

BANCA D'ITALIA

**Economic Bulletin**



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## SYMBOLS AND CONVENTIONS

- when the phenomenon in question does not occur, or does occur and is observed but not in this case;
- .... when the phenomenon occurs but its value is not known;
- .. when the value is known but is less than the minimum figure considered significant.

“Post Office deposits” includes PO savings certificates.

# *Economic developments and policies*

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## **The international economy**

### **1. Recent developments**

The growth rate of the industrial countries in 1985 was slightly less than 3 per cent, a substantial slowdown compared with 1984 (4.9 per cent). In the second part of the year the pace of economic activity became stronger, especially in Germany and France. During 1985 there was a notable shift in the roles played by domestic and external (i.e. net export) demand in fuelling growth in the major industrial countries (Table 1). The strong stimulus from abroad that had been a feature of the first part of the year in the UK, Japan and Germany gradually eased off. According to recent national accounts data, external demand made a small positive contribution to US growth in the first part of the year and a large negative one in the second, when the rate of increase in domestic demand accelerated from 2 to 3.4 per cent. Even so, this was below the average (3.8 per cent) recorded by the four major European countries, an event that had not occurred for three years.

The OECD unemployment rate declined only marginally. In the EEC over 10 per cent of the labour force continued to be unemployed, while the US unemployment rate, which had fallen by two points between 1983 and 1984, came down slightly to average 7.2 per cent over the year (Table 1).

There was thus a further widening of the difference between the unemployment rates of these two areas, which had had similar rates at the end of the seventies. One of the causes of this divergence that has frequently been stressed is the difference in the development of real labour costs in relation to productivity. The last cycle suggests

that an important factor contributing to the disparities between the two areas is the difference in the growth in GDP, which between 1979 and 1985 increased by 14 per cent in real terms in the United States and by only 7 per cent in the EEC. In the United States the gap that opened up in 1980-82 between actual and potential income has largely been closed since then, with a parallel fall in unemployment from the peak recorded at the end of 1982. By contrast, the wide gap that developed in the major European countries has not narrowed in the present recovery (Figure 1) and has been coupled with a further rise in the unemployment rate. The strength of the link between GDP and unemployment nonetheless varies within the Community, which suggests that factors such as labour market rigidities and the pace of innovation in production have influenced employment in some countries.

The faster pace of growth in the industrial countries in the second part of 1985 was coupled with a further half percentage point fall in the rate of inflation, which declined to 4.5 per cent in terms of the GDP deflator, with Germany recording a particularly large slowdown (Table 2). The annualized end-year rate of increase in consumer prices was less than 2 per cent in Germany and Japan, and equal to 3.8 per cent in the United States, 4.4 per cent in Canada, 4.7 per cent in France, 5.7 per cent in the United Kingdom and 8.6 per cent in Italy.

The further slowing down of inflation in the industrial area was mainly due to the fall in primary goods prices. The dollar prices of commodities continued to decline in 1985 (Figure 2) and in the last part of the year reached their lowest level since the summer of 1976. This

confirmed the tendency that had first appeared in the second quarter of 1984 for the dollar prices of non-oil primary materials to weaken concomitantly with rising production in the industrial area. Whereas until February 1985 this might have seemed consistent with a pricing policy designed to take account of the appreciation of the dollar, since then the depreciation of the dollar appears to support an explanation based on the existence of an excess supply generated by the need of many heavily indebted developing countries to increase their exports of primary materials.

**Table 1**  
**Contributions of demand to changes in gross product and the unemployment rate in the leading industrial countries**

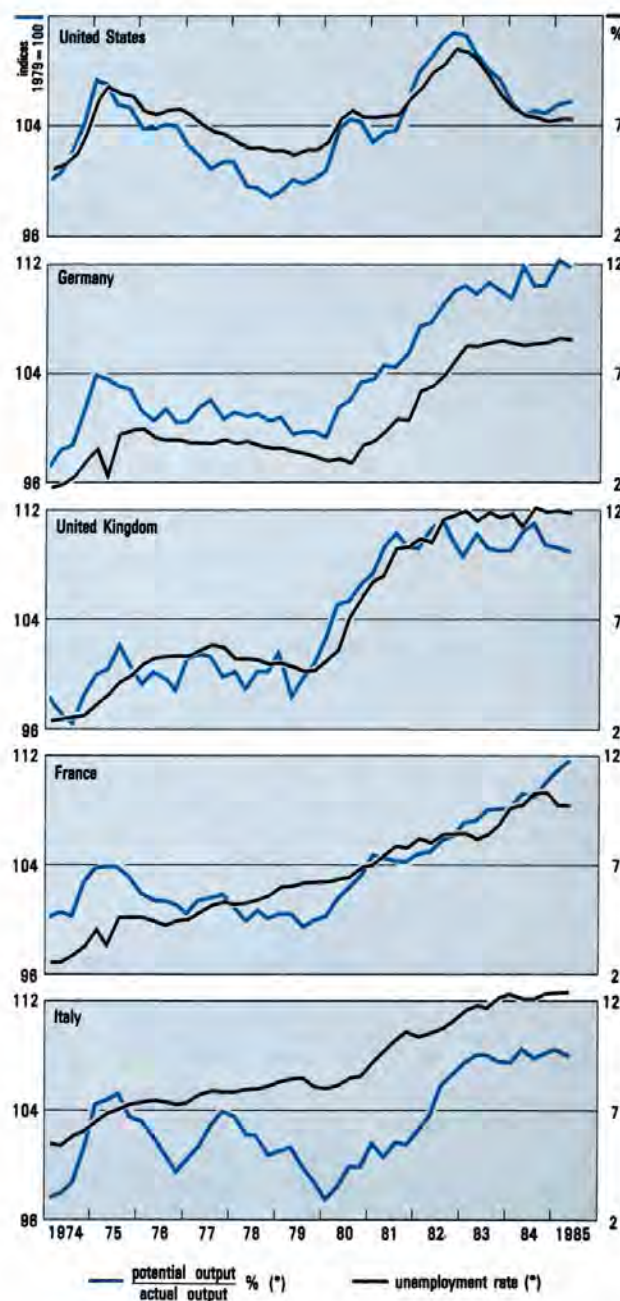
	1984	1985		
		Year	1st half	2nd half
<b>United States</b>				
GNP (1)	6.6	2.3	2.2	2.4
domestic demand (2)	8.5	2.9	2.0	3.4
external demand (2)	-1.9	-0.6	0.2	-1.0
Unemployment rate	7.5	7.2	7.3	7.1
<b>Japan</b>				
GNP (1)	5.8	5.0	4.7	5.0
domestic demand (2)	3.8	3.5	2.6	4.5
external demand (2)	2.0	1.5	2.1	0.5
Unemployment rate	2.7	2.5	2.5	2.5
<b>Canada</b>				
GNP (1)	5.0	4.0	4.0	2.8
domestic demand (2)	3.7	4.2	5.2	4.6
external demand (2)	1.3	-0.2	-1.2	-1.8
Unemployment rate	11.3	10.5	10.9	10.3
<b>EEC</b>				
GDP (1)	2.2	2.3	1.7	3.4
domestic demand (2)	2.0	1.9	1.3	2.9
external demand (2)	0.2	0.4	0.4	0.5
Unemployment rate	10.3	10.5	10.4	10.5
<b>Germany</b>				
GNP (1)	2.7	2.3	-0.2	5.8
domestic demand (2)	1.8	1.3	-1.3	5.8
external demand (2)	0.9	1.0	1.1	0.0
Unemployment rate	8.2	8.3	8.3	8.3
<b>France</b>				
GDP (1)	1.6	1.0	0.0	2.8
domestic demand (2)	0.6	1.0	0.3	3.1
external demand (2)	1.0	0.0	-0.3	-0.3
Unemployment rate	9.9	10.5	10.3	10.5
<b>United Kingdom</b>				
GDP (1)	2.6	3.3	4.0	2.5
domestic demand (2)	3.2	2.6	1.6	2.5
external demand (2)	-0.6	0.7	2.4	0.0
Unemployment rate	11.7	11.8	11.8	11.8
<b>Italy</b>				
GDP (1)	2.6	2.2	2.3	1.8
domestic demand (2)	2.8	2.2	3.1	-0.7
external demand (2)	-0.2	0.0	-0.8	2.5
Unemployment rate	10.4	10.6	10.4	10.8

Sources: OECD, EEC and national bulletins.

(1) Percentage changes on previous period. The half-yearly data are shown on an annual basis. — (2) Contribution to the change in GNP/GDP at constant prices.

**Figure 1**

**Gap between actual and potential output and the rate of unemployment in some industrial countries**



Source: Based on OECD and Istat data.

(\*) The potential output of the United States, Germany and the United Kingdom has been calculated using econometric estimates of the link between changes in the rate of unemployment and in the growth rate of output. Those of Italy and France have been obtained using the method of peak interpolation. The Italian unemployment rate includes the hours paid by the Wage Supplementation Fund.

Table 2

**Prices and costs in the national  
currencies of the leading industrial countries (1)**  
(% changes on previous period)

	1984	1985		
		Year	1st half	2nd half
<b>United States</b>				
GNP deflator .....	3.8	3.3	3.3	3.4
Import prices .....	0.6	-1.8	-5.4	5.0
Unit labour costs (2) .....	3.1	0.8	0.8	-0.4
<b>Japan</b>				
GNP deflator .....	0.6	1.0	1.1	1.3
Import prices .....	-2.2	-2.3	0.2	-18.3
Unit labour costs (2) .....	-5.2	-1.8	-1.2	0.0
<b>Canada</b>				
GNP deflator .....	2.8	3.5	4.2	3.8
Import prices .....	5.1	2.8	4.4	0.0
Unit labour costs (2) .....	-1.0	-1.1	-0.6	0.6
<b>EEC</b>				
GDP deflator .....	5.6	5.3	5.9	5.0
Import prices .....	8.7	4.3	—	—
Unit labour costs (2) .....	4.7	4.2	—	—
<b>Germany</b>				
GNP deflator .....	1.9	2.3	3.5	1.5
Import prices .....	5.9	3.0	8.0	-7.3
Unit labour costs (2) .....	-2.2	-2.2	-0.8	-2.0
<b>France</b>				
GDP deflator .....	7.1	6.0	5.9	5.8
Import prices .....	11.0	3.8	7.8	-6.5
Unit labour costs (2) .....	1.9	3.4	3.0	0.2
<b>United Kingdom</b>				
GDP deflator .....	4.4	5.0	5.2	5.3
Import prices .....	8.8	4.0	9.8	-11.0
Unit labour costs (2) .....	4.0	3.8	2.0	5.5
<b>Italy</b>				
GDP deflator .....	10.7	8.8	—	—
Import prices .....	10.8	8.0	—	—
Unit labour costs (2) .....	5.3	7.5	—	—

Sources: OECD and national bulletins.

(1) The half-yearly data are shown on an annual basis. — (2) in manufacturing industry.

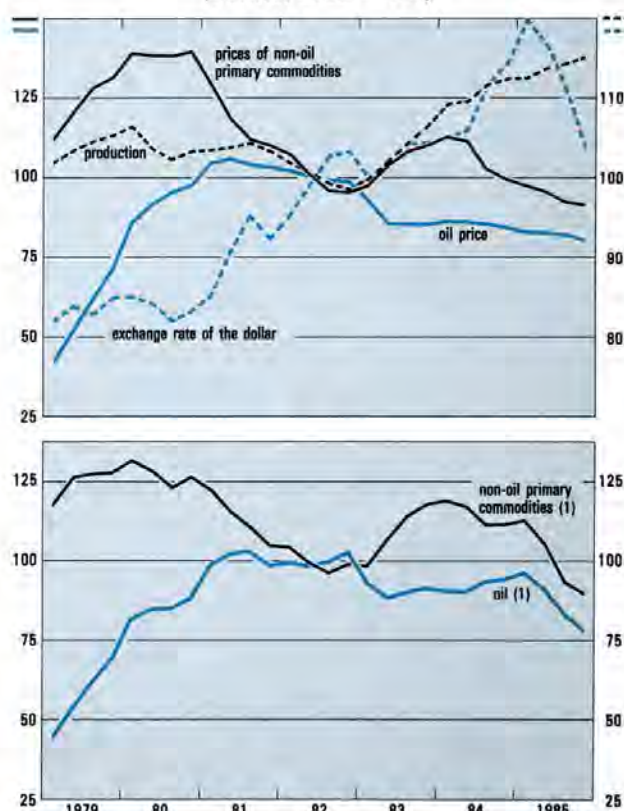
The official oil price remained unchanged for most of 1985 at between 27 and 28 dollars per barrel. On the other hand, the import prices the industrial countries paid for their imports of crude recorded a further small decrease (to below 27 dollars per barrel in the summer). This reflected both the difficulty OPEC members had in maintaining discipline in the cartel and the basically stable demand of the industrial

countries notwithstanding the pick-up in economic activity in the second half of the year. In December of last year and January of this prices fell sharply after leaders of important OPEC countries, and in particular Saudi Arabia, had declared that member countries would follow a strategy of expanding supply with the aim of recapturing the market shares they had lost in the past few years. In January contracts were signed at prices well below 20 dollars per barrel (see insert).

Figure 2

**The dollar prices of primary commodities,  
their terms of trade vis-à-vis manufactures,  
production in the industrial countries and  
the effective exchange rate of the dollar**

(indices, 1982 = 100)



Sources: IMF, UN and UNCTAD.

(1) The dollar prices of primary commodities exported by LDCs deflated with the dollar prices of manufactures exported by industrial countries.

The decrease in the dollar prices of primary materials together with the depreciation of the US currency led to a substantial decline in import



### The reduction in the price of oil in 1986 and its effects on the major industrial economies

At the end of 1985 and at the beginning of 1986 the spot prices of the main types of crude oil fell sharply in a market characterized by uncertainty and moderate turnover.

According to the International Energy Agency the spot price of North Sea oil fell between the end of November and the end of January from 30.1 to 18.9 dollars per barrel, that of US oil from 30.6 to 20, that of African oil from 30.7 to 20 and that of Gulf oil from 27.9 to 22.9. Over the same period the prices of oil products in the main areas of world consumption also fell: in Europe from 29 to 19.6 dollars per barrel, in the United States from 29.1 to 21.5 and in the Far East from 27.5 to 21.8.

The fall in oil prices has occurred in a period of fiercer competition among the major producers for shares of a market that has steadily grown smaller since the second oil crisis in 1979. Moreover, not only did the energy consumption of the OECD countries measured in tons of oil equivalent (TOE) fall between 1979 and 1984 by 1 per cent a year (with consumption falling faster in Europe than the United States) but oil was also replaced by other sources of energy on a substantial scale. The reduction in oil consumption amounted to 4.1 per cent a year (4.4 per cent in Europe). Consequently, oil's share of the OECD countries' energy consumption fell from 50.4 per cent in 1979 to 43.2 per cent in 1984. On the other hand, the share of coal increased considerably (from 20 to around 24 per cent), as did that of nuclear power (from 3.5 to over 6 per cent).

In parallel with the decline in the demand for oil there was also a shift in the geographical distribution of production. Between 1979 and 1985 OPEC's share of the total supply to the market-economy world shrank from 60 to 39 per cent, while the shares of the OECD, the non-OPEC developing countries and the Comecon countries increased from 27.4 to 39 per cent, from 10 to 19 per cent and from 2 to 4 per cent respectively.

A large part of the contraction in OPEC output from 31.6 million barrels a day in 1979 to 17.2 million in 1985 was borne by Saudi Arabia, whose share of OPEC production fell during the same period from 30 to 19 per cent. Saudi production continued to contract during the first three quarters of 1985. At the end of last year, however, a basic strategy change was made with the aim of winning back the market shares lost by Saudi Arabia and the cartel as a whole to non-OPEC producers. Under the new strategy Saudi Arabia almost doubled its supply, thereby triggering a large fall in prices.

If oil prices remain at their present levels in the immediate future, there will be important consequences for the world economy. The effects on the industrial countries will depend on the interaction between some structural features of their economies and the behaviour of economic agents and policy-makers. They will also depend on the real and financial impact of the fall in oil prices on other economic areas, which, however, is not considered here.

Table 1

#### Effects on the trade balances and domestic demand deflators of the seven major industrial countries of a reduction of oil and gas prices in 1986

	Net imports millions of TOE in 1984 (1)	Import saving effect (2)		Oil and Gas consumption millions of TOE in 1984	Effect on the domestic demand deflator (3)	
		Total	of which: due to the reduction in the \$ prices of oil and gas		Total	of which: due to the reduction in the \$ prices of oil and gas
United States .....	258	0.3	0.3	1.067	0.9	0.9
Japan .....	252	1.4	0.7	238	1.3	0.7
Germany .....	135	1.4	0.7	156	1.7	0.9
France .....	104	1.3	0.7	104	1.3	0.7
United Kingdom .....	-26	-0.3	-0.2	127	1.4	1.0
Italy .....	98 (4)	1.7	0.9	113 (4)	1.8	1.0
Canada .....	-25	-0.2	-0.2	109	0.8	1.0

Source: Based on IEA, OECD and ENI data.

(1) Net imports of crude oil, natural gas and oil products (excluding NGL). — (2) As a percentage of 1985 nominal GDP/GNP. The estimates are based on the assumption of a 20 per cent fall in dollar import and export prices. The dollar exchange rates of the various countries are assumed to remain at their February 1986 values. — (3) The reduction in domestic expenditure as a percentage of nominal domestic demand in 1985. The estimate is based on the assumption that consumer prices will fall by the same amount as import prices. — (4) 1985 data.

Table 1 shows the changes in the oil and gas trade balances of the major industrial countries between 1985 and 1986 on the assumption that the dollar prices of oil and gas imports fall by 20 per cent and that the 1986 balances in volume terms are the same as those recorded in 1984. The price change used here and below is not to be interpreted as a forecast. The total effect also takes into account the exchange rates prevailing in February 1986 and their changes compared with the averages for 1985.

Two of the countries considered, Canada and the United Kingdom, are net exporters of oil and gas and their balances therefore deteriorate. Except for the United States, all the other countries benefit considerably, with Italy recording an especially large improvement in relation to its GDP. In addition, the total improvements of Japan, Germany and France, whose currencies have appreciated most against the dollar, are much larger than those attributable to the reduction in the dollar price of oil on its own.

The effects of changes in oil prices on industrial economies depend to a large extent on how oil and energy intensive they are. The energy requirements of North America have remained substantially greater than those of the EEC and Japan (Table 2). The latter achieved the best results over the period in question, reducing the energy intensity of its economy by 29 per cent. Italy's energy requirements recorded a fall similar to that of the EEC average and are more or less in line with those of other European countries. By contrast, the oil intensity of the Italian economy is well above the European average. The consumption of oil per unit of output decreased faster than that of energy in every country.

An estimate of the potential impact on the domestic demand deflator of the economies in question is shown in Table 1. This estimate is based on the hypothesis of a reduction in the consumer prices of gas and oil products equal to that in the import prices of such products neglecting, as before, the effects of a probable decline in the prices of other energy products. The results need to be interpreted with considerable caution since they only reflect the interaction between the share of the final consumption of gas and oil products in domestic demand (this share may differ considerably from the energy intensity shown in Table 2) and the price changes in national currencies between 1985 and 1986. No attempt has been made, on the other hand, to assess the reactions of economic agents or of the authorities responsible for economic policy.

The potential impact effect on inflation is given by the percentage point reduction in the change of the domestic demand deflator caused by the fall in the prices of gas and oil products. This reduction is larger for Italy and Germany, and smaller for the United States and Canada. The contribution to the total impact of the fall in the dollar price of oil is smaller in Japan and France and very much the same in the other countries.

Table 2

**Energy intensity (a) and oil intensity (b)  
of the major industrial countries (1)**

		1973	1978	1982	1983	1984
Canada	a) . . . .	0.85	0.86	0.81	0.80	0.81
	b) . . . .	0.38	0.35	0.29	0.27	0.26
	b/a) . . . .	0.45	0.41	0.36	0.34	0.32
United States	a) . . . .	0.79	0.75	0.65	0.63	0.62
	b) . . . .	0.35	0.35	0.27	0.26	0.25
	b/a) . . . .	0.44	0.47	0.42	0.41	0.40
Japan	a) . . . .	0.42	0.37	0.31	0.30	0.30
	b) . . . .	0.32	0.27	0.19	0.18	0.18
	b/a) . . . .	0.76	0.73	0.61	0.60	0.60
Germany	a) . . . .	0.39	0.35	0.31	0.31	0.31
	b) . . . .	0.21	0.18	0.14	0.13	0.13
	b/a) . . . .	0.54	0.51	0.45	0.42	0.42
Italy	a) . . . .	0.41	0.38	0.34	0.34	0.34
	b) . . . .	0.30	0.25	0.21	0.21	0.19
	b/a) . . . .	0.73	0.66	0.62	0.62	0.56
United Kingdom	a) . . . .	0.44	0.39	0.35	0.35	0.35
	b) . . . .	0.22	0.18	0.14	0.13	0.16
	b/a) . . . .	0.50	0.46	0.40	0.37	0.46
France	a) . . . .	0.33	0.30	0.27	0.28	—
	b) . . . .	0.23	0.18	0.14	0.13	0.13
	b/a) . . . .	0.70	0.60	0.52	0.46	—
EEC	a) . . . .	0.39	0.36	0.32	0.32	0.32
	b) . . . .	0.24	0.20	0.15	0.15	0.15
	b/a) . . . .	0.62	0.55	0.47	0.47	0.47

Sources: IEA and OECD.

(1) Energy requirements (a) and oil requirements (b) in TOEs per unit of output (GNP/GDP) in dollars at 1980 prices and exchange rates.

prices in Japan and the major European countries in the second half of the year, following an increase during the first half, and thus contributed significantly to the slowdown in inflation. By contrast, US import prices (Table 2) were affected by the movement of the dollar, decreasing considerably in the first half-year but increasing again in the second, returning to their end-1984 levels.

Domestic cost developments in many of the major industrial countries also contributed to the reduction in the rate of inflation in 1985. Unit labour costs in manufacturing showed almost no change in the United States and actually decreased in Germany, Japan and Canada. By contrast, they increased by a little less than 4 per cent in France and the United Kingdom, and rose by 7.5 per cent in Italy.

The elimination of the cyclical lag between the North American economy and the rest of the industrial countries and the significant realignment of exchange rates have not yet led to a reduction in the large current account imbalances among these countries. The US deficit reached nearly 130 billion dollars in 1985 after worsening in the second half of the year (Table 3), while the surpluses of Japan and Germany increased further to 50 and 11 billion dollars respectively. For the year as a whole the larger US deficit was primarily due to unfavourable developments in the volumes of trade in goods and services, which were affected by the cumulatively large loss of competitiveness over previous years (Figure 3). The big increases in the Japanese and German surpluses can be attributed mainly to the volume growth in their exports of goods and services. In the second part of the year the terms of trade also improved, especially in Japan.

According to recent OECD estimates, the current account of the industrial countries as a whole recorded a deficit of 72 billion dollars in 1985 (64 billion in 1984). The deficits of the OPEC and non-oil developing countries are also estimated to have grown. This means a further increase in the world discrepancy of the current account by major areas to an amount of 122 billion dollars (Table 3).

One negative development in the international economy was the worsening of the deficit of the

non-oil developing countries, both compared with 1984 and during 1985. This ended the uninterrupted improvement that started in 1981 and aggravated these countries' debt situation. Seen in this light, the plan proposed by the US Treasury Secretary is important not only for the amount of resources to be channelled to the countries whose position is the most precarious but also because of its recognition of the need for a coordinated effort by all the parties involved.

Table 3

**Balance of payments on current account (1)**  
(billions of dollars)

	1984	1985 (2)		
		Year	1st half	2nd half
<b>United States</b> .....	-107.3	-128.3	-108.3	-152.8
<b>Other industrial countries</b> .....	38.3	69.3	54.3	88.8
<i>of which:</i> Japan .....	35.0	49.5	40.2	58.8
Germany .....	6.3	11.2	10.5	11.9
France .....	-1.0	0.6	-1.1	2.3
United Kingdom .....	1.3	3.5	-0.1	7.1
Italy .....	-3	-3.5	-10.6	3.7
Canada .....	1.9	-1.5	-1.4	-1.7
<b>OPEC</b> .....	-19.0	-26.0	-22.0	-30.0
<b>Non-oil LDCs</b> .....	-21.0	-27.0	-20.0	-34.0
<i>Memorandum item:</i>				
World discrepancy .....	-92.0	-122.0	-116.0	-128.0

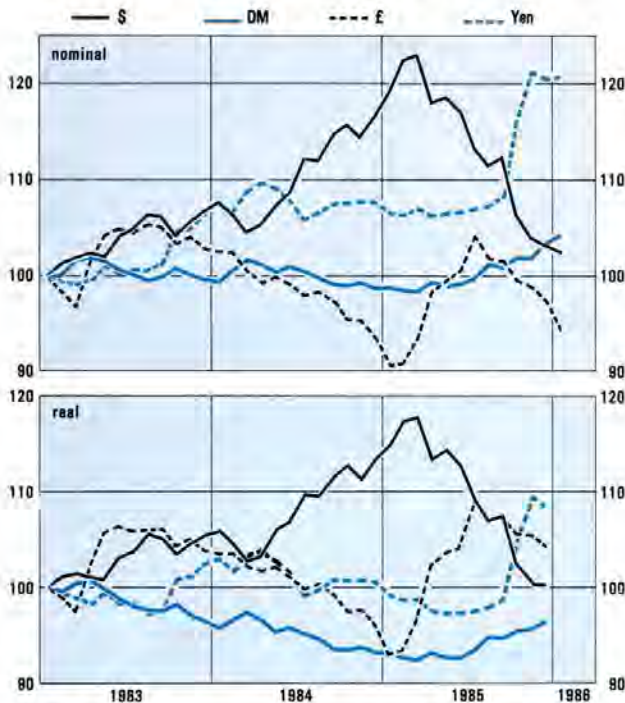
Sources: National bulletins and OECD.

(1) Including official transfers. — (2) Partially estimated data; the half-yearly data are shown on an annual basis.

The worsening of the non-oil developing countries' current balance can be attributed, on the basis of OECD preliminary estimates, primarily to the item "private transfers and services", reflecting the unfavourable trend of debt servicing, and only to a smaller extent to trade. The latter suffered from the deterioration in the terms of trade between primary materials and manufactures, which was also a significant factor contributing to the increase in the deficit of the oil-exporting countries. The worsening of the terms of trade of the most heavily indebted countries could involve a risk for the development of the world economy as a whole.

Figure 3

**Nominal and real effective exchange rates**  
(indices, January 1983 = 100)



The difficulties outlined above led the developing countries as a whole to curb sharply the growth in the volume of their imports in 1985. There was equally a sharp reduction in the growth of imports by the industrial countries as a result of the fall in their growth rate. Consequently, world trade expanded by only 3.5 per cent, as against 8.5 per cent in 1984.

#### Economic policies and exchange rates

The divergence between the expansionary stance of fiscal policy in North America and the more cautious one pursued in the major European countries and Japan persisted. The US Federal budget deficit rose to 212 billion dollars in the last fiscal year and increased as a ratio to GNP in 1985 by around half a percentage point (to 5.3 per cent), above all because the strong recovery of the previous year began to run out of steam. However, the Administration and

Congress are now more convinced of the need for measures to moderate the increase in public expenditure and permit a return to a balanced budget over the next five years. In fiscal 1986 the effects of the measures already introduced are likely to be small, implying a reduction of no more than 12 billion dollars in the 220 billion dollar deficit forecast, assuming no policy changes. The public sector deficit in France also increased because of a slowing down of the economy, rising by half a percentage point to 3.3 per cent of GDP.

Japan and Germany, on the other hand, continued with determination in the strategy of curbing their deficits. In both countries the public sector deficit decreased to less than 2 per cent of income. The restrictive stance of fiscal policy in these two countries is not likely to be changed in 1986, when their deficits will probably amount to less than 1 per cent of GNP. Neither the effects of the fiscal package approved in Japan last October, nor those of the reduction in personal income tax in Germany since the beginning of this year, will be strong enough to interrupt the process of eliminating the deficit. In the UK, after two years of expansionary tendencies, fiscal policy became restrictive and the deficit fell from 3.8 to 3.4 per cent of GDP.

1985 saw significant changes in the conduct of monetary policy in several of the major industrial countries. Not only in Japan and the United Kingdom but also in the United States greater importance was given to exchange rate management.

In the United States the growth in the broader monetary aggregates (M2 and M3) was generally on target. M1, by contrast, overshot considerably, but the authorities did not seek to counter this development. This decision was influenced by the view that other factors, both external (primary material prices) and domestic (wage moderation), would in any case keep inflation under control. In this way the upward pressure on interest rates generated in the second half-year by faster growth and the further increase in the public sector borrowing requirement was prevented from leading to an excessive rise in the level of rates. Such a rise would have made it more difficult to achieve the objective, underwritten by the September agreement of the G-5 monetary authorities, to bring down the exchange rate of

the dollar. In the event, short-term rates rose only by about half a percentage point in the second half of the year, after falling in June to their lowest level since mid-1978 (6.96 per cent on three-month Treasury bills).

In Japan, especially after the G-5 agreement, the monetary authorities actively sought to bring about an appreciation of the yen. This was undertaken by means of a substantial increase in interest rates achieved, in practice, by not compensating in other ways the destruction of liquidity produced by exchange market interventions. Thus, after a period of stability lasting until August, Japanese short-term rates rose by nearly two percentage points and those at the long end by about half a point. In January 1986, however, the discount rate was lowered (from 5.0 to 4.5 per cent).

In the United Kingdom the attention given to the monetary aggregates gradually diminished owing to the difficulty of interpreting their behaviour, which has been strongly influenced by the effects of financial innovations. The management of interest rates came to play a bigger role, in part because of the need for effective measures to curb the substantial depreciations of the pound recorded at the beginning of 1985 and again at the turn of 1986. In the first few days of 1986 the base lending rate was raised from 11.5 to 12.5 per cent.

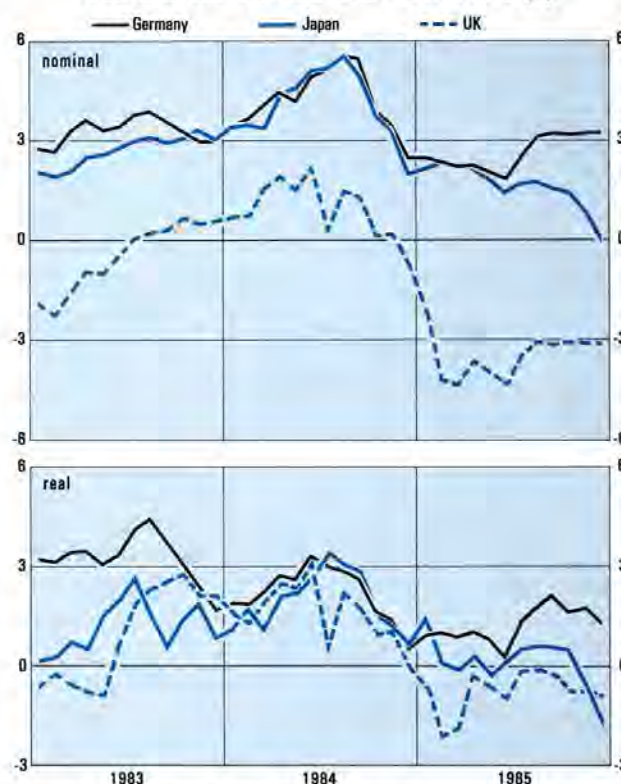
Monetary policy in Germany did not undergo any significant changes. The growth rate of central bank money remained within the target range (3-5 per cent) over the whole year. In the fourth quarter there was a slight acceleration, resulting in an increase of about 4.5 per cent compared with the fourth quarter of 1984. After recording a sizable fall through September, interest rates stabilized, with those at short term just below 5 per cent.

The downward movement of the dollar, which had got under way at the end of February when the central banks of the major industrial countries had made large concerted interventions on the exchange markets, strengthened considerably in the last part of the year. On top of the continuing effects of long-term factors connected with the large and growing deficit of the US external current account, this further weakening of the dollar can be attributed to two others: the changes

in US and Japanese monetary policy, which eliminated the differential between the nominal short-term interest rates in the two countries and led to the creation of a differential in Japan's favour for real short-term interest rates (Figure 4), and the interventions of the central banks of the major industrial countries, in which the US Federal Reserve took an active part.

Figure 4

Short-term interest rate differentials between the US and other countries (1)



Source: Based on IMF data and national bulletins.

(1) The rates have been calculated by deflating the nominal rates with percentage changes in consumer price indices over the preceding twelve months.

The nominal effective exchange rate of the dollar fell by 9 per cent between March and September and from then to January of this year by another 9 per cent (Figure 3). In the first of these two periods the dollar weakened much more against the Deutschmark (14.2 per cent) than against the yen (8.5 per cent); by contrast, in the second period, which was when the Japanese authorities took action, the corresponding figures were 13.9 and 15.4. As a result of the fall in the

dollar's nominal exchange rate, its real effective rate, calculated in terms of the wholesale prices of manufactures, dropped overall by 15 per cent. The competitiveness of US products thus improved considerably from its nadir in March through the end of the year, by which time it had returned approximately to its average level for 1982.

Over the twelve months to January 1986 the nominal effective exchange rate of the yen appreciated by 13.6 per cent, while that of the Deutschmark rose by only 5.4 per cent. Since, as seen above, these two currencies strengthened against the dollar to roughly the same extent, most of the difference between the changes in their nominal effective exchange rates can be attributed to the differences in the two countries' trade structures. On the one hand, the greater importance of trade with Europe for Germany tended to curb the appreciation of the DM's effective rate since numerous European currencies are linked to the mark by the EMS Exchange Rate Agreement; on the other, the greater importance of trade with the United States for Japan tended to amplify the appreciation of the yen's effective rate given that the strengthening of the Japanese currency was particularly pronounced against the dollar. These nominal effective exchange rate changes resulted in the different movements of real effective exchange rates: between January and December of last year that of the mark rose by 3.7 per cent and that of the yen by 9.3 per cent.

After the sharp fall recorded at the beginning of 1985, the pound sterling recovered in the first part of the year but then weakened appreciably in the second. Since the end of last year the British currency has been affected by the sudden sharp fall in oil prices and the uncertainty about their future course. Notwithstanding an increase in interest rates, the effective rate of the pound declined by 8.7 per cent between the beginning of December and the end of January.

In the wake of last July's EMS realignment the nominal effective exchange rates of the currencies participating in the EMS Exchange Rate Agreement recorded only small changes. The largest over the period from August 1985 to January 1986 were the appreciation of the DM (1 per cent) and the depreciations of the Irish pound

(1.8 per cent) and the lira (1.4 per cent). From August to December the changes in the intra-EMS real effective rates of the currencies participating in the Agreement, calculated in terms of the wholesale prices of manufactures, involved losses in competitiveness for Italy (1.4 per cent) and Germany (1.3 per cent) and gains for France (2 per cent) and Belgium (1.3 per cent).

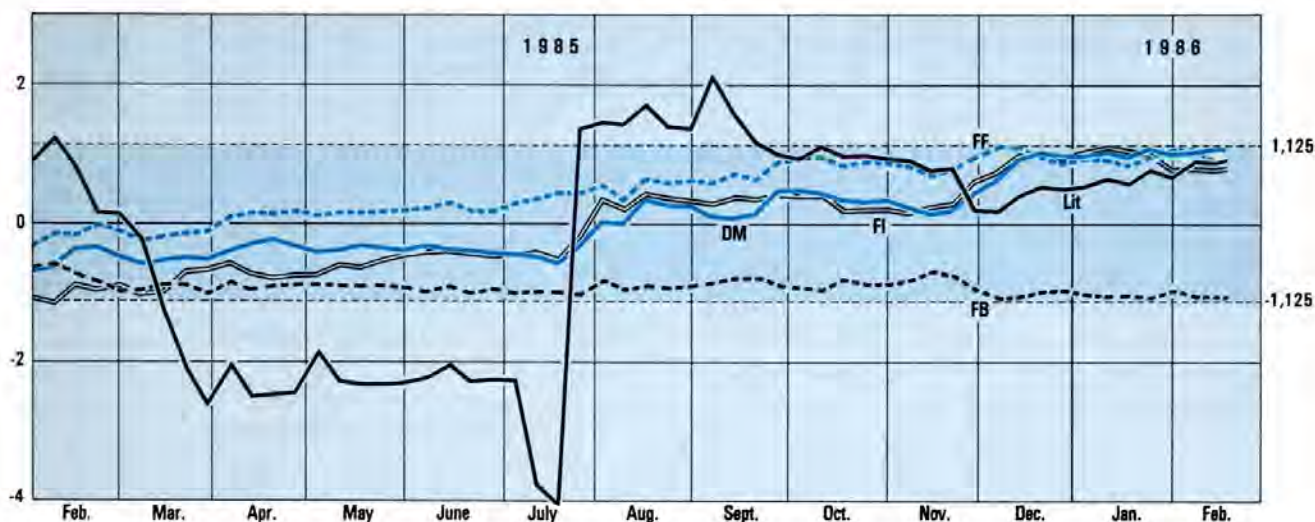
Over this period the exchange rate developments in the EMS were influenced by the varying course of the dollar. In general, the greatest strains coincided with the periods of fastest depreciation of the US currency. During the two months after the July realignment the currencies were relatively stable in the fluctuation band (Figure 5) in conjunction with a rising trend of the dollar. In this period interest rates fell in France and Belgium, the lira strengthened its position and the interventions in EMS currencies consisted primarily of purchases of Deutschmarks. Following the announcement of the decisions taken at the meeting of G-5 Finance Ministers and Governors on 22 September and the sharp decline of the dollar in the succeeding weeks, the DM and, to a lesser extent, the Netherlands guilder rose in the fluctuation band, while the lira and the French and Belgian francs lost ground.

The strains became more acute in the second half of November and in December when the decline in the dollar resumed and there were growing expectations of an imminent realignment. The Netherlands guilder and the Deutschmark rose rapidly towards the upper intervention limit, while the Irish pound, the Danish krone and the Belgian franc weakened, the latter reaching the lower intervention limit. By contrast, the lira and the French franc remained broadly stable, but their interest rates on the Euromarket increased. Between the end of November and the end of December the rate on three-month Eurolire rose from 14 to 17 per cent and that on Eurofrancs from 10 to 13 per cent.

During this period the measures taken by the monetary authorities of the EMS countries to maintain the cohesion of the System varied in nature and strength from country to country. In Belgium the discount rate was raised by one percentage point and money market rates rose in Ireland. On January 16 of this year the Italian

Figure 5

**Divergence of market rates from EMS central parities**  
(percentages)



monetary authorities introduced a series of foreign exchange and credit measures that are described below. In addition, the central banks of the weaker currency countries intervened heavily, in almost every instance before the intervention limit was reached. However, it did not prove necessary to activate the very-short-term financing mechanism that provides for use of credit lines granted by the central banks of the countries whose currencies are needed for intervention. Consequently, there were no direct effects on these countries' monetary aggregates via this channel. The interventions, mostly made on the days when the dollar fell fastest, consisted primarily of sales of Deutschemarks, though dollars were also sold. These operations in the period of maximum strain from the end of November 1985 to 10 January 1986 involved a combined outlay equivalent to about 8.5 billion dollars from France, Belgium, Ireland and, above all, Italy. Over the same period the Bundesbank had to perform the difficult task of reconciling the objective of promoting the depreciation of the dollar, in accordance with its commitment to the G-5 agreement of 22 September, with that of not jeopardizing the cohesion of the EMS exchange rates. The conflict between these two objectives was avoided both through cooperation with the other EMS central banks and by refraining from

making spot interventions in the exchange market. In January the strains eased and all the currencies held their positions in the fluctuation band, except for the Irish pound which reached its lower limit.

#### International financial markets

In the second part of the year the gross financing provided by the international markets amounted to 146.5 billion dollars, or 12 per cent higher than the total for the first half. The flow of finance in 1985 as a whole is estimated to have amounted to 277 billion dollars, an increase of 38 per cent on 1984 (Table 4).

The fastest growing market was again that for bonds and it now accounts for over 60 per cent of the total. Specifically, the value of floating rate issues more than tripled between 1983 (\$19.5 billion) and 1985 (\$58.4 billion).

As regards bank credit, back-up facilities continued to be highly successful, and have risen in value from 9.5 to 50.2 billion dollars since 1983. Within this category there was a very rapid growth in Multi-Option Financing Facilities (MOFFs), which, compared with the original

### The lira Eurobond market

The Euroaira market, composed of financial instruments denominated in lire and held outside the Republic of Italy, was until recently less developed than its counterparts in other European currencies. In practice, the development of the Euroaira market was confined to the short-term sector, in particular, to bank deposits, and has been conditioned by some controls imposed by the Italian authorities on the movements of capital.

Though still small, the stock of Euroaira deposits has expanded over the last two years, primarily as a result of non-residents' greater willingness to hold lire, taking advantage of a large interest rate differential.

At the end of September 1985 the lira liabilities of the banks reporting to the BIS were equivalent to 5.8 billion dollars and their assets to 5.1 billion dollars. As a proportion of total Eurocurrency liabilities and assets, these amounts were 0.26 and 0.23 per cent respectively.

In October 1985 the Italian monetary authorities decided, consonant with the demands of market operators, to lend their support to the opening of a longer term Euroaira segment of the market by clearing the way for the issue of fixed rate lira Eurobonds.

The introduction of Eurobonds denominated in lire opens up new fields of activity for the financial institutions engaged in international banking and may help to stabilize operations in Euroaira by providing a more diversified range of maturities.

To ensure a gradual and balanced growth of the new market, the Italian monetary authorities followed

a procedure similar to those adopted for other Eurocurrencies and has laid down general rules which issuers are invited to keep to.

The flow of issues is coordinated by the Treasury Ministry and the Bank of Italy, which jointly manage the informal queuing system designed to schedule issues according to the absorptive capacity of the market. Access to the new market is limited to supranational bodies (e.g. Community institutions, the World Bank, etc.) and foreign held companies that intend to finance investments in Italy, either directly or through Italian subsidiaries. For the moment Italian companies are not allowed access, even in the form of swap operations. However, swaps between non-residents are allowed, provided they are in connection with investments in Italy.

Although it is not explicitly foreseen that issues should have particular characteristics, the monetary authorities reserve the right to approve diversified terms and conditions depending on the demands of the market. Nonetheless, issues should as a rule have a maturity of at least five years and be for an amount of not less than 50 billion lire.

Following the general rules issued by the authorities, Italian banks play an important role in the international underwriting of these issues by acting as lead manager. Banks are to submit their proposals for issues to the Treasury Ministry and the Bank of Italy for possible inclusion in the queue.

To date three Euroaira issues have been completed for a total amount of 225 billion lire. The terms and conditions are shown below.

#### Lira Eurobond issues

Issuer	Lead managers	Amount (billions of lire)	Maturity	Issue price	Coupon (%)
European Investment Bank . . . . .	Istituto Bancario S. Paolo di Torino Crédit Lyonnais Générale de Banque Krediet Bank Morgan Stanley	100	21.10.1990	100	13.50
United Technologies . . .	Banca Commerciale Italiana Morgan Guaranty Trust	50	21.11.1990	100	13.50
General Motors Acceptance Corp. . . . .	Banca Nazionale del Lavoro Bank of America	75	17.12.1990	100	13.25



Note Issuance Facilities (NIFs), offer borrowers a much wider range of financing instruments. According to preliminary estimates, the flow of funds provided by MOFFs more than doubled compared with 1984 and accounted for around 40 per cent of the total for all back-up facilities.

Table 4

**International capital markets**  
(billions of dollars)

	1984	1985		
		Year	1st half	2nd half
<b>Bank loans (1)</b> . . . . .	89.2	109.3	47.5	61.8
<i>of which: back-up facilities</i> . . . . .	27.3	50.2	20.0	30.2
<b>Bond issues (2)</b> . . . . .	111.5	167.7	82.9	84.8
<i>of which: FRNs</i> . . . . .	38.2	58.4	33.3	25.1
<b>Total</b> . . . . .	<b>200.7</b>	<b>277.0</b>	<b>130.5</b>	<b>146.5</b>
<i>Memorandum item:</i>				
<i>% breakdown by borrowers</i>				
Industrial countries . . . . .	76.3	81.9	84.5	79.6
Non-oil LDCs . . . . .	14.1	8.9	6.0	11.5
Other . . . . .	9.6	9.2	9.5	8.9

Source: OECD.

(1) Announced medium and long-term Eurocredits plus loans in domestic currency to non-residents, excluding merger-related facilities to corporations.  
— (2) International issues plus foreign issues in domestic market.

The industrial countries' share of total borrowing in international markets increased by over 5 percentage points in 1985 to 81.9 per cent, consistent with the tendency observed since the 1982 debt crisis for the flows of international lending to be mainly towards the industrial area. In the second part of the year there was a small upturn in lending to non-oil developing countries. This was primarily due to the disbursement of concerted loans in connection with the restructuring of the debts of some Latin American countries, the renegotiation of loans to China and the granting of new ones, and the refinancing of loans to Southeast Asian countries.

Euromarket interest rates reflected developments in national markets. The Eurodollar yield curve grew flatter over the year,

confirming that market expectations regarding the future course of interest rates stabilized somewhat. In December the three and twelve-month Eurodollar rates were almost the same (close to 8 per cent), compared with an average differential of around one point in favour of the twelve-month rate during the first half of the year.

Further progress was made in 1985 in the liberalization of capital movements, especially in several European countries. The Netherlands introduced measures allowing residents and non-residents to issue bearer securities with maturities of less than two years, bank CDs and floating rate bonds. In addition, the authorities streamlined the preliminary procedures for Euroguilder issues. The French authorities authorized residents to undertake a number of foreign exchange operations, particularly in connection with the hedging of exchange risk, and eased the regulations governing direct investment abroad.

In October the first Eurolira issues were made in the Euromarket (see insert). The Chicago and New York markets started trading in ECU futures and as a currency denomination the ECU is now fifth in terms of issue volume in the Euromarket, ranking after the dollar, the Swiss franc, the yen and the Deutschemark.

The stock exchanges of the leading industrial countries recorded very substantial rises in share prices in 1985. The indices rose most in Italy (where they more than doubled), Germany (56 per cent), France (34 per cent), the United States (21 per cent) and Canada (18 per cent), all being countries in which interest rates declined. In Japan and the United Kingdom, where interest rates remained stable or increased slightly, the gains were smaller (respectively 9 and 12 per cent). One of the factors causing share indices to climb to record levels was the improvement in corporate profitability. In some countries there were also special factors: in Italy the huge scale of operations of the Italian investment funds; in France the reduction in the taxes on retained earnings and dividends; and in the United States the numerous mergers, takeover bids and corporate raids.

## The Italian economy and the balance of payments

### The performance of the economy in 1985

Though complete and definitive data are not yet available, it is possible to present a relatively accurate survey that both quantifies the Italian economic performance in 1985 and describes the point of departure for 1986. The rate of growth in real GDP last year was about 2 per cent, slightly less than had been predicted by the Government's Forecasting and Planning Report in September. On the supply side, the slower growth was due particularly to a smaller-than-expected rise in value added in industry excluding construction.

In real terms, households' consumption rose about 2 per cent, or by somewhat less than their disposable income. This curbing of the propensity to consume was encouraged not only by the high yield on financial savings but also by precautionary savings, especially in the second half of the year. Households and individual enterprises may have been cautious in their spending because of uncertainties regarding the renewal of collective bargaining contracts and of the need to make provision for several extraordinary fiscal deadlines, such as the condonation of building regulations offences and the collection of pension contribution arrears by the social security system.

Fixed investment, repeating its good 1984 performance with a rise of more than 4 per cent, returned to a level approximating its historic peaks of the early eighties. Despite substantial unutilized capacity and the high cost of money in real terms, firms carried out their plans for desired investment in fixed capital, especially for plant renovation and modernization. In this, they were favoured by improved conditions with respect both to self-financing and to the availability of risk capital. Investment in plant and equipment, the type most directly related to this process, rose by more than 10 per cent. The uncertain outlook for production and considerations of a financial nature coupled with the downward trend in raw materials prices and

the high cost of financing inventories, kept stock-building in line with the strict needs of production.

Exports at constant prices advanced on average at a rate of over 6 per cent, thus increasing their shares of Italy's market outlets, while imports expanded one percentage point faster, with an income elasticity that continues to be markedly higher than it was in the sixties and seventies. The trade deficit, on a cif-fob basis, amounted to 23 trillion lire, while the deficit on current account came to 7 trillion lire (1.0 per cent of GDP), both figures being substantially lower than the estimate of the Forecasting and Planning Report.

Despite the generally weak economic situation, some signs of improvement in the employment picture were observable in industry excluding construction, with an impact on the number of hours paid by the Wage Supplementation Fund, which were sharply lower. These phenomena suggest that the massive productive restructuring under way for years in industry, and which has led to significant declines in employment, is now nearly complete. However, the expansion of the labour force more than offset the increase in overall employment (0.4 per cent), so that the unemployment rate worsened to 10.6 per cent on average for the year.

The deceleration of domestic prices went ahead extremely slowly in 1985. The targeted increase of no more than 7 per cent in consumer prices for the year was overshoot by more than two percentage points, leaving a momentum effect for 1986 estimated at 3.5 per cent. After the progress made in 1984 Italy's inflation differential vis-à-vis other leading industrial countries failed to narrow further last year. It remained at 4 and 5 percentage points for wholesale manufactures and consumer prices, respectively.

The performance of the prices of industrial output was better. The average increase over the year was 8.5 per cent, with a deceleration of about

3 percentage points in the course of the year. Here again, however, the disinflation process did not reap the full benefit of the opportunities offered by world economic conditions, where the weakening dollar and slumping international commodity prices produced a marked deceleration in the lira costs of industrial inputs. However, as a result of the realignment of central EMS parities in July, Italy's international competitiveness, measured by wholesale manufactures prices, recovered by about 1.5 percentage points during the second half of the year, although on average for 1985 as a whole it remained essentially stable.

### The slowdown of growth in the second half

The slow but steady expansion of economic activity that had characterized the first half of 1985, when real domestic demand and output rose by 2.2 and 1.0 per cent respectively and were 3.0 and 2.4 per cent higher than in the first half of 1984, appeared to come to a halt in the summer.

Istat's national economic accounts for the third quarter show a substantial drop in domestic demand including stock-building (down 2.5 per cent from the second quarter). The fall in domestic demand was reflected in an even more pronounced contraction in imports of goods and services (down 4.7 per cent). Exports, on the strength of the improved competitiveness of Italian goods on European markets from the spring onwards and the acceleration of demand in some Community countries, grew strongly (4.6 per cent).

The resulting significant improvement in the balance of payments in real terms meant that in the third quarter the real GDP held to the same level as in the second quarter, while being 1.6 per cent larger than in the third quarter of 1984 (Figure 6).

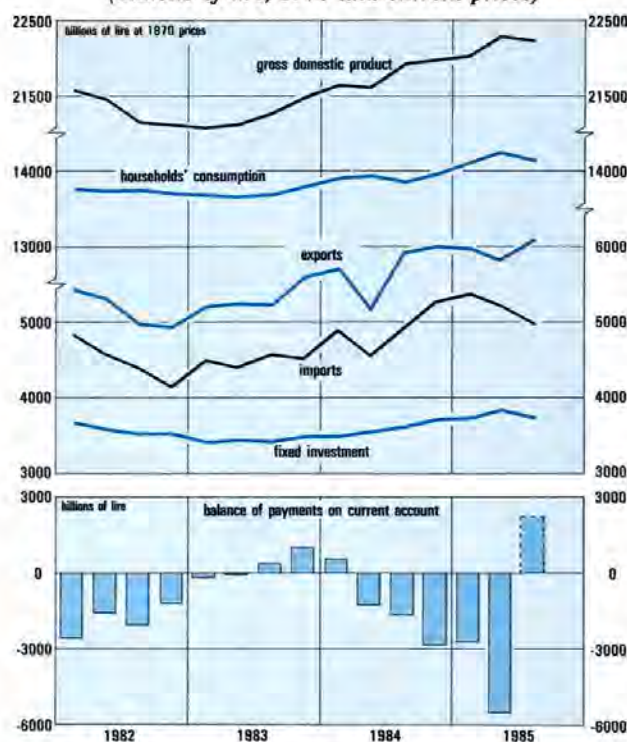
The decline in domestic demand in the third quarter was sharpest for gross fixed investment, which dropped by about 2 per cent in real terms. The contraction of household consumption was not as great (0.7 per cent), but it involved virtually all the components of spending, especially consumer durables and semi-durables. Owing primarily to uncertainty about the course of

demand, the third quarter also saw a decline in stocks of about 4 trillion lire in current prices.

Figure 6

### Supply, demand and balance of payments on current account

(billions of lire, 1970 and current prices)



Sources: Istat and Bank of Italy; data seasonally adjusted.

The sudden slackening of consumer spending in the third quarter may have been related, as noted above, to greater awareness by households of the potential risks for their future purchasing capacity of the delay in the renewal of collective bargaining contracts. The deadline for the payments connected with the condonation of building regulations offences, originally set at the end of 1985, may also have affected households' short-term propensity to consume.

On the supply side, the slackening of demand in the third quarter was reflected in an analogous way for value added. There was a rise in services of 0.5 per cent, to set against a slight decline of 0.2 per cent for the industrial sector as a whole; the 2.1 per cent contraction of value added in the

agricultural sector was the result of bad weather conditions in the winter of 1984-85.

The adjusted industrial production index for industry excluding construction declined on average by 1.2 per cent in the third quarter in relation to the second, and by 0.9 percent with respect to the third quarter of 1984, even though domestic orders continued to increase and foreign demand showed signs of improvement (Figure 7). The slackening of productive activity continued in October, with a further contraction of 0.8 per cent compared to September, but in the last two months of the year the trend of production staged a modest recovery. For the fourth quarter as a whole production increased by more than half a percentage point, bringing average growth for 1985 to approximately 1.2 per cent, or about one third of the growth achieved in 1984.

In early 1986 surveys of business and household expectations seemed to confirm a gradual improvement in economic activity, spurred by a substantial rise in both domestic and foreign orders. This development should reflect a recovery in investment goods output and above all the greater spending capacity of households.

### The labour market, costs and prices

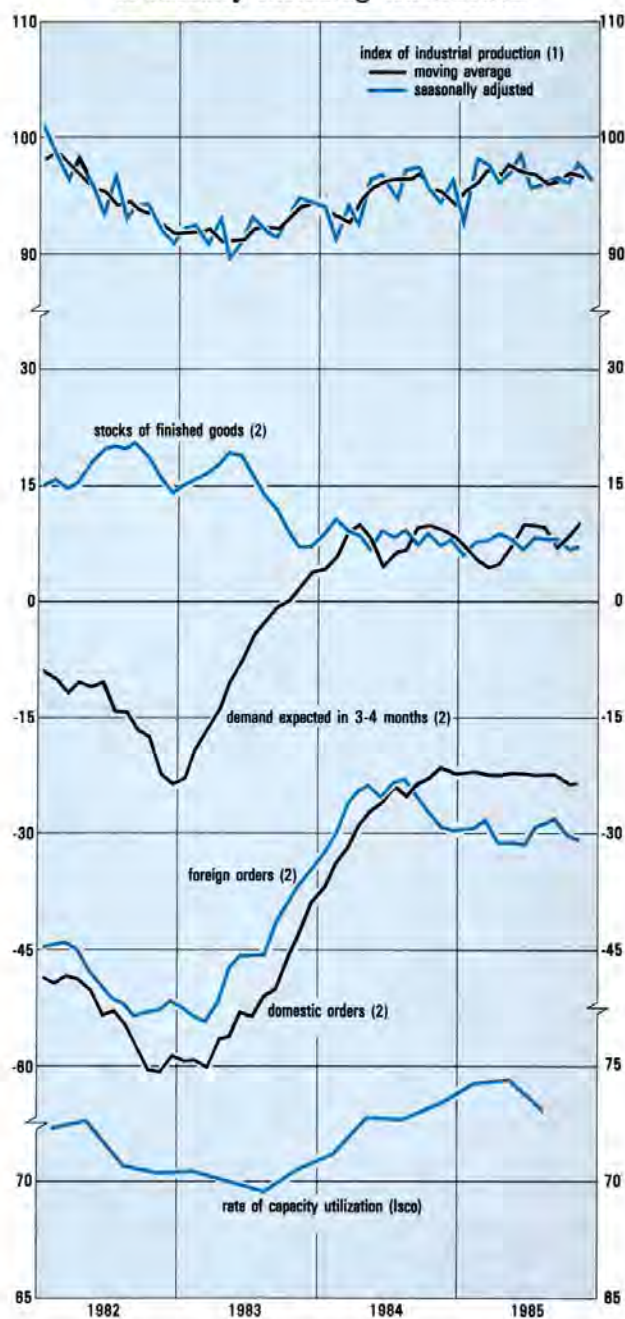
As a result of demographic trends and the increasing participation rate of women, the labour force continued to grow throughout the year, with an accentuation in the second half when the total labour force was 1.1 per cent larger than in July-December 1984, whereas in the first half it was only 0.4 per cent higher. At the same time the participation rate rose by about half a point over the 1984 average, exceeding 41 per cent for the first time since 1965.

Already from the beginning of the decade, because of industrial restructuring and the modest expansion of economic activity, the increase in the labour force was only partly compensated for by expanded job opportunities. Once again the dominant feature was the increase in the number of persons seeking employment who totalled 190,000 more in the second half of 1985 than in the same period of the previous year, bringing the unemployment rate to a historic high of 10.8 per cent (12.4 per cent including workers on Wage

Supplementation). This result is almost entirely attributable to the progressive worsening of the employment situation in the South, where the

Figure 7

### Output, demand, stocks and capacity utilization in industry excluding construction



(1) Overall index of industrial production, data seasonally adjusted (1980 = 100); based on Istat data. — (2) Centred moving average of monthly replies to Isco-ME survey of businessmen; data seasonally adjusted, except for stocks of finished goods.

unemployment rate rose while remaining essentially stable elsewhere (Table 5). Among the unemployed, those in search of their first job have especially continued to increase, underlying further the disproportionate amount of youth unemployment in Italy.

Table 5

**Unemployment and economic activity  
rates by region (1)**  
(percentages)

	North		Center		South and Islands		Italy	
	Unem- plov- ment	Activity	Unem- plov- ment	Activity	Unem- plov- ment	Activity	Unem- plov- ment	Activity
1980 .	5.1	43.0	7.4	39.7	11.5	35.9	7.6	39.9
1981 .	6.1	43.5	8.3	40.5	12.2	36.0	8.4	40.3
1982 .	6.7	43.3	8.6	41.0	13.0	36.1	9.1	40.3
1983 .	7.7	43.4	9.1	41.4	13.8	36.7	9.9	40.6
1984 .	8.4	43.8	9.4	42.0	14.0	36.7	10.4	40.9
1985 .	8.3	43.7	9.4	42.4	14.7	37.1	10.6	41.1
1st half . .	8.2	43.2	9.5	41.8	14.3	36.6	10.5	40.6
2nd half . .	8.4	44.2	9.3	42.9	15.1	37.7	10.8	41.6

Source: Istat, labour force sample survey.

(1) From 1984 the data are not strictly comparable with those for previous years, owing to changes in the standards for measuring the labour force.

The total number of employed persons in the second half of the year was 75,000 greater than in the same period of 1984, thanks once again entirely to the contribution of the services sector, where the number employed was 270,000 greater than in the year-earlier period, thus more than offsetting the declines in industry and agriculture. Especially noteworthy is the fact that the bulk of the employment gain consisted of new jobs for wage and salary earners, while the increase in the number of self-employed was much more modest. The latest labour-force sample data, in fact, confirm a slowing down of the loss of salaried jobs in industry excluding construction, and above all an increase in such jobs in services and more recently in agriculture as well.

Moderate though it is, the continued expansion of economic activity has substantially reduced the number of hours paid by the Wage

Supplementation Fund, which declined by 12 per cent over the first eleven months of the year (and by 36 per cent if construction is excluded). At the same time, there has been a marked change in the composition of benefits: since 1980 the share of ordinary benefits has been nearly halved (from 37 to 19 per cent).

Last December the collective bargaining contract for public employees was agreed on. Its key feature, apart from the shortening of the work week to 36 hours for the entire government sector by the end of 1987, is the acceptance of a new *scala mobile* with cost-of-living adjustments on a half-yearly basis (in May and November). The new system restricts 100 per cent indexation to salaries up to 580,000 lire net monthly, instead of the current 910,000, and provides for 25 per cent indexation of the residual in excess of the base pay augmented by cost-of-living benefits. (For a more detailed treatment, see "The Reform of the *Scala Mobile*", page 55 below).

Following the failure of the negotiations between unions and private employer associations on the question of labour costs, most of the organizations involved decided to extend the public sector agreement, as it relates to the *scala mobile*, to the rest of the economy. The universal applicability of the new indexation system has been made explicit in a recent bill presented by the Minister of Labour. The degree of coverage of the average salary is slightly under 45 per cent for the public sector, slightly under 50 per cent for industry excluding construction. The new mechanism makes some progress in attenuating the narrowing of salary differentials but does not eliminate the problem; under inflationary conditions, medium-to-high salaries will continue to be penalized in relative terms.

The agreement contains no built-in mechanism for eliminating variations in indirect taxation from the index, but only the possibility, under a procedure that is not yet well defined, of an extraordinary meeting between the two sides to agree on any adjustments to be made in case of changes in tax rates. No provision at all is made for the elimination from the price index of changes in the terms of trade.

Productivity in industry excluding construction followed the usual pattern connected with the business cycle, increasing over the first

half of the year, then decreasing over the summer, chiefly because of the pause in economic expansion. In the third quarter productivity declined by 1.4 per cent both per hour worked and per worker (net of Wage Supplementation). For the first three quarters, however, both measures of productivity averaged more than 2 per cent higher than in the same period of 1984.

Real wages increased over the first nine months of 1985. The increase in compensation per employee averaged 10.2 per cent (net of Wage Supplementation), while the rise in consumer prices for households of workers and white-collar employees was about 2 percentage points less.

Primarily because of productivity movements, labour costs per unit of output gradually accelerated in the course of 1985. Compared with the corresponding period a year earlier, unit labour costs in the first half were higher by 6.4 per cent, while in the third quarter they were up by 9.7 per cent. On average for the first three quarters unit labour costs were about 7.5 per cent higher than in the first three quarters of 1984, or slightly less than the expected increase for the year as a whole (Table 6).

Table 6

**Total unit costs and output prices,  
industry excluding construction**  
(% changes)

	1984	1985 (2)			
		Year (1)	1st qtr.	2nd qtr.	3rd qtr.
Unit labour costs (3) .....	5.3	7.8	5.8	7.1	9.7
Total input costs .....	11.7	7.2	12.0	11.3	5.4
domestic .....	10.6	7.8	7.8	8.0	7.9
imported .....	12.3	6.9	14.5	13.3	3.9
Total unit costs .....	8.8	7.4	9.6	9.5	6.9
Output prices .....	10.7	8.5	9.5	9.5	8.2

(1) Estimated. — (2) Change on corresponding period of previous year. — (3) Net of Wage Supplementation.

As for the lira costs of imported industrial inputs, the third quarter saw a situation opposite to that regarding unit labour costs, because the dollar began to weaken while international

commodity prices continued to decline. As a result the cost of imported inputs in this quarter was only about 4 per cent higher than in the same period of 1984, whereas in the first half it had recorded an average increase of 14 per cent.

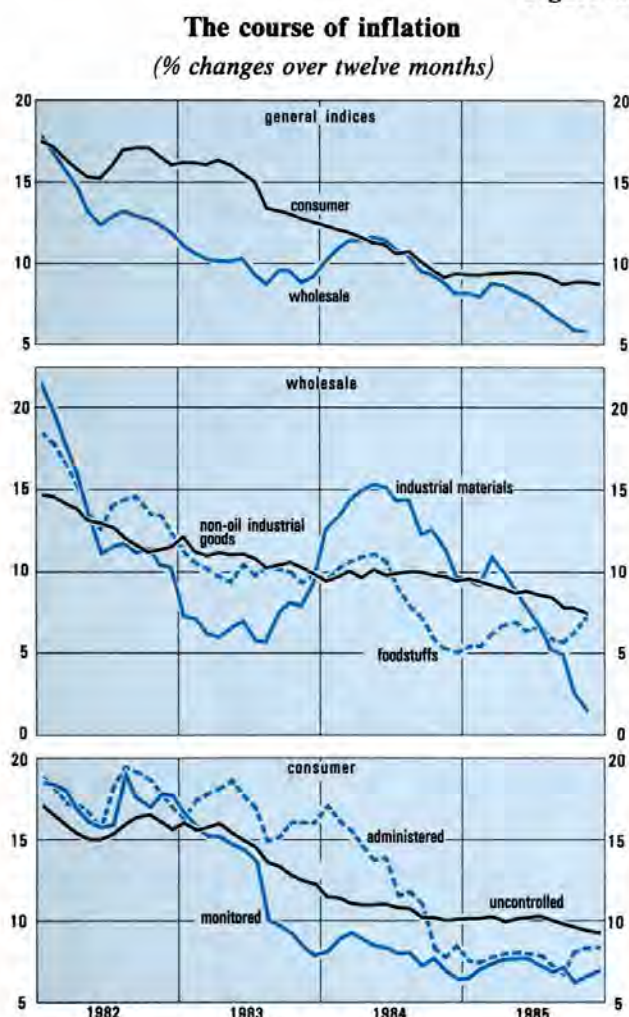
The end result of the behaviour of the major cost components was that the rise in total unit costs in industry excluding construction was essentially stable over the first two quarters and slowed markedly in the third. Up to mid-year price increases for industrial output kept more or less in line with rising costs, but then outstripped these latter, indicating a further recovery of gross profit margins that should average about one percentage point for the year (Table 6).

As noted above, 1985 saw an interruption in progress towards disinflation. There was no deceleration in wholesale price increases until the second half of the year, when it reflected the sharp slowdown in price rises for industrial raw materials. In the course of the second half, the twelve-month rate of increase slowed down by about two-and-a-half percentage points, falling below 6 per cent in December. On average for the year it was 7.3 per cent, three points less than in 1984.

The deceleration of consumer prices, by contrast, came virtually to a halt. The twelve-month inflation rate was essentially unchanged, with a decrease of less than half a point whether for consumer prices or the cost of living. On average for the year, the deceleration of the two indicators was quite modest, to 9.2 and 8.6 per cent respectively (as against 10.8 and 10.6 per cent in 1984). The greater stickiness of consumer prices once again produced a divergence from wholesale prices that was accentuated in the course of the year (Figure 8). It is worth noting, however, that if comparable product baskets are used for these two indices the divergence virtually disappears. No slowing down was evident in the prices of consumer goods and services not subject to formal price controls — which continued to rise throughout the year at about their end-1984 rate of 10 per cent. This result appears to be attributable primarily to policies with respect to administered prices and public tariffs, which in contrast to 1984 led to no deceleration of prices during the year, and to the effects of new fiscal regulations concerning both

VAT and direct taxes aimed at raising the level of taxation on several categories of self-employed workers and commercial businesses.

Figure 8



N.B.: Source of general indices is Istat. Components of wholesale and consumer prices are based on Istat data.

### The balance of payments on current account

In 1985, the commercial trade deficit (cif-fob customs data) amounted to 23,023 billion lire, or nearly 4,000 billion more than in the previous year (Table 7). The rate of increase of exports (16 per cent) was slightly lower than in 1984, but that of imports (16.6 per cent) slowed by almost five percentage points.

Table 7

### Foreign trade

(customs data seasonally adjusted)

	Amounts in billions of lire			% changes on previous period	
	Exports	Imports	Balance	Exports	Imports
1984-1st qtr.	31,863	35,547	-3,684	3.8	10.7
2nd "	28,636	33,682	-5,046	-10.1	-5.2
3rd "	33,704	37,790	-4,086	17.7	12.2
4th "	34,824	41,143	-6,319	3.3	8.9
1984-Year ...	129,027	148,162	-19,135	16.7	21.4
1985-1st qtr.	35,683	43,513	-7,830	2.5	5.8
2nd "	35,734	43,369	-7,635	0.1	-0.3
3rd "	38,169	40,052	-1,883	6.8	-7.6
4th "	40,120	45,795	-5,675	5.1	14.3
1985-1st half	71,417	86,882	-15,465	4.2	10.1
2nd "	78,289	85,847	-7,558	9.6	-1.2
1985-Year ...	149,706	172,729	-23,023	16.0	16.6

Source: Based on Istat data.

The course of trade during the year fell into well-defined phases. Seasonally adjusted data show that, in the first half, the deficit increased by more than 5.0 trillion lire compared with the second half of 1984. In the following six months it halved, dropping sharply in the summer and again widening somewhat towards the end of the year. The acceleration in exports between the two six-month periods was offset by a decline in imports which reflected mainly developments as regards purchases abroad of energy sources, transportation equipment and "other" products (chiefly commodities and semiprocessed goods) (Table 8).

It is estimated that, on average for the year, Italy's terms of trade and price competitiveness recorded no significant change. The worsening of the merchandise balance in 1985 can, therefore, be largely ascribable to the narrowing of the differential between the growth of domestic demand and that of the world as a whole.

Separate data on the volume and average unit value of traded goods in 1985 are available only for the first ten months (Table 9). The terms of

Table 8

**Foreign trade by product groups**  
(billions of lire)

	EXPORTS (fob)				IMPORTS (cif)				BALANCE			
	1984		1985		1984		1985		1984		1985	
	Jan.-June	July-Dec.	Jan.-June	July-Dec.	Jan.-June	July-Dec.	Jan.-June	July-Dec.	Jan.-June	July-Dec.	Jan.-June	July-Dec.
Energy sources .....	3,010	3,593	3,774	3,860	21,033	21,144	24,643	22,040	-18,023	-17,551	-20,869	-18,180
Foodstuffs .....	3,413	5,171	4,565	6,298	6,671	10,836	10,294	11,994	-3,258	-5,665	-5,729	-5,696
Textiles and clothing .....	10,436	12,276	12,138	14,415	3,143	3,385	4,093	3,850	7,293	8,891	8,045	10,565
Basic metals .....	5,073	6,269	6,287	6,481	5,705	6,548	6,762	6,649	-632	-279	-475	-168
Chemicals .....	5,121	5,745	6,152	6,350	7,602	7,749	8,991	9,158	-2,481	-2,004	-2,839	-2,808
Machinery .....	15,502	17,392	18,309	20,797	8,585	10,105	11,024	11,903	6,917	7,287	7,285	8,894
Transportation equipment ..	6,076	6,801	6,602	7,791	5,743	6,112	7,437	6,755	333	689	-835	1,036
Other .....	10,767	12,382	12,290	13,597	11,051	12,750	13,854	13,282	-284	-368	-1,564	315
<b>Total</b> . . .	<b>59,398</b>	<b>69,629</b>	<b>70,117</b>	<b>79,589</b>	<b>69,533</b>	<b>78,629</b>	<b>87,098</b>	<b>85,631</b>	<b>-10,135</b>	<b>-9,000</b>	<b>-16,981</b>	<b>-6,042</b>

Source: Istat.

Table 9

**Foreign trade: values, volumes  
and main determinants**  
(% changes)

	85 Jan.-June	85 July-Oct.	85 Jan.-Oct.
	84 Jan.-June	84 July-Oct.	84 Jan.-Oct.
<b>Exports</b>			
Value .....	18.1	11.9	16.3
Average unit value . . .	9.2	8.1	8.8
Volume .....	8.2	3.5	6.9
<b>Imports</b>			
Value .....	25.2	5.0	16.7
Average unit value . . .	11.1	5.6	8.8
Volume .....	12.7	-0.6	7.3
<b>Domestic demand (1) . .</b>	3.4	1.3	2.7
<b>Capacity utilization . . .</b>	3.1	0.4	2.2
<b>World demand (1) (2) . .</b>	5.3	3.4	4.6
<b>Competitiveness (3) . . .</b>	1.1	-1.7	..
<b>Terms of trade (4) . . . .</b>	-1.7	2.4	..

Source: Based on Istat, Isco, IMF and national sources.

(1) In the last two columns, data up to September only. — (2) OECD exports of manufactures. — (3) Wholesale prices. The (-) sign indicates an improvement in competitiveness. — (4) The (-) sign indicates a deterioration in the terms of trade.

trade, which deteriorated in the first half by 1.7 per cent compared with the corresponding period in 1984, improved markedly in the following four

months (2.4 per cent), as a result of the much stronger decline in the growth of the average unit value in lire of imports than of exports (see insert).

In volume terms, too, available data show a change of tendency in the July-October period compared with the first half of the year: a notable slowdown in sales was accompanied by a change of sign in purchases, from an increase of 12.7 per cent to a decline — albeit a slight one. The latter was a reflection of the drop in imports of commodities as well as in imports of investment goods, induced by the slowdown in fixed investments in vehicles and equipment. Similarly, the change in final private demand for durable consumer goods had a strong effect on the volume of imported consumer goods which, in the second subperiod, grew by only 7.5 per cent as against 31 per cent in the previous six months.

In relation to Italy's principal competitors, the competitiveness of Italian goods, measured by relative wholesale manufactures prices (excluding oil products), improved in the first half of the year. From its January peak (which was about the same as the other two historical levels reached in the past decade, at the beginning of 1980 and 1983), the real exchange rate of the lira fell back in the following three months, concurrently with the declining value of the lira within the EMS,



### Recent trends in the terms of trade

Last summer's improvement in the trade balance was due in no small part to developments in the terms of trade which in the third quarter were characterized by a sudden reversal of the unfavourable trend of the preceding two years.

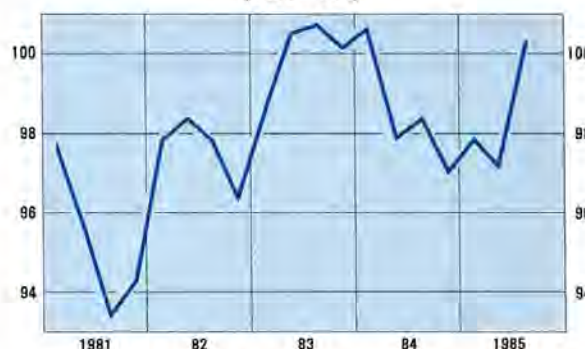
This development reflected the combined effects of various factors, but especially the further reductions in the dollar prices of imported energy — following those which had occurred during the long upward phase of the dollar — in tandem with a sharp decline in the value of the dollar. The weakening in the position of oil-producing countries in the energy markets was confirmed in the following months as the dollar began to slide steeply. Preliminary estimates indicate that the lira price of energy sources acquired abroad substantially declined in the fourth quarter compared with the corresponding period the year before.

The depreciation of the dollar also led to a fall in the lira price of imported commodities in the second half of the year, even though prices in dollars were again recovering after having weakened last winter.

Favourable movements in input prices enabled countries producing manufactured goods to curb substantially the rise in export prices, expressed in their respective currencies. The unit values in foreign currency of manufactures purchased by Italy (which

account for more than a half of Italy's total imports) recorded an average increase of only 2.2 per cent in the third quarter: the concurrent depreciation of the lira, however, limited the benefits in terms of unit value in lire, which rose by 10.6 per cent.

Terms of trade (1)  
(1980 = 100)



(1) Ratio of the index of the average unit value of exports to that of imports.

On the export side, the progressive reduction in the growth rate of output prices has for some time been affecting the course of selling prices abroad. In the second and third quarters of 1985, however, they grew at rates higher than those of prices at home.

### Average unit value of imports and exports, principal components and determinants (% changes on corresponding period)

	A.u.v. of imports of energy sources in \$	A.u.v. of imports of commodities in \$	A.u.v. of imports of manufact. in foreign currency	Appreciation of \$ against the lira	Effective depreciation of the lira (1)	A.u.v. of total imports in lire	A.u.v. of total exports in lire	Output prices of manufact.	Competitiveness of exports (2)
1981	15.5	-7.9	11.4	32.7	9.1	29.4	23.1	18.6	-2.9
1982	-6.3	-7.3	7.2	19.0	6.4	12.5	15.4	16.6	-0.6
1983	-9.4	-5.5	1.3	12.3	3.3	4.8	7.4	11.6	-1.9
1984	-1.4	3.3	7.5	15.7	4.0	11.3	9.6	10.8	1.7
1985	-3.0(3)			8.7	5.9				
1984 — 1st qtr.	-6.7	4.9	4.8	18.8	5.6	10.9	13.1	11.6	-0.7
2nd "	0.7	5.2	7.8	13.4	4.2	12.8	9.7	11.9	1.6
3rd "	-1.0	5.7	8.9	14.4	3.5	11.4	8.8	10.9	4.5
4th "	..	-2.5	8.6	16.4	2.7	10.3	6.8	9.0	1.6
1985 — 1st qtr.	-2.9	-9.4	10.5	21.6	2.2	11.0	8.0	8.8	1.9
2nd "	-2.8	-5.6	7.9	17.6	4.9	11.2	10.4	8.2	-0.2
3rd "	-4.8	2.9	2.2	5.3	8.2	6.4	8.5	7.7	-3.3
4th "	-1.5(3)			-7.4	8.4				

Source: Based on IMF, ISCO, Istat and national sources.

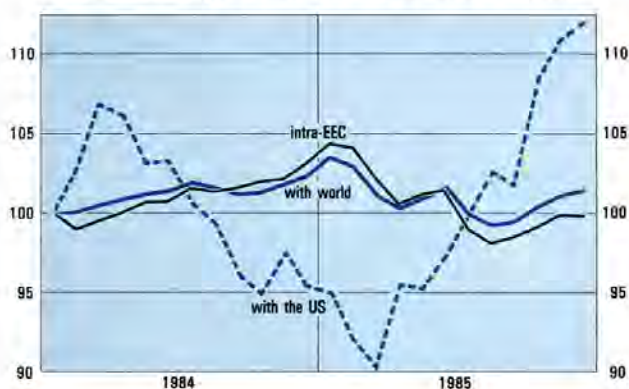
(1) Weights derived from imports. — (2) On the basis of average unit values of exports of manufactures (excluding petroleum products). The sign (-) indicates an increase. — (3) Estimates for the 4th quarter of 1985 are based on the most recent Istat data.

producing a 3 per cent gain in competitiveness. The realignment in July brought a further improvement up to August — for a total of four percentage points. Intra-EEC real exchange rates evolved along the same lines, though showing wider movements: the gain in competitiveness between January and August was 6 per cent.

Figure 9

**Real exchange rates of the lira**

(wholesale price index, January 1984 = 100)



These developments should in themselves have contributed to the volume improvement in trade in manufactured goods in the July-October period, with repercussions on both foreign and, especially, domestic markets where they slowed down penetration by foreign goods. However, the further substantial fall of the dollar from September at a time when the nominal exchange rate of the lira in Europe was stationary and wholesale price differentials between Italy and its main competitors were widening, caused a new appreciation of the lira in real terms. Compared with August, the loss in competitiveness by December was 2.3 per cent (10.1 and 1.8 per cent vis-à-vis the United States and the EEC countries, respectively).

The renewed worsening of the merchandise deficit towards the end of the year is probably ascribable to the recovery in domestic demand following the summer slowdown. This was not sufficient, however, to prevent an improvement in the second half as a whole, thanks largely to a favourable turn in the terms of trade in the latter part of the year and to a strengthening of demand in a number of important markets for Italian goods.

In terms of geographical composition, data on Italy's merchandise trade available in value terms up to October (Table 10) show that the improvement after the first half of the year reflects a shift in trade with EEC and non-oil developing countries. In both cases, there was a strong slowing down of imports that brought the trade balance for the four months July-October to near-equilibrium. The deceleration apparently was the result not only of the easing of domestic demand but also of the improvements in both competitiveness and the terms of trade. On the other hand, the deficit with OPEC continued to grow, as a result of a reduction in exports (19.3 per cent) that more than offset a cutback in imports (5.8 per cent). There was a marked fall in direct exports to Libya, while at the same time imports increased substantially; the trade deficit has more than doubled, and in the ten months exceeded 3.5 trillion.

The trade surplus with the United States continued to expand in July-October. Although the growth of exports decelerated markedly compared with the first half (from 43.1 to 24.7 per cent), there was an actual decline of 6.6 per cent in imports which in the previous six months had increased by almost a third. The latter phenomenon was attributable partly to volume movements depressed by the slowdown in domestic demand, partly to the effects on lire prices of a fall in the dollar exchange rate during the period in question back to its values of more or less a year ago, and partly, presumably, to the stability of prices at the source. The effects of the depreciation of the dollar on real flows, through changes in competitiveness, have over the period in question not yet had time enough to make themselves widely felt.

With regard to invisibles, the surplus in respect of "foreign travel" recorded an increase over the first eight months compared with the corresponding period in 1984 (from 7,587 to 8,475 billion). Receipts grew at a higher rate (13.8 per cent) than domestic prices for the services concerned (11.9 per cent), reflecting an increase in the number of overnight stays by foreign tourists. At the same time, however, spending by Italian tourists abroad also increased, moving up from 2,534 to 3,043 billion; seasonally adjusted data for monthly spending show that the net upward trend

Table 10

**Foreign trade by group of countries**  
(billions of lire)

	EXPORTS (fob)				IMPORTS (cif)				BALANCE			
	1984		1985		1984		1985		1984		1985	
	Jan.-June	July-Oct.	Jan.-June	July-Oct.	Jan.-June	July-Oct.	Jan.-June	July-Oct.	Jan.-June	July-Oct.	Jan.-June	July-Oct.
<b>EUROPEAN COMMUNITY..</b>	<b>27,413</b>	<b>20,155</b>	<b>31,701</b>	<b>23,499</b>	<b>29,782</b>	<b>20,716</b>	<b>37,977</b>	<b>23,620</b>	<b>-2,369</b>	<b>-561</b>	<b>-6,276</b>	<b>-121</b>
<i>of which:</i>												
Germany .....	9,703	7,340	10,911	8,578	10,985	7,678	13,961	8,986	-1,282	-338	-3,050	-408
France .....	8,643	6,050	9,901	6,842	8,613	5,814	10,572	6,448	30	236	-671	394
United Kingdom .....	3,886	3,060	4,651	3,654	2,802	2,170	4,166	2,745	1,084	890	485	909
Netherlands .....	1,701	1,315	2,137	1,589	3,447	2,329	4,484	2,427	-1,746	-1,014	-2,347	-838
Belgium-Luxembourg ..	1,768	1,268	2,106	1,479	2,594	1,739	3,180	1,934	-826	-471	-1,074	-455
<b>UNITED STATES .....</b>	<b>5,841</b>	<b>5,234</b>	<b>8,358</b>	<b>6,529</b>	<b>4,218</b>	<b>3,172</b>	<b>5,588</b>	<b>2,963</b>	<b>1,623</b>	<b>2,062</b>	<b>2,770</b>	<b>3,566</b>
<b>EASTERN EUROPE .....</b>	<b>1,930</b>	<b>1,493</b>	<b>2,299</b>	<b>1,657</b>	<b>4,842</b>	<b>3,838</b>	<b>4,238</b>	<b>3,336</b>	<b>-2,912</b>	<b>-2,345</b>	<b>-1,939</b>	<b>-1,679</b>
<i>of which:</i>												
USSR .....	1,274	919	1,376	956	3,124	2,683	2,418	2,211	-1,850	-1,764	-1,042	-1,255
<b>OPEC .....</b>	<b>7,358</b>	<b>5,026</b>	<b>7,336</b>	<b>4,055</b>	<b>11,891</b>	<b>7,391</b>	<b>15,238</b>	<b>6,962</b>	<b>-4,533</b>	<b>-2,365</b>	<b>-7,902</b>	<b>-2,907</b>
<i>of which:</i>												
Libya .....	1,356	924	1,332	694	2,461	1,528	3,479	2,107	-1,105	-604	-2,147	-1,413
Algeria .....	653	429	832	572	1,542	926	2,478	1,497	-889	-497	-1,646	-925
Nigeria .....	265	185	340	203	1,153	719	1,945	348	-888	-534	-1,605	-145
<b>OTHER .....</b>	<b>16,856</b>	<b>12,706</b>	<b>20,457</b>	<b>14,197</b>	<b>18,800</b>	<b>13,647</b>	<b>24,050</b>	<b>14,207</b>	<b>-1,944</b>	<b>-941</b>	<b>-3,593</b>	<b>-10</b>
<b>Total . . .</b>	<b>59,398</b>	<b>44,614</b>	<b>70,151</b>	<b>49,937</b>	<b>69,533</b>	<b>48,764</b>	<b>87,091</b>	<b>51,088</b>	<b>-10,135</b>	<b>-4,150</b>	<b>-16,940</b>	<b>-1,151</b>

Source: Istat.

observable since the beginning of the previous year has continued.

Net payments on capital income which in 1984 as a whole amounted to 6,855 billion lire, were close to 4,500 billion in the first half of 1985.

Customs data on merchandise trade and estimates for the service sector and transfers indicate a deficit on current account of the order of 7.0 trillion lire for 1985 (Table 11).

#### Capital movements and the exchange rate

In 1985 the overall balance of payments on current account plus non-bank capital

movements, after being substantially in balance in the previous year, shifted to a deficit of 8,518 billion lire, largely reflecting the imbalance on current account. Preliminary estimates for non-bank capital movements show that they yielded a surplus of 1.0 trillion lire more than in 1984 (2,363 trillion). Furthermore, "errors and omissions" account for an outflow of almost 5.0 trillion. On balance, bank capital movements also recorded a deficit, of 5,166 billion (1).

Total external current and capital transactions by nonofficial operators led in 1985 to substantial losses in official reserves. These losses are put at 13,684 billion lire after adjustments for exchange rate movements and the value of gold holdings are taken into account.

**Table 11**  
**Balance of payments on a transactions basis (1)**  
*(billions of lire)*

	1984	1985	1985 1st half	1985 3rd qtr.	1985 4th qtr.
Current account . . . . .	-5,188	-7,000	-10,500		3,500
(memorandum: goods cif-fob)	(-19,163)	(-23,023)	(-16,940)		(-6,083)
Capital movements, errors and omissions . . . .	5,245	-1,500	4,750		-6,250
Overall balance . . . . .	57	-8,518	-5,743	912	-3,687
Bank funds . . . . .	5,138	-5,166	4,193	-4,096	-5,263
Changes in official reserves (2) . . . . .	-5,195	13,684	1,550	3,184	8,950

(1) Data for "above-the-line" items (current account, capital movements, errors and omissions) which are provisional for the first half of 1985 and estimated for the second half, may be subject to substantial revision. — (2) The sign (-) indicates an increase.

Though still incomplete and provisional, January-September data for individual items on non-bank capital account, compared with those for the corresponding period in 1984 (Table 12), show a continuation of the trend that emerged two years ago towards a higher net amount of medium and long-term inflows, contemporaneously with a deterioration in the current account position.

In the period under review, this phenomenon is particularly evident in terms of portfolio investment, which in earlier years, instead, had generally recorded net flows not far from equilibrium. In fact, net inflows over the first nine months amounted to 3.9 trillion, (as against -116 billion in the same period of 1984). Italian investments abroad showed little substantial change over the previous year, producing an outflow of about 450 billion, net of disinvestment, and attributable to purchases of foreign mutual fund shares. On the other hand, new investments in Italy by non-residents more than doubled, reaching 10 trillion lire; the contemporaneous increase in disinvestment limited the net inflows

to about 3,450 billion, which was still markedly higher than the 293 billion lire of the year before. More than two thirds of the gross flows involved transactions in government securities. These movements were chiefly encouraged by the large differentials in nominal yield between comparable Italian and foreign assets and by the growing interest of foreign investors in the Italian financial market. There were, however, momentary interruptions in March and, especially, August when the rapid appreciation of the lira against the dollar presumably induced some foreign investors to sell Italian securities to realize the profits already gained on foreign exchange account, given substantial uncertainty about the future movements of the dollar.

Direct investment flows continued on balance to be negative throughout the period. The net outflows became even larger, rising from 497 billion lire in the first nine months of 1984 to more than 700 billion, mainly as a result of the marked increase in non-residents' disinvestment coupled with a substantial flow of new Italian investment abroad.

International loans, on the other hand, made a noteworthy contribution to the increase in net capital inflows during the period, rising from 2,019 billion lire to 4,800 billion. While lending to the public sector remained unchanged, at nearly 4,000 billion net of repayments, lending to the private sector shifted to a surplus of 900 billion from a negative balance of 1,671 billion lire in the corresponding period of 1984.

Comparing trade data on a settlements basis with the corresponding customs data, it emerges that in the first half of the year sizable net inflows of trade credit took place. As indicated in the previous *Economic Bulletin*, this was basically the result of a shift by Italian importers from foreign exchange borrowing from the banking system, owing to difficulties created by the constraint on banks' net foreign positions, to commercial credit granted by suppliers.

In the last part of the year, expectations of a devaluation of the lira led to an acceleration in repayments of commercial debts, with a resultant outflow of capital that more or less matched the inflows recorded in the first half. The concomitant strong outflows of bank funds brought the total outflow of short-term funds in

Table 12

## Capital movements

(billions of lire)

	Investment/loans		Disinvestment/repayments		Balance (1)	
	1984 Jan.-Sept.	1985 Jan.-Sept. (2)	1984 Jan.-Sept.	1985 Jan.-Sept. (2)	1984 Jan.-Sept.	1985 Jan.-Sept. (2)
<b>Direct investment</b>						
Foreign capital .....	1,556	1,850	300	1,350	1,256	500
Italian capital .....	2,034	1,500	281	250	-1,753	-1,250
Total .....					-497	-750
<b>Portfolio investment</b>						
Foreign capital .....	4,190	10,000	3,893	6,550	297	3,450
<i>of which:</i>						
government securities .....	2,592	7,050	2,711	4,500	-119	2,550
Italian capital .....	1,369	1,400	956	950	-413	-450
<i>of which:</i>						
foreign mutual fund shares ...	819	1,000	300	550	-519	-450
Total .....					-116	3,900
<b>Loans</b>						
Foreign capital .....	10,478	14,700	8,459	9,900	2,019	4,800
public .....	4,936	6,400	1,246	2,500	3,690	3,900
private .....	5,542	8,300	7,213	7,400	-1,671	900
Italian capital .....	1,496	1,200	559	500	-937	-700
Total .....					1,082	4,100

(1) The sign (-) indicates an outflow. — (2) Provisional and partly estimated data, excluding operations without foreign currency movements.

the last quarter to almost 10 trillion lire, with direct repercussions on official reserves (see insert).

The net external creditor position of the Bank of Italy and the Italian Foreign Exchange Office, equal to 81,813 and 82,405 billion lire at end-1984 and mid-1985 respectively, amounted at end-December 1985 to 65,180 billion. Expressed in US dollars, it declined from 42.3 to 38.8 billion over the period in question. In particular, holdings of convertible currencies and ECUs fell from 36,953 billion lire at end-1984 to 23,541 billion at end-1985 (from 19.1 billion to 13.0

billion dollars). The loss of official reserves recorded in the second half was almost equal to the loss for 1985 as a whole; the loss in December alone came to one third of the total.

In the course of 1985 the effective exchange rate of the lira depreciated by 1.2 per cent. This was the result, on balance, of a 9.6 per cent devaluation in relation to EEC currencies as a whole, offset almost entirely by an appreciation of 16.2 per cent against the dollar. The lira maintained its position within the EMS in the two months following the July realignment, a little above the narrow fluctuation band. From

### Developments in official reserves and the measures of 16 January 1986

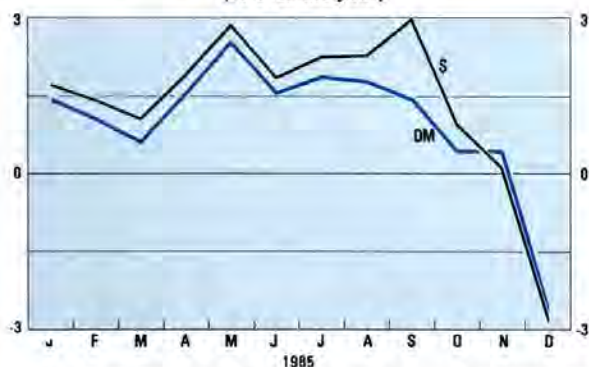
Losses in official reserves in 1985 were largely concentrated in the last months of the year.

In the first half, the large deficit on current account was financed almost entirely with the net inflow of investments and loans and the increase in trade debts.

In the period July-September, the improvement in trade and net receipts from tourism helped to produce an overall surplus of almost 1 trillion lire. At the same time, the banking system was requested by the Bank of Italy and the Foreign Exchange Office to bring its net external liability position within the limits established a year earlier (a measure prompted largely by problems of liquidity and credit control): at end of June these limits had been exceeded by more than 5 trillion lire. In the third quarter, there were outflows of bank capital which helped to make up for four-fifths of this overshooting. However, the above-mentioned overall surplus limited reserve losses to a little more than 3 trillion lire.

In the last quarter of the year, the balance of payments on current account, though shifting back into deficit, continued to show an improvement compared with the first half. On the other hand, the situation with regard to capital movements changed drastically. The accentuation of the dollar's decline helped to nourish expectations of an imminent realignment of EMS central rates and, in particular, of a devaluation of the lira against the ECU. The 3-month discount of the lira on the Deutschmark increased on an annual basis by more than three points between September and December, creating an inversion of the sign of the cover differential at a time when the nominal interest rate differential between the lira and the Deutschmark showed a slight decline.

3-month interest cover differential  
between lire, D-marks and dollars (1)  
(% over the year)



(1) For lire: minimum bank lending rate; for D-marks and US dollars: rate on Eurodeposits.

Similar movements were recorded between the lira and the dollar.

Italian traders reduced their foreign debtor position and expanded their credit position. At the same time, they converted into lire part of their existing foreign currency liabilities to the banks; as a result, the banks reduced their own net external liabilities, from 30,273 billion lire at end-September (still somewhat over the ceiling) to 27,650 billion two months later. On 5 December, the limit was removed. At year-end, the net position had fallen to 24,459 billion lire.

These actions by Italian firms — together with likely changes in the foreign currency composition of the portfolios of some foreign investors to the disadvantage of Italian securities (the same which had been heavily subscribed in the first part of the year) — created by the end of 1985 a substantial excess supply of lire on foreign exchange markets. This was almost entirely covered by the interventions of the Bank of Italy, in order to minimize changes in the lira exchange rate in the EMS. To facilitate these interventions, agreements were reached with the other European central banks so that foreign currency reserves could be better structured. In late December, recourse was made to the mechanism for mobilizing official ECU holdings provided for in the framework of agreements for reinforcing the EMS established last June among EEC central banks; as a result of the operation (in the form of 3-month swaps with the European Monetary Cooperation Fund) official ECU holdings were reduced by about 4,862 billion lire and holdings in convertible currencies increased by the same amount. Overall losses in official reserves in the last quarter exceeded 9 trillion lire, of which more than 4.5 trillion occurred in December.

Persistently strong pressures on the foreign exchange market in the first two weeks of January resulting in a further loss in reserves of 2 trillion lire, induced the authorities to introduce foreign exchange, credit and financial measures with the aim of directly influencing the underlying forces.

In particular, foreign exchange measures — which accompanied the establishment of a ceiling to the growth of lire bank loans for the first half of the current year and the rise in interest rates on short-term government securities (see below) — consisted of re-introducing a 75 per cent foreign currency financing requirement on export credits up to 18 months and requiring importers not to settle their trade debts in advance.

Conditions in the foreign exchange market have changed rapidly, permitting a substantial rebuilding of official reserves.

end-September, contemporaneously with the renewed decline of the dollar, the lira fell back somewhat, so that by early December it had reached the center of the band.

From the end of 1985 to 19 February the lira further appreciated against the dollar, by 6.7 per cent. However, it remained virtually stable within the EMS, with limited fluctuations in the upper part of the narrow band. The foreign exchange, credit and financial measures taken on 16 January removed the downward pressures on the lira and

brought about some rebuilding of official reserves (see insert).

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(1) The substantial totals for items recorded as "errors and omissions" is attributable to the same kinds of phenomena, described in the last Bulletin, which gave rise to those which emerged last year, of opposite sign but equally large. It was pointed out on that occasion that, at the end of 1984, data on movements of bank funds did not pick up a part of the flows of funds, causing the omission to appear instead in the residual items included "above-the-line". Last spring, the introduction of new surveys brought to light the real extent of the banks' foreign debt. Therefore, it was necessary to take account, in those months, of assumed flows of bank funds and, correspondingly, "errors" of negative sign.

## Public finances

### A first look at 1985

The borrowing requirement of the state sector, net of settlements of past debts, amounted to 108.8 trillion lire. The original target for this aggregate, set in September 1984, was 96.3 trillion, which was subsequently raised to 99.9 trillion in February 1985. The borrowing requirement also exceeded, albeit only by a small amount, the 106.7 trillion outturn projected by the Treasury last September. This overshoot can be attributed to an extension to 1986 of the deadline for applications for the condonation of building offences and the related payments.

Current expenditure net of debt interest rose faster than consumer prices, the rate fixed as the target for this aggregate in the Government Forecasting and Planning Report. As will be shown in the next section, the growth in expenditure was primarily attributable to the rate of increase in spending on pensions and health care. Taxes in relation to GDP remained unchanged compared with 1984, in line with the projection of the aforementioned Report. This result was achieved even though some of the measures introduced in 1985 generated less additional revenue than expected while others

scheduled for introduction during the year did not materialize. The favourable outcome was due to several direct taxes having produced substantially larger revenues than originally forecast in the budget.

The total borrowing requirement, which includes not only settlements of past debts in cash (2.15 trillion lire in respect of local health units' trade debts) but also those in securities (10.4 trillion), amounted to 121.35 trillion lire. The settlements in securities include: 4.84 trillion in respect of the refund of the flat-rate withholding tax on deposit interest paid by the banking system in excess of their corporate income tax liabilities from the mid-seventies on (in assessing the growth of the borrowing requirement it would be more accurate to divide the above total among the years in which the tax credits accrued); 5.13 trillion in respect of health insurance institutions' and local health units' bank debts taken over by the state sector, which do not involve any increase in the public sector borrowing requirement since they had already been included in its accounts when the debt was incurred; and 0.43 trillion in respect of debts of port authorities and opera companies, which are not part of the public sector as defined in the Bank of Italy's statistics.

Table 13

### State sector borrowing requirement (billions of lire)

	1984			1985		
	1st half	2nd half	Year	1st half	2nd half	Year
Net of settlements of past debts . . . .	38,286	57,065	95,351	51,736	57,064	108,800
<i>as a % of GDP</i> . . . . .			(15.6)			(16.0)
Payments in cash . . . . .	—	—	—	1,769	380	2,149
Payments in securities . . . . .	—	—	—	2,195	8,208	10,403
Total borrowing requirement . . . . .	38,286	57,065	95,351	55,700	65,652	121,352
<i>as a % of GDP</i> . . . . .			(15.6)			(17.8)
Total borrowing requirement net of debt interest . . . . .	12,230	25,528	37,758	25,457	34,696	60,152
<i>as a % of GDP</i> . . . . .			(6.2)			(8.8)



As a ratio to GDP the general government deficit on current and capital account (national accounts basis) rose compared with 1984 by around half a point, to 14.1 per cent. Net of interest payments the increase in the ratio was larger, from 3.9 to 4.7 per cent.

The expansion of the public sector debt in real terms, which takes account of the loss of purchasing power incurred by holders of the debt (and thus permits an assessment of the fiscal stimulus to economic activity), continued at the high rate reached in 1984.

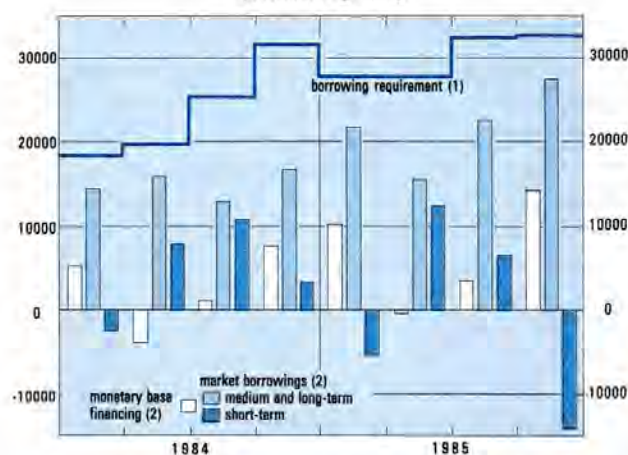
The growth in the state sector borrowing requirement (net of settlements of past debts) was concentrated in the first half of the year. Through June this borrowing requirement amounted to 51.74 trillion lire (as against 38.29 trillion in the first half of 1984), while the 57.06 trillion recorded from July to December was virtually the same as last year's second-half total. This pattern reflected a number of mainly temporary factors, including: a) the postponement to the beginning of July of the first instalment of the withholding tax on deposit interest falling due in 1985 (in 1984 more than half the corresponding amount was paid in June); b) the transfer to the Treasury in the second half of the year (under Decree Law 356/1985, which was resubmitted and then ratified on 31.1.1986) of a part of the proceeds of loans granted by special credit institutions to local authorities and held by the latter on deposit with the same institutions (in 1984 the measures providing for non-state public bodies' bank deposits to be transferred to the Treasury produced their effects primarily in the first half of the year); c) the reduction in debt interest payments in the second half of the year owing to the issue of Treasury credit certificates carrying an annual instead of a half-yearly coupon (in the second half of 1984 these payments rose sharply compared with the first six months, when very large issues of these certificates were made); and d) the introduction in July of measures to reduce the amount of social security contributions charged to the budget and speed up the payment of contributions to INPS.

Around 76 per cent of the 1985 state sector borrowing requirement (net of PO deposits) was financed with medium and long-term debt (consisting mainly of securities placed with the

market), compared with 67 per cent in 1984 (Figure 10). In the first part of the year such financing accounted for around 69 per cent of the total, central bank financing for around 18 per cent, and other short-term debt for 13 per cent. In the second half of the year the proportion of medium and long-term debt rose to around 83 per cent. This increase was matched by a reduction in short-term debt, roughly equivalent to the rise in the first half of the year, and an expansion of central bank financing to 30 per cent of the total. This expansion came primarily in the fourth quarter and, especially in October and December, was mainly in the form of securities purchases.

Figure 10

**State sector borrowing requirement and its financing**  
(billions of lire)



(1) Gross of settlements of past debts. — (2) Excluding Post Office deposits.

**The main items of the public accounts**

The preliminary data prepared by Isco show that the aforementioned increase in the general government's net indebtedness relative to GDP can be attributed in large part to the growth in expenditure, and above all to that in current expenditure. Net of interest payments, the latter recorded a substantial rise of 13.2 per cent, which exceeded the growth in GDP by two points (Table 14).

Spending on social services increased by nearly 15 per cent, as against 11 per cent in 1984. This outcome was the result of: the re-emergence of underlying expansionary trends, which had

Table 14

**General government income statement**  
(billions of lire; % changes)

	1984	1985	1984 1983	1985 1984
<b>EXPENDITURES</b>				
Wages and salaries . . . . .	86,336	95,500	14.1	10.6
Intermediate consumption . . . . .	35,031	40,000	16.2	14.2
Social services . . . . .	119,649	137,500	11.0	14.9
Production subsidies . . . . .	16,032	17,900	17.6	11.7
Debt interest . . . . .	58,969	64,000	21.3	8.5
Other . . . . .	8,338	9,500	15.2	13.9
<b>Total current expenditures</b> . . . . .	<b>324,355</b>	<b>364,400</b>	<b>14.6</b>	<b>12.3</b>
<i>as a % of GDP</i> . . . . .	<i>53.0</i>	<i>53.5</i>		
Investment . . . . .	25,232	28,900	12.3	14.5
Investment grants . . . . .	13,532	15,000	36.3	10.8
Other capital expenditure . . . . .	3,512	3,000	204.6	-14.6
<b>Total capital expenditure</b> . . . . .	<b>42,276</b>	<b>46,900</b>	<b>26.0</b>	<b>10.9</b>
<b>Total expenditure</b> . . . . .	<b>366,631</b>	<b>411,300</b>	<b>15.8</b>	<b>12.2</b>
<i>as a % of GDP</i> . . . . .	<i>59.9</i>	<i>60.4</i>		
<b>REVENUES</b>				
Direct taxes . . . . .	93,789	105,500	12.5	12.5
Indirect taxes . . . . .	69,460	76,000	15.0	9.4
Social security contributions . . . . .	99,441	111,000	13.1	11.6
Other . . . . .	19,996	21,800	14.3	9.0
<b>Total current revenues</b> . . . . .	<b>282,686</b>	<b>314,300</b>	<b>13.4</b>	<b>11.2</b>
Capital revenues . . . . .	1,050	1,100	32.1	4.8
<b>Total revenues</b> . . . . .	<b>283,736</b>	<b>315,400</b>	<b>13.5</b>	<b>11.2</b>
<i>as a % of GDP</i> . . . . .	<i>46.4</i>	<i>46.3</i>		
<b>Net borrowing</b> . . . . .	<b>82,895</b>	<b>95,900</b>	<b>24.3</b>	<b>15.7</b>
<i>as a % of GDP</i> . . . . .	<i>13.5</i>	<i>14.1</i>		
Borrowing net of debt interest . . . . .	23,926	31,900	33.1	33.3
<i>as a % of GDP</i> . . . . .	<i>3.9</i>	<i>4.7</i>		

Source: Isco.

been damped by the effects of the measures taken in 1983 to reduce spending on pensions and family allowances; the considerable improvements in both private and public sector pension schemes approved in April 1985; and the payment of the balance of cost-of-living allowances corresponding to the difference between the actual and target inflation rates in

1984. Thus, even though pensions were raised during the year in accordance with the 7 per cent target inflation rate, total spending on this item increased twice as fast. Health care spending rose even faster, by 25 per cent. This was primarily due to the renewal of health service family doctors' labour contract, which also entailed the payment of arrears for 1984. By contrast, there was a relatively small increase in the other social service items, including payments by the Wage Supplementation Fund, which were curbed by a reduction in the number of hours authorized.

Wages and salaries in the public sector increased by 10.6 per cent. Net of imputed social security contributions, the figure was 9.8 per cent. When account is taken of the growth in employment, estimated at over 0.5 per cent, per capita earnings appear to have risen in line with consumer prices. The contribution of the *scala mobile* to the growth in per capita earnings amounted to around 4 percentage points, while the third and last increase in base pay foreseen by the public sector's labour contract produced another 2 percentage points. A decisive contribution to the rise in gross earnings thus came from the other components of wages, of which automatic seniority bonuses and promotions are two of the most important.

Debt interest increased less than GDP, rising by 8.5 per cent, compared with 21.3 per cent in 1984. The increase was particularly moderate in the second half of the year. In the medium and long-term sector the issue of Treasury credit certificates with annual coupons shifted an interest burden of 3.8 trillion lire from the second half of 1985 to subsequent years. This resulted in the interest on these securities, which are now the most important financial market instrument, growing by 8.4 per cent in the year as a whole (as against 28 per cent in the first six months). In the short-term sector the effect of the larger volume of Treasury bill issues was fully offset by the decline in interest rates. The corresponding interest burden rose by around 3 per cent in the second half of the year after falling by an equal amount in the first half. The containment of interest payments was also due to the substantial drawings made by the Treasury on its overdraft account with the Bank of Italy, which bear a charge of 1 per cent. One factor tending to push up debt interest was the capitalization of interest

accrued on PO savings, which as from September 1984 have qualified for the higher rates established by the Treasury Decree of 15 June 1981.

Expenditure on capital account grew by 10.9 per cent, which was less than the rise in current expenditure. This result reflected the reduction in the activity of the Southern Italy Development Fund since the launching in August 1984 of the procedure for its liquidation.

According to the preliminary estimate, general government revenues increased from 283.74 to 315.40 trillion lire, or at the same rate as GDP (11.2 per cent). The tax burden, based on direct and indirect taxes and actual social security contributions, thus remained at 41.1 per cent of GDP, the level reached in 1983.

Direct taxes, rising by 12.5 per cent, remained virtually unchanged in relation to GDP. This was the result of two offsetting movements: an upward one fuelled by the fiscal drag on personal income together with the improvement in company profitability in 1984; and a downward one reflecting the fall in revenues from the withholding tax on interest income and the drying up of fiscal condonation receipts. Indirect taxes increased by only 9.4 per cent.

Budget fiscal revenues (net of accounting transactions with the special statute regions and of VAT receipts used for reimbursements and for EEC levies) are provisionally estimated to have risen to 174 trillion lire, an increase of 11.7 per cent. This confirmed the forecast in the October issue of the Economic Bulletin that these revenues would accelerate in the second half of the year so as to exceed the projection of the revised budget presented in June (171 trillion lire).

Among the direct taxes, corporate income tax revenues recorded a large increase (17 per cent). As previously mentioned, this was attributable in large part to the improvement in gross profits in 1984. Personal income tax revenues increased even more (22 per cent). This result benefited from the revision of the coefficients for the calculation of imputed property income and, to an even greater extent, from the expiry of the reductions in local personal income tax granted when the municipal surtax on buildings was introduced. The elasticity of the income tax withheld on employee incomes with respect to

earnings in the private sector was the same as in 1984 (around 1.8), while the higher incomes of proprietorships and partnerships contributed to the increase in self-assessed income tax.

The revenues from the withholding tax on interest income decreased from the 15.77 trillion lire recorded in 1984 to 14.00 trillion (which was nonetheless more than the original official forecast). Though the base was virtually stationary compared with 1984, since the growth in deposits was offset by the fall in interest rates between 1983 and 1984, a part of the revenues assigned to 1985 were collected in 1984 as a result of the increase in the coefficient of banks' advance instalment payments.

Among the indirect taxes, VAT revenues increased by nearly 10 per cent in total, with the domestic component rising by 12 per cent. The measure introducing conventional assessment of VAT for taxpayers who opt to keep simplified accounts made a small contribution to this result. The first quarterly payment under the new system was in May, when an increase of 11 per cent was recorded, suggesting the measure had made no impact. The August payment was more encouraging with revenues rising by nearly 20 per cent, and in November the rise was only slightly less. It should nonetheless be borne in mind that, as mentioned in the October Economic Bulletin, the effects of the measure are probably being obscured by the use taxpayers are making of the tax credits they had accumulated in the past.

As regards the other taxes on business, registration taxes and stamp duties produced virtually no extra revenues, but there was a substantial increase in radio-television fees (30 per cent) and an even larger one in that from government concessions (75 per cent), primarily as a result of the large rise in company registration fees.

Among the other indirect taxes, the higher revenues from state monopoly goods (up by around 10 per cent) primarily reflected the increases of about 8 per cent in the specific duties on tobacco products in December 1984 and October 1985. By contrast, the receipts from oil products rose sluggishly (5 per cent), notwithstanding the higher average level of the tax. This result can be attributed to the small growth in the consumption of petrol (1 per cent).

Despite the drying up of the flow of social security condonation payments, the growth in paid-in contributions (around 11 per cent) was almost the same as that in employee incomes. The loss of condonation payments was offset

by the cutback, as of the beginning of June, in contributory relief and by the measures taken to recover the credits of social security institutions and speed up the payment of contributions.

## Money and financial markets

### Monetary policy

The action to curb monetary expansion, undertaken at the beginning of the second quarter, helped over the following months to bring the growth of bank deposits back to a path consistent with the targets for the year. Up to November lending to the economy continued at growth rates substantially below the targeted objectives. Thus in late summer it proved possible to resume the gradual lowering of interest rates, which had been halted in April by the increase in the yields on government securities.

In mid-November, the lira suddenly came under pressure with respect to other EEC

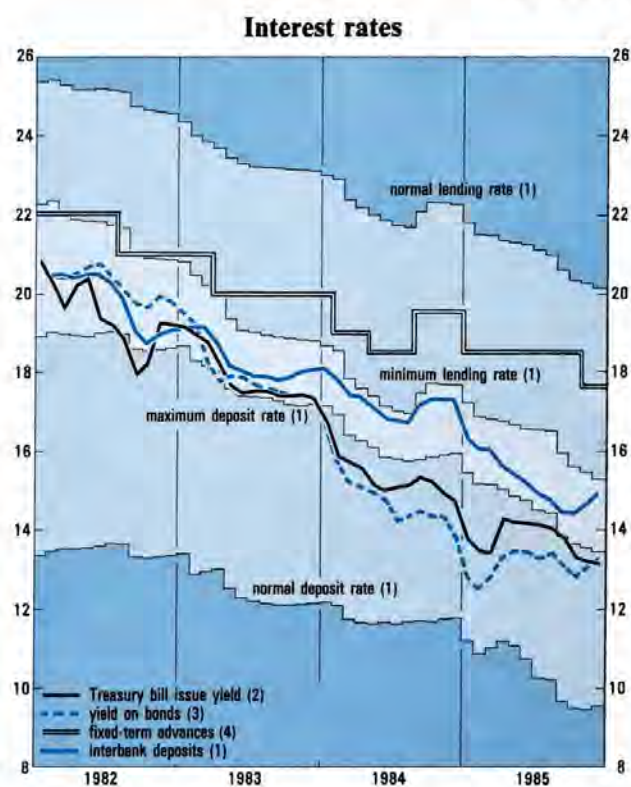
currencies, and the pressure intensified in December. With the steepening decline of the dollar, there were widespread expectations in international foreign exchange markets of a realignment of the central parities of the EMS, which also involved the lira. These expectations led exchange market operators to diminish their debt exposure, and to expand their credits, in foreign currencies, drawing on lines of credit in lire and running down deposits. The result was a significant loss of foreign exchange reserves, amounting to 3.0 trillion lire in November, mostly in the second half of the month, and 4.5 trillion lire in December.

Table 15

	Monetary base (changes in billions of lire)			
	1984		1985 (1)	
	Sept.-Dec.	Year	Sept.-Dec.	Year
<b>Sources</b>				
Foreign sector . . . .	1,842	5,141	-11,774	-14,092
Treasury . . . . .	6,694	10,028	15,002	27,629
<i>Borrowing requirement</i> . . .	41,852	95,351	47,547	121,352
<i>Placement of securities</i> . . .	-28,374	-75,410	-26,491	-83,727
<i>Other financing</i> . . . . .	-6,784	-9,913	-6,504	-9,998
Refinancing . . . . .	-190	-218	5,644	5,877
Other sectors . . . . .	1,250	-1,104	2,402	-369
<b>Total</b> . . . . .	<b>9,596</b>	<b>13,847</b>	<b>11,274</b>	<b>19,045</b>
<b>Uses</b>				
Currency in circulation . . . .	4,860	3,861	4,682	4,509
Bank reserves . . . . .	4,736	9,983	6,592	14,536

(1) The data are affected by industrial action by Bank of Italy personnel and are partially estimated.

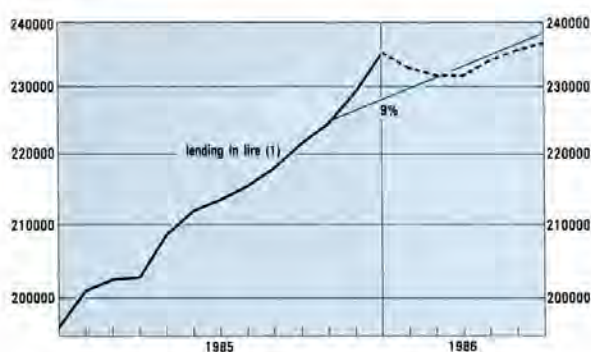
Figure 11



- (1) Based on returns made every ten days (see Table a27 in the Appendix).  
 (2) Weighted average of the yields on 3, 6 and 12-month Treasury bills.  
 (3) Average yield in the secondary market on industrial credit institution bonds.  
 (4) Maximum rate.

### The ceiling on bank lending

The ceiling on bank lending for the first half of 1986 imposed by the Bank of Italy on 16 January provides for a return, as early as the end of March (see figure), to a 9 per cent growth path starting from last October. During the first two months of the year lending should decline at an annual rate of 13 per cent. Nonetheless, it is estimated that more than half the banks subject to the ceiling can still increase their lending during these months, not having expanded their lira lending particularly fast in November and December.



(1) Seasonally adjusted data on bank lending in lire subject to the ceiling; semi-logarithmic scale; in billions of lire.

The ceiling covers loans in lire, acceptances negotiated, bad debts, overdue and protested bills, and compulsory storage agency financing; it grants no exemptions on the basis of the size of the loan or the residence of the borrower. The only exemptions from

the limit are the lending of funds administered for third parties and refinancing with the Fund for Credit to Artisanal Enterprises.

The reference base is the average of the end-September and end-October levels of the aggregate subject to the ceiling. Averaging attenuates the accidental variations in end-period figures. Moreover, the two months chosen show a seasonal pattern that does not differ greatly between banks. The percentages of growth over this base allowed by the ceiling are as follows:

January:	8 per cent
February:	6 per cent
March:	6 per cent
April:	7 per cent
May:	6 per cent
June:	6 per cent

The penalties for exceeding the ceiling are designed to offer some flexibility to those banks whose lending is not very much above the limit. For violations exceeding 1 per cent, banks must make non-interest-bearing deposits with the Bank of Italy as follows: of 40 per cent of the amount of overshoots up to 3 per cent; of 80 per cent of the amount of overshoots between 3 and 6 per cent; and of 100 per cent of the amount above 6 per cent. In order to permit a gradual return within the lending growth limits, for January alone the overshoot exempt from the deposit requirement was increased to 2 per cent, and the amounts of the deposits required were less substantial.

This outflow of monetary base led to a tightening of bank liquidity, which was reflected in decreased demand for government securities. Net of debt consolidation, issues of government securities in September-December fell short of those in the last four months of 1984 by more than 7 trillion lire, while the Treasury's borrowing requirement was 700 billion lire larger. The central bank intervened, refinancing the system at progressively higher interest rates. Through this channel some 5.6 trillion lire of monetary base was created in the last four months of 1985 (Table

15). Between 2 and 3 trillion lire of this increased refinancing, however, was due to anomalies in the working of the money market, which will be described below.

The deposit taking institutions, despite the very rapid growth of demand for loans in lire and the increased cost of refinancing, considerably reduced their lending rates, thus encouraging the substitution of financing in lire for debt denominated in foreign currencies (Figure 11). The acceleration of lending in lire was one of the most explosive in the past two decades; after

### The overnight deposit market

*The Italian interbank market suffers from a number of limitations that are generally agreed to constitute an obstacle to its efficient working. The fact that some banks are permanent suppliers of funds and others structural borrowers produces one-way flows of funds between banks. What is more, interbank deposits tend to be a stable form of investment of available finance rather than an instrument for the daily adjustment of banks' cash positions.*

*When liquidity conditions were tight in the past, the funds were not in practice available immediately. The advance notice required to move interbank deposits, generally of 48 hours, was an obstacle to the promptness of transactions. From this stemmed a certain sluggishness of interest rates in adapting to changed conditions in the money market.*

*In the last few years the need to optimize the liquidity management of individual banks and of the credit system as a whole has become more pressing as a result of the control of the monetary base exercised by the Bank of Italy. On some occasions the unequal distribution of liquidity within the banking system has required last-resort lending despite levels of total free reserves that were not particularly low. This proved steadily more burdensome for the credit system because of the rising cost of refinancing. Overnight deposits therefore moved in to fill the gap, providing a truly "sight" component to the money market. Thus a market was created for the free reserves with the*

*central bank, enabling each bank to rectify imbalances in its daily cash position immediately.*

*Overnight deposits are made the same day as they are negotiated and withdrawn on the next business day. Capital movements are settled through the clearing system, while interest is paid daily by the banks through their service accounts and, like that on other interbank deposits, is subject to a 25 per cent withholding tax. Passing through the clearing system, overnight deposits are forced to respect the system's time constraints — most of the negotiations for the deposits therefore take place in mid-morning, and all agreements are finalized by about 12.30.*

*Technically, the market operates through the network organized by Reuters in 1979 at the request of the Bank of Italy to serve domestic banks. The service permits real time communication of the operating positions of the members of the overnight market. The participant banks can interact with supply (letters) or demand (money), modify the terms, and initiate and terminate transactions. Several credit intermediaries had formulated projects for the installation of this market from as early as 1981 and these were subsequently developed by the Bank Treasurers Association (Associazione Tesorieri Istituzioni Creditizie). After a series of trials and refinements, operations began in April 1982.*

*The new market has grown rapidly. A sample survey found that in 1984 a monthly total of about 40 intermediaries participated in the overnight market; in*

strong growth in November, the volume of lira lending increased by about 14.5 trillion lire in December, corresponding to an annual rate of over 60 per cent.

Hand in hand with this upsurge in lira lending there was a decline in foreign currency lending and a sharp contraction in deposits. The divergent movement of loans and deposits in lire was compensated for in banks' balance sheets not only by increased refinancing but also by a reduction in portfolio holdings of Treasury bills.

An adjustment of the lira's exchange rate with respect to other European currencies would not have been justified, given Italy's gain in competitiveness following the July realignment and the encouraging outlook for the balance of payments on current account. Moreover, devaluation would have entailed the risk of a recrudescence of inflation, making it impossible, in particular, to take full advantage of falling energy prices and the decline of the dollar.

In the face of widespread expectations of devaluation, increases in interest rates sufficient

1985 the number of active participants rose to about 70. The volume of funds changing hands has also risen substantially, from a monthly average of 2 trillion lire in 1983 to 6.5 trillion in 1984 and 10 trillion in 1985. Finally, the volume of deposits negotiated daily is estimated to have risen from 300 billion lire in 1984 to about 450 billion in 1985, with peaks as high as 2 trillion.

Since this is a sight market, overnight interest rates are highly erratic. In normal conditions their range is bounded at one end by the rate of remuneration on deposits of free reserves with the Bank of Italy, 0.50 per cent, and at the other by the cost of fixed-term advances, including any penalty charges. Under some circumstances, however, and in particular when central bank refinancing is rationed, the rates on overnight deposits may exceed those on last-resort lending. In 1985 overnight deposit rates ranged from a minimum of 3.5 per cent to a maximum of 18 per cent, with the bulk of the daily readings (57 per cent) concentrated between 13.3 and 18 per cent.

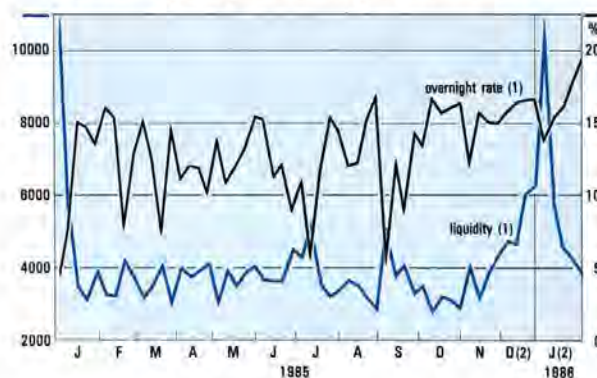
Interest rates have been negatively correlated with the level of free reserves in the banking system (see figure). Interest rate peaks came in periods of tight control of free reserves and coincided with certain technical deadlines, such as those for the settlement of purchases of government securities issues and the transfer to the government of tax revenues and social security contributions collected by banks.

Overnight interest rates were high, on average, for the entire fourth quarter of 1985. In January 1986 they

repeatedly exceeded the maximum rate on fixed term advances, currently 17.25 per cent.

The progressive enlargement of the overnight market, and especially more constant participation by the larger banks, should further improve banks' liquidity management and promote a more rational distribution of free reserves. In fact, depending on interest rate conditions it may be profitable to use the margins available on advance accounts to lend in the overnight market, or else to borrow in order to limit resort to advances.

**Banks' liquidity and overnight interest rates**



(1) Weekly averages of daily figures; liquidity, in billions of lire, has a seasonal peak in the first week of the year because of substantial deposits by the Treasury on 1st January for coupon payments and redemption of maturing securities. — (2) The liquidity data for December 1985 and January 1986 are affected by the industrial action of Bank of Italy employees and are partially estimated.

to ease the pressure on Italy's foreign exchange reserves would have had to be very sharp indeed, and they would have had less immediate impact than direct controls. Also, very sharp rises in interest rates would have had considerable restrictive effects on domestic demand, which are not called for in the present cyclical phase, and would have swelled the government deficit still further. To halt the drain on reserves it was therefore decided, on 16 January, to take several direct measures aimed specifically at the activity that had given rise to the lira's difficulties in the foreign exchange markets.

The foreign exchange measures described elsewhere in this *Bulletin* (see insert, p. 29) were enacted. The Minister of the Treasury raised the yield on Treasury bills in order to alter the relative attractiveness of investment in lire and in foreign currencies. The rise, which was concentrated at the very short end of the market, brought average interest rate levels on Treasury bills back nearly to those of September 1985. The Bank of Italy imposed a ceiling on bank lending in lire for the first half of 1986, designed to counteract the effects of the abnormal bulge



in November and December and put credit expansion back on a growth path consistent with the targets for this year (see insert, p. 37). The central bank also invited industrial credit institutions not to substitute themselves for the banks in enterprise financing by stepping up their short-term lending.

In September and October bank liquidity fell below its average for the first part of the year concomitantly with the efflux abroad of about 4.2 trillion lire in monetary base. In part, the outflow was connected with the reduction in banks' net foreign debt, which the authorities had requested during the summer in order to hold down the expansion of domestic credit and, by increasing the market supply of foreign exchange, it contributed to the concerted international intervention aimed at lowering the exchange rate of the dollar. In early October the Minister of the Treasury modified the criteria governing compulsory reserves against non-residents' bank deposits in lire, making the ratio calculable against average values, not those for the last day of the month.

In October, in its refinancing of the system through repurchase agreements, the Bank of Italy supplied less than the amounts demanded, with the result that peak overnight deposit rates were very high, and from the end of the month interbank deposit rates began to rise as well (see insert).

The placement of government securities in September and October was facilitated by the deposit taking institutions' decision in late August to lower their interest rates, which put the differential between the yield on Treasury bills and the rate on bank deposits at its maximum for the year. Following a resumption in the demand for government securities, the Treasury, through a series of adjustments of the floor prices of Treasury bills, lowered their yields by 0.7 points. With the decline in interest rates on Treasury bills, the differential between these and the discount rate reached an exceptionally high 2.3 percentage points, as compared with an average differential of 0.7 points in 1984. In early November, therefore, the discount rate was also lowered by half a percentage point.

Starting in the second half of November, when as earlier noted the sudden emergence of

exchange market tensions led to a substantial loss of foreign exchange reserves, the central bank further tightened bank liquidity. At the same time, difficulties were encountered in financing the state borrowing requirement in the market. At the Treasury bill auction in November demand was insufficient to take up the entire issue, and by the end of the month the Treasury had exceeded its overdraft limit with the Bank of Italy by 2 trillion lire. The receipts from the payment of self-assessed taxes due in November and the good response to the early-December issue of Treasury credit certificates made it possible to bring the overdraft back under the limit within the twenty days established by law.

In December, in the face of the substantial loss of foreign exchange reserves, the Bank of Italy further raised interest rates on its repurchase operations. In order to counter the interruptions in the clearing house service due to trade union action and to ensure the working of the payments system, an increase in refinancing to the system was permitted. Bank liquidity rose again, although it was unequally distributed among the different banks. Net of fixed-term advances and temporary securities purchases, liquidity declined to reach a negative value averaging more than 9 trillion lire. The extremely tight liquidity situation of the banks was reflected in overnight rates, which rose to their highest levels of the year.

Table 16

**Monetary aggregates**  
(annualized % changes) (1)

	1984		1985 (2)	
	Sept.-Dec.	Year	Sept.-Dec.	Year
Bank reserves (3) ..	21.4	14.0	26.5	17.3
Monetary base (3) .	17.4	12.5	18.4	14.6
Bank deposits . . . . .	14.2	11.6	3.3	10.2
Money supply net of CDs (M2A) . . . . .	11.3	11.2	2.4	10.2
Money supply (M2) .	13.0	12.1	4.5	11.2

(1) Seasonally adjusted. — (2) Provisional data. The data on bank reserves and the monetary base are affected by the industrial action of Bank of Italy employees in late 1985. — (3) Corrected for the change in the compulsory reserve ratio.

Over the year as a whole the monetary base expanded by 14.6 per cent (Table 16). However, this figure is affected by the unusual factors described above, which artificially swelled bank liquidity at the end of the year. Using as a reference the twelve months up to the end of January 1986, which are less distorted by such factors, the growth of the monetary base registered in 1985 is nearly three percentage points less than that of 1984 (about 10 per cent as against 12.7 per cent).

At the start of 1986 the central bank tightened its restrictive grip on bank reserves, causing interest rates on very-short-term money market instruments to rise still further. This action accompanied the measures of 16 January. Starting in mid-January the foreign exchange market first returned gradually to a more balanced position and then, more recently, made possible some recovery of foreign exchange reserves.

### The credit and financial markets

The sharp rise in lira lending towards the end of the year was reflected in an acceleration of domestic credit to the non-state sector, influenced in some degree by the modest resumption of productive activity (Figure 12). The expansion of credit to this sector, which had amounted to 10.1 per cent between January and November, finished the year at 12.6 per cent, which was in any case three percentage points less than in 1984. If the end-year accounts are adjusted for the abnormal expansion of lira lending in November and December, the deceleration can be put at more than five full points. The main causes of the slowdown were firms' improved self-financing capacity and the decreased attractiveness, on fiscal grounds, of borrowing in order to invest in government securities.

The public debt continued to expand rapidly, by about 22 per cent, or approximately the same pace as that recorded up to August. For the year as a whole the state sector borrowing requirement greatly exceeded the amount consistent with the planning targets set in September 1984. The expansion of total domestic credit thus exceeded the 16 per cent limit set at that time by nearly two percentage points, reaching 151.7 trillion lire.

Figure 12

### Total domestic credit, lending to the non-state sector and financial assets (twelve-month % changes)



(1) The non-state sector's domestic financial assets, net of shares.

The deceleration in the growth of the money supply (M2) became stronger in the later months of the year and in December turned into an actual decline, seasonally adjusted. This contraction was largely due to firms' greater use of liquidity in lire to repay debts in foreign currency. However, accidental distortions stemming from interruptions in the clearing service may also have been a factor. For the year as a whole the rate of expansion was 11.2 per cent, almost one percentage point less than in 1984 (Tables 16 and

18). The narrower aggregate excluding bank CDs (M2A) grew by 10.2 per cent. By November, these two aggregates had expanded by 13.4 and 12.3 per cent respectively.

Table 17

**Total domestic credit**  
(seasonally adjusted, annualized % changes)

	1984		1985	
	Year	Jan.-Aug.	Sept.-Dec.	Year
Bank lending (1) . . . . .	17.5	10.5	25.5	15.3
Special credit institution lending . . . . .	13.6	6.7	12.5	8.6
Net bond issues . . . . .	8.9	8.1	6.0	7.4
<b>Non-state sector financing (1) . . . . .</b>	<b>15.6</b>	<b>9.0</b>	<b>20.5</b>	<b>12.6</b>
State sector domestic borrowing requirement (2) . . . . .	22.8	21.5	21.8	21.7
<b>Total domestic credit (1) . . . . .</b>	<b>19.7</b>	<b>16.2</b>	<b>21.1</b>	<b>17.8</b>

(1) Corrected for exchange rate variations, settlements of past debts and, for 1984, the distortions connected with the abolition of the ceiling on bank lending. — (2) Net of contributions to the endowment funds of financial intermediaries and settlements of past debts.

To meet its substantial need for funds, the Treasury had to make net new issues of securities totalling around 36 trillion lire over the last four months of the year, as against about 21.6 trillion in the same period of 1984 (Table 19). For the entire year net issues of government securities came to 106.5 trillion lire, about 34 trillion more than in 1984.

Table 18

**Financial assets of the private sector**  
(% composition)

	Stocks		Flows	
	1984 Dec.	1985 Dec.	1984	1985
Money supply (M2) . . . . .	63.8	60.4	42.7	42.0
<i>of which:</i>				
bank deposits . . . . .	52.0	49.1	35.2	32.8
Treasury bills and acceptances . . . . .	14.2	13.6	16.2	10.9
Medium-term securities . . . . .	19.1	21.3	36.7	33.7
Investment fund units . . . . .	0.2	2.2	0.9	11.7
Other . . . . .	2.7	2.5	3.5	1.7
Total . . . . .	100.0	100.0	100.0	100.0

To place such a large volume of securities it was necessary to maintain high real yields. The real interest rate on six-month Treasury bills (i.e. the nominal rate net of the change in the consumer price index in the six-month period following that to which the interest rate refers) varied greatly in the course of the year. On average, however, the real rate was about half a percentage point lower than in 1984, whether calculated net of actual inflation or adjusted for expected inflation.

For banks and business firms, moreover, net yields on government securities were further decreased by heavier taxation. For the banks, which in September 1984 held more than 30 per cent of all government securities, it is estimated that the implicit tax on interest income from government securities, equivalent to 34 per cent prior to the new tax measure, rose to over 40 per cent by the end of 1985. Applying these percentages to the average yield on Treasury bills purchased in 1985, one gets a decrease in yield because of taxation alone from 9.0 to 8.2 per cent. For firms too the net yield on government securities decreased, though to an extent difficult to measure.

The process of lengthening the average life of the public debt resumed after a pause following the April increase in Treasury bill interest rates, especially those on shorter maturities (Table a26). Throughout the period under consideration, the yield on new issues of Treasury credit certificates was kept at least one percentage point higher than that on twelve-month Treasury bills (Tables a25 and a32).

The average maturity of the public debt thus lengthened from 30 months at the end of 1984 to 41 months in December 1985 (Table 20). Net of discounts, issues of Treasury bills were less than redemptions, while issues of Treasury credit certificates, net of discounts and coupons, exceeded redemptions by more than 51 trillion lire. Compared with earlier years, the Treasury increased the issue of certificates denominated in ECU (Table a32). Gross issues of these securities more than doubled, from a value of 1.7 trillion lire in 1984 to about 3.6 trillion lire in 1985. For 1985 as a whole placements of Treasury bonds net of discounts and coupons were less than redemptions, owing to uncertainty about the

future course of interest rates. In recent months, however, there have been signs of a revival in demand for Treasury bonds.

Table 19

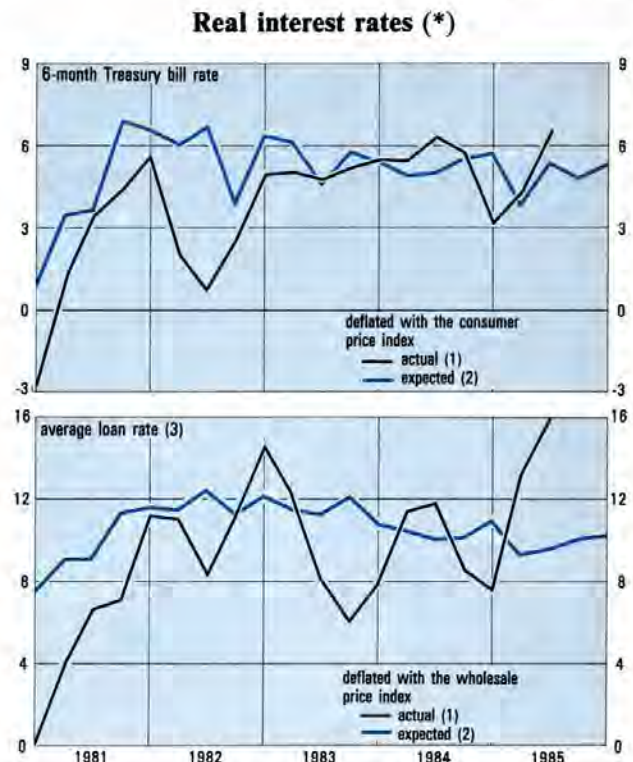
**Government securities (1)**  
(billions of lire)

	Issues		Net proceeds (3)	
	Gross	Net (2)	Total	From market (4)
<b>Treasury bills</b>				
1984 .....	227,747	9,301	-11,980	-4,811
1985 .....	256,281	13,181	-8,116	-20,341
1984 Sept.-Dec. .	76,247	3,982	-2,599	2,936
1985 Sept.-Dec. .	80,753	-2,484	-9,104	-17,173
<b>Treasury credit certificates</b>				
1984 .....	95,250	56,738	31,412	30,524
1985 .....	97,210	78,568	51,112	42,698
1984 Sept.-Dec. .	31,000	16,423	7,038	8,060
1985 Sept.-Dec. .	32,767	32,268	23,512	19,264
<b>Treasury bonds</b>				
1984 .....	17,750	8,433	4,327	884
1985 .....	17,287	3,972	-1,068	608
1984 Sept.-Dec. .	3,000	449	-836	-1,831
1985 Sept.-Dec. .	7,000	1,832	531	712
<b>Other</b>				
1984 .....	1,688	-1,988	-3,849	-2,132
1985 .....	13,775	10,866	8,791	9,824
1984 Sept.-Dec. .	732	732	535	652
1985 Sept.-Dec. .	4,262	4,262	3,987	3,933

(1) The data for 1985 include issues in settlement of past debts. — (2) Net of discounts and redemptions. For Treasury bills, net of redemptions. — (3) Gross issues less redemptions, discounts, and coupon payments. For Treasury bills, gross issues less redemptions and discounts. — (4) Total net proceeds excluding the Bank of Italy.

The outlook for a decline in inflation in 1986 may prepare the way for a return to investment in longer term fixed rate securities. To encourage this tendency, a new type of Treasury credit certificate was issued at the start of the year — a ten-year certificate convertible after one year into a five-year certificate with a fixed coupon of 11 per cent. In January and February the Treasury also issued bonds of maturity ranging from two to four years at the investor's choice, and these were well received by the public.

Figure 13



(\*) Estimated values of interest rates net of inflation; yields refer to the six months following. — (1) The deflator is the effective change in prices over the six months following the observation period on an annual basis. — (2) The deflator is the expected change in prices calculated by the Bank of Italy on *Mondo Economico* data (expected inflation over the six months following the observation of the interest rate, based on quarterly inflation expectations). — (3) The nominal rate on lira loans is provided by the Bank of Italy Central Risks Office. The 1984 and 1985 figures are adjusted for the effects of the increase in the loan reporting limit from 50 to 80 million lire in February.

Among the various categories of purchasers, the general public and the Bank of Italy made the most substantial investments, while credit institutions enlarged their portfolios by less than in 1984. The growth in business firms' holdings of securities, especially Treasury bills, was slower up to October than it had been the previous year.

In contrast, the acquisition of government securities by investment funds was substantial. The funds' portfolio of such securities doubled in the second half of the year, amounting to more than 11 trillion lire at the end of December (Table 21). Net purchases of Treasury credit certificates were substantial during the year, amounting to 8.4 trillion lire and 10.7 per cent of net issues. The percentage of net issues of Treasury bonds subscribed by the funds was 27.3 per cent, these

purchases being concentrated mainly in the last quarter. During that same quarter their holdings of Treasury bills decreased, after having expanded substantially up to September.

Table 20

## Average residual maturity of government securities

(months)

	Treasury bills	Treasury bonds	Treasury credit certificates	Total
1971-72 .....	7	54	—	82
1973-74 .....	6	39	—	74
1975-76 .....	5	35	—	54
1977-78 .....	5	31	18	41
1979-80 .....	5	38	16	29
1981-82 .....	4	22	16	17
1983-84 .....	5	15	34	21
1984 - Dec. ....	5	12	52	30
1985 - Dec. ....	5	15	65	41

The stock market continued to be characterized, just as in the first part of the year, by a strong upward tendency, in harmony with the rising trend of the principal international markets. Share purchases by Italian investment funds were very substantial. Their share portfolios increased, thanks partly to the rise in share prices, from about 1,850 billion lire in June to nearly 5,100 billion lire in December. Through September, the latest month for which data are available, investment by foreign dealers was also of some importance. The impact of these two components was decisive for the stock market's behaviour on the year, accounting for the bulk of the upsurge in transactions to a value of 26.3 trillion lire on the Milan Stock Exchange from the 7.1 trillion lire registered in 1984.

The employment of the investment funds' abundant liquidity augmented the total demand for shares at a time of markedly improving company balance sheets, thus generating strong upward pressure on share prices given the insufficient offerings of new shares. Share issues by private listed companies were only slightly

greater than in 1984, while the sale to the private sector of shares in state-controlled companies took on some importance (Table 22).

The portion of the investment funds' portfolios consisting of shares increased in the course of the year, while that accounted for by government securities declined from 69 to 61.5 per cent, these changes again partly reflecting the rise in share prices. In fact, the relation between the funds' holdings of government securities and their raising of net new resources remained essentially stable. It should also be borne in mind that at the outset most funds keep the bulk of their portfolio assets in government securities; later, when they become more fully operational, they tend to diversify.

Table 21

## Italian investment funds' portfolios

(amounts in billions of lire)

	1984		1985			
	Sept.	Dec.	Mar.	June	Sept.	Dec.(1)
<b>Lira securities</b> .....	<b>295</b>	<b>1,119</b>	<b>4,889</b>	<b>8,695</b>	<b>12,855</b>	<b>18,129</b>
Government securities (2) .....	235	772	3,511	5,745	8,124	11,149
Bonds .....	27	171	603	1,098	1,465	1,887
Shares .....	33	176	775	1,852	3,266	5,093
<b>Foreign currency securities</b> .....	<b>—</b>	<b>—</b>	<b>17</b>	<b>57</b>	<b>200</b>	<b>696</b>
Bonds .....	—	—	4	29	99	341
Shares .....	—	—	13	28	101	355
<b>Total</b> ...	<b>295</b>	<b>1,119</b>	<b>4,906</b>	<b>8,752</b>	<b>13,055</b>	<b>18,825</b>

(1) Source: Assofondi. — (2) Including Treasury bills.

Foreign securities held by the funds increased from 57 billion lire at the end of June to about 700 billion at the end of December. This rise is attributable partly to the need for portfolio diversification and partly to the increase in the number of funds in business for more than six months and thus authorized to do business abroad (Table 21).

Table 22

**Gross share issues**  
(billions of lire)

	1984	1985	1984	1985
			Sept.-Dec.	
<b>Listed shares</b> .....	<b>5,980</b>	<b>2,876</b>	<b>4,213</b>	<b>1,493</b>
state-controlled companies ..	3,970	444	3,298	129
private sector companies ....	2,010	2,432	915	1,364
<b>Unlisted shares</b> .....	<b>5,804</b>	<b>7,277</b>	<b>1,526</b>	<b>2,325</b>
state-controlled companies ..	2,434	3,757	268	1,677
private sector companies ....	3,370	3,520	1,258	648
<b>Total</b> .....	<b>11,784</b>	<b>10,153</b>	<b>5,739</b>	<b>3,818</b>
state-controlled companies ..	6,404	4,201	3,566	1,806
private sector companies ....	5,380	5,952	2,173	2,012

### The credit intermediaries

Bank lending in lire expanded at an annual rate of 31 per cent, seasonally adjusted, in the last four months of the year, as against one of 12 per cent over the first eight months. Foreign currency lending in those two periods diminished by 3,476 and 2,464 billion lire respectively, adjusted for exchange rate variations.

The acceleration of lira lending in late 1985 was partly the result, as already noted, of the lowering of bank interest rates. Between end-August and end-December the average and minimum lending rates were reduced by 1.3 percentage points. Over the same period the average rate on Treasury bills declined by 0.9 points, while that on interbank deposits rose by 0.2 points. The share of lending carried out at rates equal to or below the prime rate remained high in the last quarter, which it had not done on earlier occasions when the prime rate was lowered. This share increased in December to an estimated 45 per cent. Since significant changes in customer composition in terms of rates are unlikely in the short term, this would appear to confirm that the rapid increase in lending went chiefly to prime customers who presumably engaged in hot-money transactions on a large scale.

The decline in lending rates differed from one lending institution to another. The diversity in the reductions was reflected in the rates of growth in lending — the twenty banks whose lending expanded most rapidly over the last two months of 1985 recorded a larger decrease in their average lending rates than did the other banks. Those twenty include many large banks.

The rate of growth in 1985 as a whole was 15.4 per cent for total lending and 21.1 per cent for lending in lire (as against 17.2 and 14.8 per cent, respectively, in 1984 corrected for accounting distortions due to the abrogation of the lending ceiling). Despite the end-year acceleration, lending therefore expanded considerably less rapidly in 1985 than in 1984, when there had been some banking re-intermediation connected with the termination of the lending ceiling. Through October, i.e. before the acceleration in lending by the large banks, market shares had changed still more in favour of the medium-sized and smaller banks.

The distribution of lending by sector, for which data are available through November, is marked by a sharp acceleration of loans to financial enterprises, although these still account for a small share of total lending — the twelve-month growth rate rose from 35 per cent in June to 53 per cent in October, when lending to financial enterprises amounted to 10.8 trillion lire.

In the second half, bad debts continued to grow, at rates markedly higher than lending. The smallest banks recorded the highest growth of such debts, with increases in the 25-30 per cent range. The ratio of bad debts to loans, therefore, continued to rise throughout 1985, reaching 8 per cent at end-November.

There was a 10 per cent overall growth in bank deposits in 1985, or about 1.5 percentage points less than the previous year. Differences in growth among the various size groupings were not significant, even though the smallest banks and savings banks continued to expand deposits at rates higher than the average for the banking system as a whole.

After the rapid expansion in the first months of the year, the market for CDs stagnated for a period in the second half, partly as a result of the banks' policy on interest rates. In the first quarter the yield including tax on CDs was 1 percentage

point higher than the yield on Treasury bills, but in the last quarter these yields were more or less equal. The net new issue of CDs up to December was about 5.8 trillion lire, compared with 4.2 trillion in the same period in 1984. The proportion of total deposits accounted for by CDs remained fairly limited at about 3 per cent.

In the course of 1985 the banks' securities portfolios expanded by about 18.7 trillion lire, or 10.7 trillion when considered net of the funding of loans to public agencies and repayments of tax credits (see chapter on Public Finances). In 1984 the securities portfolio increased by about 12 trillion lire. The figures for 1985 reflect very different movements for the various components. The disinvestment in Treasury bills continued and at a faster pace than in the past. As a ratio to deposits, the Treasury bill portfolio was not higher than 6 per cent in November, compared with about 10 per cent at end-1984. This decline was more than offset by purchases of Treasury credit certificates. At end-November investments in these securities were equivalent to 20 per cent of deposits, against 15 per cent at end-1984.

The acceleration in special credit in the last four months of 1985 was exclusively in loans by industrial credit institutions, the increase being almost 2 points higher than the 8 per cent recorded in the first eight months. This expansion was accompanied by a slowing down of agricultural lending and, in particular, lending for the financing of public works.

Over 1985 as a whole, domestic lending by special credit institutions increased at a rate of 8.2 per cent, or five percentage points less than in 1984. Even excluding their public works lending, where the growth rate for the year, at 3.3 per cent, was particularly modest, lending of other kinds recorded a slowdown with respect to 1984: industrial credits from 12 to 8.6 per cent, mortgage credits from 12.5 to 9.9 per cent, and agricultural lending from 13.8 to 8 per cent.

The increased pace of investment in machinery and equipment, which took hold at the beginning of 1984 but seemed to slacken in the third quarter of 1985, did not affect the activities of special credit institutions with the same intensity as on similar occasions in the past. The linkage was weakened by the increase in firms' profits and by the greater recourse of major

companies and public agencies, the traditional clients of the special credit institutions, to the share market and to international financial markets. The process of rationalization of company finances, which has led to the creation and multiplication of institutions specializing in financial services, has also partly modified traditional channels of company financing and, as a result, firms were able to reduce their overall need to borrow from the traditional intermediaries. Confirmation of this is the marked growth of lending to financial companies in the twelve months ending in September 1985 (about 29 per cent, based on an estimate of loans to leasing companies).

Special credit institutions' financing of industrial and commercial companies increased only modestly, whether at market or at subsidized rates. In particular, there was a contraction in loans outstanding to large business firms. On the other hand, the demand for credit by small and medium-sized non-financial firms, even though less strong than in the previous year, made possible an increase of loans in this sector by about 11 per cent over the twelve months up to September.

There was particularly rapid growth — 34.5 per cent in the year up to September 1985 — in credit with maturities not exceeding 18 months, which are exempt from the flat rate tax on interest income. Institutions were able to expand their operations in this area by offering interest rates that were about 1 point below the minimum bank rates; a year earlier the differential between these two rates was about 0.5 percentage points.

The decline in interest rates meant that the limit imposed by the maximum rate at issue was less of a constraint on bonds and certificates of deposit. In the last months of the year, the rate at issue, especially for CDs, declined more than the yield on government securities and stabilized well below the permitted ceiling. In November, however, the maximum rate was reduced, so that it was once again brought close to the yield at issue.

Bond issues exceeded 5.8 trillion lire and were up 1.4 trillion on 1984. The boost came from the strong demand by non-bank operators who were attracted by both the maturity and the yield on these issues. In particular, the strengthening of expectations of reductions in interest rates had a

positive effect on fixed rate securities, which expanded by 2,736 billion lire in the first three quarters (a growth rate of 5.3 per cent, compared with 1.4 per cent in 1984). In the same period, institutional investors (insurance and social security institutions) and the sector designated as "economy and foreign" were the main subscribers to bonds of this kind (2,304 billion lire), as in 1984; credit institutions, on the other hand, disinvested by more than 660 billion lire. A new feature in the marketing of bonds was provided by investment funds, which accounted for acquisitions amounting to of 490 billion lire.

Issues of CDs, which had strongly increased in the first quarter owing to better yields than securities of similar maturity, slowed down considerably in the second and third quarters in consequence of a greater reduction in CD interest rates than on 12-month Treasury bills.

Institutions' liquid assets, largely in the form of government securities, continued to expand. Furthermore, the process of restructuring government securities portfolios continued unabated: Treasury credit certificates increased by almost 3.9 trillion lire while Treasury bills declined by about 1.4 trillion.



## Short-term prospects: international and domestic

### The international economy

Events in the oil, commodities and foreign exchange markets in late 1985 and early 1986 have rendered obsolete even quite recent projections for the international economy. The collapse of oil prices in January is, perhaps, the most outstanding feature of the rapidly changing economic scene. However, the decline in the dollar prices of non-oil commodities, the fluctuations of the US dollar in combination with its continuing downward trend, the relative weakening of sterling and the decline in Japanese

interest rates are also elements which make short-term forecasts for the main macroeconomic aggregates of industrial and developing countries difficult.

The repercussions of the fall in the price of oil on the world economy that can be gleaned from analyses by the principal international agencies are still fragmentary. It is worthwhile, therefore, to refer to the forecasts made before the drop in oil prices (Table 23) in order to outline the principal trends, assess their intensity and identify the main economic policy problems created by the new situation.

Table 23

### OECD projections for some macroeconomic aggregates

(% changes on previous year)

	1984	1985	1986		1984	1985	1986
<b>GNP (1)</b>				<b>Current balances (2)</b>			
Industrial countries .....	4.9	2.8	2.8	Industrial countries .....	-63.8	-72	-64
<i>of which:</i>				<i>of which:</i>			
United States .....	6.6	2.3	2.8	United States .....	-107.3	-128.3	-146
Japan .....	5.8	5.0	3.5	Japan .....	35.0	49.5	57.3
EEC .....	2.3	2.3	2.5	EEC .....	3.8	11.8	27
<b>GNP deflator</b>				<b>Unemployment (3)</b>			
Industrial countries .....	4.7	4.8	4.5	Industrial countries .....	8.4	8.3	8.3
<i>of which:</i>				<i>of which:</i>			
United States .....	3.8	3.3	3.8	United States .....	7.5	7.2	7.3
Japan .....	0.6	1.0	0.8	Japan .....	2.7	2.5	2.8
EEC .....	5.6	5.3	4.3	EEC .....	10.3	10.5	10.5
				<b>International trade (1)</b>			
World trade .....	8.5	3.5	3.8	Exports			
Exports				Industrial countries .....	11.75	5.5	4.5
Industrial countries .....	9.78	4.5	4.0	OPEC countries .....	-5.8	-10.0	-10.3
OPEC countries .....	-3.5	-13.0	2.0	Non-oil LDCs .....	5.8	4.3	4.0
Non-oil LDCs .....	11.8	5.0	4.3	Imports			
				Industrial countries .....	11.75	5.5	4.5
				OPEC countries .....	-5.8	-10.0	-10.3
				Non-oil LDCs .....	5.8	4.3	4.0

Source: OECD *Economic Outlook*, December 1985.

(1) At constant prices. — (2) Billions of dollars; including official transfers. — (3) Level.

According to the projections published last December, the expected growth rates of real income and domestic demand for 1986 for OECD countries as a whole were much the same as the estimates for 1985. For both aggregates the differences between the growth rates of the more vigorous and the more sluggish economies were expected to narrow further. The unemployment rate in North America, and in Europe and Japan, would be stationary; inflation rates would continue to decline slowly (except in the United States), as would inflation differentials between countries. The overall balance-of-payments deficit of the OECD countries would lessen somewhat, as a result of an increase in the surpluses, especially in Japan and Germany, in excess of the deterioration in the United States deficit.

The decline in the price of oil brought a net improvement in the short-term outlook for industrial and non-oil developing countries, giving new impetus to income and employment and helping to reduce inflation. With regard to industrial countries, preliminary estimates indicate that the stabilization of the price of oil at around 20-21 dollars per barrel would boost income growth by 0.5 per cent, curb inflation by a further 1 per cent and bring down unemployment. It is, however, especially in terms of inflation that the differential effects among countries could be large depending upon the relative importance of energy inputs in total costs, the diversity of economic structures, the speed with which the lower costs are transferred to prices and the orientation of economic policy. In countries like Germany and Japan where the rate of inflation in consumer prices, on an annualized basis, is already at around 1 per cent, one can expect prices to be fully stabilized or even to decline.

An oil price of 20 dollars a barrel in 1986 would bring about widespread repercussions in the international payments system. The fall in the revenue of fuel-exporting LDCs would amount to about 40 billion dollars, or 3-4 per cent of their overall income. For socialist countries as a whole, the decline would be 5 billion dollars. Non-fuel exporting LDCs and industrial countries, on the other hand, would be advantaged by 10 billion and 35 billion dollars, respectively.

It does not appear that the reduction in the energy deficit will be able to contribute significantly towards a re-equilibration of the

balance-of-payment and exchange rate imbalances of the three principal economies: marked reductions in the United States deficit stand to be accompanied by a further increase in the Japanese and German surpluses. For the industrial countries as a whole, the improvement in the merchandise balances will be smaller than that in the oil balances, mainly because of the slowdown in prices of manufactures of which these economies are net exporters.

With regard to the indebted LDCs as a whole, the lower oil prices will result in larger balance-of-payments deficits. The impact effect should produce a worsening of about 6 billion dollars, given that some of these countries, i.e. Mexico, Venezuela, Nigeria, Indonesia, Algeria, Malaysia and Ecuador, earn a substantial part of their foreign exchange revenues through oil sales. These economies accounted for 30 per cent of the LDCs' overall debt in 1985 and recorded an estimated net oil surplus of 60 billion dollars: the drop in the price of oil should reduce this surplus by 15 billion dollars. The energy bill of the other debtor countries should, however, decline by 9 billion dollars.

Financial problems, therefore, assume particular importance; they will be exacerbated by a rise in the dollar prices of manufactured goods higher than that expected for non-oil commodities.

On the other hand, all developing countries stand to gain from an increase in exports to the industrial countries as a result of the larger growth in real income. Finally, insofar as interest rates and inflation decline together, there would be a resultant easing in the debt-servicing burden of debtor countries and a worsening of the debt situation through increases in real interest rates would be avoided.

Coordination of economic policies and interventions in exchange markets is necessary if progress is to be made towards an effective system of multilateral surveillance. This theme is under discussion by the IMF Executive Board at the moment, and will be examined by the Interim Committee next April. It has taken on even greater importance because of the destabilizing impulses that could begin to affect the international monetary system with the changes in energy prices. The reduction in interest rates, all

the greater where a re-equilibration of public-sector finances seems to have been achieved, will not only ease the burden of indebted countries but will also boost economic growth in the industrialized nations.

The change in the pattern of costs and prices reinforces the need for a global approach to the debt problem, as stressed in the Baker Plan, to be put into operation especially for those economies which are being most adversely affected by the fall in oil prices. In fact, for the fifteen countries singled out by the Baker Plan, the impact effect of higher oil prices will be equivalent to a worsening in the commercial balance of more than 20 billion dollars.

### The Italian economy

After the summer break, the principal real macroeconomic aggregates of the Italian economy started to grow again, in line with the other major economies, particularly the European ones. In the fourth quarter of 1985, industrial production rose by 0.6 per cent compared with the third quarter. Estimates for the gross domestic product indicate an increase of about 1 per cent, slightly less than the autumn forecast. Over the same period, the trend rate of inflation, measured in terms of consumer prices, was broadly stable. The recovery in activity led to an increase in imports and a resultant worsening of the merchandise balance in spite of the fact that, of all components of demand, the external one was the most dynamic.

As a direct result of the lower cost of oil and the depreciation of the dollar, some of the macroeconomic aggregates will behave differently in 1986 than towards the end of 1985. This year, the Italian economy should be characterized by falling inflation and a change of sign in the balance of payments, with a more sustained demand growth than could have been imagined even a few months ago. Moreover, uncertainty about present impulses makes it difficult to quantify exactly the magnitude of the movements of the macroeconomic aggregates.

In the industrial sector, the increased social security contributions provided for in measures decided in 1985 and included in the Finance Bill, together with the automatic wage increases

resulting from indexation and the likely effects of the renewal of labour contracts, should raise nominal labour costs per man and labour costs per unit of output by 9 and 5 per cent respectively. This will make possible a slowdown compared with 1985, but will not suffice to narrow the differential vis-à-vis the major industrial countries. It may be noted that changes in unit labour costs, according to OECD estimates for 1986 made prior to the recent disinflationary oil shock, range from 0.5 per cent in Germany to 2.8 per cent in the United States, not including the United Kingdom.

With regard to budgetary policy, the Finance Bill and other measures, including those now being worked out, have as their aim to maintain the state sector's overall financial borrowing requirement more or less at the 1985 level.

The implementation of the corrective action has, however, suffered delays and alterations which risk reducing its effectiveness. Consequently, the extent of the interventions to be decided in the course of the year in order to keep the overall state sector borrowing requirement within the 110 trillion lire target will have to be revised upwards from the 4 trillion indicated in the *Relazione Previsionale e Programmatica*. Furthermore, it must be pointed out that delays in implementation will increase the intensity of the actions that have to be taken to achieve the desired result in the year.

The current year will reap the benefit of many temporary factors which will boost receipts and reduce expenditure. Some of these are: receipts from the condonation of building offences will be concentrated in 1986; the accelerated payment of social security contributions and the collection of past due social security payments; the shift from quarterly to half-yearly computation of *scala mobile* points for public employees and pensions; the reflow to the Treasury of part of public entities' balances held with the credit system; substantial issues of bonds by state-controlled enterprises (3.5 trillion), which reduce the need for allotments by the government (the burden of capital and interest payments will be absorbed by the public finances in the future). In addition, the gradual implementation of the revision of personal income tax (IRPEF) rates over the coming years will further add to the deficit, as will

also the planned improvements to pensions provided for by Law No. 140 and 141 of 15 and 17 April 1985.

The combined impact effect of the depreciation of the dollar and the fall in the price of oil is estimated to reduce Italy's oil deficit by the equivalent of somewhat less than two percentage points of GDP (see insert in the chapter on the International Economy). The benefits from an associated reduction in the import prices of other sources of energy should also be added to this estimate. Even though part of the reduction of the energy bill will be transferred abroad as a result of a slowing down in the prices of manufactures of which Italy is a net exporter, the remaining share will still be quite substantial. There are two main ways to take advantage of this opportunity, and these should be evaluated in the light of choices made by other major countries and the implications for competitiveness.

On the one hand, there is the possibility that these advantages be translated into a reduction of costs and prices through the market mechanism. The benefits of this would be felt pervasively by firms, partly in terms of improved competitiveness abroad, and by consumers through a decline in inflation. However, there would be a risk of reducing incentives to save oil, a matter in which Italy has made less progress than her competitors and which remains, for the medium term, an unavoidable priority. The increase in private consumption could also prove to be excessive.

On the other hand, given the need to re-equilibrate the public finances, the advantages to be derived from allowing the government to absorb part of the gains in the terms of trade should be recognized. In that case, the increase in taxes and/or the reduction in spending can take many forms, each capable of affecting the economy in a different way.

Private and state-controlled enterprises would reap some of the benefits, in terms of capital formation and the increase in employment, especially where the budget measures were aimed at reducing current expenditure and curbing consumption. And where this was not the case, the intervention could be expanded to affect resources not intended for productive investment.

In line with the latter approach, and according to a cautious estimate, it was assumed in making forecasts for the current year that about a third of the reduction in spending and/or of the increases in tax revenues originally foreseen as necessary to keep the borrowing requirement on target will come from increased taxation on consumer oil products.

The forecast picture of the Italian economy compatible with the above assumptions, with the foreign exchange rate at the average value for January and oil priced at 21 dollars a barrel, is as follows: GDP growth in real terms will be between 2.5 and 3 per cent, and near to 11 per cent in nominal terms. The increase in domestic demand will be somewhat higher than 3 per cent in constant prices and 9 in current prices; households' consumption will increase by about 3 per cent. Inflation, measured by the private consumption implicit deflator, could fall back to 6 per cent, with a gradual deceleration during the year, the modest price rise in January being a first step. The balance of payments on current account will record a surplus of a little less than 1 per cent of nominal GDP largely because of a 7-8 per cent improvement in the terms of trade.

The short-term outlook for the Italian economy is not, however, so positive as to support the hypothesis that the inflation and external accounts targets have been finally reached and, consequently, that there can be some easing in the measures to be taken in tackling the key problems of the economy.

A 6 per cent inflation will still mean an unfavourable differential for Italy vis-à-vis the main industrial countries: in relation to some, it could even be as much as the rate of inflation itself. The external current account surplus, which is small compared with the flows that generate it, will have only a marginal effect on the foreign debt accumulated since 1980. As a ratio to GDP, the public deficit will remain at a much higher level than the average for the OECD countries.

In the autumn, the Interministerial Committee for Economic Planning (CIPE) set a target growth rate of 9 per cent for the domestic credit of the non-state sector in 1986, in line with the then expected increase of nominal income. As mentioned above, the present forecast for income

growth is higher, because it has been revised to take account of the change in relative prices induced by the fall in the price of oil. In this context it is also appropriate to look at the rise, more limited, in nominal domestic demand. Moreover, in view of the expected high level of profits and the increase in risk capital, as well as of the slowing down of the income and domestic demand deflators during the year, the targets for credit expansion proposed by the CIPE would appear still to be appropriate.

The application of the 9 per cent growth rate for credit presupposes the elimination of the abnormal expansion of bank loans in lire in November and December 1985, and the ceiling on bank loans in the first quarter of 1986 provides for this needed correction. Adjusting by an estimate of this irregular expansion, the flow of financing to the non-state sector in 1986 is put at 37.5 trillion lire, 2 trillion more than in 1985. As

reflected in the actual accounts data, the increase in credit will amount to 28 trillion lire, or 7 per cent (Table 24).

With a state-sector domestic borrowing requirement of 105 trillion lire, the growth in total domestic credit will be about 13 per cent. Assuming an overall surplus in the balance of payments of about 1 per cent of GDP, the expansion in domestic financial assets of the private sector will be about 15 per cent. As a ratio to GDP, the change in the private sector's financial assets will fall to 17.6 per cent from 20.2 per cent last year. On the other hand, the stock of financial assets in relation to GDP will continue to grow, albeit at a slower pace, rising from 133 to 138 per cent.

The increase in financial assets will continue to press on the creation of money. The growth rate of M2, calculated on the basis of accounts

Table 24

## Financial flows

	Gross domestic product		State sector borrowing requirement		Credit to the non-state sector (B)		Total domestic credit (A)/(B)			Private sector financial assets (1)			
	billions of lire	% change	total	domestic (A)	changes		changes		ratio to GDP (2)	changes		ratio to GDP	
					billions of lire	%	billions of lire	%		billions of lire	%	(2)	(3)
1975	125,378	13.2	16,444	14,218	16,814	18.7	31,031	22.6	24.7	25,283	21.2	20.2	115.4
1976	156,657	24.9	14,867	14,208	19,752	18.8	33,960	20.1	21.7	29,637	20.5	18.9	111.3
1977	190,083	21.3	22,567	17,973	17,281	13.9	35,254	17.4	18.5	34,095	19.6	17.9	109.9
1978	222,254	16.9	34,305	31,763	17,495	12.7	49,258	20.7	22.2	48,374	23.2	21.8	115.9
1979	270,198	21.6	30,371	28,531	25,261	16.5	53,792	18.7	19.9	57,939	22.5	21.4	117.1
1980	338,743	25.4	37,017	34,015	29,219	16.4	63,234	18.5	18.7	51,637	16.3	15.2	108.9
1981 (4)	401,579	18.5	53,296	45,242	28,098	13.5	73,340	18.1	18.3	70,713	19.0	17.6	109.7
1982 (4)	470,484	17.2	72,653	68,987	31,604	13.4	100,591	20.9	21.4	89,242	20.3	19.0	112.8
1983	538,998	14.6	88,604	85,541	35,432	13.2	120,973	20.7	22.4	106,963	20.2	19.8	118.5
1984 (5)	612,112	13.6	95,351	91,364	48,256	15.6	139,620	19.7	22.8	129,573	20.3	21.2	125.7
<b>1985 (6)</b>	<b>680,500</b>	<b>11.2</b>	<b>108,800</b>	<b>106,700</b>	<b>45,000</b>	<b>12.6</b>	<b>151,700</b>	<b>17.8</b>	<b>22.3</b>	<b>137,600</b>	<b>17.9</b>	<b>20.2</b>	<b>133.2</b>
					(35,500)	(10.0)	(142,200)	(16.7)	(20.9)				
<b>1986 (7)</b>	<b>752,000</b>	<b>10½</b>	<b>110,000</b>	<b>105,000</b>	<b>28,000</b>	<b>7.0</b>	<b>133,000</b>	<b>13.2</b>	<b>17.7</b>	<b>132,000</b>	<b>14.6</b>	<b>17.6</b>	<b>138.1</b>
					(37,500)	(9.5)	(142,500)	(14.3)	(18.9)				

(1) Domestic, net of shares. — (2) Based on period flows. — (3) Based on end-of-period stocks. — (4) Net of the effect of the non-interest-bearing deposit on external payments. — (5) Lending to the non-state sector and total domestic credit have been corrected for the distortions in banking statistics connected with the elimination of the ceiling on bank lending. — (6) Preliminary estimates. The changes in the lending to the non-state sector and total domestic credit in 1985 and 1986 shown in brackets have been calculated by adjusting the accounting data for the anomalous expansions in lira bank lending in November-December 1985. — (7) The planning scenario for 1986. The lending to the non-state sector includes 3,500 billion lire of bond issues by state holding companies, the payments of principal and interest on which are made by the government.

N.B.: The total 1985 borrowing requirement does not include settlements of past debts totalling 12,552 billion lire, of which 2,149 billion in cash; the latter, by contrast, are included in the domestic borrowing requirement. The 1986 borrowing requirement includes cash settlements amounting to 2 billion lire.

data, should stabilize at about 9 per cent, taking into account a certain recovery of the abnormal decline in deposits in December. Changes in the behaviour of economic agents, which are a usual feature of periods of rapid decline in inflation and of transformation of the financial structure, increase the variability of the desired portfolio mix between securities and money. The money growth indicated above must not be seen, therefore, as a precise figure but rather as the central point in a range of 3-4 percentage points. The eventual shifts from the central path would reflect the need to support changes in the non-state sector's desired portfolio mix that are compatible with the targets for economic policy.

To make possible a 9 per cent growth of M2, the amount of government securities and other private-sector financial assets outstanding

should increase by 22 per cent in the course of 1986. The ratio of M2 to income should remain, on average, unchanged between 1985 and 1986. Consequently, the decline in nominal rates on government securities throughout the year should proceed with caution and should not overtake the fall in inflation rates. Banks should promptly take advantage of the possibilities of lowering interest rates.

In this framework, the growth rate of the overall monetary base should be reduced in line with that of money. The expected surplus in the balance of payments will provide the most important channel for the creation of the new base, while the Central Bank's monetary financing of the Treasury should decline from the substantial levels recorded in 1985.



# Articles

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## The reform of the *scala mobile*

### 1. Introduction

The functions and characteristics of Italy's *scala mobile* have been much discussed in the past few years; this system of wage indexation has often been considered one of the two main causes — the other is the growing public sector deficit — of the continuance of high inflationary pressures in Italy. The debate, which gathered momentum after the change to a system of flat-rate adjustments, uniform for all workers, in 1975, was recently concluded by the approval of a law extending the Civil Service's recent new *scala mobile* agreement to all workers for the next four years. This article seeks to examine the characteristics and properties of the new system, comparing them with those of the preceding one and, also, to estimate the value of the elasticity and to compare the effects on wages of each of the two systems in 1985. In view of the difficulties of making estimates for the various sectors of the economy, the latter attempt will be confined to the industrial sector excluding construction: for brevity this will be called "manufacturing" throughout this article.

A brief sketch of the evolution of the *scala mobile* and of the discussion relating to it will help evaluation of the differences and similarities between the new and former methods of wage indexation.

### 2: Historical note <sup>(1)</sup>

The *scala mobile* system was introduced in Italy in a situation of high inflation at the end of

the second world war: it provided for a flat-rate indemnity in lire for all workers and adjustments every two months; a clause prevented moderate price falls from cutting the indemnity and another provided for the *scala mobile* to be calculated separately for each province on the basis of movements in their respective retail price indices. Two important changes were made in 1952: payment of the indemnity was made on the basis of a new, unified and specifically calculated cost-of-living (COL) index (the trade union index) valid for the whole of Italy, and the allowance to be paid for each point of increase in the union index was graded in order to preserve wage differentials. Such differentials had been squeezed in the previous few years. Since a system based on fixed values of the COL point gives a protection against inflation which falls as the real wage rises, the values of the COL points were increased in 1957 and, at the same time, the interval between adjustments was lengthened from two to three months; this second change reduced the danger of erratic price movements in the price index; the principle of symmetry in the functioning of the mechanism for both upwards and downwards price movements was also established. There were no further changes until 1975, when it was decided to unify the allowances paid for each point of increase in the index at that of the highest of them over the two following years. Consequently, as from 1977 every worker of whatever grade or wage level received the same COL indemnity. In 1977 also, to moderate the effects of changes in utility charges on the union index, the *scala mobile* basket was adjusted, substituting the (subsidised) basic electricity tariff and the monthly subscription rates for urban



transport and newspapers for the previously adopted normal unit charges.

The agreement on the unified COL point sparked a wide-ranging debate on the characteristics and implications of the *scala mobile*. The main observations were <sup>(2)</sup>:

- 1) the cover against inflation was too high, approaching 100 per cent;
- 2) the interval between adjustments was too short;
- 3) the reference index did not exclude changes in indirect taxes or in the terms of trade;
- 4) the effects on wage differentials of the adoption of a single-point system giving the same money increases to all workers.

The first point stressed that too high a protection against inflation, by making real wages inflexible, would hinder the necessary adjustments to changes in the relative prices of other productive factors, as for example oil, and consequently limit the counter-cyclical effect of economic policy tools intended to modify real wages. Moreover, the high degree of indexation would strongly curtail the bargaining space available to the unions in an area where they should be most active. These criticisms seemed at the time more apposite than they do today because the data then available, before the upwards revision of the National Accounts, suggested that coverage approached 100 per cent.

The second observation emphasised that the high (quarterly) frequency of COL adjustments made the transmission of inflationary impulses through the economy very swift, helping to amplify the effects on the rate of inflation of the numerous and violent external shocks on prices occurring in that period <sup>(3)</sup>. At the same time, the fact that changes in the terms of trade were not excluded from the index exacerbated price tensions; further, the failure to exclude the effects of changes in indirect taxes from the index discouraged use of this tool to influence domestic demand.

The last observation, that of squeezing wage differentials, stressed that the change in the wage profile with respect to that determined by the market introduced by the unified COL point could have inflationary consequences both

because, distorting factor allocation, it caused overall losses in productivity and because of the risk of leap-frogging wage claims, to restore the previous wage structure.

Instead, the main argument in favour of the *scala mobile* was in the link existing between the effects of any cut in the degree of indexation and the possible reactions which such an operation might cause. In particular, if there had been no *scala mobile*, or if the coverage it offered were too low, wage contracts would probably have been negotiated for shorter periods and the various categories of workers might have made wage claims in line with the highest projected inflation rates so as not to risk losses due to unexpectedly high price rises <sup>(4)</sup>.

After Confindustria, the industrialists' organization, gave notice that it no longer considered the 1977 agreement valid, a new pact between the two sides of industry and the Government was reached in January 1983 for a partial change in the *scala mobile* system; the value of the COL point was effectively cut by 15 per cent, with an equivalent cut in the degree of coverage, by rewinding the index to 100 with a less than proportional increase in the money value of the point, from 2,389 lire to 6,800 lire. At the same time, the clause regarding the rounding of *scala mobile* points was modified: different interpretations of this clause by unions and employers later caused a long and still unresolved dispute. <sup>(5)</sup>

The need to reduce the differential between inflation in Italy and in other developed countries caused the adoption, in 1984, of a series of measures limiting increases in wages, utility tariffs and controlled prices. A law was passed fixing the *scala mobile* points for the first six months of 1984 in advance, on the basis of the planned rate of inflation, with the aim of avoiding inflationary pressures on the side of costs: the COL allowance was therefore cut by four points with respect to the actual movement of the union price index. A referendum called to abrogate the law and reinstate the four points was later defeated. Shortly afterwards Confindustria again terminated the *scala mobile* agreement, initiating a long confrontation between the two sides of industry on the changes to be made in the system of wage indexation, on working hours and on

regulations regarding the labour market. Failing to reach agreement on this complex of issues, they decided to accept the agreement already reached for the Civil Service as far as it regarded wage indexation. The government passed a law extending the new Civil Service system of the *scala mobile* to all salaried workers for a period of four years.

### 3. The new *scala mobile*

The new method of wage indexation first adopted in the Civil Service and later extended to the private sector is identical, except for the values of the reference parameters, to that originally put forward by the unions in their July 1985 platform and, two months earlier, by the CGIL when it unsuccessfully attempted to avoid the referendum on the excised *scala mobile* points.

The fundamental characteristics of the new mechanism can be summarized as follows:

- 1) 100 per cent coverage of a net monthly wage of 580,000 lire for all workers;
- 2) 25 per cent coverage of a second wage band running from this amount to the total of base pay plus COL allowance. This band is determined by taking the gross annual base wage in the month preceding the adjustment and dividing it by twelve to give the monthly wage for the worker's grade and adding the COL allowance accumulated up to that time minus the minimum wage indexed at 100 per cent and re-valued as indicated;
- 3) other residual earnings, including overtime, productivity bonuses etc., are not indexed;
- 4) the reference index continues to be the union index, but adjustments are made every six months instead of every quarter. The next adjustment will be in May 1986;
- 5) any changes in indirect taxes will be discussed by the two sides of industry in a specially-called meeting to decide how and to what extent such changes should be reflected in the union price index.

The new system is clearly more complicated than the previous one, from which it differs by the mechanism of adjustment for inflation, by the

frequency of such adjustments and by the possible future exclusion of changes in indirect taxes. Leaving discussion of the latter two points for the moment aside, let us consider the properties of the new method. To facilitate analysis it will be assumed that the base wage of the second indexation parameter is that of the period preceding the adjustment; the problem of additional wages (13th month etc.) will be left aside: this makes an analytic examination of the new *scala mobile* much easier.

The above description gives us the following definition:

$$(1) \quad W_t = W_t^M + W_t^K + W_t^R = W_t^C + W_t^R$$

with  $W_t^C = W_t^M + W_t^K$

where  $W^M$  is the fully-indexed minimum wage (580,000 lire per month),  $W^C$  is base pay plus COL allowance,  $W^R$  are residual earnings not protected against inflation and  $W^K$ , equal to  $W^C - W^M$ , is the 25 per cent protected wage.

The formulae for indexation are:

$$(2a) \quad W_t^M = W_{t-1}^M (1 + a\dot{p}_{t-1})$$

$$(2b) \quad W_t^K = W_{t-1}^K (1 + b\dot{p}_{t-1}) ; \text{ with } a > b$$

where  $\dot{p}$  represents the rate of inflation defined as  $P_t/P_{t-1} - 1$  where  $P_t$  equals the price level and prices and wages refer to the same reference period.

It is clear that this model, if the coefficient of indexation for the second band were set equal to zero, would be equivalent to the case where the minimum wage was fully indexed; if the two indexation coefficients were equal, it would give a solution equal for all in percentage terms, neglecting any residual component not covered for inflation. In comparison to the preceding system, the new mechanism can give rise to many and very different solutions according to the value of the minimum wage and of the two indexation parameters. It is however immediately obvious that the protection offered against inflation is an increasing function of the two indexation coefficients and of the share of the minimum wage in total earnings.

From formulae (2a) and (2b) we obtain an expression for the elasticity of earnings on prices (defined as the relation between percentage changes of earnings and those of prices in the preceding period) which is equal to:

$$(3) \quad r = 0.75 q_{t-1}^1 + 0.25 q_{t-1}^2 + (n / \dot{p}_{t-1}) q_{t-1}^3$$

where  $r$  is the elasticity of earnings to prices,  $q^1$ ,  $q^2$  and  $q^3$  are the relation to total earnings of, respectively, the minimum wage, the basic wage plus the COL allowance, and the residual component and  $n$  represents the rate of growth of this last. Being however concerned to estimate the degree of protection afforded by indexation in the absence of other earnings increases, the rate of growth of the residual component can be set at zero; this hypothesis gives an elasticity of wages to prices independent of the rate of inflation, an elasticity measuring only the automatic response due to the new COL mechanism, which is equal to (6):

$$(4) \quad r = 0.75 q_{t-1}^1 + 0.25 q_{t-1}^2$$

Similarly, the formula for the degree of coverage (see the Mathematical Appendix), defined as the relation between percentage changes in wages and prices in the same period, can be obtained and reveals that it increases, ceteris paribus, as inflation falls and vice versa. Since the elasticity allows for institutional lags between the recording of price changes and the wage adjustment, eliminating purely transient changes, only this last measure will be examined.

Formula (4) shows that, at a given moment of time, the degree of protection against inflation offered by the new system comes to depend on workers' wage levels; in particular, if the proportion of the base wage plus the COL allowance to total earnings remains constant, the elasticity falls as earnings increase. This is because the higher the earnings, the lower the elasticity, since the share of the 100 per cent protected minimum wage on total earnings is lower. The fall in elasticity will be very sharp for wages slightly above the minimum wage but its relevance will decrease for higher wages. This implies that the new *scala mobile* mechanism, like the former single point system, does affect wage

differentials. Vice versa, with only one coefficient of indexation, the degree of protection remains constant as earnings change, if the share of base wages plus COL on total earnings is constant, i.e. if  $q^2$  does not change.

A second proposition is that, again at a given moment of time, the values of the elasticity are increased (diminished) by rises (falls) in the share of the base wage plus COL on total earnings, the latter remaining unchanged. (7)

A third proposition is that, for the chosen values of the indexation coefficients and the minimum wage, and given the non-protected wage, the degree of coverage against inflation in general falls when the base wage plus COL increases (8). This result is not as immediate as the preceding ones; in fact an increase in the base wage plus COL in total earnings has contrasting effects on elasticity. The first is positive in that it implies a shift upwards of the elasticity curve because the share of residual non-protected earnings falls; the second is negative in that it corresponds to an increase in wages and therefore to a fall in the fully protected share. Which of these two effects will predominate depends on the ratio between non-protected and wholly protected wages; if this ratio is not very high (less than 3-to-1), as is the case for medium-low earnings, then an increase in base pay plus COL will lead to a fall in the elasticity and vice versa.

The characteristics of the previous system of indexation were based on the fundamental relationship:

$$(5) \quad W_t = W_{t-1} + 6800(P_{t-1} - P_{t-2})$$

where  $P$  is the level of the union index with base August-October 1982 = 100 and 6,800 is the value of the COL point. In this case elasticity is equal to:

$$(6) \quad r^0 = 6800 P_{t-2} / W_{t-1}$$

and therefore falls as wages increase. However, while in the preceding system as salaries continued to rise, the value of the elasticity tended to zero, under the new system the corresponding limit, assuming the share of base

pay plus COL constant, is equal to the product of this share and 0.25, the second indexation parameter. This last point can easily be derived from formula (4); as income rises the first term tends to disappear and only the second remains, with an indexation coefficient equal to 0.25.

Apart from these characteristics, other important innovations are the change from a quarterly to a semi-annual adjustment and the theoretical recognition that changes in indirect taxes should be excluded from the union index. Semi-annual adjustments should weaken the transmission effects of inflationary impulses to the economic system. Vagueness as to how the effects of changes in indirect taxes are to be excluded from the index causes some perplexity, particularly because a similar clause in the January 1983 agreement was never applied. Lastly, unlike the 1983 pact, the new agreement does not contemplate, even theoretically, the possibility of any action to exclude changes in the terms of trade from the union index. (9)

#### 4. Estimates of elasticity and comparison with the former system of indexation

One of the most relevant aspects of any system of wage indexation is the degree of protection it offers against inflation. Table 1 gives the values of the elasticity and of the coverage given by the former *scala mobile* system for average earnings in manufacturing, net, as throughout this paper, of the effects of the Wage Supplementation Fund. It can be seen that the elasticity reached its highest value of more than 80 per cent in 1977, the year in which the unification of point values at the highest level was completed. Thereafter, due to the influence of non-COL wage increases, the degree of coverage began slowly to decline, falling below 70 per cent in 1982; in January 1983 it was decided to cut the real value of the COL point and in 1984 temporarily to fix the size of COL adjustments in advance. In 1985 the elasticity was equal to 53 per cent for average earnings, or 43 per cent if the employers' interpretation of the rounding clause is adopted. (10)

A first question regards the value of the elasticity under the new system in comparison to the two values — gross and net of fractions of a point — given by the former one. This

comparison is not easy because of the variety of changes made in the new system and is the more difficult because it is no longer possible to calculate, as it was before, the increases due to the new system from information on price changes alone: an estimate of rises in base wages is also required. It was therefore decided to estimate what wage increases in lire the two systems would have given for 1985 alone, on the additional assumption that the change to semi-annual adjustment would not influence the rate of inflation; this estimate, unlike that of Section 3, is based on all the characteristics of the new *scala mobile* (semi-annual adjustments, recognition of the 13th month, and adjustments made on the basis of the base wage of the previous month). Only the possible exclusion from the index of changes in indirect taxation is not considered. Table 2 gives the results of this comparison for average per capita earnings (derived from

Table 1

#### Coverage and elasticity of per capita earnings in manufacturing (net of effects of the Wage Supplementation Fund)

Year	Change in the union index	Change in earnings	Change in earnings due to the <i>scala mobile</i>	Coverage	Elasticity
1975	16.7	23.8	10.4	62.3	55.8
1976	16.7	22.0	9.7	58.1	64.7
1977	17.7	27.6	15.5	87.9	81.4
1978	12.7	16.4	10.1	79.7	79.5
1979	15.3	16.8	11.0	72.2	75.0
1980	18.2	21.1	13.0	71.7	73.5
1981	18.4	25.3	13.6	73.8	72.1
1982	16.0	17.0	10.9	68.2	68.9
1983 (a)	14.0	15.1	9.2	65.5	61.7
1984 (a)	11.1	12.1	4.9	44.5	42.1
1985 (a) (*)	8.5	10.3	4.6	53.8	53.3
1983 (b)	14.0	15.1	9.0	64.5	60.7
1984 (b)	11.1	12.1	4.4	39.7	37.6
1985 (b) (*)	8.5	10.3	3.7	43.1	42.7

Source: Based on Istat data.

(a) Including fractions of a point. — (b) Excluding fractions of a point. — (\*) Forecast.

estimates of base pay at the beginning of 1985 plus contractual wage increases) in manufacturing. As may be noted, the new *scala mobile*, setting aside the problem of the elimination from the price index of changes in indirect taxes, gives a lower degree of protection than did the previous system; -34 per cent and -19 per cent on the COL adjustment in lire matured during the year in comparison with the previous scheme, depending on the inclusion (-34 per cent) or exclusion (-19 per cent) of fractions of a point. This result is however largely due to the one-for-all effect of the change from quarterly to six-monthly adjustments; in fact, were quarterly adjustments used, the wage increases would fall between the fraction-included and fraction-excluded results of the single-point system. It should be noted that this comparison over-estimates the degree of protection given by the new system since, in 1986, the first year of application, no revaluation of the lira value of the minimum wage to take account of intervening inflation is contemplated.

Table 2

**Increase in wages due to COL adjustments in 1985 under various systems of indexation, manufacturing**

	COL adjustment over the year (thousands of lire)	Change in wages due to COL adjustments (*)
Former system including fractions of a point . . . . .	651	2.96
Former system excluding fractions of a point . . . . .	449	2.42
New system with quarterly adjustments . . . . .	498	2.68
New system with semi-annual adjustments . . . . .	363	1.95

(\*) Ratio between COL adjustments in 1985 and average per capita earnings in 1984.

As well as the effects on average earnings, the degree of protection against inflation at various levels of wages should be assessed. The values, under normal conditions of application, of the elasticities given by the former system (fractions of a point included) and under the new regime have therefore been calculated for the first

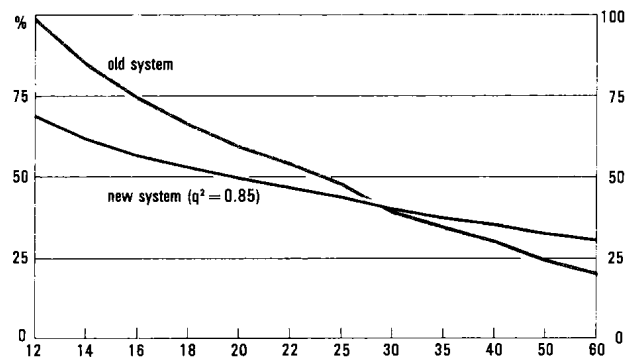
quarter of 1986. Due to the greater complexity of the calculations for the new *scala mobile* (see above), the comparison uses the analytic relationships already identified and makes the same assumptions as to frequency of adjustment and the other simplifying hypotheses, obtaining:

$$\text{new elasticity} = 0.75 q^1_{t-1} + 0.25 q^2_{t-1}$$

$$\text{old elasticity} = 6800 \times 134 / W_{t-1}$$

where  $q^2$  is equal to the ratio between the basic wage plus COL and earnings,  $q^1$  is the share of the minimum wage on earnings, while 134 is the level of the union price index for the 3rd quarter of 1985. (11)

**Elasticities to prices of the *scala mobile* system**



Considering various values between 12 and 60 million lire for annual earnings and assuming a value of the share of the base wage plus COL ( $q^2$ ) equal to 0.85, estimates of the elasticity can be derived analytically. The results of this comparison are given in the figure, where the values of the elasticity for first quarter 1986 are given on the ordinate and the various levels of income on the abscissa. Examination of the graph reveals that the new curve of elasticity slopes more gently than the old; in comparison with the previous system the degree of protection against inflation falls significantly at lower wage levels and increases slightly at higher ones (12). The point of intersection of the two curves is at a level of gross earnings just above 2 million lire per month, which compares with average earnings in 1985 of slightly more than 1.5 million in manufacturing. This indicates that, for monthly incomes of less than 2 million, the old system is

preferable in terms of the protection it affords against inflation; above that figure the new. Elasticity curves for different values of the ratio between base pay plus COL and total earnings can be derived similarly. Naturally, this comparison is indicative only, since it does not take into account the change to the semi-annual adjustment, nor any exclusion from the union price index of any changes in indirect taxes or, lastly, the effect of any other possible wage increases in earnings not due to the *scala mobile*.

(1) This section seeks to do no more than outline the main characteristics of the *scala mobile* system over the past four decades; an exhaustive account is to be found in C. Vannutelli, "Le nuove norme per la rilevazione degli indici del costo della vita ed il sistema di scala mobile dei salari", *Rivista di Politica Economica*, May 1952, and I.F. Mariani, "La revisione della scala mobile dei salari", *Rassegna di Statistiche del Lavoro*, January-February 1957 and I.F. Mariani, "Gli aspetti tecnici della riforma dell'indennità di contingenza", *Rassegna di Statistiche del Lavoro*, Supplement, (1975).

(2) Discussion of the *scala mobile* has been very animated for the past decade. What follows makes no claim to be a complete bibliography: A. Cassone, C. Marchese, F. Scacciati, *Inflazione e Salari* (F. Angeli, 1977); G. Faustini, "Indicizzazione dei salari e inflazione in Italia", *Moneta e Credito*, (1976); R. Filosa, I. Visco, "Copertura delle retribuzioni ed inflazione a tasso variabile", *Moneta e credito*, (1977); L. Spaventa, "Salario protetto dal meccanismo di scala mobile a punto pieno", *Moneta e Credito*, (1976); L. Spaventa, "Ancora sul grado di copertura del salario: un'estensione dell'analisi", *Moneta e Credito*, (1977); M. Monti, "Come migliorare la scala mobile", *Corriere della Sera*, 8 July 1982; M. Monti, "Scala mobile depurata", *Corriere della Sera*, 30 January 1984; F. Modigliani, T. Padoa Schioppa, "La politica economica con salari indicizzati al 100 o più", *Moneta e Credito*, (1975);

P. Baffi, "Una proposta per la scala mobile", *Corriere della Sera*, 18 February 1984; P. Baffi, "Sulla possibile definizione contrattuale di una fascia di flessibilità del salario reale", *Politica ed Economia*, n.10, (1985); L. Guiso, "Il dibattito sull'inflazione negli ultimi 15 anni", *Contributi all'analisi economica*, Banca d'Italia (1985).

(3) On this point see L. Guiso, "Wage indexation, income and inflation", *Temi di discussione* n. 48, Banca d'Italia (1985).

(4) In this regard see, in particular, M. Monti (1982).

(5) The clause of the agreement reads: "The increases in the cost-of-living indemnity shall be determined by reference to the absolute differences net of fractions of a point shown by the average quarterly cost-of-living index in relation to the average index of the preceding quarter". The difference in interpretation is as to whether the rounding-down should be made on the level of the index, as the unions maintain, or on the differences between the two quarterly index figures, as Confindustria considers. The difference between the two methods of rounding is on average equivalent to about 100,000 lire per annum. See G. Bodo, "Una nota sulle relazioni esistenti tra i diversi sistemi di arrotondamento dell'indice sindacale", *Economia e lavoro* (1984), pp. 123-125.

(6) The formal derivations are given in the Mathematical Appendix.

(7) The case in which the minimum wage is higher than earnings is naturally excluded.

(8) The conditions are given in the Mathematical Appendix.

(9) Other debatable characteristics of the proposal adopted are the complexity of its administration in comparison to that of a traditional points system or of a pure percentage system and the fact that the coverage given at any level of total earnings changes according to the share in them represented by basic pay plus the COL allowance.

(10) In calculating the elasticity and coverage net and gross of fractions of a point for each year the level of average earnings of the preceding year has been kept unchanged.

(11) In fact it is the average of the months of August, September and October.

(12) Calculations made on the basis of a value of  $q^2$  equal to 0.80 give very similar results.

## MATHEMATICAL APPENDIX

Given the definition

$$(1) \quad W_t = W_t^M + W_t^K + W_t^R = W_t^C + W_t^R$$

with  $W_t^C = W_t^M + W_t^K$

the indexation formulae are:

$$(2a) \quad W_t^M = W_{t-1}^M (1 + a\dot{p}_{t-1})$$

$$(2b) \quad W_t^K = W_{t-1}^K (1 + b\dot{p}_{t-1}) \quad ; \text{ where } a > b$$

where  $a$  is the degree of coverage of the minimum (100 per cent in the present case),  $b$  is the degree of coverage of the remaining part of the basic wage plus the COL payment (25 per cent in our case),  $W^M$  the minimum wage (580,000 lire),  $W^C$  the basic wage plus the COL allowance and  $p$  the rate of inflation. Substituting (2a) and (2b) in (1) and assuming that there are no increases in earnings apart from those due to the *scala mobile* in the short run, and therefore with  $W_t^R = W_{t-1}^R$ , we have:

$$(3) \quad W_t = W_{t-1}^R + W_{t-1}^M (1 + a\dot{p}_{t-1}) + W_{t-1}^K (1 + b\dot{p}_{t-1})$$

The elasticity of wages with respect to prices is easily derived from formula (3) and is equal to:

$$(4) \quad r = (a - b) q_{t-1}^1 + b q_{t-1}^2$$

where  $r$  is the elasticity of wages on prices,  $q^1$  the share of the minimum wage on overall earnings ( $W_{t-1}^M / W_{t-1}$ ) and  $q^2$  the share of basic pay plus COL payments on overall earnings ( $W_{t-1}^C / W_{t-1}$ ).

The degree of coverage ( $s$ ), defined as the ratio between the percentage change in prices and wages in the same period is instead given by:

$$(5) \quad s = (a - b) q_{t-1}^1 (\dot{p}_{t-1} / \dot{p}_t) + b q_{t-1}^2 (\dot{p}_{t-1} / \dot{p}_t)$$

From formula (4) it can also be shown that increases in the base wage plus COL payments, for equal amounts of wages not protected against inflation, cause the degree of protection against inflation to fall if:

$$(6) \quad a/b - 1 > W_{t-1}^R / W_{t-1}^M$$

where they raise if:

$$(7) \quad a/b - 1 < W_{t-1}^R / W_{t-1}^M$$

In fact, if two wages,  $W_{t-1}$  and  $W_{t-1} (1 + c)$  with  $c > 0$  and  $W^R$  unchanged, are compared, we have:

$$(8) \quad r^0 - r^N = (a - b) W_{t-1}^M / W_{t-1} + b (W_{t-1} - W_{t-1}^R) / W_{t-1} - (a - b) W_{t-1}^M / (W_{t-1} (1 + c)) - b (W_{t-1} (1 + c) - W_{t-1}^R) / (W_{t-1} (1 + c))$$

where  $r^0$  and  $r^N$  are, respectively, the old and new elasticities from which:

$$(9) \quad r^0 - r^N = c / (1 + c) (1 / W_{t-1}) ((a - b) W_{t-1}^M - b W_{t-1}^R)$$

and therefore  $r^0 \geq r^N$  if

$$a/b - 1 \geq W_{t-1}^R / W_{t-1}^M$$

Given the values of the parameters it can be considered that in general the sign of inequality is positive, implying that an increase in the basic wage, for equal amounts of non-inflation-protected earnings, leads to a fall in the degree of protection against inflation.

# Speeches

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## Lessons from the European Monetary System

by Tommaso Padoa-Schioppa, Deputy Director General of the Bank of Italy  
Lecture at the European University Institute "European Forum",  
Badia Fiesolana, Florence, 20 February 1985

### Introduction

1. To be here mitigates my nostalgia for the Brussels and Community environment in which I spent four most interesting years. During my stay at the Commission I had my first contact with the Institute in Florence; I think it was in this room that a meeting was held with Mr. Spinelli and his associates to discuss the ideas they were developing on what later became the proposal for a new treaty put forward by the European Parliament.

My subject today is the European Monetary System and, since the audience is not made up entirely of economists, I shall focus on the bridge linking the economic and the non-economic dimensions of the subject. This, therefore, is not going to be an economist's paper, nor is it going to be an academic lecture. Rather it will be an account of the reflections of a person who studied economics but who has left the field of research to become involved in policy-making.

2. When I was a student of economics I thought that economists were ahead of policy-makers in matters of international monetary relationships. Not very modestly, I now tend to think that economists today are lagging behind in some respects, that there are recent developments in monetary relationships that are difficult to explain to professional economists and yet extremely important. Perhaps the debate that will follow my remarks will help to bring these two positions together again.

Fifteen years ago the practitioners of monetary affairs still believed in, and operated under, a fixed rate regime, while most academic economists were advocating a system of floating rates and were pointing to the fundamental weaknesses and drawbacks of the Bretton Woods arrangements. The Bretton Woods system then broke down; the search for national independence in macroeconomic policies has been conducted with a system of floating rates.

The contributions of academic economists have taken several directions: one, suggested while attempts were still being made to reconstruct the system, was to adopt a variety of techniques to obtain a system of fixed but also adjustable rates, crawling pegs and the like. Subsequent contributions of academic research have come from the study of the causes and possible costs of excessive variability in exchange rates, overshootings and other aspects of this vein of the literature. Recently, the study of the relationships between sovereign countries in the area of monetary policy and more generally of macroeconomic policies have developed with increasing use of game theory, which, at least to a policy-maker, probably makes more sense than much of the preceding literature, although it does not always bring very concrete results.

Few proposals have been made for reforming the system. To talk about a reform of the international monetary system seems to be out of fashion among both practitioners and academic



economists. In all this, academic economists have tended to leave the experience of the EMS at the margin of the area of research and investigation. And I believe that to analyze the EMS and understand the essence of its six years of life economists would have to work with experts on legal matters and economic institutions. In short, I feel that the EMS experience has not yet been fully incorporated in academic research as this is conducted by economists.

So I will give my own non-technical account of this experience, which I shall divide into four points. I will first talk about the performance of the system. Secondly, about the lessons that can be learned from this experience. Thirdly, I will talk about possible and, I would say, desirable developments in the system. And, fourthly, I will talk about the difficulties we will be faced with if these developments are to be brought about. I will have to be brief on each of these four items, to leave room for the discussion.

### The performance

3. I won't talk much about the performance. Some recent research has been devoted to the appraisal of the EMS during its first years of life. In a paper I wrote last summer <sup>(1)</sup> I analyze the performance of the system in terms of exchange rate variability, interest rates, links with the dollar and convergence of macroeconomic performance in the member countries. The method adopted is to compare the performance of the EMS countries in the years before the system was established with that in the five EMS years for which evidence was available a year ago. A comparison is also made between the performance of the EMS countries in the EMS period with that of non-EMS countries in the same period. Both these comparisons show — quite convincingly, I believe — that the EMS has been fairly successful in achieving its immediate objectives, namely to have more stable exchange rates (i.e. more stable real and nominal exchange rates) and a certain degree of convergence in intermediate monetary objectives such as interest rates and the growth of monetary aggregates. There is also evidence, though weaker, that the final objectives — and inflation rates in particular — have moved substantially closer together.

In a much more general way, I would say here that the performance of the EMS in these six years can be summarized in three points.

First, *the EMS has saved free trade inside the Community* in a period in which this was threatened by numerous factors: the tensions following the second oil shock; the highly divergent inflation rates prevailing before the EMS started; and the very divergent economic policies — I would almost say ideologies — to be found in the period. To take an example that regards the last aspect, the roles assigned to macroeconomic policy by the newly elected government in France in 1981 and by its counterparts in the United Kingdom and, more recently, Germany were poles apart. In these conditions, the strains were very serious. The EMS can, I think, be said to have preserved the trade links inside the Community. This is its first and most important achievement.

Secondly, *the EMS has greatly enhanced macroeconomic adjustment in member countries*. Even though this adjustment has often been insufficient, the EMS has been the element which has pushed very strongly for macroeconomic adjustment in France and Italy, in Belgium and Denmark; indeed, in all the countries with serious problems of adjustment. This was true not only for countries with high inflation. For instance, Belgium did not have an inflation problem, its major problems were unemployment and external disequilibrium. This was probably because being a small and very open economy Belgium could not try the inflationary solution that Italy and France adopted, and had to pay for its lack of adjustment more in terms of unemployment, external disequilibrium and external debt. In all these countries, the EMS has been the catalyst of a change in policy, a catalyst which has often come late and been insufficient, but still a very substantial one if one compares the situation today with that in 1979.

Thirdly, *the EMS has helped to shield the Community from what is now called the dollar shock*. The last few years' movements in the dollar would have had a much greater impact on the cohesion of the European economies if the EMS had not existed.

I am well aware, of course, that here I provide no proof of these three points, and that my

conclusions are to some extent subjective. Certainly, it cannot be said that these goals would not have been achieved at all without the EMS, nor that they have been fully achieved or that actual achievements have been entirely due to the EMS. What I claim is that in all three respects the EMS has exerted a strong positive influence.

### The lessons

4. What lessons can be drawn from the EMS experience? For the most part I will mention the lessons that are of interest to economists. However, there are also lessons that are highly significant for those interested in the life and developments of the European Community, and I will mention some of them later on.

From an economic point of view, I think there are three main lessons. First, the EMS has shown that there is a way out of the dilemma often presented to policy-makers: to move back to a Bretton-Woods-type system of exchange rate relationships, which is inevitably too rigid and probably not feasible today, or to live in a world of totally unregulated exchange rate relationships, with all the problems, dangers and difficulties that we have experienced in the last few years.

When the EMS was set up, it was presented (and probably also conceived by its creators) as a kind of local Bretton Woods, with central rates that member countries were committed to defending, plus the possibility of making parity changes. This conception gave rise to a not entirely unjustified skepticism about the viability of the system, since the prevailing idea was that the Bretton Woods system had broken down for good reasons that were still valid when the EMS was invented. In my view, however, the latter has developed rather differently from the Bretton Woods model and cannot be seen, after five or six years of life, as a repetition, not even as a successful repetition, of the Bretton-Woods scheme.

What elements have emerged as essential components of the system that were either not included in the written provisions or, if they were written, were not originally considered essential? The first and the most important, I think, is that *realignments have become a truly collective decision*. The setting of new central rates in the EMS is a Community decision, in the same way

as the decisions setting agricultural prices. This was not built-in from the start, and indeed it was not the case in the first realignments under the system. Rather, it was achieved gradually.

The first realignment took place in September 1979, or less than six months after the system had started, and I remember very vividly that the Secretary of State of the Ministry of Finance in Germany — it was Mr. Lahnstein at the time — came to the realignment session with a list of what the new parities were to be, saying: “We have thought about the situation and have come to the conclusion that the following parity changes have to be made”. The session was rather difficult. It succeeded in setting new parities, which were in the direction indicated by that list, but not exactly the same. It was clear to all that the next realignment would have to be made differently. I remember Mr. Lahnstein himself saying that *the Commission* should propose the new parity grid on the next occasion. In a sense, this episode can be seen as the switch from the Snake to the EMS. In the Snake there were only small countries and minor currencies grouped around Germany and the DM. It was probably feasible and desirable in that context to proceed in the way tried in the first EMS realignment, but it was not possible in a full Community context.

The second realignment was totally unilateral. At a European Council meeting in Dublin a member of the Danish delegation came to me — I was then in the Commission and a member of the Monetary Committee — saying: “We have decided today in Copenhagen to change the parity; please tell the other members of the Community; we are devaluing by five percent”. The Community institutions swallowed the decision, but at the next Monetary Committee, speaking on behalf of the Commission, I clearly stated, and the other members agreed, that it was totally unacceptable to arrive at a realignment in that way ever again. So the hegemonic route, if I may use the word, was ruled out after the first realignment and the unilateral route after the second. The unilateral route was normally followed under the Bretton Woods system, with members simply communicating their new parities to the IMF.

The third realignment was made by Italy in April 1981. The Italian authorities asked to devalue by 6 per cent, and this was probably

reasonable because at the time the Italian inflation rate was running at almost 20 per cent. The extra margin Italy had acquired before the start of the system had been exhausted and a parity change was necessary. But there was renewed agreement that this procedure could not be accepted again in the future. The Italian authorities informed the chairman of the Monetary Committee late on Saturday night; there was literally no time to call a meeting and the necessary consultations were made over the telephone. The reason was that the Italian coalition Government itself had reached agreement only shortly before and, of course, to pack two big negotiations — one national, within a government coalition, and one at the Community level between ten partners — into a weekend is almost impossible.

Since then, all the realignments have been properly made, in the sense that on each occasion there was a meeting at the Community level, and that, unless the other member countries had had an opportunity to ask for an alternative change in parities and were in full agreement, the realignment was not completed.

The second element that makes the EMS so different from Bretton Woods, is that *realignments have generally been accompanied by a significant change in the domestic policies of the applicant countries*. In other words, realignments have been part of comprehensive policy packages designed to bring about adjustment. This means that changes in exchange rates have not simply been a way to ratify divergences in inflation rates, but have been actively used as a necessary element of a change in policy designed to bring national economies closer into line with that of the Community.

In conclusion, the first lesson is that there is indeed a possibility, at least for a group of countries like the Community countries, to organize their monetary relationships in a way that is neither an impossible re-edition of the old Bretton Woods system, nor the kind of monetary anarchy that was seen in the seventies and still rules at the world level.

5. The second lesson, and it is perhaps an even more surprising one, is about *parallel currencies*. I am referring to the success of the ECU.

I will not describe the facts; we have all read newspaper reports on the unforeseen growth of the ECU in the private markets. What I think is important here is that this shows, and I repeat that this was not expected, that there is a considerable potential for an international currency used by private agents, and that the development of this potential only requires a very small legal, and I would say official, platform. In reality, the only difference, as regards the ECU, between the situation before and after 1979, when the EMS started, is the name. The European Unit of Account had its name changed to ECU. Everything else remained the same. Of course, the EMS was also created, but this does not affect the private ECU directly, and yet the private ECU has developed in a very surprising way.

Now, this not only shows how important this potential is, it also shows that the ECU is more than, say, the special drawing right, i.e. it is more than a simple basket currency. For it comprises currencies bound by mutual commitments that the currencies composing the SDR do not have. Moreover, the invisible element of political commitment which is behind the EMS — invisible because it is not operational from the point of view of private markets — is very powerful indeed in showing private agents that if they want to develop a basket currency for their operations, they had better choose a standardized, easily negotiable basket, with some official endorsement, rather than composing their own on each occasion, with the aim of optimizing its composition.

In one way this is surprising, but in another it is not, because in the international financial sphere there have been other important developments that are almost entirely the fruit of private initiative. The Euromarkets are one, and they have filled a gap left by the official authorities, which were too slow to meet the needs of economic and financial integration; private agents have simply stepped in and filled the gap. More fundamentally, it is, of course, well known that in most countries central banks came after, and not before, money. As far as the ECU is concerned, we are at the stage in which there is still no central bank, but we are getting the currency.

This, I think, is a second very important lesson. When people first spoke about it more

than ten years ago, the parallel currency was simply an idea. I must confess that I myself did not know what attitude to take to the idea of a parallel currency. In practice, we have seen that it is a possibility, and there may even be problems due to the ECU being too successful.

6. The third lesson, which for lack of time I shall only mention, is that *there is scope and a need for a regional level in the organization of international monetary relationships*, a level lying between the national and the world levels.

There are various reasons why this is so. A simple way to see the point is to ask how world monetary relationships would function if the major currencies accepted to comply with binding rules and procedures. Without an intermediate step consisting of some kind of arrangement at the regional Community level, i.e. without the EMS, such a situation would probably pose a very serious threat to intra-Community relationships and these, after all, are essential not only to the well-being of the Community countries, but also to order in the world economy. It is very difficult to imagine all the European currencies being able to participate directly in a more coordinated management of world monetary relationships, or readily accepting explicit leadership by one of their members. The EMS provides the necessary link between the national and the world levels of international monetary relationships.

Moreover, in the absence of an international monetary system, the EMS at least provides order in a region as important as Europe. Other regional examples can, of course, be given. The IMF now has almost 150 member countries and most of their currencies participate in some kind of local arrangement, so that the problem of ordering monetary relationships is really a problem involving three areas, three key currencies: the US dollar, the yen, and a European currency, which is something between the ECU and the DM. I regard this third lesson as very important from the point of view of the organization of the world economy.

7. Now, if we look at the lessons of the EMS not from the economic standpoint, but from that of the life of the Community, I think the list would be even longer. In the last few years I have often been told that the only important success

and real advance in the Community has been the EMS. For myself, I think that there is at least one other important success, which is the enhanced role of the European Parliament and the fact that a fundamental aspect of political life such as election by universal suffrage has been brought into the Community. Even so, the EMS is undoubtedly a most important element and an interesting experience in Community terms, regardless of the fact that its object is money rather than some other matter.

One interesting aspect is that *the EMS was conceived and created outside the normal Community procedures*. It is not, perhaps, a praiseworthy feature, but it is a reality. It was launched here in Florence by President Roy Jenkins, in a speech that took his colleagues in the Commission almost by surprise. Indeed, the speech would perhaps not have been made if more prior consultation had taken place within the Commission. Subsequently, the bones of the system were negotiated and prepared by a small group of personal representatives of some, but not all the Community countries, completely outside the normal channels, and in spite of the lack of enthusiasm of technicians and several central banks. Again, it is not implausible to imagine that without these exceptional procedures such a major step would not have been possible.

A second lesson is the *usefulness of variable geometry in the Community*. Again, we may not like it, but it remains true that the EMS is an important case in which it was decided to move ahead even without the full participation of all the members of the Community.

A third element is that the EMS owes much of its success to the fact that it has *mobilized private agents* to a much greater extent than many other Community initiatives. In a sense those who have worked most effectively for the EMS are banks, firms and the others who have developed the ECU in the markets, simply by exploiting the initial push given by the creation of the system.

A fourth and essential element, I think, is that *the EMS has certain operational constraints which make the "threat of disaster" so strong that they practically compel decisions* and very concretely indicate what has to be done. In normal times the

operational constraint of the EMS is the obligation to intervene in the market. It is very simple. There is no room for interpretation; the system specifies exactly what is to be done. When a realignment is decided on, the critical moment in the system's life comes. The operational constraint is the fact that the markets open on Monday morning, that you cannot stop the clock, that decisions cannot be put off. This concentrates the mind most wonderfully and forces the parties to reach agreement in a way that is very difficult to achieve in other Community negotiations.

A fifth interesting element is that *the EMS develops a "parallel" system*. It does not replace national legislations or existing realities. It just creates a Community level, a Community dimension — I am thinking of the ECU — without replacing national currencies. So it shows that in some areas Community legislation can deal with the same object as national legislation, and in a way compete with it, offering a Community level to those who want and need to move at that level.

### The possible developments

8. Coming back to economics, my third subject concerns the future of the system. I shall not speak about the ultimate goal of creating a monetary union, with a single currency and a single central bank for the whole Community. I will focus instead on possible and desirable developments that could occur before reaching that ultimate goal.

The first is *the growth in the private use of the ECU*. It can be both a widening and a deepening, involving not only the use but the role and performance of the ECU.

It can be a widening because in the financial sphere we can easily conceive of an increased use of the ECU to denominate monetary assets rather than just long-term or medium-term financial assets, and some first steps are being taken in this area: credit cards, traveler's checks, instruments that can be used to make payments. Another area where a widening is possible is the non-financial area, the area of trade, where the ECU could be used to denominate non-financial contracts. A number of ideas and proposals have been put forward. One promising area is East-West trade, another is trade in primary commodities. Of

course, the problem is that there is a big difference between simply using the ECU to pay for certain commodities and using it to price them. The big change would take place the day a commodity was priced in ECU, making the price of that commodity to Community buyers independent of the dollar exchange rate. The movements of the dollar have been a strong incentive to advance in this direction, and further progress is possible. The deepening of the ECU can be conceived as the gradual disappearance of the ECU's basket nature. While the ECU was originally defined as a basket, it could conceivably — in my view there is no technical impediment — become a currency of its own, owing nothing to the fact that it was originally conceived as a basket and in no way depending on its original basket definition. Indeed, there is no operational official commitment of any kind in the private market stemming from the fact that the ECU is a basket. No agent has committed itself, so to speak, to the basket definition, and both the interest rate and the exchange rate of the ECU could at some point become independent of the basket. As a matter of fact, the interest rate of the ECU is already independent: the interest rate of an ECU-denominated bond is not the weighted average of the interest rates of the component currencies. The same could conceivably happen for the ECU's exchange rate. Here is a possible development that would take the ECU very far along the road to being a fully-fledged currency.

9. A second development — which is very important in itself and which would be even more important if the first kind of development actually took place — is the *need to devise controls over the ECU*. Those hoping for the development of a European currency may perhaps have been happy at first that there were almost no controls on the ECU and that it could take advantage of this situation. However, looking to the future, it is necessary that the same steps should be taken for the ECU as have historically been taken for all currencies: namely to develop a system of controls in the broad sense, i.e. a system whereby the stability, the good quality, and the legal framework of this particular currency are the responsibility of some institution within a legal system.

Again, this point would require a lengthy explanation. Let me simply say that this step is not particularly demanding. All or almost all the

technical elements for this kind of monetary control are already there. It may seem surprising, but in fact we have a private market for the ECU; we should soon have — and this would be a decisive advance — an organized clearing system for the ECU attached to the Bank for International Settlements in Basle. If this happens, the private circuit of the ECU will be well organized and placed, so to speak, with a point of tangency at the Bank for International Settlements, the home of the official ECU, the regular meeting place of the governors of the Community central banks. The ECU would thus be placed in an institution, the BIS, which is fully capable of acting as a bank. There is no operational reason why the critical contact between the official and the private ECU should be impossible. And this contact, namely the exchange of private ECUs against official ECUs, is the essence of monetary control. So, if central bankers one Sunday in Basle decided to allow their agent, the Bank for International Settlements, to swap private ECUs against official ECUs, we would have, qualitatively, the whole system in place. Thus control, in this essential operational sense, is possible. Of course, it is still embryonic. Though they are small, all the organs exist in the system — it is complete.

I regard this as a possible and a desirable development, though not the only one. It is my strong conviction that a legal framework is also needed. German monetary policy, which has certainly been the most successful over the years, owes much to monetary legislation, not only to monetary operations. The fact that indexation clauses in contracts denominated in Deutsche-marks are forbidden by law is, to me, an important requirement for a sound monetary constitution. Legislation of this kind is still lacking for the ECU. When I made such a proposal in Brussels, surprisingly enough the German authorities were those who objected.

The legislative capacity is in place: the Community's legal institutions are fully empowered to legislate on the ECU. Some action is needed here; the legal dimension of controls is very important.

10. The third area of future developments, after the private ECU and monetary controls, is the *shift from monetary to financial integration*.

It is surprising that integration is proceeding faster where it is more difficult to achieve, i.e., at the monetary end of the financial system, which is the most volatile and the most destabilizing, while there is so little integration at the financial end which has a potentially stabilizing role. This is even more surprising when we consider that, for obvious reasons, the Treaty of Rome hardly touches on monetary integration, whereas much is said about financial integration.

The Treaty was written when monetary integration was provided, in Europe as well as in the world, by the Bretton Woods system. In the 1950s fixed exchange rates were so deeply entrenched in our economies and ideas that the Treaty did not even need to spell out the motives that made them an essential complement of a common market. Monetary integration is really implicit in the Treaty and can well be considered as falling in the areas covered by Article 235.

Progress towards compliance with the Treaty in the financial sphere is lagging very much behind developments in the monetary sphere. Financial integration is desirable from the point of view of the efficient allocation of resources, but, alas, Europe is almost as segmented now as it was more than ten years ago. The development of the EMS, however, necessarily entails progress towards financial integration. This involves action in two areas: mobility of capital, and the integration, or harmonization, of financial structures, legislations and institutions, etc. With regard to capital mobility some countries, particularly France and Italy, are out of line. The EMS is a continuing source of pressure on laggard countries such as the above to remove existing obstacles.

In the second area, i.e. the integration of financial structures and legislations, the distinction between positive and negative country attitudes is less easy to make. What some countries desire for capital movements — and exchange controls — may not be quite so desirable for the integration of financial structures and legislation. For instance, strong opposition to further integration of insurance comes from Germany. Yet, progress in this area is very important, too. Financial integration must be striven for on all these fronts.

### The difficulties

11. Finally, a few words on the difficulties that will be encountered.

There are what I would call *false difficulties*, i.e. difficulties that are more apparent than real. Sterling is one. It is said that the EMS cannot progress without the participation of sterling. I do not share this view: sterling's joining is desirable, but it is not true that the EMS cannot advance without it. Progress has been made and further progress can be made. But such progress must not discriminate, in any way, against those who are members of the Community but do not participate in the EMS. This is an important legal problem for the experts to research. My own, non-expert view is that while the so-called *acquis* of the Community must be preserved for all members, it would not be harmful for the Community, nor illegal, for some countries to integrate more than others. If a group of countries decided on closer cooperation without discriminating against other member countries, this would not be incompatible with the spirit of the Community. Nor should there be impediments to those countries making full use of Community procedures and the Community system, including the ultimate safeguard of the system — the Court of Justice. It seems to me that the EMS has shown that this is possible. When a realignment is made, the British are present; they participate in the debate, albeit not as full members. I do not see any technical or legal impediments to further progress along this road.

A second false difficulty is the dollar. We hear people saying that the success of the EMS is attributable to the strong dollar and that with a weak dollar the system will be hard put to it to survive. But the EMS was originally created, in 1978, to face the problems posed by a weak dollar. The continued strength of the dollar in recent years has accustomed us to thinking that the high dollar has underpinned the system, and in many ways it has. We realize, of course, that the problems created by a weak dollar are not the same as those created by a strong dollar, and it would be very unwise and dangerous for the EMS to face a weak dollar with the same policies as it has faced the strong dollar. However, it is totally wrong to think that the EMS is not fit to cope with a sliding dollar.

12. Let me outline the three real and important difficulties.

One is what I would call "*breakdown before progress*". In other words, the system could break down before the kind of developments I have described take place. I do not think I need to expand on this. The system is fragile; it has been surprisingly successful and strong if we bear in mind its intrinsic fragility — a fragility that could lead to a sudden collapse. A member country could decide to opt out at any point; at realignment meetings agreement is often reached between 11 p.m. and midnight, but one day it might not be reached, and 24 hours later the system could cease to exist — a very real possibility. Again, it is possible that a democratic country could vote that it simply did not want to stay in the system, that it wanted autonomy of action. France came close to this. Fortunately, the breakdown did not occur; but the danger is always there.

To explain the second difficulty I would need more time. I will only touch on it briefly here. It is what I call "*the inconsistent quartet*". In a system of sovereign countries it is logically impossible to have free trade, free capital movements, fixed exchange rates, and full autonomy of national macroeconomic policies at the same time. It is not because countries act in bad faith or disregard the Treaty, but rather that it is impossible for all of them to reconcile the four elements I have mentioned. Of course a country — such as Germany — may be strong enough to accept the three external constraints and pursue its policies in such a way as to exert an influence on the others. The situation we have today in Europe is one in which two critical countries, France and Italy — and they make the difference between the EMS and the Snake — have accepted an exchange rate constraint, but for the time being have made little progress towards full capital mobility. For these two countries I regard this as better than the reverse situation (which has understandably been chosen by the United Kingdom) because exchange rates are, generally speaking, more important than capital movements in terms of both allocative efficiency and safeguarding free trade in the Community. But these countries could well change their position, or — as France did in 1981-82 — claim more autonomy in macroeconomic policies, even to the

point of breaking the exchange rate constraint. The fact that we are not dealing with good intentions alone, but rather with economic consistency could well prove an obstacle on the road of financial integration. If real progress is to be made on this road, it can only come from member countries accepting a further erosion of their macroeconomic sovereignty.

13. I would like to baptise the third difficulty with the somewhat provocative name of "*German reluctance*". The Federal Republic's economic strength, political importance, and remarkable record of monetary stability make it unnecessary to explain the crucial importance of its stand vis-à-vis European monetary integration.

The difficulty is not a legal one. It is not, as some seem to think, due to the special legal and institutional independence of the Deutsche Bundesbank limiting the powers of the European political institutions to proceed towards closer monetary integration. As a matter of fact no serious scholar of constitutional or Community law, in Germany or elsewhere, claims that a decision of the Council of the Communities under article 235 furthering monetary unification would not be legally binding on the Bundesbank. In the unlikely event that the debate among scholars were to end in a legal contest as a result of the Bundesbank failing to comply with such a Council decision, Germany would be taken to Court — presumably the European Court of Justice in Luxembourg. Now, it is very hard to imagine this jurisdictional body denying the power of the Community to take decisions, even far-reaching decisions in the monetary field; and the principle of the superiority of Community over national legislation is undisputed. The legal argument is thus not a difficulty in itself, but it reveals a serious political and institutional problem.

Nor does the present stance of the German monetary authorities vis-à-vis the private ECU constitute a serious difficulty, i.e. their reluctance to grant the ECU currency status because of an article of the German "*Währungsgesetz*" which forbids indexation clauses applied to DM-denominated monetary obligations. For the ECU's image this stance is certainly not a happy one. But we must not forget that, even with this somewhat paradoxical interpretation of the law,

German citizens can hold ECU-denominated assets to the same or a greater extent than citizens of countries such as Italy or France, where the ECU has the full status of a foreign currency but exchange controls severely restrict residents' foreign currency operations. The attitude of the German authorities vis-à-vis the ECU, after all, creates more problems to German banks (which are partly prevented from doing profitable business and partly led to do it through their subsidiaries in Luxembourg) than it causes to the ECU, which would not easily compete with the DM in Germany anyway.

Where then is the problem? Let me try to spell it out in my own way, that is from the standpoint of a sympathetic outside observer of Germany.

First of all one has to stress the remarkable success of Germany and the Bundesbank in maintaining monetary stability over almost forty years, even in periods in which most of the surrounding world was plagued by severe inflation. Such an outstanding performance can only command the greatest respect and admiration, particularly from a central banker operating in a country which is still striving to recover from ten years of double-digit inflation. It is only natural that in these conditions the institution which deserves most of the credit for this performance should be extremely cautious in considering the possibility of being mixed up with less virtuous partners.

But there is more than that. German monetary success is more than just monetary. It has constituted a political and historical success for post-war Germany. Since the end of the Bretton Woods system and the decoupling from the dollar, achievement of full autonomy in the monetary field has had a significance beyond the monetary sphere. I have heard acute observers of the phenomena draw a parallel between the French posture in problems of western defence and the German posture in monetary matters. In both cases there is deep attachment to the strategies and institutions which made certain accomplishments possible.

Finally, there is what I call the double dialectics: national versus supranational, and central bank versus the executive. The crossing of these two dialectics is a source of problems, that increase with the independence of the central



bank. The reason is that at the European level the decision-making institution is the Council of Ministers, which is a legislative body in the European framework but which is naturally seen by central banks as the club of the executive branches from which they claim independence in the national context. Hence Council decisions may be resented as decisions imposed by the executive on the central banks. The consequence is that these two institutional dialectics may operate in an additive way to strengthen the reluctance and hesitation of a central bank to accept institutional changes.

These are sufficient motives to explain what I have called "German reluctance". But in my view they are not justifications for it, and I say so trying to look at the long-term interest of Germany, not just taking a Community point of view. I will not develop this claim in full, as it would take more than one conference to do it. Let me only state my deeply-rooted conviction that to save both independent domestic status and national independence vis-à-vis foreign partners is going to be increasingly difficult, and in the end impossible, in an increasingly small and economically integrated world. Seeking to save oneself alone is to be regarded as a dangerous dream, particularly when the country has the size, geographical position, and history of Germany. And one should not be surprised that the temptation to take refuge in this dream is stronger in the areas of success, such as money for Germany, than in the weak areas.

Moreover, the opportunity to build a monetary authority at the European level, endowed with the same safeguards of strength and independence as the Bundesbank enjoys today in Germany, is much greater in the present state of incompleteness of the European construction than it might be at some later time when the political and institutional process of unifying Europe will have gone further. Today, a European monetary authority could only be created as part of a federal political system because the centralized, Napoleonic type of constitution simply does not exist at the European level. Thus, it is not unrealistic to think that the best way to save the special institutional position of the central bank is to place it safely at the Community level where the

hold of the executive and budgetary authorities is weak.

If this analysis is correct, then to urge further progress towards the monetary unification of our continent is not going against the fundamental interest of the strongest monetary institution among European nations, although from time to time it may entail friendly debate. Treating the difficulty facing the Germans with the understanding and respect it deserves means that action to promote further monetary integration will have to ensure that the legal, technical and institutional safeguard of independence at the Community level are at least equal to those that underlay the remarkable monetary performance of the Bundesbank. Also, it is important to give sufficient substance to the proposals for a further strengthening of monetary integration to make its political value and links with the fundamental interests and orientations of Germany more perceptible.

### Conclusions

14. Fundamentally, the three difficulties I have described are three manifestations of one and the same problem, i.e. the problem of sovereignty and institutions. The conclusion I suggest is that the essential problems of the EMS, the obstacles to the system's full success, to its possible and desirable progress, are not technical or even economic in their essence. They are basically institutional problems and involve finding a way of shifting sovereignty that is at the same time feasible, successful and acceptable. The role of the economist and the expert is to deal with the tactics or with the operational translation, so to speak, of this fundamental institutional and political problem. But if there is no clear perception that these technical aspects are just aspects of a basically non-technical problem, I think the essential point will be missed.

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## **The Italian Case: Bank Balance Sheet Trends**

*by Lamberto Dini, Director General of the Bank of Italy  
Address to the Conference "The Role of the Major Banks"*

*Organized by Banco di Roma*

*Rome, 4 November 1985*

It was with particular interest that I accepted Banco di Roma's invitation to participate in this conference, because the topic under discussion is currently of absorbing interest to experts, practitioners and the authorities.

As the first speaker, I propose to point out, while keeping to the essentials, some implications of the size and operations of Italy's large banks. As my contribution to today's proceedings, I shall present "The Italian case" seen as the outcome of a combination of historical and institutional elements. I shall indicate the factors which principally influence the market, with particular attention to those affecting the decisions of the authorities.

The specific nature of national cases should not lead us to ignore the fact that the integration of markets and the intensification of competition call increasingly for comparative analyses.

The organizers of the conference have the great merit of having solicited the contributions of experts of differing experience and diverse disciplines. Their reflections will merit our close attention and the careful assessment we owe to the strategies we have chosen.

### **1. Introduction**

The term "major banks" is an indication of size. The operational scale of these banks certainly affords them fundamental prerogatives; but it also gives them major responsibility at the level of economic policy. The major banks are called upon to finance industrial transformation and, more generally, innovations in the system of production.

Obviously, other deposit-taking institutions also exercise these functions. But in the major banks, they are a distinguishing feature that provides a measure of the adequacy of their operational role and, I would say, of their fulfilment of an obligation. The degree of stability and vitality of a banking system depends in large measure on the degree to which the major banks are able to satisfy these requirements.

They must be aware of the fact that failures in this respect interfere with the growth of the economic system.

From an operational standpoint, the term major bank is not only an indication of size; it also indicates the specialization in forms of credit for which size is an essential prerequisite: the financing of large firms, the financing of new firms, international operations, and financial services in general. Their dimensions permit them to spread risks, to sustain high rates of investment, to exploit economies of scale, and to obtain the information which gives them negotiating power equal to that of their customers.

### **2. The structure of bank balance sheets**

A consideration of banks' balance sheets should enable us to see the extent to which these prerequisites are met by the Italian banking system.

The first striking fact is that our system does not have a restricted set of banks which stand out from the others in terms of their size and share of the market. A number of economic and

institutional factors have operated through time to produce this result. I shall return to this point later.

As is well known, the thirty largest Italian banks have begun publishing accounting data twice yearly. I shall be referring to their first report, which contains data up to 30th June 1985. At that date, these banks had total resources of 506 trillion lire, equal to 78 per cent of the total for the banking system as a whole.

Looking at these 30 banks in terms of the usual indicators of market concentration, it can be seen that the ten largest administer 70 per cent of the group's total resources, 60 per cent of liabilities to customers, and 67 per cent of loans. Through their subsidiaries, these banks also dominate the medium and long-term credit market, accounting for a share of 46 per cent of the total activity of the sector. Again through their subsidiaries, their share of the investment funds market comes to about 50 per cent.

The group is composed of three banks of national interest, five public-law banks, a savings bank and a private sector bank.

Even if we keep in mind the fact that continuity rather than sharp differences in size renders our ranking of Italian banks slightly arbitrary, we can assess the role of these banks by comparing their accounting data with those of the larger group of banks.

This comparison reveals that evidence of overall stability and lower risk in the first ten banks, which is also present in the other banks, is accompanied by signs of increasing sophistication in the services provided. I will refer to averages, even though there are sizeable differences among the first ten banks, especially as regards their foreign operations and their range of customer services.

The centralness of the first ten of our system and their operational dynamism is shown by the following figures. Their share of total interbank assets and liabilities is equal to 82 and 87 per cent respectively. Their share of assets and liabilities with non-residents is about 93 per cent. Off-balance-sheet contingent liabilities, which are indicative of the range of financial and non-financial services they offer their customers, are found in these banks to a substantially higher

degree than in the others. In particular, commitment guarantees are equal to 16 per cent of assets in the former group and only 8 in the latter; the proportions with respect to total contingent liabilities are 49 and 17 per cent, respectively.

Some profit and loss indicators are also revealing in this context: the ratio of income from loans to net interest income is 2.3 for the major banks as against 1.8 for the others. The net income on interbank business is negative for the former group and positive for the latter. The net contribution of services to gross income is, respectively, 41 and 28 per cent.

The first ten banks account for 58 per cent of the net interest income of the group as a whole. This figure is less than for gross income — 62 per cent — which includes income from securities, foreign exchange trading and services. In these areas the first ten banks occupy a pre-eminent position with 70 per cent of the total for the thirty banks.

The major banks have also made a relatively large investment in information systems, the related depreciation allowance being equal to 20 per cent of their total depreciation as against 14 per cent for the other banks.

Since their assets are diversified and their loan concentration is low, the whole group of thirty banks has a low potential risk level. For the ten major banks, the indicators are close to the average. In terms of risk, their loan concentration is slightly higher for loans to industrial groups than those to individual customers.

Such a spreading of risks reflects the efforts the major banks have made over the past few years to increase their lending to medium-sized firms without at the same time reducing the credit extended to large enterprises.

In the five year period 1979-84, the major banks' share of total lending to large firms remained constant at around 40 per cent, even though these loans as a share of their overall credit portfolio decreased from 50 to 33 per cent.

This occurred while the cost of funds remained substantially the same. The incidence of fixed costs declined, while the proportion of

pre-tax profits to own funds rose to 26 per cent compared with 25 per cent for the other banks.

These banks give Italian industry comparatively great support in foreign markets, accounting for nearly all credit granted to non-resident customers.

### **3. The growth in the number of large banks**

This is the situation at present. We must now ask ourselves how it will evolve in the future.

The system did not evolve along the lines envisaged during the thirties, at the time of Italy's comprehensive banking reform. Without wishing to make predictions, I think that the historical analysis of banking, economic, and institutional phenomena should enable us to perceive the trend resulting from convergent policies in the credit, industrial, and legislative fields. We can refer to this trend for more long-term assessments. It is noteworthy that the core group of large Italian banks has not remained constant through time; that the large banks of the past have continued to be our major banks, but that others have grown and joined them; that, as a result, given that there have not been mergers among the major banks, the gap between the restricted number of major banks and other banks has not been maintained.

We may now consider to what extent these developments resulted from the strategies of bankers and authorities, and to what extent they were ascribable to market and institutional factors. For our purposes, there are three important periods in the reorganization of our banking system: the reorganization of banking in the 1930s, the changes of the postwar period, and those at the present time.

### **4. The reorganization of the banking system in the 1930s**

For the most part, the changes in the banking system in the thirties and forties were mainly the

result of the bankers' strategies. The shift of market shares from major banks to other banks was attributable to operational guidelines that had to be followed by the banks of national interest which form the nucleus of the major banks. Both legislative arrangements and government intervention laid the foundations for a division of labour in banking business, for the correct relationship between banks and firms, and for a rehabilitation of the capital bases of those banks involved in the industrial crisis. At the same time, bank officials were left with the task of reorganizing administrative structures so as to reflect new operational policies. Managers' reports reveal that the program was articulated in two parts: management reorganization and a consequent reduction of personnel, and the reduction of average costs to market levels.

Before the government interceded, bank branches were virtually excluded from granting credit. Their deposits were either absorbed by the head office for loans it granted or were invested, again at its direction, in a few large or very large local customers.

It has been observed that this transformation from the mixed banks of the previous period into modern commercial banks was so profound that it could be truly called a refoundation of the banking system.

This transformation was largely completed before World War II. However, the aim to acquire new customers beyond the traditional ones and to change the internal control systems and branch operations remained much the same in succeeding decades.

The major banks of that period (and they are still among Italy's major banks) pursued a policy of internal strengthening rather than one of expansion.

### **5. The postwar period**

The factors that contributed to the progressive reduction of the distance between the major banks and other banks in the postwar period are more complex.

I have expressed my thoughts about the changes in the structure of the Italian banking system elsewhere.<sup>(1)</sup> It is possible to argue that the

authors of the reorganization of the banking system had in mind a specialization of credit activity which appeared to be in harmony with a vision of economic development based on the geographic concentration of Italian industry and a policy of state intervention in the enhancement of markets. The major banks of that period were given the task of financing the economy and the others that of taking deposits from the general public. The aim was to create a centralized organization for credit intermediation.

a) *Economic dualism*

Subsequently, there were new interventions which, in the first place, concerned the regulation of competition based on operational despecialization, and, in the second place, involved a policy for branches that led to a comparative increase in the number opened by cooperative and savings banks. Both the increased activity of local banks and the preference given to their branch plans are attributable to policies which, in view of our spreading industrialization, were intended to correct several aspects of our economic dualism. They reflected the rule that there should be a similarity between banks and their industrial customers, in terms of geographical interests even more than of size. Medium-sized banks were assigned the responsibility for the gradual industrialization of what were at the time primarily agricultural areas.

Even when the objectives of the credit authorities were defined in terms of productivity and competition, thus leading to essentially neutral interventions with respect to the categories of banks, the major banks did not recover any ground.

In this period, expansion was easier for those banks which not only opened a network of branches for deposit-taking but also increased their range of operations.

Despecialization of those banks which had been primarily fund-raisers led to a change in the conditions of the interbank market which supplies funds to the major banks.

We should note that the major banks continued to play a propulsive role even as these influences tended to modify their structure. In particular, the development of their international business was only partly analogous to that of their domestic operations. Up to 1966 only three banks handled international business. Subsequently, this business expanded and was extended to a greater number of banks, which can be distinguished from the other banks because there is a discontinuity in this sector.

Between 1966 and 1973, the major banks participated in the rapid development of the Euromarket, with a share of more than 10 per cent. After 1974, when the precarious condition of the balance of payments necessitated a drastic cutback in such activity, the major banks were able to expand the network of foreign branches which they had created in the preceding period. In this way, they were able to defend their international banking activity, even in the frequent periods in which exchange controls were necessary.

b) *Own funds*

An insufficiency of capital hindered, in particular, the expansion of the banks of national interest.

The causes of this phenomenon, which are well known, were beyond the control of the banks, of the credit authorities, and, for the most part, even of IRI, the owner of their shares.

As Raffaele Mattioli asserted: "the phenomenon is not attributable to any shortcoming or incapacity of ours... Let us rather try to understand the underlying reasons for this difference between the performance of the banks of national interest and the other banks. Without going into individual cases, which would give us even more evidence, we should note that at the end of March 1956, the capital and reserves of the banks of national interest were 6.34 times their 1938 value, while the capital and reserves of all other deposit-taking institutions had increased 25 times, with a maximum of 44 for cooperative banks. That is, the capital and reserves of the rest

of the banking system expanded four times faster than that of banks of national interest. If we wish to protect the efficiency of this banking instrument, we must provide it with capital, which, if not adequate, is at least less ridiculously inadequate." (2)

Since IRI's budget did not permit the provision of sufficient resources to its banks, the strengthening of their capital bases would have required the sale of shares on the market. It was thought that this would undermine the banks' independence from industry, thus exposing them to the risk of takeover bids.

Government intervention with regard to the capital of deposit-taking institutions has not been confined to Italy. Nor is ours the only case in which the government has been unable to finance its enterprises adequately once it has become a shareholder. But the Italian case is unique as regards the conditions which led to the decision that it was not advisable to dispose of the public share. The size and organization of the stock exchange were insufficient to cope adequately with new flotations, and legislation did not guarantee the transparency of bank ownership or forms of control over the way shares were acquired in the market.

The requirement that banks be independent indirectly conditioned the managements of the banks of national interest in a way unknown to the managements of foreign competitor banks. This constrictive environment, together with the economic policy considerations mentioned above, forced them to pursue a strategy of maintaining their operational role rather than their market shares.

## 6. The situation today

From the past we are beneficiaries of a degree of operational despecialization that permits all banks the same range of possible activities, thus leaving it to them to determine and carry out their proper calling. We have also inherited a higher and more geographically uniform level of industrialization.

It is in this context that the credit authorities are acting to promote real equality among the operating agents, in part through regulatory innovations which were initiated in the 1970s and are being implemented today.

This trend has involved both public-law banks and banks in the form of corporations. It therefore concerns all the major banks.

There has been a lively debate about innovations affecting the role of public banks. This debate should continue to command the watchful attention needed to prevent uncertainty about the nature of this role from causing irreparable distortions to competition and the proper functioning of the entire credit system.

Serious obstacles to the operations of both private and public banks set up as corporations have also been removed. An indication of the innovations in banking law, company law, and the law that governs securities will give us a clear idea of the changes made in this respect.

The slow but steady growth of the securities market, which can be viewed with cautious optimism, is today filling a gap that economists and bankers had considered to be a factor retarding harmonious financial development in Italy. This growth has found institutional support in legislation introduced in the mid-1970s with the limited aim of ensuring control. Only in the 1980s have these provisions been implemented in such a way as to widen and deepen the financial market.

In particular, the information that companies must provide to the public has become more extensive and more reliable. Moreover, the operations of these companies have become more transparent and, with the institution of investment funds, the flow of savings has become both more selective and more widespread.

The same character of commercial rather than public law applies to innovations in banking proper fostered by the authorities.

The adoption of EEC directives designed to safeguard the banking profession by ensuring its autonomy and its moral and professional qualities constitutes a very significant innovation. The value of this innovation lies not only in its immediate effect on the operative choices of the

authorities and bank managements but also in the cultural adaptations that it produces.

As regards the updating of the company law for banks, the new provision permitting the identification of the shareholders of banks deserves special mention.

I would like to emphasize that this innovation, which the Bank of Italy had specifically supported, allows us now to keep a check on possible conflicts of interest as well as on the banks' real independence even from their owners and controllers. This lessens the risk of the banks' share of capital being acquired to make a distorted use of savings collected.

Conditions have developed whereby the large banks could now acquire a greater operational scope for investments and customer services in the securities market, also finding support for a strengthening of their capital bases. These innovations also guarantee that the recourse to capital markets will not threaten the bank's independence. The last few months have witnessed decisions by the banks of national interest to issue a substantial quantity of shares. The pricing and other conditions of these issues favour these banks' recapitalization directly on the market and do not give an advantage to the major shareholders, whose share of the equity is reduced. Compared with the three previous issues, made between 1978-84, the operations that have been announced are not at par and thus are innovative. Only one bank has issued bonus shares: the positive effect on the ratio of own funds to total resources is four times greater than that achieved on previous occasions.

Large public-law institutions such as the Banca Nazionale del Lavoro and the Banco di Napoli also intend to raise capital. The former has already asked for the authorities' approval of the operation, and the latter is planning to follow.

The positive attention given by Parliament to measures designed to modernize the system is another important factor in our context.

In addition to the innovations we have already mentioned, several others deserve our notice: a)

the law redesigning control over long-term credit institutions, which gives them greater assurance that their role in economic policy is based on a rigorous respect for the separation between banks and industry; b) the bill, already passed by the Senate, providing for control on a consolidated basis of the relationship between banks and their subsidiaries, so that the expansion of banking groups can be sufficiently transparent; c) the introduction of uniform tax treatment for the participation quotas issued by public-law banks and the shares of limited company banks; and d) the application of the same "fit and proper person" criteria to the managements and controllers of limited companies and public bodies.

To conclude, we are witnessing the confirmation of a number of innovative strands, including: a uniform principle of responsibility for all banks, which have thus been made aware of the greater scope for their operational and organizational ability; more open recourse to the capital market for both privately and publicly owned banks established either as corporations or foundations, in order to strengthen their capital bases; the reduction of geographic restrictions to competition; the greater dissemination of information revealing both merits and shortcomings.

The general purpose of this financial overhaul is to reduce the rigidities and disparities of existing restraints on the activities of credit intermediaries, while reinforcing some basic rules about transparency, information and proper behaviour. In this new framework, the pace of change in the Italian credit system will accelerate significantly in the near future, insofar as market forces provide the necessary impetus.

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(1) See "L'Autonomia dell'Impresa Bancaria", speech given at the Round Table discussion on "Prospettive per il Prossimo Futuro: l'Impresa tra Funzione e Libertà", held in June 1983 at LUISS University, Rome.

(2) From a letter written in 1956 by Raffaele Mattioli to Salvino Sernesi, Director General of the Institute for Industrial Reconstruction (IRI).

## Disinflation and Monetary Policy in Italy, 1979-85

*Speech by Carlo A. Ciampi, Governor of the Bank of Italy  
Associazione Svizzera per i Rapporti Culturali ed Economici con l'Italia  
Zurich, 10 December 1985*

### 1. The main facts

In the seventies the world economy experienced, in conjunction with the crisis of the fixed exchange rate system and the two oil shocks, slow growth, high inflation, external disequilibria, widely fluctuating exchange and interest rates, and large variations in monetary and credit aggregates. Unemployment rose relentlessly.

In Italy these developments were even more serious than elsewhere — so much so, indeed, that they produced a sharp break with the preceding decade. Earlier, between the end of the fifties and the late sixties, the Italian economy had recorded a better overall performance than the other EEC countries. Both fiscal and monetary policy, as well as the favourable development of raw material prices and domestic wages, contributed to the achievement of these results.

In the seventies both money and real wages in Italy increased more than twice as fast as in the rest of Europe and the public sector deficit rose out of all proportion. Monetary policy sought to counteract the repercussions on prices and the external accounts. Strongly restrictive measures were taken in 1974 and 1977. Nonetheless, over the decade the monetary aggregates expanded at average rates nearly twice those recorded in the other EEC countries. Nominal interest rates rose under the influence of credit restrictions and inflation expectations, but not enough to prevent real interest rates from being negative. The lira underwent a series of sharp devaluations.

These disequilibria weighed heavily on the performance of the Italian economy. In 1971-78 the rate of growth fell below that, already much

decreased, of the other European countries; inflation averaged 13 per cent, about four points above the European average; the balance of payments on current account recorded a deficit, in contrast with a surplus, albeit small, in the other Community countries; and unemployment increased considerably, though less than the Community average.

The second oil shock thwarted the partial return to equilibrium that had been achieved, above all between 1977 and 1979. Inflation, which had been brought down from 19 per cent in 1974 to 12 per cent in 1978, leapt up again and reached 21 per cent in 1980. In 1977-79 the balance of payments on current account was back in surplus making it possible to rebuild the foreign currency reserves, which had fallen to a very low level in January 1976. Between 1979 and 1980, however, the current balance swung from a surplus equivalent to approximately 2 per cent of GDP to an even larger deficit (2.5 per cent of GDP).

It was necessary to initiate new measures of adjustment. Objectively, conditions were difficult for Italy as a processing economy, heavily exposed to fluctuations in world trade and raw material prices. There was nonetheless growing awareness within the country that the deterioration in the economic situation was in large part due to domestic factors, to firmly rooted patterns of behaviour in business and government.

The task of correcting these influences fell largely to monetary policy, closely coordinated with exchange rate policy. The central bank's action was not restricted to managing aggregate demand and Italy's external competitiveness, but included structural interventions designed to increase the stability and efficiency of the credit system and the capital markets and, above all,



their ability to allocate resources. The fact that the Bank of Italy has institutional responsibility both for monetary and exchange rate policy and for the supervision of financial intermediaries enabled it to achieve significant complementarities in the two-pronged drive against inflation and stagnation.

Over the last five years some significant gains have been made.

The most important is the reduction in the rate of inflation. Between 1980 and 1985 the rate of increase in the cost of living fell from peaks of 22-23 per cent to 8.5 per cent and wholesale price inflation to 6.4 per cent. Consumer price inflation relative to the other EEC countries has fallen from the maximum differential of 9 points recorded in 1980 to 4 points. The rise in both money and real wages has slowed substantially.

By contrast, the imbalance in the public finances has grown worse. In 1980-85 the budget deficit averaged close to 12 per cent of GDP, against just over 5 per cent in the other EEC countries. Public expenditure recorded a steep rise, expanding as a ratio to GDP by nearly 11 percentage points, and considerably outstripped the increase in revenues, though it too was rapid.

The costs of disinflation have been substantial, but less than many had feared. Compared with 1971-78, the average growth in economic activity has slowed by only one percentage point and even investment has only declined by one point as a proportion of GDP. The impact on unemployment has been much more pronounced, with a three-point rise between 1980 and 1985.

## 2. Monetary and exchange rate policy

### 2.1 *The stance of policy*

After the second oil crisis monetary policy, apart from the immediate restrictive measures made necessary by the new surge in inflation, aimed over the medium term at stimulating the economy's return to a sound footing by refusing to accommodate behaviour inconsistent with growth and stability.

The resolve to bring down inflation — the long and the short of this strategy — has in the eighties come to link the Bank's action firmly with public opinion, which has become increasingly aware of the causes of the crisis and of the ways to tackle them.

The curbing of the expansion of money and credit was accompanied by a pronounced rise in real interest rates, which have since remained positive and on average close to those of the rest of the EEC.

Quantitative objectives were set and then pursued pragmatically. They were called for by: the indexation of wages and the inertia implicit in the system of three-yearly contract renewals; the financial fragility of large industrial firms that were nonetheless potentially viable; the flaws in the institutional arrangements for assuring a clear line of separation between monetary policy and fiscal policy; and the large size of the public debt.

With regard to total domestic credit, whereas lending to the non-state sector was kept more or less within limits, the public sector borrowing requirement regularly exceeded its target.

Nonetheless, these structural elements have not been viewed as immutable facts. The implementation of a rigorous monetary and exchange rate policy has rested on two basic institutional changes: Italy's participation in the EMS and the so-called "divorce" between the Bank of Italy and the Treasury. These changes made it possible to formulate and announce criteria for the management of the currency that were consistent with the stabilization and structural adjustment of the economy. The importance of these criteria lies in the more disciplined behaviour they induce, as well as in the resulting moderation of inflation expectations.

### 2.2 *The institutional aspects*

When Italy's participation in the EMS was discussed, there were many, including persons and institutions well disposed towards the development of the European Community, who adopted a cautious attitude. Though there was widespread agreement on the final objectives of policy coordination and economic and monetary integration, it was feared that in the short term

Italy might be committing itself to an undertaking that might prove to be too much for it. The memory still smarted of the country's short-lived participation in the Snake arrangement, which had ended, after a substantial loss of reserves, with a sharp fall of the lira.

Once the decision to join the EMS had been taken — after having obtained wider fluctuation margins for the lira than for the other currencies — continued participation in the exchange mechanism became at one and the same time a constraint and a priority objective. A close link was thus created between the two goals of price stability and external balance.

Of no less importance than participation in the EMS was the abrogation, in 1981, of the 1975 accord with the Treasury committing the Bank of Italy to purchase all the Treasury bills unsold at auction. This change ratified the principle that the Treasury should finance its cash needs in the market while the central bank's security purchases should be aimed at regulating the monetary base.

Previously, the Bank of Italy had bought government securities at issue and then sold them in the market to absorb the liquidity created by Treasury spending. Today, issues are mostly placed with market operators. The new procedure was a further step along the path, started on in the seventies, towards a system of monetary and credit control based on the use of market instruments rather than administrative controls.

In 1973 the ceiling on bank lending and the banks' government securities investment requirement had had to be imposed to counter the disruptive effects of inflation on a financial market in which savers' choice was limited in practice to bank deposits and long-term fixed rate bonds.

The standard of monetary management preferred by the Bank of Italy has always been that of indirect control via regulation of the monetary base and interest rates. Administrative controls are seen as emergency measures. The fact that they were kept in force without interruption for ten years was attributable to the precarious state of the economy and, above all, of the public finances; it was also a reflection of the time needed to create anew the conditions for indirect control to be effective.

The application since 1975 of the same reserve ratio to all kinds of deposits and all categories of banks has made the money multiplier more stable. Subsequently, the admission of non-bank operators to auctions of government securities and the application of the new criteria for the Bank of Italy's participation have enhanced competition and thus increased the responsiveness of yields to market conditions.

New issue methods, together with new features more adapted to inflationary conditions, resulted in a rapid expansion in sales first of Treasury bills and then of Treasury credit certificates, thereby enlarging the non-monetary financing of the government.

As of 1979 the spread of Treasury bills among savers and non-financial companies satisfied one of the basic conditions for the control of the money supply. The variability of the yields on securities such as Treasury bills, which now competed effectively with bank deposits, allowed the central bank to reduce the excessive intermediation of the banking system. In addition, a high ratio for compulsory reserves yielding a fixed rate imposes a burden on banks that becomes heavier as interest rates rise. At the same time the procedures for setting the monthly operating targets for monetary base were improved and new techniques adopted for interventions in the securities market. Noteworthy among these are securities repurchase agreements, an indispensable instrument for offsetting the fluctuations that Treasury cash flows generate in the monetary base.

The new institutional structure was severely tested in 1982, when a sudden fall in the demand for government securities — provoked by rumours of enforced consolidation and the reluctance of the Treasury to raise yields — led to a crisis in the financing of the government. The Bank of Italy was not prepared to increase its purchases of government securities beyond the level compatible with the monetary objectives. Parliament was invested with the problem and, to avoid the suspension of government payments, approved an extraordinary temporary advance by the Bank of Italy to the Treasury.

This episode dramatically highlighted the cost, in terms of either higher interest rates or the

abandonment of the fight against inflation, of the swelling of the budget deficit.

In 1983 the ceiling on bank lending was abolished and the banks' securities investment requirement reduced to negligible proportions. The decision to do so resulted in part from the sharp decline in the effectiveness of these constraints. Above all, however, direct controls had proved incompatible with progress in developing the money and financial markets. The diversification and efficiency of these markets necessitated enhancing competition — stifled by the prolonged use of the ceiling — and allowing market forces to be reflected in interest rates.

### *2.3 The effects on the behaviour of economic agents*

In the six years and more of the EMS doubts have never been raised about Italy's participation in the exchange rate agreement. Perceived as an indispensable benchmark, the exchange rate commitment has had a considerable effect on expectations and attitudes, both in the exchange market and in industry itself.

An excessively rigid exchange rate policy entailing serious losses of competitiveness can make hard-to-mend tears in the fabric of production and lead to deindustrialization. This risk has been avoided. The eighties have seen a slight fall in Italy's share of total OECD exports, together with a small drop in the ratio of investment to GDP. However, most industrial firms have returned to profitability via a far-reaching reorganization of their productive structures.

During the seventies Italian firms had eased up in their search for cost savings, put off reorganization, and relied on accommodative devaluations to remain competitive. In the middle of 1980 large firms in particular counted on yet another realignment of the exchange rate to restore their competitiveness and profitability. This expectation was reflected in heavy pressure on the lira. The Bank of Italy countered it firmly. The signal was received. Company strategies for investment and internal reorganization had to be redirected to raising productivity and resisting

cost pressures. At the same time the increase in real interest rates convinced firms to review their financial strategies, which were largely based on borrowing, and between 1980 and 1984 the sector's financial deficit was almost halved as a ratio to GDP.

To date the strengthening of industrial structures has not been accompanied by investment to increase production capacity and allow unemployment to be reduced. Nonetheless, a healthy corporate sector is a condition for better long-term employment prospects.

The changed stance of monetary and exchange rate policy has influenced the behaviour of workers both via their firms and directly. Wage claims in the seventies reflected objective uncertainty about the future value of the currency, which resulted in attempts to forestall inflation losses. In some periods, over and above the effects of excessive wage indexation, there appeared to be a perverse game of anticipation. Workers and firms fixed wages and prices on the basis of a pessimistic forecast of inflation, which had the immediate effect of creating powerful inflationary pressures.

The financial markets stabilized when the real rate of interest became consistent with the demands of the public sector on domestic savings and the requirements of the fight against inflation. The rise in yields has discouraged any flight into hedge goods since the one that ended in 1981. It has sustained households' propensity to save, while neutralizing the effects of the public sector deficit on domestic demand and, hence, on the balance of payments and inflation. Italy's abnormally high budget-deficit-to-GDP ratio is accompanied by a propensity to both real and financial saving that is one of the highest in the world. This is the key factor offsetting the imbalances created by the public finances and it will have to be preserved if the economy is to hold together.

The rigorous stance adopted in the management of the money supply and the exchange rate, together with renewed awareness of economic compatibilities, has led businessmen to make their behaviour more consistent with monetary stability and economic growth. The same cannot be said of the public sector. Between 1980 and 1984 the budget deficit increased from

10 to 16 per cent of GDP. When account is taken of the effects of inflation in depreciating the value of outstanding public debt, the budget went from a surplus equal to 2 per cent of GDP to a corresponding deficit of 8 per cent. This huge shift was due to automatic expenditure mechanisms introduced in the seventies that effectively circumvented budget constraints. Though there have been numerous legislative interventions in recent years, they have not substantially modified the mechanisms that, primarily on the expenditure side, generate the imbalance in public finances.

At the end of 1980 the public debt amounted to 67 per cent of GDP; by the end of 1985 it will reach the full equivalent of this aggregate.

Neither economic theory nor the experience of other countries permits a critical limit for the public debt to be identified. It is the deficit fuelling the debt that is the basic problem, but a large debt is nonetheless a potential cause of instability. Exogenous shocks can encourage the conversion of financial assets into real assets, with repercussions on prices and the exchange rate. Similar effects can be produced by doubts about the credibility of the government, doubts that the very size of the debt threatens to create. If the debt spiral is not halted, an unsustainable situation for the economy as a whole will eventually develop. It would prove impossible to ensure the orderly absorption of a huge and continuously expanding volume of government securities. The outcome would be a sharp acceleration in inflation and a slowdown in economic growth, to the further detriment of public finances.

Monetary policy and debt management techniques can only postpone these risks. Raising nominal and real interest rates dampens the inflationary pressures produced by the budget but boosts the growth of the debt. Demand for government securities depends not only on the yields offered but also on other important factors, including inflation expectations and the credibility of the government's economic policy. In the long run monetary restriction becomes ineffective. In view of the swelling of the debt, the stemming of aggregate demand by raising yields tends to be overwhelmed by the spending of the larger interest income.

### 3. Action on credit structures

The allocative efficiency of the credit system has been pursued not only by widening and improving the range of money and financial market instruments but also directly by sweeping action to reform the structure of intermediaries and the regulations governing them.

The crisis that afflicted Italian industrial firms in the seventies extended to their traditional methods of financing investment. Firms' resort to borrowing — which was primarily from banks and encouraged by negative real interest rates, their narrow equity bases and the small size of the stock market — had helped to generate the crisis and at the same time hindered the initiation of a new phase of expansion. Attempts to direct resources towards particular industries by administrative means, including subsidized credit, had produced inefficiencies, which, in the case of the chemical industry, were substantial.

The conviction therefore grew that, except for incentives in favour of the South of Italy, more general stimuli, applicable to broad categories of investment and firms, were preferable. The changes in the level and distribution of income made a more sophisticated and specialized financial system necessary. The strengthening of firms' equity bases required a profound transformation of the Italian stock market, which suffered from equally insufficient flows of supply and demand.

The need for major corporations and entire industries to reorganize their production, the increasingly important roles of technological innovation and new businesses for growth, and the failure of efforts at sectoral planning all called for a modernization of traditional intermediaries' operations and policies. To contribute to the competitiveness of the economy, they had to increase their operational and allocative efficiency.

The Bank of Italy's approach to ensuring that the country's credit structures responded adequately was centred on enhancing the entrepreneurial nature of banking and increasing competition throughout the financial industry. The Bank introduced administrative measures in the spheres under its jurisdiction as well as proposals for legislation.

A law passed in 1981 reformed the long-term credit sector as well as clarifying the roles of the Government, the central bank and credit institutions. Specifically, Bank of Italy authorization of major loans case-by-case was abandoned in favour of quantitative rules on the risk concentration of each institution and prudential supervision of their overall positions. Full entrepreneurial responsibility for loan decisions was restored to the banks.

In line with this approach, the Bank of Italy repeatedly proposed that the management of incentives be separated from that of credit and made the task not of credit intermediaries but of the civil service, and based as much as possible on standard, non-discretionary criteria. This principle was endorsed by the recent report of the Senate Industry Committee, which calls for the replacement of the bulk of credit subsidies by tax incentives.

Safeguarding and enhancing banking entrepreneurship in the strict sense also had complex implications, considering the public or semi-public nature of most banks. The Bank of Italy strongly reaffirmed the independence of the allocative function of banks, irrespective of their public or private status, and the conformity of this function to rigorous criteria of profitability and risk assessment. These principles underlie the entire body of Italian credit legislation. The revision of savings banks' statutes has been encouraged, to allow them to engage in virtually all types of banking business. Savings banks and public-law credit institutions have been given the right to sell minority interests in their capital to the private sector, thus giving them new means for strengthening their capital bases and permitting better market control over their operations.

A recent law requires that in banks organized as limited companies shareholders' voting rights cannot be exercised unless the beneficiary owners of the shares are known. The disclosure of ownership structures will also make it easier to preserve the boundary line between banking and industry, which until now has been maintained primarily by the public ownership of banks.

The principle of separateness between finance and industry is deeply rooted in Italian experience. Like other countries, Italy witnessed a series of banking and industrial bankruptcies

when the roles of the two types of enterprise were confused, as in the twenties and thirties. Moreover, this principle is accorded the dignity of economic theory by authoritative economists. Schumpeter, for one, has written that banks "must first be independent of the entrepreneurs whose plans they are to sanction or to refuse. This means, practically speaking, that banks and their officers must not have any stake in the gains of enterprise beyond what is implied by the loan contract".<sup>(1)</sup>

This condition of proper resource allocation is more general, and therefore more important, than the criteria supplied, with varying degrees of realism, by the theory of "perfect" financial markets. In fact, Schumpeter looked beyond market relations in the narrow sense when he set the further condition of banks' independence not only from firms but also from politics: "Alike in this respect to economists, bankers are worth their salt only if they make themselves thoroughly unpopular with governments, politicians, and the public".<sup>(2)</sup>

Heightened competition necessarily implies that non-viable banks may be liquidated or taken over by others. Only a short time ago Italian banks reached an agreement to constitute a private-law deposit guarantee fund. This means that the costs of bank failures will no longer be borne entirely by the community. Full reimbursement is only guaranteed for small depositors, while no reimbursement at all is foreseen for interbank deposits. Market control will be improved by the new practice of supplementing banks' annual accounts with the publication of interim figures and ratios enabling the profitability and soundness of individual banks to be assessed.

The changes made have opened some paths for the orderly transformation of the Italian credit system by easing the constraints on banks' freedom of action. Specifically, the procedures for the creation of new banks and the opening of branches will be gradually liberalized. The transformation of the banking system will therefore gain momentum in the near future, in part due to the concomitant effects of the end of the ceiling on lending.

The introduction of Italian investment funds has quickly had far-reaching effects on the

financial markets. These funds were authorized in 1984, after nearly two decades in which a variety of obstacles had held up the necessary legislation. Their success as well as the growth of stock market activity itself can be attributed to firms' return to profitability, investors' portfolio diversification and the major banks' search for new forms of intermediation.

Other institutional innovations are still needed to further improve the Italian financial system.

Like investment funds, pension funds would provide the stock market with support from professional investors with a long-term time frame. They would also meet the pent-up demand for an extremely useful financial product that enables current savings to be transformed into guaranteed future income. The growth of pension funds would limit the risk that an imbalance between commitments and resources invested to generate future incomes might turn social security into a threat to the stability of the entire economy.

Merchant banking services would play a fundamental balancing role now that, partly thanks to investment funds, the demand for shares is expanding. Increasing the number of listed shares would be made easier. Moreover, small and medium-sized firms would have greater access to high-quality financial assistance from intermediaries that operate in the financial market but which do not take deposits from the general public and rigorously limit their share of capital in and lending to individual firms.

It has been decided to develop a specific regulatory framework covering the establishment, operations, and supervision of these new financial intermediaries. A bill is now before Parliament, and bank and non-bank operators are waiting for the outcome of its deliberations to launch ventures that are already on the drawing board.

#### **4. The outlook and tasks for economic policy**

As the seventies drew to a close, Italy ran a serious risk that double-digit inflation might become endemic. Previously, it had long been the prevalent belief that inflation was a lesser evil, without repercussions on growth and employment or actually complementary to them.

That risk has been averted. Though not yet definitive, encouraging gains have been made notwithstanding the unfavourable conditions in the world economy and the difficulties encountered internally in integrating credit and exchange rate policy with systematic action on the budget, incomes, and the mechanisms of resource allocation. The most significant achievements came when, as in 1984, all these policies worked together.

The conviction underlying the central bank's action was that Italy's inflation was a complex phenomenon that could not be eliminated simply by means of a sharp monetary squeeze. Rather, inflation was the product of behaviour by economic agents that perpetuated and amplified inflationary impulses of domestic and external origin. This behaviour had to be eradicated by applying gradual, but firm and continuing pressure.

Monetary management, with a wider range of more discriminating tools, has gained in effectiveness, and so has exchange rate policy. The elements contributing to the soundness and allocative efficiency of the financial system have been strengthened.

Disinflation has been accompanied by the return of the productive system to health after it had progressively weakened as a result of the wage and oil shocks of the early seventies. Firms' response to the crisis had consisted more in passing the increased costs on in the form of higher prices than in reorganizing production. Then came the investment expansion of 1979-80 and considerable industrial rationalization. Today, a good part of Italian industry, comprising firms of all sizes in a diversified range of product lines, has overcome much of its former technological and organizational backwardness and constitutes a strong point for the whole economy. Remaining competitive, however, demands continuity in the application of resources, including capital as well as technical and managerial entrepreneurship.

To complete the task of closing the inflation gap with the other industrial countries is within the reach of the Italian economy, which must not let slip the opportunity provided by present international conditions. The weakness of the

dollar and the excess supply in world commodity and energy markets are conducive to price deceleration. The recent changes in the value of the lira, which has appreciated against the dollar and depreciated against the other major currencies, are already reducing the balance-of-payments deficit on current account, which had worsened steadily beginning in the fourth quarter of 1984. The deficit forecast for 1985 as a whole can now be adjusted downward, to less than 1.5 per cent of GDP.

In May 1981, addressing the annual general meeting of the Bank of Italy, I advocated a monetary policy for a return to non-inflationary growth founded on three principles: the independence of the central bank, incomes policy and rigorous control of public spending.

As to the management of money and credit, the separation of roles and responsibilities between monetary policy and the financing of public expenditure needs to be reinforced. This separation is threatened by the size of the public sector borrowing requirement. It is also undermined by the provision allowing the Treasury to draw directly on credit from the Bank of Italy up to a given proportion of its expenditure. Too often the achievement of monetary objectives clashes with the need to ensure that the government does not run out of funds.

Victory over inflation will also require new methods for determining income levels and differentials that rely less on automatic mechanisms and give greater weight to the development of productivity in the economy and individual companies as well as to skill levels.

In this area too, progress has been made since 1981. The current negotiations between business and labour on the revision of the *scala mobile* will constitute a significant step forward if, in addition to decreasing the frequency of indexation adjustments and excluding the impact of indirect taxation, they also moderate the system's wage levelling effects. The rate of increase in money wages, together with that in prices, must come down to the low values obtaining in the major industrial countries.

The all-important tessera that is still missing from the adjustment of the economy is public finances. Budget deficits and the public debt

continue on their worrying upward trend. In addition to urgent measures to curb expenditure, more stringent rules are needed in the longer run for the preparation of the budget. In this domain, institutional reforms are needed to achieve a radical change in the conduct of public finances in the direction of greater rigour and efficiency. Policies based on indiscriminate welfarism are no longer sustainable.

The only way to reverse the steadily rising ratio of public debt to GDP is by progressively reducing and eventually eliminating the budget deficit, net of interest payments. A smaller borrowing requirement and less inflation will permit nominal interest rates to come down to the extent that real interest rates do not exceed the real rate of GDP growth. This is a condition both of long-term equilibrium in the management of the public debt and of a sustained propensity to invest.

The resources freed by the public sector, which now go chiefly for consumption, can be channelled into productive investment to reduce the external dependence of the Italian economy in sectors such as energy, and to speed up research and development and the introduction of new technology. The productivity and competitiveness of the economy will be improved.

The external constraint will have to be relaxed if the GDP growth rate is to be increased over the next few years above the 2.5 per cent recorded this year and forecast for 1986. This is the only way to overcome the serious problem of the excess supply of labour that, partly for demographic reasons, will be with us until the early nineties and which is already reflected in a 12 per cent rate of unemployment. It is the only way to improve the prospect of jobs for the young, who account for a growing proportion of the unemployed, notably in the South of Italy.

The objective of greater development requires that the industrial countries, and especially those in Europe, should achieve faster GDP growth (with world trade following suit) than today's low forecasts. Unsatisfied needs exist, albeit in varying forms and to varying extents, in every country, side by side with unused resources and, above all, labour. It will be up to economic policy coordination to improve on today's projections of high unemployment and low growth over the next

five years, with their worrying implications for the international debt problem.

Italian society and individuals have important needs to be satisfied. Among our assets are a high propensity to save and able entrepreneurs and workers. Once a start has been made on putting right the public finances, our economy will return to the dynamism and the successes of the not-so-distant past. Italy will again be able to combine stability with growth. The underlying trends in the country are in this direction, even if it is proving difficult to carry out the final phase

of adjustment, and even if in its analyses the Bank of Italy still has to emphasize the persistent gravity of the state of the public finances.

It is not up to monetary policy to decide how and when the public finances are to be righted. Its task is to persevere in a rigorous anti-inflationary stance. The additional contribution it can make is to underscore that change is both urgent and feasible.

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(1) J.A. Schumpeter, *Business Cycles*, McGraw Hill, New York, 1939, Vol. I, p. 118.

(2) *Ibid.*



## Public Debt, Households' Wealth and Economic Growth

by Antonio Fazio, Deputy Director General of the Bank of Italy  
Address to the 6th National Congress of the  
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### Introduction

Throughout the seventies, but especially in the second half, the Italian economy was subjected to powerful destabilizing impulses coming both from abroad and from within the country itself. The result was a reduction in the rate of growth, a tendency for productive investment to decrease and a high rate of inflation. The budget deficit grew rapidly in relation to GDP. To safeguard financial equilibrium, the central bank curbed the growth in the money supply sufficiently to induce positive real interest rates.

Over the last few years the demand for government securities has been supported by high interest rates, which, however, have also contributed to the growth of the public debt.

In the first two sections I shall analyze the link between the budget deficit, credit and productive investment. In the third I shall look at the question whether the ongoing rapid growth of the public debt is sustainable. To this end it appeared helpful to consider the total wealth of the household sector. I shall then go on to assess the costs imposed on the economy by the existence of a very large public debt and conclude with some brief remarks on the strategy for alleviating the burden of public debt.

In examining these issues, I shall avoid reference to simplified models, which, though valuable as a first approximation, limit themselves to a study of the debt/GDP ratio and conclude that in reality it cannot go up for ever. Rather, I shall try to indicate the costs the economy has to bear as a result of growth in the public debt and analyze some of the factors that influence savers' demand for government securities.

### 1. Saving and investment

Over the quarter of a century from 1960 to 1984 total gross saving on a national accounts basis recorded a steady trend decline in relation to GDP, with a particularly sharp fall occurring in 1980-84. The component responsible for the downward movement of this ratio was public sector saving, which went from a positive value (a current surplus) corresponding to 2.8 per cent of GDP in 1960-64 to a negative one (a current deficit) equivalent to 6.3 per cent of GDP in 1980-84. The private sector, and the household sector in particular, made an offsetting increase in its saving, though not sufficiently large to prevent the fall in the total saving ratio (Table 1).

Similar trends are found for the components of financial saving, both as measured traditionally and when corrected for inflation (Table A1). The rise relative to GDP of the adjusted financial saving of households became significantly more pronounced after 1980, also in relation to the path followed by interest rates (Figure A1).

The correction of the various sectors' financial saving for the loss of purchasing power has only a redistributive effect. The reduction in the private sector's financial saving is matched by the decrease in the public sector deficit. The previously mentioned downward trend of the ratio of saving to GDP thus remains.

The counterparts of saving are principally domestic investment in fixed capital and inventories. The difference consists of the balance of current transactions with the rest of the world (Table 1).

The external current account was nearly always in surplus in the sixties and close to being

Table 1

## Saving and investment

(% ratios to GDP)(1)

	Constant prices	Current prices									
	Gross investment	Gross fixed investment				Change in stocks	External current balance	Gross saving			
		Private		General government	Total			Private sector		General government	
		Housing	Other					of which: households			
1960-64 .	25.0	6.2	13.6	3.3		1.5	0.4	25.0	22.2	16.7	2.8
1965-69 .	21.5	6.0	11.0	2.9	0.6	3.0	23.5	23.0	16.7	0.5	
1970-74 .	22.1	5.7	12.3	3.1	2.4	-0.9	22.6	25.0	19.7	-2.4	
1975-79 .	18.3	5.1	11.0	3.3	1.9	0.7	22.0	27.2	22.3	-5.2	
1980-84 .	17.9	5.1	9.7	4.0	1.3	-1.3	18.8	25.1	19.7	-6.3	
1980 ...	21.2	5.3	11.1	3.4	5.2	-2.5	22.5	26.3	19.9	-3.8	
1981 ...	18.2	5.5	10.9	3.8	1.1	-2.3	19.0	25.0	20.4	-6.8	
1982 ...	17.4	5.3	9.7	4.0	1.1	-1.6	18.5	25.7	20.1	-7.2	
1983 ...	16.0	5.1	8.7	4.2	-0.3	0.2	17.9	24.3	19.1	-6.4	
1984 ...	16.8	4.8	9.0	4.1	0.7	-0.9	17.7	24.5	(2) 19.0	-6.8	

(1) Except for housing the data for the 1960s are those recalculated by Istat to be compatible with the new system of national accounts. For housing the figures of the old national accounts were used since they have not been recalculated. — (2) Bank of Italy estimates.

in balance in the seventies. By contrast, it was in deficit in 1980-84, with the exception of 1983. In other words the reduction in national saving relative to GDP was partly offset by an inflow of resources from abroad. Over the same period the average annual increase in the net foreign indebtedness of the Italian economy was equivalent to 1.3 per cent of GDP. This is the converse of the situation in the sixties, when the high level of saving was partly transformed into net credit to the rest of the world.

Notwithstanding the above offsetting effect of the external accounts and the slightly upward trend of public investment, total fixed investment followed a downward course (decreasing from 23.1 per cent of GDP in 1960-64 to 18 per cent in 1980-84). The reduction in private sector investment affected the housing component as well as other types of investment which can be generically classified as productive (the greater part being in plant and equipment). As a ratio to GDP, the latter dropped from 13.6 per cent in 1960-64 to 9.7 per cent in 1980-84.

The level and changes in this ratio deserve further comment.

In the first place it needs to be remembered that we are dealing with flows calculated gross of depreciation. The rapid pace of investment in the sixties probably caused the stock of productive capital to expand faster (even considering all the uncertainty surrounding the measurement of this aggregate) than GDP. This gave rise to the increase in employment and productivity recorded in that decade of economic expansion and stability.

This above-mentioned growth in the stock of productive capital and the economic changes that occurred in the mid-seventies undoubtedly increased the need for replacements and hence the depreciation charges. The conceptual and measurement difficulties implicit in this item of the national accounts make it very hard to calculate. According to some estimates, its value in 1980-84 was close to that of the flow of gross productive investment, so that growth in the stock of productive capital was very small, or even nil.

Recent fixed investment has had an important characteristic feature (which was not altogether absent earlier, but which has grown more pronounced) — the incorporation of new

labour-saving technologies that give a greater production capacity per unit of expenditure. This has also entailed, however, a reduction in employment.

In any case the volume of investment has been limited by the availability of saving and has generated only a moderate increase in productive capacity.

Had there been a larger quantity of saving, it would not have been difficult to envisage a different scenario for the Italian economy. Less negative saving by the public sector would have made more room for domestic investment and thus permitted faster growth in productive capital and a higher level of employment.

This scenario does not rely on an increase in productive capacity through investments with a low new-technology content, designed to preserve and expand employment. Such a strategy appears feasible only for relatively closed economies, and in any case it would be economically misconceived since it involves using available resources inefficiently.

The framework outlined here envisages a maximization of growth through a higher level of productive investment in place of public consumption. The medium-term growth rate of the economy would benefit from the expansion in the stock of productive capital, the rapid rise in productivity and the consequent increase in international competitiveness.

## 2. Credit, financial assets and public debt

In view of the growing size of the public sector deficit, the instrument used to curb private investment, with the aim of preserving or not aggravating the foreign position, was the restriction of lending to the private sector.

The total flow of finance to the economy, as measured by total domestic credit (excluding, therefore, share issues and finance from abroad) fluctuated during the sixties around a value a little over 10 per cent of GDP (Table 2).

As I mentioned earlier, the growing public sector current deficit in the seventies was accompanied by a flow of public investment equal to around 3-4 per cent of GDP.

Consequently, the recourse of the public sector to the financial market rose from an amount averaging 2.2 per cent of GDP in the sixties to one of around 6.9 per cent in 1970-74. In the next five-year period the figure went up to 11 per cent and in 1980-84 it reached 13.4 per cent.

The share of credit going to the non-state sector, which had been especially large in the first half of the seventies in conjunction with the high level of investment in that period, fell sharply after 1977 and even more in recent years. Looking at the whole period, it can be seen that whereas in 1960-64 the credit aggregate as a ratio to GDP was 9 per cent, compared with 13.6 per cent for fixed investment (excluding housing), in 1980-84 the corresponding figures were 7.4 and 9.7 per cent. Though there has been a considerable improvement in firms' financial situations over the last few years, they are still less good on average than in the first half of the sixties. There are thus grounds for believing that the reduced availability of credit to the private sector limited the scope for investment.

The overall increase in credit to the public and private sectors tended regularly to exceed the rate of growth in nominal GDP. As a counterpart, the volume of financial assets, especially money and securities, public and private, also tended to increase steadily in relation to GDP.

A part of this excess of money and securities has been absorbed in the last few years via the external deficit. Previously, the inflationary flare-ups of 1973-74, 1976-77 and 1978-81 had been the major factor causing the GDP ratio of money and assets to fall back to just above one.

Turning to the composition of finance, the share absorbed by the public sector grew steadily, as I have already mentioned, so that the ratio of the public debt to GDP continued to rise.

While its value is now around one, it can easily be shown that it tends to reach a technical limit somewhere between 1.5 and 2, on the assumption that the ratio of the borrowing requirement to GDP and the latter's nominal rate of growth do not change. The ratio of debt to GDP is thus likely to rise considerably in the next few years. This conclusion is confirmed by extrapolations made by the Bank of Italy, the EEC, research bodies and academics.

Table 2

## Total domestic credit and the private sector's financial assets (1)

(% ratios to GDP and % composition)

	% ratios to GDP			% composition		
	Total domestic credit (a) = (b) + (c)	Financing of the non-state sector (b) (2)	Domestic state sector debt (c)	Private sector's financial assets	(b)/(a)	Bank loans to private sector/(b)
<b>Stocks</b>						
1960-64 .....	86.9	59.9	27.0		68.9	56.5
1965-69 .....	99.9	71.7	28.2		71.7	54.3
1970 .....	105.2	76.4	28.8		72.6	55.7
1971 .....	111.5	81.0	30.5		72.6	55.6
1972 .....	120.5	86.9	33.7		72.1	56.0
1973 .....	130.9	88.2	42.7		67.4	55.9
1974 .....	124.2	81.3	42.8		65.5	57.1
1975 .....	134.5	83.8	50.7	115.2	62.3	56.1
1976 .....	129.4	79.4	49.9	111.5	61.4	58.1
1977 .....	125.3	72.3	52.9	110.0	57.8	57.2
1978 .....	129.3	68.9	60.4	116.2	53.3	56.5
1979 .....	126.2	66.0	60.2	117.5	52.3	59.1
1980 .....	119.6	61.4	58.2	109.2	51.3	60.7
1981 .....	119.9	58.6	61.3	110.9	48.9	59.3
1982 .....	124.0	56.9	67.1	113.1	45.9	57.7
1983 .....	131.0	56.6	74.4	119.0	43.2	58.3
1984 .....	139.1	58.6	80.4	126.1	42.1	61.0
1985 (3) .....	146.0	58.2	87.8	131.4	39.8	(4) 60.2
<b>Flows</b>						
1960-64 .....	10.4	9.0	1.4		86.0	52.1
1965-69 .....	11.4	8.4	3.0		73.4	52.9
1970 .....	10.1	8.3	4.8		63.3	64.9
1971 .....	17.4	11.2	6.3		64.1	50.3
1972 .....	20.7	13.1	7.5		63.6	60.0
1973 .....	23.4	15.4	8.1		65.6	59.4
1974 .....	18.0	10.1	7.9		55.9	70.1
1975 .....	24.9	13.4	11.5	19.7	54.3	54.0
1976 .....	21.7	12.6	9.1	18.9	58.2	69.8
1977 .....	18.6	9.1	9.5	17.9	49.0	62.2
1978 .....	22.2	7.9	14.3	21.9	35.5	55.7
1979 .....	19.9	9.3	10.6	21.5	46.9	75.3
1980 .....	18.7	8.6	10.0	15.2	46.2	69.9
1981 .....	18.3	7.0	11.3	17.5	38.3	45.6
1982 .....	21.4	6.7	14.7	19.0	31.4	43.4
1983 .....	22.4	6.6	15.9	20.1	29.3	60.6
1984 .....	22.8	7.9	14.9	21.1	34.6	66.2
1985 (3) .....	20.6	5.3	15.3	18.1	25.7	(4) 68.4

(1) The private sector follows the definitions of the flow-of-funds accounts. Thus, unlike Table 1, it excludes credit and insurance institutions. — (2) Includes the funding of past debts, which is excluded instead from the domestic state sector debt. — (3) Estimates. — (4) First eleven months data seasonally adjusted.

Source: Bank of Italy.

I shall look more closely at the sustainability of these trends and their possible consequences in the following sections.

### 3. Households' wealth and the sustainability of the public debt

Table 3 shows the growth in the public debt since 1975, together with its ratio to GDP and composition by type of financial instrument.

Over the ten years in question the debt rose from 67 to virtually 100 per cent of GDP.

A part of the debt, as can be seen from the breakdown by instruments, has the foreign sector

as its counterpart and another part the Bank of Italy (the Treasury's overdraft facility). At the end of 1985, these two components accounted for around 10 per cent of the total debt. The item "other debt" mainly comprises lending by credit institutions to public bodies. A large proportion (around 50 per cent) of short and long-term government securities (mainly Treasury bills and Treasury bonds and credit certificates), which accounted for 75 per cent of the total debt at end-1985, was held by financial intermediaries (Bank of Italy, banks and special credit institutions, and social security and insurance institutions). Nonetheless, the proportion held by the credit system has been declining sharply over the last few years.

Table 3

#### The public debt (billions of lire and % composition)

	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985 (1)
Total debt . . . . .	83,732	102,516	124,001	158,274	190,307	227,679	282,190	360,417	454,973	560,478	677,000
Public debt as a % of GDP . . . . .	66.8	65.4	65.2	71.2	70.4	67.2	70.3	76.6	84.4	91.6	99.7
<i>% Composition</i>											
Treasury bills . . . . .	23.7	27.0	26.0	24.0	25.0	32.0	37.9	38.7	33.1	28.5	25.7
Medium and long-term securities . . . . .	34.4	31.8	40.2	44.4	42.0	34.2	30.4	30.6	39.8	43.7	50.6
of which:											
Treasury bonds . . . . .	5.9	6.3	6.2	10.9	9.9	7.5	7.5	5.4	5.1	5.7	5.4
Treasury credit certificates (floating rate) . . . . .			4.4	9.6	13.4	12.4	11.0	16.5	27.9	32.8	39.0
PO deposits . . . . .	16.0	15.6	15.5	15.2	16.2	14.5	12.6	10.9	9.7	9.0	8.4
Treasury overdraft with BI and extraordinary advance (2) . . . . .	4.2	5.0	3.9	4.2	5.3	8.4	9.0	8.8	6.9	7.5	6.9
Foreign loans . . . . .	1.3	1.4	1.3	1.3	1.3	1.5	2.3	2.6	2.7	2.8	2.7
Other debt . . . . .	20.4	19.2	13.1	10.9	10.2	9.4	7.8	8.4	7.8	8.5	5.7
<b>Total debt . . . . .</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

(1) Estimated. Includes the securities issued to fund past debts. — (2) An extraordinary advance of 8 trillion lire was granted in 1983 and repaid in 1984.  
Source: Bank of Italy.

Table 4

**Public debt held by households**  
(trillions of lire)

	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984
Government securities . . . .	4.7	7.2	11.7	20.6	32.2	46.8	73.8	92.8	139.8	194.2
Government securities + PO deposits . . . . .	16.5	21.3	28.2	40.9	57.0	75.3	104.2	126.0	176.7	236.7
Government securities/ GDP (%) . . . . .	3.7	4.6	6.2	9.3	11.9	13.8	18.4	19.7	25.9	31.7
Government securities + PO deposits/GDP (%) . . . .	13.2	13.6	14.8	18.4	21.1	22.2	25.9	26.8	32.8	38.7

Source: Bank of Italy.

When the components of the public debt held by foreign residents and financial intermediaries are set aside, the private sector (firms and households) owns about half the securities in circulation and all the PO deposits, or alternatively between 40 and 45 per cent of the total public debt.

Table 4 shows the amount of public debt held directly by households. As a ratio to GDP, this amount increased from 13 per cent at end-1975 to 39 per cent at end-1984.

An assessment of the trend of the economy's demand for government securities, and hence of the sustainability of a given level of public debt and the implications for the ways of investing savings, requires an analysis of the behaviour of the household sector in accumulating real and financial assets.

Table 5 shows an estimate of the evaluation of households' real and financial wealth at current prices between 1975 and 1984, and Table 6 the corresponding percentage breakdowns (see Appendix 2 for a description of the underlying methodology). For the purposes of this study, the period is sufficiently long since it covers the years during which the public debt grew most.

One of the best established explanations of how savers behave and wealth varies is the life-cycle theory put forward by Modigliani (which had been independently developed in part

by various other economists, including, in Italy, Giorgio Mortara). Starting from the behaviour of each economic agent during his life cycle, the theory divides each individual's existence into: a) a first phase lasting until he starts working, during which consumption exceeds income; b) a second phase, the individual's working life, during which his income exceeds consumption and he saves and accumulates wealth; c) a third phase coinciding with retirement, during which some or all of the previously accumulated wealth is consumed. The model was originally constructed on the basis of the behaviour of individual economic agents. However, it has come to be extended to cover the savings behaviour of households.

If an economy's productivity does not rise over time, and if the population does not grow and its age distribution remains constant, an equilibrium tends to be established between income saved by some individuals and income spent in excess of production by other individuals. The result is a stock of wealth accumulated by previous generations but zero net saving, in that at the end of its life cycle each generation consumes what it accumulated during its years of economic activity.

If the population is increasing, assuming a constant labour force participation rate, the number of persons who save tends to exceed the number of those who consume previously

Table 5

**Wealth of Italian households**  
(trillions of lire)

	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984
<b>Real assets</b>										
Housing .....	276.6	339.3	378.7	448.8	568.0	755.2	876.5	1,147.0	1,222.5	1,328.9
Consumer durables .....	31.2	39.5	47.8	57.5	75.6	92.3	110.9	134.5	153.9	166.6
<b>Financial assets</b> .....	147.3	174.6	202.7	247.8	296.1	364.9	427.2	503.4	612.5	733.7
Monetary assets .....	88.9	107.4	130.4	156.0	188.2	212.7	239.3	287.4	323.9	366.0
<i>of which: PO deposits</i> ..	11.8	14.1	16.5	20.3	24.8	28.5	30.4	33.2	36.9	42.5
Government securities ..	4.7	7.2	11.7	20.6	32.2	46.8	73.8	92.8	139.8	194.2
Other .....	12.4	12.3	11.4	11.8	12.1	12.9	14.9	17.9	22.1	26.7
Shares and participations	9.5	10.9	8.1	13.8	12.4	33.9	33.6	30.9	41.7	49.4
Retirement funds and actuarial reserves .....	31.8	36.8	41.1	45.6	51.2	58.6	65.6	74.4	85.0	97.4
<b>Financial liabilities</b> .....	12.1	13.3	14.8	16.9	20.0	24.7	28.6	32.5	37.5	44.5
<b>Wealth</b> .....	443.0	540.1	614.4	737.2	919.7	1,187.7	1,386.0	1,752.4	1,951.1	2,184.7

Source: See Appendix 2.

Table 6

**Composition of wealth of Italian households**  
(percentages)

	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984
<b>Real assets</b>										
Housing .....	62.4	62.9	61.6	60.9	61.8	63.6	63.3	65.4	62.6	60.8
Consumer durables .....	7.0	7.3	7.8	7.8	8.2	7.8	8.0	7.7	7.9	7.6
<b>Financial assets</b> .....	33.3	32.3	33.0	33.6	32.2	30.7	30.8	28.7	31.4	33.6
Monetary assets .....	20.1	19.9	21.3	21.1	20.5	18.0	17.3	16.4	16.6	16.4
<i>of which: PO deposits</i> .....	2.7	2.6	2.7	2.7	2.7	2.4	2.2	1.9	1.9	1.9
Government securities .....	1.1	1.3	1.9	2.8	3.5	3.9	5.3	5.3	7.2	8.9
Other .....	2.8	2.3	1.8	1.6	1.3	1.1	1.1	1.0	1.1	1.2
Shares and participations .....	2.1	2.0	1.3	1.9	1.3	2.8	2.4	1.8	2.1	2.3
Retirement funds and actuarial reserves ..	7.2	6.8	6.7	6.2	5.6	4.9	4.7	4.2	4.4	4.5
<b>Financial liabilities</b> .....	2.7	2.5	2.4	2.3	2.2	2.1	2.1	1.8	1.9	2.0
<b>Wealth</b> .....	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Memorandum item:										
Wealth/disposable income .....	4.1	4.1	3.9	4.0	4.1	4.3	4.2	4.5	4.5	4.4

Source: See Appendix 2.

accumulated wealth. If each successive generation has higher productivity as well, there is an additional positive effect on savings and on wealth, since the economically active save more than is consumed by those who have retired (the latter's consumption being constrained by their lower past income).

In the light of this model, social security systems that link pensions to the total output of the economy at any given time (i.e. pay as you go systems) necessarily diminish the positive impact of rising per capita incomes on overall savings and wealth (primarily through the emergence of public sector deficits). Demographic imbalances that lower the ratio of the economically active to the economically inactive also affect savings negatively.

Rates of population and income growth of the order of magnitude of those registered by the industrial countries over the last few decades lead to equilibrium ratios between private wealth and income of between four and five to one.

Interestingly, the wealth ratio of the household sector in Italy has usually been within these theoretical limits, with a slight tendency to increase over the past ten years (Table 6).

This wealth consists primarily of real assets, and in particular of housing, which for the last decade has always accounted for more than 60 per cent of the total (the decline of the last three years being due mainly to the trend of prices in the real estate market). Consumer durables, consisting of cars, furniture, and home appliances, also account for a significant share (about the same as government securities). One may note, finally, that owing to estimation difficulties, the calculation does not include real estate properties other than housing or such other real assets as jewelry and other hedge goods.

Shares and participations, the portion of financial assets most substitutable for real assets, have on the whole relatively limited importance. The estimate comprises only shares and equity registered in share registers, thus excluding direct ownership of unincorporated small business interests by households. These latter, apart from the difficulty of valuing them, are often linked essentially with their owners' own labour, and are therefore not easily marketable and can be transferred only in part to another owner.

The proportion accounted for by retirement funds and actuarial reserves is markedly smaller in the eighties than it was in the mid-to-late seventies.

At the end of 1984 the volume of government securities held by Italian households accounted for 8.9 per cent of their total wealth. This share appears to be correlated with the behaviour of real interest rates. For much of the seventies it was barely above 1 per cent, but then rose rapidly in conjunction with the emergence of substantial government deficits. Postal deposits accounted for between 2 and 3 per cent of households' total wealth over much of the period considered, declining to less than 2 per cent in the last few years. The sum of these last two items, therefore, has registered less rapid growth (as a share of total wealth) than have government securities alone.

The volume of government securities held by households is still substantially smaller than the other most liquid components of wealth, namely deposits and currency. Together, the total amount of securities and monetary assets is approximately equivalent to households' disposable income and to one quarter of their wealth. Over time a shift from monetary assets to securities is observable.

Given orderly financial markets and substantial confidence in the institutions, the immediate alternative to holding government securities is not current consumption but other forms of savings.

Significantly, even in disturbed periods (autumn 1982) the unwillingness to subscribe to government securities resulted, at least initially, in an increase in bank deposits. As debt maturity lengthening proceeds, both the desire for and the technical feasibility of liquidating holdings of government securities are reduced. The situation today is still far from being without dangers, but since 1983 some progress has been made in this regard.

The strong demand for consumer durables in the first half of 1980, stimulated by inadequate real yields on new issues of government securities, should be interpreted in the light of the foregoing. At other times in the postwar era, even aside from the great inflation of 1946-47, excess financial wealth has tended to go into investment in real



assets, especially housing (as in the perturbed periods of 1963-64, 1969-70, and 1979-81).

One possible way of diversifying wealth, of course, is to purchase assets abroad. Given Italy's very low ratio of foreign exchange reserves to wealth, this would immediately create problems for the exchange rate and for inflation.

The effect of a shift from monetary and financial assets to hedge goods proper (jewelry, precious metals, objets d'art, etc.), within limits, is not cause for concern over macroeconomic equilibria. It results largely in rising prices for goods that are not essential consumer items and do not affect a large portion of the population.

Savers' felt need to diversify their financial assets explains the strong demand for shares in investment funds in 1985 (not shown in the tables, which run only through 1984). This helped cause the rapid rise in stock market prices.

It has proved possible to utilize data on the structure of the wealth of households in the United States and the United Kingdom comparable to those available for Italy (Table 7). The comparison highlights interesting similarities and differences.

The first important observation is that the ratio of households' wealth to disposable income in the US and the UK does not differ greatly from the Italian ratio. The share accounted for by holdings of monetary assets is also similar.

By contrast, the proportion accounted for by shares and other equities is much higher in those countries. In the US it approaches 40 per cent and, compared to Italy, cuts sharply into the share of housing. In the UK, housing accounts for more than half of households' total wealth. Particularly high, and rising, is the value of pension funds and actuarial reserves. Unsurprisingly, the share of wealth accounted for by holdings of public debt is much higher in Italy.

A final consideration on the structure of wealth in Italy relates to the ultimate wealth content of its components. For real assets, of course, this is self-evident. Financial and monetary assets, however, consist of claims against financial intermediaries and firms, which in turn hold part of the public debt on the asset side of their balance sheets. This might suggest that households' wealth actually includes the

entire public debt, some directly and the rest through financial intermediaries and firms.

Table 7

**Composition of wealth of households**  
(percentages)

	USA		UK		Italy	
	1980	1980	1983	1980	1983	
<b>Real assets</b>						
Housing . . . . .	24.7	53.7	50.7	63.6	62.6	
Consumer durables . . . .	24.5	12.2	10.6	7.8	7.9	
<b>Financial assets</b>						
Monetary assets . . . . .	20.5	19.3	19.9	18.0	16.6	
Government securities . .	3.7	2.3	2.3	3.9	7.2	
Other . . . . .	3.4	4.0	4.1	1.1	1.1	
Shares and participations (1) . . . .	38.6	6.9	7.9	2.8	2.1	
Retirement funds and actuarial reserves (2) .	2.7	16.6	22.1	4.9	4.4	
<b>Financial liabilities</b>						
Mortgages . . . . .	11.7	8.8	10.8	2.1	1.9	
Other . . . . .	6.4	6.2	6.8			
<b>Wealth . . . . .</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	
Memorandum item:						
Wealth/disposable income . . . . .	4.4	3.7	4.1	4.3	4.5	

(1) For US and UK, includes investment trusts. — (2) For Italy, includes an estimate of retirement funds.

Source: See Appendix 2.

It appears, however, that savers' behaviour as concerns demand for government securities is affected only by the volume held directly. A bank deposit is perceived as a credit with the bank, not as in part a claim on the public sector. As for shareholdings and credits with firms, there is an even greater tendency to ignore, when evaluating risks, the fact that part of their assets consists of holdings of the public debt.

Pension funds and investment funds, by contrast, could well represent a more tenuous screen as regards risk perception and the consequent behaviour of savers.

The foregoing suggests several conclusions. In Italy, the share of the public debt held directly by households is rising rapidly, and is relatively high by international standards, but it is not especially high as a ratio to total wealth.

As to indirect holdings of public debt through the financial system and productive firms, both risk and savers' perception of it are reduced. At any rate, holding of the public debt by households directly and through banks and firms is equivalent to one fourth of their total wealth. And, as we have seen, this share will rise.

Apart from distribution problems, the cost to the community of a large volume of public debt must be assessed in the light of its effects on savings and investment along the lines of analysis outlined above, as well as in the light of the constraints it places on monetary policy and economic policy in general.

#### 4. The debt burden

Given public expenditure and revenues which do not depend on the debt, the question arises: what changes would occur in the macroeconomic picture and, more specifically, in the amount of saving and total investment in the presence of a substantial amount of debt?

A given public debt implies corresponding interest payments, which may be financed through increased revenue or alternatively a larger deficit. In the first case, public expenditure and revenue increase by equal amounts. The effect on aggregate demand, saving and investment depends on the propensity to spend of both those who receive interest and those who bear the extra tax burden. In circumstances such as these, those who saved in the past and provided the State with purchasing power enjoy the fruits of their savings. The public as a whole contributes to the payment for the benefits deriving from expenditure already made and debt-financed. In principle, the advantage of debt-financing certain government spending must be evaluated by contrasting the benefits the collectivity derives from that expenditure and the burden of interest payments imposed through the necessary taxation.

This reasoning can be extended to include the case of a partial or total reimbursement of the debt by means of taxes.

If taxation does not cover, totally or in part, the interest payments on the debt, the current government deficit will increase. Such being the case, holders of the debt receive interest payments, at least part of which will go to increase consumption. In conditions of full employment, there is a resultant reduction in aggregate saving in the country and an increase in demand for consumer goods and, consequently, problems for the balance of payments and investment. The burden of a large public debt on a country's economy is thus a crowding out of investment and the prospect of a lesser growth. This problem has been exacerbated for Italy and other countries, over the last decade, by the increase in real interest rates and the slowdown in economic activity.

Simplified analytical models of the consequences of the public debt, when comparing the growth rate of the economy with real interest rates on the debt, seem to assume implicitly that the debt service on interest payments generates a deficit — in other words, that it cannot be covered by taxation.

Recently in Italy, the public sector borrowing requirement has been greater than interest payments; consequently, the debt tends to grow, not only on account of interest payments but also because of further deficit spending. However, part of this expenditure, being investment, increases the overall wealth of the economy. This component, therefore, does not adversely affect saving or the formation of capital stock (in the broad sense).

The objective of the Minister of the Treasury for zero borrowing requirement net of interest can be evaluated in the light of these points.

The way out of a situation like the present Italian one, where the growth of the public debt is fuelled by a deficit higher than interest payments and public investment, can be none other than the gradual solution proposed in Banca d'Italia and Treasury documents. Specifically, the first essential stage is, over a period of four to five years, to make the borrowing requirement equal to interest payments. The characteristics of adjustment strategies of this kind are gradualness

and effectiveness, without undesired side-effects, on the whole complex of macroeconomic variables.

Among the costs which a large public debt imposes on an economic system we must also include those deriving from constraints on the implementation of monetary policy resulting from interest rate movements.

An increase in interest rates, as part of a policy of monetary base control, has a stabilizing effect in so far as the additional demand for financial assets is greater than the increase in interest service on the debt (produced by the change in interest rates). In particular, the interest burden increases with the growth in the share of short-term debt or of debt whose yield is indexed to short-term rates. Moreover, with the existence of a substantial volume of short-term debt, interest rates on the public debt must always be in line with money market rates if the financial system is to be controlled. In the contrary case, assuming that public debt is not renewed, the economy and, in particular, the banking system can make up for every reduction in the volume of the monetary base (which is not the case with indexed debt).

With respect to the first case, it has been shown that, in equilibrium, the additional demand for financial assets, following an increase in the interest rate, is still greater than the resulting expansion of the deficit. However, a further growth in the debt pushes the system towards a situation where interest rate movements give rise to market conditions which modify the economy's demand for government securities and the size of the public debt by approximately equal amounts.

As to the second case, the potential creation of money resulting from the redemption of securities and interest payments can be deduced from Table 8, which shows debt service (redemption and interest payments) as a ratio of GDP. In 1982 the ratio was almost 60 per cent, compared with earlier low values of around 5 per cent. This very rapid growth helps explain the frequent recourse to administrative controls on the monetary and credit aggregates from the mid-seventies.

The maturity lengthening since 1983 lies at the origin of the — gradual — reduction in the debt service ratio even at a time of growing debt. The

cost of this outcome is to be seen partly in the technical nature of the supply (indexed rates) and partly in yields capable of maintaining equilibrium in investors' portfolios.

**Table 8**

**Service on the public debt**

	Redemptions and interest	
	billions of lire	as a % of GDP
1970 .....	3,306	5.3
1971 .....	3,202	4.7
1972 .....	4,342	5.8
1973 .....	5,873	6.5
1974 .....	14,009	12.7
1975 .....	30,430	24.3
1976 .....	42,055	26.8
1977 .....	66,158	34.8
1978 .....	65,511	29.5
1979 .....	66,773	24.7
1980 .....	125,563	37.1
1981 .....	185,039	46.1
1982 .....	280,880	59.7
1983 .....	295,730	54.9
1984 .....	303,296	49.5
1985 (1) .....	313,880	46.2

(1) Provisional data.

Source: Bank of Italy.

## 5. Conclusions

The analysis in the previous four sections can be summed up as follows.

The growth of public spending and, in particular, the existence of deficits in the public sector, which since the mid-seventies have been persistently larger, have limited the growth of productive capital in the Italian economy, with resultant problems for the efficiency of the system and for employment.

Funds available for investment have been reduced to make room, in financial wealth, for a growing volume of public debt and to curb financing of the economy (even by means of administrative controls) so as to maintain macroeconomic and, especially, balance-of-payments equilibria. It may be added that, in spite

of the external deficits recorded in the last five years and the resultant inflow of foreign capital, the share of productive investment has continued to decline.

Investors' attitudes towards the demand for government securities must be examined taking into account all forms of wealth.

Where orderly financial markets exist, the amount of government securities in households' portfolios does not yet give rise to serious problems of financial equilibrium. Nevertheless, the expansion in total financial assets, for which the public debt is largely responsible, has at different times put pressure on the prices of dwellings, as well as on the demand for durable goods and for shares. To some degree or other, these pressures are always latent in the system.

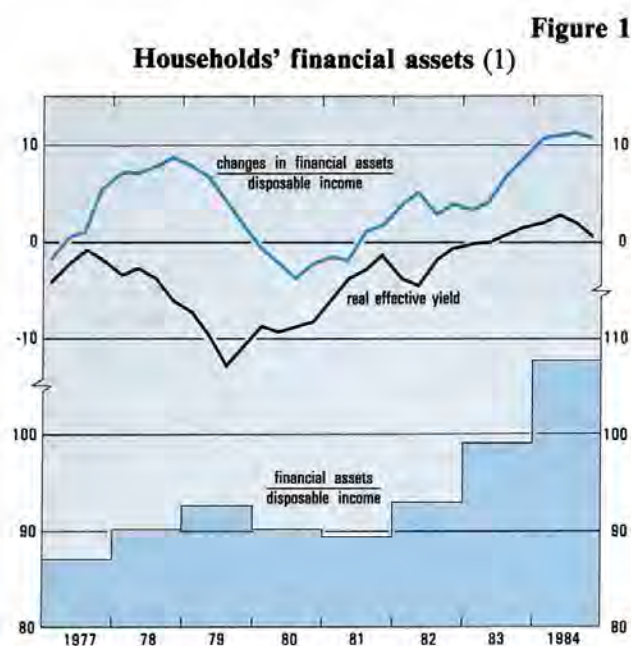
The existence of a public debt equal in size to GDP continues to have adverse effects on the availability of saving for productive investment because of the increase in the deficit resulting from interest payments.

The new debt should only finance public investment which raises the productivity of the economic system. The reduction of the borrowing requirement to the value of interest payments is the first step towards equilibrium. The only feasible path is a prudent policy of management of existing debt, as part of a gradual adjustment programme. The problem of debt accumulation is a legacy of the last decade and will presumably require five years to be resolved.

Excessive current public spending in the last ten years has cost the economy a reduction in investment; given the saving available, this adverse situation will continue over the coming few years.

Traumatic solutions, such as rapid inflationary flare-ups which could reduce or cancel the real value of the debt, or solutions of a coercive nature, would jeopardize the confidence between holders of public debt and the State and would undermine the institutional structure of the country.

## APPENDIX 1



(1) Currency plus bank, PO and special credit institution deposits, and securities.

Note: The change in financial assets in the first ratio is adjusted for the loss in purchasing power on the financial assets held at the beginning of the period and on the assets acquired during the year. The real effective yield is computed as a weighted average of those on different financial assets; it is net of taxes and deflated by the annualized recorded change in consumer prices in the two following quarters.

Table a1

## Financial balances

(% of GDP)

	Households		Firms		Public sector		Foreign sector
	Ad-just-ed	Con-ven-tional	Ad-just-ed	Con-ven-tional	Ad-just-ed	Con-ven-tional	Con-ven-tional
1976	-0.6	13.9	-1.3	-8.3	2.1	-10.0	1,5
1977	4.7	13.9	0.3	-4.0	-1.5	-9.2	-1,1
1978	7.6	15.6	-0.3	-3.6	-3.6	-10.3	-2,4
1979	1.0	14.3	2.4	-2.4	0.9	-10.2	-1,7
1980	-2.1	12.2	-2.5	-7.6	1.9	-10.1	2,4
1981	1.6	13.8	-1.9	-6.2	-3.0	-13.6	2,3
1982	3.1	14.6	-0.2	-3.9	-4.1	-14.7	1,5
1983	6.9	16.3	-1.6	-4.4	-5.3	-14.3	-0,2
1984	9.2	16.7	-1.9	-4.0	-8.3	-15.6	0,8

Source: Bank of Italy, Economic Bulletin, no. 1, 1985.

## APPENDIX 2

(sources of data in Tables 5, 6 and 7)

United Kingdom: Based on CSO, *Financial Statistics*, June 1985, Table S2.

USA: Based on R. Ruggles - N. Ruggles "Integrated Economic Accounts for the United States, 1947-80", *Survey of Current Business*, 1982.

Italy: Based on Bank of Italy and Istat data. Specifically:

1. Wealth in dwellings: estimates using the methodology in E. Lecaldano, G. Marotta, R.S. Masera, "Consumo, risparmio e tasso di interesse: la correzione per l'inflazione", in *Moneta ed economia nazionale*, Cassa di Risparmio di

Torino, 1985, Table 3. Data on the number of dwellings were updated for 1983 and 1984 with the investment in dwellings in the national accounts; unit values of dwellings are taken from the Bank of Italy's *Survey on Households' Budgets*. However, in contrast to the work cited, we assume that only 90% of the stock of dwellings is owned by households (see Istat: "Dati sulle caratteristiche strutturali della popolazione e delle abitazioni", *12th General Census*, 1983).

2. Consumer durables: perpetual inventory method with 1970 benchmark value from P. Manfroni, "Flussi e consistenze di beni durevoli

di consumo in Italia nel periodo 1951-73", *Rivista Italiana di Economia, Demografia e Statistica*, 1976.

3. Financial assets and liabilities (excluding retirement funds): Banca d'Italia, *Conti Finanziari*.

4. Retirement funds: the ratio of the net change in retirement funds to existing stock at

end-1982 taken from Istat's 1982 survey of large firms' balance sheets (Istat, *Supplemento al Bollettino mensile di statistica*, no. 1) is used to rescale the net change in retirement funds in the national accounts.

5. Disposable income: the sum of households' national consumption and gross saving.

## Developing Countries' Foreign Debt: the Situation and the Prospect

*Speech by Paolo Baffi, Honorary Governor of the Bank of Italy,  
in the Senate programme of "Expert Statements in Support of Parliamentary Debate"*

*Rome, 26 February 1986 (\*)*

As a preface to my statement, I should like to indicate to you my frame of mind in embarking on the theme assigned to me by President Fanfani. The literature on international debt has expanded at a rate comparable to that of the debt itself over the last ten years. Its profusive growth is evidenced by the existence of over seventy different plans for attacking the problems created by the debt.

The time I was able to spend in order to deepen my knowledge of this vast and recent subject and to prepare this statement proved far too short. My research, moreover, had to be based on texts that always lagged a little behind actual fast-moving developments, as well as on statistics that, even now in February, provide only partial data and estimates for 1985.

In the search for figures and in their presentation and interpretation I was helped by Mr. Falchi and Mr. Micossi, economists at the Bank of Italy, and I thank them for their contribution. I am also grateful to Morgan Guaranty Trust Company of New York for having made available the figures of Table 4, updated to 1985, in advance of their publication just a few days ago.

The flow of information that accompanies the unceasing changes in credit relations among countries and in their broader context has three sources: periodicals and reviews; the annual reports of international institutions and organizations — the IMF, the World Bank, the Inter-American Development Bank, the BIS, the UN, the OECD and UNCTAD; and, finally, the analyses of research institutes and academics. Some of these attain a high level of abstraction, all the way to theories of international debt based on sophisticated applications of mathematical logic, credit market theory, games theory and information theory. Among the analyses

produced by research institutes, the study recently published by the Istituto Italo-Latino Americano (Rome) on the American sub-continent's financial prospects in the medium term deserves special mention for its novelty, intelligibility and intrinsic value.

In addition to these external sources of information, direct experience of the facts is available to some who play an active role on the international economic scene: businessmen, bankers, politicians and government officials, for instance. For some years now I have not belonged to any of these categories. Thus, my information came primarily from the first two documentary sources, and only to a limited extent from the third. It consequently suffers from gaps that ought, perhaps, to have led me to decline President Fanfani's friendly invitation. However, rather than to take the risk of disappointing him, I preferred the one of appearing before this select audience, though fearful of falling short of your expectations and failing to make good the time you have kindly diverted from other cares.

The build-up in the developing countries' debt gained momentum after 1973, when the cartel of oil-producing countries succeeded in almost quadrupling the price per barrel. The blow was a savage one and importing countries were faced with the choice between financing and adjustment or, in other words, between meeting the extra cost by drawing on their foreign exchange reserves and borrowing abroad or adopting restrictive monetary and fiscal policies so as to curb the total volume of imports, though at the expense of domestic economic activity.

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(\*) For the present version, some data in text and tables have been updated.

The industrial countries generally resorted to a combination of the two policy approaches, though these were used in differing degrees from one country to another. If reliance had been placed exclusively or predominantly on restricting demand, there would have been a precipitate fall in world demand that would have jeopardized the deficit countries' own exports. The outcome would have been that each country's efforts to reduce its external deficit would have been thwarted, largely by the analogous efforts of other countries. At the end of a general deflationary process, the only positive result would have been a reduction in the global demand for energy, but it would have been obtained at an extremely high price in terms of reduced output.

Though applied moderately, restrictive policies were nonetheless sufficiently powerful and widespread to count as one of the principal causes of the 1975 recession in the world economy, from which Italy also suffered badly. Our gross domestic product contracted in that year by nearly 4 per cent and the attempt to reflate demand in order to overcome the crisis in productive activity pitched us into one of another kind — the exchange rate crisis that erupted at the beginning of 1976.

Use of the alternative approach, recourse to financing, was facilitated in the second half of the seventies by certain conditions, partly new, of an institutional and cyclical nature. The United States' abandonment of gold convertibility in August 1971 precluded the oil-producing countries from investing their foreign exchange proceeds in gold taken from official reserves and thus avoided the contractive effect on the supply of money that might otherwise have occurred. The foreign exchange flowed, instead, into the international money market, stimulating a corresponding supply of credit to the deficit countries.

The epoch-making decision of August 1971 had in effect created a condition of easy money, which was reflected among other things in the rise in commodity prices and, as a reaction, prompted the producing countries to multiply the price of oil. However, besides producing these harmful effects, inconvertibility strengthened the antidote provided by the new channels for financing the emerging payments imbalances.

One of these channels carried the surplus foreign exchange accruing to the oil-exporting countries — over and above their ability to import goods and services — to the international capital markets, including the multilateral financial institutions (the IMF and the World Bank), and from there to the oil-importing industrial countries to finance their external deficits. Another circuit supplied surplus oil funds to the developing countries, especially in Latin America, through the willing efforts of over-enthusiastic banks. The largest of these were engaged in a struggle for position in the rankings by balance sheet size and profits, while the smaller ones sought to enlarge their operations and prestige by entering the international market through the provision of support for their customers' foreign business, the opening of offices in the major financial centres and participation in loan syndicates. The supply of credit facilities to the developing countries exceeded their immediate balance-of-payments needs, thereby encouraging the adoption of expansionary policies that swelled the deficits. The foreign exchange borrowed in international markets and put back into circulation by the developing countries in the form of import demand flowed largely to the industrial countries and from them back to the oil-exporting countries, which redeposited it with the international markets. The growth in lending in these latter reflected in significant measure the accumulation of deficits by the non-oil developing countries.

By 1978 the surplus of the oil-exporting countries was on its way to being absorbed, but in the following year the second oil shock intervened, with a resultant tripling of the price per barrel. This recreated a huge oil surplus, as can be seen in Table 1 and Figure 1. The shock plunged the external current accounts of the industrial countries back into the red in 1980, but the adjustment policies promptly adopted lifted them into surplus again in 1981-83. The deficit that reappeared in 1984-85 was due entirely to the United States.

After the new shock the international financial carrousel therefore started off anew, this time on an even grander scale. In 1982, when the oil exporters' surplus had started to shrink once more, it was replaced by a new source of international liquidity — the surpluses recorded



Table 1

**Payments balances on current account (1) by major area**  
(in billions of US dollars)

	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985 (2)
United States .....	9.1	7.6	21.2	7.5	-11.7	-12.3	2.6	6.6	10.8	-2.6	-34.5	-93.0	-123.2
Other industrial countries .....	11.2	-18.4	-1.4	-7.0	9.3	44.2	-8.3	-45.4	-7.6	5.1	38.4	57.8	71.1
Oil-exporting developing countries .....	6.7	68.3	35.4	40.3	29.4	5.7	62.1	109.4	51.9	-13.6	-14.5	-3.5	-5.7
Non-oil developing countries .....	-11.3	-37.0	-46.3	-32.6	-29.6	-41.5	-61.1	-86.6	-107.8	-86.3	-53.9	-38.7	-43.8
<i>Memorandum item:</i>													
Real GNP of the industrial countries (in per cent)	6.1	0.5	-0.6	5.0	3.9	4.2	3.3	1.3	1.4	-0.4	2.6	4.7	2.7

Source: IMF, *World Economic Outlook*.  
(1) Excluding official transfers. — (2) Partially estimated.

as the counterpart of the US balance-of-payments deficit, which emerged then and grew to a huge size in 1983-85. The alternating pattern of surpluses and deficits can be seen in Figure 1. One censurable channel that developed alongside the principal one was the re-exporting by Latin American countries, both openly and clandestinely, of a sizable part of the funds lent for their development.

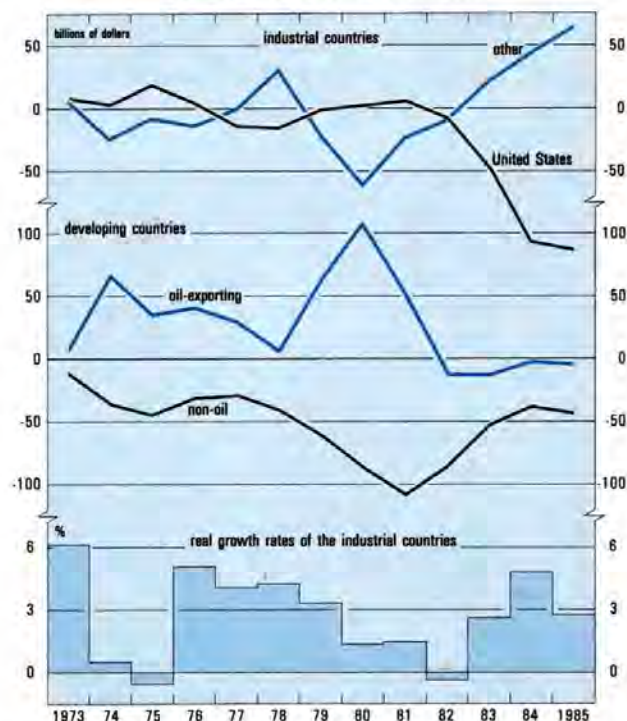
Encouraged to borrow, at real interest rates that were substantially negative in the second half of the seventies, and pressed by the investment and consumption demands of expanding populations, the developing countries, and especially those in Latin America, failed to take adequate account of the growing illiquidity and insolvency risks they were running. These risks are reflected in the unprecedented levels reached by the various measures of vulnerability: the ratios of outstanding debt to GDP and exports, and the corresponding ratios for debt service (interest plus capital) and interest on its own. These ratios are shown in Tables 2 and 3 and Figures 2 and 3, both for the indebted developing countries as a whole, and for the most heavily indebted group, the Latin American countries.

The above risks were further aggravated by the now primarily disinflationary aim of economic policies in the rest of the world, as well as by a lack of policy coordination, neglect of the external repercussions of domestic policies and their possible feedback effects, and the consequently heightened and partly random variability of not only interest and exchange rates

in both nominal and real terms but also of the flows of international finance.

Figure 1

**Payments balances on current account by major area and real growth rates of the industrial countries**



Source: IMF.

In an international context so lacking in cooperative efforts the average rate of real growth in the seven major industrial countries fell from 4

Table 2

## External debt and main indicators of risk of the indebted developing countries (1)

(in billions of US dollars)

	1980	1981	1982	1983	1984	1985 (2)
<b>Total debt (3)</b> .....	566.8	662.4	749.1	796.9	840.7	877.6
— medium and long-term .....	455.8	529.4	598.6	664.9	707.9	753.8
— guaranteed .....	370.7	422.2	481.8	553.9	603.9	653.0
<i>of which:</i>						
to official creditors .....	172.5	193.7	215.6	239.6	270.3	290.3
to financial institutions .....	154.8	182.7	212.9	254.9	280.4	307.9
— unguaranteed .....	85.1	107.2	116.8	111.0	104.0	100.7
— short-term .....	111.0	133.0	150.4	132.0	132.7	123.8
Total debt/GDP (%) .....	25.7	28.9	33.2	35.9	36.8	37.7
Total debt/exports of goods and services (%) .....	110.4	122.9	147.6	158.8	152.8	161.2
<b>Debt service</b> .....	87.8	110.7	122.4	111.0	126.2	131.4
— interest .....	44.9	62.3	70.7	66.8	72.2	71.8
— principal (4) .....	42.9	48.3	51.7	44.1	53.9	59.5
Debt service/exports of goods and services (%) .....	17.1	20.5	23.6	22.0	22.9	24.1
<i>of which:</i>						
interest/exports of goods and services (%) .....	8.7	11.2	13.6	13.0	13.1	13.2

Source: IMF, *World Economic Outlook*.

(1) All the oil-exporting and non-oil developing countries except eight oil-exporting countries in the Middle East whose foreign liabilities are negligible compared with their assets (Saudi Arabia, United Arab Emirates, Iran, Iraq, Kuwait, Libya, Oman and Qatar). — (2) Partially estimated. — (3) Excluding amounts owed to the IMF. — (4) Medium and long-term debt.

Table 3

## External debt and main indicators of risk of the indebted developing countries in Latin America

(in billions of US dollars)

	1980	1981	1982	1983	1984	1985 (1)
<b>Total debt (2)</b> .....	229.4	285.6	325.5	340.2	355.9	365.5
— medium and long-term .....	176.2	217.2	248.6	282.6	300.0	314.1
<i>of which:</i>						
to official creditors .....	31.5	35.2	39.9	49.8	57.1	60.4
to financial institutions .....	80.2	98.7	115.7	147.2	165.3	181.0
— short-term .....	53.2	68.3	76.9	57.6	56.0	51.4
Total debt/GDP (%) .....	32.8	36.2	43.1	48.2	47.3	45.8
Total debt/exports of goods and services (%) .....	182.8	208.8	267.2	287.5	273.3	294.0
<b>Debt service</b> .....	41.6	55.8	62.0	48.1	53.8	55.8
— interest .....	22.9	33.5	39.0	35.9	39.6	38.5
— principal (3) .....	18.7	22.3	23.0	12.2	14.2	17.3
Debt service/exports of goods and services (%) .....	33.3	41.1	49.6	43.0	42.4	44.2
<i>of which:</i>						
interest/exports of goods and services (%) .....	18.2	24.4	31.9	30.7	29.8	29.6

Source: IMF, *World Economic Outlook*.

(1) Partially estimated. — (2) Excluding amounts owed to the IMF. — (3) Medium and long-term debt.

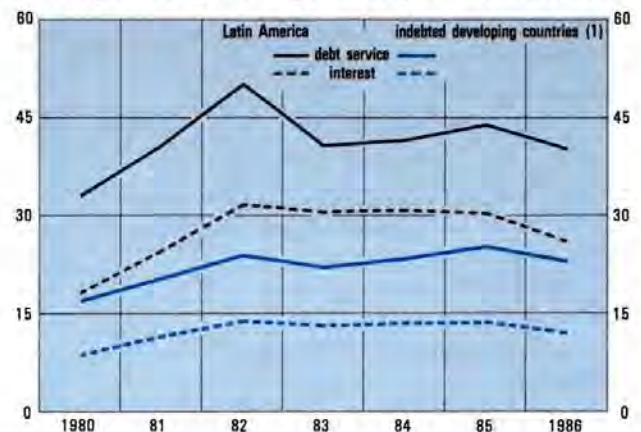
per cent in 1977-79 to 1 per cent over the three following years. The prices of non-energy primary materials fell steadily during the two years 1981-82, as can be seen in Figure 4. Real interest rates (i.e. nominal rates adjusted for the rate of inflation) leapt from 2-3 per cent in 1980 to around 7 per cent in 1982 as a result of the increase in nominal rates. In 1983-85 they remained at this high level as a result of the fall in inflation rates in line with that in nominal interest rates. The exchange rate of the dollar, the currency in which most of the developing countries' debt is denominated, rose in average effective terms by roughly 25 per cent between 1980 and 1982 and by another 25 per cent between 1982 and the beginning of 1985. The effective exchange rate of the dollar in both nominal and real terms is shown, together with that of the Deutschmark, in Figure 5.

The recession eroded the volume of the developing countries' exports. After expanding at an average annual rate of 4 per cent in 1977-79, an average contraction of 6 per cent was recorded in each year between 1980 and 1982. In conjunction with this fall in exports, the non-oil developing countries suffered a worsening in their terms of trade amounting to about 13 per cent over the three years 1980-82.

The appreciation of the dollar, the high real cost of money, the shrinking of export markets, the fall in export prices and the worsening of the terms of trade caught the developing countries in a pincer movement, some of the forces in play tending to reduce their foreign exchange earnings, others to increase their outlays, and together combining to produce a debt service crisis that came to a head first in Mexico in August 1982 and then spread to numerous other countries. The reaction of the international financial community was both rapid and orderly. The central banks acting under the aegis of the BIS, together with the US Treasury, successfully arranged a number of bridging operations that gave the IMF time to set up financial assistance and adjustment programmes which served as the cornerstone for the rescheduling and refinancing of commercial bank loans. Rescheduling operations had been organized by the Paris Club since as early as the 1950s for government and government-guaranteed loans.

Figure 2

### Debt service and interest payments as a percentage of exports of goods and services

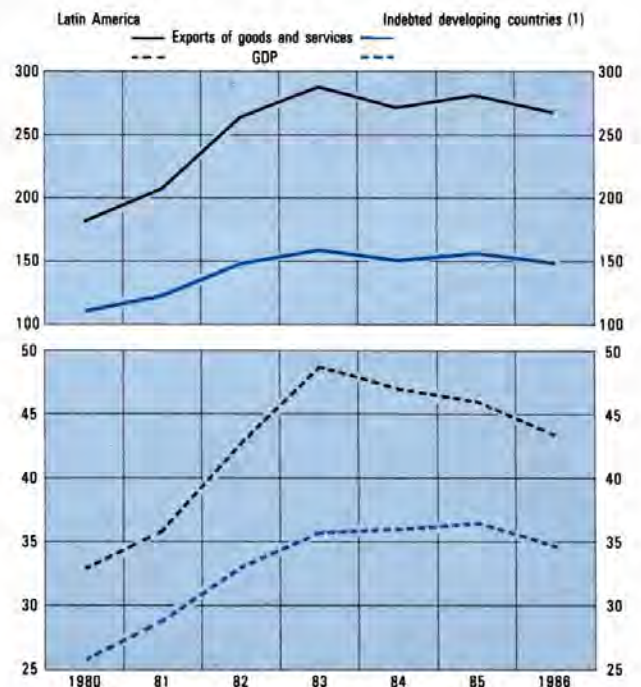


Source: IMF.

(1) All the oil-exporting and non-oil developing countries except eight oil-exporting countries in the Middle East whose foreign liabilities are negligible compared with their assets (Saudi Arabia, United Arab Emirates, Iran, Iraq, Kuwait, Libya, Oman and Qatar).

Figure 3

### Total debt as a percentage of GDP and exports of goods and services



Source: IMF.

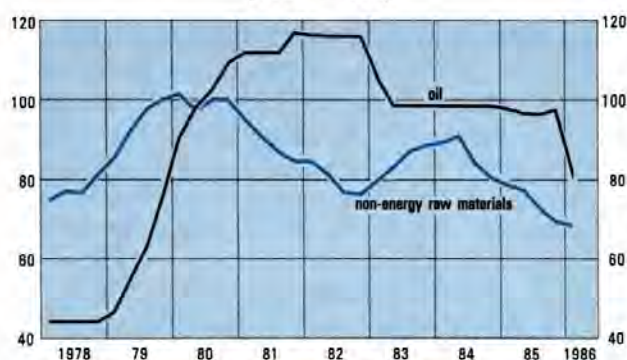
(1) All the oil-exporting and non-oil developing countries except eight oil-exporting countries in the Middle East whose foreign liabilities are negligible compared with their assets (Saudi Arabia, United Arab Emirates, Iran, Iraq, Kuwait, Libya, Oman and Qatar).

Together, the steps taken in 1982-83 prevented a crisis of the international financial system. The danger was further diminished by the improvement in 1983 and 1984 in the world economic situation and especially in that of the developing countries.

Figure 4

#### Indices of dollar prices of oil and non-energy raw materials

(1980 = 100)



Source: IMF.

In 1985, unfortunately, some of the negative developments of 1980-82 re-emerged: the growth rate of the OECD area fell from 5 per cent in 1984 to 2.5 per cent and that of world trade from 8.5 to 3.0 per cent; the terms of trade of the developing countries worsened, as did their current account balances, notwithstanding their cuts in imports since 1983; and their debt and its servicing rose again in relation to exports. At the same time, in response to pressure exerted by some of the major industrial countries, the IMF appreciably reduced access to its financing and the World Bank and the IDA diminished their disbursements.

Awareness of how serious the potential consequences of these developments were, both for the countries directly affected and for international relations, finally led, in the autumn of 1985, to a shift in policy attitudes, as evidenced by the so-called *Baker plan*. The plan sets as an objective for the developing countries an annual growth rate of 5 per cent in the three years 1986-88. This appears feasible provided: the industrial countries grow on average by 3 per cent annually and world trade by 5 per cent; the debtor nations implement adequate macro-economic and structural policies; and the flow of

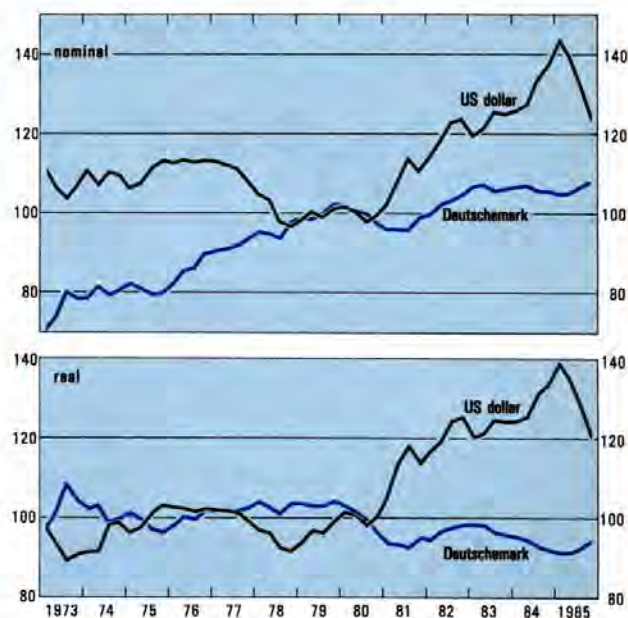
new lending by commercial banks to the 15 countries that account for about half the developing countries' total debt amounts to \$20 billion over the next three years (corresponding to a 2.5 per cent annual increase in outstanding loans) and is supplemented by \$9 billion of World Bank and Inter-American Development Bank lending over and above their normal annual flows of \$6 billion.

The announcement of the plan eased North-South tensions but its implementation is hindered by the recent deterioration in the relations between the IMF and some debtor countries, internal management problems in the World Bank, and the difficulties inherent in devising programmes in which the adjustment and development objectives converge and in modifying and coordinating the operating criteria of the two institutions in this new light.

Figure 5

#### Effective exchange rate indices

(1980 = 100)



Source: Based on IMF and OECD data.

Since last autumn when the plan was announced, the price of oil has fallen to around \$15 a barrel and the dollar has depreciated, thereby substantially changing the context in which it is expected to operate. The prospects for the growth of the world economy now appear

more favourable. According to the OECD, the fall in the oil price is likely to increase the real growth of the industrial countries by about half a percentage point. The related damping of inflationary pressures opens the way to a fall in interest rates. This, together with the fall in the exchange rate of the principal currency used to denominate loans, will bring debtors a double advantage.

The decrease in the price of oil will improve the external balance of the non-oil developing countries by about \$10 billion, but at the same time it makes more dramatic the situation of a small group of indebted developing countries that rely on oil for a large share of their exports: Mexico, whose debt amounts to \$100 billion, Ecuador, Nigeria and Egypt. In the not too distant future Venezuela, which still has substantial foreign-exchange reserves, Algeria and Indonesia could also find themselves in difficulty. The share of oil in the exports of a number of these countries is shown in Table 4; it is as high as 90 per cent and over for Venezuela and Nigeria.

Table 4

**Exports of the major oil-exporting developing countries**

(in billions of US dollars)

	1978			1985 (*)		
	Net exports of oil (1)	Exports of goods (2)	(1)/(2) (%)	Net exports of oil (1)	Exports of goods (2)	(1)/(2) (%)
Mexico .....	1.8	6.7	27	13.3	22.9	58
Venezuela .....	8.7	9.2	95	12.8	14.2	90
Nigeria .....	9.4	10.4	90	11.4	11.8	97
Algeria .....	5.9	6.3	94	9.5	13.3	71
Indonesia .....	6.3	11.0	57	8.6	19.8	43
Ecuador .....	0.6	1.5	40	1.8	2.8	64
<b>Total ...</b>	<b>32.7</b>	<b>45.1</b>	<b>73</b>	<b>57.4</b>	<b>84.8</b>	<b>68</b>

Source: IMF.

(\*) Partially estimated.

The "reinforced strategy", of which the Baker plan is part, will have to adapt to this new configuration of crisis points and rewrite the roles of the various actors in the light of the lessons of

recent events. Among these, I would include the recognition of the limits imposed by various factors on the efficiency of a system of developing country financing based primarily on commercial bank loans to governments and public sector bodies. Commercial banks are skilled in assessing credit risks at the microeconomic level of individual firms, rather than at the level of sovereign countries, where the uses of funds, the degree of maturity transformation and the possibility of attaching assets are all very different. In a recent essay Rainer S. Masera recalled the enormous losses that sovereign loans brought to the houses of the Bardi, the Peruzzi and the Medici in the Middle Ages. In practice the only penalty banks can impose on indebted foreign states is to stop lending — a two-edged sword since, by eliminating the prospect of assistance in the future, the lender removes the borrower's principal motive for honouring his outstanding debt. "To throw good money after bad" is not necessarily an irrational course. The application of penalties other than the withdrawal of credit, such as restrictions on debtors' trade and international assets, is the business of governments. Moreover, too many banks financing any one sovereign borrower can lead not only to competition inward but also to competition outward, i.e. to attempts by individual banks to be the first to recover their credits when doubts arise about the solvency, liquidity or the good intentions of the borrower: in other words, to situations not dissimilar to the runs on deposits from which banks themselves suffer.

The rapid and responsible action taken in 1982-83 by finance ministers and central bankers, in concert with the major creditor banks, almost certainly prevented such behaviour from spreading and threatening the stability of the international financial system. It is also true, however, that the flow of commercial bank funds to the developing countries has been highly variable. After the bonanza of the second half of the seventies and the early eighties, the flow decreased sharply in 1984 and dried up in 1985. Since 1983 the interest paid by the indebted developing countries has exceeded the net new credit they have received from the market. There has thus been a reversal of roles, with a net financial transfer to the creditor countries. Over

the three years 1983-85 this amounted to close on \$80 billion, and this year another \$40 billion is on the cards. While the market borrowing of the middle-income developing countries has exposed them to these violent fluctuations, the poorest countries' reliance on official lending, for lack of access to the market, has led to their benefiting from a more stable flow of finance.

Over the last three years the debt-service obligations of the developing countries have

forced them to adjust in an essentially negative way, i.e. primarily by cutting imports, investment and consumption. These disturbing features of the process are clearly brought out in Table 5, which summarizes the data provided by Morgan Guaranty. The figures refer only to ten Latin American countries, but evidence from other sources indicates that the African debtor countries, and especially Nigeria, have pursued the same route of sharply reducing the resources available for domestic uses.

Table 5

## Some economic indicators of 10 Latin American countries

	trade		Balance on current account		Growth in volume from 1981-82 to 1985		Real GNP per capita from early 1980s' peak to 1985 (% change)	Rate of inflation (1)
	1980-82	1983-85	1980-82	1983-85	Exports	Imports		
	in billions of U.S. dollars				percentages			
Argentina .....	2.1	12.5	-11.8	-6.2	26.7	-43.4	-16.8	34
Bolivia .....	0.9	0.6	-0.5	-0.7	-28.9	-8.5	-28.4	495
Brazil .....	-0.8	32.0	-40.9	-8.0	27.6	-26.4	-3.4	336
Chile .....	-3.4	2.0	-9.0	-4.6	23.1	-34.8	-14.4	21
Colombia .....	-4.1	-2.3	-5.1	-6.4	14.3	-22.6	-0.9	16
Ecuador .....	0.6	3.0	-2.8	-0.6	41.6	-26.1	-6.6	20
Mexico .....	-1.4	34.3	-26.0	9.7	16.2	-28.9	-8.0	87
Peru .....	-0.1	2.3	-3.3	-1.4	-6.7	-45.5	-14.2	45
Uruguay .....	-1.0	0.6	-1.7	-0.5	11.6	-46.1	-18.0	73
Venezuela .....	18.8	24.4	4.5	13.7	-21.3	-28.1	-19.3	8
<b>Total ...</b>	<b>11.5</b>	<b>109.3</b>	<b>-96.4</b>	<b>-5.0</b>	<b>11.8</b>	<b>-29.8</b>	<b>-7.2</b>	<b>121 (2)</b>

Source: Morgan Guaranty Trust Company of New York, *World Financial Markets* (February 1986).

(1) Change in consumer prices in the last three months on an annual basis. — (2) Weighted with the 1984 GDP of each country.

The table shows that the trade balances of the ten countries recorded a fairly general improvement, with the overall surplus rising from \$11.5 billion in 1980-82 to \$110 billion in 1983-85. It also shows that the overall current deficit was reduced considerably and almost eliminated, falling from \$96 to \$5 billion. Moreover, it can be seen that these results were obtained through a 30 per cent contraction in the volume of imports and a 12 per cent expansion in export volume, that in 1985 real GNP per capita in these countries was 7 per cent down on average compared with the peaks reached at the beginning of the eighties,

and that this decrease in expenditure in real terms only served in a few countries, notably in Argentina, to curb inflation.

From what I have said it can be seen that the instability of credit flows and interest rates has been partly responsible for the form — very costly in terms of welfare — that adjustment has taken in the developing countries. This instability depends in turn on the present distribution of roles, which is flawed by an excess of public sector debtors and private sector creditors. To eliminate this imbalance, two corrections of

opposite sign will have to be made: on the one hand, debtor countries will have to pursue policies — and not simply of privatization but for prices, public service tariffs, and interest and exchange rates — that will permit the private sector to expand and attract direct investment from abroad; on the other, the lending capacity of the international financial institutions will have to be improved together with the systems for financing exports. This strengthening presupposes, in turn, the rapid approval of a general capital increase for the World Bank and the completion of the 8th replenishment of IDA resources. The IMF can use channels and resources that are already available. In this context, it will be recalled that in 1983 the Group of Ten countries renewed the General Arrangements to Borrow, increasing the amount involved from SDR 6.4 to SDR 17.0 billion and opening the possibility for countries not in the Group to use these funds if world financial stability appeared threatened. The substantial liquid resources of the Fund can therefore be expanded if need be by activating the GAB.

As for the role of export credits, it is worth noting how the implementation of development programmes, which the new strategy sets in a relationship of mutual dependence with adjustment programmes, is necessarily based on investment. Inasmuch as export credit is generally linked to the supply of investment goods, it tends to be an integral part of such programmes and provides an implicit test of their congruence. Thus export credit, which has developed as an instrument of trade competition, should also perhaps be put on a more cooperative footing.

It is almost superfluous, given all that has been said on the subject, to recall the need for the industrial countries to maintain and enlarge the access to their markets of the producers of primary products. Argentina and Uruguay rightly complained a few days ago that the EEC not only pursues protectionist agricultural policies but also dumps excess production.

Earlier I indicated interest rates as one of the causes of the worsening of the developing countries' debt situation. The reference rate most commonly used for three-month dollar maturities, LIBOR, rose from 6 per cent in 1977 to 17 per cent in 1981. I also mentioned that, despite the

subsequent fall in nominal rates, real rates remained at historically high levels owing to the simultaneous slowdown in inflation. Since the growth rates of nearly all the developing countries are below the real rate of interest, increasing demands — in the long run unsustainable — are being imposed on their national products.

Various plans have been promulgated, as I mentioned at the outset, with a view to relieving the debt burden of the developing countries. Some of these tackle the problem of high interest rates in ways that I think are worth describing and commenting upon. Specifically, I have in mind the proposals of Erik Hoffmeyer, the Governor of the Danish central bank, and Professor Assar Lindbeck in Sweden. Governor Hoffmeyer suggests that the governments of the rich countries should jointly subsidize the interest on the outstanding debts of the poor countries and indicates two ways of doing so. The first foresees a tax on the interest earned on foreign currency reserves, the resulting revenues being distributed in proportion to developing countries' foreign debt interest burdens. The second proposal is for a direct refund of a part of the interest paid to creditors, who would acquire a corresponding tax credit. The proposal is based on the consideration that the tax systems of the industrial countries, which allow interest payments to be deducted from taxable income, provide an incentive to borrow that pushes up interest rates. It seems to me that Hoffmeyer has only identified one source of the upward pressure public finances exert on interest rates. While entrepreneurs do not normally borrow at rates above the expected rate of return on investment, governments take little notice of this constraint, and indeed they may also borrow to finance current expenditure. Their demand crowds out that of the private sector, which finds room, at higher rates, for only a fraction of the investments it would make if it could finance them at lower rates. This preemption of saving by governments, with little concern for its short-term costs or longer term effects on development, also imposes a burden on the developing countries. Hoffmeyer's proposal is, I believe, given a second and stronger leg to stand on by this diversion of saving towards unproductive uses.

Everybody knows that the best example of a forcing up of interest rates caused by a

combination of an easy fiscal policy with a tight monetary policy is that provided in the last five years by the United States. The rise in interest rates in the US market encouraged a substantial inflow of capital that, on the domestic front, contributed to financing the budget deficit and, on the external front, financed the initially moderate and then enormous US deficit on current account. At the same time the higher rates helped drive the dollar to heights unreasonable by any standard, thus further reducing US competitiveness and preparing the subsequent fall.

The indifference shown until recently by the US authorities towards these upheavals, which went beyond the "benign neglect" of previous administrations, is claimed by some to have had the beneficial effect of supporting world demand. This is seen to have come about through the huge net absorption of resources from abroad (albeit by a rich country that should have a different vocation), which helped the developing countries to service their debts while satisfying the demand for dollar-denominated assets on the part of the rest of the world and especially Japan.

There are persons here who have followed the debate on this issue more closely than I have. I shall therefore only point out that the demand for dollar assets also depends on the yield offered. A more balanced US fiscal and monetary policy mix would have led to lower interest rates, which in turn would have reduced the demand for dollar assets, while world demand for goods and services could have received equal support from a high volume of international trade with a more acceptable distribution of current account balances.

I shall now turn to Professor Lindbeck's proposal, which is to transform existing debt into perpetual debt, ranking after new loans in order of interest payments and yielding a return below the market rate or else index-linked to the prices debtor countries are able to obtain for their exports. It has been objected that the implementation of Lindbeck's scheme would involve enormous legal difficulties since it would require the agreement of thousands of creditors or legislation to modify contracts. Nonetheless, the idea underlying the second formulation, i.e. of relating the interest burden to debtor countries'

export prices could be put into practice in other ways, through the IMF, for instance. The Fund already provides the Compensatory Financing Facility, designed to offset pronounced deviations from trend in countries' trade balances due to natural, social or market developments that are beyond their control and temporarily raise import expenditure or lower export revenue. This facility could be extended to interest rate fluctuations, measured, Lindbeck suggests, in real rather than nominal terms. Alternatively, an ad hoc facility could be set up, drawing, for example, on the resources provided by the reimbursement of loans granted from the Trust Fund established with the proceeds of IMF gold sales.

The choice of export prices as the basis for calculating the real rate of interest appears well founded, both historically and logically. Between 1980 and 1985 the weighted nominal rates the developing countries paid on their debt fluctuated over a very narrow range — from 8 per cent to 9 per cent. However, when these rates are deflated with the index of the debtor countries' export prices, they are found to have risen on average from a negative value in 1980 to around 16 per cent in 1982-83 and to have still been about 14 per cent last year.

Turning to the logical arguments, I should like to observe, though I know this is a point that I have already made on previous occasions, that the wide fluctuations in the purchasing power of national currencies — in relation to goods and other currencies — lessen the determinateness of the contracts between exporters and importers, lenders and borrowers, and firms and their customers and employees. The mechanisms for protecting the substance of obligations from the inherent weaknesses and volatility of the unit of account — provided they are suitably constrained so as to prevent the damage they could otherwise wreak on domestic and external monetary equilibria — work, I believe, to increase social welfare.

The second formulation of Lindbeck's proposal falls into this category. It represents one of the many ways of relating the debt burden to an index of ability to pay or to aggregates that influence this, such as the prices of debtor countries' exports. Proposals of this kind introduce a partnership strand into credit



relations that can increase both the ability of borrowers to service their debt, by linking payments to the flow of resources, and their willingness to do so, by adding an element of equity.

It is true, of course, that reference to ability to pay in credit relations may have the perverse effect of encouraging debtor behaviour that will actually reduce this ability (the so-called moral hazard), but in the context of developing country debt this risk does not exist since the link between interest rates and prices would tend to encourage developing countries to increase production and creditors to open up their markets. The proposal reduces the risk of default, which in any case could be covered by arrangements for country-risk insurance within the ambit of the IMF, in line with the ideas put forward by its former Managing Director, Witteveen, and subsequently revived and developed by Masera.

In my statement I have stressed the need for the flow of funds to the developing countries to be maintained and for elements of flexibility and equity to be introduced into credit relations. This circumscription of the broader theme was in response not only to the time factor but also to two other considerations.

The first is that the debate on the general lines of economic policy in the situation facing debtors and creditors today has already been amply developed. Several of the conclusions that have received wide acceptance were set out, almost in codified form, in the speech given by the Managing Director of the IMF, de Larosière, to

the Overseas Bankers Club in London at the beginning of this month.

The second is that debt service runs up against the limit of willingness to pay before reaching that of ability to pay. The suggestions I have made are partly designed to sustain the former, bearing in mind the good account debtor countries have given of themselves to date in the midst of very real difficulties that recent developments have aggravated for some countries and which President de la Madrid forcefully described in a message to the Mexican people on 21 February.

The wide range of technical solutions that have emerged from the theoretical debate gives ample scope to the implementation of political will, provided the North-South dialogue advances in a constructive spirit with both parties aware that their interests are intertwined and not opposed.

The heads of the international financial institutions and the leading bankers of the industrial countries must often have occasion to say with Hamlet,

I must be cruel, only to be kind.

But one is justified in reminding them, their counterparts in the developing countries and the other protagonists of the drama that is unfolding on the world stage that when Polonius wishes to treat the actors "according to their desert", the same Hamlet replies:

"..... much better! use every man after his desert, and who shall 'scape whipping? Use them after your own honour and dignity".

# Appendix

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## Statistical tables

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Table a1

## Gross product, implicit price deflator and current account balance

	US	Japan	Germany	France	UK	Italy	Canada
<b>Real GNP (1)</b>							
<i>(% changes on previous period; seasonally adjusted data)</i>							
1980 .....	-0.3	4.8	1.5	1.0	-2.3	3.9	1.1
1981 .....	2.5	4.0	—	0.2	-1.4	0.2	3.3
1982 .....	-2.1	3.3	-1.0	2.0	1.4	-0.5	-4.4
1983 .....	3.4	3.4	1.6	0.7	3.5	-0.4	3.3
1984 .....	6.6	5.8	2.7	1.9	1.8	2.6	5.0
1985 .....	2.3	....	2.5	1.3	....	2.2(3)	....
1984 — 3rd qtr. ....	0.5	0.6	2.2	1.1	—	1.5	1.6
4th " .....	0.1	2.4	0.8	—	2.5	0.2	0.8
1985 — 1st qtr. ....	0.9	0.2	-1.2	-0.3	0.7	0.3	0.9
2nd " .....	0.3	1.9	1.4	0.9	0.6	1.2	1.0
3rd " .....	0.8	0.6	2.2	0.6	-0.1	-0.1	1.6
4th " .....	0.6	....	....	....	....	....	....
<b>GNP deflator (1)</b>							
<i>(% changes on previous period; seasonally adjusted data)</i>							
1980 .....	9.2	2.9	4.8	11.8	19.9	20.8	11.4
1981 .....	9.6	2.7	4.0	12.0	11.9	18.3	10.6
1982 .....	6.0	1.8	4.4	12.0	7.2	17.8	10.3
1983 .....	3.9	0.5	3.3	9.4	5.1	15.0	5.3
1984 .....	4.0	0.6	1.9	6.8	4.2	10.7	2.8
1985 .....	3.3	....	....	....	....	8.8(3)	....
1984 — 3rd qtr. ....	0.9	0.3	-0.1	1.8	1.4	1.0	-0.2
4th " .....	0.8	-0.3	0.6	0.8	1.0	1.6	0.6
1985 — 1st qtr. ....	0.7	0.7	1.5	1.5	1.8	2.3	1.4
2nd " .....	0.8	—	-0.1	2.0	1.3	3.2	0.9
3rd " .....	0.7	....	0.3	....	1.6	1.1	0.4
4th " .....	0.8	....	....	....	....	....	....
<b>Current account balance (2)</b>							
<i>(billions of dollars)</i>							
1980 .....	1.8	-10.7	-16.0	-4.2	9.3	-9.7	-1.0
1981 .....	6.4	4.8	-5.4	-4.8	15.4	-8.1	-5.1
1982 .....	-8.0	6.8	3.2	-12.1	9.3	-5.5	2.1
1983 .....	-40.8	20.8	4.2	-5.2	5.9	0.8	1.4
1984 .....	-107.4	35.0	6.1	-1.0	1.3	-2.9	1.9
1985 (3) .....	-102.4	49.5	16.2	0.5	3.9	-3.7	....
1984 — 3rd qtr. ....	-29.0	8.7	-0.8	0.4	-0.5	0.7	1.4
4th " .....	-31.8	11.5	5.1	0.4	1.5	-2.2	1.4
1985 — 1st qtr. ....	-24.3	6.8	1.7	-1.7	-0.8	-2.9	-0.6
2nd " .....	-27.7	13.3	3.1	1.1	1.1	....	-0.1
3rd " .....	-30.5	13.3	2.1	—	1.6	....	-0.5
4th " (3) .....	-19.9	16.1	9.3	1.1	2.0	....	....

Sources: National bulletins, OECD and IMF.

(1) GNP for the US, Japan, Germany and Canada; "marchand" GDP for France; GDP for the UK and Italy. — (2) Seasonally adjusted data for the US. — (3) Estimated data.

Table a2

## Industrial production

(% changes on previous period; seasonally adjusted data)

	US	Japan	Germany	France	UK	Italy	Canada
1980 .....	-1.9	4.6	—	—	-6.5	5.5	-1.5
1981 .....	2.2	1.0	-1.5	-1.0	-3.5	-1.6	0.9
1982 .....	-7.1	0.4	-2.9	-2.0	2.2	-3.1	-10.7
1983 .....	6.0	3.6	0.7	1.0	3.3	-3.2	6.0
1984 .....	11.5	11.0	3.4	2.0	1.2	3.4	8.5
1985 .....	2.2	4.7	....	....	....	1.2 <sup>(1)</sup>	....
1983 — 4th qtr. ....	2.8	2.7	3.1	1.0	1.2	1.8	4.7
1984 — 1st qtr. ....	3.8	3.3	—	1.0	0.3	-1.0	0.6
2nd " .....	1.8	2.5	-4.0	-2.0	-1.8	2.3	0.9
3rd " .....	1.6	1.7	6.3	2.0	—	1.5	3.0
4th " .....	-0.2	2.6	1.0	—	1.0	-1.1	-0.1
1985 — 1st qtr. ....	0.5	-0.7	1.0	-1.0	2.5	0.3	0.1
2nd " .....	0.3	2.6	1.0	—	2.2	1.5	1.1
3rd " .....	0.5	0.2	1.9	....	-0.4	-1.2	2.7
4th " .....	0.3	-0.8	....	....	....	-1.5 <sup>(1)</sup>	....
1984 — Dec. ....	-0.1	-0.5	-1.0	-2.0	0.7	2.7	0.9
1985 — Jan. ....	0.3	0.2	1.0	-2.0	1.5	-5.1	-0.8
Feb. ....	0.1	-0.2	-1.0	4.2	-0.4	6.3	-0.3
Mar. ....	0.3	-1.4	1.0	1.0	1.8	-0.3	0.1
Apr. ....	0.1	2.6	—	-2.0	0.9	-1.7	0.5
May ....	—	2.6	1.0	1.0	0.3	0.9	0.2
June ....	0.2	-2.1	1.9	-1.0	-0.1	2.2	1.6
July ....	-0.2	1.9	1.9	3.0	-1.0	-3.8	1.7
Aug. ....	0.9	-1.2	-2.8	—	0.3	0.9	-0.2
Sept. ....	-0.2	-1.0	—	-2.0	1.5	0.7	0.2
Oct. ....	-0.3	0.7	1.9	1.0	-0.3	-0.8	0.6
Nov. ....	0.4	-1.1	....	2.2	....	1.8	....
Dec. ....	0.7	0.7	....	....	....	-1.5 <sup>(1)</sup>	....

Sources: National bulletins and OECD. — (1) Provisional data.

Table a3

## Consumer prices

(% changes on corresponding period)

	US	Japan	Germany	France	UK	Italy	Canada
1980 .....	13.5	8.0	5.5	13.5	18.3	21.2	10.1
1981 .....	10.4	4.9	6.3	13.4	11.9	17.8	12.5
1982 .....	6.1	2.7	5.3	11.8	8.5	16.5	10.8
1983 .....	3.2	1.9	3.3	9.6	4.7	14.7	5.9
1984 .....	4.3	2.2	2.4	7.4	4.7	10.8	4.3
1985 .....	3.5	2.0	2.2	5.8	6.3	....	3.9
1983 — 4th qtr. ....	3.3	1.5	2.7	9.8	4.4	12.8	4.6
1984 — 1st qtr. ....	4.5	2.3	2.9	8.8	4.6	12.1	5.2
2nd " .....	4.3	2.1	2.9	7.8	4.6	11.4	4.7
3rd " .....	4.2	2.0	1.8	7.3	4.7	10.5	4.1
4th " .....	4.0	2.4	2.1	6.8	5.2	9.4	3.7
1985 — 1st qtr. ....	3.5	2.0	2.3	6.5	5.9	9.3	3.7
2nd " .....	3.7	2.0	2.5	6.4	7.3	9.4	3.9
3rd " .....	3.4	2.1	2.3	5.6	6.6	9.1	4.0
4th " .....	3.5	1.9	1.8	4.8	5.5	...	4.0
1984 — Dec. ....	4.0	2.7	2.0	6.7	5.0	9.4	3.8
1985 — Jan. ....	3.6	2.9	2.0	6.5	5.3	9.3	3.7
Feb. ....	3.5	1.5	2.3	6.4	5.8	9.3	3.7
Mar. ....	3.6	1.5	2.5	6.4	6.4	9.4	3.7
Apr. ....	3.6	1.9	2.6	6.5	7.2	9.4	3.9
May ....	3.7	1.5	2.5	6.5	7.4	9.5	4.0
June ....	3.7	2.5	2.3	6.4	7.2	9.4	4.1
July ....	3.6	2.4	2.3	6.1	7.4	9.4	3.8
Aug. ....	3.3	2.3	2.2	5.6	6.5	9.1	4.0
Sept. ....	3.1	1.7	2.2	5.3	6.0	8.8	4.1
Oct. ....	3.1	2.3	1.8	4.9	5.5	8.9	4.3
Nov. ....	3.6	1.9	1.8	4.8	5.4	8.9	3.9
Dec. ....	3.8	1.8	1.8	4.7	5.7	....	4.4

Sources: National bulletins and OECD.

Table a4

## Wholesale prices

(% changes on corresponding period)

	US	Japan	Germany	France	UK	Italy	Canada
1980 .....	13.6	17.6	7.1	8.7	14.0	20.0	13.4
1981 .....	9.0	1.0	6.0	13.0	9.5	16.6	10.2
1982 .....	1.8	2.0	4.8	8.8	7.8	13.9	6.1
1983 .....	1.8	-1.9	1.5	11.4	5.5	9.7	3.4
1984 .....	2.7	—	2.8	13.1	6.0	10.4	4.1
1985 .....	....	....	....	3.9	....	....	....
1983 — 4th qtr. ....	1.8	-3.8	1.6	15.1	5.6	9.1	3.5
1984 — 1st qtr. ....	2.7	-2.0	3.0	16.3	5.9	10.8	4.5
2nd " .....	3.6	-1.0	3.1	14.1	6.3	11.5	4.1
3rd " .....	2.7	—	2.7	12.1	6.2	10.3	3.9
4th " .....	0.9	1.0	2.5	10.3	6.1	8.8	3.8
1985 — 1st qtr. ....	—	1.0	2.7	8.7	5.9	8.4	3.2
2nd " .....	-0.9	—	2.6	6.5	5.6	8.3	2.5
3rd " .....	-1.7	-2.0	2.0	3.2	5.6	6.9	2.1
4th " .....	....	....	....	-1.1	....	....	....
1984 — Dec. ....	0.9	1.0	2.4	8.8	6.0	8.2	3.8
1985 — Jan. ....	—	1.0	2.6	8.7	6.1	8.2	3.5
Feb. ....	—	—	2.8	9.4	6.1	8.0	3.2
Mar. ....	-0.9	1.0	2.8	7.9	5.5	8.9	3.0
Apr. ....	-0.9	1.0	2.7	6.5	5.6	8.7	2.5
May ....	-0.9	1.0	2.6	6.5	5.6	8.3	2.7
June ....	-0.9	—	2.4	5.8	5.6	8.0	2.6
July ....	-0.9	-1.0	2.2	3.2	5.6	7.5	2.1
Aug. ....	-1.7	-2.0	2.0	3.2	5.7	6.9	2.1
Sept. ....	-0.9	-2.0	1.8	0.6	5.5	6.4	2.4
Oct. ....	—	-3.0	1.1	-0.6	5.1	5.9	2.7
Nov. ....	-0.9	-4.0	1.1	-1.3	5.1	5.8	2.4
Dec. ....	....	....	....	-1.8	....	....	....

Sources: National bulletins and OECD.

Table a5

## Short-term interest rates

	US	Japan	Germany	France	UK	Italy	Canada
<b>Official reference rates (1)</b> <i>(end-of-period data)</i>							
1980 — Dec. ....	13.0	7.2	7.5	9.5	14.0	16.5	17.3
1981 — Dec. ....	12.0	5.5	7.5	9.5	14.5	19.0	14.7
1982 — Dec. ....	8.5	5.5	5.0	9.5	10.1	18.0	10.1
1983 — Dec. ....	8.5	5.0	4.0	9.5	9.0	17.0	10.0
1984 — Dec. ....	8.0	5.0	4.5	9.5	9.6	16.5	10.2
1985 — Jan. ....	8.0	5.0	4.5	9.5	14.0	15.5	9.7
Feb. ....	8.0	5.0	4.5	9.5	14.0	15.5	11.0
Mar. ....	8.0	5.0	4.5	9.5	13.3	15.5	11.2
Apr. ....	8.0	5.0	4.5	9.5	12.6	15.5	9.8
May ....	7.5	5.0	4.5	9.5	12.6	15.5	9.6
June ....	7.5	5.0	4.5	9.5	12.5	15.5	9.6
July ....	7.5	5.0	4.5	9.5	11.5	15.5	9.3
Aug. ....	7.5	5.0	4.0	9.5	11.5	15.5	9.2
Sept. ....	7.5	5.0	4.0	9.5	11.5	15.5	9.0
Oct. ....	7.5	5.0	4.0	9.5	11.5	15.5	8.8
Nov. ....	7.5	5.0	4.0	9.5	11.5	15.0	9.1
Dec. ....	7.5	5.0	4.0	9.5	11.5	15.0	9.5
<b>Money market rates (2)</b> <i>(monthly averages)</i>							
1980 — Dec. ....	18.9	9.5	10.2	10.9	13.1	17.0	17.0
1981 — Dec. ....	12.4	6.8	10.8	15.5	14.5	21.4	14.4
1982 — Dec. ....	9.0	6.9	6.6	12.9	9.9	19.1	9.8
1983 — Dec. ....	9.5	6.4	6.5	12.3	8.9	17.0	9.7
1984 — Dec. ....	8.4	6.4	5.8	11.0	9.1	14.7	9.8
1985 — Jan. ....	8.3	6.2	5.9	10.6	10.5	13.8	9.5
Feb. ....	8.5	6.2	6.2	10.6	12.7	13.5	11.3
Mar. ....	8.6	6.4	6.4	10.7	12.9	13.4	10.4
Apr. ....	8.3	6.1	6.0	10.5	11.9	14.3	9.8
May ....	8.0	6.0	5.8	10.2	11.9	14.2	9.5
June ....	7.5	6.1	5.7	10.2	11.9	14.2	9.3
July ....	7.9	6.2	5.3	9.9	11.4	14.1	9.1
Aug. ....	7.9	6.2	4.8	9.7	11.0	14.0	8.9
Sept. ....	7.9	6.4	4.7	9.6	11.1	13.8	8.7
Oct. ....	8.0	6.5	4.8	9.3	11.0	13.3	8.5
Nov. ....	8.0	7.3	4.8	9.0	11.1	13.2	8.8
Dec. ....	8.0	8.0	4.8	8.9	11.2	13.1	9.2

Sources: National bulletins and IMF.

(1) UK: base rate; all other countries: discount rate. — (2) US: Federal funds rate; Japan: call-money rate; Germany: 3-month interbank rate; France: call-money rate; UK: 3-month Treasury bill rate; Italy: auction rate on 6-month Treasury bills; Canada: end-of-period rate on 3-month Treasury bills.

Table a6

## Long-term interest rates and share price indices

*(monthly averages)*

	US	Japan	Germany	France	UK	Italy	Canada
<b>Bond rates (1)</b>							
1980 — Dec. ....	12.5	9.4	8.9	13.7	13.7	16.2	12.7
1981 — Dec. ....	13.7	7.9	9.7	15.8	15.7	21.3	15.3
1982 — Dec. ....	10.6	7.5	7.9	14.8	11.3	19.6	11.7
1983 — Dec. ....	12.0	7.3	8.2	13.3	10.6	17.7	12.0
1984 — Dec. ....	11.6	6.3	7.0	11.9	10.5	14.5	11.7
1985 — Jan. ....	11.6	6.3	7.1	11.4	11.0	13.3	11.4
Feb. ....	11.7	6.8	7.4	11.4	11.1	13.3	12.3
Mar. ....	12.1	6.6	7.6	11.4	10.9	13.6	11.9
Apr. ....	11.7	6.5	7.3	11.1	10.7	13.6	11.5
May ....	11.2	6.4	7.1	10.8	10.9	13.9	10.8
June ....	10.6	6.3	6.9	10.9	10.7	13.9	10.9
July ....	10.7	6.2	6.7	10.7	10.4	14.1	10.9
Aug. ....	10.7	6.1	6.4	10.7	10.4	14.1	10.8
Sept. ....	10.8	5.9	6.3	10.8	10.4	13.8	11.0
Oct. ....	10.7	6.7	6.5	10.7	10.2	13.7	10.7
Nov. ....	10.2	6.8	6.6	10.5	10.6	13.7	10.3
Dec. ....	10.3	6.2	6.9	10.5	10.6	13.7	10.0
<b>Share price indices (1975=100)</b>							
1980 — Dec. ....	157.1	157.0	104.9	154.4	219.9	137.8	226.9
1981 — Dec. ....	145.3	181.6	106.5	125.8	232.9	138.9	195.4
1982 — Dec. ....	163.6	187.1	114.3	137.8	285.0	131.0	195.8
1983 — Dec. ....	193.1	227.6	160.3	207.6	350.0	161.1	255.2
1984 — Dec. ....	193.2	277.2	173.4	247.6	436.4	187.8	240.0
1985 — Jan. ....	201.2	297.1	181.6	258.9	453.5	210.3	259.5
Feb. ....	212.6	302.7	185.4	274.4	461.4	236.2	259.5
Mar. ....	210.5	319.1	192.7	283.5	468.0	236.7	261.3
Apr. ....	212.0	312.1	193.9	294.3	465.5	257.2	263.5
May ....	216.3	315.3	200.3	304.7	476.8	268.6	273.6
June ....	221.8	324.2	217.4	311.4	466.6	285.8	271.3
July ....	225.8	332.6	221.0	298.0	450.8	303.3	277.9
Aug. ....	221.6	322.8	223.0	296.4	470.1	314.3	282.0
Sept. ....	216.3	325.0	240.7	297.3	474.8	328.2	263.2
Oct. ....	218.6	330.0	258.9	289.4	486.2	354.0	267.5
Nov. ....	232.4	322.8	273.0	322.8	514.3	376.3	285.7
Dec. ....	243.8	322.5	283.9	347.2	507.5	441.1	....

Sources: National bulletins and IMF.

(1) Rates on government bonds.



Table a7

## Interest rates and forward exchange rates in international markets

*(end-of-period data)*

	US dollar	Japanese yen	Deutsche- mark	Pound sterling	US dollar	Japanese yen	Deutsche- mark	Pound sterling
<b>rates on 3-month Eurodeposits</b>								
				<b>rates on 12-month Eurodeposits</b>				
1980 — Dec. ....	17.55	9.25	8.87	14.75	14.87	9.37	8.93	14.00
1981 — Dec. ....	13.75	6.12	10.50	15.69	14.75	6.87	10.25	15.37
1982 — Dec. ....	9.19	6.75	5.88	10.44	9.63	6.81	6.00	10.31
1983 — Dec. ....	9.81	6.31	5.88	9.31	10.38	6.44	6.38	9.81
1984 — Dec. ....	8.63	6.19	5.50	9.88	9.81	6.13	5.56	10.19
1985 — Apr. ....	8.69	6.25	5.81	12.69	9.75	6.31	6.06	12.13
May ....	7.63	6.25	5.56	12.44	8.38	6.31	5.56	12.01
June ....	7.75	6.25	5.44	12.44	8.25	6.31	5.63	11.94
July ....	8.19	6.31	4.81	11.19	8.88	6.25	5.00	10.88
Aug. ....	8.00	6.38	4.50	11.63	8.56	6.31	4.69	11.06
Sept. ....	8.06	6.38	4.50	11.50	8.56	6.38	4.75	11.00
Oct. ....	7.94	7.75	4.63	11.50	8.25	7.06	5.06	11.19
Nov. ....	8.06	7.69	4.69	11.56	8.17	6.94	4.88	11.13
Dec. ....	7.88	6.56	4.75	11.81	7.94	6.38	4.81	11.69
1986 — Jan. ....	8.00	6.16	4.63	12.88	8.19	6.03	4.69	12.69
<b>3-month forward exchange rates</b>								
<i>(against the dollar)</i>				<b>12-month forward exchange rates</b>				
				<i>(against the dollar)</i>				
1980 — Dec. ....		8.30	8.68	2.80	5.50	5.94	0.87	
1981 — Dec. ....		7.63	3.25	-1.94	7.88	4.50	-0.62	
1982 — Dec. ....		2.44	3.31	-1.25	2.82	3.63	-0.68	
1983 — Dec. ....		3.50	3.93	0.50	3.94	4.00	0.57	
1984 — Dec. ....		2.44	3.13	-1.25	3.68	4.25	-0.38	
1985 — Apr. ....		2.44	2.88	-4.00	3.44	3.69	-2.38	
May ....		1.38	2.07	-4.81	2.07	2.82	-3.63	
June ....		1.50	2.31	-4.69	1.94	2.62	-3.69	
July ....		1.88	3.38	-3.00	2.63	3.88	-2.00	
Aug. ....		1.62	3.50	-3.63	2.25	3.87	-2.50	
Sept. ....		1.68	3.56	-3.44	2.18	3.81	-2.44	
Oct. ....		0.19	3.31	-3.56	1.19	3.19	-2.94	
Nov. ....		0.37	3.37	-3.50	1.23	3.29	-2.96	
Dec. ....		1.32	3.13	-3.93	1.56	3.13	-3.75	
1986 — Jan. ....		1.84	3.37	-4.88	2.16	3.50	-4.50	

Source: Morgan Guaranty, *World Financial Markets*.

Table a8

## Lira exchange rates and the price of gold

*(period average)*

	Lire per unit of currency								Gold price (dollars per ounce) (1)
	US dollar	Japanese yen	Deutsche-mark	French franc	Pound sterling	Swiss franc	SDR	ECU	
1980 .....	855.51	3.8031	471.08	202.64	1,992.0	510.85	1,114.7	1,189.2	589.50
1981 .....	1,138.0	5.1567	502.91	209.18	2,286.7	580.30	1,340.4	1,263.4	397.50
1982 .....	1,353.6	5.4382	557.26	206.08	2,362.0	666.47	1,493.2	1,323.7	456.90
1983 .....	1,519.2	6.3995	594.53	199.43	2,301.7	722.77	1,623.7	1,349.7	381.50
1984 .....	1,756.5	7.3905	617.27	201.08	2,339.8	747.54	1,799.1	1,381.1	308.30
1985 .....	1,909.7	7.0240	650.26	213.08	2,462.5	780.26	1,934.8	1,447.7	326.15
1983 — 4th qtr. . .	1,624.4	6.9406	606.71	198.98	2,386.9	752.36	1,709.7	1,370.2	381.50
1984 — 1st qtr. . .	1,662.4	7.2032	615.41	200.33	2,385.2	756.72	1,743.5	1,381.6	388.50
2nd " . .	1,676.9	7.2958	618.29	201.20	2,339.6	745.89	1,752.3	1,382.6	373.05
3rd " . .	1,797.4	7.3831	616.26	200.81	2,332.3	736.22	1,820.8	1,379.5	343.75
4th " . .	1,809.2	7.6843	619.20	202.00	2,301.0	751.21	1,879.8	1,380.6	308.30
1985 — 1st qtr. . .	2,022.9	7.8539	621.01	203.14	2,254.4	733.86	1,957.8	1,381.7	329.25
2nd " . .	1,970.0	7.8578	638.02	209.43	2,474.1	759.65	1,954.4	1,430.4	317.75
3rd " . .	1,896.0	7.9352	664.42	217.87	2,602.1	806.21	1,947.3	1,484.2	330.87
4th " . .	1,750.0	8.3253	677.48	222.03	2,513.8	820.61	1,885.9	1,494.2	325.51
1984 — Dec. ....	1,912.9	7.7154	616.46	201.41	2,270.8	746.39	1,889.1	1,374.1	308.30
1985 — Jan. ....	1,949.0	7.6712	615.14	200.94	2,199.7	733.39	1,901.1	1,367.2	306.65
Feb. ....	2,036.1	7.8232	618.12	202.29	2,230.7	727.55	1,957.8	1,374.5	287.75
Mar. ....	2,083.7	8.0674	629.78	206.21	2,332.9	740.66	2,007.4	1,403.6	329.25
Apr. ....	1,971.9	7.8391	638.68	209.34	2,447.0	761.39	1,953.8	1,430.0	321.35
May ....	1,984.2	7.8832	637.51	209.07	2,473.7	757.84	1,963.1	1,429.2	314.00
June ....	1,954.1	7.8513	637.89	209.19	2,501.7	759.73	1,948.0	1,432.2	317.75
July ....	1,914.4	7.8700	652.50	214.34	2,617.9	787.31	1,938.8	1,466.9	327.50
Aug. ....	1,871.4	7.8896	670.45	219.56	2,593.1	816.34	1,933.7	1,493.1	335.25
Sept. ....	1,902.3	8.0464	670.33	219.73	2,595.2	814.98	1,956.1	1,492.5	325.75
Oct. ....	1,785.4	8.3121	675.04	221.32	2,538.1	823.29	1,897.7	1,492.9	325.10
Nov. ....	1,751.2	8.6050	675.58	221.71	2,522.3	823.23	1,892.2	1,492.5	325.30
Dec. ....	1,713.4	8.0590	681.84	223.07	2,480.9	815.31	1,867.8	1,497.2	326.80
1986 — Jan. ....	1,665.3	8.3240	681.86	222.26	2,372.0	805.27	1,828.5	1,484.9	350.50

(1) End-of-period data.

Table a9

## Nominal effective exchange rates (1)

(indices, 1980 = 100)

	US	Canada	Japan	Germany	France	UK	Italy	Switzerland
1980 .....	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1981 .....	108.7	100.3	113.7	96.8	94.0	102.3	90.8	102.5
1982 .....	119.8	100.1	106.8	102.6	86.9	98.4	85.1	110.8
1983 .....	122.9	101.6	117.0	106.5	80.5	91.2	82.0	115.8
1984 .....	130.9	98.4	124.2	106.1	77.7	87.5	78.6	114.7
1985 .....	135.1	93.9	126.8	106.2	78.4	87.1	74.2	113.5
1983 — 4th qtr. ....	125.0	101.7	121.4	106.2	78.3	91.9	80.1	117.5
1984 — 1st qtr. ....	125.7	100.5	124.1	106.7	77.9	90.5	79.1	116.8
2nd " .....	127.0	97.7	125.7	107.0	78.2	88.4	78.9	115.0
3rd " .....	133.8	97.5	122.8	105.8	77.5	87.0	78.5	112.9
4th " .....	137.0	98.0	124.3	105.1	77.2	84.2	77.7	114.2
1985 — 1st qtr. ....	144.0	96.8	123.0	104.5	77.1	81.3	77.2	110.6
2nd " .....	139.6	94.5	122.7	105.1	77.8	88.2	75.0	111.5
3rd " .....	133.1	93.7	124.0	106.7	78.9	91.0	72.5	115.2
4th " .....	123.6	90.6	137.5	108.5	80.1	87.8	72.2	116.9
1984 — Dec. ....	138.3	98.1	124.4	104.7	77.1	83.1	77.9	113.9
1985 — Jan. ....	141.0	98.5	123.0	104.8	77.2	80.5	78.1	112.1
Feb. ....	145.1	97.0	122.5	104.4	77.0	80.6	77.6	110.1
Mar. ....	145.8	94.8	123.5	104.3	77.1	82.8	75.7	109.7
Apr. ....	139.8	94.8	122.3	105.4	77.8	87.2	75.0	111.9
May ....	140.4	94.1	122.8	104.9	77.8	88.2	74.9	111.1
June ....	138.7	94.4	122.9	105.1	77.7	89.3	75.0	111.5
July ....	134.2	94.5	123.4	105.9	78.4	92.6	73.1	113.5
Aug. ....	131.9	93.7	123.7	107.4	79.1	90.3	72.3	116.2
Sept. ....	133.1	93.0	124.9	106.9	79.0	90.0	72.1	115.8
Oct. ....	125.7	91.8	133.6	108.1	79.8	88.6	72.2	117.2
Nov. ....	123.0	90.6	139.7	108.0	80.0	88.0	72.3	117.1
Dec. ....	122.2	89.2	139.0	109.3	80.6	86.8	72.2	116.1
1986 — Jan. ....	121.4	88.3	139.2	110.5	81.0	84.0	72.9	116.0

Source: Based on IMF data. For the method of calculation, see the "Note Metodologiche" section of the Appendix to the Banca d'Italia, *Relazione Annuale sul 1983*.

(1) Weighted on the basis of shares in trade with the 14 leading countries.

Table a10

## Real effective exchange rates (1)

(indices, 1980 = 100)

	US	Canada	Japan	Germany	France	UK	Italy	Switzerland
1980 .....	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1981 .....	112.7	100.7	104.8	93.8	96.2	103.0	96.5	100.0
1982 .....	121.5	103.1	94.2	97.0	92.9	100.2	95.9	104.1
1983 .....	122.5	106.5	99.5	97.2	92.2	94.2	98.4	104.8
1984 .....	128.7	104.6	101.6	93.7	96.7	91.4	98.0	101.8
1983 — 3rd qtr. ....	124.7	107.4	97.8	96.1	92.0	96.1	97.7	105.1
4th " .....	124.2	106.7	101.5	95.7	93.3	94.7	97.0	105.1
1984 — 1st qtr. ....	124.3	106.3	102.7	95.2	94.8	93.6	97.0	104.1
2nd " .....	125.4	103.7	102.8	94.5	96.8	92.5	98.0	102.0
3rd " .....	131.3	104.0	100.1	93.0	97.5	90.9	98.4	100.0
4th " .....	133.9	104.5	100.8	92.1	97.8	88.4	98.7	101.2
1985 — 1st qtr. ....	139.0	104.3	99.0	91.3	98.0	85.8	99.3	98.2
2nd " .....	135.1	101.8	97.5	91.3	98.9	94.3	97.9	98.2
3rd " .....	128.5	101.7	98.2	92.9	98.9	98.2	96.4	100.5
1984 — Sept. ....	132.6	104.5	101.0	92.0	97.5	90.5	97.9	100.1
Oct. ....	134.2	104.2	100.7	92.0	97.5	88.8	98.0	101.2
Nov. ....	132.2	104.2	100.7	92.2	98.0	89.0	98.5	101.2
Dec. ....	134.6	105.0	100.6	91.6	97.6	87.5	99.0	100.6
1985 — Jan. ....	136.6	105.9	99.3	91.8	98.1	84.8	100.3	99.3
Feb. ....	139.9	104.5	98.7	91.3	98.1	85.0	99.8	97.9
Mar. ....	140.5	102.5	99.1	90.9	98.0	87.7	97.8	97.3
Apr. ....	135.0	102.2	97.6	91.7	98.7	93.1	97.3	98.9
May ....	136.0	101.3	97.5	91.2	99.1	94.3	97.9	97.8
June ....	134.3	101.8	97.4	91.2	98.8	95.6	98.5	98.3
July ....	130.0	102.2	97.7	92.1	98.7	99.6	96.7	99.5
Aug. ....	127.5	101.4	98.1	93.3	99.7	97.5	96.1	101.1
Sept. ....	128.2	101.1	98.9	93.3	98.4	97.5	96.4	101.6
Oct. ....	121.9	99.7	105.3	94.1	98.7	96.2	97.4	103.0
Nov. ....	119.5	98.4	109.6	94.3	98.1	96.1	98.0	102.9

Source: Based on IMF, OECD and Istat data. For the method of calculation, see the *Note Metodologiche* section of the Appendix to the Banca d'Italia, *Relazione Annuale sul 1983*.

(1) Calculated on the basis of wholesale manufactures prices.

Table a11

## Sources and uses of income

(% changes on previous period)

	SOURCES			USES				
	GDP	Imports	Total	Gross fixed investment			Other domestic uses	Exports
				Buildings	Equipment and vehicles	Total		
<b>At 1970 prices</b>								
1980 .....	3.9	8.3	4.7	4.7	15.0	9.4	6.5	-4.3
1981 .....	0.2	-5.3	-0.8	0.5	0.8	0.6	-2.8	5.2
1982 .....	-0.5	1.5	-0.2	-3.2	-7.3	-5.2	0.8	0.4
1983 .....	-0.4	0.1	-0.3	-1.9	-6.0	-3.8	-0.7	3.3
1984 .....	2.6	9.6	3.8	-0.5	9.5	4.1	2.7	7.0
1983 — 3rd qtr. ....	0.6	3.8	1.1	-0.1	-0.7	-0.4	1.8	..
4th " .....	1.2	-1.4	0.7	0.4	3.5	1.8	-1.4	6.8
1984 — 1st qtr. ....	0.8	9.2	2.2	-0.4	-0.5	-0.4	3.0	1.8
2nd " .....	-0.3	-7.5	-1.7	-0.9	4.6	1.6	0.1	-9.2
3rd " .....	1.5	8.7	2.7	1.3	3.6	2.4	-0.7	14.3
4th " .....	0.2	6.7	1.4	-1.7	6.8	2.4	1.2	1.4
1985 — 1st qtr. ....	0.3	1.7	0.6	-2.9	2.7	-0.1	1.1	-0.6
2nd " .....	1.2	-2.4	0.5	0.8	4.9	2.9	0.8	-2.1
3rd " .....	-0.1	-4.7	-1.0	-1.4	-2.3	-1.9	-2.6	4.6
<b>Implicit price deflators</b>								
1980 .....	20.6	22.0	21.1	32.5	17.2	20.3	22.0	18.0
1981 .....	18.3	27.8	20.0	22.7	17.3	20.3	19.7	21.1
1982 .....	17.8	11.3	16.5	18.0	13.5	16.4	16.9	15.3
1983 .....	15.0	5.1	12.9	14.2	8.8	12.4	14.7	7.8
1984 .....	10.7	10.7	10.9	9.6	9.9	8.9	11.7	10.0
1983 — 3rd qtr. ....	3.2	3.0	3.2	4.3	1.8	3.4	3.2	3.2
4th " .....	2.3	3.5	2.5	2.0	1.4	1.6	2.6	3.7
1984 — 1st qtr. ....	3.2	2.9	3.3	2.2	3.3	2.6	3.6	2.7
2nd " .....	2.7	2.4	2.5	2.1	4.6	2.7	2.7	0.3
3rd " .....	1.0	1.5	1.3	1.4	..	0.6	1.5	2.2
4th " .....	1.6	2.7	2.0	2.2	..	0.6	2.1	2.3
1985 — 1st qtr. ....	2.3	4.4	2.8	2.1	1.1	1.2	2.8	3.7
2nd " .....	3.2	2.1	2.8	2.3	3.4	2.5	3.1	2.0
3rd " .....	1.1	-3.7	-0.1	1.3	1.4	1.4	-0.5	1.1

Source: Istat, seasonally adjusted data.

Table a12

## Industrial production and business opinion indicators

(seasonally adjusted data (1))

	INDUSTRIAL PRODUCTION				ISCO BUSINESS OPINION INDICATORS				
	General index	Consumer goods	Investment goods	Intermediate goods	Changes in level of orders			Expected demand in 3-4 months	Stocks of finished goods vis-à-vis normal (2)
					Domestic	Foreign	Total		
	<i>(indices, 1980 = 100)</i>				<i>(average monthly differences in percentages of reported increases and decreases)</i>				
1981 .....	98.4	97.4	103.4	97.4	-46.8	-42.0	-45.8	-12.5	16.6
1982 .....	95.4	97.6	95.8	93.7	-53.6	-49.2	-52.6	-14.4	17.3
1983 .....	92.3	94.2	92.6	90.9	-52.4	-45.9	-51.3	-7.6	13.8
1984 .....	95.4	96.3	93.2	95.2	-27.0	-26.6	-24.6	7.5	8.4
1985 (3) .....	96.5								
1981 —1st qtr. ...	98.9	96.2	105.2	98.6	-47.4	-45.3	-46.7	-15.6	16.7
2nd " ...	99.9	98.2	107.0	98.6	-48.2	-44.7	-48.4	-9.8	18.7
3rd " ...	97.5	97.4	102.2	96.0	-45.4	-39.4	-41.5	-13.2	17.3
4th " ...	97.4	97.9	99.2	96.4	-46.3	-38.6	-46.4	-11.3	13.7
1982 —1st qtr. ...	98.7	98.8	101.2	97.7	-49.0	-42.9	-47.4	-8.6	15.7
2nd " ...	95.7	97.3	96.9	94.2	-50.2	-47.3	-50.7	-11.5	18.0
3rd " ...	94.7	97.4	94.2	93.1	-54.4	-53.1	-53.5	-15.6	19.7
4th " ...	92.5	97.1	90.8	89.9	-60.7	-53.3	-58.8	-22.0	16.0
1983 —1st qtr. ...	91.8	95.9	91.3	89.2	-59.0	-52.6	-59.1	-18.3	15.7
2nd " ...	91.0	93.4	90.6	89.4	-56.6	-47.0	-55.7	-10.8	19.0
3rd " ...	92.4	93.5	93.4	91.2	-50.7	-46.4	-48.1	-3.2	13.7
4th " ...	94.2	94.0	95.2	93.9	-43.3	-37.6	-42.1	2.0	7.0
1984 —1st qtr. ...	93.2	93.1	91.5	93.9	-33.7	-29.9	-31.4	6.4	10.7
2nd " ...	95.3	96.9	91.0	95.6	-27.6	-23.0	-25.4	7.8	6.7
3rd " ...	96.7	97.9	95.0	96.4	-25.1	-23.8	-23.5	6.8	9.0
4th " ...	95.7	97.3	95.3	94.8	-21.7	-29.6	-18.1	9.0	7.3
1985 —1st qtr. ...	96.0	96.9	97.6	94.8	-21.7	-28.9	-21.4	6.0	7.7
2nd " ...	97.4	98.2	100.5	95.6	-22.6	-30.7	-22.0	6.8	8.0
3rd " ...	96.1	97.2	98.4	94.6	-22.1	-29.4	-18.8	10.1	8.0
4th " (3) .	96.5								

Source: Based on Istat and Isco data.

(1) Industrial production data are also adjusted for trading-day variations. — (2) Raw data. — (3) Provisional data.

Table a13

## Labour statistics

*(seasonally adjusted data in thousands)*

	INDUSTRY (excl. construction)			THE ECONOMY (1)						
	Employment			Employment			Total	Unemploy- ment	Labour force	Unemploy- ment rate %
	Total	Employees	Employees excluding those on wage supplemen- tation	Agricul- ture	Industry	Services				
1979 .....	5,812	5,071	4,947	2,977	7,600	9,669	20,246	1,696	21,942	7.7
1980 .....	5,847	5,085	4,938	2,895	7,708	9,928	20,531	1,687	22,218	7.6
1981 .....	5,762	4,995	4,697	2,690	7,630	10,201	20,521	1,944	22,465	8.7
1982 .....	5,655	4,887	4,547	2,516	7,516	10,470	20,502	2,069	22,571	9.2
1983 .....	5,496	4,737	4,326	2,525	7,321	10,727	20,573	2,302	22,874	10.1
1984 .....	5,306	4,553	4,117	2,397	7,016	11,236	20,650	2,386	23,036	10.4
1981 — 1st qtr. ....	5,832	5,049	4,784	2,836	7,709	10,058	20,603	1,791	22,393	8.0
2nd " .....	5,779	5,002	4,717	2,722	7,643	10,124	20,489	1,914	22,403	8.5
3rd " .....	5,717	4,965	4,664	2,625	7,586	10,270	20,481	2,008	22,489	8.9
4th " .....	5,721	4,965	4,623	2,576	7,583	10,354	20,512	2,062	22,574	9.1
1982 — 1st qtr. ....	5,711	4,945	4,642	2,537	7,594	10,433	20,564	2,026	22,590	9.0
2nd " .....	5,676	4,912	4,582	2,533	7,536	10,454	20,523	2,038	22,561	9.0
3rd " .....	5,634	4,863	4,509	2,506	7,481	10,453	20,440	2,084	22,524	9.3
4th " .....	5,600	4,828	4,454	2,487	7,454	10,540	20,482	2,128	22,610	9.4
1983 — 1st qtr. ....	5,558	4,801	4,401	2,494	7,397	10,659	20,551	2,234	22,784	9.8
2nd " .....	5,509	4,755	4,318	2,512	7,344	10,711	20,567	2,270	22,836	9.9
3rd " .....	5,477	4,722	4,319	2,554	7,309	10,699	20,562	2,298	22,860	10.1
4th " .....	5,440	4,671	4,269	2,539	7,233	10,840	20,611	2,405	23,016	10.4
1984 — 1st qtr. ....	5,373	4,601	4,195	2,470	7,116	10,998	20,585	2,424	23,008	10.5
2nd " .....	5,312	4,554	4,126	2,404	7,042	11,146	20,592	2,370	22,962	10.3
3rd " .....	5,282	4,532	4,065	2,381	6,970	11,359	20,710	2,361	23,070	10.2
4th " .....	5,258	4,526	4,084	2,332	6,938	11,442	20,713	2,391	23,103	10.3
1985 — 1st qtr. ....	5,224	4,524	4,084	2,293	6,933	11,473	20,699	2,394	23,093	10.4
2nd " .....	5,216	4,538	4,154	2,309	6,884	11,581	20,774	2,444	23,218	10.5
3rd " .....	5,237	4,547	4,206	2,300	6,858	11,627	20,785	2,548	23,333	10.9

Source: Based on Istat data. For industry excluding construction, national accounts data were used.

(1) The annual data are the averages of the raw quarterly data and therefore do not necessarily coincide with the annual averages of the seasonally adjusted data.

Table a14

### Productivity and labour costs in industry excluding construction

(% changes on corresponding period)

	Productivity			Gross wages and salaries per employee		Labour costs	
	Hourly	Per worker		Including employees on wage supplementation	Excluding employees on wage supplementation	Per employee including employees on wage supplementation	Per unit of output
		Including employees on wage supplementation	Excluding employees on wage supplementation				
1979 .....	6.9	5.8	5.4	17.4	16.8	16.5	10.1
1980 .....	4.0	4.1	4.5	20.5	21.1	19.1	14.4
1981 .....	2.9	0.6	3.4	21.3	25.3	20.2	19.5
1982 .....	1.7	-0.3	0.6	15.8	17.0	17.8	18.2
1983 .....	1.7	0.3	1.9	13.0	15.1	15.3	14.9
1984 .....	4.5	7.0	7.9	10.9	12.1	12.5	5.1
1981 — 1st qtr. ....	1.0	-4.7	-1.7	16.7	21.0	14.8	20.5
2nd " .....	3.1	1.1	4.1	22.2	26.5	19.7	18.4
3rd " .....	3.4	3.2	5.9	23.1	26.8	23.4	19.6
4th " .....	4.1	3.1	5.6	23.1	26.6	22.7	19.1
1982 — 1st qtr. ....	2.7	2.7	3.5	20.3	21.4	19.4	16.2
2nd " .....	1.7	-0.6	0.4	14.3	15.6	14.4	15.1
3rd " .....	2.2	-0.8	0.3	15.1	16.6	18.9	19.9
4th " .....	0.3	-2.5	-1.7	14.0	15.1	18.6	21.6
1983 — 1st qtr. ....	2.0	-1.8	0.2	12.9	15.6	17.0	19.1
2nd " .....	0.8	-2.0	0.3	13.7	16.8	17.4	19.8
3rd " .....	1.3	1.5	2.7	14.1	15.7	14.7	13.0
4th " .....	2.7	3.7	4.5	11.5	12.6	12.5	8.5
1984 — 1st qtr. ....	3.0	7.3	7.7	15.0	15.6	17.0	9.1
2nd " .....	5.8	7.8	7.9	11.6	11.8	13.5	5.3
3rd " .....	4.9	6.3	8.0	8.0	10.1	9.5	3.0
4th " .....	4.5	6.8	8.0	9.6	11.0	10.3	3.3
1985 — 1st qtr. ....	4.5	3.7	4.6	9.5	10.6	9.7	5.8
2nd " .....	1.8	3.4	2.7	12.3	11.2	12.1	8.4
3rd " .....	0.6	2.1	-0.4	12.3	8.9	13.0	10.6

Source: Based on Istat data.



Table a15

## Costs, profits and prices in industry excluding construction (1)

(% changes on corresponding period)

	Total labour income	Gross profits	Value added at factor cost	Input value	Production value	Mark-up (% ratio to costs)	Output prices	Input prices
1979 .....	17.1	36.0	23.3	27.0	25.0	23.4	17.2	18.6
1980 .....	19.4	32.4	24.1	33.3	28.5	24.3	21.9	26.3
1981 .....	18.1	2.2	11.9	25.6	18.7	20.2	20.5	28.1
1982 .....	15.3	16.9	15.8	8.2	11.8	21.4	15.4	12.5
1983 .....	11.8	5.8	9.6	3.9	6.7	21.1	10.2	7.9
1984 .....	8.1	23.7	13.5	14.8	14.1	23.3	10.7	11.6
1981 — 1st qtr.	14.2	-14.6	2.5	22.5	12.2	18.9	17.5	28.1
2nd "	17.3	8.1	13.8	24.3	19.0	20.9	20.4	26.3
3rd "	20.2	-1.2	12.1	30.5	21.2	18.5	21.7	32.0
4th "	20.3	16.9	19.0	24.9	21.9	22.5	22.2	26.2
1982 — 1st qtr.	16.9	34.3	22.8	15.6	19.0	21.9	19.7	17.4
2nd "	12.4	20.0	15.1	7.9	11.3	22.9	15.0	12.3
3rd "	16.4	19.4	17.4	4.3	10.4	20.3	14.0	8.5
4th "	15.4	-0.8	9.3	5.7	7.5	20.4	13.4	12.2
1983 — 1st qtr.	13.5	—	8.5	1.9	5.1	20.6	10.8	8.0
2nd "	13.7	-1.5	8.0	0.7	4.3	21.3	10.4	7.1
3rd "	11.4	9.8	10.9	4.3	7.6	20.8	9.9	7.2
4th "	8.9	15.2	11.0	8.4	9.7	21.7	9.8	9.1
1984 — 1st qtr.	12.1	25.8	16.8	13.5	15.1	22.9	11.7	10.7
2nd "	8.7	26.9	14.9	17.2	16.0	23.8	12.0	13.6
3rd "	5.1	22.1	10.9	15.3	13.0	22.9	10.2	12.5
4th "	6.9	20.3	11.6	13.6	12.6	23.5	8.9	9.8
1985 — 1st qtr.	7.8	4.4	6.6	12.6	9.6	21.6	9.7	12.0
2nd "	11.7	6.5	9.7	15.2	12.4	22.3	9.8	11.3
3rd "	13.4	12.8	13.2	8.9	11.0	23.4	8.6	5.4

Source: Based on Istat data.

(1) Value added at factor cost is the sum of total labour income and gross profits. Production value is the sum of the value of inputs and value added. The mark-up (net of intersectoral transactions) is given by the ratio of production value to total costs (total labour income plus input value).

Table a16

## Wholesale and consumer prices

(% changes on corresponding period)

	Wholesale prices				Consumer prices				Cost of living	Scala mobile index
	Consumer goods	Investment goods	Intermediate goods	Total	Food	Non-food products	Services	Total		
1980 .....	17.1	18.3	22.8	20.0	15.6	28.1	20.6	21.2	21.1	18.2
1981 .....	14.9	19.4	17.5	16.6	16.3	17.1	20.6	17.8	18.7	18.4
1982 .....	14.8	14.8	12.9	13.9	16.4	15.8	17.5	16.5	16.3	16.0
1983 .....	11.3	13.1	8.0	9.7	12.3	14.1	18.2	14.7	15.0	13.9
1984 .....	9.7	9.8	10.9	10.4	9.1	10.4	13.3	10.8	10.6	11.1
1985 .....									8.6	
1983 — 3rd qtr. ...	10.5	13.1	7.5	9.2	11.2	13.4	18.0	13.9	14.3	12.5
4th " ...	9.3	12.5	8.4	9.1	10.1	11.3	18.1	12.8	13.0	12.3
1984 — 1st qtr. ...	10.3	11.7	11.1	10.8	10.1	11.6	15.0	12.1	12.2	12.4
2nd " ...	10.9	10.4	12.3	11.5	10.1	10.8	13.6	11.4	11.3	12.0
3rd " ...	9.7	9.2	11.1	10.4	8.5	9.9	13.4	10.5	10.2	11.3
4th " ...	8.3	8.3	9.3	8.8	7.7	9.4	11.2	9.4	8.8	8.8
1985 — 1st qtr. ...	8.1	8.1	8.6	8.4	8.2	8.5	11.6	9.3	8.6	8.6
2nd " ...	9.0	8.0	8.0	8.3	8.5	9.0	10.9	9.4	8.8	8.7
3rd " ...	8.3	7.9	7.9	6.9	8.9	8.8	9.7	9.1	8.5	8.4
4th " ...									8.6	
1984 — Dec. ....	8.2	8.0	8.3	8.2	7.8	9.3	11.4	9.4	8.8	8.6
1985 — Jan. ....	8.1	8.4	8.2	8.2	8.1	8.5	11.6	9.3	8.6	8.5
Feb. ....	7.8	8.5	8.0	8.0	8.2	8.2	11.8	9.3	8.6	8.6
Mar. ....	8.4	7.7	9.5	8.9	8.2	8.7	11.6	9.4	8.6	8.8
Apr. ....	8.8	8.4	8.6	8.7	8.3	8.9	11.2	9.4	8.8	9.0
May ....	9.0	7.9	7.8	8.3	8.5	9.0	11.0	9.5	8.8	8.9
June ....	9.3	7.9	6.9	8.0	8.8	9.2	10.5	9.4	8.7	8.3
July ....	8.8	8.1	6.5	7.5	8.9	9.0	10.5	9.4	8.7	8.2
Aug. ....	8.3	8.0	5.5	6.9	8.9	8.8	9.7	9.1	8.6	8.2
Sept. ....	7.8	7.5	5.1	6.4	8.7	8.7	9.1	8.8	8.3	8.9
Oct. ....	8.0	7.4	3.9	5.9	9.4	8.2	9.3	8.9	8.5	8.5
Nov. ....	7.8	7.0	3.9	5.8	9.4	8.0	9.5	8.9	8.6	8.0
Dec. ....									8.6	

Source: Istat.

Table a17

## Indices of competitiveness (1)

(calculated on manufacturing wholesale prices, 1980 = 100)

	Italy's competitive position with respect to:							EEC countries (2)	13 industrial countries (3)
	Germany	France	UK	Belgium	Netherlands	US			
1980 .....	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	
1981 .....	101.6	100.4	91.3	103.1	99.5	78.6	100.0	96.5	
1982 .....	98.7	103.5	92.6	112.3	94.9	72.3	100.1	95.9	
1983 .....	100.9	106.7	99.9	120.1	98.1	70.6	103.7	98.4	
1984 .....	103.8	102.5	101.6	124.6	100.4	65.6	104.4	98.1	
1983 — 2nd qtr....	100.6	108.6	99.4	119.5	98.6	72.3	104.1	98.9	
3rd " ....	101.2	106.4	96.9	120.8	97.9	68.3	103.5	97.7	
4th " ....	101.0	104.6	97.5	122.0	98.7	67.5	103.0	97.0	
1984 — 1st qtr....	101.5	103.3	98.6	123.2	98.1	67.3	103.0	97.1	
2nd " ....	103.0	102.4	100.8	124.3	99.5	68.0	103.9	98.0	
3rd " ....	104.8	102.2	102.3	124.9	101.2	64.4	104.9	98.4	
4th " ....	105.8	102.2	104.7	125.8	102.9	62.6	105.8	98.7	
1985 — 1st qtr....	107.1	102.6	107.9	126.6	104.7	60.2	107.1	99.3	
2nd " ....	105.9	100.6	98.1	125.3	102.2	62.6	104.5	97.9	
3rd " ....	103.1	99.2	93.9	122.6	98.9	66.1	102.0	96.4	
1984 — Oct. ....	105.3	101.9	103.7	125.7	102.3	61.9	105.4	98.2	
Nov. ....	105.5	102.1	104.4	125.4	102.7	63.6	105.6	98.7	
Dec. ....	106.6	102.7	106.1	126.2	103.8	62.2	106.6	99.2	
1985 — Jan. ....	107.7	103.4	110.3	127.1	105.3	61.9	107.9	100.3	
Feb. ....	107.7	103.1	109.2	127.4	105.5	60.0	107.7	99.9	
Mar. ....	106.0	101.4	104.1	125.4	103.4	58.8	105.6	97.9	
Apr. ....	104.9	100.2	98.8	124.0	102.1	62.3	104.0	97.3	
May.....	106.0	100.4	98.1	125.6	102.4	62.1	104.6	97.9	
June.....	106.6	101.2	97.5	126.4	102.1	63.5	105.0	98.5	
July.....	104.1	99.6	92.7	123.6	99.7	65.1	102.5	96.7	
Aug. ....	102.5	98.3	94.4	121.8	98.2	67.0	101.4	96.1	
Sept.....	102.7	99.6	94.5	122.3	98.8	66.3	102.0	96.4	
Oct. (4) ..	102.9	100.1	97.0	123.6	99.4	70.8	102.6	97.4	
Nov. (4) ..	103.2	101.2	97.6	124.4	99.7	72.3	103.3	98.0	

(1) A decline in the index signifies a gain in competitiveness for Italy. — (2) Germany, France, the UK, Belgium, the Netherlands, Ireland and Denmark. — (3) The seven EEC countries plus the US, Canada, Japan, Switzerland, Sweden and Austria. — (4) Provisional and partly estimated data.

Table a18

## Balance of payments on a settlements basis

(billions of lire)

	Goods (1)	Services and transfers				Balance on current account	Non-bank capital movements plus errors and omissions	Bank capital movements (2) (4)	Change in official reserves (2)
		Travel	Income from capital	Other	Total				
1980 .....	-18,351	5,399	-973	3,780	8,206	-10,145	3,887	6,929	-671
1981 .....	-14,017	6,693	-4,151	3,800	6,342	-7,675	9,208	-1,524	-9
1982 .....	-17,189	8,928	-5,815	4,028	7,141	-10,048	7,527	-3,062	5,583
1983 .....	-9,176	10,953	-6,418	5,347	9,882	706	3,087	4,995	-8,788
1984 (3) .....	-18,352	11,412	-7,554	7,240	11,098	-7,254	7,311	5,138	-5,195
1985 (3) .....								-5,166	13,684
1983 — Dec. ...	-449	691	-622	422	491	42	-359	339	-22
1984 — Jan. ...	-1,121	429	-577	451	303	-818	68	579	171
Feb. ...	-1,926	343	-518	682	507	-1,419	911	-626	1,134
Mar. ...	-1,647	523	-498	210	235	-1,412	-552	833	1,131
Apr. ...	-1,889	837	-659	960	1,138	-751	1,501	451	-1,201
May ...	-1,622	1,131	-431	654	1,354	-268	-1,301	2,739	-1,170
June ...	-1,670	1,371	-833	171	709	-961	776	790	-605
July ...	-1,387	1,633	-524	927	2,036	649	1,215	-78	-1,786
Aug. ...	-35	1,322	-606	676	1,392	1,357	325	-655	-1,027
Sept. ...	-1,824	1,259	-793	745	1,211	-613	176	198	239
Oct. ...	-1,424	1,167	-864	696	999	-425	1,683	-626	-632
Nov. ...	-1,433	747	-536	632	843	-590	3,228	294	-2,932
Dec. ...	-2,372	652	-716	425	361	-2,011	-711	1,239	1,483
1985 — Jan. ...	-1,369	476	-863	1,261	874	-495	655	498	-658
Feb. ...	-2,411	488	-559	715	644	-1,767	172	173	1,422
Mar. ...	-3,257	740	-518	611	833	-2,424	-513	-905	3,842
Apr. ...	-2,248	872	-1,034	238	76	-2,172	-830	2,980	22
May ...	-1,139	1,193	-745	871	1,319	180	316	798	-1,294
June ...	-490	1,409	-770	415	1,054	564	571	649	-1,784
July ...								-1,987	209
Aug. ...								-1,928	504
Sept. ...								-1,027	2,435
Oct. ...								-1,274	1,769
Nov. ...								-952	3,000
Dec. ...								-2,986	4,572

(1) Imports, cif; exports, fob. — (2) Adjusted for exchange rate variations; a minus sign indicates an increase in net assets. — (3) Annual totals may not coincide with the sum of the monthly totals because of the provisional nature of the data. — (4) The July 1984 figures take account of the arrangements regarding the foreign assets held by the old Banco Ambrosiano.

Table a19

## External position of BI-UIC

		Short-term position							Medium and long-term position	Total official reserves (1)
		Assets					Liabilities	Balance (1)		
		Gold	Convertible currencies	ECU	SDR	Reserve position in the IMF				
<i>(billions of lire)</i>										
1980	— Dec. ...	34,169	10,152	9,982	618	766	—272	55,415	—381	55,034
1981	— Dec. ...	34,791	11,657	10,684	940	881	—183	58,770	—759	58,011
1982	— Dec. ...	32,449	9,137	8,140	1,107	953	—144	51,642	—475	51,167
1983	— Dec. ...	43,399	17,587	13,153	1,094	1,642	—355	76,520	—483	76,037
1984	— Dec. ...	41,887	23,794	13,159	1,346	2,079	—263	82,002	—189	81,813
1985	— Jan. ...	41,887	24,302	12,980	1,417	2,126	—210	82,502	—192	82,310
	Feb. ...	41,887	23,509	13,125	1,608	2,174	—106	82,197	—166	82,031
	Mar. ...	39,722	19,558	13,568	1,589	2,149	—94	76,492	—156	76,336
	Apr. ...	39,722	20,354	12,964	1,593	2,154	—96	76,691	—139	76,552
	May ...	39,722	21,733	12,979	1,640	2,148	—181	78,041	—201	77,840
	June ...	42,666	23,488	12,971	1,658	2,126	—104	82,805	—400	82,405
	July ...	42,666	23,214	13,339	1,662	2,040	—154	82,767	—430	82,337
	Aug. ...	42,666	22,549	13,301	1,717	2,061	—110	82,184	—426	81,758
	Sept. ...	41,091	19,963	13,260	1,719	2,059	—132	77,960	—450	77,510
	Oct. ...	41,091	18,073	12,015	1,709	2,049	—50	74,887	—459	74,428
	Nov. ...	41,091	14,997	12,120	1,731	1,970	—139	71,770	—465	71,305
	Dec. ...	39,530	16,402	7,139	879	1,946	—224	65,672	—492	65,180
<i>(millions of dollars)</i>										
1980	— Dec. ...	36,722	10,910	10,728	664	823	—292	59,555	—409	59,146
1981	— Dec. ...	28,993	9,714	8,903	783	734	—152	48,975	—632	48,343
1982	— Dec. ...	23,685	6,669	5,942	808	696	—105	37,695	—347	37,348
1983	— Dec. ...	26,152	10,598	7,926	659	989	—214	46,110	—291	45,819
1984	— Dec. ...	21,637	12,291	6,797	695	1,074	—136	42,359	—98	42,261
1985	— Jan. ...	21,637	12,435	6,642	725	1,088	—107	42,420	—98	42,322
	Feb. ...	21,637	11,361	6,343	777	1,051	—51	41,117	—80	41,036
	Mar. ...	20,069	9,882	6,855	803	1,086	—47	38,647	—79	38,568
	Apr. ...	20,069	10,306	6,564	807	1,091	—49	38,787	—70	38,717
	May ...	20,069	11,026	6,585	832	1,090	—92	39,510	—102	39,408
	June ...	21,881	12,046	6,652	850	1,090	—53	42,467	—206	42,260
	July ...	21,881	12,406	7,128	888	1,090	—82	43,311	—230	43,081
	Aug. ...	21,881	12,078	7,125	920	1,104	—59	43,049	—228	42,821
	Sept. ...	22,770	11,062	7,348	953	1,141	—73	43,200	—249	42,951
	Oct. ...	22,770	10,229	6,799	967	1,160	—28	41,896	—260	41,636
	Nov. ...	22,770	8,788	7,102	1,014	1,154	—81	40,748	—273	40,475
	Dec. ...	23,558	9,775	4,254	524	1,160	—133	39,137	—293	38,844

(1) The dollar values may not coincide with the sum of the single components because of rounding.

Table a20

## State sector borrowing requirement (1)

(billions of lire)

	Budget revenues			Budget disbursements			Deficit (-)	Other transactions (2)	BORROW- ING REQUIRE- MENT (-)	Borrowing requirement net of debt settlements in securities
	Fiscal	Other	Total	Current expenditure	Capital expenditure	Total				
1980 .....	72,015	18,303	90,318	-110,697	-20,517	-131,214	-40,896	3,879	-37,017	-36,078
1981 .....	89,240	19,448	108,688	-131,662	-22,394	-154,056	-45,368	-7,928	-53,296	-49,616
1982 .....	114,668	40,515	155,183	-176,469	-35,439	-211,908	-56,725	-15,928	-72,653	-71,941
1983 .....	144,603	36,700	181,303	-203,258	-50,868	-254,126	-72,823	-15,781	-88,604	-88,604
1984 .....	162,688	41,452	204,140	-248,299	-48,762	-297,061	-92,921	-2,430	-95,351	-95,351
1985 (3) .....									-121,352	-110,949
1983 — 4th qtr.	47,008	18,490	65,498	-66,557	-15,742	-82,299	-16,801	-8,653	-25,454	-25,454
1984 — 1st qtr.	35,532	4,947	40,479	-49,794	-7,068	-56,862	-16,383	-2,042	-18,425	-18,425
2nd "	39,611	5,867	45,478	-54,026	-13,468	-67,494	-22,016	2,155	-19,861	-19,861
3rd "	34,211	12,917	47,128	-67,542	-8,696	-76,238	-29,110	3,727	-25,383	-25,383
4th "	53,334	17,721	71,055	-76,937	-19,530	-96,467	-25,412	-6,270	-31,682	-31,682
1985 — 1st qtr.	35,336	7,394	42,730	-59,540	-11,998	-71,538	-28,808	952	-27,856	-27,856
2nd "	43,759	7,040	50,799	-73,519	-8,917	-82,436	-31,636	3,792	-27,844	-25,649
3rd "	42,001	7,327	49,328	-71,630	-13,707	-85,336	-36,009	3,443	-32,565	-29,627
4th (3)									-33,087	-27,817
1984 — Nov. ...	14,869	3,175	18,044	-25,084	-3,233	-28,317	-10,273	-1,307	-11,580	-11,580
Dec. ...	26,006	9,851	35,857	-34,308	-9,283	-43,591	-7,734	-3,040	-10,774	-10,774
1985 — Jan. ...	11,890	794	12,684	-14,102	-2,447	-16,549	-3,865	-1,369	-5,233	-5,233
Feb. ...	12,095	3,007	15,102	-26,844	-3,965	-30,809	-15,707	6,507	-9,200	-9,200
Mar. ...	11,351	3,593	14,944	-18,595	-5,585	-24,180	-9,236	-4,187	-13,423	-13,423
Apr. ...	11,761	2,090	13,851	-16,575	-2,381	-18,956	-5,105	-4,936	-10,041	-10,041
May ...	13,148	2,348	15,496	-25,744	-3,300	-29,044	-13,547	3,973	-9,574	-9,574
June ...	18,850	2,602	21,452	-31,201	-3,235	-34,436	-12,984	4,755	-8,229	-6,034
July ....	17,422	2,827	20,249	-28,071	-6,076	-34,147	-13,898	3,293	-10,605	-10,605
Aug. ...	14,033	1,395	15,428	-22,405	-5,755	-28,159	-12,731	5,230	-7,501	-7,501
Sept. ...	10,546	3,105	13,651	-21,155	-1,876	-23,031	-9,380	-5,080	-14,460	-11,522
Oct. ...	16,979	3,967	20,946	-16,828	-3,817	-20,645	301	-7,609	-7,308	-7,158
Nov. (3)	13,315	8,143	21,458	-30,637	-3,009	-33,646	-12,188	-1,781	-13,969	-13,969
Dec. (3)									-11,810	-6,690

(1) Rounding may cause discrepancies in totals. — (2) Minor Treasury operations and those of the Deposits and Loans Fund, the autonomous government agencies and the Southern Italy Development Fund. — (3) Provisional and partly estimated data.

Table a21

## Financing of the state sector borrowing requirement (1)

(billions of lire)

	Medium and long-term securities			BI-UIC financing other than securities purchases		PO deposits	Foreign loans	Other	BORROWING REQUIREMENT	of which: creation of monetary base (2)
	Total	of which: floating rate Treasury credit certificates	Treasury bills	Total	of which: Treasury overdraft with B.I.					
1980 .....	-1,553	2,691	25,500	10,236	8,944	2,195	787	-148	37,017	9,740
1981 .....	7,354	2,816	33,783	6,734	6,186	2,591	2,515	319	53,296	14,233
1982 .....	23,473	27,378	32,604	8,883	6,598	3,586	2,570	1,537	72,653	12,676
1983 .....	69,275	66,652	11,071	-1,125	-8,622	4,937	1,259	3,188	88,604	4,514
1984 .....	62,741	56,738	9,300	13,288	18,555	6,057	2,271	1,693	95,351	10,028
1985 (3) .....	94,259	78,566	13,183	3,700	6,340	7,105	2,326	779	121,352	27,629
1983 — 4th qtr. ....	20,992	17,534	-435	-1,295	-856	4,269	630	1,294	25,454	4,894
1984 — 1st qtr. ....	19,580	16,913	-5,370	2,093	10,472	1,525	533	64	18,425	5,103
2nd " .....	16,846	15,939	6,597	-4,282	-4,664	47	-7	660	19,861	-3,850
3rd " .....	12,973	12,443	8,122	2,794	2,746	439	1,327	-272	25,383	1,138
4th " .....	13,343	11,443	-49	12,683	10,000	4,046	418	1,242	31,682	7,639
1985 — 1st qtr. ....	23,268	19,444	-2,166	5,948	8,201	1,486	-689	7	27,856	10,137
2nd " .....	18,767	15,651	10,182	-2,172	-1,757	246	1,442	-620	27,844	-405
3rd " .....	21,222	20,744	10,352	-556	678	2	721	824	32,565	3,512
4th (3) .....	31,002	22,727	-5,187	479	-783	5,372	852	569	33,087	14,386
1984 — Nov. ....	4,900	3,982	-698	5,691	4,093	76	1,783	-172	11,580	3,762
Dec. ....	4,860	3,984	-1,185	4,402	3,496	3,841	-1,370	226	10,774	3,435
1985 — Jan. ....	2,641	3,481	-1,695	2,265	2,449	2,274	-724	472	5,233	6,565
Feb. ....	10,550	7,721	-537	-113	942	-591	-44	-65	9,200	-790
Mar. ....	10,078	8,242	67	3,796	4,810	-197	79	-400	13,423	4,362
Apr. ....	7,659	5,626	2,978	-2,265	-2,262	-58	880	847	10,041	-1,683
May ....	5,457	6,150	3,044	1,249	1,739	84	547	-807	9,574	2,659
June ....	5,651	3,875	4,160	-1,156	-1,234	220	14	-660	8,229	-1,381
July ....	4,132	6,289	3,186	1,553	1,136	336	586	812	10,605	3,039
Aug. ....	4,850	4,914	4,462	-2,160	-1,726	361	29	-42	7,501	-143
Sept. ....	12,240	9,541	2,704	51	1,268	-695	106	53	14,460	616
Oct. ....	11,245	10,316	-2,601	-2,463	-3,016	349	111	668	7,308	5,442
Nov. (3) .....	8,207	6,285	-1,922	7,318	6,808	523	-59	-99	13,969	5,786
Dec. (3) .....	11,550	6,126	-664	-4,376	-4,575	4,500	800	-	11,810	3,158

(1) Rounding may cause discrepancies in totals. — (2) The series has been adjusted for Bank of Italy sales of securities to banks in connection with advances granted under the Ministerial Decree of 27 September 1974. — (3) Provisional and partly estimated data.

Table a22

## The domestic public debt (1)

*(face value; billions of lire)*

	Medium and long-term securities excluding BI portfolio	Treasury bills excluding BI portfolio	PO deposits	Lending by credit institutions	Other domestic debt	Sub-total	Borrowing from BI-UIC	TOTAL	of which: state sector
1979 — Dec. ..	52,143	43,905	30,853	16,195	1,563	144,660	43,255	187,915	172,673
1980 — Dec. ..	49,682	70,123	33,048	16,716	1,700	171,269	52,978	224,246	208,522
1981 — Dec. ..	56,057	98,750	35,639	16,996	1,779	209,220	66,556	275,776	259,753
1982 — Mar. ..	59,895	106,515	35,583	17,099	1,803	220,895	68,666	289,561	273,429
June ..	58,999	121,099	35,227	17,503	1,845	234,673	69,631	304,304	288,065
Sept. ..	70,762	132,886	35,010	18,579	1,902	259,139	69,055	328,194	311,746
Dec. ..	81,308	127,587	39,225	22,140	1,938	272,198	78,670	350,868	330,968
1983 — Mar. ..	91,862	123,508	39,737	22,099	1,979	279,186	85,051	364,236	344,660
June ..	111,153	133,592	39,644	23,475	2,020	309,884	75,961	385,845	366,123
Sept. ..	134,401	139,681	39,893	23,933	2,084	339,992	74,647	414,639	394,734
Dec. ..	150,671	137,992	44,162	28,225	2,147	363,198	79,630	442,827	420,008
1984 — Mar. ..	166,899	135,166	45,687	29,515	2,196	379,462	82,915	462,377	438,306
June ...	183,512	140,531	45,733	31,790	2,246	403,812	80,740	484,552	458,829
Sept. ..	195,193	150,318	46,172	33,235	2,290	427,208	83,208	510,417	482,940
Dec. ..	208,883	153,233	50,219	36,925	2,379	451,639	92,864	544,503	514,554
1985 — Jan. ..	212,186	147,089	52,493	38,313	2,445	452,526	99,311	551,837	520,928
Feb. ..	222,090	147,756	51,902	37,831	2,405	461,983	98,616	560,599	530,150
Mar. ..	231,906	147,909	51,705	37,739	2,450	471,708	102,991	574,699	543,897
Apr. ..	238,880	151,114	51,647	38,338	2,441	482,420	101,337	583,755	553,226
May ..	241,376	155,885	51,731	37,845	2,467	489,304	104,075	593,379	562,509
June ..	252,393	160,311	51,951	36,816	2,474	503,945	102,664	606,609	576,099
July ...	257,828	160,858	52,286	35,575	2,484	509,030	105,528	614,558	586,099
Aug. ..	262,432	163,544	52,639	35,273	2,477	516,364	105,391	621,755	593,566
Sept. ..	274,601	165,976	51,910	35,145	2,493	530,124	106,015	636,139	608,090

(1) Rounding may cause discrepancies in totals.



Table a23

## Monetary base (1)

(billions of lire)

S O U R C E S							
	Foreign sector	Treasury				Refinancing	Other sectors
		Total	of which:		memorandum item: unused credit on Treasury current account		
			BI-UIC government securities	Treasury overdraft with B.I.			
1982 — Dec.	8,710	76,732	38,059	31,910	-2,290	3,103	-4,721
1983 — Dec.	17,550	81,244	43,614	23,288	13,469	3,100	-5,465
1984 — Dec.	22,691	91,271	40	41,842	1,282	2,882	-6,569
1985 — Jan.	23,353	97,834	44,505	44,291	5,758	3,859	-7,537
Feb.	21,926	97,046	43,869	45,233	4,836	4,314	-7,342
Mar.	18,085	101,407	44,431	50,043	78	2,900	-7,399
Apr.	48,062	99,725	45,017	47,781	2,340	5,421	-8,608
May	19,356	102,383	46,411	49,520	1,026	3,705	-9,504
June	21,105	101,002	46,192	48,286	2,225	2,594	-7,863
July	20,867	104,041	47,664	49,423	1,089	2,692	-8,908
Aug.	20,373	103,898	49,685	47,697	2,991	3,117	-9,342
Sept.	17,968	104,514	50,232	48,965	1,731	4,852	-9,378
Oct.	16,170	109,956	58,139	45,949	4,804	3,332	-9,650
Nov. (2)	13,170	115,742	56,595	52,751	-2,009	3,012	-9,638
Dec. (2)	8,598	118,900	63,998	48,175	2,960	8,761	-6,939

U S E S							TOTAL MONETARY BASE
	Non-state sector		Banks			Total	
	Total	of which: notes and coin	Compulsory reserves	Deposit against overshoots of lending ceiling	Liquidity		
1982 — Dec.	33,283	33,245	45,926	929	3,687	50,541	83,824
1983 — Dec.	37,363	37,325	55,017	2	4,045	59,965	96,428
1984 — Dec.	41,225	41,195	63,872	—	5,178	69,050	110,275
1985 — Jan.	38,646	38,422	74,806	—	4,056	78,862	117,508
Feb.	38,380	38,247	74,236	—	3,329	77,564	115,944
Mar.	39,570	39,408	72,798	—	2,625	75,424	114,994
Apr.	38,713	38,591	72,731	—	3,155	75,886	114,599
May	39,046	38,953	72,772	—	4,123	76,895	115,940
June	40,960	40,829	71,857	—	4,021	75,879	116,838
July	42,245	42,075	73,267	—	3,180	76,447	118,692
Aug.	41,052	40,799	74,229	—	2,765	76,994	118,046
Sept.	41,844	40,693	74,276	—	2,837	77,113	117,956
Oct.	40,582	40,400	75,893	—	3,333	79,226	119,808
Nov. (2)	41,809	41,663	76,307	—	4,170	80,477	122,286
Dec. (2)	45,734	45,554	76,086	—	7,500	83,586	129,320

(1) Rounding may cause discrepancies in totals. — (2) Provisional and partly estimated data.

Table a23 cont.

## Monetary base (1)

(changes in billions of lire)

	Foreign sector	Treasury	Refinancing	Other	TOTAL	Non-state sector	Banks		
							Compulsory reserves	Deposits against ceiling overshoots	Liquidity
1982 .....	-5,647	12,676	638	2,670	10,336	3,528	8,544	-519	-1,218
1983 .....	8,840	4,514	-3	-747	12,604	4,081	9,092	-927	359
1984 .....	5,141	10,028	-218	-1,104	13,847	3,861	8,855	-2	1,133
1985 .....	-14,092	27,629	5,877	-370	19,045	4,509	12,213	-	2,323
1985 — Jan. ...	662	6,563	976	-968	7,233	-2,579	10,934	-	-1,122
Feb. ...	-1,427	-789	455	196	-1,565	-267	-571	-	-727
Mar. ...	-3,841	4,362	-1,414	-57	-950	1,191	-1,437	-	-703
Apr. ...	-23	-1,683	2,521	-1,210	-395	-857	-67	-	529
May ...	1,294	2,659	-1,716	-895	1,341	332	40	-	968
June ...	1,749	-1,381	-1,111	1,641	898	1,914	-914	-	-102
July ...	-238	3,039	97	-1,045	1,854	1,286	1,409	-	-841
Aug. ...	-494	-143	425	-434	-646	-1,193	962	-	-414
Sept. ...	-2,404	616	1,735	-36	-89	-208	47	-	72
Oct. ...	-1,798	5,442	-1,520	-273	1,852	-262	1,617	-	496
Nov. (2) .	-3,000	5,786	-320	12	2,478	1,227	414	-	837
Dec. (2) .	-4,572	3,158	5,749	2,699	7,034	3,925	-221	-	3,330

## Monetary base financing of the Treasury

(billions of lire)

	Borrowing requirement	Net sales of securities					TOTAL	Other forms of non-monetary base financing	Monetary base financing
		Primary market			Open market				
		Treasury bills	Treasury credit certificates	Other	Total	of which: repurchase agreements			
1982 .....	72,653	-6,947	-20,490	4,018	-28,944	-401	-52,363	-7,614	12,676
1983 .....	88,604	8,632	-59,602	-2,210	-21,609	-1,628	-74,789	-9,301	4,514
1984 .....	95,351	-13,187	-54,436	-2,775	-5,012	2,661	-75,410	-9,913	10,028
1985 .....	121,352	1,807	-68,099	-15,908	-1,527	4,933	-83,727	-9,998	27,629
1985 — Jan. ...	5,233	3,579	-3,290	659	2,366	3,489	3,314	-1,984	6,563
Feb. ...	9,200	-205	-6,950	-1,514	-1,980	-1,932	-10,648	660	-789
Mar. ...	13,423	715	-6,305	-1,213	-2,779	-2,818	-9,582	521	4,362
Apr. ...	10,041	-3,275	-3,607	-1,943	-1,226	-759	-10,051	-1,673	-1,683
May ...	9,574	-2,764	-5,299	1,117	-153	2,028	-7,099	184	2,659
June ...	8,223	-4,191	-3,441	-1,612	-787	-829	-10,030	420	-1,381
July ...	10,605	-1,004	-4,993	59	92	2,460	-5,846	-1,720	3,039
Aug. ...	7,501	-1,747	-4,550	-	-995	-950	-7,292	-352	-143
Sept. ...	14,460	-3,239	-9,157	-2,755	753	791	-14,398	554	616
Oct. ...	7,308	3,634	-9,864	-1,435	6,929	7,204	-736	-1,130	5,442
Nov. (2) .	13,969	4,064	-5,743	-1,847	-4,338	-4,361	-7,864	-319	5,786
Dec. (2) .	11,810	6,240	-4,900	-5,424	591	610	-3,493	-5,159	3,158

(1) Rounding may cause discrepancies in totals. — (2) Provisional and partly estimated data.

Table a24

## BI-UIC operations in government securities (1)

(billions of lire)

	Primary market			Open market			Variations in BI-UIC portfolio
	Subscrip- tions	Redemptions	Total	of which: repurchase agreements			
				Financing of subscriptions	Other purchases	Sales	
<b>Treasury bills</b>							
1982 .....	35,259	9,602	-21,662	426	—	-1,404	3,995
1983 .....	38,342	18,639	-15,946	-179	—	420	3,757
1984 .....	12,597	16,484	-5,947	636	—	780	-9,834
1985 (2) .....	25,548	10,556	66	-386	1,075	-1,200	15,058
1985 — Jan. ....	1,900	16	2,567	-666	1,030	-1,200	4,451
Feb. ....	960	1,702	-466	568	-1,030	—	-1,208
Mar. ....	1,832	1,050	-866	-868	—	—	-84
Apr. ....	1,800	2,097	69	541	—	—	-228
May ....	657	376	-2,005	113	—	—	-1,724
June ....	808	838	-235	-234	—	—	-265
July ....	3,106	924	458	530	—	—	2,640
Aug. ....	3,103	387	-940	-950	—	—	1,776
Sept. ....	500	1,034	806	791	—	—	272
Oct. ....	1,388	356	3,324	154	3,342	—	4,356
Nov. ....	3,500	1,358	-3,595	-618	-2,982	—	-1,453
Dec. (2) .....	5,994	418	949	253	715	—	6,525
<b>Treasury credit certificates</b>							
1982 .....	10,607	3,719	-4,095	—	—	2,231	2,793
1983 .....	8,515	1,465	-5,229	—	—	1,029	1,821
1984 .....	6,993	4,691	1,128	—	—	-2,805	3,430
1985 (2) .....	9,954	91	667	—	2,101	-455	10,530
1985 — Jan. ....	191	—	-205	—	1,457	-455	-14
Feb. ....	816	45	-1,482	—	-1,457	—	-711
Mar. ....	1,959	22	-1,917	—	—	1,950	20
Apr. ....	1,950	—	173	—	—	-200	2,123
May ....	773	2	382	—	—	-415	1,153
June ....	419	22	418	—	—	-405	815
July ....	1,176	—	887	—	—	-930	2,063
Aug. ....	300	—	-2	—	—	—	298
Sept. ....	328	—	-52	—	—	—	276
Oct. ....	327	—	2,934	—	3,037	—	3,261
Nov. ....	489	—	-523	—	-990	—	-34
Dec. (2) .....	1,226	—	54	—	54	—	1,280

(1) Final figures are given at balance sheet values. The portfolio variations differ from those given by the BI-UIC accounts since they do not take account of the sales of securities made to supply collateral for advances granted under the Ministerial Decree of 27 September 1974. — (2) Provisional data.

Table a24 cont.

## BI-UIC operations in government securities (1)

(billions of lire)

	Primary market		Open market				Variations in BI-UIC portfolio
	Subscrip- tions	Redemptions	Total	of which: repurchase agreements			
				Financing of subscriptions	Other purchases	Sales	
<b>Other government securities</b>							
1982 .....	1,690	1,577	-3,188	—	—	—	-3,074
1983 .....	2,481	2,068	-434	—	—	—	-21
1984 .....	5,806	2,578	-193	—	—	—	3,036
1985 (2) .....	3,912	3,497	-2,261	—	488	—	-1,846
1985 — Jan. ....	128	310	4	—	13	—	-178
Feb. ....	1,315	—	-32	—	-13	—	1,283
Mar. ....	622	—	4	—	—	—	626
Apr. ....	159	—	-1,468	—	—	1,500	-1,309
May ....	975	480	1,470	—	—	-1,500	1,965
June ....	201	—	-970	—	—	1,000	-769
July ....	61	2,038	-1,253	—	—	-1,000	-3,230
Aug. ....	—	—	-54	—	—	—	-54
Sept. ....	—	—	-1	—	—	—	-1
Oct. ....	288	669	671	—	671	—	290
Nov. ....	163	—	-220	—	229	—	-57
Dec. (2) .....	—	—	-412	—	-412	—	-412
<b>T O T A L</b>							
1982 .....	47,556	14,898	-28,944	426	—	827	3,714
1983 .....	49,338	22,172	-21,609	-179	—	1,449	5,557
1984 .....	25,396	23,753	-5,012	636	—	-2,025	-3,368
1985 (2) .....	39,414	14,144	-1,528	-386	3,664	-1,655	23,742
1985 — Jan. ....	2,219	326	2,366	-666	2,500	-1,655	4,259
Feb. ....	3,091	1,747	-1,980	568	-2,500	—	-636
Mar. ....	4,413	1,072	-2,779	-868	—	1,950	562
Apr. ....	3,909	2,097	-1,226	541	—	1,300	586
May ....	2,405	858	-153	113	—	-1,915	1,394
June ....	1,428	860	-787	-234	—	595	-219
July ....	4,343	2,962	92	530	—	-1,930	1,473
Aug. ....	3,403	387	-996	-950	—	—	2,020
Sept. ....	828	1,034	753	791	—	—	547
Oct. ....	2,003	1,025	6,929	154	7,050	—	7,907
Nov. ....	4,152	1,358	-4,338	-618	-3,743	—	-1,544
Dec. (2) .....	7,220	418	591	253	357	—	7,393

(1) Final figures are given at balance sheet values. The portfolio variations differ from those given by the BI-UIC accounts since they do not take account of the sales of securities made to supply collateral for advances granted under the Ministerial Decree of 27 September 1974. — (2) Provisional data.

Table a25

## Temporary sales of securities by the Bank of Italy (1)

(billions of lire)

	Amount offered	Amount taken up	Maturity (days)	Yields			Amount offered	Amount taken up	Maturity (days)	Yields	
				Maximum	Weighted average					Maximum	Weighted average
<b>1984</b>											
4 Sept.	1,250	981	10-24	16.00	15.18	1 Apr.	1,500	765	11	13.20	13.05
5 "	750	620	23	16.00	15.79	2 "	500	310	10	14.00	13.64
12 "	1,000	—	15-16	—	—	4 "	750	750	8	13.90	13.57
17 "	500	405	11	16.00	15.95	9 "	1,000	1,000	17	13.95	13.78
19 "	750	750	9	15.85	15.77	11 "	1,000	1,000	15	13.70	13.51
20 "	1,000	1,000	8-22	16.00	15.88	12 "	1,250	895	14	14.10	13.72
21 "	500	370	21	16.00	15.94	19 "	1,000	1,000	13	12.85	12.76
28 "	500	490	14-28	16.00	15.99	23 "	1,500	1,500	9-10	12.95	12.67
1 Oct.	1,500	1,500	25	15.20	15.04	24 "	750	750	8	13.20	12.79
9 "	500	425	17	16.00	15.59	13 May	750	750	21-23	13.90	13.37
10 "	500	500	16-21	15.60	15.45	22 "	1,000	955	6-9-10	13.95	13.69
11 "	750	750	15-20	15.45	15.38	14 June	750	750	14	13.90	13.59
16 "	500	295	20	16.00	15.81	19 "	750	750	9	13.70	13.47
18 "	600	600	18	15.35	15.30	20 "	1,250	1,200	8	14.00	13.77
19 "	1,000	1,000	17	15.45	15.23	21 "	1,000	1,000	13	13.30	13.14
25 "	750	750	40-42	15.30	15.14	25 "	1,000	930	9	14.00	13.73
26 "	500	500	38-41	14.90	14.67	1 July	1,250	300	25	14.20	14.05
21 Dec.	1,200	1,200	25	14.10	14.03	5 "	1,500	1,500	20-21	13.80	13.69
24 "	1,000	455	22	14.75	14.19	11 "	1,500	1,500	14-15	12.85	12.75
27-28 "	500	—	18-19	—	—	15 "	500	500	10-11	12.85	12.66
<b>1985</b>											
10 Jan.	750	750	15-21	13.10	13.03	9 Aug.	600	600	10	13.30	13.20
11 "	1,000	1,000	14-19	13.00	12.85	12 "	500	400	7	14.00	13.65
20 Feb.	1,000	1,000	8	12.60	12.35	13 "	500	500	10	13.90	13.51
18 Mar.	1,500	1,500	14	12.45	12.26	10 Sept.	750	750	15	13.60	13.34
19 "	750	750	10-13	12.40	12.33	11 "	750	750	14	13.60	13.47
						12 "	700	520	13-14	13.95	13.79

(1) Repurchase agreements based on competitive bid auctions.



Table a26

## Treasury bill auctions

(face value; billions of lire)

	Bills offered	Maturity in days	Demand for bills from banks and the private sector	Bills allotted at auction			Total	
				to banks and the private sector		Subscribed by BI-UIC		
				Competitive bid	Other			
<b>3 months</b>								
1985 —	mid- Aug. ...	1,000	92	1,057	1,000	—	—	1,000
	end- Aug. ...	3,250	91	3,105	3,101	4	—	3,105
	mid- Sept. ...	1,500	91	1,167	1,167	—	250	1,417
	end- Sept. ...	3,500	91	4,063	3,499	1	—	3,500
	mid- Oct. ...	1,250	96	997	997	—	253	1,250
	end- Oct. ...	3,000	97	2,338	2,334	4	—	2,338
	mid- Nov. ...	750	92	307	307	—	200	507
	end- Nov. ...	2,000	98	1,248	1,244	5	—	1,248
	mid- Dec. ...	—	—	—	—	—	—	—
	end- Dec. ...	3,000	91	1,928	1,928	—	1,071	3,000
1986 —	mid- Jan. ...	—	—	—	—	—	—	—
	end- Jan. ...	4,500	90	3,851	3,847	4	649	4,500
	mid- Feb. ...	—	—	—	—	—	—	—
<b>6 months</b>								
1985 —	mid- Aug. ...	2,000	184	1,340	1,340	—	660	2,000
	end- Aug. ...	9,250	189	7,204	7,200	4	1,750	8,954
	mid- Sept. ...	1,500	182	805	805	—	250	1,055
	end- Sept. ...	6,500	182	6,824	6,497	3	—	6,500
	mid- Oct. ...	750	186	614	614	—	136	750
	end- Oct. ...	7,000	187	6,455	6,449	6	—	6,455
	mid- Nov. ...	1,000	182	528	528	—	300	828
	end- Nov. ...	6,000	189	4,994	4,987	7	700	5,694
	mid- Dec. ...	750	185	527	527	—	223	750
	end- Dec. ...	9,500	185	6,281	6,277	4	3,219	9,500
1986 —	mid- Jan. ...	1,500	181	802	802	—	250	1,052
	end- Jan. ...	9,500	181	8,269	8,261	8	1,231	9,500
	mid- Feb. ...	1,250	181	1,252	1,250	—	—	1,250
<b>12 months</b>								
1985 —	mid- Aug. ...	1,000	365	672	—	672	—	672
	end- Aug. ...	7,000	371	6,308	—	6,308	692	7,000
	mid- Sept. ...	1,000	367	1,133	—	1,000	—	1,000
	end- Sept. ...	6,500	368	7,323	—	6,500	—	6,500
	mid- Oct. ...	750	369	993	—	750	—	750
	end- Oct. ...	8,500	370	7,054	—	7,054	1,000	8,054
	mid- Nov. ...	1,250	365	722	—	722	500	1,222
	end- Nov. ...	7,500	371	5,385	—	5,385	1,800	7,185
	mid- Dec. ...	1,250	367	690	—	690	560	1,250
	end- Dec. ...	10,000	368	9,079	—	9,079	920	10,000
1986 —	mid- Jan. ...	2,500	365	1,572	—	1,572	250	1,822
	end- Jan. ...	9,500	365	11,642	—	9,500	—	9,500
	mid- Feb. ...	2,250	364	1,681	—	1,681	569	2,250

Table a26 cont.

**Treasury bill auctions**  
(prices and yields)

		P R I C E S		Y I E L D S (1)					
		Floor	Average tender price	Simple			Compound		
				Floor-price	At auction		Floor-price	At auction	
					Competitive bid	Other		Competitive bid	Other
<b>3 months</b>									
1985	— mid- Aug. ...	96.75	96.75	13.33	13.33	12.90	14.01	14.01	13.54
	end- Aug. ...	96.80	96.80	13.26	13.26	12.83	13.93	13.93	13.46
	mid- Sept. ...	96.80	96.80	13.26	13.26	12.83	13.93	13.93	13.46
	end- Sept. ...	96.80	96.80	13.26	13.26	12.83	13.93	13.93	13.46
	mid- Oct. ....	96.75	96.75	12.77	12.77	12.37	13.39	13.39	12.94
	end- Oct. ....	96.75	96.75	12.64	12.64	12.24	13.24	13.24	12.80
	mid- Nov. ...	96.90	96.90	12.69	12.69	12.27	13.31	13.31	12.84
	end- Nov. ...	96.70	96.70	12.71	12.71	12.31	13.31	13.31	12.88
	mid- Dec. ....	—	—	—	—	—	—	—	—
	end- Dec. ...	96.95	96.95	12.62	12.62	12.19	13.23	13.23	12.76
1986	— mid- Jan. ...	—	—	—	—	—	—	—	—
	end- Jan. ...	96.75	96.75	13.62	13.62	13.19	14.34	14.34	13.86
	mid- Feb. ...	—	—	—	—	—	—	—	—
<b>6 months</b>									
1985	— mid- Aug. ...	93.60	93.60	13.56	13.56	13.34	14.02	14.02	13.78
	end- Aug. ...	93.45	93.45	13.54	13.54	13.32	13.98	13.98	13.74
	mid- Sept. ...	93.75	93.75	13.37	13.37	13.14	13.82	13.82	13.58
	end- Sept. ...	93.75	93.75	13.37	13.37	13.14	13.82	13.82	13.58
	mid- Oct. ...	93.75	93.75	13.08	13.08	12.86	13.50	13.50	13.26
	end- Oct. ...	93.80	93.80	12.90	12.90	12.68	13.31	13.31	13.07
	mid- Nov. ...	94.00	94.00	12.80	12.80	12.57	13.21	13.21	12.97
	end- Nov. ...	93.80	93.80	12.76	12.76	12.55	13.16	13.16	12.92
	mid- Dec. ...	93.95	93.95	12.71	12.71	12.48	13.10	13.10	12.87
	end- Dec. ...	93.95	93.95	12.71	12.71	12.48	13.10	13.10	12.87
1986	— mid- Jan. ...	94.05	94.05	12.76	12.76	12.53	13.17	13.17	12.93
	end- Jan. ...	93.80	93.80	13.33	13.33	13.10	13.78	13.78	13.53
	mid- Feb. ...	93.80	93.85	13.33	13.21	12.99	13.78	13.65	13.41
<b>12 months</b>									
1985	— mid- Aug. ...	87.70	87.70	14.03	—	14.03	14.03	—	14.03
	end- Aug. ...	87.50	87.50	14.05	—	14.05	14.05	—	14.05
	mid- Sept. ...	87.75	87.75	13.88	—	13.88	13.88	—	13.88
	end- Sept. ...	87.80	87.90	13.78	—	13.65	13.78	—	13.65
	mid- Oct. ...	88.00	88.20	13.49	—	13.23	13.49	—	13.23
	end- Oct. ...	88.20	88.20	13.20	—	13.20	13.20	—	13.20
	mid- Nov. ...	88.35	88.35	13.19	—	13.19	13.19	—	13.19
	end- Nov. ...	88.20	88.20	13.16	—	13.16	13.16	—	13.16
	mid- Dec. ...	88.30	88.30	13.18	—	13.18	13.18	—	13.18
	end- Dec. ...	88.30	88.30	13.14	—	13.14	13.14	—	13.14
1986	— mid- Jan. ...	88.35	88.35	13.19	—	13.19	13.19	—	13.19
	end- Jan. ...	88.10	88.35	13.51	—	13.19	13.51	—	13.19
	mid- Feb. ...	88.25	88.25	13.35	—	13.35	13.35	—	13.35

(1) Calendar year.



Table a27

## Interest rates

	Rates on BI-UIC loans			Yields				Bonds of industrial credit institutions	Interbank rates (4)
	Base	Actual on fixed-term advances (1)	Treasury bill 3-month (2)	Treasury bill 6-month (2)	Treasury bill 12-month (2)	Treasury bill average (2) (3)	Treasury bonds		
1980 — Dec. ....	16.50	—	16.77	17.02	16.14	15.92	16.17	16.30	17.36
1981 — Dec. ....	19.00	19.23	22.08	21.36	19.98	19.70	21.34	21.00	20.67
1982 — Dec. ....	18.00	21.00	19.51	19.11	18.55	19.17	19.62	19.86	19.05
1983 — Dec. ....	17.00	19.81	17.54	16.95	17.48	17.29	17.69	17.33	18.04
1984 — Dec. ....	16.50	17.48	14.82	14.69	14.68	14.70	14.53	13.84	17.31
1985 — Jan. ....	15.50	15.95	13.93	13.75	13.77	13.77	13.27	12.86	16.36
Feb. ....	"	16.68	13.62	13.46	13.36	13.42	13.29	12.49	16.09
Mar. ....	"	17.10	13.54	13.38	13.38	13.40	13.51	12.78	16.04
Apr. ....	"	16.04	14.41	14.31	14.00	14.24	13.57	13.22	15.67
May. ....	"	16.75	14.47	14.22	13.90	14.15	13.89	13.42	15.46
June ....	"	15.85	14.41	14.18	13.95	14.10	13.91	13.42	15.28
July ....	"	15.60	14.22	14.08	13.99	14.07	14.12	13.23	14.96
Aug. ....	"	17.69	13.95	13.99	14.05	14.00	14.09	13.38	14.73
Sept. ....	"	16.58	13.93	13.82	13.68	13.79	13.76	13.08	14.41
Oct. ....	"	17.19	13.28	13.33	13.20	13.27	13.75	12.80	14.39
Nov. ....	15.00	16.41	13.31	13.16	13.16	13.18	13.72	13.04	14.64
Dec. ....	"	16.17	13.23	13.10	13.14	13.14	13.67	13.27	14.93
1986 — Jan. (6) ..	15.00	16.97	14.34	13.73	13.19	13.58	13.44	12.95	15.23

	Bank rates (4)								
	ABI prime rate (5)	Lending in lire			Deposit rates			Certificates of deposit	
		Minimum	Normal	Average	Maximum	Normal	Average	6-month	12-month
1980 — Dec. ....	21.00	20.24	23.36	—	16.31	11.59	—	—	—
1981 — Dec. ....	22.50	22.23	25.37	—	18.73	13.33	—	—	—
1982 — Dec. ....	20.75	20.85	24.54	—	18.60	13.31	—	—	—
1983 — Dec. ....	18.75	18.80	23.10	—	17.17	12.11	—	—	—
1984 — Dec. ....	18.00	17.68	22.24	—	15.96	11.77	—	—	—
1985 — Jan. ....	17.00	17.20	21.84	—	15.46	11.39	—	—	—
Feb. ....	"	16.89	21.49	—	15.15	10.87	—	—	—
Mar. ....	"	16.82	21.43	18.59	15.14	11.02	11.61	14.72	14.82
Apr. ....	"	16.78	21.35	18.44	15.05	11.14	11.58	14.53	14.83
May ....	"	16.69	21.32	18.36	14.86	11.04	11.41	14.47	14.68
June ....	"	16.58	21.24	18.27	14.73	10.74	11.27	14.23	14.63
July ....	"	16.53	21.10	18.15	14.52	10.27	11.00	13.93	14.34
Aug. ....	"	16.50	21.04	18.02	14.42	10.20	10.90	13.89	14.24
Sept. ....	16.00	15.96	20.61	17.72	13.82	9.69	10.44	13.65	14.03
Oct. ....	"	15.63	20.34	17.33	13.63	9.49	10.20	13.28	13.69
Nov. ....	15.88	15.45	20.26	17.14	13.55	9.48	10.19	13.22	13.61
Dec. ....	"	15.29	20.16	16.86	13.43	9.56	10.11	13.21	13.61
1986 — Jan. (6) .	15.88	15.27	20.22	....	13.38	9.67	....	....	....

(1) Average rate weighted according to the premiums charged. — (2) Calculated with reference only to issues sold at end-of-month auctions. Annual rates, calendar year, compound interest formula. — (3) Weighted average of auction rates. — (4) With the exception of the ABI prime rate, bank rates are based on ten-day returns and calculated as a centered monthly average. Average rates for March 1985 are calculated as a simple arithmetic average of the three ten-day returns for that month. For the definition of bank interest rates, see Banca d'Italia, *Supplemento al Bollettino* (on banks). — (5) Rates recorded by the Italian Bankers' Association (ABI) on unsecured overdraft facilities granted to prime customers. The figures do not include the maximum overdraft commission of 1/8 of a percentage point per quarter. — (6) Provisional data.

Table a28

## Principal assets and liabilities of banks

(billions of lire)

A S S E T S											
	Bank reserves (1)	Credits					Interbank accounts		Bad debts (4)	Total	of which: special credit institutions
		Loans		Bankers' acceptances acquired	Treasury bills (2) (9)	Other securities (3) (9)	Total	of which: special credit institutions			
		in lire	in foreign currency								
1982 — Dec. ...	49,639	137,864	16,500	948	50,923	101,018	9,267	85,059	7,507		
1983 — Dec. ...	58,007	156,828	21,574	398	47,972	132,126	11,566	97,159	7,662		
1984 — Oct. ...	65,754	180,766	28,569	58	39,346	132,975	14,332	69,455	6,494		
Nov. ...	67,986	182,539	29,311	53	37,388	135,964	14,315	73,122	6,582		
Dec. ...	67,807	185,014	30,531	49	42,291	144,746	14,569	102,789	8,277		
1985 — Jan. ...	77,656	188,396	31,051	50	32,024	139,683	15,123	75,490	7,153		
Feb. ...	76,049	186,898	32,367	40	27,986	140,349	15,253	73,931	6,427		
Mar. ...	73,932	186,874	32,032	17	28,241	145,553	15,526	74,381	6,388		
Apr. ...	74,688	192,740	30,928	16	28,131	149,052	15,768	74,184	6,365		
May ...	75,740	192,407	31,568	16	28,030	149,247	16,064	75,755	6,647		
June ...	74,288	191,748	31,014	21	30,334	156,304	16,208	73,447	6,512		
July ...	75,243	198,440	31,135	17	27,265	156,237	16,505	70,906	5,869		
Aug. ...	75,744	195,198	29,374	19	29,127	157,206	16,692	72,937	6,445		
Sept. ...	75,885	195,604	28,467	16	30,404	162,654	16,967	71,516	6,210		
Oct. ....	77,516	200,206	27,178	18	25,592	166,311	17,336	71,035	6,850		
Nov. ....	79,278	204,887	26,214	20	25,091	169,492	17,518	82,674	7,337		
Dec. (10)	....	219,000	25,000	....	....	....	....	....	....	....	

L I A B I L I T I E S										
	Deposits (5)		Other domestic funds (6)	Loans from BI-UIC	Interbank accounts		Equity capital	Net foreign position (7)	Bankers' acceptances issued (8)	
	Total	of which: current accounts			Total	of which: special credit institutions				
1982 — Dec. ...	328,448	180,046	2,318	3,625	75,221	6,632	21,312	13,957	2,707	
1983 — Dec. ...	372,245	202,711	3,568	6,349	88,572	5,252	29,518	20,398	1,590	
1984 — Oct. ...	371,109	198,350	4,722	7,105	62,697	3,174	37,149	26,415	715	
Nov. ...	372,163	197,656	4,624	4,975	66,920	3,449	37,200	26,841	696	
Dec. ...	415,581	227,668	4,949	2,864	93,751	4,518	36,989	27,715	609	
1985 — Jan. ...	411,126	219,717	5,347	3,838	68,792	5,166	36,846	28,593	572	
Feb. ...	405,608	214,697	5,718	4,293	70,597	4,683	36,935	29,329	569	
Mar. ...	407,372	215,901	5,893	2,881	68,526	4,689	38,690	28,607	554	
Apr. ...	410,346	218,002	5,556	5,400	69,342	3,730	41,898	30,503	509	
May ...	406,055	213,598	5,397	3,684	70,823	3,746	42,154	31,286	476	
June ...	410,718	217,576	5,537	2,574	70,571	5,002	41,692	31,485	462	
July ...	414,333	220,729	5,416	2,670	66,152	4,282	42,087	....	456	
Aug. ....	414,780	219,610	5,352	3,092	66,059	3,952	42,090	....	456	
Sept. ...	420,848	224,925	5,616	4,827	63,886	4,332	42,398	....	424	
Oct. ...	422,048	225,486	5,545	3,309	61,745	3,847	42,731	....	422	
Nov. ....	421,486	224,539	6,002	2,991	73,903	3,459	42,907	....	415	
Dec. (10)	458,100	....	....	....	....	....	....	....	....	

(1) Comprises lira liquidity (excluding deposits with the PO and the Deposits and Loans Fund), compulsory reserves, collateral in respect of bankers' drafts, and, until October 1983, the non-interest-bearing deposit against ceiling overshoots. — (2) At face value. — (3) Italian and foreign lira securities for trading, investment and repurchase agreements at balance sheet value (shares are excluded). — (4) Including protested bills. — (5) Lira deposits by non-bank resident customers. — (6) Trust accounts and residents' foreign-exchange accounts. — (7) Source, UIC. — (8) Bankers' acceptances issued are included among guarantee commitments. Only those acquired by banks represent actual disbursement of funds by the banking system. — (9) Securities subject to repurchase agreements are included in the case of temporary purchases and excluded in that of temporary sales. — (10) Provisional data.

Table a29

## Principal assets and liabilities of the special credit institutions

(billions of lire)

		A S S E T S								
		Cash and liquid assets		Government securities	Loans				Other	
		of which: interbank deposits	Total		Domestic (1)	of which: industrial	of which: real estate	Foreign		On behalf of the Treasury
1982	— Dec. . . .	4,600	5,452	8,148	96,530	53,859	25,974	4,360	9,913	. 562
1983	— Dec. . . . .	4,389	5,196	11,409	109,933	59,044	29,687	4,693	9,684	— 1,991
1984	— Dec. . . .	4,257	4,964	15,023	125,300	66,144	32,927	4,585	9,193	— 7,941
1985	— Jan. . . .	5,076	5,724	15,969	124,966	65,804	33,066	4,442	8,703	— 10,051
	Feb. . . .	4,691	5,347	16,972	125,984	66,385	33,363	4,679	8,705	— 10,420
	Mar. . . .	4,855	5,435	17,162	127,461	67,189	33,802	4,553	8,703	— 10,761
	Apr. . . .	3,707	4,222	16,319	127,864	67,380	34,043	4,503	8,703	— 9,688
	May . . . .	3,555	4,410	16,141	127,703	66,836	34,291	4,557	8,697	— 9,068
	June . . . .	4,553	5,482	16,929	127,131	66,767	34,193	4,488	8,271	— 7,547
	July . . . .	4,522	5,407	19,029	127,798	67,037	34,530	4,211	8,226	— 10,781
	Aug. . . .	3,915	5,080	18,905	129,284	68,187	34,763	4,183	8,225	— 11,346
	Sept. . . .	4,383	5,512	18,566	129,929	68,346	35,148	4,057	8,224	— 11,432
	Oct. . . . .	3,651	4,694	18,667	130,431	68,280	35,543	4,015	8,223	— 10,156
	Nov. (3) .	3,310	4,230	18,160	131,760	69,060	35,870	4,000	8,200	— 10,020
	Dec. (3) .	.....	.....	.....	135,600	.....	.....	.....	.....	.....
		L I A B I L I T I E S								
		Savings deposits	Bonds			Current accounts with banks	Public funds	Medio-credito centrale	Foreign loans (2)	
			Ordinary	of which: industrial	of which: real estate					On behalf of the Treasury
1982	— Dec. . . .	18,060	77,172	34,809	28,364	10,015	4,022	3,712	2,379	9,605
1983	— Dec. . . .	19,264	85,134	36,147	32,075	9,119	4,314	4,696	2,436	13,961
1984	— Dec. . . .	23,480	89,554	35,871	33,605	8,159	4,912	4,767	2,422	17,830
1985	— Jan. . . .	23,705	89,229	35,335	33,674	7,678	4,128	4,746	2,382	17,885
	Feb. . . .	24,424	89,993	35,627	34,149	7,638	3,609	4,759	2,402	18,442
	Mar. . . .	24,988	90,738	36,071	34,342	7,571	3,531	4,864	2,387	18,474
	Apr. . . .	24,857	90,228	35,629	34,247	7,568	3,300	4,822	2,390	18,758
	May . . . .	24,816	90,590	35,917	34,315	7,567	3,547	4,793	2,391	18,736
	June . . . .	25,522	92,369	36,786	34,919	7,567	3,363	4,856	2,350	18,727
	July . . . .	25,397	92,037	36,252	35,139	7,253	2,914	4,980	2,342	18,967
	Aug. . . . .	25,058	92,035	36,088	35,303	7,180	3,112	5,305	2,376	19,265
	Sep. . . . .	24,634	93,603	37,349	35,433	7,174	2,343	5,442	2,397	19,263
	Oct. . . . .	24,593	93,562	37,574	35,324	7,175	3,058	5,469	2,467	19,550
	Nov. (3) .	24,600	93,470	37,610	35,580	7,150	3,450	5,450	2,510	19,700
	Dec. (3) .	.....	95,400	.....	.....	.....	.....	.....	.....	.....

(1) Excluding financing of compulsory stockpiling. — (2) Gross of exchange rate variations. — (3) Partially estimated data.

Table a30

## Loans by branch of economic activity and type of enterprise

(billions of lire; % changes)

	BANKS				SPECIAL CREDIT INSTITUTIONS			
	Total as of October 1985	% change in the 12 months ending			Total as of October 1985	% change in the 12 months ending		
		Dec. 84	June 85	Oct. 85		Dec. 84	June 85	Oct. 85
General government . . . . .	8,314	37.3	11.3	-34.2	21,062	24.9	21.6	16.0
Credit and insurance institutions . . . . .	10,467	40.0	34.9	59.6	4,398	22.9	46.2	48.4
Non-financial firms . . . . .	184,458	23.2	15.3	9.3	90,529	12.3	10.0	7.2
Agriculture, forestry and fisheries . . . . .	7,383	16.9	12.0	13.0	6,061	16.3	15.2	14.0
Industry . . . . .	118,926	22.8	14.0	5.6	54,310	10.9	9.4	6.1
Mining and quarrying . . . . .	2,300	7.1	-7.4	-22.7	997	70.9	64.0	48.1
Food and related products . . . . .	11,939	24.2	15.4	9.9	4,710	12.2	9.8	12.8
Textiles . . . . .	9,260	25.8	19.2	11.0	2,072	3.7	3.2	-3.5
Clothing, footwear, hides & leather . . . . .	8,282	32.6	28.7	27.1	948	12.0	16.3	16.6
Wood, wooden furniture & fittings . . . . .	4,914	17.5	19.6	18.2	1,018	18.1	14.9	13.5
Basic metals . . . . .	6,901	21.5	9.9	—	3,072	18.9	18.6	1.6
Engineering . . . . .	24,635	24.1	17.4	9.1	11,099	8.2	9.1	6.9
Vehicles . . . . .	6,308	20.6	13.5	-0.2	4,206	9.2	—	-0.4
Non-ferrous mineral products . . . . .	4,708	17.0	16.5	7.2	2,148	11.1	12.0	12.9
Chemicals, oil & coal products . . . . .	10,134	15.7	-9.5	-18.6	4,404	7.7	3.7	1.2
Rubber and plastics . . . . .	3,102	15.3	7.1	2.3	1,058	-0.9	3.9	1.9
Paper, printing, publishing and related products . . . . .	4,236	24.7	14.7	3.4	1,486	19.7	8.1	20.6
Still and motion picture equip- ment, sundry manufactures . . . . .	834	10.2	17.7	11.1	261	8.1	22.5	29.9
Construction and plant installation . . . . .	19,650	20.0	18.6	17.4	14,609	11.5	8.6	5.5
Production and distribution of power, gas and water . . . . .	1,723	102.9	43.3	-31.9	2,222	5.0	20.9	-1.4
Distributive trades, other commercial activities and miscellaneous services . . . . .	45,225	23.8	18.5	18.4	12,898	17.4	11.4	12.6
Lodging and catering . . . . .	1,890	26.5	24.5	26.7	1,560	17.0	16.8	19.1
Transport and communications . . . . .	5,750	22.3	22.5	4.5	14,003	11.7	4.0	-0.1
Coordination and financial services to enterprises . . . . .	5,284	33.7	12.6	19.7	1,697	1.2	35.9	43.0
Non-profit institutions, households and unclassifiable . . . . .	7,764	25.3	25.9	27.6	2,042	24.8	14.7	25.3
TOTAL (RESIDENT CUSTOMERS) . . . . .	211,003	24.7	16.1	8.7	118,031	14.8	13.0	10.1
<i>of which: public enterprises . . . . .</i>	<i>19,457</i>	<i>24.5</i>	<i>5.2</i>	<i>-9.0</i>	<i>22,698</i>	<i>12.4</i>	<i>10.4</i>	<i>2.0</i>
<i>of which: state controlled . . . . .</i>	<i>15,562</i>	<i>16.5</i>	<i>3.0</i>	<i>-12.4</i>	<i>18,554</i>	<i>13.0</i>	<i>15.4</i>	<i>8.7</i>
<i>leading private sector firms . . . . .</i>	<i>24,361</i>	<i>13.4</i>	<i>—</i>	<i>-11.2</i>	<i>15,606</i>	<i>2.9</i>	<i>3.0</i>	<i>2.7</i>
<i>other . . . . .</i>	<i>151,107</i>	<i>26.0</i>	<i>21.2</i>	<i>19.4</i>	<i>56,623</i>	<i>16.1</i>	<i>14.2</i>	<i>13.4</i>

Source: Bank of Italy, Central Risks Office.

Table a31

## Net issues of securities

(billions of lire)

	ISSUERS				Total bonds and govern- ment securities	INVESTORS				Shares
	Public sector	Special credit insti- tutions	Public agencies and firms			BI-UIC	Deposits and Loans Fund	Banks	Other	
1980 .....	-1,927	5,648	226	3,947	821	1,175	2,931	-980	3,085	
1981 .....	7,498	7,508	807	15,813	1,492	380	5,095	8,846	7,186	
1982 .....	23,626	8,147	4,570	36,343	-273	-91	19,744	16,963	6,005	
1983 .....	69,942	7,640	2,374	79,956	1,948	562	29,975	47,471	10,899	
1984 .....	63,705	4,315	2,035	70,055	6,792	256	11,190	51,817	9,774	
1985 .....	94,607	5,702	2,267	102,576					8,650	
1984 — 1st qtr. ...	19,804	-32	181	19,953	3,961	56	-9,087	25,023	1,836	
2nd " ...	17,382	398	648	18,428	970	137	3,992	13,329	1,458	
3rd " ...	12,917	190	988	14,095	1,702	-36	2,174	10,255	2,546	
4th " ...	13,602	3,759	218	17,579	159	99	14,111	3,210	3,934	
1985 — 1st qtr. ...	23,604	1,156	436	25,196	1,110	153	255	23,678	2,565	
2nd " ....	23,963	1,514	910	26,387	3,982	124	10,305	11,976	2,010	
3rd " (1)	21,040	1,146	55	22,241	-593	280	6,166	16,388	1,410	
4th " (1)	26,000	1,886	866	28,752					2,665	
1984 — Dec. ....	4,979	1,986	-431	6,534	848	116	8,709	-3,139	2,873	
1985 — Jan. ....	2,969	-309	-205	2,455	-139	-14	-5,429	8,037	1,490	
Feb. ....	10,471	746	-	11,217	599	179	480	9,959	500	
Mar. ....	10,164	719	641	11,524	650	-12	5,204	5,682	575	
Apr. ....	7,590	-523	-66	7,001	826	4	3,097	3,074	1,070	
May ....	5,471	299	1,286	7,056	3,113	76	-104	3,971	230	
June ....	10,902	1,738	-310	12,330	43	44	7,312	4,931	710	
July .....	3,998	-352	260	3,906	-1,120	-19	-201	5,246	400	
Aug. ....	4,766	-55	-15	4,696	245	154	1,018	3,279	410	
Sept. (1) .	12,276	1,553	-190	13,639	282	145	5,349	7,863	600	
Oct. (1) ..	11,153	-52	835	11,936	3,530	-15	3,409	5,012	1,200	
Nov. (1) ..	8,571	41	50	8,662	-91	-3	3,051	5,705	165	
Dec. (1) ..	6,276	1,897	-19	8,154					1,300	

(1) Provisional data.

Table a32

## Issue conditions of government securities

ABI number	Maturity	Date of issue	Price at issue	Yield at issue (1)	Amount offered (billions of lire)	Amount taken up (billions of lire)	Spread	First coupon
12825 (2) ..	CCT 1.3.95	1.3.85	97.50	14.32	13,000	12,249	0.50	13.80
12826 (2) ..	CCT 1.4.95	1.4.85	97.50	14.36	12,000	8,847	0.50	13.80
12828 (2) ..	CCT 1.5.95	1.5.85	97.50	14.97	8,000	8,000	0.50	14.40
12829 (2) ..	CCT 1.6.95	1.6.85	97.50	14.93	5,000	5,000	0.50	14.40
12831 (2) ..	CCT 1.7.95	1.7.85	98.50	14.94	6,000	3,347	0.75	14.40
12832 (3) ..	CCT 15.7.90	15.7.85	99.75	14.65	3,000	3,000	0.30	7.00
12834 (2) ..	CCT 1.8.95	1.8.85	97.50	15.22	3,250	3,250	0.75	14.60
12835 (3) ..	CCT 16.8.90	16.8.85	99.75	14.74	2,500	1,750	0.30	7.00
12836 (2) ..	CCT 1.9.95	1.9.85	97.50	15.26	6,000	6,000	0.75	14.60
12838 (3) ..	CCT 18.9.90	18.9.85	99.75	14.75	3,700	3,700	0.30	7.00
12839 (2) ..	CCT 1.10.95	1.10.85	98.00	14.82	9,000	9,000	0.75	14.60
12841 (3) ..	CCT 18.10.90	18.10.85	99.75	14.32	1,500	1,500	0.30	6.80
12842 (2) ..	CCT 1.11.95	1.11.85	98.50	14.27	5,300	5,300	0.75	14.20
12843 (3) ..	CCT 18.11.90	18.11.85	99.75	13.93	3,000	1,067	0.30	6.75
12846 (2) ..	CCT 1.12.95	1.12.85	98.50	14.23	4,700	4,700	0.75	14.20
12847 (3) ..	CCT 18.12.90	18.12.85	99.75	13.93	1,500	1,500	0.30	6.75
12848 (2) ..	CCT 1.1.96	1.1.86	98.50	14.20	6,000	5,100	0.75	14.00
12849 (2) ..	CCT 1.1.96 C.	1.1.86	100.00	13.97	2,000	400	0.75	14.00
12850 (3) ..	CCT 17.1.91	17.1.86	99.75	13.84	2,000	2,000	0.30	6.75
12851 (2) ..	CCT 1.2.96	1.2.86	98.50	14.29	5,000		0.75	14.30

ABI number	Maturity	Date of issue	Price of issue	Yield at issue	Amount offered (billions of lire)	Amount taken up (billions of)	Coupon
12486 .....	BTP 1.3.88	1.3.85	99.00	12.79	1,000	1,000	6.00
12487 .....	BTP 1.5.88	1.5.85	97.75	13.62	3,000	1,915	6.125
12488 .....	BTP 1.7.88	1.7.85	97.50	14.00	2,500	1,372	6.25
12489 .....	BTP 1.10.88	1.10.85	97.50	14.00	6,000	6,000	6.25
12490 .....	BTP 1.11.88	1.11.85	98.25	13.66	1,000	1,000	6.25
12491 .....	BTP 1.1.89	1.1.86	98.75	13.44	7,000		6.25
12492 .....	BTP 1.1.90	1.1.86	98.75	13.33			6.25
12493 .....	BTP 1.2.88	1.2.86	98.75	13.67	2,500		6.25
12494 .....	BTP 1.2.89	1.2.86	98.75	13.44			6.25
12495 .....	BTP 1.2.90	1.2.86	98.75	13.33			6.25

ABI number	Maturity	Date of issue	Price at issue	Yield at issue	Amount taken up (billions of ECU) (4)	Lira/ECU exchange rate at issue	Coupon
12824 .....	CTE 22.2.93	22.2.85	100	9.59	600	1,375.60	9.60
12827 .....	CTE 15.4.93	15.4.85	100	9.74	600	1,428.20	9.75
12833 .....	CTE 22.7.93	22.7.85	100	8.99	600	1,459.00	9.00
12844 .....	CTE 22.11.93	22.11.85	100	8.74	700	1,491.37	8.75

(1) Expected yield in the months the first coupon matures on the assumption that rates are unchanged over the period. In general, there is a difference between this yield and that calculated on the assumption that the coupon will be unchanged; for example, the latter is equal to 14.49 per cent for TCC 1.12.95. — (2) Annual coupon determined on the basis of 12-month Treasury bill rate. — (3) 6-monthly coupon determined on the basis of the 12-month Treasury bill rate. — (4) Domestic market only.

## Treasury credit certificates, Treasury credit certificates in ECU and investment funds (1)

	Expected yields (2)			Total return indices (3)									
	Treasury credit certificates	Treasury credit certificates in ECU	Treasury credit certificates	Treasury credit certificates in ECU (4)				Investment funds					
				Interest	Price	Exchange rate	Total	Bond-based	Mixed	Share-based	Total		
1981 .....	20.25		107.71										
1982 .....	20.78		130.51										
1983 .....	19.82	13.11	159.09	105.81	101.93	102.08	110.21						
1984 .....	16.98	11.51	191.33	118.89	106.57	104.59	132.51						
1985 .....	14.68	9.88	226.18	132.42	111.76	109.64	162.52	118.64	129.96	143.94	130.99		
1983 - 4th qtr.	18.86	12.44	170.74	110.47	104.36	103.48	119.29						
1984 - 1st qtr.	18.00	11.48	178.88	113.67	107.48	104.86	128.13						
2nd "...	17.05	11.57	187.04	117.45	106.29	104.63	130.61						
3rd "...	16.52	11.51	195.66	120.44	106.06	104.55	133.55	101.97	104.07	102.20	102.63		
4th "...	16.35	11.46	203.75	124.00	106.46	104.34	137.74	105.78	108.70	106.99	106.94		
1985 - 1st qtr.	14.63	10.16	214.91	127.16	111.17	104.50	147.74	112.61	120.56	123.60	118.34		
2nd "...	14.84	10.41	222.22	130.86	109.84	108.39	155.77	116.35	125.66	133.08	124.94		
3rd "...	14.86	9.74	229.91	134.14	112.09	112.42	169.08	120.43	133.30	152.11	135.77		
4th "...	14.38	9.21	237.68	137.54	113.94	113.26	177.50	125.15	140.32	166.97	144.92		
1984 - Dec. ...	16.01	11.18	206.89	124.96	107.31	104.18	139.70	107.46	111.22	110.06	109.29		
1985 - Jan. ....	15.15	10.32	212.14	126.04	110.64	103.53	144.37	110.58	116.84	118.01	114.61		
Feb. ....	14.50	10.17	215.12	127.14	111.15	104.05	147.04	113.00	122.02	125.47	119.39		
Mar. ....	14.23	9.99	217.47	128.31	111.71	105.90	151.80	114.26	122.82	127.31	121.03		
Apr. ....	14.44	9.96	219.81	129.51	111.64	108.34	156.64	115.15	123.10	126.80	121.51		
May ....	15.02	10.38	222.28	130.90	109.85	108.29	155.70	116.34	125.68	132.80	124.77		
June ...	15.06	10.90	224.56	132.16	108.02	108.55	154.97	117.56	128.20	139.64	128.55		
July ....	14.99	10.05	227.06	133.06	111.03	110.95	163.93	118.98	131.08	146.97	132.68		
Aug. ....	14.89	9.63	229.84	134.14	112.47	113.19	170.76	120.19	133.08	151.33	135.34		
Sept. ....	14.70	9.54	232.84	135.23	112.78	113.14	172.55	122.11	135.75	158.03	139.30		
Oct. ....	14.59	9.21	235.50	136.32	114.06	113.15	175.93	123.79	137.70	161.42	141.70		
Nov. ...	14.29	9.41	237.61	137.59	113.09	113.08	175.94	125.20	140.34	166.53	144.79		
Dec. ...	14.26	9.00	239.92	138.71	114.68	113.55	180.63	126.47	142.91	172.97	148.26		

(1) The yields and indices on both types of Treasury credit certificates were calculated using the quotations of the Milan Stock Exchange. The investment funds surveyed are those established under Law 77 of 23 Mar., 1983. — (2) The expected yield on Treasury credit certificates is that based on the assumption of no change in interest rates. That on Treasury credit certificates in ECU is not comparable with the expected yields on lira investments except when the Lira/ECU exchange rate is assumed to remain constant. — (3) The base dates (= 100) of these indices are as follows: Treasury credit certificates, 31 December 1982; Treasury credit certificates in ECU, 26 January 1983; and investment funds, 2 July 1984. — (4) The breakdown of the index into its interest, price and exchange rate components is multiplicative.

Table a34

## Total domestic credit (1)

(changes in billions of lire; % changes)

	Total domestic credit	Loans to the non-state sector (2)	State sector borrowing requirement (3)	Total domestic credit		Loans to the non-state sector	
				3-month (4)	12-month	3-month (4)	12-month
1980 .....	63,234	29,219	34,015	—	18.5	—	16.4
1981 .....	73,339	28,098	45,242	—	18.1	—	13.5
1982 .....	100,591	31,604	68,987	—	20.9	—	13.4
1983 .....	120,973	35,432	85,541	—	20.7	—	13.2
1984 .....	143,620	52,256	91,364	—	20.3	—	17.1
1985 (5) .....	151,777	45,031	106,747	—	17.8	—	12.6
1983 — Nov. ....	13,441	4,578	8,863	5.6	21.3	3.9	14.0
Dec. ....	16,038	8,462	7,576	5.3	20.7	3.9	13.2
1984 — Jan. ....	7,471	5,171	2,300	4.8	21.4	4.6	14.8
Feb. ....	8,484	1,875	6,609	4.3	21.5	4.5	15.4
Mar. ....	11,197	2,562	8,635	4.4	21.5	4.4	14.4
Apr. ....	14,679	5,463	9,216	5.2	21.6	4.0	15.3
May ....	9,458	1,870	7,588	5.2	21.6	3.9	15.4
June ....	6,360	3,697	2,663	4.5	21.5	4.4	16.5
July ....	18,471	10,676	7,795	4.2	20.9	4.2	16.7
Aug. ....	6,353	— 649	7,002	4.1	20.7	4.2	17.6
Sept. ....	12,967	4,106	8,861	5.3	21.0	5.2	19.1
Oct. ....	14,841	5,622	9,219	5.1	20.7	4.3	18.3
Nov. ....	13,850	4,281	9,569	5.3	20.3	4.2	17.9
Dec. ....	19,489	7,582	11,907	4.7	20.3	2.1	17.1
1985 — Jan. ....	8,842	2,881	5,961	4.5	20.3	2.7	16.1
(5) Feb. ....	8,762	— 57	8,819	4.1	20.1	2.2	15.4
Mar. ....	14,817	1,577	13,241	4.3	20.3	2.4	14.9
Apr. ....	13,958	4,861	9,097	4.7	19.8	2.6	14.5
May ....	9,882	1,344	8,538	4.8	19.6	2.9	14.2
June ....	6,827	— 507	7,335	3.8	19.5	2.4	12.8
July ....	16,149	7,524	8,625	3.3	18.7	1.4	11.4
Aug. ....	3,811	— 2,860	6,671	2.9	18.3	1.1	10.8
Sept. ....	15,420	1,327	14,093	4.2	18.3	2.5	9.8
Oct. ....	11,964	7,317	4,648	4.0	17.6	3.1	10.2
Nov. ....	18,426	4,535	13,891	4.9	17.8	3.5	10.1
Dec. ....	22,918	17,089	5,829	4.4	17.8	4.7	12.6

(1) Total domestic credit comprises bank loans in lire and foreign currencies (adjusted for exchange rate variations and for the bank loans used to finance non-interest-bearing deposits on payments abroad), special credit institution loans, bond issues by companies and local authorities, the state sector domestic borrowing requirement (the Treasury, the Deposits and Loans Fund, the Southern Italy Development Fund, and the autonomous government agencies), net of Treasury credit to credit institutions. — (2) Includes the debt funding operations referred to in footnote 3; and, since September 1984, banks' purchases of securities under resale agreements with customers. — (3) Net of financing of credit institutions, debt funding operations and foreign debt. — (4) Seasonally adjusted. — (5) Provisional data. The state sector borrowing requirement, in 1985, excludes debt funding operations in securities for 10,035 billion lire, of which 4,841 billion for tax credits; the remaining 5,194 billion of securities issued to fund debts is included in financing of the non-state sector.



Table a35

**Monetary aggregates and their counterparts**  
(changes in billions of lire)

	1982	1983	1984			1985		
			Year	Jan.-Sept.	July	Aug.	Sept.	Jan.-Sept.
<b>A) BI-UIC</b>								
<b>ASSETS</b>								
Foreign sector (a1) . . . . .	-5,582	8,788	5,195	3,114	-209	-504	-2,435	-4,738
State sector (a2) (1) . . . . .	12,362	1,125	13,529	3,974	2,957	-77	599	13,281
Banks (a3) . . . . .	1,049	2,768	-3,550	-481	848	498	1,918	3,035
Special credit institutions (a4)	123	241	433	436	127	74	50	-66
Other (a5) . . . . .	2,637	-491	-2,129	-1,740	-1,201	-497	-60	-2,729
<b>LIABILITIES</b>								
Non-state sector (a6) . . . . .	3,354	3,862	3,562	-634	1,208	-1,132	-215	-340
Banks (a7) . . . . .	7,235	8,569	9,916	5,937	1,314	626	287	9,123
<b>B) Banks</b>								
<b>ASSETS</b>								
BI-UIC (b1=a7) . . . . .	7,235	8,569	9,916	5,937	1,314	626	287	9,123
Foreign sector (b2) . . . . .	3,062	-4,996	-5,138	-4,231	1,987	1,928	1,026	1,100
State sector (b3) (1) . . . . .	30,951	21,416	4,635	-8,576	-2,405	3,315	5,572	7,255
Non-state sector (b4) . . . . .	15,562	23,157	38,160	28,481	6,803	-4,703	365	9,148
Special credit institutions (b5)	4,392	4,641	2,115	-2,590	-482	617	-77	-2,484
Other (b6) . . . . .	-4,989	-9,625	-9,444	-22,256	-2,414	-666	653	-14,775
<b>LIABILITIES</b>								
Non-state sector:								
current accounts (b7) . . . . .	26,461	21,915	26,226	-6,221	3,141	-1,132	5,169	-2,868
savings deposits (b8) . . . . .	23,520	17,852	14,080	-1,297	822	1,641	459	2,477
repurchase agreements (b9) . . . . .	4,186	-3,371	32	1,767	339	174	-168	1,052
banks' CDs (b10) . . . . .	-	3,257	4,276	3,445	-357	-74	293	5,528
BI-UIC (b11=a3) . . . . .	1,049	2,768	-3,550	-481	848	498	1,918	3,035
State sector (b12) . . . . .	997	741	-820	-448	10	10	155	143

(1) Including the securities used to extinguish credit institutions' tax credits. These securities have already been reported in the latter's statistical returns even though they are not yet recorded in the budget accounts.

Table a35 cont.

### Monetary aggregates and their counterparts

(changes in billions of lire)

	1982	1983	1984		1985			
			Year	Jan.-Sept.	July	Aug.	Sept.	Jan.-Sept.
<b>C) State sector</b>								
<b>DOMESTIC BORROWING</b>								
REQUIREMENT (c1) . . . . .	70,083	87,346	93,080	61,816	10,018	7,472	14,354	86,790
<b>LIABILITIES TOWARDS:</b>								
Non-state sector								
PO savings:								
current accounts (c2) . . . . .	1,167	2,235	657	326	449	400	-793	489
savings deposits (c3) . . . . .	2,800	3,687	5,664	1,683	216	307	184	2,044
Treasury bills and other government securities (c4)	16,198	54,294	63,914	61,278	4,993	3,460	8,770	59,352
BI-UIC (c5 = a2) . . . . .	12,362	1,125	13,529	3,974	2,957	-77	599	13,281
Banks (c6 = b3 - b12) . . . . .	29,954	20,675	5,455	-8,128	-2,415	3,305	5,417	7,112
Other (c7) . . . . .	7,602	5,330	3,861	2,683	3,818	77	177	4,512
<b>D) Monetary aggregates and their counterparts</b>								
(consolidated account of liquidity-creating bodies)								
<b>MONETARY AGGREGATES</b>								
M1 (d1 = a6 + b7 + c2) . . . . .	30,982	28,012	30,445	-6,529	4,798	-1,864	4,161	-2,719
Savings deposits (d2 = b8 + c3)	26,320	21,539	19,744	386	1,038	1,948	643	4,521
Repurchase agreements (d3 = b9) . . . . .	4,186	-3,371	32	1,767	339	174	-168	1,052
M2A (d4 = d1 + d2 + d3) . . . . .	61,488	46,180	50,221	-4,376	6,175	258	4,636	2,854
Banks' CDs (d5 = b10) . . . . .	-	3,257	4,276	3,445	-357	-74	293	5,528
M2 (d6 = d4 + d5) . . . . .	61,488	49,437	54,497	-931	5,818	184	4,929	8,382
<b>SOURCES</b>								
Foreign sector (d7 = a1 + b2)	-2,520	3,792	57	-1,117	1,778	1,424	-1,409	-3,638
State sector (d8 = c1 - c4 - c7) . . . . .	46,283	27,722	25,305	-2,145	1,207	3,935	5,407	22,926
Non-state sector (d9 = b4) . . . . .	15,562	23,157	38,160	28,481	6,803	-4,703	365	9,148
Special credit institutions (d10 = a4 + b5) . . . . .	4,515	4,882	2,548	-2,154	-355	691	-27	-2,550
Other (d11 = a5 + b6) . . . . .	-2,352	-10,116	-11,573	-23,996	-3,615	-1,163	593	-17,504

Table a36

## Liquid assets held by the non-state sector

(amounts outstanding in billions of lire; % changes on corresponding period)

	End-of-period amounts				End-of-period changes			
	M1 (1)	M2A (2)	M2 (3)	M3 (4)	M1	M2A	M2	M3
1980 — Dec. ....	168,498	309,804	309,804	346,636	13.5	12.7	12.7	17.8
1981 — Dec. ....	185,657	340,737	340,737	403,028	10.2	10.0	10.0	16.3
1982 — Dec. ....	216,639	402,226	402,226	475,559	16.7	18.0	18.0	18.0
1983 — Nov. ....	214,131	401,939	405,182	497,900	10.9	12.9	13.8	15.0
Dec. ....	244,650	448,405	451,662	540,243	12.9	11.5	12.3	13.6
1984 — Jan. ....	232,946	436,304	440,828	538,551	12.9	11.6	12.7	14.7
Feb. ....	227,969	429,094	434,278	536,485	12.2	10.9	12.2	14.5
Mar. ....	230,116	430,479	435,958	539,247	13.6	11.9	13.0	14.8
Apr. ....	230,994	431,243	436,863	541,353	13.6	11.9	13.0	14.8
May ....	228,715	429,059	434,940	542,430	13.7	12.1	13.0	14.9
June ....	233,114	433,360	439,516	546,834	12.6	11.3	12.2	14.1
July ....	236,556	438,344	444,754	552,739	11.6	10.9	11.7	14.0
Aug. ....	233,596	437,356	443,960	554,318	10.7	10.4	11.1	13.6
Sept. ....	238,120	444,027	450,729	561,921	10.8	10.7	11.5	13.9
Oct. ....	241,292	447,932	455,029	568,990	11.5	11.0	11.9	14.5
Nov. ....	241,179	449,275	456,558	573,128	12.6	11.8	12.7	15.1
Dec. ....	275,095	498,626	506,159	615,929	12.4	11.2	12.1	14.0
1985 — Jan. ....	266,818	492,281	502,174	615,871	14.5	12.8	13.9	14.4
(5) Feb. ....	260,503	484,667	495,847	614,405	14.3	13.0	14.2	14.5
Mar. ....	262,239	486,375	498,329	616,996	14.0	13.0	14.3	14.4
Apr. ....	263,922	488,897	501,267	623,157	14.3	13.4	14.7	15.1
May ....	259,943	484,890	497,719	624,395	13.7	13.0	14.4	15.1
June ....	265,281	490,412	503,610	631,715	13.8	13.2	14.6	15.5
July ....	270,080	496,587	509,429	639,827	14.2	13.3	14.5	15.8
Aug. ....	268,215	496,845	509,612	641,456	14.8	13.6	14.8	15.7
Sept. ....	272,376	501,480	514,540	647,939	14.4	12.9	14.2	15.3
Oct. ....	273,802	503,529	516,764	648,280	13.5	12.4	13.6	13.9
Nov. ....	274,033	504,313	517,548	649,335	13.6	12.3	13.4	13.3
Dec. ....	—	549,320	562,610	—	—	10.2	11.2	—

(1) Notes and coin and current accounts. — (2) Notes and coin, current accounts, savings deposits and banks' securities repurchase agreements with customers. — (3) M2A plus banks' CDs conforming with the Ministerial Decree of 28.12.1982. — (4) M2 plus bankers' acceptances and Treasury bills. — (5) Provisional data.

Table a37

## Financial assets held by the non-state sector and their counterparts

(changes in billions of lire)

	Financial assets	Financing of the non-state sector by:									
		Banks (1)	Special credit institutions (1)	Bonds	State sector (2)	Shares	Other domestic liabilities (3)	Foreign sector	State sector (4)	Foreign sector (5)	Unclassified
1980 .....	56,464	20,507	8,554	155	4,835	2,673	3,710	4,733	29,029	-10,145	-7,587
1981 .....	76,367	15,201	14,521	756	6,291	4,475	2,835	9,463	42,234	-7,675	-11,734
1982 .....	89,492	11,351	13,461	4,412	11,592	4,054	2,234	3,517	58,933	-10,048	-10,014
1983 .....	122,252	21,462	11,549	2,422	14,139	8,555	2,972	1,735	72,011	706	-13,299
1984 .....	138,092	35,927	14,469	1,859	10,781	6,923	3,324	1,339	81,622	-7,254	-10,898
1985 (6) .....		33,013	10,323	1,695							
1983 — Nov. . .	3,839	3,332	900	345	560	15	235	236	8,414	-99	-10,009
Dec. . .	44,084	4,295	3,836	331	1,498	2,519	166	-300	6,348	42	25,349
1984 — Jan. . .	7,266	5,345	-338	163	1,245	797	691	217	1,095	-818	-1,131
Feb. . .	6,444	1,436	431	7	899	209	373	716	5,502	-1,419	-1,710
Mar. . .	9,644	1,440	1,127	-5	1,641	270	210	-437	7,115	-1,412	-305
Apr. . .	8,257	4,429	568	466	308	65	243	639	8,939	-761	-6,639
May . .	7,347	978	749	143	1,766	443	146	-620	5,704	-266	-1,696
June . .	8,953	3,240	579	-122	2,628	131	89	250	-15	-945	3,118
July . .	11,707	8,801	1,306	570	168	1,798	546	-706	7,270	649	-8,695
Aug. . .	2,888	-2,023	1,358	16	271	13	423	867	6,926	1,357	-6,320
Sept. . .	11,234	3,142	565	398	864	474	361	-1,058	9,768	-613	-2,667
Oct. . .	10,542	3,140	1,914	569	-226	340	216	-195	9,000	-425	-3,791
Nov. . .	8,722	2,514	1,685	82	400	—	-91	1,335	10,831	-590	-7,444
Dec. . .	45,089	3,485	4,526	-429	818	2,384	116	332	9,488	-2,011	26,380
1985 — Jan. . .	8,171	3,500	-295	-323	3,503	980	811	1,018	1,736	-495	-2,264
(6) Feb. . .	6,545	-1,072	1,015	1	460	-162	435	826	8,191	-1,767	-1,382
Mar. . .	9,569	-557	1,491	643	411	518	580	-65	13,019	-2,424	-4,047
Apr. . .	10,210	4,625	461	-226	345	1,012	92	343	9,648	-2,172	-3,918
May . .	4,639	379	-322	1,286	1,143	-1,306	198	2,366	7,737	180	-7,022
June . .	13,617	-503	306	-310	2,844	104	42	398	4,283	564	5,889
July . .		7,492	-124	156	-706		523		9,456		
Aug. . .		-4,333	1,486	-13	474		413		5,739		
Sept. . .		42	1,476	-191	3,421		473		10,819		
Oct. . .		6,017	463	836	-1,196		365		5,907		
Nov. . .		4,002	531	3	211		173		13,431		
Dec. . .		13,420	3,835	-167							

(1) Data adjusted for securities issued to fund debts; foreign currency bank loans adjusted for exchange rate variations. — (2) Loans and equity participations of the Treasury and loans of the Deposits and Loans Fund. Net of the funding of the debts of municipalities and enterprises. — (3) Includes credits with BI-UIC, bankers' acceptances held by the non-state sector, estimated atypical securities and credit institutions' bad debts. — (4) Net of the funding of the debts of health and social security institutions. — (5) Current account balance on a settlements basis. — (6) Provisional data.

## Economic policy provisions

### Monetary and credit policy

On 16 January 1986 the Bank of Italy introduced a ceiling on lending in lire by the banks. The ceiling applies to all banks whose outstanding loans as of 31 December 1985 totalled at least five billion lire. The expansion of the aggregate covered by the ceiling is limited to 8 per cent through January of 1986, 6 per cent through February, 6 per cent through March, 7 per cent through April, 6 per cent through May and 6 per cent through June.

Banks that exceed the ceilings will be required to make a non-interest-bearing deposit with the Bank of Italy related to the excess in any given month and increasing progressively with the size of the excess.

### Exchange provisions

With effect from 5 December 1985, the ceiling on banks' net foreign indebtedness has been abolished.

On 16 January, the following measures were adopted : 1) Final exports invoiced in foreign currency and with payment deferred for up to 18

months from the date of clearing customs were made subject to compulsory foreign-exchange financing equivalent to 75 per cent of the value of the deferred payment; 2) Payment to non-residents for imports of goods or performance of services prior to the date stipulated by contract was prohibited.

### Fiscal policy

Early in 1986 several measures were enacted to reduce the public sector borrowing requirement. Specifically, free and reduced-fare railway travel benefits were abolished beginning 15 January; cost-of-living adjustment of pensions, which had been quarterly since 1983, was made half-yearly; and as of 1st January 1986, national health service contribution rates were modified.

As of 1st January 1986, individual income tax rates and brackets were modified and the system of tax allowances on total tax liability was simplified. The fixed allowance, the allowance for expenses for employee income, and the "additional", progressively decreasing, allowances for low employee and self-employed incomes were abolished.

### List of abbreviations

ABI	— <i>Associazione bancaria italiana</i> — Italian Banking Association —
BI-UIC	— <i>Banca d'Italia-Ufficio italiano cambi</i> — Bank of Italy-Italian Foreign Exchange Office —
CICR	— <i>Comitato interministeriale per il credito e il risparmio</i> — Interministerial Committee for Credit and Savings (Credit Committee) —
CIP	— <i>Comitato interministeriale per i prezzi</i> — Interministerial Committee on Prices —
CIPE	— <i>Comitato interministeriale per la programmazione economica</i> — Interministerial Committee for Economic Planning —
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 centrale di statistica</i> — Central Institute for Statistics —
SACE	— <i>Sezioni specifiche per l'assicurazione del credito all'esportazione</i> — Special Department for the Insurance of Export Credits —
SOCOF	— <i>Sovraimposta comunale sui fabbricati</i> — Municipal surtax on buildings —
UIC	— <i>Ufficio italiano cambi</i> — Italian Foreign Exchange Office —

## Statistical aggregates

### Autonomous government agencies

- railways (FS), roads (ANAS), post and telecommunications (PT), state monopolies (MS), telephone service (ASST), state forests, and agricultural market intervention (AIMA).

### Deposits and Loans Fund

- run by the Treasury, its resources consist of funds placed with the PO and its lending is almost all to local authorities.

**M1:** currency in circulation, bank and PO current accounts (the latter net of "service" accounts) and sight deposits with the Treasury.

**M2A:** M1 + savings deposits and bank's securities repurchase agreements with customers.

**M2:** M2A + banks' CDs conforming with the Ministerial Decree of 28.12.1982.

**M3:** M2 + bankers' acceptances and Treasury bills.

### Monetary base

- notes and coin held by the non-state sector and banks
- deposits of the non-state sector and banks with the Bank of Italy
- deposits of banks with the Treasury
- banks' unused overdraft facilities with the Bank of Italy
- bills and current account overdrafts in respect of the financing of compulsory stockpiling and of corn marketing campaigns (until 1963-64)
- banks' liquid foreign assets (sight deposits and short-term investments in respect of the part freely available and convertible into lire under the regulations governing borrowing from abroad and convertibility) (until 1983)
- Treasury bills used to meet banks' reserve requirement (until February 1976).

### Non-state public bodies

- local authorities and social security institutions.

### Non-state sector

- households
- firms (including public enterprises)
- insurance companies
- non-state public bodies.

### Private sector

- households
- firms (including public enterprises).

### Public enterprises

- ENEL and the state-controlled companies
- autonomous government agencies producing marketed goods and services
- municipal companies.

### Public sector

- state sector
- local authorities
- social security institutions.

### State sector

- the Treasury
- Deposits and Loans Fund
- Southern Italy Development Fund
- autonomous government agencies.

### Total domestic credit (TDC)

- bank lending in lire and foreign currency
- lending of the special credit institutions
- domestic bonds of firms and local authorities
- state sector borrowing requirement net of borrowing abroad and Treasury lending to credit intermediaries.

## Statistical aggregates cont. (Labour market)

### First job seekers

- persons who have never worked or who have voluntarily not worked for over a year and who are looking for a job, have a job starting subsequently or plan to start a business and have the means to do so.

*The residual wage component (including overtime, production and seniority bonuses, etc.) is not indexed.*

*In the event of an increase in indirect taxes, unions, employers and the Government are to agree how and how much of the effect is to be included in the reference price index.*

### Labour force

- employed persons (excluding conscripts) plus job seekers (unemployed persons, first job seekers and other job seekers).

### Under-employed persons

- persons working less than 26 hours in the survey week owing to lack of demand for labour.

### Other job seekers

- persons who declare they are of non-working status (housewives, students and pensioners, etc.) but also declare that they are seeking employment. This category also includes unemployed persons and first job seekers who plan to start a business but have not yet the means to do so.

### Unemployment

- Persons out of work + First job seekers + Other job seekers.

### Unemployment rate

- ratio of job seekers to the labour force.

### Persons out of work

- persons who have previously been in employment and who are seeking a job, have a job starting subsequently or plan to start a business and have the means to do so.

### Unemployment rate adjusted for Wage Supplementation

- ratio of job seekers plus equivalent full-time workers on Wage Supplementation to the labour force.

### Scala mobile

- various Italian systems of wage indexation. The mechanism introduced in 1986 is based on the trade union cost-of-living index and half-yearly adjustments. It provides:

- 1) 100% indexation of a minimum wage of 580,000 lire for all workers;
- 2) 25% indexation of a second wage component equal to base pay + cost-of-living allowance — the indexed minimum wage of point 1).

### Wage Supplementation Fund

- a fund administered by INPS to supplement the wages of workers in industry who have been temporarily laid off or put on short time without termination of employment. INPS (with a nominal contribution from firms) pays such workers up to about 80 per cent of their gross standard hourly rate. "Ordinary" payments cover short-term layoffs (up to three months), "extraordinary" payments long-term ones (normally limited to two years).



## MANAGEMENT OF THE BANK OF ITALY

as at 28 February 1986

### THE DIRECTORATE

Carlo Azeglio CIAMPI	— Governor
Lamberto DINI	— Director General
Antonio FAZIO	— Deputy Director General
Tommaso PADOA-SCHIOPPA	— Deputy Director General

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### CENTRAL MANAGERS

Giorgio SANGIORGIO	— Chief Legal Adviser
Luigi PATRIA	— Central Manager for Technical Departments
Felice SCORDINO	— Central Manager for the Rome Branch
Vincenzo DESARIO	— Central Manager for Banking Supervision
Antonio FINOCCHIARO	— Secretary General
Rainer Stefano MASERA	— Central Manager for Economic Research
Pierluigi CIOCCA	— Central Manager for Central Bank Operations
Luigi GIANNOCOLI	— Accountant General