelopment has combined with these initial signs of a revival of productive activity to steer regional development policy towards promoting and exploiting local initiatives, within the framework of area contracts and territorial agreements. Such accords are still relatively few and limited in scope, but their potential is great.

Recent developments and the outlook for 1998

The moderate inflationary pressures that developed in the second half of 1997 eased in the first five months of this year. The seasonally adjusted annualized three-month rate of increase in the producer prices of non-energy goods dropped from 2.7 per cent in November to 0.2 per cent in March. The differential with respect to Germany, measured in terms of twelve-month rates of increase, began to narrow again, falling from 0.6 points in February to 0.3 points in March. The seasonally adjusted annualized three-month rate of increase in the consumer price index for worker and employee households, net of tobacco products, declined from 2.5 per cent in February to 1.6 per cent three months later. However, the differential with France and Germany in the twelve-month increase in the harmonized CPI, which is slower to reflect changes in inflation, continued to widen, reaching 1.3 and 1.5 points respectively in March.

In accordance with market expectations, the average annual rise in the CPI in 1998 will be only slightly higher than in 1997 owing to the fact that

the effects of the revision of VAT rates and the appreciation of the dollar will drop out of the index and, above all, to the pronounced slowdown in unit labour costs. The deceleration in unit labour costs will be the result of slower wage growth, thanks to the perception that the process of disinflation led by monetary policy was stable and to an acceleration in productivity gains. In contrast to 1997, this will permit a simultaneous increase in real wages and in the share of income going to private sector profits.

Despite the pause in the growth of industrial output in the first five months of the year, owing in part to the Asian crisis, industrial firms generally continued to expect production to increase and orders for capital goods to pick up.

The growth in GDP could exceed 2 per cent this year. Employment should show a modest increase and the unemployment rate should decline slightly.

The gains in competitiveness achieved in 1997 and 1998 are expected to result in faster export growth than in 1997, more than offsetting the effects of the slowdown in the growth of world trade, which will nonetheless continue to expand at a rapid pace, barring further deflationary effusions from Asia. On the prevailing market assumption that international interest rates at the end of the year will be only slightly above their current level, gross fixed capital formation, and particularly investment in machinery, equipment and transport equipment, will be sustained by the good prospects for the growth of aggregate demand, by an easing of uncertainty about the stability of demand and above all by a reduction in real interest rates as a result of the convergence of Italian rates with those obtaining elsewhere in the euro area. Manufacturing firms' investment plans revealed in the Bank of Italy survey confirm expectations of a surge in fixed capital formation in 1998.

Household consumption is likely to grow at a marginally slower rate, owing entirely to the fact that the general incentives offered in 1997 for purchases of motor vehicles ceased to have a stimulatory effect in the second quarter. An increase in the disposable income of the private sector, thanks to the less restrictive fiscal stance and a further decline in expected losses on net financial assets, should generate a sharper rise than last year in spending on non-durable goods.

The growth in domestic demand is expected to be more moderate than in 1997, not only on account of the slowdown in consumption growth but also because of a halt in stockbuilding after last year's rapid expansion. Together with the waning of the exceptional effect of incentives for the purchase of motor vehicles, this should bring the rate of import growth down to about the rate of export growth. An intimation of future developments can be gleaned from the trade figures for the first quarter, when on a seasonally

adjusted basis imports and exports grew at about the same rate, resulting in a slight improvement in the balance. The current account surplus is likely to amount to about 3.5 per cent of GDP in 1998, with no significant change in the terms of trade.

Macroeconomic estimates based on past behaviour suggest that if European interest rates conform to current market expectations, then sustained growth in world demand, wage increases consistent with Italian inflation in line with levels elsewhere in Europe and the pursuit of the public finance objectives set out in the Economic and Financial Planning Document would set the Italian economy on a medium-term growth path of around 2.5 per cent. Domestic demand is likely to remain subdued owing to households' continued caution about spending. In the four years from 1998 to 2001 employment should increase moderately and the unemployment rate decline slightly.

Higher rates of growth in output and employment could be produced by further liberalization in product markets and the development of flexible ways of deploying resources and setting company and regional wage levels consistent with the institutional and contractual changes that have recently occurred. Such developments could alter current patterns of behaviour. Membership of a single currency area makes it much more important than in the past for relative prices and factor use to adjust rapidly to external shocks, especially if they have uneven effects on the area. Capitalizing on market initiatives is also the proper objective of regional development policies, which are needed to reduce the economic backwardness of the South of Italy by comparison with the North of the country and the central regions of the European Union.

DEMAND

Last year's recovery in economic activity was sustained by domestic demand, and in particular by households' consumption and stockbuilding by firms. The growth in private consumption came mainly from motor vehicle purchases, which benefited from government incentives for scrapping old vehicles; the increase in consumer spending on other items was more modest. Gross fixed investment continued to stagnate, reflecting above all the recession in the construction industry. The contribution of foreign trade to the growth in output was negative, owing to the exceptionally large rise in imports, especially of motor vehicles. Exports, whose growth was curbed by the loss of price competitiveness recorded in 1996, expanded less rapidly than world trade and only about half as fast as imports. According to provisional quarterly national accounts data, the seasonally adjusted quarter-to-quarter rate of growth in GDP surged in the spring of 1997, led by stockbuilding and households' consumption, and then subsided to more moderate values.

Households' consumption

Domestic consumption of goods and services increased by 2.4 per cent in real terms in 1997, a sharp acceleration from the modest growth of 0.8 per cent recorded in 1996 (Table 5). Consumption in Italy by non-residents contributed 0.3 percentage points, compared with a negative effect of 0.2 points the previous year, reflecting essentially the cyclical upswing in their own countries, which fueled the tourist inflow. Excluding this component and including spending by Italians abroad, which increased by 14.0 per cent, Italian households' consumption rose at the same rate as domestic consumption and thus finally exceeded its 1992 level.

Consumer spending, which was especially robust in the first half, when it expanded at an annualized rate of nearly 4 per cent, lost momentum in the second half owing to a slowdown in motor vehicle purchases and a temporary bout of uncertainty over the political situation. The impact of the latter factor is confirmed by the Isco index of households' confidence, which after reaching cyclical peak levels in September fell by the end of the year to about its average level for 1996 (Figure 4).

The disposable income of consumer households increased by 2.6 per cent at current prices in 1997, remaining essentially unchanged in real terms (Table 6). However, adjusting for the decreased monetary erosion of net financial assets resulting from the decline in expected inflation for the year, the growth in income works out to 4.4 per cent at current prices, or 1.8 per cent in real terms.

Table 5

HOUSEHOLDS' CONSUMPTION
(at 1990 prices; percentage changes)

	% share in 1997	1994	1995	1996	1997
Non-durable goods	31.6	-0.4	0.9	0.6	0.9
of which: food	17.7	-0.1	-0.5	-1.3	0.3
Semi-durable goods	19.1	2.4	2.7	-1.8	2.9
Durable goods	11.6	0.8	1.3	-0.3	8.6
of which: furniture and carpets	2.6	2.3	1.7	-3.1	-2.2
electrical household appliances and household equipment	1.0	4.3	-1.3	-7.0	5.6
therapeutic equipment and goods, photographic equipment and musical instruments, radio and television receiving sets and record players ...	2.2	5.6	3.2	1.7	-3.1
transport equipment	4.1	1.0	1.2	0.8	31.8
precious and costume jewellery	1.7	-8.6	..	3.4	-0.2
Services	37.7	2.7	2.5	2.7	1.6
Total domestic consumption ...	100.0	1.4	1.9	0.8	2.4
Residents' consumption abroad	-	-16.5	8.8	5.5	14.0
Non-residents' consumption in Italy	-	6.4	16.0	-4.8	7.8
Total national consumption	-	0.9	1.4	1.2	2.4
<i>Memorandum item:</i>					
Implicit price deflator of national consumption .	-	4.6	5.9	4.3	2.5
Source: Istat.					

Given the increase in consumption, the average propensity to save, based on income adjusted for expected inflation for the year, fell by nearly half a percentage point, more than offsetting the modest rise of the previous year (Table 6). If the rise in domestic consumption were calculated net of the effects of the incentives for car scrapping, the average propensity to save would have remained virtually unchanged, reflecting not inconsiderable lingering uncertainty among households over their future spending capacity.

Despite a decline of nearly 3.5 percentage points over the past five years, Italy's household saving rate remains among the highest in the industrial world. Last year only France, with a sharp increase in the propensity to save, recorded a higher figure than Italy; elsewhere the propensity to save diminished, but less than in Italy.

Table 6

GROSS DISPOSABLE INCOME AND AVERAGE PROPENSITY TO SAVE
(at current prices unless specified)

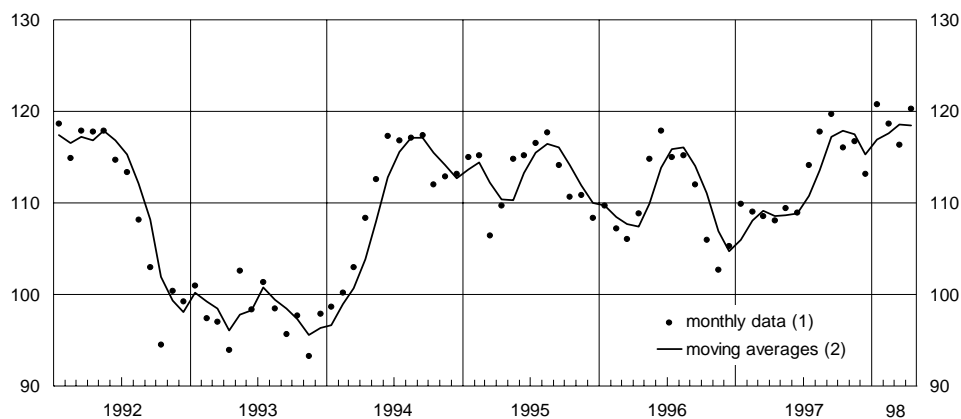
	1994	1995	1996	1997
<i>Percentage changes</i>				
Wages and salaries net of employees' social security contributions	1.7	3.0	4.4	3.2
<i>per capita compensation of employees</i>	2.9	4.6	6.1	4.6
<i>total social security contributions (1)</i>	0.2	-1.1	-1.5	-1.4
<i>employee labour units</i>	-1.4	-0.5	-0.1	..
Self-employment income net of social security contributions	4.2	6.9	6.0	4.0
<i>per capita self-employment income</i>	4.9	7.1	5.0	4.4
<i>total social security contributions (1)</i>	0.5	-0.5	0.5	0.2
<i>self-employed labour units</i>	-1.2	0.3	0.4	-0.6
Net property income (2)	0.4	11.9	3.7	-2.6
Social security benefits and other net transfers	5.7	4.3	7.1	6.7
<i>of which: net social security benefits</i>	5.4	4.5	7.1	6.1
Current taxes on income and wealth (-)	-4.5	5.9	8.0	6.2
Gross disposable income of households (3)	4.2	6.0	4.9	2.6
at 1990 prices (4)	-0.4	0.1	0.6	0.1
at 1990 prices, adjusted for expected inflation (5)	-0.5	0.3	1.5	1.8
at 1990 prices, adjusted for past inflation (6)	0.8	-2.1	4.4	1.7
Gross disposable income of the private sector	6.5	8.0	4.5	1.0
at 1990 prices (4)	1.8	2.0	0.2	-1.5
at 1990 prices, adjusted for expected inflation (5)	1.7	2.2	0.9	-0.3
at 1990 prices, adjusted for past inflation (6)	2.8	0.3	3.2	-0.4
<i>Percentages</i>				
Households' average propensity to save (3) (7)	17.1	16.0	15.4	13.6
calculated on income adjusted for expected inflation ..	11.8	10.7	11.0	10.6
calculated on income adjusted for inflation	11.9	8.8	11.6	11.0
Average propensity to save of the private sector (7)	28.0	28.4	27.8	25.0
calculated on income adjusted for expected inflation ...	24.3	24.9	24.7	22.7
calculated on income adjusted for inflation	24.4	23.6	25.1	23.1

Sources: Based on Istat and Bank of Italy data; for 1997, partly estimated.

(1) Change in net wages and salaries and net self-employment incomes attributable to social security contributions, in percentage points; a minus sign indicates an increase in contributions. – (2) Comprises gross operating surplus (primarily actual and imputed rents), net income from land and intangible assets, net interest, dividends and other profits distributed by companies. – (3) Consumer households, including private non-profit institutions. – (4) Deflated using the implicit price deflator of national consumption. – (5) Gross disposable income net of expected losses on net financial assets due to inflation (estimated from the results of the Forum-Mondo Economico survey); deflated using the implicit price deflator of national consumption. – (6) Gross disposable income net of actual losses on net financial assets due to inflation; deflated using the implicit price deflator of national consumption. – (7) Ratio between saving, before deduction of depreciation and net of the change in severance pay and pension funds, and the gross disposable income of the sector.

Figure 4

CLIMATE OF CONFIDENCE AMONG CONSUMER HOUSEHOLDS
(indices 1980=100)



Source: Based on Isco data.

(1) Until 1994 no survey was conducted in August; the data for that month were calculated as simple averages of adjacent data. Since January 1995 interviews have been conducted by telephone and the interviewee is no longer necessarily the head of household but any adult member who contributes to the income of the household. - (2) Three-month moving average ending in the reference month.

The gross disposable income of the private sector as a whole increased less than that of consumer households, or by 1.0 per cent at current prices. This reflects the significant decrease in undistributed profits of firms, notably those of sole proprietorships, which fell by 9.5 per cent. A period of expansion stretching from 1993 to 1996, during which saving by firms grew at an average annual rate of 15 per cent, thus came to an end. As a result, the propensity to save in the private sector as a whole declined by 2 points to 22.7 per cent, based on income adjusted for expected inflation. As the general government deficit shrank from 3.2 to 0.1 per cent of gross disposable income, for the national economy as a whole the propensity to save remained almost unchanged at 20.7 per cent. (Table 7).

Table 7

GROSS SAVING AND INVESTMENT
(as a percentage of gross national disposable income)

	Average 1971-1980	Average 1981-1990	1991	1992	1993	1994	1995	1996
General government saving	-4.3	-6.3	-5.9	-7.3	-5.6	-5.6	-4.1	-3.3
Private sector saving	29.7	27.8	24.7	24.8	23.9	24.7	25.1	24.2
of which: consumer households	18.3	16.1	15.4	15.8	14.1	13.1	12.2	11.6
Gross national saving	25.4	21.5	18.8	17.5	18.3	19.1	21.0	20.9
Gross investment	25.6	22.5	21.0	20.0	17.3	17.7	18.5	17.4
<i>Memorandum item:</i>								
Balance of current account transactions with the rest of the world	-0.2	-1.0	-2.2	-2.5	1.0	1.4	2.5	3.5

Source: Based on Istat data.

Investment

The increase in gross fixed investment was modest for the second consecutive year, amounting to 0.6 per cent in real terms. The ratio of gross investment to GDP held at the level of recent years, slightly below 18 per cent. Net of depreciation, fixed investment decreased by 3.9 per cent (Table 8).

Table 8

FIXED INVESTMENT (at 1990 prices; percentage changes and percentages)

	Percentage change			As a percentage of GDP		
	1995	1996	1997	1995	1996	1997
Construction	0.6	1.1	-1.6	8.6	8.6	8.3
<i>of which: residential buildings</i>	-1.7	-3.4	-4.4	4.9	4.7	4.4
<i>non-residential buildings</i> <i>and public works</i>	3.9	7.0	1.8	3.7	3.9	4.0
Machinery, equipment and sundry products	11.4	0.6	1.2	7.3	7.3	7.3
Transport equipment	24.0	-3.7	7.9	1.9	1.8	2.0
<i>of which: motor vehicles</i>	28.8	-2.4	9.1	1.6	1.6	1.7
<i>other</i>	4.6	-10.1	1.6	0.3	0.3	0.3
Total gross fixed investment	7.1	0.4	0.6	17.8	17.8	17.6
Total excluding residential buildings .	10.8	1.8	2.3	13.0	13.1	13.2
Total excluding construction	13.8	-0.3	2.6	9.3	9.2	9.3
Total net fixed investment (1)	20.6	-4.4	-3.9	5.8	5.5	5.2

Source: Based on Istat data.
(1) Excluding depreciation.

In a context of progressively improving current and expected demand, the growth of investment in machinery, equipment and transport equipment more than offset the decline in construction spending, which was due entirely to the residential component. A contributory factor, especially in the second half of the year, was a reduction in the use cost of capital, made possible by the decline in interest rates.

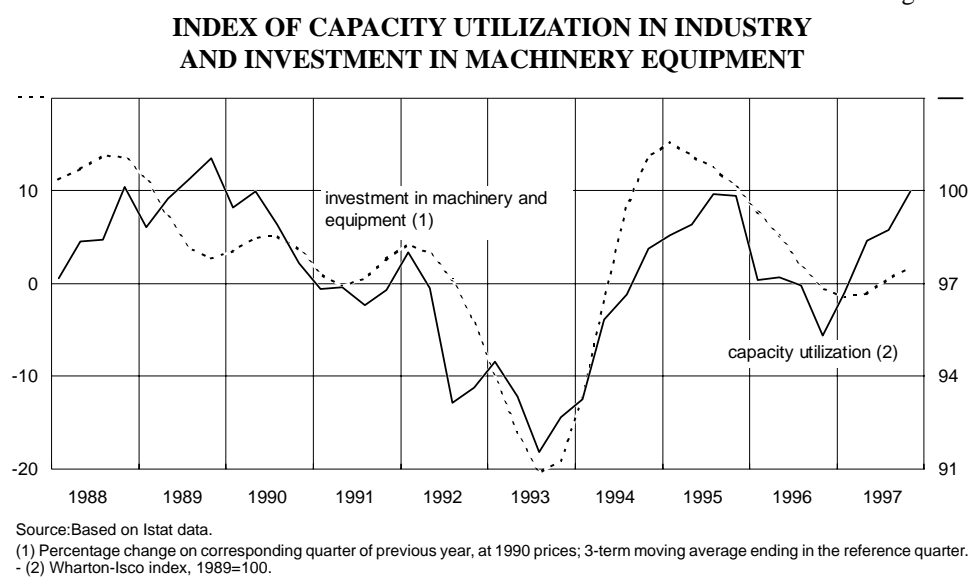
The volume of total gross investment increased by 5.9 per cent, thanks to an exceptionally strong increase in stocks of raw materials, semi-finished goods and finished products. According to the national accounts, the change in stocks (which includes statistical discrepancies between the supply-side and demand-side estimates) contributed 1 percentage point to GDP growth.

Machinery, equipment and transport equipment. - The expansion of the economy created the conditions for a return to growth in purchases of

machinery, equipment and transport equipment, which increased by 2.6 per cent in real terms, compared with a decline of 0.3 per cent in 1996.

From the start of 1997 the pressure of demand resulted above all in more intensive exploitation of productive factors by firms. Capacity utilization rose gradually and by the end of the year had reached the peak levels recorded in the previous expansionary phase (Figure 5); however, the estimates of international organizations indicate there is still ample spare capacity. The progressive abatement of uncertainty over the prospects for growth, the steady decline in nominal and real interest rates and the good state of corporate finances, favoured by persistently high profits despite a small reduction with respect to 1996, all worked to strengthen the process of capital formation. In the second half of the year investment in machinery, equipment and transport equipment grew at an annual rate of nearly 5 per cent.

Figure 5



Investment in machinery and equipment, excluding transport equipment, increased by 1.2 per cent in 1997. Investment in metal products and electrical equipment was intense, with growth of 6.1 and 7.2 per cent respectively. Purchases of office machines and precision instruments rose by 1.8 per cent, while those of agricultural and industrial machinery declined by 5.6 per cent. The strong growth of 7.9 per cent in investment in transport equipment was led by spending on motor vehicles, which was stimulated by the incentives for vehicle scrapping and rose by 9.1 per cent.

Construction. - After more or less stagnating in 1995 and 1996, investment in construction decreased by 1.6 per cent last year (Table 8). The

contraction was entirely due to the residential sector, where investment fell by 4.4 per cent, its sixth consecutive year of decline. This year, however, the growth of rehabilitation and restructuring work, spurred by the tax incentives introduced at the end of 1997, should more than compensate for the fall in new house construction.

Investment in private non-residential building increased by 1.4 per cent in 1997, following sharp gains of 7.1 per cent in 1995 and 11.6 per cent in 1996 stemming partly from the Tremonti Law incentives.

Investment in public works grew by 2.5 per cent, the first increase in six years, reflecting the gradual revival in government contracting, with increasing tender activity in recent years. With the end of the most critical phase of fiscal adjustment and in light of the programmes now in place for the modernization of public infrastructure, the sector's prospects for 1998 appear to be good.

Stocks. - In the second quarter the recovery in demand and the steadily improving expectations of its further growth, together with the favourable exchange rate of the lira with the dollar, began to prompt firms to build up stocks of finished products, semi-finished goods and raw materials. This is confirmed by Isco's survey of businesses, which found that during the first few months of the year industrial firms met the rise in demand by drawing down stocks of finished products but built them back in the second and fourth quarters. Raw materials stocks followed more or less the same pattern.

Net exports

According to the national accounts, the effect of net exports of goods and services at constant prices made a negative contribution of 0.9 percentage points to GDP growth. Imports increased by 11.8 per cent, or almost twice as fast as exports, which themselves rose by a respectable 6.3 per cent (Table 9). On an *fob-fob* basis, the surplus on trade in merchandise alone contracted from 5.0 to 4.1 per cent of GDP.

Merchandise exports, which had stagnated in 1996, grew by 5.1 per cent in real terms. The acceleration in world demand and, in particular, the consolidation of the economic upturn in Italy's main export markets were partially counterbalanced by the lagged effects of losses of competitiveness in 1995 and 1996.

In 1997 the slight nominal appreciation of the lira was more than offset by the fact that the lira prices of Italian manufacturing exports rose less, on

average, than the final prices of Italy's main competitors. This resulted in an improvement of competitiveness that came to 2.0 per cent on average for the year, but with two distinct phases: a sharp gain of 3.6 per cent during the first half and near stagnation in the second. One factor in this pattern was the pricing strategy of Italian exporters, who initially sought to defend their market shares and later acted to recoup profit margins, at least in part.

Table 9

**EXPORTS AND IMPORTS OF GOODS AND SERVICES
IN THE NATIONAL ACCOUNTS**
(percentage changes on previous year)

	1995			1996			1997		
	Goods	Services	Total	Goods	Services	Total	Goods	Services	Total
Exports									
At current prices	23.6	18.9	23.0	2.0	2.4	2.0	4.5	18.1	6.3
At constant prices	11.5	12.5	11.6	-0.1	-0.9	-0.2	5.1	14.7	6.3
Deflators	10.8	5.7	10.2	2.1	3.3	2.2	-0.6	2.9	-0.1
<i>Contribution to growth of GDP at constant prices (1)</i>	<i>2.3</i>	<i>0.4</i>	<i>2.7</i>	<i>..</i>	<i>..</i>	<i>-0.1</i>	<i>1.1</i>	<i>0.5</i>	<i>1.6</i>
Imports									
At current prices	23.3	21.6	23.1	-4.3	-0.5	-3.8	10.3	16.8	11.2
At constant prices	9.9	7.3	9.6	-2.9	5.6	-2.0	11.2	16.7	11.8
Deflators	12.2	13.4	12.3	-1.4	-5.8	-1.8	-0.8	0.1	-0.5
<i>Contribution to growth of GDP at constant prices (1)</i>	<i>-1.8</i>	<i>-0.2</i>	<i>-1.9</i>	<i>0.6</i>	<i>-0.1</i>	<i>0.4</i>	<i>-2.1</i>	<i>-0.4</i>	<i>-2.5</i>
Exports/Imports									
At current prices	0.3	-2.2	-0.1	6.5	2.9	6.0	-5.3	1.1	-4.5
At constant prices	1.5	4.9	1.8	2.9	-6.2	1.9	-5.5	-1.7	-4.9
Deflators	-1.2	-6.8	-1.9	3.5	9.7	4.1	0.2	2.8	0.5
<i>Contribution to growth of GDP at constant prices (1) (2) .</i>	<i>0.5</i>	<i>0.2</i>	<i>0.8</i>	<i>0.6</i>	<i>-0.1</i>	<i>0.3</i>	<i>-1.0</i>	<i>0.1</i>	<i>-0.9</i>
Memorandum items:	1995			1996			1997		
Total demand (3)	6.4			-0.2			4.6		
World trade (4)	9.5			6.6			9.4		
Real exchange rate of the lira (5)									
Overall (6)	-4.7			11.5			-0.1		
Imports (7)	1.3			7.3			-2.0		
Exports (7)	-4.4			12.3			1.1		

Sources: Based on Istat, OECD and IMF data.
(1) Percentage points. – (2) Sum of the contribution of exports and imports. – (3) Exports of goods and services and components of domestic demand weighted according to import content calculated from the 1988 input-output tables. – (4) Average annual growth in world imports and exports of goods and services at constant prices (IMF data). – (5) Positive values indicate appreciation. – (6) Based on producer prices of manufactures alone. – (7) Based on the prices and average unit values of manufactures alone.

Merchandise exports surged in the second half, growing by 10.7 per cent compared with the first. After a slowdown towards the end of the year, the prospect for 1998, based on exports at current prices in the first few months and the volume of export orders in hand, is for Italian exports to grow more or less in line with world trade.

The volume of merchandise imports increased by 11.2 per cent under the impetus imparted by the growth of exports and stockbuilding. A significant role was played by motor vehicle imports, which rose by 26.9 per cent. In the second half of the year the pick-up in domestic demand lent additional momentum to imports, whose rate of growth with respect to the previous half rose from 4.9 to 11.3 per cent. In 1998 the decreased impact of the incentives for scrapping motor vehicles and the completion of stockbuilding should produce a significant slowdown in imports, which are expected to grow at about the same rate as exports.

DOMESTIC SUPPLY

In 1997 GDP grew by 1.5 per cent, about twice the rate of the previous year but 1 percentage point lower than the average for the eleven countries that will adopt the euro on 1 January 1999. The recovery was driven by manufacturing industry, where output increased by 2.3 per cent, in turn stimulating growth in business services, communications and some transport services.

As the launch of European monetary union approaches, the Italian economy displays both strengths and weaknesses that are evident in its industrial specialization and in the size and location of firms. It is dominated by small and medium-sized enterprises, especially in manufacturing industries with a low capital intensity. This has not had a prejudicial effect on the growth and efficiency of production, however. On the contrary, over the last decade SMEs have contributed significantly to the trade surplus and have limited the decline in employment. These achievements are attributable to the external economies of scale existing in some sectors, especially traditional industries, owing to the congregation of small firms in industrial districts.

The intensification of competition, even in sectors where industrial districts are most common, has prompted Italian firms to seek new organizational arrangements, including the transfer of some stages of production abroad in order to meet local demand more easily by lowering transport costs and, in many cases, avoiding trade barriers, or to serve the Italian market by using more competitively priced factors of production.

In early 1998 the Bank of Italy's branch offices and Research Department conducted a survey of about 230 Italian manufacturing groups in order to collect preliminary information on industrial firms' choice of location, which is not available from other sources. The sample represents one tenth of Italian-owned groups and more than 45 per cent of those with more than 1,000 employees. Extrapolated to Italian industry as a whole, the results of the survey indicate that in 1996 22 per cent of the turnover and 26 per cent of the employees of Italian groups could be attributed to plant situated outside Italy; 11 per cent of employees worked in EU countries, 6 per cent in non-EU European countries, 3 per cent in the United States and 6 per cent in the remaining non-European countries (Table 10). The EU countries accounted for the largest proportion of turnover.

Table 10

**PERCENTAGE DISTRIBUTION OF EMPLOYEES IN ITALIAN
MANUFACTURING GROUPS BY SECTOR AND GEOGRAPHICAL AREA**

Branches of activity	Italy	Rest of Europe		Non-European countries		Total
			of which: EU		of which: US	
Food products, beverages and tobacco products	96.5	3.3	3.3	0.2	0.2	100.0
Textiles and clothing, skins, leather and footwear	54.7	37.9	5.3	7.4	2.7	100.0
Chemical products, rubber and plastics	82.0	12.8	11.7	5.2	1.2	100.0
Non-metallic mineral products ...	63.1	24.4	18.7	12.5	5.5	100.0
Engineering products	81.3	10.3	9.9	8.4	7.6	100.0
Sundry manufactures (wood, furniture, paper, publishing, etc.)	93.5	6.0	6.0	0.5	0.1	100.0
Total . . .	73.6	17.2	11.3	9.2	2.9	100.0

Source: Banca d'Italia, *Indagine sugli investimenti all'estero dei gruppi manifatturieri*.

Industry and agriculture

Manufacturing. - In 1997 the continued growth in exports and the pick-up in domestic demand, which was driven by private consumption and the replenishment of stocks, led to an increase in manufacturing output following a decline the previous year. Real value added at factor cost rose by 2.3 per cent, compared with a decline of 1.3 per cent in 1996 (Table 11). The index of manufacturing production increased by an annual average of 2.1 per cent; corrected for the number of working days, it rose by 2.6 per cent. The recovery in output was accompanied by an improvement of 2.8 per cent in productivity per employee, with nearly all branches of manufacturing showing gains, especially producers of intermediate products and final consumer goods.

The output of intermediate goods rose by 3.4 per cent, reflecting not only the increase in domestic industrial activity but also foreign demand and stockbuilding.

The growth in household spending, accompanied by an acceleration in exports in the middle part of the year, generated an increase of 3.0 per cent in the output of consumer goods, compared with a decline of 1.4 per cent in 1996. The rise in the real turnover of firms producing consumer goods was attributable mainly to the increase in sales of motor vehicles (20.1 per cent, with domestic sales increasing by 28.0 per cent and exports by 9.4 per cent) and the pick-up in demand for other consumer goods.

Table 11

VALUE ADDED OF AGRICULTURE AND INDUSTRY AT FACTOR COST

	1997		Percentage changes			
			Volume		Prices	
	Billions of lire	Percentage of GDP	1996	1997	1996	1997
Industry	522,365	30.0	-0.8	1.7	4.3	1.1
Industry excluding construction .	428,139	24.6	-1.4	2.2	4.6	0.8
Manufacturing	378,372	21.7	-1.3	2.3	4.9	0.7
Energy	49,767	2.9	-2.5	1.6	2.8	1.7
Construction and public works . .	94,226	5.4	2.1	-1.0	2.9	2.6
Agriculture	60,501	3.5	1.4	0.0	4.9	-1.6

Source: *Relazione generale sulla situazione economica del Paese.*

The stagnation in investment was reflected in the poor results of the capital goods sector; however, the strength of exports limited the decline in output to 3.2 per cent.

With capacity increasing only marginally, the expansion in industrial output was achieved by exploiting existing plant more intensively. The capacity utilization index rose by about 2 percentage points on an annual average basis to a level close to the cyclical peak recorded at the end of 1995. The rise reflected developments in branches producing consumer and intermediate goods; capacity utilization declined in capital goods industries, especially the machinery sector.

The automobile industry. - In 1997 the introduction of government incentives for the purchase of new motor vehicles, on condition that purchasers scrapped a vehicle registered at least ten years previously, triggered strong growth in sales. More than 2.4 million new cars were registered, 39 per cent more than in 1996. This was the largest increase in western Europe (comprising the EU countries, Norway and Switzerland), making Italy once again the second most important continental market after Germany. New vehicle registrations had fallen from an annual average of 2.3 million between 1988 and 1992 to one of 1.7 million between 1993 and 1996. The growth of 4.8 per cent in the western European motor vehicle market in 1997 was largely due to developments in Italy; motor vehicle sales fell by more than 19 per cent in France, where the market was still feeling the impact of the abrupt termination of government incentives there, and stagnated in Germany, but increased by more than 7 per cent in the United Kingdom.

Energy. - The recovery in industrial activity was reflected in an increase of 1.1 per cent in energy demand to 174.7 million tonnes of oil equivalent, despite only modest demand for heating. The energy industry's real value added at factor cost rose by 1.6 per cent (Table 11). Domestic primary energy output declined slightly (by 0.3 per cent), chiefly because of a fall of 4.2 per cent in natural gas production, which offset an increase of 2.0 per cent in energy imports.

Construction. - The value added of the construction industry at constant prices declined by 1.0 per cent in 1997, despite the tentative signs of recovery in the previous two years (Table 11). Investment in residential building contracted by 4.4 per cent; a more pronounced fall in new construction was partly offset by an increase in maintenance and renovation work. Spending on public works increased by 1.0 per cent at constant prices, in contrast to the large contraction recorded in previous years.

Agriculture. - In 1997 the marketable output of agriculture, forestry and fisheries fell by 2.6 per cent as a result of a decline of 0.7 per cent in volume and one of 1.9 per cent in the prices of agricultural products. Value added decreased by only 1.6 per cent at factor cost, while remaining virtually unchanged in volume terms. The overall performance of the sector was affected by adverse weather conditions in the first half of the year. The fall of nearly 2 per cent in prices in 1997 was partly due to the easing of the upward pressure on the world prices of agricultural products and livestock in the previous two years. Another factor was the gradual reduction in intervention prices in ecus as part of the 1992 reform of the Common Agricultural Policy, which in previous years had been outweighed by the depreciation of the lira. On 1 January 1999 the agricultural conversion rates on which transfers from the EU budget to the member states under the CAP are based (the so-called green exchange rates) will be replaced by the conversion rates against the euro.

Services

The real value added of market services rose by 1.8 per cent in 1997, compared with 1.5 per cent in 1996 (Table 12).

The output of the distribution sector grew by 1.9 per cent, a modest recovery from the decline of the previous year. Sales increased by 2.5 per

cent at current prices, with food products rising by 2.7 per cent and non-food goods by 2.4 per cent. The turnover of large stores increased by 4.4 per cent, more than twice the rise in that of smaller outlets (2.1 per cent). Sales at hypermarkets increased by 6.8 per cent, more than those of any other category of large store.

Table 12

VALUE ADDED OF MARKET SERVICES AT FACTOR COST

	1997		Percentage changes			
			Volume		Prices	
	Billions of lire	Percentage of GDP	1996	1997	1996	1997
Wholesale and retail trade (1)	288,823	16.6	-0.6	1.9	4.2	1.2
Lodging and catering	66,273	3.8	5.5	0.4	6.8	2.7
Transport	104,169	6.0	0.7	1.7	1.4	2.9
Communications	36,052	2.1	10.9	6.6	-3.4	0.1
Banking and insurance	77,853	4.5	1.8	1.9	4.1	-1.5
Other market services	231,817	13.3	1.9	2.4	3.8	1.3
Renting of buildings	173,416	10.0	1.4	-0.4	8.2	6.5
Total . . .	978,403	56.3	1.5	1.8	4.3	2.0
Source: <i>Relazione generale sulla situazione economica del Paese</i> .						
(1) Includes repair services.						

The slowdown in the growth in the number of large outlets was partly due to the further tightening of restrictions on store openings, mainly by local authorities.

Activity in the transport sector benefited from the economic recovery, increasing by 1.7 per cent; air and maritime transport services showed especially rapid growth of 5.9 per cent.

Growth slowed down in the communications industry, but the sector's output still expanded by 6.6 per cent, mainly owing to household demand. The lodging and catering sector recorded its smallest increase in recent years (0.4 per cent), partly as a result of a decline in the number of foreign visitors.

The growth in economic activity helped to boost business services, which increased by 3.3 per cent. Banking and insurance services rose by 1.9 per cent as the deflator fell by 1.5 per cent. Some household services benefited from the recovery in consumption, with the largest increases in value added being recorded in health care services (2.9 per cent) and recreational and cultural services (1.3 per cent).

Public enterprises and privatization

The privatization of state-controlled enterprises continued in 1997. At the end of June the Treasury disposed of a third tranche of 17.6 per cent of the shares in ENI by means of a public offer for sale, generating gross proceeds of 13.3 trillion lire. Since the first tranche in 1995, a total of 48.49 per cent of the company's share capital has been sold, producing gross receipts of about 28.5 trillion lire. In July the IRI group sold 45 per cent of Società Aeroporti di Roma to the public for 541 billion lire. In November it disposed of its 44.74 per cent holding in the SEAT publishing company for 1,643 billion lire (Table 13).

Table 13

MAIN PRIVATIZATIONS IN ITALY BETWEEN 1 JULY 1996 AND 1 DECEMBER 1997

	Group (sector)	Number of employees (1)	Method of sale	Percentage sold (%) (2)	Remaining public holding (%) (2)	Completion date of sale	Gross proceeds (billions of lire)
IMI (3rd tranche)	(Banking)	883 (1995)	Auction	6.93	(3) 1.13	(4) 8.7.96	501
Montefibre	Enichem-ENI (Chemical fibres)	1,649 (1995)	Public offer	65.00	. .	9.7.96	183
ENI (2nd tranche)	(Energy)	87,503 (1995)	Public offer	15.81	(5) 69.18	28.10.96	8,872
ENI (3rd tranche)	(Energy)	87,503 (1995)	Public offer	17.68	51.50	30.6.97	13,300
Aeroporti di Roma	IRI (Transport)	6,215 (1995)	Public offer	45.00	54.00	17.7.97	541
Telecom Italia . .	(Telecommu- nications)	126,400 (1996)	Core investors +public offer	39.50	5.17	25.10.97	(6) 22,883
SEAT	(Publishing)	2,000 (1996)	Core investors +public offer	44.74	. .	25.11.97	1,643

Sources: R&S (various years); company annual accounts (various years); Ministry of the Treasury, Budget and Economic Planning, *Relazione sulle privatizzazioni*, July 1997; *Documento di programmazione economico-finanziaria per gli anni 1999-2001*; the financial press.

(1) Average number in the year in question. – (2) For all the companies the remaining public holding is in relation to the ordinary capital. – (3) The remaining public holding is earmarked for the issue of the bonus shares provided for at the time of the sale of the first tranche. – (4) Date of allotment. – (5) Includes 1.21 per cent of equity earmarked for the issue of the bonus shares of the two tranches. – (6) Includes the 2,520 billion lire of the green shoe, received in January 1998.

Following a long debate on the optimum structure for the Italian telecommunications market and the way in which STET was to be privatized, the Government decided in 1997 to dispose of the group en bloc, thus preserving the integrity of the group comprising Telecom Italia, Telecom Italia Mobile and other subsidiaries. The public sale of the Treasury's holding in STET was preceded by a private sale of about 6.8 per

cent of the company's shares to a group of "core" shareholders, consisting primarily of Italian banks, banking foundations and insurance and financial companies. The articles of association of the new Telecom Italia reserve a "golden share" to the Treasury for a period of three years and place a ceiling of 3 per cent on individual holdings of ordinary shares. The operation, in which the Treasury disposed of a total of 39.5 per cent of the company's share capital, was concluded on 24 October 1997 and generated gross proceeds of 22,883 billion lire, the largest amount raised by a single sale in Italy and one of the largest privatizations in Europe.

On 31 July 1997 Parliament approved Law 249 establishing the regulatory authority for the communications sector. Consisting of a chairman and eight members, the authority is responsible for overseeing publishing, radio and television and telecommunications.

By the end of 1997 the privatization programme had raised about 80 trillion lire since its launch in 1993, a substantial amount compared with the other European countries, especially considering the speed with which it has been carried out. The desire to accelerate the disposal of public enterprises and maximize the proceeds from their sale has influenced the choice of privatization methods. On the one hand, public offers for sale have been used to reach a broad base of small investors, while on the other clauses have been inserted in the articles of association of the largest companies to give the Treasury preferential powers in the company ("golden share" clauses) or to impose restrictions on share ownership that make it impossible or extremely costly to acquire control through a hostile takeover. These measures have created a substantial disparity in the rules of corporate governance for privatized companies and those for other enterprises.

In public utility services, which until now have been public sector monopolies, privatization has been slow, as demonstrated in the case of electricity and the railways. In general, privatization has not been accompanied by significant liberalization measures.

Economic developments in the South and regional policy

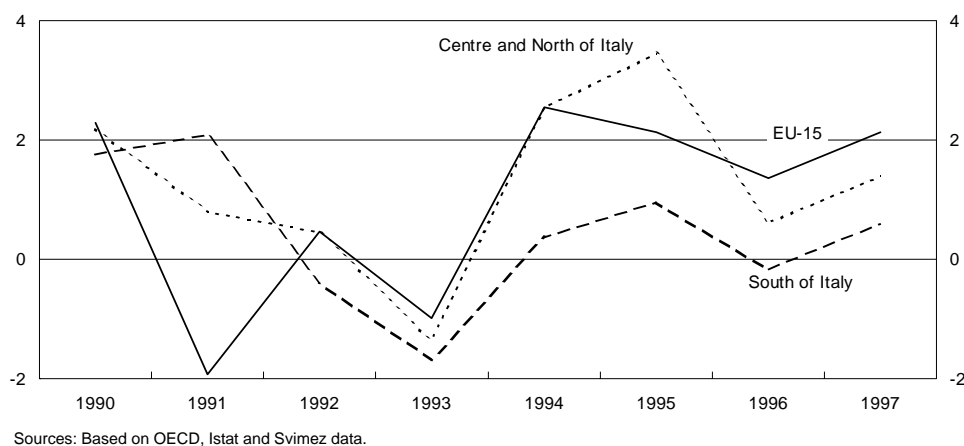
The disparity in economic development between southern regions and the rest of the country widened in 1997. According to the Association for Industrial Development in Southern Italy, GDP grew by an estimated 0.9 per cent in the South, compared with 1.7 per cent in the Centre and North. Per capita output increased by 0.6 per cent in the South, about half the rise in the Centre and North and less than a third of the EU average (Figure 6).

Further steps were taken last year in the gradual reform of regional policy, which began with the termination of the special development

programme for the South and an expansion of the role of the European Commission in promoting competition and economic and social development. Numerous legislative and administrative measures were introduced regarding development planning procedures, concertation between central and local government and support for local development initiatives in the South and other depressed areas of Italy. At the end of 1997 disbursements by EU structural funds in southern Italy amounted to 38.4 per cent of the resources allocated under the Community Support Framework for 1994-1999, more than twice the level in 1996.

Figure 6

PER CAPITA GDP IN ITALY AND THE EU
(at 1991 purchasing power parities; annual)



Territorial agreements and area contracts, which are instruments of public intervention that seek to mobilize local resources to stimulate growth in less developed areas, have only partially met the expectations they have raised. So far, only 12 of more than 50 territorial agreements proposed since 1995 have received final approval from the Interministerial Committee for Economic Planning; the remainder, including 10 pilot schemes designated as “territorial employment agreements” and assisted by the EU, have yet to reach or complete the assessment stage. The 12 agreements that received official approval in the summer of 1997, all of which are located in the South, envisage investment of 1,246 billion lire, of which more than 70 per cent will be provided by the state. The projects are expected to create nearly 7,000 jobs. The delays in the evaluation procedure are at least partly attributable to the difficulty of assessing whether the proposals comply with local planning objectives; in many cases the modest planning capabilities of local authorities have also been a factor. Area contracts, which can be used in depressed areas in any part of the country, have only been signed in Crotone, Manfredonia and Torrese-Stabiese, providing for total investment of 169 billion lire.

THE LABOUR MARKET

Employment

Employment began to increase again in 1997 after pausing in the second half of 1996 and the early months of 1997 owing to the cyclical downturn. In the fourth quarter employment was about 110,000 standard labour units higher than at the beginning of the year, a rise of 0.5 per cent. However, the large contraction in the first quarter meant that there was a decrease of 0.2 per cent on average for the year (Table 14). Employment in market services increased slightly, by 0.4 per cent.

Table 14

EMPLOYMENT

(standard labour units: percentage shares of total
and percentage changes on previous year)

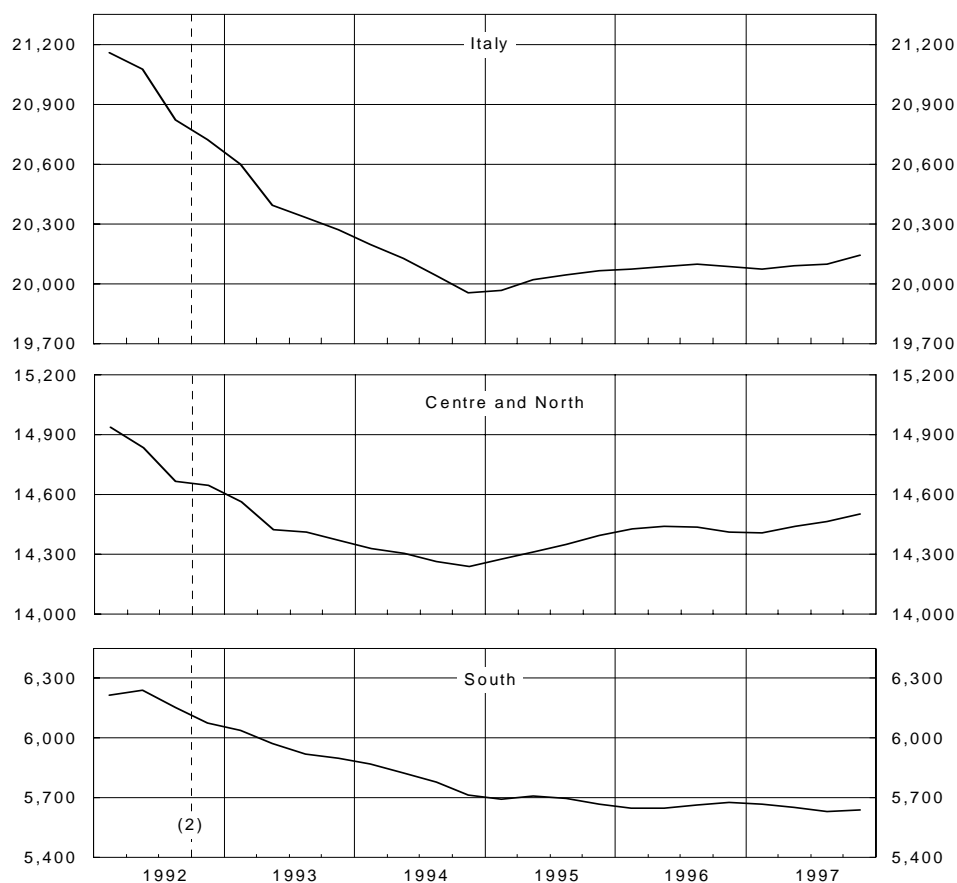
	Total employment					Salaried employment				
	(1)	Average 1990/94	1995	1996	1997	(1)	Average 1990/94	1995	1996	1997
Agriculture	7.8	-3.7	-4.0	-3.0	-1.3	3.7	-4.0	-3.7	-2.6	-1.9
Industry	28.1	-1.6	-0.7	-1.0	-0.5	32.0	-2.0	-1.1	-1.4	-0.5
Industry excluding construction	21.0	-2.1	-0.6	-0.8	-0.6	25.5	-2.3	-0.7	-0.9	-0.9
energy products	0.7	-1.8	-5.3	-0.8	-4.0	1.1	-1.8	-5.4	-0.8	-4.0
manufacturing	20.3	-2.1	-0.4	-0.8	-0.5	24.5	-2.4	-0.5	-0.9	-0.7
Construction	7.0	0.1	-0.8	-1.7	0.0	6.4	-0.7	-2.5	-3.5	0.9
Market services	45.0	0.1	0.7	1.5	0.4	36.6	0.6	0.1	1.5	1.2
distributive trades, lodging and catering	22.0	-0.2	0.0	1.0	-0.7	14.7	1.0	0.2	2.0	1.2
transport and communications	6.2	-0.9	-1.7	-0.5	-0.7	7.1	-1.1	-2.5	-0.2	-0.5
credit and insurance	1.9	1.1	-0.4	-0.8	-1.8	2.8	1.1	-0.4	-0.8	-1.8
other market services	14.8	0.8	3.1	3.4	3.0	12.1	1.3	1.8	2.6	3.1
Goods and market services ..	80.9	-1.0	-0.3	0.1	-0.1	72.2	-0.9	-0.6	0.0	0.3
Non-market services	19.2	0.4	-0.2	-0.3	-0.6	27.8	0.4	-0.2	-0.3	-0.6
Total ...	100.0	-0.7	-0.3	0.0	-0.2	100.0	-0.6	-0.5	-0.1	0.0

Source: Based on Istat data.
(1) Percentage share of total in 1997.

Only the regions in the Centre and North benefited significantly from last year's economic recovery (Figure 7). The Istat labour force survey shows that at the beginning of 1998 employment in the area was 136,000 persons higher than twelve months previously; in the South it rose marginally in the last quarter of 1997 but was still 20,000 lower than a year earlier.

Figure 7

EMPLOYMENT ACCORDING TO THE LABOUR FORCE SURVEY
(reconstructed data, seasonally adjusted (1); thousands of persons)



Source: Based on Istat data (labour force survey).

(1) Moving averages of start-of-period and end-of-period data. - (2) A new questionnaire was introduced in October 1992.

The demand for labour in industry. - In the current upturn employment has responded more rapidly to the growth in output than it did in past cycles, especially in manufacturing industry. Although manufacturing firms reduced the number of employees by an annual average of 0.5 per cent last year (Table 14), signs of a recovery in the demand for labour emerged clearly from the spring onwards. An increase of about 7.2 per cent in real

value added between the first and fourth quarters was accompanied by a rise of 2.3 per cent in employment in terms of standard labour units.

The greater responsiveness of employment in 1997 appears to have been due partly to the fact that in the early stages of the recovery actual employment was already close to the level firms considered desirable as a result of the substantial labour-shedding of previous years. The ability of manufacturing firms to adapt production rapidly to cyclical changes is increasing, thanks partly to the flexible use of additional shifts and partly to greater recourse to fixed-term employment contracts.

The Bank of Italy's survey of investment by manufacturing firms with more than 50 employees indicates these firms' intention to keep overall employment at the end of 1998 at the same level as the previous year, though larger firms report a continuation of the structural decline in the numbers of employed. Smaller firms, those in the South and those with a high rate of capacity utilization, expect to increase employment.

The demand for labour in the service sector. - In market services, where restructuring is still under way in several branches, employment increased by 0.4 per cent (42,000 standard labour units), with output rising by 2.1 per cent; the relative performance of both variables was broadly similar to that of the previous years. The increase in employment, which was markedly smaller than in 1996, was due exclusively to "other market services", where the rate of increase exceeded 3 per cent for the third consecutive year; employment contracted in all the other segments (Table 14). The fall in the number of workers in the distributive trades reflects the reorganization under way in this sector, where large retail stores are gaining ground. The number of self-employed fell by an annual average of 50,000 standard labour units, or 2.2 per cent, while the number of employees rose by 20,000 units, or 1.2 per cent. Firms with more than 500 employees recorded considerable employment growth, at 1.7 per cent. The trend is in line with that in the rest of Europe. The decline in self-employment, which still accounts for 56 per cent of employment in this sector in Italy, appears likely to continue: in 1995 the share of self-employment in France and Germany was about 15 per cent.

Employment by gender and geographical area. - According to labour force surveys overall employment in 1997 was unchanged on an annual average basis. In the countries that will participate in monetary union, where the behaviour of employment was not uniform, there was a modest increase of 0.5 per cent.

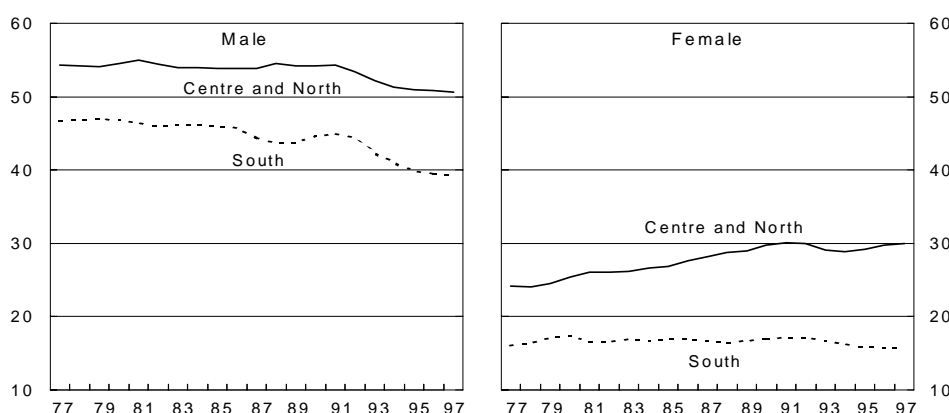
There was no let-up in the fall in male employment, which declined by around 40,000 persons. All parts of the country were affected, but the largest contraction was among men in the central age groups living in the North. Here female employment continued to rise, albeit at a slower pace than in 1996; the increase over the year came to 40,000 persons. The trend is evident in nearly all age groups but is strongest among women aged between 35 and 54. Apart from the medium-term upward trend, employment among women and young people between the ages of 25 and 34 in the Centre and North has displayed greater responsiveness to cyclical conditions in recent years.

In the last three years the greater cyclical variability of employment has been attributable partly to the increased use of more flexible forms of employment. The recovery in salaried employment from the low point reached in 1995 was due mainly to an increase in types of employment other than that on traditional full-time non fixed-term contracts. Whereas the number of full-time employees on non fixed-term contracts remained broadly unchanged between January 1995 and January 1998, the number of part-time workers rose by 16.6 per cent (194,000 persons) and that of employees on fixed-term contracts by 31.2 per cent (282,000). The increase in the use of the latter is due both to the generational change in the workforce (various types of fixed-term contract can be applied to young people) and to the gradual extension of the circumstances in which fixed-term contracts are permitted under labour agreements and legislation.

Employment has stagnated in the South (Figure 7). Although signs of recovery appeared in the last quarter of 1997, the number of employed in the southern regions as a whole remains at the minimum levels recorded in the first half of 1996, about 600,000 less than in 1992, when uninterrupted downward trend began (Figure 8).

Figure 8

EMPLOYMENT RATE BY GENDER AND GEOGRAPHIC AREA (1)
(percentages)



Source: Based on Istat data (labour force survey).
(1) Ratio of employed persons to the total population.

The supply of labour and unemployment

The increase in the average unemployment rate last year from 12.1 to 12.3 per cent was due to a slight expansion in the supply of labour. As in previous years, the increase in the labour supply was concentrated in the female component, which rose by about 70,000 persons, while the male segment continued to contract, by about 30,000.

In the Centre and North the recovery in employment that developed during 1997 gradually reduced unemployment. The rate for males who have been seeking employment for less than 12 months, the most responsive to changes in economic conditions, fell from 2.6 to 2.1 per cent in the twelve months to January of this year. The youth unemployment rate also fell significantly over the same period, from 23 to 21 per cent. The reduction in the overall unemployment rate was less evident on an annual average basis (from 7.7 to 7.6 per cent).

By contrast, in the South the annual average unemployment rate rose from 21.7 to 22.2 per cent in 1997, an all-time high. The male unemployment rate deteriorated by about 0.5 percentage points, from 17.5 to 17.9 per cent; the rate for the female component rose by about 0.8 points to 31 per cent.

Long-term unemployment and difficulties in entering or re-entering the labour market also affect the Centre and North. In both areas almost 60 per cent of those seeking re-employment after losing a previous job have been out of work for more than twelve months. Nevertheless, unemployment in Italy is increasingly a problem of the South, where the majority of unemployed (57 per cent, compared with 35 per cent of the population over 15 years of age) reside; unemployment in the area is particularly high for groups that have traditionally had the strongest position in the labour market, such as males in the central age groups.

Last year the average rate of unemployment for males over the age of 25 in the South was more than 13 per cent, higher than that in all other EU countries. In the Centre and North, unemployment rates are generally close to or, for some groups, even lower than those in the majority of EU countries (Table 15). In particular, the unemployment rates for adult males in the Centre and North are lower than those in the historically flexible market of the United Kingdom and comparable to those of Austria which, together with very low unemployment rates for both women and young persons, reflect a well-functioning labour market. The other major European countries also present significant regional disparities; nonetheless, the greatest differences tend to be associated with age and gender.

Table 15

UNEMPLOYMENT RATES IN EUROPE IN 1997 BY AGE AND GENDER*(percentages)*

	Age group 15-24 (male and female)	Female (all ages)	Male (all ages)	Male (25 years and over)	Total (male and female)
Italy	33.5	16.8	9.5	6.8	12.3
<i>Centre and North</i>	22.0	11.4	5.1	3.6	7.6
<i>South</i>	56.3	31.0	17.9	13.1	22.2
Belgium	23.0	11.9	7.2	6.0	9.2
Germany	10.3	10.6	9.0	8.8	9.7
Spain	38.8	28.3	16.0	13.0	20.8
France	29.1	14.4	10.7	9.0	12.4
Ireland	16.0	10.4	10.1	8.7	10.2
Luxembourg	9.9	5.2	2.7	1.9	3.7
Netherlands	9.2	6.9	3.9	3.2	5.2
Austria	6.7	5.3	3.6	3.3	4.4
Portugal	15.4	7.8	6.0	5.0	6.8
Finland	27.5	14.9	13.2	11.6	14.0
Denmark	8.2	7.8	4.7	4.3	6.1
Greece	31.0	14.9	6.2	4.5	9.6
Sweden	20.9	9.7	10.6	9.3	10.2
United Kingdom	14.2	6.0	7.9	6.4	7.1
Sources: Eurostat; for Italy, Istat, labour force survey.					

Industrial relations and wage bargaining

Following the difficulties encountered in the second half of 1996 in connection with the contract renewal for metal and engineering workers, last year saw the renewal of about 70 per cent of national industrywide contracts in the private sector. The bargaining mainly involved only wage provisions for the second two-year period of national contracts. There was a parallel slowdown in the signing of company-level agreements from the high levels of the two previous years.

Settlements in the manufacturing sector gradually reflected the reduction in inflation expectations helping to strengthen them. The same

tendency characterized much of the market services sector. Greater tension was evident in the public utilities and general government sectors, where delays in renewing contracts and sudden accelerations in nominal wage growth generated uncertainty about wage developments. In particular, the contracts signed in the public utilities sector appear especially burdensome in the light of the structural problems affecting these sectors.

The uncertainty associated with the possibility of introducing legislation to reduce working hours, proposed last autumn, has blocked the renewal of expiring contracts since the last quarter of 1997. The contract for the paper and paper products sector was signed in January, more than six months late; the duration of the wage-related clauses of the contract was shortened to December 1998, with provision also being made to review the regulatory content of contracts in the light of future legislation on working hours.

At the end of March the Government submitted a bill that would establish a normal working week of 35 hours for firms with more than 15 employees, to take effect from January 2001. As a temporary measure, existing provisions imposing higher social security contributions on hours in excess of 40 per week will be flanked by the introduction of as-yet-undefined relief measures as an incentive to bring the number of hours envisaged in current labour contracts down to 35. The effectiveness of the incentives and the extent to which they are applied will be assessed by the Government, employers and labour before the end of the year 2000. In the case of industry-wide contracts, it will be possible to calculate the 35 hours as average weekly figures over relatively long periods (up to one year), after which firms will be required to pay additional social security contributions. The bill leaves the definition of actual working hours and wages to the bargaining process at both the national and company levels.

Wages and labour costs

Gross earnings per standard labour unit in the economy as a whole rose by an annual average of 3.3 per cent, compared with 5.3 per cent in 1996 (Table 16); in real terms they increased by 1.3 per cent, compared with 1.2 per cent in 1996. The sharpest slowdown came in the public sector, where wages rose by 3 per cent last year, compared with 8.4 in 1996. The rate of wage growth also fell in market services (from 4.2 to 3.3 per cent) and construction (from 4.1 to 2.2 per cent). By contrast, the pace of wage growth in manufacturing was the same as the previous year, at 4.5 per cent.

Inter-sectoral earnings differentials in the economy as a whole remained unchanged from the previous year, interrupting the widening that had resumed in 1993. This development is attributable to the higher relative weight in the market services sector of branches in which unit wages are lower but growing faster.

Table 16

LABOUR COSTS AND PRODUCTIVITY
(percentage changes)

	Value added at factor cost (1)	Total standard labour units	Output per standard labour unit	Earnings per standard labour unit (salaried employment)	Labour costs per standard labour unit (salaried employment)	Unit labour costs
<i>Total (2)</i>						
Average 1990-94	1.1	-0.7	1.8	6.2	6.4	4.5
1995	3.0	-0.3	3.3	3.9	4.6	1.2
1996	0.5	0.0	0.4	5.3	6.1	5.7
1997	1.5	-0.2	1.7	3.3	4.7	2.9
<i>Goods and market services (2)</i>						
Average 1990-94	1.1	-1.0	2.1	6.1	6.2	4.0
1995	3.6	-0.3	3.8	4.0	5.3	1.4
1996	0.6	0.1	0.5	4.2	5.1	4.6
1997	1.9	-0.1	1.9	3.6	4.1	2.2
<i>Agriculture</i>						
Average 1990-94	1.0	-3.7	4.8	5.3	5.6	0.8
1995	0.8	-4.0	5.0	2.2	2.1	-2.7
1996	1.4	-3.0	4.6	1.9	2.7	-1.8
1997	0.0	-1.3	1.3	2.2	2.4	1.0
<i>Manufacturing industry</i>						
Average 1990-94	0.7	-2.1	2.9	6.5	6.5	3.6
1995	5.6	-0.4	6.0	3.8	5.5	-0.5
1996	-1.3	-0.8	-0.5	4.5	5.5	6.0
1997	2.3	-0.5	2.8	4.5	5.3	2.4
<i>Construction</i>						
Average 1990-94	-1.3	0.1	-1.5	5.9	5.7	7.3
1995	0.8	-0.8	1.7	1.0	2.2	0.5
1996	2.1	-1.7	3.9	4.1	4.9	1.0
1997	-1.0	0.0	-1.0	2.2	2.1	3.1
<i>Market services (2)</i>						
Average 1990-94	1.7	0.1	1.6	5.9	5.9	4.2
1995	3.2	0.7	2.5	4.5	5.5	3.0
1996	1.5	1.5	0.1	4.2	4.9	4.8
1997	2.1	0.4	1.7	3.3	3.9	2.1

Source: Based on Istat data.

(1) At 1990 prices; including imputed output of bank services. - (2) Excluding rental of buildings.

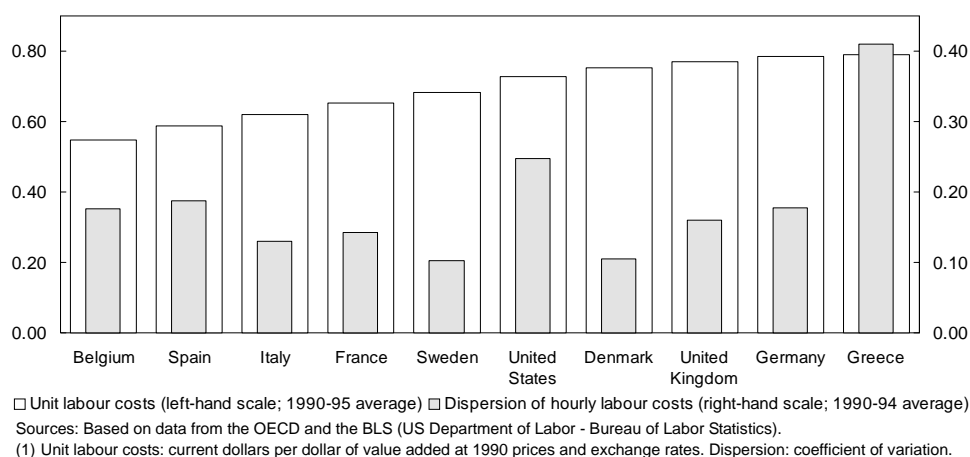
The gradual reduction in the amount of employers' social security contributions charged to the budget and in tax relief granted to industrial firms operating in the South caused the share of social security costs charged to firms to continue to increase last year, generating a larger rise in labour costs per employee than in wages in the market goods and services sector (4.1 and 3.6 per cent respectively).

The halving of the rate of increase in unit labour costs in market goods and services, from 4.6 to 2.2 per cent, was mainly due to the large increase in productivity growth which rose from 0.5 to 1.9 per cent (Table 16). The rise in costs was kept below 2.4 per cent in the manufacturing sector, compared with 6 per cent the previous year. Unit labour costs rose much more slowly in the second half of the year, pointing to a reduction in the annual average increase for 1998.

In the period between 1990 and 1995 the level of unit labour costs expressed in dollars was lower on average than in the other European countries except for Belgium and Spain (Figure 9). This was the result not only of lower average earnings but also of higher productivity levels, even when the effects of differences in sectoral composition are accounted for.

Figure 9

**UNIT LABOUR COSTS AND DISPERSION OF HOURLY LABOUR COSTS
BETWEEN BRANCHES OF MANUFACTURING INDUSTRY (1)**
(US dollars; coefficients of variation)



Real wages and the distribution of income. - On average for 1997 real gross earnings per standard labour unit in the private sector excluding agriculture grew by about two percentage points, returning to the level of 1992 thanks to the recovery recorded in the last two years.

As in the previous year, the share of gross operating profits in value added in the private sector excluding agriculture declined slightly in 1997, slipping from 37.1 to 36.5 per cent. The reduction of the last two years has involved both the manufacturing and market services sectors (see Figure 15 in the Chapter *Prices*). Nevertheless, the figure is one of the highest both among European countries and in comparison with those recorded in Italy over the last 25 years.

PRICES

In 1997 the average annual increase in consumer prices fell to the lowest level for the last thirty years: 1.9 per cent according to the EU harmonized index. Inflation expectations progressively stabilized around that value. The inflation differential with the main countries of the euro area narrowed considerably but did not disappear completely, owing to domestic pressures on prices, largely stemming from labour costs. These effects are now waning.

As the recovery of the lira and the weakness of economic activity had a moderating effect on prices, the restoration of the purchasing power of wages that had been eroded between 1993 and early 1996 was not an impediment to the convergence of Italian inflation with the levels prevailing in the main countries of the euro area in 1996 and the first half of 1997; subsequently, however, it was a factor in the pause in the narrowing of the differential. Whereas in Germany and France the inflationary impact of the appreciation of the dollar and the recovery in economic activity was attenuated by a sharp slowdown in wage growth, which virtually came to a halt in industry, in Italy it was reinforced by wage acceleration. Consequently, even the modest pick-up in the rate of increase in prices during the year - from the spring onwards in the case of producer prices and from the summer in that of consumer prices - was larger than that recorded in the leading euro area countries, with which the inflation differential widened again.

The maintenance of a rigorous monetary policy stance helped foster a continuous improvement in expectations, even during the mild revival of inflation; as a result, nominal wage increases agreed in the second half of 1997 were considerably lower than those awarded at the beginning of the year. The rise in unit labour costs slowed down perceptibly and came to a halt at the end of the year, in part owing to productivity growth associated with the economic upturn; the differential with respect to Germany and France has begun to diminish again, although it remains substantial. Now that workers in Italy have recouped the purchasing power they had lost, the conditions exist for the continuation and consolidation of convergence.

The behaviour of producer prices since the end of 1997 and that of consumer prices since this spring show that the moderate tensions of last

year have begun to abate, thanks partly to the decline in the prices of raw materials as a result of the Asian crisis.

Businessmen's expectations regarding Italian inflation appear consistent with this scenario, converging with the average level of inflation forecast for the euro area as a whole as early as 1999.

Consumer prices

Average annual consumer price inflation as measured by the index for the population as a whole fell to 2.0 per cent in 1997, from 4.0 per cent in 1996 (Table a5). The rate as measured by the harmonized index was only slightly lower - 1.9 per cent, compared with 4.0 per cent the previous year (Table a6). The consumer price index for worker and employee households recorded an even smaller rise of 1.7 per cent, compared with 3.9 per cent in 1996 (Table a7).

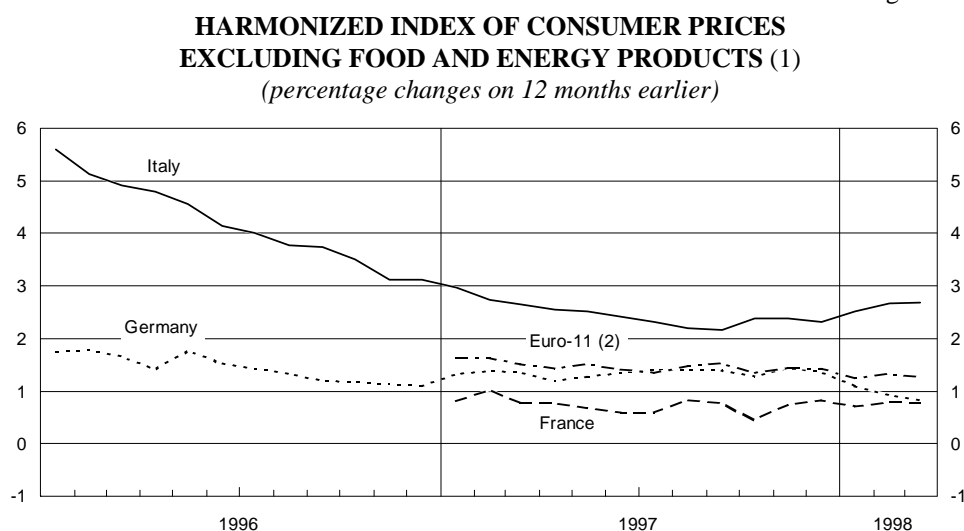
The average annual rate of consumer price inflation in the countries of the euro area, calculated on the basis of the average of the harmonized indices, declined from 2.2 per cent in 1996 to 1.6 per cent last year. Italy's inflation differential with Germany thus narrowed from 2.8 to 0.4 percentage points and that with France from 1.9 to 0.6 points.

Overall inflation in the countries that will adopt the euro, calculated on the basis of the twelve-month change in the average of the harmonized indices, continued to decline until the spring, falling to 1.3 per cent in April, compared with 2.1 per cent in December 1996 (see Figure 2 above). It subsequently edged upwards to 1.7 per cent in August as a result of the appreciation of the dollar and the economic recovery. The quickening in inflation occurred in Italy several months later than in the other main economies of the euro area, owing to the lingering effects of the appreciation of the lira in 1996 and doubts as to whether the upturn had actually begun; a specific contributory factor was the fall in the prices of unprocessed foodstuffs. As a result, the inflation differential between Italy and the leading European countries continued to narrow until the summer, when it reached a very low value. In particular, the differential with Germany, calculated on the basis of the twelve-month changes in the harmonized indices, turned slightly negative in August; the differential excluding food and energy products also diminished, although it remained significant at 0.8 percentage points (Figure 10).

During this period the twelve-month rate of increase in the general consumer price index for the whole population steadily diminished to reach a low of 1.7 per cent in June, compared with 2.8 per cent in December 1996. The annualized, seasonally adjusted three-month rise in the index excluding

items whose short-term variations are more erratic - those subject to official control and energy products - declined to an average of just over 1 per cent in the first half of the year, below the already very low levels of the closing months of 1996 (Figure 11); the index excluding food products as well as these items followed a similar path, albeit at a level around half a point higher.

Figure 10



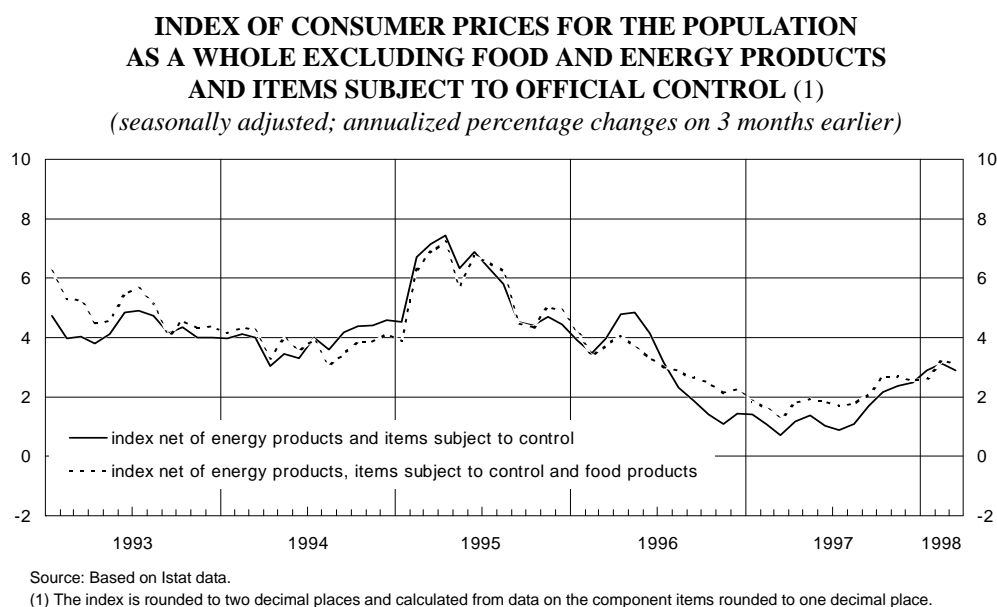
Source: Based on Eurostat data.

(1) For some countries, including France, the raw data are available only from 1996 onwards. - (2) Average of the harmonized indices of the 11 countries that will adopt the euro, weighted on the basis of 1996 final consumption translated into a single currency using the bilateral exchange rates announced on 2 May 1998. Eurostat revises the weights every January in accordance with the change in the harmonized consumer price index in the 12 months ending in the previous December.

Consumer prices accelerated moderately in the summer, mirroring the pick-up in producer prices with a lag of about three months. The causes of price pressures common to all the European countries were compounded by others specific to Italy: first and foremost the recovery of real wages, to a lesser extent the rise in food prices and, from October onwards, the revision of VAT rates. The latter had a limited impact, since the pass-through to prices was almost immediate in the case of energy products and motor vehicles but small in that of clothing, which bore the brunt of the tax increase.

The annualized, seasonally adjusted three-month rate of increase in the index for the population as a whole steadily rose; excluding energy and food products and items subject to official control, it reached a peak of more than 3 per cent in February 1998. The twelve-month rate of change in the general index rose back above 2 per cent. With inflation again falling in the main countries of the euro area, the differential between Italy and the others, calculated on the basis of the twelve-month rates of change in the harmonized indices, thus began widening again: in March 1998 the differential with Germany was equal to 1.5 percentage points, or 1.9 points if food and energy products are excluded.

Figure 11



The latter figure is the result of differentials of similar magnitude for services (1.8 percentage points) and non-food and non-energy products (2.0 points; Table 17). The difference between the rate of increase in the prices of services and that in the prices of goods, which was just under 1 percentage point in March 1998, has been smaller over the last five years in Italy than in the other main countries of the euro area. This represents a reversal of the trend that had prevailed until the early nineties, when the rate of increase in the consumer prices of services had been distinctly higher in Italy than in the other main European economies (Figure 12) and was often cited as a cause of Italy's persistently higher inflation. The change has presumably been abetted by the action taken by the Competition Authority to raise the low level of competition in the services sector and by the alignment of Italian law with European legislation on the liberalization of markets.

Table 17

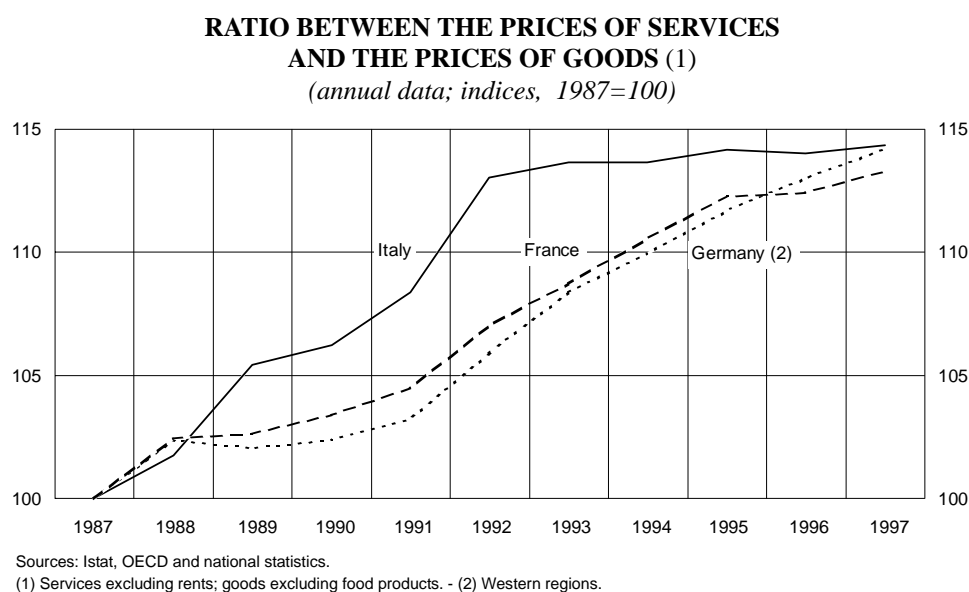
HARMONIZED INDEX OF CONSUMER PRICES: COMPONENTS
(percentage changes in the 12 months ending in March 1998)

	Non-food and non-energy products	Services	Total excluding food and energy products	Food and energy products	Total
Italy	2.3	3.1	2.7	0.8	2.1
Germany	0.3	1.3	0.8	0.4	0.6
France	0.0	1.4	0.8	1.0	0.8
Spain	1.3	3.2	2.0	1.1	1.7
Euro-11 (1)	0.7	1.9	1.3	1.0	1.2

Source: Based on Eurostat data.

(1) Average of the harmonized indices of the 11 countries that will adopt the euro, weighted on the basis of 1996 final consumption translated into the same currency using the bilateral exchange rates announced on 2 May 1998. Eurostat revises the weights every January in accordance with the change in the harmonized consumer price index in the 12 months ending in the previous December.

Figure 12



The latest data indicate that the moderate acceleration in inflation has begun to abate. The reversal of trend is clearest for the items most directly influenced by the fall in the prices of raw materials due to the Asian crisis, notably energy products; it appears to be more limited for those that are more closely linked to the underlying causes of inflation. The annualized, seasonally adjusted three-month rate of increase in the index for the population of a whole net of energy products and items subject to official control (the latter include tobacco products, the prices of which were raised substantially in March, albeit by less than in the previous year) declined by 0.3 percentage points between February and March, to 2.9 per cent; estimates based on the data published for the index for worker and employee households suggest a more marked slowdown in April and May. The rise in the index that excludes food as well as energy products and items subject to official control remained unchanged at 3.2 per cent in March, reflecting an increase of 3.6 per cent in the prices of services and one of 2.8 per cent in those of non-food and non-energy products; the rate of increase appears to have diminished in the last two months.

Producer prices and the export and import prices of manufactures

The producer prices of manufactures for the domestic market rose by an average of 1.3 per cent in 1997, compared with 1.9 per cent in 1996

(Table a8); excluding energy prices, which rose by 4.3 per cent last year and 3.4 per cent in 1996, the increase in the two years falls to 0.8 and 1.7 per cent respectively.

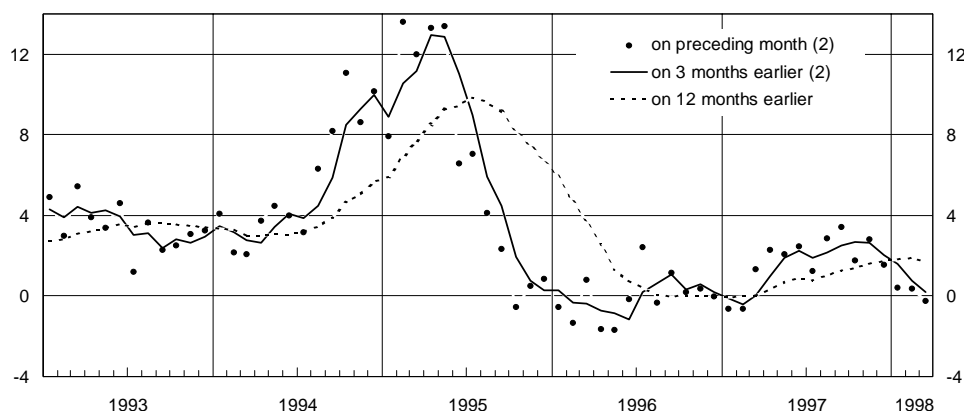
The size of the rise for the year as a whole primarily reflects the slowdown in the rate of increase in 1996 and the particularly low rate recorded in the early months of 1997 owing to the strong appreciation of the lira and the stagnation of domestic demand. Mounting cost pressures and a renewed widening of profit margins as the upturn gained momentum led to a steady acceleration from the spring onwards. The trend was reversed at the end of the year, thanks mainly to the behaviour of the prices of intermediate goods and food products, which were most directly affected by the repercussions of the Asian crisis.

These developments mirrored the pattern recorded in the other main euro area countries, albeit with a lag of a few months. The differential between Italian and German twelve-month rates of change in producer prices for the domestic market closed in the first half of 1997 but subsequently reappeared, widening to 0.6 percentage points in January 1998; in March it narrowed again to 0.3 points.

The annualized, seasonally adjusted three-month rate of change in the index that excludes the most volatile components - energy products and items whose consumer prices are subject to official control - rose from marginally negative values at the beginning of 1997 to a peak of 2.7 per cent in November before falling back to virtually zero in March of this year (Figure 13).

Figure 13

**INDEX OF THE PRODUCER PRICES OF MANUFACTURES
FOR THE DOMESTIC MARKET, EXCLUDING ENERGY PRODUCTS
AND ITEMS SUBJECT TO OFFICIAL CONTROL (1)**
(percentage changes)



Source: Based on Istat data.

(1) Items subject to official control include tobacco products and medicines, whose consumer prices are controlled. - (2) Annualized and seasonally adjusted.

The average unit values in lire of exported manufactures decreased by 0.9 per cent over the year as a whole, whereas in 1996 they had increased by 2.9 per cent. As the nominal effective exchange rate of the lira for exports also declined slightly, by 0.4 per cent, the corresponding prices in foreign currency fell by more than 1 per cent. Since there was virtually no change in the average export prices in foreign currency set by Italy's main trading partners, this development seems to reflect the intention of Italian manufacturers to restore the export competitiveness they had lost in the two previous years, even at the cost of a narrowing of their profit margins.

For the second consecutive year the average unit values in lire of imports of manufactures remained practically unchanged, showing a rise of 0.1 per cent in 1997 after a decline of 0.2 per cent in 1996; net of energy products they fell by 1.1 per cent in 1997 and 0.9 per cent in 1996. The figure for the year as a whole reflects the sharp slowdown recorded in 1996 in connection with the recovery of the lira; in fact, import unit values in lire began to rise at a gradually increasing rate early in 1997, thereby easing the competitive pressure on domestic producers and generating cost pressures for Italian firms. The pace finally began to slacken towards the end of the year, reflecting both the impact of the fall in the prices of oil and other raw materials on those of intermediate goods and food products and the abatement of the moderate price pressures experienced by Italy's main European partners. During 1997 the twelve-month rate of change in the average unit values in lire of imported products gradually rose from substantial decreases at the beginning of the year to increases of more than 3 per cent in the third quarter before falling back below 2 per cent in the fourth, close to the rate of increase in the producer prices of Italian manufactures for the domestic market.

Costs and profit margins in manufacturing industry and market services

The unit variable costs of manufacturing firms rose by an annual average of 1.2 per cent, considerably less than the figure of 3.8 per cent recorded in 1996 (Table 18). The slowdown reflected the deceleration in the rate of increase in domestic costs from the high levels of the previous year; the moderating effect of imported inputs was less pronounced than in 1996, when it had reflected the strong recovery of the lira. The behaviour of costs during the year - accelerating in the first quarter and slowing down thereafter - was determined primarily by that of domestic inputs.

The slowdown in domestic costs over the year as a whole was attributable to the behaviour of both unit labour costs and input costs, whose

annual rates of increase fell respectively from 6.0 to 2.4 per cent and from 5.3 to just 0.7 per cent. The deceleration in unit labour costs was due above all to the cyclical recovery in productivity from a decline of 0.5 per cent in 1996 to a gain of 2.8 per cent last year. In fact, labour costs rose by 5.3 per cent, similar to the rate recorded in 1996. There was an acceleration in the first quarter, owing mainly to the one-off effects of the wage settlement in the engineering industry; subsequently, the improvement in inflation expectations and their stabilization at the same levels as in the other main countries of the euro area fostered a gradual reduction in the size of the wage increases agreed as contracts came up for renewal. These developments, together with the recovery in productivity, caused the rate of change in unit labour costs to slow down sharply following the surge at the beginning of the year and to turn slightly negative in the last quarter (Table a9).

Table 18

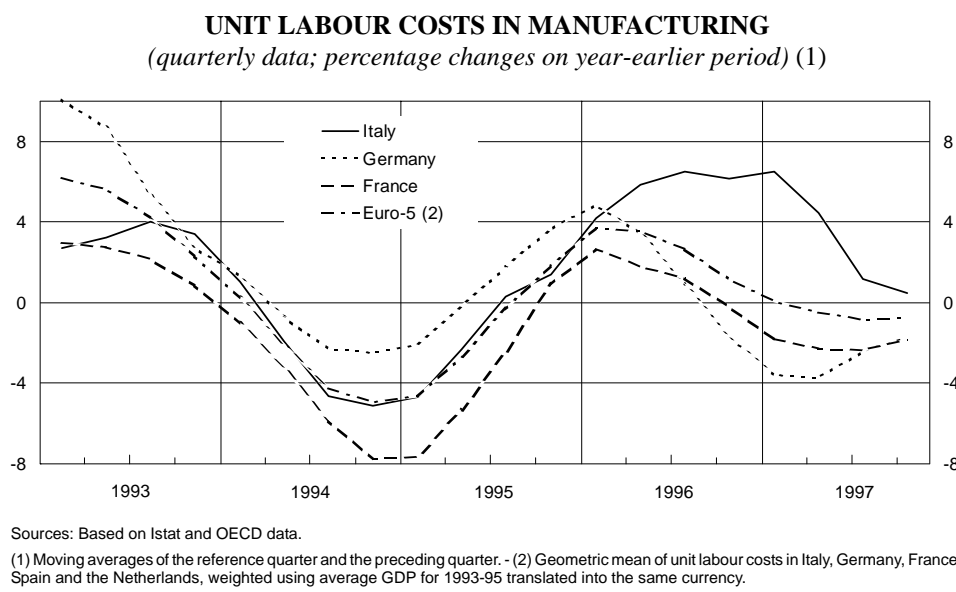
UNIT VARIABLE COSTS AND FINAL PRICES
(percentage changes on year-earlier period)

	Manufacturing (1)			Market services (2)		
	Percentage weights (3)	1996	1997	Percentage weights (3)	1996	1997
Unit variable costs	100.0	3.8	1.2	100.0	4.2	1.8
Domestic	74.5	5.7	1.7	91.9	4.4	1.9
Unit labour costs	49.6	6.0	2.4	78.2	4.9	2.1
labour costs .....	...	5.5	5.3	...	4.9	3.9
productivity .....	...	-0.5	2.8	...	0.1	1.7
Input costs	24.9	5.3	0.7	13.7	1.3	0.0
services	18.7	5.3	1.6	...	...	...
agricultural materials	5.8	5.1	-3.7	0.9	5.1	-3.7
manufactures .....	...	...	...	10.9	1.4	0.0
Foreign	25.5	-2.2	-0.7	8.1	-0.4	0.8
intermediate goods	10.4	-0.2	-1.7	0.9	0.9	-1.4
industrial raw materials	5.0	-9.4	-1.3	...	...	...
energy (4)	5.1	6.5	3.1	5.3	6.6	2.5
Output prices	100.0	2.0	0.4	100.0	5.0	2.3
Domestic	72.0	1.9	0.8	94.7	5.0	2.3
Export	28.0	2.3	-0.7	5.3	4.2	2.3

Sources: Based on Istat and ENI data.
(1) Net of intrasectoral transactions; excluding transport equipment other than motor vehicles. – (2) Net of intrasectoral transactions; excluding the renting of buildings. – (3) Calculated on the basis of the input-output table for 1988, at 1980 prices. – (4) Includes domestic as well as imported energy products.

The differential between the rate of change in unit labour costs in manufacturing industry in Italy on the one hand and France and Germany on the other widened markedly over the last two years as a whole, in part because of a decrease in the two latter countries (Figure 14). In the course of 1997 the differential began to narrow, but in the fourth quarter it was still quite considerable, standing at around 2 percentage points.

Figure 14

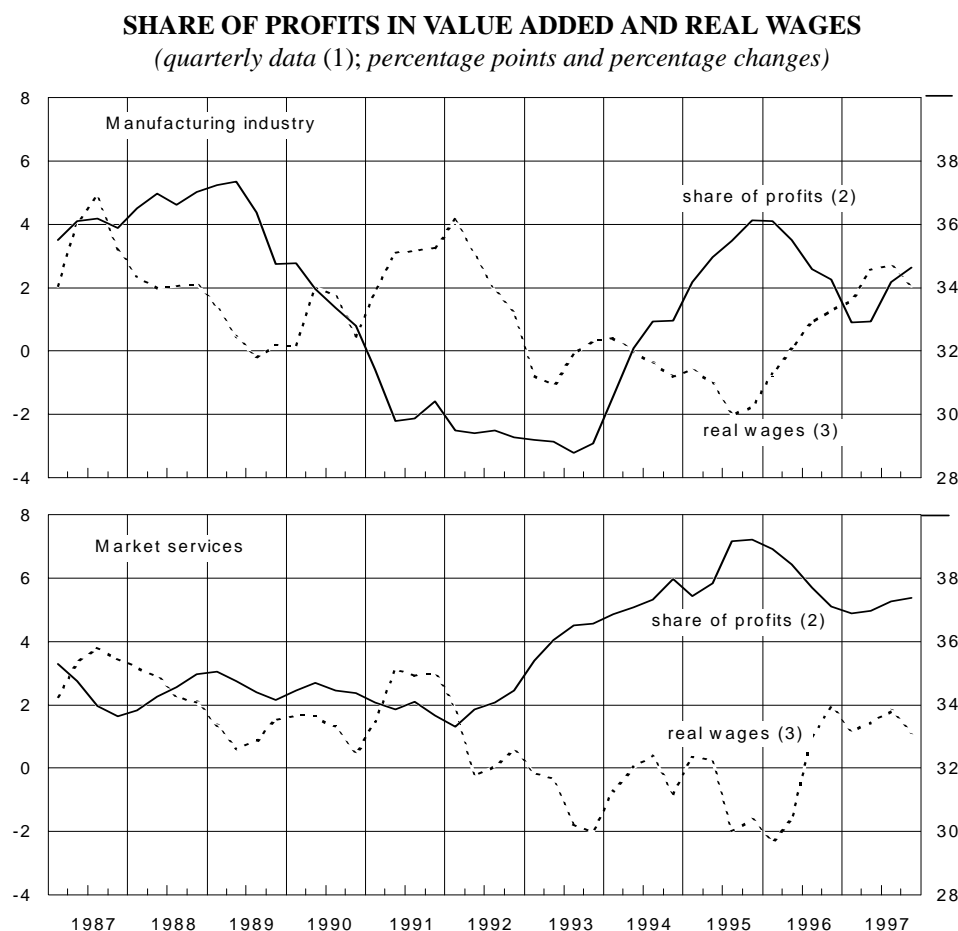


Positive signals are also coming from the behaviour of costs in market services, which rose by an average of 1.8 per cent in 1997, compared with 4.2 per cent the previous year. In particular, unit labour costs increased by 2.1 per cent, nearly 3 percentage points lower than in 1996 and less than the rise in industry, thanks to the smaller increase in direct labour costs per employee (3.9 per cent), which more than offset the slower growth in productivity (1.7 per cent).

The share of profits in the value added of manufacturing industry fluctuated quite widely during 1997, contracting by around 1 percentage point over the year as a whole (Figure 15). There was a similar, though much less marked trend, in the share of profits in market services.

In the private sector as a whole, the high share of profits and the simultaneous recovery in real wages point to lasting disinflation, since they testify to the current absence of significant distributive conflicts, which can fuel inflation.

Figure 15



Source: Based on Istat data.

(1) Moving averages of the reference quarter and the preceding quarter. - (2) Share of gross operating profits in value added, calculated by attributing the same unit incomes to the self-employed as those earned by employees. Right-hand scale. - (3) Percentage changes on year-earlier quarter in gross earnings per employee deflated with the index of consumer prices for the population as a whole. Left-hand scale.

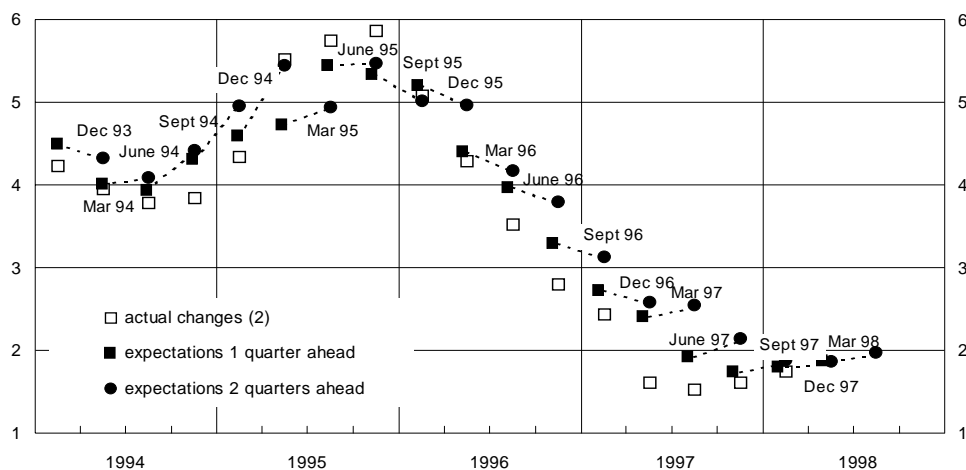
Inflation expectations

In 1997 there was a pronounced improvement in inflation expectations over all time horizons. The decline in expected inflation was larger in Italy than in the other main economies that will adopt the euro, leading to a substantial convergence of the Italian rate with the average for the euro area.

As the Forum-Mondo Economico survey shows (Figure 16), expectations adjusted with a lag to the fall in actual inflation: the forecasts made at the beginning of 1997 proved to be around 1 percentage point higher than the actual figures; the gap diminished steadily and disappeared towards the end of the year.

Figure 16

**FORUM-ME SURVEY OF EXPECTATIONS OF CONSUMER
PRICE INFLATION IN THE SUBSEQUENT TWO QUARTERS (1)**
(percentage changes on year-earlier quarter)

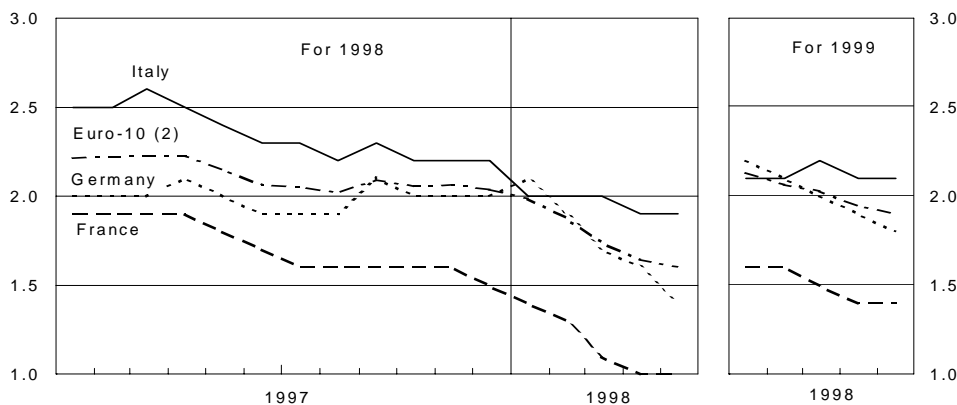


Sources: Based on Istat and Forum-ME data.

(1) Expectations of a panel of businessmen and experts. The dates given in the figure refer to the survey date. Some aspects of the survey were changed in March 1995. - (2) Index of consumer prices for worker and employee households, excluding tobacco products.

Figure 17

**PROFESSIONAL FORECASTERS'
INFLATION EXPECTATIONS FOR 1998 AND 1999 (1)**
(percentages)



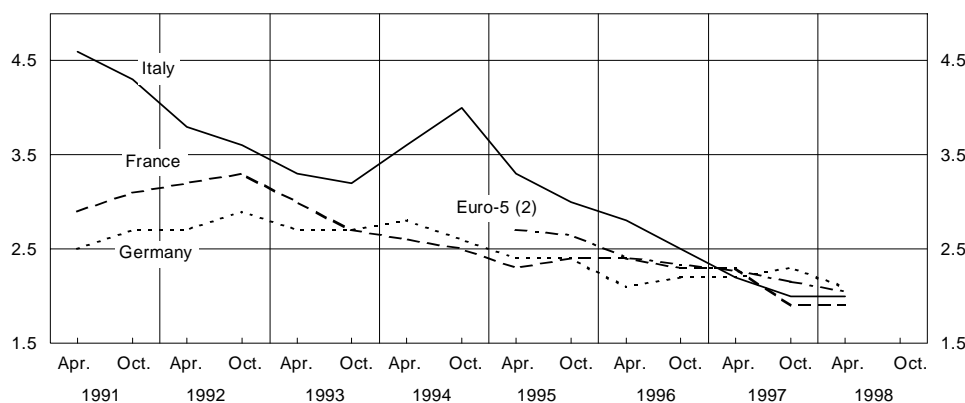
Source: Based on Consensus Forecasts data.

(1) Average annual rate of consumer price inflation. - (2) Average of the forecasts for the national consumer price indices (for Italy, the consumer price index for worker and employee households) of the countries that will adopt the euro, excluding Luxembourg, weighted on the basis of 1996 final consumption translated into the same currency using the bilateral exchange rates announced on 2 May 1998. The weights are revised every January in accordance with the change in the harmonized consumer price index in the 12 months ending in the previous December.

In the early months of 1998 inflation expectations for this year and next improved more strongly in the other leading European countries than in Italy, causing the differential to widen. According to a survey conducted in

Figure 18

**PROFESSIONAL FORECASTERS' LONG-TERM
INFLATION EXPECTATIONS (1)**
(percentages)



Source: Based on Consensus Forecasts data.

(1) Average inflation rate expected for the period between 5 and 10 years ahead of the survey year (e.g. average expected inflation for the period 2004-2008 according to the surveys conducted in 1998). Surveys are conducted in April and October of each year. - (2) Average of the forecasts for Italy, Germany, France, Spain and the Netherlands, weighted on the basis of 1996 final consumption translated into the same currency using the bilateral exchange rates announced on 2 May 1998. The weights are revised every January in accordance with the change in the harmonized consumer price index in the 12 months ending in the previous December.

May by Consensus Forecasts, inflation is expected to average 1.9 per cent in Italy in 1998, compared with 1.4 per cent in Germany, 1.0 per cent in France and 1.6 per cent in the euro area (Figure 17). Survey findings regarding longer time horizons, however, show that the markets judge the widening of the differential to be temporary (Figure 18). The disparity is expected to narrow in 1999 to 0.3 and 0.7 percentage points vis-à-vis Germany and France respectively and to vanish as early as 2000. Expectations of complete convergence in the long term also emerge from the behaviour of 1-year forward interest rates nine years ahead, which fell below 6 per cent to the same level as the corresponding German rates.

THE BALANCE OF PAYMENTS AND ITALY'S NET EXTERNAL POSITION

In 1997 the surplus on the current account of the balance of payments amounted to 62,542 billion lire, or 3.2 per cent of GDP, thus remaining close to the high level recorded in 1996, when it had equalled 3.4 per cent of GDP (Table 19). The trade surplus declined from 5.0 to 4.1 per cent of GDP, with the bulk of the reduction occurring in trade with EU countries. The deterioration was almost completely offset by a contraction in the deficit on invisibles.

Table 19

BALANCE OF PAYMENTS (billions of lire)

	1995	1996	1997
Current account	43,680	63,351	62,542
Goods	72,882	93,736	79,897
Invisibles	-29,202	-30,385	-17,355
Capital movements	-6,312	-9,916	-11,525
Non-bank capital	51,790	37,478	-23,204
Italian	-32,506	-79,403	-159,877
Direct investment	-9,337	-9,975	-18,083
Portfolio investment	-11,865	-52,143	-112,528
Loans	-4,444	-15,890	-26,010
Trade credit (1)	-6,860	-1,395	-3,256
Foreign	84,296	116,881	136,673
Direct investment	7,846	5,454	6,296
Portfolio investment	61,490	125,349	119,428
Loans	9,656	-9,112	6,064
Trade credit (1)	5,304	-4,810	4,885
Bank capital	-58,102	-47,394	11,679
Change in official reserves (2)	-2,910	-20,597	-22,840
<i>Memorandum items:</i>			
Total financial flows	-9,222	-30,513	-34,365
Change in net external position	33,315	30,697	38,247
Errors and omissions	-34,458	-32,838	-28,177

(1) For 1997, partially estimated. – (2) At constant exchange rates and prices. A minus sign indicates an increase in the reserves.

The current account surplus vis-à-vis countries outside the euro area came to 53 trillion lire in 1997, equal to nearly one third of the area's total surplus.

Italy's net external debt decreased further. At the end of the year there was a net external debtor position of about 15.6 trillion lire, equal to 0.8 per cent of GDP, 2.1 percentage points less than at the end of 1996. In view of the net outflow of 11,525 billion lire on account of capital movements and the increase of 22,840 billion lire in the official reserves, a very large deficit of 28,177 billion lire, equal to 1.4 per cent of GDP, was attributed to errors and omissions.

Merchandise trade

The rate of increase in the value of exports rose modestly, from 2.0 to 4.3 per cent. After decreasing in 1996, imports began to grow rapidly again, increasing by 10.4 per cent. The *fob-fob* trade surplus declined from 93,736 to 79,897 billion lire.

The rise in the value of exports can be ascribed fully to an increase of 4.6 per cent at constant prices, as average unit values in lire declined by 0.3 per cent (0.8 per cent in the currencies of Italy's competitors). The rise was far less than that in world trade, which the IMF estimates to have increased by 9.6 per cent. As a result, Italy's share of world markets at constant prices declined to 4.0 per cent in the first nine months of 1997, 0.3 percentage points less than in the same period of 1996.

Exports at constant prices increased in most branches of manufacturing except those producing office machinery and transport equipment other than motor vehicles. Exports of agricultural and industrial machinery, which account for a sixth of all Italian exports, increased by 4.1 per cent; most of this concerned exports of textile and sewing machinery, agricultural machinery and tractors. Foreign sales of textiles and clothing, which make up more than a tenth of exports, increased by 5.1 per cent.

The rise in the value of imports was also due entirely to an increase in volume. Imports at constant prices rose by 10.3 per cent, fueled by the recovery in domestic demand, especially stockbuilding. The expansion involved all manufacturing sectors except for food products. The pick-up in investment stimulated imports of capital goods, especially in the second half of the year, while government incentives boosted those of motor vehicles, which increased by 26.9 per cent. Among intermediate goods, imports of mineral and metal products and chemical products increased particularly

rapidly, rising by 16.4 and 12.8 per cent respectively. Imports of textiles and clothing increased by 14.8 per cent.

The trade surplus with EU countries contracted sharply in 1997. In the first nine months of the year Italian exporters' share of the EU market at constant prices slipped from 6.9 to 6.6 per cent.

The trade surplus vis-à-vis non-EU countries fell by only 2.4 trillion lire. A deterioration with respect to Asia and the OPEC countries was partly offset by an improvement in trade with the industrial countries and those of Central and Eastern Europe.

Invisibles

There was a deficit of 17,355 billion lire on the invisible items of the balance of payments (services, investment income, compensation of employees and unrequited transfers), about 13 trillion less than in 1996 (Table 20).

Table 20

CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS (billions of lire)

	1995	1996	1997
Goods	72,882	93,736	79,897
Services	1,011	3,074	3,419
Transport	-13,851	-13,146	-15,022
Travel	23,117	22,352	22,453
Other services	-8,255	-6,132	-4,012
Income	-25,533	-23,124	-19,005
Investment income	-26,328	-23,925	-19,253
Compensation of employees	795	801	248
Transfer	-4,680	-10,335	-1,769
Private	1,191	475	-1,181
Workers' remittances	161	44	55
Other	1,030	431	-1,236
Public	-5,871	-10,810	-588
From/to EU	-1,944	-7,198	1,237
Other	-3,927	-3,612	-1,825
Total ...	43,680	63,351	62,542

The surplus on foreign travel was broadly the same as in 1996, at 22,453 billion lire, equal to 1.2 per cent of GDP. Receipts increased by 9.9 per cent at current prices and by 7.8 per cent in real terms. Since the number of foreign visitors and their overnight stays did not change, the increase can be ascribed to a considerable rise in daily per capita spending generated by an increase in the number of visitors from the United States and the United Kingdom, whose propensity to spend is higher than the average. Calculated in terms of consumer prices, the competitiveness of Italian tourist locations vis-à-vis those countries increased by 9.6 and 14.5 per cent respectively. Expenditure by Italian tourists abroad rose by 18.8 per cent (18.0 per cent at constant prices), reflecting not only an increase in average relative prices at Italian locations but also a shift of preferences in favour of more expensive destinations, with more than a third of the increase being attributable to higher spending on trips to the United States and the United Kingdom. Expenditure at constant prices increased from 2.4 to 2.7 per cent of the final consumption of Italian households, thus continuing the long-term trend. As in previous years, the tourism surplus was earned largely in trade with industrial countries, particularly Germany (10.9 trillion lire), Japan (4.4 trillion), Austria (1.8 trillion), the United States (1.4 trillion) and the United Kingdom (1.3 trillion); by contrast, there were deficits in relation to Spain, France and countries in Africa.

Trade in transport and other services gave rise to a deficit of 19,034 billion lire, broadly the same as in 1996. The reduction in the deficit on business services, trade-related and financial services and personal services was accompanied by an increase in the surplus on construction services and services for government; the improvement was offset by a decrease in the surplus on insurance services and a worsening of the deficit on transport services. The latter arose largely in trade with France, Germany, the United Kingdom and the Netherlands. EU countries accounted for all of the deficit of 4 trillion lire on other services, most of which was due to trade-related services, especially vis-à-vis the Netherlands, with which Italy had a deficit of 2.8 trillion lire on this item. The surplus with non-EU countries reflected the marked improvement in trade with Latin American developing countries, the United States and the other industrial countries.

The net outflow of investment income declined for the second consecutive year to 19,253 billion lire, 4,700 billion less than in 1996; in proportion to GDP it fell from 1.3 to 1.0 per cent. The improvement reflected the reduction in the stock of external debt and the general decline in interest rates, which was particularly rapid in Italy. The positive impact of the latter development was due to the fact that lira-denominated instruments make up a larger proportion of liabilities than assets.

The geographic composition of flows of investment income reflected that of the underlying financial flows. Hence, the largest income flows were

in relation to the United Kingdom, Luxembourg, Germany, the United States and offshore centres in Latin America.

The deficit on unrequited transfers contracted sharply, falling from 10.3 to 1.8 trillion lire owing to an improvement of 10.2 trillion lire in official transfers, ascribable to an increase of 68.7 per cent in transfers from the EU due to the payment of arrears and an improvement in public authorities' capacity to submit new projects that attract EU funding. Italy's gross contributions to the EU declined by about 1 trillion lire, thanks primarily to a decline of about 3 trillion lire in VAT payments.

The net external position and capital movements

The recording of a current account surplus for the fifth consecutive year brought the country's net external position close to balance. At the end of 1997 Italy's gross external liabilities exceeded its gross external assets by 15.6 trillion lire, equal to 0.8 per cent of GDP (Table 21).

On the basis of data reclassified according to the origin of the demand for foreign funds (Table 22), the private non-bank sector increased its net external assets by 134.4 trillion lire; the rise was offset by increases of 103.6 trillion lire in the net external liabilities of general government and 22.2 trillion in those of Italian banks. Excluding currency swaps with resident banks, the official reserves increased by nearly 26 trillion lire.

The private non-bank sector. - In 1997 Italian non-financial enterprises were responsible for a net outflow of 9.1 trillion lire, compared with 6.1 trillion the previous year. In 1996 they had drawn on the resources generated by the current account surplus to repay foreign loans (10.5 trillion lire) and grant more trade credit abroad than they received (6.2 trillion); at the same time, non-residents had made substantial net purchases of shares and other equities (10.6 trillion lire), stimulated by the success of several privatizations and the strong performance of the Italian stock market. In 1997, by contrast, non-financial enterprises granted 7.7 trillion lire in net new foreign loans. The sign of the net flows in respect of trade credit and shares was reversed, reflecting on the one hand the acceleration in imports and on the other a large increase in Italian shareholdings in foreign companies.

Households and Italian investment funds also repaid foreign loans. Unlike non-financial enterprises, in 1996 they had made large purchases of foreign medium and long-term securities (17.1 trillion lire); such purchases

more than doubled in 1997, rising to 42.9 trillion lire, and also spread to shares (19.9 trillion). Households and Italian investment funds accounted for half of the net outflows effected by the private non-bank sector over the two years. The sector's net external creditor position nearly doubled to 317 trillion lire in the twelve months to the end of 1997.

Table 21

ITALY'S NET EXTERNAL POSITION
(billions of lire)

	Stocks at end of 1996 (1)	January-December 1997					Stocks at end of 1997 (1)
		Flows (2)	Adjustments		Change in stocks (d)=(b)+(c)		
			in exchan- ge rates (3)	other (4)			
	(a)	(b)	(c)	(3)	(4)	(d)=(b)+(c)	(a)+(d)
Resident non-banks							
Assets	676,485	159,877	84,885	39,350	45,535	244,762	921,247
Direct investment	179,598	18,083	39,042	10,587	28,455	57,125	236,723
Portfolio investment	343,532	112,528	42,290	25,210	17,080	154,818	498,350
Loans	72,860	26,010	3,553	3,553	—	29,563	102,423
Trade credit	80,495	3,256	—	—	—	3,256	83,751
Liabilities	786,230	136,673	76,059	2,801	73,258	212,732	998,962
Direct investment	114,242	6,296	25,752	..	25,752	32,048	146,290
Portfolio investment	510,327	119,428	48,216	710	47,506	167,644	677,971
Government securities	397,937	102,879	15,098	710	14,388	117,977	515,914
Loans	119,012	6,064	2,091	2,091	—	8,155	127,167
Trade credit	42,649	4,885	—	—	—	4,885	47,534
Net position . . .	-109,745	23,204	8,826	36,549	-27,723	32,030	-77,715
Resident banks							
Assets	328,344	8,577	12,314	12,314	—	20,891	349,235
Liabilities	379,171	20,256	21,321	21,321	—	41,577	420,748
Net position . . .	-50,827	-11,679	-9,007	-9,007	—	-20,686	-71,513
Central bank							
Assets	108,653	22,770	4,196	5,181	-985	26,966	135,619
Liabilities	1,912	-70	133	133	—	63	1975
Net position . . .	106,741	22,840	4,063	5,048	-985	26,903	133,644
NET OVERALL POSITION . . .	-53,831	34,365	3,882	32,590	-28,708	38,247	-15,584

(1) At end-of-period prices and exchange rates. – (2) Capital movements at the securities prices and exchange rates prevailing on the date of the transaction. A minus sign indicates a decrease in the relevant assets or liabilities. – (3) Calculated on the basis of the composition according to currency. – (4) Calculated on the basis of the composition according to financial instrument.

(1) At end-of-period prices and exchange rates. – (2) Capital movements at the securities prices and exchange rates prevailing on the date of the transaction. A minus sign indicates a decrease in the relevant assets or liabilities. – (3) Calculated on the basis of the composition according to currency. – (4) Calculated on the basis of the composition according to financial instrument.

Table 22

FINANCIAL FLOWS AND ITALY'S NET EXTERNAL POSITION*(data reclassified according to the origin of the demand for foreign funds; trillions of lire)*

		Non-banks					Monetary institutions		Total	
		Private sector				General government	Banks	Central bank		
		Households & investment funds	Non-financial enterprises	Other enterprises	Unallocated					
Flows: assets (1)										
Shares and other	1996	-2.9	5.5	1.9	..	4.5	0.9	2.6	0.1	8.2
equities	1997	19.9	10.1	5.0	..	35.0	0.5	0.4	-0.1	35.9
Short-term	1996	0.4	0.1	-0.1	-	0.5	..	-	-0.1	0.3
securities ...	1997	0.1	-0.3	0.4	-	0.3	..	-	0.1	0.4
Medium and long-term securities	1996	17.1	1.0	6.4	..	24.6	0.3	2.2	1.9	29.0
	1997	42.9	0.8	11.4	0.5	55.6	0.8	3.7	1.9	62.0
Loans and trade credit	1996	-	2.3	15.4	-0.4	17.3	..	34.2	..	51.5
	1997	-	10.1	21.1	-0.8	30.4	-1.1	13.8	0.9	44.0
Other instruments .	1996	6.2	2.4	1.9	20.8	31.3	0.1	16.6	40.9	88.9
	1997	7.8	3.2	4.3	22.7	38.1	0.2	-12.3	22.9	48.9
Total	1996	20.8	11.4	25.5	20.5	78.2	1.2	55.7	42.9	177.9
	1997	70.8	23.9	42.2	22.4	159.2	0.6	5.7	25.7	191.2
Flows: liabilities (1)										
Shares and other	1996	-0.1	16.1	1.9	1.6	19.5	-	-	-	19.5
equities	1997	0.2	8.5	8.0	5.6	22.3	-	-	-	22.3
Short-term	1996	-	-	-	-	-	13.7	-	-	13.7
securities ...	1997	-	-	-	-	-	7.9	-	-	7.9
Medium and long-term securities	1996	-	0.6	-	-	0.6	87.1	0.1	-	87.8
	1997	-	-0.3	-	-	-0.3	95.4	0.9	-	96.0
Loans and trade credit	1996	-1.7	-14.4	-2.7	-0.5	-19.3	-1.7	20.8	-2.0	-2.1
	1997	-2.8	4.0	1.2	0.2	2.6	0.8	15.3	..	18.6
Other instruments .	1996	..	2.9	1.6	3.2	7.7	2.1	18.7	-	28.5
	1997	..	2.5	2.1	-4.3	0.3	..	11.6	-	12.0
Total	1996	-1.8	5.3	0.8	4.3	8.5	101.2	39.6	-2.0	147.4
	1997	-2.6	14.7	11.2	1.5	24.9	104.2	27.8	..	156.8
Flows: assets - liabilities (1)										
Shares and other	1996	-2.8	-10.6	0.1	-1.6	-14.9	0.9	2.6	0.1	-11.3
equities	1997	19.7	1.6	-3.0	-5.6	12.7	0.6	0.4	-0.1	13.6
Short-term	1996	0.4	0.1	-0.1	-	0.5	-13.7	-	-0.1	-13.4
securities ...	1997	0.1	-0.3	0.4	-	0.3	-7.9	-	0.1	-7.5
Medium and long-term securities	1996	17.1	0.4	6.4	..	24.0	-86.8	2.1	1.9	-58.8
	1997	42.9	1.1	11.4	0.5	55.9	-94.6	2.8	1.9	-34.0
Loans and trade credit	1996	1.7	16.7	18.1	0.1	36.6	1.7	13.4	2.0	53.7
	1997	2.8	6.1	19.9	-1.0	27.8	-1.9	-1.5	1.0	25.4
Other instruments .	1996	6.2	-0.5	-1.0	17.6	23.6	-2.0	-2.0	40.9	60.4
	1997	7.8	0.7	1.8	27.0	37.7	0.2	-23.9	22.9	36.9
Total	1996	22.6	6.1	24.8	16.2	69.7	-100.0	16.1	44.8	30.5
	1997	73.4	9.1	31.0	20.9	134.4	-103.6	-22.2	25.8	34.4
Net external position (total instruments) (2)										
1992	.....	83.0	-169.0	3.0	4.0	-79.0	-110.0	-10.0	36.0	-164.0
1993	.....	125.0	-150.0	13.0	10.0	-3.0	-223.0	31.0	50.0	-145.0
1994	.....	139.0	-121.0	32.0	45.0	96.0	-249.0	-24.0	59.0	-118.0
1995	.....	154.0	-91.0	35.0	89.0	188.0	-316.0	-6.0	50.0	-85.0
1996	.....	182.0	-85.0	60.0	103.0	258.0	-420.0	16.0	92.0	-54.0
1997	.....	317.0	-95.0	103.0	89.0	413.0	-535.0	-13.0	120.0	-16.0

(1) A minus sign indicates a decrease in the relevant assets or liabilities. Rounding may cause discrepancies in totals. - (2) At constant exchange rates and prices.

The gross external assets of private non-bank enterprises increased by 36.2 per cent during the year. The largest component was portfolio investment, which amounted to 112.5 trillion lire, with an additional 42.3 trillion lire in value adjustments.

General government. - The increase in the net external assets of the private non-bank sector was offset by a rise in the external liabilities of general government, consisting almost entirely of medium and long-term government securities. The sector's financial balance deteriorated by 103.6 trillion lire last year, after having worsened by more than 100 trillion in 1996. Its net external debtor position increased from 420 to 535 trillion lire.

At the end of 1997 resident non-banks had a net external debtor position of 77.7 trillion lire (4.0 per cent of GDP), 32 trillion less than in 1996 (Table 21).

The sign of net foreign and Italian portfolio investment has changed over the last four years; whereas in 1994 there had been an outflow of 8.3 trillion lire, last year there was an inflow of 6.9 trillion. Italian portfolio investment in the other ten countries that will participate in EMU consistently exceeded the corresponding inflows; in the last two years this form of investment abroad has accelerated markedly, giving rise to net outflows of 9.1 trillion lire in 1997.

The banks and the official reserves. - At the end of 1997 Italian banks had a net external debtor position of 71.5 trillion lire, 20.7 trillion more than at the end of the previous year (Table 23). If currency swaps with the Bank of Italy are included on the assets side and foreign currency loans to residents (net of their foreign currency deposits) are subtracted from the corresponding liabilities, the banks' external position moved from net assets of 15.9 trillion lire in 1996 to net liabilities of 12.6 trillion in 1997. The deterioration was entirely attributable to changes in the lira component; reverse repos on Italian securities with non-residents seeking to hedge their exchange risk fell to 9.5 trillion lire. The banks' overall spot and forward foreign currency position, including lira loans indexed to foreign currencies and currency swaps with residents, worsened by 2.3 trillion lire.

The official reserves increased by 26.9 trillion lire at end-of-period exchange rates and prices; nearly all of the rise reflected the increase in holdings of convertible currencies (Table 21). Excluding currency swaps with resident banks, the reserves were broadly unchanged until 1995 and began to increase in 1996. At average exchange rates and prices, they rose by 22.8 trillion lire in 1997; at the end of the year the central bank had a net

external creditor position of 133.6 trillion lire. Currency swaps with resident banks amounted to 14.1 trillion lire.

Table 23

**STOCKS AND CHANGES IN THE EXTERNAL POSITION, DOMESTIC
POSITION IN FOREIGN CURRENCY AND OVERALL POSITION IN
FOREIGN CURRENCY OF ITALIAN BANKS (1)**
(billions of lire)

	1996	1997	1997			
			Q1	Q2	Q3	Q4
	Stocks					
External position	-50,827	-71,513	-81,698	-40,437	-54,798	-71,513
in lire	52,230	31,655	42,863	67,632	53,495	31,655
in foreign currency . . .	-103,057	-103,168	-124,561	-108,069	-108,293	-103,168
Domestic position in foreign currency (2) .	79,470	72,044	86,708	78,553	73,136	72,044
Overall position in foreign currency (3)	113	-2,158	-980	783	1,029	-2,158
	Changes (4)					
External position	47,394	-11,679	-24,627	42,089	-14,019	-15,122
in lire	30,252	-20,575	-9,367	24,769	-14,137	-21,840
in foreign currency . . .	17,142	8,896	-15,260	17,320	118	6,718
Domestic position in foreign currency (2) .	-30,800	-12,937	3,578	-8,189	-6,134	-2,192
Overall position in foreign currency (3)	4,954	330	517	2,250	117	-2,554

(1) Including the Italian branches of foreign banks. – (2) Including currency swaps with the Bank of Italy and loans indexed to foreign currencies. – (3) Spot and forward, including domestic currency swaps, commitments to be settled within 2 days and loans indexed to foreign currencies. – (4) At constant exchange rates and securities prices. A minus sign indicates an inflow of bank capital.

Direct investment

Italian direct investment abroad amounted to 18.1 trillion lire in 1997; this far exceeded the inflow of 6.3 trillion in foreign direct investment in Italy (Table 21) and was more than in previous years. Between 1990 and 1997 there were average annual outflows of more than 10.3 trillion lire (3.6 per cent of national gross fixed investment), compared with inward investment of 6.3 trillion (1.9 per cent). Italian firms invested 82.5 trillion lire abroad over the period; the stock of their direct investment quadrupled between the end of 1989 and the end of last year, rising from 59.1 to 236.7 trillion lire and from 5.0 to 12.3 per cent of GDP, partly owing to the behaviour of exchange

rates and the performance of foreign stock markets. Net of their corresponding liabilities, Italian firms had an external creditor position of 90.4 trillion lire at the end of last year, equal to 4.9 per cent of GDP.

Between 1992 and 1996 a large part of direct investment in manufacturing within the EU went not only to countries on the Union's periphery (Spain and Portugal) but also to countries with high labour costs at the region's centre (the Netherlands and France). The flows to both areas were greatest in sectors producing traditional consumer goods (textiles, clothing, wood products and furniture) and those enjoying considerable economies of scale (chemical products, rubber and plastic products, transport equipment). The geographic and sectoral composition of Italian investment abroad does not differ radically from that of the country's European partners. During the period in question, 60 per cent of Italian direct investment in industry was channeled into EU countries, especially France, the Netherlands and Spain. As a proportion of value added, however, the volume of Italian foreign direct investment is systematically below the European average in all sectors except transport equipment.

THE PUBLIC FINANCES

The budgetary policy for 1997, which was set out in the Forecasting and Planning Report published in September 1996, was aimed primarily at keeping general government net borrowing within a ceiling of 3 per cent of GDP. It implied a sharp acceleration in the process of reducing the budget deficit and the ratio of the public debt to GDP compared with the timetable laid down in the Economic and Financial Planning Document of June 1996 for the three years 1997-99. The adjustment to the budget on a current programmes basis was increased considerably.

The objectives were achieved: general government net borrowing fell to 2.7 per cent of GDP and the public debt declined from 124 to 121.6 per cent of GDP.

These results were decisive for Italy's participation in the euro area from the launch date in 1999. They are part of the drive to consolidate the public finances that was begun in the second half of the eighties, when the economic situation was favourable, and intensified in the nineties, despite the deterioration in cyclical conditions. During this second phase structural measures were also adopted that attenuated the expansionary trends in the major expenditure items. The slowdown in inflation helped to reduce the burden of interest payments, thereby reinforcing the effects of the improvement in the primary balance and speeding up the decrease in net borrowing towards the threshold of 3 per cent of GDP.

The ratio of net borrowing to GDP fell by 4 percentage points in 1997, even though the growth in economic activity remained modest. The primary surplus rose from 4.1 to 6.8 per cent of GDP and interest payments declined from 10.8 to 9.5 per cent. The latter figure does not fully reflect the fall in yields that has occurred during the last two years, as the lag with which interest payments are affected by changes in market rates has become longer in recent years as a consequence of the policy of lengthening the average maturity of the debt.

The general government current account was nearly in balance in 1997, compared with a deficit of 59.5 trillion lire in 1996. The absorption of savings by the public sector was thus arrested.

The reduction of 2.4 percentage points in the ratio of the public debt to GDP was considerably larger than the total of 0.9 points achieved in the two previous years. The acceleration was due to the increase in the primary surplus, the decrease in interest payments and the increase in privatization receipts.

The correction made to the primary balance was very substantial, of the order of 3 per cent of GDP and only slightly less than planned by the Government. Most of the budget measures were on the revenue side and caused the ratio of tax and social security contributions to GDP to return to the peak recorded in 1993. The decline in primary expenditure in relation to GDP was small: the reduction in capital expenditure, which was almost entirely due to the absence of settlements of tax credits in securities, was accompanied by a further increase in current expenditure, fueled by the rise in social benefits.

The restrictions imposed on budget appropriations, on transfers of budget resources to the centralized Treasury accounts of non-state public bodies and on their withdrawals from these accounts helped to keep expenditure within the limits set. Temporary measures are estimated to have reduced the 1997 budget deficit by around 1 per cent of GDP.

1998 is set to be a year for consolidating the results achieved. The projections contained in the Quarterly Report on the Borrowing Requirement published in March show that the further fall in interest payments is likely to result in a small decrease in net borrowing, from 2.7 to 2.6 per cent of GDP, despite the significant reduction in the size of the primary surplus, from 6.8 to 5.5 per cent of GDP. The ratio of revenue to GDP is expected to fall by 1.1 percentage points, primarily owing to the expiry of the temporary measures introduced in 1997. Primary expenditure is likely to rise slightly in relation to GDP as a result of an increase in capital outlays.

The budget for 1998 is designed to produce an adjustment amounting to 1.2 per cent of GDP. The overall effect of the measures approved by Parliament was the same as that outlined in the Planning and Forecasting Report, but their composition was modified; in particular, the reductions in social spending were scaled down and the increases in social security contributions enlarged. The expenditure objectives will again be pursued in part by monitoring and managing cash flows. In the longer term this could help to reduce expenditure if it encouraged public bodies to use resources more efficiently.

This year the Government has enacted legislation under the tax-reforming powers it was granted in 1997. A new regional tax on

productive activities (Irap) has been introduced and at the same time health service contributions and some other taxes have been abolished. The structure of personal income tax (Irpef) and the system for taxing income from financial assets have been revised. A new system of corporate income tax has been introduced, known as Dual Income Tax. The reforms are aimed at simplifying and rationalizing the tax system, reducing the distortions that impinged on decisions concerning the use of the factors of production and the forms of corporate finance, increasing the fiscal autonomy of lower levels of government and giving relief to large families. In using its delegated powers, the Government set itself the objective of keeping revenue basically unchanged.

The budget measures relating to pensions speeded up the standardization of the different pension systems, tightened the eligibility requirements for long-service pensions and temporarily reduced the cost-of-living adjustments for larger pensions. These changes are expected to reduce expenditure by 3.2 trillion lire in 1998; they will not affect the volume of disbursements in the long term.

The Economic and Financial Planning Document for the three years 1999-2001 maps a course for reducing the budget deficit and the public debt to 1 and 107 per cent of GDP respectively in 2001. It is based on the assumption that the primary surplus will stabilize at 5.5 per cent of GDP. Only part of the larger reduction expected in interest payments by comparison with the scenario set out in the previous Document is reflected in a smaller overall deficit, 1.5 per cent of GDP in 2000 instead of 1.8 per cent; the remainder is reflected mainly in a less ambitious objective for the primary surplus, 5.5 per cent of GDP in 2000 instead of 6.1 per cent.

The budget adjustments planned for the next three years amount to 19.5 trillion lire; the Government intends to use a large part of the resources made available in this way to finance measures aimed at fostering economic growth. The ratios of revenue and primary expenditure to GDP are expected to fall by one percentage point between 1998 and 2001, but are higher than had been envisaged in the earlier Document. The reduction in the ratio of taxation to GDP, which depends crucially on success in curbing expenditure, would help create the macroeconomic conditions assumed when drawing up the plan for the consolidation of the public finances; it is a prerequisite for making Italy competitive in an increasingly integrated economic environment.

Looking further ahead, it will be necessary to aim for a budgetary position that is close to balance or in surplus, in compliance with the undertakings made in the Stability and Growth Pact. This would provide

adequate scope for counter-cyclical policies in a situation in which monetary policy will be determined at the European level and ensure that the public debt falls steadily towards 60 per cent of GDP, without reversals of trend in times of recession.

Keeping the primary surplus at or above this year's planned level after 2001 would speed up the reduction in the public debt in relation to GDP. This would attenuate the adverse effects on the public finances of any increases in interest rates and would put Italy in a sounder financial position to cope with the period in which the pressure on the budget due to the ageing of the population will be greatest.

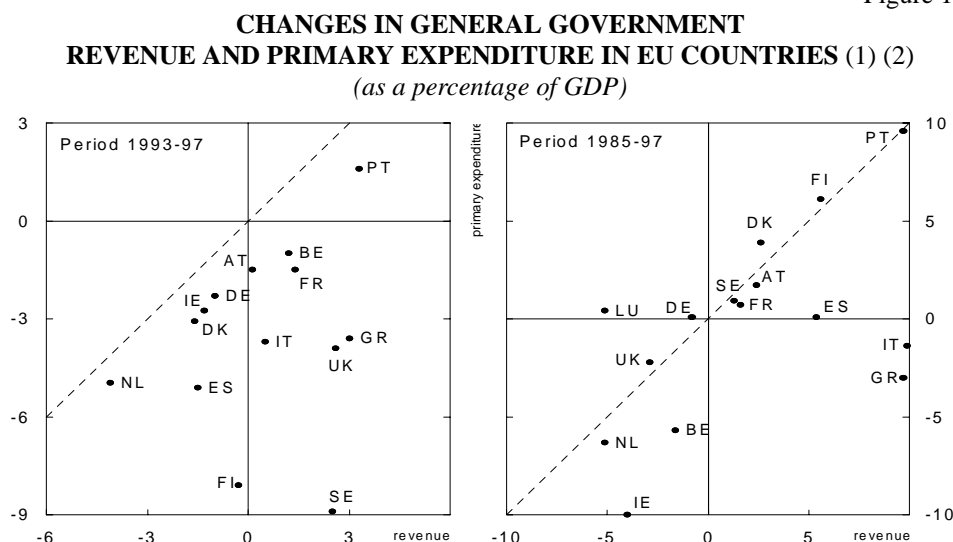
The consolidation of the public finances in the countries of the European Union. - At its meeting on 3 May, the European Council noted that the budgetary results achieved in 1997 by all the EU countries except Greece were consistent with the convergence criteria laid down in the Maastricht Treaty. Acting on a recommendation from the European Commission, the Council abrogated the decisions on the existence of an excessive budget deficit for nine of the ten countries that had exceeded the reference value in 1996. The progress made in adjusting public finances was decisive for the adoption of the single currency by a large number of countries in 1999.

In its *Convergence Report* published in March, the European Commission stressed that compliance with the limits set in the Treaty had called for major efforts in the field of budgetary policy, especially after the start of the second stage of EMU in 1994. Between 1993 and 1997 the ratio of general government net borrowing to GDP in the European Union fell by 3.7 percentage points, from 6.1 to 2.4 per cent, with 1.8 points of the decrease occurring in the last year. Some 0.4 percentage points of the fall were due to the decline in interest payments, from 5.4 to 5 per cent of GDP, while the remainder was due to an improvement in the primary balance, which more directly reflects the effects of budgetary measures. Over the same period the primary balance for the European Union as a whole passed from a deficit of 0.7 per cent of GDP to a surplus of 2.6 per cent. The Commission estimates that 0.5 points of this shift were due to the effects of the improvement in economic conditions, marked by a modest recovery from the cyclical trough reached in 1993; adjustment measures of a temporary nature, although significant in some countries, made a relatively limited contribution to the overall effect.

Between 1993 and 1997 the largest reductions in net borrowing in relation to GDP were achieved by Sweden (11.4 percentage points), Greece (9.8 points), Finland (7.1 points) and Italy (6.8 points). In 1997, when the adjustment process was given additional impetus, the ratio fell by 4 points in Italy, 3.5 points in Greece and 2 points in Spain.

All the EU countries achieved an improvement in their primary budget position in this period, largely by reducing expenditure in relation to GDP (Figure 19).

Figure 19



Sources: Based on European Commission data and Istat data for Italy.

(1) In order to provide a uniform basis of comparison, the data for both revenue and primary expenditure are considered net of capital revenue other than tax receipts owing to the lack of sufficient detail in the items of the capital account in the general government statistics published by the Commission. - (2) The changes are calculated as the difference between the ratios to GDP at the beginning and end of each period. The values on the vertical axis refer to changes in primary expenditure, those on the horizontal axis to changes in revenue. The dotted diagonal line indicates the points at which changes in revenue and expenditure leave the primary balance unchanged; points below this line correspond to an improvement in the balance, those above it to a deterioration. The size of the improvement (deterioration) is given by the length of the perpendicular joining the point to the diagonal.

Between 1993 and 1997 the ratio of primary expenditure to GDP in the European Union fell by 3.4 percentage points. Staff costs declined by 1 point, transfers to households and enterprises by 0.6 and 0.4 points respectively, and direct investment by 0.5 points. By contrast, purchases of goods and services rose by 0.5 points. The spending ratio fell in all the EU countries except Portugal. The ratio of revenue to GDP for the European Union as a whole remained virtually unchanged at around 47 per cent. Increases of 0.3 and 0.5 percentage points in direct and indirect taxes respectively were coupled with a decline of 0.2 points in social security contributions and one of 0.4 points in other current revenue. The changes in the revenue ratio differed widely across the Union: it declined in Denmark, Ireland, Germany, the Netherlands and Spain, whereas it increased in Belgium, France, Greece, Portugal, the United Kingdom, Sweden and, to a lesser extent, Italy.

In the second stage of EMU the consolidation of the public finances was based mainly on reductions in primary expenditure and thus moved in the direction required to produce lasting results. There were nonetheless some less satisfactory aspects.

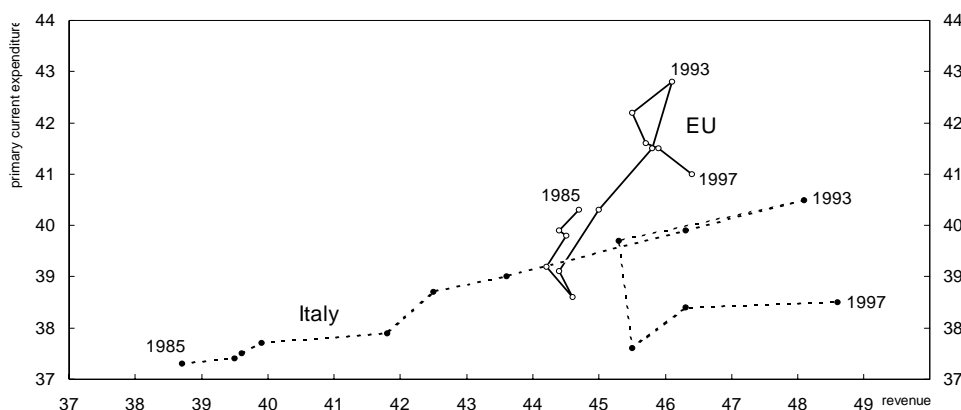
A significant part of the improvement in the primary balance was due to the movements in the capital account, in particular the decline in direct investment and investment grants, in other words to the reduction in the public sector's contribution to capital formation. Between 1993 and 1997 the balance on capital account improved in relation to GDP by 1.3 and 1.5

percentage points in the European Union and Italy respectively, compared with improvements in the overall primary balance of 3.3 and 4.2 points. Direct investment fell from 2.7 to 2.2 per cent of GDP in the European Union and from 2.7 to 2.4 per cent in Italy. The rates had already declined in previous years, by a particularly large amount in Italy: in 1985 direct investment had been equal to 2.9 per cent of GDP in the European Union and 3.7 per cent in Italy.

The reduction in primary current expenditure in relation to GDP that has been a prominent feature of the adjustment of government finances in the last four years (amounting to 2.1 percentage points in the European Union and 2.2 points in Italy) has offset only part of the increase that occurred in the immediately preceding years (Figure 20). In fact, between 1985 and 1997 the ratio rose by 0.3 percentage points in the European Union and by 1.1 points in Italy. On the other hand, whereas revenue remained broadly stable in relation to GDP between 1993 and 1997, the ratio rose by 1.2 percentage points in the European Union over the period 1985-97 and by almost 10 points in Italy, from 38.7 to 48.6 per cent.

Figure 20

**PRIMARY CURRENT EXPENDITURE AND TOTAL REVENUE
IN THE PERIOD 1985-1997 (1)**
(as a percentage of GDP)



Sources: Based on European Commission data and Istat data for Italy.

(1) In order to provide a uniform basis of comparison, revenue does not include capital revenue other than tax receipts (see note 1 to Figure 19).

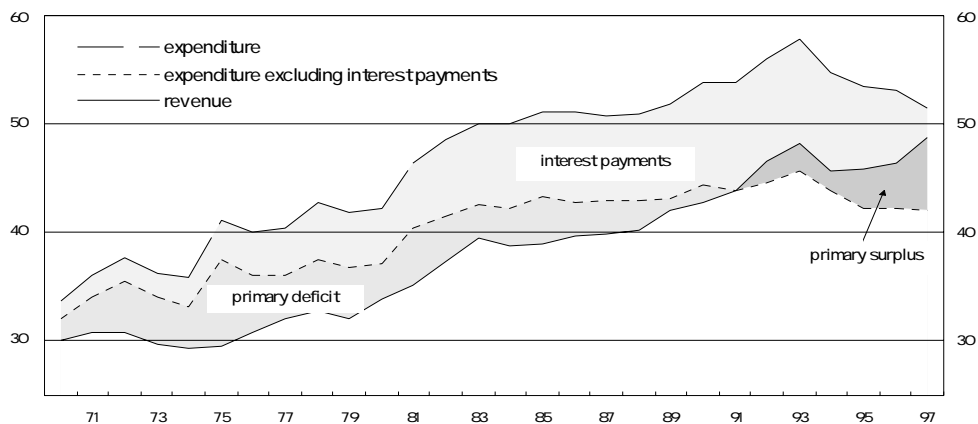
Despite the major improvement in budget balances, the ratio of government debt to GDP for the European Union as a whole declined by only 0.9 percentage points in 1997, to stand at 72.1 per cent. The ratio rose in three countries, notably by 2.3 and 0.9 percentage points in France and Germany respectively, and remained far above the reference value in Belgium (122.2 per cent), Italy (121.6 per cent) and Greece (108.7 per cent). The ratio for the European Union as a whole was 6.2 percentage points higher than in 1993 and 18.5 points above the 1985 level.

BUDGETARY POLICY IN 1997 AND THE RESULTS FOR THE YEAR

General government net borrowing fell from 125 to 52.2 trillion lire and from 6.7 to 2.7 per cent of GDP (Figure 21 and Tables 24 and a13). The primary surplus rose from 77.2 to 132.9 trillion and from 4.1 to 6.8 per cent of GDP. The decline in interest payments from 10.8 to 9.5 per cent of GDP contributed significantly to the reduction in net borrowing.

Figure 21

GENERAL GOVERNMENT REVENUE AND EXPENDITURE (as a percentage of GDP)



Source: Based on the *Relazione generale sulla situazione economica del Paese*.

Interest payments in 1997 did not fully reflect the fall in issue rates in 1996 and were affected to only a limited extent by their further decline in 1997. The full effects of the fall in yields will be felt in the coming years.

The structural, or cyclically adjusted, value of general government net borrowing, obtained by eliminating the effects on the budget of the divergence of GDP growth from its medium-term trend, fell from 6.2 to 2.2 per cent of GDP.

The cyclically adjusted budget balance is a useful indicator for the medium-term analysis of fiscal policies. It provides an estimate of what net borrowing would be if the

economy followed a “normal” growth path, in the sense of nearly constant annual increases in product in the medium term. The estimates reported above were obtained using a methodology broadly similar to that developed by the EU Commission, albeit with some differences: it takes account of the effects on the budget of changes in the composition of GDP, uses the results of simulations carried out with the Bank of Italy’s quarterly econometric model to determine the “normal” growth path and refers to new estimates of the elasticities of budget items with respect to the macroeconomic variables. The results for 1996 and 1997 do not differ significantly from those obtained by the Commission or the OECD.

Table 24

**MAIN INDICATORS OF THE
GENERAL GOVERNMENT INCOME STATEMENT**
(as a percentage of GDP)

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
Revenue	40.2	42.0	42.7	43.8	46.5	48.3	45.7	45.8	46.4	48.8
Expenditure	50.9	51.9	53.8	53.9	56.1	57.8	54.8	53.5	53.1	51.5
of which: interest payments	7.9	8.8	9.5	10.2	11.5	12.1	11.0	11.3	10.8	9.5
Primary balance (surplus: -)	2.8	1.1	1.7	-0.1	-1.9	-2.6	-1.8	-3.7	-4.1	-6.8
Net borrowing	10.7	9.8	11.1	10.1	9.6	9.5	9.2	7.7	6.7	2.7

Source: Based on the *Relazione generale sulla situazione economica del Paese*.

Net borrowing was 0.3 percentage points less than the policy objective, mainly because interest rates fell faster than had been envisaged. Other contributory factors included the larger-than-expected growth in GDP and the revision of VAT rates, which was included in the budget for 1998 but brought into effect in October 1997.

The composition of last year’s budget adjustment measures meant that most of the improvement in the primary balance was due to the increase in revenues, which rose from 46.4 to 48.8 per cent of GDP. The ratio to GDP of taxes and social security contributions rose from 42.4 to 44.3 per cent. The expenditure ratio declined slightly, from 42.3 to 42 per cent, owing to the almost complete absence of settlements of tax credits in securities, which had been equal to 0.3 per cent of GDP in 1996. Capital expenditure net of this item declined by 0.2 percentage points in relation to GDP, while primary current expenditure rose by the same amount.

Budgetary policy in 1997. - Last year’s adjustment was carried out in two stages. The Finance Law and the accompanying legislation contained measures that were expected to reduce the budget deficit by 46 trillion lire.

At the end of March, slower-than-forecast economic growth and a more cautious evaluation of the effects of the budget led to the adoption of additional measures to reduce the deficit by a further 16 trillion. In the event the correction was only slightly smaller than had been planned.

According to official estimates, the total adjustment achieved last year was around 62 trillion lire, or just over 3 per cent of GDP, and comprised 24 trillion of expenditure cuts and 38 trillion of additional revenue. The main reductions in expenditure concerned transfers to non-state government bodies and public enterprises and spending on pensions, health care and employees; the allocations for central government purchases of goods and services were also reduced. The main revenue measures were the so-called "Europe" tax, which consisted in a highly progressive surtax on personal incomes and a levy on the funds set aside by companies to provide for workers' severance pay. Changes were also made to the accounting treatment of certain items in the general government income statement in order to comply with the rules laid down by Eurostat. The changes reduced net borrowing in 1996 by 14 trillion lire and the Government estimated that they would reduce the deficit by 16 trillion in 1997. Temporary measures are estimated to have reduced the 1997 budget deficit by around 1 per cent of GDP; about one third of the decrease was produced by measures that will increase the deficit in the coming years, the remainder by measures that will have no effect in the future. This analysis does not take account of the Government's intention, stated in April in the Economic and Financial Planning Document for 1999-2001, of refunding part of the personal income surtax from 1999 onwards.

The restrictions on cash outlays. - In order to achieve the expenditure objectives, extensive action was taken to control the cash flows of central government departments and other public bodies. The measures concerned three distinct aspects of the linkage between budget appropriations and actual general government cash disbursements.

One measure consisted in determining the amounts of cash authorizations during the drafting of the budget, that is the maximum amounts disbursable under each expenditure heading. In the past these amounts had been quantified when the budget bill was submitted to Parliament by putting them equal to the sum of the authorizations on an accruals basis and the expenditure carryovers expected at the end of the year (residui passivi). Last year, by contrast, the cash authorizations were set in many cases at a lower level than the corresponding appropriations on an accruals basis in order to reduce the balances held with the Treasury. Two other measures concerned the cash flows that pass through the accounts held with the Treasury: ceilings were placed on the transfer of budget resources to the accounts of non-state public bodies and provision was made for their withdrawals to be monitored. In particular, the inflow of funds to these accounts was made conditional on the balances being reduced to a level 20 per cent below that obtaining at the beginning of 1997. Withdrawals by non-state public bodies other than local authorities from their accounts with the Treasury were initially capped at 90 per cent of the amounts withdrawn in 1996, while a moving ceiling was placed on the withdrawals of local authorities. Since the application of these rules excessively hampered the activities of non-state public bodies, the focus of control was shifted for both local authorities and the other public bodies involved to the planning of the balances on their accounts, for which objectives were set consistent with the broader ones of budgetary policy.

The purpose of the restrictions placed on withdrawals was to impinge rapidly on the disbursements of non-state public bodies. The reductions in cash authorizations and the ceilings placed on the transfer of budget resources, which had the effect of reducing the liquid balances held with the Treasury, tightened the linkage between budget appropriations and final expenditure, thereby making it easier to plan the latter in the future.

Despite the reduction in budget appropriations, the contraction in the balances held with the Treasury from 7.1 to 4.1 per cent of GDP was accompanied by a sharp rise in expenditure carryovers, which are estimated to have totaled 8.7 per cent of GDP at the end of 1997, compared with 7.3 per cent at the end of 1996. The Government has taken steps to reduce the amount of these carryovers and restrict their transferability from one year to the next.

There remains the risk that the volume of expenditure carryovers, which has remained large despite the action taken by the Government, will have an adverse effect on the public finances in the future. In some fields reducing disbursements could prove untenable in the medium term in the absence of changes in the mechanisms governing expenditure.

The borrowing requirement and the debt. - The general government borrowing requirement, which differs from net borrowing by including the balance of financial items and being measured in terms of the financing obtained, fell from 143.2 to 35.8 trillion lire and from 7.6 to 1.8 per cent of GDP (Tables 25 and a14). The fall was larger than that in net borrowing for three main reasons: the increase in net privatization receipts from 6.2 to 21.2 trillion lire; the early repayment of a loan contracted by IRI with the Deposits and Loans Fund, whereas in 1996 the Fund had granted loans for a comparable amount to state-controlled enterprises; and the 3.1 trillion of taxes paid by UIC on the capital gain it realized on the sale of its holding of gold reserves to the Bank of Italy, an amount that was not included in the general government income statement in compliance with a ruling by Eurostat.

The pronounced improvement in inflation expectations in 1997 made it easier to continue with the policy of lengthening the average maturity of the debt. Net redemptions of Treasury bills rose substantially from 27.2 to 81.8 trillion lire, excluding transactions with other general government bodies. Government fund-raising by means of medium and long-term securities amounted to 100.4 trillion, compared with 126.4 trillion in 1996. Post Office funds and debt issues abroad contributed 11.6 and 6.2 trillion respectively, which was less than in 1996 but still substantial (Table a14).

Last year brought an acceleration in the process that had begun in 1997 of reducing the general government debt in relation to GDP. In 1995 and

1996 the ratio had declined by 0.7 and 0.2 percentage points respectively, whereas last year it fell by 2.4 points to 121.6 per cent.

Table 25

GENERAL GOVERNMENT BALANCES AND DEBT
(billions of lire)

	1994	1995	1996	1997
Net borrowing	150,150	136,377	125,148	52,220
as a percentage of GDP	9.2	7.7	6.7	2.7
Total borrowing requirement	154,282	127,109	143,170	35,825
as a percentage of GDP	9.4	7.2	7.6	1.8
Debt (EU definition)	2,047,163	2,200,965	2,321,810	2,372,700
as a percentage of GDP	124.9	124.2	124.0	121.6

The increase in the public debt from 2,321.8 to 2,372.7 trillion lire according to the definition adopted by the EU was around 15 trillion larger than that in the general government borrowing requirement. Two thirds of the difference was due to the effects of exchange rate movements and especially the strengthening of the dollar on the debt denominated in foreign currency. Some 2.5 trillion was due to the increase from 56.5 to 59 trillion in the Treasury's claims on the central bank since such changes are included in the computation of the borrowing requirement but do not affect the debt according to the EU definition. The remainder of the difference of around 2 trillion corresponded to the issue discounts on the government securities placed during the year, that is the difference between their redemption value, which is the amount included in the debt, and the value based on the allotment price, which is the amount used to compute the borrowing requirement.

The currency composition of the general government debt changed slightly. The proportion denominated in foreign currencies and ecus rose from 6.6 to 6.9 per cent; in particular, the debt denominated in currencies of countries outside the euro area rose from 3 to 3.3 per cent of the total. As regards the distribution of the debt by type of holder, the growth in the proportion held by non-residents accelerated: after rising from 5.5 to 17.2 per cent between 1990 and 1996, it reached 21 per cent in 1997. The debt issued abroad increased from 5.4 to 5.9 per cent of the total.

The reduction in budget deficits in the nineties: an analysis of the short-term effects on economic activity. - Between 1989 and 1997 the general government primary balance swung from a deficit of 1.1 per cent of GDP to a surplus of 6.8 per cent. In the absence of this adjustment the public debt would have continued to soar with potentially serious economic and financial repercussions. The restoration of sound public finances has enabled the Italian economy to return to a path of balanced growth.

The improvement in the primary balance was achieved by means of budgetary adjustments whose size and composition varied from year to year. In order to assess the impact of the improvement on the performance of the economy in each year, simulations were made with the Bank of Italy's quarterly econometric model. The results of the exercise capture only some of the ways in which the budget may have influenced the economy and refer only to the impact of the budgetary adjustments on GDP in the year they were made. No account is taken of the consequences that the Government's actions may have had on expectations, interest rates and the exchange rate.

The effects of the budget on economic activity were estimated for each year by comparing the actual performance of the economy with that simulated with the Bank's quarterly econometric model by putting the ratios to GDP of the items of the general government income statement equal to those recorded the previous year (except for interest payments). The monetary policy pursued during the year and the movements in the exchange rate were incorporated in each simulation. It should be noted that the aim of the exercise was not to measure the effects of the budgetary correction measures, which would have required the figures for the public finances on a current programmes basis to be included in the simulations. The difference between the size of the budgetary measures and the change recorded in the ratio of the primary surplus to GDP was particularly large in 1993, when the budgetary adjustment was about 5 per cent of GDP while the ratio of the primary surplus rose by only 0.7 percentage points.

The results of the simulations show the budget as having had a restrictive effect on GDP growth throughout the nineties, except in 1992 and 1994, when it was virtually neutral. The effect was greatest and equal to around 0.6 percentage points in each of the three years 1993, 1995 and 1997. In 1997 the shift in the composition of the budget slightly attenuated the effect of the deficit reduction. In 1990, 1991 and 1996 the restrictive effect of the budget was equal to 0.2 percentage points.

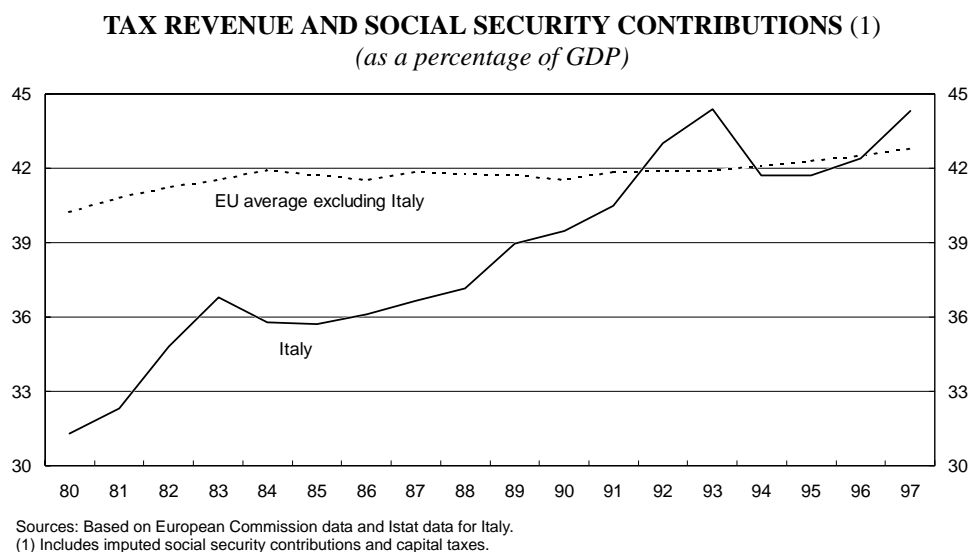
The effects produced by changes in the composition of the budget were estimated for each year by comparing the actual performance of the economy with the results of a simulation in which the change recorded in net borrowing was obtained by means of measures divided proportionately among all the items of the budget. The composition effect was expansionary in 1997 and especially in 1992, in view of the recourse made in those years to one-off revenue-raising measures, which have a relatively limited impact on economic activity. By contrast, the effect was notably restrictive in 1993 and 1994 owing to the replacement of the temporary measures enacted in 1992 with others of a permanent nature and the sharp fall in investment, which has a more direct and immediate effect on aggregate demand than other items of the budget.

REVENUE AND EXPENDITURE

Revenue

General government revenue increased by 9.5 per cent to 952 trillion lire (Table a13) and was equal to 48.8 per cent of GDP, an increase of 2.4 percentage points. The ratio to GDP of direct and indirect taxes (excluding those accruing to the EU), actual and imputed social security contributions and capital taxes rose by 1.9 percentage points from 42.4 to 44.3 per cent (Figure 22).

Figure 22



Direct taxes. - Receipts increased by 9 per cent and from 15.2 to 15.9 per cent of GDP (Table 26).

The increase of 8.9 per cent in personal income tax receipts reflected the substantial growth in withholding tax resulting from the increase in wages and salaries. It was also a result of the corrective measures adopted for 1997: the reduction in the deductibility of medical expenses and the fact that tax credits were not adjusted for inflation (except for those applicable to pensions and employee incomes up to 9.1 million lire).

Table 26

GENERAL GOVERNMENT FISCAL REVENUE
(as a percentage of GDP)

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
Direct taxes	13.4	14.3	14.4	14.5	14.7	16.2	14.9	14.7	15.2	15.9
Indirect taxes	10.0	10.4	10.6	11.1	11.2	12.0	11.7	11.8	11.8	12.2
Current tax revenue	23.4	24.7	25.1	25.6	25.9	28.2	26.7	26.5	27.0	28.1
Actual social security contributions	12.2	12.6	12.9	13.1	13.3	13.7	13.0	13.1	14.8	15.1
Imputed social security contributions	1.5	1.5	1.6	1.6	1.7	1.8	1.9	1.7	0.3	0.4
Current fiscal revenue ...	37.1	38.8	39.5	40.4	41.0	43.7	41.6	41.3	42.1	43.6
Capital taxes	0.1	0.2	0.1	0.2	2.0	0.7	0.1	0.5	0.3	0.7
Fiscal revenue ...	37.2	39.0	39.6	40.6	43.0	44.4	41.7	41.7	42.4	44.3

Source: Based on the *Relazione generale sulla situazione economica del Paese*. See statistical table a13.

The increases of 39.4 per cent in corporate income tax (Irpeg) and 28 per cent in local income tax (Ilor) were the result of three factors. Firstly, the restrictions placed on the deductibility of certain expenses and the banking system's large profits on securities following the fall in interest rates boosted the balances paid for 1996. Secondly, the size of the payment on account of corporate income tax for 1997 was increased to offset the abolition of the withholding tax on interest income from bonds held by legal persons. Payments of this tax were deducted from direct tax liabilities and its abolition would otherwise have led to a loss of revenue in 1997 owing to timing differences in the payment of the two taxes. Thirdly, there was UIC's payment on account of the tax on the capital gain it realized on the sale of its holding of gold reserves to the Bank of Italy. In compliance with a ruling by Eurostat, this amount was not included in general government revenue.

The yield of the tax on interest income decreased by 11.3 per cent, entirely owing to the fall in receipts of the tax on bond interest income. The abolition of the withholding tax for bonds held by legal persons discussed above led in fact to an increase in the receipts of self-assessed taxes. The yield of the tax on bank deposit interest income was virtually unchanged compared with 1996. The fall in interest rates and the revision of the relevant tax rates in June 1996 did not affect last year's result because their effects were offset by the increase in the rate of the payment on account. Receipts were nonetheless depressed by the existence of a large volume of tax credits.

Indirect taxes. - Indirect tax revenue rose from 11.8 to 12.2 per cent of GDP (Table 26). The increase of 7.7 per cent in receipts benefited in the

second half of the year from the recovery in economic activity and the rate increases introduced in adjustment measures.

VAT receipts, net of settlements with the Sicily and Sardinia regions and the part accruing to the EU, rose by 7.7 per cent. The growth of 8.6 per cent in the consumption of durable goods was an important contributory factor, while the revision of VAT rates with effect from 1 October 1997 generated 1.4 trillion lire of additional revenue.

Capital taxes. - This revenue was boosted by the special “Europe” tax (receipts of which were included among direct taxes in the accounts of the state sector). The surtax on personal incomes raised 4.8 trillion lire and the levy on company’s severance pay provisions another 6.6 trillion.

The surtax on personal incomes was introduced just for 1997; it was progressive and non-deductible for the purpose of computing other taxes and was based on the same taxable income as personal income tax. Five income brackets were fixed with the surtax rate rising to a maximum of 3.5 per cent; tax credits were provided for dependent relatives and for the earnings of employees and the self-employed. The system of tax credits resulted in the threshold for exemption from the surtax varying with the type of taxpayer: for an employee with no dependent relatives the threshold was 25 million lire, for an employee with a dependent spouse and two children it was 31 million, while the corresponding thresholds for the self-employed were 18 and 24 million. In the Economic and Financial Planning Document for 1999-2001 the Government stated its intention of refunding part of the surtax paid, starting in 1999.

A levy was also introduced on the amounts set aside for employees’ severance pay. The amounts paid will be deducted from the tax companies are required to withhold when severance pay is disbursed. Businesses with fewer than six employees were exempted from the levy; for those with between six and fifteen employees the levy was fixed at 2 per cent of their severance pay provisions at 31 December 1996, while for those with more than fifteen employees the rate was 5.89 per cent of their severance pay provisions at 31 December 1996 and will fall to 3.89 per cent of their severance pay provisions at 31 December 1997.

Social security contributions. - Receipts rose by 6.8 per cent and outpaced the increase in the base (estimated at around 3.2 per cent) as a result of the rate increases introduced for public sector employees and the self-employed and the reduction in relief for private sector employees. The ratio of contributions to GDP rose from 15.1 to 15.5 per cent.

The delegated powers in the tax field. - In 1998 the Government has enacted legislation reforming parts of the Italian tax system under the powers contained in the provisions accompanying the Finance Law for 1997.

The most important innovations consisted in: a) the introduction of a new regional tax on business activities (Irap); b) the simultaneous abolition of a series of taxes and

contributions, including National Health Service contributions and the so-called health tax, local income tax (*Ilor*), the tax on companies' net worth, the VAT registration tax, the municipal tax on businesses and the self-employed (*Iciap*) and certain other municipal taxes; c) the revision of the structure of personal income tax (*Irpef*), aimed at counterbalancing the effects of the introduction of *Irap* on the distribution of taxation and easing the tax burden for large families; d) the reorganization, with effect from 1 July of this year, of withholding tax on income from financial assets on the basis of the principles of uniformity and neutrality (by providing for the application of no more than two rates, 12.5 and 27 per cent), generality (by taxing capital gains on securities, precious metals and foreign exchange and income from derivatives trading) and simplicity for taxpayers (by introducing new options for tax to be withheld at source and increasing the role of intermediaries as tax-collection agents); and e) the introduction of a new tax regime for corporate incomes known as *Dual Income Tax*, which provides for a lower rate to be applied to the part of profits corresponding to an imputed return on any increase in shareholders' equity, thereby reducing the tax discrimination in favour of debt capital.

Expenditure

General government expenditure amounted to nearly 1,005 trillion lire, an increase of 1 per cent on 1996 (Table a13). As a ratio to GDP, it declined from 53.1 to 51.5 per cent (Table 27), primarily owing to the fall in interest payments from 10.8 to 9.5 per cent of GDP. Primary expenditure, by contrast, increased by 3.4 per cent but decreased slightly in relation to GDP from 42.3 to 42 per cent (Figure 23).

Table 27

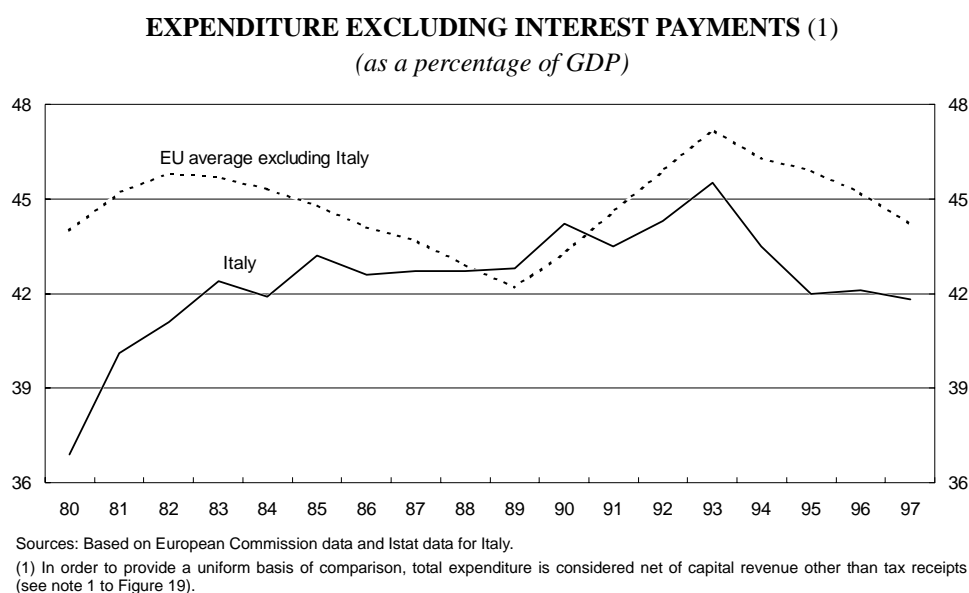
GENERAL GOVERNMENT EXPENDITURE (as a percentage of GDP)

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
Compensation of employees . .	12.1	11.9	12.7	12.7	12.7	12.5	12.0	11.4	11.6	11.8
Intermediate consumption	5.0	4.9	4.8	4.9	5.0	5.2	5.0	4.7	4.7	4.5
Social security benefits	17.3	17.6	18.2	18.3	19.3	19.5	19.5	18.9	19.2	19.6
Interest payments	7.9	8.8	9.5	10.2	11.5	12.1	11.0	11.3	10.8	9.5
Other current expenditure	3.2	3.5	3.0	3.1	2.9	3.6	3.1	2.6	2.8	2.6
Investment	3.4	3.3	3.3	3.3	3.0	2.7	2.3	2.2	2.3	2.4
Other capital expenditure	1.9	1.8	2.3	1.5	1.6	2.3	1.8	2.5	1.7	1.1
Total . . .	50.9	51.9	53.8	53.9	56.1	57.8	54.8	53.5	53.1	51.5
of which: expenditure excluding interest payments	42.9	43.1	44.4	43.8	44.6	45.7	43.8	42.2	42.3	42.0

Source: Based on the *Relazione generale sulla situazione economica del Paese*. See statistical table a13.

The relatively rapid growth in social security benefits and compensation of employees of 6.2 and 5.3 per cent respectively (7.5 and 8.4 per cent in 1996) was accompanied by a decrease of 3.4 per cent in the other items of expenditure, whereas in 1996 they had increased by 1.4 per cent. The decrease reflects the sharp falls in production subsidies, investment grants and other capital expenditure, which fell from nearly 8.4 trillion lire to around 1.4 trillion, primarily owing to the almost complete absence of settlements of tax credits in securities. Investment increased by 7.7 per cent and intermediate consumption by 1.6 per cent.

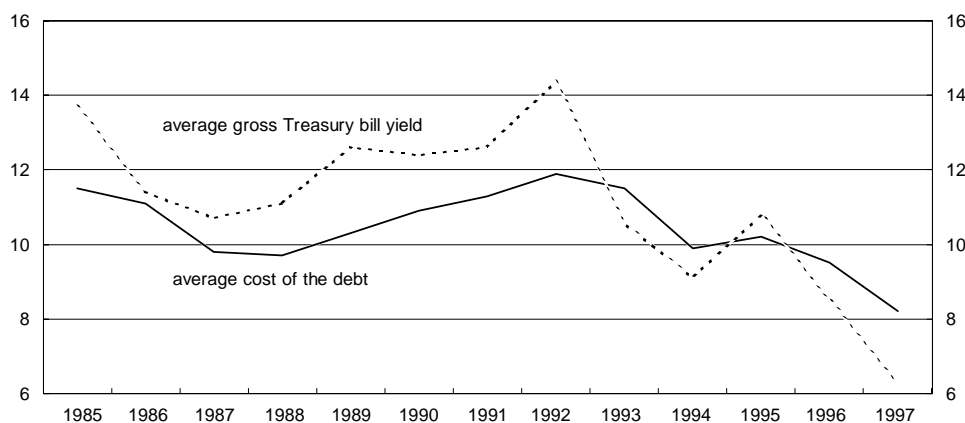
Figure 23



Interest payments. - The large reduction of 17.2 trillion lire in this item did not reflect the full effect of the fall in yields at issue in 1996 and was only marginally due to their further fall in 1997. Between 1995 and 1997 the average gross yield on Treasury bills fell by around 4.5 percentage points, from 10.8 to 6.3 per cent, while the gross yield on 10-year Treasury bonds fell from 12.2 to 6.9 per cent. The average cost of debt servicing, defined as the ratio of interest payments to the average size of the debt, decreased much less, falling by only 1.6 percentage points from 9.5 per cent in 1995, 8.9 per cent in 1996 and 7.9 per cent in 1997 (Figure 24). Changes in market rates are reflected in the interest paid by the government with a lag that is related to the term structure of the debt. The lag has increased in recent years as a consequence of the lengthening of the average maturity of the debt from 2.4 years in 1990 to 4.5 years in 1997.

Figure 24

**AVERAGE COST OF THE DEBT AND
AVERAGE GROSS TREASURY BILL YIELD**
(percentages)



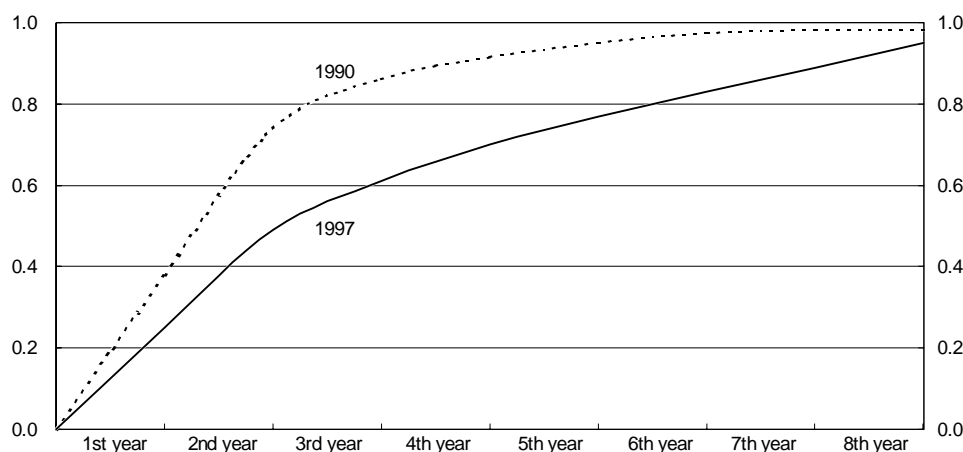
Between 1990 and 1997 the proportion of the public debt with a residual maturity of one year or less (including variable rate securities) fell from more than 67 per cent to around 49.5 per cent. Conversely, the proportion with a residual maturity of between one and five years rose from around 21 per cent to nearly 26 per cent, and that with a residual maturity of over five years more than doubled from around 11.5 per cent to nearly 25 per cent. The effects of a change in market rates on the cost of servicing the debt depend on the term structure and technical features of the liabilities of which it is composed. Estimates based on the composition of the debt at the end of 1997 show that a rise of one percentage point in market rates would increase the average cost of servicing the debt by around 0.25 percentage points in the first twelve months (divided almost equally between the additional costs arising on Treasury bills and Treasury credit certificates) and by a similar amount in the second year (with the full effects being felt for Treasury credit certificates and the first effects for the other debt instruments, except for 2-year Treasury zero-coupon certificates). In both the third and the fourth years the average cost would rise by around 0.1 percentage points (with the effects for Treasury zero-coupon certificates making themselves felt, since interest on these instruments is included in the accounts at redemption). The adjustment of the average cost of servicing the debt to the increase in interest rates would be largely completed in the four following years. With the composition of the debt as it was at the end of 1990 the adjustment would be much faster: the average cost would rise by around 0.4 percentage points in both the first and the second years and the process would be almost complete by the end of the fourth year (Figure 25).

Social security benefits. - The growth in this item from 19.2 to 19.6 per cent of GDP was fueled by the increases in expenditure on pensions and health care, while other welfare spending remained basically unchanged. With reference to the broader aggregate that includes the cost of welfare services provided by public entities in addition to benefits disbursed in cash and in kind, expenditure on pensions and health care increased by 6.9 and 7.1 per cent respectively, while other welfare spending declined by 0.6 per cent.

Pension outlays showed a particularly large increase of 7.7 per cent, although it was smaller than that of 8.9 per cent recorded in 1996. Nearly half the increase was due to the annual inflation adjustment, which was nonetheless smaller than in 1996, when it accounted for about 5 percentage points of the total increase. Despite the minimum age requirement for the retirement of private sector employees on long-service pensions having been raised by one year, the number of new pensions paid had an expansionary effect on expenditure comparable to that of the previous year.

Figure 25

**ADJUSTMENT OF THE AVERAGE COST OF THE DEBT
TO A ONE-POINT RISE IN MARKET RATES**
(percentage points)



Spending on unemployment benefits and the disbursements of the Wage Equalization Fund declined by 4.6 and 2.5 per cent respectively. By contrast, the cost of family allowances rose by 9.3 per cent as a consequence of the improvements introduced in the budget.

As regards health care, hospital costs increased by 7.6 per cent in connection with the renewal of the labour contracts of doctors and other medical staff and spending on medicines rose by 10 per cent, partly as a result of the revision of VAT rates. The deficit of the National Health Service increased from 2.6 to 8.6 trillion lire, reflecting the near stability of funding and the large rise of 7.1 per cent in expenditure.

Compensation of employees. - The growth in this item from 11.6 to 11.8 per cent of GDP was due to increases in earnings and social security contributions of 1.8 and 13 per cent respectively. The large rise in the latter was basically due to the increases in public sector contribution rates and the additional contribution payable by central government departments to

rebalance their staff's pension fund. The rise in total earnings was the result of a further reduction in employment of 1.2 per cent, which took the total decline from the peak recorded in 1992 to 4.2 per cent, and an increase of 3 per cent in unit earnings. Excluding the extraordinary payment in 1996 of around 2 trillion lire of central government employees' portion of social security contributions for previous years, the increase in unit earnings was 4.2 per cent.

Other expenditure. - This declined from 11.5 to 10.6 per cent, prolonging the downward trend of this item over the last ten years (in 1985 it had been equal to 14.3 per cent of GDP). The trend affected both capital expenditure, which fell from 6 per cent of GDP in 1985 to 3.5 per cent last year, and current expenditure, which declined from 8.3 to 7.1 per cent.

Local authorities

The fiscal balances of local authorities did not improve in line with those of the other branches of general government. Whereas the net borrowing of central government fell in relation to GDP by 3.8 percentage points, that of local authorities rose by 0.2 percentage points from 2.4 to 6.1 trillion lire.

Local authority revenue rose by 4.3 per cent as a result of a decrease of 2.8 per cent in tax revenue and an increase of 5.3 per cent in current and capital transfers from the state. This pattern was largely determined by the regions, which recorded a fall in tax revenue, despite the increase from 6.3 to 7.1 trillion lire in their share of petrol tax receipts, and a rise in transfers in connection with the increase in the social security contributions payable for their own staffs and those of the Local Health Units. By contrast, the provinces and municipalities recorded an increase in tax revenue and a decrease in transfers. Their tax revenue was boosted by the yield from motor vehicle registration taxes and receipts of the municipal tax on buildings (ICI), which rose from 15.1 to 16 trillion lire owing to the increase in imputed property incomes. The transfers they received from the state were curbed by the extension of the system of centralized Treasury accounts to municipalities with fewer than 5,000 inhabitants and the restrictions imposed on cash flows in 1997.

Total local authority expenditure rose by 5.7 per cent. Compensation of employees increased by 7.3 per cent, compared with 5.3 per cent for general government as a whole. The growth in intermediate consumption slowed from 9.5 to 6 per cent, partly as a result of the monitoring of non-state public bodies' withdrawals from their centralized Treasury accounts, which was

introduced in 1997 in order to ensure the consistency of their spending with the more general objectives of budgetary policy.

The legislation enacted by the Government under the tax reform powers granted at the end of 1997 modified the structure of the revenues of the different levels of government with effect from this year. In line with the recommendations made in 1996 by the Commission set up at the Finance Ministry to draft proposals on fiscal federalism, the Government introduced a regional tax on productive activities (Irap). Not including the amount payable by general government bodies, the new tax is expected to raise around 52 trillion lire, which is equal to about 40 per cent of the regions' current expenditure. The regions will also receive the revenue from the personal income surtax, which also came into effect this year. The increase in the regions' tax-levying powers will be gradual. Once the system is fully operational, they will be able to increase the standard rate of Irap set by central government within predetermined limits and to apply different rates for different categories of taxpayer and branches of activity. During the transitional phase, however, central government will have sole responsibility for setting rates, assessing liabilities and collecting revenue. Initially 90 per cent of the revenue will be earmarked to finance the National Health Service.

THE OUTLOOK

Budgetary policy for 1998

The Government's objective in 1998 is to consolidate the results achieved last year for general government net borrowing and to accelerate the reduction in the ratio of government debt to GDP.

In the Economic and Financial Planning Document for 1998-2000 presented in May 1997 and in the Convergence Programme subsequently submitted to the EU, the Government set the target for general government net borrowing in 1998 at 2.8 per cent of GDP. Interest expenditure was shown as amounting to 8.6 per cent of GDP and the primary surplus to 5.8 per cent. These objectives were set in a scenario in which net borrowing and the primary surplus in 1997 were expected to amount to respectively 3 and 6.7 per cent of GDP.

The Forecasting and Planning Report published in September left the objective for net borrowing unchanged. The reduction in the forecast for interest payments to 8.4 per cent of GDP was offset by a less ambitious objective of 5.6 per cent for the primary surplus. The adjustment needed to achieve these results was estimated at 25 trillion lire, the same as the figure indicated in the Economic and Financial Planning Document in view of the intervening contraction in the primary surplus on a current programmes basis. The proposals the Government submitted to Parliament provided for additional revenue of 11 trillion lire and expenditure cuts of 14 trillion. This included a reduction of 5.9 trillion in social security expenditure, significantly less than the correction of around 9 trillion implied by the objective indicated in the Economic and Financial Planning Document, namely to keep the ratio of this item to GDP at the average of the 1996 and 1997 values.

The approval of the budget by Parliament left the overall size of the adjustment unchanged but modified the composition of the measures: the expenditure cuts were scaled down to 12 trillion lire and the additional revenue was increased to 13 trillion. The further scaling down of the reduction in social security expenditure to around 4.5 trillion was mostly offset by increases in contributions. The other measures to reduce expenditure included curbs on government transfers to local authorities and

public utility companies, and cuts in staff costs and purchases by central government departments. The revenue-raising measures included the revision of VAT rates (which had already come into effect in October 1997), increases in social security contribution rates, changes in the withholding tax applicable to certain categories of the self-employed and administrative measures.

The Quarterly Report on the Borrowing Requirement published in March further reduced the forecast for interest payments from 8.4 to 8 per cent of GDP and raised the GDP growth forecast by 0.5 percentage points to 2.5 per cent. This more favourable scenario allowed the Government to reduce the target for net borrowing to 2.6 per cent of GDP, while shaving the forecast for the primary surplus to 5.5 per cent.

The decrease of 1.3 percentage points in the ratio of the primary surplus to GDP compared with 1997 is primarily attributable to the expected fall of 1.1 percentage points in the revenue ratio owing to the expiry of the temporary measures adopted in 1997 (the so-called "Europe" tax and special payments by tax collection offices) and the decrease in the yield of the tax on interest income as a result of the fall in interest rates. Primary expenditure is expected to rise from 42 to 42.2 per cent of GDP on account of a rise of the same size in the capital expenditure ratio.

Net of settlements of past debts and privatization receipts, the state sector borrowing requirement, which is the public finance indicator with the shortest lag, is expected to amount to 52.7 trillion lire, in line with the outturn in 1997. The results during the year will be affected by the tax reforms enacted, especially the abolition of health service contributions from January onwards and the introduction of the regional tax on productive activities (Irap), which will begin to generate receipts in June. In the first four months of the year the state sector borrowing requirement amounted to 49.8 trillion lire; the increase of 7.7 trillion compared with the same period of 1997 was largely due to the above-mentioned reforms.

On 1 May the European Council decided to bring forward the start of the budgetary surveillance procedure to 1 July 1998; at the same time the EU governments undertook to ensure that the budget objectives set for this year would be achieved in full. Keeping net borrowing in Italy down to 2.6 per cent of GDP will require spending discipline throughout the public sector; in particular, as in 1997, it implies strict compliance with the rules for central and local government cash flows. Revenue will have to be carefully monitored during the year in order to detect shortfalls in receipts and permit any necessary remedial action to be taken.

The pension system: reforms and prospects. - The 1998 budget measures in this field speeded up the standardization of the rules governing

the different pension systems, raised the age threshold for long-service pensions for some categories of worker, postponed the retirement dates for new long-service pensions due to take effect in 1998 and temporarily reduced the cost-of-living adjustments for larger pensions. The resulting reduction in expenditure is estimated at 3.2 trillion lire in 1998 and around 0.2 per cent of GDP in each of the next ten years. In the long term, however, the level of spending will not be affected.

The measures are part of the reform of the pension system begun in 1992, which is one of the main steps taken to achieve a lasting consolidation of the public finances. Spending on pensions rose from 5 per cent of GDP in 1960 to 7.4 per cent in 1970, 10.2 per cent in 1980 and 13.8 per cent in 1990. In the early nineties the outlook was for further untenable growth; in the absence of corrective action, it was estimated that the figure would have been close to 25 per cent of GDP by 2030.

Despite the reforms introduced during the nineties, spending on pensions reached 16 per cent of GDP last year. According to the forecasts prepared by the General Accounting Office of the Treasury, which take account of the 1998 budget measures, the ratio is likely to rise by another 0.5 percentage points by 2010 and by an additional 0.8 points between 2010 and 2025. Subsequently, even though the ratio of pensioners to workers is forecast to rise sharply, expenditure should stabilize in relation to GDP for some years and is then expected to decline significantly. The projections of the Accounting Office assume that pensions will remain indexed exclusively to prices and that the “transformation coefficients” used to relate new pensions to each individual’s contributions record will be revised every ten years on the basis of demographic trends. Although both of these assumptions are consistent with current legislation, they could prove untenable in the long run, since indexing pensions to prices alone reduces their purchasing power by comparison with that of earnings and because revisions at ten-year intervals may produce large differences in the treatment of contiguous generations of pensioners. The projections also assume that there will be no change in participation rates, which implies a marked fall in employment, and an acceleration in productivity growth; assumptions more favourable to employment and less favourable to productivity result in a more rapid increase in spending on pensions. In fact, for a given rate of increase in GDP, a rise in participation rates will cause pensions to increase in relation to final earnings because of the mechanism for revaluing contributions to take account of GDP growth. This is likely to encourage people to retire earlier and thus increase the number of pensions to be paid.

The expenditure levels projected by the Accounting Office imply either a further increase in social security contribution rates, which are already higher than in the other leading industrial countries, or larger transfers from general taxation. Both these solutions conflict with the need to reduce the tax

and contributions burden in view of growing international economic integration.

The plan for bringing the pension system back into balance relies primarily on reducing the average pension in order to curb expenditure; limiting the number of pensions plays a relatively modest role. The projections of the Accounting Office show the ratio between the pensions paid by the main pension funds and the total number of persons in work rising from 86 per cent in 1995 to 129 per cent in 2045. Some of the provisions of Italian law, in particular the right to retire at the age of 57, differ from those applying in other European countries and appear to be inconsistent with the pressure created by the rapid rise in the ratio between senior citizens and those of working age, which is expected to be higher than the levels projected for the other Western countries in the coming decades.

Demographic trends and changes in the structure of households are increasing the demands on the public finances in other fields as well, including health care and welfare. Curbing the rise in pension expenditure would gradually free the financial resources required to meet these new needs.

Budgetary policy in the medium term

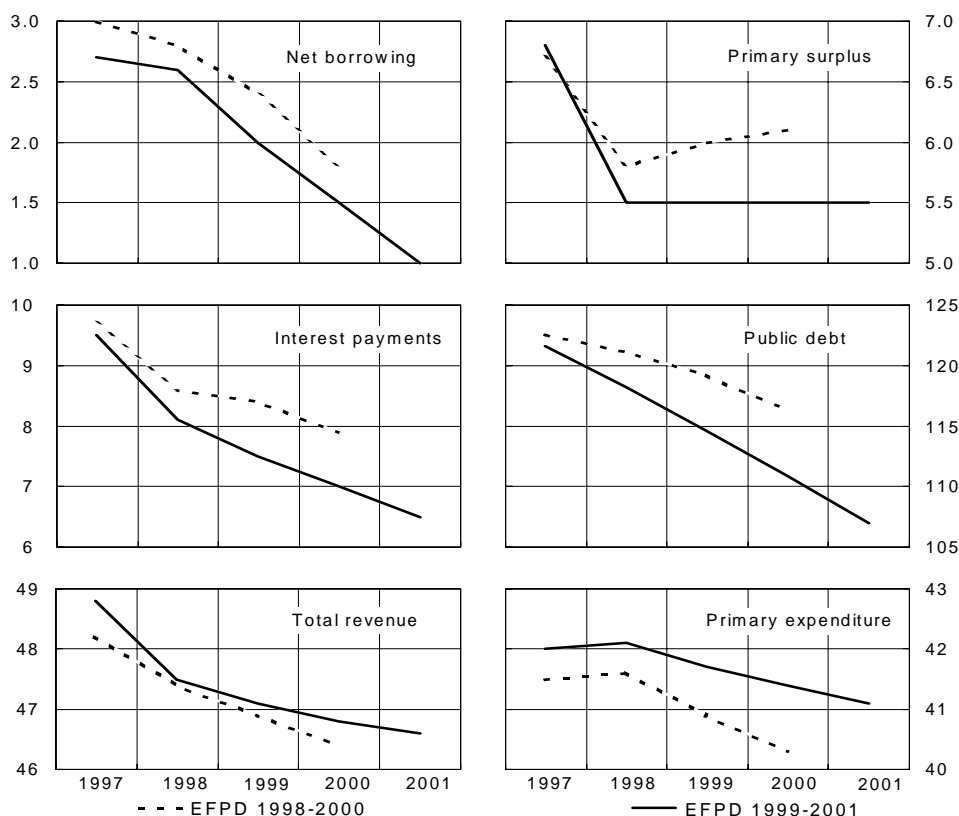
The Economic and Financial Planning Document for 1999-2001 establishes a timetable for the gradual reduction of general government net borrowing, following a trend that is consistent with the undertaking made in the Stability and Growth Pact to achieve a budgetary position that is close to balance or in surplus. According to the Planning Document, net borrowing will fall to 2 per cent of GDP in 1999, 1.5 per cent in 2000 and 1 per cent in 2001 (Figure 26). The primary surplus should remain at the level forecast for 1998 (5.5 per cent of GDP), while interest payments are expected to fall from 8 per cent of GDP in 1998 to 6.5 per cent in 2001, in line with the hypothesis that Treasury bill rates will stabilize at 4.5 per cent. The public debt is expected to fall from 118.2 per cent of GDP in 1998 to 107 per cent in 2001.

The reduction in interest payments is larger than that envisaged in the Economic and Financial Planning Document for 1998-2000. This allows the Government to set a more ambitious objective for net borrowing in 2000 (1.5 per cent of GDP, as against 1.8 per cent) and a less ambitious objective for the primary surplus (5.5 per cent of GDP, as against 6.1 per cent). This year's Planning Document also foresees a larger contraction in the ratio of the public debt to GDP (11.2 percentage points in the period 1998-2001, compared with the 6.1 points in the period 1997-2000 indicated in the

previous Planning Document) in view of the lower level of net borrowing, the faster rise in GDP and the more favourable assumptions for the other factors that influence the growth of the debt.

Figure 26

**THE MAIN AGGREGATES IN THE
ECONOMIC AND FINANCIAL PLANNING DOCUMENTS
FOR THE PERIODS 1998-2000 AND 1999-2001 (1)**
(as a percentage of GDP)



(1) The revenue and primary expenditure figures of the EFPD for 1998-2000 have been adjusted on the basis of those contained in Italy's Convergence Programme. In order to provide a uniform basis of comparison, revenue and primary expenditure are shown net of settlements of tax credits in securities.

The Government foresees adjustment measures totaling 13.5 trillion lire in 1999, 4 trillion in 2000 and 2 trillion in 2001. A large proportion of the resources made available in this way will be used to finance measures aimed at fostering economic growth. According to the Government's estimates, it would be sufficient to correct the budget on a current programmes basis by 8 trillion lire in 1999 in order to keep the primary surplus at 5.5 per cent of GDP until 2001. This underlying stability of the primary balance, which contrasts sharply with the pattern of the last five years, is an effect of the budget adjustments and structural reforms implemented in earlier years. It also presupposes spending discipline on the part of government bodies.

Total revenue is expected to fall from 47.5 per cent of GDP in 1998 to 46.6 per cent in 2001 and primary expenditure from 42.1 to 41.1 per cent of GDP. In particular, current expenditure should fall, while capital expenditure is expected to rise from 3.5 to 4.1 per cent of GDP. The levels of revenue and expenditure indicated in the Economic and Financial Planning Document for 1999-2001 are higher than those contained in the previous Planning Document. The ratio of revenue to GDP foreseen in 2001 was exceeded only in 1993 and 1997, years in which extraordinarily large budget corrections were made. The primary expenditure ratio will be only 1 percentage point below the levels recorded in the three years from 1995 to 1997.

The reduction in the ratio of revenue to GDP, which presupposes the curbing of expenditure, must go hand in hand with the reduction in the budget deficit. It would help bring about the macroeconomic conditions that were used as assumptions when drawing up the Economic and Financial Planning Document and is a prerequisite for the achievement of lasting equilibrium. In view of the fragmented nature of production in Italy, which makes it difficult to assess some taxable income accurately, a high level of taxation may place a particularly heavy burden on some categories of taxpayers and cause significant distortions in the allocation of resources. A reduction in taxation is essential if Italy is to be competitive in an increasingly integrated economic environment.

The expected increase in capital expenditure should mark the end of the period in which the public sector's contribution to capital formation was progressively reduced because of the need to contain the budget deficit. The recovery in public investment should help to make good the lack of infrastructure in some sectors and regions and narrow the disparity in relation to capital endowment in the other leading European countries.

The Stability and Growth Pact. - The Pact, which was approved in June 1997 by the European Council meeting in Amsterdam, completes the definition of the budgetary policy rules laid down in the Treaty on European Union.

In the Pact the EU countries "commit themselves to respect the medium-term budgetary objective of positions close to balance or in surplus" and to take the necessary corrective action to achieve that objective. The Pact defines the exceptional and temporary circumstances in which a deficit exceeding 3 per cent of GDP will not be deemed excessive, establishes the time limits for the actions contemplated by the excessive deficit procedure, specifies the magnitude of the sanctions for non-compliance and the conditions for their application, and outlines the features of the stability programmes to be presented by the countries that will

adopt the single currency and the convergence programmes to be submitted by the others.

The Pact is intended to reconcile the objective of sound public finances with that of ensuring a margin of flexibility in budgetary policy, in a setting in which monetary policy and the exchange rate will be managed at Community level. The first of these objectives is pursued by enforcing compliance with the 3 per cent ceiling for deficits, apart from limited temporary overshoots due to exceptional circumstances; for this purpose a procedure has been introduced whereby increasing pressure will be exerted on non-compliant countries, culminating in the imposition of sanctions. The second objective is pursued by means of the commitment to achieve a budgetary position close to balance or in surplus.

Structural budget balance, in other words a budget that is in surplus during cyclical upturns and in deficit during downturns, would provide scope for Italy to pursue an adequate countercyclical fiscal policy by the use of automatic stabilizers or discretionary measures without running excessive deficits. Such a budgetary position, which is implicit in the long-term projections set out in the Economic and Financial Planning Document for 1999-2001, would avoid suspending the progressive decline in the ratio of the public debt to GDP in times of recession.

Achieving a budgetary position close to balance will gradually reduce the debt ratio, which will mitigate the repercussions of increases in interest rates on the public finances. In addition, reducing the debt will put Italy in a stronger financial position to cope with the period of most acute population ageing and the associated decrease in interest payments will compensate for the expansionary effects of spending on pensions and health care. This suggests that it is necessary to speed up the reduction of the debt ratio by means of privatizations or by achieving temporary structural surpluses, such as those that would accrue in the next decade if the primary surplus were kept at this year's forecast level after 2001 as well.

Growing economic integration and factor mobility facilitate the transfer of taxable activities to countries with lower tax rates. This deterioration in the tax base can be accentuated by tax competition, that is to say by policies designed to attract taxable activities from other countries by offering tax concessions. These developments have influenced the redistribution of tax revenues at European level over the last twenty years, which have seen an increase in the tax burden on the less mobile tax bases, and particularly on labour. European tax coordination agreements can attenuate the adverse implications of economic integration for tax systems; the initiatives taken by the European Commission to establish common rules for the taxation of financial assets and entrepreneurial incomes go in this direction. However, coordination can only limit the loss of revenue due to

the aforementioned factors. The need to maintain large primary surpluses in Italy will therefore necessitate a further reduction in expenditure as a percentage of GDP. As a consequence, the work of reforming the main sectors of expenditure, revising the operating procedures of government bodies and redefining the tasks of spending centres must continue. Adequate resources will have to be provided for public investment.

MONETARY POLICY AND THE MONEY AND FINANCIAL MARKETS

Monetary policy gradually became less restrictive during 1997; the relaxation was more pronounced in the latter part of the year and the first few months of 1998. The caution exercised in easing monetary conditions helped to reinforce expectations and conduct consistent with price stability. The fall in inflation to under 2 per cent, the lowest rate for thirty years, was conducive to a decline in long-term interest rates and to exchange rate stability and contributed to the exceptional progress made in adjusting the public finances. Against this background, Italian membership of EMU from the outset in 1999 became possible. A common objective of the central banks participating in the European System of Central Banks is to ensure that even now their monetary policies are consistent with price stability in the euro area.

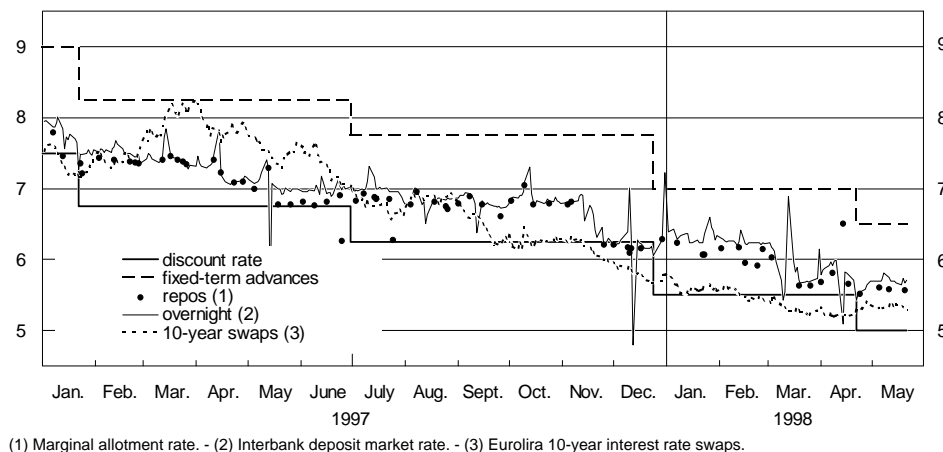
The gradualness of the relaxation of monetary conditions

The Bank of Italy began to reduce official interest rates in the summer of 1996. The decrease from the beginning of 1997 to the present date amounts to 2.5 percentage points (Figure 27). Over the same period the rate on 3-month lira funds has declined by more than 2 points, while the corresponding DM rate has risen by about half a point. Real short-term rates have declined significantly but remain higher than in the other leading countries (Figures 28 and 36).

The cautious approach to lowering rates reduced the risk that the trend might have to be reversed. It helped to strengthen expectations of lasting monetary stability and to ensure propitious conditions for achieving an average inflation rate of no more than 2 per cent in 1998, in line with the target announced last May. The maintenance of positive interest rate differentials with the other major countries signaled the authorities' determination to counter any speculation against the lira. The markets read the monetary stance correctly; the downward path of nominal short-term interest rates did not diverge significantly from the expectations embodied in Eurolira contracts three months earlier (Figure 29).

Figure 27

**OFFICIAL INTEREST RATES AND
MONEY AND FINANCIAL MARKET RATES**
(percentages)



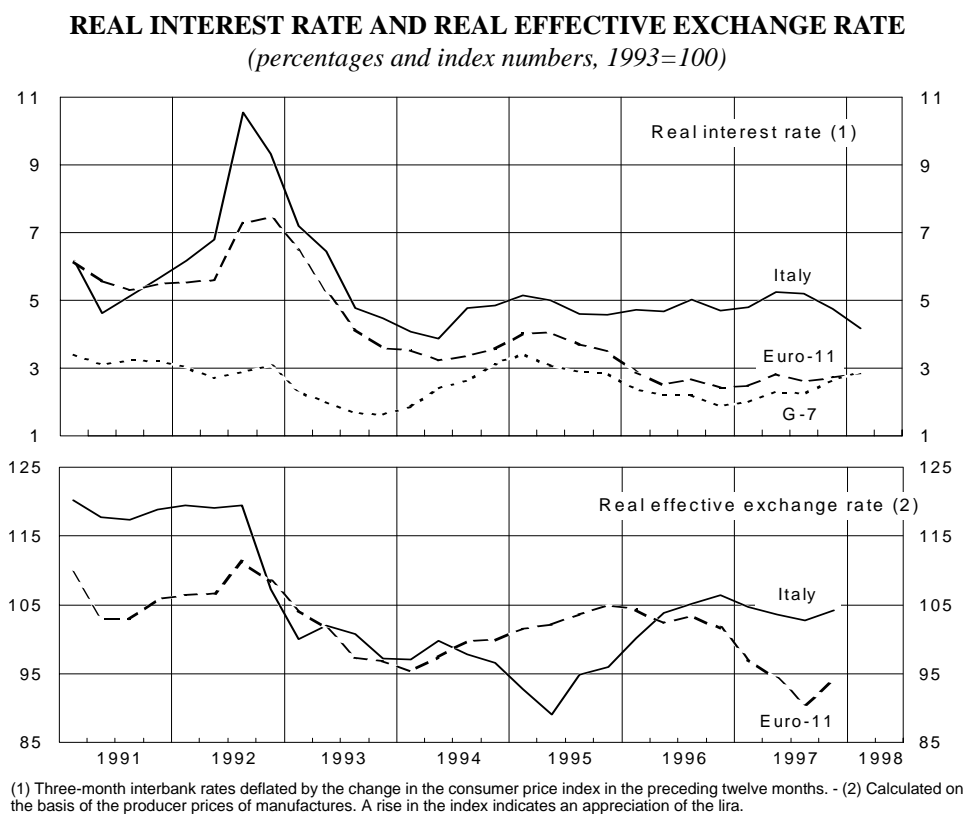
The easing of monetary conditions became possible as a number of factors that were still causing uncertainty at the beginning of last year gradually faded, thanks in part to the prudent conduct of monetary policy. Inflation expectations diminished steadily, so that by the end of the year they were in line with both the inflation target and actual inflation. The main indicators are now signaling expectations of around 2 per cent in both the short and the long term, a figure broadly in line with the European average and consistent with the objective of monetary stability.

The narrowing of actual and expected inflation differentials and the improved outlook for the public finances fostered a further decline in long-term interest rate differentials with the main European countries. In February the yield on the benchmark 10-year Italian Treasury bond came under the reference level laid down in the Maastricht Treaty. The cumulative decrease of 2.4 percentage points in the yield since the end of 1996 is significantly larger than the decline in interest rates abroad, which has been given greater impetus since October by the Asian crisis.

In 1997 the growth in the M2 money supply was nearly twice the target of 5 per cent, owing chiefly to structural changes in the public's portfolio preferences. This suggests that the value of this aggregate as an early indicator of inflationary pressures has been diminished, at least temporarily. Nevertheless, experience demonstrates that in the long run excessive monetary growth tends to be reflected in price and exchange rate pressures. This consideration was one reason for the caution with

which monetary conditions were relaxed in the course of the year. Were it to endure, the rapid expansion of the monetary aggregates, which has been observed recently in some other euro area countries as well, could take on importance for the conduct of monetary policy.

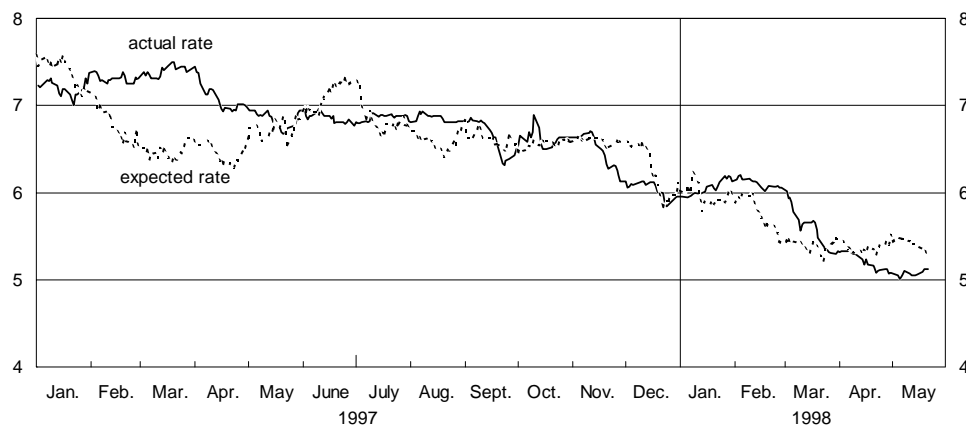
Figure 28



The inflationary pressures stemming from the appreciation of the dollar were partly neutralized by a fall in the world prices of raw materials, especially towards the end of the year. Confidence that EMU would be launched on schedule with a large number of member countries steadily grew during the summer. In Italy this was signaled by the gradual convergence of the implicit forward lira/DM exchange rate for the end of 1998 towards the ERM bilateral central rate; in March the rate had still been above 1,050 lire per mark (Figure 30), but it then declined progressively, so that by the end of the year it was near parity. The improvement in the exchange rate and the reduction in long-term interest rate differentials were aided by substantial inflows of capital, invested mostly in government securities and attracted by growing confidence in the outlook for the Italian economy.

Figure 29

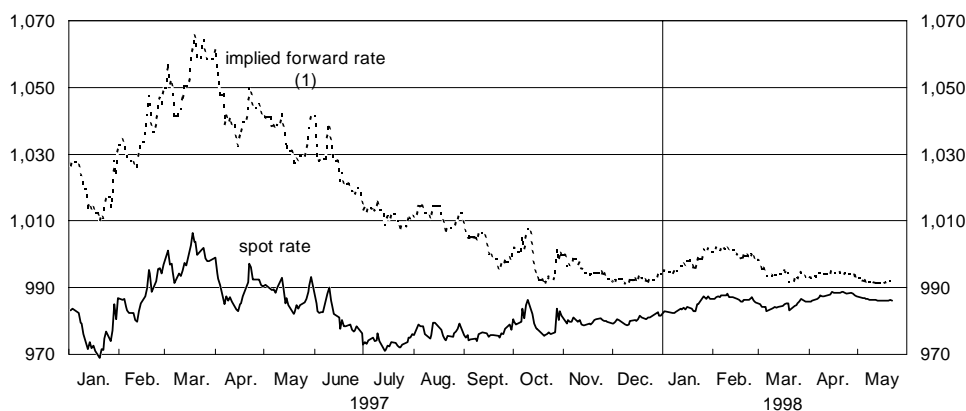
**EXPECTED AND ACTUAL RATES ON
THREE-MONTH EUROLIRA DEPOSITS (1)**
(percentages)



(1) The actual rate is that observed on three-month Eurolira deposits at the date shown on the horizontal axis; the expected rate is derived from the rates observed on 3 and 6-month Eurolira deposits three months earlier.

Figure 30

**LIRA/DM EXCHANGE RATE:
SPOT AND IMPLIED FORWARD AT 1 JANUARY 1999**



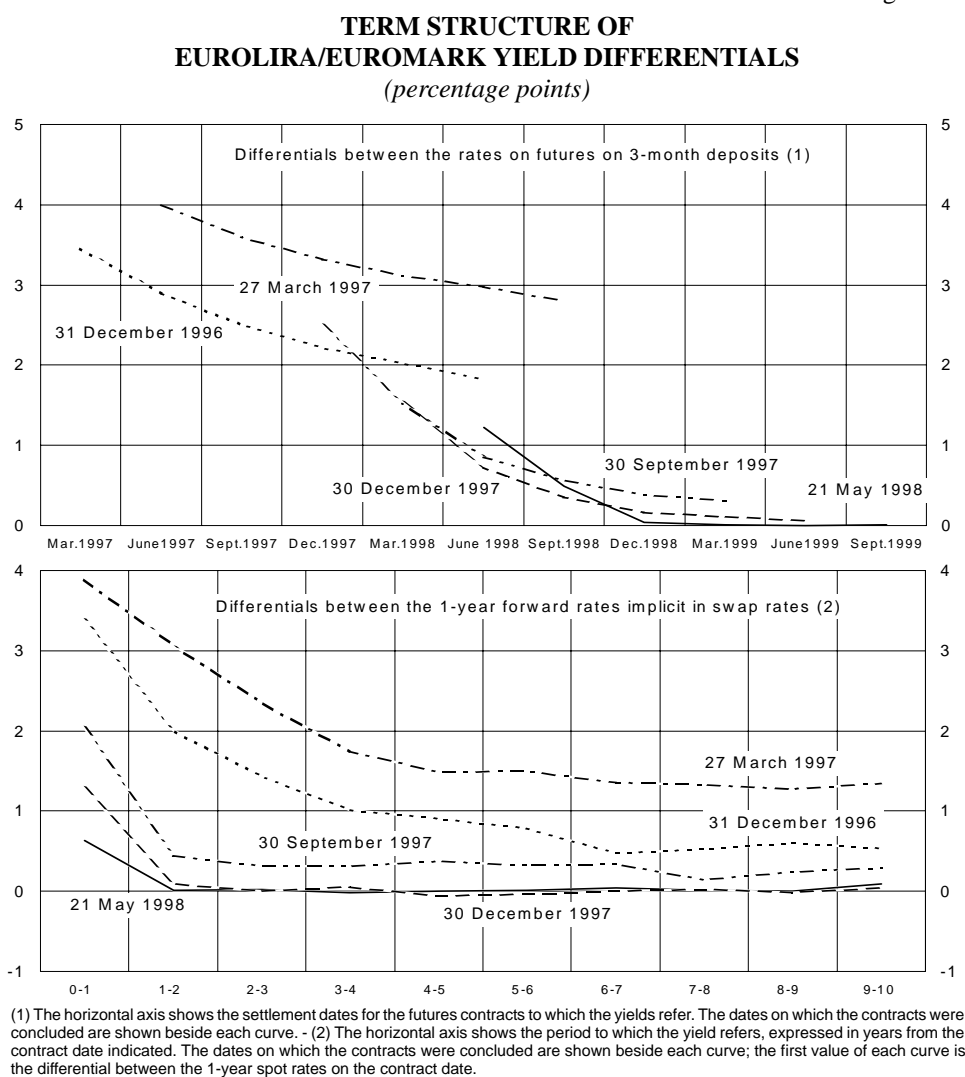
(1) Obtained using the spot exchange rate and the differential between Eurolira and Euromark yields.

Developments in 1997 and the first few months of 1998

Monetary policy. - Official interest rates were lowered in January, June and December by a total of 2 percentage points. In June the rate on compulsory reserves was cut by one point to 4.5 per cent. The differential between 3-month interbank funds in lire and German marks narrowed by 1.8 percentage points to 2.3 points, and that on benchmark 10-year government bonds came down by 1.5 points to 0.3 points. The convergence

of forward differentials was even more pronounced. In the latter part of the year the differential implicit in lira and DM swap rates was virtually nil for maturities from 1999 onwards; that for rates on futures contracts for settlement in December 1998 was about 0.2 points (Figure 31).

Figure 31



The persistence of a short-term interest rate differential helped keep the lira above its central exchange rate with the mark. The effective exchange rate of the lira declined by 1.9 per cent in 1997, primarily owing to the appreciation of the dollar against all the continental European currencies.

In the first nine months of the year there was a gradual and slight easing of monetary conditions. Despite the decline in nominal money

market rates, real short-term rates remained essentially unchanged, decreasing slightly when calculated using inflation expectations and rising marginally when deflated by actual changes in consumer prices in the preceding twelve months (Figure 36). The real effective exchange rate declined slightly (Figure 28). The rate on central bank repurchase agreements decreased by about 0.9 percentage points to 6.8 per cent. Spreading uncertainty within the markets about the convergence of the candidates for participation in EMU resulted in a pause in the decrease in short-term rates and an increase in long-term ones in the first few months of the year; in April, however, rates for all maturities resumed their downward course. During the first three quarters the 3-month interbank rate came down by 0.7 points to 6.5 per cent and the yield on the benchmark 10-year Treasury bond fell by 1.4 points to 6.2 per cent; the differentials with corresponding DM rates narrowed by 3.1 and 0.7 points respectively.

Monetary conditions grew progressively more relaxed in the final part of the year. The decline in money market rates now led to a fall of about 0.5 points in the corresponding real rates. The real effective exchange rate rose moderately, mainly as a result of the behaviour of producer prices. In October the Deutsche Bundesbank raised its repo rate by 0.3 percentage points in response to signs of a cyclical upturn and a weakening of the mark against the dollar. The DM interbank rate rose by the same amount, to 3.7 per cent. Lira rates remained virtually unchanged. In the last two months of the year the decline in Bank of Italy repo rates resumed, with a decrease of 0.6 points to 6.2 per cent. The 3-month interbank rate fell by the same amount to 6.0 per cent. The yield on benchmark Treasury bonds declined to 5.6 per cent.

In 1997 as a whole monetary base expanded by 8.9 per cent (Table 28), significantly faster than the average rate of 3.7 per cent recorded from 1993 to 1996. The increase occurred primarily in bank reserves, reflecting the rapid growth of deposits subject to the reserve requirement. The growth in currency in circulation accelerated less markedly to 7.1 per cent, compared with 5.4 per cent in the four years 1993-96, owing to a modest recovery in consumption and the decline in bank deposit rates. The official reserves increased by 22.8 trillion lire (Table 29), with foreign exchange inflows being concentrated in the second half of the year. The Bank of Italy used repurchase operations to mop up liquidity, offsetting the excess of monetary base created via the external sector. Outright operations, consisting mostly of purchases of Treasury bills at auction, resulted in monetary base creation, but this was offset in the course of the year by redemptions of bills held in the Bank of Italy's portfolio, which are recorded under the Treasury sector.

Table 28

MONETARY BASE AND MONEY SUPPLY (1)
(12-month percentage changes)

	1996	1997				1998
	December	March	June	September	December	March (2)
Monetary base (3)	2.6	8.1	8.5	10.1	8.9	8.7
<i>of which: currency</i>	3.4	6.6	6.4	7.5	7.1	7.8
<i>bank reserves</i> (3)	2.0	10.0	11.1	13.5	11.2	9.7
Money supply (M2) (4)	3.0	8.1	10.1	11.5	9.7	9.7
<i>of which: bank deposits</i>	3.3	9.9	11.5	13.3	11.0	9.9

(1) Currency, bank reserves and monetary base are calculated as averages of daily data for the reserve maintenance period (from the 15th of each month to the 14th of the following month), bank deposits and the money supply as averages for the three months ending in the reference month. – (2) Provisional. – (3) Adjusted for changes in the compulsory reserve ratio. – (4) The figures for 1996 include CDs with maturities of more than 18 months.

Table 29

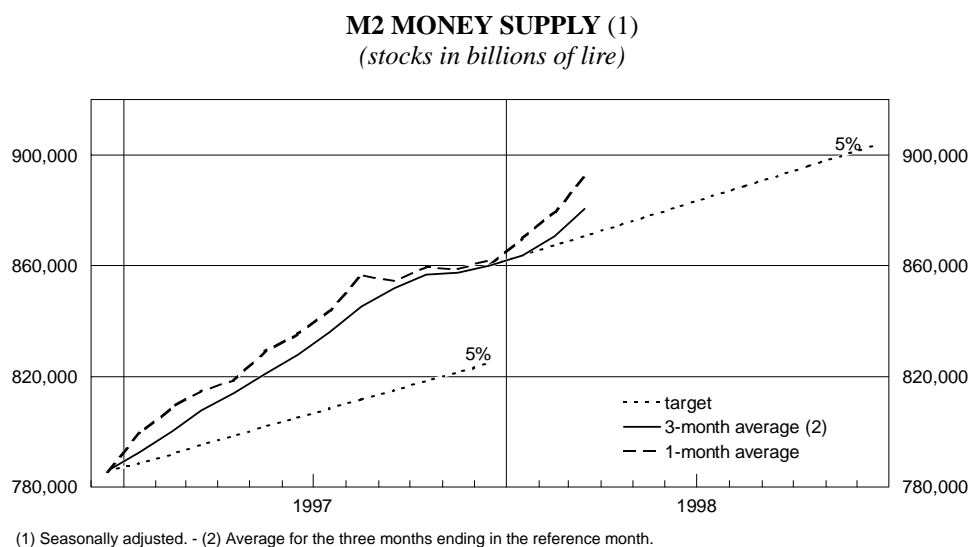
MONETARY BASE (1)
(changes in billions of lire)

	1996	1997					1998
		Year	Q1	Q2	Q3	Q4	Q1 (2)
Sources							
Foreign sector	20,449	22,829	-507	-1,700	22,597	2,438	-1,298
<i>of which: foreign currency swaps</i>	-24,227	-2,921	-	-	-2,921	-	-
Treasury	-6,464	-49,537	-7,376	-19,155	-10,775	-12,232	-1,417
<i>Treasury payments account</i>	8,371	1,204	4,498	-10,729	-199	7,634	10,860
<i>Sinking fund for the redemption of government securities</i>	8,999	-4,224	-2,601	1,911	-126	-3,407	782
<i>Other BI-UIC operations with the Treasury</i> (3)	-23,834	-46,517	-9,273	-10,336	-10,449	-16,459	-13,059
Open market	6,291	32,734	8,384	13,346	-3,149	14,154	7,887
<i>Repos</i>	12,389	-19,270	-9,780	1,097	-11,049	462	-4,589
<i>Outright Treasury bill operations</i>	9,140	42,630	12,496	11,384	9,000	9,750	9,000
<i>Other outright transactions</i>	-15,238	9,374	5,667	865	-1,101	3,943	3,477
Refinancing	-5,647	862	-151	-27	-192	1,233	-1,270
Other sectors	-10,477	6,616	-1,018	6,565	-2,661	3,730	-3,727
Total	4,152	13,503	-668	-971	5,819	9,323	175
Uses							
Currency	1,826	7,327	-781	-1,633	2,241	7,500	-2,466
Bank reserves	2,326	6,176	113	662	3,578	1,823	2,641
<i>of which: compulsory reserves</i> (4)	-1,779	10,669	4,552	2,533	686	2,898	5,273

(1) Rounding may cause discrepancies in totals. – (2) Provisional. – (3) Net redemptions of government securities in the BI-UIC portfolio and other items. – (4) Average reserve requirement for the reserve maintenance period (from the 15th of each month to the 14th of the following month).

The M2 money supply increased by 9.7 per cent, compared with the target of 5 per cent set in the autumn of 1996 (Figure 32). The narrower monetary aggregates also grew more rapidly than in 1996 (Table 30 and Figure 33). The Divisia index, which weights liquid assets in inverse proportion to their yield, showed a less pronounced acceleration, from 3.5 per cent in 1996 to 6.8 per cent last year.

Figure 32



The growth in the monetary aggregates partly reflected the decline in money market rates, which was not accompanied by a comparable fall in bank deposit rates. Large net redemptions of Treasury bills, which the Treasury carried out in order to lengthen the average maturity of the public debt, facilitated a decrease in bill yields. However, the growth in short-term deposits was considerably greater than could have been expected on the basis of interest rate trends and income growth, which are the fundamental determinants of the demand for liquid balances. A contributory factor in this regard was the gradual unfolding of the effects of the tax reform enacted in the summer of 1996, which prompted not only the substitution of bank bonds for long-term certificates of deposit but also an increase in the demand for bank deposits included in M2. Structural changes in savers' portfolio preferences also had a significant impact. A shift towards managed savings, shares and foreign financial assets, fostered partly by the fall in yields on government securities to historic lows, boosted the demand for bank deposits both on a permanent basis, reflecting the desire to compensate for the lesser liquidity of the new investment instruments, and in order to meet temporary requirements for funds in connection with securities transactions.

Table 30

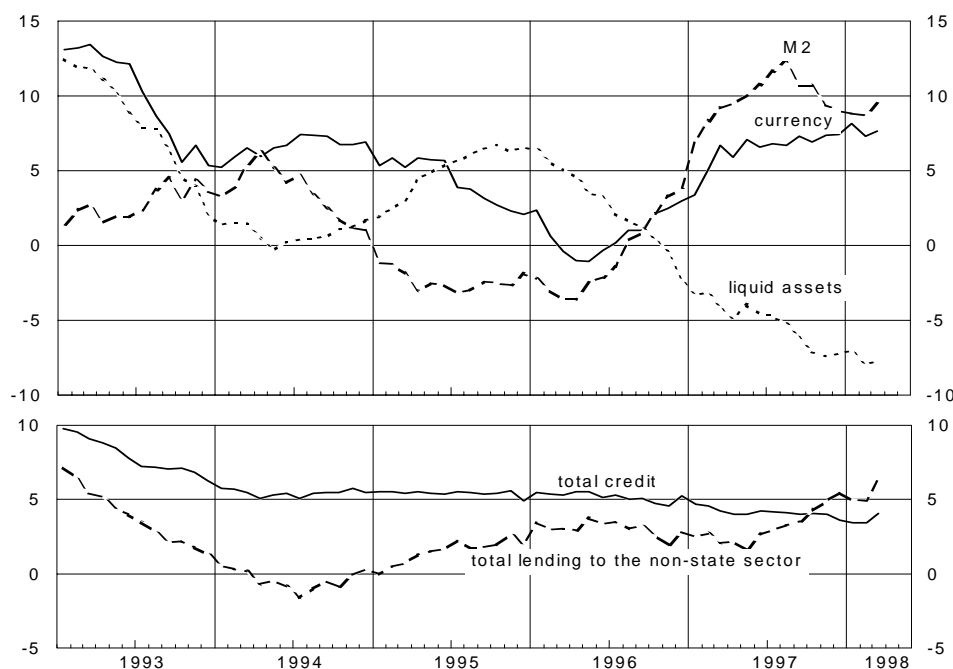
CREDIT, MONEY AND FINANCIAL ASSETS
(percentages)

	Finance to the non-state sector		Total credit		M1	M2	Liquid assets	Financial assets	
	Domestic	(1)	Domestic	(1)				Domestic	(2)
	Growth rates (3)								
1994	1.1	0.3	5.8	5.5	3.7	1.3	1.7	5.7	6.8
1995	2.1	2.0	4.3	4.9	0.7	-2.4	6.6	5.3	5.5
1996	3.4	2.8	5.2	5.2	3.7	3.1	-2.3	3.5	5.1
1997	5.2	5.5	3.5	3.6	8.1	9.7	-7.2	3.1	5.5
	As a ratio to GDP (4)								
1994	60.8	68.4	168.1	181.0	32.8	47.9	93.2	148.1	158.0
1995	58.1	65.3	165.7	179.3	30.4	43.3	90.2	146.4	157.1
1996	56.2	63.0	164.1	177.4	29.1	40.7	87.9	145.1	156.5
1997	56.0	62.7	164.4	178.0	30.4	42.9	80.2	145.8	160.9

(1) Includes foreign loans and purchases of bonds by non-residents. – (2) Net of shares. – (3) For M1 and M2, year-on-year changes based on averages for the fourth quarter; for the other aggregates, twelve-month rates calculated on end-of-period data. – (4) For the money and credit aggregates, average annual stocks.

Figure 33

MONETARY AND CREDIT AGGREGATES (1)
(12-month percentage changes)



(1) Rates of change calculated on monthly averages of daily data for currency and M2 and on end-of-month data for liquid assets and the credit aggregates.

Liquid assets contracted by 7.2 per cent in 1997 (Table 31), reflecting two changes in the portfolio of the non-state sector, namely the substitution of bank bonds for CDs with terms of 18 months or more and a sharp reduction in Treasury bills. The financial assets of the non-state sector increased by 5.5 per cent, slightly less than the average figure for the four years from 1993 to 1996, and there was a significant shift in their composition: holdings of medium and long-term government securities diminished by 5.2 per cent, owing primarily to disposals of Treasury bonds in the second half of the year, while holdings of investment fund units, bank bonds and foreign assets increased.

The growth in credit to the non-state sector picked up somewhat during the year, reflecting an acceleration in short-term bank lending. The increase of 5.5 per cent, compared with 2.8 per cent in 1996 (Table 30), was broadly in line with the targets published in September 1996. By contrast, total credit grew by only 3.6 per cent, compared with 5.2 per cent in 1996, owing to the large reduction in the state sector borrowing requirement.

Table 31

FINANCIAL ASSETS OF THE NON-STATE SECTOR (1)
(end-of-period data; billions of lire and percentages)

	Flows		12-month growth rates		Percentage composition	
	1996	1997	1996	1997	1996	1997
Liquid assets	-39,278	-118,759	-2.3	-7.2	54.0	46.7
M2	29,142	67,701	3.5	7.8	28.4	28.6
<i>of which: bank current accounts</i>	23,123	32,078	4.8	6.3	16.7	16.5
<i>short-term CDs and savings accounts</i>	5,919	22,199	3.2	11.7	6.3	6.5
Other liquid assets	-68,420	-186,460	-8.1	-24.1	25.5	18.1
<i>of which: BOTs</i>	-63,157	-69,226	-18.6	-25.0	9.1	6.3
<i>CDs with maturities of 18 months and more</i> ..	-9,699	-134,264	-3.5	-49.8	8.9	4.2
Medium and long-term securities	73,606	59,284	8.4	6.2	31.4	31.4
Government securities (2)	5,758	-36,642	0.8	-5.2	23.2	20.7
Bonds	67,848	95,926	36.3	38.2	8.3	10.7
<i>of which: issued by banks</i>	64,288	97,884	42.4	46.1	7.0	9.6
Investment fund units	58,226	143,377	45.9	72.6	6.5	11.3
Other financial assets	2,454	2,916	58.6	43.9	0.2	0.3
Foreign financial assets	51,659	79,146	27.1	33.1	7.9	10.3
Total ...	146,667	165,964	5.1	5.5	100.0	100.0
(1) Excludes shares. Rounding may cause discrepancies in totals. - (2) Excludes Republic of Italy issues.						

The substantial decline in total credit expansion from 170.8 trillion lire in 1996 to 123.5 trillion last year is entirely attributable to the reduction in the state sector borrowing requirement; finance to the non-state sector increased by 66.2 trillion lire, compared with 33.5 trillion in 1996. The contribution of the balance of payments on current account was virtually unchanged (62.5 trillion, compared with 63.4 trillion in 1996). Taking account of residual items and statistical discrepancies amounting to 20 trillion lire, total financial assets increased by 166 trillion lire.

Monetary conditions continued to ease in the first part of 1998. Real 3-month lira interest rates came down by approximately 0.6 percentage points to around 4 per cent, approaching the levels prevailing elsewhere in continental Europe. The convergence of yields in lire with those in German marks initially came to a halt owing to the revival of doubts about Italian participation in EMU. It resumed in March, ahead of the publication of the convergence reports of the European Monetary Institute and the European Commission at the end of the month. Under the continued influence of a 21.6 per cent increase in bank current accounts, the M2 money supply began growing again at a sustained pace of 9.7 per cent in the first quarter in conjunction with a further acceleration in investment fund subscriptions and a pronounced rise in turnover on the share market.

On 21 April official interest rates were lowered by half a percentage point - the discount rate to 5.0 per cent and the rate on fixed-term advances to 6.5 per cent - and the rate on banks' compulsory reserves was reduced to 4 per cent. These changes were consistent with the decline in actual and expected interest rates towards the lower levels prevailing elsewhere in Europe and with the consolidation of inflation expectations in line with the inflation targets. The differential between 3-month interbank rates in lire and marks narrowed to 1.4 percentage points in mid-May and that on benchmark 10-year bonds to 0.2 points. Following the official announcement on 3 May of the eleven countries that would adopt the euro, the implicit forward exchange rate of the lira against the mark approached the bilateral central rate of 990 lire.

Financial saving, intermediaries and markets. - The reallocation of the household sector's financial portfolio intensified in 1997 and the first few months of 1998: there was a further increase in holdings of foreign assets, investment fund units and shares and a decrease in those of government securities. The financial balance of consumer households remained broadly unchanged in relation to GDP. The deficit of non-financial enterprises fell, whereas that of sole proprietorships rose sharply. The former had greater recourse to share issues and short-term borrowing, using a good part of the funds so raised to purchase financial assets; the latter increased their medium and long-term debt.

Bank lending accommodated the recovery in productive activity and began growing again in real terms in 1997. Banks ran down their securities portfolios, partly in order to finance an increase in lending that exceeded the growth in deposits and borrowed funds; they continued to realize ample capital gains on such disposals. The large shift of household assets into managed products, 90 per cent of it intermediated by banks, generated a substantial flow of commission income. Bank profitability remained low, however: income declined slightly, as the spread between lending rates and the cost of funds narrowed, while operating expenses edged upwards, notwithstanding the reduction in the number of staff. The slowdown in the growth in bad loans did not lead to a decrease in loan losses, as several large banks made substantial value adjustments on asset items. Overall, net profit was equal to 1.0 per cent of banks' capital and reserves.

The volume of resources managed by institutional investors grew strongly, reaching 50 per cent of GDP at the end of the year. The duration of the portfolios of investment funds and portfolio management services lengthened moderately. The share of foreign securities in investment funds' total portfolios, which had diminished significantly in 1996, rose again in 1997. There was a further marked acceleration in net subscriptions in the first four months of this year.

The rise in share prices in Italy, which was steeper than that recorded in the leading industrial countries, was fueled in part by the start of restructuring in the banking industry, privatizations and reform of the taxation of corporate income; the surge in prices in the first quarter of 1998 caused the ratio of expected earnings to capitalization to fall below those of the main international markets. The portion of Italian shares held by foreign investors, which had increased considerably in 1996, rose further last year.

The fall in long-term yields enabled the Treasury to reduce the cost of borrowing and lengthen the average residual maturity and duration of its debt. Foreign demand for Italian government securities remained strong. Issues of lira-denominated securities abroad also increased considerably.

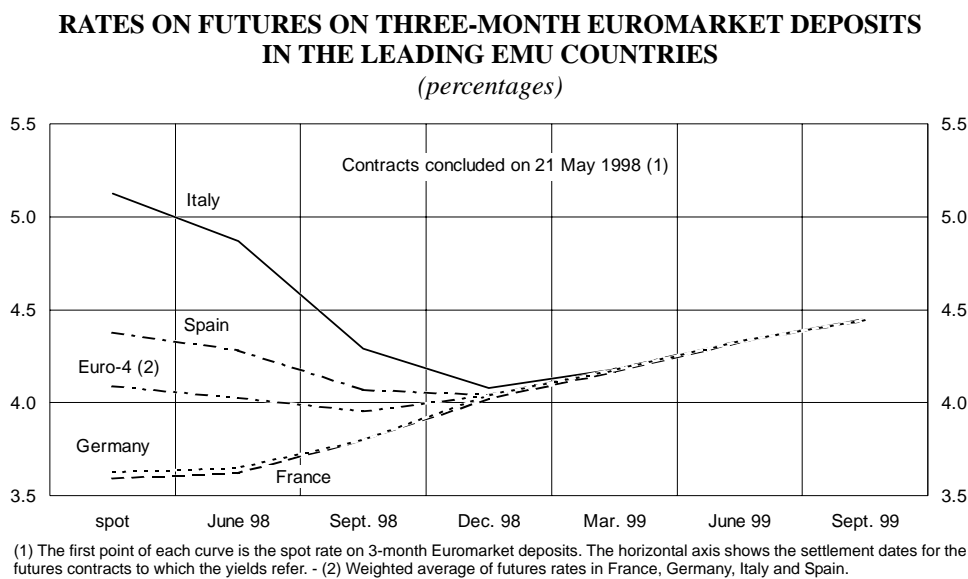
The preparations for EMU

In the second half of the year, during the transition to the third stage of EMU, the European Central Bank and the national central banks will complete the preparatory work for the conduct of the single monetary policy. An overall assessment of the operating structure will be carried out, the ECB's organizational and logistical apparatus will be completed,

the rules for compulsory reserves will be defined, and the analytical and reporting system needed to determine the most appropriate monetary policy stance for the euro area will be established. During the transitional phase it will be necessary to decide the average level of short-term interest rates that is consistent with price stability in the area, taking the lags in the transmission mechanism into account, and the pace at which money market rates in the participating countries will have to converge towards a common level.

The financial markets' expectations regarding short-term interest rates, which can be derived from the rates on 3-month futures contracts, point to a pronounced reduction in differentials within the euro area towards the end of the summer (Figure 34). However, full convergence is not expected to be achieved until December 1998, at a level just above 4 per cent. Since this is roughly equal to the average now prevailing, the markets expect the area's monetary policy to remain virtually unchanged for the rest of the year, but rates to rise by around half a percentage point over the first nine months of 1999.

Figure 34



Market expectations of future movements in short-term rates, as derived from the yield curve of futures contracts, are subject to margins of uncertainty. These are evident both from the changes in the curve in the recent past and from the dispersion of expectations at any point in time.

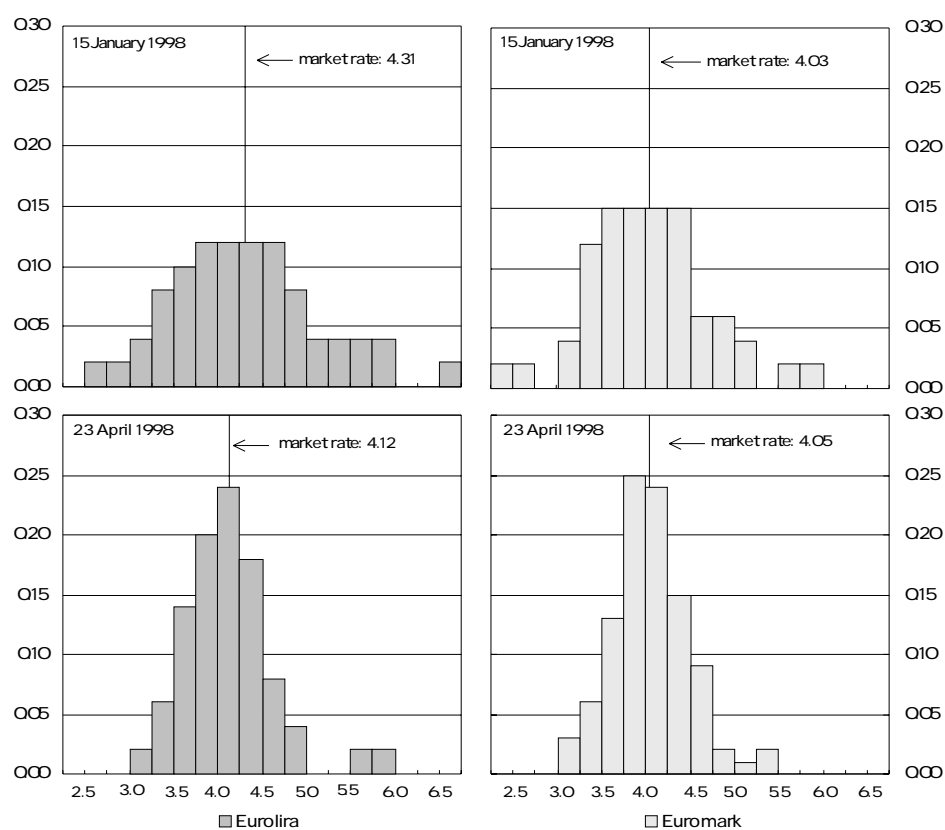
Euromarket rates in the various currencies have fluctuated considerably. In particular, the 3-month rate expected for the time of the launch of EMU, derived from DM futures contracts, rose by 1 percentage point between June and October 1997 to 5 per cent;

it then gradually declined, to stand at around 4 per cent in January 1998, and remained stable thereafter. Changing assessments of the economic outlook in the countries of the area, conditioned above all by developments in the Asian crisis, contributed to these movements.

A probability distribution corresponding to the value of the rate expected at any given time for several future dates can be calculated on the basis of the prices of options on futures contracts. Figure 35 shows the probability distribution of 3-month rates in lire and marks expected for December 1998, as implied by the options prices at 15 January and 23 April 1998 respectively (the average value of the distribution corresponds to the futures rate). In both countries the narrowing of the differential between the two rates was accompanied by an appreciable reduction in uncertainty. The expected year-end DM rate currently ranges between 3.4 and 4.7 per cent with a probability of 90 per cent.

Figure 35

**DISTRIBUTIONS OF THE THREE-MONTH RATE
ON FUTURES FOR SETTLEMENT IN DECEMBER 1998 (1)**



(1) Probability distributions of rates on futures contracts derived from options prices.

Information that will help in shaping monetary policy in the coming months can also be derived from the actual and expected levels of economic activity and inflation in the euro countries and from financial market indicators.

In general, the correlation between euro countries as regards economic performance and inflation has become closer, but cyclical differences

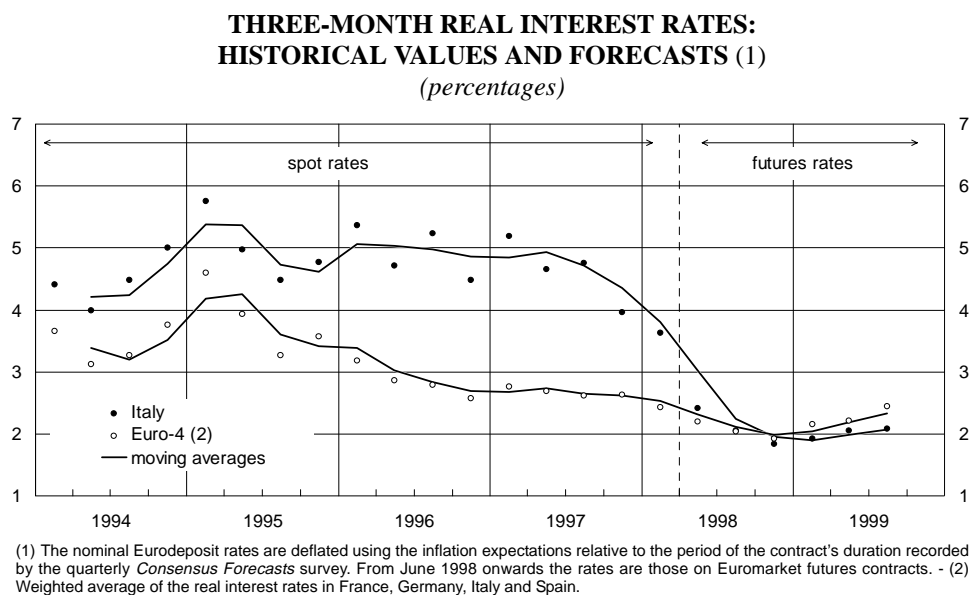
remain. The recovery began earlier in the Netherlands, Ireland, Spain and Portugal than in other countries such as Italy, Germany and France. The more advanced phase of the cycle in the first group suggests the possibility of price tensions, whereas at the moment the outlook for inflation in the second group is more favourable.

Extrapolating the relationship observed in the last few years between short-term interest rates on the one hand and expected inflation and the cyclical position of the real economy on the other indicates that the current and expected monetary stance in the four leading euro countries is, on average, neutral or slightly expansionary.

The relationship between short-term interest rates, inflation and cyclical position can be used to provide a concise and necessarily approximate representation of the rules underlying monetary policy. Numerous recent empirical studies have used this method to interpret the behaviour of the main central banks. Econometric estimations of these relationships in the leading euro countries demonstrate that the policy rules of their respective central banks have tended to converge in the last few years. On average, short-term interest rates in these countries are currently below or at most equal to the value obtained by extrapolating the historical data.

The markets expect real short-term interest rates to hover around an average for the area of around 2 per cent for the rest of the year (Figure 36). By comparison with real rates in Germany, this is about 1 percentage point lower than the average for the nineties and about 2 points less than that for the eighties; it is in line with the average recorded in the sixties and seventies.

Figure 36



The signals coming from the financial markets are also expansionary. The indices of the leading European stock exchanges, which had already

risen strongly in 1997, rose even more rapidly in the early months of this year before marking time in the last few weeks. Moreover, even though the harmonized M3 money supply in the euro area grew only slightly faster than nominal GDP in 1997, the narrower monetary aggregates expanded much more rapidly, with the highest rates occurring in the countries furthest advanced in the economic cycle. Such growth could prove excessive, especially if the greater liquidity resulting from the adoption of a single currency were to increase the velocity of circulation of the aggregates.

On the other hand, recent forecasts by some international organizations for the next twelve months suggest that short-term interest rates even lower than those currently expected by the market would be compatible with the maintenance of price stability within the euro area. A series of arguments is adduced to justify these assessments. The Stability and Growth Pact to which the euro countries have subscribed is seen as considerably reducing the scope for expansionary fiscal policies, a view shared by the markets. Despite rising capacity utilization rates, unemployment remains structurally high in the leading euro countries, contributing to the recent wage restraint, which is expected to continue. Awareness in each country that it will not be possible to offset divergences in inflation rates by devaluing the currency is helping to make expectations anti-inflationary and to instil discipline into firms' pricing policies.

In Italy short-term interest rates still have further to fall than elsewhere, but this should not jeopardize domestic price stability. Arguments along the above lines support this view. In addition, the fact that inflation expectations have fallen to a low level means that a non-inflationary easing of monetary policy is possible; the markets already appear to have discounted a decline in interest rates and there is still room for an increase in capacity utilization.

Against a background of increasingly close coordination among the central banks of the euro countries, the reduction of Italy's short-term interest rates in the coming months will need to be carried out in an orderly manner by choosing the appropriate moments to converge towards the common level for the area at the beginning of 1999.

The legislative and operational changes required for stage three of EMU

The legislation implementing Article 108 of the Treaty establishing the European Community and the amendments to the Statute of the Bank of Italy approved by the General Meeting of Shareholders in March made

the legal provisions concerning the Bank of Italy compatible with the requirements of the Treaty, and in particular with the Statute of the ESCB.

The Bank of Italy is recognized as an integral part of the ESCB (Article 2 of Legislative Decree 43 of 10 March 1998), performs the latter's tasks and functions and pursues its objectives, particularly the primary one of price stability. The Bank remains responsible for the other tasks and functions assigned to it by law, specifically those concerning the supervision of banking and financial intermediaries, the surveillance of markets, the protection of competition in the banking industry and, jointly with the ECB, the oversight of payment systems.

Three measures strengthen the institutional, personal and operational independence of the Bank of Italy: the power of the Minister of the Treasury to suspend or revoke decisions taken by the Bank's Board of Directors no longer applies to those relating to matters within the competence of the ESCB; the term of office of Directors has been extended to five years; and the power to set interest rates on interest-bearing current account deposits held with the Bank of Italy, which is currently exercised by the Minister of the Treasury, has been bestowed on the Governor until the beginning of the third stage.

Lastly, in order to smooth the transition to the new operational regime, in the six months preceding the introduction of the single currency the Bank will be permitted to carry out operations that are compatible with the legal framework of the ESCB even if they conflict with the Codified Law on the Banks of Issue and with the Bank's Statute.

The procedures for conducting monetary policy within the ESCB are described in two EMI publications: *The Single Monetary Policy in Stage Three: Specification of the operational framework* (January 1997) and *The Single Monetary Policy in Stage Three: General documentation on ESCB monetary policy instruments and procedures* (September 1997). There are strong similarities with the procedures already employed by the Bank of Italy, especially as regards the predominant use of repurchase operations to regulate liquidity, the maintenance in normal circumstances of very-short-term interbank rates within the "corridor" between the official rates, and the probable use of compulsory reserves, with provision for their mobilization (the EMI left the latter question to be decided by the Governing Council of the ECB).

In order to control its operational target, identified as a short-term interest rate, the ESCB will use a broader range of intervention methods than currently employed by the Bank of Italy and will intervene more regularly. A wide variety of counterparties will be eligible to participate in the ESCB's monetary policy operations; in addition to banks, they may include other monetary institutions subject to minimum reserve requirements. Counterparties will have to meet certain criteria regarding their financial soundness and be subject to supervision by national authorities.

The ESCB will carry out operations according to a fixed timetable, at weekly and monthly intervals for maturities of two weeks and three months respectively, and fine-tuning operations effected by means of “quick tenders” or bilateral procedures. The methods for such operations envisage the possibility for each participant to submit several bids, the option of holding variable or fixed rate tenders and the restriction of quick tenders to a few large participants. Operations will normally be executed via the national central banks, in accordance with the procedures indicated in the two EMI publications mentioned above. From the standpoint of the competitiveness of the allotment mechanism, the ESCB tender procedure appears to be more complex than that currently used in Italy. Moreover, Italian banks will have to compete with larger foreign banks for euro funds. The Bank of Italy will be responsible for collecting bids and settling funds allotted in Italy.

The range of fluctuation of short-term interest rates will normally be limited in an upward direction by the official rate on the marginal lending facility and in a downward direction by the rate on funds deposited with the ESCB. There will be no limit on the volume of either the marginal lending facility or the deposit facility, which will be available on an overnight basis exclusively for the purpose of regulating liquidity; intervention to assist banks in difficulties does not fall within the responsibilities of the ESCB. There is no provision in the ESCB for ordinary central bank advances of the kind currently available in Italy, and they will be suspended by the end of the year.

The adaptation of Italy’s compulsory reserve requirements to conform with the new arrangements established by the ESCB will release a very large amount of liquidity into the market in view of the difference between the present average reserve ratio for Italian banks of 12.4 per cent of short-term deposits (corresponding to around 90 trillion lire) and the certainly lower value that will be set by the Governing Council of the ECB. It will be possible to absorb the excess liquidity using the instruments currently available, bearing in mind that, under current legislation, the volume of repurchase operations is likely to rise to a very high level in the second half of the year. Even before the end of the year, however, it will be possible to introduce types of interest-earning deposit with the central bank, as prescribed in the Statute of the ESCB.

In accordance with Article 18.1 of its Statute, all ESCB financing will be provided against adequate collateral or in the form of repurchase agreements. In view of the differences between the financial structures of the member states, eligible assets have been divided into two categories, known as “tier one” and “tier two”.

Tier one consists of marketable debt instruments fulfilling uniform eligibility criteria specified by the ECB (essentially the requirement for instruments to be listed on regulated markets and the award of a credit rating for the issuer or, in the case of bonds issued by banks, the issue itself). Tier two consists of other marketable and non-marketable assets which are considered of particular importance for national financial markets and for which eligibility criteria are established by the NCBs in accordance with minimum

standards laid down by the ECB; these eligibility criteria are subject to the latter's approval (for more details, see the EMI document The Single Monetary Policy in Stage Three: Specification of the operational framework). The ECB draws up and maintains a publicly available list of tier-one assets, while the NCBs do likewise for tier-two assets. The legal and solvency risks associated with tier-one assets will be borne by the ESCB, while the risks associated with tier-two assets (and the costs incurred in assessing creditworthiness) will fall on the individual NCBs that placed them on the list.

Fewer than ten securities issued by private Italian companies are currently eligible for inclusion in the list of tier-one assets, but the number could increase if more bond issues were listed and rated. This would also benefit the development and efficiency of the market, especially the private bond and securitized loan segments. The Bank of Italy will list unrated bonds issued by banks as tier-two assets.

From the start of stage three, the ESCB will be able to intervene in foreign exchange markets to counter excessive or erratic movements in the exchange rate of the euro. The Bank of Italy will contribute to such intervention in accordance with procedures to be established by the Governing Council of the ECB.

Last year saw the launch of BI-REL, the Italian segment of the European gross settlement system for interbank payments known as TARGET. In order to facilitate the flow of payments during the day, BI-REL allows banks to mobilize up to 10 per cent of their compulsory reserves on an intraday basis (in addition to the 12.5 per cent they can already mobilize at the end of the day) and to obtain collateralized intraday credit.

HOUSEHOLDS AND ENTERPRISES

The fall in inflation, the convergence of interest rates in Italy with those abroad and the reduction in issues of government securities encouraged a further shift in the composition of households' financial portfolios from government securities to investment fund units, shares, bank bonds and foreign financial assets. This pattern of asset reallocation, which has been under way for several years, intensified considerably in 1997 and the first few months of this year. The financial surplus of consumer households was virtually unchanged in relation to GDP in nominal terms but increased further if the effects of inflation on the real value of wealth are taken into account (Table 32).

Table 32

FINANCIAL BALANCES

	1992	1993	1994	1995	1996	1997
<i>(billions of lire)</i>						
Consumer households	173,758	171,296	144,285	158,406	152,301	157,504
Sole proprietorships	-3,903	-727	-4,985	-2,188	-9,770	-28,973
Non financial corporate and quasi-corporate enterprises	-76,504	-25,961	-18,761	-51,890	-30,001	-23,059
General government	-158,688	-155,774	-147,560	-124,274	-130,160	-38,378
Rest of the world	35,967	-16,068	-22,815	-43,680	-63,351	-62,542
Financial institutions (1) . . .	33,296	22,119	33,978	29,842	60,586	-26,153
Other sectors (2)	-3,926	5,115	15,858	33,784	20,396	22,601
<i>(as a percentage of GDP)</i>						
Consumer households	11.6	11.0	8.8	8.9	8.1	8.1
Sole proprietorships	-0.3	0.0	-0.3	-0.1	-0.5	-1.5
Non financial corporate and quasi-corporate enterprises	-5.1	-1.7	-1.1	-2.9	-1.6	-1.2
General government	-10.6	-10.0	-9.0	-7.0	-7.0	-2.0
Rest of the world	2.4	-1.0	-1.4	-2.5	-3.4	-3.2
Financial institutions (1) . . .	2.2	1.4	2.1	1.7	3.2	-1.3
Other sectors (2)	-0.2	0.3	0.9	1.9	1.2	1.1
<i>(adjusted for inflation (3), as a percentage of GDP)</i>						
Consumer households	7.4	6.4	4.8	3.4	4.8	5.6
Sole proprietorships	-0.3	-0.1	-0.3	-0.1	-0.5	-1.5
Non financial corporate and quasi-corporate enterprises	-4.1	-0.6	-0.2	-1.7	-0.8	-0.6
General government	-6.5	-5.5	-4.9	-1.3	-3.5	0.7

Source: Flow-of-funds accounts. See statistical tables a30 and a31.

(1) Credit institutions and insurance companies. - (2) Unclassified items and leads and lags. See statistical tables a30 and a31.

- (3) Adjusted for the loss of purchasing power of net financial assets due to inflation.

The overall borrowing requirement of firms rose from 39.8 to 52.0 trillion lire. The contraction in the deficit of non-financial enterprises was counterbalanced by a large increase in that of sole proprietorships. With interest rates and the cost of raising equity capital declining, non-financial enterprises increased both their demand for short-term credit and their volume of share issues; they then used a considerable portion of the proceeds to finance the purchase of financial assets, mainly shares and foreign assets. Sole proprietorships increased their recourse to medium and long-term debt in order to finance a larger volume of investment.

The financial balance and debt of households

The financial surplus of consumer households rose slightly, from 152.3 to 157.5 trillion lire. The financial deficit of sole proprietorships, which are included in the household sector in the flow-of-funds accounts, increased from 0.5 to 1.5 per cent of GDP owing to the effects of the recovery in investment and the reduction in self-financing due to the narrowing of profit margins and the decline in financial income.

The abatement of inflation, the narrowing of the differential between yields in Italy and abroad and the contraction in the supply of government securities have led to important permanent changes in the financial behaviour of households. These changes, which intensified last year, are gradually diminishing the differences between the financial structure of Italy and that of the other leading industrial countries.

The share of households' financial assets held via specialized intermediaries grew considerably in 1997. Investment fund units represented 9.0 per cent of the total at the end of 1997, compared with 5.3 per cent a year earlier; including insurance companies' technical provisions and "other financial assets" (severance and pension provisions, inter alia), the share rose from 15.5 to 19.4 per cent, compared with 19.9 per cent in France and 27.7 per cent in Germany at the end of 1996. Among direct holdings of financial assets, medium and long-term instruments rose from 53.1 to 59.4 per cent of the total (Table 33). Finally, the international diversification of households' portfolios intensified: the share of foreign assets rose from 4.2 to 5.5 per cent, or from 5.0 to 7.7 per cent if those held via investment funds are included.

The decline in the opportunity cost of holding bank deposits as yields on government securities came down, the lingering uncertainty about the outlook for long-term interest rates for part of the year and the need to hold liquid balances for purposes of portfolio adjustment prompted households

to increase their sight deposits by a further 27.1 trillion lire, compared with 22.9 trillion in 1996; other deposits (including medium and long-term CDs) fell by 97.2 trillion, owing in part to the changes in tax treatment, whereas they had grown by 11.4 trillion in 1996.

Table 33

FINANCIAL ASSETS AND LIABILITIES OF HOUSEHOLDS (1)

	Stocks			Flows		
	Billions of lire	Percentage composition		Billions of lire		
	Dec. 1997	Dec. 1996	Dec. 1997	1995	1996	1997
ASSETS						
Cash	97,283	2.5	2.4	1,930	1,720	6,557
Sight deposits	405,796	10.4	10.0	-2,513	22,930	27,128
Other deposits	512,111	16.7	12.6	34,235	11,409	-97,151
<i>bank</i>	341,640	12.4	8.4	17,709	-3,038	-109,417
<i>postal</i>	170,471	4.3	4.2	16,526	14,447	12,265
Repos	94,082	2.5	2.3	31,004	-10,875	4,244
Short-term securities	204,338	7.4	5.0	26,396	-62,804	-64,416
Medium and long-term securities ...	798,321	20.7	19.7	44,673	95,229	41,795
<i>government</i>	506,482	15.2	12.5	41,657	30,836	-47,512
Investment fund units	363,032	5.3	9.0	-10,517	58,286	143,175
Shares and other equities	931,680	20.3	23.0	16,870	-4,321	14,869
External assets (2)	223,298	4.2	5.5	8,553	20,563	33,126
<i>short-term securities</i>	3,394	0.1	0.1	-521	792	-126
<i>medium and long-term securities</i> .	102,179	2.0	2.5	7,143	14,582	21,592
<i>shares and other equities</i>	90,091	1.6	2.2	93	-539	4,036
Insurance company provisions for policy claims	228,557	5.1	5.6	27,059	28,291	41,689
Other (3)	196,042	5.1	4.8	11,213	11,463	11,774
Total assets	4,054,539	100.0	100.0	188,903	171,892	162,790
<i>as a ratio to GDP</i>	<i>2.08</i>					
LIABILITIES						
Short-term loans (4)	125,834	27.6	26.0	2,335	4,327	1,619
<i>bank</i>	123,373	26.9	25.5	2,412	2,201	2,443
Medium and long-term loans (5)	243,085	48.2	50.2	18,689	13,638	22,938
<i>bank</i> .	207,641	43.0	42.9	16,442	9,339	14,317
Other (6)	115,081	24.2	23.8	11,661	11,395	9,703
Total liabilities	483,999	100.0	100.0	32,685	29,361	34,259
<i>as a ratio to GDP</i>	<i>0.25</i>					
Net balance	3,570,540			156,218	142,531	128,531

Source: Flow-of-funds accounts. See statistical tables a30 and a31.

(1) Includes both consumer households and sole proprietorships. Rounding may cause discrepancies in totals. - (2) Short-term securities, bonds, shares issued by non-residents and units of foreign investment funds. - (3) Severance pay and pension funds and sundry minor items. - (4) Includes finance provided by factoring companies. - (5) Includes finance provided by leasing companies, consumer credit from financial companies and sundry minor items. - (6) Severance pay, bad debts, and sundry minor items.

Holdings of government securities decreased considerably, by 64.3 trillion lire in the case of short-term securities and by 47.5 trillion in that of medium and long-term paper, whereas holdings of bank bonds increased by around 90 trillion. Net purchases of investment fund units also rose substantially, from 58.3 trillion lire in 1996 to 143.2 trillion in 1997.

Investment in domestic shares and other equities was stimulated by the good performance of the stock market and the offerings of privatization shares. Net purchases were appreciable, totaling 14.9 trillion lire, compared with net disposals of 4.3 trillion in 1996.

There was pronounced growth in investment abroad, mostly in medium and long-term securities (up from 14.6 to 21.6 trillion lire) and shares (net purchases of 4 trillion lire, compared with net disposals of 500 billion in 1996). If purchases via investment funds are included, net investment in foreign assets by the household sector last year amounted to 74.8 trillion lire.

The flow of consumer households' financial liabilities rose from 12.5 to 15.3 trillion lire; the increase was predominantly in medium and long-term items in connection with the financing of purchases of durable consumer goods.

Sole proprietorships increased their investment, especially in transport equipment eligible for tax incentives. Since self-financing decreased, the proportion of capital spending financed internally fell from 82.6 to 72.6 per cent. As a result, the flow of liabilities increased from 16.9 to 19 trillion lire, a large proportion of which consisted of debt towards leasing companies, the flow of which grew from 2.6 to 9.4 trillion; the growth in bank borrowing slowed down.

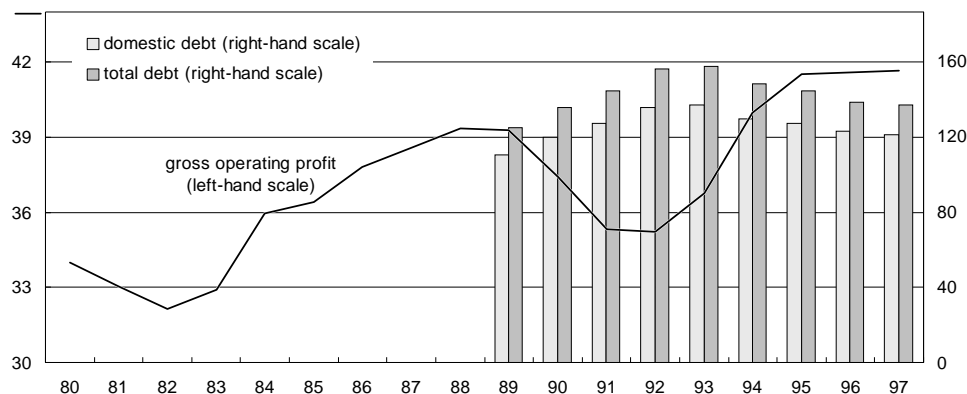
The financing of enterprises and their liquidity

Firms' gross operating profits were equal to 41.7 per cent of their value added, broadly the same as in 1996 (Figure 37). The pattern during the year shows a steady recovery from the second quarter onwards, following the contraction that had begun in the second half of 1996. The decline in bank lending rates led to a considerable reduction in net interest payments, which fell from 27.5 to 21.2 per cent of gross operating profits. Self-financing rose slightly as a result (Figure 38).

Owing in part to the stagnation in capital spending for much of the year, the proportion of investment financed from internal sources rose further, from 83 to 85 per cent.

Figure 37

CORPORATE DEBT AND GROSS OPERATING PROFIT AS A PERCENTAGE OF VALUE ADDED (1)



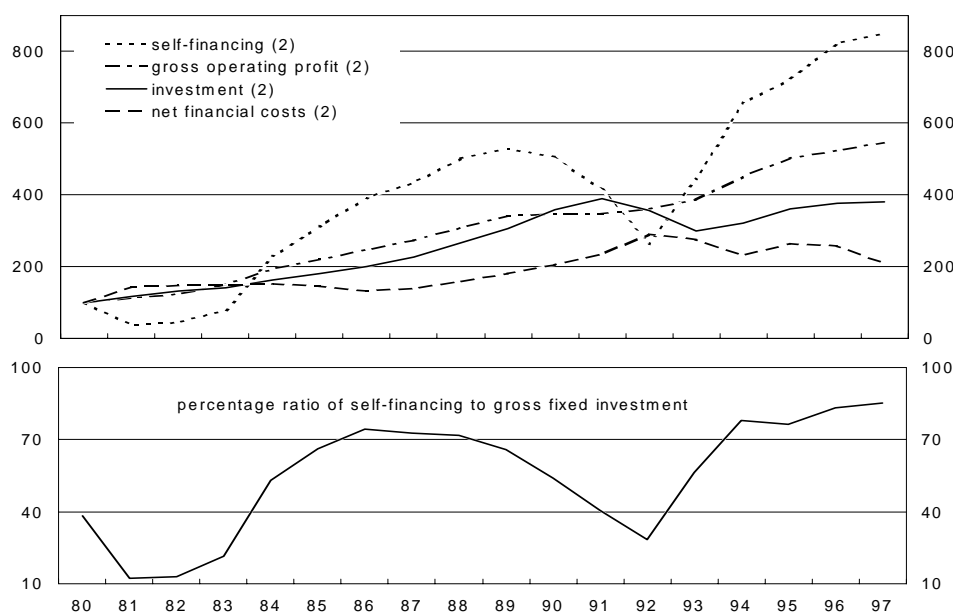
Sources: Estimates based on Istat and Bank of Italy data. The figures for 1997 are provisional.

(1) Domestic debt consists of loans and corporate bonds. Total debt includes finance from non-residents in the form of loans and non-share portfolio investment.

Against the background of a decline in the cost of borrowing and of equity issuance, the flow of liabilities increased from 33.6 to 67.7 trillion lire (Table 34). The funds raised were used to finance the large increase in net purchases of financial assets, which rose from 3.0 to 44.7 trillion lire and mainly involved shares and external assets; the sector's financial deficit fell from 30.0 to 23.1 trillion lire.

Figure 38

THE BORROWING REQUIREMENT OF FIRMS (1)



Sources: Estimates based on Istat and Bank of Italy data. The figures for 1997 are provisional.

(1) Non-financial corporate and quasi-corporate enterprises. - (2) Indices, 1980=100.

Table 34

FINANCIAL ASSETS AND LIABILITIES OF ENTERPRISES (1)

	Stocks			Flows		
	Billions of lire	Percentage composition		Billions of lire		
	Dec. 1997	Dec. 1996	Dec. 1997	1995	1996	1997
ASSETS						
Cash	10,007	1.4	1.3	189	172	680
Sight deposits	102,981	14.3	13.3	-593	-1,419	4,324
<i>bank</i>	96,645	13.4	12.5	97	-914	4,707
Other deposits	6,057	0.9	0.8	252	-628	62
<i>bank</i>	4,392	0.6	0.6	134	-732	5
Repos	22,692	2.3	2.9	4,513	-1,086	7,015
Short-term securities	1,810	0.4	0.2	181	-923	-1,009
Medium and long-term securities	52,292	7.4	6.7	3,809	-3,311	1,719
<i>government</i>	39,267	5.7	5.1	2,531	-5,162	78
Shares and other equities	278,053	39.5	35.9	7,530	-1,941	5,900
External assets	277,122	30.6	35.7	18,403	11,213	23,698
<i>bonds</i>	21,593	2.8	2.8	340	1,185	463
<i>shares and other equities</i>	126,966	11.2	16.4	5,650	5,439	10,118
<i>trade credit receivable</i>	83,751	11.8	10.8	6,860	1,395	3,256
<i>other external assets</i>	30,669	3.4	4.0	4,441	942	6,812
Other (2)	24,395	3.2	3.1	1,326	1,496	2,274
Total assets	775,409	100.0	100.0	35,610	3,573	44,662
<i>as a percentage of value added</i>	1.28					
LIABILITIES						
Domestic liabilities	1,911,077	88.0	85.6	68,940	23,334	47,198
Short-term loans (3)	404,331	18.7	18.1	13,442	-2,497	19,404
<i>bank</i>	375,641	17.4	16.8	8,993	-1,393	16,599
Medium and long-term loans (4)	315,658	15.5	14.1	20,860	11,097	-7,680
<i>bank</i>	229,734	11.2	10.3	12,658	3,648	4,414
Bonds	12,027	0.7	0.5	-2,757	-578	-1,960
Shares and other equities	1,019,608	45.4	45.7	18,236	3,374	29,988
Other (5)	159,454	7.7	7.1	19,159	11,938	7,447
External liabilities	321,977	12.0	14.4	18,560	10,240	20,523
<i>trade credit payable</i>	47,534	2.1	2.1	5,304	-4,810	4,885
<i>foreign loans</i>	81,741	3.8	3.7	-601	-4,670	3,528
<i>bonds</i>	13,979	0.6	0.6	-270	734	485
<i>shares and other equities</i>	170,704	5.3	7.6	12,653	16,084	9,077
Total liabilities	2,233,054	100.0	100.0	87,500	33,574	67,721
<i>as a percentage of value added</i>	3.68					
Net balance	-1,457,645			-51,890	-30,001	-23,059

Source: Flow-of-funds accounts. See statistical tables a30 and a31.

(1) Non-financial corporate and quasi-corporate enterprises. Rounding may cause discrepancies in totals. - (2) Includes insurance companies' technical provisions and sundry minor items. - (3) Includes finance provided by factoring companies and repo transactions. - (4) Includes finance provided by leasing companies. - (5) Severance pay and pension funds, bad debts, and sundry minor items.

In view of the rapid rise in share prices, share issues were the largest source of new liabilities as a counterpart to the growth in financial assets. Issue volume rose from 19.5 to 39.1 trillion lire, including 9.1 trillion placed abroad, but only a fairly small portion of these funds was raised in the stock exchange; listed firms did not begin to take substantial advantage of the fall in the cost of capital until the first quarter of 1998. There were significant changes in the ownership structure of listed firms, in part as a result of the privatization process.

Corporate debt rose by 13.8 trillion lire, compared with 4.1 trillion in 1996; most of the growth occurred in the fourth quarter. In contrast with the two previous years, the increase occurred mainly in short-term finance, which grew considerably in the last quarter in conjunction with an acceleration in stockbuilding. Foreign trade credit payable, which had contracted by 4.8 trillion lire in 1996, grew by 4.9 trillion last year as a result of the large increase in imports.

The debt-equity ratio fell further, from 78 to 70 per cent; corporate debt amounted to 138 per cent of value added, little different from the figure of 137 per cent recorded in 1996.

Forms of investment that are particularly suitable for financing periods of rapid corporate growth, such as venture capital finance, are still not widely used in Italy and the rest of continental Europe. In 1996 equity investment of this kind amounted to around 1 trillion lire in Italy, or 0.1 per cent of value added, a ratio comparable to those recorded in Germany and France (0.1 and 0.2 per cent respectively) but lower than that of the United Kingdom (0.8 per cent). Such investment remained limited in 1997, despite rising slightly to around 1.1 trillion lire.

The flow of foreign trade credit receivable rose from 1.4 to 3.3 trillion lire as a result of the rapid growth in exports. There was also a substantial increase in the flow of other external assets, from 900 billion lire in 1996 to 6.8 trillion last year, part of which was attributable to loans from Italian firms to branches or subsidiaries abroad.

There was an increase of 7 trillion lire in firms' holdings of securities under repurchase agreements and one of 4.4 trillion in their deposits, compared with decreases of 1.1 and 2 trillion respectively in 1996.

Equity holdings grew substantially: net purchases of domestic shares totaled 5.9 trillion lire, compared with net disposals of 1.9 trillion in 1996, and those of foreign shares rose from 5.4 to 10.1 trillion. The increase was attributable in part to the acquisition of controlling interests and in part to speculative investment.

The figures compiled by the Company Accounts Data Service allow more detailed analysis of firms' economic results and financial position in

1996, the latest year for which all companies' accounts are available. The profits of small private firms located in the North-East fell. The higher level of self-financing led to a recovery in investment only in the case of public utilities. The overall reduction in corporate debt was due almost entirely to large public sector enterprises; the ratio of debt to value added began rising again for small and medium-sized private enterprises.

BANKS AND OTHER CREDIT INTERMEDIARIES

The acceleration in output and the increase in stockbuilding fostered the recovery in bank lending, which grew in real terms throughout the country in 1997 (Table 35). Banks fostered the demand for finance by increasing credit lines and reducing lending rates (Figure 39). Adjusted for the three-month change in producer prices, the average interest rate on short-term loans in lire fell by nearly four percentage points over the year; in March 1998 it was equal to 7.9 per cent, about one point less than the real rate of interest on overdrafts of between 1 and 5 million marks in Germany.

The prospect of lasting monetary stability encouraged further growth in medium and long-term lending; in March of this year the average interest rate on new disbursements was equal to 7.5 per cent, compared with 9.7 per cent at the end of 1996. Short-term lending rose rapidly in the second half of 1997 and the first quarter of this year. This result, which is typical of periods of accelerating economic activity, benefited from particularly low interest rates for prime borrowers: in the six months ending in March of this year the minimum short-term rate averaged 6.1 per cent, which was slightly less than the three-month interbank rate.

Bad debts fell following the transfer by Banco di Napoli of substandard loans to a specially created non-bank collection company called SGA and the liquidation of Sicilcassa. Even when the amounts involved in these two operations are included, the rate of increase in bad debts was still lower throughout the country.

Banks' fund-raising slowed sharply last year compared with 1996, although there were significant differences among its components. Short-term fund-raising grew substantially, especially in the case of current account deposits (Figure 40). The increase was prompted by the fall in money market interest rates but also benefited on the demand side from households' need to compensate for the reduction in the liquidity of their portfolios following their large acquisitions of investment fund units, shares and foreign assets. By contrast, the medium and long-term component contracted owing to the fall in CDs with maturities of at least 18 months, which was only offset in part by net issues of bonds.

Table 35

MAIN ITEMS IN BANKS' BALANCE SHEETS (1)*(percentage changes on corresponding period of previous year; billions of lire)*

	Dec. 1994	Dec. 1995	Dec. 1996	1997				March 1998	Outstanding December 1997
				Mar.	June	Sept.	Dec.		
Assets									
Securities (2)	10.0	-8.7	8.9	6.5	-0.2	-5.0	-10.5	-10.3	343,406
<i>government securities (2)</i>	<i>10.6</i>	<i>-7.8</i>	<i>10.8</i>	<i>8.1</i>	<i>0.5</i>	<i>-4.8</i>	<i>-11.3</i>	<i>-13.0</i>	<i>296,481</i>
Loans (3) (4) (5)	1.0	2.7	2.4	2.3	3.4	3.7	5.4	6.3	1,160,916
<i>short-term (4)</i>	<i>-4.3</i>	<i>3.2</i>	<i>0.9</i>	<i>2.0</i>	<i>2.0</i>	<i>2.5</i>	<i>5.6</i>	<i>5.9</i>	<i>590,716</i>
<i>medium and long-term (5)</i>	<i>7.3</i>	<i>2.1</i>	<i>4.0</i>	<i>2.6</i>	<i>4.8</i>	<i>5.0</i>	<i>5.3</i>	<i>6.6</i>	<i>570,200</i>
Bad debts	29.8	21.0	11.7	4.8	1.7	-1.5	-2.5	3.8	119,990
External assets in lire (6)	-10.8	50.8	53.0	44.4	49.6	41.9	3.2	11.5	191,452
External assets in foreign currency (3) (6)	-4.4	-4.5	11.5	5.8	7.1	3.0	1.8	7.9	157,783
Liabilities									
Domestic deposits and bonds (averages) (7)	2.6	1.4	8.3	8.2	6.4	5.6	2.3	2.7	1,210,352
<i>deposits</i>	<i>0.6</i>	<i>1.7</i>	<i>2.9</i>	<i>0.7</i>	<i>-3.5</i>	<i>-5.1</i>	<i>-7.8</i>	<i>-6.6</i>	<i>832,609</i>
<i>current accounts</i>	<i>3.2</i>	<i>0.6</i>	<i>6.0</i>	<i>10.9</i>	<i>10.7</i>	<i>11.4</i>	<i>9.3</i>	<i>12.4</i>	<i>495,589</i>
<i>short-term CDs</i>	<i>-19.5</i>	<i>-14.1</i>	<i>12.3</i>	<i>27.5</i>	<i>42.0</i>	<i>30.2</i>	<i>27.5</i>	<i>12.9</i>	<i>86,478</i>
<i>medium and long-term CDs ..</i>	<i>4.0</i>	<i>16.2</i>	<i>-1.5</i>	<i>-18.8</i>	<i>-32.9</i>	<i>-40.3</i>	<i>-49.0</i>	<i>-52.3</i>	<i>138,466</i>
<i>bonds</i>	<i>11.1</i>	<i>-0.2</i>	<i>30.2</i>	<i>38.3</i>	<i>46.3</i>	<i>44.5</i>	<i>34.8</i>	<i>29.9</i>	<i>377,743</i>
External liabilities in lire (6)	37.1	27.6	34.2	23.9	17.6	26.3	19.9	28.0	159,797
External liabilities in foreign currency (3) (6)	-5.1	-15.1	-0.6	-2.2	-4.9	-4.4	-2.6	5.6	260,951
Repos with non-bank residents ...	-8.4	44.5	-5.5	-3.0	7.8	7.2	10.6	-6.4	132,466

(1) The figures for March 1998 are provisional. The adjustments described in notes 2-5 relate only to the percentage changes. – (2) Excluding loan conversion securities. – (3) The foreign currency component is net of exchange rate adjustments. – (4) Including loans converted into securities and settlements of storage agency bills. – (5) Net of the effect of the operations concluded in January 1997 between Banco di Napoli and the non-bank collection company SGA. – (6) Source, UIC. – (7) For deposits, monthly averages of daily data; for bonds, end-of-period data; for medium and long-term CDs until 1994, averages of end-month data for the reference month and the previous month.

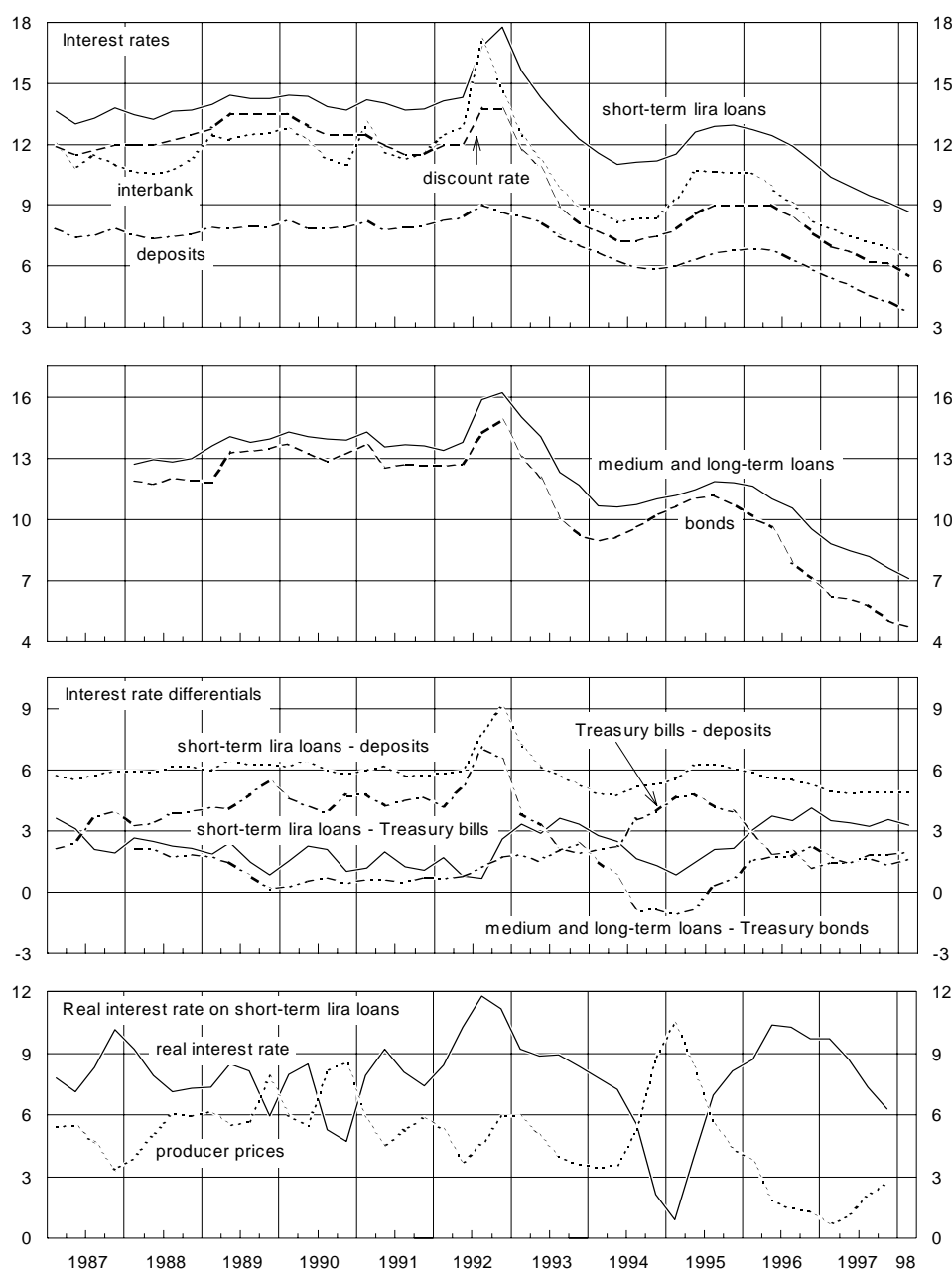
In order to allow lending to grow faster than fund-raising, banks increased their net foreign liabilities and reduced their securities portfolios.

The rate spread on short-term operations narrowed from 5.6 to 4.9 percentage points, thereby contributing to the contraction of 3.6 trillion lire in net interest income. For the second consecutive year, securities prices rose as interest rates converged towards the levels prevailing in the other EMU countries; banks' bond trading accordingly generated considerable profits, although not as large as in 1996. Banks' income also benefited from the growth in asset management instruments, nearly 90 per cent of which are placed through bank branches; revenues from asset management more than

doubled compared with 1996, when they had already risen strongly. The rise in trading profits and fee income offset most of the fall in net interest income; gross income declined by 0.6 trillion lire compared with the already low value recorded the previous year.

Figure 39

INTEREST RATES AND INTEREST RATE DIFFERENTIALS (1)
(quarterly data; percentages and percentage points)

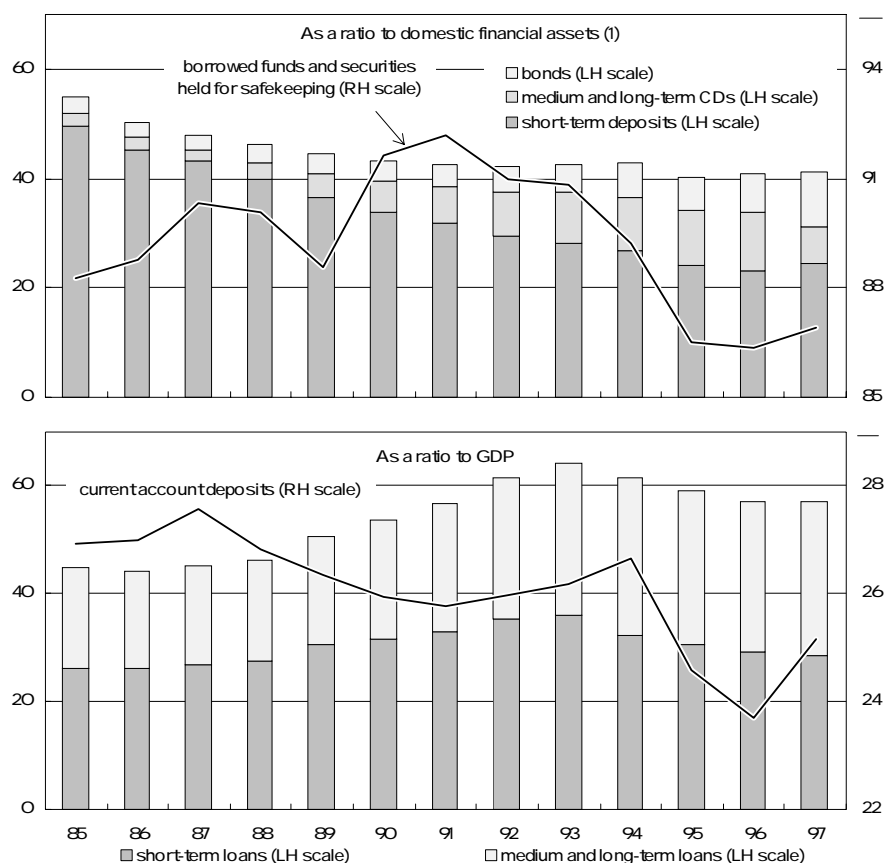


(1) The yield on Treasury bonds refers to bonds with a residual maturity of at least one year traded on the Milan Stock Exchange.

Figure 40

BANKING INDICATORS

(percentages based on average annual data)



(1) Current and savings account deposits, CDs, bonds issued by banks and securities owned by the non-state sector held for safekeeping as a ratio to the domestic financial assets of the non-state sector excluding shares. The securities held for safekeeping are those owned by non-bank customers; they do not include shares, bonds issued by banks, foreign bonds or CDs.

Operating costs rose by 2.3 per cent despite a small reduction in staff costs. The contraction in staff numbers continued, especially among the major banks and in response to substantial incentives to retire early. Staff costs per employee remained basically unchanged.

Notwithstanding the slower growth in bad debts, value adjustments to asset items increased; in part this was due to changes in the accounting policies adopted by some major banks. The net profit for the year of the banking system as a whole amounted to 1 trillion lire; when the 0.6 trillion earned by Italian banks' foreign branches is included, the return on equity was equal to 1 per cent.

Lending

Net of the effects of exchange rate adjustments on the foreign currency component, loans to resident customers grew by 59.1 trillion lire, or 5.4 per cent, compared with an increase of 25.8 trillion, or 2.4 per cent, in 1996. In real terms lending grew by 0.8 per cent on an annual average basis, compared with a contraction of 2 per cent the previous year. The increase over the year was entirely attributable to the lira component, which grew by 6.4 per cent, as against 3.3 per cent in 1996; foreign currency loans continued to contract at much the same rate as in 1996 (5.9 per cent, as against 6 per cent).

Short-term lending grew by 5.6 per cent after rising by 0.9 per cent in 1996; the growth was particularly pronounced in the last part of the year, when the recovery in output became more firmly established and firms' increased their financial investments. The growth in medium and long-term lending accelerated from 4 to 5.3 per cent. The share of short-term loans in total lending declined slightly on an annual average basis, in line with the trend that emerged at the beginning of the nineties.

Bank lending continued to grow in the first quarter of 1998; in March the twelve-month rate of increase was 6.3 per cent for the total and 5.9 per cent for the short-term component.

Bank lending rates came down in parallel with money market rates and official rates in 1997. The average rate on short-term lira loans declined slightly more than the average yield on Treasury bills, falling by 1.8 percentage points to 9 per cent. As regards medium and long-term lending, the rate on new corporate loans fell by 2.2 percentage points to 6.9 per cent, while that on new mortgage loans to consumer households fell by 1.8 percentage points to 9.4 per cent. The downward trend of lending rates continued in the early months of 1998.

The differential between the rate on short-term lira loans and that on overdrafts of between 1 and 5 million marks in Germany narrowed from 3 to 1.3 percentage points in 1997 and was equal to 0.6 percentage points in April of this year. The situation with respect to France and the United Kingdom also improved: the average minimum rate in Italy last year was about 0.5 percentage points above the corresponding rate in France and 0.8 percentage points below that in the United Kingdom. In 1996 both differentials had been positive and equal to around 2 percentage points.

The differential between the rates on medium and long-term corporate loans in Italy and Germany also narrowed. In March of this year the nominal rate on fixed and variable rate loans in lire, weighted according to the amounts disbursed, was 6.8 per cent, while the rate on fixed rate loans in

marks with maturities of at least four years, calculated as the simple average of the rates on disbursements of between 1 and 10 million marks, was 6.2 per cent. The differential of 0.6 percentage points compared with one of 2.6 percentage points at the end of 1996.

The growth in loans to industrial companies was higher than the average, while total lending to firms showed only limited growth owing to the reductions in loans to construction companies and holding and operating companies belonging to public sector groups. Outstanding loans to consumer households increased sharply for all maturities. Lending to finance companies grew by nearly 20 per cent, primarily as a consequence of the strong recovery in the activity of consumer credit and factoring companies, which raise most of their funds from banks. Italian securities firms also contributed by financing temporary operations in securities with non-residents by drawing on their credit lines with banks, which in most cases were members of the same group.

The growth in lending was more pronounced in the northern regions of Italy, where it increased from 4.7 to 8.6 per cent. In the South it amounted to 1.3 per cent after being near zero in 1996 and was almost entirely due to the increase of 5.2 per cent in lending to industry, since outstanding loans to the services sector, the construction industry and sole proprietorships all contracted. The differentials between short-term lending rates in the South and Centre-North narrowed in 1997 by 0.2 percentage points to 2.2 points. The reduction in the gap was much the same for all the main categories of customer.

Bad debts. - Bad debts decreased over the year by 3.1 trillion lire, or 2.5 per cent. At the end of the year they amounted 120 trillion, or 9.4 per cent of total loans, compared with 10.1 per cent a year earlier. In 1996 bad debts had increased by 12.8 trillion lire, or 11.7 per cent.

Including the bad debts Banco di Napoli transferred to the non-bank collection company SGA and those still on the books of Sicilcassa, which has been placed in liquidation, the national total rose by 7.1 per cent and was equal to 10.2 per cent of total loans. In March of this year bad debts were up by 3.8 per cent compared with twelve months earlier (6.1 per cent when those of Sicilcassa are included). The slower growth in bad debts was common to all the main customer categories and geographical areas.

In the South bad debts fell by 8 per cent in 1997 and were equal to 21.8 per cent of total loans at the end of the year. When the amounts involved in the Banco di Napoli and Sicilcassa operations are included, bad debts rose by 11.1 per cent, as against 23.3 per cent in 1996, and by one percentage point to 25.2 per cent of total loans.

Treasury management and securities portfolios

Banks' securities portfolios contracted by 40.2 trillion lire, or 10.5 per cent, after growing in 1996 by 31.3 trillion, or 8.9 per cent. Over the year the share of securities in banks' combined loan and securities portfolios declined from 26 to 22.8 per cent, a value close to the previous low recorded in 1990.

Large purchases of Treasury bonds in the first quarter, when their prices weakened temporarily, were followed by substantial net sales, so that this part of banks' portfolios contracted over the year by 13.1 trillion lire. Banks' holdings of Treasury credit certificates continued to increase in the first quarter but contracted over the year. More than half the total contraction in the portfolio was due to the decrease in banks' holdings of Treasury bills.

Banks' equity investments increased by 5.9 trillion lire after rising by 10.2 trillion in 1996. Some 4.5 trillion of the increase consisted of interests in Italian companies. As a result of major acquisitions, equity investments in resident banks increased by 11 trillion in January of this year.

Domestic deposits and borrowed funds

The funds raised by banks from domestic non-bank customers increased by 2.3 per cent, compared with 8.3 per cent in the previous year. After accelerating strongly in the second half of 1996, the growth in such fund-raising began to slow down as early as February 1997. There was only a partial substitution of medium and long-term CDs with bank bonds following the changes in the taxation of interest income that came into force at the end of June 1996. Banks reduced their total medium and long-term funding liabilities towards non-bank customers by 6.5 per cent. Certificates of deposit with maturities of less than 18 months increased by 27.5 per cent, although the rapid growth in fund-raising by this means that had begun in July 1996 subsided from July 1997 onwards.

The growth in current account deposits accelerated markedly, from 6 to 9.3 per cent. During the year the increase was irregular as it was affected by the recovery in consumption and shifts in the composition of individuals' portfolios.

In the first four months of 1998 banks' fund-raising accelerated. After marking time in the last four months of 1997, the short-term component again grew substantially: the seasonally adjusted and annualized increase in the first four months amounted to 18.3 per cent.

The average after-tax differential in 1997 between the interest rate on current account deposits and the yield on Treasury bills was close to the minimum of 2.8 percentage points reached at the end of 1996; the corresponding differential with respect to the yield on medium and long-term securities fell to an even lower level. The real interest rate on current account deposits net of withholding tax was equal to nearly one per cent. The differential between short-term CDs, the volume of which increased considerably, and Treasury bills narrowed to 1.5 percentage points.

Italian banks' net external position and international activity

Italian banks' net external liabilities at monthly average exchange rates grew by 11.7 trillion lire in 1997 as a result of an increase of 20.3 trillion in liabilities and of 8.6 trillion in assets. At the end of the year banks' net external debtor position amounted to 71.5 trillion.

Between the end of 1992 and the end of 1996 banks' net external liabilities declined gradually by 140 trillion lire at current exchange rates. The decrease was primarily due to two factors: firstly, the reduction in domestic foreign currency loans as a result of the fall in demand prompted banks to cut back their foreign currency borrowing abroad by around 84 trillion; secondly, foreign investors' practice of covering their very large investments in Italian government securities against exchange rate risk led to a substantial increase in external assets denominated in lire.

Last year external lira-denominated assets grew by only 6 trillion lire after increasing by 64.2 trillion in 1996. Lending to non-resident customers fell sharply, from 36.1 to 15.9 trillion, with the repo component contracting from 30 to 9.4 trillion.

Lira-denominated liabilities rose by 26.6 trillion lire, compared with 34 trillion in 1996. Funds raised from non-bank customers increased, partly as a result of the growth in the Eurolira market. The growth in banks' net external lira-denominated liabilities also reflected the increase in their fund-raising in the interbank market, which was only offset in part by net purchases of foreign securities denominated in lire.

Banks' net external foreign currency liabilities at end-of-period exchange rates remained virtually unchanged at 103.2 trillion lire. At the end of the year the exchange rate risk associated with banks' net holdings of spot foreign currency liabilities was almost completely covered by forward positions.

Italian banks and securities firms continued to play a limited role in the placement of securities issued in the Euromarket. They took part in 42 per cent of the placements of bond and share issues denominated in lire, which rose from \$28.8 billion in 1996 to \$41 billion last year, and in 5 per cent of international placements. Italian banks handled 12 per cent of the placements of issues made by residents in both lire and foreign currency, which amounted to \$22 billion. Overall, Italian intermediaries handled 2 per cent of the total placements of securities in 1997.

Asset management services

The face value of the securities deposited with Italian banks for custody by customers and investment funds amounted to more than 2,000 trillion lire at the end of last year, an increase of 12.7 per cent on the end of 1996. The securities acquired directly by customers and deposited for custody increased by 3.3 per cent, while those deposited by investment funds and banks' portfolio management services increased by 49.4 per cent.

The share of securities deposited directly by customers declined from 84 to 73 per cent of the total between 1995 and 1997. The proportion of such customer deposits consisting of government securities dropped from 53 per cent at the end of 1996 to 43 per cent at the end of last year, while the share of bank bonds rose from 16 to 21 per cent and that of foreign securities from 9 to 11 per cent. The growth in the foreign component is related to the gradual diversification of residents' portfolios, which now also include a significant proportion of foreign bonds denominated in lire.

The investment portfolios managed directly by banks grew by more than 30 per cent, compared with 35.4 per cent in 1996, and accounted for 10 per cent of the total value of securities deposited with banks for custody. At the end of the year 62 per cent of these investment portfolios consisted of government securities; foreign securities accounted for 8 per cent, compared with a share of 11 per cent for securities deposited directly by customers.

Profit and loss accounts

Banks' net interest income fell by 5.5 per cent and from 2.54 to 2.26 per cent of total assets (Table 36). The decrease was primarily due to the reduction in the average rate of return on domestic loans in lire, which fell by 0.7 percentage points more than the average rate paid on lira-denominated funds raised from residents.

Table 36

PROFIT AND LOSS ACCOUNTS OF BANKS (1)

	1994	1995	1996	1997	1994	1995	1996	1997
	As a percentage of total assets				Percentage changes			
Net interest income (a)	2.54	2.69	2.54	2.26	-7.6	7.9	-1.2	-5.5
Non-interest income (b)	0.89	0.86	1.04	1.09	-18.5	-1.2	26.9	11.5
<i>securities and foreign exchange trading</i> ..	<i>0.26</i>	<i>0.25</i>	<i>0.38</i>	<i>0.29</i>	<i>-56.6</i>	<i>-0.7</i>	<i>56.2</i>	<i>-17.8</i>
<i>services</i>	<i>0.30</i>	<i>0.27</i>	<i>0.30</i>	<i>0.42</i>	<i>36.3</i>	<i>-6.5</i>	<i>16.2</i>	<i>46.1</i>
<i>other financial operations</i>	<i>0.13</i>	<i>0.13</i>	<i>0.14</i>	<i>0.16</i>	<i>22.6</i>	<i>8.1</i>	<i>8.3</i>	<i>21.7</i>
Gross income (c=a+b)	3.44	3.56	3.58	3.35	-10.7	5.5	5.6	-0.5
Operating expenses (d)	2.36	2.42	2.39	2.31	0.7	4.8	4.5	2.3
<i>staff costs (2)</i>	<i>1.53</i>	<i>1.54</i>	<i>1.54</i>	<i>1.44</i>	<i>3.8</i>	<i>3.0</i>	<i>5.9</i>	<i>-0.6</i>
Net income (e=c-d)	1.08	1.14	1.19	1.05	-28.4	7.1	7.8	-6.4
Value adjustments, readjustments and allocations to provisions (f)	0.80	0.78	0.69	0.72	8.3	-1.1	0.5	11.5
<i>loan losses</i>	<i>0.51</i>	<i>0.68</i>	<i>0.49</i>	<i>0.59</i>	<i>-27.3</i>	<i>37.2</i>	<i>-18.1</i>	<i>29.2</i>
Profit before tax (g=e-f)	0.28	0.36	0.50	0.32	-63.7	30.9	19.8	-30.9
Tax (h)	0.23	0.33	0.32	0.29	-57.2	48.0	-0.4	-4.7
Net profit (g-h)	0.05	0.03	0.18	0.04	-78.6	-47.1	86.0	-77.0
Dividends	0.12	0.14	0.16	0.16	18.2	22.0	19.5	10.0
	Other data							
	Profit before tax				Net profit			
Profit as a percentage of capital and reserves (ROE) (3)	4.2	5.4	7.8	5.4	0.7	0.8	3.2	1.0
	Amounts				Percentage changes			
Total assets <i>(billions of lire)</i>	2,365,680	2,410,102	2,538,141	2,685,298	5.1	1.9	5.5	6.1
Number of employees	338,937	337,893	331,136	322,924	-0.3	-0.3	-1.9	-2.1
<i>bank staff (4)</i>	<i>333,606</i>	<i>333,918</i>	<i>330,850</i>	<i>322,292</i>	<i>-0.6</i>	<i>0.1</i>	<i>-0.9</i>	<i>-2.0</i>
Total assets per employee <i>(millions of lire)</i>								
<i>at current prices</i>	6,980	7,133	7,665	8,316	5.5	2.2	7.5	8.4
<i>at constant prices (5)</i>	7,341	7,133	7,370	7,837	1.3	-2.8	3.4	6.3
Staff costs per employee <i>(millions of lire)</i>								
<i>at current prices (6)</i>	108.3	111.4	118.3	118.2	4.4	2.9	6.8	-0.1
<i>at constant prices (5)</i>	113.9	111.4	113.8	111.4	0.3	-2.2	2.7	-2.1

(1) Rounding may cause discrepancies in totals. The data for 1997 are provisional. – (2) Salaries, allocations for severance payments and pensions and various benefits for bank staff. The figures for 1997 include the extraordinary costs incurred in connection with early retirement incentive schemes. The number of bank staff is obtained by deducting tax collection staff and staff seconded to other bodies from the total number of employees and adding employees of other bodies on secondment to the banks in the monthly sample. – (3) Profit includes the net income of foreign branches and the change in the provision for general banking risks. – (4) For 1995, 1996 and 1997, centred averages of 3-month data. – (5) Deflated using the consumer price index (1995=100). – (6) Excluding the extraordinary costs incurred in connection with early retirement incentive schemes.

The fall in net interest income was largely offset by the rise of 3 trillion lire, or 11.5 per cent, in non-interest income (Table a22). In particular, fees for portfolio management services and commissions on sales of investment fund units rose from 1.9 to 4.5 trillion. On the other hand the profits from securities and foreign exchange trading dropped by 1.7 trillion, or 17.8 per cent, although they remained at a high level compared with the four preceding years. Gross income declined by 0.5 per cent to 89 trillion and from 3.58 to 3.35 per cent of total assets.

Staff costs, including the extraordinary expense incurred in connection with early retirement schemes, amounted to 38.3 trillion lire, a decrease of 0.6 per cent. As a ratio to gross income, they remained unchanged at 43 per cent. The number of bank employees fell by 2 per cent, while the average cost per employee, excluding the incentives referred to above, remained basically unchanged compared with 1996.

The incentives for early departures of bank staff cost 610 billion lire in 1997; of the total 540 billion referred to 5,400 departures during the year while the remaining 70 billion referred to 950 departures in earlier years.

On 28 February 1998 a framework agreement was reached between the Italian Bankers' Association and the trade unions that will serve as the basis for the renewal of the labour contract for banking that is currently being negotiated. The economic aspects of the new contract will remain in force for two years and the other aspects concerning conditions of employment for four years.

The agreement lays down the objective of reducing the "ratio of staff costs to gross income in the industry to a level at least 3.7-4.1 percentage points below that obtaining in 1997" (Article 2). The objective for the staff cost ratio implicit in the agreement is thus around 39 per cent. In 1996, the last year for which data are available, the average value of this indicator for France, Germany and Spain was around 38 per cent.

Operating costs other than staff costs increased by 1.6 trillion lire. Contributory factors included the payment of 0.5 trillion to the Interbank Deposit Protection Fund in connection with the Sicilcassa crisis and the expenditure incurred in preparing for the introduction of the euro. Overall, operating costs rose by 2.3 per cent compared with 1996.

Net income decreased by 6.4 per cent to 27.8 trillion lire and from 1.19 to 1.05 per cent of total assets. The income used to make good actual losses or set aside to cover those expected increased from 17.2 to 19.2 trillion lire; the amount in respect of loan losses increased by 3.5 trillion. The largest value adjustments were made by some major banks. In fact four banks accounted for 51 per cent of the total, whereas in 1996 the four banks that made the largest writedowns accounted for 31 per cent of the total.

Profit before tax dropped from 12.5 to 8.6 trillion lire. Last year 27 of the 252 banks in the sample considered here made a pre-tax loss, compared with 20 out of 258 in the previous year's sample, and the aggregate loss rose from 2.9 to 7 trillion.

Direct tax for the financial year amounted to 7.6 trillion lire, or 87.9 per cent of the gross profit of the banking system as a whole; the ratio falls to 48.6 per cent for banks that showed a pre-tax profit. Net profit amounted to 1 trillion lire, or 0.04 per cent of total assets. When the 0.6 trillion earned by Italian banks' foreign branches is included, the return on capital and reserves amounted to 1 per cent, compared with 3.2 per cent in 1996.

The creation of a single market for capital following the removal of the currency barriers between the financial systems of the countries participating in the Monetary Union will intensify competition, especially as regards the financing of large customers, but it will also offer an opportunity for Italian banks to broaden their sources of fee income. The complete convergence of Italian interest rates on those prevailing in the other EMU countries may lead to a further, albeit small, reduction in banks' net interest income. Their gross income will depend crucially on their ability to raise the amount they earn from services, not least because profits from securities trading appear almost certain to contract. Improving the profitability of Italian banks calls first and foremost for a smaller proportion of loan losses and effective measures to curb costs.

Other credit intermediaries

The funds provided by leasing, factoring and consumer credit companies showed a substantial increase of 17.4 per cent; the financing of purchases of motor vehicles contributed significantly to the growth.

Leasing. - The volume of leasing finance grew less fast than in the two previous years, rising by 2.8 trillion lire, or 6.3 per cent. The business of specialized companies increased by 6.6 per cent and that of banks by 4.3 per cent. However, the credit disbursed by companies belonging to banking groups was equal to around three quarters of the total disbursed by specialized leasing companies, as in 1996.

Factoring. - After contracting by 3 per cent in 1996, the activity of factoring companies grew by 6.9 trillion lire, or 21.1 per cent; claims

acquired without recourse increased by 13.2 per cent. The growth in advances was less pronounced, amounting to 0.8 trillion, or 3.8 per cent.

The market share of companies controlled by credit institutions fell below 50 per cent owing to the increase in banks that provide factoring services directly and the rapid growth of some factoring companies directly or indirectly linked to the automotive industry.

Consumer credit. - Consumer credit business grew substantially, fueled by the rise in sales of motor vehicles. Outstanding loans increased by 7.4 trillion lire, or 20 per cent, compared with 11.9 per cent in 1996 (Table 37). The lending of consumer credit companies increased by 35.6 per cent, outpacing that of banks, which grew by 8.6 per cent. The market share of companies belonging to banking groups fell below 20 per cent.

Table 37

CONSUMER CREDIT (1)
(end-of-period data; billions of lire and changes on previous year)

	Outstanding 1997 (2)	Percentage changes (3)		
		1995	1996	1997 (2)
Finance companies	22,857	10.8	17.0	35.6
<i>of which: credit cards</i>	2,923	....	....	30.4
Banks	23,293	1.0	8.0	8.6
<i>of which: credit cards</i>	626	....	....	16.1
Total	46,150	5.1	11.9	20.0
<i>of which: credit cards</i>	3,549	....	....	27.8

(1) Up to 1996 the data are based on a survey sample, while those for 1997 are based on supervisory returns. - (2) Provisional. - (3) Figures computed with reference to a homogeneous sample.

Some two thirds of the credit granted by consumer credit companies serves to finance the purchase of motor vehicles. Loans linked to specific purchases accounted for just under 90 per cent of the total and around 70 per cent had an original maturity of more than 18 months.

Nearly 50 per cent of consumer credit is granted to persons living in the North of Italy, while loans granted to persons living in the South exceed 30 per cent of the total, a higher proportion than for either bank credit or consumption.

At the end of the year bad debts amounted to 0.55 trillion lire, or 2.4 per cent of outstanding loans. When instalments that were more than 120 days overdue are included, the figure rises to 1.15 trillion.

INSTITUTIONAL INVESTORS

The positive performance of the financial markets and the contraction in new issues of government securities buoyed net fund-raising by institutional investors, which reached exceptionally high levels in 1997. After adjustment for flows within the sector, the net inflow amounted to 259.6 trillion lire, almost double the already substantial figure of 131.6 trillion for the previous year (Table 38). It accounted for a considerably larger share of the change in households' gross financial assets than fund-raising by other intermediaries. Institutional investors' net assets rose by 37 per cent to 1,000 trillion lire and from 39 to 57 per cent of GDP. As a proportion of households' gross financial assets, they increased from 21.5 to 26.4 per cent (Table 39). The asset management industry in Italy has now attained a size approaching that of Germany but still lags far behind that of other leading countries with advanced financial systems.

The growth of investment funds and portfolio management services was especially rapid. Insurance companies recorded a smaller increase, while pension funds' share in households' financial assets decreased slightly.

Table 38

INSTITUTIONAL INVESTORS: NET FUND-RAISING

(billions of lire)

	Net flows				End-of-period stocks	
	1996	1997	Percentage composition		1997	
			1996	1997	Amount	Percentage composition
Investment funds (1)	58,226	143,377	42.5	52.5	368,432	33.5
Portfolio management services (1)	50,457	82,970	36.9	30.4	375,465	34.1
Insurance companies (2) (3)	29,772	43,960	21.7	16.1	243,959	22.2
Pension funds (2) (3)	-2,118	2,339	-1.5	0.9	101,246	9.2
Securities firms (3) (4)	550	400	0.4	0.1	11,102	1.0
Total	136,887	273,046	100.0	100.0	1,100,204	100.0
Consolidated total (5)	131,608	259,554			999,985	

(1) Net fund-raising. – (2) Change in technical reserves. – (3) The figure for 1997 is estimated. – (4) Change in net asset value. – (5) Net of flows within the sector.

Table 39

**INSTITUTIONAL INVESTORS: NET ASSETS AS A
PERCENTAGE OF HOUSEHOLDS' FINANCIAL ASSETS**
(*end-of-period data*)

	1990	1992	1993	1994	1995	1996	1997
Investment funds	2.3	2.5	3.9	4.4	4.0	5.8	9.7
Portfolio management services	3.2	4.0	5.1	6.1	6.1	7.4	8.2
Insurance companies (1) (2) ..	3.7	4.1	4.3	4.2	4.7	5.1	5.5
Pension funds (2)	0.6	3.1	3.1	3.3	3.2	2.9	2.7
Securities firms (3)	–	..	0.3	0.2	0.2	0.2	0.3
Total	9.8	13.7	16.7	18.2	18.3	21.5	26.4

(1) Technical reserves, excluding securities entrusted to portfolio management services. – (2) The figure for 1996 is estimated. –
(3) Own trading portfolios.

The good performance of the markets fostered some lengthening of the average duration of the portfolios of investment funds and portfolio management services. For investment funds this strategy involved both medium and long-term bonds and shares and was accompanied by international diversification; after contracting considerably in 1996, the proportion of foreign securities in the total portfolio began to grow again. There was also some international diversification of the financial assets held directly by households.

The year saw a further widening of the range of products offered to customers both in the field of investment funds, particularly those specializing in foreign securities, and in that of management services that buy investment fund units. The pre-eminence of bank-controlled institutional investors was confirmed.

Investment funds and portfolio management services achieved broadly similar returns over the year as a whole, after adjustment for the larger proportion of short-term bonds and the far smaller proportion of shares in the latter's portfolios. The performance of both sectors improved with respect to 1996; the dispersion of yields was most pronounced among the various categories of investment fund, owing to the exceptional rise in share prices.

Investment funds recorded a further, sharp acceleration in net subscriptions in the first quarter of 1998, in concomitance with a new surge in domestic and foreign share prices; the flow of savings came to nearly 103.7 trillion lire, almost three times more than in the same period of 1997. Portfolio reallocation in favour of foreign securities resumed after marking time in the fourth quarter owing to the uncertainty generated by the Asian crisis. According to provisional data, investment funds recorded net subscriptions of more than 44 trillion lire in April.

Securities investment funds

Securities funds' net subscriptions rose from 58.2 trillion lire in 1996 to 143.4 trillion last year. Bond funds took the lion's share (106.8 trillion). Equity funds recovered from net redemptions of almost 4 trillion in 1996 to record net subscriptions of more than 30 trillion (Table 40). The overall increase was largely attributable to the expansion of funds specializing in foreign securities, which accounted for 75 per cent of net subscriptions among equity funds and 35 per cent among bond funds.

Table 40

ITALIAN INVESTMENT FUNDS: FUND-RAISING AND SECURITIES PORTFOLIO (billions of lire)

	Net flows			End-of-period stocks		
	1996	1997	1998 (1) (January-March)	1996	1997	1998(1) (March)
Fund-raising						
Bond funds	64,757	106,778	67,740	149,662	267,529	338,027
<i>linked to current accounts</i>	11,473	9,789	1,810	36,909	37,668	32,205
Mixed funds	-2,566	6,331	9,917	12,869	22,292	36,603
Equity funds	-3,965	30,268	25,999	35,013	78,611	129,285
Total	58,226	143,377	103,656	197,544	368,432	503,915
Securities portfolio				Percentage composition		
Government securities and Italian bonds	67,465	69,630	40,545	70.8	60.3	51.9
Short-term and floating rate	26,386	-3,365	8,029	33.7	17.4	14.1
Treasury bills	15,893	-10,929	4,888	14.3	4.7	4.4
Treasury credit certificates	10,493	7,564	3,141	19.4	12.7	9.7
Medium and long-term	41,079	72,995	32,516	37.1	43.0	37.8
Zero-coupon Treasury credit certificates	18,508	41,071	3,528	11.2	19.0	14.3
Treasury bonds	21,287	29,429	28,771	23.2	21.9	21.8
Other	1,284	2,495	217	2.7	2.1	1.6
Italian shares	128	6,362	13,363	11.5	11.9	16.0
Foreign securities	4,723	55,326	47,580	17.2	27.7	32.0
Bonds	5,123	35,331	27,585	8.5	15.9	18.8
Shares	-400	19,995	14,848	8.7	11.8	13.2
Other financial assets	1,260	-805	39	0.5	..	..
Total	73,576	130,513	101,527	100.0	100.0	100.0
<i>Memorandum items:</i>						
Cash and deposits (2)	-15,350	12,864	2,129	17,293	37,712	40,097
Securities portfolio	73,576	130,513	101,527	180,251	330,720	463,818
<i>bonds</i>	<i>72,588</i>	<i>104,961</i>	<i>68,130</i>	<i>142,913</i>	<i>252,085</i>	<i>327,724</i>
<i>shares</i>	<i>-272</i>	<i>26,357</i>	<i>28,211</i>	<i>36,358</i>	<i>78,422</i>	<i>135,377</i>

(1) Provisional. - (2) Difference between fund-raising and securities portfolios, including leads and lags.

The flow of savings to investment funds was quite regular for equity, bond and mixed funds alike during the year except for a slowdown in the second quarter, the period of greatest uncertainty over market trends. In the first quarter of 1998, with share prices in the leading markets rising again, net subscriptions totaled 103.7 trillion, against 39.4 trillion in the same period of 1997; equity funds accounted for roughly 25 per cent of this fund-raising, against 15 per cent a year earlier. Compared with the preceding quarter, bond and mixed funds accounted for a larger proportion of total net subscriptions; the decline in subscriptions to equity funds reflected the fall in funds specializing in Italian shares due to the sudden increase in the Italian stock market's volatility.

Funds' net assets rose by 170.9 trillion lire to stand at 368.4 trillion at the end of the year. Most of the increase, more than two thirds of which occurred in bond funds, was attributable to new subscriptions. The rise in securities prices contributed around one quarter of the overall gain; in the case of equity funds the proportion was higher, approaching 40 per cent.

Table 41

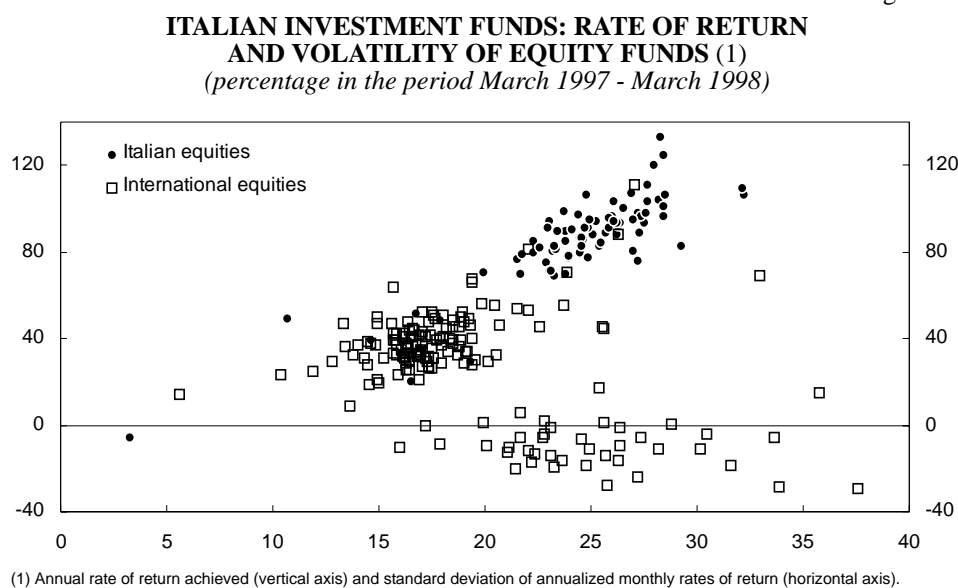
**RATES OF RETURN OF INVESTMENT FUNDS
AND ALTERNATIVE INVESTMENTS (1)**
(percentages)

	Investment funds				Alternative investments					
	Share-based	Mixed	Bond-based	of which: pure (2)	Italian shares (3)	Foreign shares (4)	Treasury bonds (5)	Treasury credit certificates (5)	Treasury bills (6)	Foreign bonds (7)
1986	35.6	27.9	15.6	–	59.3	14.2	16.4	14.0	13.1	–3.6
1987	–14.8	–11.1	4.9	–	–30.8	0.5	9.1	10.3	9.3	–1.8
1988	15.8	14.0	8.4	–	23.7	37.9	10.1	9.2	9.8	18.3
1989 ...	12.9	13.5	9.1	9.3	19.2	13.1	9.8	11.2	9.9	3.5
1990	–13.3	–8.0	10.5	11.2	–23.2	–26.1	12.1	14.2	11.2	–0.9
1991	7.5	7.3	11.6	10.7	0.8	19.3	13.6	13.2	11.2	17.6
1992	5.2	3.9	11.3	10.3	–7.8	22.8	9.8	10.4	11.1	36.0
1993 ...	37.1	32.8	19.9	16.5	46.4	42.6	25.0	17.3	12.1	29.8
1994	–3.6	–1.2	–1.3	3.2	2.2	–0.9	–0.8	7.4	7.4	–4.1
1995	1.3	3.9	10.4	9.2	–2.1	18.2	15.6	11.3	9.0	16.6
1996	8.4	9.5	9.4	9.3	16.9	8.5	19.2	9.9	8.9	–1.1
1997	30.3	24.8	6.6	5.3	59.5	34.2	11.4	6.1	5.7	18.1

(1) For year-on-year comparisons, especially during the eighties, it should be remembered that foreign investment by Italian investment funds was subject to restrictions. – (2) Funds investing exclusively in bonds. – (3) Includes dividends. – (4) Percentage changes in Morgan Stanley index of world stock markets; includes dividends, net of withholding tax; adjusted for exchange rate changes. – (5) Percentage change in index of total return, net of the 12.5 per cent withholding tax, based on prices on Milan Stock Exchange. – (6) Issue yield on 1-year bills, net of the 12.5 per cent withholding tax, on 1 January. – (7) Changes in J.P. Morgan index of world bond markets, excluding Italy; adjusted for exchange rate changes.

There were marked differences in funds' rates of return according to segment. Thanks to the sharp rise in share prices, equity and mixed funds showed rates of return of 30.3 and 24.8 per cent respectively; the bond fund index rose by an average of 6.6 per cent (Table 41). Equity funds that invest predominantly in Italian shares recorded an average rate of return of 45 per cent, compared with 18 per cent for those that invest mainly in foreign shares (Figure 41).

Figure 41



Equity funds and funds specializing in foreign bonds underperformed their benchmarks by a wider margin than in 1996; in the case of bond funds specializing in Italian securities, by contrast, the negative differential was modest and narrower than a year earlier.

Expenses charged to investment funds - largely management and sales fees - totaled 4.2 trillion lire, almost doubling with respect to 1996 and outpacing the growth in net subscriptions. Expenses rose from 1.48 to 1.66 per cent of average net assets.

Shares accounted for one fifth of net purchases of securities by all investment funds, reflecting the recovery in subscriptions to equity funds, especially those specializing in foreign shares; Italian shares' contribution was limited, amounting to 6.4 trillion lire (less than a quarter of the total for shares). Foreign securities also made a considerably larger contribution to funds' net purchases of bonds, accounting for around one third. Net purchases of Italian bonds consisted of fixed rate government paper, notably zero-coupon Treasury credit certificates (almost 60 per cent of the total) and Treasury bonds; as a whole, short-term and floating rate securities (Treasury bills and Treasury credit certificates) recorded net redemptions.

Portfolio management services and securities firms

Portfolio management services. - The value of the assets entrusted to the portfolio management arms of banks and securities firms rose by 115 trillion last year to 375.5 trillion. The gain was mainly due to the flow of fresh funds, which increased from 50.5 to 85.4 trillion lire. The inflow was fairly constant during the year; as with investment funds, there was a slowdown in the second quarter, but in this case the ensuing recovery fell short of the very high level recorded in the first quarter.

Banks' portfolio management services accounted for around 75 per cent of the total inflow of resources for the year as a whole. However, in the second half their share fell significantly, to just over 50 per cent; the increase in the share going to securities firms reflected the latter's development of investment-fund-based products and the greater orientation of their portfolios towards shares, the demand for which rose.

After deducting net inflows of funds, the increase in the net assets of portfolio management services rose from 8.5 to 9.9 per cent; this approximates the financial return to investors on the assumption that coupons are fully reinvested. The negative yield differential of almost 2 percentage points vis-à-vis the average for investment funds was due to the composition of managed portfolios, which are heavily weighted towards short-term instruments and invest a smaller proportion of resources in shares (7.6 per cent at the end of 1997, less than a third of the corresponding figure for investment funds). As in the previous year, the aggregate conceals differences in performance between securities firms and banks: the average rate of return of the former rose from 10.5 to 12.6 percent, while that of the latter remained unchanged at 8 per cent. The better performance of securities firms can be attributed to the composition of their portfolios, which contained a higher proportion of fixed rate securities and shares than those managed by banks.

Net purchases of government securities by portfolio management services totaled 34 trillion lire during the year. Like investment funds, the services shifted out of short-term and floating rate instruments, with net disposals of Treasury bills and Treasury credit certificates amounting to almost 20 trillion, in order to purchase medium and long-term paper, i.e. Treasury bonds and zero-coupon Treasury credit certificates: their net purchases of Italian shares totaled 4.5 trillion lire, comparable to those effected by investment funds. The spread of new investment-fund-based products led to substantial net purchases of fund units amounting to 42 trillion lire. Net purchases of foreign securities consisted almost exclusively in bonds and amounted to just under 10 trillion, much less than the total for investment funds. Foreign securities accounted for 9.3 per cent of managed

portfolios at the end of 1997, compared with 8.5 per cent a year earlier; this was equal to less than one third of the proportion of foreign securities held by investment funds.

Securities firms. - The value of securities firms' own trading portfolios grew by 2.7 trillion lire to stand at 11.1 trillion at the end of the year (Table 42). Almost all of the growth was accounted for by foreign bonds and Italian shares, which contributed 1.8 and 0.7 trillion lire respectively. Trading for own account intensified, concentrating on Italian and foreign bonds in the first half of the year and Italian shares in the second. Trading in derivative products almost doubled over the year, with instruments based on Italian shares in the lead.

Table 42

PORTFOLIOS OF SECURITIES FIRMS (1)
(end-of-period market values; stocks in billions of lire)

	1996	1997			
	December (1)	March	June	September	December
Italian securities	8,298	4,972	8,833	10,065	9,171
Government securities	7,014	3,888	6,588	8,303	7,425
Bonds	743	610	654	550	552
Shares	541	473	1,591	1,212	1,195
Foreign securities	97	798	-92	1,331	1,896
Bonds	93	788	-96	1,324	1,888
Shares	4	9	4	7	8
Other financial assets	28	29	30	30	34
Total ...	8,422	5,798	8,771	11,426	11,102
<i>Memorandum item:</i>					
Repos (2)	2,632	-810	-254	2,362	-351

(1) Own trading assets; includes technical short positions; rounding may cause discrepancies in totals. - (2) Net position.

Trading on behalf of customers rose by 30 per cent, primarily as a result of the growth in both spot and forward transactions in Italian shares. The largest increase regarded spot market trading, which rose by 52 per cent overall; the proportion of such activity attributable to Italian shares rose from 19 to 27 per cent, in contrast with a decline in that attributable to bonds, especially Italian paper. Derivatives trading for customer account increased by 12 per cent, thanks mainly to options trading, which more than doubled. Equity-based instruments accounted for a larger share of futures trading. Trading in connection with portfolio management activity also showed very rapid growth of 60 per cent, most of it due to transactions in shares.

Insurance companies and pension funds

Insurance companies. - In 1997 the premium income of insurance companies amounted to 44.4 trillion lire in the casualty sector and 36.9 trillion in the life sector (Table 43). The rate of increase in premium income rose from 7.9 to 20.1 per cent overall as a result of the strong expansion in the life sector, where it almost quadrupled to more than 40 per cent, and a modest pick up in the casualty sector, where it increased from 5.3 to 6.7 per cent. The gain for the year raised the ratio of premium income to GDP from 1.37 to 1.87 per cent, but this still falls far short of the level prevailing in the countries where institutional investors are most highly developed. The notable growth in premium income in the life sector was due primarily to policies offering yield-linked benefits, the insurance product most resembling investment funds and managed portfolios. A significant contribution came from the increasing popularity of policies whose value is indexed to the performance of markets, equity markets above all. The role of the banks in the distribution of life policies expanded considerably to around one third of the total, compared with one quarter in 1996.

Table 43

INSURANCE COMPANIES: ASSETS AND LIABILITIES (*end-of-period balance sheet values in billions of lire*)

	Assets						Liabilities		Memorandum item: premium income (4)
	Deposits and cash (1)	Securities (1)	Loans & annuities (2)	Real estate	Other net assets	Total (1)	Technical reserves (1) (3)	Net worth	
	Life sector								
1994	2,422	92,048	1,720	12,376	2,325	110,891	87,287	23,604	18,625
1995	2,734	112,354	1,583	12,217	3,961	132,849	108,912	23,937	23,225
1996	2,012	137,856	1,808	10,319	4,226	156,221	130,890	25,331	26,063
1997 (5) ..	2,777	168,749	1,995	10,234	5,769	189,524	162,900	26,624	36,875
	Casualty sector								
1994	3,067	52,063	515	11,612	8,771	76,028	54,606	21,422	36,794
1995	3,047	58,043	188	12,210	8,752	82,240	61,315	20,925	39,594
1996	3,045	62,816	626	13,063	11,192	90,742	69,109	21,633	41,650
1997 (5) ..	3,438	71,103	341	14,350	16,900	106,132	81,059	25,073	44,425
	Total								
1994	5,489	144,111	2,235	23,988	11,096	186,919	141,893	45,026	55,419
1995	5,781	170,397	1,771	24,427	12,713	215,089	170,227	44,862	62,819
1996	5,057	200,672	2,434	23,382	15,418	246,963	199,999	46,964	67,713
1997 (5) ..	6,215	239,852	2,336	24,584	22,669	295,656	243,959	51,697	81,300

(1) In lire and foreign currency; excluding securities entrusted to portfolio management services. - (2) Net of corresponding liabilities.
- (3) Excluding reinsurance. - (4) Since 1995 includes premium income of offices in other EU countries. - (5) Partly estimated.

Total technical reserves rose from 200 to 244 trillion lire (Table 43); most of the growth came in the life sector, reflecting the large rise in its premium income. Insurance companies' total assets increased by almost 49 trillion lire, thanks principally to the growth in their securities portfolios, which amounted to 239.9 trillion at the end of the year.

The changes in the composition of insurance companies' securities portfolios mirrored those in the portfolios of other institutional investors (Table 44). Like investment funds, insurance companies lengthened the duration of their portfolios by disposing of short-term and floating rate securities (notably Treasury bills and Treasury credit certificates amounting to 14.5 trillion) and making net purchases of medium and long-term paper (especially Treasury bonds) totaling 30.2 trillion. Unlike investment funds, insurance companies only marginally increased the proportion of foreign currency securities in their holdings - from 15.6 to 16.3 per cent, almost all of this in bonds. Net purchases of Italian shares amounted to 4.7 trillion; with the rise in prices, the proportion of Italian shares in the companies' portfolios rose from 10.7 to 12.1 per cent.

Table 44

INSURANCE COMPANIES: SECURITIES PORTFOLIO (1)

(end-of-period balance sheet values in billions of lire)

	Public sector				Total	Banks (2)	Public and private enter- prises	Shares (3)	Foreign currency securities (3)		Invest- ment fund units	Total
	of which:								of which: shares			
	BOTs	CTZs	CCTs	BTPs								
	Life sector											
1994 ..	1,110	–	26,381	24,053	55,563	14,163	3,867	7,591	10,075	5,148	789	92,048
1995 ..	705	521	36,196	32,955	73,258	12,886	3,695	8,780	12,807	6,131	928	112,354
1996 ..	677	1,702	38,010	47,000	89,917	15,087	3,660	10,514	18,144	6,609	534	137,856
1997 (4)	241	1,770	24,234	75,300	103,167	19,383	4,157	15,427	25,636	7,559	979	168,749
	Casualty sector											
1994 ..	306	–	11,840	7,872	21,351	8,828	1,594	10,158	9,989	3,996	143	52,063
1995 ..	747	469	14,290	9,053	26,105	8,403	1,650	9,883	11,819	6,117	183	58,043
1996 ..	629	1,133	12,817	12,915	29,179	7,583	1,675	10,928	13,225	7,361	226	62,816
1997 (4)	26	2,048	12,345	18,433	34,199	7,769	1,898	13,647	13,489	6,853	101	71,103
	Total											
1994 ..	1,416	–	38,221	31,925	76,914	22,991	5,461	17,749	20,064	9,144	932	144,111
1995 ..	1,452	990	50,486	42,008	99,363	21,289	5,345	18,663	24,626	12,248	1,111	170,397
1996 ..	1,306	2,835	50,827	59,915	119,096	22,670	5,335	21,442	31,369	13,970	760	200,672
1997 (4)	267	3,818	36,579	93,733	137,366	27,152	6,055	29,074	39,125	14,412	1,080	239,852

(1) Including securities entrusted to portfolio management services. Since 1996 Eurolira securities are included in lira securities. -
(2) Including certificates of deposit. - (3) Including equity participations. - (4) Partly estimated.

Pension funds. - The total assets of non-INPS pension funds and banks' supplementary pension funds - the intermediaries for which complete data are available - stood at 101.2 trillion lire at the end of 1997, just over 2.3 trillion more than a year earlier and virtually the same as at the end of 1995 (Table 45). The increase was chiefly due to the banking industry's funds. The share of pension funds in households' gross financial assets diminished slightly, to 2.7 per cent.

Table 45

PENSION FUNDS: MAIN ASSETS
(*end-of-period balance sheet values in billions of lire*)

	1995			1996			1997 (1)		
	Non-INPS funds	Credit sector funds	Total	Non-INPS funds	Credit sector funds	Total	Non-INPS funds	Credit sector funds	Total
Cash and deposits	15,568	917	16,485	13,147	2,106	15,253	12,052	1,644	13,696
Government securities	11,245	14,520	25,765	11,075	13,916	24,991	10,304	13,284	23,588
Corporate bonds	2,224	1,749	3,973	2,006	1,902	3,908	1,225	1,952	3,177
Shares	872	2,002	2,874	472	1,982	2,454	558	2,384	2,942
Foreign currency securities . . . . .	..	763	763	..	932	932	31	1,752	1,783
Loans and other financial assets	10,552	1,329	11,881	10,882	1,603	12,485	10,747	2,809	13,556
Real estate	33,910	5,374	39,284	34,008	4,876	38,884	37,174	5,330	42,504
Total assets	74,371	26,654	101,025	71,590	27,317	98,907	72,091	29,155	101,246
(1) Provisional.									

The increase in the funds' assets was accounted for by real estate; financial assets contracted, particularly liquidity and the securities portfolio. There were marginal changes in the composition of the latter: the proportion of government securities and lira bonds diminished slightly, to the benefit of shares and foreign currency securities.

THE SECURITIES MARKETS

The yield differential between long-term Italian securities and those of the EU countries with the most stable currencies narrowed considerably again in 1997 and almost disappeared. The Treasury was consequently able to reduce the cost of its borrowing while simultaneously lengthening the average maturity and duration of government debt. Foreign investors' demand for government securities remained very strong. International issues of bonds denominated in lire also grew substantially; they were mostly made by governments of developing countries and private borrowers in industrial countries and subscribed by Italian investors.

The Consolidated Law on Financial Markets fully implemented the highly innovative solutions that had been introduced in the legislative decree giving effect to the Community's Investment Services Directive. The securities markets have been removed from the public sphere by transforming them into limited companies and privatizing the Italian stock exchange, the screen-based market in government securities (MTS) and the Italian futures market (MIF), which are now owned by market participants. A clear distinction has been made between the running of the privatized markets by the new management companies and their surveillance by the regulatory authorities. In view of the importance for monetary policy of the wholesale market in government securities and the interbank deposit market, their surveillance has been entrusted to the Bank of Italy and extends to the management companies involved. Surveillance is aimed at ensuring orderly trading while promoting the overall efficiency of the market. The separation between the public surveillance and private management of markets has prompted a review of the organization and ownership of the companies that provide supporting services to the markets, especially Cedborsa and Società Interbancaria per l'Automazione (SIA), which is partly owned by the Bank of Italy.

Share prices rose considerably, outpacing those of the other leading industrial countries. The strong performance benefited from the taming of inflation, the fall in interest rates and expectations of a recovery in economic activity. Other contributory factors included structural changes associated

with the start of a process of consolidation, especially in the banking sector, privatizations and a major reform of the taxation of corporate incomes. There was a further substantial rise in share prices in the first quarter of this year, when issues of new shares also picked up after running at a low level in 1997. At the end of April the market ratio of expected earnings to prices was lower than in any other leading financial centre except Japan, both in absolute terms and in relation to real interest rates. Italian institutional investors made only limited purchases of listed shares last year, while foreign investors bought heavily into the market, so that there was a further rise in their share of the capitalization of the Italian stock market following the already large increase recorded in 1996.

Government securities and corporate bonds

Supply and demand. - Net issues of government securities plummeted from 115.3 trillion lire in 1996 to no more than 18.5 trillion in 1997 (Table 46). Net bond issues by banks rose from 64.7 to 97.2 trillion, while those by firms, already of minor significance, contracted further. Total net issues accordingly fell from 181.3 to 116.5 trillion.

The favourable conditions created in the Italian market in 1997 by the progress in curbing inflation and adjusting the public finances allowed the Treasury to lower the cost of issues and lengthen the average maturity of the debt. The reduction in the stock of Treasury bills outstanding was larger than that made in 1996: the net redemptions of 82.3 trillion lire were partially replaced by 41.5 trillion of net issues of zero-coupon Treasury certificates (CTZs), sales of which were boosted by the introduction of an 18-month maturity in January. Net issues of Treasury bonds (BTPs) amounted to 68.6 trillion; the large fall in long-term interest rates that had begun in the second half of 1996 led to 30-year bonds being issued again in February 1997 after a pause of nearly two years. The proportion of the debt consisting of Treasury credit certificates (CCTs) remained almost unchanged. For the first time for several years no Treasury certificates in ecus were issued.

In order to prevent the reduction in the borrowing requirement causing issues to be excessively small, their frequency was reduced. From July onwards CCTs and long-term BTPs were issued only once a month and from October onwards Treasury bills were issued in tranches with the aim of increasing their liquidity in the secondary market.

Table 46

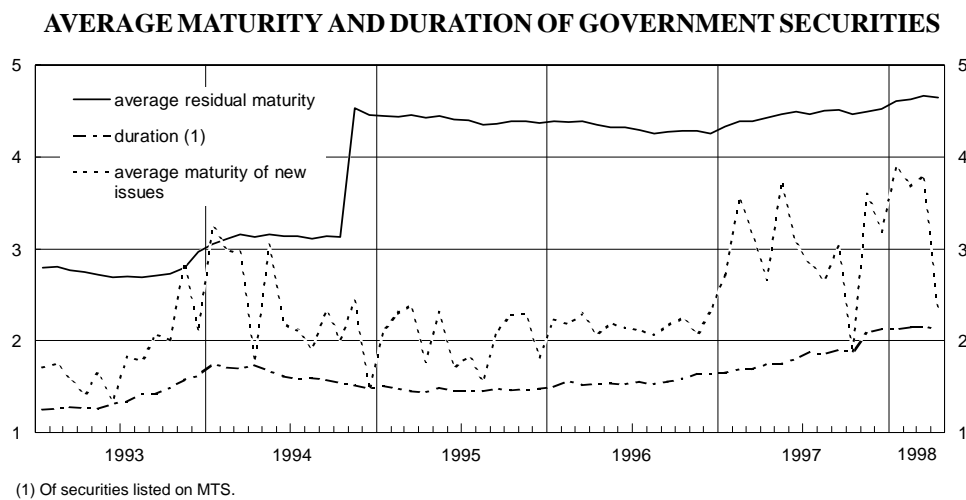
BONDS AND GOVERNMENT SECURITIES: ISSUES AND STOCKS (1)

	Gross issues			Net issues			Stocks (2)		
	1996	1997	Jan.-Apr. 1998 (3)	1996	1997	Jan.-Apr. 1998 (3)	1996	1997	April 1998 (3)
<i>billions of lire</i>									
Public sector	1,016,338	880,200	303,496	115,334	18,538	22,509	2,025,001	2,062,676	2,084,572
Treasury bills	665,023	506,000	157,500	-27,453	-82,310	-16,750	384,560	302,250	285,500
Zero-coupon Treasury certificates	59,924	105,905	35,647	51,515	41,484	11,951	107,141	158,771	173,309
Treasury credit certificates (4) ..	105,945	64,404	12,578	30,460	7,982	-3,793	558,773	566,964	563,082
Treasury bonds ...	148,917	190,596	89,925	57,652	68,590	53,314	697,356	766,988	816,578
Ecu Treasury credit certificates	3,913	..	..	-4,734	-4,354	..	41,045	37,632	37,862
Republic of Italy issues	17,982	12,481	7,800	14,480	6,291	2,669	86,307	99,396	102,448
Other	14,634	814	46	-6,586	-19,145	-24,882	149,819	130,675	105,793
Banks	97,075	148,240	26,386	64,715	97,228	8,643	280,213	377,743	386,410
Firms	3,923	5,886	500	1,205	722	-2	30,068	32,283	32,282
Total ...	1,117,336	1,034,326	330,382	181,254	116,488	31,151	2,335,282	2,472,702	2,503,264
<i>percentage composition (5)</i>									
Public sector	91.0	85.1	91.9	63.6	15.9	72.3	86.7	83.4	83.3
Treasury bills	65.4	57.5	51.9	-23.8	-444.0	-74.4	19.0	14.7	13.7
Zero-coupon Treasury certificates	5.9	12.0	11.7	44.7	223.8	53.1	5.3	7.7	8.3
Treasury credit certificates (4) ..	10.4	7.3	4.1	26.4	43.1	-16.8	27.6	27.5	27.0
Treasury bonds ...	14.7	21.7	29.6	50.0	370.0	236.9	34.4	37.2	39.2
Ecu Treasury credit certificates	0.4	..	..	-4.1	-23.5	..	2.0	1.8	1.8
Republic of Italy issues	1.8	1.4	2.6	12.6	33.9	11.9	4.3	4.8	4.9
Other	1.4	0.1	0.0	-5.7	-103.3	-110.5	7.4	6.3	5.1
Banks	8.7	14.3	8.0	35.7	83.5	27.7	12.0	15.3	15.4
Firms	0.4	0.6	0.2	0.7	0.6	..	1.3	1.4	1.3
Total ...	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
<i>as a percentage of GDP</i>	<i>59.7</i>	<i>53.0</i>	<i>48.8</i>	<i>9.7</i>	<i>6.0</i>	<i>4.6</i>	<i>124.7</i>	<i>126.8</i>	<i>123.3</i>

(1) Comprises Italian government securities and the lira issues of other issuers on the Italian market; excludes certificates of deposit. - (2) End-of-period face value. - (3) Provisional. - (4) Includes only variable-coupon certificates. - (5) The percentages shown for the various types of government security are ratios to the total of public sector securities.

The average residual maturity of the public debt lengthened from 51 to 54 months and its duration from 20 to 25 months (Figure 42).

Figure 42



The Treasury's net issues in foreign currency amounted to 6.3 trillion lire and were made mainly in the first seven months of the year. Nearly all the issues carried fixed coupons and, in contrast with previous years, were denominated in a wide variety of currencies. The first issue denominated in euros was made in April; it was followed in February of this year by a large issue of 4 billion euros of 10-year bonds that will be fungible with the 10-year BTPs of the same maturity from 1 January 1999 onwards.

Demand for government securities in the primary market nearly always exceeded supply and the overall ratio between the two aggregates rose from 1.54 to 1.88. The ratio rose significantly not only for Treasury bills and CCTs, issues of which were smaller than in 1996, but also for CTZs, which were issued in very large quantities.

The jump of around 50 per cent in banks' net issues of bonds can be explained by the increase in June 1996 in the taxation of CDs with maturities of at least 18 months.

There was a particularly high level of activity in the primary Eurolira market, to which expectations of a fall in interest rates and the smaller volume of public debt issues also contributed. Gross Eurobond issues in lire increased by more than 40 per cent from 37.4 to 52.6 trillion lire. Nearly half the increase was attributable to issuers resident in emerging countries, predominantly sovereign borrowers, and to private sector issuers in industrial countries. The greater interest shown by investors made it possible

to broaden the range of securities on offer. In addition to straight bonds, numerous step-downs were issued with coupons that will become smaller in 1999, as well as fixed reverse floaters carrying coupons that are initially fixed and later inversely linked to short-term interest rates, so that they are highly reactive with respect to changes in market rates. After running at a high level in 1996, the supply of long-term zero-coupon bonds diminished considerably in the first half of the year but picked up again in the second half.

In the first four months of this year net issues of government securities amounted to 22.5 trillion lire, as against 14.8 trillion in the corresponding period in 1997. The increase was due to the rise in the borrowing requirement caused, in turn, primarily by timing differences in the receipt of taxes. Market sentiment nonetheless remained favourable, enabling the Treasury to lengthen the average maturity of the debt further, to 56 months at the end of April.

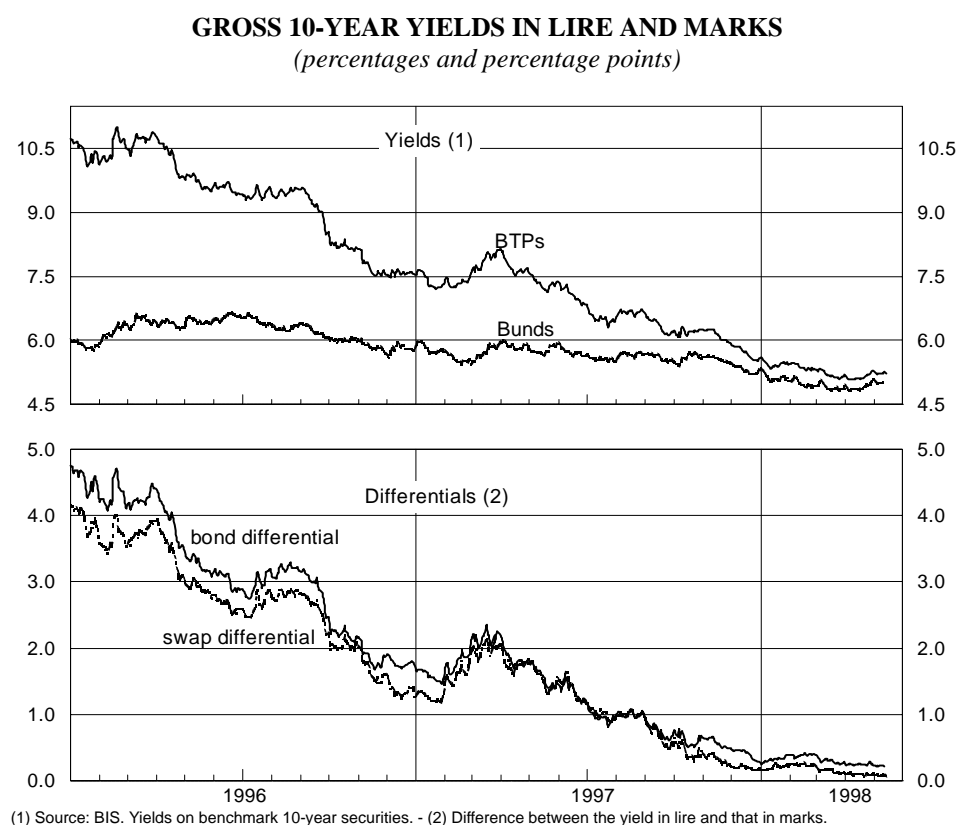
The distribution of the demand for government securities by category of subscriber underwent a change compared with the previous year (Table 47). In order to allow lending to grow faster than fund-raising, banks made net sales amounting to 38.7 trillion lire (mostly of Treasury bills and BTPs), whereas in 1996 they had made net purchases totaling 30.3 trillion. The continued decline in yields prompted households, which account for the bulk of the category of other investors, to run down their portfolios by a massive 119.1 trillion, thereby accentuating the trend that had emerged in 1996. This sector nonetheless acquired government securities indirectly via investment funds, which used part of their exceptionally large intake of resources to make net purchases totaling 68 trillion, including 42.2 trillion of CTZs. As in 1996, foreign investors made by far the largest net purchases, for a total of 102.9 trillion. Benefiting from the elimination of withholding tax and attracted by the likelihood of Italian interest rates converging towards the lowest European levels, with the consequent prospect of capital gains on fixed rate securities, they focused mainly on BTPs and made 83.9 trillion of net purchases, which far exceeded the net issues of such securities.

Interest rates. - Interest rates declined considerably last year across the whole maturity spectrum in response to the improvement in inflation expectations, the progress made in restoring the public finances to balance and the growing probability of Italy's participating in EMU from the start in January 1999. The yield on 10-year BTPs fell from 7.6 per cent at the end of 1996 to 5.6 per cent at the end of last year and was below the threshold

value established in the Treaty of Maastricht from February 1997 onwards (Figure 43).

The decline in interest rates was not continuous. After coming down slightly in January in connection with the elimination of the withholding tax on interest income for foreign investors, the yields on long-term government securities rose in the two following months, primarily owing to fears of an increase in international interest rates and uncertainty about convergence. The rate on 10-year BTPs peaked at the beginning of April and then fell steadily over the rest of the year. It continued the downward trend in the first part of 1998 to stand at 5.3 per cent in the middle of May.

Figure 43



The slope of the yield curve did not change significantly in 1997. Short-term interest rates remained high since the monetary policy stance was kept restrictive, with the curve having a pronounced negative slope up to maturities of two years; beyond this point it had a slight positive slope that reflected expectations of a recovery in economic activity and conditions in international markets. The easing of monetary policy in the last few months has resulted in short-term rates falling significantly and the negative slope of the first part of the curve becoming less pronounced.

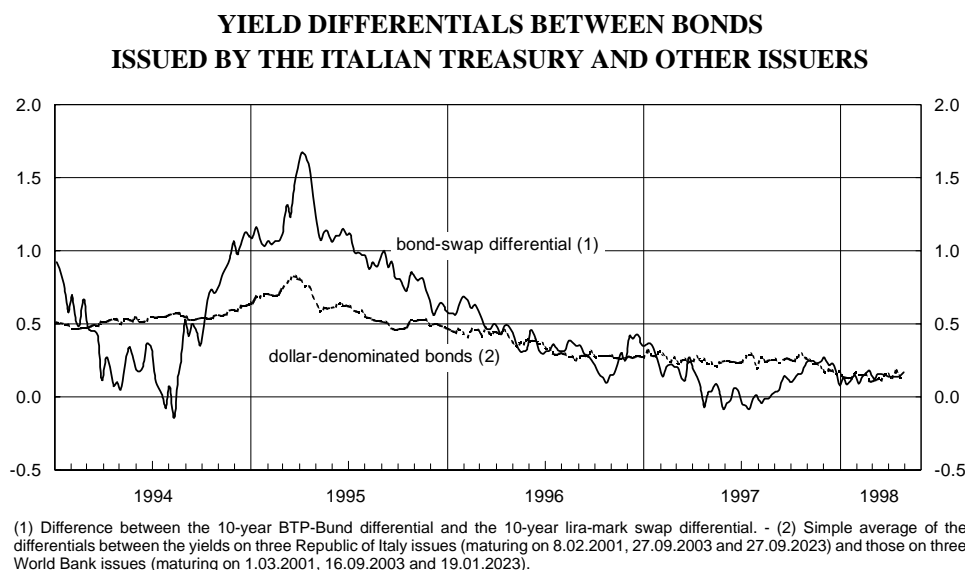
Table 47

NET PURCHASES AND STOCKS OF SECURITIES (1)

	Public sector						Corporate bonds	Total corporate bonds and government securities	Listed shares
	Treasury bills	Zero-coupon Treasury certificates	Treasury credit certificates	Treasury bonds	Other (2)	Total			
	Net purchases (billions of lire)								
1996									
BI-UIC	-1,636	907	-3,894	-24,465	-1,288	-30,376	-31	-30,407	555
Banks	7,750	9,414	26,212	-7,759	-5,299	30,318	-615	29,703	904
Insurance companies	-146	1,844	341	17,907	-217	19,729	1,370	21,099	2,798
Investment funds ..	15,893	18,508	10,493	21,287	259	66,440	1,025	67,465	128
Non-residents (3) ..	13,719	4,900	3,585	68,785	9,483	100,473	..	100,473	14,416
Other (4)	-63,033	15,942	-6,277	-18,103	222	-71,250	64,171	-7,079	-13,011
Total ...	-27,453	51,515	30,460	57,652	3,160	115,334	65,920	181,254	5,790
1997									
BI-UIC	12,642	-1,409	-10,686	-10,967	-2,523	-12,943	-142	-13,085	2,003
Banks	-22,738	-975	2,603	-13,111	-4,440	-38,661	-17	-38,678	886
Insurance companies	-1,039	1,429	-13,441	30,151	-1,690	15,410	5,202	20,612	4,726
Investment funds ..	-10,929	42,201	7,564	29,429	-221	68,044	1,586	69,630	6,362
Non-residents (3) ..	7,947	7,361	1,092	83,907	2,571	102,879	..	102,879	17,616
Other (4)	-68,193	-7,123	20,850	-50,819	-10,906	-116,192	91,321	-24,871	-23,764
Total ...	-82,310	41,484	7,982	68,590	-17,209	18,538	97,950	116,488	7,829
	Stocks (percentage composition)								
December 1997									
BI-UIC	4.7	0.2	1.4	6.8	28.9	7.4	0.1	6.2	1.1
Banks	11.1	12.9	26.0	10.9	3.9	14.4	12.1	14.0	0.6
Insurance companies	0.1	2.5	6.4	10.6	1.1	6.1	8.3	6.4	4.9
Investment funds ..	5.3	43.2	7.3	8.7	0.6	9.4	1.3	8.1	6.6
Non-residents (3) ..	10.7	3.5	12.9	36.9	45.5	25.0	..	20.8	12.1
Other (4)	68.1	37.7	46.0	26.1	20.0	37.7	78.2	44.5	74.7
Total ...	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Total (billions of lire)	302,250	158,771	566,964	766,988	267,703	2,062,676	410,026	2,472,702	598,809

(1) Net purchases are valued at market prices. The composition of the holdings of stocks of government securities and corporate bonds is based on face values; that of shareholdings at market prices. - (2) Includes Republic of Italy issues, the composition of which is partly estimated. - (3) The data on zero-coupon Treasury certificates are partly estimated; Treasury credit certificates include both floating and fixed rate credit certificates issued by the Treasury. - (4) Households, enterprises, social security institutions, the Deposits and Loans Fund, and Italian investment firms; the data on shares are partly estimated.

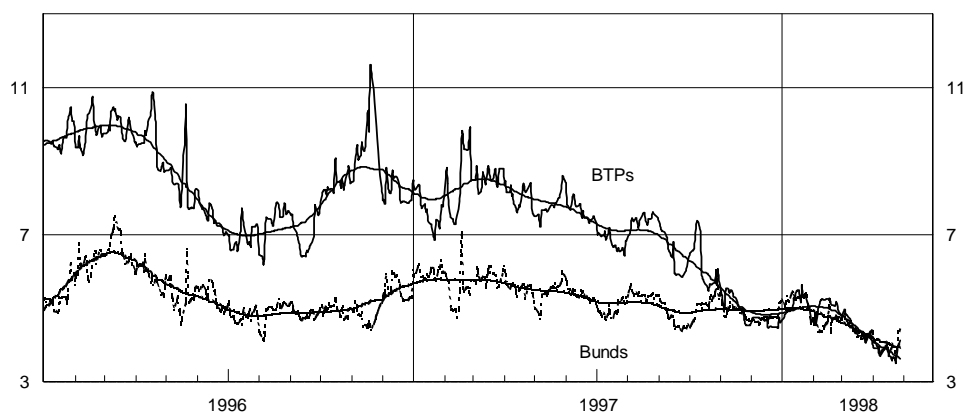
Figure 44



The differential between the yields on 10-year BTPs and Bunds followed a similar path to Italian interest rates and narrowed over the year by 1.5 percentage points, from 1.8 to 0.3 points (Figure 43). A contribution to this result came from the improvement in the creditworthiness of the Treasury, which can be measured by the reduction from 0.27 to 0.18 percentage points in the dollar yield differential with respect to securities issued by international organizations (Figure 44). The BTP-Bund differential has narrowed further since the beginning of this year to stand at 0.2 percentage points in May.

Fig. 45

IMPLIED VOLATILITY OF BTPs AND BUNDS LISTED ON LIFFE (1)
(percentage points on an annual basis)



(1) Standard deviation of the probability distribution of the percentage changes in the price of 10-year BTP and Bund futures, implied by the price of the at-the-money option closest to expiry. The trend lines were generated using the Hodrick and Prescott method.

The convergence of long-term interest rates towards those prevailing in international markets is confirmed by the expected volatility of 10-year BTPs. Measured on the basis of the prices of futures options quoted on LIFFE, this fell in 1997 from 7.8 per cent, or nearly three percentage points more than the expected volatility of Bunds, to 4.7 per cent, which was below the level for the German securities (Figure 45). The sharp increase between the middle of January and the end of February can be attributed to uncertainty about Italy's participation in EMU and was gradually reabsorbed in the following months. The improvement accelerated in October and from December onwards the expected volatility of 10-year BTPs moved in line with that of Bunds, averaging 4 per cent in the first four months of this year.

The secondary market. - The volume of trading in the screen-based secondary market for government securities (MTS) increased by a further 17 per cent last year, with average daily turnover rising from 34.7 to 40.6 trillion lire. From June onwards turnover followed a downward trend that became more pronounced in the first four months of this year, when it was down by 29 per cent compared with the corresponding period in 1997. One factor contributing to the contraction was the revision of the MTS rules, which reduced the importance of the purely quantitative requirements intermediaries must meet in order to qualify as specialist dealers.

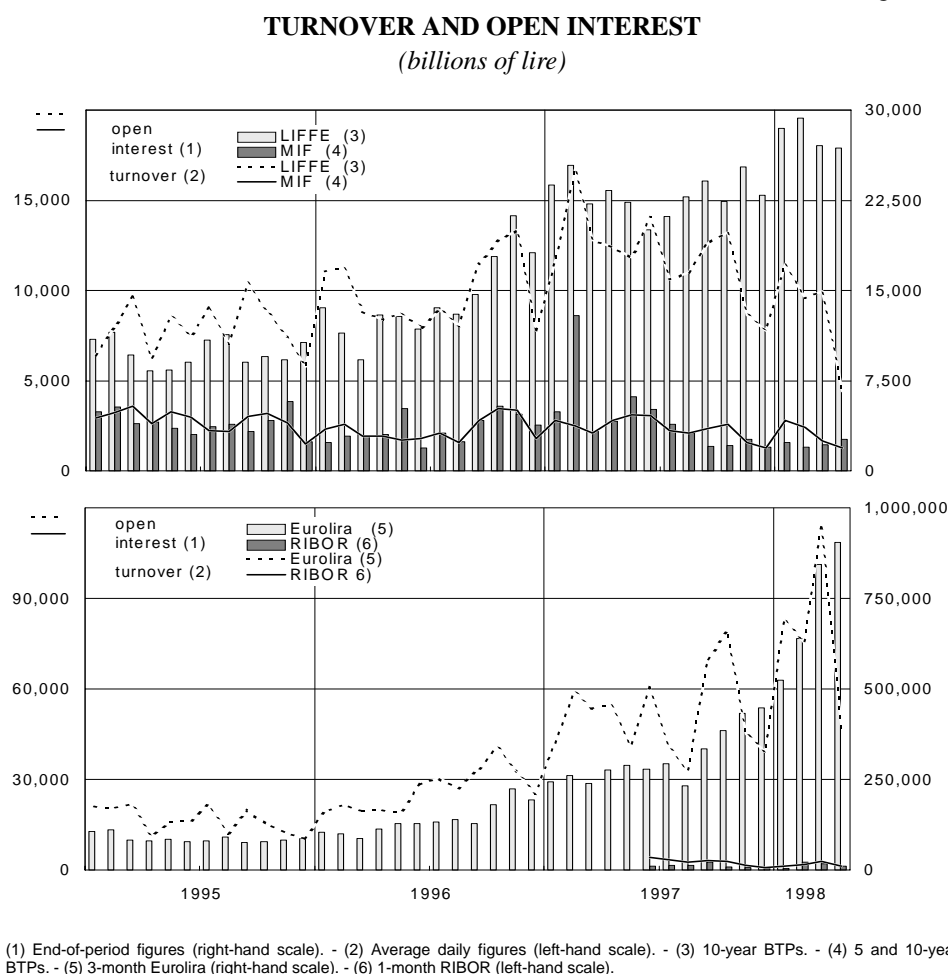
The largest increases in trading volumes occurred for CTZs, up by 193 per cent, and Treasury bills, up by 35 per cent. The share of the total volume of trading accounted for by the 10 most heavily traded securities fell from 65 to 48 per cent, with a consequent improvement in the overall liquidity of the market. The average bid-offer spread for all the securities listed except Treasury certificates in ecus narrowed from 9.5 to 8 basis points.

In December the regulated market for repurchase agreements on government securities began operations using the infrastructure of the MTS market. Thirteen maturities are quoted, ranging from spot-next (three days) to three months; as in the interbank deposit market, the shortest maturity accounts for most of the turnover (81 per cent in April).

Interest rate derivatives markets. - As in 1996, the growth in the volume of trading in futures on 10-year BTPs on LIFFE was especially strong: average daily turnover rose by 20 per cent from 9.9 to 11.9 trillion lire, partly owing to speculation based on expectations that Italian long-term interest rates would converge towards the lowest European levels (Figure 46). Trading in the contracts quoted on MIF also increased, but to a lesser extent, rising by 4 per cent from 2.3 to 2.4 trillion. The notional amount and interest rate of the MIF contract were brought into line with those of the LIFFE

contract during the year: in February the former was set equal to 200 million lire and in August the latter to 8 per cent). MIF's share of the total turnover in the two markets fell on an annual average basis from 18.6 to 16.4 per cent. The loss of share was made good in the first four months of this year, when turnover on the London exchange declined as the volatilities of Italian and German securities converged.

Figure 46



The 3-month interest rate was less closely correlated with European rates than long-term rates and investors were attracted to the related futures contract quoted on LIFFE; average daily turnover increased very substantially, rising by 94 per cent from 26.4 to 51.3 trillion. By contrast, trading in the futures contract introduced in June 1997 on the 1-month rate in the interbank deposit market was modest in the first five months, when daily turnover averaged 3.3 trillion; it then fell sharply and averaged 1.6 trillion between November 1997 and April 1998 (Figure 46).

Trading in options on the lira contracts quoted on LIFFE reflected the movements in the expected volatility of the underlying securities; turnover in 10-year BTP futures decreased significantly in the second half of the year and the increase in turnover in the related options contract was only 4 per cent, which was less than that in the underlying contract. By contrast, the average volatility of the 3-month Eurolira futures did not change significantly compared with the previous year and turnover in the related options contract grew faster than that in the underlying contract and increased by 150 per cent. Expectations that short-term Italian interest rates would converge with those prevailing in continental Europe appear to have boosted trading in the second half of the year, when the open interest in options on 3-month Eurolira futures increased very rapidly.

The equity market

Supply and demand. - Privatizations were the main source of the flow of capital to the stock market last year and led to placements totaling more than 38 trillion lire, the highest value since 1994. Gross issues of new shares by listed companies rose from 5.5 to 7.9 trillion, but were well below the average for the three years 1993-95; two large issues accounted for more than three quarters of the total. The contribution of new listings to the increase in stock market capitalization decreased further: the 14 companies admitted to listing raised 12.7 trillion, compared with 14.9 trillion in 1996 and 64.4 trillion in 1995 (Table 48). During the year 18 companies dropped out of the list. In the first four months of this year the supply of shares amounted to 5.3 trillion, a substantial increase on the 540 billion recorded in the year-earlier period.

Investment funds bought a total of 6.4 trillion lire of Italian shares; foreign investors and households and enterprises made larger purchases totaling respectively 17.6 and 11.1 trillion. The higher level of demand for equities compared with the previous year is confirmed by the results of initial public offerings, which were oversubscribed 8.2 times on average, as against 7.2 times in 1996.

Share prices and turnover. - A series of favourable circumstances combined to produce a rise of 58.2 per cent in the share price index, the largest since 1986 and a major factor in the increase in the ratio of market capitalization to GDP from 20.6 to 30.7 per cent. Share prices rose sharply in January, with the result that the Italian stock market made good its slower growth in 1996 compared with the other leading markets; in the following

months the market was held in check by fears of a revival of inflationary pressures and an increase in interest rates in international markets. As these fears subsided, signs of a cyclical recovery in economic activity and the strengthening of expectations that Italy would participate in the third stage of EMU from the start fueled a further rise in the market that was interrupted only for a short time by fears of an increase in US interest rates and the outbreak of the Asian crisis. In August and again in October uncertainty about the international situation led to a weakening of share prices and a pronounced increase in their volatility, but in the last few months of the year the market moved ahead strongly and volatility decreased.

Table 48

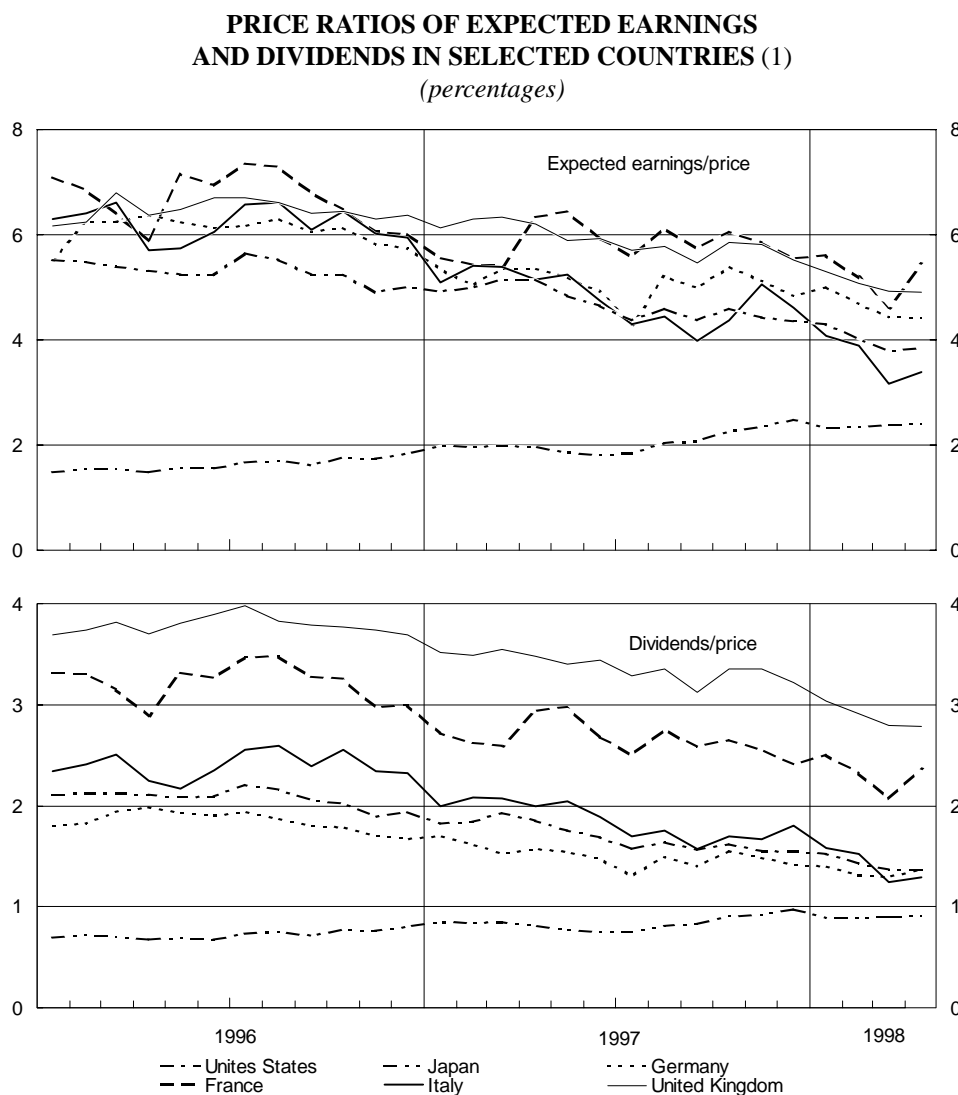
MAIN INDICATORS OF THE ITALIAN STOCK EXCHANGE

	1993	1994	1995	1996	1997	1998 April (1)
Total market capitalization (billions of lire) (2)	234,256	293,566	325,568	386,157	598,809	814,029
as a percentage of GDP	15.1	17.9	18.4	20.6	30.7	40.1
percentage breakdown: services	26	26	25	32	31	28
industry	21	25	33	34	30	28
insurance	26	23	20	15	15	16
banking	18	18	17	15	19	24
finance	9	8	5	4	4	4
Gross issues (billions of lire)	15,230	12,982	8,515	5,506	7,933	5,251
of which: state-controlled companies	911	2,332	191	81	904	..
Market capitalization of newly listed companies (billions of lire) (3) .	1,745	26,388	64,411	14,886	12,731	1,775
Distributed dividends (billions of lire)	6,468	5,105	6,180	9,786	12,112	283
Earnings/price ratio (4)	5.6	4.6	5.8	6.3	4.6	3.4
Dividends/price ratio	2.4	1.6	1.7	2.2	1.6	1.2
Turnover (billions of lire):						
stock exchange	103,554	190,009	140,341	156,521	337,071	346,309
futures	–	4,543	166,838	400,951	919,010	606,728
options	–	–	1,697	71,457	242,073	209,630
Annual change in Mib price index (5)	37.4	3.3	–6.9	13.1	58.2	34.6

(1) Provisional. – (2) End-of-period values. – (3) At the placement date. – (4) Source: Datastream. – (5) Percentages; for 1998, the change over the first four months of the year.

Expected earnings and dividends continued the downward trend in relation to prices that had begun in 1996 and the respective ratios fell by 1.7 and 0.6 percentage points to 4.6 and 1.6 per cent (Figure 47).

Figure 47



(1) Source: Datastream.

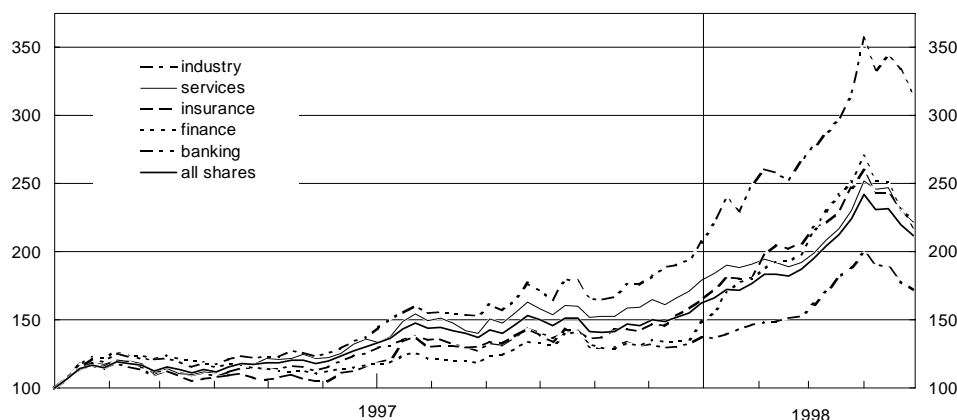
The banking sector outperformed the market by a wide margin: the rise in the index of total return was equal to 106 per cent, compared with a market average of 63 per cent (Figure 48). This performance owed much to the upward revision of expected earnings for banks involved in mergers and corporate restructurings, which accounted for 68 per cent of the sector's market capitalization. When they are excluded from the computation, the

index rose by 74 per cent. Furthermore, despite a fall of more than 2 percentage points over the year, the sector's earnings/price ratio of around 3 per cent at the end of 1997 was still higher than the market average.

The rise in prices accelerated in the early months of this year in response to the increased demand of Italian institutional investors. In March the price ratios of expected earnings and dividends fell to their lowest values since 1986 and to levels below those in the other leading stock markets apart from Tokyo, both in absolute terms and in relation to real interest rates. The rise in prices came to a halt in April and their volatility increased. However, even though the index declined over the month, at the end of April it was 35 per cent higher than at the beginning of the year. The ratio of market capitalization to GDP consequently recorded an exceptional increase of nearly 10 percentage points on its value at the end of 1997 and reached 40 per cent.

Figure 48

ITALIAN STOCK EXCHANGE: INDICES OF TOTAL RETURN
(weekly data; 31 December 1996=100)

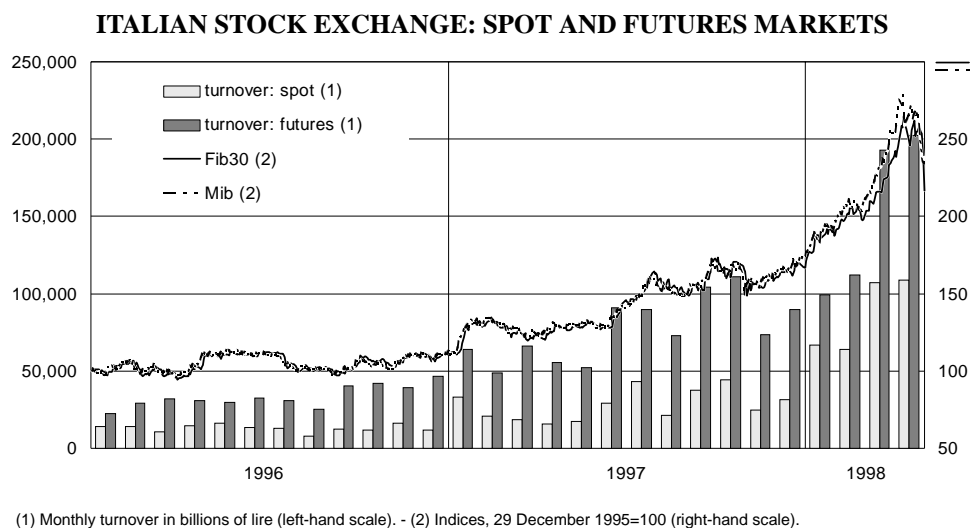


The equity-based derivatives market. - Last year also saw exceptional growth in the market for equity-based derivatives. Turnover in the Mib30 stock index futures contract more than doubled to 919 trillion lire (Figure 49) and was 3.5 times the turnover in the shares making up the index, compared with a factor of 3.3 in 1996.

The volume of spot trading on the stock exchange more than doubled in 1997 (Table 48), with average daily turnover rising from 621 to 1,343 trillion lire. On an annual basis the ratio of turnover to market capitalization rose from 43.6 to 68.6 per cent. On a quarterly basis it rose from an average of 10.9 per cent in 1996 to an average of 17 per cent in 1997 and in the first

quarter of this year reached 31.3 per cent, the highest value ever recorded (Figure 49). There was virtually no change in the concentration of trading in the leading stocks.

Figure 49



Turnover in options on the Fib30 index grew steadily over the year and peaked in October in conjunction with the greatest volatility of share prices. The notional value of the contracts concluded rose from 71.5 to 242 trillion lire. The ratio of turnover in options contracts to that in the underlying futures contract rose from 46 to 72 per cent. The volume of options on individual shares also grew, although less than for the two stock index derivatives. Turnover in market-traded contracts, which are available for 16 highly-capitalized shares, amounted to 25 trillion, or 11 per cent of the volume of trading in the underlying securities.

THE PAYMENT SYSTEM

In 1997 work continued on preparing the infrastructure and procedures of the payment system for stage three of EMU, with the aim of ensuring that it will be possible from 1 January 1999 onwards to implement the single monetary policy, use euro-denominated payment instruments and conduct market business in euros. The measures to prepare for operations in euros do not conflict with the privatization of the markets provided for in the Consolidated Law on Financial Markets, which comes into force on 1 July 1998.

The Bank of Italy conducted its oversight of the payment system, a responsibility entrusted to it by Article 146 of the 1993 Banking Law, in accordance with the guidelines set out in its *White Paper on Payment System Oversight*, published in May 1997. It also took account of the recommendations of the European Monetary Institute regarding certain sectors of the payment system. Special attention was paid to the activities of non-bank firms that supply network services to markets and financial intermediaries. In addition to monitoring the behaviour of the participants in the settlement system, the Bank of Italy took action to assess the adequacy and state of progress of the technical and organizational measures planned by financial intermediaries to prepare for the introduction of the euro and the date change in the year 2000.

The full implementation of the BI-REL real time gross settlement system and the creation of the Interlinking system for communications with the European Central Bank and the other national central banks marked the completion of the Italian component of TARGET, the European payment system that will permit the conduct of the single monetary policy, reduce risk and increase the efficiency of payments between the EU countries. The BI-REL system will allow Italian banks to settle transactions in euros with other EU countries in real time and exploit the potential of the system to develop services that will help to maintain and increase their competitiveness in the euro area.

The changes being made to the procedures for the clearing of bank payment items and the settlement of securities transactions will enable intermediaries to transmit payments to the two systems in the currency selected by customers during the transition period, when both the lira and the euro may be used.

In the securities sector, the prospect of the changeover to the euro has speeded up the process of dematerialization, which will be regulated by a decree soon to be issued by the Government.

Among other things the consolidated law provides for the bilateral netting of forward contracts to be legally valid in cases of insolvency and introduced measures to ensure settlement finality for transactions in financial instruments. The law also established that settlement services, with the exception of the cash leg, may be managed by a company authorized by the Bank of Italy in agreement with Consob. The new institutional arrangements, which eliminate the Bank of Italy's monopoly on the management of securities settlement services, reflects the authorities' new approach to the market provision of services of public interest, which also prompted the Bank's decision to dispose of its holding in Monte Titoli S.p.A.

The consolidated law also defined the system for market surveillance, a task entrusted to Consob and the Bank of Italy. The latter has been given broader powers over the wholesale markets involved in the conduct of monetary policy. In addition, the Bank of Italy and Consob have been granted joint powers of surveillance of settlement systems for transactions in financial instruments. In view of their importance for the payment system, the Bank of Italy is also charged with their oversight.

Domestic and international cooperation

At the national level, the Euro Committee of the Ministry of the Treasury has set out the reference framework for the transition to the euro in the fields of payments, markets and financial instruments. From 1 January 1999 onwards financial intermediaries and the public will be able to use the euro in cashless transactions, trading on the money and financial markets will be conducted in euros and new issues of public debt instruments will be denominated in the single currency. Listed government securities and any other form of transferable public debt will be redenominated in euros from the same date, while other financial instruments will be redenominated gradually.

Following the launch of BI-REL, the Bank of Italy and ABI have worked together on raising awareness of the system's potential for banks and firms; they have also formed a group of TARGET users, as recommended by the EMI, to serve as a forum for proposals to improve the level of service.

In view of the importance of cooperation between intermediaries for the efficiency and quality of payment services, the Bank of Italy has

continued to pay special attention to the work of the Interbank Convention on Automation (CIPA). Its activities have focused on modifying interbank procedures to handle operations in euros and the year 2000 date change, as well as on improving the quality of services provided to customers. CIPA has accompanied its planning activities with studies, especially on the security of communications related to banking operations on the Internet and other networks and the replacement of traditional payment cards with those using chip technology.

Cooperation between EU central banks in the field of payment systems has primarily regarded the issues involved in creating the infrastructure and operational framework for the conduct of the single monetary policy in stage three of EMU, including the implementation of the TARGET system and the definition of the standards that EU securities settlement systems must meet to be used in ESCB credit operations. The national central banks also began a study to define the objectives and organization of payment system oversight in the euro area. In turn, the EMI continued its oversight of the EBA Clearing System, with special reference to the changeover to the euro.

Work continued within the G-10 on identifying areas of common interest in payment system oversight and banking supervision and on developing a reference framework for the exchange of information to increase the effectiveness of the two functions. The Bank for International Settlements coordinated efforts aimed at improving the control of financial and operational risks through the assessment of measures adopted by settlement systems for large-value transactions involving securities and foreign exchange and the evaluation of plans for dealing with the year 2000 problem.

As regards retail payment systems and instruments, the BIS began an analysis of current trends, including the problems associated with electronic money (and its possible use for money laundering) and the role of the central banks in this field. The Council of the EMI has expressed the view that, in order to preserve the public's confidence and prevent the use of electronic money for criminal purposes, it should only be issued by institutions subject to prudential supervision and to the application of reserve requirements. The European Commission is preparing a directive on the matter.

Payment trends in Italy

In 1997 the recovery in economic activity was reflected in an increase in cashless payments, which rose by 6.4 per cent in volume and 9.2 per cent

in value, the largest increase in recent years. Payments made via the banking system and with credit cards contributed to the increase, as did those made through the postal system, albeit to a very limited extent. The wider spread of banks' branch networks and the growth in the number of ATM and POS terminals also played a part, although the volume of transactions made through these outlets is still small by comparison with other countries.

The volume of transactions made using payment cards and credit transfers continued to increase, while the use of cheques decreased. The changes made to the procedures for the exchange of the most widely used instruments generally reduced the time needed to make funds available to customers. The increased integration of the banking and postal circuits and the more extensive participation of intermediaries in the national interbank network and its procedures fostered the integrated use of payment instruments and the development of innovative services, especially for firms.

The value of payments handled by the Bank of Italy's clearing and settlement systems rose to 75,000 trillion lire and from 34 to around 39 times gross domestic product.

Following the migration of interbank deposit market contracts, together with external lira interbank transfers and the lira leg of foreign exchange transactions, to the BI-REL system in January 1998, the payments settled on a gross basis in the first quarter amounted to 13,300 trillion lire, about 66 per cent of total flows. By the end of 1998 BI-REL will also handle the settlement of the cash balances arising from securities transactions. These currently account for more than half the value of transactions channeled through the BI-COMP system and the switch will help to prevent the transmission of risk between this system and the securities settlement system.

The volume of securities handled by the clearing system increased considerably, with share settlements rising by about 120 per cent. Nevertheless, the share of equities in the total value of securities handled remained very small (2.3 per cent).

In April 1997 the Bank of Italy, in agreement with Consob, issued regulations for the clearing and settlement of financial instruments. The new rules allow resident and non-resident investors to settle market trades through settlement agents, intermediaries that participate directly in the securities settlement system. In order to increase the security and efficiency of the system, the procedure for postponing settlements was kept in place and steps were taken to encourage the development of securities lending.

Retail payment instruments and services

Cashless payments in Italy increased by 6.4 per cent in volume and 9.2 per cent in value in 1997. This was faster than the average annual growth rates of 1.8 and 3.3 per cent, respectively, over the three previous years.

The use of cash. - Notes and coin in circulation expanded by 7.1 per cent in 1997, compared with an average increase of 2.1 per cent in the previous two years. The ratio of currency to GDP rose from 5.3 to 5.5 per cent.

The increase in the number and value of cash withdrawals from current accounts (5.1 and 3.4 per cent respectively) and the decline in their average size are indicative of the continuing importance of cash in payments, especially in low-value transactions. Nevertheless, the sharp increase in bank operations, especially those carried out with payment cards, would appear to signal a gradual erosion of the share of transactions settled in cash.

Bank payment instruments. - Payments made via the banking system increased by 8.0 per cent in volume and 10.7 per cent in value. The volume and value of credit transfers, collection orders and debit card transactions increased. The number of cheques continued to decline, although more slowly than in the past (Table 49).

A number of measures were implemented during the year to increase the efficiency of interbank cheque exchange procedures. In addition, in order to enhance the security of cheques and payment cards, the Interbank Convention on Automation Problems defined the features and operational procedures of the interbank database on persons debarred from writing cheques, lost and stolen cheques and revoked payment cards.

In particular, the plans for the interbank circuits envisage that as from the second half of 1998 untruncated cheques, wherever negotiated, will only be exchanged at the Rome and Milan clearing houses. Consideration will also be given to raising the ceiling on the value of cheques eligible for truncation, currently 2 million lire for bank cheques and 20 million lire for banker's drafts, in order to increase the proportion of instruments handled electronically.

By the end of last year all banks had joined the system for the electronic notification of unpaid bank cheques and banker's drafts over the interbank network.

Table 49

BANK PAYMENT INSTRUMENTS IN 1997 (1)

	Number				Value			
	Thousands	% compo- sition	Percentage change		Billions of lire	% compo- sition	Percentage change	
			1996/1995	1997/1996			1996/1995	1997/1996
Cheques	493,583	43.9	-4.9	-1.3	1,700,427	22.9	-5.0	3.3
Personal cheques (2)	381,428	33.9	-4.1	-1.2	1,162,688	15.6	-7.0	1.0
Bankers' drafts	112,155	10.0	-7.2	-1.7	537,739	7.2	-0.2	8.7
Credit transfers and collection orders (3)	631,005	56.1	9.2	16.7	5,731,629	77.1	6.1	13.1
Credit transfers	202,173	18.0	9.4	7.3	4,915,635	66.1	6.0	13.4
<i>of which:</i>								
<i>paperless</i>	94,861	8.4	13.6	14.2	606,752	8.2	25.5	10.3
Collection orders	329,070	29.2	4.7	11.3	796,810	10.7	6.6	10.1
<i>of which:</i>								
<i>paperless</i>	290,075	25.8	7.0	17.5	646,502	8.7	7.6	19.1
Direct debits	154,488	13.7	12.6	26.3	205,923	2.8	22.9	48.1
Riba and Mav	135,587	12.1	2.9	8.9	440,579	5.9	3.9	9.0
Transactions at POS terminals	99,762	8.9	38.1	76.9	19,184	0.3	22.0	96.4
Total	1,124,588	100.0	1.9	8.0	7,432,056	100.0	3.3	10.7

(1) Based on a sample of 82 banks that account for about 80 per cent of bank current account deposits. - (2) Excludes cheques for cash withdrawals at bank counters. - (3) Excludes collection orders handled by bank branches for certain types of transaction (e.g. loan repayments, payment of taxes and utility bills, collections on behalf of public sector bodies), for a total of 74.2 million operations amounting to 684,561 billion lire in 1996 and 88.5 million operations totaling 901,594 billion lire in 1997.

Payment cards. - In 1997 the number of payment cards in circulation increased by 8.7 per cent. The volume and value of card payments rose by 39.6 and 45.0 per cent respectively (Table 50). The largest contribution to the increase came from debit card payments at POS terminals, whose volume rose by 76.9 per cent.

The issuing of multi-purpose prepaid cards continued. Their spread and use is still modest, however, reflecting the gradualness of the new instruments' acceptance by customers, the small number of outlets where they can be used and often ineffective marketing policies.

In 1997 there were 220,000 electronic purses in circulation in Italy, with a value of about 3.7 billion lire; they were used to effect 294,000 payments with an average value of about 13,000 lire.

Postal payment instruments. - Postal payments grew by 1.1 per cent in number and decreased by 3.2 per cent in value last year.

The integration of the bank and postal payment circuits continued, leading to the acceptance of bank debit cards at around 540 Post Office branches.

The transformation of the Post Office from a public-sector enterprise into a company limited by shares wholly-owned by the state, as provided for under Law 71 of 29 January 1994 and the resolution of the Interministerial Committee for Economic Planning of 18 December 1997, was completed in February 1998. The guidelines governing the transformation also envisage the strengthening of postal banking services.

Table 50

**CREDIT AND DEBIT CARDS:
CIRCULATION AND TRANSACTIONS IN 1997**

	Number			Value		
	Thousands	Percentage change		Billions of lire	Percentage change	
		1996/1995	1997/1996		1996/1995	1997/1996
Credit cards (1)						
Cards in circulation	8,828	14.2	15.5	–	–	–
<i>of which: active (2)</i>	6,160	11.8	10.7	–	–	–
Transactions (a)	141,503	25.2	22.0	26,293	22.5	22.2
<i>of which: abroad</i>	20,871	20.7	12.0	4,583	13.0	16.8
Debit cards (3)						
Bancomat cards in circulation (3)	17,317	10.5	13.4	–	–	–
<i>of which: POS capabilities</i>	15,693	8.1	5.3	–	–	–
Transactions at ATMs (4)	338,638	17.3	15.3	108,736	18.2	13.6
Transactions at POS terminals (4) (b) .	99,762	38.1	76.9	19,184	22.0	96.4
Total payment cards (5)	24,521	10.1	8.7	–	–	–
Total transactions (a+b)	241,265	29.2	39.6	45,477	22.3	45.0

(1) Data provided by banks and other credit card issuers (excluding retailers' cards). – (2) Cards used at least once during the year. – (3) Does not include debit cards used in ATMs not linked to the Bancomat system. – (4) Based on a sample of 82 banks that account for about 80 per cent of bank current account deposits. – (5) Credit cards and debit cards with POS capabilities.

The interbank clearing and settlement circuit

The interbank payment system. - The value of payments handled by the Bank of Italy's clearing and settlement systems grew more slowly last year, rising by 16.4 per cent to 75,000 trillion lire, about 39 times GDP (Table 51). The deceleration is attributable to the slower growth in large-value interbank payments, which totaled 60,000 trillion lire, and in particular interbank deposits, which increased by only 11.5 per cent,

compared with 30 per cent in 1996. The rate of increase in other wholesale operations was stable. External lira and foreign exchange transactions, which rose by 20.8 per cent, were mainly related to Italian banks' securities operations with non-residents in the form of repos and direct subscriptions.

Table 51

CLEARING AND SETTLEMENT OF INTERBANK PAYMENTS
(amounts in trillions of lire)

	Clearing (1)		Gross settlement (2) (b)	Total transactions settled in central bank money (a+b) / PIL
	Gross flows (a)	Multilateral balances		
1991	20,377	1,586	1,651	15.4
1992	29,053	2,411	3,004	21.3
1993	40,476	2,725	2,626	27.8
1994	48,832	2,627	2,623	31.4
1995	50,603	2,849	2,755	30.1
1996	62,112	2,568	2,723	34.5
1997	71,090	2,829	4,375	38.7

Sources: Based on Bank of Italy, Interbank Company for Automation (SIA) and Istat data.
(1) Includes transactions of the Bank of Italy, its provincial Treasury departments and the Post Office. - (2) Transactions settled on centralized accounts net of clearing balances and intrabank transfers within the management account.

The clearing system (BI-COMP). - The value of transactions handled by the clearing system rose by more than 14 per cent to 71,000 trillion lire (Table 52). Flows were affected by the shifting of the interbank funds transfer procedures for large-value domestic and cross-border credit transfers, which accounted for 5 per cent of interbank flows, to the gross settlement system in June. In the first half of the year flows through the clearing system increased by 23.4 per cent in relation to the same period of the previous year, but they grew by only 6.6 per cent in the second half.

The gross settlement system (BI-REL). - In 1997 the value of payments settled directly on centralized accounts at the Bank of Italy increased by 38 per cent to 7,000 trillion lire (Table 52). The launch of the BI-REL system increased the volume of interbank transactions settled directly in central bank money from 3 to 26 per cent of the total. In the second half of the year, cross-border and large-value credit transfers totaled 1,500 trillion lire.

In order to ensure that banks have access to sufficient intraday liquidity to settle their obligations on a gross basis, on 20 May 1997 the Governor issued a provision that came into force with the launch of BI-REL authorizing the banks to mobilize up to 10 per cent of their compulsory reserves during the day.

Table 52

FLOW OF FUNDS THROUGH THE SETTLEMENT SYSTEMS
(trillions of lire)

	Clearing (BI-COMP)			Gross settlement (BI-REL) (1)		
	Total	of which:		Total	of which:	
		Retail and Local clearing	Cash balances in securities settlements		Interbank deposit market (MID)	BIR, BOE and GEC (2)
1995	50,603	4,818	4,666	5,155	..	..
1996	62,112	4,481	6,239	5,078	..	..
1997	71,090	4,352	7,437	7,024	..	1,529
1997 - 1st qtr.	17,891	1,058	1,900	1,350	..	..
2nd "	17,878	1,080	1,859	1,370	..	82
3rd "	17,654	1,074	1,868	1,989	..	659
4th "	17,667	1,140	1,810	2,315	..	788
1998 - 1st qtr.	6,847	1,102	1,950	13,271	2,502	9,160

Sources: Based on Bank of Italy and Interbank Company for Automation (SIA) data.

(1) Excludes the credit balances of the clearing system and intrabank transfers in the management account. - (2) Large-value domestic credit transfers, cross-border credit transfers and external lira interbank transfers and the lira leg of foreign exchange transactions.

The gradual transition to the BI-REL system gave participants time to experiment with the gross settlement functions (intraday liquidity, queueing, cash management services) and adjust to the new operating day, which provides for the settlement of multilateral clearing balances at the end of the morning. In the first quarter of 1998 interbank transactions made up nearly 90 per cent of the flows through the centralized accounts; the value of operations entered in the system was more than 13,300 trillion lire (Table 52). The system, with 787 participants, settles a daily average of 42,000 payments with a total value of more than 270 trillion lire. In the first two months of full operations, the amount of intraday liquidity granted was very small, only 5.9 trillion lire, equal to 2 per cent of total settlements.

With the beginning of full operations on BI-REL, the utilization of the services offered with settlement increased. More than 70 per cent of management account holders signed on for the BI-REL "service pack" for the electronic handling of messages. A total of 148 participants opened intraday advance accounts, nearly all the direct participants in the funds transfer procedures.

The Bank of Italy was one of the first EU central banks to begin testing the European TARGET settlement system, on 1 July 1997.

The pricing policy for Bank of Italy payment services. - The fee schedule for BI-REL came into force during the year. The Bank of Italy's policy is aimed at gradually recovering the costs it incurs in providing the service. The work to determine the fees charged by the Bank of Italy for payment services also regarded the central securities system, the clearing of bank items and cashier's cheques.

Efforts to set a joint pricing policy for cross-border transactions via TARGET continued at the EMI during the year. A methodology was developed to identify a standard level of service, and its cost, for a cross-border payment. Cost estimates that more accurately reflect the effective level of operations were developed following the gradual launch of the national gross settlement systems.

Clearing and settlement of securities transactions

Securities settlement. - In 1997 the value of the securities handled by the clearing system for transactions in financial instruments rose by more than 40 per cent to about 42,000 trillion lire. Share settlements increased the most, by about 120 per cent; settlements involving government securities and bonds rose by 40 and 12 per cent respectively. The distribution of settlements by category of security was broadly the same as in 1996: share settlements rose from 1.5 to 2.3 per cent of the total, while settlements of government securities declined slightly, from 98.2 to 97.5 per cent; the share of bond settlements remained negligible at 0.2 per cent.

In April 1997, the Bank of Italy, in agreement with Consob, issued new regulations for the securities clearing and settlement system. *Inter alia*, they allow participants to act as settlement agents for other intermediaries, settling in their own name transactions carried out in the various markets by others, including non-residents.

The centralized management of government securities. - At the end of 1997 the government securities centralized in accounts with the Bank of Italy amounted to 1,900 trillion lire, equal to 99 per cent of the total in circulation. The face value of Italian government securities held at the Bank of Italy by Cedel and Euroclear rose markedly, increasing from 27.5 trillion lire in 1996 to 46.2 trillion in 1997 (compared with 12.8 trillion in 1995).

Monte Titoli S.p.A. - The face value of securities deposited with Monte Titoli (shares, convertible and non-convertible bonds and warrants)

was 286 trillion lire at the end of the year, an increase of 36.8 per cent compared with 1996. The face value of centralized bonds increased by 46 per cent to 211 trillion lire, mainly as a consequence of bond issues by banks to replace certificates of deposit that were not renewed by investors. The face value of shares was 75 trillion lire, a rise of 16.4 per cent. The number of depositors fell from 442 to 426 at the end of 1997.

The legislative decree on the introduction of the euro and the consolidated law on financial markets will introduce far-reaching changes in the frame of reference for the centralized management of securities. The former contains the provisions for the dematerialization of securities, while the latter completely revises the general regulations governing the activities of the central securities depositories, imposing controls by the Ministry of the Treasury, Consob and the Bank of Italy. The law grants Consob and the Bank of Italy powers to carry out prudential supervision and inspections. Considering the role of the depositories in the operation of the payment system, their activities are also relevant to the oversight functions performed by the Bank of Italy under Article 146 of the 1993 Banking Law.

The settlement of securities transactions in a European perspective

In January 1998 the EMI published a report entitled “Standards for the use of EU securities settlement systems in ESCB credit operations”, establishing the standards that securities settlement systems must meet in order to be used by the ESCB in monetary policy operations.

The standards, which address both technical and legal issues, require that such systems: have a sound legal basis; be subject to control by the competent authorities; ensure the transparency and objectivity of access conditions; ensure the reliability of technical systems; use central bank money to settle the cash side of operations; have a unique and direct relationship with issuers; and ensure the intraday finality of settlements. In addition, the operating hours and opening days of securities settlement systems should be consistent with those of the TARGET system. The ECB will publish the list of eligible systems in the second half of 1998.

In Italy, the planned modifications to securities settlement systems are consistent with the European reference framework. They envisage the adjustment of procedures to handle the introduction of the euro, the strengthening of measures to control multilateral settlement risk and the implementation of real-time gross settlement procedures. From the start of Stage Three of EMU and throughout the transition period, the system for the settlement of transactions in financial instruments will permit

settlement in lire or euros, regardless of the denomination of the instruments involved. Monte Titoli is currently involved in drafting a plan for the real-time gross settlement of transactions in securities deposited with it that are carried out off the Stock Exchange.

The consolidated law on financial markets also introduces finality for the clearing and settlement of transactions in financial instruments and sanctions their validity in cases of insolvency, thus anticipating the legislation transposing the European directive on settlement finality into Italian law, which was approved by Parliament and the European Council in April 1998.

The European central banks are currently implementing a correspondent central banking model, i.e. the opening of reciprocal custody accounts to permit the cross-border use of securities as collateral for the credit they grant. Under the model, which will become operational with the launch of Stage Three, the central banks will exchange custody services for securities pledged as collateral. The central bank of the country where the securities are deposited will also provide guarantees to the central bank granting the credit only in special cases and then only for non-transferable securities. The correspondent central banking model will eventually be replaced by a network of links between the European central securities depositories.

SUPERVISORY ACTIVITY

This section of the Report sets out the criteria and methods the Bank of Italy uses in performing supervision and describes the action taken in 1997. By this means the Bank complies with Article 4 of Legislative Decree 385/1993 requiring it to publish an annual report on its supervisory activity.

Last year the banking system benefited from the rise in firms' profitability and the strengthening of their capital structures, which brought an improvement in loan quality. The slowdown in the growth in bad debts halted the rise in their ratio to total loans, a trend which had been under way since 1991. Loan losses nonetheless remained at a high level and the profitability of the banking system as a whole declined compared with the previous year; in particular, banks' interest and non-interest income net of operating expenses fell by more than 6 per cent.

The judgements passed on individual banks by supervisory units confirm this assessment for the banking system as a whole. Compared with the two previous years, there was a reduction in the proportion of banks in distress, coupled with continued difficulty in achieving adequate profit margins in an increasingly competitive environment.

In the South of Italy the most complex phase of the restructuring of the banking system triggered by the crises at the leading banks in the area is drawing to a close. The action taken to restore the banks to health and reorganize their ownership structures made it possible to avoid systemic risks and initiated their return to operational profitability. The liquidation of Isveimer is at an advanced stage, the collection company SGA has begun to recover the claims transferred from Banco di Napoli, and the acquisition by Banco di Sicilia of the assets of Sicilcassa, which had been placed in compulsory liquidation, made it possible to limit the effects of the crisis on Sicilcassa's depositors and borrowers.

The profitability of the banking system as a whole, measured in terms of the ratio of net profits to own funds, declined from 3.8 to 1.6 per cent, a figure that was depressed by the loan writedowns made by some large banks. However, even excluding this item, profitability was still below the average level of other banking systems. The fall of 5 per cent in net interest income compared with the previous year was almost completely offset by the rise in revenues from services, so that gross income remained virtually unchanged. Operating costs and staff costs remained high in relation to gross income, at 69 and 43 per cent respectively. Both these figures are much higher than those observed in most other banking systems.

The objective of lower and more flexible costs is being pursued in part by re-engineering production processes and outsourcing the activities most easily decentralized, such as the management of IT systems and buildings, staff training and legal advice.

Even though the reduction in the number of bank staff was more pronounced than in previous years, it led to only a small reduction in labour costs owing to the increase in unit costs produced by automatic wage mechanisms and the extraordinary expenses arising from the payment of redundancy incentives. The cost-cutting measures taken by the largest banks, which have the highest unit costs, helped to reduce the disparity in relation to the other banks. The agreement reached between employers and trade unions to reduce the ratio of labour costs to gross income is an important first step towards narrowing the gap that has opened up over the years between Italian banks and their main European competitors.

On the revenue side, banks are pursuing the objective of increasing profitability primarily by expanding asset management services, provided both directly and via subsidiaries. The fall in interest rates has caused savers to shift away from securities deposited with banks for safekeeping and administration towards investment funds. Bank-controlled fund management companies accounted for nearly 90 per cent of the sector's net fund-raising last year and their share of total net assets rose to 84 per cent. The involvement of banks grew not only in the collective investment sector but also in other areas of financial intermediation. The earning capacity of firms in the investment services field increased considerably; the gross operating profit of investment firms and fund management companies together was twice as large as in 1996.

As in other countries, the fiercer competition in financial markets has prompted far-reaching restructuring of production in the various sectors of the financial industry in Italy. In addition to carrying out internal reorganization, banks have pursued a policy of merger and acquisition in order to achieve the scale and range of services needed to counter the decline in profit margins.

The restructuring taking place in the banking industry has led to increasingly complex organizational arrangements within banks and banking groups. The range of activities engaged in, the emergence of new specializations and the different ways in which operations are configured mean that the supervisory authority constantly has to update its instruments and methods. Meetings with bank managements to discuss both general matters and questions concerning specific sectors of operations have become more frequent. Inspections were carried out at 197 banks and non-bank intermediaries to assess their capital strength, profitability, liquidity and organizational arrangements. They also served to verify that the institutions continued to meet the conditions for sound and prudent management and to test the reliability of the information provided to the supervisory authority. At nine banks the directors were replaced by special administrators in order to determine whether it was possible to turn the company round; five institutions were placed in compulsory liquidation.

Market globalization and, more recently, the forthcoming launch of monetary unification in Europe have accelerated the concentration of European banking systems, a process that has increasingly involved large banks. Between 1990 and 1996 the number of banks in business in Germany and France fell by around one third; the decline was smaller in Italy, equal to approximately one fifth. Despite intensifying, the process of amalgamation has remained essentially domestic in scope; this is one reason why the degree of concentration of the EU-wide banking market is modest and far lower than that prevailing in other economic sectors.

The mergers and acquisitions announced in Italy in 1997 and the first few months of this year involved institutions that rank at the top of the Italian banking system. However, these banks are still not large by comparison with their counterparts in the other main European countries, reflecting Italy's lower ratio of gross financial assets to GDP and the size of the economy. Including operations carried out in the first quarter of 1998, the share of each country's five largest banking groups in the total banking assets of the fifteen members of the European Union was estimated at 11 per cent for Germany, 10 per cent for France, 8 per cent for the United Kingdom and 4 per cent for Italy.

The privatization of the banking system has accelerated considerably in Italy, increasing the contestability of bank ownership. The change in the ownership structure of public sector banks and the process of concentration under way in the system involve banks that account for 49 per cent of total domestic lending. Once the operations now in progress have been completed, the share of funds intermediated by banks and banking groups controlled by the government, local authorities or banking foundations will fall to 25 per cent, compared with 68 per cent in 1992.

Concentration within the sector has strengthened the more competitive intermediaries and reduced the geographical segmentation of markets, helping to improve the tenor of competition in the supply of banking services. Increasingly uniform regulations, the privatization of large sections of the banking industry, the progress made in improving the transparency and circulation of financial information, and the use of new marketing techniques that are less and less tied to local branch networks have greatly increased the price sensitivity of demand for financial products. In general, customers in local markets are increasingly able to choose among financial services offered by a plurality of banks. Where evidence of the reinforcement of positions which are potentially harmful to competition has been found, the Bank of Italy, as the competition authority for the banking industry, has taken steps to remove the distortionary elements in price determination.

The approval of the Consolidated Law on Financial Markets, which completes the reorganization and simplification of legislation that began with the passage of the 1993 Banking Law, has improved the possibility of competing on an equal footing in the single market in financial services. The autonomy and organizational flexibility of intermediaries and markets have been enhanced by the confirmation of the private nature of the financial markets. The model of corporate control has been updated on the basis of international standards by introducing a series of innovations regarding take-over bids, voting proxies, the protection of minority interests and internal controls.

Greater efficiency in the production of financial services will be fostered by the removal of legislative constraints on the diversification of asset management products, by the rule enabling the same institutions to engage in both individual and collective portfolio management, and by the provisions allowing the management and distribution of financial products to be performed by different entities and delegated to third parties. With regard to controls, the Consolidated Law on Financial Markets revised the supervisory provisions applicable to the different types of intermediary and confirmed the principle of allocating supervisory tasks according to purpose, entrusting the Bank of Italy with responsibility for safeguarding financial stability and the containment of risk and Consob with the duty of ensuring transparency and proper conduct.

THE REGULATORY FRAMEWORK

EU legislation and international cooperation

Progress was made in updating European Union rules on prudential supervision in the financial intermediation sector. The European Council adopted a common position on three proposed directives amending the EU provisions primarily regarding capital requirements.

The European Commission prepared a draft directive revising EU provisions on collective securities portfolio management (EEC Directive 85/611 of 20 December 1985). The draft defines the general rules for engaging in management activity, extends the list of harmonized products and establishes minimum requirements for them.

In order to strengthen international financial stability, especially in the emerging economies, in September 1997 the Basle Committee published the final version of the Core Principles for Effective Banking Supervision. Supervisory authorities throughout the world were asked to adhere to the principles by October 1998 and to promote the appropriate legislative changes required to implement them.

With the aim of calling attention to the risks of operational malfunction connected with the year 2000, the Basle Committee, the International Organization of Securities Commissions (IOSCO) and the International Association of Insurance Supervisors (IAIS) issued a joint communiqué urging financial institutions around the world to move quickly in preparing plans of action to ensure there is no interruption in the operation of computer procedures. The Basle Committee will closely monitor the initiatives taken by authorities in order to verify that supervised institutions are prepared for the date change.

Italian legislation

The Consolidated Law on Financial Markets (Legislative Decree 58 of 24 February 1998), which will enter into force on 1 July, modernizes and

reorganizes Italian legislation governing securities intermediaries, financial markets and issuers. The legislative decree was drafted by a committee established at the Treasury Ministry in whose proceedings the Bank of Italy participated.

Securities intermediaries. - The reorganization of the provisions concerning intermediaries seeks to delineate a legislative framework that will permit Italian intermediaries to compete on an equal footing in the single market for financial services.

The consolidated law confirms the innovations introduced in 1996 with the incorporation in Italian legislation of EEC Directive 93/22 of 10 May 1993 on investment services in the securities field. However, it amends the provisions on restricted activities by extending the possibility to provide individual portfolio management services to asset management companies and introduces new rules with regard to consolidated supervision.

The regulations governing collective asset management have been completely revised in order to enable domestic intermediaries to diversify and enhance the range of products they offer and to adopt more efficient organizational structures. The legal constraints on product diversification in the activity of portfolio management have been removed, while responsibility for all matters relating to the structure and operations of investment funds has been delegated to administrative authorities.

The consolidated law gives intermediaries broad discretion in organizational matters. Asset management companies are allowed to engage in both individual and collective portfolio management, acting as a “single manager”, and may also choose whether to engage in both the marketing and management of funds or to separate the two activities. Securities firms, banks and management companies can offer individual portfolio management services both directly and, with the customer’s prior written authorization, by entrusting the task to others.

Taking the law on securities firms as a model, the consolidated law establishes uniform supervisory rules, provisions on ownership structures and crisis procedures for all the intermediaries it governs.

The objectives of supervisory activity are transparency, proper conduct and the sound and prudent management of the supervised institutions, having regard to the protection of investors and to the stability, competitiveness and effective functioning of the financial system.

The principle of dividing supervisory responsibility according to objectives is respected, with the Bank of Italy being entrusted with safeguarding stability and containing risk and Consob with ensuring transparency and proper conduct.

The decisions regarding crisis procedures are adopted by the Minister of the Treasury, acting on a proposal from the Bank of Italy or Consob; responsibility for directing the procedures and performing the related duties is assigned to the Bank of Italy. The precautionary measures already provided for in the case of securities firms - suspension of the administrative bodies and appointment of a provisional administrator to manage the firm - are extended to asset management companies and SICAVs.

Financial markets. - The consolidated law completes the innovations introduced by Legislative Decree 415 of 23 July 1996, which in transposing the EU's Investment Services and Capital Adequacy Directives had ended the securities markets' status as public institutions, entrusting the organization and management of the markets to entities established under private law and endowed with self-regulatory powers, although they are still subject to control by the supervisory authorities.

In view of the importance of certain markets for the exercise of monetary policy, supervision of the wholesale market in government securities is expressly assigned to the Bank of Italy; the Bank's powers of control also extend to trading in interbank deposits.

Securities issuers. - The provisions concerning issuers complete the regulations governing the securities market with rules concerning public disclosure and the organization of listed companies. A model of corporate governance based on international standards has been adopted.

The provisions on takeover bids for listed companies have been simplified, reconciling the need to permit change of corporate control with the protection of minority shareholders. The new rules are based on the obligation for a party to bid for all of a company's ordinary shares once it has purchased more than 30 per cent of the company's capital. The procedures for takeover bids are to be established in regulations issued by Consob. Other significant innovations are the admission of an auction system for competing bids and the possibility for the shareholders' meeting to authorize defensive tactics against hostile bids.

The price offered to shareholders may not be lower than the arithmetic mean of the weighted average market price in the preceding twelve months and the highest value offered by the party making the bid in the same period. The mandatory bid rule also applies to shareholders who have made concerted acquisitions.

In the area of corporate disclosure, the scope of some reporting requirements has been broadened to cover unlisted companies that have

issued widely held financial instruments. To contain the disclosure costs connected with operating in a multiplicity of markets, the consolidated law allows Italian companies that are also listed in foreign markets to draw up a single set of consolidated accounts according to internationally accepted standards.

With the aim of rendering the ownership of listed companies transparent, the consolidated law confirms the requirement to notify Consob of equity interests that exceed 2 per cent. The same threshold is also maintained with regard to the prohibition on cross-holdings. Nevertheless, with a view to facilitating the formation of industrial alliances, if the acquisition is authorized by the general meetings of both companies the limit on cross-holdings is raised to 5 per cent.

The consolidated law has enhanced the transparency of shareholder agreements, limiting their maximum duration to three years. If the parties have not fixed an expiry date for the agreement, they may withdraw at any time after giving notice.

Shareholders with at least a 1 per cent interest in a company may engage qualified intermediaries (banks, securities firms, asset management companies, SICAVs or specialized firms) to solicit proxies from the other shareholders for use in the general meeting. The votes for which proxies have been collected are cast by the delegated shareholder or, at the latter's behest, by the intermediary that was engaged to carry out the solicitation.

The role of a listed company's board of auditors in exercising control on the running of the company is strengthened by rationalizing the division of accounting-related tasks between the board and the external auditors. The external auditors are charged with examining the accounts, while the board is assigned higher-profile controls, i.e. testing the adequacy of the administrative and accounting procedures and, in particular, the reliability of the latter in giving a true and fair view of the company's operations.

In connection with the reorganization of accounts-related tasks for listed companies and with the aim of implementing EC Directive 95/26 of 29 June 1995 (the so-called BCCI Directive), disclosure requirements in respect of the supervisory authorities have been introduced for those who are legally charged with auditing the accounts of financial undertakings (banks, securities firms, asset management companies, SICAVs).

The provisions concerning insider trading have been amended, with the safeguards now based on the privileged rather than the merely confidential nature of the information used. For a crime to be committed, there has to be a causal link between possession of the inside information and the carrying out of the transaction.

Legislative Decree 153 of 26 May 1997 incorporated EEC Directive 91/308 of 10 June 1991 on the laundering of proceeds from criminal

activities into Italian law and amended Law 197 of 5 July 1991. The decree provides for the Italian Foreign Exchange Office, to which the banking and financial system sends reports of suspected money-laundering transactions, to avail itself of the cooperation of the supervisory authorities for the sector in assessing such reports.

Secondary legislation

Banks. - The supervisory rules on the compulsory reserves were made consistent with the new possibilities offered by the BI-REL gross settlement system. In particular, banks are now allowed to draw on their reserve accounts beyond the daily mobilization limit, provided the end-of-day balance is above that limit. In addition, the definition of non-compliance with the reserve requirement was restricted to cases where banks fail to meet the average reserve requirement.

In February 1998 the rules on supervisory capital were amended to take account of the growing difference between the market value and the book value of banks' equity investments.

Securities firms. - A regulation issued by the Governor on 30 September 1997 completed the set of measures within the competence of the Bank of Italy implementing Legislative Decree 415 of 23 July 1996.

The regulation, which concerns the organization of securities firms, eases the requirement to separate assets held on own and on customers' account, limiting its scope to the firms' asset management business. It also eliminates the requirement that banks keep investment services separate from banking activities.

The regulation also lays down the organizational requirements governing these intermediaries' accounting information systems, risk management procedures and internal controls. These are minimum rules that do not cover all of the actions that intermediaries must undertake to ensure that they have reliable structures suitable to the business conducted and the risks taken.

With the broadening of the range of companies in which securities firms may take equity interests, they have been allowed to form groups in order to expand their activities.

The financial intermediaries entered in the special register may engage in trading in derivative financial instruments for their own account or in

securities placement only if there is a functional link between their principal financial activity and their securities business. Trading for own account is open only to institutions engaged in foreign exchange intermediation, lending or equity investment. The latter two categories of institution are also allowed to engage in the placement of financial instruments. The prudential rules and rules of conduct governing securities firms are extended to all of the above intermediaries.

Investment funds. - A measure issued by the Governor on 18 September 1997 modifies the regulations governing closed-end real estate investment funds, implementing the changes in the provisions on funds established with contributions of real estate from the State and other public sector institutions introduced by Law 662 of 23 December 1996.

Management of pension funds by financial intermediaries. - In August 1997 capital adequacy requirements were established for banks, securities firms and investment fund management companies that intend to manage “closed” supplementary pension funds or to institute and manage “open” pension funds pursuant to Legislative Decree 124 of 21 April 1993.

THE STRUCTURE OF THE FINANCIAL SYSTEM

Banks and banking groups

Mergers and acquisitions. - As in other countries in continental Europe, the growing pressure of competition has accelerated the process of consolidation in the Italian banking industry in recent years. The average number of mergers and acquisitions rose from 12 per year in the early nineties to 17 in 1994-97 and from 27 to 39 if mutual banks are counted. Excluding the latter, a total of 112 such operations have been carried out in the nineties, involving in the two periods respectively 4 and 7 per cent of banks and 5 and 7 per cent of total assets. Last year saw an increase in the importance of acquisitions of majority equity interests.

Developments in 1997. - The privatization of Italy's public sector banks has been accompanied by an increase in the number of mergers involving major banks. The operations already completed and those in the pipeline are giving birth to groups whose size and range of products will enable them to compete in Europe and at the same time creating the conditions for the rationalization of both production processes and group structures.

When the foregoing operations have all been implemented, banks and groups controlled by the State, local authorities and foundations will account for 25 of the total assets of the banking system, compared with 68 per cent at the end of 1992.

A total of 47 consolidations were carried out in 1997, one of which took effect on 1 January 1998. Almost half the banks that were absorbed had serious anomalies and more than three quarters of these were based in the South. The number of consolidations involving banks other than mutual banks remained at the high levels of recent years; more than 60 per cent consisted in the acquisition of a controlling interest and the subsequent inclusion of the subsidiary in the group of the acquiring bank. By contrast, the number of mergers between mutual banks declined from 26 to 12.

Last year 30 new banks opened for business, compared with 15 in 1996: of these, 12 were mutual banks, 9 the result of the transformation of securities firms or financial companies and 6 branches of foreign banks. At the end of 1997 there were 935 banks operating in Italy (Table 53).

Table 53

THE ITALIAN BANKING SYSTEM

	At end-1996			Changes in 1997 (1)		At end-1997		
	No. of banks	No. of branches		New registrations	Cancellations	No. of banks	No. of branches	
		Italy	Abroad				Italy	Abroad
Limited company banks accepting short-term funds	176	17,524	91	23	9	190	18,026	93
Limited company banks accepting medium and long-term funds (2)	33	86	–	–	1	32	98	–
Cooperative banks (<i>banche popolari</i>)	80	4,163	9	1	12	69	4,357	9
Mutual banks (<i>banche di credito cooperativo</i>)	591	2,530	–	12	20	583	2,659	–
Central credit and refinancing institutions	6	28	–	–	–	6	28	–
Branches of foreign banks . . .	51	75	–	6	2	55	82	–
Total	937	24,406	100	42	44	935	25,250	102
In the process of opening . . .	7	558	4	–	–	6	449	1

(1) Includes changes due to the creation of new banks, closures, mergers and changes in institutional category. – (2) Includes *Istituto per il credito sportivo*.

At the end of 1997 there were 28 Italian banking groups operating abroad through branches or subsidiaries. The number of foreign branches rose by two to 102; of the total 52 were in EU countries. The number of banking subsidiaries abroad rose by one to 56.

The number of foreign banks with branches in Italy rose from 51 to 55 and the number of branches from 75 to 82. Some of these banks hold significant market shares in securities intermediation and in some of the more innovative sectors. Six Italian banks are owned by foreign banking groups, of which 4 are EU-based.

Branch networks. - Banks increasingly differentiated their distribution systems by adapting them to the requirements of different customer groups and made growing use of new distribution channels in order to reduce unit transaction costs and exploit market niches opened up by technological

developments. New banks are being established that operate either wholly or mostly without the support of a branch network.

Some 844 branches were opened last year, about 120 fewer than in 1996 (Table 53). Over the last five years the number of branches has risen from around 20,900 to 25,250, although the annual rate of increase has fallen steadily and was 3.5 per cent in 1997.

There continues to be rapid growth in POS installations and ATMs, which allow banks to streamline their counter operations and reduce transaction costs. In the last five years the number of ATMs has grown from 14,200 to more than 25,300 and POS installations have increased from 64,600 to 280,200. The number of transactions handled is growing fast but is still smaller than in the other leading industrialized countries.

There was also rapid growth in remote banking services that enable firms to carry transactions directly. At the end of 1997 more than 300 banks offered such facilities, an increase of around one third; the number of firms connected rose by over 30 per cent to nearly 150,000.

Telephone banking expanded considerably in 1997. The number of banks offering this service rose from 23 to 113 and more than one million customers have signed up. Thirteen banks now offer almost 260,000 customers the possibility of obtaining information and carrying out transactions.

Securities intermediaries

Undertakings for collective investment in transferable securities (UCITS). - At the end of 1997 there were 53 open-end investment fund management companies and one open-end investment company (SICAV), so that the situation in the sector was practically unchanged compared with the end of 1996 (Table 54).

Subscriptions increased by 150 per cent to 143.1 trillion lire and assets under management rose from 197 to 367.4 trillion. The growth continued in the first quarter of 1998, at the end of which assets under management exceeded 500 trillion.

The 35 bank-controlled management companies accounted for 89 per cent of net subscriptions and 84 per cent of total assets (compared with 79 per cent at the end of 1996). The degree of concentration increased further, with the market share of the five largest companies rising from 40 to 42 per cent.

Table 54

UNDERTAKINGS FOR COLLECTIVE INVESTMENT

	1996		1997	
	Total	of which: bank-controlled (1)	Total	of which: bank-controlled (1)
Italian open-end securities investment fund management companies and SICAVs	58	34	59	37
<i>operational</i> (2)	55	33	54	35
Authorized funds and sectors	665	481	749	569
Operational funds and sectors	533	377	630	479
<i>equity</i>	236	164	279	210
<i>mixed</i>	57	39	54	38
<i>bond</i>	161	112	202	155
<i>money market</i>	79	62	95	76
Foreign management companies and SICAVs (3)	77	....	86	....
Funds and sectors marketed in Italy	548	....	694	....
<i>equity</i>	276	....	343	....
<i>mixed</i>	44	....	59	....
<i>bond</i>	176	....	220	....
<i>money market</i>	52	....	72	....
Italian closed-end securities investment fund management companies	7	7	9	8
<i>operational</i> (2)	3	3	4	4
Authorized funds	7	7	9	8
<i>operational</i>	3	3	4	4
Italian closed-end real-estate investment fund management companies	-	-	1	1
Authorized funds	-	-	1	1

(1) Management companies in which banks have an equity interest of more than 50 per cent. – (2) Includes one multi-sector SICAV with four sectors (two equity, one bond and one money market). – (3) Companies that offer their shares in Italy under Article 10-bis of Law 77 of 23 March 1983, as amended by Legislative Decree 83 of 25 January 1992.

Securities firms. - The number of securities firms in operation fell by 24 to 212, since 27 firms ceased activity and 3 new ones were constituted (Table 55). At the end of the year 80 firms were controlled by banks, 18 belonged to insurance groups and 41 were subsidiaries of foreign companies. The reduction in the number of intermediaries was mostly the result of a rationalization of the system that included the voluntary withdrawal from the market by small unprofitable firms and restructurings and mergers within Italian and foreign groups.

Table 55

ITALIAN SECURITIES FIRMS' ACTIVITIES (1)

	Authorized		Authorized	
	at 31.12.1996	of which: operational	at 31.12.1997	of which: operational
Trading for own account	90	90	79	77
Trading on behalf of customers	94	93	81	79
Underwriting	43	41	43	40
Placement	116	111	118	110
Individual portfolio management	116	112	114	108
Reception of orders and mediation	102	99	93	86
Total	236	233	212	210
(1) From 1996 onwards the expression Italian securities firms comprises trust companies. Legislative Decree 415/1996 made the latter equivalent to securities firms operating in the portfolio management sector.				

At the end of the year four Italian securities firms were using their “European passports” to operate elsewhere in the Union. Two had branches abroad, one was doing business under the freedom to provide services, and the fourth had adopted both solutions. During the year 43 EU investment firms notified their intention of doing business in Italy.

Financial companies

At the end of 1997 there were 219 registered financial companies subject to supervision by the Bank of Italy. This sector also saw extensive rationalization within groups to improve competitiveness, leading to the creation of some of the largest companies. The intermediaries that completed or began mergers during the year accounted for 28 per cent of total lending.

RISKS, PROFITABILITY AND CAPITAL ADEQUACY OF INTERMEDIARIES

Banks

Credit risk. - The improved profitability of Italian firms in 1995 and 1996 was reflected in the quality of banks' loan portfolios in 1997, with a marked slowdown in the growth of bad debts.

Multivariate analyses of the 36,000 non-financial companies surveyed by the Company Accounts Data Service showed that the share of total bank borrowings accounted for by high-risk companies declined in 1996 to 20 per cent, its lowest level since 1989.

Bad debts increased by 8.8 trillion lire or 6.9 per cent in 1997, a slowdown of more than 5 percentage points compared with the 12 per cent increase in 1996 and less than a third of the average of 25 per cent for 1994 and 1995. The improvement involved banks of all sizes, with growth slowing from 12.4 to 7.3 per cent for larger banks and from 10.8 to 5 per cent for minor banks. The deceleration for banks in the South of Italy was from 26.3 to 10 per cent.

The growth in bad debts reported above was calculated including the 9 trillion lire of claims transferred by Banco di Napoli to Società di Gestione di Attività S.p.A. and the 2.8 trillion of claims left with the liquidators of Sicilcassa.

Gross of value adjustments, bad debts amounted to 124.9 trillion lire in December 1997, or 2.3 per cent less than a year earlier (Table 56), and declined from 10 to 9.2 per cent of outstanding loans. If the assets transferred by Banco di Napoli and those still held by Sicilcassa are included, the ratio is about the same as at the end of 1996.

The improvement in asset quality in 1997 is confirmed by data that include all the exposures to borrowers that only some banks classify as being at risk ("adjusted bad debts"). Last year this measure declined to 111.1 per cent of the unadjusted figure, compared with a peak of 128.9 per cent in 1993.

Table 56

BANKS: BAD AND DOUBTFUL DEBTS AND TOTAL LOANS (1) (2)*(end-of-period amounts in billions of lire)*

	Banks accepting short-term funds			Banks accepting medium and long-term funds			Total		
	Bad debts (3)	Doubtful debts (4)	Total loans (3)	Bad debts (3)	Doubtful debts (4)	Total loans (3)	Bad debts (3)	Doubtful debts (4)	Total loans (3)
1993 ..	62,771	44,692	933,703	10,275	9,399	232,151	73,046	54,091	1,165,854
1994 ..	80,532	45,853	957,510	13,522	8,719	237,938	94,054	54,572	1,195,448
1995 ..	98,669	42,849	1,027,871	15,382	6,582	233,772	114,050	49,431	1,261,643
1996 ..	109,936	44,485	1,058,197	17,932	6,683	225,072	127,868	51,168	1,283,269
1997 ..	106,000	39,796	1,138,441	18,899	6,091	225,772	124,899	45,887	1,364,213

(1) Loans to resident customers of banks operating in Italy and Italian banks' branches abroad. - (2) The classification of banks is that which was in force in 1997; merged banks have been considered as belonging to the category of the bank with which they were merged. - (3) Includes protested bills. - (4) For banks accepting medium and long-term funds, until 1994 the figure refers to the statistical item "loans overdue by more than 6 months".

The growth of bad debts in 1997 was attributable mainly to two sectors: consumer households, whose bad debts increased by 12 per cent, and the construction industry, which recorded an increase of 17 per cent.

Last year saw a further reduction in the concentration of lending to individual borrowers and groups. Large exposures amounted to 116.9 trillion lire in September, compared with 130.6 trillion a year earlier. The amount in excess of the ceiling of 40 per cent of capital and reserves, which came into force at the beginning of 1997, was equal to 8.7 trillion lire and is expected to be eliminated by the end of the year. In September 1996 the overshoot with respect to the 40 per cent ceiling had been about 20 trillion lire.

The international financial markets' development of asset securitization techniques and credit derivatives provides intermediaries with new ways to manage credit risk. Since 1994 some 4.6 trillion lire of securities have been issued in connection with the transfer of claims by Italian residents. The securitized credits of banks and financial companies subject to supervision amounted to just over 3 trillion. To date, such operations have been organized by foreign intermediaries.

Country risk. - In December 1997 Italian banks' loans subject to prudential value adjustment under the supervisory rules on country risk - those not guaranteed by OECD countries (or guaranteed by OECD countries that have rescheduled their debt within the last five years) -

amounted to 22.9 trillion lire, including 5.2 trillion of short-term trade credits. The increase of 6 trillion since December 1996 was partly due to the inclusion of loans to South Korea. The required value adjustments amounted to 1.7 trillion lire, about 200 billion less than in 1996, reflecting a sharp decrease in the adjustment to loans to the countries of Central and Eastern Europe.

The Italian banking system's exposure to the Asian countries most severely affected by the recent financial crisis has remained roughly stable in the last few years. At the end of 1997 outstanding loans totaled some 3.6 trillion lire. Virtually none of this debt is secured and about two thirds is short-term.

Profitability. - A decrease in net interest income combined with the rigidity of operating expenses led to a deterioration in banks' profitability. Very substantial loan losses, mostly attributable to three large institutions, accentuated the system's decline in profits.

Net interest income fell by 5.1 per cent to 65.9 trillion lire. The increase in the volume of funds intermediated failed to compensate for the narrowing of the spread between the average return on assets and the average cost of liabilities.

The decline in net interest income was almost fully offset by an increase in income from services, primarily asset management. The overall increase in income came to 3.8 trillion lire, even though income from securities trading, while remaining at a high level, declined by 2 trillion. Gross income amounted to 96.8 trillion lire.

Operating costs rose by 2.9 per cent to 66.4 trillion lire; about one third of the increase consisted of contributions to the Interbank Deposit Guarantee Fund to cover the payments it made in 1997. In relation to gross income, operating costs rose by more than 2 percentage points to 68.6 per cent.

Staff costs, including the extraordinary expense incurred in connection with early retirement schemes, remained unchanged at 41.1 trillion lire.

Net income fell by 2.1 trillion lire, or 6.5 per cent, to 30.4 trillion (Tables 57 and a32). Banks located in the Centre and North accounted for most of the fall; those located in the South recorded an increase of 700 billion lire, or more than 40 per cent.

A decline in value adjustments to securities and equity investments and an increase in capital gains on disposals of real estate and equity investments helped to produce extraordinary income of 1.1 trillion lire, compared with extraordinary expense of 2 trillion in 1996.

Table 57

SELECTED INDICATORS FOR ITALIAN BANKS
BY GEOGRAPHICAL AREA (1)
(amounts in billions of lire)

	Centre and North		South		Total	
	1996	1997	1996	1997	1996	1997
Net income	30,769	27,914	1,760	2,494	32,529	30,408
Charges for loan losses	8,902	11,889	2,394	2,249	11,296	14,138
ROE (<i>percentages</i>)	5.4	1.7	-12.5	0.3	3.8	1.6
Allocations to supervisory capital	6,931	846	-2,534	-91	4,397	755
Supervisory capital	186,185	194,214	16,476	18,023	202,660	212,237
Solvency ratio (<i>percentages</i>) (2)	13.2	12.5	10.6	14.6	13.0	12.7
Excess amounts (2)	73,498	71,141	7,269	8,244	80,767	79,385
Shortfalls (2)	301	1,497	3,249	111	3,550	1,608

(1) See the notes to Statistical tables a32, a33 and a34. - (2) Excluding the branches of foreign banks.

Net of withdrawals from loan loss provisions and value readjustments, loan losses increased by 2.8 trillion lire. The substantial rise was due entirely to the value adjustments effected by Banca Nazionale del Lavoro, Banca di Roma and Istituto San Paolo di Torino, partly in connection with the continuing weakness of the real estate sector.

Income taxes decreased by 400 billion lire, or 4.5 per cent. Dividends amounted to 4.7 trillion lire.

Allocations to supervisory capital amounted to 800 billion lire, a decrease of 3.6 trillion.

Banks again failed to take sufficiently rapid action to curb costs in response to the squeeze on margins produced by increased competition.

Italian banks' return on equity fell to 1.6 per cent, less than half the figure for 1996.

Efforts to curb staff costs centred on lowering manning levels; the number of bank employees decreased in 1997 by 7,000, or 2 per cent. The reduction in staff was largely due to the early departure of employees near retirement age in response to incentive schemes.

Automatic salary mechanisms and increases under the banking industry's collective bargaining agreement, now in its final year, almost entirely offset the effect of the departure of senior employees, which thus did not result in a reduction in staff costs per employee.

In June 1997, with a view to launching a radical reform of the banking system to close the gap in profitability and competitiveness compared with the banking industries in the other leading European countries, banking employers and trade unions signed a protocol of understanding in the presence of the Government.

In February 1998 a framework agreement for the implementation of the June protocol was signed, establishing the guidelines for the forthcoming renewal of the national labour contract. The agreement establishes the objective for the new contract of significantly reducing the ratio of staff costs to gross income by 2001 with the aim of reaching a level comparable with the average for the main European banking systems. The agreement also provides for access to a specially constituted banking system solidarity fund in cases of temporary or structural redundancies.

Capital adequacy. - The supervisory capital of the banking system, measured on a solo basis, increased by 9.6 trillion lire or 4.7 per cent to 212.2 trillion at the end of the year. As in 1996, banks located in the Centre and North of the country accounted for most of the growth (8 trillion); those in the South recorded an increase of 1.6 trillion, compared with a decrease of 1.2 trillion in 1996.

Individual banks' solvency ratio, adjusted to take account of market risks, averaged 12.7 per cent at the end of 1997, down slightly from 13 per cent a year earlier (Table a34).

The amounts in excess of the minimum capital requirements, calculated on the basis of the 8 per cent minimum and ignoring the lower requirement of 7 per cent for institutions belonging to banking groups and any special requirements, decreased by 1.4 trillion lire to 79.4 trillion. The shortfalls diminished by 1.9 trillion to 1.6 trillion.

The charge for market risks was 3.6 per cent of total supervisory capital, more than half a percentage point higher than in 1996.

On a consolidated basis, the capital adequacy of the Italian banking system is in line with the situation in other European countries. The average solvency ratio rose to 12.4 per cent in June 1997, the most recent date for which reports are available, compared with 12.6 per cent in the rest of Europe. The improvement in the Italian ratio with respect to June 1996 mainly concerned banks located in the South, whose ratio rose by 1.6 percentage points owing to a significant reduction in the risk-weighted exposures of troubled institutions.

The flexibility of the system's financial structure improved in the year ending in June 1997. The banks' free capital amounted to 15.8 trillion lire on a consolidated basis, compared with 6.4 trillion in June 1996.

Investment fund management companies

Assets under management increased by 86 per cent during the year, with a positive impact on the profitability of the open-end investment fund management companies. Their net income (excluding financial income and before allocations to provisions and depreciation) rose by 68 per cent to 819 billion lire. Net income from their management activities increased by 51 per cent.

Total net income as a percentage of average assets under management fell from 0.32 to 0.3 per cent, despite an increase in management commissions from 1.22 to 1.34 per cent.

The net income of the non-bank companies improved from 0.54 to 0.6 per cent of average assets under management, owing to an increase in management commissions from 1.5 to 1.7 per cent; the bank-owned companies registered a decline in average commissions from 0.25 to 0.23 per cent.

Operating costs were again proportionally lower for the larger management companies, where they fell from 0.22 to 0.17 per cent of average assets under management; for medium-sized companies the ratio rose from 0.44 to 0.54 per cent.

Securities firms

Profitability. - The net profits of securities firms nearly tripled last year to stand at 501 billion lire. Revenues rose by 500 billion lire, or 25 per cent, to 2.7 trillion, while operating costs rose by 3 per cent. The largest contribution (41.2 per cent of the total, 5.4 points more than in 1996) came from trading on customers' account. There was also a sharp improvement in earnings from portfolio management services and door-to-door selling, which together accounted for 33 per cent of total revenues as against 30 per cent in 1996.

The return on equity rose sharply from 5.6 to 15.5 per cent. Bank-controlled firms were more profitable than others owing to the advantages of belonging to a group, such as lower cost of debt and economies deriving from use of the group's administrative and marketing structures.

Capital and risks. - The supervisory capital of securities firms decreased by 6.6 per cent, as a result of a reduction in the number of firms.

Considering only those that were operational for the entire year, supervisory capital actually increased by 10.2 per cent. Tier one capital was the main component of supervisory capital, accounting for nearly 90 per cent of the total.

The supervisory capital of firms that traded for own account was 2.8 times the requirement for risks subject to capital charges, compared with a ratio of 3.7 in 1996. The proportion of capital charges in respect of market risks rose from 64.5 to 72.1 per cent of the total. The main components were general risk on debt securities (20.9 per cent of the total), large exposure risk (20.3 per cent) and counterparty risk (15.7 per cent); the charges in respect of structural costs amounted to 10 per cent of the total.

Financial companies

Risks. - The total lending of the financial companies entered in the special register of financial intermediaries subject to Bank of Italy supervision referred to in Article 107 of the 1993 Banking Law amounted to 116.6 trillion lire at the end of the year, including 11.9 trillion of guarantees and commitments. Their loan portfolios comprised 3.65 trillion lire of bad debts, or 2.07 trillion net of value adjustments.

Profitability. - Registered financial companies recorded a net profit of 650 billion lire in 1997, compared with a loss of 70 billion in 1996; the return on equity was equal to nearly 10 per cent.

Capital. - At the end of the year the companies' total supervisory capital amounted to 8.69 trillion lire and consisted almost entirely of capital and reserves (94 per cent).

SUPERVISORY CONTROLS

Banking supervision

Analytical tools. - In line with the trends in the international sphere, indications are being obtained experimentally on certain fields of activity using information and risk evaluation methods that banks have developed internally. This approach, which was first adopted for the measurement of market risks, takes account of the difficulty of building models that are appropriate for all banks and of the need to minimize the related costs.

Studies were carried out during the year aimed at defining new peer groups on the basis of banks' operational features. In addition to the continued existence of forms of institutional specialization, there is statistically significant evidence of groupings that are partly independent of banks' size. The new classification will be used in experimental analyses in 1998.

Prudential analysis of banks' situations. - The picture that emerges from the evaluations carried out by the Bank's supervisory units in 1997 is not dissimilar from that of the previous year in terms of average values, although there was some increase in the proportion of intermediate scores. The banks that received a negative evaluation (scores of 4 or 5) decreased from 20 to 18 per cent with reference to the total borrowed funds of the banking system, whereas in purely numerical terms the proportion remained unchanged at around 18 per cent. The borrowed funds of banks with significant weaknesses in some technical indicators (a score of 3) rose from 43 to 49 per cent of the total; in numerical terms the proportion of such banks increased from 32 to 34 per cent. The banks awarded a clean bill of health (scores of 1 or 2) declined in numerical terms from 50 to 48 per cent of the total and in terms of borrowed funds from 37 to 33 per cent. The changes that occurred in the distribution based on these scores are evidence of the difficulties banks face in restoring adequate levels of operational efficiency and maintaining high profit margins in an increasingly competitive environment.

Credit risk and organizational structure continued to be the areas of evaluation with the most severe problems. The average score for these aspects was equal to 3, as in 1996. In the South the riskiness of the loan portfolios of 7 out of 10 banks was deemed unsatisfactory.

Remedial action. - In 1997 the Bank of Italy took action, in the form of meetings or letters, involving 470 banks. For the first time the number of meetings exceeded the number of letters. The latter continue to be used to call formally for corrective measures to overcome shortcomings revealed during inspections, prudential analysis or meetings.

Many more sectoral meetings were held last year, notably to discuss problems concerning lending, organizational structure and internal controls. The action taken involved 50 larger banks and banking groups, more than three times as many as in 1996.

Special attention was paid to banks' information technology systems, in particular in order to verify the adequacy of the measures adopted to cope with the introduction of the euro and the Year 2000. As regards the impact of these problems on costs, a survey conducted by the Bank of Italy showed that fewer than half of Italian banks were in a position to provide estimates. For the banks that did respond, which represented three quarters of the banking system's total borrowed funds, the cost is expected to be around 2.7 trillion lire, or 5.5 per cent of their total operating costs in 1996.

A total of 288 banks received one or more letters in 1997. As in the previous year, the majority of these formal invitations to take corrective measures concerned credit risk, organizational structure and, less frequently, profitability.

Action with regard to banks' capital focused primarily on the cases where own funds were below the level that would have been necessary for the bank to be established. In December of last year, which marked the end of the transitional period granted to comply with the minimum capital requirements, nearly all of the 65 banks with insufficient capital when the regulations came into force had corrected the situation, either by merging with another bank or, in a minority of cases, by raising additional capital.

On-site controls

Inspections serve to evaluate banks' capital strength, profitability and liquidity, as well as their organizational structure and internal controls, and involve the scrutiny of some or all of the different sectors of operations

(lending, fund-raising, securities business, services, etc.). They also serve to check the procedures adopted to comply with the statutory provisions on money laundering, the transparency of contractual conditions and usury. Depending on the scope of the controls carried out, inspections are classified as general or sectoral; the former are concerned with banks' overall performance, while the latter focus on specific sectors of operations or types of risks.

Controls were extended last year to include banks' participation in the payment system in compliance with Article 146 of the 1993 Banking Law, which entrusted the oversight of such systems to the Bank of Italy.

A total of 197 inspections were carried out in 1997, three less than in 1996. The controls involving banking groups and non-bank intermediaries were intensified. The 165 banks at which general inspections were carried out represented 17 per cent of Italian banks and 13 per cent of the system's total assets, compared with respectively 20 and 11 per cent in 1996.

The distribution of the overall evaluations resulting from inspections was broadly in line with that for the five years 1992-96. In particular, the proportion of unfavourable assessments remained high (28 per cent). The banks in question were mostly small and located in the South; the shortcomings most frequently cited were the poor quality of assets, unsatisfactory profitability and inadequate internal controls. Inspections led to the application of sanctions at nine banks, of which eight were located in the South.

The on-site verifications carried out on a consolidated basis in accordance with Article 68 of the 1993 Banking Law revealed weaknesses in the strategic control of groups that derived in part from shortcomings in planning systems and the procedures for monitoring the operations and results of subsidiaries.

The inspections of non-bank intermediaries involved six securities firms, two investment fund management companies, one leasing company, one factoring company and five other financial companies (three of which had applied for a banking licence).

Crisis procedures. - Nine banks were placed under special administration last year; seven were mutual banks (*banche di credito cooperativo*), one a limited company bank and one a cooperative bank (*banca popolare*). Special administration was terminated at eight banks; in only one case did the measures adopted by the bodies responsible for the procedure allow the bank to be returned to ordinary administration. At the end of the year seven banks were still under special administration.

Five banks were placed in compulsory administrative liquidation in 1997. In four cases this followed a period of special administration.

After one year the special administration of Sicilcassa was prolonged in March 1997. In the months that followed none of the solutions proposed by the shareholders to revive the bank proved feasible and it had to be placed in compulsory administrative liquidation. The crisis was prevented from having adverse effects on depositors and borrowers by the transfer to Banco di Sicilia of Sicilcassa's assets and liabilities, except for around 1.5 trillion lire of bad debts, which were left with the liquidators. The size of the failure made it necessary to supplement the intervention of the Interbank Deposit Protection Fund by taking the action provided for in a Ministerial Decree of 27 September 1974 on the basis of the resolution recognizing a special case of general interest adopted by the Interministerial Committee for Credit and Savings on 5 September 1997.

The regulatory system established by Legislative Decree 415/1996 came into force in 1997, including the introduction of compulsory administrative liquidation for Italian securities firms and the attribution to the Bank of Italy of responsibility for implementing crisis procedures in this field.

Six securities firms were placed in special administration in 1997 and in four of these cases the procedure was closed within the year.

Special procedures. - Last year saw further progress in the liquidation of Isveimer and the start of operations by SGA S.p.A., the collection company set up under the plan for rescuing Banco di Napoli approved by Law 588 of 19 November 1996.

The first provisional accounts of the liquidation of Isveimer for the period ending 31 December 1996 showed liabilities some 1,775 billion lire in excess of assets, which corresponds to the estimate of the present value of the final loss at the end of the liquidation. The results for the 1997 fiscal year were in line with the estimate of the total loss indicated the previous year. The shortfall was made good by Banco di Napoli, which was granted a special advance by the Bank of Italy, as provided for in Article 3 of Law 588 of 19 November 1996, under the procedure established in a Ministerial Decree of 27 September 1974.

For its part, SGA began to realize its assets last year. The accounts for the 1997 fiscal year showed a loss of 1,225 billion lire. At the end of the year recoveries amounted to 1,476 billion, or 12 per cent of the total claims transferred from Banco di Napoli. The figure comprised 660 billion of receipts from the disposal of foreign securities and loans to high risk

countries and 780 billion collected in connection with non-performing loans.

Supervision of securities intermediaries

Investment funds. - In the performance of its task of examining applications for access to the market, the Bank of Italy expressed a favourable opinion to the Minister of the Treasury on 98 new funds, one merger and four sales of funds between management companies.

Supervisory activity revealed 5 cases in which the ratio of the management company's own funds to assets under management fell short of the minimum required. In each case the reason was the increase in the value of the company's investment funds and the situation was put right. Mistakes were found in the valuation of units on 19 occasions; these were corrected by the management company making up the difference and unit-holders suffered no damage. Serious organizational shortcomings were revealed at one management company and it was invited to prepare a reorganization plan, which led to a change in the company's shareholders.

Securities firms. - The regulatory changes provided for in Legislative Decree 415/1996 became fully effective in 1997 following the issue of the related implementing measures. The Decree entrusted the Bank of Italy with new tasks concerning authorization to engage in securities business, ownership structures and the control of groups. Accordingly the Bank sent Consob 41 opinions on applications to provide investment services and examined 50 proposed changes in the ownership structure of Italian securities firms.

Methods were developed during the year for the analysis of the situations of securities firms based primarily on monthly and three-monthly indicators that permit the changes in the main variables to be assessed.

The findings of inspections and prudential analysis led to action, in the form of meetings or letters, involving some 70 Italian securities firms, or one third of the total. The shortcomings mainly concerned unsatisfactory profitability, capital inadequacy and poor organizational structure. The latter continues to be the underlying cause of the weaknesses that have led to instability.

Supervision of financial companies

The Bank of Italy examined 33 applications for inclusion in the special register of financial intermediaries subject to its supervision referred to in Article 107 of the 1993 Banking Law. In three cases the application was turned down because the activity carried on or the volume of business did not comply with the requirements.

The findings of analytical controls led to action in the form of meetings or letters in which corporate officers were invited to improve compliance with the rules on preparing annual accounts and statistical reports. Some intermediaries with more serious problems concerning riskiness and profitability were invited to adopt corrective measures. Authorizations were granted to 11 financial companies to issue subordinated loans to strengthen their capital bases.

THE PROTECTION OF COMPETITION IN THE BANKING SECTOR

Competition among banks in Italy began to intensify in the eighties as a result of the easing of restrictions on operations and the changes in the geographical structure of the banking system. Areas in which established banks exercised considerable market power saw the entry of competitors from other areas and a resulting decrease in the degree of concentration.

During the nineties competition has intensified even more owing to further regulatory changes, the removal of exchange controls and the rapid international integration of financial markets.

Looking ahead, the growing use of computer and telephone-based channels for doing business with customers will make markets increasingly contestable by eroding the competitive advantage of branch networks and further reducing geographical segmentation.

The effects of the increase in competition are evident in the loan market, where the redistribution of market shares has become increasingly pronounced. In the last three years the share of the fastest-growing banks has risen by an annual average of around 6.5 percentage points, despite the fact that total lending remained broadly unchanged in real terms. In the ten preceding years the annual average redistribution of market shares had been 4 percentage points.

Customers have benefited from the more intense competition: the spread between lending and deposit rates narrowed from 7 percentage points at the end of the eighties to 4.7 points in 1997, notwithstanding the rise in the proportion of bad debts.

Concentrations. - In 1997 the Bank of Italy was notified of 69 planned concentrations pursuant to Article 16 of Law 287/1996, compared with 64 in 1996 and 53 in 1995. In 54 cases the plans were reviewed, while the remaining 15 cases were not considered to fall within the scope of the law.

An investigation was undertaken into Banco di Sicilia's acquisition of the assets and liabilities of Sicilcassa S.p.A., which was placed in compulsory administrative liquidation by a decree issued by the Minister of the Treasury on 5 September 1997 at the end of the period of special administration that had begun in March 1996. The operation is part of the rescue plan under which Mediocredito Centrale acquired 40 per cent of the capital of Banco di Sicilia by taking up a special issue of new shares for a total of 1 trillion lire.

The Bank of Italy took account of the views expressed by the Competition Authority in reaching its conclusion that the acquisition would lead to the creation of a dominant position likely to affect the proper working of competition in the markets in question. In order to prevent this, the Bank made its authorization of the concentration subject to a reduction in the number of Banco di Sicilia branches, including the sale to other banks of some of the branches in the provinces of Enna and Palermo.

Abuse of dominant positions. - Last year the Bank of Italy conducted an investigation pursuant to Article 14 of Law 287/1990 of Banco di Sardegna for the alleged violation of Article 3 of the law.

The investigation was concerned with plans for a major expansion of Banco di Sardegna's branch network, the size and rapidity of which appeared likely to be a barrier to competing banks' entry into the Sardinian market.

On the basis of the results of the investigation, the Bank of Italy decided that the alleged abuse on the part of Banco di Sardegna had been overcome by the latter having renounced its intention of opening the new branches in question and undertaken not to open any others for three years. It accordingly closed the procedure, reserving the right to verify that the bank fulfilled its commitments and to adopt appropriate measures to put an end to any distortion of competition.

Survey on corporate finance services. - The survey on corporate finance services undertaken jointly with the Competition Authority pursuant to Article 12 of Law 287/1990 was completed last year.

The aim of the survey was to assess the situation with regard to competition in the markets for services in the fields of mergers and acquisitions, initial listings, new issues of securities by listed companies and the restructuring of distressed firms.

Supply was found to be highly concentrated, with one intermediary in a dominant position, in the market for services related to the stock

market placement of shares of listed companies following increases in capital or disposals in the secondary market and in that for assistance to distressed companies and the restructuring of debt.

The competitive structure of the markets considered in the survey will undoubtedly change rapidly as a consequence of the globalization of markets and the implementation of economic and monetary union.

The rules governing state aid

In accordance with the principle adopted by the Community, the provisions and procedures in matters concerning state aid are applicable to banking, albeit with account being taken of the sector's special features.

Since the turn of the nineties the European Commission has examined numerous cases of public intervention in support of distressed banks and some of these examinations are still under way. As regards Italy, the Commission concluded that the Bank of Italy's release of Banco di Napoli's compulsory reserves in 1996 was an eligible form of aid and that the disbursement by the Interbank Deposit Protection Fund of 1 trillion lire to Sicilcassa did not constitute aid within the meaning of Article 92 of the Treaty. The Commission is currently examining the recapitalization of Banco di Napoli and that of Banco di Sicilia, as well as the advances the Bank of Italy made to these two banks under a Ministerial Decree of 27 September 1974.

THE GOVERNOR'S CONCLUDING REMARKS

At the beginning of this month a historic political decision was taken in the process of economic and monetary integration within the European Union: the decision to move to a single currency in eleven of the fifteen member states of the Union.

From 1 January 1999 onwards the central banks of the eleven countries and the European Central Bank will consolidate their accounts for the purposes of monetary policy. A single interest rate will be applied to operations; the liabilities of the various central banks, redenominated in euros, will be interchangeable without limit.

The Extraordinary General Meeting of Shareholders of the Bank of Italy held in March approved amendments to the Bank's Statute in order to make it consistent with that of the European System of Central Banks.

In the Governing Council, the central bank Governors and the Executive Board will assume responsibility for assessing and pursuing the common interests of the euro area. The maintenance of price stability will be the primary objective of the European System of Central Banks.

In accordance with the principle of subsidiarity, operational activities will normally be decentralized. The European Central Bank will intervene directly in the money and foreign exchange markets only in emergencies.

The work that the Bank of Italy is called upon to perform in the fields of economic and legal research and analysis will become more demanding.

The new European framework will not alter the Bank's activities in the supervision of banking and financial intermediaries, the surveillance of markets and the protection of competition in the banking sector. Responsibility for these tasks will remain at the national level; there is increasing awareness of the need for and commitment to international coordination.

In the payments field, the domestic real-time gross settlement system will be integrated with those of the other countries; in collaboration with the

European Central Bank, we shall develop more sophisticated and far-reaching surveillance to safeguard the operational effectiveness and security of the system.

The 500,000-lira banknote came into circulation last September; so far, the branches of the Bank have issued around 12,900,000 of these notes, worth 6,453 billion lire. We shall participate in the production of banknotes denominated in euros, which will come into circulation on 1 January 2002 at the end of the transitional period.

In 1997 the Bank drew up its corporate plan aimed at completing the changes that need to be made, increasing the effectiveness of the Bank's actions and enhancing operational efficiency. The first revision of the plan is now under way.

In the data-processing field, important infrastructure and applications projects have been developed, in particular to prepare for the changeover to the single currency and make the adjustments needed to cope with the year 2000. The new Central Credit Register came into operation; the integrated system for distributing financial information is already in use within the Bank; the procedure to enable the Treasury payment offices to handle computerized payment instructions was written.

Work has begun on the revision of the accounting procedures and annual accounts of the Bank; the firm that will be responsible for auditing the accounts has been appointed; integrated procedures are being used for the expenditure verification system; close attention is being paid to the control of costs.

This morning the Board of Directors of the Bank decided that the Services Centre in Frascati, which is at an advanced stage of completion, will be named after Donato Menichella.

On behalf of the Board of Directors and the Directorate, I would once again like to express sincere and warm thanks to all the staff of the Bank, not only for their commitment to the everyday activities of the institution but also for their exceptional efforts in planning and realizing the launch of the European System of Central Banks.

The world economy

Last year saw an acceleration in economic activity in North America and Europe and a drastic slowdown in Japan and the Asian economies. Inflation declined further. World trade grew by 9.6 per cent.

Gross national product in the United States increased by 3.8 per cent and unemployment fell to a very low level. Cost pressures were absent,

thanks to productivity gains and the fall in the prices of raw materials; producer prices declined during the year and consumer price inflation was especially low.

In the European Union output grew by 2.7 per cent, one percentage point more than in 1996. Unemployment remained high and inflation came down further to 1.9 per cent.

In Japan the recovery in growth in 1996 came to a halt; there is now a risk of deflation.

The growth in the US economy and the economic stagnation in Japan exacerbated the trade imbalance between the two countries, leading to substantial transfers of savings and reallocations of funds through the international financial markets.

The crisis in Asia has had a profound effect on confidence and the financial sector in Japan. The consequences for activity in the Western economies have been less serious so far; the outflows of capital from Asia have affected primarily the exchange rate of the dollar and securities prices.

The dollar appreciated by 12 per cent during last year, the yen fluctuated widely and the currencies of the leading European continental countries depreciated by between 2 and 3 per cent.

Efforts continued to be made to reduce budget deficits and halt the growth of the public debt in the major industrial economies.

The countries of continental Europe still have to address the problems caused by the excessive size and the structure of their budgets. The volume, composition and continued growth of current public expenditure and revenue are the ultimate result of social policies formulated and adopted decades ago, when both actual and expected economic growth were more rapid and the age distribution of the population and demographic trends were closer to normal. Those policies are no longer sustainable in the changed context of the world economy and in view of the rapid ageing of the population.

Unemployment in continental Europe has been rising since the mid-eighties; a source of serious individual and social deprivation, it reflects inefficiencies in the allocation of resources within economies, as well as prices, capital costs and labour costs that are incompatible with the creation of jobs. Investment is directed largely towards introducing technologies that will improve competitiveness and reduce the input of labour. The level of effective demand is still inadequate, particularly for capital goods, reflecting uncertainty about future growth.

Monetary developments and interest rates

Monetary policies in the leading industrial countries made a decisive contribution to bringing down inflation during the eighties and early nineties. It has been possible to adopt a more relaxed stance in the last three years.

Long-term interest rates declined, continuing the downward trend that had begun in the spring of 1995 once the disruptive effects of the Mexican crisis on the financial and foreign exchange markets had subsided.

In the United States the years 1992 and 1993, like the last three years, were marked by a declining trend in long-term yields, which spread to all markets. This came to an end when the Federal Reserve began to raise policy rates in early 1994. Long-term rates swiftly increased everywhere, culminating in the Mexican crisis at the beginning of 1995. In the space of a few weeks the dollar lost 7 per cent of its value; the exchange rate of the lira collapsed, the German mark appreciated significantly and the yen rose by 20 per cent. As a consequence of the crisis, yields on government securities exceeded 13 per cent in Italy and reached about 8 per cent in the United States, Germany and France.

During 1997 the fall in long-term rates was about 2 percentage points in Italy, 1.5 points in the United Kingdom and Spain, and less than one point in the United States, Germany and France. In the early months of this year yields stood at just over 5 per cent in Italy and were marginally below 6 per cent in the United Kingdom. In Germany and France they fell to less than 5 per cent; in Japan, where they were already extremely low at the end of 1996, they have declined to around 1.5 per cent in recent weeks.

In the early months of this year short-term interest rates in five of the seven leading industrial countries were the lowest recorded during the eighties and nineties.

The phase of monetary expansion that is still under way in Japan began in the middle of 1995; the lowering of short-term interest rates to nearly zero was accompanied by phenomenal growth in monetary base.

The value of the yen has fallen by almost one third from the peaks reached in March 1995; it is 16 per cent lower than in December 1994.

The Japanese central bank appears to be ensnared in a classic liquidity trap. Interest rates cannot be brought down further, monetary policy is unable to stimulate economic activity, and liquidity is spilling onto the international market.

The weakening of the Japanese yen and the large volume of funds available in Japan at interest rates close to zero have made it easier for banks

and international market operators to finance risk positions on foreign exchange and financial instruments. Against a background of low inflation, restrictive fiscal policies and relaxed monetary conditions in the leading countries, this has fostered a general decline in long-term interest rates; the Asian crisis was another contributory factor in the second half of last year, as it generated expectations of a slowdown in the world economy and a shifting of funds towards less risky markets.

The ever-closer parallel movements in bond yields and share prices across countries is increasingly associated with the activities of institutional investors. They handle an enormous volume of funds, raising liquidity in the currencies with the largest markets and the best terms and investing in accordance with expectations regarding exchange rates and risk and yield differentials, thereby transmitting expansionary or restrictive impulses from the key money markets to the global market.

The aggregate balance sheet total of these institutions has grown extremely rapidly in recent years. At the end of last year their total resources amounted to around \$28 trillion, almost four times the annual output of the United States and 25 times that of Italy. Public and private sector bonds account for 36 per cent of their total financial assets.

Institutional investors also increased their equity investment last year. Their share portfolios exceeded \$10 trillion at the end of 1997, close to the market capitalization of the US stock market and 30 times that of the Italian market.

The Japanese share price index declined by 20 per cent last year, whereas those of the other major industrial countries rose by between 20 and 60 per cent. The rise continued until recent weeks. The earnings/price ratio fell to a level close to the real yields on the most secure bonds; investors appear to consider that the risk is outweighed by expectations of further growth in profits or reductions in interest rates.

The economic cycle and payments disequilibria in the industrial countries. The Asian crisis

Domestic demand in the United States increased by 4.1 per cent in 1997. Investment grew by more than 10 per cent in real terms for the fifth consecutive year. At the same time, non-farm payroll employment again rose, by 2.3 per cent. Labour force participation is extremely high, about 67 per cent of the population of working age. The unemployment rate fell to 4.3 per cent in April 1998, the lowest level since 1970.

The state of industrial relations, the framework of labour contracts and technical progress have induced a sense of insecurity among workers that is

curbing wage growth. Productivity gains and a flexible supply of labour, due in part to immigration, are continuing to hold down the rise in unit labour costs.

The growth in domestic demand nevertheless resulted in a further deterioration in the current account of the balance of payments. In 1997 the deficit amounted to \$166 billion, even more than in previous years; a deficit of the order of \$230 billion is forecast for this year.

The United States recorded a net inflow of portfolio investment of \$300 billion last year; the country's net external debtor position now exceeds \$1 trillion, equal to 12.3 per cent of GDP.

In Japan there was a severe downturn in economic activity in the second quarter, when domestic demand declined at an annual rate of 14 per cent. In an economic situation already made precarious by widespread financial instability and falling prices, consumption and investment were depressed by an increase in taxes as part of a plan for the structural adjustment of the public finances.

The surplus on the current account of the balance of payments could reach \$120 billion this year, nearly twice as much as in 1996.

The substantial and growing funds deriving from the trade surplus were reinvested in the principal financial markets. Portfolio investment abroad, which had totaled \$115 billion in 1996, amounted to \$90 billion in the first three quarters of 1997. The direction of capital flows changed abruptly in the fourth quarter, when the crisis in the Asian countries prompted a large-scale repatriation of funds. More than half of outward investment goes to the United States; at the end of 1996 Japanese investors held US bonds worth \$780 billion and shares worth \$155 billion.

Japan has a net external creditor position of about \$1 trillion, or 23 per cent of GDP.

For many years the availability of loans at very low interest rates from Japan, and also from Europe, facilitated the funding of current account deficits and sustained economic growth in the South-East Asian countries and Korea. Bank capital continued to pour into these countries from 1994 to early 1997. Loan quality progressively deteriorated. Competitiveness in these economies, which had already been eroded by inflation averaging about twice the worldwide rate, was further reduced by the appreciation of the dollar, to which their currencies were pegged. Their foreign debt, which is largely at short term and denominated in dollars, continued to grow. The sudden reversal of market expectations sowed doubt as to the sustainability of growth and the solvency of firms and banks, thus triggering the crisis. The rapid outflow of funds resulted in the halving of share prices and caused currencies to depreciate by an average of 50 per cent.

The scale of the crisis and its rapid spread in Asia required unprecedented efforts by the international community to restore market confidence. International organizations and the leading countries have committed resources totaling more than \$110 billion to Korea, Indonesia and Thailand. The International Monetary Fund played the leading role in coordinating intervention and designing adjustment programmes.

The debate taking place in the various fora about the risks to world economic stability inherent in the present configuration and *modus operandi* of the global market has intensified. Consideration is being given to ways of countering liquidity crises without providing private lenders with full protection against risk and to initiatives aimed at enhancing the soundness of banking and financial systems by means of more effective supervision. The need for macroeconomic surveillance to reduce the risk of new crises is becoming increasingly evident.

The slowdown in demand in Korea and South-East Asia aggravated the economic situation in Japan, causing problems for the banking system, which had already been weakened by the depressed state of the economy and the fall in share prices. The currency of China has remained stable.

In the European Union the pickup in economic activity did not reduce the cyclical disparities among the major economies. In the United Kingdom, which had already experienced four years of expansion, economic growth accelerated to 3.3 per cent, generating inflationary pressures that necessitated a progressive tightening of monetary conditions. The recovery was still weak in the three largest continental economies, where the growth in consumption remains modest and investment demand hesitant. Some stimulus to economic activity is coming from export demand. On the whole, monetary policy has maintained a non-restrictive stance. The money supply has grown rapidly in several countries.

The weakness of internal demand fostered a further increase in the Union's current account surplus, which rose to 1.4 per cent of the area's GDP, compared with 0.6 per cent in 1995 and 1.1 per cent in 1996. France and Italy accounted for two thirds of the surplus.

Unemployment is still around 10.7 per cent of the labour force in the European Union. It is especially high in Spain, where it stands at 21 per cent; the rate in Italy, France and Germany is between 11 and 12 per cent. It is particularly low in the United Kingdom, where labour market flexibility is comparable to that obtaining in the United States.

The budgetary and labour market conditions for a sustained and vigorous expansion of investment demand in continental Europe must be created; this will also foster more balanced growth in the world economy.

Above all, there must be a recovery in consumption and investment in Japan, a feasible objective in view of the country's savings and large external

assets. The stimulus must come from budget measures capable of inducing a resumption of growth. The Government's programme to cope with the difficulties of the banks, amounting to around \$220 billion, appears adequate. The size and composition of the proposed expansionary measures, as well as their timing and implementation, must be such as to produce a durable recovery in domestic demand.

Japan's return to economic growth is indispensable to overcome the Asian crisis, avert the risk of further instability in the region and in other parts of the world, correct the large and growing trade imbalances and contribute to a better and more stable international financial system.

The European currency

On 3 May the monetary authorities of the eleven member states of the European Union that will adopt the single currency announced the bilateral exchange rates that will be used to set the conversion rates in relation to the euro. These values, which are the same as the present ERM central rates, are consistent with the fundamentals and competitive positions of the countries concerned.

In our opinion it is profoundly mistaken to view the relationship between the euro and the other major currencies, first and foremost the dollar, in terms of opposition or conflict.

A stable European currency can make a decisive contribution to the equilibrium and prosperity of the world economy.

The accumulation of foreign debt by the United States has been easily financed to date, thanks to an unflagging demand for dollars; this has been fueled partly by monetary expansion in Japan and, more recently, by the transfer of funds to the US market in the wake of the Asian crisis.

The single European currency can help stimulate the growth of the European economies. The benefits of a new period of stable growth will spill over onto other regions of the world. It will foster the reduction of imbalances, to the advantage of the international monetary order.

Growth in Europe appears to be restrained by the excessive size of government budgets, the poor quality of public services in some countries and overly rigid and constrictive regulations.

The Convergence Report of the European Monetary Institute emphasizes that price stability and competitiveness depend crucially on reforms to reduce current public spending and taxes, on an easing of the structural constraints that impede the proper functioning of the labour market and on more efficient resource allocation in the individual national economies.

After the demise of the Bretton Woods monetary order, a system of prices and costs dictated essentially by the level of wages came into being in the industrial economies and prevailed longest in continental Europe. To some extent, monetary and exchange rate policies were adapted accordingly. The result was a long period of inflation, high interest rates, slack investment and unemployment.

In the second half of the eighties and the early nineties monetary policy in the major countries brought inflation back down to very low levels, aided by an increase in domestic and international competition and in Italy by concertation between employers and trade unions that was effective in moderating wage growth.

Price stability requires replacing the labour standard by systems in which wages, relative prices and the allocation of resources are once again determined with reference to productivity, product quality and demand. Labour market flexibility must be increased while safeguarding adequate levels of income and social protection.

These are the prerequisites for the success of the single currency, for encouraging saving and capital formation and enabling the European economy to maintain and improve its competitiveness, return to a path of growth and aim at a new period of rising employment.

The Italian economy

In the second half of 1996 it became evident that the growth in GDP would not exceed 1 per cent for the year as a whole. Industrial production was declining sharply and overall employment was stagnant. The increase in output in 1997 would be less than the official forecast.

At the end of 1996 tax incentives were introduced to encourage the replacement of motor vehicles.

In February 1997 it could be foreseen that the budget deficit would overshoot the objective of 3 per cent of GDP by nearly one percentage point; its behaviour was influenced by the slowdown in economic growth and fiscal measures that were less effective than expected. At the end of March measures were adopted to reduce the deficit by a further 16 trillion lire.

The tax incentives contributed to the growth in household consumption, which increased by 2.4 per cent for the year; in particular, demand for durable goods rose by 8.6 per cent and purchases of motor vehicles by 32 per cent.

Industrial production responded promptly: over the year it rose by 8 per cent to equal the peak of two years earlier. In the first few months of 1998

it has been declining, although it has remained well above last year's average level.

About one third of the increase in production in 1997 appears to be attributable to the measures relating to motor vehicles. The higher growth in income also stimulated demand for non-durable goods.

Gross domestic product grew by 1.5 per cent.

The contribution from fixed capital spending was limited; investment in construction declined.

Exports rose by 6 per cent but failed to keep pace with the growth in world trade, owing to the loss of competitiveness and the briskness of domestic demand. The same factors, together with stockbuilding, caused imports to rise by 12 per cent.

The acceleration in economic activity had a positive effect on productivity, to the benefit of unit labour costs, production prices and consumer price inflation.

Labour costs per employee in the sectors producing goods and market services, which had increased by 5.1 per cent in 1996, rose by a further 4.1 per cent in 1997. Given the rise in productivity, the annual increase in unit labour costs came down from 4.6 to 2.2 per cent.

The growth in production brought benefits in terms of costs, as it had in 1995. On that occasion, however, against the background of the depreciation of the lira and the rapid expansion in domestic demand, the curbing of costs translated into wider profit margins.

In 1997 the stability of the lira and monetary policy made a decisive contribution to disinflation.

The monetary policy stance became less restrictive during the year. The gradualness with which official interest rates were reduced consolidated market behaviour consistent with price stability. Inflation expectations improved continuously, bringing the expected inflation rate close to 2 per cent at the end of the year. In December the twelve-month rate of inflation was 1.5 per cent in the case of producer prices and 1.9 per cent in that of consumer prices.

As a result, not only did nominal wages rise, but their purchasing power also increased; monetary stability ensured that the real value of financial wealth was maintained. However, households' income was eroded by the increase in the tax burden, the effect of which was only partly offset by the growth in social benefits. Households' propensity to save fell from 15.4 per cent in 1996 to 13.6 per cent in 1997, and that of the private sector from 27.8 to 25.0 per cent.

As well as the reduction in the budget deficit, there was a decline in saving by households and firms. The stagnation of investment was accompanied by a further considerable surplus on the current account of the balance of payments.

The balance of payments and capital movements

The current account surplus was only dented by the rapid growth in imports and the modest expansion in exports.

As in previous years, tourism made a considerable contribution to the balance of payments and national income; the sector's surplus was equal to 1.2 per cent of GDP.

Smaller interest payments on the foreign debt were another factor in the current account surplus. There was also a net inflow of EU budgetary funds, in contrast to net transfers to the EU in the preceding years.

Italy's net external position finally returned to balance at the end of last year. There was a further increase in the external debt of the public sector on the one hand and in the external assets of the private sector on the other, particularly those of households; the latter are aiming to manage their financial wealth more efficiently by diversifying their portfolios.

The net external creditor position of households and firms, including positions held via investment funds, rose by 119 trillion lire; their gross external assets increased to 591 trillion, or 11.4 per cent of their total gross assets. The public sector's liabilities to non-residents amount to 500 trillion lire.

The net external position of the Bank of Italy showed a further improvement.

Households accentuated the tendencies that had begun to emerge the previous year in their allocation of financial investments. They greatly reduced their demand for government securities and channeled savings to the domestic share market, foreign markets and intermediaries that then reinvested a substantial part of their funds abroad. Outflows of portfolio investment amounted to 113 trillion lire, double the figure for 1996.

Inflows of portfolio investment were again large, totaling 119 trillion lire, attracted by yield differentials, the rising prices of Italian securities and the stability of the lira.

With the advent of the single European currency, the public sector and firms will be able to raise funds in a larger and more liquid market.

The ability of the Italian economy to reap the benefits of the high domestic saving rate and to attract resources from abroad will depend crucially on the banking and financial system's efficiency in screening and selecting productive investments in Italy.

Increasing financial openness offers greater opportunities, but competition also involves greater risks for the market in government securities, the private capital market and the banking system. In the background there is the problem of the competitiveness of the Italian economy.

The balance between inflows and outflows of direct investment in the five years from 1992 to 1996 shows an average outflow of about 4 trillion lire a year. In 1997 there was a sudden acceleration in direct investment abroad by Italian firms and only a limited increase in inflows, which rose to 6 trillion. The rise in outflows brought the deficit to 12 trillion lire.

A flow of direct investment abroad is normal for advanced economies. For Italy, however, it raises the problem of the burden of tax and social contributions on the productive system in a context of growing fiscal competition; this problem is accompanied by insufficient flexibility in the use of the factors of production, often unduly restrictive regulation of economic activity and infrastructure deficiencies that are an impediment to business operations.

Italian direct investment abroad is motivated increasingly by the desire to transfer production abroad in order to reap cost advantages. In many cases it involves the intermediate processing of products that are subsequently reimported into Italy. In others the purpose is to gain easier access to larger markets, reducing transport costs, surmounting trade barriers and benefiting from more favourable tax treatment. According to a Bank of Italy survey of a sample of Italian manufacturing groups, employment in Italian factories abroad, some of them in emerging economies, is estimated to be equal to about 10 per cent of industrial employment in Italy.

Employment and investment

The number of people in employment was the same in 1997 as in 1996 on an average annual basis; during the course of the year the number rose.

The strong growth in activity in manufacturing was reflected in both employment and productivity in the sector. In the Centre and North, where the bulk of plant capacity is concentrated, the twelve-month increase in January 1998 was equal to 71,000 workers, or 1.8 per cent, raising the region's overall level of employment and reducing its unemployment rate to 7.5 per cent.

During the year the manufacturing workforce also grew in the South, but because of the sector's lesser importance in these regions the increase was not enough to prevent a further decline in overall employment and a rise in the regional unemployment rate to 22.4 per cent.

The pattern of the two preceding years persisted: after falling sharply between 1992 and 1994, employment increased by 260,000 in the Centre and North over the next three years but decreased by a further 70,000 in the South.

Employment responded more rapidly to the upturn in industry than in previous cycles. This was due in part to the reduced number of underemployed workers, a point corroborated by the increase in overtime work. Recourse to the Wage Supplementation Fund diminished.

Forms of fixed-term employment are growing and additional shifts are being introduced to cope with cyclical fluctuations and seasonal factors.

The Bank's annual survey of manufacturing firms shows that more than half operate at least two shifts per day. Those surveyed have plant in operation for an average of 13.6 hours a day, with 5.2 working days to the week.

Employment in the construction industry remained at the low levels recorded at the beginning of last year. It has fallen by around 15 per cent since 1991, reflecting the decline in activity in public works and residential building. The employment outlook appears uncertain in the services sector as well, where there has been a pronounced contraction in the number of self-employed workers.

The problem of unemployment in Italy largely coincides with that of the economy of the South, which has been stagnating for several years, has a low level of industrialization and is uncompetitive, owing in part to infrastructure deficiencies and problems in the social environment.

A year ago I highlighted the continuous, prolonged decline in investment in relation to output; I stressed the close connection between this and the fall in the overall level of employment and the emergence of various forms of irregular work intended to circumvent regulations and nationally agreed wage rates.

Although total fixed capital formation was sustained in 1994 and 1995 by a large increase in investment in machinery and equipment, particularly in the market services sector, in the four years from 1994 to 1997 it rose at a moderate rate of around 2 per cent a year, only slightly faster than the growth in output. Investment in construction as a whole diminished by an

average of 1.5 per cent a year; that in non-residential construction stagnated. The growth in gross fixed investment during that period occurred solely in the Centre and North, where it is estimated to have exceeded 3 per cent annually; in the South gross fixed investment contracted by between 1 and 2 per cent a year.

The annual flow of productive investment has grown around fourfold since the beginning of the seventies in the United States. In Europe it has doubled. The convergence of per capita GDP in the countries of the European Union towards the level of the United States has stalled in the nineties.

The less intense rate of investment in Europe reflects more uncertain expectations of growth; at the same time it is one of the factors responsible for creating less favourable conditions for higher employment and output.

The European economies face the prospect of a static or declining population and a deterioration in its age distribution. Among the ten leading industrial countries, Japan and Italy will soon have the oldest populations.

The consequences for expenditure on pensions and welfare will be considerable. They could cause labour costs and the budget deficit to increase.

In the advanced economies the ageing of the population and the high standard of living reduce the growth prospects of an industrial sector whose development in past decades depended on demand for durable consumer goods. The opportunities for expanding production must be seized in order to satisfy both the demand for services related to the new needs of the population and new forms of consumption and demand from more backward areas for industrial goods, including medium-technology products.

Taxes and social security contributions correspond to 32 per cent of GDP in the United States and 37 per cent in the United Kingdom; in Germany, Italy and France the ratio is between 43 and 48 per cent.

The heavier tax burden increases the cost of labour and products by comparison with other countries, especially when it is not matched by adequate public services and infrastructure that can contribute to the productivity of the economy.

In Italy the rate of tax on corporate profits rose from 36 to 53 per cent between 1980 and 1997. Since 1992 companies have been subject to an extraordinary tax of 0.75 per cent of their net worth. During the same period the other leading countries lowered their corporate tax rates. Italy's are at the

same high level as Germany's and higher than those of France and the United Kingdom. In 1995 the ratio of corporate tax receipts to GDP was 3.6 per cent in Italy, compared with an average of 2.9 per cent in the European Union as a whole.

The recent reform of the tax system is intended to redistribute the burden among the factors of production: it eliminates the tax on net worth and reduces that on profits and labour inputs by shifting the burden on to debt capital; it reduces the rate of tax on profits, provided they are retained within the business. The greater simplicity and neutrality of the tax system will bring gains in efficiency. In the long term the tax burden is likely to diminish as a result of an increase in equity capital. In the medium term, however, the requirement that revenue initially remain unchanged means that the overall tax burden on firms will remain high.

In Europe, with the advent of the single currency, there appears to be an urgent need for agreements to coordinate the tax treatment of financial and entrepreneurial income; in the future it might be necessary to extend the agreements to cover personal income tax and the social security system.

Output growth is hindered in continental Europe and in Italy by labour market arrangements that ultimately penalize employment. In an economic environment increasingly open to international competition, the demand for labour tends to be close to levels consistent with production at the low points of the business cycle.

On several occasions in the past I have drawn attention to the need for pay arrangements that make it easier to adjust labour costs to the state of the economy, variations in production and the situation of the company, and thus create the conditions for a closer link between the interests of workers and those of the firm and foster competitiveness and employment.

In Italy a reduction in contractual working hours is under discussion; in France legislation providing for such a reduction has already been approved. The annual number of working hours laid down in labour contracts has shown a long-term downward trend: in Italian manufacturing industry it was around 2,000 in 1970; today it is 1,700.

Any mandatory ceiling on annual contractual working hours will need to permit large variations in the number of hours worked per week and per month, so as to allow production to adapt to seasonal and cyclical requirements. Employers and trade unions will have to find solutions that enable firms to adjust production to fluctuations in demand and create a closer correlation between labour costs and corporate revenues.

Significant steps are already being taken in Italy to adapt the supply of labour to firms' production and plant utilization requirements. Greater

flexibility can be achieved by making more extensive use of the new forms of employment introduced on the basis of proposals put forward by the Minister of Labour. Labour contracts at company level are also increasingly providing for forms of variable pay linked to profitability; however, such solutions relate to a negligible proportion of less than 3 per cent of average earnings.

In order to make a significant impact on productivity, the fixed component of earnings, the part that is the same for all, will need to diminish, albeit continuing to be the preponderant element; the variable component will need to be able to increase and decrease.

The mismatch between productivity and earnings encourages forms of irregular work, which I discussed at length last year. There is clearly an imbalance in the South that leads to a low level of legal employment and gives rise to forms of work that are equivocal, detrimental to competition and prejudicial for the workers, who are not covered by social security or insurance. These forms of employment are socially harmful, infringe legality, undermine the dignity of workers and blur the perception of the distinction between legal activities carried on in an irregular manner and illegal activities.

A solution is urgently needed in order to help improve social conditions in the most economically backward areas. Territorial pacts and area contracts are only an initial response to this serious problem. In a small number of cases they have made it possible to experiment with agreements that increase labour flexibility and keep down labour costs in the light of local conditions of production.

The public finances

The notable adjustment of the public finances achieved in 1997 is part of the consolidation that was begun in the second half of the eighties and intensified in the early nineties, when general government net borrowing still amounted to between 9 and 11 per cent of GDP. The improvement was substantial in 1995 and extremely large last year.

The primary surplus increased from 1.8 per cent of GDP in 1994 to 4.1 per cent in 1996; in 1997 it rose to 6.8 per cent. Net borrowing in the same three years fell from 9.2 to 6.7 per cent and then to 2.7 per cent of GDP.

The progress achieved last year was due to an increase of around 2 percentage points in the ratio of tax to GDP and to the effects of other measures that consisted partly in the postponement of expenditure. The reduction in the budget deficit also benefited from a fall of 1.3 percentage points in interest payments in relation to GDP, which reflected the curbing

of inflation, favourable international monetary conditions, the increase in the primary surplus and the prospect of participation in the Monetary Union.

Total public expenditure in the European Union as a whole fluctuated around 48 per cent of GDP in the eighties and reached a peak of 53 per cent in 1993. In Italy it rose from 42 per cent in 1980 to nearly 58 per cent in 1993.

The tax ratio in Europe remained close to 41 per cent for most of the eighties and into the early nineties, rising to around 43 per cent in 1997. In Italy it increased by 13 percentage points in the thirteen years from 1980 to 1993, when it reached 44 per cent; it declined in the three years from 1994 to 1996, but last year it equaled the earlier peak.

Revenue in Italy remained consistently lower than expenditure, despite its very rapid growth; the high interest rates required to ensure the non-monetary financing of the large deficits and to bring down inflation contributed to the enormous accumulation of public debt.

Social security benefits played a major role in the growth of expenditure: they rose from 14 per cent of GDP in 1980 to slightly less than 20 per cent in 1993. They decreased temporarily in 1995 but then began to rise again; last year they increased at a rate well in excess of the growth in GDP.

Expenditure on public investment has contracted, falling from nearly 4 per cent of GDP in the early eighties to just under 2.5 per cent.

The budgets for 1996 and 1997, together with the restrictions imposed on cash disbursements, kept expenditure excluding interest payments at the level of 42 per cent of GDP reached in 1995 and more than 3 percentage points below the peak recorded in 1993. The reduction in the cost of debt servicing made it possible for total public expenditure to continue to decline in relative terms in 1996 and especially in 1997, when it fell to 51.5 per cent of GDP.

The underlying trend of the main expenditure items and the nature of the policies adopted in the last two years now call for structural measures to consolidate the results achieved and make further progress aimed at producing a significant reduction in the public debt.

The Convergence Report of the European Monetary Institute indicates the objectives that budgetary policy will have to pursue in Italy in the coming years to ensure that the ratio of debt to GDP approaches the reference value of 60 per cent at a satisfactory pace.

The Report stresses the need for ongoing concern with regard to the future development of Italy's public finances; more explicitly, it calls for

rapid progress towards overall fiscal surpluses in order to bring down the debt in absolute as well as relative terms.

The Economic and Financial Planning Document indicates a reduction in net borrowing from the 2.6 per cent of GDP forecast for this year to 2 per cent in 1999, 1.5 per cent in 2000 and 1 per cent in 2001.

Advantage has been taken of the decrease in interest payments to make the objective for the primary surplus less ambitious: that for 1998 has already been lowered to 5.5 per cent of GDP, compared with the outturn of 6.8 per cent recorded last year. In order to achieve a rapid reduction in the debt, this figure will have to be considered a minimum for at least ten years.

The economic policies set out in the Planning Document move in the right direction. In the medium term the budget objectives will have to be made more ambitious in order to meet the commitments entered into at the European level.

It is necessary to aim, at least in the longer term, for a significantly larger reduction in the tax ratio than that of 2 percentage points announced for the four years from 1998 to 2001, which is attributable mainly to the expiry of measures temporarily bringing forward tax payments and increasing tax rates and to the decrease in the withholding tax on interest payments.

The steps taken to date in the health and pension fields do not appear sufficient to put a permanent brake on the expansion of expenditure unless a series of favourable assumptions all prove correct.

The need for a far-reaching overhaul of the existing arrangements for social security is recognized in all the industrial countries.

Reform of the social security system is necessary to ensure its very survival, make its benefits available to those who are still working and guarantee the necessary support for the weakest members of society.

The aim must be to encourage the development of supplementary pensions and private insurance schemes to protect against a broad range of health risks, by providing adequate tax relief where necessary, to lengthen working lives and to increase the cross-border mobility of workers without prejudice to their social security entitlements.

The law reforming central and local government and the important changes in the rules governing the budget, public administration and the production of public services lay the basis for improving productivity and adapting the machinery of government to the new needs of society. The achievement of these objectives will not follow automatically from the adoption of the rules; it calls for supervision and constant monitoring, at both the political and administrative levels, aimed at assessing the effectiveness and efficiency of public sector activities.

The extensive use of cash ceilings to curb the spending of local authorities and other public bodies has proved effective; the balances held with the Treasury have been reduced. It may also have made spending more efficient. However, investment in infrastructure and expenditure on the provision of adequate public services have been curtailed. The volume of expenditure carryovers has increased considerably. In some fields the contraction in outlays may prove to be temporary.

The curbing of disbursements must evolve into action to restore sound public finances that will extend to reconsidering citizens' rights and expectations and eliminate the benefits and services the public sector can no longer provide while safeguarding the fundamental tasks with which it is entrusted.

The ability to carry out investment projects will have to be improved. On several occasions we have drawn attention to the shortcomings in the planning capacity of local authorities, especially in the South of Italy, one of the reasons for the widening of the output and employment gap between the country's developed and depressed regions.

The benefits of the reduction in interest rates have not yet fed through completely to the interest payments on the public debt. The average cost of debt servicing is still above current market rates; assuming these remain unchanged, there is scope for a further fall of nearly one percentage point by 2001. However, such a virtuous outcome requires not only continued price stability but also favourable international monetary conditions and an enduring return to sound public finances. This reinforces the need for structural reforms aimed at producing a permanent reduction in expenditure.

In the new situation in Europe budgetary imbalances in the leading economies will be reflected in the cost of public debt and private finance throughout the area.

The Stability and Growth Pact commits the EU countries to the medium-term objective of budgetary positions close to balance or in surplus.

Countries with a high level of public debt must achieve this objective rapidly in order to foster growth, permit further reductions in interest rates and free resources for productive investment.

The outlook

Average daily output rose to a peak in December and January and then declined in February and March; in the first quarter of this year the index was 0.3 percentage points lower than in the fourth quarter of 1997. Preliminary estimates indicate that output stagnated in April but picked up in May.

The growth in households' final consumption will accelerate during the year, but on an annual average basis it will be less than in 1996 owing to the slowdown in the demand for consumer durables.

Investment in machinery and equipment should stage a strong recovery, largely as a result of the fall in real interest rates; the growth is expected to amount to 7 per cent, a figure that is confirmed by the Bank's own survey of industrial firms. The construction industry should also come out of the doldrums as a consequence of the introduction of tax incentives for the restructuring of residential buildings.

The growth in GDP will not be less than 2 per cent; the surplus on the current account of the balance of payments is expected to increase further in both absolute and relative terms. Economic activity will tend to accelerate during the year, which will have a positive effect on the results for 1999.

The persistence of a large current account surplus coupled with high unemployment indicates that there is substantial scope for domestic demand to expand. The increase in economic activity will need to be stimulated by a reduction in labour costs in the regions where unemployment is highest and by an ability on the part of both central and local government to plan and implement projects that will boost the volume of public investment, in part by seeking to involve private investors.

According to estimates based on the pattern that has emerged to date, the growth in investment, production and employment up to 2001 will be less than that indicated in the Economic and Financial Planning Document. Employment in the private sector excluding agriculture appears likely to rise by around 450,000, total employment by slightly more than 300,000.

The exercise shows inflation will be in line with that in the other leading countries. The level assumed for short-term interest rates is that expected by the financial markets for the euro area.

In order to sustain the growth in economic activity and employment indicated in the Planning Document, investment will have to increase more rapidly than is envisaged.

The Planning Document presupposes a change in the way the economy operates; if the employment objectives are to be achieved, the structural change must be defined and brought about in terms of the efficiency of government, the policies for supporting private investment, the attraction of foreign direct investment and the conditions regarding the supply and cost of labour.

The easing of monetary conditions towards the end of last year has been accentuated. The official discount rate was lowered in December and again

in April by a total of 1.25 percentage points; since the beginning of 1997 it has been reduced by 2.5 points. The spot and forward exchange rates are consistent with the parities that have been announced.

The growth in the monetary aggregates in 1997 exceeded the targets, partly owing to the changes in the tax treatment of bank deposits but also on account of the sharp fall in yields on government securities and the shift in households' portfolio preferences. The same phenomenon has been observed in other countries, coupled in some cases with innovations in the financial system; it has been fueled by the abundant supply of international liquidity. In regulating the supply of funds to the banking system, we took account of the risks associated with an excessive increase in the money supply and of the structural factors that contributed to its growth. After pausing in the last few months of 1997, monetary growth has accelerated again in Italy; credit is also expanding, in line with the rising trend of economic activity.

Between the end of 1995 and April of this year the interest rate on short-term bank loans fell in Italy from 12.9 to 8.3 per cent; in Germany the rate on comparable loans denominated in marks declined from 8.3 to 7.7 per cent. The differential between the nominal rates in the two countries narrowed from 4.6 to 0.6 percentage points.

Net of the increase in producer prices, interest rates on short-term bank loans in Italy are now in line with those in Germany.

Comparison of the rates on medium and long-term loans to corporate borrowers also shows a narrowing of the differential, from around 3 percentage points at the end of 1996 to 0.6 points today. In Italy the current rate on new corporate loans is 6.8 per cent; in Germany the rate on fixed rate loans is 6.2 per cent.

Money market differentials remain wider; they will be eliminated by the end of the year, taking account of the money supply and the increasingly large flows of inward and outward portfolio investment.

Inflation in Italy is around 2 per cent according to the harmonized consumer price index. The differential with Germany and France is just over one percentage point. The markets expect the gap to narrow.

The renewed soundness of the lira in foreign exchange markets, and at home in terms of purchasing power, is based on Italy's overall net external position and the competitiveness of the economy.

By achieving a net external position close to equilibrium towards the end of 1997, Italy is able to stand alongside the other founder members of the Monetary Union with a balance sheet in which the saving accumulated

by its citizens matches the total capital stock and the large volume of public debt.

The competitiveness of the Italian economy will cease to be reflected in the exchange rate, as far as the other EMU countries are concerned; it will retain its importance as a contribution to the strength of the European economy, but above all it will be decisive for the creation of wealth and the production of income within Italy.

Gains in competitiveness will have a direct effect on the ability to generate saving and accumulate wealth, on the growth in investment and on the expansion of economic activity and employment.

Banking and finance

The globalization of financial activities requires intermediaries and markets to become more efficient in order to seize the new opportunities and withstand keener competition; it calls for institutional and organizational changes that will enable the resulting risks to be controlled.

The international openness of markets will increase. Competition between national systems will intensify; business will tend to be concentrated where the financial industry is most efficient.

The progress made by the Italian economy in the last five years and the return to monetary stability have accelerated the transformation of the financial system.

The financial market

The Italian capital market is still small in relation to the size of the real economy: at the end of 1996 the gross value of financial assets was 4.9 times GDP, compared with factors of 5.6 in Germany, 7.4 in the United States, more than 8 in France and Japan, and over 10 in the United Kingdom.

The changes in households' investment preferences are contributing to the financial deepening of the Italian economy; institutional investors, whose development has been impeded by the high level of public pension provision and health cover, must play a larger part.

An expansion of the private capital market and a broadening of the range of intermediaries and their activities are urgently needed in order to meet investors' demand for diversification and to assist firms in placing debt instruments and raising equity capital, both in Italy and abroad.

Fund-raising by institutional investors, which had already increased considerably in 1996, doubled to 260 trillion lire last year. The growth in their resources contributed to the large rise in the gross value of Italian households' and firms' holdings of foreign assets. These were equal to 30 per cent of GDP at the end of last year, three times the figure recorded at the end of 1990 but still less than in other leading countries.

The stock exchange is still small for the size of the economy. The supply of new shares, both from companies already listed and new entrants to the stock market, was limited last year, despite the heavy demand and the prolonged rise in share prices and turnover. The increase in the total float was mainly the result of privatizations. Share issues recovered moderately in the early months of this year.

Admission to listing in regulated markets and introduction to the stock exchange enhance the transparency and reputation of companies, not only with investors but also with the banking system; it increases the interest of foreign investors.

The European currency will increase the opportunities for firms to raise capital in other markets. Italy's financial industry will have to respond by enlarging its European and global operations and expanding its supply of services with a high value added.

The range of services provided to small and medium-sized enterprises will have to be broadened and their quality improved. Such companies play a major role in the Italian economy. At the beginning of the nineties persons working in firms with fewer than 20 employees accounted for 57 per cent of total employment in industry and services, more than twice the figures for France, Germany and the United Kingdom. Small firms have high operating profits, but they are much more highly geared than large companies. Their financial liabilities are almost entirely towards banks and consist mostly of short-term loans; their financial costs come out of income and considerably reduce their return on equity.

Excessive debt and an inadequate capital base are detrimental to operational flexibility and an obstacle to investment and growth, especially for young companies in innovative sectors.

Banks enjoy an informational advantage in assisting small and medium-sized firms because of their local roots and regular contacts with borrowers; a larger flow of fee income would improve the banks' profitability.

The Consolidated Law on Financial Markets has created legal conditions favourable to the development of the capital market. Together

with the 1993 Banking Law, it provides the basis for the new regulatory framework for the Italian financial sector. The new law improves the quality of the information provided to the public, lays down a transparent procedure for seeking and collecting proxies, increases the involvement of minority shareholders in the governance of companies, amends the rules on take-over bids and reconciles the objective of not hindering changes in ownership with that of protecting the interests of small shareholders. All in all, it establishes a model of corporate governance on a par with those of other important financial systems.

In the asset management field the new law fosters product innovation by streamlining the earlier provisions and allowing intermediaries greater operational flexibility. It eliminates the separation of asset management on an individual basis from that performed on a collective basis, gives the Bank of Italy responsibility for setting prudential criteria for the management of portfolios and makes it easier to adapt the regulations to changes in the market.

The Bank's powers to introduce secondary legislation on settlement systems for transactions in financial instruments, to be exercised in agreement with Consob, have been widened; responsibility for the supervision of companies engaging in the centralized management of financial instruments is shared between the two regulatory bodies.

The law confirms the transformation of Italy's securities markets into private sector companies and entrusts the surveillance of the interbank market and the wholesale market in government securities to the Bank of Italy. In terms of transparency and liquidity, these markets bear comparison with the other leading financial centres; now that they are in the private sector and open to international competition, their competitiveness is a matter for the intermediaries themselves. The Bank is ready and willing to support their actions within the ambit of its supervisory powers.

The expansion of the market for private capital will be given additional impetus by the recent reform of corporate taxation, the continuation of the programme of privatizations and the modernization of the legal system.

The ability of the financial and real economies to compete in Europe would benefit from a simplification of the procedures for enforcing court decisions, a reduction in the duration of civil suits, and a reform of company law that, within the framework provided by Community directives, accorded with the needs of Italian firms, especially those of small and medium size.

The banking system

Italian banks have suffered from low profitability for several years, raising doubts about their ability to compete in an open market if they fail to reorganize and cut costs.

The banks' labour costs in Italy are significantly higher than those of their competitors in continental Europe and much higher than those of banks in the United States and the United Kingdom.

In performing our supervisory duties, we took the exceptional step in January 1997 of calling on banks to make a sharp reduction in their operating costs.

We informed the Presidency of the Council of Ministers and the Ministers of Labour and the Treasury of this initiative.

The banks and trade unions reacted positively, and the Government urged them to come to an agreement.

The parties reached an understanding in February of this year. They have committed themselves to reducing the ratio of staff costs to gross income towards the European average within four years by restructuring labour contracts, revising wage levels and carrying out a programme of phased redundancies.

The agreement sets out guidelines for the renewal of the labour contract that will lead between 1998 and 2001 to a reduction in unit labour costs, closer linkage between wages and company performance and increased labour flexibility.

The banking systems of the other leading continental European countries are restructuring in order to reduce costs and increase revenues. In France, Germany and Spain the ratio of staff costs to gross income averaged around 38 per cent in 1996; in Italy the ratio is currently 43 per cent. The agreement represents a first, crucial step forward. The new labour contract must strive to eliminate the differential.

In the course of the Bank's supervisory activities, high staff costs were also found in banks with insufficient revenues and located in economically distressed areas. We consider that the requirement for "sound and prudent management of credit" is not met if the intermediary does not consistently achieve an adequate level of profitability.

Cost reduction must be accompanied by policies to broaden the range of services offered, which are still inferior in terms of quality and earning capacity to those found in the other leading systems. Organizational arrangements and information systems must also be adapted to handle the transition to the single currency and the date change in the year 2000.

The Bank of Italy has been promoting the liberalization of banking since the eighties. Since 1990, acting as the guarantor of competition in the sector, it has prevented local and national markets from being distorted by the formation of dominant positions, abuses and agreements aimed at restricting competition. Cooperation with the Competition Authority proved fruitful both in decisions on individual cases and in conducting the survey of services in the field of corporate finance, which was completed in 1997.

The banks have extended their branch networks to areas they had not previously served and there is now considerable overlap between rival networks. The redistribution of market share has intensified. Foreign banks have established a significant presence in the areas of business services, lending to households and asset management. Quantitative studies reveal a sharp decline in banks' market power.

Despite the increase in bad debts as a proportion of total lending, the spread between lending and deposit rates narrowed from 7 percentage points in 1989 to 5 points in 1997. Bank rates declined in line with money market yields last year, reaching levels close to those in the other leading European countries.

Stability and competition are complementary objectives. Both require allocative and operational efficiency, which is the foundation for the sound and prudent management of credit.

In 1997 net interest income declined by 3.6 trillion lire, mainly owing to the narrowing of interest rate spreads by 0.7 percentage points. The fall was largely offset by the large increase in income from asset management activities. Total revenues from banking and services declined. Large value adjustments to balance sheet assets caused profits to fall to 1 per cent of capital and reserves.

The increased profitability and improved financial structure of firms were reflected in a slowdown in the growth of bad debts, even in the South; the twelve-month rate of increase gradually declined from a peak of 30 per cent in 1994 to 6 per cent last March. New bad debts in 1997 were 15 per cent lower than in the previous year; more than one fifth involved construction firms, which receive 7.5 per cent of total bank loans. Credit quality was affected by the crisis in the sector and the decline in property prices, which has eroded the value of mortgages; losses on loans to construction firms since 1993 are estimated at more than 17 trillion lire, around one fifth of the total. The revival of the sector will also benefit the banks.

Supervisory activity was directed at finding ways to eliminate shortcomings in credit quality, company organization and profitability. On

the basis of supervisory data and inspection reports, about one fifth of banks received unfavourable assessments on more than one aspect of their business.

Banks that were not able to correct the irregularities were absorbed by sounder institutions. The severest action available under the law was taken in the most serious cases, with nine banks being placed in special administration and five compulsorily wound up. Similar measures were taken with regard to securities firms, with six being placed in special administration and four liquidated.

During the year authorization was granted for the formation of 21 new banks; 16 applications were rejected for lack of adequate programmes or failure to satisfy the requirements for directors or principal shareholders.

At the end of last year the own funds of the banking system amounted to 212 trillion lire. Thirteen banks did not satisfy the capital adequacy standard, showing a total shortfall of 1.6 trillion lire, less than half the level of 1996. The remaining banks had excess capital of more than 79 trillion lire.

Experience confirms that the stability of banks depends on the strength of the real economy, even more so in the extremely competitive environment that exists today. Symptoms of an endemic crisis emerged in the South's banking system, owing partly to inefficient organization and cost structures but above all to the grave difficulties facing the economy of the southern regions.

The crisis at one of the largest southern banks was resolved last year. With the aid of public funds and considerable financing from the banking system itself, a banking group was created that will be able to achieve profitability and contribute to the development of the southern economy once the necessary rationalization measures have been taken. Paying heed to the view expressed by the Competition Authority, the Bank of Italy ordered Banco di Sicilia to reduce the size of its branch network over the next two years, in part by selling branches to competitors, in order to safeguard competition in some provinces in the region.

The reorganization plans launched at the main southern banks improved efficiency; staff numbers declined by 12 per cent and unit labour costs by about 2.5 per cent compared with the end of 1995.

The measures that were taken safeguarded the continuity of lending relationships and depositors' funds, while shareholders suffered a capital loss. Governing bodies were replaced. In 1997 the average short-term lira lending rate fell by more in the South than in the rest of the country; lending to industry began to grow again.

The action taken by the Government and Parliament prevented a systemic crisis in the area and initiated the process of restructuring.

Concentration in the banking and financial sector

Since the mid-eighties the globalization of capital markets and the easing of regulatory constraints have forced financial intermediaries to seek efficiency improvements, create new services for customers and increase in size. The result has been an intense process of concentration: the value of mergers and acquisitions carried out between 1985 and 1995 is estimated at \$2 trillion; in the last two years the value of such operations was more than \$600 billion.

In the banking sector this trend has been accentuated by the decline in profitability recorded in all the leading countries at different times. In the United States concentration in the banking market began in the eighties and has recently gathered momentum following the removal of restrictions on interstate banking.

In Europe the value of mergers and acquisitions in the banking sector doubled from about \$70 billion in the five years from 1988 to 1992 to \$150 billion between 1993 and 1997. Mergers have led to a reduction in the ratio of operating costs to revenues, above all in the United Kingdom; the impact has been smaller in Germany and France, owing to greater labour market rigidity.

At last year's General Meeting I reaffirmed the Bank's willingness to support efforts to increase the average size of banks and improve their efficiency and competitiveness, to be realized by means of operating agreements and mergers between Italian banks or with foreign intermediaries.

We have maintained a continuing dialogue with bankers as a basis for the examination and approval of merger and restructuring plans.

In monitoring bank ownership as required by law, the Bank of Italy refused three requests to increase holdings above the ceiling of 5 per cent of the share capital. In two of these cases, the application was turned down to prevent violation of the letter and spirit of the banks' statutes, and in the third to prevent uncertainty or instability.

The number of Italian banks, excluding cooperatives, stood at 297 at the end of 1997, a decline of 107 since 1990, largely as a result of mergers and takeovers. Over the same period 87 acquisitions of control were also carried out.

Concentration must be accompanied by firm action to rationalize costs and exploit the full potential offered by the production and distribution of services with a high value added.

The fund set up to manage redundancies among bank staff should make it possible to achieve efficiency gains in the wake of the concentrations.

In the case of banking groups, ensuring the effectiveness of corporate strategies calls for clearly defined command structures and the simplification of decision-making procedures.

Three of the leading banking groups were privatized last year and two other large groups were merged.

The privatizations were accompanied by share issues in the market to strengthen the capital bases of the institutions involved. When the operations now under way have been completed, the share of total assets held by banks controlled by the state or banking foundations will decline to 25 per cent, compared with 68 per cent at the end of 1992.

The main mergers and acquisitions carried out in 1997 or announced in the first few months of this year involved banks accounting for 42 per cent of total bank lending. Possible mergers and acquisitions now under consideration regard banks responsible for a further 15 per cent of lending.

The way has been paved for the creation of intermediaries with adequate capital, size and operational capabilities to meet the challenge of foreign competitors.

The financial sector can help the Italian economy to return to a higher and more stable growth path, to the benefit of an increase in income and employment.

Italy stands on the threshold of a change of immense importance, similar to those it faced in the post-war years when it joined the Bretton Woods institutions and opened its economy to world trade, and again when it became a member of the European common market. These decisions, which were taken in an orderly international context conducive to growth, greatly benefited the development of the country and its transformation from an agricultural economy into an industrial economy.

In the seventies domestic and international pressures generated a wave of inflation, a rapid increase in labour costs and a deterioration in the public finances. The macroeconomic environment changed radically, affecting the

country's growth prospects for the decades that followed. Interest rates rose, growth slowed down, employment fell and the public debt began to increase.

In the eighties monetary policy brought down inflation. It lacked support from budgetary policy and, in general, from a combination of measures able to guide the economy back onto a path of stable growth.

The fundamental disequilibria in the economy were highlighted by the currency crisis of 1992. The radical change in fiscal policy aimed at reducing the budget deficit played a part in restoring a balanced external position and preventing a rekindling of inflation.

The tighter monetary policy stance adopted from the summer of 1994 onwards curbed inflation expectations, and within two years it had closed the differential in the rate of price increase between Italy and the other industrial countries.

On several occasions we have exhorted the Government to complete the structural reform of the public finances and called upon firms and workers' organizations to pursue profit and wage policies consistent with disinflation.

The reduction in the budget deficit that has been achieved in recent years has made a decisive contribution to restoring the confidence of the domestic and international markets and bringing down interest rates.

Adoption of the single European currency sets a lasting seal on monetary stability. It can be a source of growth, employment and sound public finances if economic policies and the behaviour of the two sides of industry are compatible. Otherwise, it will lead to a loss of competitiveness, a weakening of the industrial fabric and an increase in unemployment.

The outcome depends crucially on the policies pursued with regard to the public finances and labour costs; in the preceding pages we have sought to indicate the direction these should take and some of the hurdles. It also depends on the economy's response to the need for greater flexibility in the allocation of resources and the use of the factors of production.

In exercising our responsibility for the supervision of the financial markets and the banks, we will continue with the action we began more than a decade ago to adapt the financial sector to the new demands of the economy and international openness.

The present configuration of the international monetary and financial system is the result of the spontaneous developments that have taken place over the last few decades. This train of events has had a beneficial effect on the growth of the world economy but, precisely because of its tumultuous pace, has created weaknesses and risks and a need for rules.

The efforts made by the international community to contend with the crises have been immense; it is absolutely essential to prevent other outbreaks of systemic instability. This requires constant scrutiny of the emerging and newly industrialized economies and a strengthening of supervision over banks and financial markets. The International Monetary Fund must take on greater responsibility for the analysis and prevention of crises.

Money and credit cannot always achieve equilibrium unaided. Recurrent crises, fraught with economic, social and political consequences, led in the first half of this century to the establishment of central banks as we know them today. A similar development must take place in the international monetary system.

The central banks of the eleven countries that will adopt the single currency will not only consolidate their accounts for the sake of European monetary policy but above all pool their resources of technical knowledge, experience and popular confidence, which have been acquired over the decades.

The financial markets have expressed confidence in the launch of the European currency. Its success requires structural changes and flexibility in participating economies. Confidence on the part of firms will be measurable in terms of a recovery in investment, which would trigger renewed growth and bring down unemployment.

Cooperation among sovereign states, to which credit must be given for having achieved this important step in European integration, will now be directed towards higher objectives in order to consolidate the achievements that have already been made, to meet citizens' aspirations and their expectations of an improved social environment and prospects of work for young people.

STATISTICAL APPENDIX

LIST OF TABLES

	Page
a1. Sources and uses of income and households' consumption	266
a2. Labour costs per unit of output and value added per worker, by sector	268
a3. Industrial production by economic purpose	269
a4. Capacity utilization rates in industry	270
a5. Consumer price index	271
a6. Harmonized index of consumer prices	272
a7. Consumer price index for worker and employee households	273
a8. Index of the producer prices of manufactures sold in the domestic market .	274
a9. Unit variable costs and output prices in manufacturing	275
a10. Italy's real effective exchange rates based on the producer prices of manufactures	276
a11. Italy's external position	277
a12. Main items of the balance of payments on a transactions basis	278
a13. Consolidated accounts of general government	280
a14. Financing of the general government and public sector borrowing requirements	281
a15. The public debt	282
a16. State sector balances	283
a17. Sources and uses of monetary base	284
a18. Interest rates on Bank of Italy operations	285
a19. Banks' assets and liabilities	286
a20. Banks: loan portfolio	288
a21. Banks: securities portfolio	289
a22. Profit and loss accounts of banks by category of bank	290
a23. Financial market: gross and net issues of securities	292
a24. Money market and interbank interest rates	294
a25. Bank interest rates	295
a26. Interest rates on securities	296
a27. M2 and its counterparts	297
a28. The money supply	298
a29. Credit	300
a30. Italy's financial assets and liabilities in 1997 (stocks)	302
a31. Italy's financial assets and liabilities in 1997 (flows)	304
a32. Banks: contribution of operations to supervisory capital	306
a33. Banks: supervisory capital	307
a34. Banks: capital adequacy	308

Table a1

SOURCES AND USES OF INCOME
(billions of lire)

	National								
	Sources								Total
	Agriculture, forestry and fisheries (1)	Industry (1)	Market services (1)	Imputed output of bank services (-)	Non-market services (1)	Indirect taxes on imports	GDP	Imports of goods and services	
1988	43,460	412,713	593,001	54,524	178,399	73,917	1,246,966	210,708	1,457,674
1989	43,768	427,331	612,093	57,820	180,269	77,264	1,282,905	229,922	1,512,827
1990	42,133	437,629	630,097	60,721	182,330	79,191	1,310,659	250,301	1,560,960
1991	45,541	437,135	639,197	61,973	184,354	81,328	1,325,582	257,119	1,582,701
1992	46,699	438,644	648,644	68,851	185,910	82,026	1,333,072	271,107	1,604,179
1993	45,987	426,363	654,533	72,540	185,975	77,350	1,317,668	249,092	1,566,760
1994	46,196	440,980	665,805	71,028	185,815	78,499	1,346,267	269,951	1,616,218
1995	46,393	458,469	684,972	70,362	185,552	80,836	1,385,860	295,949	1,681,809
1996	47,276	456,127	695,215	69,652	185,016	81,036	1,395,018	289,953	1,684,971
1997	47,061	463,327	707,364	70,489	184,503	84,289	1,416,055	324,183	1,740,238
1993 – I	11,563	106,769	162,991	18,481	46,517	19,605	328,964	62,550	391,514
II	11,367	107,072	163,190	18,182	46,495	19,231	329,175	62,106	391,281
III	11,188	105,609	163,763	17,950	46,484	19,223	328,316	62,624	390,940
IV	11,869	106,912	164,589	17,927	46,479	19,292	331,214	61,812	393,026
1994 – I	12,024	106,958	165,604	18,006	46,492	19,488	332,560	64,842	397,402
II	11,584	110,325	165,924	17,728	46,483	19,547	336,135	66,326	402,461
III	11,343	111,435	166,733	17,564	46,431	19,663	338,041	68,022	406,063
IV	11,245	112,262	167,544	17,730	46,409	19,800	339,530	70,761	410,292
1995 – I	12,121	114,945	169,600	17,800	46,422	20,033	345,321	72,586	417,907
II	11,545	113,539	170,923	17,597	46,409	20,173	344,992	73,935	418,927
III	11,135	114,758	171,995	17,469	46,378	20,320	347,118	74,732	421,849
IV	11,591	115,227	172,454	17,496	46,343	20,310	348,430	74,696	423,125
1996 – I	11,807	116,318	173,329	17,238	46,314	20,326	350,855	73,838	424,693
II	11,852	113,081	173,489	17,214	46,273	20,144	347,625	69,891	417,516
III	11,996	113,840	174,102	17,439	46,229	20,177	348,904	70,785	419,689
IV	11,621	112,888	174,296	17,760	46,201	20,389	347,634	75,439	423,073
1997 – I	12,182	111,665	174,729	17,634	46,208	20,610	347,759	71,725	419,484
II	11,372	116,613	176,705	17,544	46,164	21,057	354,367	81,531	435,898
III	11,577	117,194	178,098	17,620	46,104	21,298	356,652	84,668	441,320
IV	11,930	117,855	177,832	17,691	46,027	21,324	357,277	86,258	443,535

Source: Istat.
(1) Value added at market prices.

Table a1 cont.

AND HOUSEHOLDS' CONSUMPTION
(at 1990 prices)

accounts						Households' domestic consumption						
Uses						By type of consumption				By type of good		
Buildings and public works	Machinery, equipment and vehicles	Households' consumption	Collective consumption	Change in stocks	Exports of goods and services	Non-durable	Semi-durable	Durable	Services	Food	Non-food	
125,856	120,016	763,563	228,318	10,882	209,039	254,146	147,972	87,140	274,306	154,821	608,742	
130,560	126,160	789,062	230,462	8,861	227,722	259,019	154,093	95,051	280,899	155,684	633,378	
135,091	130,953	807,987	233,370	10,361	243,198	263,085	156,955	98,220	289,727	156,240	651,747	
137,033	131,240	829,642	237,299	6,147	241,340	267,572	162,694	101,534	297,842	156,975	672,667	
133,753	129,608	838,324	240,019	7,004	255,471	269,891	164,011	104,951	299,472	157,459	680,865	
125,324	104,304	817,890	241,106	-517	278,653	269,787	156,975	91,512	299,616	157,154	660,736	
117,960	112,825	829,433	239,693	7,960	308,347	268,765	160,755	92,281	307,632	156,993	672,440	
118,704	128,430	844,958	237,254	8,196	344,267	271,073	165,097	93,482	315,306	156,215	688,743	
120,023	128,094	851,921	237,834	3,530	343,569	272,791	162,152	93,183	323,795	154,116	697,805	
118,154	131,381	872,066	236,209	17,083	365,345	275,153	166,861	101,157	328,895	154,534	717,532	
32,030	27,754	204,906	60,331	-641	67,134	66,952	39,297	24,106	74,550	38,967	165,938	
31,545	25,590	203,216	60,334	2,376	68,221	67,174	38,996	22,494	74,551	39,189	164,026	
31,107	25,102	204,141	60,255	-159	70,494	67,730	39,123	22,312	74,976	39,448	164,694	
30,642	25,858	205,628	60,186	-2,092	72,804	67,931	39,558	22,599	75,539	39,550	166,078	
30,110	26,514	206,877	60,216	-1,300	74,985	67,639	39,897	23,172	76,169	39,473	167,404	
29,627	27,777	207,142	60,143	2,608	75,164	67,119	40,020	23,074	76,929	39,295	167,847	
29,172	28,939	207,436	59,831	2,349	78,335	66,886	40,206	23,131	77,213	39,130	168,306	
29,050	29,594	207,979	59,503	4,303	79,863	67,121	40,632	22,904	77,321	39,095	168,884	
29,348	30,931	209,715	59,329	2,067	86,518	67,566	41,157	23,212	77,780	39,116	170,599	
29,454	31,818	210,895	59,213	-773	88,321	67,820	41,498	23,148	78,429	39,076	171,819	
29,652	32,770	212,135	59,300	2,658	85,335	67,922	41,465	23,632	79,116	39,027	173,108	
30,250	32,911	212,214	59,412	4,245	84,093	67,765	40,979	23,489	79,981	39,996	173,217	
30,214	32,397	212,682	59,479	4,472	85,449	67,727	40,432	23,548	80,975	38,890	173,792	
29,993	32,216	212,267	59,599	-1,085	84,525	67,964	40,278	22,911	81,115	38,645	173,622	
29,988	31,849	212,742	59,532	-317	85,896	68,314	40,465	23,070	80,893	38,321	174,421	
29,828	31,632	214,230	59,224	459	87,700	68,787	40,976	23,654	80,812	38,260	175,970	
29,302	32,279	216,781	58,956	-431	82,597	69,154	41,558	24,857	81,212	38,387	178,394	
29,713	32,639	218,267	59,023	5,800	90,455	69,043	41,798	25,316	82,111	38,585	179,683	
29,734	33,107	218,781	59,110	3,971	96,618	68,608	41,757	25,717	82,700	38,734	180,047	
29,404	33,356	218,236	59,121	7,742	95,675	68,348	41,749	25,267	82,872	38,828	179,408	

Table a2

**LABOUR COSTS PER UNIT OF OUTPUT AND VALUE
ADDED PER WORKER, BY SECTOR**

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
<p align="center">Unit labour costs (current lire per thousand lire of value added at factor cost at 1990 prices)</p>										
Market goods and services (1) .	606.1	639.9	685.3	743.4	772.3	784.5	776.4	787.7	824.2	842.2
Agriculture, forestry and fisheries	846.6	841.3	908.3	882.9	914.9	902.4	873.4	849.8	834.8	843.4
Industry	568.2	603.9	649.9	705.8	733.5	758.9	742.3	742.8	781.3	798.7
<i>Excluding construction</i>	<i>565.2</i>	<i>601.6</i>	<i>643.8</i>	<i>696.5</i>	<i>716.7</i>	<i>736.3</i>	<i>712.3</i>	<i>711.1</i>	<i>753.7</i>	<i>769.0</i>
<i>Energy products</i>	<i>352.0</i>	<i>374.6</i>	<i>405.7</i>	<i>437.6</i>	<i>449.5</i>	<i>435.4</i>	<i>434.1</i>	<i>441.7</i>	<i>466.3</i>	<i>450.9</i>
<i>Manufactures</i>	<i>585.3</i>	<i>622.8</i>	<i>666.3</i>	<i>721.3</i>	<i>742.8</i>	<i>767.4</i>	<i>740.2</i>	<i>736.6</i>	<i>780.7</i>	<i>799.3</i>
<i>Construction</i>	<i>553.4</i>	<i>584.3</i>	<i>645.8</i>	<i>709.3</i>	<i>764.0</i>	<i>804.9</i>	<i>828.3</i>	<i>832.8</i>	<i>840.9</i>	<i>867.0</i>
Services (1)	577.6	613.7	645.8	714.2	745.7	751.8	752.2	774.5	812.1	829.4
<i>Wholesale and retail trade, lodging & catering</i>	<i>526.1</i>	<i>557.8</i>	<i>599.8</i>	<i>655.3</i>	<i>680.0</i>	<i>710.6</i>	<i>706.2</i>	<i>727.5</i>	<i>771.0</i>	<i>787.9</i>
<i>Transport & communications</i>	<i>600.8</i>	<i>637.0</i>	<i>668.2</i>	<i>708.1</i>	<i>727.4</i>	<i>713.8</i>	<i>675.7</i>	<i>663.5</i>	<i>662.3</i>	<i>661.0</i>
<i>Finance and insurance</i>	<i>529.9</i>	<i>555.7</i>	<i>580.1</i>	<i>635.8</i>	<i>675.2</i>	<i>592.5</i>	<i>629.1</i>	<i>683.5</i>	<i>711.9</i>	<i>707.3</i>
<i>Miscellaneous services</i>	<i>510.7</i>	<i>549.0</i>	<i>595.6</i>	<i>665.1</i>	<i>694.2</i>	<i>726.7</i>	<i>740.0</i>	<i>770.3</i>	<i>824.0</i>	<i>872.1</i>
Non-market services	779.4	835.0	968.2	1,046.1	1,090.8	1,110.6	1,138.7	1,168.1	1,267.4	1,339.1
General government	778.8	830.5	966.6	1,042.6	1,086.2	1,102.8	1,129.8	1,155.4	1,258.3	1,330.6
Total (1) ...	639.9	676.0	739.8	801.5	831.4	844.3	840.9	851.4	899.8	926.1
<p align="center">Value added at factor cost per full-time equivalent worker (thousands of lire at 1990 prices)</p>										
Market goods and services (1) .	49,209.1	50,861.6	51,536.8	51,470.7	53,032.1	54,388.5	56,533.3	58,706.6	58,982.3	60,111.5
Agriculture, forestry and fisheries	19,945.7	21,186.8	20,702.0	22,598.7	23,946.6	25,480.1	26,738.3	28,069.6	29,356.6	29,745.9
Industry	54,400.0	56,205.2	56,951.2	57,335.8	58,967.3	59,283.3	62,230.7	65,417.9	65,556.2	66,972.8
<i>Excluding construction</i>	<i>57,350.3</i>	<i>59,115.6</i>	<i>60,083.4</i>	<i>60,975.7</i>	<i>63,576.7</i>	<i>64,824.3</i>	<i>68,632.2</i>	<i>72,636.8</i>	<i>72,185.9</i>	<i>74,266.1</i>
<i>Energy products</i>	<i>145,909.8</i>	<i>152,487.3</i>	<i>157,656.9</i>	<i>161,256.4</i>	<i>167,831.5</i>	<i>175,008.1</i>	<i>185,784.2</i>	<i>199,747.4</i>	<i>196,163.4</i>	<i>207,631.1</i>
<i>Manufactures</i>	<i>53,869.4</i>	<i>55,530.4</i>	<i>56,332.4</i>	<i>57,080.3</i>	<i>59,445.7</i>	<i>60,417.1</i>	<i>64,041.5</i>	<i>67,901.3</i>	<i>67,565.2</i>	<i>69,471.8</i>
<i>Construction</i>	<i>44,734.8</i>	<i>46,524.9</i>	<i>46,718.1</i>	<i>45,996.8</i>	<i>45,286.2</i>	<i>43,401.4</i>	<i>43,221.0</i>	<i>43,937.2</i>	<i>45,639.4</i>	<i>45,190.8</i>
Services (1)	52,786.7	54,014.5	54,695.1	54,372.6	55,218.6	56,975.2	58,570.0	60,027.9	60,068.3	61,091.9
<i>Wholesale and retail trade, lodging & catering</i>	<i>46,477.5</i>	<i>47,702.2</i>	<i>48,232.1</i>	<i>48,128.1</i>	<i>48,532.1</i>	<i>48,807.9</i>	<i>50,436.9</i>	<i>52,107.4</i>	<i>51,802.8</i>	<i>53,027.2</i>
<i>Transport & communications</i>	<i>56,489.3</i>	<i>58,461.5</i>	<i>60,469.7</i>	<i>61,974.5</i>	<i>64,576.2</i>	<i>67,837.7</i>	<i>72,691.2</i>	<i>77,882.1</i>	<i>81,006.6</i>	<i>84,206.7</i>
<i>Finance and insurance</i>	<i>130,996.0</i>	<i>133,325.3</i>	<i>136,468.8</i>	<i>133,485.4</i>	<i>139,124.9</i>	<i>160,196.1</i>	<i>157,285.6</i>	<i>153,084.5</i>	<i>157,146.8</i>	<i>163,004.0</i>
<i>Miscellaneous services</i>	<i>50,686.7</i>	<i>51,090.8</i>	<i>51,003.0</i>	<i>49,783.0</i>	<i>49,716.2</i>	<i>50,006.0</i>	<i>50,662.4</i>	<i>51,297.9</i>	<i>50,528.5</i>	<i>50,198.0</i>
Non-market services	42,502.3	42,702.6	42,885.0	42,886.0	42,757.6	43,011.9	43,204.8	43,251.2	43,252.3	43,393.1
General government	46,488.7	46,715.8	47,084.4	47,295.1	47,336.1	47,673.7	47,985.4	48,201.3	48,327.7	48,668.1
Total (1) ...	47,989.7	49,372.0	49,960.0	50,122.0	51,112.5	52,212.3	53,961.6	55,723.8	55,956.8	56,909.9

Source: Istat.

(1) Net of renting of buildings.

Table a3

INDUSTRIAL PRODUCTION BY ECONOMIC PURPOSE
(indices, 1990=100; seasonally adjusted)

	Final investment goods				Final consumer goods				Intermediate goods				Manufacturing	Aggregate index
	For industry	Transport equipment	Multi-sector	Total	Durable	Semi-durable	Non-durable	Total	For industry	For consumer goods	Mixed purpose	Total		
1988	93.9	97.7	99.0	95.4	98.0	97.9	93.8	96.4	92.8	97.6	98.1	97.5	97.2	96.9
1989	97.8	96.1	103.0	98.2	101.5	100.3	96.1	99.1	99.1	102.0	100.9	100.8	100.3	99.9
1990	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1991	95.4	94.8	98.3	95.9	99.4	100.0	101.4	100.4	97.5	100.0	99.5	99.4	98.8	99.1
1992	93.6	84.8	95.1	92.1	96.3	100.4	104.7	101.1	96.5	101.3	99.9	99.7	98.4	98.9
1993	93.2	67.9	97.8	88.9	90.6	97.2	104.8	98.7	87.9	98.9	98.9	97.7	95.7	96.5
1994	98.1	70.0	97.7	92.2	101.4	103.9	105.8	104.1	88.4	102.9	105.1	103.0	100.9	101.5
1995	114.3	79.7	104.0	105.0	108.2	108.3	106.9	107.8	97.5	103.1	109.3	107.2	106.6	107.0
1996	116.5	80.0	100.4	105.6	105.2	104.8	108.2	106.2	94.5	100.9	106.7	104.6	104.6	105.2
1997	112.4	87.5	88.2	102.3	107.7	106.5	113.2	109.3	93.4	104.8	110.9	108.2	106.7	107.5
1991 – I	96.8	95.9	100.7	97.4	98.7	101.1	101.3	100.7	97.1	99.8	98.6	98.6	98.6	98.7
II	96.3	96.3	94.7	96.0	99.3	98.8	99.2	99.1	98.3	98.9	99.4	99.2	98.5	98.8
III ...	94.0	91.4	102.5	95.2	100.2	97.1	102.8	100.0	97.6	102.1	99.6	99.7	98.7	98.9
IV ...	94.6	95.6	95.3	94.9	99.5	103.1	102.4	102.0	96.9	99.4	100.6	100.0	99.4	99.9
1992 – I	95.9	91.8	95.8	95.0	99.8	103.4	104.5	103.0	100.4	101.9	102.0	101.9	100.9	101.2
II	94.5	89.3	97.5	94.0	96.8	100.2	106.8	102.0	98.7	104.4	101.7	101.7	100.6	100.9
III ...	90.2	77.5	95.1	88.6	92.9	97.3	103.0	98.5	94.9	99.8	98.4	98.2	95.1	96.0
IV ...	93.8	80.7	92.2	90.8	95.7	100.7	104.4	101.0	92.0	99.2	97.6	97.2	96.9	97.4
1993 – I	95.4	72.3	107.5	93.1	92.7	101.3	109.0	102.4	89.5	99.1	100.0	98.7	98.2	98.8
II	95.7	68.7	93.2	89.6	86.7	97.3	105.0	97.9	88.6	98.5	98.7	97.6	95.8	96.6
III ...	88.4	64.9	101.3	86.2	90.5	95.3	102.8	97.1	87.0	98.3	97.1	96.1	93.6	94.5
IV ...	93.2	65.7	89.2	86.7	92.7	94.9	102.3	97.3	86.7	99.7	99.7	98.3	95.3	96.2
1994 – I	92.4	64.8	90.1	86.2	95.9	100.7	104.0	100.9	87.5	100.9	100.6	99.2	96.9	97.5
II	97.2	69.4	101.9	92.4	101.1	103.2	107.1	104.2	87.8	103.6	103.9	102.1	100.6	101.1
III ...	99.9	72.8	101.6	94.6	102.6	107.2	107.1	106.1	87.1	102.8	107.3	104.5	102.6	103.3
IV ...	103.0	73.0	97.3	95.7	105.7	104.6	105.0	105.0	91.1	104.2	108.7	106.2	103.5	104.2
1995 – I	105.9	77.2	91.9	97.1	107.2	107.4	104.8	106.3	93.3	103.8	108.3	106.1	103.9	104.6
II	109.0	76.8	97.9	100.1	107.6	106.3	107.1	106.9	94.6	103.3	108.0	106.0	104.6	105.1
III ...	118.1	82.3	110.9	109.2	107.7	113.2	106.9	109.5	100.3	102.8	111.3	109.0	109.5	109.6
IV ...	124.4	82.4	115.1	113.8	110.2	106.5	108.9	108.2	101.6	102.4	109.4	107.7	108.3	108.6
1996 – I	117.3	82.6	102.5	107.1	106.5	104.2	105.2	105.1	97.4	99.5	107.7	105.6	104.8	105.7
II	118.6	80.4	102.8	107.5	106.7	102.2	108.8	105.7	95.4	99.4	106.7	104.6	104.7	105.2
III ...	116.4	80.3	102.2	106.0	104.9	107.8	108.8	107.6	93.8	101.6	107.7	105.4	105.7	106.2
IV ...	113.6	76.5	94.1	101.9	102.5	105.1	109.9	106.4	91.4	103.2	104.6	103.0	103.0	103.7
1997 – I	112.7	79.9	95.0	102.3	108.3	103.7	111.8	107.9	91.2	104.5	107.2	105.1	104.8	105.4
II	114.3	85.5	91.4	103.7	110.3	104.7	111.5	108.6	94.3	104.8	109.9	107.6	106.2	107.2
III ...	110.6	91.0	84.0	101.2	105.9	109.6	115.0	110.9	93.7	104.3	112.4	109.3	107.3	108.2
IV ...	111.8	93.4	82.4	102.0	106.3	107.8	114.5	110.0	94.4	105.5	114.0	110.8	108.6	109.4

Source: Based on Istat data.

Table a4

CAPACITY UTILIZATION RATES IN INDUSTRY
(percentages; seasonally adjusted)

	Final investment goods				Final consumer goods				Intermediate goods				Manufacturing	Aggregate index
	For industry	Transport equipment	Multi-sector	Total	Durable	Semi-durable	Non-durable	Total	For industry	For consumer goods	Mixed purpose	Total		
1988	90.9	96.9	90.6	92.1	95.4	94.1	97.3	95.5	91.2	93.6	96.1	95.3	93.4	93.7
1989	95.3	93.2	93.0	94.5	98.0	95.9	97.0	96.8	97.4	96.7	97.8	97.6	94.2	94.5
1990	96.5	95.6	90.4	95.0	95.6	95.1	98.2	96.4	98.1	94.7	95.9	95.9	92.9	93.4
1991	88.8	96.2	89.9	90.4	94.1	94.6	97.0	95.4	95.7	95.0	94.2	94.4	91.2	91.8
1992	84.1	89.0	87.9	85.8	90.3	94.5	97.6	94.7	94.9	96.6	93.4	93.9	90.3	90.9
1993	80.9	71.5	90.2	81.1	84.1	91.0	95.7	91.3	86.5	94.6	91.2	91.1	87.1	87.9
1994	82.4	74.0	87.9	82.0	93.1	96.7	95.5	95.4	87.0	98.8	95.8	95.2	91.4	91.6
1995	93.0	84.5	91.2	91.2	98.5	98.9	95.4	97.4	96.1	98.8	98.3	98.2	95.7	95.3
1996	93.6	85.1	87.4	91.0	95.3	96.1	95.4	95.6	93.3	96.4	95.0	95.0	92.7	93.1
1997	90.3	93.4	76.8	88.1	97.6	96.8	98.7	97.7	92.3	99.8	97.7	97.4	93.9	94.3
1991 – I	91.3	94.4	91.7	92.0	93.7	95.7	97.9	96.1	95.3	94.6	93.7	94.0	91.3	91.8
II	90.0	96.7	86.5	90.5	94.1	93.4	95.2	94.3	96.4	94.0	94.2	94.4	91.1	91.6
III	87.0	93.6	93.9	89.7	94.7	92.0	97.9	94.9	95.9	97.0	94.1	94.6	91.0	91.5
IV	86.8	100.0	87.3	89.4	93.9	97.3	97.0	96.4	95.0	94.4	94.7	94.7	91.6	92.3
1992 – I	87.3	96.1	88.1	89.1	93.8	97.3	98.3	96.9	98.7	97.0	95.8	96.2	92.9	93.3
II	85.2	93.6	89.9	87.7	90.9	94.2	100.0	95.7	97.0	99.6	95.1	95.9	92.3	92.8
III	80.7	81.4	88.0	82.3	86.9	91.8	95.6	92.2	93.3	95.1	91.8	92.4	87.2	88.1
IV	83.1	84.7	85.5	83.9	89.4	94.6	96.4	94.1	90.4	94.6	90.7	91.2	88.6	89.2
1993 – I	83.8	76.0	100.0	85.7	86.3	94.8	100.0	95.0	88.0	94.8	92.7	92.4	89.6	90.2
II	83.4	72.2	86.1	81.9	80.5	91.0	96.2	90.7	87.2	94.3	91.2	91.2	87.3	88.1
III	76.5	68.3	93.1	78.4	83.8	89.4	93.6	89.8	85.6	94.0	89.4	89.6	85.2	86.0
IV	79.9	69.3	81.4	78.3	85.7	88.7	93.0	89.7	85.2	95.3	91.5	91.3	86.5	87.3
1994 – I	78.6	68.3	81.8	77.4	88.4	93.7	94.3	92.7	86.2	96.9	92.1	92.0	87.8	88.3
II	82.0	73.2	91.9	82.4	93.0	95.9	97.0	95.7	86.5	99.5	94.8	94.5	90.9	91.4
III	83.5	77.0	91.1	83.9	94.1	100.0	96.3	97.2	85.8	98.6	97.6	96.5	92.6	93.1
IV	85.5	77.3	86.6	84.3	96.8	97.2	94.3	96.0	89.6	100.0	98.5	97.8	93.3	93.8
1995 – I	87.2	81.6	81.5	85.1	97.9	99.2	93.8	96.8	92.1	99.9	97.9	97.6	93.4	93.9
II	89.0	81.3	86.3	87.1	98.0	98.1	95.8	97.2	93.3	99.1	97.4	97.2	93.8	94.1
III	95.7	87.4	97.1	94.5	97.9	100.0	95.1	97.6	98.9	98.4	100.0	99.7	97.3	97.2
IV	100.0	87.5	100.0	97.9	100.0	98.2	96.7	98.0	100.0	97.9	98.0	98.2	95.8	96.0
1996 – I	94.4	87.6	89.3	92.2	96.5	95.5	93.1	94.8	96.4	95.4	96.3	96.2	93.2	93.9
II	95.3	85.5	89.5	92.5	96.7	93.5	96.1	95.2	94.2	95.1	95.2	95.1	93.0	93.2
III	93.5	85.6	89.0	91.3	95.1	99.1	95.7	96.9	92.5	96.9	95.7	95.5	93.7	93.9
IV	91.3	81.6	81.7	87.8	93.0	96.2	96.5	95.6	89.9	98.3	92.7	93.1	91.0	91.4
1997 – I	90.7	84.9	82.8	88.1	98.0	94.3	97.8	96.5	90.4	100.0	94.7	94.9	92.5	92.8
II	91.8	91.3	79.6	89.3	100.0	95.0	97.3	97.0	93.3	99.9	97.0	96.9	93.5	94.2
III	88.9	97.4	73.2	87.1	96.0	100.0	100.0	99.1	92.6	99.2	98.9	98.3	94.3	94.8
IV	89.9	100.0	71.4	87.9	96.5	97.9	99.7	98.3	92.9	100.0	100.0	99.3	95.2	95.6

Source: Based on Istat data.

Table a5

CONSUMER PRICE INDEX (1)
(percentage changes on corresponding period)

Weights (2)	Goods and services with unregulated prices							Goods and with regulated prices						Overall index (4)
	Non-food and non-energy products	Food products			Energy products	Services	Total	Goods (3)		Utility charges		Rents	Total	
		Processed	Not processed	Total				of which: tobacco products	of which: energy products					
	32.7	10.2	9.5	19.7	3.4	26.7	82.5	4.2	1.8	10.3	3.4	3.0	17.5	100
1988	4.9	3.3	3.8	3.6	4.9	7.5	5.1	4.5	7.8	4.2	2.9	4.3	4.3	5.0
1989	5.2	6.4	6.0	6.2	5.7	7.5	6.1	3.4	6.6	8.1	3.2	5.6	6.3	6.3
1990	4.5	6.2	6.1	6.1	13.8	8.1	6.5	3.9	7.0	6.4	8.2	6.1	5.7	6.5
1991	4.5	5.8	7.4	6.5	9.2	7.4	6.2	11.9	8.1	7.8	8.9	5.9	9.3	6.3
1992	4.0	5.0	5.1	5.0	0.7	7.3	5.1	2.7	9.4	6.5	1.3	6.5	5.5	5.3
1993	4.7	4.6	-0.4	2.1	5.6	5.7	4.4	7.7	15.3	4.2	3.2	7.6	5.6	4.6
1994	4.1	4.0	3.0	3.5	4.0	4.3	4.0	3.3	7.1	3.3	4.7	8.4	4.1	4.1
1995	4.9	6.7	5.4	6.1	7.8	5.3	5.4	1.9	8.0	3.8	3.7	7.6	3.9	5.2
1996	3.8	4.6	3.7	4.2	4.6	4.5	4.5	4.2	5.9	1.3	-0.7	8.3	3.2	4.0
1997	1.5	0.8	-0.8	0.0	2.0	2.9	1.6	5.4	4.1	2.5	1.9	6.6	4.0	2.0
1996 – Oct.	3.0	3.4	2.4	2.9	4.9	3.9	3.7	2.9	4.8	-0.4	-3.9	8.4	2.0	3.1
Nov.	2.4	3.0	2.3	2.7	5.2	3.7	3.4	2.9	4.8	0.3	-1.6	8.4	2.4	2.9
Dec.	2.5	2.8	2.0	2.4	4.9	3.7	3.3	3.0	4.8	0.3	-1.6	8.4	2.4	2.8
1997 – Jan.	2.3	2.5	1.8	2.2	4.6	3.5	2.7	2.8	0.0	0.4	-1.4	7.9	2.3	2.7
Feb.	2.0	1.8	1.2	1.5	4.7	3.3	2.4	3.1	0.0	0.4	-1.0	7.9	2.2	2.4
Mar.	1.7	1.4	0.6	1.0	3.7	3.1	2.1	5.2	4.9	1.2	0.0	7.9	3.3	2.3
Apr.	1.6	1.1	-0.6	0.3	1.0	3.1	1.7	5.1	4.9	1.1	0.1	6.7	3.1	2.0
May	1.4	0.6	-1.8	-0.6	1.5	3.0	1.4	5.1	4.9	2.5	0.2	6.7	3.9	1.9
June	1.3	0.4	-2.4	-0.9	2.0	2.9	1.3	5.3	4.9	2.4	0.1	6.7	3.9	1.7
July	1.2	0.3	-2.5	-1.0	1.8	2.9	1.2	5.8	4.9	4.2	5.8	6.2	5.0	1.8
Aug.	1.2	0.3	-2.3	-1.0	2.3	2.7	1.2	5.8	4.9	4.0	5.4	6.2	4.9	1.8
Sept.	1.2	0.2	-1.7	-0.7	1.5	2.7	1.2	6.5	4.9	3.5	4.1	6.2	4.7	1.8
Oct.	1.3	0.1	-1.0	-0.4	0.8	2.8	1.4	6.5	4.9	4.1	4.6	5.7	5.0	2.0
Nov.	1.5	0.2	-0.5	-0.1	0.3	2.6	1.4	6.7	4.9	3.4	2.8	5.7	4.7	2.0
Dec.	1.4	0.2	0.0	0.1	-0.3	2.6	1.4	6.7	4.9	3.2	2.7	5.7	4.5	1.9
1998 – Jan.	1.8	0.3	0.8	0.5	-1.2	2.7	1.6	3.8	4.9	2.8	2.1	5.3	3.5	1.9
Feb.	2.0	0.4	1.2	0.8	-2.0	2.8	1.8	3.5	4.9	2.8	1.9	5.3	3.4	2.1
Mar.	2.0	0.5	1.2	0.8	-2.6	2.9	1.8	3.9	5.6	2.2	0.9	5.3	3.2	2.1

Source: Based on Istat data.

(1) Sundry bases; for 1996 the comparison is with the 1990-based index, with the average for 1995 set equal to 100. – (2) With reference to 1995=100. – (3) Medicines and salt. For the former, the reference is to the aggregate calculated by Istat; around one third of this consists of products in the so-called "C band", the prices of which are unregulated. Drinking water, electricity and natural gas are included under utility charges. – (4) Percentage changes published by Istat and calculated on indices rounded to the first decimal place.

Table a6

HARMONIZED INDEX OF CONSUMER PRICES
(percentage changes on corresponding period)

Weights (1)	Goods							Services			Overall index
	Non-food and non-energy products	Food products				Energy products	Total	Services (excluding rents)	Rents	Total	
		Processed	Not processed	Tobacco products	Total						
	36.7	9.5	10.9	1.9	22.3	6.8	65.7	31.6	2.7	34.3	100.0
1996	3.8	4.9	3.4	5.9	4.3	1.8	3.8	4.3	8.4	4.6	4.0
1997	1.7	0.7	-0.7	3.9	0.3	1.9	1.3	3.0	6.7	3.3	1.9
1996 – Jan.	5.2	7.0	3.8	11.7	5.8	7.2	5.6	5.8	8.2	6.0	5.7
Feb.	4.8	6.6	3.6	11.7	5.5	6.7	5.2	5.3	8.2	5.5	5.3
Mar.	4.9	6.1	3.8	4.8	4.8	2.3	4.6	4.7	8.2	5.0	4.7
Apr.	4.6	5.7	4.3	4.8	4.9	2.5	4.5	4.7	8.3	5.0	4.6
May	4.3	5.5	4.5	4.8	4.9	1.2	4.2	4.6	8.3	4.9	4.4
June	3.8	5.3	4.1	4.8	4.7	0.8	3.8	4.3	8.3	4.6	3.9
July	3.7	4.8	4.1	4.8	4.5	-1.3	3.4	4.1	8.5	4.4	3.6
Aug.	3.5	4.5	3.7	4.8	4.1	-0.9	3.2	3.8	8.5	4.1	3.5
Sept.	3.3	4.1	2.8	4.8	3.5	-0.2	3.0	3.8	8.5	4.2	3.3
Oct.	3.1	3.6	2.3	4.8	3.1	0.2	2.8	3.6	8.4	4.0	3.1
Nov.	2.5	3.3	2.2	4.8	2.9	1.5	2.5	3.4	8.4	3.8	2.9
Dec.	2.6	3.0	2.0	4.8	2.7	1.5	2.5	3.4	8.4	3.7	2.9
1997 – Jan.	2.4	2.5	1.6	0.0	1.9	1.8	2.2	3.2	7.5	3.5	2.6
Feb.	2.2	1.9	0.9	0.0	1.2	2.1	1.8	3.0	7.5	3.4	2.3
Mar.	1.9	1.5	0.3	4.7	1.2	2.0	1.7	3.1	7.5	3.4	2.2
Apr.	1.8	1.1	-0.7	4.7	0.5	0.6	1.2	3.1	7.0	3.4	1.9
May	1.6	0.5	-1.6	4.7	-0.2	0.8	0.9	3.2	7.0	3.5	1.8
June	1.5	0.4	-2.1	4.7	-0.5	1.1	0.8	3.1	7.0	3.4	1.6
July	1.4	0.2	-2.1	4.7	-0.6	3.6	0.9	3.0	6.6	3.3	1.7
Aug.	1.3	0.2	-1.9	4.7	-0.5	3.7	1.0	2.8	6.6	3.1	1.6
Sept.	1.4	0.1	-1.4	4.7	-0.2	2.7	1.0	2.7	6.6	3.0	1.6
Oct.	1.6	0.1	-0.8	4.7	0.0	2.6	1.2	3.0	5.9	3.3	1.9
Nov.	1.8	0.2	-0.4	4.7	0.3	1.5	1.2	2.8	5.9	3.0	1.8
Dec.	1.7	0.2	0.0	4.7	0.5	1.1	1.2	2.7	5.9	3.0	1.8
1998 – Jan.	2.1	0.2	0.7	4.7	0.8	0.3	1.5	2.8	5.3	3.0	1.9
Feb.	2.3	0.4	1.2	4.7	1.1	-0.2	1.7	2.9	5.3	3.1	2.1
Mar.	2.3	0.4	1.2	5.5	1.3	-1.0	1.6	2.9	5.3	3.1	2.1

Source: Based on Eurostat data.

(1) In January of each year the weight of each elementary item, determined initially with reference to the structure of consumption in 1996, is adjusted by Eurostat on the basis of the 12-month percentage change in the preceding December. The sum of weights is then made equal to 100. The weights shown in the table are those established in January 1998.

Table a7

CONSUMER PRICE INDEX FOR WORKER AND EMPLOYEE HOUSEHOLDS (1)
(percentage changes on corresponding period)

Weights (2)	Goods and services with unregulated prices							Goods and services with regulated prices					Overall index (4)
	Non-food and non-energy products	Food products			Energy products	Services	Total	Goods (3)	Utility charges		Rents	Total	
		Processed	Not processed	Total					of which: energy products				
	35.6	10.6	9.7	20.3	3.7	23.6	83.2	2.0	11.4	3.2	3.4	16.8	100
1988	4.8	3.1	4.0	3.6	4.4	7.3	5.0	1.0	4.6	2.8	5.1	4.4	5.0
1989	5.6	6.3	6.0	6.2	4.6	8.4	6.4	0.9	9.1	3.2	5.8	7.4	6.6
1990	4.8	6.1	5.7	5.9	12.6	7.3	6.1	0.9	6.1	8.6	5.7	5.7	6.1
1991	5.5	6.6	7.1	6.8	9.3	7.8	6.7	7.3	4.1	-2.7	6.1	4.8	6.4
1992	4.3	5.0	4.2	4.6	0.9	7.5	5.1	-0.4	7.4	-1.5	6.5	6.8	5.4
1993	4.3	4.3	-0.2	2.1	5.9	5.5	4.2	7.5	2.8	2.9	8.1	4.7	4.2
1994	3.8	3.8	2.9	3.4	4.6	4.0	3.8	0.3	3.5	4.5	8.3	4.7	3.9
1995	5.0	6.5	5.1	5.8	8.1	5.2	5.4	-7.9	5.5	3.3	7.5	5.2	5.4
1996	3.9	4.6	3.8	4.2	4.5	3.9	4.0	3.0	1.7	-1.4	9.3	3.4	3.9
1997	1.5	0.6	-0.8	-0.1	1.8	2.4	1.4	6.5	1.9	1.3	7.0	3.5	1.7
1996 – Oct.	3.0	3.2	3.4	3.3	4.3	3.6	3.3	1.6	-0.8	-4.8	9.7	1.4	3.0
Nov.	2.5	2.9	3.1	3.0	4.7	3.2	2.9	1.6	-0.2	-2.6	9.7	1.8	2.6
Dec.	2.5	2.5	2.9	2.7	4.3	3.1	2.8	1.9	-0.2	-2.6	9.7	1.8	2.6
1997 – Jan.	2.4	2.3	2.2	2.2	4.3	3.0	2.6	5.0	0.5	-2.3	9.1	2.8	2.6
Feb.	2.1	1.5	1.4	1.5	4.6	3.0	2.3	5.5	0.4	-1.9	9.1	2.8	2.4
Mar.	1.8	1.2	0.9	1.0	3.6	2.9	2.0	5.5	0.9	-0.8	9.1	3.2	2.2
Apr.	1.6	0.8	-0.2	0.3	0.5	2.8	1.6	5.4	0.6	-0.7	7.2	2.6	1.7
May	1.4	0.4	-1.6	-0.5	1.0	2.4	1.2	5.4	1.7	-0.7	7.2	3.3	1.6
June	1.4	0.3	-2.2	-0.9	1.7	2.2	1.1	5.7	1.7	-0.7	7.2	3.4	1.4
July	1.3	0.2	-2.3	-1.0	1.5	2.3	1.0	6.6	3.3	5.7	6.2	4.3	1.6
Aug.	1.2	0.2	-2.3	-1.0	2.0	2.1	1.0	6.6	3.1	5.2	6.2	4.2	1.5
Sept.	1.2	0.1	-2.1	-0.9	1.4	2.1	0.9	7.9	2.5	3.9	6.2	3.9	1.4
Oct.	1.3	0.2	-1.6	-0.7	1.0	2.3	1.1	7.9	3.2	4.3	5.7	4.3	1.6
Nov.	1.4	0.1	-1.1	-0.5	0.4	2.0	1.1	8.1	2.7	2.4	5.7	4.0	1.6
Dec.	1.3	0.2	-0.7	-0.3	-0.2	2.1	1.1	8.1	2.5	2.4	5.7	3.8	1.5
1998 – Jan.	1.6	0.2	-0.1	0.1	-1.1	2.3	1.3	3.0	2.1	2.2	5.5	3.0	1.6
Feb.	1.8	0.5	0.6	0.5	-1.8	2.5	1.5	2.5	2.1	2.1	5.5	2.9	1.8
Mar.	1.8	0.6	0.6	0.6	-2.6	2.6	1.6	2.7	1.9	0.9	5.5	2.8	1.7
Apr.	1.9	0.7	0.9	0.8	-2.0	2.6	1.6	2.9	1.6	0.8	5.8	2.7	1.8

Source: Based on Istat data.

(1) Excluding tobacco products. Sundry bases; for 1996 the comparison is with the 1992-based index, with the average for 1995 set equal to 100. – (2) With reference to 1995=100. – (3) Medicines and salt. For the former, the reference is to the aggregate calculated by Istat; around one third if this consists of products in the so-called "C band", the prices of which are unregulated. Drinking water, electricity and natural gas are included under utility charges. – (4) Percentage changes published by Istat and calculated on indices rounded to the first decimal place.

Table a8

INDEX OF THE PRODUCER PRICES OF MANUFACTURES SOLD IN THE DOMESTIC MARKET (1)
(percentage changes on corresponding period)

Weights (2)	Non-energy products								Energy products	Overall index
	Consumer goods with unregulated prices (3)				Investment goods	Intermediate goods	Other goods (4)	Total		
	Non-food-products		Food products	Total						
		of which: cars								
	18.5	2.1	12.3	30.8	9.5	41.0	4.1	85.4	14.6	100.0
1988	5.1	2.3	2.1	3.8	3.1	4.8	5.1	4.1	-0.2	3.6
1989	4.9	6.3	5.3	5.0	5.8	5.8	3.2	5.5	9.4	5.9
1990	2.7	4.2	3.0	2.8	4.1	1.7	3.1	2.6	16.2	4.1
1991	2.3	2.8	5.3	3.8	3.3	5.5	1.9	3.8	-2.4	3.3
1992	3.2	4.6	3.8	3.4	3.3	1.0	5.3	2.2	-0.4	1.9
1993	3.1	6.0	3.9	3.4	3.6	3.2	6.0	3.4	6.3	3.8
1994	3.2	7.0	3.6	3.3	2.9	4.2	5.0	3.8	3.2	3.7
1995	5.1	5.4	6.0	5.4	5.0	10.7	4.4	8.1	6.4	7.9
1996	3.4	5.3	2.8	3.2	3.6	-0.1	3.5	1.7	3.4	1.9
1997	0.7	-1.7	1.1	0.9	1.8	0.5	0.9	0.8	4.3	1.3
1996 – Oct.	2.6	4.9	1.4	2.1	2.9	-2.2	3.0	0.2	4.3	0.7
Nov.	2.3	3.9	0.8	1.7	2.6	-1.9	2.4	0.1	6.1	0.9
Dec.	2.2	3.9	0.5	1.5	2.7	-2.0	2.3	0.0	6.0	0.9
1997 – Jan.	1.6	2.1	0.5	1.1	2.3	-1.6	-0.1	-0.1	6.5	0.9
Feb.	1.1	1.2	0.1	0.7	2.1	-1.1	-0.2	0.0	6.0	0.8
Mar.	0.8	-0.2	0.4	0.7	1.8	-0.9	0.9	0.1	5.4	0.9
Apr.	1.0	-0.6	-0.3	0.5	1.9	-0.1	0.6	0.4	3.7	0.8
May	0.9	-1.0	0.1	0.6	1.9	0.4	0.8	0.7	4.4	1.1
June	0.6	-2.8	0.7	0.7	1.8	0.8	0.8	0.9	6.0	1.6
July	0.3	-3.4	1.2	0.7	1.4	0.7	0.8	0.8	7.2	1.7
Aug.	0.5	-3.1	1.5	0.9	1.7	1.0	0.7	1.0	5.5	1.7
Sept.	0.5	-2.9	2.0	1.1	1.7	1.2	0.9	1.2	3.7	1.6
Oct.	0.3	-4.0	2.1	1.0	1.6	1.6	1.6	1.4	2.7	1.6
Nov.	0.6	-2.7	2.6	1.4	1.6	1.7	2.1	1.6	1.2	1.6
Dec.	0.6	-2.9	2.7	1.4	1.5	2.0	2.4	1.7	-0.5	1.5
1998 – Jan.	1.0	-1.2	2.3	1.5	1.8	2.0	3.4	1.9	-2.3	1.3
Feb.	1.3	0.3	2.3	1.7	2.0	2.0	3.0	1.9	-2.7	1.3
Mar.	1.4	1.1	2.1	1.6	1.8	1.8	2.4	1.8	-3.6	0.9

Source: Based on Istat data.

(1) Sundry bases; for 1996 the comparison is with the 1990-based index, with the average for 1995 set equal to 100. – (2) With reference to 1995=100.– (3) Excludes tobacco products and medicines. – (4) Includes tobacco products and medicines, the prices of which are subject to official control. In the absence of elementary indices for medicines, the reference is to the Istat aggregate "Chemical, pharmaceutical and medical products", which also includes goods with unregulated prices.

Table a9

UNIT VARIABLE COSTS AND OUTPUT PRICES IN MANUFACTURING (1)
(percentage changes on corresponding period)

Weights	Unit variable costs											Output prices		
	Domestic components						Foreign components				Total	Domestic	Foreign	Total
	Input costs	Unit labour costs			Total	of which:			Total					
		Components		Semi-finished goods		Industrial raw materials	Energy products (2)							
		of which: services	Labour costs					Productivity						
	24.9	18.7	–	–	49.6	74.5	10.4	5.0	5.1	25.5	100.0	72.0	28.0	100.0
1988	4.2	3.5	7.5	5.4	2.0	2.8	6.6	15.3	–7.6	5.9	3.1	3.4	4.9	3.8
1989	5.3	5.6	9.7	3.1	6.4	6.0	5.9	12.2	13.9	7.6	6.4	5.2	6.2	5.5
1990	7.2	8.3	8.5	1.4	7.0	7.1	–1.9	–12.9	14.7	–1.4	5.3	2.8	1.7	2.5
1991	7.4	8.0	9.7	1.3	8.3	7.9	0.3	–6.7	3.7	0.7	6.5	2.8	2.4	2.7
1992	3.4	3.8	7.3	4.1	3.0	3.1	–0.9	–4.7	–3.5	–0.6	2.4	2.7	2.0	2.5
1993	4.0	4.8	5.0	1.6	3.3	3.6	14.8	12.1	9.8	13.7	5.5	3.6	11.5	5.8
1994	2.9	2.7	2.2	6.0	–3.6	–1.2	3.3	11.9	3.2	5.6	0.3	3.6	3.1	3.4
1995	8.0	7.3	5.5	6.0	–0.5	2.8	11.6	20.5	9.3	13.1	5.0	7.3	8.9	7.8
1996	5.3	5.3	5.5	–0.5	6.0	5.7	–0.2	–9.4	6.5	–2.2	3.8	1.9	2.3	2.0
1997	0.7	1.6	5.3	2.8	2.4	1.7	–1.7	–1.3	3.1	–0.7	1.2	0.8	–0.7	0.4
1996 – Oct. ...	4.0	4.2	–	–	–	–	–4.1	–18.6	13.1	–5.7	–	0.5	–1.6	–0.1
Nov. ...	2.9	3.2	–	–	–	–	–5.5	–18.4	14.6	–5.7	–	0.4	–3.3	–0.7
Dec. ...	2.3	2.7	4.6	–0.6	5.2	4.3	–6.3	–17.2	12.6	–6.3	2.0	0.3	–2.8	–0.6
1997 – Jan. ...	1.7	2.3	–	–	–	–	–8.4	–16.4	11.3	–7.0	–	0.2	–3.9	–1.0
Feb. ...	1.3	2.0	–	–	–	–	–4.5	–12.0	10.6	–4.1	–	0.1	–3.0	–0.8
Mar. ...	0.7	1.6	5.9	–1.8	7.8	5.1	–4.1	–9.3	5.7	–3.3	2.9	0.2	–3.0	–0.7
Apr. ...	0.2	1.1	–	–	–	–	–3.1	–5.3	1.5	–2.3	–	0.4	–0.8	0.1
May ...	0.7	1.5	–	–	–	–	–1.3	–1.6	2.1	–0.8	–	0.6	–1.4	0.1
June ...	0.7	1.7	6.0	4.8	1.1	0.9	–1.3	–1.0	4.2	–0.4	0.4	0.8	–1.0	0.3
July ...	0.6	1.7	–	–	–	–	–0.2	0.5	5.2	1.1	–	0.8	–0.6	0.4
Aug. ...	0.8	1.7	–	–	–	–	0.0	4.6	5.9	1.6	–	0.9	0.2	0.7
Sept. ...	0.5	1.4	5.2	3.9	1.3	1.0	0.7	7.1	1.8	2.3	1.2	1.1	1.1	1.1
Oct. ...	0.2	1.1	–	–	–	–	0.5	9.1	–1.5	1.9	–	1.3	1.1	1.2
Nov. ...	0.5	1.5	–	–	–	–	0.1	8.5	–2.3	1.7	–	1.5	2.0	1.7
Dec. ...	0.6	1.8	4.0	4.4	–0.4	0.0	1.8	5.1	–5.2	1.9	0.3	1.6	1.4	1.6
1998 – Jan. ...	0.8	2.1	–	–	–	–	–	–	–	–	–	1.8	–	–
Feb. ...	1.0	2.5	–	–	–	–	–	–	–	–	–	1.9	–	–
Mar. ...	–	3.0	–	–	–	–	–	–	–	–	–	1.7	–	–

Sources: Based on ENI, Istat and OECD data.

(1) The components, which exclude intrasectoral transactions, are calculated using a weighting structure derived from the intersectoral input-output tables (for the moment reference is made to the table compiled for 1998 at 1980 prices). Compared with the aggregate for manufacturing industry, excludes transport equipment other than motor vehicles. – (2) Includes domestically produced energy products.

Table a10

**ITALY'S REAL EFFECTIVE EXCHANGE RATES BASED
ON THE PRODUCER PRICES OF MANUFACTURES (1)**
(averages; indices, 1993 = 100)

	24 industrial countries	EU	United States	Germany	France	UK	Netherlands	Belgium
1988	111.4	110.0	111.5	115.1	110.0	105.1	107.6	109.9
1989	113.4	113.1	106.3	119.4	113.7	109.4	110.3	110.7
1990	118.8	115.1	122.7	121.1	114.6	113.9	114.1	112.3
1991	118.6	115.7	122.0	121.6	117.7	108.8	116.5	115.8
1992	116.3	112.5	124.8	116.3	114.4	108.7	114.2	112.6
1993	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1994	97.8	98.1	99.7	98.4	98.3	96.7	98.5	96.1
1995	93.2	91.8	102.2	90.8	92.8	96.3	90.4	88.4
1996	103.9	102.1	108.9	102.9	104.3	102.3	101.1	99.6
1997	103.8	103.4	99.1	107.4	108.3	87.8	104.0	103.0
1991 – I	120.2	115.7	130.3	121.7	117.5	110.1	115.3	115.6
II	117.7	115.7	117.3	122.5	117.5	107.6	117.3	116.1
III	117.4	115.6	116.3	121.4	117.5	108.1	117.2	116.0
IV	118.8	115.8	124.0	120.9	118.4	109.2	116.2	115.6
1992 – I	119.5	116.1	126.1	121.2	118.8	109.1	117.6	116.8
II	119.1	115.3	125.6	120.7	118.2	106.6	118.2	116.2
III	119.4	114.1	134.2	117.9	116.3	108.8	116.7	114.5
IV	107.3	104.6	113.1	105.3	104.3	110.1	104.3	102.7
1993 – I	100.1	99.1	100.7	99.3	98.2	103.7	99.1	98.2
II	102.0	101.4	103.8	102.0	100.8	102.0	101.7	100.5
III	100.8	101.6	99.6	101.2	102.5	98.9	101.4	102.4
IV	97.1	97.9	95.7	97.5	98.5	95.4	97.7	98.9
1994 – I	97.0	98.1	95.1	99.0	97.8	94.4	99.5	97.7
II	99.8	100.5	100.0	100.9	100.8	98.5	101.2	98.2
III	97.7	97.7	101.8	97.6	97.8	98.2	97.8	94.8
IV	96.5	96.1	101.8	96.3	96.9	95.8	95.3	93.8
1995 – I	92.8	91.8	99.5	90.9	93.0	93.8	89.8	88.9
II	89.0	88.1	99.5	86.5	89.6	93.5	85.9	84.2
III	94.8	93.4	104.2	92.6	93.9	98.4	92.4	90.0
IV	96.0	93.9	105.6	93.2	94.7	99.6	93.4	90.3
1996 – I	100.1	98.2	107.2	98.1	99.5	102.3	97.4	95.0
II	103.8	102.4	108.1	103.3	104.0	103.8	101.5	99.8
III	105.2	103.3	110.5	104.0	105.6	104.1	101.9	100.9
IV	106.5	104.4	110.0	106.3	107.9	98.9	103.8	102.8
1997 – I	104.7	103.6	101.7	106.8	107.9	91.6	103.9	103.1
II	103.6	103.2	100.2	107.0	108.0	88.3	103.8	102.9
III	102.7	103.5	96.1	108.2	109.0	85.5	104.1	103.0
IV	104.2	103.3	98.5	107.8	108.4	85.8	104.0	103.1

Sources: Based on national statistics and IMF and OECD data.

(1) Rounding may cause discrepancies between quarterly and annual data.

Table a11

ITALY'S EXTERNAL POSITION
(billions of lire)

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
ASSETS	227,232	282,239	325,362	392,553	527,926	681,897	747,585	851,768	1,004,829	1,270,482
Non-bank capital	135,745	167,769	209,656	267,807	358,897	442,552	524,989	594,338	676,485	921,247
Investments	84,679	107,533	139,477	191,099	268,768	344,346	402,747	459,459	523,130	735,073
Direct	52,780	59,122	68,018	81,034	103,503	138,138	146,072	168,492	179,598	236,723
International organizations	3,903	3,903	3,304	3,672	4,068	4,550	5,084	5,497	6,260	6,854
Real estate	685	868	1,307	5,186	6,715	7,847	8,442	9,211	8,803	9,839
Other	48,192	54,351	63,407	72,176	92,720	125,741	132,546	153,784	164,535	220,030
Portfolio	31,899	48,411	71,459	110,065	165,265	206,208	256,675	290,967	343,532	498,350
Loans	8,742	14,013	18,671	23,325	32,811	37,277	51,144	55,781	72,860	102,423
Public	6,584	9,836	11,160	12,791	15,722	18,694	21,740	25,471	27,071	28,646
Private	2,158	4,177	7,511	10,534	17,089	18,583	29,404	30,310	45,789	73,777
Trade credits	42,324	46,223	51,508	53,383	57,318	60,929	71,098	79,098	80,495	83,751
Short-term	23,779	26,777	29,812	29,887	30,873	33,105	40,756	45,432	45,704	48,584
Medium and long-term ..	18,545	19,446	21,696	23,496	26,445	27,824	30,342	33,666	34,791	35,167
Bank capital	91,487	114,470	115,706	124,746	169,029	239,345	222,596	257,430	328,344	349,235
LIABILITIES	336,319	434,973	525,599	610,068	759,328	911,238	956,864	1,027,772	1,165,401	1,419,710
Non-bank capital	167,530	229,226	296,294	334,075	399,141	544,685	581,021	661,807	786,230	998,962
Investments	71,072	105,495	128,065	175,828	220,404	363,538	404,262	478,214	624,569	824,261
Direct	50,310	64,715	67,806	70,878	73,489	91,929	98,398	103,561	114,242	146,290
Real estate	2,148	1,964	2,274	2,194	2,203	2,471	2,558	3,002	3,244	3,540
Other	48,162	62,751	65,532	68,684	71,286	89,458	95,840	100,559	110,998	142,750
Portfolio	20,762	40,780	60,259	104,950	146,915	271,609	305,864	374,653	510,327	677,971
of which: <i>government securities</i>	15,607	25,162	41,637	74,233	99,011	206,893	233,629	291,486	397,937	515,914
BOTs	459	1,715	2,622	2,884	2,891	4,286	5,387	10,355	24,169	32,255
BTPs	1,636	2,409	3,986	12,355	42,964	109,504	91,428	108,221	189,851	283,139
CTEs	6,351	8,338	18,426	19,325	23,824	28,667	31,183	33,850	30,981	30,550
other <i>government securities</i>	7,161	12,700	16,603	18,985	5,184	17,258	42,623	61,823	70,801	78,684
<i>Republic of Italy</i> ..	..	..	..	20,684	24,148	47,178	63,008	77,237	82,135	91,286
Loans	67,386	94,100	133,700	124,200	143,500	146,458	135,045	136,128	119,012	127,167
Public	40,094	47,900	53,319	29,400	31,740	36,646	35,123	41,722	33,958	37,770
Private	27,292	46,200	80,381	94,800	111,760	109,812	99,922	94,406	85,054	89,397
Trade credits	29,072	29,631	34,529	34,047	35,237	34,689	41,714	47,465	42,649	47,534
Short-term	24,240	24,928	29,776	29,274	30,647	30,278	37,178	42,038	37,669	43,394
Medium and long-term ..	4,832	4,703	4,753	4,773	4,590	4,411	4,536	5,427	4,980	4,140
Bank capital	168,789	205,747	229,305	275,993	360,187	366,553	375,843	365,965	379,171	420,748
NET POSITION	-109,087	-152,734	-200,237	-217,515	-231,402	-229,341	-209,279	-176,004	-160,572	-149,228
(excluding the central bank)										
Non-bank capital	-31,785	-61,457	-86,638	-66,268	-40,244	-102,133	-56,032	-67,469	-109,745	-77,715
Bank capital	-77,302	-91,277	-113,599	-151,247	-191,158	-127,208	-153,247	-108,535	-50,827	-71,513
CENTRAL BANK										
Assets	84,201	94,814	104,928	95,913	76,539	86,566	93,897	95,593	108,653	135,619
of which: <i>gold</i>	37,242	33,663	30,579	29,288	29,944	36,910	41,338	40,257	38,366	37,578
Liabilities	1,426	1,573	1,529	1,575	9,240	2,629	2,461	4,117	1,912	1,975
Net position	82,775	93,241	103,399	94,338	67,299	83,937	91,436	91,476	106,741	133,644
OVERALL NET POSITION										
(including the central bank)										
Excluding central bank gold from the assets ...	-26,312	-59,493	-96,838	-123,177	-164,103	-145,404	-117,843	-84,528	-53,831	-15,584
	-63,554	-93,156	-127,417	-152,465	-194,047	-182,314	-159,181	-124,785	-92,197	-53,162

Table a12

MAIN ITEMS OF THE BALANCE OF
(billions)

	Current account									
	Goods (fob)						Invisibles		Current account balance	
	Imports		Exports		Balance		Balance		Unadjusted	Seasonally adjusted
	Unadjusted	Seasonally adjusted	Unadjusted	Seasonally adjusted	Unadjusted	Seasonally adjusted	Unadjusted	Seasonally adjusted		
1988	167,318		166,379		-939		-7,321		-8,260	
1989	195,105		192,797		-2,308		-13,897		-16,205	
1990	202,387		203,515		1,128		-20,779		-19,651	
1991	209,975		209,731		-244		-29,194		-29,438	
1992	215,466		219,435		3,969		-39,936		-35,967	
1993	214,223		266,213		51,990		-35,922		16,068	
1994	250,864		308,045		57,181		-34,366		22,815	
1995	308,293		381,175		72,882		-29,202		43,680	
1996	295,149		388,885		93,736		-30,385		63,351	
1997	325,835		405,732		79,897		-17,355		62,542	
1993 – I	54,692	52,582	61,452	62,415	6,760	9,833	-10,236	-9,340	-3,476	493
II	55,774	53,443	67,631	65,737	11,857	12,294	-8,801	-10,170	3,056	2,123
III	47,791	53,675	63,375	66,595	15,584	12,919	-9,690	-10,275	5,894	2,644
IV	55,966	54,522	73,755	71,466	17,789	16,944	-7,195	-6,137	10,594	10,807
1994 – I	60,170	57,797	73,292	73,769	13,122	15,972	-9,610	-8,815	3,512	7,157
II	63,477	60,761	77,312	74,875	13,835	14,113	-7,783	-8,819	6,052	5,295
III	57,066	64,011	73,794	78,294	16,728	14,283	-9,544	-9,998	7,184	4,285
IV	70,151	68,295	83,647	81,107	13,496	12,812	-7,429	-6,734	6,067	6,078
1995 – I	75,610	72,790	90,708	91,485	15,098	18,695	-7,884	-7,156	7,214	11,538
II	81,664	78,247	100,337	97,265	18,673	19,018	-5,963	-6,779	12,710	12,239
III	70,360	79,104	90,557	95,756	20,197	16,652	-6,285	-6,940	13,912	9,712
IV	80,659	78,151	99,573	96,669	18,914	18,518	-9,070	-8,328	9,844	10,190
1996 – I	79,641	77,547	97,935	99,493	18,294	21,946	-7,143	-6,380	11,151	15,567
II	74,588	71,862	99,738	96,796	25,150	24,934	-8,715	-9,208	16,435	15,726
III	64,879	72,206	91,430	95,964	26,551	23,758	-4,709	-5,659	21,842	18,099
IV	76,041	73,534	99,782	96,632	23,741	23,098	-9,818	-9,138	13,923	13,959
1997 – I	74,042	72,144	90,777	92,434	16,735	20,291	-2,438	-1,784	14,297	18,507
II	84,962	81,666	104,770	101,513	19,808	19,847	-7,711	-7,997	12,097	11,850
III	77,863	86,290	101,471	106,501	23,608	20,210	-3,632	-5,028	19,976	15,183
IV	88,968	85,735	108,714	105,284	19,746	19,548	-3,574	-2,546	16,172	17,002

(1) Rounding may cause discrepancies in totals. – (2) Changes in official reserves are given net of valuation adjustments. A minus sign indicates an increase in assets or a decrease in liabilities.

Table a12 cont.

PAYMENTS ON A TRANSACTIONS BASIS (1)

of lire)

[illegible]

Table a13

CONSOLIDATED ACCOUNTS OF GENERAL GOVERNMENT
(billions of lire)

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
Revenue										
Direct taxes	145,720	170,697	189,124	207,054	221,506	250,835	244,854	259,741	284,344	309,855
Indirect taxes	109,076	123,867	139,465	159,022	167,660	186,611	192,173	209,610	221,463	238,521
Actual social security contributions . . .	133,353	149,754	168,953	187,193	200,031	212,816	213,679	231,671	277,061	294,716
Imputed social security contributions .	16,028	17,718	20,356	22,761	26,157	27,799	30,588	30,153	5,735	7,173
Income from capital	6,742	7,525	8,459	8,820	9,412	9,177	8,516	11,771	13,155	14,949
Sales of goods and services	7,828	8,992	9,409	10,335	11,786	11,913	12,703	13,626	15,086	16,905
Other	15,980	17,986	20,542	25,570	28,996	35,853	38,069	40,619	43,381	51,835
Total current revenue	434,727	496,539	556,308	620,755	665,548	735,004	740,582	797,191	860,225	933,954
Capital account revenue	3,182	4,470	3,366	5,188	33,783	14,115	7,573	14,878	9,025	18,198
Total revenue	437,909	501,009	559,674	625,943	699,331	749,119	748,155	812,069	869,250	952,152
<i>as a percentage of GDP</i>	<i>40.2</i>	<i>42.0</i>	<i>42.7</i>	<i>43.8</i>	<i>46.5</i>	<i>48.3</i>	<i>45.7</i>	<i>45.8</i>	<i>46.4</i>	<i>48.8</i>
Expenditure										
Compensation of employees	132,136	142,331	167,058	181,755	190,248	193,121	197,446	201,188	218,039	229,494
Intermediate consumption	54,432	58,634	63,328	70,042	75,608	79,923	82,371	82,825	87,148	88,537
Social services	189,065	209,963	238,585	261,320	290,578	302,873	319,464	335,041	360,039	382,524
Subsidies to firms	24,799	27,382	26,543	28,763	27,032	33,915	32,864	27,852	29,214	27,246
Interest payments	86,550	104,404	124,143	144,978	172,622	187,800	179,927	201,132	202,362	185,163
Other	10,378	14,469	12,428	15,749	16,726	21,489	18,419	17,876	22,891	23,622
Total current expenditure	497,360	557,183	632,085	702,607	772,814	819,121	830,491	865,914	919,693	936,586
Gross investment	36,763	39,784	43,141	46,587	45,454	41,104	37,907	38,836	42,735	46,033
Investment grants	19,995	20,267	26,172	19,112	23,410	26,616	24,387	23,543	23,600	20,314
Other	564	1,052	4,078	1,718	1,307	9,197	5,520	20,153	8,370	1,439
Total capital account expenditure	57,322	61,103	73,391	67,417	70,171	76,917	67,814	82,532	74,705	67,786
Total expenditure	554,682	618,286	705,476	770,024	842,985	896,038	898,305	948,446	994,398	1,004,372
<i>as a percentage of GDP</i>	<i>50.9</i>	<i>51.9</i>	<i>53.8</i>	<i>53.9</i>	<i>56.1</i>	<i>57.8</i>	<i>54.8</i>	<i>53.5</i>	<i>53.1</i>	<i>51.5</i>
Deficit on current account	62,633	60,644	75,777	81,852	107,266	84,117	89,909	68,723	59,468	2,632
Net borrowing	116,773	117,277	145,802	144,081	143,654	146,919	150,150	136,377	125,148	52,220
<i>as a percentage of GDP</i>	<i>10.7</i>	<i>9.8</i>	<i>11.1</i>	<i>10.1</i>	<i>9.6</i>	<i>9.5</i>	<i>9.2</i>	<i>7.7</i>	<i>6.7</i>	<i>2.7</i>

Source: Based on the *Relazione generale sulla situazione economica del Paese*.

Table a14

**FINANCING OF THE GENERAL GOVERNMENT
AND PUBLIC SECTOR BORROWING REQUIREMENTS (1)**
(billions of lire)

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
GENERAL GOVERNMENT										
Medium and long-term securities . . .	59,071	57,036	66,306	111,502	89,168	162,865	224,641	89,900	126,429	100,449
<i>of which: BI-UIC and banks</i>	4,095	370	-8,579	56,478	73,964	-719	133,469	8,573	-6,137	-23,663
<i>other holders</i>	54,976	56,667	74,885	55,025	15,204	163,584	91,172	81,327	132,565	124,113
Treasury bills, in lire and ecus	42,667	42,615	40,338	12,161	45,339	5,331	11,311	-857	-27,174	-81,771
<i>of which: BI-UIC and banks</i>	-8,095	-2,569	10,333	-1,205	-9,936	46,584	7,377	-35,561	6,114	-10,083
<i>other holders</i>	50,762	45,184	30,005	13,366	55,275	-41,253	3,934	34,704	-33,288	-71,687
Post Office deposits	6,847	10,691	7,485	7,036	9,111	8,922	21,738	15,791	13,229	11,635
Lending by banks	5,181	9,426	6,431	20,080	12,856	13,813	-1,276	4,919	-2,813	1,694
<i>central government bodies</i>	3,608	5,295	2,721	5,952	8,545	1,899	-2,103	3,167	-3,726	-1,094
<i>social security institutions</i>	545	-464	-221	266	817	-826	906	-898	-36	41
<i>local authorities</i>	1,028	4,595	3,931	13,862	3,494	12,740	-78	2,649	950	2,747
Other net borrowing from BI-UIC . . .	3,704	1,835	2,811	2,472	7,116	-34,512	-111,720	-8,440	17,674	-2,585
Other domestic debt	137	101	188	173	254	140	33	212	194	194
Debt issues abroad	4,188	8,359	14,876	5,484	151	12,358	9,554	25,584	15,632	6,209
General government borrowing requirement	121,794	130,063	138,434	158,908	163,995	168,917	154,282	127,109	143,170	35,825
<i>as a percentage of GDP</i>	11.2	10.9	10.6	11.1	10.9	10.9	9.4	7.2	7.6	1.8
<i>of which: settlements of past debts and privatization receipts</i>	-	600	3,000	1,900	800	10,808	513	-5,189	4,168	-26,108
<i>debts of other bodies serviced by the government</i>	2,044	3,624	7,413	3,037	4,910	-2,118	94	1,232	552	-6,611
OTHER PUBLIC SECTOR BODIES										
Total financing (2)	-47	67	20	648	79	-59	710	-131	-509	296
<i>of which: bond issues</i>	-152	-82	-66	-36	-28	-	-	-	-	-
<i>bank loans</i>	105	149	86	685	107	-59	710	-131	-509	296
Public sector borrowing requirement	121,747	130,131	138,454	159,556	164,074	168,858	154,992	126,978	142,660	36,121
<i>as a percentage of GDP</i>	11.2	10.9	10.6	11.2	10.9	10.9	9.5	7.2	7.6	1.9

(1) Rounding may cause discrepancies in totals. - (2) Excludes debts serviced by the government.

Table a15

THE PUBLIC DEBT (1)
(face value in billions of lire and percentage composition)

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
<i>Amounts outstanding</i>										
GENERAL GOVERNMENT										
Medium and long-term securities, excluding BI portfolio	483,520	537,430	618,870	732,625	805,338	958,951	1,104,569	1,203,549	1,366,098	1,499,963
<i>of which: held by banks</i>	143,048	133,729	131,542	182,242	236,679	212,298	263,304	262,350	280,369	262,511
Treasury bills in lire and ecus, excluding BI portfolio	240,046	286,892	322,422	338,254	393,827	399,434	397,016	407,144	381,599	287,195
<i>of which: held by banks</i>	24,279	26,035	31,394	33,901	33,273	79,459	73,101	48,506	56,256	33,519
Post Office deposits	70,986	81,677	89,162	96,198	105,308	114,230	135,968	151,759	164,988	176,623
<i>memorandum item: redemption value</i>	94,873	110,237	122,954	134,700	146,115	159,935	185,471	206,069	227,259	246,144
Lending by banks	45,104	54,511	60,942	81,022	93,878	107,691	106,415	111,333	108,521	110,214
<i>central government bodies</i>	12,731	18,047	20,767	26,719	35,264	37,163	35,060	38,227	34,501	33,407
<i>social security institutions</i>	1,348	1,104	883	1,149	1,966	1,140	2,046	1,148	1,112	1,153
<i>local authorities</i>	31,025	35,361	39,292	53,154	56,647	69,387	69,309	71,958	72,908	75,655
Other domestic debt	2,743	2,844	3,032	3,204	3,458	3,599	3,632	3,844	3,994	4,133
Debt issued abroad	28,744	35,112	49,098	54,987	64,575	85,505	96,022	119,274	125,592	139,738
Total ...	871,143	998,465	1,143,525	1,306,289	1,466,385	1,669,409	1,843,623	1,996,904	2,150,792	2,217,866
<i>of which: debts of other bodies serviced by the gov- ernment</i>	23,385	26,784	34,047	37,021	43,222	42,323	42,627	44,474	44,305	38,125
Borrowing from BI-UIC	140,502	143,193	141,080	142,858	167,385	176,990	203,541	204,061	171,018	154,834
<i>of which: medium and long- term securities</i>	57,881	62,911	53,105	56,017	82,426	95,044	186,333	197,841	166,478	137,709
<i>Treasury bills in lire and ecus</i>	12,545	8,220	13,194	9,482	173	572	14,306	3,327	1,698	14,331
<i>Treasury accounts with BI</i>	66,312	68,155	71,063	73,074	80,780	76,206	-	-	-	-
<i>other</i>	3,764	3,907	3,718	4,285	4,006	5,169	2,902	2,893	2,842	2,794
General government debt (EU definition) (2)	1,011,646	1,141,658	1,284,605	1,449,147	1,633,770	1,846,399	2,047,163	2,200,965	2,321,810	2,372,700
<i>as a percentage of GDP</i>	92.8	95.8	98.0	101.5	108.7	119.1	124.9	124.2	124.0	121.6
Treasury claims on BI-UIC	-931	-1,081	-989	-1,095	-1,406	-32,507	-65,754	-74,184	-56,459	-58,997
General government debt	1,010,715	1,140,577	1,283,616	1,448,052	1,632,364	1,813,892	1,981,410	2,126,781	2,265,351	2,313,703
OTHER PUBLIC SECTOR BODIES										
Total financing (3)	1,065	1,260	1,279	1,928	2,007	1,948	2,658	2,526	2,017	2,313
<i>of which: bond issues</i>	212	130	64	28	-	-	-	-	-	-
<i>bank loans</i>	853	1,130	1,216	1,900	2,007	1,948	2,658	2,526	2,017	2,313
Public sector debt	1,011,780	1,141,836	1,284,895	1,449,980	1,634,371	1,815,840	1,984,067	2,129,307	2,267,368	2,316,016
<i>Percentage composition</i>										
General government debt (EU definition)										
Medium and long-term securities, excluding BI portfolio	47.8	47.1	48.2	50.6	49.3	51.9	54.0	54.7	58.8	63.2
Treasury bills in lire and ecus, excluding BI portfolio	23.7	25.1	25.1	23.3	24.1	21.6	19.4	18.5	16.4	12.1
Post Office deposits	7.0	7.2	6.9	6.6	6.4	6.2	6.6	6.9	7.1	7.4
Lending by banks	4.5	4.8	4.7	5.6	5.7	5.8	5.2	5.1	4.7	4.6
Other domestic debt	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Debt issued abroad	2.8	3.1	3.8	3.8	4.0	4.6	4.7	5.4	5.4	5.9
Borrowing from BI-UIC	13.9	12.5	11.0	9.9	10.2	9.6	9.9	9.3	7.4	6.5

(1) Rounding may cause discrepancies in totals. - (2) Based on the methodology established in European Council Regulation 3605/93. - (3) Excludes debts serviced by the government.

Table a16

STATE SECTOR BALANCES
(billions of lire)

	1994	1995	1996	1997
Revenue	477,160	523,486	549,509	621,690
Expenditure	615,877	639,646	680,987	599,774
State budget deficit	-138,717	-116,161	-131,479	21,916
Treasury operations	1,493	8,977	4,081	-48,533
Lending of the Deposits and Loans Fund	-15,346	-12,923	-10,086	-5,906
Borrowing requirement of ANAS and the State Forests	-531	-2,494	1,409	1,391
Borrowing requirement of other former autonomous government agencies ...	-	-	-	-
State sector borrowing requirement	-153,101	-122,600	-136,074	-31,131
State sector borrowing requirement excluding settlements of past debts and privatization receipts	-149,679	-126,869	-128,799	-52,720
as a percentage of GDP	-9.1	-7.2	-6.9	-2.7
DETAIL OF REVENUE				
Direct taxes				
Personal income tax	143,803	156,631	167,650	182,608
Corporate income tax	25,824	26,126	31,738	44,231
Local income tax	15,874	14,987	18,995	24,308
Withholding tax on interest income	36,048	34,378	41,221	36,548
Withholding tax on dividends	1,924	2,288	3,008	3,467
Direct tax condonation schemes	94	6,406	2,530	84
Other	11,694	16,329	14,621	24,546
Total direct taxes	235,261	257,145	279,763	315,792
Indirect taxes				
Value added tax	92,411	105,817	109,468	117,933
Other business taxes	28,925	29,484	33,539	39,211
Excise taxes on oil products	38,992	42,618	37,120	38,055
Other excise taxes	9,459	10,742	12,288	13,582
Sales taxes on tobacco products	9,206	9,554	10,512	10,587
Lotteries	5,785	6,988	9,476	11,439
Indirect tax condonation schemes	195	705	823	341
Other	2,466	2,992	3,406	3,239
Total indirect taxes	187,439	208,900	216,632	234,387
Total tax revenue				
EU levies	11,972	11,658	12,060	9,896
Health care and other social security contributions	5,241	4,252	4,634	5,013
Other income	37,247	41,531	36,420	56,602
Total budget revenue	477,160	523,486	549,509	621,690

Table a17

SOURCES AND USES OF MONETARY BASE (1)
(changes in billions of lire)

	Sources							Total	Uses				
	Foreign sector		Treasury accounts with the Bank of Italy	Other BI-UIC operations with the Treasury (3)	Open market operations (4)	Refi- nancing	Other sectors		Currency in circulation	Bank reserves			
	(2)	of which: currency swaps								Deposits with BI		Other (6)	Total
											of which: compul- sory reserves (5)		
1988	10,947	-	4,331	9,018	-10,601	80	-728	13,046	4,449	8,833	9,444	-236	8,597
1989	14,971	-	1,842	6,608	-2,106	1,190	-2,019	20,486	10,477	9,733	9,567	276	10,009
1990	15,458	-	2,909	-4,292	2,392	1,261	-3,964	13,765	1,805	10,829	13,026	1,131	11,960
1991	-8,674	-	2,011	-11,468	27,172	2,679	-648	11,071	6,906	3,613	3,424	552	4,165
1992	-32,591	29,249	7,706	-10,402	42,781	106	822	8,422	9,263	69	1,012	-909	-841
1993	2,564	-2,055	-4,574	1,196	-14,098	-6,434	1,868	-19,479	4,152	-23,600	-24,131	-30	-23,630
1994	3,297	-813	-33,269	-21,474	47,451	238	-6,154	-9,911	6,452	-16,566	-13,332	202	-16,364
1995	2,915	10,592	-8,195	-25,174	15,455	4,857	-1,786	-11,928	2,060	-15,310	-18,728	1,322	-13,988
1996	20,449	-24,227	17,370	-23,834	6,291	-5,647	-10,477	4,152	1,826	684	-1,779	1,641	2,326
1997	22,829	-2,921	-3,020	-46,517	32,734	862	6,616	13,503	7,327	6,111	10,669	65	6,176
1996 - Jan.	-138	..	5,293	157	-5,768	-4,616	-1,793	-6,865	-6,275	1,290	-1,649	-1,881	-591
Feb.	-916	..	1,659	-337	567	37	-1,240	-230	-2,161	1,808	1,039	124	1,931
Mar.	1,330	..	12,858	403	-12,354	25	-1,639	623	2,495	-1,688	-3,982	-184	-1,872
Apr.	8,042	..	4,865	-844	-16,554	-1,096	-934	-6,522	-1,602	-5,593	-350	673	-4,919
May	9,267	-1,558	-10,248	-1,007	4,602	-30	-838	1,746	1,230	672	-1,350	-156	516
June	6,773	-1,010	-27,284	-2,161	20,108	-47	2,332	-279	1,041	-792	1,310	-528	-1,320
July	-325	-3,557	-5,616	-709	7,848	76	-1,266	9	1,841	-2,845	-1,903	1,014	-1,832
Aug.	-2,812	-1,517	-2,333	-1,661	8,265	48	-370	1,137	-2,394	4,327	913	-796	3,531
Sept.	731	-1,520	19,933	-2,175	-19,925	-15	-534	-1,985	994	-3,836	-1,052	857	-2,979
Oct.	5,382	-5,986	19,362	-3,161	-21,858	-58	-1,899	-2,232	-845	-900	2,035	-487	-1,388
Nov.	-2,922	-9,079	10,530	-3,592	7,419	-42	-1,826	9,568	3,768	5,499	1,951	300	5,799
Dec.	-3,963	..	-11,648	-8,746	33,940	69	-470	9,183	3,733	2,743	1,259	2,707	5,449
1997 - Jan.	5,363	..	-846	-2,493	-8,171	-145	-1,065	-7,358	-3,772	-397	1,866	-3,189	-3,586
Feb.	-1,608	..	-6,949	-3,204	16,388	31	378	5,036	-620	5,863	5,889	-206	5,656
Mar.	-4,262	..	9,692	-3,576	167	-36	-331	1,654	3,611	-2,858	-3,202	900	-1,958
Apr.	-2,131	..	16,217	-2,275	-14,348	-18	-1,395	-3,951	-2,464	-1,286	289	-200	-1,486
May	1,570	..	1,185	-4,146	7,716	-22	159	6,463	2,484	4,088	515	-110	3,979
June	-1,139	..	-26,221	-3,915	19,978	12	7,801	-3,483	-1,653	-2,184	1,729	354	-1,830
July	12,124	-2,921	-23,491	-2,527	24,721	7	-1,689	9,143	3,716	5,336	-882	91	5,427
Aug.	4,801	..	11,707	-2,124	-20,377	-114	4	-6,103	-2,526	-3,027	1,832	-550	-3,577
Sept.	5,673	..	11,458	-5,797	-7,494	-85	-976	2,779	1,051	1,246	-264	482	1,728
Oct.	-2,393	..	12,915	-5,974	418	133	-1,040	4,060	-772	5,017	438	-184	4,833
Nov.	832	..	-6,357	-6,941	7,644	8	4,487	-327	4,076	-5,734	2,204	1,331	-4,403
Dec.	3,999	..	-2,332	-3,543	6,092	1,092	283	5,590	4,196	48	256	1,346	1,394
1998 - Jan. (7)	-4,362	..	844	-3,745	8,415	-1,237	-1,224	-1,309	-3,814	4,948	1,633	-2,443	2,505
Feb. (7)	3,816	..	-5,349	-5,832	16,567	-29	66	9,239	-784	10,481	6,713	-458	10,023
Mar. (7)	-752	..	16,146	-3,481	-17,096	-5	2,569	-7,755	2,131	-10,522	-3,073	635	-9,887

(1) Rounding may cause discrepancies in totals. - (2) Variation in the net external position of BI-UIC, net of exchange rate adjustments. - (3) Net purchases of government securities at issue by BI-UIC, state notes and coin in circulation or held by the Bank of Italy and other minor items. - (4) Excludes securities purchased with advances under the Ministerial Decree of 27.9.1974. - (5) From October 1990 onwards average reserve requirement in the maintenance period (15th of the month indicated - 14th of the following month) and, until May 1991, compulsory reserves against net foreign currency deposits. - (6) Vault cash and undrawn margin on ordinary advance facility; until December 1988 includes banks' deposits with the Deposits and Loans Fund and undiscounted stockpiling finance bills. - (7) Provisional.

Table a18

INTEREST RATES ON BANK OF ITALY OPERATIONS

	Official							Temporary operations (4)					
	Current account (1)		Discount		Advances			Securities repos				Currency swaps	
								Purchases		Sales		Minimum	Average
	Excess reserves	Compulsory reserves (2)	Ordinary bills	Agricultural working credits	Ordinary (base rate)	Fixed-term (sur-charge) (3)		Minimum	Average	Maximum	Average		
From: 4 Sept. 1984	0.50	5.50	16.50	8.50	16.50	—	1995 - Jan. .	8.48	8.53	—	—	8.71	8.73
4 Jan. 1985	"	"	15.50	"	15.50	—	Feb. .	8.44	8.48	—	—	8.80	8.82
8 Nov. 1985	"	"	15.00	8.00	15.00	—	Mar. .	10.17	10.22	—	—	10.50	10.58
22 Mar. 1986	"	"	14.00	7.50	14.00	—	Apr. .	10.45	10.48	—	—	10.54	10.56
25 Apr. 1986	"	"	13.00	7.00	13.00	—	May .	10.32	10.35	—	—	10.16	10.18
27 May 1986	"	"	12.00	6.50	12.00	—	June .	10.54	10.58	—	—	10.53	10.56
14 Mar. 1987	"	"	11.50	"	11.50	—	July .	10.50	10.55	—	—	10.56	10.63
28 Aug. 1987	"	"	12.00	"	12.00	—	Aug. .	10.18	10.20	—	—	10.15	10.17
26 Aug. 1988	"	"	12.50	"	12.50	—	Sept. .	10.19	10.21	—	—	10.12	10.14
6 Mar. 1989	"	"	13.50	"	13.50	—	Oct. .	10.59	10.61	—	—	10.57	10.58
21 May 1990	"	"	12.50	"	12.50	—	Nov. .	10.54	10.57	—	—	10.39	10.41
13 May 1991	"	"	11.50	6.00	11.50	0	Dec. .	10.59	10.65	—	—	10.48	10.50
26 Nov. 1991	"	"	"	"	"	0.50	1996 - Jan. .	10.07	10.11	—	—	10.08	10.11
23 Dec. 1991	"	"	12.00	"	12.00	"	Feb. .	9.98	10.04	—	—	9.87	9.90
5 June 1992	"	"	"	"	"	1.00	Mar. .	9.93	9.94	—	—	9.64	9.65
6 July 1992	"	"	13.00	"	13.00	1.50	Apr. .	9.66	9.69	—	—	9.59	9.61
17 July 1992	"	"	13.75	"	13.75	"	May .	9.32	9.33	9.29	9.23	8.93	8.95
4 Aug. 1992	"	"	13.25	"	13.25	"	June .	9.13	9.20	—	—	8.84	8.86
4 Sept. 1992	"	"	15.00	"	15.00	"	July .	8.94	9.01	—	—	8.88	8.90
9 Oct. 1992	"	"	"	"	"	1.00	Aug. .	8.84	8.88	—	—	8.76	8.77
26 Oct. 1992	"	"	14.00	"	14.00	"	Sept. .	8.47	8.50	—	—	8.37	8.39
13 Nov. 1992	"	"	13.00	"	13.00	"	Oct. .	—	—	8.55	8.51	8.25	8.25
23 Dec. 1992	"	"	12.00	"	12.00	"	Nov. .	7.97	7.99	8.12	8.05	7.34	7.36
4 Feb. 1993	"	"	11.50	"	11.50	"	Dec. .	7.46	7.68	—	—	7.58	7.61
23 Apr. 1993	"	"	11.00	"	11.00	"	1997 - Jan. .	7.45	7.50	—	—	7.34	7.36
21 May 1993	"	"	10.50	"	10.50	"	Feb. .	7.39	7.41	—	—	7.34	7.36
14 June 1993	"	"	10.00	5.50	10.00	"	Mar. .	7.40	7.42	—	—	7.37	7.39
6 July 1993	"	"	9.00	"	9.00	"	Apr. .	7.20	7.21	—	—	7.03	7.05
10 Sept. 1993	"	"	8.50	"	8.50	"	May .	6.96	7.00	—	—	6.75	6.76
22 Oct. 1993	"	"	8.00	"	8.00	"	June .	6.71	6.83	—	—	6.81	6.83
18 Feb. 1994	"	"	7.50	"	7.50	"	July .	6.77	6.85	—	—	—	—
12 May 1994	"	"	7.00	"	7.00	"	Aug. .	6.80	6.83	—	—	6.76	6.79
12 Aug. 1994	"	"	7.50	"	7.50	"	Sept. .	6.77	6.79	—	—	6.03	6.31
22 Feb. 1995	"	"	8.25	"	8.25	1.50	Oct. .	6.86	6.87	—	—	—	—
29 May 1995	"	"	9.00	"	9.00	"	Nov. .	6.60	6.63	—	—	6.24	6.26
24 July 1996	"	"	8.25	"	8.25	"	Dec. .	6.16	6.20	6.29	6.24	5.80	5.86
24 Oct. 1996	"	"	7.50	"	7.50	"	1998 - Jan. .	6.12	6.21	—	—	—	—
22 Jan. 1997	"	"	6.75	"	6.75	"	Feb. .	6.07	6.14	—	—	6.02	6.03
30 June 1997	"	4.50	6.25	4.75	6.25	"	Mar. .	5.76	5.79	—	—	5.23	5.24
24 Dec. 1997	"	"	5.50	"	5.50	"	Apr. .	5.67	5.67	6.50	6.04	—	—
22 Apr. 1998	"	4.00	5.00	4.25	5.00	"							

(1) Current accounts of banks, social security institutions, insurance companies and public corporations. – (2) On 28 December 1982 the rate of interest on the proportion of reserves corresponding to the ratio of certificates of deposit to total funds subject to reserve requirements was fixed at 9.5 per cent. The higher rate was subsequently extended to CDs with maturities of between 3 and 6 months in November 1986 and to variable rate CDs with maturities of at least 18 months in December 1989. The rate was reduced to 8.5 per cent in November 1986 and to 6.5 per cent in September 1993. As part of the May 1994 reform of the system, the return on reserves was fixed at 5.5 per cent for all forms of deposit with effect from July 1994. – (3) Added to the base rate to determine the rate on fixed-term advances. Until 12 May 1991 the surcharge increased with the frequency of recourse to such refinancing. – (4) Average of the allotment rates on operations during the month.

Table a19

BANKS' ASSETS
(billions)

	Assets								Memorandum item
	Bank reserves	Lending to residents	Securities	Bad debts & protested bills	Repurchase agreements	Shares & equity participations	Interbank accounts	External assets	Bad debts (estimated realizable value)
1992 – Dec.	131,957	989,183	327,513	54,729	12,511	41,763	157,849	165,187	33,067
1993 – "	108,514	1,028,446	349,770	70,185	30,351	43,427	171,104	229,057	41,197
1994 – "	92,691	1,039,792	385,969	91,108	16,846	50,067	165,436	201,953	59,994
1995 – "	78,996	1,073,410	352,260	110,269	14,771	51,205	151,979	231,119	72,370
1996 – Jan.	78,395	1,066,235	351,616	110,845	14,384	55,164	141,645	221,780	70,975
Feb.	80,301	1,060,330	361,788	111,503	18,397	54,433	146,301	229,511	67,489
Mar.	78,462	1,059,117	364,587	111,876	18,726	54,887	150,225	221,592	64,182
Apr.	74,530	1,057,097	351,748	113,060	19,420	55,056	154,853	237,586	63,941
May	74,040	1,062,818	359,412	115,454	21,209	56,349	152,117	237,373	66,754
June	72,702	1,073,633	360,677	116,668	20,382	56,040	160,222	241,206	68,076
July	70,868	1,081,529	365,050	117,777	17,846	56,256	150,525	239,238	69,348
Aug.	74,383	1,062,009	369,066	118,402	17,384	56,397	153,929	238,945	69,797
Sept.	71,412	1,063,140	367,983	119,091	19,622	56,785	164,054	250,196	71,149
Oct.	69,991	1,058,639	371,456	120,102	21,059	57,122	167,163	259,072	72,103
Nov.	75,658	1,061,475	378,339	120,779	23,071	57,347	168,038	276,630	72,830
Dec.	80,892	1,090,928	383,583	123,117	22,264	57,667	182,128	295,728	74,231
1997 – Jan.	77,437	1,094,826	380,302	114,828	21,335	57,468	164,582	274,789	67,031
Feb.	82,939	1,095,930	385,317	115,701	22,276	57,389	156,502	283,104	67,378
Mar.	81,059	1,087,705	388,304	117,236	22,088	56,909	151,862	279,467	66,955
Apr.	79,564	1,092,582	377,216	118,061	18,878	57,385	151,042	282,662	67,696
May	83,493	1,095,922	377,976	118,685	21,553	58,419	156,244	292,544	68,556
June	84,134	1,118,399	359,838	118,701	20,884	58,288	159,979	312,416	69,738
July	86,901	1,126,880	361,481	119,375	23,776	58,273	149,656	319,199	70,525
Aug.	83,269	1,109,155	354,505	119,697	21,487	58,942	146,959	291,472	71,110
Sept.	85,117	1,111,782	349,517	117,327	18,698	58,843	156,640	313,060	68,294
Oct.	89,952	1,111,271	351,404	118,589	17,870	60,284	157,842	304,480	69,643
Nov.	85,227	1,120,270	351,953	118,565	18,241	61,420	164,091	305,012	70,343
Dec.	86,803	1,160,916	343,406	119,990	27,743	62,714	184,791	311,639	70,911
1998 – Jan. (2)	89,279	1,150,123	350,998	119,833	34,016	72,418	162,897	297,524	70,036
Feb. (2)	99,196	1,150,225	346,299	121,078	36,852	72,202	158,891	305,232	64,682
Mar. (2)	89,335	1,158,109	348,132	121,697	37,355	73,651	168,167	319,422	63,293

(1) Rounding may cause discrepancies in totals. – (2) Provisional.

Table a19 cont.

AND LIABILITIES (1)
of lire)

Liabilities									Memorandum item	
Deposits of residents	Bonds	Other domestic funds	Lending by BI-UIC	Repurchase agreements	Interbank accounts	Funds raised abroad	Capital and reserves	Other items	Supervisory capital	
852,840	166,407	15,372	8,936	141,951	159,320	367,496	189,993	-21,624	155,130	Dec. – 1992
919,115	194,113	19,425	2,722	140,386	179,086	369,979	206,017	10	167,188	" – 1993
923,371	215,676	20,506	2,834	132,680	166,671	375,663	219,387	-12,925	173,721	" – 1994
935,199	215,286	22,820	7,989	164,501	166,069	343,580	232,439	-23,874	171,776	" – 1995
895,993	218,082	23,024	3,242	182,531	154,916	343,644	243,844	-25,210	175,432	Jan. – 1996
895,085	219,235	23,287	3,240	194,956	159,573	350,601	247,825	-31,237	176,267	Feb.
906,004	220,640	23,552	3,119	176,945	164,284	352,512	249,782	-37,368	177,783	Mar.
919,094	221,520	23,372	3,023	164,708	167,266	343,382	250,367	-29,380	177,664	Apr.
908,837	224,153	22,675	1,992	163,012	165,796	351,459	250,370	-9,525	177,203	May
927,629	225,226	22,714	1,946	165,811	173,513	352,232	251,665	-19,205	176,736	June
907,287	228,291	22,869	2,022	176,952	164,291	356,723	250,926	-10,272	177,367	July
899,371	234,347	23,977	2,068	191,562	168,116	346,653	248,731	-24,310	180,189	Aug.
918,400	244,572	23,289	2,055	158,612	178,782	352,202	248,861	-14,489	179,761	Sept.
909,635	258,068	23,374	1,999	154,717	181,766	353,541	248,390	-6,887	180,148	Oct.
905,969	269,564	23,017	1,957	161,767	183,568	362,828	248,048	4,620	180,674	Nov.
959,577	280,213	22,447	1,897	174,006	193,714	364,080	250,188	-9,815	182,305	Dec.
919,505	288,857	22,218	1,881	174,287	176,839	362,373	254,986	-15,379	....	Jan. – 1997
912,792	298,384	23,301	1,915	192,492	170,044	373,573	255,159	-28,501	....	Feb.
900,544	305,219	23,861	1,877	189,617	164,635	375,454	256,374	-32,951	184,052	Mar.
890,630	313,263	23,864	1,849	178,095	162,993	369,615	257,953	-20,873	....	Apr.
889,968	321,764	25,879	1,835	189,485	167,879	368,412	257,591	-17,975	....	May
896,931	329,590	26,095	1,835	184,784	174,355	370,434	258,429	-9,814	186,392	June
871,197	335,631	27,434	1,817	213,021	163,684	369,794	258,140	4,822	....	July
857,115	343,867	27,384	1,674	202,011	161,941	364,459	257,079	-30,044	....	Aug.
867,734	353,384	26,507	1,699	175,250	166,215	381,329	256,096	-17,231	185,366	Sept.
860,945	363,118	27,184	1,751	170,134	175,169	374,085	252,375	-13,067	....	Oct.
838,647	370,858	27,007	1,763	179,538	178,721	384,466	253,890	-10,111	....	Nov.
881,329	377,743	25,898	2,854	172,454	200,333	392,738	257,052	-12,400	187,485	Dec.
850,552	380,882	28,730	1,617	198,186	174,526	404,015	267,711	-29,130	....	(2) Jan. – 1998
837,865	386,410	30,226	1,587	215,992	172,002	404,190	275,679	-33,976	....	(2) Feb.
855,399	396,467	26,581	1,587	179,060	177,201	429,194	279,113	-28,734	186,840	(2) Mar.

Table a20

BANKS: LOAN PORTFOLIO (1)
(billions of lire)

	Loans to residents						Loans to non-residents
	Short-term		Medium and long-term		Total		
		of which: in lire		of which: in lire		of which: in lire	
1992 – Dec.	571,745	456,661	417,438	354,216	989,183	810,877	17,036
1993 – ".....	559,308	468,053	469,138	404,495	1,028,446	872,549	22,312
1994 – ".....	535,159	458,553	504,633	449,277	1,039,792	907,830	17,901
1995 – ".....	556,942	496,539	516,468	472,383	1,073,410	968,922	16,124
1996 – Jan.	553,904	494,876	512,331	469,821	1,066,235	964,697	14,987
Feb.	545,485	487,212	514,845	472,814	1,060,330	960,026	15,347
Mar.	539,417	480,932	519,700	477,736	1,059,117	958,668	15,793
Apr.	539,418	484,234	517,679	477,452	1,057,097	961,686	16,837
May	542,432	487,061	520,387	481,119	1,062,818	968,180	17,470
June	551,057	495,955	522,575	484,526	1,073,633	980,481	14,591
July	560,820	502,957	520,709	480,945	1,081,529	983,902	13,041
Aug.	540,165	485,550	521,845	482,617	1,062,009	968,167	12,507
Sept.	540,277	485,865	522,864	484,218	1,063,140	970,082	12,700
Oct.	534,828	479,470	523,811	488,243	1,058,639	967,713	13,559
Nov.	534,016	478,985	527,459	492,001	1,061,475	970,987	13,328
Dec.	556,364	502,124	534,565	498,854	1,090,928	1,000,978	17,854
1997 – Jan.	554,906	493,876	539,919	507,574	1,094,826	1,001,451	17,052
Feb.	555,345	491,297	540,585	508,082	1,095,930	999,380	17,114
Mar.	548,728	483,427	538,977	506,705	1,087,705	990,131	15,699
Apr.	547,258	483,371	545,324	513,388	1,092,582	996,759	17,815
May	546,498	483,509	549,425	517,676	1,095,922	1,001,185	16,715
June	563,814	502,151	554,585	523,557	1,118,399	1,025,708	22,138
July	573,027	506,894	553,853	522,611	1,126,880	1,029,505	19,622
Aug.	556,218	493,333	552,938	522,170	1,109,155	1,015,502	18,101
Sept.	555,890	494,396	555,892	525,740	1,111,782	1,020,135	18,745
Oct.	552,547	492,877	558,724	528,811	1,111,271	1,021,689	18,596
Nov.	556,318	496,798	563,952	534,135	1,120,270	1,030,933	19,166
Dec.	590,716	530,778	570,200	540,684	1,160,916	1,071,462	23,181
1998 – Jan. (2)	583,022	520,927	567,101	537,790	1,150,123	1,058,717	20,593
Feb. (2)	579,190	514,044	571,035	541,610	1,150,225	1,055,654	20,943
Mar. (2)	582,954	515,282	575,155	545,711	1,158,109	1,060,993	22,977

(1) Rounding may cause discrepancies in totals. – (2) Provisional.

Table a21

BANKS: SECURITIES PORTFOLIO (1)*(billions of lire)*

	Government securities					Other		TOTAL
	of which:				of which: bonds issued by banks			
	BOTs and BTEs	CTZs	CCTs	BTPs				
1992 – Dec.	261,568	31,217	–	162,862	64,106	65,945	57,825	327,513
1993 – "	294,657	74,863	–	140,032	76,766	55,014	49,206	349,770
1994 – "	326,992	68,456	–	134,351	119,663	58,978	50,842	385,969
1995 – "	301,552	44,650	10,222	133,268	107,090	50,708	47,576	352,260
1996 – Jan.	301,793	37,631	11,212	137,406	109,217	49,823	46,875	351,616
Feb.	311,950	37,611	14,013	141,416	114,725	49,839	46,897	361,788
Mar.	314,433	36,723	14,838	143,388	115,656	50,154	46,722	364,587
Apr.	301,925	38,570	16,543	139,206	103,801	49,822	47,058	351,748
May	310,743	38,657	18,917	142,263	106,263	48,669	46,130	359,412
June	312,205	38,116	21,353	144,604	101,603	48,472	46,474	360,677
July	318,750	41,591	21,605	146,774	101,950	46,300	44,356	365,050
Aug.	323,175	42,056	22,485	148,542	102,775	45,892	44,020	369,066
Sept.	321,353	41,532	23,671	149,288	99,669	46,631	44,787	367,983
Oct.	325,343	39,297	24,414	151,986	102,643	46,113	44,311	371,456
Nov.	332,347	45,356	22,528	155,080	102,384	45,992	44,214	378,339
Dec.	334,173	52,957	19,636	155,306	99,331	49,411	47,050	383,583
1997 – Jan.	332,707	44,207	20,590	165,200	95,176	47,596	45,412	380,302
Feb.	337,329	41,341	20,965	164,966	103,064	47,988	45,804	385,317
Mar.	340,005	36,117	21,691	162,278	113,003	48,299	45,763	388,304
Apr.	330,883	32,924	21,273	159,453	110,233	46,332	43,820	377,216
May	331,567	32,122	22,206	163,349	107,084	46,409	43,748	377,976
June	313,820	28,555	21,560	157,352	99,831	46,017	43,466	359,838
July	317,887	28,002	21,658	155,010	107,135	43,594	40,962	361,481
Aug.	310,092	26,688	19,651	154,098	103,679	44,413	41,833	354,505
Sept.	305,954	27,837	19,564	157,094	95,622	43,563	40,915	349,517
Oct.	306,424	30,429	17,688	155,265	97,088	44,980	42,324	351,404
Nov.	306,471	29,852	18,453	155,329	96,751	45,481	42,829	351,953
Dec.	296,481	32,094	18,661	154,455	86,220	46,925	43,491	343,406
1998 – Jan. (2)	304,007	31,731	20,503	155,215	94,164	46,991	43,584	350,998
Feb. (2)	296,788	33,680	20,236	150,703	88,672	49,511	45,815	346,299
Mar. (2)	295,887	33,185	21,070	148,651	89,708	52,245	48,193	348,132

(1) Rounding may cause discrepancies in totals. – (2) Provisional.

(1) Rounding may cause discrepancies in totals. – (2) Provisional.

Table a22

PROFIT AND LOSS ACCOUNTS OF BANKS
(billions)

	Interest receivable						Interest payable						Balance of derivative hedging contracts (2)	Net interest income (a)
	Deposits with BI-UIC & Treasury	Domestic lending in lire	Securities	Interbank accounts	Repos (2)	Claims on non-residents & on residents in foreign currency	Deposits	BI-UIC financing	Interbank accounts	Repos (2)	Bonds and subordinated liabilities	Liabilities to non-residents & to residents in foreign currency		
Limited company														
1992 ...	7,213	106,168	19,145	6,641	....	23,504	54,435	820	8,056	....	19,701	26,159	....	53,499
1993 ...	5,885	104,132	28,015	6,461	4,574	24,826	55,363	183	7,221	9,819	21,881	24,993	-199	54,234
1994 ...	5,163	92,485	27,494	4,528	2,620	19,154	45,055	185	7,004	9,544	20,756	18,410	-1,247	49,243
1995 ...	4,242	104,942	28,552	6,292	1,905	19,810	46,674	430	7,717	12,080	23,200	21,468	-1,740	52,435
1996 ...	3,596	104,601	27,099	7,206	1,745	18,410	47,832	173	8,440	11,405	23,678	17,790	-1,681	51,656
1997 (3)	3,635	90,437	21,129	5,688	1,164	19,701	34,850	87	6,518	9,349	24,423	17,427	-249	48,851
Cooperative banks														
1992 ...	1,529	14,325	3,550	1,413	....	2,066	9,720	60	1,162	....	..	2,045	....	9,897
1993 ...	1,210	13,662	5,556	1,544	588	2,106	9,919	19	969	1,821	10	1,809	-217	9,905
1994 ...	1,045	12,063	5,765	1,094	373	1,818	8,291	16	872	1,803	79	1,460	-160	9,476
1995 ...	811	15,495	6,361	1,500	277	2,001	9,085	20	1,251	2,575	619	1,607	-273	11,016
1996 ...	638	15,744	5,576	1,655	413	1,644	9,051	19	1,115	2,455	971	1,258	-353	10,447
1997 (3)	672	14,178	4,322	1,471	409	1,825	6,581	12	892	1,981	1,924	1,351	-218	9,918
Main mutual banks														
1992 ...	13	454	232	87	....	9	398	..	8	....	..	7	....	382
1993 ...	15	463	427	91	5	12	424	..	8	137	..	11	..	433
1994 ...	10	434	389	74	3	14	379	..	5	124	..	10	-1	404
1995 ...	12	517	407	86	3	14	393	1	5	162	..	10	-3	466
1996 ...	12	570	398	102	10	9	429	1	4	159	12	5	..	490
1997 (3)	15	548	342	69	8	13	331	1	6	108	78	6	-3	463
Central credit														
1992 ...	17	564	774	843	....	360	60	63	1,450	....	..	466	....	519
1993 ...	23	424	927	679	87	535	63	38	1,302	201	11	482	-33	545
1994 ...	7	316	882	495	5	339	54	37	868	191	12	396	-55	431
1995 ...	24	294	998	598	10	428	65	50	1,141	253	13	433	-9	387
1996 ...	32	242	1,068	863	43	340	66	43	1,503	213	31	373	-15	343
1997 (3)	33	192	827	714	127	325	69	33	1,132	232	91	345	2	317
Branches of														
1992 ...	28	950	630	708	....	863	42	154	699	....	..	1,491	....	793
1993 ...	26	1,237	1,054	615	188	1,080	137	9	1,514	152	..	1,842	-438	108
1994 ...	25	892	1,439	568	386	1,819	49	7	922	872	..	2,354	-315	610
1995 ...	29	1,215	1,465	819	315	2,753	101	12	1,051	814	..	3,713	-318	589
1996 ...	27	1,342	1,765	705	442	2,552	123	4	1,278	711	..	3,783	-249	684
1997 (3)	29	1,166	1,465	554	577	2,975	70	5	1,334	669	..	3,823	-366	499
Total														
1992 ...	8,800	122,461	24,331	9,692	....	26,802	64,655	1,097	11,374	....	19,701	30,168	....	65,090
1993 ...	7,159	119,918	35,980	9,390	5,442	28,559	65,906	249	11,014	12,130	21,902	29,138	-886	65,224
1994 ...	6,250	106,191	35,969	6,758	3,387	23,143	53,828	245	9,671	12,534	20,847	22,630	-1,778	60,164
1995 ...	5,118	122,463	37,783	9,295	2,511	25,006	56,318	512	11,165	15,882	23,831	27,230	-2,343	64,893
1996 ...	4,305	122,500	35,906	10,531	2,653	22,954	57,501	241	12,341	14,944	24,692	23,209	-2,299	63,621
1997 (3)	4,384	106,522	28,084	8,497	2,284	24,838	41,900	138	9,882	12,338	26,515	22,951	-835	60,049

(1) Rounding may cause discrepancies in totals. - (2) For the banks accepting medium and long-term funds, the figure is only available since 1994. - (3) Provisional.

Table a22 cont.

BY CATEGORY OF BANK (1)
of lire)

Other net income			Gross income (c)=(a)+(b)	Operating expenses		Operating income (e)=(c)-(d)	Value adjustments and re-adjustments and allocations to provisions		Taxes (g)	Net profit (e)-(f)-(g)	Total resources	Number of staff	
(b)	of which: trading	of which: services		(d)	of which: banking staff costs		(f)	of which: for loan losses				of which: banking	
banks													
11,924	3,667	2,421	65,423	43,370	28,040	22,053	10,874	8,554	5,898	5,281	1,713,258	280,451	276,687
20,457	11,082	4,025	74,691	46,035	29,219	28,655	14,702	13,907	10,130	3,823	1,879,437	281,112	277,165
16,948	5,003	5,398	66,191	46,053	30,221	20,138	16,284	10,000	4,040	-185	1,966,214	281,139	276,301
16,680	4,640	5,137	69,115	47,854	30,830	21,260	16,199	14,178	5,969	-909	1,969,625	275,133	271,085
21,350	7,544	6,176	73,006	49,496	32,233	23,510	15,096	10,459	5,898	2,516	2,039,757	269,351	265,441
23,476	5,806	8,973	72,327	50,322	31,759	22,005	16,985	14,041	5,835	-815	2,135,273	264,438	260,731
(banche popolari)													
2,400	952	651	12,298	7,606	4,736	4,691	1,881	1,217	1,501	1,310	240,794	51,922	51,433
4,028	2,178	1,003	13,933	8,072	4,893	5,861	2,400	2,166	2,123	1,338	268,665	53,599	53,096
3,392	1,103	1,220	12,868	8,360	5,196	4,507	2,405	1,684	1,098	1,004	289,411	51,861	51,368
3,427	1,050	1,273	14,442	9,151	5,592	5,291	2,430	2,025	1,708	1,153	320,011	56,826	56,384
4,014	1,617	1,310	14,461	9,076	5,622	5,385	2,017	1,580	1,784	1,584	323,569	52,157	51,733
4,734	1,644	1,839	14,652	9,473	5,783	5,179	2,048	1,512	1,505	1,626	356,377	51,962	51,544
(banche di credito cooperativo)													
75	42	13	457	270	162	187	27	27	15	144	8,238	1,830	1,828
104	57	19	537	301	175	235	31	25	12	192	9,275	1,941	1,939
106	34	19	510	332	197	178	62	27	7	109	10,234	2,030	2,030
102	40	20	568	369	213	199	33	31	8	158	10,909	2,100	2,100
155	85	23	645	404	229	240	39	37	18	183	12,012	2,175	2,175
169	82	35	632	432	245	200	34	35	4	162	13,429	2,228	2,228
institutions													
85	-93	107	604	373	175	231	86	131	73	72	29,851	1,536	1,536
421	266	122	967	475	247	492	206	171	154	132	33,743	1,557	1,557
342	83	149	773	391	187	382	217	175	67	99	30,939	1,549	1,549
286	122	131	673	404	193	269	109	99	74	85	31,658	1,545	1,545
370	187	154	714	404	200	310	133	88	88	89	37,410	1,543	1,543
410	204	166	727	412	200	316	244	114	67	5	39,729	1,543	1,543
foreign banks													
-243	407	-1,151	550	485	220	65	69	81	53	-57	41,246	1,599	1,599
839	543	14	947	480	234	467	173	172	219	75	58,803	1,740	1,740
265	-102	269	875	548	268	327	-22	53	187	162	67,065	1,909	1,909
302	229	35	892	561	305	330	-43	53	233	141	76,351	1,852	1,852
153	85	-62	837	596	332	241	-82	64	169	154	91,650	1,822	1,822
211	85	78	711	630	346	81	-150	64	170	61	110,864	1,884	1,884
banks													
14,241	4,975	2,041	79,331	52,104	33,333	27,227	12,937	10,010	7,540	6,750	2,033,386	337,338	333,083
25,850	14,127	5,183	91,074	55,364	34,769	35,710	17,512	16,441	12,639	5,560	2,249,923	339,949	335,497
21,053	6,122	7,056	81,217	55,684	36,070	25,533	18,947	11,940	5,399	1,188	2,363,863	338,488	333,157
20,796	6,081	6,596	85,690	58,340	37,133	27,349	18,728	16,386	7,992	629	2,408,554	337,456	332,966
26,042	9,518	7,603	89,662	59,976	38,617	29,686	17,202	12,228	7,957	4,528	2,504,398	327,048	322,714
29,000	7,821	11,092	89,049	61,269	38,333	27,780	19,159	15,765	7,581	1,039	2,655,672	322,055	317,930

Table a23

FINANCIAL MARKET: GROSS AND
(billions)

	Bonds and government										
	Public sector										
	Government securities										
	Treasury bills	Treasury bills in ecus	Zero-coupon Treasury certificates	Floating rate Treasury credit certificates (2)	Treasury bonds (2)	Treasury certificates in ecus	Treasury discount certificates	Treasury option certificates	Ordinary certificates (3)	Other (4)	Total
											Gross
1990	559,196	6,109	-	75,538	74,460	8,017	-	27,161	4,582	-	755,062
1991	602,421	4,989	-	99,000	93,010	3,680	-	23,000	-	-	826,101
1992	675,055	6,961	-	83,426	95,519	4,759	-	14,500	-	-	880,220
1993	737,345	7,145	-	56,000	166,452	12,838	-	-	7,370	2,170	989,322
1994	679,500	-	-	60,767	167,574	17,665	-	-	3,095	78,706	1,007,306
1995	714,250	-	47,217	121,899	118,484	6,769	-	-	665	2,500	1,011,784
1996	665,023	-	59,924	105,945	148,917	3,913	-	-	5,364	5,031	994,117
1997	506,000	-	105,905	64,404	190,596	-	-	-	71	91	867,067
											Rede
1990	514,557	10,236	-	20,017	85,716	927	-	-	4,225	470	636,148
1991	588,527	7,294	-	88,275	4,846	2,144	1,411	-	1,398	487	694,382
1992	630,323	5,181	-	21,313	59,399	4,502	-	10,630	6,774	262	738,384
1993	730,866	7,918	-	34,387	27,521	13,719	-	7,041	572	1,270	823,293
1994	660,346	7,443	-	22,200	55,523	14,140	3,638	3,108	5,067	158	771,624
1995	715,750	-	-	148,917	15,844	14,797	-	10,628	-	118	906,054
1996	692,476	-	-	76,258	92,255	8,600	-	20,149	-	32	889,769
1997	588,310	-	54,275	56,213	120,963	4,354	-	19,892	-	31	844,038
											Issue
1990	-	-	-	1,307	2,091	-67	-	483	-	-	3,814
1991	-	-	-	1,457	2,381	-104	-	77	-	-	3,812
1992	-	29	-	2,089	2,544	-62	-	23	-	-	4,623
1993	-	-35	-	915	446	-225	-	-	-	-	1,102
1994	-	-	-	938	7,592	788	-	-	-	-	9,317
1995	-	-	8,918	2,763	6,715	135	-	-	-	-	18,531
1996	-	-	8,409	-773	-990	48	-	-	-	-	6,693
1997	-	-	10,146	209	1,043	-	-	-	-	-	11,398
											Net
1990	44,640	-4,127	-	54,214	-13,347	7,157	-	26,678	357	-470	115,101
1991	13,894	-2,306	-	9,268	85,784	1,640	-1,411	22,923	-1,398	-487	127,907
1992	44,731	1,751	-	60,024	33,576	319	-	3,847	-6,774	-261	137,213
1993	6,480	-738	-	20,698	138,485	-656	-	-7,041	6,798	901	164,927
1994	19,155	-7,443	-	37,629	104,458	2,736	-3,638	-3,108	-1,972	78,547	226,363
1995	-1,500	-	38,299	-29,781	95,925	-8,163	-	-10,628	665	2,382	87,198
1996	-27,453	-	51,515	30,460	57,652	-4,734	-	-20,149	5,364	4,999	97,655
1997	-82,310	-	41,484	7,982	68,590	-4,354	-	-19,892	71	60	11,631
											Cou
1990	36,052	1,072	-	46,444	20,086	2,979	277	2,961	1,433	167	111,471
1991	38,484	879	-	52,724	23,553	3,777	306	6,395	1,566	143	127,827
1992	46,677	566	-	57,883	32,673	4,155	221	9,075	1,414	121	152,785
1993	40,960	893	-	69,212	39,418	4,852	211	8,205	736	101	164,588
1994	34,958	677	-	56,751	52,386	4,920	221	7,765	812	236	158,726
1995	41,250	-	-	58,871	61,277	5,308	-	6,884	1,110	1,326	176,026
1996	31,079	-	-	60,398	67,581	3,818	-	5,581	1,179	1,592	171,228
1997	17,637	-	10,038	48,549	70,583	3,123	-	2,584	1,614	1,820	155,947

(1) Rounding may cause discrepancies in totals. - (2) The 1993 issues include 10,000 billion lire of CCTs and 21,000 billion of BTPs placed with the Bank of Italy to finance the new Treasury overdraft on its current account with the Bank of Italy; excludes Republic of Italy loans. - (5) The total for the public sector differs from the sum of the individual components by the amount of bond for cash. The figure for gross issues in 1996 is provisional.

Table a23 cont.

NET ISSUES OF SECURITIES (1)
of lire)

securities										Listed shares (7)	
			Banks	Firms and international institutions					Total bonds and government securities		
Autonomous government agencies and State Railways	Crediop on behalf of Treasury	Total (5)		ENEL	IRI ENI EFIM	Private firms	International institutions	Total (6)			
issues											
3,200	-	758,262	22,364	1,085	-	515	200	1,800	782,426	7,775	..... 1990
-	-	826,101	32,307	2,253	4,902	507	400	8,062	866,470	4,497	..... 1991
1,500	-	881,720	29,022	1,108	-	290	-	1,518	912,260	3,368	..... 1992
-	-	989,322	44,185	2,111	1,000	1,289	-	4,950	1,038,457	15,230	..... 1993
4,000	-	1,011,306	43,252	114	-	3,421	650	4,285	1,058,843	12,892	..... 1994
-	-	1,011,784	28,355	117	-	963	1,000	2,080	1,042,219	8,515	..... 1995
4,000	-	998,356	97,075	121	-	1,302	2,500	3,923	1,099,354	5,790	..... 1996
-	-	867,719	148,240	124	-	1,422	4,340	5,886	1,021,845	7,829	..... 1997
mptions											
582	1,098	637,850	15,540	960	1,594	1,700	80	4,353	657,743	-	..... 1990
160	782	695,344	16,119	921	1,772	1,350	163	4,226	715,689	-	..... 1991
2,160	493	741,053	16,995	1,533	1,796	1,220	424	4,973	763,021	-	..... 1992
2,000	309	825,612	17,606	3,966	1,775	930	603	7,274	850,493	-	..... 1993
27	74	771,730	20,705	2,174	2,669	1,030	460	6,333	798,768	-	..... 1994
1,200	49	907,304	28,745	1,250	2,754	103	465	4,572	940,621	-	..... 1995
1,000	40	890,809	32,148	800	467	-	250	1,517	924,475	-	..... 1996
-	20	844,074	50,710	800	2,221	-	650	3,671	898,455	-	..... 1997
discounts											
7	-	3,821	839	35	-	-	3	38	4,698	-	..... 1990
-	-	3,812	250	17	-	-	7	24	4,085	-	..... 1991
-	-	4,623	1,179	9	-	-	-	9	5,811	-	..... 1992
-	-	1,102	365	17	-	-	-	17	1,484	-	..... 1993
-	-	9,317	288	-	-	-	-	22	9,627	-	..... 1994
-	-	18,531	131	-	-	-	-	-	18,662	-	..... 1995
-	-	6,694	211	-	-	-	1,201	1,201	8,105	-	..... 1996
-	-	11,398	302	-	-	-	1,493	1,493	13,192	-	..... 1997
issues											
2,611	-1,098	116,592	5,985	90	-1,594	-1,185	117	-2,592	119,985	7,775	..... 1990
-160	-782	126,946	15,938	1,316	3,131	-843	230	3,813	146,697	4,497	..... 1991
-660	-493	136,045	10,848	-434	-1,797	-930	-424	-3,464	143,429	3,368	..... 1992
-2,000	-309	162,608	26,213	-1,872	-775	359	-603	-2,341	186,480	15,230	..... 1993
3,973	-74	230,258	22,259	-2,060	-2,669	2,391	190	-2,070	250,447	12,892	..... 1994
-1,200	-49	85,948	-521	-1,133	-2,754	860	535	-2,492	82,936	8,515	..... 1995
3,000	-40	100,854	64,715	-679	-467	1,302	1,049	1,205	166,774	5,790	..... 1996
-	-20	12,247	97,228	-676	-2,221	1,422	2,198	722	110,197	7,829	..... 1997
pons											
1,007	190	112,673	15,855	1,878	1,309	, , , ,	273	3,463	131,991	5,798	..... 1990
1,254	111	129,196	16,827	1,898	1,277	, , , ,	281	3,457	149,480	5,888	..... 1991
1,276	60	154,123	19,458	1,899	1,507	, , , ,	315	3,721	177,302	6,031	..... 1992
1,369	27	165,985	21,696	2,464	1,405	, , , ,	261	4,176	191,857	6,468	..... 1993
1,041	9	159,777	20,395	1,367	952	, , , ,	183	2,561	182,733	5,105	..... 1994
1,114	6	177,146	22,876	1,255	707	, , , ,	196	2,221	202,243	6,180	..... 1995
1,129	6	172,363	23,317	1,183	459	, , , ,	142	1,833	197,513	9,786	..... 1996
876	5	156,828	25,203	833	212	, , , ,	208	1,289	183,320	12,112	..... 1997
payments account. - (3) Includes securities issued by the Treasury to consolidate past debts. - (4) Includes the 76,206 billion lire of securities issued in November 1994 to consolidate the Treasury's issues by local authorities. - (6) The total for firms and international institutions differs from the sum of the individual components by the amount of bond issues by Autostrade-IRI. - (7) Gross issues											

Table a24

MONEY MARKET AND INTERBANK INTEREST RATES (1)

	Treasury bill yields (2)				Interbank accounts (3)	Interbank operations				
	3-month bills	6-month bills	12-month bills	Average		Overnight (4)	1 month (4)	3 month (4)	12 month (4)	3 month Eurolira (5)
1988	11.17	11.06	11.17	11.13	<i>10.82</i>	10.17	....	....	....	10.79
1989	12.65	12.55	12.55	12.58	12.46	11.97	....	....	....	12.01
1990	12.28	12.33	12.53	12.38	11.83	10.93	11.92	12.10	....	11.63
1991	12.66	12.53	12.39	12.54	11.89	11.83	12.14	12.21	....	11.52
1992	14.48	14.38	14.02	14.32	14.29	14.38	14.42	14.02	....	13.48
1993	10.47	10.52	10.74	10.58	10.59	10.25	10.24	10.20	8.94	9.96
1994	8.84	9.13	9.50	9.17	8.43	8.20	8.33	8.51	9.17	8.29
1995	10.73	10.85	10.96	10.85	10.32	10.07	10.23	10.46	10.98	10.24
1996	8.61	8.48	8.31	8.46	9.44	9.10	8.99	8.82	8.42	8.65
1997	6.40	6.36	6.26	6.33	7.36	7.02	6.98	6.88	6.46	6.74
1995 – Jan.	9.80	9.64	9.47	9.63	10.79	10.20	10.20	10.07	9.74	9.92
Feb.	9.90	9.67	9.60	9.71	10.61	10.14	10.08	9.93	9.76	9.69
Mar.	9.86	9.76	9.63	9.75	10.43	9.99	9.92	9.85	9.39	9.60
Apr.	9.29	9.02	8.87	9.07	10.26	9.83	9.78	9.62	8.93	9.44
May	8.96	8.65	8.51	8.71	9.75	9.38	9.17	8.92	8.61	8.76
June	8.38	8.29	8.21	8.30	9.56	9.23	9.03	8.77	8.54	8.69
July	8.60	8.48	8.34	8.47	9.45	9.12	8.99	8.75	8.48	8.55
Aug.	8.70	8.71	8.53	8.65	9.10	8.74	8.87	8.81	8.57	8.67
Sept.	8.10	8.19	8.01	8.10	8.75	8.48	8.46	8.44	8.15	8.41
Oct.	7.68	7.56	7.28	7.48	8.47	8.32	8.20	8.02	7.49	7.83
Nov.	7.11	6.98	6.74	6.93	8.14	8.01	7.66	7.41	6.71	7.23
Dec.	6.95	6.79	6.58	6.76	8.01	7.80	7.57	7.25	6.67	7.05
1996 – Jan.	6.98	6.78	6.55	6.74	8.02	7.68	7.48	7.23	6.62	7.09
Feb.	6.75	6.87	6.67	6.76	7.83	7.51	7.48	7.36	6.84	7.17
Mar.	7.10	7.24	7.24	7.20	7.74	7.45	7.45	7.43	7.29	7.29
Apr.	6.69	6.55	6.78	6.67	7.64	7.27	7.18	7.13	7.05	6.95
May	6.39	6.46	6.45	6.44	7.46	6.99	6.95	6.83	6.78	6.72
June	6.65	6.52	6.45	6.54	7.29	6.99	6.94	6.88	6.61	6.75
July	6.52	6.60	6.37	6.49	7.27	6.99	6.95	6.89	6.50	6.71
Aug.	6.53	6.54	6.43	6.50	7.20	6.84	6.90	6.87	6.58	6.74
Sept.	5.81	5.94	5.73	5.82	7.08	6.80	6.78	6.66	6.24	6.54
Oct.	6.21	5.94	5.86	5.98	7.04	6.88	6.83	6.65	5.87	6.52
Nov.	5.96	5.80	5.59	5.76	7.02	6.61	6.65	6.49	5.81	6.42
Dec.	5.17	5.13	5.02	5.10	6.73	6.26	6.21	6.08	5.34	5.92
1997 – Jan.	5.62	5.59	5.20	5.43	6.43	6.33	6.25	6.09	5.25	5.93
Feb.	6.20	5.79	5.25	5.66	6.45	6.25	6.25	6.13	5.27	6.01
Mar.	5.73	5.12	4.71	5.10	6.27	5.91	5.81	5.62	4.77	5.47
Apr.	5.35	4.92	4.66	4.92	6.02	5.72	5.58	5.23	4.58	5.08

(1) Before tax; annual figures are the average of monthly values. – (2) Average of allotment rates at public auctions, before tax; for 3 and 6-month bills, compounded. – (3) Maximum rate applied to the lira sight deposits of resident banks with a debit balance of more than 1 billion lire, monthly average of the rates reported at 10-day intervals. The figures in italics refer to an earlier sample covering fewer banks. – (4) Weighted monthly average of the rates on transactions carried out on the interbank deposit market (MID). – (5) Monthly average of the bid rates recorded daily on lira interbank deposits in London.

Table a25

BANK INTEREST RATES (1)

	Deposits (2)						Loans (2)		New medium & long-term loans to enterprises (7)	New medium & long-term loans to consumer households (7)	ABI prime rate (8)
	Average: current accounts	Overall average	Maximum (3)	Certificates of deposit			Overall average	Minimum (6)			
				Overall average	Maturities up to 6 months (4)	Maturities from 18 to 24 months (5)					
1988	6.96	6.89	9.51	....	9.88	....	13.57	12.11	....	....	12.76
1989	7.29	7.30	9.33	....	10.35	....	14.26	11.95	....	....	13.83
1990	7.15	7.39	9.58	....	10.62	....	14.09	11.74	....	....	13.35
1991	6.99	7.38	9.33	....	10.42	....	13.90	11.33	....	....	12.84
1992	7.47	8.55	9.99	....	11.20	....	15.76	12.50	....	....	14.36
1993	6.46	7.79	8.86	....	9.30	....	13.87	10.51	....	....	11.40
1994	5.02	6.20	7.01	....	6.88	....	11.22	8.36	....	....	9.27
1995	5.49	6.45	8.00	8.46	8.37	8.89	12.47	9.60	11.44	13.37	11.03
1996	5.26	6.49	7.92	8.61	7.48	7.76	12.06	9.00	10.68	12.91	10.95
1997	3.73	4.83	6.11	7.29	5.43	5.33	9.75	6.79	8.26	10.65	9.21
1996 – Jan.	5.83	6.88	8.54	8.90	8.53	9.10	12.82	10.13	11.67	13.65	11.50
Feb.	5.70	6.87	8.31	8.91	8.24	8.59	12.73	9.93	11.70	13.62	11.50
Mar.	5.75	6.90	8.40	8.89	8.17	8.46	12.64	9.83	11.49	13.57	11.50
Apr.	5.78	6.90	8.46	8.84	8.11	8.44	12.55	9.74	11.31	13.56	11.50
May	5.60	6.79	8.24	8.80	7.82	8.10	12.43	9.43	10.89	13.38	11.50
June	5.52	6.74	8.22	8.73	7.59	7.75	12.24	9.14	10.87	13.17	11.50
July	5.33	6.56	7.99	8.62	7.42	7.64	12.11	8.87	10.68	12.99	10.88
Aug.	4.91	6.28	7.62	8.51	7.12	7.50	11.89	8.73	10.54	12.70	10.75
Sept.	4.94	6.23	7.64	8.43	7.08	7.45	11.69	8.55	10.45	12.72	10.75
Oct.	4.82	6.10	7.44	8.34	6.94	7.24	11.53	8.27	9.83	12.40	10.13
Nov.	4.45	5.81	7.05	8.24	6.51	6.64	11.22	7.91	9.67	12.00	10.00
Dec.	4.51	5.80	7.10	8.13	6.24	6.26	10.82	7.48	9.10	11.22	9.88
1997 – Jan.	4.36	5.60	6.81	7.99	6.08	6.04	10.64	7.31	8.84	11.50	9.63
Feb.	4.11	5.39	6.47	7.82	5.72	5.65	10.37	7.20	8.74	11.27	9.50
Mar.	4.07	5.28	6.40	7.69	5.67	5.58	10.20	7.15	8.84	11.27	9.38
Apr.	4.01	5.18	6.34	7.56	5.69	5.59	10.10	7.08	8.66	11.14	9.38
May	3.99	5.10	6.30	7.45	5.64	5.58	9.96	6.96	8.67	11.00	9.38
June	3.84	4.95	6.20	7.34	5.56	5.54	9.78	6.81	8.04	10.73	9.38
July	3.55	4.69	5.91	7.24	5.36	5.32	9.61	6.73	8.12	10.46	9.00
Aug.	3.44	4.55	5.83	7.12	5.21	5.15	9.46	6.67	8.35	10.54	9.00
Sept.	3.46	4.49	5.84	7.01	5.21	5.15	9.37	6.61	8.13	10.32	9.00
Oct.	3.29	4.29	5.66	6.89	5.04	4.86	9.27	6.45	7.98	10.17	9.00
Nov.	3.33	4.24	5.80	6.76	4.97	4.77	9.19	6.36	7.92	9.98	9.00
Dec.	3.37	4.19	5.79	6.63	4.95	4.73	9.02	6.12	6.90	9.38	8.88
1998 – Jan.	3.09	3.91	5.37	6.49	4.60	4.38	8.84	5.94	7.18	9.53	8.25
Feb.	2.94	3.76	5.23	6.33	4.49	4.22	8.70	5.89	7.29	9.20	8.25
Mar.	2.94	3.69	5.22	6.19	4.44	4.16	8.52	5.77	6.77	8.89	8.25
Apr.	2.79	3.50	5.02	6.04	4.28	4.10	8.34	5.54	6.66	8.60	7.88

(1) Before tax; annual figures are the average of monthly values. – (2) The rates shown are monthly averages of the rates reported at 10-day intervals. The "Overall average" rates are the weighted average of the rates on individual positions weighted with the relevant balances. The figures in italics refer to an earlier sample covering fewer banks. Until 1989, the figures for "Maximum" deposit rates and "Minimum" lending rates are based on the old definition; those for the "Overall average" deposit rates do not take account of banks' former special credit sections. – (3) Rate applied to the last decile of freely available deposits in lire on current and savings accounts ranked according to the interest rate. – (4) Until 1994, average issue rate of 6-month CDs. – (5) Average issue rate of fixed-rate lira CDs with an original maturity of between 18 and 24 months. – (6) Rate applied to the first decile of short-term loans in lire to enterprises ranked according to the interest rate. – (7) The rates are reported only for the last 10-day period of each month. – (8) The monthly data are end-of-period data.

Table a26

INTEREST RATES ON SECURITIES

(average values before tax)

	Floating rate Treasury credit certificates	Treasury certificates in ecus	Treasury option certificates	Treasury bonds	Zero-coupon Treasury certificates	Straight bonds			
						Banks	State-controlled enterprises	International institutions	Total (1)
1988	11.46	8.14	–	10.92	–	11.72	11.16	10.65	10.76
1989	13.12	9.60	12.17	12.78	–	12.52	12.06	11.09	11.59
1990	12.84	10.89	13.22	13.49	–	13.02	12.49	11.93	12.28
1991	12.60	10.09	12.91	13.14	–	12.74	11.62	11.40	11.79
1992	14.98	10.20	13.20	13.59	–	13.17	12.73	11.66	12.63
1993	11.77	7.81	11.12	11.32	–	11.21	10.90	10.02	11.09
1994	9.97	7.64	10.53	10.68	–	10.03	10.55	9.83	10.15
1995	11.60	8.82	11.64	11.94	11.40	11.45	11.35	11.00	11.45
1996	9.01	6.33	8.77	9.06	8.49	9.03	9.08	9.46	9.09
1997	6.81	5.42	7.17	6.76	6.45	7.24	7.07	7.17	7.14
1996 – Jan.	10.42	6.97	10.06	10.18	9.71	10.19	10.32	10.44	10.28
Feb.	9.97	6.57	9.92	10.14	9.59	10.02	10.15	10.32	10.11
Mar.	10.24	6.04	9.95	10.28	9.70	10.09	10.20	10.43	10.17
Apr.	10.01	6.43	9.71	9.99	9.43	9.97	10.04	10.12	10.02
May	9.22	6.61	8.88	9.32	8.66	9.39	9.33	9.75	9.38
June	8.93	6.56	8.70	9.15	8.47	9.08	9.09	9.64	9.12
July	8.76	6.49	8.69	9.03	8.37	8.82	8.97	9.30	8.94
Aug.	9.01	6.40	8.83	9.11	8.51	8.88	9.02	9.20	8.98
Sept.	8.82	6.27	8.48	8.82	8.24	8.75	8.89	9.33	8.87
Oct.	8.13	6.10	7.81	8.01	7.48	8.10	8.04	8.70	8.10
Nov.	7.44	5.94	7.19	7.42	6.93	7.66	7.47	8.25	7.59
Dec.	7.14	5.56	6.99	7.22	6.79	7.40	7.44	8.02	7.46
1997 – Jan.	6.93	5.48	6.96	7.02	6.69	7.31	7.07	7.50	7.17
Feb.	7.09	5.50	7.23	7.14	7.06	7.47	7.31	7.92	7.40
Mar.	7.34	5.48	7.67	7.73	7.29	7.71	7.71	8.02	7.73
Apr.	7.32	5.43	7.33	7.59	7.01	7.70	7.74	7.98	7.75
May	7.02	5.23	7.05	7.25	6.71	7.47	7.41	7.86	7.46
June	7.07	5.10	7.13	7.04	6.67	7.37	7.31	7.55	7.33
July	6.95	5.26	7.11	6.56	6.37	7.00	7.04	6.85	6.99
Aug.	7.01	5.14	7.06	6.71	6.45	7.05	7.07	6.83	7.01
Sept.	6.65	5.38	7.06	6.31	6.04	7.01	6.85	6.65	6.88
Oct.	6.36	5.67	7.18	6.12	5.97	6.84	6.61	6.40	6.67
Nov.	6.21	5.65	7.12	6.04	5.75	7.08	6.57	6.41	6.78
Dec.	5.77	5.67	7.14	5.67	5.34	6.89	6.21	6.05	6.50
1998 – Jan.	5.60	5.12	6.76	5.44	5.26	6.26	5.85	5.74	5.99
Feb.	5.98	5.00	6.84	5.37	5.45	6.45	6.09	5.82	6.18
Mar.	5.54	5.57	6.78	5.17	5.03	6.09	6.07	5.76	6.01
Apr.	5.17	5.63	7.67	5.13	4.90	5.68	6.03	5.64	5.76

(1) Until September 1995 includes the bonds issued by autonomous government agencies and public enterprises.

Table a27

M2 AND ITS COUNTERPARTS (1)
(changes in billions of lire)

	M2 (excluding longer-term CDs) (2)	Counterparts				
		Net external position of BI-UIC (3)	Net external position of banks	Credit to the non-state sector (4)	Credit to the state sector (5)	Other (6)
1988	35,683	10,947	-10,224	77,630	3,486	-46,155
1989	57,187	14,971	-14,979	112,370	9,076	-64,251
1990	47,933	15,458	-22,976	110,384	10,846	-65,779
1991	48,424	-8,674	-39,369	120,895	66,928	-91,355
1992	6,366	-32,591	-12,187	73,688	83,416	-105,960
1993	25,767	2,564	84,589	53,603	14,875	-129,864
1994	6,103	3,297	-21,594	10,198	27,004	-12,803
1995	-13,271	2,915	58,102	37,693	-25,491	-86,490
1996	29,142	20,449	47,394	51,111	3,073	-92,886
1997	67,701	22,829	-11,679	52,004	-50,560	55,107
1996 - Jan.	-58,006	-138	-7,450	-6,111	-2,161	-42,145
Feb.	-12,827	-916	550	-5,313	11,380	-18,527
Mar.	7,446	1,330	-12,110	2,452	15,812	-39
Apr.	3,825	8,042	26,808	1,636	-10,779	-21,881
May	-14,680	9,267	-13,151	11,522	1,962	-24,280
June	17,685	6,773	808	11,434	-25,906	24,577
July	-9,168	-325	-6,933	6,602	-3,465	-5,047
Aug.	-4,623	-2,812	15,024	-17,844	599	410
Sept.	29,300	731	3,310	4,161	17,018	4,081
Oct.	-1,144	5,382	5,718	-1,273	14,266	-25,238
Nov.	11,148	-2,922	10,748	6,223	10,317	-13,219
Dec.	60,186	-3,963	24,072	37,622	-25,970	28,424
1997 - Jan.	-31,917	5,363	-20,639	-18,640	4,729	-2,730
Feb.	5,212	-1,608	-937	454	2,352	4,950
Mar.	-1,184	-4,262	-3,051	-7,042	13,256	-85
Apr.	-390	-2,131	4,371	-339	4,655	-6,946
May	12,942	1,571	17,061	5,323	-551	-10,461
June	16,170	-1,139	20,657	24,722	-40,921	12,851
July	-7,543	12,124	647	8,018	-28,686	354
Aug.	-10,183	4,801	-11,963	-17,628	-550	15,157
Sept.	24,359	5,672	-2,703	-37	6,705	14,722
Oct.	5,408	-2,393	-656	559	11,706	-3,809
Nov.	-3,663	832	-16,613	9,350	-6,819	9,588
Dec.	58,491	3,999	2,147	47,264	-16,436	21,517
1998 - Jan. (7)	-25,731	-4,362	-14,900	-9,273	8,780	-5,977
Feb. (7)	-6,101	3,816	-348	248	-17,852	8,035
Mar. (7)	19,549	-752	-15,597	7,202	9,293	19,403

(1) Rounding may cause discrepancies in totals. - (2) Domestic money supply of the non-state sector; end-of-period data. Longer-term CDs are those not redeemable for at least 18 months. - (3) Net of exchange rate adjustments. - (4) Claims of banks on the non-state sector. - (5) Claims of banks and the Bank of Italy on the state sector. - (6) Repo fund-raising, monetary base creation by "other sectors", longer-term CDs, capital items and residual items in the balance sheets of banks. - (7) Provisional.

Table a28

THE MONEY
(stocks in billions)

	Notes and coin	End-of-period				
		Sight deposits (2)		Other assets (3)	Total: M1	Postal savings accounts
		Banks	Post Office			
1988 – Dec.	57,167	324,071	7,696	12,200	401,133	16,372
1989 – "	67,644	356,375	9,388	18,681	452,088	19,733
1990 – "	69,449	388,409	7,825	17,068	482,751	23,589
1991 – "	76,354	435,150	7,017	19,429	537,950	26,924
1992 – "	85,617	434,823	9,337	16,011	545,788	29,057
1993 – "	89,769	465,071	9,479	14,760	579,078	30,861
1994 – "	96,221	478,258	8,160	15,728	598,367	39,152
1995 – "	98,281	482,902	8,493	15,971	605,647	43,936
1996 – Jan.	92,006	437,798	10,410	11,273	551,488	44,577
Feb.	89,845	432,672	9,359	9,098	540,974	44,625
Mar.	92,341	440,180	7,786	8,869	549,176	44,516
Apr.	90,738	449,636	7,161	8,136	555,671	44,499
May	91,968	434,327	8,730	8,858	543,883	44,194
June	93,009	447,973	8,954	11,531	561,467	43,623
July	94,849	435,279	8,740	10,201	549,068	43,270
Aug.	92,456	433,195	8,897	6,171	540,719	43,889
Sept.	93,450	455,779	8,972	9,028	567,228	43,839
Oct.	92,605	453,742	9,437	10,191	565,975	43,301
Nov.	96,373	456,305	9,561	11,652	573,891	44,314
Dec.	100,107	506,025	7,275	13,144	626,551	46,256
1997 – Jan.	96,334	475,796	8,709	11,167	592,005	46,914
Feb.	95,714	477,765	8,674	12,197	594,350	47,770
Mar.	99,325	474,162	7,568	9,616	590,671	48,203
Apr.	96,861	476,427	7,138	9,259	589,685	48,524
May	99,345	485,235	6,763	9,348	600,690	48,597
June	97,692	497,278	7,681	12,710	615,361	48,485
July	101,408	487,648	6,024	11,943	607,024	48,230
Aug.	98,883	481,770	5,868	6,557	593,077	49,126
Sept.	99,933	499,079	7,986	9,180	616,178	49,316
Oct.	99,161	503,919	7,431	10,116	620,627	49,378
Nov.	103,237	493,475	6,686	11,216	614,615	49,776
Dec.	107,433	538,103	6,673	14,095	666,304	52,004
1998 – Jan. (8)	103,620	519,817	6,585	11,489	641,512	52,229
Feb. (8)	102,835	518,372	6,101	9,278	636,587	53,075
Mar. (8)	104,967	539,321	5,281	9,614	659,183	53,402

(1) Money held by the non-state sector. Rounding may cause discrepancies in totals. – (2) Demand deposits in lire and in foreign currency. – (3) Banker's drafts issued by banks and the Bank months. – (6) For notes and coin, deposits and banker's drafts, averages of daily data; for the other items, two-period moving averages of end-of-month data. – (7) Includes the deposits of the

Table a28 cont.

SUPPLY (1)
of lire

data			Average data (6)			
Savings deposits of bank (4)	Short-term CDs (5)	M2 excluding longer-term CDs (5)	M1	M2 excluding longer-term CDs (5)	Extended M2 (7)	
192,167	44,619	654,292	376,337	623,054	623,763	..... Dec. – 1988
182,090	57,568	711,479	415,018	668,520	669,519	..... " – 1989
178,384	74,688	759,412	442,428	709,331	711,604	..... " – 1990
161,798	81,164	807,836	488,712	750,765	754,376	..... " – 1991
146,967	92,390	814,203	492,082	751,789	757,185	..... " – 1992
144,091	87,286	841,316	529,612	780,319	786,096	..... " – 1993
138,297	71,602	847,418	547,354	788,390	795,392	..... " – 1994
121,047	63,518	834,148	555,147	773,423	784,824	..... " – 1995
116,368	63,709	776,142	557,975	780,079	792,202	..... Jan. – 1996
114,755	62,961	763,315	531,121	751,275	764,986	..... Feb.
115,042	62,027	770,761	530,370	747,206	762,688	..... Mar.
113,437	60,979	774,586	532,849	747,878	765,062	..... Apr.
111,873	59,956	759,906	542,844	756,148	774,367	..... May
113,414	59,088	777,591	537,138	746,619	764,579	..... June
112,277	63,808	768,423	541,426	751,268	767,435	..... July
113,287	65,905	763,800	532,314	745,945	761,215	..... Aug.
113,970	68,063	793,100	540,835	757,881	773,508	..... Sept.
112,882	69,798	791,956	551,651	770,135	786,894	..... Oct.
114,361	70,538	803,104	562,121	783,210	800,020	..... Nov.
118,399	72,084	863,290	576,638	802,938	818,010	..... Dec.
117,014	75,439	831,372	599,902	834,070	848,867	..... Jan. – 1997
117,051	77,413	836,584	577,572	813,801	829,940	..... Feb.
117,508	79,018	835,400	577,379	815,465	831,677	..... Mar.
116,169	80,633	835,010	578,970	818,708	835,401	..... Apr.
116,215	82,450	847,952	590,728	832,324	848,225	..... May
116,777	83,500	864,122	583,990	826,557	841,807	..... June
116,794	84,530	856,579	594,331	838,533	854,405	..... July
118,615	85,578	846,395	591,107	838,091	853,195	..... Aug.
117,759	87,501	870,755	589,621	838,849	853,847	..... Sept.
117,313	88,844	876,163	601,918	852,436	869,852	..... Oct.
118,586	89,523	872,500	605,018	856,652	875,583	..... Nov.
121,433	91,249	930,991	621,001	875,279	892,939	..... Dec.
121,251	90,268	905,260	647,577	907,659	924,603	..... (8) Jan. – 1998
121,198	88,299	899,158	626,634	884,544	901,792	..... (8) Feb.
118,370	87,753	918,708	635,930	892,437	909,703	..... (8) Mar.

of Italy and deposits with the Treasury. – (4) Savings accounts and tied current account deposits in lire and in foreign currency. – (5) Longer-term CDs are those not redeemable for at least 18 non-state sector with the foreign branches of Italian banks; excludes longer-term CDs. – (8) Provisional.

Table a29

CRE
(stocks)

	Finance to the non-state sector				
	Short-term bank loans (2)	Medium and long-term bank loans (2)	Bonds placed domestically	Total domestic finance	Foreign finance (3)
1988 – Dec.	329,638	217,719	25,719	573,076	51,036
1989 – "	392,737	259,653	25,638	678,028	68,029
1990 – "	455,671	300,933	23,453	780,057	93,504
1991 – "	513,495	347,530	25,109	886,134	107,686
1992 – "	570,627	384,286	20,510	975,423	128,680
1993 – "	557,979	433,812	24,783	1,016,573	131,547
1994 – "	531,853	474,804	21,873	1,028,530	124,660
1995 – "	551,973	485,350	18,409	1,055,732	129,596
1996 – Jan.	548,992	481,929	18,717	1,049,638	130,505
Feb.	542,260	482,922	18,794	1,043,976	130,952
Mar.	536,206	488,147	18,973	1,043,326	131,233
Apr.	537,167	485,692	19,183	1,042,042	129,825
May	540,194	488,694	19,004	1,047,891	131,399
June	548,812	492,014	18,760	1,059,585	130,055
July	558,602	492,530	19,252	1,070,383	126,821
Aug.	537,929	494,205	19,029	1,051,162	125,413
Sept.	537,992	495,655	18,753	1,052,401	123,751
Oct.	532,905	496,969	17,498	1,047,372	123,175
Nov.	532,099	499,612	17,795	1,049,506	121,491
Dec.	554,157	511,158	17,957	1,083,271	122,955
1997 – Jan.	553,406	512,539	17,936	1,083,881	124,758
Feb.	553,774	512,916	17,772	1,084,462	126,692
Mar.	547,224	512,075	17,417	1,076,716	125,842
Apr.	545,851	514,072	17,629	1,077,551	126,551
May	545,227	517,336	16,741	1,079,303	127,515
June	562,202	524,430	14,307	1,100,938	128,476
July	571,826	523,293	14,554	1,109,673	132,218
Aug.	554,995	522,447	14,608	1,092,050	132,657
Sept.	554,559	526,424	14,720	1,095,702	132,116
Oct.	551,172	529,362	15,103	1,095,638	135,199
Nov.	554,976	534,970	15,446	1,105,392	135,694
Dec.	590,209	543,957	15,764	1,149,930	136,029
1998 – Jan. (7)	582,151	541,112	14,777	1,138,039	136,745
Feb. (7)	578,612	544,602	14,656	1,137,870	135,327
Mar. (7)	582,479	548,732	14,383	1,145,593	136,073

(1) Rounding may cause discrepancies in totals. – (2) In lire and in foreign currency. – (3) Foreign loans and bonds. – (4) At face value. – (5) Domestic finance to the non-state sector and the

Table a29 cont.

DIT (1)
in billions of lire

	State sector debt (4)		Credit		
	Total finance	of which: domestic	Total domestic (5)	Total (6)	
624,112	987,707	959,140	1,532,216	1,611,819	..... Dec. – 1988
746,057	1,116,652	1,081,677	1,759,705	1,862,709	..... ” – 1988
873,561	1,259,875	1,210,878	1,990,935	2,133,436	..... ” – 1990
993,820	1,411,919	1,357,010	2,243,144	2,405,739	..... ” – 1991
1,104,103	1,595,007	1,530,498	2,505,921	2,699,110	..... ” – 1992
1,148,120	1,765,403	1,679,954	2,696,527	2,913,523	..... ” – 1993
1,153,190	1,931,738	1,835,757	2,864,287	3,084,928	..... ” – 1994
1,185,328	2,072,599	1,953,354	3,009,086	3,257,928	..... – 1995
1,180,143	2,082,106	1,964,200	3,013,838	3,262,249	..... Jan. – 1996
1,174,928	2,094,280	1,978,191	3,022,137	3,269,208	..... Feb.
1,174,559	2,116,865	1,997,774	3,041,100	3,291,424	..... Mar.
1,171,868	2,141,218	2,021,288	3,063,330	3,313,086	..... Apr.
1,179,290	2,148,369	2,030,671	3,078,562	3,327,660	..... May
1,189,640	2,122,880	2,002,943	3,062,528	3,312,521	..... June
1,197,204	2,137,421	2,014,791	3,085,174	3,334,625	..... July
1,176,575	2,146,061	2,024,831	3,075,993	3,322,636	..... Aug.
1,176,151	2,171,950	2,049,262	3,101,663	3,348,101	..... Sept.
1,170,547	2,194,828	2,073,195	3,120,567	3,365,375	..... Oct.
1,170,996	2,205,998	2,083,767	3,133,273	3,376,995	..... Nov.
1,206,226	2,204,129	2,078,805	3,162,076	3,410,355	..... Dec.
1,208,639	2,206,306	2,078,477	3,162,358	3,414,945	..... Jan. – 1997
1,211,154	2,217,931	2,086,232	3,170,694	3,429,085	..... Feb.
1,202,557	2,242,659	2,110,558	3,187,274	3,445,216	..... Mar.
1,204,103	2,261,546	2,129,542	3,207,093	3,465,649	..... Apr.
1,206,819	2,277,866	2,141,307	3,220,611	3,484,685	..... May
1,229,414	2,250,669	2,113,863	3,214,621	3,480,083	..... June
1,241,891	2,247,022	2,103,625	3,213,298	3,488,913	..... July
1,224,707	2,246,794	2,104,932	3,196,982	3,471,501	..... Aug.
1,227,818	2,265,527	2,125,723	3,221,426	3,493,346	..... Sept.
1,230,836	2,280,746	2,142,037	3,237,674	3,511,582	..... Oct.
1,241,086	2,270,865	2,132,325	3,237,717	3,511,951	..... Nov.
1,285,960	2,247,804	2,110,524	3,260,454	3,533,763	..... Dec.
1,274,784	2,243,819	2,107,579	3,245,618	3,518,603	..... Jan. – 1998
1,273,197	2,251,496	2,114,724	3,252,594	3,524,693	..... Feb.
1,281,667	2,273,768	2,136,833	3,282,426	3,555,434	..... Mar.

state sector. – (6) Domestic and foreign finance to the non-state sector and the state sector. – (7) Provisional.

Table a30

ITALY'S FINANCIAL ASSETS
(stocks in

Sectors	1. Non-financial corporate or quasi- corporate enterprises		2. Credit institutions						3. Insurance enterprises		4.1 Central government	
			2.1 Central banking authorities		2.2 Other monetary institutions		2.3 Other credit institutions					
	assets	liabilities	assets	liabilities	assets	liabilities	assets	liabilities	assets	liabilities	assets	liabilities
Financial instruments												
a) Gold	-	-	37,578	-	-	-	-	-	-	-	-	-
b) SDRs	-	-	118	-	-	-	-	-	-	-	-	-
c) Currency	10,007	-	-	114,074	8,732	-	-	-	18	-	178	2,144
1) banknotes	10,007	-	-	114,074	8,732	-	-	-	18	-	178	-
2) coins and foreign currencies ..	-	-	-	-	-	-	-	-	-	-	-	2,144
d) Transferable sight deposits	102,981	-	91,680	524	85,770	670,651	27,730	-	4,374	-	9,413	35,914
1) with banks	96,645	-	-	-	61,843	670,651	27,730	-	4,374	-	9,413	-
2) with central government	6,336	-	..	-	1,345	-	..	-	-	-	-	35,914
3) with Bank of Italy - UIC	-	-	-	524	418	-	-	-	-	-	-	-
4) with non-residents	-	-	91,680	-	22,163	-	-	-	-	-	-	-
e) Other deposits	6,057	-	-	136,505	310,569	651,582	825	-	154	-	58,868	172,136
1) with banks	4,392	-	-	-	109,241	651,582	825	-	154	-	1,084	-
2) with Deposits and Loans Fund ..	1,665	-	-	-	-	-	-	-	-	-	-	172,136
3) with Bank of Italy - UIC	-	-	-	136,505	78,647	-	-	-	-	-	57,784	-
4) with non-residents	-	-	-	-	122,681	-	-	-	-	-	-	-
f) Bills and short-term bonds	4,688	3,954	14,503	-	36,672	16	23,713	260	1,131	-	-	302,233
1) BOTs	1,795	-	14,331	-	33,519	-	17,035	-	273	-	-	302,233
2) BTEs	-	-	-	-	-	-	-	-	-	-	-	-
3) banker's acceptances	15	3,954	-	-	3,153	16	140	260	-	-	-	-
4) foreign	2,878	-	173	-	-	-	6,539	-	858	-	-	-
g) Short-term loans	101,946	529,466	40,440	4,789	750,583	266,782	87,812	115,878	1,363	806	1,908	431
1) of banks	-	375,641	-	-	646,300	2,819	-	85,256	-	803	-	431
2) of Bank of Italy - UIC	-	-	6,643	-	-	2,701	-	-	-	-	-	..
3) of central government	-	-	-	-	-	-	-	-	-	-	1,794	-
4) other	101,946	153,824	33,797	4,789	104,283	261,261	87,812	30,622	1,363	3	114	..
h) Medium and long-term loans ...	44,127	319,798	19,932	1,893	577,699	86,070	88,717	47,756	2,336	6,067	201,701	65,854
1) of banks	-	229,734	-	-	577,699	7,795	-	24,637	-	2,941	-	33,472
2) of Bank of Italy - UIC	-	-	19,932	-	-	-	-	18,558	-	-	-	1,374
3) of central government	-	46,883	-	..	-	4,304	-	-	-	2,131	201,701	-
4) other	44,127	43,181	-	1,893	-	73,971	88,717	4,560	2,336	995	-	31,008
i) Medium and long-term bonds ..	71,118	26,006	139,031	-	323,741	377,743	303,227	-	173,103	-	4,407	1,762,003
1) CCTs	20,828	-	8,831	-	153,867	-	58,281	-	36,519	-	-	630,408
2) other central government	18,439	-	128,879	-	107,165	-	152,547	-	85,784	-	-	1,110,987
3) issued by banks	11,035	-	482	-	44,503	377,743	5,381	-	25,395	-	4,399	-
4) issued by autonomous government agencies	1,426	..	..	-	1,072	-	599	-	2,381	-	-	20,608
5) issued by local authorities	3	-	..	-	407	-	37	-	18	-	..	-
6) issued by enterprises	673	26,006	15	-	1,285	-	1,546	-	3,308	-	9	-
7) foreign	18,715	-	826	-	15,443	-	84,837	-	19,698	-	-	-
l) Shares and other equities	405,019	1,190,312	7,045	11,804	73,262	274,061	154,623	96,886	78,996	189,550	130,877	-
1) Italian	278,053	1,190,312	6,522	11,804	60,336	274,061	69,682	96,886	47,121	189,550	118,951	-
2) foreign	126,966	-	523	-	12,927	-	84,942	-	31,875	-	11,926	-
m) Insurance technical reserves et al.	15,401	90,373	-	7,022	-	29,455	-	-	-	250,673	-	-
1) technical reserves of insurance companies	15,401	-	-	-	-	-	-	-	-	243,958	-	-
2) severance pay and non-autonomous pension funds ..	-	90,373	-	7,022	-	29,455	-	-	-	6,715	-	-
n) Other assets and liabilities	14,176	73,145	837	1,195	117,934	8,488	12,146	378,513	233	17	879	3
1) investment funds	-	-	-	-	-	-	-	368,432	-	-	-	-
2) other	14,176	73,145	837	1,195	117,934	8,488	12,146	10,081	233	17	879	3
Total ...	775,520	2,233,054	351,165	277,807	2,284,962	2,364,847	698,793	639,293	261,708	447,112	408,231	2,340,718

(1) Provisional. Rounding may cause discrepancies in totals.

Table a30 cont.

AND LIABILITIES IN 1997 (1)*billions of lire*

4. General government				5. Households				6. Rest of the world		Items not elsewhere classified and discrepancies		Total	
4.2 Local government		4.3 Social security funds		5.1 Consumer households		5.2 Sole proprietorships							
assets	liabilities	assets	liabilities	assets	liabilities	assets	liabilities	assets	liabilities	assets	liabilities	assets	liabilities
-	-	-	-	-	-	-	-	-	37,578	-	-	37,578	37,578
-	-	-	-	-	-	-	-	-	118	-	-	118	118
-	-	1	-	85,535	-	11,748	-	-	-	-	-	116,218	116,218
-	-	1	-	83,391	-	11,748	-	-	-	-	-	114,074	114,074
-	-	-	-	2,144	-	-	-	-	-	-	-	2,144	2,144
40,835	-	4,763	-	353,244	-	52,552	-	35,212	171,495	70,030	-	878,584	878,584
12,839	-	4,526	-	353,244	-	52,552	-	35,152	-	12,332	-	670,651	670,651
27,995	-	237	-	-	-	-	-	-	-	-	-	35,914	35,914
-	-	-	-	-	-	-	-	60	-	46	-	524	524
-	-	-	-	-	-	-	-	-	171,495	57,652	-	171,495	171,495
266	-	222	-	501,601	-	10,509	-	191,562	122,681	2,270	-	1,082,904	1,082,904
266	-	222	-	331,130	-	10,509	-	191,488	-	2,270	-	651,582	651,582
-	-	-	-	170,471	-	-	-	-	-	-	-	172,136	172,136
-	-	-	-	-	-	-	-	75	-	-	-	136,505	136,505
-	-	-	-	-	-	-	-	-	122,681	-	-	122,681	122,681
145	-	578	-	198,609	-	9,123	738	31,881	13,842	-	-	321,043	321,043
145	-	578	-	193,973	-	8,704	-	31,881	-	-	-	302,233	302,233
-	-	-	-	-	-	-	-	-	-	-	-	-	-
-	-	-	-	1,590	-	71	738	-	-	-	-	4,969	4,969
-	-	-	-	3,046	-	348	-	-	13,842	-	-	13,842	13,842
1,202	4,952	862	2,139	85,933	39,669	8,149	86,165	238,657	258,666	-4,225	4,888	1,314,629	1,314,629
-	4,943	-	345	-	38,948	-	84,424	-	49,902	-2,787	-	643,512	643,512
-	-	-	-	-	-	-	-	-	3,942	-	-	6,643	6,643
-	-	-	1,794	-	-	-	-	-	-	-	-	1,794	1,794
1,202	10	862	-	85,933	720	8,149	1,741	238,657	204,822	-1,438	4,888	662,680	662,680
48	196,936	15,086	808	-	163,741	-	79,345	110,701	47,410	2,955	47,624	1,063,301	1,063,301
-	70,090	-	808	-	144,653	-	62,988	-	11,165	2,955	-7,630	580,653	580,653
-	-	-	-	-	-	-	-	-	-	-	-	19,932	19,932
-	126,631	-	-	-	308	-	7	-	44	-	21,394	201,701	201,701
48	216	15,086	-	-	18,780	-	16,349	110,701	36,202	-	33,861	261,015	261,015
2,294	875	23,670	-	839,032	-	64,298	-	453,463	242,932	12,173	-	2,409,559	2,409,559
809	-	9,933	-	222,201	-	16,614	-	102,526	-	-	-	630,408	630,408
726	-	9,004	-	249,613	-	18,054	-	332,666	-	8,110	-	1,110,987	1,110,987
601	-	2,554	-	256,645	-	24,061	-	2,687	-	-	-	377,743	377,743
15	-	283	-	8,330	-	835	-	1,605	-	4,063	-	20,608	20,608
..	875	..	-	380	-	30	-	..	-	-	-	875	875
18	-	788	-	4,103	-	284	-	13,979	-	-	-	26,006	26,006
125	-	1,108	-	97,759	-	4,419	-	-	242,932	-	-	242,932	242,932
23,225	129	1,664	-	930,058	-	91,712	-	225,800	359,540	..	..	2,122,282	2,122,282
23,180	129	1,418	-	847,914	-	83,766	-	225,800	-	-	..	1,762,742	1,762,742
45	-	246	-	82,145	-	7,946	-	-	359,540	..	-	359,540	359,540
-	-	-	-	405,955	8,755	18,644	53,722	-	-	-	-	440,000	440,000
-	-	-	-	209,913	-	18,644	-	-	-	-	-	243,958	243,958
-	-	-	-	196,042	8,755	-	53,722	-	-	-	-	196,042	196,042
1,384	622	40	..	390,574	23,928	92	27,938	36,277	86,404	34,522	8,842	609,094	609,094
-	-	-	-	363,032	-	-	-	5,400	-	-	-	368,432	368,432
1,384	622	40	..	27,542	23,928	92	27,938	30,877	86,404	34,522	8,842	240,662	240,662
69,399	203,515	46,884	2,947	3,790,542	236,092	266,828	247,907	1,323,553	1,340,665	117,725	61,354	10,395,310	10,395,310

Table a31

ITALY'S FINANCIAL ASSETS
(flows in

Sectors	1. Non-financial corporate or quasi- corporate enterprises		2. Credit institutions						3. Insurance enterprises		4.1 Central government		
			2.1 Central banking authorities		2.2 Other monetary institutions		2.3 Other credit institutions						
	Financial instruments	assets	liabilities	assets	liabilities	assets	liabilities	assets	liabilities	assets	liabilities	assets	liabilities
a) Gold	-	-	..	-	-	-	-	-	-	-	-	-	-
b) SDRs	-	-	68	-	-	-	-	-	-	-	-	-	-
c) Currency	680	-	-	7,968	717	-	-	-	3	-	99	89	
1) banknotes	680	-	-	7,968	717	-	-	-	3	-	99	-	
2) coins and foreign currencies ..	-	-	-	-	-	-	-	-	-	-	-	89	
d) Transferable sight deposits	4,324	-	21,573	-776	1,140	54,031	5,071	-	-223	-	1,706	-2,036	
1) with banks	4,707	-	-	-	4,173	54,031	5,072	-	-223	-	1,706	-	
2) with central government	-384	-	..	-	31	-	..	-	-	-	-	-2,036	
3) with Bank of Italy - UIC	-	-	-	-776	-602	-	-	-	-	-	-	-	
4) with non-residents	-	-	21,573	-	-2,462	-	-	-	-	-	-	-	
e) Other deposits	62	-	-	9,063	-9,950	-124,497	-1,919	-	-28	-	3,151	12,322	
1) with banks	5	-	-	-	-7,150	-124,497	-1,919	-	-28	-	130	-	
2) with Deposits and Loans Fund	57	-	-	-	-	-	-	-	-	-	-	12,322	
3) with Bank of Italy - UIC	-	-	-	9,063	6,027	-	-	-	-	-	3,020	-	
4) with non-residents	-	-	-	-	-8,828	-	-	-	-	-	-	-	
f) Bills and short-term bonds	-1,299	532	12,784	-	-21,998	2	-12,281	12	-1,213	-	-	-82,191	
1) BOTs	-1,005	-	12,642	-	-22,738	-	-13,079	-	-1,061	-	-	-82,191	
2) BTEs	-	-	-	-	-	-	-	-	-	-	-	-	
3) banker's acceptances	-4	532	-	-	740	2	-56	12	-	-	-	-	
4) foreign	-291	-	142	-	-	-	853	-	-152	-	-	-	
g) Short-term loans	16,651	29,652	-12,628	4,191	47,274	17,526	24,266	9,469	110	99	-26	-929	
1) of banks	-	16,599	-	-	37,573	-454	-	10,815	-	101	-	-929	
2) of Bank of Italy - UIC	-	-	2,398	-	-	1,514	-	-	-	-	-	..	
3) of central government	-	-	-	-	-	-	-	-	-	-	..	-	
4) accounts receivable and payable	-	-	-	-	-	-	-	-	-	-	-	-	
5) other	16,651	13,052	-15,026	4,191	9,701	16,467	24,266	-1,347	110	-3	-26	..	
h) Medium and long-term loans ...	432	-9,516	18,864	282	25,037	-6,640	9,113	31,118	-97	-374	7,072	-277	
1) of banks	-	4,414	-	-	25,037	-545	-	12,936	-	-598	-	313	
2) of Bank of Italy - UIC	-	-	18,864	-	-	-	-	18,558	-	-	-	306	
3) of central government	-	51	-	..	-	161	-	-	-	95	7,072	-	
4) other	432	-13,980	-	282	-	-6,256	9,113	-376	-97	128	-	-895	
i) Medium and long-term bonds ..	2,459	-1,475	-25,498	-	-12,879	97,228	131,052	-	24,412	-	-209	97,134	
1) CCTs	-212	-	-13,738	-	-852	-	18,235	-	-14,090	-	-	-16,185	
2) other central government	290	-	-11,846	-	-15,953	-	82,465	-	30,844	-	-	113,775	
3) issued by banks	1,646	-	-129	-	-1,915	97,228	1,026	-	4,147	-	-207	-	
4) issued by autonomous government agencies	138	..	..	-	-97	-	-10	-	-313	-	-	-456	
5) issued by local authorities	-9	-	..	-	979	-	35	-	8	-	..	-	
6) issued by enterprises	-147	-1,475	-13	-	176	-	471	-	-571	-	-1	-	
7) foreign	754	-	229	-	4,783	-	28,830	-	4,387	-	-	-	
l) Shares and other equities	16,018	39,065	262	..	6,436	3,907	32,865	3,501	8,418	412	-14,128	-	
1) Italian	5,899	39,065	259	..	5,047	3,907	8,056	3,501	8,243	412	-14,456	-	
2) foreign	10,118	-	3	-	1,388	-	24,809	-	175	-	328	-	
m) Insurance technical reserves et al.	2,270	4,739	-	1,095	-	292	-	-	-	44,531	-	-	
1) technical reserves of insurance companies	2,270	-	-	-	-	-	-	-	-	43,959	-	-	
2) severance pay and non-autonomous pension funds	-	4,739	-	1,095	-	292	-	-	-	572	-	-	
n) Other assets and liabilities	3,051	4,724	51	-460	-1,739	1,842	3,571	145,767	466	1	63	..	
1) investment funds	-	-	-	-	-	-	-	143,377	-	-	-	-	
2) other	3,051	4,724	51	-460	-1,739	1,842	3,571	2,390	466	1	63	..	
Total ...	44,648	67,721	15,475	21,363	34,038	43,692	191,739	189,866	31,848	44,668	-2,272	24,113	

(1) Provisional. Rounding may cause discrepancies in totals.

Table a31 cont.

AND LIABILITIES IN 1997 (1)*billions of lire*

4. General government				5. Households				6. Rest of the world		Items not elsewhere classified and discrepancies		Total	
4.2 Local government		4.3 Social security funds		5.1 Consumer households		5.2 Sole proprietorships							
assets	liabilities	assets	liabilities	assets	liabilities	assets	liabilities	assets	liabilities	assets	liabilities	assets	liabilities
-	-	-	-	-	-	-	-	-	..	-	-
-	-	-	-	-	-	-	-	-	68	-	-	68	68
-	-	..	-	5,759	-	799	-	-	-	-	-	8,057	8,057
-	-	..	-	5,670	-	799	-	-	-	-	-	7,968	7,968
-	-	-	-	89	-	-	-	-	-	-	-	89	89
-3,854	-	-686	-	27,592	-	-463	-	6,638	28,679	17,081	-	79,898	79,898
-2,170	-	-686	-	27,592	-	-463	-	6,820	-	7,505	-	54,031	54,031
-1,683	-	..	-	-	-	-	-	-	-	-	-	-2,036	-2,036
-	-	-	-	-	-	-	-	-182	-	8	-	-776	-776
-	-	-	-	-	-	-	-	-	28,679	9,568	-	28,679	28,679
-56	-	202	-	-95,044	-	-2,107	-	-6,965	-8,828	713	-	-111,940	-111,940
-56	-	202	-	-107,309	-	-2,107	-	-6,980	-	713	-	-124,497	-124,497
-	-	-	-	12,265	-	-	-	-	-	-	-	12,322	12,322
-	-	-	-	-	-	-	-	16	-	-	-	9,063	9,063
-	-	-	-	-	-	-	-	-	-8,828	-	-	-8,828	-8,828
-115	-	-454	-	-59,222	-	-5,319	46	7,947	426	-	-	-81,172	-81,172
-115	-	-454	-	-59,032	-	-5,296	-	7,947	-	-	-	-82,191	-82,191
-	-	-	-	-	-	-	-	-	-	-	-	-	-
-	-	-	-	-68	-	-20	46	-	-	-	-	593	593
-	-	-	-	-123	-	-3	-	-	426	-	-	426	426
453	-65	-210	-58	5,157	1,306	-913	312	29,617	52,924	8,108	3,432	117,859	117,859
-	53	-	-58	-	2,980	-	-537	-	9,627	625	..	38,197	38,197
-	-	-	-	-	-	-	-	-	884	-	-	2,398	2,398
-	-	-	..	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-	8,519	8,519	-	8,519	8,519
453	-118	-210	..	5,157	-1,673	-913	849	29,617	33,894	-1,036	3,432	68,745	68,745
31	8,779	..	99	-	9,402	-	13,535	-8,672	1,665	-10,787	-7,081	40,993	40,993
-	2,865	-	99	-	10,179	-	4,138	-	343	1,476	-7,630	26,513	26,513
-	-	-	-	-	-	-	-	-	..	-	-	18,864	18,864
-	6,552	-	-	-	-377	-	..	-	2	-	587	7,072	7,072
31	-637	..	-	-	-399	-	9,396	-8,672	1,319	-12,263	-38	-11,456	-11,456
411	636	-625	-	69,994	-	-6,261	-	95,520	61,359	-23,495	-	254,883	254,883
34	-	-1,243	-	-7,198	-	-3,723	-	7,540	-	-938	-	-16,185	-16,185
61	-	182	-	-30,116	-	-6,475	-	87,357	-	-23,035	-	113,775	113,775
177	-	-160	-	87,782	-	3,932	-	928	-	-	-	97,228	97,228
6	-	-49	-	205	-	-23	-	-790	-	478	-	-456	-456
..	636	..	-	-346	-	-30	-	..	-	-	-	636	636
1	-	-8	-	-1,695	-	-171	-	485	-	-	-	-1,475	-1,475
133	-	652	-	21,362	-	229	-	-	61,359	..	-	61,359	61,359
1,742	12	178	-	17,408	-	1,497	-	17,068	40,868	..	..	87,765	87,765
1,742	12	167	-	13,405	-	1,464	-	17,068	-	-	..	46,897	46,897
..	-	11	-	4,003	-	33	-	-	40,868	..	-	40,868	40,868
-	-	-	-	50,714	909	2,748	4,167	-	-	-	-	55,733	55,733
-	-	-	-	38,940	-	2,748	-	-	-	-	-	43,959	43,959
-	-	-	-	11,774	909	-	4,167	-	-	-	-	11,774	11,774
-290	-181	3	..	150,810	3,654	-10	927	165	26,701	19,235	-7,598	175,376	175,376
-	-	-	-	143,175	-	-	-	202	-	-	-	143,377	143,377
-290	-181	3	..	7,635	3,654	-10	927	-37	26,701	19,235	-7,598	31,999	31,999
-1,678	9,180	-1,591	41	173,167	15,272	-10,029	18,988	141,320	203,862	10,855	-11,246	627,521	627,521

Table a32

BANKS: CONTRIBUTION OF OPERATIONS TO SUPERVISORY CAPITAL (1) (2)
(billions of lire)

	Classification by type of bank						Total	Classification by size		Classification by location of head office	
	Limited cos. raising short-term funds	Limited cos. raising medium and long-term funds	Cooperative banks	Mutual banks	Central credit institutions	Branches of foreign banks		Major, large and medium-sized banks	Small and minor banks	Centre-North	South
	Net income										
1995	19,261	2,906	5,166	1,968	269	475	30,044	20,545	9,500	27,980	2,064
1996	20,518	3,610	5,556	2,146	310	389	32,529	22,495	10,034	30,769	1,760
1997 (3)	19,728	3,033	5,266	1,982	316	83	30,408	21,723	8,685	27,914	2,494
	Extraordinary expenses, net										
1995	500	251	-282	-74	4	-97	301	668	-367	-348	649
1996	2,045	393	-75	-149	1	-169	2,044	2,442	-398	1,708	336
1997 (3)	-747	-45	30	-90	72	-327	-1,107	-408	-699	-468	-639
	Sundry provisions										
1995	1,350	-606	483	8	1	23	1,259	1,063	195	1,206	53
1996	2,034	-423	324	21	40	41	2,039	1,873	166	1,232	807
1997 (3)	3,552	-311	394	37	57	40	3,769	3,303	466	3,386	383
	Charges for loan losses										
1995	11,943	1,376	1,924	266	158	117	15,783	12,894	2,890	10,381	5,402
1996	8,242	1,126	1,444	326	87	70	11,296	8,582	2,714	8,902	2,394
1997 (3)	10,922	1,086	1,533	398	113	86	14,138	11,376	2,762	11,889	2,249
	Taxes										
1995	5,160	1,112	1,700	97	74	301	8,443	5,325	3,118	7,850	592
1996	4,928	1,215	1,885	129	88	269	8,514	5,230	3,284	7,936	578
1997 (3)	5,005	1,198	1,539	87	67	231	8,127	5,349	2,778	7,677	450
	Dividends										
1995	2,050	522	841	65	18	33	3,529	2,556	973	3,373	156
1996	2,483	677	943	56	20	60	4,239	3,067	1,172	4,060	179
1997 (3)	2,749	828	992	48	18	19	4,654	3,461	1,193	4,515	139
	Allocations to supervisory capital										
1995	-1,745	252	502	1,606	13	96	724	-1,961	2,685	5,512	-4,788
1996	786	621	1,035	1,762	75	118	4,397	1,300	3,097	6,931	-2,534
1997 (3)	-1,875	311	781	1,515	-11	34	755	-1,367	2,122	846	-91
.....											
	ROE										
1995	-0.3	0.8	5.4	14.0	4.1	7.2	1.6	-0.3	6.3	4.7	-30.9
1996	2.2	2.3	7.4	13.8	4.2	10.5	3.8	2.4	7.0	5.4	-12.5
1997 (3)	-0.5	2.0	6.6	10.5	0.3	3.4	1.6	-	5.2	1.7	0.3

(1) The classifications are those that were in force at the end of 1997; merged banks have been considered as belonging to the category of the bank with which they were merged. - (2) For 1996 and 1997 excludes Isveimer, which is in voluntary liquidation. - (3) Provisional.

Table a33

BANKS: SUPERVISORY CAPITAL (1)*(billions of lire)*

	Classification by type of bank						Total	Classification by size		Classification by location of head office	
	Limited companies raising short-term funds	Limited companies raising medium and long-term funds	Cooperative banks	Mutual banks	Central credit institutions	Branches of foreign banks (2)		Major, large and medium sized banks	Small and minor banks	Centre-North	South
December 1996											
Supervisory capital	130,117	27,526	27,263	14,941	1,969	844	202,660	140,018	62,642	186,185	16,475
Primary capital	107,982	24,575	22,106	14,179	1,981	798	171,621	115,121	56,500	157,794	13,827
of which: capital and reserves ..	113,071	22,858	22,400	14,030	1,951	855	175,165	119,546	55,619	159,167	15,998
provision for general banking risks	2,059	2,204	1,286	342	47	16	5,954	3,638	2,316	5,251	703
intangible assets and goodwill	4,433	96	1,460	157	15	21	6,182	5,343	839	5,822	360
Supplementary capital	26,249	3,550	6,188	778	381	46	37,192	30,479	6,713	34,128	3,064
of which: subordinated liabilities (3)	15,515	584	4,238	74	–	–	20,411	17,569	2,842	18,371	2,040
revaluation losses on securities	85	11	2	4	–	–	102	86	16	89	13
loan loss provisions (4)	3,594	1,914	550	468	16	64	6,606	4,849	1,757	6,001	605
Equity interests not included in the consolidation	4,114	599	1,031	16	393	–	6,153	5,582	571	5,737	416
Memorandum item:											
Excess provisions (5)	186	1,188	52	173	–	–	1,599	894	705	1,340	259
December 1997											
Supervisory capital	135,370	28,346	29,798	16,158	1,833	732	212,237	147,749	64,488	194,214	18,023
Primary capital	113,275	23,696	24,339	15,344	1,937	685	179,276	120,622	58,654	163,783	15,493
of which: capital and reserves ..	118,435	21,961	24,971	15,242	1,952	762	183,323	125,168	58,155	167,414	15,909
provision for general banking risks	2,163	2,062	1,401	333	49	–	6,007	3,636	2,371	5,310	697
intangible assets and goodwill	3,325	84	1,910	155	19	20	5,513	4,503	1,009	5,207	306
Supplementary capital	26,878	4,812	6,481	830	382	48	39,431	32,748	6,683	36,551	2,880
of which: subordinated liabilities (3)	16,927	1,112	4,768	103	–	–	22,910	19,925	2,985	20,845	2,065
revaluation losses on securities	2	16	–	1	–	–	19	16	3	18	1
loan loss provisions (4)	4,339	3,201	567	496	17	71	8,691	6,897	1,794	8,279	412
Equity interests not included in the consolidation	4,784	163	1,022	15	486	–	6,470	5,622	848	6,120	350
Memorandum item:											
Excess provisions (5)	654	1,296	37	140	–	–	2,127	1,493	634	1,947	180
Equity capital raised (6)											
1995	1,119	43	877	59	–	–	2,098	1,072	1,026	1,320	778
1996	3,619	70	1,079	43	–	3	4,814	3,734	1,080	1,231	3,583
1997	2,840	155	1,874	68	–	–	4,937	4,012	925	4,627	310

(1) The classifications are those that were in force at the end of 1997; merged banks have been considered as belonging to the category of the bank with which they were merged. - (2) Branches of non-EU banks only. - (3) Includes "hybrid" capital instruments. - (4) Excludes "excess provisions", which are not eligible for inclusion in supervisory capital. - (5) Loan loss provisions in excess of 1.25 per cent of risk-weighted assets. - (6) Share issues for cash net of redemptions. The figures for 1996 include the capital contributions of public-sector shareholders provided for by law.

Table a34

BANKS: CAPITAL ADEQUACY (1) (2) (3)*(billions of lire)*

	December 1995 (4)			December 1996			December 1997		
	Number of banks	Billion lire	Average solvency ratio	Number of banks	Billion lire	Average solvency ratio	Number of banks	Billion lire	Average solvency ratio
Classification by size									
Major, large and medium-sized banks			11.3			11.1			10.9
Excess amounts	53	42,318		51	42,222		50	41,039	
Shortfalls	4	1,971		6	3,472		5	1,493	
Small and minor banks			21.6			21.2			20.0
Excess amounts	843	36,061		17	38,545		792	38,346	
Shortfalls	7	111		8	78		8	115	
Classification by type of bank									
Limited companies raising short term funds			11.7			11.5			11.3
Excess amounts	178	41,782		180	43,277		179	40,885	
Shortfalls	9	2,063		7	3,386		6	1,312	
Limited companies raising medium and long-term funds			17.2			16.8			16.5
Excess amounts	32	14,612		29	14,463		27	14,930	
Shortfalls	1	18		4	44		4	286	
Cooperative banks			14.6			13.9			13.3
Excess amounts	70	11,701		69	11,735		67	11,848	
Shortfalls	-	-		1	117		1	2	
Mutual banks			26.4			25.6			24.2
Excess amounts	612	9,099		586	10,270		565	10,815	
Shortfalls	1	1		2	2		2	8	
Central credit institutions			19.0			16.6			15.8
Excess amounts	4	1,185		4	1,023		4	907	
Shortfalls	-	-		-	-		-	-	
Classification by location of head office									
Centre-North			13.4			13.2			12.5
Excess amounts	632	71,349		616	73,498		615	71,141	
Shortfalls	4	402		6	301		6	1,497	
South			11.5			10.6			14.6
Excess amounts	264	7,030		252	7,269		227	8,244	
Shortfalls	7	1,680		8	3,249		7	111	
Banking system as a whole			13.2			13.0			12.7
Excess amounts	896	78,379		868	80,767		842	79,385	
Shortfalls	11	2,082		14	3,550		13	1,608	

(1) The classifications are those that were in force at the end of 1997; merged banks have been considered as belonging to the category of the bank with which they were merged. Excludes branches of foreign banks. - (2) The limit of 8 per cent of risk-weighted assets was applied regardless of any special capital requirements in force and of the 7 per cent requirement for banks belonging to groups. - (3) Includes the capital charge for market risk. - (4) The figures were obtained by applying a weighting of 100 per cent to bad debts and the related forecast losses.

**BALANCE SHEET
AND PROFIT AND LOSS ACCOUNT
for the year ended 31 December 1997**

BALANCE

AMOUNTS IN LIRE

ASSETS				1997	1996
GOLD					
I	on hand		12,342,034,910,340		
II	on deposit abroad		25,236,302,173,343	37,578,337,083,683	27,828,636,888,245
GOLD CLAIMS (EMI)				9,394,584,267,999	9,591,484,423,174
CASH ON HAND				14,670,339,701	8,829,944,631
DISCOUNTS AND ADVANCES					
I	bill portfolio		259,185,595,113		
II	advances:				
	— current account	1,293,535,295,793			
	— fixed term	1,143,165,000,000			
	— under Treasury Decree of 27.9.1974	18,558,136,176,000	20,994,836,471,793		
III	deferred payments in the clearing system		—	21,254,022,066,906	1,178,157,697,863
BILLS FOR COLLECTION WITH CORRESPONDENTS				—	—
EXTERNAL ASSETS IN FOREIGN CURRENCIES					
I	ecus		15,783,245,738,001		
II	other:				
	— banknotes and foreign currency bills	6,776,079,513			
	— current accounts with correspondents	5,742,703,025,437			
	— time deposits	1,006,403,927,240			
	— other	13,946,996,270,651	20,702,879,302,841	36,486,125,040,842	31,414,919,010,760
DOLLAR CLAIMS (EMI)				6,484,776,926,164	6,881,044,957,153
ITALIAN FOREIGN EXCHANGE OFFICE (UIC)					
I	current account		45,445,902,599,260		
II	special accounts		6,902,231,404,813	52,348,134,004,073	39,082,388,020,912
SUNDRY CLAIMS ON THE GOVERNMENT					
I	under Art. 6 (2c) of Law 483/1993		—		
II	other		16,156,756,725	16,156,756,725	115,455,000
CLAIMS ARISING FROM SECURITIES REPURCHASE AGREEMENTS				33,744,740,930,479	48,823,090,068,355
SECURITIES					
I	government and government-guaranteed securities:				
	— freely available	63,232,581,035,505			
	— freely available under Law 483/1993	76,205,757,000,000			
	— investment of statutory reserves	7,684,993,041,690			
	— investment of staff severance pay and pension funds	3,566,401,765,353	150,689,732,842,548		
II	securities of companies and agencies:				
	— investment of statutory reserves	60,769,533,100			
	— investment of staff severance pay and pension funds	402,958,273,756	463,727,806,856		
III	shares and other equities:				
	— subsidiaries				
	a) investment of statutory reserves	303,656,344			
	b) investment of staff severance pay and pension funds	194,760,188,582	195,063,844,926		
	— affiliates				
	a) investment of statutory reserves	23,829,044,098			
	b) investment of staff severance pay and pension funds	—	23,829,044,098		
	— other				
	a) investment of statutory reserves	1,008,820,383,798			
	b) investment of staff severance pay and pension funds	1,008,309,011,674	2,017,129,395,472	2,236,022,284,496	153,389,482,933,900
				153,389,482,933,900	167,124,676,587,138
<i>carried forward . . .</i>				350,711,030,350,472	331,933,343,053,231

SHEET

LIABILITIES		1997	1996
BANKNOTES IN CIRCULATION		114,074,089,041,000	106,106,394,637,000
BANK OF ITALY DRAFTS		1,195,468,796,244	1,655,118,761,541
OTHER SIGHT LIABILITIES		—	—
BANKS' COMPULSORY RESERVE DEPOSITS		78,633,627,484,348	72,572,237,395,506
OTHER COMPULSORY DEPOSITS		19,877,819,468	27,414,757,750
OTHER DEPOSITS			
I current accounts	281,381,351,680		
II tied current accounts	—		
III for cashier's department services	82,416,104	281,463,767,784	219,682,048,693
EXTERNAL ACCOUNTS IN LIRE ON BEHALF OF THE UIC		6,902,231,404,813	7,263,151,005,573
EXTERNAL LIABILITIES			
I deposits in foreign currencies	77,148,005,469		
II external accounts in lire	58,181,674,542		
III other	—	135,329,680,011	344,327,436,410
ECU LIABILITIES (EMI)		15,879,361,194,163	16,472,529,380,327
ITALIAN FOREIGN EXCHANGE OFFICE (UIC) - current account		—	—
TREASURY PAYMENTS ACCOUNT		53,547,202,749,655	54,750,969,768,768
SINKING FUND FOR THE REDEMPTION OF GOVERNMENT SECURITIES		4,236,755,428,090	13,032,873,650
SUNDRY LIABILITIES TOWARDS THE GOVERNMENT		425,583,593,775	1,046,482,341,485
LIABILITIES ARISING FROM SECURITIES REPURCHASE AGREEMENTS		4,789,334,597,500	598,134,934,500
SUNDRY PROVISIONS			
I for gold price fluctuations (under Decree Law 867/1976 and Art. 104 (1b) of the income tax code)	32,691,276,371,082		
II for losses ensuing from exchange rate management	1,200,795,276,401		
III for losses on bill portfolio	234,919,178,078		
IV for diminution in value of foreign exchange	8,474,273,466,464		
V for exchange rate adjustments (under Art. 104 (1c) of the income tax code)	1,381,371,698,905		
VI for diminution in value of securities	8,062,124,561,244		
VII for contingent losses	4,845,006,748,480		
VIII for insurance cover	1,019,691,685,925		
IX for building works	2,523,801,851,969		
X for renewal of equipment	971,250,000,000		
XI for taxation	4,474,473,986,745		
XII for staff severance pay and pensions	7,022,344,003,181		
XIII for grants to BI pensioners and their surviving dependents	2,569,749,830		
XIV for severance pay of contract staff under Law 297/1982	2,296,860,639		
XV for staff costs in respect of wage negotiations	16,539,216,378	72,922,734,655,321	73,458,591,256,051
<i>carried forward</i> . . .		353,043,060,212,172	334,528,066,597,254

BALANCE

AMOUNTS IN LIRE

ASSETS		1997	1996
<i>brought forward . . .</i>		350,711,030,350,472	331,933,343,053,231
UIC ENDOWMENT FUND		500,000,000,000	500,000,000,000
PARTICIPATION IN EMI		190,205,278,649	185,891,231,311
INTANGIBLE FIXED ASSETS (net of amortization)			
I procedures, studies and designs	86,050,724,842		
II other deferred charges	15,714,496,830	101,765,221,672	74,348,158,989
TANGIBLE FIXED ASSETS			
I buildings - used by the Bank	3,443,803,300,876		
II buildings - staff severance pay and pension fund investments	688,899,354,102		
III furniture and fittings	187,856,996,852		
IV equipment	403,620,325,306		
V coins and collections	2,354,093,038		
VI assets under construction and payments on account:			
— buildings for use by the Bank and related equipment	672,320,219,789		
— buildings for staff severance pay and pension fund investments and related equipment	—	672,320,219,789	
less: ACCUMULATED DEPRECIATION	1,708,241,448,351	3,690,612,841,612	3,655,326,622,135
OTHER INVESTMENTS OF STAFF SEVERANCE PAY AND PENSION FUNDS		25,727,548,152	23,480,781,633
STOCKS OF THE TECHNICAL DEPARTMENTS			
I procedures, studies and designs in preparation	36,472,052,189		
II banknotes in production	10,437,615,671		
III other	15,064,397,509	61,974,065,369	72,137,936,201
SUNDRY ASSETS			
I suppliers for other payments on account	37,270,001,791		
II sundry debtors:			
— items arising from the former management of stockpiling bills (under Decree Laws 565/1993 and 423/1994, not ratified)	2,893,856,834,669		
— other	6,970,610,945,090	9,864,467,779,759	
III other items	512,797,798,124	10,414,535,579,674	8,466,630,853,200
ACCRUED INCOME		2,782,697,278,503	3,562,002,897,842
PREPAID EXPENSES		7,671,007,866	11,400,765,123
		368,486,219,171,969	348,484,562,299,665
MEMORANDUM ACCOUNTS			
I Securities and other valuables	2,833,264,650,033,904		
II Depositories of securities and valuables	22,386,047,326,986		
III Unused overdraft facilities	189,603,137,982		
IV Debtors for securities, foreign exchange and lire receivable (BI forward sales)	55,680,500,603,521		
V Securities, foreign exchange and lire receivable (BI forward purchases)	27,225,385,879,905		
VI Securities, foreign exchange and lire receivable (order suspense accounts)	38,318,021,810		
VII Debtors for securities, foreign exchange and lire receivable (order suspense accounts)	1,749,787,116,574	2,940,534,292,120,682	2,809,842,202,704,383
TOTAL . . .		3,309,020,511,292,651	3,158,326,765,004,048

Audited and found correct. – Rome, 29 April 1998

THE AUDITORS
GIUSEPPE BRUNI
MARIO CATTANEO
MASSIMO STIPO
GIANFRANCO ZANDA

SHEET

LIABILITIES		1997	1996
<i>brought forward . . .</i>		353,043,060,212,172	334,528,066,597,254
SUNDRY LIABILITIES			
I sundry creditors	110,594,577,416		
II other	812,529,859,357	923,124,436,773	753,055,710,161
ACCRUED EXPENSES		175,142,666,449	185,400,469,171
DEFERRED INCOME		413,618,235,864	142,421,285,940
CAPITAL		300,000,000	300,000,000
ORDINARY RESERVE		4,742,755,828,568	3,909,835,434,813
EXTRAORDINARY RESERVE		4,893,927,946,249	4,228,271,657,704
REVALUATION SURPLUS RESERVE UNDER LAW 72/1983		1,304,000,000,000	1,304,000,000,000
REVALUATION SURPLUS RESERVE UNDER LAW 408/1990		1,278,970,875,346	1,278,970,875,346
REVALUTATION SURPLUS RESERVE UNDER LAW 413/1991		32,766,651,690	32,766,651,690
RESERVE FOR ACCELERATED DEPRECIATION (under Art. 67 (3) of the income tax code)		43,963,478,666	37,855,414,299
NET PROFIT FOR DISTRIBUTION		1,634,588,840,192	2,083,618,203,287
		368,486,219,171,969	348,484,562,299,665
MEMORANDUM ACCOUNTS			
I Depositors of securities and other valuables	2,833,264,650,033,904		
II Securities and valuables on deposit	22,386,047,326,986		
III Holders of unused overdraft facilities	189,603,137,982		
IV Securities, foreign exchange and lire for delivery (BI forward sales)	55,680,500,603,521		
V Creditors for securities, foreign exchange and lire for delivery (BI forward purchases)	27,225,385,879,905		
VI Creditors for securities, foreign exchange and lire for delivery (order suspense accounts)	38,318,021,810		
VII Securities, foreign exchange and lire for delivery (order suspense accounts)	1,749,787,116,574	2,940,534,292,120,682	2,809,842,202,704,383
TOTAL . . .		3,309,020,511,292,651	3,158,326,765,004,048

THE ACCOUNTANT GENERAL

VINCENZO PONTOLILLO

THE GOVERNOR

ANTONIO FAZIO

PROFIT AND LOSS

AMOUNTS IN LIRE

EXPENDITURE AND LOSSES		1997	1996
ADMINISTRATIVE COSTS			
central and local boards	3,962,022,241		
staff:			
- wages and salaries and related costs	1,222,158,978,024		
- pensions and severance payments	532,461,678,913	1,754,620,656,937	
services	276,712,528,589		
other	359,353,555,039	2,394,648,762,806	2,168,792,245,444
TAXES AND DUTIES			
stamp duty on the circulation of banknotes and Bank of Italy drafts	56,928,873,200		
taxes on income for the year	3,752,000,000,000		
other	173,737,343,850	3,982,666,217,050	7,234,960,859,416
INTEREST PAID			
on banks' compulsory reserves	3,939,498,374,008		
on Treasury accounts:			
- Treasury payments account	3,182,410,626,838		
- other	323,256,259,302	3,505,666,886,140	
other	6,119,291,900	7,451,284,552,048	8,972,937,943,729
FINANCIAL COSTS ARISING FROM SECURITIES REPURCHASE AGREEMENTS		66,804,556,388	247,069,351,534
EXPENDITURE ON SECURITIES TRANSACTIONS		229,103,068	308,512,729
EXPENDITURE ON FOREIGN TRANSACTIONS		1,069,531,049	592,174,829
LOSSES ON SECURITIES		—	—
LOSSES ON FOREIGN EXCHANGE		—	—
LOSSES ON SUNDRY FINANCIAL TRANSACTIONS		—	—
LOSSES ON THE DISPOSAL OF ASSETS			
securities	47,912,190		
buildings	—		
other	6,751,319	54,663,509	12,832,909
FINANCIAL COSTS ARISING FROM SECURITIES REPURCHASE AGREEMENTS		66,804,556,388	247,069,351,534
CONTRIBUTIONS TO CHARITIES AND SOCIAL AND CULTURAL ACTIVITIES		8,428,988,273	5,325,511,835
TECHNICAL DEPARTMENTS – INITIAL STOCKS		72,137,936,201	53,787,286,138
EXPENDITURE ON TRANSACTIONS WITH THE TREASURY		182,221,117,000	886,615,459,000
VALUE ADJUSTMENTS (1)			
securities	—		
foreign exchange	—		
other	—	—	—
DEPRECIATION			
buildings	98,930,668,438		
furniture and fittings	13,931,918,786		
equipment	50,410,025,693		
procedures, studies and designs	82,443,517,735		
other deferred charges	13,938,141,235		
other	—	259,654,271,887	255,182,636,441
APPROPRIATION OF INVESTMENT INCOME TO RESERVES			
to the ordinary reserve	419,597,160,521		
to the extraordinary reserve	460,961,760,793	880,558,921,314	795,748,875,494
(1) In excess of the related provisions. <i>carried forward</i> ...		15,299,758,620,593	20,621,333,689,498

ACCOUNT

INCOME AND PROFITS				1997	1996
INTEREST RECEIVED					
on discounts and advances:					
- bill portfolio	11,415,295,488				
- advances	192,832,904,851	204,248,200,339			
on lending to the UIC		1,810,725,473,858			
on lending abroad		1,077,509,104,326			
other		102,916,062,751		3,195,398,841,274	2,927,279,003,165
INTEREST, PREMIUMS AND DIVIDENDS ON SECURITIES					
<i>freely available</i>					
interest-bearing securities:					
- Treasury bills	932,779,869,436				
- variable rate Treasury credit certificates	937,213,324,311				
- other government securities	6,229,286,946,946	8,099,280,140,693			
- government-guaranteed securities		1,041,750,000	8,100,321,890,693		
<i>investment of reserves and staff severance pay and pension funds</i>					
interest-bearing securities:					
- government and government-guaranteed securities	1,093,098,548,610				
- other	31,460,046,823	1,124,558,595,433			
investments in:					
- subsidiaries	4,095,409,520				
- affiliates	18,321,105,735				
- other	110,041,713,913	132,458,229,168	1,257,016,824,601	9,357,338,715,294	13,186,338,570,265
FINANCIAL REVENUES ARISING FROM SECURITIES REPURCHASE AGREEMENTS				1,880,441,590,967	1,195,891,748,942
INCOME FROM PARTICIPATION IN THE UIC ENDOWMENT FUND				117,864,085,682	71,242,923,147
SECURITIES ISSUE AND PURCHASE DISCOUNTS/PREMIUMS				355,257,568,543	582,998,995,858
PROFITS ON SECURITIES TRADING				1,875,837,334,602	3,744,579,059,215
PROFITS ON FOREIGN EXCHANGE TRADING				1,245,888,580,482	2,666,402,033,433
<i>carried forward ...</i>				18,028,026,716,844	24,374,732,334,025

PROFIT AND LOSS

AMOUNTS IN LIRE

EXPENDITURE AND LOSSES		1997	1996
<i>brought forward . . .</i>		15,299,758,620,593	20,621,333,689,498
ALLOCATIONS TO PROVISIONS			
for losses on bill portfolio	—		
for diminution in value of foreign exchange	1,200,000,000,000		
for diminution in value of securities	—		
for contingent losses	772,000,000,000		
for insurance cover	—		
for building works	—		
for renewal of equipment	—		
for staff severance pay and pensions	1,019,482,252,931		
for grants to BI pensioners and their surviving dependents	387,592,217		
for severance pay of contract staff under Law 297/1982	274,546,140		
for staff costs in respect of wage negotiations	16,189,330,000	3,008,333,721,288	4,953,887,878,991
PRIOR-YEAR ADJUSTMENTS		8,882,405,246	969,588,845
		18,316,974,747,127	25,576,191,157,334
NET PROFIT		1,634,588,840,192	2,083,618,203,287
TOTAL . . .		19,951,563,587,319	27,659,809,360,621

ALLOCATION

TO THE ORDINARY RESERVE

TO THE EXTRAORDINARY RESERVE

TO SHAREHOLDERS

TO THE TREASURY

Audited and found correct. – Rome, 29 April 1998

THE AUDITORS
 GIUSEPPE BRUNI
 MARIO CATTANEO
 MASSIMO STIPO
 GIANFRANCO ZANDA

ACCOUNT

INCOME AND PROFITS		1997	1996
<i>brought forward . . .</i>		18,028,026,716,844	24,374,732,334,025
PROFITS ON SUNDRY FINANCIAL TRANSACTIONS		1,260,613,100,798	281,788,417,835
COMMISSIONS, RECOVERIES AND OTHER FINANCIAL INCOME		276,875,989,353	435,928,628,876
INCOME FROM BUILDINGS		26,584,468,707	23,936,360,588
PROFITS ON THE DISPOSAL OF:			
securities	22,605,987,076		
buildings	1,236,131,367		
other property	3,410,107,489	27,252,225,932	3,324,929,205
CAPITALIZATION OF OTHER DEFERRED CHARGES		16,525,126,828	8,172,426,710
TECHNICAL DEPARTMENTS – FINAL STOCKS		61,974,065,369	72,137,936,201
TECHNICAL DEPARTMENTS – PROCEDURES, STUDIES AND DESIGNS COMPLETED DURING THE YEAR		61,395,112,629	25,532,645,883
VALUE READJUSTMENTS			
securities	75,099,482,425		
foreign exchange	—		
other	—	75,099,482,425	2,427,394,871,601
PRIOR-YEAR ADJUSTMENTS		117,217,298,434	6,860,809,697
TOTAL . . .		19,951,563,587,319	27,659,809,360,621

OF THE NET PROFIT	
.....	326,917,768,038
.....	163,458,884,019
.....	30,000,000
.....	1,144,182,188,135
TOTAL . . .	1,634,588,840,192

THE ACCOUNTANT GENERAL

VINCENZO PONTOLILLO

THE GOVERNOR

ANTONIO FAZIO

NOTES TO THE ACCOUNTS (1)

The accounts for 1997 reflect the fall in yields in financial markets and the gradual easing of monetary conditions. The official reserves grew against a background of a stable exchange rate of the lira, especially with respect to the other ERM currencies. The Bank's interventions in the market consisted mostly of temporary financing operations.

On the assets side of the balance sheet there were increases in assets denominated in foreign currencies, the balance on the current account of the Italian Foreign Exchange Office (UIC) and the holding of gold, following the concentration of the gold reserves at the Bank. The securities portfolio contracted as a result of redemptions and sales. Claims arising from repurchase agreements were lower than at the end of 1996, but were up substantially on an annual average basis.

On the liabilities side there were increases in banks' compulsory reserve deposits and in the sinking fund for the redemption of government securities, to which the receipts from the privatizations carried out during the year were credited. The balance on the Treasury's payments account declined slightly. The increase in banknotes in circulation was larger than in 1996.

As regards the profit and loss account, operating income before allocations to provisions and taxes on income and net worth fell from 14,103 to 8,531 billion lire. The result reflected a reduction in income larger than that in expenditure: the contraction in interest income, securities value readjustments and profits on securities and foreign exchange trading exceeded the decrease in interest expense and expenditure on transactions with the Treasury.

Taxes for the year consequently fell from 7,065 to 3,888 billion lire and the result after taxes accordingly amounted to 4,643 billion lire, compared with 7,038 billion in 1996. Allocations to provisions decreased from 4,954 to 3,008 billion, so that the net profit for the year amounted to 1,635 billion, compared with 2,084 billion in 1996.

The valuation methods adopted were unchanged compared with the previous year and are described at the end of these notes.

(1) This abridged English version of the Bank's annual accounts does not contain all of the information required by the EEC directives concerning companies' and banks' annual accounts included in the original in Italian.

Information on the balance sheet

As in the past, the discussion of the balance sheet focuses on the sectors that are important for the creation and use of monetary base.

The value of the Bank's *gold* rose by 9,749 billion lire, from 27,829 to 37,578 billion. The increase of 10,519 billion as a consequence of the purchase of the UIC's entire gold holding was offset by a revaluation loss of 770 billion caused by the fall in the price of a fine gram from 18,501.3 to 18,121.5 lire (the price of the swap carried out with the EMI on 10 October 1997).

For the same reason *gold claims on the EMI* (corresponding to the 518 tonnes of gold receivable at the maturity of the quarterly swap) decreased by 197 billion lire, from 9,591 to 9,394 billion.

The total gold value adjustment of 967 billion lire resulted in the withdrawal of an equal amount from the *provision for gold price fluctuations (under Decree Law 867/1976 and Article 104(1b) of the income tax code*, which accordingly amounted to 32,691 billion.

External assets in foreign currencies increased by a total of 5,071 billion lire, from 31,415 to 36,486 billion.

In particular, the item *ecus* decreased by 594 billion lire, from 16,377 to 15,783 billion, as a result of a reduction in the quantity of official ecus received from the EMI in the latest swap and the rise in the exchange rate applied from 1,902.69 to 1,922.31 lire per ecu.

Other external assets in foreign currencies increased by 5,665 billion lire, from 15,038 to 20,703 billion.

The increase in external assets was the result of larger purchases of foreign exchange, which allowed the Bank to reduce its auction-based foreign currency swaps; those denominated in marks fell to zero from DM3 billion at the end of 1996, while those in US dollars remained unchanged at \$8 billion. As in the previous year all the US dollars acquired in this way were transferred to UIC.

The item *dollar claims on the EMI* refers to the amount of US currency receivable at the maturity of the swap entered into on 10 October 1997. It decreased by 396 billion lire, from 6,881 to 6,485 billion, as a result of the reduction in the quantity of dollars transferred to the EMI on that occasion from \$4.5 billion to \$3.8 billion and the rise in the exchange rate of the dollar. The total decrease in gold and dollar claims on the EMI is equal to the fall of 593 billion lire in the item *ecu liabilities towards the EMI*.

As regards the asset items under the heading *Italian Foreign Exchange Office (UIC)*, the *current account* balance increased by 13,627 billion lire,

from 31,819 to 45,446 billion, since the substantial increase in the UIC's foreign currency reserves more than offset the reduction in the balance resulting from the sale of its gold reserves; the average balance rose by 7,621 billion lire, from 28,629 to 36,250 billion. The balance of the *special accounts* decreased by 361 billion lire, from 7,263 to 6,902 billion; the liabilities item *external accounts in lire on behalf of the UIC*, which refers to the lira accounts held by the International Monetary Fund, decreased by an equal amount.

The item *participation in EMI* amounted to 190 billion lire at the year-end ecu exchange rate (compared with 186 billion at the end of 1996) and corresponded to 98 million ecus (unchanged) and 15.85 per cent of the EMI's total capital.

The *UIC endowment fund* remained unchanged at 500 billion lire.

External liabilities decreased by a total of 209 billion lire, from 344 to 135 billion, owing to the reductions of 28 and 181 billion lire respectively in *deposits in foreign currencies* and *external accounts in lire*.

The Bank's holdings of *government and government-guaranteed securities* fell from 164,642 to 150,690 billion lire. Excluding the 76,206 billion lire of securities assigned to the Bank to close the Treasury's former current account, the total was 74,484 billion; the average balance during the year was equal to 85,057 billion.

The movements over the year were as follows: the holding of Treasury bills increased from 1,695 to 14,349 billion lire, while that of Treasury bonds, excluding those received in connection with the closing of the Treasury's former current account, decreased from 62,983 to 51,731 billion and that of variable rate Treasury credit certificates and the like from 21,757 to 7,857 billion.

The balance of the *Treasury payments account* declined by 1,204 billion lire, from 54,751 to 53,547 billion.

The *sinking fund for government securities* rose from 13 to 4,237 billion lire and the average balance amounted to 4,438 billion. The fund was credited with 41,775 billion lire of privatization receipts, while 24,636 billion was withdrawn to buy back and redeem government securities and 13,500 billion to pay for the Treasury's purchase of IRI's shareholding in STET.

Sundry claims on the government rose from 115 million to 16 billion lire.

Sundry liabilities towards the government fell from 1,047 to 426 billion lire and consisted almost entirely of the amount still payable of the financial

revenues that accrued to the Treasury in 1997 (62 billion, compared with 287 billion at the end of 1996), the interest that accrued on the sinking fund for government securities in the second half of the year (183 billion, compared with 454 billion) and the amount payable by the Bank as paying agent for Treasury credit certificates (164 billion, compared with 201 billion).

The item *sundry assets* includes the non-interest-bearing claim of 2,894 billion lire in respect of items arising from the Bank's former management of stockpiling bills. The settlement of this claim will require specific legislation since Decree Law 565 of 30 December 1993 and subsequent reiterations was not ratified.

Cash on hand, comprising coins and notes issued by the Treasury, rose from 9 to 15 billion lire.

Claims arising from securities repurchase agreements fell from 48,823 to 33,745 billion lire, but the average amount of this item during the year more than doubled, rising from 13,058 to 27,090 billion.

Liabilities arising from securities repurchase agreements increased from 598 to 4,789 billion lire, while the average amount of this item fell from 2,819 to 993 billion.

The repo claims outstanding at the end of the year referred to 2,740 billion of Treasury bills, 23,145 billion of Treasury bonds and 7,860 billion of Treasury credit certificates and other securities; the repo liabilities referred to 4,744 billion of Treasury bonds and 45 billion of Treasury credit certificates and other securities.

Current account advances rose from 944 to 1,294 billion lire and fixed-term advances from zero to 1,143 billion; the bill portfolio increased slightly from 234 to 259 billion.

Pursuant to Law 588 of 19 November 1996, the Bank granted 18,558 billion lire of advances in 1997 in accordance with the procedure laid down in a Ministerial Decree of 27 September 1974. These advances were outstanding at the end of the year.

Banks' compulsory reserve deposits rose by 6,062 billion lire, from 72,572 to 78,634 billion. The total excludes amounts that have been mobilized and includes any amounts in excess of the reserve requirement. The average amount of compulsory reserves due from banks rose by 9,025 billion lire or 13 per cent, from 69,407 to 78,432 billion, primarily as a result of the growth in bank current accounts.

Banknotes in circulation increased by 7,968 billion lire, from 106,106 to 114,074 billion. In percentage terms the increase was equal to 7.5 per cent, compared with 2.8 per cent in 1996.

Outstanding *Bank of Italy drafts* decreased by 460 billion lire, from 1,655 to 1,195 billion.

Intangible fixed assets (net of amortization) rose from 74 to 102 billion lire and comprised 86 billion of *completed procedures, studies and projects* and 16 billion of *other deferred charges*.

Tangible fixed assets rose from 3,655 to 3,691 billion lire, net of 1,708 billion of accumulated depreciation, as detailed below:

- *buildings used by the Bank* rose from 3,437 to 3,444 billion, net of 1,173 billion of accumulated depreciation;
- *buildings for staff severance pay and pension fund investments* rose from 647 to 689 billion, net of 34 billion of accumulated depreciation;
- *furniture and fittings and equipment* registered an increase of 9 billion lire that was entirely attributable to furniture and fittings (up from 179 to 188 billion, net of 171 billion of accumulated depreciation) since the value of equipment remained unchanged (404 billion, net of 330 billion of accumulated depreciation);
- *coins and collections* remained unchanged at 2 billion lire; and
- *assets under construction and payments on account* rose from 578 to 672 billion lire and referred to *buildings for use by the Bank and related equipment*.

Accrued income fell from 3,562 to 2,783 billion lire, primarily as a result of the decrease of 849 billion in bond interest, from 3,131 to 2,282 billion; *prepaid expenses* declined from 12 to 7 billion.

Accrued expenses declined from 186 to 175 billion lire; *deferred income* rose from 143 to 414 billion.

Sundry provisions declined by 536 billion lire, from 73,459 to 72,923 billion, as a result of the writedown of the Bank's gold by 967 billion and withdrawals totaling 7,210 billion (7,065 billion from the tax provision, 99 from the provision for staff costs in respect of wage negotiations, 11 from the provision for diminution in value of foreign exchange and 35 from the provision for diminution in value of securities) offset by 3,083 billion of allocations to provisions, 3,888 billion set aside to pay the tax for the year and 670 billion in respect of the exchange gain included in the provision for exchange rate adjustments (under Article 104(1c) of the income tax code).

The bank's capital and reserves

Capital. - The number of shareholders decreased in 1997, as can be seen from the table below showing the distribution of the Bank's shares

among the various categories of shareholders. In May of this year 51.5 per cent of the shares, corresponding to 62.5 per cent of the voting rights, were held by public entities or limited companies of which such entities held the majority of voting rights.

SHAREHOLDERS

	At 31 December 1997				At 31 December 1996			
	Number	Shares held (1)	%	Votes	Number	Shares held (1)	%	Votes
Shareholders with voting rights	83	299,934	100.0	758	84	299,932	100.0	762
<i>Limited company banks</i>	75	253,434	84.5	633	76	253,432	84.5	637
<i>Social security institutions</i>	1	15,000	5.0	34	1	15,000	5.0	34
<i>Insurance companies</i>	7	31,500	10.5	91	7	31,500	10.5	91
Shareholders without voting rights .	6	66	..	–	7	68	..	–
Total . . .	89	300,000	100.0	758	91	300,000	100.0	762

(1) Face value, 1,000 lire each.

Reserves.- The ordinary reserve rose to 4,743 billion lire and the extraordinary reserve to 4,894 billion. The total increase in the reserves was equal to 1,499 billion lire or 18.4 per cent. The movements in the reserves in 1997 are shown in the table below.

MOVEMENTS IN THE ORDINARY AND EXTRAORDINARY RESERVES

	Ordinary reserve	Extraordinary reserve
Balance at 31 December 1996	3,909,835,434,813	4,228,271,657,704
increase:		
due to appropriation of the profits for 1996 (20 per cent to the ordinary reserve and 10 per cent to the extraordinary reserve)	416,723,640,657	208,361,820,329
due to income received in 1997 from investment of reserves	419,597,160,521	460,961,760,793
decrease:		
due to distribution to shareholders of a part of the income accruing in the course of 1996 (Article 56 of the Statute	3,400,407,423	3,667,292,577
Balance at 31 December 1997	4,742,755,828,568	4,893,927,946,249

Information on the profit and loss account

Total *interest received* rose from 2,927 to 3,195 billion lire owing to the following changes compared with 1996.

Interest on lending to the UIC rose by 292 billion lire, from 1,519 to 1,811 billion, the combined result of the increase in the average size of the current account balance from 28,629 to 36,250 billion and the decline in the effective yield from 5.3 to 5 per cent; *interest on discounts and advances* rose by 18 billion lire, from 186 to 204 billion, as a result of the increase of 101 billion in the interest on the advances granted pursuant to Law 588/1996 and the decreases of 73 billion for current account advances, 6 billion for fixed-term advances and 4 billion for the discounting of bills.

Interest on lending abroad decreased by 21 billion lire, from 1,098 to 1,077 billion and *other* interest also decreased by 21 billion lire, from 124 to 103 billion.

Interest, premiums and dividends on securities decreased by a total of 3,829 billion lire, from 13,186 to 9,357 billion, as a result of:

- a fall of 3,878 billion lire, from 11,978 to 8,100 billion, in interest and premiums on freely available government and government-guaranteed securities attributable to the reduction in the average stock from 176,716 to 151,234 billion and the decline in the average rate of return from 11.2 to 9.8 per cent, excluding the securities assigned to the Bank to close the overdraft on the Treasury's former current account, which earn interest at the rate of 1 per cent.
- a small rise of 49 billion lire, from 1,208 to 1,257 billion, in interest and dividends on the securities acquired for the investment of reserves and staff severance pay and pension funds attributable to the increase in the average stock from 11,249 to 12,563 billion and the decline in the average rate of return from 10.7 to 10 per cent.

Financial revenues arising from repurchase agreements rose by 684 billion lire, from 1,196 to 1,880 billion. The increase was the result of the doubling of the average amount outstanding from 13,058 to 27,090 billion and the decline in the average rate of return from 9.2 to 6.9 per cent.

Income from participation in the UIC endowment fund rose by 47 billion lire, from 71 to 118 billion, as a result of the increase in UIC's net profit from 185 billion in 1995 to 371 billion in 1996.

Securities issue and purchase discounts/premiums declined from 583 to 355 billion lire.

Despite the continued high level of turnover, *profits on securities trading* fell 3,745 to 1,876 billion lire as a consequence of the narrowing of the difference between sales prices and carrying values.

Profits on foreign exchange trading fell from 2,666 to 1,246 billion lire. Trading in marks and US dollars produced profits of 331 and 916 billion respectively.

Profits on sundry financial transactions rose from 282 to 1,261 billion lire as a result of the increase from 265 to 1,251 billion in income arising from the revision of the maturities of long-term forward transactions in US dollars and marks and the small decrease from 17 to 10 billion in margin income arising from futures on government securities.

Commissions, recoveries and other financial income showed an overall decrease of 159 billion lire, from 436 to 277 billion.

Value readjustments to securities written down in prior years amounted to 75 billion lire. The substantial 2,427 billion lire of writebacks in 1996 had made good most of the large writedowns effected in 1994.

On the expenditure side, *administrative costs* increased by 226 billion lire, from 2,169 to 2,395 billion. Of the total increase, 110 billion was attributable to the rise in staff severance payments associated with the large number of terminations during the year. In more detail:

- *wages and salaries and related costs* rose by 47 billion lire, from 1,175 to 1,222 billion, net of the 18 billion withdrawn from the provision for staff costs in respect of wage negotiations (34 billion in 1996);
- *pensions and severance payments* rose by 134 billion lire, from 399 to 533 billion. Pensions rose by 24 billion lire, from 324 to 348 billion, net of the 6 billion withdrawn from the provision for staff costs in respect of wage negotiations (10 billion in 1996).

As regards the remaining administrative costs, *expenditure on services* rose from 230 to 277 billion lire, primarily owing to the increase of 41 billion in security services, *other* administrative costs declined from 361 to 359 billion lire, while the *costs in respect of the central and local boards*, including the emoluments paid to the members of the Board of Directors and the Board of Auditors, remained unchanged at 4 billion lire.

Taxes and duties fell by 3,252 billion lire, from 7,235 to 3,983 billion, primarily owing to the decrease of 3,192 billion lire, from 6,944 to 3,752 billion, in *taxes on income for the year*. The *stamp duty on the circulation of banknotes and Bank of Italy drafts* fell from 137 to 57 billion lire since the increase in deductible items exceeded the growth in the circulation. *Other* taxes and duties rose by a total of 20 billion lire, from 154 to 174 billion, while the tax on net worth, which is included in this subitem, rose from 121 to 136 billion.

Interest paid fell by 1,522 billion lire, from 8,973 to 7,451 billion. In more detail:

- the interest paid *on the Treasury payments account* decreased by 628 billion, owing to the fall in the rate of return from 8.8 to 7.5 per cent and

to a lesser extent to the decline in the average balance from 43,259 to 42,677 billion. This subitem includes the differential amount of 525 billion lire payable to the Treasury pursuant to Article 4 of Law 483 of 26 November 1993;

- the interest paid *on the sinking fund for the redemption of government securities* decreased by 795 billion lire owing to the fall in the average balance from 11,192 to 4,438 billion and that in the average rate of return from 9.9 to 7 per cent;
- the *other* interest paid decreased by 203 billion lire, primarily as a result of the fall of 150 billion in the interest paid on foreign currency liabilities.

The interest paid *on compulsory bank reserves* rose, instead, by 112 billion as a result of the increase in the average amount banks were required to deposit from 69,407 to 78,432 billion, the impact of which was partly offset by the decline in the effective rate of return from 5.5 per cent to 5.02 per cent following the decision taken on 27 June 1997 to reduce the interest rate on compulsory bank reserves from 5.5 to 4.5 per cent.

Financial costs arising from securities repurchase agreements fell by 180 billion lire, from 247 to 67 billion, owing to the smaller volume of such transactions and the reduction in the average rate thereon from 8.8 to 6.7 per cent.

Contributions to charities and social and cultural activities rose from 5 to 8 billion lire.

The item *technical departments - initial stocks* rose by 18 billion lire, from 54 to 72 billion.

Expenditure on transactions with the Treasury fell by 705 billion lire, from 887 to 182 billion, despite the increase in the average amount of compulsory reserves banks were required to deposit. The decrease was due to the narrowing of the difference between the average rate of return on freely available government securities and the average rate of return on compulsory reserve deposits.

Depreciation rose from 255 to 260 billion lire and referred mainly to buildings (99 billion, of which 6 billion of accelerated depreciation), procedures, studies and designs (83 billion) and equipment (50 billion).

The item *attribution of investment income to reserves* rose by 85 billion lire, from 796 to 881 billion, and comprised the income from the investment of the Bank's ordinary and extraordinary reserves, which has to be reinvested in the same reserves pursuant to Article 55 of the Statute.

Allocations to provisions fell from 4,954 to 3,008 billion lire and were determined on the basis of a prudential assessment of the relevant risks and charges.

Valuation methods

GOLD AND FOREIGN CURRENCY ASSETS:

- gold is valued using the method established by a Ministerial Decree of 23.3.1979 (which implemented Decree Law 867/1976, ratified as Law 42/1977), whereby the price adopted is that of the last swap of gold for ecus entered into with the EMI. Revaluation differences that arise are taken to the provision for gold price fluctuations (under Decree Law 867/1976 and Art. 104(1b) of the income tax code);
- exchange rate gains and losses on foreign currency assets are determined by applying the LIFO method with annual intervals;
- assets denominated in foreign currency are translated at year-end exchange rates. Deficits with respect to cost are charged to the *provision for diminution in value of foreign exchange*; surpluses are taken to the *provision for exchange rate adjustments (under Art. 104(1c) of the income tax code)*;
- official ecus are stated at the exchange rate ruling on the day of the last swap transaction with the EMI.

Securities

SECURITIES NOT HELD AS FINANCIAL FIXED ASSETS:

- for the purpose of determining profits and losses, such securities are valued by applying the weighted average cost method;
- the valuation is effected as follows:
 - a) for listed securities: at the lower of cost and market value, determined on the basis of the arithmetic mean of the market prices recorded in the last month of the year (the “normal value”);
 - b) for unlisted bonds: at the lower of cost and the “normal value” of listed securities with comparable features; securities acquired in the last month of the year and those redeemable in the next financial year are not written down;
 - c) for unlisted shares: at the lower of cost and the corresponding proportion of the shareholders’ equity shown in the latest published accounts of the investee company;
 - d) for Treasury bills: at cost, determined as the face value plus or minus the difference between the interest entered in the books at the

allotment rate and that actually earned at the rate corresponding to the purchase price.

The cost of listed and unlisted bonds acquired since 1 December 1983 includes the accrued portion of the issue discount (calculated as the difference between the issue price and the redemption value), net of withholding tax determined in accordance with Legislative Decree 239 of 1 April 1996.

SECURITIES HELD AS FINANCIAL FIXED ASSETS:

- for the purpose of determining profits and losses on disposals, such securities are valued by applying the specific cost;
- the valuation is effected as follows:
 - a) for listed and unlisted bonds: at cost or a lower value that takes account of special circumstances concerning the issuer;
 - b) for listed shares: at the lower of cost and market value, determined on the basis of the arithmetic mean of the prices recorded in the last six months of the year;
 - c) for unlisted shares: at the lower of cost and the corresponding proportion of the shareholders' equity shown in the latest published accounts of the investee company.

The cost of listed and unlisted bonds includes the accrued portion of the purchase discount/premium (calculated as the difference between the purchase price and the redemption value), net, for the part corresponding to the issue discount, of withholding tax determined in accordance with Legislative Decree 239 of 1 April 1996.

Both for securities not held as financial fixed assets and for those held as financial fixed assets:

- amounts written off as a result of the application of the foregoing methods are charged to the *provision for diminution in value of securities*;
- amounts written off in prior years (starting from 1993) are written back, up to the cost of the securities, when the conditions that determined the writedown no longer obtain.

Intangible fixed assets

PROCEDURES, STUDIES AND DESIGNS:

- are stated at cost, of purchase or production, and amortized on the basis of the allowances established for tax purposes since these are appropriate in relation to the estimated useful lives of the assets.

OTHER DEFERRED CHARGES:

- software licence fees are stated at cost and amortized on a straight line basis over the period of the licence or, in the case of licences granted for an indeterminate or exceptionally long period, over the estimated useful life of the product, which is taken to be equal to three years;
- costs incurred in installing and enlarging communications networks and lump-sum payments under multi-year contracts are amortized on a straight line basis according to the estimated useful life of the network for the former and the duration of the contract for the latter;
- capitalized costs incurred in the restructuring of rented premises are amortized on a straight line basis over the residual duration of the contract.

Tangible fixed assets

BUILDINGS:

- are stated at cost inclusive of the amounts of revaluations effected under specific laws. Depreciation of the buildings used by the Bank for its institutional purposes is charged on the basis of the allowances established for tax purposes since these are appropriate in relation to the estimated useful lives of the assets. The same method is adopted for buildings that represent staff severance pay and pension fund investments and which meet the requirements of Article 40(2) of the income tax code. The Bank again took advantage of the possibility provided by Article 67(3) of the income tax code to charge accelerated depreciation. The amount in excess of the depreciation on an economic basis was taken to the *reserve for accelerated depreciation*.

FURNITURE AND FITTINGS AND EQUIPMENT:

- are stated at cost. Depreciation is charged on the basis of the allowances established for tax purposes since these are appropriate in relation to the estimated useful lives of the assets.

Stocks of the technical departments

PROCEDURES, STUDIES AND DESIGNS IN PREPARATION:

- are stated at production cost.

BANKNOTES IN PRODUCTION:

- are stated at production cost.

OTHER (INVENTORIES):

- inventories are valued by applying the LIFO method.

Futures contracts on government securities

- income in respect of contracts that have been partly or wholly closed out or that have matured is determined by applying the continuous daily LIFO method;
- contracts are valued at the lower of market value and the originally agreed price for purchases and at the higher of market value and the originally agreed price for sales; negative differentials on purchases and positive differentials on sales are taken to profit and loss account.

Accruals and deferrals

- the portions of income and expense items relative to two or more fiscal years determined on an accruals basis.

ALLOCATION OF THE NET PROFIT

Pursuant to Articles 54 and 57 of the Statute and after hearing the report of the Board of Auditors, it is proposed that the net profit for 1997 of 1,634,588,840,192 lire be allocated as follows (amounts in lire):

as resolved by the Board of Directors:

- | | |
|---|-----------------|
| - 20 per cent to the ordinary reserve | 326,917,768,038 |
| - an amount equal to 6 per cent of the share capital
to shareholders | 18,000,000 |

as proposed by the Board of Directors and approved by
the Minister of the Treasury, Budget and Economic Planning:

- | | |
|--|-------------------|
| - 10 per cent to the extraordinary reserve | 163,458,884,019 |
| - an additional amount equal to 4 per cent of the
share capital to shareholders | 12,000,000 |
| - the remaining amount to the Treasury | 1,144,182,188,135 |
| TOTAL | 1,634,588,840,192 |

Pursuant to Article 56 of the Statute, the Board of Directors has also proposed the distribution to shareholders — drawing on the income earned on the ordinary and extraordinary reserves — of an additional 12,207.3 million lire, equal to 0.15 per cent of the total reserves at 31 December 1996.

From 1982 onwards the percentage applied to the reserves was equal to 0.1 per cent. The proposed increase is intended to improve the overall return on the Bank's capital, with account also being taken of the long period of invariance.

Accordingly, the total dividend is equal to 12,237.3 million lire, corresponding to 40,791 lire per share.

THE GOVERNOR
Antonio Fazio

ADMINISTRATION OF THE BANK OF ITALY

AT 31 DECEMBER 1997

DIRECTORATE

Antonio FAZIO
Vincenzo DESARIO
Pierluigi CIOCCA
Antonio FINOCCHIARO

- GOVERNOR AND CHAIRMAN OF THE BOARD OF DIRECTORS
- DIRECTOR GENERAL
- DEPUTY DIRECTOR GENERAL
- DEPUTY DIRECTOR GENERAL AND SECRETARY TO THE BOARD

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Francesco CONTI
Giampaolo de FERRA
Gaetano DI MARZO*
Paolo Emilio FERRERI*
Giuseppe GIOIA
Paolo LATERZA

Rinaldo MARSANO
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* Member of the Executive Committee

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Massimo STIPO
Gianfranco ZANDA

ALTERNATE AUDITORS

Cesare BISONI

CENTRAL MANAGERS

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Carlo SANTINI
Vincenzo PONTOLILLO
Bruno BIANCHI
Stefano LO FASO
Cesare Augusto GIUSSANI
Franco COTULA
Fabrizio SACCOMANNI

- CENTRAL MANAGER FOR PROPERTY AND PURCHASING
- CENTRAL MANAGER FOR NOTE ISSUE
- CENTRAL MANAGER FOR ECONOMIC RESEARCH
- ACCOUNTANT GENERAL
- CENTRAL MANAGER FOR BANKING SUPERVISION
- CENTRAL MANAGER FOR CENTRAL BANK OPERATIONS
- SECRETARY GENERAL
- CENTRAL MANAGER FOR HISTORICAL RESEARCH
- CENTRAL MANAGER FOR INTERNATIONAL AFFAIRS

LIST OF ABBREVIATIONS

ABI	- <i>Associazione bancaria italiana</i> Italian Bankers' Association
ANAS	- <i>Azienda nazionale autonoma delle strade statali</i> State Road Agency
ANIA	- <i>Associazione nazionale fra le imprese assicuratrici</i> National Association of Insurance Companies
BI	- <i>Banca d'Italia</i> Bank of Italy
CIPA	- <i>Convenzione interbancaria per i problemi dell'automazione</i> Interbank Convention on Automation
Confindustria	- <i>Confederazione generale dell'industria italiana</i> Confederation of Italian Industry
Consob	- <i>Commissione nazionale per le società e la borsa</i> Companies and Stock Exchange Commission
EFIM	- <i>Ente partecipazioni e finanziamento industria manifatturiera</i> Shareholding and Financing Agency for Manufacturing Industry
Enel	- <i>Ente nazionale energia elettrica</i> National Electricity Agency
ENI	- <i>Ente nazionale idrocarburi</i> National Hydrocarbon Agency
ILOR	- <i>Imposta locale sui redditi</i> Local income tax
INA	- <i>Istituto nazionale assicurazioni</i> National Insurance Institute
INPS	- <i>Istituto nazionale per la previdenza sociale</i> National Social Security Institute
INVIM	- <i>Imposta nazionale sul valore immobiliare</i> Capital gains tax on property
IRI	- <i>Istituto per la ricostruzione industriale</i> Institute for Industrial Reconstruction
IRPEF	- <i>Imposta sul reddito delle persone fisiche</i> Personal income tax
IRPEG	- <i>Imposta sul reddito delle persone giuridiche</i> Corporate income tax
Isco	- <i>Istituto nazionale per lo studio della congiuntura</i> National Institute for the Study of the Economic Situation
Istat	- <i>Istituto nazionale di statistica</i> National Institute of Statistics
SACE	- <i>Sezione speciale per l'assicurazione del credito all'esportazione</i> Export Credit Insurance Agency
UIC	- <i>Ufficio italiano dei cambi</i> Italian Foreign Exchange Office